

## Mock Exam 1 Question

### Section B

#### Question 1:

Division X is a division of XYZ plc. Its net assets are currently £10million and it earns a profit of £2.2million per annum. Division X's Cost of Capital is 10% per annum. The division is considering two proposals.

Proposal 1 - involves investing a further £1million in fixed assets to earn an annual profit of £0.15million.

Proposal 2 - involves the disposal of assets at their net book value of £2.3million. This would lead to a reduction in profits of £0.3million. Proceeds from the disposal of assets would be credited to head office not Division X.

#### Required:

- 1) In what way can the use of Return On Investment (ROI) as a performance measure for investment centres lead to bad decisions? How does the Residual Income (RI) approach overcome this problem?  
(7 marks)
  - 2) Calculate the current ROI and RI for Division X?  
(5 marks)
  - 3) Show how both ROI and RI would change under each of the two proposals?  
(8 marks)
  - 4) Comment on which proposal should X consider and why?  
(5 marks)
- (Total 25 marks)