

Learning Assessment Guide

Unit Standard 11626 – Version 3

Explain and apply concepts of financial management

Level 6 – 20 Credits

| | | | |
|---|--|----------------|--|
| Assessment Summary | | | |
| Learner to complete | | | |
| Learner's name: | | | |
| Employer: | | | |
| NSN no. (ROL): | | DOB: | |
| Signed: | | Date: | |
| Assessor to complete | | | |
| <input type="checkbox"/> Meets requirements <input type="checkbox"/> More training required <input type="checkbox"/> More evidence required | | | |
| Assessor's name: | | Assessor's No. | |
| Signed: | | Date: | |

Before you begin...

- As well as this Learning Assessment Guide, you may also want to refer to the unit standard from the NZQA website (<http://www.nzqa.govt.nz>).
- Read the Trainee Information Kit. The kit contains important information and guidelines for Learners and can be found on the Learning State website (<http://www.learningstate.govt.nz>) under Learners, then Learning Assessment Guides.
- Check the learning resources available for this unit standard on the Learning State website (<http://www.learningstate.govt.nz>) under Learners, then Learning Assessment Guides.

This Learning Assessment Guide is made up of:

- Tasks for you to complete
- Assessment results that the assessor will use to assess your competence.

The tasks in this assessment are designed to show your assessor that you can:

1. Explain the nature of and the need for strategies for financial management
2. Explain the nature and calculate measures of risk
3. Explain and apply the principles of project appraisal
4. Explain the processes of funds management
5. Explain and evaluate the nature of, and calculate cost of, capital
6. Explain the processes of managing capital structures and liability portfolios

Assessment Task One – Element 1

The questions in task one are designed to address:

- The objectives of financial management
- The purpose of financial management
- The consequences relating to inadequate financial management

Task one questions

1. The purpose of owning a firm is to create value for the owner. Financial management plays an imperative role in assisting with value creation. Discuss the objectives of financial management.
2. Some of the specific areas of financial management include investment decisions, financing decisions, and dividend decisions. Describe the purpose of each of these areas of financial management:
 - Investment decisions
 - Financing decisions
 - Dividend decisions
3. Historical analysis of a situation can assist in providing information about what to do, or not to do, in the future. Often historical information is not enough information for a company. Discuss the importance of forecasting financing needs.
4. Describe the consequences of inadequate financial management. In your answer you should discuss uneconomic return on investment, financial distress, insolvency, and receivership.

Assessment Task Two – Element 2

The questions in task two are designed to address:

- The relationship between risk and return
- The principles and assumptions of the Capital Asset Pricing Model (CAPM)
- Your understanding of risk features
- Your ability to calculate measures of risk
- Your ability to compare different measures of risk

Task two questions

1. Describe the relationship between risk and return.
2. The capital asset pricing model (CAPM) is an important economic model. Discuss the principles and assumptions of the CAPM.
3. There is no universally agreed-upon definition of risk however, a number of measures of risk exist. Describe the features of these measures of risk:
 - Standard deviation
 - Coefficient of variation
4. Mr Young owns Office Supplies Limited. He is interested in the risk adjusted discount rate for a new printing machine. Equity is \$20,000, debt is \$50,000 and the beta of equity is 1.41. The risk free rate is 7 percent and the market risk premium is 9.5 percent. Using the **Hamada Equation** to calculate the beta of assets, calculate the risk adjusted discount rate for Mr Young.

The β_{ASSET} formula is given below:

$$\beta_{\text{ASSET}} = \frac{\text{Equity}}{\text{Debt} + \text{Equity}} \times \beta_{\text{EQUITY}}$$

The Risk Adjusted Discount Rate formula is given below:

$$\text{Risk Adjusted Discount Rate} = R_F + \beta_{\text{ASSET}} \times R_M$$

5. Mrs Young has come into possession of an uncertain alternative that has equal chances of yielding a profit of \$60,000 or a loss of \$40,000. Mrs Young has the opportunity for a definitive sale of this alternative for \$20,000. Mrs Young requires you to:
 - Calculate the expected value for the alternative, and
 - Determine the certainty equivalent for the alternative.

6. The risk adjusted discount rate and the certainty equivalent are two measures of risk. Compare these two measures.

7. Describe the process involved in any **two** of the following:
 - Sensitivity analysis
 - Scenario analysis
 - Computer simulation

Assessment Task Three – Element 3

The questions in task three are designed to address:

- Your ability to identify relevant cash flows for calculations
- Your ability to perform project appraisal calculations
- Your understanding of different appraisal techniques

Task three questions

1. Mary Brown has just won the lottery, paying \$30,000 a year for 25 years. She is to receive her first payment one year from now. The interest rate is currently 7 percent. Calculate the present value of this annuity.
2. Mike Arnold has been offered a job at \$100,000 a year. He anticipates his salary will increase by 5 percent a year until he retires in 40 years. Given an interest rate of 15 percent, what is the present value of his lifetime salary?
3. Philip Computer Services is evaluating whether or not to buy a store in a newly built shopping centre. The purchase price of the store is \$650,000. The appropriate discount rate is 10 percent. Assume the store has an estimated life of five years and will need to be completely scrapped or rebuilt at the end of that time. The target rate of return is 15 percent and the depreciation on the store is \$100,000 each year. The projected net income for the five years is shown below.

Projected Net Income:

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|------------|-----------|-----------|----------|--------|---------------|
| Net Income | \$100,000 | \$150,000 | \$50,000 | \$0 | - \$50,000 |

Philip Computer Services has asked you to make a recommendation on whether they should buy the new store. You are required to evaluate the investment and make a recommendation to Philip Computer Services. You should use the following appraisal techniques to evaluate the investment:

- Payback method
- Accounting rate of return
- Net present value
- Profitability Index

4. Amy Owen is considering the purchase of a computer for her sewing company. She knows that the computer will cost \$3,000 to buy and will yield \$3,500 in revenue for the company in the first year. Amy has heard that it is possible to calculate the internal rate of return of an asset. You are required to calculate the internal rate of return for Amy.

5. Net present value and internal rate of return are two methods that can be used to evaluate a project. Compare these two methods.

Note: in your answer you should discuss mutually exclusive projects of different size, capital rationing, and reinvestment assumptions.

Assessment Task Four – Element 4

The questions in task four are designed to address:

- The sources of short-term financing, their advantages and risks
- International finance risks and protection available
- Your understanding of strategies to manage accounts receivable
- Your understanding of strategies to manage inventories

Task four questions

1. There are multiple sources available for short-term financing. Discuss the advantages and risks of **two** of the following sources:
 - Trade credit
 - Bank loans
 - Accounts receivable factoring
2. One alternative method of finance is through international sources. Describe the risks associated with international financing and the methods of protection that can be employed.
3. It is important that the accounts receivable of a firm is well managed and strategies are in place to manage the accounts receivable. Discuss and evaluate possible strategies for managing accounts receivable.
4. Like accounts receivable, a firm's inventories must be well managed to ensure efficient financial management. Discuss and evaluate possible strategies for managing inventories.

Assessment Task Five – Element 5

The questions in task five are designed to address:

- The definition of the cost of capital
- Your ability to calculate the cost of capital

Task five questions

1. Define and explain the cost of capital.
2. Mr Jones owns a manufacturing company, Widgets Limited. His company has debt with a market value of \$50 million and has stock with a market value of \$70 million. The company pays a 17-percent rate of interest on its new debt and has a beta of 1.43. The corporate tax rate is 33 percent. (You may assume that the Security Market Line (SML) holds, that the risk premium on the market is 10.5 percent, and that the current Treasury bill rate is 13 percent.) From this information you are required to calculate the weighted average cost of capital (r_{WACC}).

The r_{WACC} formula is given below:

$$r_{WACC} = \left(\frac{S}{S+B} \right) \times r_S + \left(\frac{B}{S+B} \right) \times r_B \times (1 - T_C)$$

3. The capital asset pricing model (CAPM) provides a method for calculating the expected return on an individual security. Mrs Smith is interested in what the expected return for her company, Smith Limited, is. The stock of Smith Limited has a beta of 1.5. The risk free rate is 7 percent with an expected return on the market of 16.5 percent. From this information you are required to calculate the expected return using the CAPM.

The CAPM formula is given below:

$$E(R) = R_F + \beta \times (E(R_M) - R_F)$$

Assessment Task Six – Element 6

The questions in task six are designed to address:

- The theory of optimal capital structures
- The effect of financial leverage
- Your understanding of capital structure in business failure
- Sources of finance and the distinguishing features, advantages and risks
- Dividend policies and factors affecting dividend decisions

Task six questions

1. Describe the theory of optimal capital structures.
2. Discuss the effects, positive and negative, of financial leverage.
3. Different capital structures place different risks on an organisation. Describe the risk of business failure due to capital structure.
4. Discuss the sources of finance available to an organisation. You should discuss the distinguishing features, advantages and risks of the sources.
5. Many factors affect decisions that relate to dividends. Discuss dividend policies and the factors that affect dividend decisions.

Assessment Results

These are the judgements that your assessor will use to assess you.

| | | |
|---|-----|----|
| Does the learner understand the objectives and purpose of financial management? | Yes | No |
| Does the learner describe the need to forecast financing needs? | Yes | No |
| Can the learner describe the consequences of inadequate financial management? | Yes | No |
| Can the learner describe the relationship between risk and return? | Yes | No |
| Does the learner demonstrate understanding of the principles and assumptions of the Capital Asset Pricing Model (CAPM)? | Yes | No |
| Does the learner demonstrate an understanding of the features of risk? | Yes | No |
| Can the learner calculate and compare measures of risk? | Yes | No |
| Does the learner identify relevant cash flows for calculations? | Yes | No |
| Does the learner demonstrate an ability to perform and understand different appraisal techniques? | Yes | No |
| Does the learner demonstrate an understanding of short-term financing, the advantages and risks? | Yes | No |
| Does the learner understand the risks and protection available for international finance? | Yes | No |
| Does the learner understand strategies for managing accounts receivable and inventories? | Yes | No |
| Can the learner define and calculate the cost of capital? | Yes | No |
| Does the learner demonstrate an understanding of the theory of optimal capital structures? | Yes | No |
| Does the learner show understanding of the effect of financial leverage? | Yes | No |
| Learner understands the effect of capital structure on business failure? | Yes | No |
| Can the learner identify sources of finance, the distinguishing features of each, their risks and advantages? | Yes | No |
| Does the learner show understanding of dividend policies and factors that affect dividend decisions? | Yes | No |