

INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

14th November 2011

Subject CT2 – Finance and Financial Reporting

Time allowed: Three Hours (10.00 – 13.00 Hrs)

Total Marks: 100

INSTRUCTIONS TO THE CANDIDATES

- 1. Please read the instructions on the front page of answer booklet and instructions to examinees sent along with hall ticket carefully and follow without exception*
- 2. Mark allocations are shown in brackets.*
- 3. Attempt all questions, beginning your answer to each question on a separate sheet. However, answers to objective type questions could be written on the same sheet.*
- 4. In addition to this paper you will be provided with graph paper, if required.*
- 5. Please check if you have received complete Question Paper and no page is missing. If so, kindly get new set of Question Paper from the Invigilator.*

AT THE END OF THE EXAMINATION

Please return your answer book and this question paper to the supervisor separately.

- Q. 1)** Select the most appropriate statement in relation to financial statements –
- A. The cashflow statement is not intended to supplement the income statement and statement of financial position.
 - B. Depreciation adjustments are required because virtually all non - current assets have infinite useful economic lives.
 - C. Prudence should only be applied in situations where there is uncertainty.
 - D. The statement of change in debt summarizes the change in the capital and reserves attributable to debt holders of the company over the accounting period.
- [2]
- Q. 2)** Which of the following instruments is often used by companies that require a regular series of payments –
- A. Commercial Paper.
 - B. Leasing.
 - C. Bills of exchange.
 - D. Invoice Discounting.
- [2]
- Q. 3)** Which of the following instruments are not variants of ordinary shares –
- A. Golden shares with voting rights and veto rights
 - B. Shares with multiple voting rights
 - C. Shares with no voting rights
 - D. Silver shares with voting rights and veto rights
- [2]
- Q. 4)** At the time of a takeover the predator company will enter into the following future contract to hedge the risk of increase in price:
- A. Sell the stock index future
 - B. Buy the currency index future
 - C. Sell the interest rate future
 - D. None of the above
- [2]
- Q. 5)** Which of the following financial institutions **underwrites** a share issue?
- A. Stock exchange
 - B. Share broker
 - C. Bank
 - D. Issuing house
- [2]

- Q. 6)** It is the responsibility of which one of following to give an opinion on whether or not the financial statements give a 'true and fair view'?
- A. Directors
 - B. Management
 - C. Shareholders
 - D. Auditors
- [2]**
- Q. 7)** Which one of the following statements represents the main roles of the stock exchange –
- A. Settlement of equity trades
 - B. Certificates of Deposit
 - C. Money market deposit
 - D. Settlement of Debt trades
- [2]**
- Q. 8)** Which of the following items appears in both technical and non technical accounts of an insurance company –
- A. Realised Capital Gains
 - B. Realised and unrealized gains (losses on investment)
 - C. Investment Income
 - D. Claims incurred or benefit payable
- [2]**
- Q. 9)** Which of the following items will not appear in a cashflow statement –
- A. Purchase of plant & machinery
 - B. Purchase of personal car
 - C. Issue of shares
 - D. Loan repayments
- [2]**
- Q. 10)** Out of the following the only item which appears in a Trial Balance is ?
- A. Contingent liabilities
 - B. Closing stock
 - C. Addition to assets or assets purchased during the year
 - D. Cumulative depreciation
- [2]**

Q. 11) a) Define the following:-

- Beta Value
- Chinese walls
- Covenant
- Puttable Bond

(2)

b) Company XYZ Ltd issued invoices to its customers for the following amounts –

| <u>Name of Customer</u> | <u>Value</u> | <u>Date of Invoice</u> |
|-------------------------|--------------|---------------------------|
| • Simran Enterprises | Rs. 10,000/- | 1 st Jan 2011 |
| • Radhika Enterprises | Rs. 45,000/- | 16 th Jan 2011 |
| • Swati Enterprises | Rs. 20,000/- | 1 st Mar 2011 |
| • Poornima Enterprises | Rs. 50,000/- | 1 st May 2011 |
| • Janavi Enterprises | Rs. 15,000/- | 1 st June 2011 |

Simultaneously it sends out a copy of the same invoices to its factor, Neeta Enterprises, in return for a fixed percentage (%) i.e. 85% of invoice amount.

Company XYZ Ltd receives the money from its customers on following dates –

| <u>Name of customer</u> | <u>Amount</u> | <u>Date</u> |
|-------------------------|---------------|----------------------------|
| • Simran Enterprises | Rs. 2,500/- | 31st Jan 2011 |
| • Radhika Enterprises | Rs. 20,000/- | 28 th Feb 2011 |
| • Radhika Enterprises | Rs. 25,000/- | 31 st Mar 2011 |
| • Swati Enterprises | Rs. 8,000/- | 31 st Mar 2011 |
| • Simran Enterprises | Rs. 7,500/- | 31 st Mar 2011 |
| • Swati Enterprises | Rs. 8,000/- | 30 th Apr 2011 |
| • Poornima Enterprises | Rs. 40,000/- | 30 th May 2011 |
| • Swati Enterprises | Rs. 4,000/- | 30 th June 2011 |
| • Janavi Enterprises | Rs. 15,000/- | 30 th June 2011 |
| • Poornima Enterprises | Rs. 10,000/- | 30 th June 2011 |

Company XYZ Ltd then sends the money to Neeta Enterprises up to 30th June 2011, simple interest @ 2% per month has been incurred on the loan amount from Neeta Enterprises. Demonstrate with the help of calculations, how Neeta Enterprises will settle its accounts with XYZ Ltd up to 30th June 2011 under RECOURSE FACTORING.

[Assume 100% of the invoice amount for the calculation of interest]

(6)

[8]

- Q. 12)** The company makes widgelets, a component required by the widget-making industry. The company has issued both share capital, including ordinary and preference shares, and loan capital: some fixed-charge debentures secured on the company's factory, and an unsecured loan stock. The company has borrowed money from the bank using a flexible loan facility.

It has also pushed its overdraft to the limit. The company has trade credit agreements with its suppliers and is buying some machinery on hire purchase.

The company has had a bad year owing to a recession, which has hit the widget industry particularly hard. Its profits are down to such an extent that it is unable to pay the interest on the unsecured loan stock, although the debenture interest payments are made in full.

The unsecured loan stock holders have a meeting and decide to sue the company. Their claim is successful and the court orders the company to be wound up.

Analysis the situation and accordingly describe how the assets are sold and the various lenders receive payment.

[6]

- Q. 13) Complete the Balance sheet by using the following information and ratios.**

| | |
|-----------------------------|-----------|
| Long term debt to net worth | 0.5 to 1 |
| Sales to Total Assets | 2.5 times |
| Debtor turnover period | 18 days |
| Inventory turnover ratio | 9 times |
| Gross Profit Margin | 10% |
| Quick Ratio | 1 to 1 |

Projected Balance sheet Format

| | | | |
|------------------------------|--------|--------------|---|
| Payables | 100000 | Cash | ? |
| Long term Debt | ? | Debtors | ? |
| Equity shares | 100000 | Stock | ? |
| Profit | 100000 | Plant | ? |
| Total Liabilities and Equity | | Total Assets | |

Assume 360 days in a year

[10]

- Q. 14)** Give the formula to calculate the beta of the stock. Define all the terms used in the formula.

[5]

- Q. 15) a)** List all circumstances under which companies may be considered to be group companies, and explain why shareholders will be interested in consolidated accounts. (3)
- b)** Explain the consolidation process of income statements and statements of financial position of the individual group member. (2)

[5]

- Q. 16) a)** The operating profit of a company is Rs 50 Lakhs after including an adjustment in respect of depreciation of Rs 10 Lakhs. Movements in the following items were recorded over the financial period –

- Trade and Other Receivables Increase of Rs 60,000/-
- Inventories Increase of Rs 56,000/-
- Trade and Other Payables Decrease of Rs 1,50,000/-

Calculate the cash generated from operating activities. (2)

- b)** Draw up a table to compare Investment trusts, Unit trusts and Building societies with respect to their role, sources of funds and application of funds. (4)

[6]

- Q. 17) a)**
- i) Find all the combinations of projects out of the options given in the table below, which are feasible given the capital budget restriction and project interdependencies (7)
- ii) Select the feasible combination which has the highest NPV. (1)

The firm has a capital budget constraint of Rs. 3 million.

| Project | Outlay (in Lakhs) | NPV (in Lakhs) |
|---------|-------------------|----------------|
| A | 18.0 | 7.5 |
| B | 15.0 | 6.0 |
| C | 12.0 | 5.0 |
| D | 7.5 | 3.6 |
| E | 6.0 | 3.0 |

Projects B & C are mutually exclusive.

- b)** A company decided to replace its existing computer system. The original cost of the old system was Rs. 25000 and it was installed 5 years ago. The current market value of the old system is Rs. 5000. Depreciation of the old system was charged using an estimated useful life of 10 years. The estimated salvage value of the old system at the time of purchase was assumed to be NIL. Depreciation of the new system will be charged with an estimated useful life of 5 years. The present cost of the new system is Rs. 50000. The estimated cost savings of the new system is Rs. 5000 per year. The increase in sales with new system is assumed to be 10% per year based on original total sales of Rs. 100000. The company follows the straight line method of depreciation. The cost of capital is 10% and the tax rate is 30%.

- i) Estimate the net cash outflows on the new system after selling the existing system. (3)
- ii) Estimate the net cash inflows for 5 years and NPV. (8)
- iii) Decide whether to buy the new system or not with reasoning. (1)

[20]

Q. 18)

- a) A plant was acquired 15 years ago at a cost of Rs 5 crores. Its accumulated depreciation as at 31st March 2009 was Rs 4.15 crores. Depreciation estimated for the financial year 2009–10 is Rs 25 Lakhs. The estimated net selling price as 31st March 2009 was Rs 30 Lakhs, which is expected to decline by 20%, by the end of next financial year.

Its value in use has been computed at Rs 35 Lakhs as of 1st April 2009, which is expected to decrease by 30% by the end of financial year.

- i) How much will be amount of write off for the financial year ending on 31st March 2010? (4)
- ii) If the plant had been revalued 10 years ago and the current reserves against the plant were to be Rs 12 Lakhs, how would your answer to the above question change? (2)
- b) The following particulars relate to Forge Ltd for the year ended 31st March 2011:
- Furniture with a book value of Rs 15,500 was disposed off for Rs 12,000.
 - Machinery costing Rs 3,10,000 was purchased and Rs 20,000 were spent on its erection.
 - Fully paid 8% preference shares with a nominal value of Rs 10, 00,000 were redeemed at a premium of 3%. In this connection 60,000 equity shares of Rs 10 each were issued at a premium of Rs 2 per share. All of the proceeds of the issue was received with applications.
 - Dividends were paid as follows –

| | |
|---------------------------------------|-------------|
| On 8% preference shares | Rs 40,000 |
| On equity shares for the year 2010–11 | Rs 1,10,000 |
 - Total sales were Rs 32,00,000 out of which cash sales were Rs 11,50,000.
 - Total purchases were Rs 8,00,000 including cash purchases of Rs 60,000.
 - Total expenses were Rs 12,40,000.
 - Taxes paid, including a dividend tax of Rs 22,500, were Rs 3,30,000.
 - Cash and cash equivalents as on 31st March 2011 were Rs 1,25,000.

You are required to prepare a cash flow statement for the year ended 31st March 2011 after taking into consideration the following information:

| | On 31st March 2010 (RS) | On 31st March'2011 (Rs) |
|------------------|---|---|
| Sundry Debtors | 1,50,000 | 1,47,000 |
| Sundry Creditors | 78,000 | 83,000 |
| Unpaid expenses | 63,000 | 55,000 |

[9 marks for cash flow statements, 5 marks for working notes] (14)

[20]
