

BTEC HN in Business

Unit 2: Managing Financial Resources and Decisions

Handout Date: _____

Hand In Date: _____

Assignment 2 - Making Financial Decisions

Scenario

The Financial Accountant of Northfield Components has recently resigned and left his post with immediate effect. The Directors decide to advertise for a replacement but realize that the recruitment process may take up to three months. In the short term they decide to bring in a financial consultant to tide them over until a permanent appointment is made. You are asked by your line manager to take on this role - initially for three months.

Task 1

On your first morning in early January 2008 the Directors present you with two budgets prepared by the departed financial accountant. You are given the cash flow forecast for the twelve months from January 2008 and the sales budget covering the twelve month period from July 2007 to June 2008 - the first six months of which include actual sales figures and variances between budgeted and actual sales.

The directors are concerned about the likely cash deficits shown in the cash flow forecast and the sales performance from July to December 2007. They are also concerned that they are very unlikely to meet their budgeted sales targets for January to June 2008.

With this in mind they ask you to:-

- Scrutinise the cash flow forecast and the sales budget and identify the main problems that Northfield Components are faced with
- Identify the likely causes of the problems and how they might be remedied and avoided in the future
- Make recommendations for improving the cash flow situation with a view to minimizing the cash deficit or, possibly, generating a cash surplus
- Make recommendations for resolving the issues highlighted in the sales budget and decide what approach should be taken in relation to the January to June budget

You are required to present your findings and recommendations in a formal written report to the Directors of Northfield Components Ltd.

(This provides evidence for outcome 3 - assessment criteria 3.1)

Task 2

The Directors of North Seaton Engineering Company are considering two alternative business projects each of which involve an initial investment of £ 450,000. In your role as financial consultant you are asked to advise the Directors which of the two projects would be the more financially viable.

Project 'A' involves the introduction of modern, hi-tech machinery into the company's main production unit. This will result in significant increases in output and substantial savings in production and maintenance costs. This in turn will result in a net increase in turnover to the company of:-

Year 1 - £ 180,000
Year 2 - £ 230,000
Year 3 - £ 280,000
Year 4 - £ 120,000

Project 'B' involves an increase in the company's marketing activities. The Directors would employ one of the region's most prestigious marketing companies to manage a massive national campaign. They feel that business could be increased without, necessarily, updating production processes. It is anticipated that the net effect of their campaign would bring in additional annual turnovers of:-

Year 1 - £ 60,000
Year 2 - £ 120,000
Year 3 - £ 250,000
Year 4 - £ 250,000

As financial consultant, you are asked to carry out a full investment appraisal of the two projects. In order to fully assess the pros and cons of the two alternatives you decide to employ a number of appraisal techniques:-

- Payback
- Accounting rate of return
- Net present value
- Internal rate of return

For calculation purposes, you assume that the cost of capital will remain fairly static at around 6% per annum over the four year period

Your appraisal should be presented in the form of a written report to the Directors and include all financial computations and a summary of the conclusions which can be drawn from the results of the appraisal - including recommendations as to which project should be taken on board

(This provides evidence for outcome 3 - assessment criteria 3.3)

Task 3

You decide to meet with the Directors to go through the report and explain how you have reached your conclusions. You also feel that it would be of benefit to explain the significance of each appraisal method and the formulae used to produce your financial computations.

With this in mind you need to produce a power point presentation which highlights:-

- The mechanics behind each appraisal method
- The relative pros and cons of each method
- The impact of the value of money on future cash flows
- Any assumptions that need to be made when making investment decisions

(This provides evidence for outcome 3 - assessment criteria 3.3)

Task 4(a)

The Directors of Northfield Components Ltd are very concerned about the company's current costing and pricing policies. They are also anxious to find out which products are going to be profitable or otherwise in the future. With this in mind the Directors ask you to carry out a full costing and pricing review across the company's product range and an assessment of the break-even figures for each item currently manufactured by Northfield.

One of the most popular products is a multi-purpose component - the ACE Converter. You ascertain that the following costs are incurred in the production of each unit:-

Material costs - £ 52.50

Labour Costs - £ 35.75

Variable Overheads £ 10.20

The fixed costs of running the factory where the ACE Converter is produced amount to £120,000 per annum. The current selling price of the converter is £120.

You decide to use the ACE Converter as the model for all your forthcoming calculations and decide to present your information in the following order:-

- The contribution per unit and the contribution/sales ratio
- The break-even point in unit and sales value
- A break-even chart for the product
- The margin of safety per unit and in sales value (unit sales for 2008 are expected to be 7,500)

You also decide to calculate the profit or loss at various sales levels (e.g. 5,000, 8,000 and 10,000 units) and indicate what the following changes will have on the break-even point:-

- A £5 increase or decrease in the selling price
- A £5,000 increase or decrease in fixed costs
- A £5 increase or decrease in material or labour costs per unit

All the above information regarding the ACE Converter should be presented in the form of a brief report showing the relevant financial material in tabular/graphical format supported by relevant text

Task 4(b)

Two customers have recently placed large orders for the ACE Converter at substantially discounted prices. The Directors ask you to calculate the likely impact that either of these orders would have on the company's profits. They are new customers and their business would push the sales levels well above the anticipated demand of 7,500:-

- Southwood Electricals - an order for 500 units at a discount of 15% on the normal selling price
- Westbrook Engineering - an order for 1000 units at a discount of 25% on the normal selling price

You are asked to produce a computation for each order illustrating the likely impact on the profits for the ACE Converter and a memorandum to the Directors making recommendations as to whether they should accept or reject either of the orders. The Managing Director has indicated that financial issues may not be the only consideration

(This provides evidence for outcome 3 - assessment criteria 3.2)

Task 5

The Directors of Northfield Components have been very impressed with your contribution to date and, with this in mind, ask you to produce some briefing papers on costing systems and pricing methods which the departmental managers within the company would find useful and informative. These papers will be accompanied by a presentation which you have been asked to give before your three month consultancy period is over.

As a guide the briefing paper on costing systems should include:

- Fixed and variable costs and break-even analysis
- Marginal and absorption costing
- Activity-based costing
- Standard costing

And on pricing methods:-

- Market-led pricing
- Full-cost pricing
- Marginal cost pricing
- Opportunity cost approach to pricing

The papers should include descriptions, examples and an evaluation of each system/method. The presentation should provide a summary of the information provided in the papers in bullet-point format.

In conclusion, the Directors ask you to recommend the most appropriate methods of costing and pricing for Northfield Components. This can be produced in the form of a detailed memorandum

(This provides evidence for outcome 3 - assessment criteria 3.2)

Sales Budget - Northfield Components Ltd. - July 2007- June 2008

Month	Monthly Budget	Cumulative Budget	Actual Monthly	Actual Cumulative	Variance
July	230,000	230,000	215,000	215,000	(15,000)
August	230,000	460,000	220,000	435,000	(25,000)
September	270,000	730,000	245,000	680,000	(50,000)
October	265,000	995,000	235,000	915,000	(80,000)
November	265,000	1,260,000	237,000	1,152,000	(108,000)
December	300,000	1,560,000	270,000	1,422,000	(138,000)
January	250,000	1,810,000			
February	265,000	2,075,000			
March	300,000	2,375,000			
April	325,000	2,700,000			
May	325,000	3,025,000			
June	350,000	3,375,000			

- Look at the Sales Budget and identify the main issues for Northfield Components Ltd
- Identify the likely causes of those problems
- Identify ways in which those problems could have been avoided

Cash Flow Forecast for a new business - Northfield Components Ltd Jan 2008 - Dec 2008

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Brought forward	40,000											
Sales	200,000	300,000	300,000	300,000	250,000	260,000	300,000	260,000	300,000	325,000	265,000	265,000
Total Income	240,000	300,000	300,000	300,000	250,000	260,000	300,000	260,000	300,000	325,000	265,000	265,000
Purchases	150,000	140,000	135,000	135,000	140,000	130,000	135,000	145,000	140,000	140,000	145,000	145,000
Wages	55,000	55,000	55,000	55,000	55,000	55,000	55,000	55,000	55,000	55,000	55,000	55,000
Rent & Rates	56,000			56,000			56,000			56,000		
Light & Heat			55,000			55,000			55,000			55,000
Advertising	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Insurances	55,000				52,000							
Equipment	50,000	10,000		10,000		10,000						
Vehicles	20,000											
Directors Salaries	22,000	22,000	22,000	22,000	22,000	22,000	22,000	22,000	22,000	22,000	22,000	22,000
Motor Expenses	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000
Sundry Expenses	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000
Total Expenditure	432,000	251,000	291,000	302,000	293,000	296,000	292,000	246,000	296,000	297,000	246,000	301,000
Monthly deficit/surplus	(192,000)	49,000	9,000	(2,000)	(43,000)	(36,000)	8,000	14,000	4,000	28,000	19,000	(36,000)
Accumulative deficit/surplus	(192,000)	(143,000)	(134,000)	(136,000)	(179,000)	(215,000)	(207,000)	(193,000)	(189,000)	(161,000)	(142,000)	(178,000)

- Look at the Cash Flow Forecast and identify the main problems that the company are faced with
- Identify the main causes of those problems
- Suggest ways of improving cash inflows/outflows in order to minimize the cash deficit or generate a cash surplus

Assignment One : Finance as a resource

Unit 2: - Managing Financial Resources and Decisions

Outcome(s)/criteria:	Possible evidence	Feedback
<p>3 Make financial decisions based on financial information</p> <p>3.1 Analyse budgets and make appropriate decisions</p> <p>3.2 Calculate unit costs and make pricing decisions using relevant information</p> <p>3.3 Assess the viability of a project using investment appraisal techniques</p>	<p>Analysis of the cash flow forecast and cash budget - identifying the problems and finding remedies for the future. Making recommendations on how to improve cash flow and improve the budget setting and monitoring processes</p> <p>Investment appraisal of two projects - a financial appraisal using appropriate techniques. An evaluation of the various techniques and recommendations/conclusions as to which project should be adopted</p> <p>Reports on costing and pricing - cost and price computations, tables and charts and decisions relating to findings. Briefing papers and presentation material on various costing systems and methods of pricing. Recommendations as to the best options to adopt</p>	

Grade descriptors:	Possible evidence	Feedback
<p>Merit:</p> <p>M1 identify and apply strategies to find appropriate solutions</p> <p>M2 select/design and apply appropriate methods/ techniques</p> <p>M3 present and communicate appropriate findings</p>	<p>Relevant costing, budgeting and investment appraisal theories and techniques have been applied when completing the relevant tasks.</p> <p>Effective judgements have been made in relation to:-</p> <ul style="list-style-type: none"> • The choice of capital investment • The selection of orders for ACE Converters • The choice of costing and pricing methods/ techniques <p>A range of costing, budgeting and investment appraisal techniques have been applied when:-</p> <ul style="list-style-type: none"> • Calculating the return on capital investments • Calculating break-even, profits and margins <p>The reports, briefing papers and memoranda to the Directors covering the budget issues, the investment decisions and the costing and pricing methods have produced using an appropriate structure and approach</p> <p>Logical and coherent arguments have been presented when making recommendations for:-</p> <ul style="list-style-type: none"> • improving the cash flow and sales budgets • costing and pricing methods • capital investments <p>Appropriate technical language relating to costing, budgeting and investment appraisal is used throughout</p>	

Distinction:			
D1	use critical reflection to evaluate own work and justify valid conclusions	<p>Synthesis has been used to generate and justify valid conclusions regarding the budgets, the capital investments and the costing and pricing methods</p> <p>An effective and adequately detailed evaluation of the capital investment projects and the costing and pricing techniques has taken place</p>	
D2	take responsibility for managing and organising activities	<p>Autonomy and independence has been demonstrated when completing the range of assignment tasks. Minimal tutor guidance and advice has been sought when manipulating financial data and preparing reports and briefing papers</p> <p>All substantial activities relating to the three scenarios have been planned, managed and organised in an efficient and effective manner</p>	
D3	demonstrate convergent/lateral/creative thinking	<p>Ideas have been generated and decisions taken relating to the cash flow and sales budget problems, the choices of capital investment project and the costing and pricing methods to use</p> <p>Problems relating to cash flow and the poor performance against the sales budget have been solved in a logical coherent manner</p>	

