INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

31st March 2021

Subject CB1 – Business Finance

Time allowed: 3 Hours 30 Minutes (09.30 – 13.00 Hours)

Total Marks: 100

Q .1) A small penalty has been imposed upon a general insurance company by the regulator for breaching a guideline. As per materiality concept, while preparing financial statements, the insurer should:

A. Disclose the penalty since regulatory breach is a significant event
B. Not disclose the penalty because the insurer might get a bad reputation for a minor breach
C. Not disclose the fine since the penalty amount is not material
D. Disclose only if the regulator specifically asks the insurer to do so **[2]**

Q. 2) In the statement of financial position, equity can arise by:

I. Sale of shares
II. Revaluation of non-current assets
III. Increase in market capitalisation
IV. Retention of profit

A. I and II only
B. II and III only
C. I, II and III only
D. I, II and IV only **[2]**

Q. 3) Which of the following is not a consideration for trade receivable management?

A. Credit Rating of the customer
B. Prior trade experience with the customer
C. Customer's bank balance
D. Profit margins of the customer **[2]**

Q. 4) Which of the following is NOT a forecasting technique?

A. Moving average
B. Expert judgement
C. Delphi Technique
D. Beyond Budgeting Approach **[2]**

Q. 5) What is the nature of relationship between market price of a share and pay-out ratio of the company?

A. Pay-out ratio is independent of market price
B. Pay-out ratio increases with market price, but at a constant rate
C. Pay-out ratio increases with market price, but at an increasing rate
D. As market price increases, pay-out ratio decreases **[2]**

Q. 6) Who of the following is legally responsible for the commitment owed by a private limited company to its lenders?

A. The directors
B. The auditor

C. The shareholders.
D. The Chief Financial Officer (CFO) **[2]**

Q. 7) An actuarial consultant in India is due to receive a payment in $US from an overseas client on 31 December 2021. The consultant has decided to buy an option contract to protect himself from fluctuations in the value of the $US. Which of the following is the most important aspect of the option contract he should purchase?

A. It should be an American option.
B. It should be an European option.
C. It should be a call option to buy dollars.
D. It should be a put option to sell dollars. **[2]**

Q. 8) Which is the best measure of the cost of retained profits in a business?

A. Retained earnings are a cost-free source of finance.
B. The cost of retained earnings is the same as that of the weighted average cost of capital (WACC) of the company
C. The cost of retained earnings is the same as that of ordinary share capital.
D. The cost of retained earnings is the same as that of preference shares. **[2]**

Q. 9) Why life insurance companies' financial statements are normally produced in a conservative way?

A. This is not a true statement for Insurance companies.
B. The underlying liabilities are generally both long term and difficult to estimate.
C. The asset base is composed largely of long term investments.
D. None of the above. **[2]**

Q. 10) Why financial valuers generally calculate Earnings before Interest, Taxation, Depreciation and Amortisation (EBITDA)?

A. EBITDA is less prone to fluctuations than net profit
B. Depreciation and amortisation are not real costs to the business
C. Valuers are only interested in performance before tax
D. EBITDA is regarded as less prone to manipulation than net profit **[2]**

Q. 11) Explain what do you understand by working capital cycle.
Further, what would you infer about the operations of the company if working capital cycle is negative? **[5]**

Q. 12) Two partners (A and B) started a chemical manufacturing company 2 years ago. "A" hails from an engineering background and mainly takes care of operations; "B", on the other hand, is a chartered accountant and manages the financials more than operations.

A is concerned that even after managing operations efficiently, the company is facing significant liquidity concerns. B reassures A that the situation is not problematic because the company is generating healthy profits.

Discuss B's argument. (from all perspectives) **[5]**

Q. 13) Give two reasons why preparation of insurance company accounts is more complicated than those of any other business? Also, list additional items that appear in the statement of financial position of an insurance company. **[5]**

Q. 14) Explain how inflation can distort accounting results, assuming financials have been prepared on historical cost basis. **[5]**

Q. 15) The current share price of MTG Ltd is Rs 27. The company wants to offer a choice between a cash dividend of Rs 5.75 per share or a scrip dividend of two fully paid shares for every nine shares held. Discuss the factors that shareholders would have to take into account when deciding whether to take the cash or the scrip dividend. **[5]**

Q. 16) You are the CFO of a healthcare company. The Company's board is planning to revise the company's investment appraisal process. They need to make a presentation of the concept of opportunity cost and how it might impact on the selection of projects. Outline the points you would make with an example. Also, can a company use the same opportunity cost for all the projects. **[5]**

Q. 17) Discuss whether the objective of maximisation of shareholder wealth can be realistically and consistently regarded as the guiding principle for management of a company. Can wealth be created for shareholders at the expense of other stakeholders? Explain giving reasons. **[5]**

Q. 18) Real Estate companies raise a high proportion of their long term financing from debt rather than from equity. What could be rationale behind this financing strategy? **[5]**

Q. 19) You are a team member of an Investment committee responsible for the evaluation of investment proposals in a large listed multinational company. The directors of one of the company's largest subsidiaries based out of an emerging economy has proposed a major investment that would double that subsidiary's manufacturing capacity and would enable it to export to several new markets.
The proposed investment would require the company to raise money, either by borrowing or by the issue of equity, but not a combination of the two. The proposal has been backed by a detailed analysis of the cash flows that are expected to arise from this expansion.

The company has a policy of evaluating investment opportunities on the basis of the net present value (NPV) of estimated cash flows.

i) Identify and explain the factors which may be used to determine the discounting rate for evaluation. (3)

ii) Explain why the company has preferred NPV over IRR to evaluate the investment opportunities. (3)

iii) Discuss how the decision to raise finance using either debt or equity would affect the company's weighted average cost of capital (WACC). (7)

iv) Generally it is suggested that subjective and non-economic factors such as political environment, social context, regulatory environment or company specific factors are more relevant to investment decisions than objective economic factors in deciding whether a project should proceed. Explain this statement. (7)

[20]

Q. 20) An analyst has calculated the following financial ratios for FY19-20 for A Ltd.

Profit Margin	5.0%
Asset Utilization Ratio	1.64
Current Ratio	1.80
Quick Ratio	1.30
Inventory Turnover Ratio (days)	14
Receivable Turnover Ratio (days)	28
Asset Gearing Ratio	5.0%
Earnings Per Share (paisa)	15

Note: Inventory and Receivable Turnover ratios in the above table are based on revenue.

Using the accounting ratios above and following additional information, prepare the statement of financial position for year ending 31st March 2020.

Additional information:

Nominal value per share (paisa)	25
Interest Rate on Borrowings (p.a.)	10.0%
Corporate Tax Rate	30%
Revenue for the year ('000 INR)	3,00,000

Details of Non-Current Assets:

Heading	**Factory**	**Machinery**
Book Value (As at 31st March 2019)	1,40,000	40,000
Estimated Life at Inception (Years)	25	10
Years since Purchase (As at 31st March 2020)	9	2
Estimated Residual Value	12,500	5,400
Depreciation Method	Straight Line	Reducing Balance

Note: For simplicity of calculation, round every calculated financial figure to nearest hundred. **[20]**

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