Skillshort

Self-Study Preparation Pack

CS EXECUTIVE

Paper 4: Corporate Accounting and Financial Management (CAFM)

Mock Test 1 – Full Paper with Model Answers

ICSI Syllabus 2022 pattern: 100 marks · 3 hours (+15 minutes' reading) · Part I Corporate Accounting (60 marks) Q1–Q4 · Part II Financial Management (40 marks) Q5–Q6 · all questions compulsory · internal choice in Q4/Q4A and Q6/Q6A · Original Skillshort questions, all figures verified in Python

Time: 3 hours | Max marks: 100 | Answer ALL questions | Show working notes | Model answers follow the paper

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This subject pack has 6 parts

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Prepared by Skillshort for self-study. Original explanations and questions; not an official ICSI publication. Items marked VERIFY should be checked against the latest official material.

Question Paper

Answer ALL questions. Show working notes. Assume tax at 25% where not given. Present values may be taken to three decimals.

Part I – Corporate Accounting (60 marks)

Q1 Case study. Nirmal Foods Ltd. makes packaged snacks. Its summarised figures for 2025-26 (₹ lakh) are: Revenue from operations 1,200; cost of goods sold 840; other operating expenses 180; interest on 10% debentures 30; tax 25%. Balance sheet at 31 March 2026: equity share capital 300; other equity 300; 10% debentures 300; trade payables 150; other current liabilities 50; fixed assets 600; inventory 210; trade receivables 200; cash and bank 90. The Board wants to know whether the company is liquid, solvent and profitable before a bank review.

(i) Compute the current ratio and the quick ratio and comment. **(3 marks)**

(ii) Compute the debt-equity ratio and the interest coverage ratio. **(3 marks)**

(iii) Compute ROCE and ROE. **(3 marks)**

(iv) Compute the inventory turnover ratio and the average collection period (365 days). **(3 marks)**

(v) Break ROE into its three DuPont components and show that they give the same ROE. **(3 marks)**

Q2 (a) Vardhan Ltd. issued 1,00,000 equity shares of ₹10 each at par. The issue was underwritten: A 50%, B 30%, C 20%. Applications received: marked – A 38,000, B 22,000, C 12,000; unmarked 18,000. Compute the net liability of each underwriter and the commission at 2.5% of the issue price. **(5 marks)**

(b) Lalit held 500 shares of ₹10 each issued at a premium of ₹2 (₹3 on application, ₹5 on allotment including premium, ₹4 on first and final call). He paid only the application money and his shares were forfeited after the call. 300 of these shares were re-issued as fully paid at ₹8 per share. Pass journal entries for forfeiture and re-issue and compute the transfer to capital reserve. **(5 marks)**

(c) Kirti Ltd. had 10,000 12% debentures of ₹100 each. Holders of 40% of the debentures chose to convert them into equity shares of ₹10 each at ₹25 per share; the rest were redeemed at a premium of 5%. Pass journal entries. **(5 marks)**

Q3 (a) From the following, compute cash flow from operating activities (indirect method) of Sagar Ltd. for 2025-26 (₹'000): profit before tax 840; depreciation 160; loss on sale of machinery 20; interest on debentures 60; dividend received 15; increase in trade receivables 70; decrease in inventory 30; increase in trade payables 25; decrease in outstanding expenses 10; income tax paid 210. **(5 marks)**

(b) H Ltd. acquired 75% of the shares of S Ltd. for ₹6,50,000 when S Ltd. had share capital ₹5,00,000, general reserve ₹2,00,000 and profit and loss balance ₹40,000. At the balance-sheet date, S Ltd.'s general reserve was ₹2,00,000 and profit and loss balance ₹1,60,000. Compute goodwill, post-acquisition profit to be added to group reserves, and non-controlling interest. **(5 marks)**

(c) On 1 April 2023 Pragati Ltd. granted 100 options each to 500 employees, vesting after three years of service. Fair value per option at grant ₹30. Expected employees at vesting: 460 (end of Year 1), 450 (end of Year 2); options actually vested for 440 employees. Compute the expense to be recognised each year. **(5 marks)**

Q4 Answer the following (3 marks each):

(i) What is a qualifying asset under AS 16, and when does capitalisation of borrowing costs start and stop?

(ii) State the criteria for classifying an asset as current under Schedule III.

(iii) Meru Ltd. has paid-up equity capital ₹500 lakh (shares of ₹10), free reserves ₹700 lakh and secured debt ₹2,000 lakh. It proposes a buy-back at ₹40 per share. Compute the maximum number of shares it can buy back.

(iv) Sales are expected to rise from ₹200 crore to ₹250 crore. Assets of ₹120 crore and spontaneous liabilities of ₹30 crore vary with sales; net profit margin 6%; payout 50%. Compute the external funds needed.

(v) Distinguish free cash flow to the firm and free cash flow to equity.

OR Q4A Answer the following (3 marks each):

(i) Explain the treatment of government grants related to specific fixed assets under AS 12.

(ii) State the conditions for issue of bonus shares under s.63 of the Companies Act, 2013.

(iii) State the rules on the Debenture Redemption Reserve under rule 18(7) of the Companies (Share Capital and Debentures) Rules, 2014.

(iv) Profit after tax ₹50 lakh; preference dividend ₹8 lakh; 10 lakh equity shares. Compute basic EPS. If a 1:4 bonus issue is made after the year end but before approval of the accounts, what EPS is reported?

(v) Distinguish amalgamation in the nature of merger and amalgamation in the nature of purchase.

Part II – Financial Management (40 marks)

Q5 Case study. Kaveri Packaging Ltd. is considering a new line costing ₹50 lakh, with a life of 5 years and salvage value ₹5 lakh (straight-line depreciation ₹9 lakh a year). It needs additional working capital of ₹6 lakh, released at the end of Year 5. Profit before depreciation and tax: Year 1 ₹15 lakh, Year 2 ₹16 lakh, Year 3 ₹18 lakh, Year 4 ₹17 lakh, Year 5 ₹14 lakh. Tax 25%. Cost of capital 12%. The project will be financed 60% by equity and 40% by 10% debentures; risk-free rate 7%, beta 1.2, market return 13%.

(i) Compute annual cash flows after tax and the NPV at 12%. **(5 marks)**

(ii) Compute the profitability index and the discounted payback period. **(5 marks)**

(iii) Compute the IRR by interpolation and advise. **(5 marks)**

(iv) Compute the cost of equity (CAPM) and the WACC for the financing mix, and comment on whether 12% is a safe hurdle rate. **(5 marks)**

Q6 (a) Vega Ltd. sells 50,000 units at ₹100; variable cost ₹60 per unit; fixed costs ₹10 lakh; 10% debt ₹20 lakh. Compute operating, financial and combined leverage. **(5 marks)**

(b) EPS ₹15; cost of equity 12%; payout 40%. Using Walter's model, compute the price per share if the return on investment is 15%, 12% and 9%, and state the optimum payout in each case. **(5 marks)**

(c) Annual demand 24,000 units; ordering cost ₹150 per order; price ₹40 per unit; carrying cost 15% a year. Compute EOQ, the number of orders a year and total ordering and carrying cost at EOQ. **(5 marks)**

(d) Rhea bought 500 shares at ₹400, received dividends of ₹6,000 and sold the shares at ₹430 after one year. Compute the holding-period return and distinguish systematic and unsystematic risk. **(5 marks)**

OR Q6A (a) Using Gordon's model, compute the price of a share: EPS ₹12, retention 60%, return on investment 14%, cost of equity 12%. **(5 marks)**

(b) Estimate net working capital: production and sales 36,000 units a year evenly; per unit – raw material ₹50, labour ₹20, overheads ₹30, selling price ₹125. Raw material stock 1 month; WIP ½ month (material full, conversion 50%); finished goods 1 month; debtors 1½ months (at cost); creditors 1 month; wages paid ½ month in arrear; cash ₹50,000. **(5 marks)**

(c) 10% debentures of ₹100 are issued at ₹95 and redeemable at ₹105 after 5 years. Tax 25%. Compute the cost of debt (approximation method). **(5 marks)**

(d) Why is wealth maximisation a better objective than profit maximisation? **(5 marks)**

Model Answers

SOLUTION Q1 Nirmal Foods Ltd. (₹ lakh)

Working: EBIT = 1,200 − 840 − 180 = **180**; PBT = 180 − 30 = 150; PAT = 150 × 75% = **112.5**. Total assets = 600 + 210 + 200 + 90 = **1,100** = 600 + 300 + 200.

(i) Current assets = 210 + 200 + 90 = 500; current liabilities = 200.

Current ratio = 500 ÷ 200 = **2.5 : 1**

Quick ratio = (500 − 210) ÷ 200 = **1.45 : 1**

Both are above the usual norms (2 : 1 and 1 : 1) – the company is liquid; the high current ratio may also mean idle inventory.

(ii)

Debt-equity = 300 ÷ 600 = **0.5 : 1** (low, safe)

Interest coverage = EBIT 180 ÷ interest 30 = **6 times**

(iii)

ROCE = EBIT 180 ÷ capital employed (600 + 300) = **20%**

ROE = PAT 112.5 ÷ equity 600 = **18.75%**

ROCE (20%) is above the debenture rate (10%), so leverage is favourable.

(iv)

Inventory turnover = COGS 840 ÷ inventory 210 = **4 times** (about 91 days)

Collection period = 200 ÷ 1,200 × 365 = **60.83 days**

(v) ROE = net profit margin × asset turnover × equity multiplier

NPM = 112.5 ÷ 1,200 = 9.375%

Asset turnover = 1,200 ÷ 1,100 = 1.0909 times

Equity multiplier = 1,100 ÷ 600 = 1.8333

ROE = 9.375% × 1.0909 × 1.8333 = **18.75%** ✓ (same as (iii))

SOLUTION Q2 (a) Underwriters' liability (shares)

Particulars	A	B	C	Total
Gross liability (50 : 30 : 20)	50,000	30,000	20,000	1,00,000
Less marked applications	(38,000)	(22,000)	(12,000)	(72,000)
Balance	12,000	8,000	8,000	28,000
Less unmarked 18,000 in gross ratio 5 : 3 : 2	(9,000)	(5,400)	(3,600)	(18,000)
Net liability (shares)	**3,000**	**2,600**	**4,400**	**10,000**

Check: total applications 90,000 + 10,000 taken up = 1,00,000 ✓. **Commission** at 2.5% of issue price on shares underwritten: A ₹12,500; B ₹7,500; C ₹5,000 (total ₹25,000). Commission is payable on the whole amount underwritten, not only on the net liability.

SOLUTION Q2 (b) Forfeiture and re-issue

Particulars	Dr ₹	Cr ₹
Share capital A/c (500 × 10) Dr	5,000	
Securities premium A/c (500 × 2, not received) Dr	1,000	
To Share allotment A/c (500 × 5)		2,500
To Share first and final call A/c (500 × 4)		2,000
To Share forfeiture A/c (500 × 3 received)		1,500
Bank A/c (300 × 8) Dr	2,400	
Share forfeiture A/c (300 × 2 discount) Dr	600	
To Share capital A/c (300 × 10)		3,000
Share forfeiture A/c Dr	300	
To Capital reserve A/c		300

Capital reserve = forfeited on 300 shares (300 × 3 = 900) − discount on re-issue (600) = **₹300**

The premium not received is reversed because it was credited on allotment. Balance in share forfeiture A/c ₹600 (200 shares × ₹3) remains until those shares are re-issued.

SOLUTION Q2 (c) Conversion and redemption

- Debentures converted: 40% × 10,000 = 4,000 × ₹100 = **₹4,00,000** ÷ ₹25 = **16,000 equity shares** (capital ₹1,60,000; premium ₹2,40,000).
- Debentures redeemed: 6,000 × ₹105 = **₹6,30,000** (premium on redemption ₹30,000).

Particulars	Dr ₹	Cr ₹
12% Debentures A/c Dr	4,00,000	
To Debentureholders A/c		4,00,000
Debentureholders A/c Dr	4,00,000	
To Equity share capital A/c		1,60,000
To Securities premium A/c		2,40,000
12% Debentures A/c Dr	6,00,000	
Premium on redemption of debentures A/c Dr	30,000	
To Debentureholders A/c		6,30,000
Debentureholders A/c Dr	6,30,000	
To Bank A/c		6,30,000

Premium on redemption is written off against securities premium or profit and loss. If a DRR was created, transfer it to general reserve after redemption.

SOLUTION Q3 (a) Cash flow from operating activities (₹'000)

Particulars	₹'000
Profit before tax	840
Add: depreciation	160
Add: loss on sale of machinery	20
Add: interest on debentures (financing)	60
Less: dividend received (investing)	(15)
Operating profit before working-capital changes	**1,065**
Increase in trade receivables	(70)
Decrease in inventory	30
Increase in trade payables	25
Decrease in outstanding expenses	(10)
Cash generated from operations	1,040
Less: income tax paid	(210)
Net cash from operating activities	**830**

SOLUTION Q3 (b) Consolidation – analysis of S Ltd.'s equity

Net assets at acquisition = 5,00,000 + 2,00,000 + 40,000 = ₹7,40,000

Goodwill = cost 6,50,000 − 75% × 7,40,000 (5,55,000) = **₹95,000**

Post-acquisition profit = (1,60,000 − 40,000) = 1,20,000 → H's share 75% = **₹90,000** added to consolidated profit and loss

NCI = 25% × (5,00,000 + 2,00,000 + 1,60,000) = **₹2,15,000**

General reserve has not changed since acquisition, so it is entirely pre-acquisition. Goodwill is shown under intangible assets; NCI is shown within equity, separately from the parent's equity.

SOLUTION Q3 (c) ESOP expense (fair value ₹30, vesting 3 years)

Year	Cumulative expense	Expense for the year
1	460 × 100 × 30 × 1/3 = 4,60,000	**₹4,60,000**
2	450 × 100 × 30 × 2/3 = 9,00,000	**₹4,40,000**
3	440 × 100 × 30 × 3/3 = 13,20,000	**₹4,20,000**

Entry each year: Employee compensation expense A/c Dr; To Stock options outstanding A/c. On exercise, the balance in stock options outstanding is transferred to share capital and securities premium.

SOLUTION Q4

(i) A **qualifying asset** takes a **substantial period (normally 12 months or more)** to get ready for its intended use or sale. Capitalisation **starts** when expenditure and borrowing costs are being incurred and activities to prepare the asset are in progress; it is **suspended** during long interruptions of active development; it **stops** when substantially all activities to prepare the asset are complete. Income from temporary investment of specific borrowings is deducted.

(ii) An asset is **current** if it is (1) expected to be realised in, or held for sale or consumption in, the company's **normal operating cycle**; (2) held mainly for **trading**; (3) expected to be realised **within 12 months** after the reporting date; or (4) **cash or cash equivalent** not restricted for 12 months. All other assets are non-current. Where the operating cycle cannot be identified it is assumed to be 12 months.

(iii) Limits under s.68:

Test	Working	Shares (lakh)
25% of equity shares (if only equity)	25% × 50 lakh	12.5
25% of paid-up capital + free reserves	25% × 1,200 = 300 ÷ 40	7.5
Debt-equity not above 2 : 1 after buy-back	Minimum equity 2,000 ÷ 2 = 1,000; possible reduction 1,200 − 1,000 = 200 ÷ 40	**5.0**

Maximum buy-back = **5 lakh shares** (debt-equity test). As it exceeds 10% of capital + free reserves (₹120 lakh vs ₹200 lakh needed), a **special resolution** is required.

(iv)

Increase in assets = 120/200 × 50 = 30

Spontaneous liabilities = 30/200 × 50 = 7.5

Retained earnings = 6% × 250 × 50% = 7.5

EFN = 30 − 7.5 − 7.5 = **₹15 crore**

(v) FCFF is cash available to **all providers of capital** (equity and debt): EBIT(1 − t) + depreciation − capex − increase in working capital; discounted at **WACC** to value the firm. **FCFE** is cash left for **equity shareholders** after debt payments: FCFF − interest(1 − t) + net borrowing; discounted at the **cost of equity** to value equity.

SOLUTION Q4A

(i) Grants for specific fixed assets: either (a) **deduct** the grant from the gross value of the asset (depreciation is on the reduced amount; if the grant equals the whole cost, show the asset at a nominal value) or (b) treat it as **deferred income**, recognised in profit and loss over the useful life in proportion to depreciation. Grants in the nature of promoters' contribution go to **capital reserve**. A grant that becomes refundable is a revision of estimate.

(ii) Bonus shares may be issued from **free reserves, securities premium or capital redemption reserve** (not revaluation reserve), only if (1) **authorised by the articles**; (2) approved in a **general meeting** on the Board's recommendation; (3) **no default** in interest or principal of fixed deposits or debt securities; (4) **no default** in statutory dues of employees (PF, gratuity, bonus); (5) partly paid shares are made **fully paid** first; (6) bonus is **not in lieu of dividend**. Once announced by the Board, it cannot be withdrawn.

(iii) A DRR is **not required** for listed companies, NBFCs and HFCs (public issue or private placement) and for privately placed debentures of listed companies. **Unlisted companies** (other than NBFCs/HFCs) must create DRR of **10% of outstanding debentures**. Companies needing DRR must also **invest or deposit at least 15%** of debentures maturing in the year by **30 April** in specified securities VERIFY.

(iv)

Basic EPS = (50 − 8) ÷ 10 = **₹4.20**

A bonus issue after the year end but before approval is adjusted **retrospectively** (AS 20): shares = 10 + 2.5 = 12.5 lakh.

Reported EPS = 42 ÷ 12.5 = **₹3.36**

(v)

Basis	Merger	Purchase
Conditions	All 5 AS 14 conditions met (all assets/liabilities, 90% holders, consideration in equity, business continued, no adjustment to book values)	Any condition not met
Method	**Pooling of interests**	**Purchase method**
Values	Book values; reserves preserved	Fair values allowed; only statutory reserves preserved
Difference	Adjusted in reserves	Goodwill or capital reserve

SOLUTION Q5 Kaveri Packaging Ltd. (₹ lakh)

(i) Outlay = 50 + working capital 6 = **56**. CFAT = (PBDT − depreciation 9) × 75% + 9; Year 5 adds salvage 5 and working capital 6.

Year	PBDT	CFAT	DF @12%	PV
1	15	13.50	0.893	12.056
2	16	14.25	0.797	11.357
3	18	15.75	0.712	11.214
4	17	15.00	0.636	9.540
5	14	12.75 + 11 = 23.75	0.567	13.466
			Total PV	**57.633**

NPV = 57.633 − 56 = **₹1.633 lakh** (positive)

Salvage ₹5 lakh equals book value at the end of Year 5, so no tax on it.

(ii)

PI = 57.633 ÷ 56 = **1.029**

Cumulative PV: 12.056 → 23.413 → 34.627 → 44.167 after Year 4; balance 11.833 ÷ 13.466 = 0.88.

Discounted payback = 4.88 years (just within the 5-year life)

(iii) NPV at 14% (DF 0.877, 0.769, 0.675, 0.592, 0.519) = 54.635 − 56 = **−1.365**.

IRR = 12% + 1.633 ÷ (1.633 + 1.365) × 2% = **13.09%**

IRR (about 13.1%) > 12% → **accept**, but the margin is thin; test sensitivity to sales and salvage.

(iv)

Ke (CAPM) = 7% + 1.2 × (13% − 7%) = **14.2%**

Kd = 10% × (1 − 0.25) = 7.5%

WACC = 0.6 × 14.2% + 0.4 × 7.5% = 8.52% + 3.00% = **11.52%**

The 12% hurdle is above the WACC of 11.52%, so it is a **conservative** rate; at 11.52% the NPV is higher. Accept the project.

SOLUTION Q6 (a) Leverage (₹)

Contribution = 50,000 × (100 − 60) = 20,00,000

EBIT = 20,00,000 − 10,00,000 = 10,00,000; EBT = 10,00,000 − 2,00,000 = 8,00,000

DOL = 20 ÷ 10 = **2.0**; DFL = 10 ÷ 8 = **1.25**; DCL = 20 ÷ 8 = **2.5**

A 1% change in sales changes EPS by 2.5%.

SOLUTION Q6 (b) Walter's model: P = [D + (r/Ke)(E − D)] ÷ Ke, D = ₹6

r	Price at 40% payout	Optimum payout
15% (r > Ke, growth firm)	(6 + 1.25 × 9) ÷ 0.12 = **₹143.75**	0% – price ₹156.25
12% (r = Ke, normal firm)	(6 + 1 × 9) ÷ 0.12 = **₹125.00**	Any – price stays ₹125
9% (r < Ke, declining firm)	(6 + 0.75 × 9) ÷ 0.12 = **₹106.25**	100% – price ₹125

SOLUTION Q6 (c) EOQ

Carrying cost per unit = 15% × 40 = ₹6

EOQ = √(2 × 24,000 × 150 ÷ 6) = √12,00,000 = **1,095 units** (approx.)

Orders a year = 24,000 ÷ 1,095.4 = **about 22**

Ordering cost = 21.9 × 150 = ₹3,286; carrying cost = 1,095.4 ÷ 2 × 6 = ₹3,286; **total ₹6,572**

At EOQ, ordering cost equals carrying cost.

SOLUTION Q6 (d) HPR and risk

HPR = [(430 − 400) × 500 + 6,000] ÷ 2,00,000 = 21,000 ÷ 2,00,000 = **10.5%**

Systematic risk affects the whole market (interest rates, inflation, recession, changes in tax laws); it cannot be diversified away and is measured by **beta**. **Unsystematic risk** is specific to a company or industry (strike, loss of a contract, management fraud); it can be reduced by **diversification**.

SOLUTION Q6A (a) Gordon's model

g = b × r = 0.6 × 14% = 8.4%; D1 = 12 × 40% = ₹4.80

P = 4.80 ÷ (0.12 − 0.084) = **₹133.33**

SOLUTION Q6A (b) Working capital (monthly output 3,000 units; cost ₹100 a unit)

Item	Working	₹
Raw material	3,000 × 50 × 1 month	1,50,000
WIP	1,500 × (50 + 50% × 50)	1,12,500
Finished goods	3,000 × 100	3,00,000
Debtors (at cost)	4,500 × 100	4,50,000
Cash		50,000
Current assets		**10,62,500**
Less creditors	3,000 × 50	(1,50,000)
Less wages outstanding	36,000 × 20 ÷ 24	(30,000)
Net working capital		**8,82,500**

SOLUTION Q6A (c) Cost of debt

Kd = [I(1 − t) + (RV − NP) ÷ n] ÷ [(RV + NP) ÷ 2] = [7.5 + (105 − 95) ÷ 5] ÷ 100 = **9.5%**

SOLUTION Q6A (d) Wealth vs profit maximisation

Profit maximisation ignores the **timing** of returns (time value), ignores **risk**, uses an **ambiguous** measure (which profit – gross, net, short or long term?) and may encourage short-term decisions. **Wealth maximisation** maximises the **market value of shares** – the present value of expected cash flows discounted at a rate reflecting risk – so it considers timing, risk and the dividend policy, and serves all stakeholders over the long term. It is therefore the accepted objective of financial management.