

June 08, 2004

**SPECIFIED PAPER OF
ADVANCED ACCOUNTING & FINANCIAL REPORTING;
MANAGEMENT ACCOUNTING;
BUSINESS FINANCE DECISIONS.**

**(Marks 100)
(3 hours)**

Q.1 Buyout Limited is involved in managing a small airport under license from the government to allow traffic of small propeller aircrafts in the area. Major investors group of the company has decided to disinvest from this business which has resulted in an opportunity for the management buyout. The arrangement is to sell all the facilities to the MBO team. However, the operating license will be leased to MBO team for an irrevocable term of 20 years against an annual payment. This payment for the first year of operations will be Rs. 750,000 and will thereafter be adjusted to the level of revenues earned in every year in relation to the revenues earned in the first year.

Profit and loss account of the company for the latest year is given hereunder:

	Note	Rs. '000
Revenue from		
- landings	1	11,863
- aircraft parking	2	684
- other services	3	450
		12,997
Operating costs	4	(8,899)
Profit before interest		4,098

The following further information is available:

- 1 The airport is operating throughout the year with 5 flights landing per day. An amount of Rs.6,500 is charged as 'landing fee' per flight. This fee is regulated by the government and a 3% increase is allowed every year. The average number of aircrafts landing per day is expected to become 6 from year 3 and 7 from year 5.
- 2 An aircraft is parked for an average of half an hour before re-flying. A fee of Rs. 750 per hour is charged for parking. This rate is expected to remain constant.
- 3 This represents the revenue from general maintenance services performed for the aircrafts. Revenue from such services is expected to grow at a rate of 10% per annum.
- 4 Operating costs include a fixed portion of Rs.5 million. Remaining costs are a function of revenue. An amount of Rs.1.20 million is included in fixed costs representing charge of senior management which can be outsourced for Rs.750 thousand per year after the buyout by MBO. Fixed costs are expected to grow at a rate of 5% p.a. other than the amount of depreciation which, for the given year was Rs. 1 million. A capital replacement of Rs. 3 million is required at the end of year 3 which will result in depreciation expense increasing by Rs.350

(2)

5 Taxation rate is expected to remain at the current rate of 35% of income for the foreseeable future.

A price of Rs. 40 million has been agreed between the representatives of the management employees (MBO team). The funding has been arranged as follows:

	Rs '000	
Equity		
MBO Team	5,000	
Other Investors	<u>2,000</u>	
Total equity	<u>7,000</u>	
Debt		
Long Term	13,000	Term – 20 years @ 8.50% p.a. repayable from the end of year 11 in ten equal principal installments. The loan will be payable in full at the end of 5 th year if the company fails to achieve a debt to equity ratio of 1:1 by then.
Medium Term	15,000	Term – 10 years @ 7.50% p.a. repayable from the end of year 2 i.e. after a grace period of one year. Repayment being 5%, 10%, 15% and 20% of principal for the first four repayments and then 10% of principal per year for 5 years.
Bridge Financing	5,000	Term – 5 years @ 9% p.a. Repayable in five equal principal installments from the end of first year.
Total Debt	<u>33,000</u>	
	<u>40,000</u>	

Required:

Demonstrate, taking into account the cash position, whether the MBO team will be able to meet the covenants attached with the Long Term Loan.

(20)

Q.2 Your company is currently searching for avenues to invest its excess funds and has selected five stocks. You have gathered the following data from the stock broker:

Stock	Current Price	Expected Price after one year	Expected Dividend	Beta
	Rupees	Rupees	Rupees	
A	25	27	1.00	0.70
B	40	42	1.25	1.00
C	33	40	1.00	1.15
D	64	65	2.40	1.40
E	50	55	Nil	-0.30

The risk free rate of return is 8% and the return on market portfolio is 14%.

Required:

The finance director has asked you to advise him regarding:

- (a) the expected future rate of return on the stocks, and
- (b) whether the current share price is overvalued, undervalued or at par.

(05)

(10)

(3)

- Q.3 (a) Issued share capital of BF Limited is 500,000 ordinary shares of Rs.10. Its results for the year are as follows:

	<u>Rupees</u>
Profit before taxation	7,500,000
Taxation	<u>1,500,000</u>
Profit after taxation	6,000,000
Ordinary dividend – proposed	<u>1,500,000</u>
Retained profit	<u>4,500,000</u>

The market price per share is currently Rs. 83 cum dividend.

Required:

Calculate the following ratios:

- (i) price/earnings;
- (ii) dividend payout;
- (iii) dividend yield; and
- (iv) dividend cover.

(08)

- (b) Wonders Limited is a medium size listed company. The results to December 31, 2003 have just been announced, declaring a dividend of Rs. 3 per share. The directors of Wonders Limited estimate that if the current dividend policy is maintained the annual growth in earning and dividends will be no better than the average growth in earnings over the past four years which is 3.5 percent.

The market risk premium is expected to be 4 percent over the risk free rate of 6 percent. The company's beta is currently quoted at 1.5 and is not expected to change for the foreseeable future.

Required:

Calculate the share price which might be expected by the market.

(04)

- Q.4 Following are the extracts of the balance sheet and profit and loss account of a closed end mutual fund M/s BCD Limited for the year ended June 30, 2003:

Balance Sheet (Partial)

	<u>Rs. in '000'</u>	
	<u>2003</u>	<u>2002</u>
Share Capital	595,000	595,000
Unappropriated Profit	486,327	24,362
Reserves	77,000	17,500
Unrealised appreciation in market value of securities	-	<u>98,448</u>
	<u>1,158,327</u>	<u>735,310</u>

Profit and Loss Account (Extract)

	<u>Rs. in 000</u>	
	<u>2003</u>	<u>2002</u>
Profit after tax	<u>512,267</u>	<u>148,400</u>
Income excluding unrealized appreciation	206,581	148,400
Unrealised appreciation in market value of securities	<u>205,696</u>	

Further information:

1. The Authorized Capital of the company is 87,500,000 Ordinary shares of Rs. 10 each.
2. The Issued, Subscribed and Paid up capital of the company is 59,500,000 Ordinary shares of Rs. 10 each. (2002 : 59,500,000)
3. Proposed Dividend Rs. 1.50 per share for 2003 (2002 : Rs.1.50).
4. The net assets value per share as at July 1, 2001 was Rs. 11.36.

Required:

Prepare a Statement of Movement in Reserves.

(10)

- Q.5 (a) What are bonus shares and what is the accounting treatment of bonus shares
- (i) by the recipient and
 - (ii) by the issuer. (04)
- (b) A company's fixed assets have been revalued by an independent valuer. It is suggested to charge depreciation on revalued amount while fixed assets to be carried in books at historical cost. Do you agree? If not why? (08)
- (c) Should the realized gain on sale of land be treated as a capital reserve or revenue reserve? Discuss. (06)

- Q.6 Factory Manager of GHI Company has given following results of an incomplete trial run for a product to be made on a newly installed facility in factory:

No.of units produced	Assembly plant Labour Hrs	Spray painting plant Labour Hrs	Finishing Deptt Labour Hrs
First	80 .00	161.50	40.00
Second	76 .00	90.44	39.20
Third	74 .20		
Fourth	74 .00		
Fifth	73 .50		
Sixth	72 .90		
Seventh	71 .70		
Eighth	70 .50		
Ninth - twentieth	70 .50 per unit		

Trial run is still in process and further results of spray painting plant and finishing department are yet to come.

The manager thinks that there will be a serious bottleneck at spray painting plant where product is piling up from assembly department.

When contacted, the designer and supplier of assembly and spray paint plants stated that reasonable smooth production flow is being experienced in all other factories where similar plants with similar pace and capacity were supplied earlier.

Required:

Under what conditions possibility of delay in spray painting department can be avoided. Explain the same with reference to learning curve theory.

(12)

- Q.7 Print Media Technologies Ltd (the company) manufactures computerized printing equipment used by newspaper publishers. In recent years, the company's market share has been eroded by stiff competition. Price and product quality are the two key areas in which companies compete in the market.

The CEO of the company decided to devote more resources to the improvement of product quality after learning that his company's products had been ranked fourth in product quality in a recent survey of newspaper publishers. He believed that the company could no longer afford to ignore the importance of product quality. The CEO set up a task force, which he headed to implement a formal quality-improvement program. Included in the task force were representatives from engineering, sales, customer service, production and accounting departments as the CEO believed this was a company wide program and all employees should share the responsibility for its success.

The company's quality improvement program has now been in operation for 18 months. Cost assistant has gathered the following costs data.

Print Media Technologies Ltd.
Costs data
(In thousands of Rupees)

	<i>Quarter ended</i>					
	<i>31/12/02</i>	<i>31/03/03</i>	<i>30/06/03</i>	<i>30/09/03</i>	<i>31/12/03</i>	<i>31/3/04</i>
Warrant repairs	69	31	24	25	23	23
Design review cost	20	102	111	100	104	95
Rework cost	120	106	114	88	78	62
Incoming inspection cost	45	53	57	36	34	22
Machine maintenance	215	215	202	190	170	160
Scrap cost	68	64	53	42	40	40
Final testing cost	160	160	154	140	115	94
Customer returns	262	251	122	116	87	80
Training suppliers	5	45	25	20	20	15
Total production cost	4,120	4,540	4,380	4,650	4,580	4,580

Required:

Prepare a "Cost of Quality Report" based on the above data.

(13)

(THE END)