Downloaded From www.scanneradda.com

Test Series: October, 2020

MOCK TEST PAPER

INTERMEDIATE (NEW): GROUP – II

PAPER – 8: FINANCIAL MANAGEMENT & ECONOMICS FOR FINANCE

PAPER 8A: FINANICAL MANAGEMENT

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.

Time Allowed – 3 Hours (Total time for 8A and 8B) **Maximum Marks – 60**

1. Answer the following:

(a) ABC Pvt. Ltd. is considering relaxing its present credit policy for accounts receivable and is in the process of evaluating two proposed policies. Currently, the company has annual credit sales of ₹ 50 lakhs and accounts receivable turnover ratio of 4 times a year. The current level of loss due to bad debts is ₹ 1,50,000. The company is required to give a return of 20% on the investment in new accounts receivable. The company's variable costs are 70% of the selling price. Given the following information, IDENTIFY which is the better policy?

(Amount in ₹)

Particulars	Present Policy	Proposed Policy 1	Proposed Policy 2
Annual credit sales	50,00,000	60,00,000	67,50,000
Accounts receivable turnover ratio	4 times	3 times	2.4 times
Bad debt losses	1,50,000	3,00,000	4,50,000

(b) The annual report of XYZ Ltd. provides the following information for the Financial Year 2019-20:

Particulars	Amount (₹)
Net Profit	50 lakhs
Outstanding 15% preference shares	100 lakhs
No. of equity shares	5 lakhs
Return on Investment	20%
Cost of capital i.e. (K_e)	16%

CALCULATE price per share using Gordon's Model when dividend pay-out is-

(i) 25%;

(ii) 50%;

(iii) 100%.

© The Institute of Chartered Accountants of India

Downloaded From www.scanneradda.com

(c) ABC Ltd. is considering a project "X" with an initial outlay of ₹ 16,00,000 and the possible three cash inflow attached with the project is as follows:

(Amount in ₹ '000)

Particular	Year 1	Year 2	Year 3
Scenario 1	550	500	800
Scenario 2	650	550	900
Scenario 3	750	600	1000

Assuming the cost of capital as 9%.

(i) DETERMINE NPV in each scenario.

(ii) If ABC Ltd. is certain about the 1st and 2nd year's results in scenario 2 but uncertain about the third year's cash flow, DETERMINE NPV expecting scenario 1 in the third year.

Year	1	2	3
DF @ 9%	0.917	0.842	0.772

(d) Using the information given below, PREPARE the Balance Sheet of SKY Private Limited:

(i)	Current ratio	1.6 :1
(ii)	Cash and Bank balance	15% of total current assets
(iii)	Debtors turnover ratio	12 times
(iv)	Stock turnover (cost of goods sold) ratio	16 times
(v)	Creditors turnover (cost of goods sold) ratio	10 times
(vi)	Gross profit ratio	20%
(vii)	Capital gearing ratio	0.6
(viii)	Depreciation rate	15% on W.D.V.
(ix)	Net fixed Assets	20% of total assets

(Assume all purchase and sales are on credit)

Balance Sheet of SKY Private Limited as at 31.03.2020

Liabilities	Amount in ₹	Assets		Amount in ₹
Share Capital	25,00,000	**Fixed assets**		
Reserve & surplus	?	Opening WDV	?	
12% Long term debt	?	Less: Depreciation	?	?
Current liabilities				
Creditors ?		**Current Assets**		
Provisions & outstanding expenses ?	68,50,000	Stock	?	
		Debtors	?	
		Cash and bank balance	?	?
Total	**?**	**Total**		**?**

(Detailed working notes are not required to be shown) **[4 × 5 Marks = 20 Marks]**

© The Institute of Chartered Accountants of India

Downloaded From www.scanneradda.com

2. Sinha Steel Ltd. requires ₹ 30,00,000 for a new plant which expects to yield earnings before interest and taxes of ₹ 5,00,000. While deciding about the financial plan, the company considers the objective of maximizing earnings per share. It has three alternatives to finance the project as follows -

Alternative	Debt	Equity Shares
1	₹ 2,50,000	balance
2	₹ 10,00,000	balance
3	₹ 15,00,000	balance

The company's share is currently selling at ₹ 200, but is expected to decline to ₹ 160 in case the funds are borrowed in excess of ₹ 10,00,000.

Slab wise interest rate for fund borrowed are as follows -

Fund Limit	Applicable Interest rate
up-to ₹ 2,50,000	10%
over ₹ 2,50,000 and up-to ₹ 10,00,000	15%
over ₹ 10,00,000	20%

The tax rate applicable to the company is 50 percent.

ANALYSE which form of financing should the company choose? **[10 Marks]**

3. P Ltd. has the following capital structure at book-value as on 31st March, 2020:

Particulars	(₹)
Equity share capital (10,00,000 shares)	3,00,00,000
11.5% Preference shares	60,00,000
10% Debentures	1,00,00,000
	4,60,00,000

The equity shares of the company are sold for ₹ 300. It is expected that the company will pay next year a dividend of ₹ 15 per equity share, which is expected to grow by 5% p.a. forever. Assume a 35% corporate tax rate.

Required:

(i) COMPUTE weighted average cost of capital (WACC) of the company based on the existing capital structure.

(ii) COMPUTE the new WACC, if the company raises an additional ₹ 50 lakhs debt by issuing 12% debentures. This would result in increasing the expected equity dividend to ₹ 20 and leave the growth rate unchanged, but the price of equity share will fall to ₹ 250 per share. **[10 Marks]**

4. A firm can make investment in either of the following two projects. The firm anticipates its cost of capital to be 10%. The pre-tax cash flows of the projects for five years are as follows:

Year	0	1	2	3	4	5
Project A (₹)	(2,00,000)	35,000	80,000	90,000	75,000	20,000
Project 8 (₹)	(2,00,000)	2,18,000	10,000	10,000	4,000	3,000

Ignore Taxation.

An amount of ₹ 35,000 will be spent on account of sales promotion in year 3 in case of Project A. This has not been taken into account in calculation of pre-tax cash flows.

© The Institute of Chartered Accountants of India

Downloaded From www.scanneradda.com

The discount factors are as under:

Year	0	1	2	3	4	5
PVF (10%)	1	0.91	0.83	0.75	0.68	0.62

You are required to calculate for each project:

(i) The payback period

(ii) The discounted payback period

(iii) Desirability factor

(iv) Net Present Value **[10 Marks]**

5. (a) Following Balance Sheet and Income Statement have been obtained from the books of accounts of Benaca Pvt. Ltd.

Balance Sheet as on March 31st 2020

Liabilities	Amount (₹)	Assets	Amount (₹)
Equity Capital (₹10 per share)	80,00,000	Net Fixed Assets	1,00,00,000
10% Debt	60,00,000	Current Assets	90,00,000
Retained Earnings	35,00,000		
Current Liabilities	15,00,000		
	1,90,00,000		1,90,00,000

Income Statement for the year ending March 31st 2020

Particulars	Amount (₹)
Sales	34,00,000
Less: Operating expenses (including ₹ 6,00,000 depreciation)	(12,00,000)
EBIT	22,00,000
Less: Interest	(6,00,000)
Earnings before tax	16,00,000

The tax rate applicable to the company is 35 percent.

(i) DETERMINE the degree of operating, financial and combined leverages at the current sales level, if all operating expenses, other than depreciation, are variable costs.

(ii) If total assets remain at the same level, but sales (i) increase by 20 percent and (ii) decrease by 20 percent, COMPUTE the earnings per share at the new sales level? **[8 Marks]**

(b) EXPLAIN certainty equivalents, one of the techniques of risk analysis. **[2 Marks]**

6. (a) DISCUSS Agency Problem and Agency Cost. **[4 Marks]**

(b) EXPLAIN in brief the features of Commercial Papers. **[4 Marks]**

(c) EXPLAIN Billing float and Mail float with reference to management of cash.

Or

STATE any four factors which need to be considered while planning for working capital requirement. **[2 Marks]**

© The Institute of Chartered Accountants of India

Downloaded From www.scanneradda.com

Section B: ECONOMICS FOR FINANCE

*Question No. **7** is compulsory.*

*Answer any **three** questions from the rest.*

Working notes should form parts of the respective answers.

Marks: 40

7. (a) Assume in an economy, saving function is S = -10 + 0.2Y and autonomous investment is I = 50 crore. Find out the equilibrium level of income and consumption. If investment increases by ₹ 5 crores, what will be the new level of income and consumption? **(3 Marks)**

   (b) Are health and education pure public goods? Comment **(2 Marks)**

   (c) Why does measurement of money supply essential from a monetary policy perspective? Explain. **(2 Marks)**

   (d) Which technical measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms. Explain with an example. **(3 Marks)**

8. (a) How do governments ensure that market power does not create distortions in the market? **(3 Marks)**

   (b) Do you think money is a unique store of value? **(2 Marks)**

   (c) Countries China and India have a total of 6000 hours each of labour available each day to produce shirts and trousers. Both countries use equal number of hours on each good each day. China produces 1000 shirts and 300 trousers per day. India produces 300 shirts and 200 trousers per day.

   In the absence of trade:

   i. Which country has absolute advantage in producing Shirts and Trousers?

   ii. Which country has comparative advantage in producing Shirts and Trousers? **(5 Marks)**

9. (a) Calculate Gross Domestic Product at market price (GDP_{MP}) and derive National Income from the following data (in Crores of Rupees) **(5 Marks)**

Particulars	**in ₹ Crore**
Inventory investment	400
Exports	350
Indirect taxes	150
Net factor income from abroad	- 75
Personal consumption expenditure	7500
Gross residential construction investment	700
Depreciation	100
Imports	200
Government purchases of goods and services	1800
Gross public investment	400
Gross business fixed investment	375

© The Institute of Chartered Accountants of India

Downloaded From www.scanneradda.com

(b) Define near public goods. Is it desirable to keep people away from such goods? Give comments. **(2 Marks)**

(c) Write a note on Cash Reserve Ratio (CRR). Explain the operation of CRR. **(3 Marks)**

10. (a) (i) Define common resources. Why are they overused? **(2 Marks)**

(ii) Explain the free rider problem. Give examples **(3 Marks)**

(b) Distinguish between Leakages and Injections in the circular flow of income? **(2 Marks)**

(c) Differentiate Trade- Related Investment Measures (TRIMS) and Trade-Related Aspects of Intellectual Property Rights (TRIPS). **(3 Marks)**

11. (a) Explain the Fisher's Quantity theory of demand for money? **(5 Marks)**

(b) (i) How are the following transactions treated in national income calculation? What is the rationale in each case? **(3 Marks)**

(1) Expenditure by government on providing free education.

(2) Capital gain on sale of a house.

(3) Mineral wealth of a nation.

(ii) Define Contractionary monetary policy **(2 Marks)**

OR

Differentiate Crawling Peg and Crawling Bands.

© The Institute of Chartered Accountants of India