Test Series: August, 2018

MOCK TEST PAPER – 1

INTERMEDIATE (NEW): GROUP – II

PAPER – 8: FINANCIAL MANAGEMENT& ECONOMICS FOR FINANCE

Time Allowed – 3 Hours **Maximum Marks – 100**

PAPER 8A : FINANICAL MANAGEMENT (60 Marks)

Answers are to be given only in English except in the case of the candidates who have opted for Hindi medium. If a candidate has not opted for Hindi medium his/ her answers in Hindi will not be valued.

Question No. ***1*** *is compulsory.*

Attempt any ***four*** *questions from the remaining* ***five*** *questions.*

Working notes should form part of the answer.

1. Answer the following:

(a) From the following information, PREPARE a summarised Balance Sheet as at 31st March, 20X6:

Working Capital	Rs.2,40,000
Bank overdraft	Rs.40,000
Fixed Assets to Proprietary ratio	0.75
Reserves and Surplus	Rs.1,60,000
Current ratio	2.5
Liquid ratio	1.5

(b) An enterprise is investing Rs.100 lakhs in a project. The risk-free rate of return is 7%. Risk premium expected by the management is 7%. The life of the project is 5 years. Following are the cash flows that are estimated over the life of the project.

Year	Cash flows (Rs.)
1	25,00,000
2	60,00,000
3	75,00,000
4	80,00,000
5	65,00,000

CALCULATE Net Present Value of the project based on Risk free rate and also on the basis of Risks adjusted discount rate.

(c) M Ltd. belongs to a risk class for which the capitalization rate is 10%. It has 25,000 outstanding shares and the current market price is Rs. 100. It expects a net profit of Rs. 2,50,000 for the year and the Board is considering dividend of Rs. 5 per share.

M Ltd. requires to raise Rs. 5,00,000 for an approved investment expenditure. ANALYSE, how the MM approach affects the value of M Ltd. if dividends are paid or not paid.

(d) PQR Ltd. has the following capital structure on October 31, 20X8:

Sources of capital	(Rs.)
Equity Share Capital (2,00,000 Shares of Rs. 10 each)	20,00,000
Reserves & Surplus	20,00,000

12% Preference Shares	10,00,000
9% Debentures	30,00,000
	80,00,000

The market price of equity share is Rs. 30. It is expected that the company will pay next year a dividend of Rs. 3 per share, which will grow at 7% forever. Assume 40% income tax rate.

You are required to COMPUTE weighted average cost of capital using market value weights.

(4 × 5 = 20 Marks)

2. A newly formed company has applied to the commercial bank for the first time for financing its working capital requirements. The following information is available about the projections for the current year:

Estimated level of activity: 1,04,000 completed units of production plus 4,000 units of work-in progress. Based on the above activity, estimated cost per unit is:

Raw material	Rs. 80 per unit
Direct wages	Rs. 30 per unit
Overheads (exclusive of depreciation)	Rs. 60 per unit
Total cost	Rs. 170 per unit
Selling price	Rs. 200 per unit

Raw materials in stock: Average 4 weeks consumption, work-in-progress (assume 50% completion stage in respect of conversion cost) (materials issued at the start of the processing).

Finished goods in stock	8,000 units
Credit allowed by suppliers	Average 4 weeks
Credit allowed to debtors/receivables	Average 8 weeks
Lag in payment of wages	Average $1\frac{1}{2}$ weeks

Cash at banks (for smooth operation) is expected to be Rs.25,000

Assume that production is carried on evenly throughout the year (52 weeks) and wages and overheads accrue similarly. All sales are on credit basis only.

CALCULATE

(i) Net Working Capital required;

(ii) Maximum Permissible Bank finance under first and second methods of financing as per Tandon Committee Norms. **(10 Marks)**

3. A company has to make a choice between two projects namely A and B. The initial capital outlay of two Projects are Rs.1,35,00,000 and Rs.2,40,00,000 respectively for A and B. There will be no scrap value at the end of the life of both the projects. The opportunity cost of capital of the company is 16%. The annual incomes are as under:

Year	Project A	Project B	Discounting factor @ 16%
1	--	60,00,000	0.862
2	30,00,000	84,00,000	0.743
3	1,32,00,000	96,00,000	0.641
4	84,00,000	1,02,00,000	0.552
5	84,00,000	90,00,000	0.476

You are required to CALCULATE for each project:

(i) Discounted payback period

(ii) Profitability index

(iii) Net present value **(10 Marks)**

4. The Modern Chemicals Ltd. requires Rs.25,00,000 for a new plant. This plant is expected to yield earnings before interest and taxes of Rs. 5,00,000. While deciding about the financial plan, the company considers the objective of maximising earnings per share. It has three alternatives to finance the project-by raising debt of Rs.2,50,000 or Rs.10,00,000 or Rs.15,00,000 and the balance, in each case, by issuing equity shares. The company's share is currently selling at Rs. 150, but is expected to decline to Rs.125 in case the funds are borrowed in excess of Rs.10,00,000. The funds can be borrowed at the rate of 10% upto Rs. 2,50,000, at 15% over Rs.2,50,000 and upto Rs.10,00,000 and at 20% over Rs.10,00,000. The tax rate applicable to the company is 50%.

   DETERMINE, which form of financing should the company choose? **(10 Marks)**

5. From the following, PREPARE Income Statement of Company A and B.

Company	**A**	**B**
Financial leverage	3:1	4:1
Interest	Rs.20,000	Rs.30,000
Operating leverage	4:1	5:1
Variable Cost as a Percentage to Sales	$66\frac{2}{3}\%$	75%
Income tax Rate	45%	45%

(10 Marks)

6. (a) STATE Agency Cost. DISCUSS the ways to reduce the effect of it.

   (b) EXPLAIN the importance of trade credit and accruals as source of short-term finance. DISCUSS the cost of these sources?

   (c) STATE two advantages of Walter Model of Dividend Decision. **(4 + 4 + 2 =10 Marks)**

PAPER – 8B: ECONOMICS FOR FINANCE

*Question No.7 is compulsory. Answer any **three** from rest.*

In case, any candidate answers extra question(s) / Sub -question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Working Notes should from part of the respective questions.

7. (a) The equilibrium level of real GDP is Rs 1,000 billion, the full employment level of real GDP is Rs 1,250 billion, and the marginal propensity to consume (MPC) is 0.60. How much government spending (ΔG) would be needed to raise income to full-employment level? **(2 Marks)**

(b) Explain how Reserve Bank of India acts as a 'lender of last resort 'to commercial banks? Or Explain the operation of Marginal Standing Facility? **(3 Marks)**

(c) Classify each of the following goods based on their characteristics. Mention the rationale.

(i) Open-access Wi-Fi networks

(ii) Roads with toll booths

(iii) Parks **(3 Marks)**

(d) Define Real Effective Exchange Rate (REER)? **(2 Marks)**

8. (a) (i) Explain the Cambridge Version of Cash Balance Approach

$M^d = k P Y$ **(3 Marks)**

(ii) Distinguish between 'pump priming' and 'compensatory spending' **(3 Marks)**

(b) (i) If an economy has a flat aggregate expenditure function, what would be the nature of the multiplier? **(2 Marks)**

(ii) Distinguish between private cost and social cost **(2 Marks)**

9. (a) (i) What is meant by Liquidity Adjustment Facility (LAF)? How does it help commercial banks? **(3 Marks)**

(ii) Define 'Moral Hazard' **(2 Marks)**

(b) You are given the following data on an economy (Rs. in Cores):

Investment expenditure (I):	250
Government expenditure on goods and services (G):	800
Exports (X):	600

All tax revenues are derived from a uniform rate of income tax of 30% of income.

Consumption expenditure is given by: $C = 0.75\ Y_d$; Where: Y_d is disposable national income (i.e. income less taxes) and C is consumption expenditure

Import expenditure is given by: $M = 0.15\ Y$ Where: Y is national income and M is import expenditure

(i) Calculate the equilibrium value of National Income.

(ii) Calculate the Current Account Balance at the equilibrium value of National Income.

(ii) Calculate the Fiscal Surplus (+) or Deficit (-) at the equilibrium value of National Income.

(5 Marks)

10. (a) (i) What is meant by 'monetary policy instruments' **(3 Marks)**

(ii) Estimate national Income by (a) Expenditure Method (b) Income Method From Following data **(3 Marks)**

	Rs. in Crores
Private Final Consumption Expenditure	210
Govt. Final Consumption Expenditure	50
Net domestic capital Formation	40
Net Exports	(-) 5
Wages and Salaries	170
Employers Contribution	10
Profit	45
Interest	20
Indirect Taxes	30
Subsidies	05
Rent	10
Factor Income from abroad	03
Consumption of Fixed capital	25
Royalty	15

(b) (i) What do you understand by the term 'Most-Favored-Nation' (MFN)? **(2 Marks)**

(ii) What's meant by free trade area? **(2 Marks)**

11. (a) (i) What is the rationale behind resource seeking foreign direct investments **(3 Marks)**

(ii) What is meant by 'safeguard measures' under WTO? **(2 Marks)**

(b) (i) What is the major determinant of the economic functions of a government **(3 Marks)**

(ii) What 's Arbitrage? What is the outcome of Arbitrage? **(2 Marks)**

Or

Define Money Multiplier **(2 Marks)**