M.Com. Part-I Examination, 2013

FINANCIAL POLICY AND MANAGEMENT ACCOUNTING

PAPER – III

Full Marks : 100

Time : 4 hours

The figures in the right-hand margin indicate marks

Candidates are required to give their answers in their own words as far as practicable

Illustrate the answers wherever necessary

Write the answers to Questions of each Half in separate books

FIRST HALF

(*Financial Policy*)

[*Marks* : 50]

Answer **Q.No. 1** and any **two** questions from the rest

1. Answer any *four* of the following : 5 × 4 (*a*) Distinguish between profit maximisation objective and wealth maximisation objective of the firm so far as the limitations of the former are concerned. 5

(*b*) What is internal financing ? Explain the arguments in favour of the statement – "Provision for depreciation is a source of internal financing ". 2 + 3.

(*c*) Is there any relationship between cost-volume-profit analysis and operating leverage ? Mathematically deduce the relationship. 5

(*d*) Write a short note on 'Time value of money'. 5

(*e*) *AB* Ltd. issues 100, 10% Debentures of ₹ 1,000 each issued at a discount of 2 % ; redeemable at par after 10 years. If the tax rate is 50 %, find out cost of debentures. 5

(*f*) A manufacturer buys certain components from outside suppliers. The total annual demand is 5,000 units . The prices at different quantities are : 5

Ordering Quantities	Price per Unit(₹)	Foregone discount per unit (₹)
Less than 400	4	·20
400 and less than 800	3·95	·15
800 and less than 1000	3·90	·10
1000 and less than 5000	3·80	—

Order placing cost per order : ₹ 10

Carrying cost per unit per year : Re 0·50

What is the economic order quantity ?

(*g*) Briefly write the disinvestment policy of public sector undertakings in India. 5

(*h*) What is trade credit ? What is the cost of trade credit ? 3 + 2

2. (*a*) Distinguish between permanent working capital and temporary working capital. 3

(*b*) You are required to prepare for the board of directors of XYZ Ltd. a statement showing the working capital needed to finance a level of activity of 5,200 units of output per annum. You are given the following information :

Element of Cost	Amount per unit (₹)
Raw material	8·00
Direct Labour	2·00
Overhead	6·00
Total Cost	16·00
Profit	4·00
Selling Price	20·00

Raw materials are in stock on average one month. Materials are in process on an average half a month.

Finished goods are in stock on average 6 weeks.

Credit allowed by creditors is one month

Credit allowed to debtors is two months

Lag in payment of wages is $1\frac{1}{2}$ weeks

Cash in hand and at bank is expectd to be ₹ 7,300

You are informed that production is carried on evenly during the year, wages and overhead accrue similarly. 12

3. (*a*) Explain the Traditional Approach to Capital structure theory and examine its rationality. 6

(*b*) What factors would you consider in planning capital structure of a firm ? 3

(*c*) X Ltd. provides you the following information :

	Rs.
Profit	3,00,000
Less : Interest on Debentures (@12%)	60,000
	2,40,000
Less : Taxes @ 35 %	84,000
Earnings after tax	1,56,000
No. of equity shares (Rs. 10 each)	40,000
EPS	Rs. 3·90
Current Market Price per share	Rs. 39
P/E Ratio (times)	10

The Company has undistributed reserves of Rs. 6,00,000. It needs Rs. 2,00,000 for expansion programme which will earn same rate of return as present.

You are informed that a debt-equity ratio (debt/debt-equity) higher than 35 % will push the P/E Ratio down to 8 % and raise the rate of additional amount borrowed to 14 %.

You are required to ascertain the probable price of the equity share :

(*i*) If the additional funds are raised as debts ; and

(*ii*) If the amount is raised by issuing equity shares. 6

4. (*a*) Discuss in brief the different methods of computation of cost of equity share capital. 7

(*b*) What do you mean by marginal cost of capital ? 2

(*c*) Capital structure of Y Ltd. is as follows :

	Rs.
Equity share capital	
(Rs. 10 each)	1,00,000
Retained earnings	50,000
Long-term Loan	1,00,000
	2,50,000

Additional information :

(*i*) The market price per share is Rs. 70, EPS is Rs. 7 and the expected growth rate in earnings is 6 % p.a.

(*ii*) Cost of debts (before tax) : 12 % p.a.

(*iii*) Corporate tax rate : 40 %

On the basis of above information, compute overall cost of capital of the company using market value weights. 6

5. (*a*) Distinguish between : 4 + 4

(*i*) Business risk and financial risk.

(*ii*) Operating Leverage and Financial Leverage.

(*b*) What do you mean by "Trading on Equity" ? 2

(*c*) Prepare an income statement of Z Ltd. from the following information : 5

DOL	6
DFL	4
Interest on Long-term Debts(Rs.)	30,000
Variable cost to sales (%)	75
Income tax rate (%)	40

SECOND HALF

(*Management Accounting*)

[*Marks* : 50]

Answer **Q.No. 6** and any **two** questions from the rest

6. Answer any *two* questions : 10 × 2

(*a*) Define Management Accounting. Write down the different tools that are applied in Management Accounting. Write down the qualities that an efficient Management Accountant should have. 2 + 3 + 5

(*b*) Is there any difference between the NPV method and IRR method ? Explain. If so, what may be the reason for such difference ? 10

(*c*) Do you think that depreciation is a source of fund ? Explain. 10

(*d*) (*i*) What do you understand by 'Learning Curve' ? Express the learning curve model.

(*ii*) A Company wants a special tool. It has procured 4 numbers of these tools from a vendor for the first time on developmental order basis.

It has paid Rs. 1150 per tool to the vendor as per the vendor's break-up cost, indicated below :

Material Rs. 550, Labour Rs. 200 Overhead Rs. 250, Profit @ 15% = Rs. 150 The company wants to order 4 more of these special tools. What would be the reasonable price for these 4, in your opinion, if it is found that an 80 %

learning curve applies for the job ? The vendor believes in a slab system of overhead charges i.e. a constant rate per unit from 1 to 10 numbers. 5 + 5

7. The selected ratio's of two companies belonging in the same industry, along with their industry average is given below :

Ratio	Company A	Company B	Industry
Current Ratio	220 %	560 %	240 %
Acid test Ratio	120 %	300 %	130 %
Debt–Assets Ratio	36 %	5%	35%
Operating Expenses Ratio	18 %	17 %	20 %
Interest Coverage Ratio (times)	6	12	5
Stock-turnover Ratio (times)	8·5	6·5	7·0
Debtors turnover Ratio (times)	11·0	15·0	11·4
Return on total Assets	17 %	10 %	14 %

On the basis of above ratios, can we say that Company–B is better than Company–A because its ratios are better in 6 out of 8 areas (all except stock turnover and return on total assets) ? Justify your answer. 15

8. (*a*) A Company has estimated its unit variable cost for one of its products as Rs. 10 per unit and selling price as Rs. 15 per unit. The budgeted sales for the year is 20,000 units. The estimated fixed costs and their respective probabilities are :

Estimated Fixed Costs	Probability
Rs. 50,000–	0·1
Rs. 60,000–	0·3
Rs. 70,000–	0·3
Rs. 80,000–	0·2
Rs. 90,000–	0·1

Find the probability that the company will achieve its target profit of Rs. 25,000 for the year. 5

(*b*) Briefly explain one Indian study and one Foreign study for predicting corporate sickness. 10

9. A machine purchased four years back for Rs. 7,00,000, has been depriciated to a book value of Rs. 5,00,000. The machine originally had a projected life of 14 years and zero salvage value. A new machine will cost for Rs. 13,00,000. Its installation cost estimated by the technician is Rs. 2,00,000. The technician also estimates that the installation of the new machine will result in a reduction in operating cost by Rs. 1,50,000 p.a. for the next 10 years. The old machine could be sold now at Rs. 8,00,000. The new machine will have a 10 years life with no salvage value. The new machine also requires an additional working capital of Rs. 3,00,000 which will be freed at the end of 10th year.

The company's normal income is taxed at 30% and capital gain tax at 15 %. Assume cost of capital 10% ; determine whether the existing machine should be replaced. Use discounted cash flow criteria ie. NPV or IRR. 15

10. From the following Balance Sheets of a company, you are required to prepare :

(*a*) a statement of changes in working capital. 3

(*b*) a funds flow statement.

Balance Sheet as at 31st March

Liabilities	2011 Rs.	2012 Rs.	*Assets*	2011 Rs.	2012 Rs.
Equity share Capital	75,000	1,20,000	Fixed Assets at cost	2,40,070	2,53,730
10% Redeemable			less: Depreciation	90,020	98,480
preference share				1,50,050	1,55,250
capital	1,00,000	80,000	Investments	61,000	76,000
P & L Account	1,00,350	1,02,700	Stocks	98,000	1,04,000
Reserve for replace-			Trade Debtors	88,000	85,000
ment of machines	15,000	10,000	Bank	11,750	32,000
Long term Loan	—	40,000			
Creditors	84,450	75,550			
Bank Overdraft	22,000	—			
Proposed dividend					
on Equity shares	12,000	24,000			
	4,08,800	4,52,250		4,08,800	4,52,250

Additional Information :

(*i*) During the year, additional equity capital was issued to the extent of Rs. 25,000 by way of bonus shares fully paid up.

(*ii*) Final dividend on preference shares and an interim dividend of Rs. 4000 on equity shares were paid on 31st March, 2012.

(*iii*) During the year one item of Plant was upvalued by Rs. 3000 and credit for this was taken in P & L Account.

(*iv*) Rs. 1,700 being expenditure on fixed assets for the year ended on 31st March 2011, wrongly debited to sundry debtors and then was corrected in the next year.

(*v*) Fixed assets costing Rs. 6000 (accumulated depreciation Rs. 4,800) were sold for Rs. 250. Loss arising therefrom was written off.

(*vi*) Preference shares redeemed in the year were out of the fresh issue of equity shares. Premium paid on redemption was 10 %. 12