VU LEARNING HUB

ACC501 Assignment 1 Solution

Fall 2026

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Fall 2026 | Total Marks: 10 | Due Date: 16 November 2026

Name: VU Learning Hub

The company is a manufacturing company. The data below is for the year ended 31 December 2025. Net sales revenue is Rs. 3000000. Net income is Rs. 400000. Total assets are Rs. 2500000. Total debt is Rs. 1000000.

(a) Return on Equity by DuPont Model

Equity is total assets minus total debt. Equity = 2500000 minus 1000000 = 1500000. Equity is Rs. 1500000. Net profit margin is net income divided by net sales revenue. Net profit margin = 400000 / 3000000 = 0.1333. Net profit margin is 13.33%. Asset turnover is net sales revenue divided by total assets. Asset turnover = 3000000 / 2500000 = 1.2. Asset turnover is 1.2 times. Equity multiplier is total assets divided by equity. Equity multiplier = 2500000 / 1500000 = 1.67. Equity multiplier is 1.67. ROE is net profit margin x asset turnover x equity multiplier. ROE = 13.33% x 1.2 x 1.67 = 26.67%. ROE is 26.67%. Check: ROE is net income divided by equity. ROE = 400000 / 1500000 = 26.67%. The two answers match.

(b) Effect of Higher Debt on Equity Multiplier and ROE

Debt rises to Rs. 1500000. Total assets stay at Rs. 2500000. Net income stays at Rs. 400000. New equity is total assets minus total debt. New equity = 2500000 minus 1500000 = 1000000. New equity is Rs. 1000000. New equity multiplier is total assets divided by new equity. New equity multiplier = 2500000 / 1000000 = 2.5. The equity multiplier rises from 1.67 to 2.5. New ROE is net profit margin x asset turnover x new equity multiplier. New ROE = 13.33% x 1.2 x 2.5 = 40%. ROE rises from 26.67% to 40%. Check: new ROE is net income divided by new equity. New ROE = 400000 / 1000000 = 40%. The two answers match. The rise in ROE comes from more debt and not from better business. The same profit is now spread over a smaller equity base. Net income and total assets have not changed.

(c) Two Financial Risks of More Debt

Risk 1. Higher interest cost. More debt means more fixed interest to pay each year. If profit falls the company may fail to pay the interest. Then it may face default. Risk 2. Higher risk of failure. More debt raises the financial risk of the company. Lenders may refuse more loans or charge higher interest. In a bad year the company may fail to pay its debts.