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IPCC NOVEMBER 2016 EXAM

FINANCIAL MANAGEMENT

Test Code - I N J1 1 0 0

BRANCH - (MULTIPLE) (Date : 10.07.2016)

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Answer-1 :
Preparation of Financial Statements

Particulars	%	Rs.
Share capital	50%	1,00,000
Other shareholders funds	15%	30,000
5% Debentures	10%	20,000
Trade creditors	25%	50,000
Total	**100%**	**2,00,000**

Land and Buildings	=	Rs. 80,000
Total Liabilities	=	Total Assets
Rs. 2,00,000	=	Total Assets
Fixed Assets	=	60% of Total Gross Fixed Assets and Current Assets
	=	Rs. 2,00,000 x60/100
	=	Rs. 1,20,000

Calculation of Additions to Plant & Machinery

	Rs.
Total Fixed Assets	1,20,000
Less: Land and Building	80,000
Plant and Machinery (after providing depreciation)	40,000
Depreciation on Machinery up to 31-3-2013	15,000
Add: Further Depreciation	5,000
Total	**20,000**

(3 Marks)

Current Assets = Total Assets - Fixed Assets

= Rs. 2,00,000-Rs. 1,20,000 = Rs. 80,000

Calculation of Stock

Quick Ratio = $\frac{\text{Current Assets - Stock}}{\text{Current Liabilities}} = 1$

= $\frac{\text{Rs.80,000 - Stock}}{\text{Rs.30,000}} = 1$

Rs. 50,000 = Rs. 80,000 - Stock

Stock = Rs. 80,000 - Rs. 50,000

= Rs. 30,000

Debtors = 4/5th of Quick Assets

= (Rs. 80,000 - 30,000) x 4/5

= Rs. 40,000

(1 Mark)

Debtors Turnover Ratio

= $\frac{40{,}000 \times 12}{\text{Credit Sales}} = 2$ months

2 Credit Sales = 4,80,000

Credit Sales = 4,80,000/2

= 2,40,000

Gross Profit (15% of Sales)

Rs. 2,40,000 x 15/100= Rs. 36,000

(1 Mark)

Return on Networth (profit after tax)

Networth = Rs. 1,00,000 + Rs. 30,000

= Rs.1,30,000

Net Profit = Rs.1,30,000 x 10/100 = Rs.13,000

Debenture Interest = Rs.20,000 x 5/100 = Rs.1,000

(1 Mark)

Projected Profit and Loss Account for the year ended 31.03.2014

To Cost of Goods sold To Gross Profit	2,04,000 36,000	By Sales	2,40,000
	2,40,000		2,40,000
To Debenture Interest To Administration & Other Expenses To Net Profit	1,000 22,000 13,000	By Gross Profit	36,000
	36,000		36,000

(2 Marks)

Ganesha Limited
Projected Balance Sheet as on 31st March, 2014

Liabilities	Rs.	Assets	Rs.	Rs.
Share Capital	1,00,000	Fixed Assets		
Profit and Loss A/c.	30,000	Land and Buildings		80,000
(17,000 + 13,000)		Plant & Machinery	60,000	
5% Debentures	20,000	Less : Depreciation	20,000	40,000
Current Liabilities		Current Assets :		
Trade Creditors	50,000	Stock	30,000	
		Debtors	40,000	
		Bank	10,000	80,000
Total	**2,00,000**	**Total**		**2,00,000**

(4 Marks)

Answer-2 (a) :

Statement of Existing Profit

Sales	Rs. 10,00,000
Less : Variable Cost	7,00,000
Contribution	3,00,000
Less : Fixed Cost	2,00,000
EBIT	1,00,000
Less : Interest @ 10% on 5,00,000	50,000
Profit before tax (PBT)	50,000

(2 Marks)

$$\text{Operating Leverage} = \frac{\text{Contribution}}{\text{EPBT}} = \frac{3,00,000}{1,00,000} = 3$$

(1 Mark)

$$\text{Financial Leverage} = \frac{\text{EBIT}}{\text{PBT}} = \frac{1,00,000}{50,000} = 2$$

(1 Mark)

$$\text{Combined Leverage} = \frac{\text{Contribution}}{\text{PBT}} = \frac{3,00,000}{50,000} = 6$$

(1 Mark)

Statement of Sales needed to double the EBIT

Operating leverage is 3 times i.e., 33-1/3% increase in sales volume cause a 100% increase in operating profit or EBIT. Thus, at the sales of Rs. 13,33,333, operating profit or EBIT will become Rs. 2,00,000 i.e., double the existing one.

Verification

Sales	Rs. 13,33,333
Variable Cost (70%)	9,33,333
Contribution	4,00,000
Fixed Costs	2,00,000
EBIT	2,00,000

(1 Mark)

Answer-2 (b) :

The information regarding the operating leverage and financial leverage may be interpreted as follows–For Company A, the DFL is 3 : 1 (i.e., EBIT : PBT) and it means that out of EBIT of 3, the PBT is 1 and the remaining 2 is the interest component. Or, in other words, the EBIT : Interest is 3:2.
Similarly, for the operating leverage of 6:1 (i.e., Contribution : EBIT) for Company B, it means that out of Contribution of 6, the EBIT is 1 and the balance 5 is fixed costs. In other words, the Fixed costs: EBIT is 5:1. This information may be used to draw the statement of sales and profit for all the three firms as follows:

Statement of Operating Profit and Sales

Particulars	A	B	C
Financial leverage = (EBIT/PBT) =	3 : 1	4 : 1	2 : 1
or, EBIT/Interest	3 : 2	4 : 3	2 : 1
Interest	Rs. 200	Rs. 300	Rs. 1,000
EBIT 200×3/2; 300×4/3; 1,000×2/1	= 300	= 400	= 2,000
Operating leverage = (Cont./EBIT)	5 : 1	6 : 1	2 : 1
i.e., Fixed Exp./EBIT	4 : 1	5 : 1	1 : 1
Variable Exp. to Sales	66.67%	75%	50%
Contribution to Sales	33.33%	25%	50%
Fixed costs	300×4/1	400×5/1	2,000×1/1
= 1,200	= 2,000	= 2,000	
Contribution = (Fixed cost + EBIT)	1,500	2,400	4,000
Sales	4,500	9,600	8,000

(4 Marks)

Income Statement for the year ended 31.03.12

Particulars	A	B	C
Sales	Rs. 4,500	Rs. 9,600	Rs. 8,000
Variable cost	3,000	7,200	4,000
Contribution	1,500	2,400	4,000
Fixed Costs	1,200	2,000	2,000
EBIT	300	400	2,000
Interest	200	300	1,000
PBT	100	100	1,000
Tax at 50%	50	50	500
Profit after Tax (PAT)	50	50	500
Operating leverage (Cont./EBIT) =	5	6	2
Financial leverage (EBIT/PBT) =	3	4	2
Combined leverage	15	24	4

(4 Marks)

Answer-3 :

SWASTIK OILS LIMITED
Cash Flow Statement for the Year Ended 31st March, 2014

(a) Cash Flows from Operating Activities	**(Rs. in lakhs)**
Net profit before taxation (37,500 + 7,500)	45,000.00
Adjustment for:	
Depreciation charged to P&L A/c	30,000.00
Loss on sale of assets (net)	60.00
Profit on sale of investments	(150.00)
Interest income on investments	(3,759.00)
Interest expenses	15,000.00
Operating profit before working capital changes	86,151.00

Increase (change) in working capital (excluding cash and bank balance)	(84,112.50)
Cash generated from operations	2,038.50
Income tax paid	(6,372.00)
Net cash used in operating activities (A)	(4,333.50)

(b) Cash Flow from investing Activities

Sale of Assets (277.50-60.00)	217.50
Sale of Investments (41,647.50+150)	41,797.50
Interest Income on investments (assumed)	3,759.00
Purchase of fixed assets	(21,840.00)
Investments in Joint Venture	(5,775.00)
Expenditure on construction work-in-progress	(69,480.00)
Net Cash used in investing activities (B)	(51,321.00)

(c) Cash Flow from Financing Activities

Proceeds from long-term borrowings	38,970.00
Proceeds from short-term borrowings	30,862.50
Interest paid	(15,780.00)
Dividends (including interim dividend paid)	(12,000.00)
Net cash from financing activities (C)	42,052.50
Net increase in cash and cash equivalents (A) + (B) + (C)	(13,602.00)
Cash and cash equivalents at the beginning of the year	11,032.50
Cash and cash equivalents at the end of the year	2,569.50

(8 Marks)

Answer-4 :

(1) Working Capital of X Ltd. during 2011-12, 2012-13 and 2013-14

Current Assets :

	2011-12	**2012-13**	**2013-14 (Rs. in Lacs)**
Stock	15,00	15,00	20,00
Debtors	5,00	5,50	5,00
Cash at Bank	5,00	3,00	3,25
	25,00	23,50	28,25
Less : Current Liabilities :			
Cash Credit	5,00	7,00	12,00
Creditors	12,00	14,00	18,00
	17,00	21,00	30,00
Working Capital	8,00	2,50	(1,75)
Decrease in Working Capital	—	5,50	4,25

(4 Marks)

So working capital decreased by Rs. 550 lacs in 2008-09 and Rs. 425 lacs in 2013-14.

(2) Profit earned and funds from operations

Profit during the year :	2012-13	(Rs. in Lacs) 2013-14
Increase in Profit & Loss A/c	1,00	2,00
Increase in Reserve	4,00	9,00
Tax provision	17,00	28,00
Proposed Dividend	22,50	26,25
	44,50	65,25
Less : Profit on sale of Investment	(10)	—
Add : Depreciation	7,00	7,75
Fund from operations	51,40	73,00

(4 Marks)

X Ltd. earned Rs. 44,50 lacs profit and Rs. 51,40 Lacs fund in 2012-13. It earned Rs. 62,25lacs profit and Rs.73,00 lacs fund in 2013-14.

(3) Fund Flow Statements **(Rs. in Lacs)**

	2012-13	2013-14
Sources:		
Fund from operations	51,40	73,00
Issue of 12% debentures	—	5,00
Sale of investments	5,10	
	56,50	78,00
Applications:		
Purchase of Plant and Machinery	37,00	27,75
Purchase of Investments	—	15,00
Tax payment	11,00	17,00
Dividend payment	14,00	22,50
	62,00	82,25
Decrease in Working Capital	5,50	4,25

(6 Marks)

Comments:

(1) It appears (Rs. 25,00 lacs) that 48.64% (Rs. 51,40 lacs) „e 100 of the fund generatedduring 2012-13 were used to pay tax and dividend. The percentage became stillhigher (54.11%)

$$\frac{\text{Rs.39,50}}{\text{Rs.73,00}} \times 100 \text{ in 2013-14}$$

(2) In 2012-13 the balance of the fund generated was 51.36% (100 – 48.64%) which isused to finance purchase of plant and machinery. Sources of finance for long-terminvestment were:

Fund from Operations 71.35% (Rs. 26,40 lacs/Rs. 37,00 lacs) x 100
Sale of Investments 13.78% (Rs. 5,10 lacs / Rs. 37,00 lacs) x 100
Working Capital 14.87% (Rs. 5,50 lacs / Rs. 37,00 lacs) x 100

Thus inadequate long-term fund to finance purchase of plant and machinerydeteriorated working capital position. Also the management proposed 30% dividend in2012-13.

So, liquidity deterioration in 2012-13 was due to (a) deployment of working capital inlong term investment and (b) high rate of dividend.

(3) In 2013-14, fund generation was 42.02% more. But dividend was increased from 20% to30% which absorbed about 30.83% of funds generated. Tax paid to fund generated wasalso increased from 21.40% to 23.29%, Investment in Plant & Machinery (net ofcollection by issue of debentures) was 31.16% of the fund generated. Thus, margin of14.73 would remain had there been no investment outside business. This amounts toRs. 10.75 lacs. So outside investment caused liquidity deterioration in 2013-14. **(2 Marks)**