

## Question Paper

### Financial Management - II (MB212) : July 2008

- Answer all 72 questions.
- Marks are indicated against each question.

**Total Marks : 100**

1. Which of the following statements is **true**? [<Answer>](#)
- (a) While managing fixed assets time factor is not important  
 (b) Debentures are short-term liabilities  
 (c) Liquidity position of a firm generally depends on investment in current assets  
 (d) Short term or immediate need of cash cannot be met by adjusting the levels of current assets  
 (e) Liabilities are always short term obligations. **(1 mark)**
2. Hire purchase dues are [<Answer>](#)
- (a) Current assets  
 (b) Current liabilities  
 (c) Provisions  
 (d) Fixed assets  
 (e) Long-term liabilities. **(1 mark)**
3. Inventories' value is certified by the management in accordance with the principle of [<Answer>](#)
- (a) Accounting entity  
 (b) Going concern  
 (c) Revenue recognition  
 (d) Materiality  
 (e) Conservatism. **(1 mark)**
4. Working capital management covers [<Answer>](#)
- I. Management of current assets.  
 II. Attitude of management towards the risk.  
 III. Management of current liabilities.
- (a) Only (I) above  
 (b) Only (II) above  
 (c) Only (III) above  
 (d) Both (I) and (II) above  
 (e) All (I), (II) and (III) above. **(1 mark)**
5. As compared to dynamic view, the static view of working capital is considered less useful from the point of view of managerial decision making, because it fails to reflect the true amount of net working capital. This is due to which of the following reason(s)? [<Answer>](#)
- I. Bank borrowings in the form of cash credit/overdraft accounts are shown as a part of long-term liabilities.  
 II. Current assets, as presented in the balance sheet do not include marketable securities.  
 III. Marketable securities are considered as investments.
- (a) Only (I) above  
 (b) Only (II) above  
 (c) Only (III) above  
 (d) Both (II) and (III) above  
 (e) All (I), (II) and (III) above. **(1 mark)**
6. Incredible Speed Ltd. is an automobile manufacturing firm. It mainly manufactures high speed racing cars for formula one racing events. The following information is available for Incredible Speed Ltd.: [<Answer>](#)

	(Rs. millions)	
Average stock of raw materials and stores	250	<b>(3 marks)</b>
Average work-in-process inventory	300	
Average finished goods inventory	180	
Average accounts receivable	300	

Average accounts payable	180
Average raw materials and stores purchased on credit and consumed per day	10
Average-work-in-process value of raw materials committed per day	12.5
Average cost of goods sold per day	18
Average sales per day	20

The net operating cycle of Incredible Speed Ltd. is

- (a) 45 days
- (b) 50 days
- (c) 56 days
- (d) 59 days
- (e) 60 days.

7. Pace Auto Parts Company sells to retail auto supply stores on credit terms of "net 60". Annual credit sales are Rs.300 million (spread evenly throughout the year) and the firm's variable cost ratio is 0.75. On an average, it's accounts receivable are overdue for 28 days. Assuming 365 days per year, the average investment in receivables of Pace is

[<Answer>](#)

- (a) Rs. 0.822 million
- (b) Rs.34.091 million
- (c) Rs.52.942 million
- (d) Rs.72.329 million
- (e) Rs.82.392 million.

(2 marks)

[<Answer>](#)

8. Negative working capital indicates

- (a) Long-term funds have been used for financing short-term assets
- (b) Long-term funds have been used for financing long-term assets
- (c) Short-term funds have been used for financing long-term assets
- (d) Short-term funds have been used for financing short-term assets
- (e) The financing structure of the company is normal.

(1 mark)

[<Answer>](#)

9. In seasonal industries, working capital can be considered consisting of permanent and fluctuating components. The permanent component needs to be financed by

- (a) Internal accruals, ordinary and preference shares
- (b) Accounts payable
- (c) Short-term bank borrowings
- (d) Public deposits
- (e) Commercial papers.

(1 mark)

[<Answer>](#)

10. Which of the following is a qualitative measure to prove the creditworthiness of a company

- (a) Record of prompt payment by the company
- (b) Free and frank discussion
- (c) Price Earning ratio
- (d) Earnings per share
- (e) Current ratio.

(1 mark)

[<Answer>](#)

11. A short-term usance promissory note issued mostly by large corporations with high credit rating is referred to as

- (a) Participation certificate
- (b) Certificate of deposit
- (c) Gilt edged securities
- (d) Letter of credit
- (e) Commercial paper.

(1 mark)

[<Answer>](#)

12. Regarding the style of credit which of the following is/are **not** the recommendation(s) of Tandon committee?

- I. A bank may bifurcate the credit limit into loan and demand cash credit.
- II. The irreducible minimum level of borrowing which is expected to be used throughout the year will comprise loan component.
- III. The irreducible minimum level of borrowing which is expected to be used throughout the year will comprise cash credit component.

- (a) Only (I) above
- (b) Only (II) above

(1 mark)

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

13. Opportunity cost of funds tied up with inventory results from

[<Answer>](#)

- (a) Carrying cost
- (b) Materials cost
- (c) Cost of losses due to damage and pilferage
- (d) Stock out cost
- (e) Ordering cost.

(1 mark)

14. Holding cash balance to pay for the purchases made is

[<Answer>](#)

- I. An indication of the precautionary motive.
- II. An implication for the transaction motive.
- III. A motivation due to the speculative motive.
- IV. Caused by lack of synchronization between cash inflows and outflows.

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

(1 mark)

15. Which of the following techniques is used to monitor the status of the receivables?

[<Answer>](#)

- (a) Ageing schedule
- (b) Outstanding creditors
- (c) Selection matrix
- (d) Funds flow analysis
- (e) Credit evaluation.

(1 mark)

16. To get the cash payments against sales, which of the following courses of action is/are often adopted by a company?

[<Answer>](#)

- I. Provide Attractive cash discounts.
- II. Improve the quality of accounts receivables.
- III. Increase volume of credit sales.

- (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)

17. Which of the following is **not** a principle to determine the costs and benefits of a project?

[<Answer>](#)

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

(1 mark)

18. When the net float is negative, it is said that

[<Answer>](#)

- (a) The company has used the short term sources of funds for financing long term assets
- (b) The current ratio is less than unity
- (c) The payment float is larger than the collection float
- (d) The balance in the books of the bank is less than the balance in the books of the firm
- (e) The outstanding debtors are more than the outstanding creditors.

(1 mark)

19. Which of the following is **not correct** with respect to the purpose of maintaining inventories?

[<Answer>](#)

- (a) To reduce the costs of ordering
- (b) To improve the product quality
- (c) To avoid lost sales
- (d) To reduce the possibility of the stoppage of production
- (e) To obtain discounts through buying more quantity.

(1 mark)

20. Which of the following statements is **true** if the Net Present Value (NPV) of a project is positive? [<Answer>](#)
- (a) Internal Rate of Return(IRR) is more than the cost of capital
  - (b) The pay-back period of the project is less than one year
  - (c) The discount rate is equal to the risk free rate of return
  - (d) Benefit cost ratio is less than unity
  - (e) Accepting the project has an indeterminate effect on shareholders.
- (1 mark)

21. Which of the following is **not** a relevant factor in an efficient cash management system for a business entity? [<Answer>](#)
- (a) Prompt billing and mailing to the customers
  - (b) Payment of interest on term loans whenever it becomes due
  - (c) Collection of receivables from branches
  - (d) Deposit the cheques immediately to the bank on receiving the same from customers
  - (e) Making a centralized payment system for the suppliers.
- (1 mark)

22. Other things remaining the same, which of the following will generally result as a consequence of making the credit standards more stringent? [<Answer>](#)
- (a) More bad debt losses
  - (b) Increase in the number of customers
  - (c) Higher sales turnover
  - (d) Reduction of the outstanding debtors in the balance sheet
  - (e) Incremental cost of collection of the receivables.
- (1 mark)

23. Consider the following data [<Answer>](#)

Annual credit purchase	=	Rs.72,72,000
Opening balance of accounts payable	=	Rs.17,66,400
Closing balance of accounts payable	=	Rs.29,20,000

The average payment period assuming 360 days in a year is

- (a) 36 days
  - (b) 66 days
  - (c) 96 days
  - (d) 116 days
  - (e) 136 days.
- (2 marks)
24. If the terms of a credit purchase transaction is 2/10, net 40, the implicit cost of trade credit is (assume one year is equal to 360 days) [<Answer>](#)

- (a) 36.70 percent
- (b) 24.50 percent
- (c) 20.99 percent
- (d) 18.18 percent
- (e) 14.69 percent.

(2 marks) [<Answer>](#)

25. Stepin Bakers formulates its credit policy on the basis of average days' sales outstanding (DSO) at the end of every quarter. The monthly sales and outstanding receivables for the year 2007 are as follows: (Sales and receivables figures are in Rs. Lakh)

Month	Sales	Receivables	Month	Sales	Receivables
January	480	1000	July	500	800
February	540	860	August	550	850
March	550	750	September	600	850
April	400	700	October	500	650
May	450	750	November	600	950
June	450	700	December	600	800

The average collection period in second quarter will be

- (a) 35 days
  - (b) 38 days
  - (c) 44 days
  - (d) 49 days
  - (e) 51 days.
- (2 marks) [<Answer>](#)
26. Kiran Ltd. is examining the question of relaxing its credit policy. At present, it sells 20,000 units at Rs.100 per unit. The variable cost per unit is Rs.88 and average cost per unit at the current sales volume (2 marks)

is Rs.92. All the sales are on credit and the average collection period is 36 days. A relaxed credit policy is expected to increase the sales by 10% and the average collection period to 60 days. If the required rate of return is 15%, the net benefit/loss as a result of relaxing the credit policy is (Assume 360 days in a year)

- (a) –Rs. 400
- (b) –Rs. 600
- (c) Rs. 800
- (d) Rs.1,200
- (e) Rs.2,400.

[<Answer>](#)

27. Ramba International had bank balance of Rs.100,000 on 1st January, 2008 according to both the company's account and bank pass book. From that day, it issues daily cheques for Rs.25,000 that are cleared on the 3rd working day and deposits daily cheques of Rs.18,000 which are realized on the 2nd working day. The amount of net float on 3rd January is

- (a) Rs.42,000
- (b) Rs.38,000
- (c) Rs.32,000
- (d) –Rs.42,000
- (e) –Rs.32,000.

(2 marks)

[<Answer>](#)

28. A company requires a maximum inventory of 1,000 units of a material annually, the carrying cost of which per unit is Rs.25, the cost per order is Rs.250 and there are 6 orders per year. The total cost related to the inventories is (Assume the assumptions of EOQ holds good)

- (a) Rs.12,000
- (b) Rs.14,000
- (c) Rs.16,000
- (d) Rs.18,000
- (e) Rs.20,000.

(2 marks)

[<Answer>](#)

29. The cash flows from a project are estimated as follows:

Year	0	1	2	3
Cash flows	- Rs.160 lakh	Rs.60 lakh	Rs.80 lakh	Rs.116 lakh

The benefit cost ratio for the above project if the cost of capital is 12 percent is

- (a) 0.25
- (b) 0.80
- (c) 1.25
- (d) 1.80
- (e) 2.25.

(2 marks)

[<Answer>](#)

30. The average daily usage rates of an inventory, lead time and their respective probabilities are as follows

Average Daily Usage (Units)	Probability	Lead Time (No. of days)	Probability
300	0.40	12	0.25
400	0.60	16	0.75

The expected normal consumption during the lead time is

- (a) 3,600 units
- (b) 4,800 units
- (c) 5,400 units
- (d) 6,400 units
- (e) 6,632 units.

(2 marks)

[<Answer>](#)

31. Ashwani Industries Limited is planning for a capital investment at a cost of Rs.100 lakh where the projected cash inflows are as follows:

(Rs. in lakh)				
Year	1	2	3	4
Cash inflows	25.0	30.0	40.0	48.0

The Internal Rate of Return (IRR) of the project is

(2 marks)

- (c) 14.24%
- (d) 15.84%
- (e) 17.64%

32. Sundan Electricals needs 60,000 pieces of aluminum bars to produce switchgears. The price of each bar is Rs.100, cost of placing an order is Rs.1,200 and the carrying cost is 10 percent. The purchase manager has set the economic order quantity based on the EOQ model, as 12,000 units. Recently, a supplier has offered discounts of 3 percent against an order size of 20,000 units or more. What will be the net incremental benefit/cost to the company, if such discount is availed?

[<Answer>](#)

- (a) Rs.1,20,100
- (b) Rs.1,32,700
- (c) Rs.1,35,200
- (d) Rs.1,45,400
- (e) -Rs.1,48,000.

(2 marks)

[<Answer>](#)

33. The average daily cost of production is Rs.50 lakhs and average conversion period is 5 days. The closing stock of work in process is 10% higher than the opening stock of work in process. The value of closing stock of work in process is

- (a) 100 lakhs
- (b) 262 lakhs
- (c) 338 lakhs
- (d) 438 lakhs
- (e) 538 lakhs.

(2 marks)

[<Answer>](#)

34. Which of the following results in a collection float?

- (a) Cheques issued by a firm, but awaiting payment by the bank
- (b) Cheques deposited by a firm in the bank, but not cleared by the bank
- (c) Payments due from sundry debtors
- (d) Payments due to sundry creditors
- (e) The minimum balance shown in current account.

(1 mark)

[<Answer>](#)

35. 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.

(2 marks)

[<Answer>](#)

36. Current account deficit occurs when

- I. Imports exceed exports.
- II. Exports exceed Imports.
- III. National income exceeds national expenditure.
- IV. National expenditure exceeds national income.

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

(1 mark)

[<Answer>](#)

37. Investment in shares/debentures by the foreign investors is recorded in which of the following accounts of Balance of Payments (BOP) statement?

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

(1 mark)

38. A quote is called as European quote, if the exchange rate is expressed

[<Answer>](#)

- I. In terms of US dollars per unit of any other currency.
  - II. In terms of number of units of any other currency per unit of US dollar.
  - III. In terms of number of units of any other currency per unit of British pound.
  - IV. In terms of number of units of any other currency per unit of any other currency excluding US dollar.
- (a) Only (I) above
  - (b) Only (II) above
  - (c) Only (III) above
  - (d) Only (IV) above
  - (e) Both (I) and (III) above.

(1 mark)

39. Which of the following theories of International Trade, classifies the products / goods in to Labor intensive and capital intensive segments?

[<Answer>](#)

- (a) Theory of absolute advantage
- (b) Theory of comparative advantage
- (c) Imitation – gap theory
- (d) Heckscher – Ohlin model
- (e) International product life cycle theory.

(1 mark)

40. Exchange rates quoted in Singapore are as follows:

[<Answer>](#)

S\$/Euro	2.0118/21
S\$/US\$	1.7384/86

The synthetic rates of US \$/Euro are

- (a) 1.1572/73
- (b) 1.1571/74
- (c) 0.8640/41
- (d) 0.8639/42
- (e) 3.4977/79.

(2 marks)

41. The Indian foreign exchange market consists of

[<Answer>](#)

- I. Central bank.
  - II. Commercial banks.
  - III. Corporates and individuals.
- (a) Only (I) above
  - (b) Only (II) above
  - (c) Both (I) and (III) above
  - (d) Both (II) and (III) above
  - (e) All (I), (II) and (III) above.

(1 mark)

42. Foreign exchange risk is defined as

[<Answer>](#)

- (a) Variance in the value of assets, liabilities and operating income due to unanticipated changes in exchange rates
- (b) Variance in operating income due to expected changes in exchange rates
- (c) Variance in operating income, value of assets and liabilities due to unfavourable movement of exchange rates
- (d) Possibility of loss a firm may sustain due to changes in the exchange rates
- (e) Actual and potential loss suffered due to changes in exchange rates.

(1 mark)

43. Crawling peg system is a

[<Answer>](#)

- (a) Fixed exchange rate system
- (b) Floating exchange rate system
- (c) Hybrid of fixed and flexible exchange rate system
- (d) Currency board system
- (e) Free float system.

(1 mark)

44. The buyer of a put option on a stock which has a strike price of Rs.55 and a premium of Rs.5 will make profit if spot price goes

[<Answer>](#)

- (a) Above Rs.60
- (b) Below Rs.60

(2 marks)

- (c) Above Rs.55
- (d) Below Rs.50
- (e) Remains at Rs.55.

45. If the Euro is quoted \$1.1410 today and the inflation rates are 2% in Euro-zone and 3% in USA, what should be the \$/Euro quote after 3 months?

[<Answer>](#)

- (a) \$1.1382/Euro
- (b) \$1.1438/Euro
- (c) \$1.1522/Euro
- (d) \$1.1300/Euro
- (e) \$1.1466/Euro.

(2 marks)

[<Answer>](#)

46. M/s. DJ India Ltd. is considering to invest in a printing machine the details of which are as follows:

Cost of machine	Rs.25,00,000
Annual cost of operations	Rs. 2,00,000
Useful life	9 years

The annual capital charge of the machine at a cost of capital of 12% is

- (a) Rs.4,69,219
- (b) Rs.4,77,778
- (c) Rs.5,49,113
- (d) Rs.6,69,219
- (e) Rs.8,07,057.

(2 marks)

[<Answer>](#)

47. If the identical product or service can be sold in two different markets, no restrictions exist on the sale, and transportation costs of moving the product between markets are zero, the product's price should be the same in both the markets. This theory is called:

- (a) The law of one price
- (b) The Fisher effect
- (c) Market parity theory
- (d) Interest rate parity
- (e) Efficient Market Theory.

(1 mark)

[<Answer>](#)

48. Treasury bills are often said to be "risk free". Which of the following risks impacts T-bill investors?

- (a) Inflation risk
- (b) Default risk
- (c) Liquidity risk
- (d) Prepayment risk
- (e) Reinvestment risk.

(1 mark)

[<Answer>](#)

49. Which of the following statements is/are **false** about the credit sales of the company?

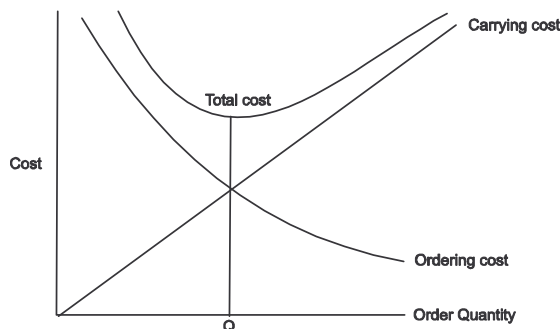
- I. Credit sales will help the company increase the total sales volume.
- II. These sales will always result in the decrease of profit.
- III. This facility may help the company to enhance its competitive position.

- (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)

[<Answer>](#)

50. Consider the following graph:



(1 mark)



In the above figure point 'Q' represents Economic Order Quantity (EOQ) because

- (a) The ordering cost is minimum at this point
- (b) The carrying cost is minimum at this point
- (c) The ordering cost is maximum at this point
- (d) The carrying cost is maximum at this point
- (e) The total cost is minimum at this point.

[<Answer>](#)

51. The use of safety stock by a firm will

- I. Increase ordering costs.
  - II. Increase carrying costs.
  - III. Increase stock-out costs.
- (a) Only (I) above
  - (b) Only (II) above
  - (c) Only (III) above
  - (d) Both (I) and (III) above
  - (e) Both (II) and (III) above.

(1 mark)

[<Answer>](#)

52. Which of the following statements is **not true**?

- (a) The basic EOQ model assumes that orders to replenish the inventory of an item are filled instantaneously
- (b) Irrespective of the fluctuations in consumption during lead time, re-order point remains constant
- (c) In the FIFO method, the issue is in the order of receipt
- (d) In the replacement method, the current realizable value is taken for pricing the issues
- (e) Cost per order and cost of carrying per unit are assumed to be constant.

(1 mark)

[<Answer>](#)

53. Which of the following statements is/are **true** regarding "under-trading"?

- I. The symptoms of under trading can be noticed from the lower turnover of working capital.
  - II. Precautionary measures for under trading can be taken by increasing the asset base.
  - III. Under-trading arises, when the volume of sales is much less in comparison to the amount of assets employed.
  - IV. Under trading can be restated as under capitalization.
- (a) Only (I) above
  - (b) Only (IV) above
  - (c) Both (I) and (III) above
  - (d) Both (II) and (III) above
  - (e) Both (III) and (IV) above.

(1 mark)

[<Answer>](#)

54. The finance manager of M/s. Easy Credits Ltd. is considering to change its credit terms of 1/10, net 20 to 1/10, net 30. With the change in the credit period it expects the sales to increase from Rs.30 lakhs to Rs.50 lakhs and average collection period from 36 days to 45 days. The contribution margin is 30% of the selling price.

Assuming a cost of capital of 12%, the increase in the cost of funds locked in receivables is

- (a) Rs.12,000
- (b) Rs.18,000
- (c) Rs.30,000
- (d) Rs.39,600
- (e) Rs.52,500.

(2 marks)

[<Answer>](#)

55. Consider the following data regarding a product:

Total cost of ordering and carrying inventory	Rs.2,00,000
Quantity per order	10,000 units
Carrying cost	20% of the purchase price
Fixed cost per order	Rs.500
Purchase price	Rs.100.

The annual usage of the materials in unit is

- (a) 5 lakhs
- (b) 10 lakhs
- (c) 15 lakhs
- (d) 20 lakhs
- (e) 25 lakhs.

(2 marks)

(e) 25 lakhs.

56. If the net benefit cost ratio is 0.2, the net present value is Rs.2,000, the present value of the cash inflows associated with the project is

[<Answer>](#)

- (a) Rs. 9,800
- (b) Rs.10,000
- (c) Rs.12,000
- (d) Rs.13,200
- (e) Rs.14,000.

(2 marks)

57. Which of the following is **true** with regard to letter of credit?

[<Answer>](#)

- (a) It is an offer of loan by a bank to a firm
- (b) It is an offer to supply raw materials on credit to a firm by its supplier
- (c) It represents the assurance of a bank to pay a supplier, if its customer fails to pay for the purchases made
- (d) It is the letter from a company to its supplier requesting it to increase the credit period
- (e) It is the letter by which the supplier of a company confirms the extension of credit period to its customer.

(1 mark)

58. Which of the following is **not** a type of bank finance for working capital?

[<Answer>](#)

- (a) Cash credit
- (b) Overdraft
- (c) Commercial paper
- (d) Purchasing and discounting of bills
- (e) Note lending.

(1 mark)

59. Which of the following types of factoring **does not** carry the service elements of factoring?

[<Answer>](#)

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

(1 mark)

60. Mr. Aditiya, Materials Manager of a transformer manufacturing company, procures annual requirement of the copper bolts from its supplier by four equal sized orders. The total number of copper bolts the company requires in a year is 6,00,000. The fixed cost per order is Rs.300. The market price of the each copper bolt is Rs.100. The carrying cost is 10% of the average inventory value. If Mr. Aditiya decides to change from existing system to EOQ system then how much annual monetary benefit this decision would bring to the company?

[<Answer>](#)

- (a) Rs. 60,000
- (b) Rs.3,36,000
- (c) Rs.6,91,200
- (d) Rs.7,50,000
- (e) Rs.7,51,200.

(3 marks)

61. Tata Motors Ltd. is considering the replacement of existing machine which is obsolete and unable to meet the rapidly rising demand for its Tata Indigo car. The company has two alternatives:

[<Answer>](#)

- (i) To buy machine M1 which is similar to the existing machine or
- (ii) To go in for machine M2 which is more expensive and has much greater capacity.

The cash flows at present level of operations under the two alternatives are as follows:

Year	Machine (M <sub>1</sub> )	Machine (M <sub>2</sub> )
0	(25)	(40)

The company's cost of capital is 12%. The Net Present Value (NPV) M1 and M2 respectively will be

(2 marks)

- (b) Rs.10.07 lakh and Rs.10.79 lakh
- (c) Rs.11.37 lakh and Rs.11.70 lakh
- (d) Rs.12.03 lakh and Rs.12.75 lakh
- (e) Rs.13.22 lakh and Rs.13.52 lakh.

62. Pure Iron Ltd. requires steel for its fabrication work. The probability distributions of the daily usage rate and the lead time for procurement are given below:

[<Answer>](#)

Daily usage rate (in tonnes)	Probability	Lead time (in days)	Probability
5	0.3	15	0.5
7	0.4	25	0.3
9	0.3	30	0.2

What is the probability that the normal lead time consumption may exceed 225 tonnes?

- (a) 6%
- (b) 8%
- (c) 9%
- (d) 12%
- (e) 15%.

(3 marks)

[<Answer>](#)

63. Which of the following appraisal criteria is more helpful for appraising the risky project?

- (a) Annual Capital Charge
- (b) Internal Rate of Return
- (c) Benefit Cost Ratio
- (d) Net Present Value
- (e) Pay Back Period.

(1 mark)

[<Answer>](#)

64. Which of the following is **not** specified in the futures contract?

- (a) The type of the underlying asset
- (b) The contract size
- (c) The delivery month
- (d) The tick size
- (e) Basis.

(1 mark)

[<Answer>](#)

65. A currency swap can be viewed as a combination of

- I. One spot and one futures contract.
  - II. One spot and one forward.
  - III. One futures and one forward.
- (a) Only (I) above
  - (b) Only (II) above
  - (c) Only (III) above
  - (d) Both (I) and (II) above
  - (e) All (I), (II) and (III) above.

(1 mark)

[<Answer>](#)

66. For Kalyan company, the average daily usage of material is 400 units, lead time for procuring material is 20 days, the average number of units per order is 2,000 units. If the stockout acceptance factor is considered to be 1.8, the reorder level is (Round off the value to the nearest integer)

- (a) 13,800 units
- (b) 14,400 units
- (c) 15,200 units
- (d) 16,000 units
- (e) 17,400 units.

(1 mark)

[<Answer>](#)

67. Aditya Industries Ltd. uses the EOQ model to estimate its optimal cash balance for the period under consideration. The optimal cash balance under this method is Rs.20 Lakhs. Every time the marketable securities are converted into liquid reserves, a cost of Rs.500 is incurred. If the opportunity cost of funds applicable to the firm is 10 percent p.a., the annual cash usage rate will be

- (a) Rs.26,00,00,000
- (b) Rs.32,92,00,308
- (c) Rs.35,92,40,008
- (d) Rs.40,00,00,000
- (e) Rs.47,93,30,803.

(2 marks)

68. The potential loss for a call option writer is

[<Answer>](#)

- (a) Unlimited
- (b) Limited to the premium
- (c) Limited to the exercise price
- (d) Limited to stock price at the time of writing the option
- (e) Limited to difference of strike price and premium.

(1 mark)

69. Which of the following statements is **false** if a country is following a Managed Float System?

[<Answer>](#)

- (a) The volatility of exchange rates associated with a clean float increases the economic uncertainty faced by players in the international markets
- (b) The central bank may occasionally enter the market in order to smoothen the transition from one rate to another
- (c) A sudden depreciation of domestic currency may lead decrease in inflation rate in the economy
- (d) The central bank's aim in intervention of the market is to prevent speculative attacks on the currency
- (e) A sudden appreciation of the domestic currency would make the domestic goods more expensive in international markets.

(1 mark)

70. Which of following statements is/are **not true** about the Audit Committee?

[<Answer>](#)

- I. It should evaluate the financial reports and policies of the company.
  - II. It should make assessment of the extent of performance levels of management and staff.
  - III. It should have an over view of the implementation of the recommendations of internal auditors only.
- (a) Only (I) above
  - (b) Only (II) above
  - (c) Only (III) above
  - (d) Both (I) and (II) above
  - (e) All (I), (II) and (III) above.

(1 mark)

71. In the monthly cash report which of the following comes under Cash Receipts?

[<Answer>](#)

- (a) Cash sales
- (b) Cash purchases
- (c) Wages and salaries
- (d) Taxes
- (e) Capital equipment purchase.

(1 mark)

72. Which of the following is **not** an advantage of the ABC system of inventory management?

[<Answer>](#)

- (a) It is a very selective approach to inventory management
- (b) It facilitates a better control on the costlier items
- (c) It analyses the items in inventory according to their importance in the production process
- (d) It helps the usage of the scientific system for the inventory management
- (e) It helps maintain the optimum level of stocks.

(1 mark)

**END OF QUESTION PAPER**

## Suggested Answers Financial Management - II (MB212) : July 2008

### Section A : Basic Concepts

- |    | <b>Answer</b> | <b>Reason</b>   |   |
|----|---------------|---|---|
| 1. | C             | Liabilities are economic obligations of the company to pay cash or provide or provide goods or services to outsiders including shareholders. Liabilities may be long-term or current. Long-term liabilities are those which are repayable over a period greater than the accounting period like share capital, debentures, long-term loans etc. Current liabilities on the other hand have to be paid within accounting period like sundry creditors or accounts payable, bills payable, outstanding expenses, short-term loans etc.  | ≤ |
|    |               | Debentures are long-term liabilities  |   |
|    |               | In managing the fixed assets, the time factor is very important, that is why the discounting and compounding play a very important role.  |   |
|    |               | The liquidity position of a firm is dependent on the investment in current assets whereas the role of fixed assets as for liquidity is concerned is negligible.   |   |
|    |               | Any short-run, immediate need of company whether that need for cash or adjustment to fluctuations in sales can be made only through adjusting the levels of various components of current assets.   |   |
| 2. | B             | Hire purchase dues are current liabilities.   | ≤ |
| 3. | E             | Inventories value is certified by the management in accordance with the principle of conservatism   | ≤ |
| 4. | E             | The objective of working capital management covers not only the management of current assets in tune with the attitude of management toward risk and arriving at a satisfactory level of current assets that balances the liquidity and profitability criteria but also management of financing the chosen level of current assets once again taking into consideration the attitude of management towards risk.  | ≤ |
| 5. | E             | Bank borrowings in the form of cash credit/overdraft accounts obtained for financing the current assets, which are basically short-term borrowings, are not shown as a part of current liabilities but separately under the head secured loans. Similarly unsecured loans of short-term duration such as public deposits are also shown separately under the head unsecured loans. To obtain a true picture of net working capital the above mentioned items have to be regarded as current liabilities.<br>Current assets, as presented in balance sheet do not include marketable securities whose main motive is to improve the liquidity position of the company and held for short periods. These are considered under the generic head 'investments'. | ≤ |

6. C a. ≤  
 Raw material storage period =  $\frac{\text{Average stock of raw materials and store}}{\text{Average raw material and store consumed per day}} = \frac{250}{10} = 25 \text{ days}$
- b.  
 Work-in-process period =  $\frac{\text{Average work-in-process inventory}}{\text{Average WIP value of raw materials committed per day}} = \frac{300}{12.5} = 24 \text{ days.}$
- c.  
 Finished goods storage period =  $\frac{\text{Average Finished goods inventory}}{\text{Average cost of goods sold per day}} = \frac{180}{18} = 10 \text{ days.}$
- d.  
 Average collection period =  $\frac{\text{Average accounts receivable}}{\text{Average sales per day}} = \frac{300}{20} = 15 \text{ days.}$
- e.  
 Average payment period =  $\frac{\text{Average accounts payable}}{\text{Average credit purchases per day}} = \frac{180}{10} = 18 \text{ days.}$   
 Duration of the operating cycle =  $(25 + 24 + 10 + 15) - 18 = 56 \text{ days.}$
7. D ≤  
 Average collection period =  $60 + 28 = 88 \text{ days}$   
 Average Investment in Receivables =  $\text{Rs.}30,00,00,000 \times 88 / 365$   
 =  $\text{Rs.}7,23,28,767$
8. C ≤  
 Negative working capital indicates that current liabilities are more than the current assets and hence the current assets may have been used to finance the long term assets.
9. A ≤  
 The permanent component need to be financed by long-term sources of finance such as internal accruals, ordinary shares, preference shares etc.
10. B ≤  
 Free and frank discussion is the qualitative measure of proving the creditworthiness of a company.
11. E ≤  
 A short-term usance promissory note with a fixed maturity period, issued mostly by leading reputed, well established large corporations with very high credit rating is referred to as commercial/corporate paper
12. C ≤  
 As per the recommendations of Tandon committee A bank may bifurcate the credit limit into loan and demand cash credit. The irreducible minimum level of borrowing which is expected to be used throughout the year will comprise loan component. While the fluctuating part will be taken care of by cash credit component.
13. D ≤  
 Opportunity cost means the expenses or loss of profit for not availing an opportunity. In this case, when a firm is in situation of stock out, it suffers in two ways – loss of profit due to foregone

sales as well as the loss of reputation to its valuable customers. Hence, the option (d) is the right choice as the other options do not represent such a situation.

14. B With precautionary motive, a company holds cash to meet the contingent cases while transaction motive implies the reason for holding cash to meet the day to day transactions. A motivation due to the speculative motive encourages a company to hold cash in order to make speculative profit by exploiting the opportunities due to price changes in the market. Lack of synchronization between cash inflows and outflows is also an example of precautionary situation. It is also required for the large business entities.  $\leq$
15. A Ageing schedule is used to monitor the status of the receivables. Outstanding creditors in the balance sheet indicate the position of accounts receivables but do not help to monitor the status of the same. Selection matrix, funds flow analysis and credit evaluation do not play any role in this respect.  $\leq$
16. A If a company faces difficulties in getting prompt payments despite a rigorous collection effort, it may consider for an attractive cash discount. If the volume of credit sales is increased or the collection effort is reduced, the amount of bad debt will be piled up to a significant amount.  $\leq$
17. D According to the principles followed for the determination of the costs and benefits of a project, only the cash inflows and outflows are taken as benefits and costs. All revenues generated from the implementation of the project may not lead to the actual cash inflows while all expenses to be incurred may not result in actual cash outflows due to the project. The other statements as mentioned in the other options are correct for determining the costs and benefits of a project.  $\leq$
18. D When the net float is negative the balance in the books of bank is less than the balance in the books of the firm. Any relationship between the current asset and current liability does not play any role in the determination of the net float as it is related to the cash balance.  $\leq$
19. B Storing the products in the form of inventories can neither improve the quality of the inventory nor can improve the quality of the finished products. While the other purposes as mentioned in the other options are served through the maintenance of the inventories. Hence, the option (b) is the answer.  $\leq$
20. A If cost of capital is less than IRR of a project, the NPV of the project will be positive. Similarly, the benefit cost ratio is less than unity indicates the present value of the benefits is less than the present value of costs at a given cost of capital, thereby making the NPV a negative one. Similarly, a discount rate is greater than the IRR will make the NPV a negative one and hence for a project of benefit cost ratio is less than unity. Such a project will have a positive effect on the wealth of the shareholders, not an indeterminate effect.  $\leq$
21. B Whether or not to pay for the outstanding interest on term loans depends on the financial position of the company and its willingness to pay for the same. A cash management policy may influence this but this payment is not a part of the cash management policy.  $\leq$
22. D Making the credit standards more stringent one will result in lower volume of sales turnover thereby decreasing the collection costs due to the reduced number of customers which in turn reduces the bad debt losses. As a consequence of the above event, the outstanding debtors in the balance sheet will also come down. Hence, the option (d) is correct.  $\leq$

balance sheet will also come down. Hence, the option (d) is correct.

23. D ≤

$$\begin{aligned} \text{Average A/c payable} &= \frac{17,66,400 + 29,20,000}{2} = \text{Rs.}23,43,200 \\ \text{Annual credit purchases} &= \text{Rs.}72,72,000 \\ \text{Therefore, Daily credit purchases} &= \frac{72,72,000}{360} = \text{Rs.}20,200 \\ \text{Therefore the Average payment period} &= \frac{\text{Average balance of accounts payable}}{\text{Daily credit purchases}} \\ &= \frac{23,43,200}{20,200} = 116 \text{ days} \end{aligned}$$

24. B The implicit cost of trade credit is given by : ≤

$$\frac{\text{Rate of discount}}{1 - \text{Rate of discount}} \times \frac{\text{Number of days in a year}}{\text{Credit period} - \text{Discount period}}$$

$$\frac{0.02}{0.98} \times \frac{360}{40 - 10} = 0.2449 = 24.50 \text{ percent.}$$

25. E ≤

$$\frac{(750 + 700)/2}{(400 + 450 + 450)/91} = 51 \text{ days.}$$

26. A ≤

$$\text{Incremental contribution} = 2,00,000 \times \left( \frac{100 - 88}{100} \right) = \text{Rs.}24,000$$

Increase in investment in accounts receivable on existing sales

$$= 20,00,000 \times \left( \frac{60 - 36}{360} \right) = \text{Rs.}1,33,333$$

Investment in accounts receivable on increased sales

$$= [2,00,000 \times \left( \frac{60}{360} \right) \times 0.88] = \text{Rs.} 29,333$$

Cost of investment = (1,33,333 + 29,333) 0.15 = Rs.24,400.

Incremental loss = Rs.24,000 – Rs.24,400 = –Rs.400.

27. C Balance as per the cash book: ≤

Day	1st January	2nd January	3rd January
Opening balance	Rs.100,000	Rs.93,000	Rs.86,000
Cheques Deposited	Rs.18,000	Rs.18,000	Rs.18,000
Cheques Issued	Rs.25,000	Rs.25,000	Rs.25,000
Closing balance	Rs.93,000	Rs.86,000	Rs.79,000

Balance as per the pass book:

Day	1	2	3
Opening balance	Rs.100,000	Rs.100,000	Rs.118,000
Cheque Deposited		Rs.18,000	Rs.18,000
Cheque Issued			Rs.25,000
Closing balance	Rs.100,000	Rs.118,000	Rs.111,000

Net float = Rs.111,000 – Rs.79,000 = Rs.32,000 and positive.

28. B The total cost of maintaining inventory is given by: ≤



$$\text{Rs. } \frac{U}{Q} \cdot F + \text{Rs. } \frac{Q \times C}{2}$$

Here, the average inventory = 500 units, Carrying cost (C) = Rs.25 while the number of orders

$$\frac{U}{Q} = 6$$

So, total cost related to the inventories =  $6 \times 250 + 500 \times 25 = 1,500 + 12,500$   
= Rs.14,000

Here, the ordering cost =  $\text{Rs.}250 \times 6 = \text{Rs.}1500$  while the carrying cost is  $500 \times 25$   
= Rs.12,500

Hence, the total cost related to the inventories =  $\text{Rs.}1500 + \text{Rs.}12,500 = \text{Rs.}14,000$ .

29. C The present value of all the cash flows will be =  $\text{Rs.}60 \text{ lakh} \times 0.893 + \text{Rs.}80 \text{ lakh} \times 0.797 + \leq$   
 $\text{Rs.}116 \text{ lakh} \times 0.712 = 53.58 + 63.76 + 82.59 = \text{Rs.}199.932 \text{ lakh} = \text{Rs.}200 \text{ lakh}$  (approximately).  
Benefit cost ratio of a project is given by:

$$= \frac{\text{Present values of the benefits}}{\text{Initial investment}} = \frac{200}{160} = \frac{5}{4} = 1.25.$$

30. C Expected daily usage of raw materials =  $300 \times 0.40 + 400 \times 0.60 = 120 + 240 = 360 \text{ units} \leq$   
Expected lead time =  $12 \times 0.25 + 16 \times 0.75 = 3 + 12 = 15 \text{ days}$ .  
Hence, the expected normal consumption during the lead time =  $360 \times 15 = 5400 \text{ units}$ .

31. C Initial Investment = Rs.100 lakh  $\leq$   
Let the IRR of the project be k  
So,  $\text{Rs.}100 \text{ lakh} = 25 \text{ PVIF}(k,1) + 30 \text{ PVIF}(k,2) + 40 \text{ PVIF}(k,3) + 48 \text{ PVIF}(k,4)$   
At  $k = 12$  percent, the RHS = 105.243 while at  $k = 15$  percent, the RHS = 98.206  
By interpolation,

$$\frac{k-12}{15-12} = \frac{100-105.243}{98.206-105.243} = \frac{5.243}{7.037} = 0.745$$

$K = 12 + 3 \times 0.745 = 14.24 \text{ percent}$ .

32. D The economic order quantity (EOQ) may be calculated as 12,000 units by using  $U = 60,000 \text{ units}, \leq$   
 $F = \text{Rs.}1,200$  and  $\text{PC} = \text{Rs.}100 \times 10 \text{ percent} = \text{Rs.}10$  only.  
Benefits due to the discounts =  $\text{Rs.}3 \times 60,000 = \text{Rs.}180,000$

$$\text{No. of orders as per EOQ} = \frac{60,000}{12,000} = 5$$

$$\text{No. of orders as per revised quantity} = \frac{60,000}{20,000} = 3$$

Benefits due to the savings in ordering costs =  $\text{Rs.}1200 \times (5 - 3) = \text{Rs.}2400$ .

$$\text{Incremental carrying costs} = \frac{Q^1(P-D) \times C}{2} - \frac{Q^* \times P \times C}{2}$$

$$\frac{20,000 \times 97 \times 0.1}{2} - \frac{12,000 \times 100 \times 0.1}{2}$$

$$= 9,7000 - 60000 = \text{Rs.}37000.$$

Hence, the net amount of benefits will be =  $\text{Rs.}180,000 + 2400 - 37000 = \text{Rs.}1,45,400$ .

33. B Let the opening stock of Work in progress =  $x$   $\leq$   
then closing stock of Work in progress =  $1.1x$   
the Average stock of Work in progress =  $\frac{x+1.1x}{2} = \frac{2.1x}{2} = 1.05x$

- The average conversion period =  $\frac{\text{Average stock of Work in progress}}{\text{Average daily cost of production}}$
- Or,  $5 = \frac{1.05x}{50}$
- Or,  $1.05x = 250$
- $\therefore x = 238$  lakhs. Therefore closing stock =  $1.1 \times 238 = 262$  lakhs.
34. B Cheques deposited by a firm in the bank, but not cleared by the bank results in a collection float.  $\leq$
35. C  $\leq$
- Average stock of finished goods =  $\frac{\text{Rs.}2,82,000 + 2,50,000}{2}$
- = Rs.2,66,000
- Cost of sales = Opening stock of finished goods + Cost of production + Selling administration of financial expenditure + Custom and Excise duty – Closing stock of limited goods.
- =  $2,82,000 + 5,16,800 + 2,950 + 5,000 - 2,50,000$
- = Rs.5,56,750
- Daily cost of sales =  $\frac{5,56,750}{360} = 1546.52$
- The finished goods storage period =  $\frac{\text{Average stock of finished goods}}{\text{Daily cost of sales}}$
- =  $\frac{2,66,000}{1546.52} = 172$  days.
36. E Current account deficit occurs when  $\leq$
- (I) Imports exceeds exports and
- (IV) National expenditure exceeds national income
37. D Investment in shares/debentures by foreign investments is recorded in capital account of the Balance of Payments statement.  $\leq$
38. B (I) A quote in terms of U.S. dollars per unit of any other currency is called an American quote.  $\leq$
- (II) A quote in terms of number of units of any other currency per U.S. dollar is called an European quote.
- (III) & (IV) are examples of currencies quoted in American terms.
39. D Heckscher – ohlin model classifies the products/goods in to labor intensive and capital intensive.  $\leq$
40. B The synthetic rates of US \$/Euro are  $\leq$

$$\begin{aligned}
 (\text{US } \$/\text{Euro})_{\text{bid}} &= (\text{US}\$/\text{S}\$)_{\text{bid}} \times (\text{S}\$/\text{Euro})_{\text{bid}} \\
 &= \frac{1}{(\text{S}\$/\text{US}\$)_{\text{ask}}} \times (\text{S}\$/\text{Euro})_{\text{bid}} \\
 &= \frac{1}{1.7386} \times 2.0118 = 1.1571.
 \end{aligned}$$

$$\begin{aligned}
 \text{Similarly } (\text{US}\$/\text{Euro})_{\text{ask}} &= \frac{1}{1.7384} \times 2.0121 = 1.1574. \\
 \text{US}\$/\text{Euro} &= 1.1571/74
 \end{aligned}$$

41. E The Indian foreign exchange market consists of central bank (RBI), commercial banks, authorized dealers, corporates and individuals.  $\leq$

42. A Foreign exchange risk arises due to unanticipated movements in exchange rates.  $\leq$

43. C A crawling peg system is a hybrid of fixed and flexible exchange rate system. Under this system the value of a currency is fixed in terms of a reference currency and this peg itself keeps changing in accordance with the underlying economic fundamentals, by letting the market forces play a role in determining the exchange rate.  $\leq$

44. D If the price of stock goes below the (55 – 5) or Rs.50 then the put option will be exercised and a profit will be made by the holder of put option.  $\leq$

45. B  $\leq$

$$\left( \frac{1 + \frac{0.03}{4}}{1 + \frac{0.02}{4}} \right) \times 1.1410 = \$ 1.1438/\text{Euro}.$$

46. D  $\leq$

$$\begin{aligned}
 \text{Annual capital charge} &= \frac{\text{PV of costs}}{\text{PVIFA}_{k,n}} \\
 \text{ACC of the machine} &= \frac{25,00,000 + 2,00,000 \text{ PVIFA}_{12,9}}{\text{PVIFA}_{12,9}} \\
 &= \frac{25,00,000 + 10,65,640}{\text{PVIFA}_{12,9}} = \text{Rs.} 6,69,219
 \end{aligned}$$

47. A The law of one price theory holds that If the identical product or service can be sold in two different markets, no restrictions exist on the sale, and transportation costs of moving the product between markets are zero, the product's price should be the same in both the markets.  $\leq$

48. A Though treasury bills are risk-free, they are prone to inflation or purchasing risk. As these bills are issued by the Government default risk is nil. There is no prepayment risk as these bills are paid on maturity. Liquidity risk is also nil as these are short-term bills and have high liquidity.  $\leq$

49. B Credit sales help the company to increase total volume of the sales as it may act motivating in buyers, it also helps to enhance the competitive position of the company as due to credit sales market share of the company may increase. In addition to that the company may increase its profitability by charging higher margins as compared to cash sales.  $\leq$

50. E The quantity at which the total is minimized is known as Economic Order Quantity, therefore, point 'Q' in the figure represents EOQ.  $\leq$

51. B Safety stock is extra inventory a firm keeps in case of unforeseen circumstances, which will increase the carrying costs and decrease stock-out costs. It may also decrease ordering costs but may not increase the same.  $\leq$

52. B Re-order point = Normal consumption during lead time + Safety stock  $\leq$   
 From the above equation, it can be understood that whenever consumption during lead time fluctuates, reorder point also changes. Hence, alternative (b) is false and other alternatives are true.

53. C Statement (I) is true because in a situation of undertrading the turnover of working capital is low.  $\leq$   
 Statement (II) is not true because increasing the asset base in a situation of undertrading will only aggravate the problem.  
 Statement (III) is true because in a situation of undertrading the volume of sales is much less in comparison to the assets employed.  
 Statement (IV) is not true because in a situation of undertrading the capital employed is higher than the normal level, given the level of sales. Hence, undertrading is a case of overcapitalization and not undercapitalization.

54. C Increase in the receivables  $\leq$

$$= \Delta S \times \frac{ACP_N}{360} \times VC + S_0 \times \frac{ACP_N - ACP_0}{360}$$

$$= 20 \times \frac{45}{360} \times 0.7 + 30 \times \frac{45 - 36}{360}$$

$$= 1.75 + 0.75 = \text{rs.}2,50,000 \text{ lakhs}$$

$$\text{Cost of funds blocked} = kAI$$

$$= 0.12 \times 2.5 = \text{Rs.}30,000$$

55. D The total cost of ordering and carrying cost  $\leq$

$$= \frac{\text{Annual usage} \times \text{Fixed cost per order}}{\text{Quantity per order}} + \frac{\text{Quantity per order} \times \% \text{ of carrying cost}}{2}$$

$$200,000 = \frac{U \times 500}{10,000} + \frac{10,000 \times 100 \times 0.20}{2}$$

$$\frac{U \times 500}{10,000} = 100,000$$

or,  $U = 20,00,000 = 20 \text{ lakhs.}$

56. C ≤

$$\text{Net benefit cost ratio} = \frac{\text{NPV}}{I}$$

$$\text{Or } 0.2 = \frac{2000}{I}$$

$$\text{Or } 0.2 \times I = 2000$$

$$\text{Or } I = 2000/0.2$$

$$\text{Thus initial investment} = \text{Rs.}10,000$$

$$\text{The present value of cash inflows} = \text{Rs.}10,000 + \text{Rs.}2000$$

$$= \text{Rs.}12,000$$

57. C By issuing letter of credit (L/C), a bank undertakes to pay the supplier of any machinery, goods or services, if the buyer fails to pay. It is issued by a bank in favour of its customer (the buyer in this case). In case the buyer fails to make the payment, the bank will be required to keep its commitment. Hence the alternative (c) is the answer. ≤

58. C Commercial paper is a short term instrument which is issued by financially strong companies. Investment in CPs is open to all investors; so it is not necessarily a source of bank finance. ≤

59. D Invoice discounting does not carry the service elements of factoring like sales ledger administration etc. Hence, option (d) is the correct choice. Recourse factoring, Non-recourse or full factoring and maturity factoring include the service elements of factoring. ≤

60. C Existing cost of inventory ≤

$$= 4 \times 300 + \frac{1,50,000}{2} \times 100 \times 0.10$$

$$= 1200 + 7,50,000 = \text{Rs.}7,51,200$$

$$\text{EOQ} = \sqrt{\frac{2UF}{PC}} = \sqrt{\frac{2 \times 6,00,000 \times 300}{100 \times 0.1}}$$

$$= 6000$$

Cost of inventory in the EOQ system

$$= \frac{6,00,000}{6,000} \times 300 + \frac{6,000}{2} \times 100 \times 0.1$$

$$= 30,000 + 30,000$$

$$= 60,000$$

$$\therefore \text{Benefit} = 7,51,200 - 60,000 = \text{Rs.}6,91,200$$

61. B Calculation of Net Present Value: ≤

Cash Flows in lacs of Rs.	Present Value of cash flows @12% in lacs of Rs.

0	(25)	(40)	(25)	(40)
1	0	10	0	8.93
2	5	14	3.99	11.16
3	20	16	14.24	11.39
4	14	17	8.90	10.80
5	14	15	7.94	8.51
			35.07	50.79

NPV M1 = 35.07 – 25 = Rs. 10.07 lakh

NPV M2 = 50.79 – 40 = Rs.10.79 lakh

62. C Normal consumption during the lead time = (Expected daily usage rate) x (Expected lead time in days) ≤

$$\begin{aligned} \text{Expected daily usage} &= 5(0.3) + 7(0.4) + 9(0.3) \\ &= 7 \end{aligned}$$

$$\begin{aligned} \text{Expected lead time} &= 15(0.5) + 25(0.3) + 30(0.2) \\ &= 21 \end{aligned}$$

$$\begin{aligned} \text{Normal consumption} &= 7 \times 21 \\ &= 147 \text{ tonnes} \end{aligned}$$

Since the normal consumption during the lead time is 147 tonnes, stockouts can occur only if the consumption during the lead time is more than 147 tonnes.

The lead time consumption of more than 147 tonnes along with their respective probabilities of occurrence can be identified from the following table:

Possible levels of usage

Daily usage rate		Lead time in days		Possible levels of usage	
Units	Probability	Units	Probability	Units	Probability
5	0.3	15	0.5	75	0.15
		25	0.3	125	0.09
		30	0.2	150	0.06
7	0.4	15	0.5	105	0.20
		25	0.3	175	0.12
		30	0.2	210	0.08
9	0.3	15	0.5	135	0.15
		25	0.3	225	0.09
		30	0.2	270	0.06

From the table, it can be seen that in the following situations the lead time consumption is more than 147 tonnes.

- i. 150 tonnes (0.06 prob)
- ii. 175 tonnes (0.12 prob)
- iii. 210 tonnes (0.08 prob)
- iv. 225 tonnes (0.09 prob)
- v. 270 tonnes (0.06 prob).

63. E Pay back period appraisal criteria is more helpful for appraising the risky project. ≤

64. E The contract size, type of the contract, tick size and the deliver month are specified in a futures contract. But basis is not specified in the contract. ≤

65. B A currency swap is a combination of two transactions: one spot and one forward with an exchange of currencies. ≤

66. C Reorder level =  $S \times L + F \sqrt{S \times R \times L}$ , where the notations are in their standard use. ≤  
=  $400 \times 20 + 1.8 \times \sqrt{400 \times 2000 \times 20}$   
= 15,200 units.
67. D As per the EOQ model for determining the optimal cash balance, ≤  
Optimal cash balance =  $[(2 \times \text{Annual cash usage} \times \text{Cost per sale of securities}) / \text{Annual interest rate}]^{1/2}$   
or  $C = \sqrt{\frac{2FT}{I}}$   
*squaring both sides we get*  
 $C^2 = \frac{2FT}{I}$   
or  $T = \frac{C^2 I}{2F} = \frac{(2000000)^2 \times (0.10)}{2 \times 500} = \text{Rs.}40,00,00,000$   
Annual cash usage = Rs.40,00,00,000
68. A If one chooses to sell or go short a call option, that person is selling the right to buy the underlying ≤  
asset at a specified strike price to an option holder. The option writer will benefit as long as the price of the underlying asset is below the call's strike price. If the price of the asset increases beyond the strike price of the call, the option holder may choose to exercise the option. In such a case, the option seller will have to buy the underlying asset at the current price and sell it at the call's lower strike price, thereby incurring a loss and the loss is unlimited.
69. C A sudden depreciation may lead to increased prices of imported goods, thereby increasing the ≤  
inflation rate. Hence, option (c) is false.
70. C The following are the important objective of audit committee: ≤  
  
Evaluation of financial reports and policies of the company which are distributed to shareholders and other parties interested in them.  
  
Assesment of the extent of of performance levels of management and staff.  
  
Assurance of shareholders that actions of the company are in line with the target and the company is exercising proper social responsibility.  
  
Monitoring of solutions to various operational problems.  
  
Acting as an insdependent reporting channel for internal audit department.  
  
To have an overview of the implementation of the recommandations of the internal and external auditors.
71. A The cash sales come under the cash receipts whereas,cash purchases, wages and salaries, taxes and ≤  
capital equipment purchase are recorded under cash payments.

72. C ABC system of inventory management has the following advantages: ≤

- It leads a closer control on the costly items where a large amount of funds is blocked.
- A scientific method of controlling inventories can be developed based on the ABC system that will lead to the reduction of clerical costs.
- ABC system also helps to maintain the optimum level of stocks.
- The stock turnover rate can be maintained at a comparatively higher level through scientific control of inventories.
- But, it does not analyse the items in inventory according to their importance in the production process, but its' value.

Hence option (c) is the answer.

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