SUGGESTED ANSWERS TO QUESTIONS

INTERMEDIATE EXAMINATION

GROUP - II

(SYLLABUS 2016)

DECEMBER - 2021

Paper - 10 : Cost & Management Accounting and Financial Management

Time Allowed : 3 Hours

Full Marks : 100

Section: A - MCQ

20X1= 20 Marks

Q.1 ROI (Return on Investment) can be decomposed into the following ratios :

Ans

1. Overall Turnover Ratio and Current Ratio
2. Working Capital Turnover Ratio and Net Profit Ratio
3. Net Profit Ratio and Fixed Assets Turnover
4. ✔ Net Profit Ratio and Overall Turnover Ratio

Q.2 MNC Consciously manipulate the transfer Price as an instrument of maximizing achievement of

Ans

1. Investors' Goals
2. Divisional Goals
3. Managers' Goals
4. ✔ Corporate Goals

Q.3 Which of the following would be consistent with a more aggressive approach to financing working capital ?

Ans

1. Financing permanent inventory build up with long – term debt.
2. Financing short – term needs with short – term funds
3. ✔ Financing some long –term needs with short-term funds
4. Financing seasonal needs with short – term funds

Q.4 RUB LTD earned a Profit of Rs 240000 during the year 2020-21. If its P/V Ratio is 25%, what will be the Margin of Safety ?

Ans

1. Rs 880000
2. Rs 900000
3. ✔ Rs 960000
4. Rs 980000

Q.5 Which of the following Concepts suggests a basis for Correct staffing in Continuously expanding production ?

Ans

1. Growth Curve
2. ✔ Learning Curve
3. Exponential Curve
4. Production Curve

Q.6 A favourable material price variance coupled with an unfavorable material usage variance would most likely result from______

Ans

1. changes in the product mix
2. Problems with processing machines
3. ✔ the purchase of low quality materials
4. problems with labour efficiency

Q.7 Profitability and Liquidity ratios are used for :

Ans

1. Normative purposes only
2. Predictive purposes only
3. ✔ Both Normative and Predictive purposes
4. None of these

Q.8 Internal Rate of return is the discounting factor which :

Ans

1. Ensures that the present value of Net Cash Inflow is > the Net Cash Outflow
2. Ensures that the present value of Net Cash Inflow is < the Net Cash Outflow
3. None of these
4. ✔ Equates the present value of Net Cash Inflow to the Net Cash Outflow

Q.9 Decision making Concerns the-

Ans

✔ 1. Future

2. Past

3. None of these

4. Future and Past both

Q.10 Transfer Price are normally set for-

Ans

✔ 1. Intermediate Products

2. Giffen Products

3. None of these

4. Finished Products

Q.11 The degree of operating Leverage and degree of financial Leverage of VIM Ltd are 2 and 1.5 respectively. If the Sale increases by 10% what will be the percentage change in EPS ?

Ans

1. 15% increase

2. None of these

3. 10% increase

✔ 4. 30% increase

Q.12 EBIT-EPS chart is used for which of the following purpose?

Ans

1. Determining the Price-Earning ratio
2. Showing changes of EPS overtime
3. ✔ Getting EPS levels for varying levels of EBIT
4. Impact of sales on EBIT

Q.13 The Chart that shows the relationship between Profit and Sales Volume is

Ans

1. Break-even chart
2. ✔ Profit – volume chart
3. None of these
4. Contribution Break-even chart

Q.14 Corporate financing instruments which have an unlimited life, voting right and right to receive dividends are known as

Ans

1. Non-Redeemable Preference Shares
2. Redeemable Preference Shares
3. ✔ Equity Shares
4. Debentures

Q.15 **In a factory of ZINB Ltd operating Standard Costing System, 2000 kgs of a material @ Rs 12 per kg were used for a Product, resulting in Material Cost variance of Rs 3000 (FAV). The standard material cost of actual production is -**

Ans

1. Rs 30000
2. Rs 27000 ✔
3. Rs 24000
4. Rs 25000

Q.16 **UBI Ltd has EBIT of Rs 100000. The Company makes use of Debt and Equity Capital. The Company has 10% debentures of Rs 400000. If the Company's equity capitalization rate is 15% What will be value of UBI Ltd ?**

Ans

1. Rs 400000
2. Rs 700000
3. Rs 800000 ✔
4. Rs 600000

Q.17 **ABY Ltd has paid dividend of Rs 3 per share of Rs 10 each last year and it is expected to grow @ 10% next year. If the market price of share is Rs 60 what will be the Cost of equity ?**

Ans

1. 12.00%
2. 12.50%
3. 16.50%
4. 15.50% ✔

Q.18 For preparing a production budget which one of the following is not to be considered ?

Ans
1. Research and Development Budget
2. The Production plan of the factory
3. The Sales Budget
4. Cash Budget

Q.19 Which of the following Accountings records both qualitative and quantitative aspect ?

Ans
1. Green Accounting
2. Management Accounting
3. Financial Accounting

Cost Accounting

Q.20 Which of the Statements about factoring is true ?

Ans
1. The client is able to get 100% of total invoice as credit facility
2. Factoring is the purchase of the invoice of the client
3. Factoring is employed to finance domestic business only
4. Factoring is used for medium term financing at a fixed rate of interest

Q.1 **_______relates to a repetitive Job or task and represents the relationship between experience and productivity.Using the appropriate word(s) fill in the blank.**

Answer :

The learning curve

Q.2 **The total Asset - turnover ratio and total Asset to net-worth of GIN Ltd are 1.80 and 2.50 respectively. If the net – profit margin of the company is 8%. What will be its Return on Equity (ROE) ? ________**

Answer :

36%

Q.3 **Which of the following item in Column (A) is Correctly matched with the Corresponding item in Column (B) ?**

Item No.	Column (A)	Item No.	Column (B)
(1)	Transfer Price	(1)	Decision making
		(2)	Goal Congruence

Answer :

Goal congruence

Q.4 **A factory of ZINITH Ltd operates a Standard Costing System, where 1500 kgs of Raw materials @ Rs 20 per kg were used for a product resulting in Price variance of Rs 6000 (FAV). What will be the Standard Cost of raw materials per kg ?**

Answer :

Rs. 24

Q.5 **In cash Flow analysis the term cash includes cash on hand and_________.Using the appropriate word(s) fill in the blank.**

Answer :

Demand deposits with banks.

Q.6 **The current market price of an equity share of a company is Rs 80. The current dividend per share is Rs 4. In case the dividend are expected grow at the rate of 7%, the cost of equity capital will be :___________.**

Answer :

12.35%

Q.7 **Recording of actual performance is a step in_________.Using the appropriate word(s) fill in the blank.**

Answer :

Budgetary Control.

Q.8 **Roxy Ltd. maintains a margin of Safety of 25% on its current Sales and earns a profit of Rs 28 lakh per annum. If the company has a P/v Ratio of 25% its current sales will be__________.**

Answer :

Rs. 448 lakh

Q.9 All current or proposed programs, listed out in a Zero Based Budget are known as ___________.Using the appropriate word(s) fill in the blank.

Answer :

Decision packages

Q.10_______________is the notional value at which goods and services are transferred between divisions in a decentralized organization.Using the appropriate word(s) fill in the blank.

Answer :

A transfer price

Q.11 Who said - "Investors prefer the early resolution of uncertainty and are willing to pay a higher price of the shares that offer the greater current Dividends" ?

Answer :

Myron J Gordon (1962)

Q.12 Inter firm comparison is the technique of evaluation of__________.Using the appropriate word(s) fill in the blank.

Answer :

Performance

Q.13 If the sales increase from Rs 30000 to Rs 60000 and profit increases by Rs 10800. What will be the P/V Ratio ?

Answer :

36%

Q.14 The Cost per unit of a product manufactured in a factory of BOT Ltd amounts to Rs 150 (80% variable) when production is 10000 units. If production is increased by 25%. What will be the cost of product per unit ?

Answer :

Rs. 144

Q.15_____________ratio expresses the relationship between what is actually paid in the form of dividends out of available earnings and what is available as earnings per share.Using the appropriate word(s) fill in the blank.

Answer :

Pay-out

Q.16 Which item in Column (B) is an appropriate match for the item in Column (A).

Column (A)		Column (B)
Upper control and Lower control Limit for Cash balances are determined by :	(1)	Miller-Orr model
--	(2)	Baumol Model

Answer :

Millar-Orr Model

Q.17____________is caused due to the poor working conditions.Using the appropriate word(s) fill in the blank.

Answer :

Labour efficiency variance

Q.18 Management Accounting is a__________tools to management.Using the appropriate word(s) fill in the blank.

Answer :

Modern

Q.19 A project of Rs 2000000 yielded annually profit of Rs 300000 after depreciation at 12.5% for 5 years and is subject to income tax at 50%, What will be the Pay Back Period ?

Answer :

5 years

Q.20__________is the angle between Sales line and Total Cost line.Using the appropriate word(s) fill in the blank.

Answer :

Angle of incidence

Section : C

(12X4= 48 Marks)
One LAQ

Q.1 **RITU Ltd a manufacturer of Gel Pens selling in the market at Rs 100 per dozen makes an average net profit of 20% on sales by producing 50000 dozens per annum against a Capacity of 75000 dozens.** (7 Marks)

The Cost Sheet of the Company for 2020 was as under:

Particulars	Cost per dozen (Rs)
Direct Materials	36
Direct Wages	30
Works overheads (50% Variable)	10
Sales overheads (25% Variable)	4
TOTAL	**80**

In 2021, the Company anticipates its fixed cost to increase by 6%, Cost of Direct materials by 5% and Labour by 10%. Market enquires revealed that the Selling price of the product and quantity will remain unchanged in 2021.
Based on above information you are required to answer the following questions: (3 + 2 + 2 = 7)
(i) How many number of Gel Pens have to be manufactured and sold in 2021 in order to break-even?
(ii) The Profit of the Company in the year 2021 would be how much?
(iii) An inquiry has been received for the Supply of 10000 dozens of Gel Pen to ZT Company, a Customer. If the business wants to make a maximum Profit of Rs 9 Lakh in 2021, what could be the lowest quotation?

Answer :

(i) Break-even in units = "18276 dozens or 219312 units"

(ii) **Profit of the Company in 2021= Rs. 736 Thousand.**

(iii) **The amount of lowest quotation = Rs. 93.20 per dozen.**

Q.2 **PAN Ltd has the following Capital Structure on September 30, 2021.** (5 Marks)

	Amount in Rs Thousand
Equity Share Capital (2 Lakh shares of Rs 10 each)	2000
Other equity	2000
12% Preference Shares	1000
9% Debentures	3000
TOTAL	**8000**

The market Price of Equity Share is Rs 30. It is expected that the Company will pay next year a dividend of Rs 3 per share which will grow at 7% forever. Corporate Tax is 40%.
Based on above information you are required to answer the following questions : (1 + 4 = 5)
(i) What is the Cost of Equity ?
(ii) What is the weighted Average Cost of Capital (WACC) of the Company using book value weights ?

Answer :

(i) Cost of Equity = **17%**

(ii) Weighted Average Cost of Capital (WACC)= 12.03%

Q.1 **VINAK LTD uses a Standard Cost System and manufactures Product Z by blending two materials A and B.** (6 Marks)

The Standard and Actual Particulars of September 2021 are as follows:

Material	Standard		Actual	
	Qty.	Unit Price (Rs)	Qty.	Unit Price (Rs)
A	60%	20	88	30
B	40%	10	132	10

Standard loss : 10%
During September 2021 the Company Produced 180 kgs of Product Z.
Based on above information you are required to answer the following questions : (2 + 2 + 2 = 6)
(i) What is the value of Material Cost Variance ?
(ii) Material Price Variance is ____________
(iii) What will be the amount of Material Usage Variance?

Answer :

(i) Material Cost Variance:
(Std Cost- Actual Cost)
= 3200-3960= **Rs. 760 (Adv)**

(ii) Material Price Variance:
(SP-AP)xAQ
A=(20-30)x88 = 880 (Adv)
B=(10-10)x132 = 0

Rs. 880 (Adv)

(iii) Material usage variance:
(SQ-AQ) SP
A= (120-88)x20 = 640 (FAV)
B=(80-132)x10 = 520 (Adv)

Rs. 120 (Fav)

Q.2 The Balance Sheet of RIUP Ltd as on March 31' 2021 is as follows: (6 Marks)

Equity & Liabilities	Amount (Rs)	Assets	Amount (Rs)
Equity Share Capital (Rs 10 each)	120000	NET Fixed Assets	300000
Other Equity	40000	Current Assets	100000
10% Long term Debt	160000		
Current Liabilities	80000		
	400000		**400000**

The Company's total assets turnover ratio is 3. Its fixed operating costs are Rs 200000 and the variable operating costs ratio 40 percent. The Corporate Tax rate is 35 percent.
Based on above information you are required to answer the following questions : (2 + 1 + 1 + 2 = 6)
(i) What is the operating Leverage of Riup Ltd ?
(ii) Financial Leverage is ___________
(iii) What is the Combined Leverage of Riup Ltd ?
(iv) What is the likely level of EBIT if EPS is Rs 3 ?

Answer :

(i) Operating Leverage (OL) = $\frac{720000}{520000} = 1.385$

(ii) Financial Leverage (FL) = $\frac{520000}{504000} = 1.032$

(iii) Combined Leverage (CL) = $\frac{720000}{504000} = 1.43$

(iv) EBIT = Rs. 71385

Q. 1 MODERN ENT LTD is Considering the purchase of a new Computer System for its research and development Division, which would cost Rs 35 Lakh. The operation and maintenance costs (excluding depreciation) are expected to be Rs 7 lakh per annum. It is estimated that the useful life of the System would be 6 years, at the end of which the disposal value is expected to be Rs 1 Lakh.

(6 Marks)

The tangible benefits expected from the System in the form of reduction in design and draftsmanship Costs would be Rs 12 lakh per annum. The disposal of used drawing and drawing office equipment and furniture initially is anticipated to net Rs 9 lakh.

As Capital expenditure in research and development, the proposal would attract a 100 percent write-off for tax purposes. The gains arising from disposal of used assets may be considered tax-free. The Corporate tax rate is 35%. The average cost of capital of the company is 12 per cent. Ignore tax on Salvage value.

(Calculations should be made upto three digits after decimal)

Given [PVIF (12%, 6 years) = 0.507 and PVIFA (12%, 6 years) = 4.111]

Based on above information you are required to answer the following questions [Using NPV Method] : (1 + 2 + 2 + 1 = 6)

(i) What is the amount of Incremental Cash out flows from the new computer System ?

(ii) What is the amount of Total Present value of Future Cost saving from buying Computer System ?

(iii) The Net Present value (NPV) (incremental) from the Computer System will be ________.

(iv) As a financial adviser, what would be your recommendation for the company in respect of the Purchase of Computer System ?

Answer :

(i) Incremental Cash Outflows: **Rs. 26 lakh**

(ii) The total P.V. of future cost Savings: = **Rs. 13.361 lakh**

(iii) The Net Present Value (NPV) (incremental):= (1.193) lakh

(iv) Recommendations:

Since Net present value is negative, the proposal is not financially viable. The company should not consider to purchase a new computer system.

Q.2 TRIST LTD, a manufacturing Company, operating Standard Costing System has a normal Capacity of 720 machine hours per day of 25 days a month. The fixed overheads are budgeted Rs 108000 per month. The Standard time required to manufacture one unit of production is 4 hours. (6 Marks)

In June 2021, the Company worked 24 days of 630 machine hours per day and produced 3980 units of output. The actual fixed overheads are Rs 106500.

Based on the above information you are required to answer the following questions : (2 + 2 + 2 = 6)

(i) What is the amount of Fixed overhead Efficiency Variance ?

(ii) Fixed overhead Capacity Variance will be__________.

(iii) What will be the Fixed overhead Calender Variance ?

Answer :

(i) F**ixed overhead efficiency variance**:

(3780-3980)x Rs. 24= **Rs**. **4800 (Fav)**

(ii) Fixed overhead capacity variance:

(4320-3780)x Rs. 24= **Rs. 12960 (Adv)**

(iii) Fixed overhead Calendar Variance:

(4500-4320) x24 =Rs. **4320 (Adv)**

Q.1 The following financial parameters and Balance Sheet of BXA Ltd for the yearended 31.3.2021 are given : (6 Marks)

The Total Assets Turnover	2 times
Inventory turnover Ratio based on Cost of Goods sold and year end inventory	4 times
Gross Profit on Sales	25%
Average Collection Period (Assume 360 days in a year)	45 days
Total Debt to Networth	1 : 3
Quick Ratio	1 . 5

Balance Sheet as on March 31, 2021

Equity & Liabilities	RS	Assets	RS
Equity Share Capital	400000	Properties, Plants and equipments	———
Other Equity	800000	Current Assets :	
		Inventory	———
Total Debt :		Debtors	———
Current Liabilities	———	Cash and Cash equivalents	200000

Based on the above information you are required to answer the following questions : (2 + 1 + 2 + 1 = 6)
(i) What is the value of Current Liabilities ?
(ii) What is the value of Properties, Plants and equipments (PPE) ?
(iii) What is the value of Inventory ?
(iv) The value of Debtors will be__________.

Answer :

(i) Current Liabilities = **Rs. 400000.**

(ii) Value of Properties, Plants and Equipments (PPE)= **Rs. 400000.**

(iii) Value of Inventory = **Rs. 600000.**

(iv) Value of Debtors= **Rs. 400000.**

Q.2 The variable cost structure of a product manufactured by ABX company during thecurrent year is as under :

(6 Marks)

	Rs. Per unit
Material	168
Labour	42
Overheads (variable)	16.80

The selling price per units is Rs 378 and the fixed cost and sales during the current year are Rs 19.60 Lakh and Rs 56.70 Lakh respectively.
During the forthcoming year, the direct workers will be entitled to a wage increase of 10%from the beginning of the year and the material cost, variable overhead and fixed overhead are expected to increase by 7.5%, 5% and 3% respectively.
Based on the above information you are required to answer the following questions : (1 + 3 + 2 = 6)

(i) What is the current year's Profit ?

(ii) The new sale price in the forth coming year if the current P/V Ratio is to be maintained would be how much ?

(iii) How many numbers of Units would required to be sold during the forth Coming year so as to yield the same of Profit in the Current year, assuming that selling price per unit will not be increased ?

Answer :

i) Current Year's Profit = **Rs. 308000**

(ii) New Selling Price for the forthcoming year: Rs. 407.40

(iii) Number of Units to be sold= 17422 units

Q.1 XBA LTD. has furnished the following information for the year ended 31st March,2021. (6 Marks)

	(Rs. In Lakhs)
Net Profit	305
Dividend (including interim dividend) paid	95
Provision for Income Tax	75
Income Tax paid during the year	60
Loss on sale of assets (net)	2
Book value of assets sold	10
Depreciation charged to P&L Account	250
Loss on Sale of investments	3
Value of investments sold	306
Interest paid during the year	145
Increase in working capital (excluding cash and cash equivalents)	505
Purchase of fixed assets	18
Investment in Joint venture	105
Opening cash and Cash equivalents	12
Closing cash and cash equivalents	30

Based on the above information you are required to answer the following questions in accordance with AS-3 (Revised) :
(3 + 2 + 1 = 6)
(i) What is the value of the Net Cash Flow from Operating Activities ?
(ii) Net Cash Flow from Investing Activities is_____________.
(iii) What is the value of Net Cash flow from Financing Activities ?

Answer :

(i) Net Cash Flows from Operating Activities: = Rs. 70 lakh

(ii) Net Cash flows from investing Activities: Rs. 188 lakh

(iii) Net Cash Flows from Financing Activities:= (Rs. 240) Lakh

Q.2 ABT Ltd produces and sells a single product PANCO. (6 Marks)
Sales Budget for Calendar year 2021 by quarters is as under:

Quarter	*No. of Units to be sold*
I	12000
II	15000
III	16500
IV	18000

The year is expected to open with an inventory of 4000 units of finish products and close with an inventory of 6500 units.
Production is customarily scheduled to provide for two – thirds of the current quarter's Sales demand plus one third of the following quarter's demand.
Thus production anticipates Sales volume by about one month.
The Standard cost details for one unit of the product PANCO is as follows :
Direct Materials 10 kgs @ 50 Paise per kg.
Direct Labour 1 hour 30 Minutes @ Rs 4 per hour
Variable overheads 1 hour 30 minutes @ Re 1 per hour
Fixed overheads @ Rs 2 per hour, based on a budget Production Volume of 90000 Direct Labour hours for the year.
Based on the above information you are required to answer the following questions : (2 + 1 + 3 = 6)
(i) How many budgeted number of units to be produced for the four quarters of year 2021 ?
(ii) What is the value of Budgeted Production Cost for the quarter III of year 2021 ?
(iii) What is the Total value of Budgeted Production Cost for the year 2021?

Answer :

(i) **Budgeted number of units to be produced for 4 quarters of year 2021**:= **64000 units.**

(ii) Budgeted Production Cost for quarter III:= Rs. 257500.
(iii) Value of Budgeted Production Cost for year 2021:= Rs. 980000.

Six LAQ

(4X3= 12 Marks)

Q.1 Write Short Notes on Advantage of Zero Based Budgeting (ZBB) (3 Marks)

Answer :

Advantages of Zero Based Budgeting:

The Advantages of zero based budgeting are:

(i) Out of date and inefficient operations are identified

(ii) Allows managers to promptly respond to changes in the business environment

(iii) Instead of accepting the current practice, it creates a challenging and questioning attitude.

(iv) Allocation of resources is made according to needs and the benefits derived

(v) It has a psychological impact on all levels of management which makes each manager to 'pay his way'

Q.2 Write Short Notes on Angle of Incidence (3 Marks)

Answer :

Angle of Incidence:

Angle of Incidence is the angle between sales and total cost line. This angle is an indicator of profit earning capacity of the firm over the breakeven point sales. Angle of incidence is an angle formed at the intersection point of total sales line and total cost line in a formal break even chart. If the angle is larger, the rate of growth of profit is higher and if the angle is lower, the rate of growth of profit is lower. So, growth of profit or profitability rate is depicted by Angle of Incidence.

Q.3 Write Short Notes on Profitability Index (PI) (3 Marks)

Answer :

Profitability Index (PI):

Profitability Index (PI) is also known as 'Benefit Cost Ratio (BCR). According to Horne Van Home, the profitability Index of a project is "the ratio of the present value of future net cash inflows to the present value of cash outflows".

- Profitability Index= $\dfrac{\textbf{Present Value of Cash Inflows}}{\textbf{Present Value of Cash Outflows}}$

Decision criteria: If the profitability index is greater than or equal to one, the project should be accepted otherwise reject.

Demerits: However, this technique suffers from the following limitations:

☐ It is somewhat difficult to compute

☐ It is difficult to understand the analytical of the decision on the basis of profitability index

Q.4 Write Short Notes on Significance of Management Accounting (3 Marks)

Answer :

Significance of Management Accounting: (Any three points)

The various advantages that accrue out of management accounting are enumerated below:

(1) **Delegation of Authority:** Now a day the function of management is no longer personal. Management accounting helps the organization in proper delegation of authority for the attainment of the vision and mission of the business.

(2) **Need of the Management:** Management Accounting plays the role in meeting the need of the management.

(3) **Qualitative Information**: Management Accounting accumulates the qualitative information so that management would concentrate on the actual issue to deliberate and attain the specific conclusion even for the complex problem.

(4) **Objective of the Business:** Management Accounting provides measure and reports to the management thereby facilitating in attainment of the objective of the business.

Q.5 Write Short Notes on Forfeiting (3 Marks)

Answer :

Forfeiting:

Forfeiting refers to the exporter relinquishing his right to a receivable due at a future date in exchange for immediate cash payment, at an agreed discount, passing all risks and responsibilities for collecting the debt to the forfeiter. It is the discounting of international trade receivable on a 100% “Without Recourse” basis. Forfeiting transforms the supplier’s credit granted to the importer into cash transaction for the exporter protecting him completely from all the risks associated with selling overseas on credit. It effectively transforms a credit sale into a cash sale.

Section : D - Case Study Question

Q.1 HIND INSTRUMENTS LTD (HIL) manufactures Industrial Components for the heavy machinery Industry. It mainly sells to the Industrial Company at a retail price of Rs50 per Component. 2+4+2+3+1=12 Marks

The HIL has recently appointed Mr. Anupam as its new Financial Controller. Immediately after taking over, he examines the working Capital Management Policy of the Company. Against the Industry norm of 10 – 12 percent, the HIL's ratio of Networking Capital to annual turnover (Sales) was as stated 10.40%, 8.80% and 7.50% for last three years 2018 – 19 to 2020 – 21 low as well as declining.

Mr Anupam also finds that Current Ratios & Quick ratios as stated 1.64, 1.41, 1.32 and 0.87, 0.70, 0.65 respectively for last three years 2018 – 19 to 2020 – 21 are inadequate.

These findings convinced Mr Anupam that all was not well with the working capital Management of the Company. He discussed the problem with CFO of the Company Mr Anint Kapoor.

To find a solution, he undertook a detailed analysis of the Income Statements of the Company. The following points emerged from the study of Income statement of Last three years (2018 – 19 to 2020 – 21).

(i) The Company was retailing the Component for the Sale price of Rs 50, while the variable cost was 65 percent;

(ii) The fixed cost was Rs 150 lakh as long as production levels were below 14.50 Lakh units per annum.

(iii) For Production levels of 14.50 Lakh units and above, the fixed costs rose to Rs 160 lakh;

(iv) The bad debts levels had been 1.98% (2018-19), 2.11% (2019-20) and 2.3% (2020-21).

(v) The credit policy followed by the company is "2/10 net 30".

(vi) On an average, only 30 percent of the customers availed of the cash discount over all the last three years

(vii) The pre-tax rate of return that HIL was expecting for the last three years was 18 percent.

From the above facts Anupam was convinced that the solution to the ills that besieged that company lay with the customers. So he sought to meet the major customers of HIL. He found the following main facts from the customer of HIL.

(a) Many of the customers, the ones with the large orders worth nearly 65 percent of the annual Sales of HIL were of the opinion that it was high time that HIL reviewed its credit terms extended to its debtors;

(b) Many customers were asking for more credit period, though some were also ready to forego the 2 percent discount that HIL was endowing as of now; in fact, they were ready to settle with discounts as low as 1-1.5 percent, as was the industry norm, in return for an extension of the credit period by HIL.

From the talks he had with the customers and internal management of HIL, Anupam showed the two alternative to them.

From consultations with both, he was able to come to the following estimations :

(A) For first option (2/20 net 45),

(a) For Production of 14.55 lakh units, a sales of 14.55 lakh units. (after taking into account the previous year's closing inventory 0.90 lakh)
(b) The fixed cost would be Rs 160 lakh;
(c) The bad debts are expected to be 2 percent of sales revenue;
(d) 52 percent of the customers would avail of the cash discount;
(e) The pre-tax RoR expected by HIL, 18 percent;
(f) The average collection period would be 32 days.
(g) The average collection cost would be Rs 0.43 lakh

(B) For second option (1.5/30 net 60),

(a) For Production of 14.65 lakh units, a sales of 14.65 lakh units (after taking into account the previous year's closing inventory 0.90 lakh)
(b) The fixed cost would be Rs 160 lakh
(c) The bad debts are expected to be 1.5 percent of sales revenue;
(d) 56 percent of the customers would avail of the cash discount;
(e) The pre-tax RoR expected by HIL, 18 percent;
(f) The average collection period would be 43 days.
(g) The average collection cost would be 0.42 lakh.

Note : (assume 360 days in a year) (Calculations should be made upto three digits after decimal)

Based on the above information you are required to answer the following question:

i) **What are the amount (Rs in Lakh) of Cash discount and Cost of Investment in Debtors for the Credit term First Option (2/20 net 45) ?**

Answer : For the credit term first option (2/20 net 45):

Cash Discount = Rs. 7.566 lakh

Cost of Investment in Debtors= Rs. 10.126 lakh

ii) **What is the value of Net Profit (Rs in Lakh) for the Credit Term First Option (2/20 net 45) ?**

Answer : Net profit for Credit term First Option (2/20 net 45): = Rs. 61.953 lakh.

iii) **What is the amount (Rs in Lakh) of Cash discount, as well as Cost of Investment in Debtors for Credit Term Second option (1.5/30 net 60) ?**

Answer :

For credit term- Second Option (1.5/30 net 60): Cash Discount = Rs. 6.153 lakh

Cost of Investment in Debtors= Rs. 13.677 lakh

iv) **The Net Profit to be earned from the Credit term Second Option (1.5/30 net 60) would be how much ?**

Answer :

Net Profit for Credited term Second Option (1.5/30 net 60) = Rs. 65.137 lakh

v) **Which credit term option should be recommended by Mr Anupam to CFO of Hind Instruments Ltd?**

Answer :

Recommendation: The credit term –second option [1.50/30 net 60) should be recommended by Mr. Anupam to the CFO of the Hind instruments Ltd. (HIL) since the company's earnings (profit) will be increased by Rs. 3.184 lakh (65.137- 61.953).