Test Series: March, 2019

MOCK TEST PAPER – 1

INTERMEDIATE: GROUP – II

PAPER – 8: FINANCIAL MANAGEMENT & ECONOMICS FOR FINANCE

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

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.

Maximum Marks – 60

1. Answer the following:

(a) With the help of following figures CALCULATE the market price of a share of a company by using:

(i) Walter's formula

(ii) Dividend growth model (Gordon's formula)

Earnings per share (EPS)	Rs. 10
Dividend per share (DPS)	Rs. 6
Cost of capital (k)	20%
Internal rate of return on investment	25%
Retention Ratio	60%

(b) From the following details of X Ltd., PREPARE the Income Statement for the year ended 31st March, 20X8:

Financial Leverage	2
Interest	Rs. 5,000
Operating Leverage	3
Variable cost as a percentage of sales	75%
Income tax rate	30%

(c) Using the following information, PREPARE and complete the Balance Sheet given below:

(i)	Total debt to net worth	:	1 : 2
(ii)	Total assets turnover	:	2
(iii)	Gross profit on sales	:	30%
(iv)	Average collection period	:	40 days
	(Assume 360 days in a year)		
(v)	Inventory turnover ratio based on cost of goods sold and year-end inventory	:	3
(vi)	Acid test ratio	:	0.75

Balance Sheet
as on March 31, 20X8

Liabilities	Rs.	Assets	Rs.
Equity Shares Capital	4,00,000	Plant and Machinery and other Fixed Assets	–
Reserves and Surplus	6,00,000		
Total Debt:		Current Assets:	
Current Liabilities	–	Inventory	–
		Debtors	–
	-	Cash	–

(d) Determine the risk adjusted net present value of the following projects:

	X	Y	Z
Net cash outlays (Rs.)	2,10,000	1,20,000	1,00,000
Project life	5 years	5 years	5 years
Annual Cash inflow (Rs.)	70,000	42,000	30,000
Coefficient of variation	1.2	0.8	0.4

The Company selects the risk-adjusted rate of discount on the basis of the coefficient of variation:

Coefficient of Variation	Risk-Adjusted Rate of Return	P.V. Factor 1 to 5 years At risk adjusted rate of discount
0.0	10%	3.791
0.4	12%	3.605
0.8	14%	3.433
1.2	16%	3.274
1.6	18%	3.127
2.0	22%	2.864
More than 2.0	25%	2.689

[4 × 5 = 20 Marks]

2. (a) LIST the factors determining the dividend policy of a company. **[3 Marks]**

(b) A bank is analysing the receivables of J Ltd. in order to identify acceptable collateral for a short-term loan. The company's credit policy is 2/10 net 30. The bank lends 80 percent on accounts where customers are not currently overdue and where the average payment period does not exceed 10 days past the net period. A schedule of J Ltd.'s receivables has been prepared. ANALYSE, how much will the bank lend on pledge of receivables, if the bank uses a 10 per cent allowance for cash discount and returns?

Account	Amount Rs.	Days Outstanding in days	Average Payment Period historically
74	25,000	15	20
91	9,000	45	60
107	11,500	22	24
108	2,300	9	10

114	18,000	50	45
116	29,000	16	10
123	14,000	27	48
	1,08,800		

[7 Marks]

3. X Ltd. is considering to select a machine out of two mutually exclusive machines. The company's cost of capital is 15 per cent and corporate tax rate is 30 per cent. Other information relating to both machines is as follows:

	Machine – I	**Machine – II**
Cost of Machine	Rs. 30,00,000	Rs. 40,00,000
Expected Life	10 years.	10 years.
Annual Income		
(Before Tax and Depreciation)	Rs. 12,50,000	Rs. 17,50,000

Depreciation is to be charged on straight line basis:

You are required to CALCULATE:

(i) Discounted Pay Back Period

(ii) Net Present Value

(iii) Profitability Index

The present value factors of Re.1 @ 15% are as follows:

Year	01	02	03	04	05
PV factor @ 15%	0.870	0.756	0.658	0.572	0.497.

[10 Marks]

4. A Company earns a profit of Rs.6,00,000 per annum after meeting its interest liability of Rs.1,20,000 on 12% debentures. The Tax rate is 50%. The number of Equity Shares of Rs.10 each are 80,000 and the retained earnings amount to Rs.18,00,000. The company proposes to take up an expansion scheme for which a sum of Rs.8,00,000 is required. It is anticipated that after expansion, the company will be able to achieve the same return on investment as at present. The funds required for expansion can be raised either through debt at the rate of 12% or by issuing equity shares at par.

Required:

(i) COMPUTE the Earnings per Share (EPS), if:
   - The additional funds were raised as debt
   - The additional funds were raised by issue of equity shares.

(ii) ADVISE the company as to which source of finance is preferable. **[10 Marks]**

5. A company needs Rs.31,25,000 for the construction of a new plant. The following three plans are feasible:

I The company may issue 3,12,500 equity shares at Rs. 10 per share.

II The company may issue 1,56,250 equity shares at Rs. 10 per share and 15,625 debentures of Rs. 100 denomination bearing a 8% rate of interest.

III The company may issue 1,56,250 equity shares at Rs. 10 per share and 15,625 cumulative preference shares at Rs. 100 per share bearing a 8% rate of dividend.

(i) if the company's earnings before interest and taxes are Rs. 62,500, Rs. 1,25,000, Rs. 2,50,000, Rs. 3,75,000 and Rs. 6,25,000, DETERMINE earnings per share under each of three financial plans? Assume a corporate income tax rate of 40%.

(ii) IDENTIFY which alternative would you recommend and why?

(iii) DETERMINE the EBIT-EPS indifference points by formulae between Financing Plan I and Plan II and Plan I and Plan III. **[10 Marks]**

6. (a) EXPLAIN the difference between Business risk and Financial risk

(b) EXPLAIN as to how the wealth maximisation objective is superior to the profit maximisation objective What is the cost of these sources?

(c) DISCUSS the dividend-price approach to estimate cost of equity capital **[4 + 4+ 2 =10 Marks]**

PAPER – 8 SECTION B : ECONOMICS FOR FINANCE

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 7 is ***compulsory question.***

Attempt ***any three*** *from the remaining four questions*

In case, any candidate answers extra questions(s)/sub-question(s)/sub-question(s) over and above the required number, then only the requisite number of questions first answered will be the evaluated the rest answer shall be ignored

Working Notes should form part of the answer.

Maximum Marks - 40

7. (a) What do you understand by the term 'final good"? **(2 Marks)**

(b) How would each of the following affect money multiplier and money supply?

(i) Fearing shortage of money in ATMs, people decides to hoard money.

(ii) Banks open large number of ATMs all over country.

(iii) During the festival season, people decide to use ATMs very often. **(3 Marks)**

(c) The table below shows the number of labour hours required to produce wheat and cloth in two countries X and Y.

Commodity	Country X	Country Y
1 unit of cloth	4	1.0
1 unit of wheat	2	2.5

(i) Compare the productivity of labour in both countries in respect of both commodities

(ii) Which country has absolute advantage in the production of wheat?

(iii) Which country has absolute advantage in the production of cloth? **(3 Marks)**

(d) What is meant by Crowding out? **(2 Marks)**

8. (a) The equilibrium level of income of an economy is Rs. 2,000 crores. The autonomous consumption expenditure is equal to Rs.100 crores and investment expenditure is Rs.500 crores. Calculate.

(i) Consumption expenditure level of National Income.

(ii) Marginal propensity to save and Marginal propensity to consume

(iii) Break-even level of Income. **(5 Marks)**

(b) (i) Describe rationale for the stabilisation function of government policy. **(3 Marks)**

(ii) Explain the concept of Demand for Money **(2 Marks)**

9. (a) (i) What is the crux of Heckscher-Ohlin theory of International Trade **(3 Marks)**

(ii) Define common resources? Why are they over used? **(2 Marks)**

(b) (i) Define Foreign Direct Investment (FDI). Mention two arguments made in favor of FDI to developing economies like India? **(3 Marks)**

(ii) What is the nature of relationship between investment and income according to Keynes? **(2 Marks)**

10. (a) (i) Explain the term Contractionary Fiscal Policy. What are the measures under taken in a contractionary fiscal policy? **(3 Marks)**

(ii) Explain the functioning of SLR? **(2 Marks)**

(b) (i) Explain why government imposes price ceilings **(3 Marks)**

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

11. (a) (i) Outline different components of monetary policy framework for India? **(3 Marks)**

(ii) Write a note on two major components of Reserve Money **(2 Marks)**

(b) (i) Define aggregate demand. How do you derive the Keynesian aggregate demand schedule?

(3 Marks)

(ii) What is mean by Anti-dumping duties? **(2 Marks)**

OR

Explain the term on market failure **(2 Marks)**