

Question Paper

Financial Management – II (MB2E2): October 2008

- Answer all 74 questions.
- Marks are indicated against each question.

Total Marks : 100

1. All of the following are examples of tax deductible expenses, except <Answer
>
- (a) Amortization charges
 - (b) Interest payments
 - (c) Salaries and wages paid
 - (d) Sales and administrative expenses
 - (e) Dividends on common shares. **(1 mark)**
2. Shelf stock refers to <Answer
>
- (a) Items that lost their value and sold as scraps
 - (b) Items that are stored by the firm and are not sold at all
 - (c) Items that are sold with a major modification to customers
 - (d) Items that are stored and sold by the firm on installment basis
 - (e) Items that are stored by the firm and sold with little or no modification to customers. **(1 mark)**
3. Which of the following is an assumption of the economic order quantity model? <Answer
>
- (a) Carrying cost per unit increases as the number of units ordered increases
 - (b) Delivery of the material within a certain time as the order is placed
 - (c) Purchase price per unit of the raw material increases as the number of units ordered decreases
 - (d) Ordering cost is constant
 - (e) Inventory level during the year varies as per the boom phase and recessionary phase in business. **(1 mark)**
4. If a project is expected to increase inventory by Rs.15,000, increase accounts payable by Rs.10,000 and decrease accounts receivable by Rs.1,000, what effect does working capital have during the life of the project? <Answer
>
- (a) Increases working capital by Rs.4,000
 - (b) Increase working capital by Rs.6,000
 - (c) Increases working capital by Rs.7,000
 - (d) Increases working capital by Rs.9,000 **2marks**
 - (e) No effect on working capital. **()**
5. If the average daily usage of material is 25,00 units, lead time for procuring material is 9 days, the average number of units per order is 600 units and the stock out acceptance factor is considered as 1.6, the reorder level is <Answer
>
- (a) 25,000 units
 - (b) 26,432 units
 - (c) 28,379 units
 - (d) 29,600 units
 - (e) 32,100 units. **marks**
(2)
6. Which of the following **does not** result from liberalizing credit standards? <Answer
>
- (a) It leads to higher bad debt loss
 - (b) It causes an increase in sales
 - (c) It reduces the cost of collection
 - (d) It increases the investment in receivables
 - (e) Requirement for financing working capital tends to increase. **(1 mark)**

7. _____ is a measure to increase the effective cost of imported goods in order to increase the demand for domestically produced goods. <Answer
>
- (a) Testing and certifications
 (b) Transit duty
 (c) Import duty
 (d) Export duty
 (e) Quality standards. **(1 mark)**
8. Anand Textiles Ltd. is considering to buy a new piece of equipment, which is expected to cost Rs.4,00,000 and will produce cash flows of Rs.1,00,000 every year for the next 6 years (the first cash flow will be exactly one year from today). The company has to invest in an upgrade which would cost Rs.1,20,000 in year 3, which would increase the annual cash flows from 4th year onwards to Rs.2,00,000. If the discount rate appropriate for the company is 15%, the NPV of the investment is approximately <Answer
>
- (a) Rs.28,765
 (b) Rs.36,674
 (c) Rs.45,295
 (d) Rs.49,672
 (e) Rs.52,605. **marks**
(3)
9. Playing the float indicates <Answer
>
- (a) Manipulating books of accounts
 (b) The company issuing cheques to the extent that the amount shown in the bank books is higher than the amount shown in the company's books.
 (c) Converting a credit customer into a cash customer
 (d) Expediting the implementation of the project to firm's convenience before sanction of loan
 (e) Purchasing machinery and dishonoring the instrument after delivery of machinery. **(1mark)**
10. Shahnaz Herbal Products Limited is considering the purchase of a new mixing machine to replace an existing machine that has a book value of Rs.1,65,000 and can be sold for Rs.1,00,000. The estimated salvage value of the old machine in five years would be zero and it is depreciated on a straight-line basis. The new machine will contribute Rs.3,00,000 as annual cash savings over the old machine. The new machine has a life of five years. The cost of new machine is Rs.6,50,000 and can be sold for an expected amount of Rs.90,000 at the end of fifth year. Assuming straight-line method of depreciation and a 35% tax rate, in the first year of operation the net cash flows associated with this replacement decision would be <Answer
>
- (a) Rs. 64,150
 (b) Rs. 93,550
 (c) Rs.1,32,650
 (d) Rs.2,22,650
 (e) Rs.3,12,650. **marks**
(3)
11. Which of the following capital budgeting methods focuses on firms' liquidity? <Answer
>
- (a) Payback period
 (b) Net present value
 (c) Annual capital charge
 (d) Internal rate of return
 (e) Accounting rate of return. **(1 mark)**
12. The export-import policy in India is announced by <Answer
>
- (a) FEDAI
 (b) Reserve Bank of India
 (c) Ministry of Commerce
 (d) Central Board of Direct Taxes
 (e) Ministry of Finance. **(1 mark)**
13. Under trading means <Answer
>
- (a) Low growth in sales.
 (b) Having low amount of working capital
 (c) High turnover of working capital
 (d) Assets are less compared to the sales generated
 (e) Too much of Funds of the company are locked up in current assets as compared to sales. **(1 mark)**

- 14 Which of the following theories of international trade explores the possibility of two nations operating at the same level of efficiency and benefiting themselves by trading with each other? <Answer
>
- (a) Imitation gap theory
 - (b) Heckscher-Ohlin model
 - (c) Theory of comparative advantage
 - (d) Theory of absolute advantage
 - (e) International product life cycle theory.
- (1 mark)**
- 15 A trader buys a call option on dollar with strike price of Rs.45 and premium of Rs.2. He will make profits when <Answer
>
- (a) Spot price > Rs.45
 - (b) Spot price > Rs.47
 - (c) Spot price < Rs.45
 - (d) Spot price < Rs.43
 - (e) Spot price > Rs.43.
- (1 mark)**
- 16 Which of the following statements is/are **not true** with respect to Hypothecation? <Answer
>
- I. Hypothecation is limited to immovable property.
 - II. The goods hypothecated will be in the possession of the borrower.
 - III. The goods hypothecated will be in the possession of the lender.
 - IV. The title of goods will be transferred to the lender.
- (a) Only (I) above
 - (b) Only (II) above
 - (c) Both (I) and (II) above
 - (d) Both (I) and (III) above
 - (e) (I), (III) and (IV) above.
- (1 mark)**
- 17 Which of the following are objectives of Credit Authorization Scheme (CAS) under Marathe committee? <Answer
>
- I. To ensure that additional bank credit is in conformity with the approved purposes and priorities and that the bigger borrowers pre-empt scarce resources.
 - II. To enforce financial discipline on the larger borrowers, where necessary, on uniform principles.
 - III. Where a borrower is financed by more than one bank, to ensure that the customer's proposal is assessed in the light of the information available with all the banks.
 - IV. To bring about improvements in the techniques of credit appraisal by banks and their system of follow-up.
- (a) Both (I) and (IV) above
 - (b) Both (II) and (III) above
 - (c) (I), (II) and (III) above
 - (d) (II), (III) and (IV) above
 - (e) All (I), (II), (III) and (IV) above.
- (1 mark)**
- 18 Which of the following are subsystems of the inventory management system? <Answer
>
- I. EOQ subsystem.
 - II. Stock-level subsystem.
 - III. Reorder point subsystem.
 - IV. Safety-stock subsystem.
- (a) Only (I) above
 - (b) Only (IV) above
 - (c) Both (I) and (IV) above
 - (d) (I), (II) and (III) above
 - (e) All (I), (II), (III) and (IV) above.
- (1 mark)**

- 19 What is the total cost of maintaining inventory if the annual consumption is 1,250 units, the carrying cost per unit is Rs.4, the cost per order is Rs.12 and there are 5 orders per year? [<Answer](#)
>
- (a) Rs.320
 - (b) Rs.500
 - (c) Rs.560
 - (d) Rs.600
 - (e) Rs.680.
- marks
(2)
- 20 Which of the following is/are **not** technique(s) for monitoring collection of receivables? [<Answer](#)
>
- I. Ageing schedule.
 - II. Collection matrix.
 - III. Days sales outstanding.
 - IV. Funds flow analysis.
- (a) Only (I) above
 - (b) Only (IV) above
 - (c) Both (I) and (III) above
 - (d) Both (II) and (IV) above
 - (e) All (I), (II), (III) and (IV) above.
- (1 mark)
- 21 Which of the following is **not** a part of “official reserve”? [<Answer](#)
>
- (a) Gold
 - (b) Reserve of convertible foreign currencies
 - (c) SDRs
 - (d) Balance with IMF
 - (e) Deposits of NRIs.
- (1 mark)
- 22 Which of the following techniques of project appraisal **does not** take into account the time value of money? [<Answer](#)
>
- (a) Benefit cost ratio
 - (b) Net present value
 - (c) Payback period
 - (d) Annual capital charge
 - (e) Internal rate of return.
- (1 mark)
- 23 Which of the following is/are assumptions of law of one price? [<Answer](#)
>
- I. There is no restriction on the movement of goods between countries.
 - II. There are no transportation costs involved.
 - III. There are no transaction costs involved in the buying and selling of goods.
 - IV. There are no tariffs.
- (a) Only (I) above
 - (b) Only (IV) above
 - (c) Both (I) and (III) above
 - (d) Both (II) and (IV) above
 - (e) All (I), (II), (III) and (IV) above.
- (1 mark)
- 24 Which of the following statements is/are **correct** for a project with a positive net present value? [<Answer](#)
>
- I. Internal rate of return exceeds the cost of capital.
 - II. Payback period will be more than the cut-off rate.
 - III. Benefit cost ratio is greater than 1.
- (a) Only (I) above
 - (b) Only (II) above
 - (c) Only (III) above
 - (d) Both (I) and (III) above
 - (e) All (I), (II) and (III) above.
- (1 mark)

- 25 Which of the following is **not** a spontaneous liability? <Answer
>
- (a) Term loans
 - (b) Sundry creditors
 - (c) Provision for taxes
 - (d) Provision for payment of bonus
 - (e) Salary accrued but not due.
- (1 mark)**
- 26 Multiple internal rates of return can occur, when there is <Answer
>
- I. Large abandonment costs at the end of a project's life.
 - II. A major shutdown and rebuilding of a facility sometime during its life.
 - III. One or more cash outflows interspersed with the cash inflows.
- (a) Only (I) above
 - (b) Only (III) above
 - (c) Both (I) and (II) above
 - (d) Both (II) and (III) above
 - (e) All (I), (II) and (III) above.
- (1 mark)**
- 27 If a project has a cost of Rs.60,000 and a profitability index of 0.5, <Answer
>
- (a) Its cash inflows are Rs.1,20,000
 - (b) Its net present value is Rs.30,000
 - (c) The present value of its' cash inflows is Rs.60,000
 - (d) Its internal rate of return is less than cost of capital
 - (e) Its pay back period is infinite number of years.
- (1 mark)**
- 28 Which of the following is **not** a function of World Trade Organization? <Answer
>
- (a) To limit harmful trade practices
 - (b) Overseeing national trade policies
 - (c) Acting as a forum for multilateral trade negotiations
 - (d) Cooperating with other international institutes involved in global trade policies
 - (e) Short-term financing for development of trade among member countries.
- (1 mark)**
- 29 Exports of goods and services are affected by <Answer
>
- I. Trade barriers.
 - II. Inflation rate.
 - III. Incomes of foreigners.
 - IV. World prices of a commodity.
 - V. The prevailing exchange rate of the domestic currency.
- (a) (I), (II) and (IV) above
 - (b) (I), (II) and (V) above
 - (c) (I), (III) and (IV) above
 - (d) (I), (II), (III) and (IV) above
 - (e) All (I), (II), (III), (IV) and (V) above.
- (1 mark)**
- 30 The US dollar is trading at CHF 1.0270. Interest rates prevailing in Switzerland and U.S.A. are 2% p.a. and 3% p.a. respectively. What is the 3 months forward quote for CHF/\$? <Answer
>
- (a) 1.0170
 - (b) 1.0245
 - (c) 1.0296
 - (d) 1.0370
 - (e) 1.0384.
- marks**
(2)
- 31 The average collection period measures the <Answer
>
- (a) Number of days it takes a typical cheque to "clear" through the banking system
 - (b) Number of days between the day a customer places an order with the firm and the day the firm sends the goods to the customers
 - (c) Number of days beyond the end of the credit period and before a typical customer payment is received
 - (d) Number of days between the day when a typical credit sale is made and the day when the firm receives the payment
 - (e) Number of days between the day a typical credit sale is made and the day a typical account becomes delinquent.
- (1 mark)**

32 Consider the following data:

[<Answer](#)
≥

Raw-material storage period	50 days
Average stock of raw materials	Rs.6,51,000
Average balance of trade creditors	Rs.2,65,000
Assume 360 days in a year and all purchases are made on credit	

If the closing stock of raw-materials is 10% higher than the opening stock of raw-materials, the average payment period is

- (a) 15 days
- (b) 18 days
- (c) 20 days
- (d) 25 days
- (e) 30 days.

marks
(2)

33 Which of the following statements is **true** about the terms of trade credit 2/10, net 30?

[<Answer](#)
≥

- (a) 10% cash discount is offered for payment before 30 days
- (b) 2% cash discount is awarded for payment on the 30th day after purchase
- (c) 10% cash discount can be taken if paid by the second day after invoicing
- (d) No cash discount is offered from the eleventh day onwards after the date of purchase
- (e) 2% cash discount can be taken for payment before the 10th of the following month after invoicing.

(1 mark)

34 What can be the annual cost for a firm, for maintaining accounts receivables if its daily sales are Rs.40,000, average collection period is 4 days, and cost of funds is 8% p.a.

[<Answer](#)
≥

- (a) Rs.12,800
- (b) Rs.10,000
- (c) Rs. 7,500
- (d) Rs. 5,500
- (e) Rs. 3,000.

marks
(2)

35 The annual usage of a raw material is 40,000 units for the Blue Moon Corp., The price of the raw material is Rs.50 per unit. The ordering cost is Rs.200 per order and the carrying cost is 20 percent of the average value of inventory. The supplier has recently introduced a discount of 4 percent on the price of material for orders of 15,00 units and above. The company's net incremental benefit after the introduction of discount is

[<Answer](#)
≥

- (a) Rs.79,610
- (b) Rs.75,875
- (c) Rs.80,125
- (d) Rs.80,000
- (e) Rs.80,225.

marks
(3)

36 Short-term portfolio investments are recorded in which of the following accounts of Balance Of Payments (BOP) statement?

[<Answer](#)
≥

- (a) Investment income
- (b) Unilateral transfers
- (c) Current account
- (d) Capital account
- (e) Official reserves account.

(1 mark)

37 Which of the following is **not** a principle for determining the costs and benefits of projects

[<Answer](#)
≥

- (a) Cash flows must be defined in post tax terms
- (b) The cash flows must be determined in incremental terms
- (c) All costs and benefits must be measured in terms of cash flows
- (d) Interest on long term funds must be excluded from the determination of net cash flows
- (e) All revenues and costs accrued must be considered as benefits and costs respectively.

(1 mark)

38 In futures trading the margin is deposited by

[<Answer](#)
≥

- (a) Seller of the contract
- (b) Buyer of the contract
- (c) Both the parties to the contract
- (d) Clearing house
- (e) The broker.

(1 mark)

39 Ronald is building a manufacturing plant that will require a cash outlay of Rs.5,00,000 for the initial purchase of a building, Rs.3,50,000 for remodeling in the first year and Rs.5,10,000 for new equipment in the second year. Its marginal tax rate is 30%. If the firm's cost of capital is 12 percent, what is the present value of the net investment?

[<Answer](#)
≥

- (a) Rs. 2,00,000
- (b) Rs. 3,00,000
- (c) Rs.12,19,020
- (d) Rs.14,94,480
- (e) Rs.16,76,210.

marks
(2)

40 The following information pertains to Kamal Industries Ltd.

[<Answer](#)
≥

Years	Cash flows (Rs.)
0	(22,000)
1	10,000
2	12,000
3	4,000

The discount rate is 12%. The profitability index of the project is

- (a) 0.97
- (b) 0.62
- (c) 1.03
- (d) 1.12
- (e) 1.97.

marks
(2)

41 Which of the following are the quantitative measures used by the company to prove its creditworthiness in order to enjoy trade credit from the suppliers?

[<Answer](#)
≥

- I. A free and frank discussion with the suppliers.
- II. Good track record of profitability and liquidity.
- III. A record of prompt payments by the company to other suppliers.
- IV. Negotiation with suppliers for payments to synchronize with the company's cash inflows.

- (a) Both (I) and (III) above
- (b) Both (II) and (III) above
- (c) Both (III) and (IV) above
- (d) (I), (II) and (III) above
- (e) (II), (III) and (IV) above.

(1 mark)

42 The following information is related to Beta Company:

[<Answer](#)
≥

Annual Consumption of raw materials	= Rs.700 lakh
Inventory of Raw materials at the beginning of the year	= Rs. 30 lakh
Inventory of Raw materials at the end of the year	= Rs. 50 lakh
The outstanding balances for the creditors at the beginning of the year	= Rs. 79 lakh
The outstanding balances for the creditors at the end of the year	= Rs. 93 lakh.

The average payment period for the company (Assuming one year is equal to 360 days and all purchases are made on credit only) will be

- (a) 39 days
- (b) 43 days
- (c) 47 days
- (d) 51 days
- (e) 55 days.

marks
(2)

[<Answer](#)
>

43 Consider the following information with regard to a firm :

Raw material storage period	=	40 days
Work-in-process period	=	25 days
Finished goods storage period	=	20 days
Average collection period	=	25 days
Average payment period	=	25 days

The operating cycle period is

- (a) 20 days
- (b) 65 days
- (c) 85 days
- (d) 90 days
- (e) 130 days.

marks
(2)

[<Answer](#)
>

44 Which of the following is **not** an internal hedging technique?

- (a) Sourcing
- (b) Leading and lagging
- (c) Choosing the currency of invoice
- (d) Exposure netting
- (e) Money markets.

(1 mark)

[<Answer](#)
>

45 Which of the following is **not** a variable associated with credit policy?

- (a) Credit standards
- (b) Credit period
- (c) Credit evaluation
- (d) Cash discount
- (e) Collection program.

(1 mark)

[<Answer](#)
>

46 Lead time refers to

- (a) Work in process time
- (b) The time gap between two orders
- (c) The time finished goods lie as inventories
- (d) The period in which a whole lot of inventory is consumed
- (e) The time gap between placing of the order and procuring the material.

(1 mark)

[<Answer](#)
>

47 Which of the following is/are **true** regarding the limitation(s) of Ageing schedule?

- I. It is influenced by the sales pattern.
- II. It is influenced by the payment behaviors of the customer.
- III. It is influenced by the credit period.

- (a) Only (I) above
- (b) Only (II) above
- (c) Both (I) and (II) above
- (d) Both (I) and (III) above
- (e) All (I), (II) and (III) above.

(1 mark)

[<Answer](#)
>

48 Which of the following is **not** an item of current Liabilities?

- (a) Sundry creditors
- (b) Advances from customers
- (c) Hire purchase dues
- (d) Unclaimed dividends
- (e) Debentures.

(1 mark)

49 Which of the following is/ are the major reason(s) for the Purchasing Power of Parity (PPP) theory not holding good?

[<Answer](#)
≥

- I. Constrains on movement of commodities.
- II. Price index construction.
- III. Effect of the statistical method employed.

- (a) Only (I) above
- (b) Only (II) above
- (c) Only (III) above
- (d) Both (I) and (III) above
- (e) All (I), (II) and (III) above.

(1 mark)

50 The sales figures of Mr. Mohan Ltd., are as follows:

[<Answer](#)
≥

Month and Year	Sales in Rs.
Jan, 2008	1,20,000
Feb, 2008	1,40,000
March, 2008	1,60,000

The receivables from the credit sales are expected to be collected in the following manner: 25% of the receivables are collected in the month of sales, 50% of the sales are collected one month after the month of sale and 25% after two months from the date of sale. The total cash receipts from sales in the month of March 2008 were

- (a) Rs. 70,000
- (b) Rs.1,10,000
- (c) Rs.1,20,000
- (d) Rs.1,36,000
- (e) Rs.1,40,000.

marks
(2)

51 Total current assets of a company are Rs.960 lakh while the current liabilities (other than bank borrowings) are Rs.300 lakh. If the company borrowed Rs.350 lakh, what will be the amounts of Maximum Permissible Bank Finance (MPBF) under the (method I) of the Tandon committee recommendations?

[<Answer](#)
≥

- (a) Rs.495 lakh
- (b) Rs.500 lakh
- (c) Rs.505 lakh
- (d) Rs.510 lakh
- (e) Rs.515 lakh.

marks
(2)

52 In which of the following types of factoring the bad debt loss is **not** borne by the factor?

[<Answer](#)
≥

- (a) Full Factoring
- (b) Recourse Factoring
- (c) Maturity Factoring
- (d) Invoice Discounting
- (e) Non Recourse Factoring.

(1 mark)

53 Which of the following items is **not** considered while calculating finished goods storage period?

[<Answer](#)
≥

- (a) Cost of production
- (b) Credit purchases
- (c) Financial costs
- (d) Excise duty
- (e) Selling and distribution costs.

(1 mark)

54 In economic appraisal of projects, the project is studied from the point of view of the

[<Answer](#)
≥

- (a) Suppliers
- (b) Customers
- (c) Employees
- (d) Shareholders
- (e) Society.

(1 mark)

55 During the four busiest days in a month, the finance manager estimates the cash outflows to be

<Answer
>

Rs.12,000, Rs.18,000, Rs.24,000 and Rs.36,000. The finance manager desires sufficient cash to cover payments for 5 days during the peak periods. The safety level of cash to be maintained is

- (a) Rs. 40,000
- (b) Rs. 60,000
- (c) Rs. 90,000
- (d) Rs.1,80,000
- (e) Rs.2,00,000.

marks
(2)

56 Raj Industries Limited is planning for a capital investment at a cost of Rs.150 crore where the projected cash inflows are as follows:

<Answer
>

(Rs. in crore)

Year	1	2	3	4
Cash inflows	35.0	40.0	60.0	50.0

The internal rate of return (IRR) of the project is

- (a) 6.50%
- (b) 7.25%
- (c) 8.30%
- (d) 9.20%
- (e) 12.15%.

marks
(2)

57 Which of the following statements is/are **false** regarding Foreign Direct Investment (FDI)?

<Answer
>

- I. FDI is made in financial assets.
- II. FDI can be made by establishing a branch or subsidiary in a foreign country.
- III. FDI usually results in managerial control over the operations of the foreign entity.

- (a) Only (I) above
- (b) Only (II) above
- (c) Only (III) above
- (d) Both (I) and (II) above
- (e) Both (II) and (III) above.

(1 mark)

58 The rates available in the Kolkata market are as follows:

<Answer
>

Rs./\$ Spot 43.10/12
\$/£ 1.9662/1.9665

If an Indian importer requires pounds, the rate quoted to him is

- (a) Rs.84.74/£
- (b) Rs.84.76/£
- (c) Rs.84.78/£
- (d) Rs.84.80/£
- (e) Rs.84.82/£.

marks
(2)

59 The following figures are collected from annual reports of Futures Group:

<Answer
>

Particular	2007 (in Rs. 000)	2008 (in Rs.000)
Raw materials inventory – Closing Balance	160	182
Work in process inventory – Closing Balance	24	30
Purchases of raw materials during the year	900	11,00
Manufacturing expenses during the year	11,65	12,60
Depreciation	85	100

What should be the average conversion period of Futures Group for the year 2008? (Assume 360 days in a year)

- (a) 2 days
- (b) 4 days
- (c) 8 days
- (d) 9 days
- (e) 12 days.

marks
(2)

60 Dumping means

<Answer
≥

- (a) Destroying the goods to create scarcity
- (b) Throwing the goods in the sea to create scarcity
- (c) Donating the goods to least developed countries as charity
- (d) Selling the goods at actual cost
- (e) Selling the goods below the cost.

(1 mark)

61 Other things remaining the same, which of the following would increase the Economic Order

<Answer
≥

• Quantity (EOQ)?

- I. Increase in the carrying cost.
- II. Increase in the fixed cost per order.
- III. Increase in the Annual usage of material.

- (a) Only (I) above
- (b) Only (II) above
- (c) Only (III) above
- (d) Both (I) and (II) above
- (e) Both (II) and (III) above.

(1 mark)

62 Which of the following statements are **not true**?

<Answer
≥

- I. If the spread between credit period and cash discount period is greater, the cost of trade credit will be higher.
- II. If the spread between credit period and cash discount period is lower, the cost of trade credit will be higher.
- III. If the discount rate increases, the cost of trade credit decreases.
- IV. If the discount period decreases, the cost of trade credit decreases.

- (a) Both (I) and (III) above
- (b) Both (I) and (IV) above
- (c) Both (II) and (IV) above
- (d) (I), (III) and (IV) above
- (e) (II), (III) and (IV) above.

(1 mark)

63 While taking up an overseas project, a company has to take into account

<Answer
≥

- I. Political Risk.
- II. Sovereign Risk.
- III. Inflation Risk.
- IV. Currency Risk.

- (a) Both (I) and (II) above
- (b) Both (II) and (III) above
- (c) Both (III) and (IV) above
- (d) (II), (III) and (IV) above
- (e) All (I), (II), (III) and (IV) above.

(1 mark)

64 If the cost of an investment is Rs.8,000 and it pays Rs.225 in perpetuity at an interest rate of 6%, the benefit cost ratio of the investment is

<Answer
≥

- (a) 0.262
- (b) 0.312
- (c) 0.469
- (d) 0.654
- (e) 0.752.

marks
(2)

65 Which of the following aspects of internal audit judges the efficiency and effectiveness of the system when put into operation?

<Answer
≥

- (a) Expertize
- (b) Objectivity
- (c) Totality
- (d) Utility
- (e) Independence.

(1 mark)

- 66 In which of the following cases a project will **not** be accepted? <Answer
>
- (a) Net present value is greater than zero
 - (b) Benefit cost ratio is less than one
 - (c) Net benefit cost ratio is less than one
 - (d) Cost of capital is less than the Internal rate of return
 - (e) IRR is greater than the weighted average cost of capital. (1 mark)
- 67 The wealth ratio for the year 2005, 2006, and 2007 are 1.12, 1.24 and 1.51 respectively. The realized yield would be <Answer
>
- (a) 20%
 - (b) 28%
 - (c) 30%
 - (d) 35%
 - (e) 40%. marks
(2)
- 68 Which of the following is **false** regarding Currency Board System? <Answer
>
- (a) A high inflation in the domestic markets can result in low or even negative real interest rate
 - (b) Stable exchange rates act as incentive to international trade and investment
 - (c) The currency board has discretionary powers over the monetary policy
 - (d) The currency board does not lend to even the domestic banks as it cannot act as the lender of last resort
 - (e) Under currency board system, the value of the domestic currency is pegged to a foreign currency. (1 mark)
- 69 If the material is priced at the value that is realizable at the time of issue, such pricing method is known as <Answer
>
- (a) Standard price method
 - (b) Replacement price method
 - (c) Last-In-First-Out method
 - (d) Weighted average cost method
 - (e) First-In-First-Out method. (1 mark)
- 70 Sameera industries and Neethu industries are faced with the same potential investment. The project costs Rs.12 million and will result in cash flows of Rs.5 million per year of the next 3 years. Sameera industries cost of capital is 8%, while Neethu industries cost of capital is 16%. Based on NPV and BCR analysis, which of the following statements is/ are **true**? <Answer
>
- (a) Since NPV of both industries is positive both the industries can invest in the project.
 - (b) Since NPV is positive and BCR more than one, Sameera Industries can invest in the project.
 - (c) Since NPV is positive and BCR is more than one, Neethu Industries can invest in the project.
 - (d) Though NPV is positive, since BCR is less than one, Sameera Industries cannot invest in the project.
 - (e) Though NPV is positive, since BCR is less than one, Neethu Industries cannot invest in the project. marks
(2)
- 71 Which of the following is **not** a limitation of the static view of working capital? <Answer
>
- (a) The amount of working capital is obtained from the data contained in the balance sheet as on that date
 - (b) The amount of net working capital obtained by subtracting current liabilities from current assets presented in the balance sheet fails to reflect the true amount of net working capital
 - (c) Current assets do not include marketable securities whose main motive is to improve the liquidity position and are held for shorter periods such as treasury bills
 - (d) Short term bank borrowing obtained for financing current assets are not part of current liabilities
 - (e) Gross working capital is equal to the total of all the current assets. (1 mark)
- 72 How should a financial manager select one of two mutually exclusive projects that have different risk? <Answer
>
- (a) Choose any of the two projects
 - (b) Choose the project with the least relative risk
 - (c) Choose the project with greater return even if that project has greater risk
 - (d) Choose the project with less risk even though that project has less return
 - (e) Select the project with the larger risk-adjusted net present value. (1 mark)

<Answer
>

73 Exchange rate system where the central bank intervenes to smoothen out exchange rate fluctuations is known as

- (a) Free float
- (b) Clean float
- (c) Managed float
- (d) Fixed rate system
- (e) Floating rate system.

(1 mark)

<Answer
>

74 Consider the following

Opening stock of finished goods	=	Rs.2,82,000
Closing stock of finished goods	=	Rs.2,50,000
Cost of production	=	Rs.5,16,800
Selling administration and financial expenditure	=	Rs. 2,950
Custom and excise duty	=	Rs. 5,000

Finished goods storage period (in days) for the company assuming 360 days in a year is

- (a) 39 days
- (b) 153 days
- (c) 172 days
- (d) 192 days
- (e) 365 days.

marks
(2)

END OF QUESTION PAPER

Suggested Answers

Financial Management – II (MB2E2): October 2008

- | | ANSWER | REASON | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|-------------------------------|--|--|-------------------------|--|-------------------------------|-----|-----------------|----------|-------------------------|------------|-----|-----|-----|--|--|--|---|---|---|---|---|---|---|---|---|---|---|---|---|---|------|-----|-----|-----|-----|-----|-----|------|-----|-----|-----|-----|-----|-----|-------------------------|
| 1. | E | Dividends on common shares are not tax deductible expenses. All the other mentioned items are tax-deductible expenses. Hence, alternative (e) is correct. | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 2. | E | Shelf stock refers to items that are stored by the firm and sold with little or no modification to customers | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 3. | D | The assumptions of the economic order quantities are as follows: <ul style="list-style-type: none"> • Constant or uniform demand of the product throughout the year Constant unit price of the raw material

Constant carrying cost of the material

Constant ordering cost

Instantaneous delivery of the materials.

Hence, the option (d) is the correct choice. | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 4. | A | Change in current asset = +15000 – 1000= R. 14000
Change in current liabilities = 10,000.
Change in working capital = 14000-10000= Rs. 4000. | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 5. | C | Reorder level = $S \times L + F \sqrt{S \times R \times L}$, where the notations are in their standard use.

$= 25,00 \times 9 + 1.6 \times \sqrt{25,00 \times 600 \times 9}$ $= 28,379 \text{ units.}$ | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 6. | C | When credit standards are liberalized the receivables increase; hence the cost of collection increases. All other alternatives than (c) represent the consequences that result from liberalizing credit standards. | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 7. | C | Import duty is levied to increase the effective cost of imported goods in order to increase the demand for domestically produced goods. | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 8. | D | In the scenario given, the cash flows would look like this: <table border="1" style="margin: 10px auto; border-collapse: collapse; text-align: center;"> <thead> <tr> <th colspan="7">Year</th> <th colspan="7">Rs.(‘000s)</th> </tr> <tr> <th>0</th><th>1</th><th>2</th><th>3</th><th>4</th><th>5</th><th>6</th> <th>0</th><th>1</th><th>2</th><th>3</th><th>4</th><th>5</th><th>6</th> </tr> </thead> <tbody> <tr> <td>-400</td><td>100</td><td>100</td><td>-20</td><td>200</td><td>200</td><td>200</td> <td>-400</td><td>100</td><td>100</td><td>-20</td><td>200</td><td>200</td><td>200</td> </tr> </tbody> </table> $= -400 + \frac{100}{1.15} + \frac{100}{(1.15)^2} - \frac{20}{(1.15)^3} + \frac{200}{(1.15)^4} + \frac{200}{(1.15)^5} + \frac{200}{(1.15)^6}$ $= -400 + 86.956 + 75.614 - 13.150 + 114.351 + 99.435 + 86.466$ $= -400 + 449.672$ $= \text{Rs.}49.672 \text{ thousands}$ $= \text{Rs.}49,672.$ | Year | | | | | | | Rs.(‘000s) | | | | | | | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 0 | 1 | 2 | 3 | 4 | 5 | 6 | -400 | 100 | 100 | -20 | 200 | 200 | 200 | -400 | 100 | 100 | -20 | 200 | 200 | 200 | <TOP |
| Year | | | | | | | Rs.(‘000s) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 0 | 1 | 2 | 3 | 4 | 5 | 6 | 0 | 1 | 2 | 3 | 4 | 5 | 6 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| -400 | 100 | 100 | -20 | 200 | 200 | 200 | -400 | 100 | 100 | -20 | 200 | 200 | 200 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 9. | B | Playing the float indicates the company issuing cheques to the extent that the amount shown in the bank books is higher than the amount shown in the company's books. | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 10. | D | <table border="1" style="margin: 10px auto; border-collapse: collapse; text-align: center;"> <thead> <tr> <th></th> <th>Cash flows in 1st year (Rs.)</th> </tr> </thead> <tbody> <tr> <td>Net investment in new machine</td> <td>-</td> </tr> <tr> <td>Saving in costs</td> <td>3,00,000</td> </tr> </tbody> </table> | | Cash flows in 1 st year (Rs.) | Net investment in new machine | - | Saving in costs | 3,00,000 | <TOP | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Cash flows in 1 st year (Rs.) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Net investment in new machine | - | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Saving in costs | 3,00,000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

Incremental depreciation	79,000
Pre-tax profit	2,21,000
Taxes	77,350
Post-tax profit	1,43,650
Initial Cash flow	–
Operating cash flow	2,22,650
Terminal cash flow	–
Net cash flow	2,22,650

So, the net cash flow during first year is Rs.2,22,650.

11. A Payback period method focuses on firms' liquidity. [<TOP](#)
12. C The Export-Import policy is announced by Ministry of Commerce. [<TOP](#)
13. E Under-trading indicates that funds of the company are locked up in current assets resulting in a lower turnover of working capital. Hence, option (E) is correct. [<TOP](#)
14. B **Heckscher-Ohlin model:** Heckscher-Ohlin model developed by Eli Heckscher and Bertil Ohlin in the 1920s, explores the possibility of two nations operating at the same level of efficiency, benefiting by trading with each other. Hence (b) is the correct answer. [<TOP](#)
15. B Buying a call option will give profit when spot price will be greater than the sum of strike price and premium paid on call. [<TOP](#)
16. E
- Hypothecation is limited to movable property. [<TOP](#)
- The goods hypothecated will be in the possession of the borrower.
- The possession of the goods goes into the hands of lender in case of pledge.
- The title of goods will remain with the borrowers.
- Hence (e) is the correct answer.
17. D The enlarged objectives of CAS are : [<TOP](#)
- To ensure that additional bank credit is in conformity with the approved purposes and priorities and that the bigger borrowers do not pre-empt scarce resources.
 - To enforce financial discipline on the larger borrowers, where necessary, on uniform principles.
 - Where a borrower is financed by more than one bank, to ensure that the customers proposal is assessed in the light of the information available with all the banks.
 - To bring about improvements in the techniques of credit appraisal by banks and their system of follow-up.
18. D Subsystems of inventory management system are: [<TOP](#)
- EOQ subsystem
 - Stock-level subsystem
 - Reorder point subsystem
- Hence, alternative (d) is the answer.
19. C [<TOP](#)
- $$TC = \text{Ordering cost} + \text{Carrying cost} = 12 \times 5 + \frac{1}{2} \times 250 \times 4 = 60 + 500 = 560$$
20. B Funds flow analysis is a technique of understanding the flow of funds in a business; it is not a technique for monitoring the collection of receivables. All other alternatives than (b) represent the techniques for monitoring the collection [<TOP](#)

- of receivables
21. E Option in (e) – deposits of NRIs in banks is not a part of ‘official reserve’. Options in (a), (b), (c) and (d) are the examples of official reserve. [<TOP](#)
22. C The payback period does not take into account the time value of money [<TOP](#)
23. E The following are assumptions of law of one price [<TOP](#)
- i. There is no restriction on the movement of goods between countries.
 - ii. There are no transportation costs involved.
 - iii. There are no transaction costs involved in the buying and selling of goods
 - iv. There are no tariffs. Hence (e) is correct.
24. D IRR is the rate at which NPV of the project is zero. If NPV is positive then it implies that IRR exceeds the cost of capital of the project. [<TOP](#)
- Hence statement (I) is correct.
- A positive NPV indicates that the present value of inflows is greater than the present value of outflows. It does not give any relevant information about the pay back period being more than the cut-off rate.
- Hence statement (II) is incorrect.
- $$\text{BCR} = \frac{\text{Present value of inflows}}{\text{Initial investment}}$$
- Therefore a positive NPV indicates that the present value of inflows is greater than the initial investment, in other words it implies that $\text{BCR} > 1$.
- Hence option (d) is the answer.
25. A A spontaneous liability is one which emerges in the normal course of business. Alternatives (b), (c), (d) and (e) represent spontaneous liabilities whereas alternative (a) does not represent a spontaneous liability [<TOP](#)
26. E The internal rate of return is uniquely defined only for a project, whose cash flow pattern is characterized by cash outflows followed by cash inflows (such projects are called simple investments). If the cash flow stream has one or more cash outflows interspersed with cash inflows, there can be multiple internal rates of return. Statement (I) indicates the cash outflow at the end of the project’s life too, which causes change in the sign of cash flows. Statement (II) also causes cash out flow during the project’s life. Hence, under all alternatives mentioned above, multiple internal rate of return can occur. So, (e) is answer. [<TOP](#)
27. D Projects’ profitability index = Present value of cash inflows/ Present value of cash outflows [<TOP](#)
- $$0.5 = X/60,000$$
- $$X = \text{Rs.}30,000$$
- Net present value = Present value of cash inflows – Present value of cash outflows
- $$= \text{Rs.}30,000 - \text{Rs.}60,000 = -\text{Rs.}30,000.$$
- Since, net present value is negative, internal rate of return is less than cost of capital. Hence, alternative (d) answer.
28. E Statements in options (a), (b), (c) and (d) are the functions of World Trade Organization. [<TOP](#)
- (e) Short-term financing for development of trade among member countries is not a function of World Trade Organization
29. E Exports of goods and services are affected by [<TOP](#)
- I. The prevailing exchange rate of the domestic currency.
 - II. Inflation rate.
 - III. World prices of a commodity.
 - IV. Incomes of foreigners.
 - V. Trade barriers.
- Hence (e) is the correct answer.

30. B $1.02700 \times \left(\frac{1+0.02/4}{1+0.03/4} \right) = 1.0245.$ [< TOP](#)
31. D The average collection period measures the number of days between when a typical credit sale is made and when the firm receives the payment. [< TOP](#)
32. C Raw material storage period [< TOP](#)
- $\frac{\text{Average stock of raw materials}}{\text{Daily consumption of raw materials}}$
- Daily consumption of raw materials = $\frac{6,51,000}{50} = \text{Rs.13,020}$
- Annual consumption = $13,020 \times 360 = \text{Rs.46,87,200}$
- Annual consumption = Opening stock + purchases – closing stock
- $\frac{\text{Opening} + \text{Closing}}{2}$
- Average stock of raw materials = $\frac{\text{Opening} + \text{Closing}}{2}$
- Where opening stock = S and Closing stock = 1.1 S
- $\frac{S+1.1S}{2}$
- Rs.6,51,000 = $\frac{S+1.1S}{2}$
- S = Rs.6,20,000 = Opening stock
- Closing stock = Rs.6,82,000
- Annual consumption = $6,20,000 + P - 6,82,000$
- Rs.46,87,200 = $6,20,000 + P - 6,82,000$
- P = Rs.47,49,200
- Average payment period = $\frac{\text{Average balance of creditors}}{\text{Purchases} / 360} = \frac{2,65,000}{47,49,200 / 360} = 20 \text{ days}$
33. D The credit term 2/10, net 30 implies that 2% discount is given if paid within or on 10th day of invoicing and credit is given for 30 days. Hence, (d) is the answer [< TOP](#)
34. A Daily sales = Rs.40,000 [< TOP](#)
- Average accounts receivable = $40,000 \times 4 = 1,60,000$
- Cost of funds = 8% p.a
- Cost of maintaining accounts receivable = $1,60,000 \times 0.08 = \text{Rs.12,800}.$
35. C Let us first arrange the data contained in the problem in accordance with the notation familiar to us by now. [< TOP](#)
- U = 40,000 units
- F = Rs.200 per order
- P = Rs.50 per unit
- C = 20%
- D = Rs.2 per unit
- E.O.Q. without discount,
- $Q^* = \sqrt{\frac{2UF}{PC}}$
- $= \sqrt{\frac{2 \times 40,000 \times 200}{50 \times 0.2}}$
- $= 1,265 \text{ units}$
- For utilizing discount the minimum order size = 15,00 units. As Q* is less than 15,00, we have to calculate the incremental benefits and incremental costs.
- Total amount of discount available with an order size of 15,00 units.
- = UD or 40,000 units x Rs.2 per unit.
- = Rs.80,000.....(1)
- Savings due to reduction in ordering costs

$$= \text{Rs.} \left(\frac{U}{Q^*} - \frac{U}{Q'} \right) \times F$$

$$= \text{Rs.} \left(\frac{40,000}{1,265} - \frac{40,000}{1,500} \right) \times \text{Rs.}200$$

$$= (32 - 27) \times \text{Rs.}200$$

$$= \text{Rs.}1,000 \dots\dots\dots(2)$$

Incremental carrying cost

$$= \frac{Q'(P-D)C}{2} - \frac{Q^*PC}{2}$$

$$= \frac{1,500 \times 48 \times 0.2}{2} - \frac{1,265 \times 50 \times 0.2}{2}$$

$$= \text{Rs.}7,200 - \text{Rs.}6,325$$

$$= \text{Rs.}875 \dots\dots\dots(3)$$

Net incremental benefits (= 1 + 2 - 3)

$$= \text{Rs.}80,000 + \text{Rs.}1,000 - \text{Rs.}875 = \text{Rs.}80,125$$

Hence (c) is the correct answer.

36. D Short-term portfolio investments are recorded in capital account of the Balance of Payments statement. [<TOP](#)

37. E According to the principles for determining the costs and benefits of projects only cash flows (cash inflows and outflows) are considered as benefits and costs. All revenues accrued may not result in actual cash inflows and all expenses accrued may not result in actual cash outflows. [<TOP](#)

38. C Every member has to deposit margins with the exchange, whether he is buying or selling [<TOP](#)

39. C Net investment calculation: [<TOP](#)
 Present value of net investment = Rs.5,00,000 + Rs.3,50,000 (0.893) + Rs.5,10,000(0.797)
 = Rs.12,19,020

40. A Profitability Index (PI) = $\frac{\text{present value of cash flows}}{\text{Initial investment}}$ [<TOP](#)

$$\text{PV of cash inflows} = \frac{10,000}{(1.12)} + \frac{12,000}{(1.12)^2} + \frac{4,000}{(1.12)^3}$$

$$= 8,929 + 9,566 + 2,847$$

$$\text{Profitability Index (PI)} = \frac{21,342}{22,000} = 0.97$$

Hence (a) is the correct answer.

41. B In order to obtain trade credit from its suppliers, a company has to prove its creditworthiness. This can be achieved by tackling the problem both quantitatively and qualitatively. [<TOP](#)

The quantitatively measures are outlined below:

- II. Good track record of profitability and liquidity.
- III. A record of prompt payments by the company to other suppliers will not only help in projecting a good image but also instill confidence in the potential suppliers as they get the information through the usual grapevine.

The qualitatively measures are outlined below:

- I. A free and frank discussion with the suppliers can go a long way in establishing the company's credibility.
- IV. Once the suppliers are satisfied, the company can negotiate for payments to synchronize with the company's cash inflows.

Hence (b) is the correct answer.

42. B The amount of raw materials purchased during the year = $700 + 50 - 30 = \frac{720}{360} =$ [<TOP](#)
Rs.720 lakh. Average daily credit purchases made by the company = $\frac{720}{360} =$
 $\frac{79+93}{2}$
Rs.2 lakh per day while average balance of sundry creditors is given by $\frac{79+93}{2}$
= Rs.86 lakh
- Hence, the average payment period will be = $\frac{86}{2} = 43$ days.
43. C Operating cycle period = Raw material storage period + Work-in-process [<TOP](#)
period
+ Finished goods storage period + Average
collection period
– Average payment period
= $40 + 25 + 20 + 25 - 25 = 85$ days.
44. E Various internal hedging techniques [<TOP](#)
 - Exposure netting
Leading and lagging
Choosing the currency of invoice
Sourcing
Various external hedging techniques
 - Forwards
Futures
Options
Money markets.
- Hence (e) is the correct answer
45. C The various variables associated with credit policy are: [<TOP](#)
 - Credit standards
Credit periods
Cash discounts
Collection program.
- The credit evaluation and credit policy are aspects of receivables management.
Hence (c) is the correct answer.
46. E The time gap between placing an order and procuring the material is called the [<TOP](#)
lead time
47. C The limitations of Ageing schedule:- [<TOP](#)
I. Influenced by the sales pattern.
II. Influenced by the payment behaviors of the customer.
Ageing schedule is not influenced by the credit period. On the other hand
Ageing schedule is compared with credit period and if it is higher then the
stipulated norm, action has to be initiated before they turns into bad debts.
Hence (c) is the correct answer.

48. E Current liabilities are economic obligations of a company to be paid with in the accounting period. Debentures is a long-term liability. [<TOP](#)
49. E The following are the major reasons for the ppp not holding good. [<TOP](#)
 I. Constrains on movement of commodities
 II. Price index construction
 III. Effect of the statistical method employed. Hence (e) is correct.
50. E Amount collected in the same month = $25\% \times 1,60,000 = \text{Rs.}40,000$ [<TOP](#)
 Amount collected from previous month's sale = $50\% \times 1,40,000 = \text{Rs.}70,000$
 Amount collected from the sales that occurred in the month of Jan = $25\% \times 1,20,000 = \text{Rs.}30,000$.
 Hence, the total cash receipts in the month of September = $40,000 + 70,000 + 30,000 = \text{Rs.}1,40,000$.
 Hence (e) is the correct answer.
51. A **Method I** [<TOP](#)
 Total current assets = Rs.960 lakh
 Less: Current liabilities other than bank borrowings = Rs.300 lakh
 Working capital Gap = Rs.660 lakh
 Maximum permissible bank finance = 75 percent of the working capital gap

$$= \text{Rs.}660 \times 0.75 = \text{Rs.}495 \text{ lakh}$$
52. B In recourse factoring the bad debts are not borne by the factor [<TOP](#)
53. B Finished goods storage period = $\frac{\text{Average stock of finished goods}}{\text{Average daily cost of sales}}$ [<TOP](#)
 Average daily cost of sales = Opening stock of finished goods + cost of production + excise duty + selling and distribution costs + general administrative costs + financial costs – closing stock of finished goods.
 Hence (b) is the correct answer.
54. E In economic appraisal of projects, the project is studied from the point of view of society In recourse factoring the bad debts are not borne by the factor. [<TOP](#)
55. C
$$\frac{12,000+18,000+24,000+36,000}{5} = \text{Rs.}18,000$$
 [<TOP](#)
 The average cash outflows =
 Safety level = $5 \times 18,000 = \text{Rs.}90,000$
56. C Initial Investment = Rs.150 crore [<TOP](#)
 Let the IRR of the project be k
 So, Rs.150 crore = $35 \text{ PVIF}(k,1) + 40 \text{ PVIF}(k,2) + 60 \text{ PVIF}(k,3) + 50 \text{ PVIF}(k,4)$
 At k = 10 percent, the RHS = 144.10 while at k = 8 percent, the RHS = 151.07
 By interpolation,

$$= 8 + \frac{151.07 - 150}{151.07 - 144.10} \times (10-8)$$

 K = $8 + 0.15 \times 2 = 8.30$ percent.
57. A Foreign Direct Investment (FDI): [<TOP](#)
 • FDI is made in physical assets.

 FDI usually results in managerial control over the operations of the foreign entity.

 FDI can be made by establishing a branch or subsidiary in a foreign country.

- Hence (a) is the correct answer
58. D The rate to be quoted to the Importer is the ask rate [<TOP](#)

$$= (\text{Rs./\$}) \text{ ask} \times (\$/\text{£}) \text{ ask}$$

$$= 43.12 \times 1.9665 = \text{Rs.}84.80/\text{£}.$$
Hence (d) is the correct answer.
59. B The amount of raw materials consumed = Opening balance + Purchases [<TOP](#)
during the year
– Closing balance

$$= (1,60,000 + 11,00,000 - 1,82,000)$$

$$= \text{Rs.}1,078,000$$
The average stock of work in process = $(24,000 + 30,000)/2 = \text{Rs.}27,000$
Annual cost of production = Opening work in process + Consumption of raw materials
+ Manufacturing expenses + Depreciation –
Closing work in process

$$= 24,000 + 1,078,000 + 12,60,000 + 100,000 - 30,000 = \text{Rs.}2,43,2000$$
So, the average daily cost of production = $\text{Rs.}6756 (2,43,2000/360)$
Hence, the average conversion period = $27,000/6756 = 3.996 = 4$ days.
60. E Dumping means selling the goods below the cost. [<TOP](#)
61. E EOQ is computed as: [<TOP](#)

$$\text{EOQ} = \sqrt{\frac{2UF}{PC}}$$
Where U is the annual usage, F is the fixed cost per order, P is the purchase price and C is the carrying cost expressed as a percentage of purchase price. Hence increase in the annual usage of raw material and the fixed cost per order would increase the EOQ but increase in the carrying costs (other things remaining the same) decrease the EOQ.
Hence, only II and III increase EOQ, therefore (e) is the answer.
62. D Cost of trade credit [<TOP](#)

$$= (\text{Discount Rate}/1 - \text{Discount Rate}) \times [360/(\text{Credit Period} - \text{Discount Period})]$$
By careful observation of the above formula, it can be interpreted that, there is a positive relationship between discount rate and cost of trade credit and negative relationship between the spread between credit period and discount period and cost of trade credit. As statements (I), (III) and (IV) are not true.
Hence (d) is correct answer.
63. E While taking up an overseas project, a company has to take into account all the [<TOP](#)
above factors of political risk, sovereign risk, inflation risk, currency risk.
Hence answer is (e).
64. C Present value of cost = Rs.8,000 [<TOP](#)

$$\frac{225}{0.06} = 3,750$$
Present value of benefit = $\frac{3,750}{0.06} = 3,750$

$$\text{BCR} = \frac{3,750}{8,000} = 0.469$$
65. B **Elements of internal audit** [<TOP](#)
Expertise: This represents professional aspects of the job
Objectivity: The objectivity aspect of internal audit judges the efficiency and effectiveness of the system when put into operation
Totality: This concept demands that all aspects of the organization should be considered for purpose of review and control.
Utility: All the systems are finally put to practice, to be of ultimate utility to the management and not to lead to redundancy

Independence: This means that the internal auditors have the opportunity and permission to report directly to the senior management.

Hence (b) is the correct answer.

66. B Project will not be accepted if the BCR is less than One. [<TOP](#)

67. B Realized yield = $(1.12 \times 1.24 \times 1.51)^{1/3} - 1$ [<TOP](#)
 = 1.2799-1
 = 27.99% = 28%

68. C Currency Board System [<TOP](#)

- A high inflation in the domestic markets can result in low or even negative real interest rate

Stable exchange rates act as incentive to international trade and investment

The currency board does not have discretionary powers over the monetary policy and also is not allowed to print unlimited amount of domestic currency.

The currency board does not lend to even the domestic banks as it cannot act as the lender of last resort

The value of the domestic currency is pegged to a foreign currency.

Hence (c) is the correct

69. B Replacement/Current price method: In this method, material is priced at the value that is realizable at the time of the issue. [<TOP](#)

70. B Sameera Industries NPV = $5 \times PVIFA(8\%, 3) - 12$ million = $5 \times 2.577 - 12 =$ Rs.0.885 million [<TOP](#)
 Neethu Industries NPV = $5 \times PVIFA(16\%, 3) - 12$ million = $5 \times 2.246 - 12 = -$ Rs.0.77 million
 Calculation of BCR

$$\text{BCR of Sameera} = \frac{12.885}{12} = 1.07$$

$$\text{BCR of Neethu} = \frac{11.23}{12} = 0.94$$

Since NPV of Sameera is positive and BCR more than one, Sameera Industries can invest in the project.

71. E The definition of static view of working capital considers the purpose of current assets is to provide adequate cover for current liabilities. This definition suffers from the following limitations: [<TOP](#)

- Working capital provides a snapshot picture of current assets and current liabilities as on the balance sheet date. It fails to reflect the true dynamic nature of working capital which can be captured by combining the data contained in both the balance sheet and profit and loss account of a company.

The balance sheet of a company is prepared and presented in the annual report in accordance with the Schedule VI requirements of the Indian Companies Act. As a result, the amount of net working capital obtained by subtracting current liabilities from current assets presented in the balance sheet fails to reflect the true amount of net working capital.

The current assets as presented in the balance sheet do not include marketable securities such as treasury bills but are considered under the generic head

‘investments’ which include both trade investments and others.

Short term bank borrowings in the form of cash credit/overdraft accounts obtained for financing current assets, unsecured loans of short term duration such as public deposits are shown separately under the head-secured loans. To obtain the true picture of net working capital these items have to be considered as part of current liabilities

72. E To make a good financial decision, the project with the higher risk-adjusted net present value should be chosen. [<TOP](#)

73. C Exchange rate system where the central bank intervenes to smoothen out exchange rate fluctuations is known as managed float. Hence (c) is the correct answer. [<TOP](#)

74. C [<TOP](#)

$$\begin{aligned} \text{Average stock of finished goods} &= \frac{\text{Rs.2,82,000} + 2,50,000}{2} \\ &= \text{Rs.2,66,000} \end{aligned}$$

$$\begin{aligned} \text{Cost of sales} &= \text{Opening stock of finished goods} + \text{Cost of production} + \\ &\quad \text{Selling administration of financial expenditure} + \text{Custom} \\ &\quad \text{and Excise duty} \\ &\quad - \text{Closing stock of limited goods.} \\ &= 2,82,000 + 5,16,800 + 2,950 + 5,000 - 2,50,000 \\ &= \text{Rs.5,56,750} \end{aligned}$$

$$\text{Daily cost of sales} = \frac{5,56,750}{360} = 1546.53$$

$$\begin{aligned} \text{The finished goods storage period} &= \frac{\text{Average stock of finished goods}}{\text{Daily cost of sales}} \\ &= \frac{2,66,000}{1,546.53} = 172 \text{ days.} \end{aligned}$$

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