

Pros and cons of a free market



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Regulation of a market economy is reported to come at significant cost not only from responsible agencies enforcing the regulation but also by the relevant stakeholders undertaking actions to comply (McNeil & O'Brien 2010, p. 66). However the market economy relies greatly on stakeholders such as investors having confidence and trust in the system. In a free market economy without regulation investors can and would get exposed to greater unknown risks.

These risks would be of not understanding a product that they are being offered and having no consistency or transparency for the implications of their investment (Cup 2010, p. 3). This can ultimately lead to a lack of confidence and a significant departure by stakeholders to engage. When reviewing the current regulations that have come about recently such as the National Consumer Credit Protection Act 2009, it can be seen that this legislation has been enacted to ensure fair and transparent practices concerning credit lending and to expose unfair and deceptive acts or practices that expose a borrower to position where there is no capacity to be able to meet the required repayments.

McClellan & O'Brien 2010, p. 69). Ultimately the pros outweigh the cons for regulation over a free market. It is evident through the reoccurring nature of a financial crisis that regulators need to be in touch with and up to date on current market practices to ensure that they can mitigate the exposure to the risk of another financial crisis.

Ultimately regulation is crucial for confidence and economic stability for stakeholders engaged directly and the wider public in general.

B. State your opinion on the regulation versus free market economy debate. Use the backdrop of the Global Financial Crisis to illustrate your main arguments.

Transparent. Without regulation stakeholders engaged in the market economy can operate in a manner that is inconsistent and unformed and ultimately expose the wider general public to adverse outcomes, as was demonstrated through the recent Global Financial Crises (SGF).

It could be argued that we currently have regulation and that this has not prevented the SGF from occurring. I am of the opinion that regulation is actually what mitigated the extent of the SGF and that can be seen through the reduced impact that the Australian financial system was exposed to. The foundations of the current SGF were laid between 2000 to 2007.

During this time there were global low interest rates and high levels of global liquidity (McNeil & O'Brien 2010, p. 51).

The monetary position taken by the United States of America (USA) in response to the low exchange rates and positive saving investment was to engage in supreme mortgages which are a high risk mortgage loan made to borrowers with low credit scores that would not have normally been availed this type of credit lending (McNeil & O'Brien 2010, p. 53).

2 Another important point regarding the supreme mortgage loan is that these loans are subject to adjustable rates of interest which could result in increased monthly payments of which it ultimately did, causing financial stress for the borrowers and leading to a high rate of loan defaults.

The subsequent foreclosures contributed to losses on supreme and other real estate loans which in turn caused a liquidity crunch. (Cup 2010, p. 10). Serialization which is the packaging and selling of these supreme mortgage loans is largely attributed to the fact the global economy was exposed so significantly to the issues in the USA, along with the fact that many of the Banks (Lenders) were significant international companies such as the Royal Bank of Scotland, Deutsche ann.

and HACK Holdings (Cup 2010, p. 12).

Ultimately the SGF arose due to insufficient regulation specifically related to: allowing excessively risky lending to borrowers that did not meet the necessary prerequisite capacity for repayments; the creation of complex financial products sold to people who did not understand the initial lenders of supreme mortgages being highly leveraged and in turn serialization being offered through international trading. C. Do you agree with Mike Magna? Why or why not? I agree with Mike Magna for the following reasons: 3 1 .

Financial engineering is a term that can be applied to the financial products that can be offered to a person. In the case of the SGF it was clear that financial engineering had been employed by financiers and other companies such as the banks that Mike Magna referred to and that the lack of due diligence or good corporate governance led to these companies either failing to understand the risks they were passing on or having an understanding and awareness and still offering the products without declaring the risks (McNeil & O'Brien 2010, p. 70). 2. The failure by the financiers, banks, companies etc.

Identify or offer transparency of the risks with the financial products being offered then led to a significant global financial crisis that required the intervention of Governments globally to promote economic and financial stability. In the instances of some Australian Banks this was in the form of Government guarantees and bailouts (Cup 2010, p. 18). 3. Following on from this in response to the economic slowdown for the Australian economy the Australian Government through the Reserve Bank of Australia utilized the lending interest rate in an attempt to stimulate the economy.

By lowering the rate this traditionally has then had the Banking sector pass on a reduced rate to their clients. In instances following the SGF and the intervention and support provided by the Australian Government the banking industry has not always passed on the interest rate cut either at all or only partially. The reasons provided for the failure to pass on the interest rate cut by the banks appears to reflect as trying to increase their profits. QUESTION TWO Refer to the 30 June 2012 financial reports of nuthouses Holding Ltd.

The report can be found on their website or the ASS website. Answer the following questions using the consolidated financial reports and the notes to the consolidated financial reports.

PART A. For the year ending 30 June 2012 state: a) ANSWER: 4 Total Assets \$70, 247, 000 = Current assets \$6, 01 5, 000 + Non-Current Assets b) The accounting equation in dollar figures for the end and beginning period of the year and the change in the accounting equation from the beginning and the end of the year.) ANSWER: End of year accounting equation = + = cotangent of year accounting equation = + = \$ Change from beginning &

end of year = \$2, 881 , OHO Asset increase \$695, 000 Liability increase = Equity increase c) State the changes in the company's non-current liabilities during the year. C) ANSWER: Non-current liabilities are comprised of the following: 1 .

Borrowings - Increased. The statement of cash flows shows the company borrower \$3, 000, 000 during the financial year, less repayments of \$793, 000.

The company entered into commercial bill facility of which the drawn down component is split between current (due within 12 months) and non-current (due over 12 months). 2. Deferred Tax Liabilities - Increased in relation to the recognition of deferred tax abilities against software intangibles - \$423, 000 3.

Provisions - Decreased as a direct result of new company acquisitions and the identification of duplicitous roles requiring a restructure. The restructure was commenced in the 2011 financial year and completed in the early part of the 2012 financial year (August 2011).

As such the company incurred a restructuring cost in the 2011 financial year that was not ongoing into the 2012 financial year. It also appears that the outcome of the restructure for the duplicitous roles may have led t the reduction in employee benefits required.

Also the ' Make - good' provision which requires the company to restore leased good in a stipulated condition also reduced in the 2012 financial year. There as a cumulative decrease in the non-current provisions which is made

up of: - \$42, 000 deduction in employee benefits as result of restructure completed in August 2011 .

With the integration of two companies acquired, duplicate roles were identified impacting on the recognition of non-current employee benefits such as long service leave. - \$25, 000 increase in make good which is measured & recognized as an expected co to return asset to agreed condition. 5) What is the main asset the company owns and what is its value? Compare this to the total equity. State your conclusion.

Intangible assets are the company's key asset, of which Goodwill comprises 66% (Goodwill - \$39, 588, 000 / Total Intangible Assets - \$59, 618, 000).

As a percentage of total equity intangible assets make up 97% (Total Intangible Assets - \$59, 618, 000 / Total Equity - \$61, 287, 000) and 64% of Total Equity relates to Goodwill. Goodwill is an unidentifiable intangible asset in that it has no physical presence and can only be recognized on a balance sheet if it is acquired. The amount of Goodwill is determined by what the acquirer would pay over the fair value of the assets (Birrr, Chalmers, Byrne, Brooks & Oliver 2012. P.

163).

Conclusion: There are implications for impairment of intangibles. Indefinite life intangibles such as Goodwill must be tested for impairment annually. If the recoverable amount of Goodwill is less than carrying amount an impairment loss is recognized and cannot be reversed in subsequent periods. Considering the current market cap of \$42, 000, 000 (as at 23 April 2013)

which is a discount to the total equity of 31.5% which indicates the market currently values the many at a considerably less value and the Goodwill could be impaired.

This could be due to the recent acquisitions that have substantially increased revenue and the market being wary of the proper integration and management of the newly consolidated entity or potentially the market considers the company paid too much for the acquisitions. E) State the total revenue, net profit/(loss), and BIT. E) ANSWER: Total revenue = \$20,327,000 (note profit from share of Jointly controlled entity of \$22,000). Net profit = BIT = BIT = + \$627,000 + \$245,000 6 f) How does the company earn its revenue? F) ANSWER:

The company's principal activity is the provision of real estate software, data services, and online advertising to real estate professionals, financial institutions and the public in Australia and New Zealand.

(10TH Annual Report 2012, Directors Report, p. 16). The company earns its most significant revenue from the provision of software & data services, transaction services, interest earned on cash & cash equipment held during the period. G) Compare the net profit with the net cash flows from operating activities.

Which amount is larger?

Is this normal? G) ANSWER: Net cash flows from operating activities Net cash flows is larger. On the accrual method of accounting the cash flows are recognized when receipts and payments are made as well as the inclusion of

non-cash deductions being depreciation and amortization (Birr, Chalmers, Byrne, Brooks & Oliver 2012. Up. 268- 269). The profit for the company is smaller than the net cash flow from operating activities as the company has a significant non-cash deduction of Amortization and depreciation of \$408,000.

) Outline how the company has financed its activities during the year. H)

ANSWER: Based on the statement of scofflaws the company borrowed from Weakest during the erred and uses a debt facility. There was a significant increase in revenue as a result of acquisitions which has turned a loss making entity in 2011 around too net profit position in 2012. The company entered into a put and call agreement and this appears to be an investment in 7 a Jointly controlled entity that the company has opportunity to purchase the remaining 50%.) Outline the investment activity the company undertook.

Was there a net investment or divestment. I) ANSWER: Based on the statement of scofflaws the company made major acquisitions in 2011. Increased holding in Resided from 10. 2% to 50% which was a strategic decision by the company to facilitate integration to the company's database of over 20 years of proprietary real estate info.

The company also made payments for investments in company assets such as software & data intangibles and plant and equipment.) Consider the opening and closing cash balance and the total cash flow from each of the operating, investing and financing activities. What is your conclusion regarding the company's strategy and second year of operation? J) ANSWER:

Based on the statement of scofflaws, now that the business acquisitions from 2011 ND restructure have been bedded down the operating scofflaws have turned around from a significant outflow of cash to an inflow of cash of \$6,422,000. The company is still investing in strategic entities such as Resided to strengthen its future and integrate the new businesses.

The new acquisitions appear to have been funded by issue of shares to the public in 2011 and the investment in Resided was funded by debt/borrowings from Weakest in 2012, therefore the next cash inflow from financing activities dropped dramatically over the past 2 years from \$53,054,000 to \$679,000. Altogether there was a net increase in cash of \$1 bringing the balance sheet cash to a healthier to equity ratio, interest coverage ratio, ANTA, PEPS, DIPS and the PER Part B) ANSWER: ROE = 3.

55% ROE 3.5% = profit available to owners / Average Equity = x 100
 Profit Margin Ratio = 14.5% profit Margin Ratio 14.85% = BIT / sales Revenue x 100
 Asset Turnover Ratio = 0.29 times Asset Turnover Ratio 0.29 times = Sales Revenue \$20,283,000 / Average of Total Assets Current Ratio = 1.

14 times Current Ration 1.14 times = Current Assets \$6,015,000 / Current Liabilities \$5,254,000 Debt to equity ratio = 14.61% Debt to equity ratio 14.61% = Total Liabilities / Total Equity x Interest Coverage Ratio = 10.

42 times Interest coverage Ratio 10.42 times = BIT / Net Finance costs \$289,000 ANTA = 0.02 cents/share NATAL. 2 cents/share = (Ordinary Shareholders Equity \$61 - Intangible Assets \$59,618,000) / Number of ordinary shares on issue at year-end 81 PEPS = 0.02 cents / share PEPS 0.

02 cents/share = Profit available to ordinary shareholders \$2, 141 , OHO /
 Weighted number of ordinary shares on issue 81 DIPS = 0.

006 cents / share 9 DIPS 0. 006 cents/share = Dividends paid or provided to
 ordinary shareholders in the rent reporting period \$490, 000 / weighted
 number of ordinary shares on issue 81 PER = 1. 07 times PER 1. 07 times =
 Current Market Price / Earnings Per Share \$2. 62 PART C.

Short answer questions based on 30 June 2012 financial reports of nuthouses
 Holding Ltd.

Amortization is such a big expense on the income statement as a large part
 of this is attributed to accumulated amortization against intangible assets
 and these intangible assets are held in one cash generating unit. Note 2 of
 the company's 2012 Annual Report identifies that the amortization is
 calculated on a straight-line basis and is charged to the statement of income
 over the estimated useful lives of the intangible assets. The accumulated
 amortization expense is listed against the following intangible assets.

Software Development - Accumulated amortization (1 Data - at cost -
 Accumulated amortization (321 , OHO) Customer contracts and relationships
 - Accumulated amortization (2, 752, 000) Other intangibles - Accumulated
 amortization (223, 000) The estimated useful lives are reviewed on an
 annual basis and are reflected in note 2 as such: Property database - 10
 years Software - 3-5 years Customer relationships - 7-10 years Other
 intangibles - 2-20 years) In the provisions there is a liability being provided
 for called ' make good'. What does this mean?) ANSWER: 10 The ' Make -

good' provision requires the company to restore leased goods in a stipulated condition.

The Accounting Guidance Note No. 2010/1 (Revised) states that where there is a make good provision the company has an obligation to dismantle, remove and restore items of property, plant and equipment at the conclusion of the lease. The accounting standard SAAB 116. 16 require the ' Make-good' obligation to be recorded as liabilities and include: - Purchase price (including duties and taxes) Directly attributable costs as referred to in SAAB 116.

7 - Initial estimate of costs of make good. C) What was the opinion of the auditor in relation to the accounts? Why are accounts audited? C) ANSWER: AUDITORS OPINION The auditors opinion is that the financial reports and the remuneration report presented for the company as at the 30 June 2012 are in accordance with the required legislation and financial reporting standards being the: Corporations Act 2001 Corporations Regulations 2001 Auditor's opinion: ".... The financial report of nuthouses Holdings Limited is in accordance with the

Corporations Act 2001, including: I.

Giving a true and fair view of the consolidated entity financial position as at 30 June 2012 and of its performance for the year ended on that date; and it. Complying with Australian Accounting Standards and the Corporations Regulations 2001 : and b. The financial report also complies with the International Financial Reporting Standards as disclosed in Note 2. In our opinion, the Remuneration Report of Nuthouses Holdings Limited for the year
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ended 30 June 2012, complies with section AAA of the Corporations Act 2001". 1 WHY ARE ACCOUNTS AUDITED Section 301 of the Corporations Act 2001 states that a company, registered scheme or disclosing entity must have the financial report for a financial year audited in accordance with Division 3 and obtain an auditor's report.

The ASS has produced Corporate governance principles and recommendations of which the following are included: Safeguard integrity in financial reporting. Have a structure to independently verify and safeguard the integrity of the company's financial reporting. Remunerate fairly and responsibly.

Ensure that the level of composition of remuneration is sufficient ND reasonable and that its relationship to corporate and individual performance is defined. The good corporate governance of a company is crucial to have confident and informed investors and financial consumers. A significant part of the process of ensuring good corporate governance is that the financial statements of the company are prepared and presented in accordance with the relevant legislation and obligations and that there is an element of independence from the company to add integrity to this process.

This is the reason why the accounts are audited. D) If nuthouses Holdings Ltd did not borrow \$3 million what would their current Asia have been? What stakeholders would be interested in the current ratio? Why would they be interested? D) ANSWER: Current Ratio = 0.71 times current Ratio 0.71 times = / Investors would be the key stakeholder interested in the current ratio. The investors would be interested in this to foresee potential returns.

The level of the ratio indicates the company's ability to meet its short term liabilities (if the ratio is low), whereas if the ratio is high this can be attributed to excess investments in unprofitable assets and therefore may jeopardize potential returns.

) Compare the ROAR, Profit margin ratios and Asset turnover ratio. What does this comparison tell you? $12 \text{ ROAR} = 4.38\%$ $\text{ROAR} 4.38\% = (\text{BIT} / \times 100)$ Profit Margin Ratios = 14.85% The ROAR is low and this indicates that the company's ability to generate income from its current assets is low and that the current profitability is also suffering.

The profit margin which can be attributed to the company's activity being focused on real estate software, data services, and online advertising is also low.

This activity could be linked to the ROAR as the low ROAR would impact the company's ability to generate sales revenue. Further to this the Asset turnover ratio is also low but in light of the services being more information than physical products the company's ratio would need to be analysed more in comparison with other market participants.

Overall the comparison between the ROAR, Profit Margin and Asset Turnover Ratios indicates a low level of revenue at this time. F) Does the company comply with the ASS Corporate Governance Guidelines? Explain Yes the company does comply with the ASS Corporate Governance Guidelines. The Corporate Governance Guidelines are set out in the company's annual report 2012 Up. 6-29 and are provided in accordance with the eight principles stipulated by the ASS Corporate Governance Council 2010, Corporate

governance principles and recommendations with 2010 amendments, 2nd edition, www.

Sex. Com. AU Against the relevant criteria is an evaluation of the company's compliance with the guidelines and an explanation and reference to support the findings. In the report all areas where compliant. G) nuthouses Holdings Ltd is trying to compete with market leaders the REAR group and Fairfax Media's Domain.

Would you invest in nuthouses Holdings Ltd? Why or why not No I would not invest in nuthouses Holdings Ltd.