

# Past Exam

## Questions and Answers

### Service Firms

**PAST EXAM QUESTIONS****60 Marks**

1. Dr. Noctor is considering updating the IT system and requires a loan of €150,000. Outline the factors a lender should consider before granting this loan (6)

2018

**100 Marks**

2. Tranquilly Health Ltd now wishes to purchase equipment for the new extension. Advise the board on how to fund the expected cost of €140,000 (10)

2020

3. Fitpro Fitness Centre Ltd have decided to purchase and install new gym equipment. They have received a quote of €225,000. Can Fitpro Fitness Centre Ltd afford this investment? Explain your answer. (10)

2017

4. The owners of the Serenity Gym and Health Centre Ltd have proposed a 15% increase in clients' fees to help clear the bank overdraft. What arguments would you make against this proposal? (6)

2014

5. The company now wishes to purchase equipment for the new extension. Advise the company on how to fund the expected cost of €150,000. (6)

2012

6. The management of the nursing home is considering an increase of 10% in the clients' fees. What advice would you give? Explain your answer. (6)

2010

**SUGGESTED SOLUTIONS****60 Marks****2018**

**Dr. Noctor is considering updating the IT system and requires a loan of €150,000. Outline the factors a lender should consider before granting this loan (6)**

Factors to be considered before granting loan of €150,000:

1. *Gearing* - The firm has no long term loans at the moment which would encourage a lender to grant a loan.
2. *Ability to pay interest* - The net profit is €44,745 with no interest charges at present. The acid test ratio is 1.92:1 meaning the firm is liquid and could easily meet future interest charges.
3. *What is the purpose of the loan?* The purpose of the loan is to update the IT system making the company more efficient going into the future.
4. *What security can she offer?* Security is adequate with fixed assets of €174,800 and investments of €100,000 to cover a loan of €150,000.

**100 Marks****2020**

**Tranquilly Health Ltd now wishes to purchase equipment for the new extension. Advice the board on how to fund the expected cost of €140,000 (10)**

1. Sell the investments of €80,000 and issue more ordinary shares for €60,000 or alternatively issue the remaining shares of €125,000 and sell €15,000 investments.
2. The company has just repaid a loan with interest of €75,400 and still retained a current account balance of €27,200 and therefore is in a good position to borrow more money if needs be.
3. The company still has money in the bank despite having spent a net €163,000 on new fixed assets which are of a non-recurring nature. The company has made a net profit this year of €130,895.

4. Therefore, the company has no need to borrow money to finance the project and this will eliminate any future interest payments.

**2017**

**Fitpro Fitness Centre Ltd have decided to purchase and install new gym equipment. They have received a quote of €225,000. Can Fitpro Fitness Centre Ltd afford this investment? Explain your answer. (10)**

1. Fitpro Ltd can afford the new gym equipment.
2. It can finance the cost of €225,000 by selling the investments and receive €90,000 cash and issuing extra ordinary shares and collect €135,000 in cash (or €150,000 from shares and €75,000 from investments).
3. It has just repaid a loan including interest of €63,000 and spent a net €152,000 on fixed assets both of which are of a non- recurring nature.
4. The company made a profit this year of €117,040 and has cash in the bank of €2,240.
5. The company has no need to borrow to fund the project which will eliminate interest payments and result in higher future profits.

**2014**

**The owners of the Serenity Gym and Health Centre Ltd have proposed a 15% increase in clients' fees to help clear the bank overdraft. What arguments would you make against this proposal? (6)**

1. The Centre is profitable and is generating enough cash to clear the overdraft without taking any remedial action that could have negative effects on profitability. T
2. he proposed increase of 15% in clients' fees would raise only €49,620 based on this year's figures. This is only one third of the overdraft of €135,000 and so would not be adequate.
3. This increase in fees could however cause a drop in membership with loss of income. Based on this year's figures the overdraft will have been cleared by the end of next year without taking any remedial action now.

4. The Centre this year has repaid a loan of €50,000 plus interest €6,000 and had capital expenditure of €295,000 (Equipment €15,000, Extension €230,000, Vehicles €50,000). This is all non-recurring expenditure.
5. The Centre had a surplus of €157,040 this year and is clearly being run profitably and will continue to be profitable. Its return on capital employed is 17.1%.

<b>2012</b>
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The company now wishes to purchase equipment for the new extension. Advise the company on how to fund the expected cost of €150,000. (6)

Funding options for new equipment

My advice to the company would be:

Sell investments	40,000
Sell remaining shares	50,000
Borrow	<u>60,000</u>
	150,000

The company would be well able to pay back the loan quickly as the accounts show that it had a surplus €151,760 in 2011 and the company is generating enough cash. Although it owes the bank €108,600 it has paid out amounts up to €310,000 on non-recurring and non-trading items.

<b>2010</b>
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The management of the nursing home is considering an increase of 10% in the clients' fees. What advice would you give? Explain your answer. (6)

1. A 10% increase in clients' fees would increase income by €33,950.
2. There is no need to increase fees for viability or profitability purposes.
3. The company is profitable as its return on capital employed is 18.4% particularly in the current climate.
4. The company is generating ample cash. It has repaid a loan of €40,000, purchased equipment €15,000, contributed €35,000 towards a new mini bus and has financed about 58% of a €200,000 extension from cash receipts.
5. In the current climate costs are dropping, there is increased competition and consequently charges should not be increasing.