2014

DDE

M.Com. Part-I Examination

FINANCIAL POLICY AND MANAGEMENT ACCOUNTING

PAPER—III

Full Marks : 100

Time : 4 Hours

The figures in the right-hand margin indicate full marks. Candidates are required to give their answers in their own words as far as practicable.

Illustrate the answers wherever necessary.

Write the answer question of each Half in separate books.

First Half

(Financial Policy)

[Marks : 50]

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

1. Answer any *four* questions from the following : 5×4

(a) Write the needs of cost of capital computation.

(b) Explain the terms positive and negative working capital.

(c) Mathematically show that

$$DFL = EBIT/EBT$$

(d) Briefly write the role of Equity Share as a source of Industrial financing.

(e) Write the main features of the financial management in a public sector undertaking.

(f) Distinguish between Operating Lease and Financial Lease.

(g) A company has on its books the following amounts and specific costs of each type of capital :

Type of Capital	*Book Value* (Rs.)	*Market Value* (Rs.)	*Specific Costs*
Debt Capital	4,00,000	3,80,000	5%
Preference Share Capital	1,00,000	1,10,000	8%
Equity Share Capital	6,00,000	12,00,000	13%
Retained Earning	2,00,000		
Total	13,00,000	16,90,000	

Determine the weighted average cost of capital using Market Value Weight.

(h) A Company's Balance Sheet as at 31.3.2014 reflects the following position :

Current Assets	*Rs. Lakhs*	*Rs. Lakhs.*
Inventories:		
Raw Materials	500	
Work in progress	50	
Finished Goods	100	
		650
Receivable		100
Others		50
		800
Current Liabilities		
Creditors for purchases		300
Other current liabilities		100

Assume that Core Current Asset is Rs. 50 lakhs.

Calculate the maximum permissible amount of bank credit as recommended by the Tandon Committee.

2. The Well Established Company's most recent balance sheet is as follows :

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Equity Share Capital (Rs. 10 per share)	60,000	Net Fixed Assets	1,50,000
Retained Earning	20,000	Current Assets	50,000
10% Long-term debt	80,000		
Current liabilities	40,000		
	2,00,000		2,00,000

The company's total asset turnover ratio is 3, its fixed operating costs are Rs. 1,00,000 and its variable operating cost ratio is 40%. The income tax rate is 50%.

(a) Calculate for the company all the three types of leverages and comment.

(b) Determine the likely level of EBIT if EPS is (a) Re. 1, (b) Rs. 3, (c) Zero.

10+5

3. (a) XYZ company has debentures outstanding with 5 years left before maturity. The debentures are currently selling for Rs. 90 (the face value is Rs. 100). The debentures are to be redeemed at 5% premium. The interest is paid annually at a rate of interest of 12%. The firm tax rate is 50%. Calculate Cost of Debt (Kd).

(b) A company is contemplating an issue of new equity shares. The firm's equity shares are currently selling at Rs. 125 a share. The historical pattern of dividend payments per share, for the last 5 years is given below :

Year	*Dividend per share (Rs.)*
1	10.70
2	11.45
3	12.25
4	13.11
5	14.03

You are required to determine the following :

(i) Growth rate in dividends;

(ii) Cost of equity capital, assuming growth rate determined under situation (a) continues for ever.

Note : [Given that as per compounded Table $(1.3112)^{1/4} = 1.07$]

(c) Do you think that Market Value weight is more appropriate than Book Value Weight ?

5+(4+3)+3

4. (a) Critically explain the Walter's dividend Policy Model.

(b) From the following information supplied to you, determine the market value of equity shares of a company as per Walters model :

Earning of the Company	Rs. 5,00,000
Dividends paid	Rs. 3,00,000
Number of Shares Outstanding	1,00,000
Price-earning ratio	8
Rate of return on investment	15%

10+5

5. (a) Explain the Operating Cycle concept in Working Capital Management.

(b) Write the main objectives of Debtors Management.

(c) What is ABC analysis in Inventory Management ?

(d) Explain the Hedging or Matching Policy in Working Capital financing.

3+3+4+5

Second Half

(Management Accounting)

[Marks : 50]

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

6. Answer any *two* of the following : 10×2

(a) Write down the assumptions of discounted cash flow methods of capital budgeting. Do you think that Net Present Value (NPV) method is a rational method for project section? Justify your answer. 5+5

(b) (i) Briefly discuss the objectives of financial statement analysis.

(ii) Distinguish between Cash Flow Statement and Fund Flow Statement. 5+5

(c) (i) You are given the following figures relating to Dutta & Brothers Co. Ltd.

Current Ratio	2.5
Acid test ratio	1.5
Net Working Capital	Rs. 3,00,000
Stock turnover ratio	6 times
Gross profit ratio	20%
Average debt collection period	2 months
Fixed assets/Shareholders' net worth	0.80
Reserve/Share capital	0.50

Based on the above information, you are required to prepare the Balance Sheet of the Company as on 31st March, 2014.

(ii) There can be no such ratio which may be treated as 'ideal' for the firms belonging to different industries. — Explain.

6+4

(d) A Firm is considering instalment of either of the two machines which are mutually exclusive. The details of their purchase price and operating cost are given below.

	Year	Machine–X (Rs.)	Machine–Y (Rs.)
Purchase Cost	0	10,000	8,000
Operating Cost	1	2,000	2,500
	2	2,000	2,500
	3	2,000	2,500
	4	2,500	3,800
	5	2,500	3,800
	6	2,500	3,800
	7	3,000	
	8	3,000	
	9	3,000	
	10	3,000	

Machine X will recover the salvage value of Rs. 1,500 in the year 10, while Machine Y will recover Rs. 1,000 in the year 6. Determine which machine is cheaper at 10 per cent cost of capital, assuming that both the machines operate at the same efficiency. The present value of Re. 1 at 10 per cent discounting factor is given bellow.

Year :	1	2	3	4	5	6	7	8	9	10
PV factor :	0.91	0.83	0.73	0.68	0.62	0.56	0.51	0.47	0.47	0.39

The present value of an annuity of Re. 1 per period at 10 per cent discount factor :

At the end of year 6 = 4.3553

At the end of year 10 = 6.1446. 10

7. The balance Sheets of Agarwal Co. at the end of 31st March, 2013 and 31st March, 2014 are given below :

Liabilities :	*2013 (Rs.)*	*2014 (Rs.)*
Equity Share Capital (@ Rs. 100 each)	5,00,000	6,00,000
Reserve and Surplus	1,32,500	60,000
8% Debentures	1,50,000	2,00,000
Accrued Debenture interest	3,000	4,000
Proposed Dividend	50,000	60,000
Unclaimed Dividend	6,000	4,000
Depreciation Fund	1,25,000	1,75,800
Provision for Inventory	8,000	9,500
Provision for tax	19,500	17,600
Sundry Creditors	20,000	30,000
	10,14,000	11,60,900
Assets :		
Goodwill	20,000	30,000
Building and Machinery	6,20,000	6,90,000
Advances	40,000	60,000
Inventories	1,80,000	1,95,900
Debtors	1,40,000	1,50,000
Cash	10,000	30,000
Debenture Discount	4,000	5,000
	10,14,000	11,60,900

Other information :

(1) Debentures were issued at 5% discount.

(2) Machinery costing Rs. 20,000 (Accumulated depreciation Rs. 17,000) has been written off and discarded. However the scrap was sold for Rs. 400.

(3) During the year 2013-14, a running business was purchased by issuing equity shares at par. The business had machinery Rs. 30,000, Stock Rs. 40,000, Sundry Debtors Rs. 40,000 and Sundry Creditors Rs. 35,000.

(4) During the year a machine costing Rs. 40,000 has been purchased by cash.

(5) No shares were issued for cash.

Prepare Fund Flow Statement. 15

8. Explain the purpose and objectives of Management Accounting. To what extent does this subject differ from (a) Financial Accounting and (b) Cost Accounting ? 15

9. The information below is taken from the records of two companies in the same industry (Amount in Rs. Thousand)

Particulars:	A	B
Cash	210	320
Sundry Debtors	330	630
Stock	1,230	950
Plants and Equipments	1,695	2,400
Total Assets	3,465	4,300
Sundry Creditors	900	1,050
8% Debentures	500	1,000
Equity Share Capital	1,100	1,750
Retained Earnings	965	500
Total Liabilities	3,465	4,300

(Contd.)

Particulars:	A	B
Sales	5,600	8,200
Cost of Goods sold	4,000	6,480
Other operating expenses	800	860
Interest expenses	40	80
Income taxes	266	273
Dividends	100	180

Answer each of the following questions by making a comparison of one or more relevant ratios.

(i) Which company is using the ordinary shareholders money more profitably ?

(ii) Which company is better able to meet its current debts ?

(iii) If you willing to purchase the debentures of one company, which companies debentures, would you buy ?

(iv) Which company collects its receivables faster, assuming all sales to be credit sales ?

(v) How long does it take the company to convert an investment in stock to cash ?

(vi) Which company retains the larger proportion of income in the business ? 15

10. (i) Why are capital expenditure or investment decisions important to the management ?

(ii) What is meant by industrial sickness ? Discuss the factors responsible for industrial sickness in India ? 8+7

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