

IAS Mains Commerce 1990

Paper I

Section A

1. Answer any three of the following in not more than 200 words each:

- a. The unsophisticated investor has little knowledge of accounting principles and procedures and limited power to acquire the kinds of information needed for investment decisions. Government regulation of the type of information presented in company annual reports is therefore, necessary to protect the unsophisticated investor. Debate this issue. Prepare a list of the principal issue involved (do not discuss them).
- b. The approach of comparing performance at one activity level with a plan that was developed at some other activity level is nonsense from control point. Comment and explain the alternative approach.
- c. The way these modern controllers put themselves on a pedestal, you may as well as give them the title of managing director and do away with it. Look at their functions. With the change in a word or two, these functions could be a job description for the company managing director. Discuss.
- d. Define secret reserves. Give instances of the manner in which they might be created. What is the correct attitude of the statutory auditor with respect to them?

2. Answer the following questions

- a. Income-tax is a charge on total income depending on the residence of an assessee. Explain. What are the criteria for determining the residence of an individual and company? Can a man be resident in two countries, though he has one domicile?
- b. It has been stated that cost for inventory purposes may be determined under any one of several assumptions as to the flow of cost (such as first-in-first-out, last-in-first-out and average). The major objective in selecting a method should be to choose the one which, under the circumstances, most clearly reflects periodic income.
 - i. For what reasons do accountants make assumptions as to the flow of cost instead of actually identifying the cost of the specific items which are sold?
 - ii. In any given case, on what would you base your decision as to which of the three assumptions as to the flow of cost stated above (viz. FIFO, LIFO and average) most clearly reflects periodic income?
 - iii. Would application of the above directive always result in the clearest presentation of current financial position. Explain.

3. Answer the following questions

- a. F, a French national, came to India for the first time on 1st. July, 1984. For the period from that date to 31st March, 1990 he stayed in India from 1st July, 1984 to 31st October, 1985, from 1st May, 1986 to 31st October, 1986, from 1st November, 1988 to 31st December, 1988 and from 1st. July, 1989 to 31st August, 1989. During the previous year ended on 31st March, 1990, his income consisted of: Rs.
 - i. Business in India 1, 00, 000
 - ii. Dividend from Indian companies 30, 000

- iii. Dividend from non-Indian companies received in France but remitted to India. 70, 000
- iv. Business in France (but controlled from India) 90, 000
- v. Income from house property in France 40, 000

Determine, giving full reasons, the gross total income of F for the assessment year 1990 – 91 after ascertaining his residence for the purpose of income tax.

- b. After a study of cost-volume-profit relationships, the Bulachand Company concluded that its costs for any given volume of sales could be expressed as Rs. 10 crore of fixed costs plus variable costs equal to 60 per cent of sales, The companys range of expected sales volume was from zero to Rs. 50 crore.
 - i. Prepare a graph which will illustrate this cost-volume relationship. Determine the break-even, and the amount of profit at the maximum sales from the graph.
 - ii. A competitor operating a plant of the same size as that of Bulachand Company also has fixed costs of approximately Rs. 10 crore but his break-even point is Rs. 30 crore of sales. What are the probale causes of the difference between this break-even point and that of the Bulachand Company? You may make appropriate assumptions to illustrate your answer.
 - iii. What quantity should Bulachand Company sell if it desires to have after-tax profit of

Rs. 6.3 crores? You may assume a corporate tax rate of 55 per cent.

4. Answer the following questions

- a. Standards of fieldwork include the statement that there is to be proper study and evaluation of the existing internal control as a basis for reliance thereon and for determining the resultant extend of the tests to which auditing procedures are to be restricted. Another standard of fieldwork states that sufficient competent evidence be obtained.
 - i. What are the major characteristics of a satisfactory system of internal control?
 - ii. List five sources of evidence about a given system of internal control which are available to an auditor, and state briefly how the evidence from each source can be used in evaluating the system of internal control.
- b. Budgets may actually prove detrimental to effective management control. They provide preconceived plans as the criteria for evaluating actual operations. Thus, any errors in the planning process may be compounded in the control process. Critically examine this statement

Section B

5. Answer any three of the following in not more than 200 words each:

- a. Define operating leverage and financial leverage. Illustrate their implications for a companys debt equity mix
- b. Describe the recent developments in the Indian Money Market. List the relevant recommendations of the Vagul Committee and the Chakravarty Committee in this regard

- c. Give the circumstances when a bank would dishonour a cheque. Describe the liability of the drawer if the cheque is dishonoured because of the inadequate funds in his bank account.
- d. As compared to a non-convertible debenture and an equity share what are the merits and demerits of a convertible debenture form

- i. the company's

- ii. the investor's points of view?

6. The great expansion of institutional financing facilities is indeed the most outstanding post-Independence development in the sphere of industrial finance in India. A broad-based and diversified institutional structure has gradually been built up for this purpose _____. Also the whole financial system has come under the increasing control of public government financial institutions and partly through more stringent regulation of private finance institutions. Discuss.

7. Do you agree with the following statements? Give reasons:

- a. It is all very well saying that I can sell shares to cover cash needs, but that may mean selling at the bottom of the market. If the company pays a regular dividend, investors avoid that risk.
- b. Dividends are the shareholders' wages. Therefore, if a government adopts an income policy which restricts increases in wages, it should in all logic restrict increases in dividends.
- c. Risky companies tend to have lower target payout ratios and more gradual adjustment rates.

8. Answer the following questions

- a. Companies A and B differ only in respect of their capital structure. A is financed to the extent of 30 per cent debt and 70 per cent equity, B is financed to the extent of 10 per cent debt and 90 per cent equity. The debt of both companies is risk-free.
 - i. Mr P owns 1 per cent of the equity share of A. What other investment package would produce identical cash flows for Mr P?
 - ii. Mr Q owns 2 per cent of the equity shares of B. What other investment package would produce identical cash flows for Mr Q?
 - iii. Show that neither Mr P nor Mr Q would invest in the equity shares of B. If total value of company A were less than that of B.
- b. Consider a project with the following cash flows:
 - Year 0 Year 1 Year 3 (Rs.) (-) 100 (+) 200 (-) 75

Based on these answer the following

- i. How many internal rates of return does this project have? What are those rates?
- ii. If the opportunity cost of capital is 20 per cent, would you consider it an attractive project? Briefly explain.

c. Each of the following formulae for determining the cost of equity capital (k) can be right or wrong depending on the circumstances.

i. $K = D/V_1 p_0 + g$

ii. $K = EPS_1/P_0$ (Where D/V_1 is the expected dividend per share at the end of next year, EPS_1 is the earnings per share at the end of next year, g is the growth rate and p_0 is the market price per share today). For each formula, construct a simple numerical example showing that the formula can give wrong answers and explain why the error occurs.

Then construct another simple example for which the formula gives the right answer.