



Subject: Business Finance

Chapter: Unit 3 & 4

Category: Assignment 2

1. Which of the following errors in recording transactions has an impact on profitability?
- I. Purchase of a new machinery in the last month of the financial year was not recorded at all
 - II. Cash paid to one of the suppliers recorded as being paid to buy a depreciable asset
 - III. Loan taken from bank at the start of the year not being recorded at all
 - IV. Amount collected from one of the customers to whom goods were sold on credit being recorded as additional sales made

- A. IV. Only
- B. All of the above
- C. I, II, and IV.
- D. II and IV

2. The auditor believes that the financial statement does not give a true and fair view and the effect is so material that a disclosure is required to the extent that financial statement may be misleading or incomplete in nature, the auditor should issue –

- A. a disclaimer of opinion
- B. a qualified opinion
- C. an adverse opinion
- D. an unqualified opinion, but includes a reference to this matter in the audit report

3. Which of the following is NOT required as part of a listed company's accounting statement: –

- A. Cashflow statement
- B. Statement of change in equity
- C. Chairman's report
- D. Income statement and Balance Sheet

4. Which of the following accounting concepts are likely to distort the true economic value of an entity as reflected by its statement of financial position?

- I. Money measurement concept
- II. Cost concept
- III. Prudence
- IV. Accrual concept

- A. II only
- B. II and III

- C. All the above
- D. I, II and III

5.
 - a) Briefly explain the realization and accruals concepts of accounting concepts.
 - b) A Health insurance company sells one year medical plans throughout the year. Describe the specific ways the realization and accrual concepts is utilized in preparing the accounts of the company.
6. Explain different ways through which accounts can be manipulated along with example of each

7. What happens to the Gross profit and Cash flow of the company for a particular financial year (whether there is an increase / decrease) in the following cases:
- i) Property that the company possess has been revalued upwards by Rs 100crores by the Valuer.
 - ii) There has been an interest payment of Rs 1000 crores towards Masala bond issued by the company.
 - iii) There has been an increase in inventory of Rs 500 crores which were manufactured out of raw materials available in the previous year end, ignoring any man power and production cost.
 - iv) There was a depreciation of plant and machinery to the extent of Rs 250crores.
 - v) It was decided to write off Rs 200 crores due to EHFL defaulting.
8. i) Briefly list the main roles of regulation in the financial system.
- ii) Identify the regulatory bodies which regulate the Indian Financial system.
 - iii) Identify the regulatory authorities currently responsible for supervising each of the following:
 - a) Banks
 - b) Superannuation Products
 - c) General Insurance companies
 - d) Stockbrokers
 - e) Mutual Funds
 - f) Market for listed securities

- g) Foreign exchange dealers
 - h) Moneychangers
9. i) A company's accounts should comply with various accounting concepts. Outline the cost concept and the going concern concept.
- ii) A company has entered into an unusual transaction that is not directly covered by any accounting standard. Explain how the Board of Directors can go about selecting the appropriate accounting policy for this situation.
- iii) The Directors of a listed company believe that if optimistic accounting policies are applied consistently, the stock market will reward the company by increasing its share price. Explain why this may not be true.
10. Discuss the role, sources of funds and application of funds for the following financial institutions:
- a) Investment Bank
 - b) Pension Scheme
 - c) Life Insurance Company
11. There are general insurance and life insurance companies operating in a country, each of which is governed and regulated by a different regulator. If you want to interpret the accounts of these companies for your investment decision, what limitations and challenges are possible

12. i) Briefly describe why it is more complicated to prepare insurance companies accounts as compared to normal company accounts.
- ii) List and define the major component of reserves for a general insurance company's technical account.
13. A newly formed country is debating whether it should mandate compliance with the International Accounting Standards. As a reputed member of the accounting profession in a neighbouring country, you have been asked for your advice.
- i) Describe four advantages and four disadvantages of compliance with the International Accounting Standards.
- ii) List the various sources of regulations that influence the preparation of financial statements for companies in addition to the accounting standards.
- iii) Describe the additional information that cashflow statements provide which is not available in the Statement of Financial Position and Statement of Comprehensive Income.
14. As an account officer, you have been requested to assist ABC Ltd., a company, to prepare its annual accounts. The following information has been provided from the company's Book-keeping records:

Balances as on 31 March 2019

Administrative staff wages: 3,000

Cost of Marketing: 55,000

Bank overdraft: 18,000

Buildings – depreciation: 40,000

Buildings – valuation: 400,000

Cost of inventory consumed: 350,000 Delivery vehicle running costs: 60,000 Delivery vehicles – cost: 325,000

Delivery vehicles – depreciation: 170,000 Dividend paid: 45,000

Factory running costs: 100,000 Interest: 10,000

Inventory at 31 March 2019: 30,000 Land – valuation: 600,000

Loan (repayable 2024): 145,000 Machinery – cost: 150,000 Machinery – depreciation: 80,000

Manufacturing wages: 175,000

Retained earnings: 250,000

Revaluation reserve: 180,000

Revenue: 1,500,000

Sales salaries: 120,000

Share capital 200,000

Trade payables: 50,000

Trade receivables: 210,000

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In addition to figures shown above, below information is provided:

1. A revaluation exercise was conducted on 1 April 2018. Land was revalued at 800,000 and buildings at 700,000
2. Depreciation has still to be charged as follows:
 - Buildings – 1% of cost or valuation
 - Delivery vehicles – 20% reducing balance

- Machinery – 10% of cost

Prepare: i) An Income Statement for the year ended 31 March 2019

ii) A Statement of changes in Equity, and

iii) A Statement of Financial Position as on 31 March 2019

15. An interior designer company "ABC Ltd." has been set up on January 1, 2019 to provide advice to high value customers. The company has taken an office on rent starting from February 1, 2019. The terms of payment for rent are as follows–

1. Annual payment for 12 months will be INR15917.
2. First month rent payment will be INR1000.
3. Every month rent will be increased by 5% of previous month rent on compounded basis.

ABC Ltd. List of Balances on December 31, 2019 (Amount in INR)

Account	
Laptops	35,000
Office Equipment	20,000
Office Supplies	2,000
Trade Receivables	1,500
Cash	1,000
Bills Receivables	5,000
Office Building Rent	15,917
Dividends	5000
Employees' Salaries	10,000
Office Electricity Bill	4,000
Mobile and Internet Bill	583
-	-
Unearned Fees	10,000
Share Capital	32,000
Trade Payables	3,000
Fee Revenue Earned	55,000

In addition, the following information is not reflected in the figures above:-

1. The Laptops and Office equipment purchase date: February 1, 2019 and having 10 years useful life.
2. The inventory of supplies on December 31 is INR1000.
3. Fee revenue of INR 2000 is due from customers.
4. Unearned fees include INR 1000 earned in December.
5. December salaries of employees total INR 4000 have not been paid.
6. The bills receivable account is a six month bill for INR 5000 given by a customer on July 1, 2017. This bill carries INR 200 as interest income for the remaining financial year which will be paid at the end of the financial year.
7. Income tax of INR 3000 is payable on December 31.
8. The company's depreciation policy uses the straight line basis, with no salvage value after the useful life of machines and equipment.

Produce a Profit and Loss account, a Statement of Retained Earnings and a Balance Sheet (Statement of Financial Position) for ABC Ltd for the year ended December 31, 2019.

16. Which of the following statements is NOT true about Internal Rate of Return (IRR) method of project appraisal

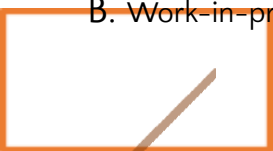
- A. IRR may give multiple solutions.
- B. IRR is less popular than Net Present Value as a measure of project worth.
- C. IRR has the benefit of highlighting the return achieved by the project.
- D. IRR is the most reliable means of choosing between mutually exclusive projects.

17. Which one of the following is the correct formula for the price earnings ratio?

- A. Market price of share/ Earning per share
- B. Issue price of share/ Earning per share
- C. Market price of share* Earning per share
- D. Issue price of share* Earning per share

18. While calculating Inventory turnover period, Inventories include

- A. Finished goods
- B. Work-in-progress



- C. Raw material
- D. All of the above

19. The following figures were taken from a company's accounts:

	2018	2019
Operating Profit	10,00,000	8,00,000
Depreciation	1,00,000	1,20,000
Working Capital (inventory + trade receivables - trade payables)	3,50,000	2,50,000

What is the company's cash inflow from operating activities for the year ended 2019?

- A. 12,00,000
- B. 11,00,000
- C. 9,00,000
- D. 10,00,000

20. The project generates 2500 in sales and 1500 in costs (excluding depreciation) at date 1. The tax rate is 40%.

The discount rate for the project is 20%.

- i. What is the cash flow from the project at date 1?
- ii. What is the NPV of the project?
- iii. Now assume (for this question only) that your suppliers allow you to pay them with a one-year delay, that is, at date 2. How does the NPV of the project change compared to the previous question?

21. If you want to measure any business efficiency, what ratios you will analysis and why?

22. Briefly list down the limitation of ratio analysis.

23. i. State possible reasons why stocks trade at different betas in the stock market.

ii. A company has a geared beta of 1.1 on a debt equity ratio of 1:2 and corporate tax rate of 30%. Calculate the geared beta if the debt equity ratio is 2:2.

24. Which of the following statements is true?

- A) In general the market value of investment trust is lower than the net present value
- B) In general the market value of investment trust is higher than the net present value
- C) In general the market value of investment trust is equal to the net present value
- D) In general the market value of investment trust is not correlated to the net present value.

25. i) In theory, companies exist to maximize the wealth of their owners. Explain the problems associated with demonstrating that companies actually do operate in such a way as to maximise their shareholders wealth.

ii) The stock of XYZ Ltd is presently trading at Rs 70. The current dividend per share is Rs 10. The company is

assumed to grow sustainably at the rate of 8%. Currently the risk free rate is 6% and market risk premium is 5%. If systematic risk is increased by 80% calculate the effect on the share price

26. i. Explain the beta of a stock along with formula

ii. How can beta be determined?

iii. As an active stock market investor, would you invest in a stock with a beta of 1 or -1?

iv. Name a financial instrument that is likely to have a beta of 0.

27. ABC Pvt. Ltd. has a debt: equity ratio of 1:1. The risk-free rate of return is 7%, the equity risk premium derived from the market is 5% and the gross cost of debt is 9%. Its beta is 1.5 and assume any profit is taxed at 25%.

i) Calculate its weighted average cost of capital.

ii) ABC is concerned about its high debt: equity ratio. If ABC were to repay all debt, what would be the required return to equity?

28. The following data relates to a capital project being evaluated by the Management of X Ltd.

	Project M
Annual Cost saving	Rupees 40,000
Useful life	4 years
I.R.R.	15%
Profitability Index (PI)	1.064
Salvage Value	0

Calculate for project M:

i. NPV

ii. Cost of Capital

iii. Cost of Project

iv. Payback

29. i) Define the following ratios and state its use:

a) Current ratio

b) Debtors turnover period

ii) Xylo Ltd deals in goods with a high inventory turnover period. Its finance manager wishes to ascertain whether the company would be able to meet its short term liabilities. Explain which ratio should he track on a regular basis and state the equation for the ratio suggested.

30.

i. A company has debt to equity ratio of 1:1, the gross redemption yield on debt is 8% and the dividend yield is 4%. Explain why an investor might buy shares in this company, and suggest a suitable cost of capital for the investor, assuming the debt is held till maturity.

ii. Explain the traditional view of the effect of gearing on the cost of capital, including why the cost of equity increases with an increase in gearing. You should include an appropriate diagram to illustrate your answer.

iii. Identify Modigliani and Miller's first irrelevance proposition, and describe its underlying assumptions.

iv. Draw a diagram showing the effect of gearing on the cost of capital using Modigliani and Miller's first

proposition.

v. Beta is a measure of the risk of investing in a security.

a. If the risk-free rate of return is 6% and the equity risk premium is 5%, what is the cost of equity for a company with Beta (ungeared) of 1.4?

b. The total market capitalization of a company is 100m, whose debt has a book value of 40% and a market value of 50%. The tax rate is 30%. Determine the geared beta of the company.

c. Determine the cost of equity of the company