Test Series: October, 2021

MOCK TEST PAPER - 1

INTERMEDIATE (NEW): GROUP – II

PAPER – 8: FINANCIAL MANAGEMENT & ECONOMICS FOR FINANCE

PAPER 8A: FINANCIAL 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) In respect of two companies having same business risk, following information is given:

Capital employed = ₹ 4,00,000; EBIT = ₹ 60,000; Ke = 12%

Sources	Levered Company (₹)	Unlevered Company (₹)
Debt (@10%)	1,50,000	Nil
Equity	1,50,000	3,00,000

Investor is holding 20% shares in levered company. CALCULATE increase in annual earnings of investor if he switches his holding from Levered to Unlevered company.

(b) The following is the capital structure of Sharda Ltd. as on 31.12.2020:

	(₹)
Equity shares: 2,00,000 shares (of ₹ 100 each)	2,00,00,000
9% Preference Shares (of ₹ 100 each)	60,00,000
8% Debentures	90,00,000
	3,50,00,000

The market price of the company's share is ₹ 120 and it is expected that a dividend of ₹ 12 per share would be declared for the year 2021. The dividend growth rate is 5% and the company is in the 30% tax bracket.

(i) CALCULATE the company's weighted average cost of capital.

(ii) Further, in order to finance an expansion plan, the company intends to borrow a fund of ₹ 2 crores bearing 12% rate of interest. In this situation, WHAT will be the company's revised weighted average cost of capital? This financing decision is expected to increase dividend from ₹ 12 to ₹ 14 per share. However, the market price of equity share is expected to decline from ₹ 120 to ₹ 115 per share.

In case of both (i) and (ii) above, use market value weight while calculating weighted average cost of capital.

(c) ABC Ltd. has total sales of 10,00,000 all of which are credit sales. It has a gross profit ratio of 25% and a current ratio of 2. The company's current liabilities are ₹ 2,00,000. Further, it has inventories of ₹ 80,000, marketable securities of ₹ 50,000 and cash of ₹ 30,000. From the above information:

(i) CALCULATE the average inventory, if the expected inventory turnover ratio is three times?

(ii) Also CALCULATE the average collection period if the opening balance of debtors is expected to be ₹ 1,50,000.

Assume 360 days a year.

(d) M Ltd. belongs to a risk class for which the capitalization rate is 12%. It has 40,000 outstanding shares and the current market price is ₹ 200. It expects a net profit of ₹ 5,00,000 for the year and the Board is considering dividend of ₹ 10 per share.

M Ltd. requires to raise ₹ 10,00,000 for an approved investment expenditure. ILLUSTRATE, how the MM approach affects the value of M Ltd. if dividends are paid or not paid.

[4 × 5 Marks = 20 Marks]

2. Sophisticated Limited is considering three financing plans. The key information is as follows:

(a) Total investment amount to be raised ₹ 4,00,000

(b) Plans of Financing Proportion:

Plans	Equity	Debt	Preference Shares
A	100%	-	-
B	50%	50%	-
C	50%	-	50%

(c) Cost of debt 10%

Cost of preference shares 10%

(d) Tax rate 30%

(e) Equity shares of the face value of ₹ 10 each will be issued at a premium of ₹ 10 per share.

(f) Expected EBIT is ₹ 10,00,000.

You are required to DETERMINE for each plan: -

(i) Earnings per share (EPS)

(ii) The financial break-even point.

(iii) Indicate if any of the plans dominate and compute the EBIT range among the plans for indifference.

[10 Marks]

3. Sadbhavna Limited is a manufacturer of computers. It wants to introduce artificial intelligence while making computers. It estimates that the annual savings from the artificial intelligence (AI) include a reduction of five employees with annual salaries of ₹ 3,00,000 each, ₹ 3,00,000 from reduction in production delays caused by inventory problem, reduction in lost sales ₹ 2,50,000 and ₹ 2,00,000 from billing issues.

The purchase price of the system for installation of artificial intelligence is ₹ 20,00,000 with installation cost of ₹ 1,00,000. The life of the system is 5 years and it will be depreciated on a straight-line basis. The salvage value is zero which will be its market value after the end of its life of five years.

However, the operation of the new system for AI requires two computer specialists with annual salaries of ₹ 5,00,000 per person. Also, the estimated maintenance and operating expenses of 1,50,000 is required.

The company's tax rate is 30% and its required rate of return is 12%.

From the above information:

(i) CALCULATE the initial cash outflow and annual operating cash flow over its life of 5 years.

(ii) Further, EVALUATE the project by using Payback Period, Net Present Value and Profitability Index.

(iii) You are also REQUIRED to obtain the cash flows and NPV on the assumption that book salvage value for depreciation purposes is ₹ 2,00,000 even though the machine is having no real worth in terms of its resale value. Also, the book salvage value of ₹ 2,00,000 is allowed for tax purposes.

Also COMMENT on the acceptability of the project in (ii) and (iii) above. **[10 Marks]**

4. The following figures and ratios are related to a company:

(i)	Sales for the year (all credit)	₹ 30,00,000
(ii)	Gross Profit ratio	25 percent
(iii)	Fixed assets turnover (based on cost of goods sold)	1.5
(iv)	Stock turnover (based on cost of goods sold)	6
(v)	Liquid ratio	1 : 1
(vi)	Current ratio	1.5 : 1
(vii)	Receivables (Debtors) collection period	2 months
(viii)	Reserves and surplus to Share capital	0.6 : 1
(ix)	Capital gearing ratio	0.5
(x)	Fixed assets to net worth	1.20 : 1

You are REQUIRED to prepare:

(a) Balance Sheet of the company on the basis of above details.

(b) The statement showing working capital requirement, if the company wants to make a provision for contingencies @ 10 percent of net working capital including such provision. **[10 Marks]**

5. (a) The following details of PQR Limited for the year ended 31st March, 2021 are given below:

Operating leverage	1.4
Combined leverage	2.8
Fixed Cost (Excluding interest)	₹ 2.10 lakhs
Sales	₹ 40.00 lakhs
10% Debentures of ₹ 100 each	₹ 25.00 lakhs
Equity Share Capital of ₹ 10 each	₹ 20.00 lakhs
Income tax rate	30 per cent

REQUIRED:

(i) Calculate Financial leverage

(ii) Calculate P/V ratio and Earning per Share (EPS)

(iii) If the company belongs to an industry, whose assets turnover is 1.6, does it have a high or low assets turnover?

(iv) At what level of sales, the Earning before Tax (EBT) of the company will be equal to zero?

In the question, assume that 10% Debentures and Share Capital consists of total liabilities.

[8 Marks]

(b) Write a short note on electronic fund transfer. **[2 Marks]**

6. (a) BRIEFLY explain the three finance function decisions. **[4 Marks]**

(b) EXPLAIN sensitivity analysis and its various steps. **[4 Marks]**

(c) WRITE two main objectives of Financial Management.

Or

BRIEFLY describe the financial needs of a business. **[2 Marks]**

PAPER 8B: ECONOMICS FOR FINANCE

Question 1 is compulsory

Students can answer 3 out of the 4 remaining

Maximum Marks – 40

1. (a) How is Personal Income and Disposable Personal Income defined and calculated? **(3 Marks)**

   (b) How Fiscal Policy had a strong influence on the performance of macro economy? **(2 Marks)**

   (c) Calculate the Operating Surplus **(3 Marks)**

Particulars	**₹ in Crores**
Compensation of employees	200
Intermediate Consumption	800
Rent	600
Interest	500
Consumption of fixed capital	300
Net Indirect Taxes	400
Mixed Income	700
Sales	2500

   (d) What are the analytics of Monetary Policy? **(2 Marks)**

2. (a) What is supra regional sector in an economy? **(2 Marks)**

   (b) What is the difference between Classical and Keynesian theory of determination of National Income? **(2 Marks)**

   (c) How is Cambridge approach different from classical approach in the theory of demand for money? **(3 Marks)**

   (d) What are the reason for superiority of Hecksher Ohlin theory of International Trade over the theory of comparative advantage? **(3 Marks)**

3. (a) What are the conceptual problem confronted in estimating national income? **(3 Marks)**

   (b) What are the role of subsidy as part of government intervention in public finance? **(2 Marks)**

   (c) How does fluctuations in exchange rate impact the domestic economy? **(3 Marks)**

   (d) What lead to emergence of WTO as a forum for Trade negotiation? **(2 Marks)**

4. (a) Market failure is a situation in which free market leads to misallocation of society's scarce resources? Comment **(2 Marks)**

   (b) Calculate National Income by Expenditure Method? **(3 Marks)**

Items	₹ In crore
Private Final Consumption Expenditure	1000
Government Final Consumption Expenditure	800
Net factor Income from abroad	40

Net Indirect Taxes	60
Net Exports	-80
Net Domestic Capital Formation	70
National debt Interest	50
Net Current Transfer to abroad	20

(c) What are the different modes of foreign Direct Investment? **(3 Marks)**

(d) What is open market operations? **(2 Marks)**

5. (a) What is the role of fiscal Policy during recession? **(3 Marks)**

(b) What are Club goods and how it is defined? **(2 Marks)**

(c) What are the impact of liquidity trap on the economy? **(3 Marks)**

(d) Why do people hold money balances? **(2 Marks)**