

INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

15th September 2017

Subject CT2 – Finance and Financial Reporting

Time allowed: Three Hours (10.30 – 13.30 Hours)

Total Marks: 100

INSTRUCTIONS TO THE CANDIDATES

- 1. Please read the instructions inside the cover 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. 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. You are not allowed to carry the question paper in any form with you.

- Q. 1)** Which of the following is NOT true of a Limited Liability Partnership (LLP)?
- A.** A LLP must have a Memorandum and Articles of Association.
 - B.** Any firm consisting of two or more members may be a LLP.
 - C.** The LLP is a separate legal entity.
 - D.** A LLP is treated in the same way as a partnership for taxation purposes. [2]
- Q. 2)** Which of the following statements are true with respect to Insider Trading?
- I.** Insider trading denotes dealing in a company's securities on the basis of confidential information relating to the company, which is not published and not known to the public.
 - II.** Insiders include directors, officers, and employees of a company and related companies, persons with professional or business relationship with a company (e.g. auditors, solicitors, bankers and brokers), large beneficial share holders, government officials and stock exchange employees.
 - III.** Insider trading rules apply to information that is price sensitive and likely to have an impact on the company's securities price in the market.
 - IV.** The SEBI has passed the regulations called the Securities and Exchange Board of India (Insider Trading) Regulations, 1992 prohibiting insider trading.
- A.** I,II and III only
 - B.** I and III only
 - C.** I,III and IV only
 - D.** All of the above. [2]
- Q. 3)** Which of the following leases would least likely be classified as an operating lease by the lessee?
- A.** The lease term is 5 years and the economic life of the leased asset is 8 years.
 - B.** Ownership of the leased asset reverts to the lessor at the end of the lease term.
 - C.** The agreement permits the lessee to buy the leased asset for one rupee at the end of the lease term.
 - D.** The fair value of the leased asset is Rupees 20 million and the present value of the lease payments is Rupees 13 million. [2]
- Q. 4)** The effect of an increase in the Cash Reserve Ratio (CRR) will be reduced/ nullified if:
- A.** Bank rate is reduced.
 - B.** Securities are sold in the open market.
 - C.** Statutory Liquidity Ratio (SLR) is increased.
 - D.** People do not borrow from non-banking institutions. [2]
- Q. 5)** The following figures are given for A Ltd.
- Cost of debt = 12%
Cost of equity = 18%
Value of debt = 2 lakhs
Value of equity = 2 lakhs
Find the cost of capital and changed cost of capital if debt equity proportion changes to

3: 1 assuming that beta does not change.

- A. 15% and 13.5%
- B. 15% and 16.5%
- C. 15% and 15%
- D. 16% and 16%

[2]

Q. 6) Company A and B are in the same risk class and are identical in all respects except that Company B uses debt finance while Company A does not. The present market values of both the firms are not at equilibrium. The cost of equity of Company A is 25%. Calculate the cost of equity of company B, if they come at equilibrium. EBIT of both the companies is Rs 90 Lakhs.

	Company A	Company B
Market Value of Equity	400 L	150 L
Market Value of Debt (Interest @18%)	-	150 L
Total Value	400 L	300 L

- A. 25%
- B. 30%
- C. 18%
- D. 28%

[2]

Q. 7) Why is accounting profit not a true measure of shareholder value in life insurance business?

- A. As insurance products are long-term in nature, profits are expected to emerge over the entire lifetime of policies.
- B. The figures are likely to be based on historical costs.
- C. The figures are likely to be manipulated by creative accounting.
- D. All of the above

[2]

Q. 8) Which of these can be classified as a systemic risk?

- A. Bond defaults in the company's asset portfolio
- B. Demonetisation
- C. Reputational damage / bad publicity
- D. High operating costs

[2]

Q. 9) Which of the following could cause a company's earnings per share figure to be diluted?

- A. A decline in revenues
- B. A loss on the revaluation of an asset
- C. The correction of an accounting estimate
- D. The issue of a convertible bond

[2]

Q. 10) Groupon is a holding company that has two subsidiaries, ABC and XYZ. During the year, Groupon recorded sales of Rs 10 crores, including sales of Rs 2 crores to ABC. ABC recorded sales of Rs 5 crores, including sales of Rs 3 crores to XYZ. XYZ recorded sales of Rs 4 crores including sales of Rs1.5 crores to Groupon. What is the value of the total group sales of Groupon?

- A. 10 crores
- B. 8 crores
- C. 12.5 crores
- D. 19 crores

[2]

Q. 11) Macroeconomic policy can be broadly divided into monetary policy and fiscal policy.

“Monetary policy is policy that employs the central bank’s control over the supply and cost of money as an instrument for achieving the objectives of economic policy”

Roughly we may say that monetary policy is credit control policy. The instruments of credit control can be divided into:

- Quantitative credit control measures; and
- Selective credit control measures.

i) List the objectives of monetary policy.

(2)

ii) Explain the quantitative credit control measures.

(6)

iii) Explain the selective credit control measures.

(6)

iv) Explain the limitations of monetary policies.

(5)

[19]

Q. 12) What is the difference between internal and external sources of raising funds? Explain

[4]

Q. 13) Distinguish between profit maximization vs wealth maximisation of the firm.

[4]

Q. 14) What are Foreign Currency Convertible Bonds (FCCBs)? Discuss the advantages and disadvantages of FCCBs.

[5]

Q. 15) 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

[8]

Q. 16) i) List the factors affecting a company's gearing decisions in practice. (3)

ii) The New India Manufacturing Company requires Rupees 25 Lakhs for a new plant. This plant is expected to yield earnings before interest and taxes of 5 Lakhs. While deciding about the financial plan, the company considers the objective of maximizing earnings per share.

It has three alternatives to finance the project by raising debt of 2.5 lakhs, 10 lakhs or 15 lakhs and the balance in each case by issuing equity shares.

The company's shares are currently selling at Rupees 150 but are expected to decline to Rupees 125 in the event funds are borrowed in excess of Rupees 10 lakhs.

The funds can be borrowed at the rate of 10% up to 2.5 lakhs, at 15% over 2.5 lakhs and up to 10 lakhs, and at 20% over 10 lakhs.

The tax rate applicable to the company is 50%. Which form of financing should the company choose?

(5)
[8]

Q. 17) GoodHomes Ltd. manufactures furniture. The trial balance of the company is provided below:

In Rupees. 000s		
Administrative expenses	386	
Audit fee	324	
Bank	972	
Debenture loan (8%)	-	3,726
Debenture loan interest	149	
Dividend paid	278	
Factory – cost	8,610	
Factory – depreciation	-	1,629
Opening inventory 1 April 2016	185	
Manufacturing equipment – cost	7,758	
Manufacturing equipment – depreciation	-	2,222
Manufacturing overheads	309	
Purchases	2,314	
Retained earnings	-	2,037
Revenue	-	9,258
Share capital	-	5,184
Trade payables	-	244
Trade receivables	778	
Wages – administration	167	
Wages – manufacturing	1,009	
Wages – sales	1,062	

	24,300	24,300
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The following additional information is provided.

Closing inventory as at 31st March 2017 is Rupees 58000.

Depreciation is yet to be charged on the following bases:

- Factory: 2% of cost
- Manufacturing equipment: 25% reducing balance

The following expenses have to be accrued:

- Wages (split equally between administration, manufacturing and sales) Rupees 9,000
- Administrative expenses Rupees 10,000
- Manufacturing overheads includes insurance that has been prepaid by Rupees 1,000.

A tax expense of Rupees 359,000 has to be provided for.

The debentures were issued in 2013 and are repayable in 2023. The interest for the period from 1st April 2016 to 31st March 2017 was paid in July 2017.

Prepare the following statements as at 31st March 2017:

- i) Income statement** (7)
 - ii) Statement of changes in equity** (3)
 - iii) Balance sheet of the company** (10)
- [20]**

Q. 18) Which is the recent significant tax reform in the Indian economy and when did it become effective? How is it likely to impact personal taxation and overall tax revenues of the Government? [2]

Q. 19) A listed company has raised finance using both debt and equity instruments that are publicly traded. In response to recent news regarding the poor performance of one of the company's projects, the market value of the equity shares has declined. However, the value of its debt instruments has remained unchanged.

Explain why it is possible that debt would not decline in value in these circumstances. [3]

Q. 20) Explain the following accounting ratios and the limitations in analyzing these ratios in the context of a financial services firm:

- i)**
 - a) NAV per share
 - b) Profit margin
 - c) Return on capital employed
 - ii) Describe additional ratios that could be monitored for an insurance company?** (5)
- [7]**
