ICMA Pakistan

27TH COMPREHENSIVE EXAMINATION

Saturday, the 23rd November 2013

Time Allowed – 2 Hours	**Maximum Marks – 60**	**Roll No.:**

(i) Attempt both the cases 1 and 2 carrying 30 marks each.
(ii) Answers must be neat, relevant and brief.
(iii) In marking the question paper, the examiners take into account clarity of exposition, logic of arguments, effective presentation, language and use of clear diagram or chart where appropriate.
(iv) Read the instructions printed on the top cover of answer script CAREFULLY before attempting the paper.
(v) Use of non-programmable scientific calculator of any model is allowed.
(vi) DO NOT write your Name, Reg. No. or Roll No. anywhere inside the answer script.
(vii) Multiple Choice Questions (MCQs) printed separately, is an integral part of this question paper.
(viii) Question paper must be returned to the invigilator before leaving the examination hall.

Marks

CASE # 1

The Nucleus Company presently has 2.2 million shares outstanding and Rs. 8 million in debt bearing an interest rate of 10% on average. It is considering a Rs. 5 million expansion program. There are different views about the financing of expansion program as stated below:

I The CEO is of the view that financing should be made exclusively with the ordinary shares, which will be realized at Rs. 10 per share.

II On the other hand, CFO proposed to finance the expansion wholly with debt bearing 11% rate of interest.

III Finance Manager put third option of financing of Rs. 5 million i.e., issuance of 10% preferred stock.

Earnings before interest and taxes (EBIT) after the new funds have been raised, are expected to be Rs. 6 million. However, CEO desires to evaluate the proposals in case of different amounts of EBIT as expected and it has been decided to assess the feasibility of financing at Rs. 3 million, Rs. 4 million and Rs. 8 million of EBIT. The company's tax rate is 35%.

Required:

(a) Determine likely earnings per share after financing for each of the three alternatives above at all levels of EBIT. **20**

(b) What would happen under the condition of Rs. 6 million EBIT? If the;

(i) interest rate on new debt were 8% and the preferred stock dividend rate were 7%? **05**

(ii) ordinary share could be sold for Rs. 20 per share? **05**

NOTE: Produce your answers providing the information in the following format under each condition:

	Ordinary Share	**Debt**	**Preferred Stock**
EBIT assumed	–	–	–
Profit before taxes	–	–	–
Profit after taxes	–	–	–
Earnings available to ordinary shareholders	–	–	–
Earnings per share (EPS)	–	–	–

CASE # 2

Marks

The Skill Limited is in an industry sector which is recovering from the recent recession. The directors of the company hope that from next year the company will be operating at 85% capacity, although currently the company is operating at only 65% capacity. At 65% capacity 10,000 units of the product are manufactured and sold. One hundred (100) direct workers are employed on production for 200,000 hours in the current year. The flexible budgets for the current year are:

			Rupees
Capacity Level	**55%**	**65%**	**75%**
Direct materials	1,692,400	2,000,000	2,307,600
Direct labour	2,961,700	3,500,000	4,038,300
Production overhead	1,192,340	1,300,000	1,407,660
Selling and distribution overhead	384,620	400,000	415,380
Administrative overhead	240,000	240,000	240,000
Total costs	6,471,060	7,440,000	8,408,940

Profit in any year is budgeted to be $16\frac{2}{3}$% of sales. The following percentage increases in costs are expected for next year:

	Increase (%)
Direct materials	6.0
Direct labour	3.0
Variable production overhead	7.0
Variable selling and distribution overhead	7.0
Fixed production overhead	10.0
Fixed selling and distribution overhead	7.5
Administrative overhead	10.0

Required:

You are required to:

(a) Prepare a flexible budget statement for next year on the assumption that the company operates at 85% capacity; your statement should show both contribution and profit. **21**

(b) Discuss briefly three problems which may arise from the change in capacity level. **04**

(c) State who is likely to serve on a budget committee operated by the Skill Limited and explain the purpose of such committee. **05**

THE END