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FIN220 FINANCIAL MANAGEMENT

TEST First Semester 2020/2021

DATE: 11 Jan. 2022

INSTRUCTION TO STUDENTS:

1. This test consists of **FOUR (4) QUESTIONS**. Students are required to answer Question 1 (**Compulsory**) and another other **two** questions. **All together 3 questions.**
2. The test represents 25% of the total assessment for the module.
3. Please read the questions carefully and answer as required.

Question 1

(a) A newly registered Agro business is considering establishing its own incubator facility, for which it currently contracts an agro specialist. Some of the committee members believe that having its own incubator will lead to a cheaper and more efficient poultry production.

The finance director has provided you with the following information:

- (i) The capital cost of establishing the incubator facility would be \$ 200,000.
- (ii) The estimated Cash Flows for the next 4 years are as follows:

Year	Cash Flows(CF in \$)
1	100,000
2	120,000
3	120,000
4	150,000

- (iii) The financial director suggests that she may be able to obtain a loan from a bank for the project. They have indicated the interest on the loan to be 10 percent.

REQUIRED:

- (i) Evaluate the above project using the following capital budgeting techniques:
 - a. Net Present Value (NPV)
 - b. Profitability Index (PI)
 - c. Payback Period (PBP)Summarize your findings in a table.
- (ii) Prepare a brief report to the committee of this new poultry farm clearly outlining whether the incubator should be undertaken. (10 Marks)

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WGU Financial Management VBC1 Sample Questions (Q53-Q58):

NEW QUESTION # 53

In the statement of cash flows, how should an increase in accounts receivable be treated when calculating cash collected from customers?

- A. It should be added to revenue.
- **B. It should be subtracted from revenue.**
- C. It should be subtracted from cost of goods sold.
- D. It should be added to the cost of goods sold.

Answer: B

Explanation:

When calculating cash collected from customers, an increase in accounts receivable must be subtracted from revenue. This is because revenue includes both cash sales and credit sales, but cash collected reflects only the amount actually received during the period. If accounts receivable increased, it means some portion of reported sales has not yet been collected in cash. Therefore, that increase must be deducted to convert accrual-based revenue into a cash basis amount. The general relationship is: Cash Collected from Customers = Sales Revenue - Increase in Accounts Receivable, assuming no other unusual adjustments. This treatment is important in preparing or interpreting the operating section of the statement of cash flows, especially under the direct method. Financial management relies on this distinction because firms may appear profitable on the income statement while still facing liquidity pressure if collections are slow. The other answer choices are incorrect because accounts receivable relates to sales revenue, not cost of goods sold. Therefore, A is the correct answer because subtracting the increase in receivables properly adjusts reported revenue to the actual cash collected from customers during the accounting period.

NEW QUESTION # 54

What is the goal of just-in-time (JIT) inventory management?

- **A. To minimize holding costs by reducing inventory levels**
- B. To extend the cash conversion cycle
- C. To increase the quantity of on-hand inventory
- D. To maximize the storage space utilized

Answer: A

Explanation:

Just-in-time (JIT) inventory management aims to minimize inventory levels by synchronizing production and deliveries closely with demand. By receiving materials only when needed, firms reduce holding costs such as storage, insurance, spoilage, and obsolescence. JIT also improves cash flow by freeing capital previously tied up in inventory and shortening the cash conversion cycle. Financial management literature highlights JIT as a strategy that enhances efficiency but requires reliable suppliers and precise demand forecasting. Option B accurately captures the core objective of JIT systems.

NEW QUESTION # 55

Ratios for FreedomRock Bicycles are shown below, along with industry average ratios.

What are appropriate recommendations for FreedomRock Bicycles based on this analysis?

- **A. To reduce non-production expenses and evaluate the company's fixed costs**
- B. To increase production expenses and invest in more assets
- C. To focus solely on increasing gross margins to match industry levels
- D. To maintain current operating expenses and reduce asset levels to be in line with the industry

Answer: A

Explanation:

The data show that Freedom Rock Bicycles has gross margins comparable to or slightly above the industry but significantly lower operating margins. This indicates that the problem is not production efficiency or cost of goods sold, but rather operating expenses such as selling, general, and administrative costs or fixed overhead. Additionally, asset turnover is roughly in line with industry averages, suggesting that asset utilization is not the primary issue. From a financial management perspective, when gross margin is healthy but operating margin lags, the logical focus is on controlling non-production costs and evaluating fixed cost structures. Reducing unnecessary overhead, improving operating efficiency, or restructuring fixed expenses can directly improve operating margin and overall profitability. Option C best reflects this targeted, ratio-driven recommendation. The other options either misdiagnose the problem or focus on areas already performing adequately relative to peers.

NEW QUESTION # 56

Which characteristic is unique to preferred stock?

- A. Fixed dividend payments for stockholders
- B. Voting rights in company decisions
- C. Ownership equity in the company
- D. Potential for capital appreciation

Answer: A

Explanation:

Preferred stock is distinguished by its fixed or stated dividend, which is typically paid before any dividends are distributed to common shareholders. This feature makes preferred stock resemble debt in terms of predictable income, while still being classified as equity on the balance sheet. Unlike common stockholders, preferred shareholders generally do not have voting rights and have limited potential for capital appreciation. However, they enjoy priority over common stockholders in dividend payments and, in liquidation, over residual equity claims. From a financial management standpoint, preferred stock provides firms with a flexible financing option that does not increase leverage in the same way as debt while offering investors relatively stable income. Option C correctly identifies the defining characteristic of preferred stock.

NEW QUESTION # 57

What does a beta of less than 1 signify in the capital asset pricing model (CAPM)?

- A. The investment has higher risk than the market.
- B. The investment is risk-free.
- C. The investment has a return that is independent of the market.
- D. The investment has lower risk than the market.

Answer: D

Explanation:

A beta less than 1 indicates that an investment has lower systematic risk than the overall market. Such securities tend to experience smaller fluctuations in response to market movements. Defensive stocks- such as utilities or consumer staples-often exhibit betas below one because their revenues are relatively stable across economic cycles. In CAPM, lower beta implies lower required return, reflecting reduced exposure to market-wide risk. Importantly, a beta below one does not mean the investment is risk-free; it still carries firm-specific (unsystematic) risk. Option B correctly describes the implication of a beta less than one within capital market theory.

NEW QUESTION # 58

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