FINANCIAL MANAGEMENT

Multiple choice

1.	B	**6.**	A	**11.**	D
2.	D	**7.**	C	**12.**	A
3.	D	**8.**	B	**13.**	A
4.	C	**9.**	A	**14.**	D
5.	C	**10.**	C	**15.**	C

Short answer questions

Question 1

(a) **Auditors examine the financial reports of a business to ensure that the reports comply with all relevant legislation and that they present a true and fair view of the business's position.**

(b) **ASIC enforces company and financial services laws to protect consumers, investors and creditors. It monitors the financial system and keeps stakeholders informed and takes legal action where necessary.**

(c) **Kombi's management have acted unethically by breaching the trust of the agency relationship. The bonuses were only to be paid according to expected financial reporting periods. Not only do management's actions breach the trust placed in them, but it could possibly contravene their employment contracts.**

Additionally, to fire an auditor because they refused to sign the accounts is an extreme move that suggests grossly unethical behaviour, and that the acccounts may not represent a true and fair view of the company's financial situation – a criminal and unethical breach.

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Question 2

(a) **The increase in wages, despite the falling levels of cash inflows.**

(b) **Working capital is a lifeblood of a business, and without it, a business cannot function properly. Poor cashflow management will severely constrain a business's working capital meaning it will not have sufficient funds to generate sales or invest in potentially lucrative projects. As a result, profits will suffer and the business may be unable to pay its debts.**

(c) **1. Expense minimisation – Eric's management must understand that expenses must be controlled in a manner that is relevant to the level of sales being generated. For example, when sales revenue falls, the business will not need the same amount of staff.**

2. Marketing and sales targets – by setting clear marketing and sales targets the business will increase the desire amongst workers to increase the business's cash inflows. At the moment, it does not seem that employees realise the need to be vigilant with cash outflows, as they may not understand the importance of relevant cash inflows from sales.

Question 3

(a) **Working capital ratio = current assets / current liabilities = 0.93:1**

(b) **The phone bill is clearly not in the business's balance sheet shown above, as the accounts payable is only at $2,006. The bill would change the working capital ratio to 0.60, by increasing current liabilities to $8,491. This highlights that the bill would effectively make the business insolvent unless they are able to sell some non-current assets or gain access to further debt or equity funds.**

(c) **1. Factoring – the business has a high level of accounts receivable ($3,701) compared to its accounts payable ($2,006). This suggests that the business may not be controlling its debtors as well as they could be. Factoring would be a logical response to this, as the business would receive immediate cash flows from all debts and would not have to worry about the possibility of bad debts or the expense of chasing accounts.**

2. Leasing – The business has a large amount of funds tieFon their balance sheet, the money would still be there as cash, and they would just have to pay regular lease instalments.

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Question 4

(a) **Expense ratio = expenses / sales x 100 = ($149,837 / $279,410) x 100 = 53.6%**

(b) **Gross Profit Ratio (GPR) = gross profit / sales x 100**
= ($162,404 / $279, 410) x 100 = 58.1%

Net Profit Ratio (NPR) = net profit / sales x 100
= ($12,567 / $279,410) x 100 = 4.5%

(c) **Efficiency – the business has a very high expense ratio (53.6%) compared to the industry at 20%. This suggests that management is not efficient at controlling costs.**

Profitability – the business has an outstanding gross profit ratio compared to the industry but as the net profit ratio shows this is wasted due to high expenses, leaving the business with a below industry level of net profit.

On the whole, Lee's obviously has excellent inventory cost management to maintain such as high gross profit but is inefficient at controlling expenses compared to the industry as a whole.

(d) **1. Cost centres – by breaking the business up into cost centres, Lee's management may be able to better identify and control expenses that are unnecessarily high.**

2. Increase budgeting and sales targets for sales staff and middle management – expense minimisation is something that must be understood by all staff if it is to be successful. Additionally, giving staff sales targets in these budgets will hopefully encourage increased motivation and revenue.

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