

Question Paper
Financial Management - II (MB2E2-01) : October 2010

- Answer all 70 questions.
- Marks are indicated against each question.

Total Marks : 100

1. Gross working capital means
 - (a) Total assets
 - (b) Total current assets
 - (c) Total current liabilities
 - (d) Fixed assets minus current assets
 - (e) Current assets minus current liabilities.

(1 mark)
2. Current assets do not include
 - (a) Cash and bank
 - (b) Short-term investments
 - (c) Sundry debtors
 - (d) Prepaid expenses
 - (e) Outstanding expenses.

(1 mark)
3. VED analysis is for
 - (a) Monitoring and controlling stores and spare parts
 - (b) Monitoring and controlling finished goods
 - (c) Monitoring and controlling work in process
 - (d) Monitoring and controlling production process
 - (e) Monitoring and controlling raw materials.

(1 mark)
4. Which of the following statements is **not true** regarding working capital policy?
 - (a) A company may hold a relatively large amount of cash if it anticipates uncertain cash outflows
 - (b) Credit policy has an impact on working capital, since it has the potential to influence sales levels and the speed with which cash is collected
 - (c) The cash budget is useful in determining future financing needs
 - (d) Holding minimal levels of inventory can reduce inventory carrying costs without leading to any adverse effects on profitability
 - (e) Managing working capital levels is important to the financial staff, since it influences financing decisions and overall profitability of the firm.

(1 mark)
5. A company had average accounts receivable of Rs. 0.35 million and sales of Rs. 3.5 million for the year. Assuming 360 days in a year, the average days of outstanding accounts receivable will be
 - (a) 7 days
 - (b) 18 days
 - (c) 36 days
 - (d) 45 days
 - (e) 60 days.

(2 marks)
6. The risk of a possible bankruptcy arising due to the inability of the firm to meet its financial obligations is known as
 - (a) Default risk
 - (b) Liquidity risk
 - (c) Business risk
 - (d) Interest rate risk
 - (e) Market risk.

(1 mark)
7. Which of the following foreign exchange transactions **does not** involve credit risk?
 - (a) Spot transaction
 - (b) Forward contract
 - (c) Option forward contract
 - (d) Futures contract
 - (e) Swap deal.

(1 mark)

8. Which of the following will cause a decrease in the net operating cycle of a firm?
- Increase in the work-in-process period
 - Increase in the raw materials storage period
 - Increase in the average payment period
 - Increase in the average collection period
 - Increase in the finished goods period.
- (1 mark)
9. A financial services company is considering offering credit to Mr. Joshi. The probability that he pays is 0.9. If it offers credit and the cost of sales is 70% of sales, net profit or loss to the firm will be
- A loss of 20% on sales
 - A profit of 20% on sales
 - No profit and no loss
 - A loss of 17% on sales
 - A profit of 17% on sales.
- (2 marks)
10. Which of the following statements is **true** regarding aggressive approach to investment in current assets?
- The investment in current assets for a given level of sales forecast will be higher
 - A company following this approach is subjected to higher degree of risk than a company following conservative approach
 - The turnover of current assets will be less
 - The current assets under this approach is generally financed by long term sources
 - The current ratio in this approach is generally high.
- (1 mark)
11. Which of the following factors influence the composition of working capital?
- Nature of business.
 - Nature of raw material.
 - Marketability of the finished goods.
 - Degree of competition in the market.
- Both (I) and (II) above
 - Both (III) and (IV) above
 - (I), (II) and (III) above
 - (II), (III) and (IV) above
 - All (I), (II), (III) and (IV) above.
- (1 mark)
12. Which of the following statements is **true** regarding Days Sales Outstanding?
- It shows the pattern of sales made by the suppliers of the firm
 - It indicates the outstanding sales order of a company
 - It shows the age-wise classification of the receivables
 - It indicates the average number of days sales outstanding at the end of month/quarter
 - It represents the percentage of receivables outstanding on a daily basis.
- (1 mark)
13. For Ajanta Ltd., the annual yield available on marketable securities is 12%, the fixed cost of effecting marketable securities is Rs. 1,600 and the standard deviation in daily cash balance is Rs. 5,000. If the management of Ajanta Ltd., would like to maintain a minimum cash balance of Rs. 50,000, the upper control limit for the company as per Miller and Orr model will be (Assume 360 days a year).
- Rs. 1,44,248
 - Rs. 1,52,566
 - Rs. 1,64,892
 - Rs. 1,74,624
 - Rs. 1,84,892.
- (2 marks)
14. Which of the following is **not** an assumption of Economic Order Quantity (EOQ)?
- Uniform demand
 - Constant ordering costs
 - Constant carrying costs
 - Constant lead time
 - Constant unit price.
- (1 mark)

15. Elixir Dairy Products Ltd., was offered credit on the terms 4/20, net 45. Assuming 360 days in a year, the cost of trade credit if payment is made after 20th day but before 45th day will be
- (a) 25%
 - (b) 44%
 - (c) 60%
 - (d) 68%
 - (e) 72%.
- (2 marks)
16. A firm's safety stock represents the
- (a) Inventory having passed quality-control inspection
 - (b) Largest order size that achieves minimum order costs
 - (c) Inventory of most frequently ordered items
 - (d) Reorder point that considers lags and uncertainties
 - (e) Inventory, which is stored but not sold.
- (1 mark)
17. Which of the following is a spontaneous source of financing current assets?
- (a) Accrued wages and salaries
 - (b) Commercial paper
 - (c) Public Deposits
 - (d) Cash credit
 - (e) Overdraft.
- (1 mark)
18. Which of the following types of factoring offers short-term finance, sales ledger administration as well as credit protection to the client?
- (a) Recourse factoring
 - (b) Non-recourse factoring
 - (c) Maturity factoring
 - (d) Invoice factoring
 - (e) Bulk factoring.
- (1 mark)
19. Your firm buys on credit terms of 2/10, net 45 days and it always pays on the 45th day. If you calculate that this policy effectively costs your firm Rs.1,59,621 each year, the firm's average accounts payable balance will be (Assume 360 days in a year)
- (a) Rs.6,60,362
 - (b) Rs.7,60,415
 - (c) Rs.8,29,885
 - (d) Rs.8,57,503
 - (e) Rs.8,60,838.
- (2 marks)
20. Which of the following statements is true with respect to Letter of Credit?
- (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)
21. 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, the amount of Maximum Permissible Bank Finance (MPBF) under the method I of the Tandon Committee recommendations will be
- (a) Rs.495 lakh
 - (b) Rs.500 lakh
 - (c) Rs.505 lakh
 - (d) Rs.510 lakh
 - (e) Rs.515 lakh.
- (2 marks)

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

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

(1 mark)

23. Consider the following information pertaining to Zeus Ltd.:

Annual raw material consumption	Rs.13,500
Opening stock of raw materials	Rs. 2,500
Closing stock of raw materials	Rs. 2,000

Assuming 360 days in a year, the raw material storage period will be

- (a) 45 days
- (b) 50 days
- (c) 55 days
- (d) 60 days
- (e) 65 days.

(3 marks)

24. Which of the following costs associated with inventories remain more or less constant irrespective of the size of the order?

- (a) Material cost
- (b) Ordering cost
- (c) Carrying cost
- (d) Cost of funds tied up with inventory
- (e) Cost of running out of goods.

(1 mark)

25. Consider the following data pertaining to a product:

Total cost of ordering and carrying inventory	Rs.900
Quantity per order	6,000 units
Carrying cost as a percentage of the purchase price	2%
Fixed cost per order	Rs.100
Purchase price	Rs.10

The annual usage of the material is

- (a) 14,000 units
- (b) 15,000 units
- (c) 16,000 units
- (d) 17,000 units
- (e) 18,000 units.

(2 marks)

26. Consider the following information pertaining to RK Electronics Ltd.:

Annual sales of television	3,000 units
Fixed cost per order	Rs.2,000
Purchase price per unit	Rs.8,000
Carrying cost per unit	Rs.2,000

Its economic order quantity for the television sets and the number of orders in a year will be approximately

- (a) 58 units and 42 orders
- (b) 68 units and 36 orders
- (c) 78 units and 38 orders
- (d) 88 units and 28 orders
- (e) 98 units and 25 orders.

(2 marks)

27. If the net benefit cost ratio is 0.4 and the net present value is Rs.4,000, the present value of the cash inflows associated with the project will be
- Rs. 9,800
 - Rs.10,000
 - Rs.12,000
 - Rs.13,200
 - Rs.14,000.
- (2 marks)
28. Which of the following techniques are adopted to manage Economic exposure?
- Forwards.
 - Futures.
 - Market Selection.
 - Product Mix.
- Both (I) and (II) above
 - Both (I) and (III) above
 - Both (I) and (IV) above
 - Both (II) and (III) above
 - Both (III) and (IV) above.
- (1 mark)
29. Which of the following may cause a reduction in the economic order quantity of a firm when other things are held constant?
- An increase in carrying cost as a percentage of unit price
 - An increase in the fixed ordering cost per order
 - An increase in the usage of inventory
 - An increase in the lead time
 - Availing the discount for purchasing the materials.
- (1 mark)
30. For Flex 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 stock-out acceptance factor is considered to be 1.8, the reorder level will be approximately
- 13,800 units
 - 14,400 units
 - 15,200 units
 - 16,000 units
 - 17,400 units.
- (2 marks)
31. During the four busiest days in a month, the finance manager estimates the cash outflows to be Rs.10,000, Rs.18,000, Rs.24,000 and Rs.28,000. The finance manager desires sufficient cash to cover payments for 4 days during the peak periods. The safety level of cash to be maintained will be
- Rs. 20,000
 - Rs. 40,000
 - Rs. 80,000
 - Rs.1,60,000
 - Rs.3,20,000.
- (2 marks)
32. Consider the following data pertaining to Moti Industries Ltd.:
- | | |
|-------------------------------------|---------------|
| Annual credit purchases | Rs.86,94,000. |
| Opening balance of accounts payable | Rs.19,50,000. |
| Closing balance of accounts payable | Rs.36,10,000. |
- Assuming 360 days in a year, the average payment period for Moti Industries Ltd., will be approximately
- 110 days
 - 115 days
 - 120 days
 - 125 days
 - 130 days.
- (3 marks)

33. In ABC inventory classification system,

- I. Very costly items appear in category 'A'.
 - II. The items are analyzed according to the usage value.
 - III. The items are analyzed according to their importance in the production process.
- (a) Only (I) above
 - (b) Only (II) above
 - (c) Both (I) and (II) above
 - (d) Both (II) and (III) above
 - (e) All (I), (II) and (III) above.

(1 mark)

34. Which of the following statements is/are **true** with respect to the purpose of receivables which is directly connected with the company's objectives of making credit sales?

- I. To increase total sales.
- II. To increase profits.
- III. To meet increasing competition.

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

(1 mark)

35. The Absolute form of Purchasing Power Parity (PPP) Principle is also known as Law of One Price. But the absolute form of PPP makes some additional assumptions. Which of the following is an additional assumption of absolute form of PPP?

- (a) There is free movement of goods between the two countries
- (b) There is no transportation cost
- (c) There is no tariff on goods
- (d) There is no foreign currency transaction cost
- (e) There is no transaction cost involved in buying and selling good.

(1 mark)

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

- (a) If credit standards are made more stringent, sales are likely to decrease and less amount of money will be locked up in receivables
- (b) If credit standards are made liberal, sales are likely to increase but bad debt losses are likely to increase
- (c) If credit period is lengthened, sales are likely to increase but bad debt losses are likely to decrease
- (d) If credit period is shortened, sales are likely to decrease and reduce the incidence of bad debt loss
- (e) If cash discount is increased, discount paid is likely to increase and amount of receivables is likely to reduce.

(1 mark)

37. A company is currently selling 1,00,000 units of its product at Rs.50 per unit and its variable cost per unit is Rs.40. The company is currently extending one month's credit to its customers. It is thinking of extending the credit period to two months on the expectation that sales will increase by 25% from the current level. If the cost of capital is 25% and sales increases as expected, the net gain to the firm due to the change in the credit policy will be

- (a) Rs.1,04,167
- (b) Rs.2,18,897
- (c) Rs.4,16,667
- (d) Rs.5,41,667
- (e) Rs.6,25,000.

(3 marks)

38. Vishnu Brick Company sells on terms of 3/10, net 30. Gross sales for the year are Rs.12,00,000 and the collections department estimates that 30% of the customers pay on the tenth day and take discounts; 40 percent pay on the thirtieth day; and the remaining 30% pay, on average, 40 days after the purchase. Assuming 360 days in a year, the average collection period will be
- 27 days
 - 35 days
 - 43 days
 - 54 days
 - 66 days.
- (2 marks)
39. Which of the following is a technique for monitoring the status of the receivables?
- Ageing schedule
 - Outstanding creditors
 - Selection matrix
 - Funds flow analysis
 - Credit evaluation.
- (1 mark)
40. Which of the following factors influences the choice of liquidity mix to be maintained by a company?
- Nature of control with the managers
 - Extent of leverage
 - Marginal cost of capital
 - Quality of the product of the company
 - Uncertainty in cash flows.
- (1 mark)
41. Amit Ltd., a manufacturing firm, expects its total cash payments over the planning period (4-months) to be Rs.20,00,000, while the fixed cost per transaction is Rs.200 and the 4-months interest rate on marketable securities is 12% p.a. The optimal level of cash balance for the period is approximately
- Rs.1,41,421
 - Rs.1,85,623
 - Rs.2,83,485
 - Rs.3,61,327
 - Rs.4,01,069.
- (2 marks)
42. Which of the following statements is **true** with respect to float?
- When the net float is negative, the balance in the books of the firm is lower than the balance in the books of the bank
 - When the net float is positive, the payment float is more than the collection float
 - When the net float is positive, the firm cannot play the float, as the balance in the bank's book is less than that in the firm's books
 - When the net float is negative, the firm can play the float and issue cheques as it has an overdrawn bank account according to its own books
 - The amount of cheques deposited by a company in the bank awaiting clearance is called payment float.
- (1 mark)
43. A firm has decided to allocate certain proportion of cash balances in order to take advantage of opportunities that do not arise in the course of its routine business activities. Which of the following motives explain(s) the decision of the firm?
- Speculative motive.
 - Precautionary motive.
 - Transaction motive.
- Only (I) above
 - Only (II) above
 - Only (III) above
 - Both (I) and (II) above
 - Both (II) and (III) above.
- (1 mark)

44. Which of the following is **not** a relevant factor in cash management?
- (a) Prompt billing and mailing the same to the customers
 - (b) Branch-wise collection of receivables
 - (c) Centralized purchases and payments to the suppliers
 - (d) Availing of term loans to the maximum possible limit
 - (e) Prompt depositing of the cheques received from customers in the bank. (1 mark)
45. Which of the following criteria is generally least important in selecting marketable securities for inclusion in the firm's portfolio for cash management purposes?
- (a) Length of maturity
 - (b) Yield
 - (c) Marketability
 - (d) Default risk
 - (e) Liquidity. (1 mark)
46. The economic appraisal of projects assesses the costs and benefits arising out of the project, from the point of view of
- (a) Shareholders
 - (b) Short-term lenders
 - (c) Long-term lenders
 - (d) Society as a whole
 - (e) Suppliers. (1 mark)
47. Which of the following reasons make(s) capital expenditure decisions very important in corporate finance?
- I. Once the decision is taken, it has far-reaching consequences which extend over a considerably long period, and influences the risk complexion of the firm.
 - II. These decisions involve huge amount of money.
 - III. These decisions are irreversible once taken.
 - IV. These are the most difficult decisions to make when the company is faced with various potentially viable investment opportunities.
- (a) Only (I) above
 - (b) Only (III) above
 - (c) Only (IV) above
 - (d) (I), (II) and (IV) above
 - (e) All (I), (II), (III) and (IV) above. (1 mark)
48. Which of the following statements is **true** regarding terms of trade credit of 2/10, net 30?
- (a) A 10% cash discount is offered for payment before 30 days after sale
 - (b) A 2% cash discount is allowed for payment within 10 days from the date of sales
 - (c) A 10% cash discount is allowed if paid within 2 days after sale
 - (d) Cash discount is available if payment is made between 2nd and 10th day of sale
 - (e) A 2% cash discount is awarded for payment made between 10th and 30th day after sale. (1 mark)
49. Which of the following measures the present value return from the outlay of each rupee?
- (a) Payback period
 - (b) Internal rate of return
 - (c) Net present value
 - (d) Benefit-cost ratio
 - (e) Accounting rate of return. (1 mark)
50. The discount rate that equates the present value of cash flows with the cash outflows is called
- (a) The net present value
 - (b) The internal rate of return
 - (c) The sum of the present value of cash flows
 - (d) The terminal value of the cash flows
 - (e) The profitability index. (1 mark)

51. The average stock of work-in-process for Epsilon Ltd., is Rs.5,00,000 and the annual cost of production is Rs.4,50,00,000. The average conversion period is (Assuming 360 days in a year)
- 3 days
 - 4 days
 - 10 days
 - 12 days
 - 15 days.

(3 marks)

52. Which of the following is **not** part of collection program?

- Dispatch of letters to customers whose due date is approaching
- Monitoring the state of payables
- Telegraphic and telephonic advice to customers around the due date
- Threat of legal actions to overdue accounts
- Legal action against overdue accounts.

(1 mark)

53. Sahara Ltd. is planning for a new plant with an initial outlay of Rs.45 crore. This plant has a life of 5 years. Net expected cash inflows from this project are as follows:

(Rs. in crore)					
Year	1	2	3	4	5
Cash inflows	11.00	13.50	14.50	15.50	16.50

If the opportunity cost of capital of the company is 14%, the Net Present Value (NPV) of the project will be

- Rs.-13.30 crore
- Rs. 2.57 crore
- Rs. 10.62 crore
- Rs. 23.18 crore
- Rs. 24.50 crore.

(2 marks)

54. A firm with a weighted average cost of capital of 12% is considering Project X, which is expected to generate the following cash flows:

Year	0	1	2	3	4
Cash Flow	(Rs.10,000)	Rs.3,500	Rs.4,500	Rs.5,000	Rs.4,000

The discounted payback period is

- 1.32 years
- 2.08 years
- 2.92 years
- 3.41 years
- 3.62 years.

(2 marks)

55. Which of the following is **not** an objective of cash management?

- To arrange for repayment/investments during periods of cash surpluses
- To find avenues for financing during periods of cash deficits
- To make long-term forecasts of cash position
- To minimize idle cash
- To effectively monitor the cash position.

(1 mark)

56. Consider the following rates quoted in forex market:

Rs./\$:	43.50/52
£/Euro	:	0.6921/23
\$/£	:	1.7874/76

The synthetic quotes of Rs./Euro are

- 53.81/53.86
- 53.83/53.88
- 53.84/53.89
- 53.80/53.84
- 53.79/53.83.

(2 marks)

57. Which of the following is **not** a function of World Trade Organization?
- (a) To limit harmful trade practices
 - (b) Cooperating with other international institutes involved in global trade policies
 - (c) Acting as a forum for multilateral trade negotiations
 - (d) Overseeing national trade policies
 - (e) Short-term financing for development of trade among member countries. (1 mark)
58. Interest rate parity implies that
- (a) Interest rate should change by an equal amount but in the opposite direction, to the difference in inflation rates between two countries
 - (b) In the long run, real interest rate between two countries will be equal
 - (c) Nominal interest rates in each country are equal to the required real rates plus compensation for expected inflation
 - (d) The interest rates between two countries start in equilibrium; any change in the differential rate of inflation between the two countries tend to offset over the long-term by an equal but opposite change in the spot exchange rate
 - (e) The difference in interest rates in different currencies for securities of similar risk and maturity should be consistent with the forward rate discount or premium for the foreign currency. (1 mark)
59. Marvel Industries is engaged in the production of nuts and bolts and the main raw-materials used is steel rod. The annual usage of steel is 9000 tonnes. The lead-time for procuring material is 10 days, the average quantity per order is 100 tonnes. If the reorder level is 475 tonnes, the stock out acceptance factor will be approximately (Assume 360 days in a year)
- (a) 1.0
 - (b) 1.6
 - (c) 1.9
 - (d) 2.2
 - (e) 2.6. (2 marks)
60. In balance of payments statement, current account deficits are offset by
- (a) Merchandise trade deficits
 - (b) Merchandise trade surpluses
 - (c) Capital account surpluses
 - (d) Capital account deficits
 - (e) Official reserves. (1 mark)
61. If the dollar price of one Swiss franc is \$ 0.68 and the expected price of Swiss franc after one year is \$ 0.70 and the interest rate on U.S. bonds is 4 % p.a., the interest rate on Swiss franc bonds for the interest rate parity condition to hold will be
- (a) 0.98%
 - (b) 1.03%
 - (c) 2.06%
 - (d) 4.03%
 - (e) 7.06%. (2 marks)
62. Which of the following theories of international trade states that the improvement in technology is a continuous process and the resulting inventions and innovations in existing products give rise to trade between such countries?
- (a) Theory of absolute advantage
 - (b) Theory of comparative advantage
 - (c) Hecksher-Ohlin model
 - (d) Imitation gap theory
 - (e) International product life cycle theory. (1 mark)
63. Which of the following is **not** a marketing strategy?
- (a) Market selection
 - (b) Pricing strategy
 - (c) Promotional strategy
 - (d) Product sourcing
 - (e) Product strategy. (1 mark)

64. The system under which the exchange rates are determined by the demand and supply position for the currencies in the foreign exchange market is known as

- (a) Target zone arrangement system
- (b) Crawling peg system
- (c) Fixed exchange rate system
- (d) Floating exchange rate system
- (e) Currency board system.

(1 mark)

65. Consider the following data pertaining to a company:

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

Assuming 360 days in a year, finished goods storage period for the company will be

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

(3 marks)

66. In futures trading, the margin is deposited by

- (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)

67. If a stock is purchased at Rs.50 and a Rs.55 call is written on the above stock for a premium of Rs.2, the maximum possible gain per share will be

- (a) Rs. 2
- (b) Rs. 5
- (c) Rs. 7
- (d) Rs. 8
- (e) Rs.10.

(2 marks)

68. Which of the following statements is true with respect to callable swap?

- (a) The fixed rate payer has the right to terminate the swap at any time before its maturity
- (b) Both fixed rate payer and receiver have right to terminate the swap at any time before its maturity
- (c) The fixed rate receiver has the right to terminate the swap at any time before its maturity
- (d) Both fixed rate payer and receiver have right to extend the swap beyond maturity
- (e) The fixed rate payer has the right to extend the swap beyond maturity.

(1 mark)

69. Which of the following statements is false with respect to forward swaps?

- (a) The commencement date is set at a future date
- (b) It works to the convenience of the fixed rate payer
- (c) It is also termed as deferred swaps
- (d) It provides the benefit from existing rate of interest
- (e) It helps in locking the swap rates.

(1 mark)

70. Link Inc., is planning to purchase a new mixer for Rs.50,000. The new equipment will replace an older mixer that has been fully depreciated but has a market value of Rs.5,000. Assume the marginal tax rate of 36%, the net investment required for this project will be

- (a) Rs.43,200
- (b) Rs.46,800
- (c) Rs.49,000
- (d) Rs.52,400
- (e) Rs.58,400.

(2 marks)

END OF QUESTION PAPER

Suggested Answers

Financial Management - II (MB2E2-01) : October 2010

ANSWER	REASON
1. B	Gross working capital means total current assets.
2. E	An outstanding expense comes under current liability.
3. A	VED analysis is for monitoring and controlling of stores and spare parts by classifying them into 3 categories viz., vital, essential and desirable.
4. D	Holding minimal levels of inventory may result in lost sales, which in turn effects profitability. Statement (d) is false and thus the appropriate choice. Statements (a), (b), (c) and (e) are all true statements.
5. C	Accounts Receivable turnover = Annual sales/Accounts receivable. $= 35,00,000/3,50,000 = 10$ Average receivables collection period = 360/Accounts receivable turnover Turnover = 360/10 = 36 days.
6. B	Liquidity risk refers to the risk of a possible bankruptcy arising due to the inability of the firm to meet its financial obligations. Business risk refers to the risk of doing business in particular industry or environment and it gets transferred to the investors who invest in the business or company. Interest rate risk is the variability in a security's return resulting from changes in the level of interest rates. Market risk refers to the variability of returns due to fluctuations in the securities market. Default risk is the risk of non-recovery of the sums due from outsiders, which may arise either due to their inability to pay or unwillingness to do so. This risk has to be considered when credit is extended to any party.
7. D	In futures contract there is no credit risk as the futures clearing house bears the credit risk.
8. C	The average payment period is deducted from the gross operating cycle period, which is the total of the raw materials storage period, work-in-process period, finished goods period and receivables period. Hence, an increase in the payment period will cause a decrease in the net operating cycle period. All other alternatives represent changes, which cause an increase in the operating cycle period.
9. B	$P_p \times (1 - \text{Percentage of Cost on Sales}) - (1 - P_p) \times \text{Percentage of Cost on Sales}$ $0.9 \times 0.3 - 0.1 \times 0.7 = 0.2 = 20\% \text{ on sales.}$
10. B	In aggressive approach company generally subjected to higher degree of risk than the company following conservative approach. Hence option (b) is correct. The turnover of current asset will be high. The current assets under this approach are generally not financed by long term sources. The investment in current assets for a given level of sales forecast is not high.
11. E	Factors affecting the composition of working capital: I. Nature of business. II. Nature of raw material. III. Marketability of the finished goods. IV. Degree of competition in the market. V. Process technology used.
12. D	Days sales outstanding (DSO) is the ratio between the accounts receivables at the time chosen and the average daily sales. In this way, it gives some indication regarding the span of the average collection period. DSO indicates the average number of days sales outstanding at the end of month/quarter. DSO is neither better than collection matrix, nor does it indicate the outstanding sales order of a company. DSO shows the pattern of sales made by the company not any of its' suppliers. Agewise classification of the receivables is shown in the ageing schedule. Hence, the option (d) is correct.

13. E The return point and the upper control limit for beta as per Miller and Orr model are as follows:
- $$RP = \sqrt{\frac{3b\sigma^2}{4I}} + LL$$
- $$UL = 3RP - 2LL$$
- RP = Return Point
b = Rs.1600
- $$I = \frac{0.12}{360} = 0.00033 \text{ or } 0.0333 \text{ percent}$$
- σ = Rs. 5000
LL = Rs. 50,000
UL = Upper control Limit.
- $$RP = \sqrt{\frac{3(1600)(5000)^2}{4 \times 0.00033}} + 50,000 = 94,964$$
- $$UL = 3 \times 94,964 - 2 \times 50,000$$
- $$UL = \text{Rs. } 1,84,892.$$
14. D EOQ model assumes that there is no lead time. Delivery is instantaneous. Hence, (d) is the correct answer.
15. C Cost of trade credit = $\frac{\text{Rate of discount}}{1 - \text{Rate of discount}} \times \frac{\text{Number of days in a year}}{(\text{Credit period} - \text{Discount period})}$
- $$= \frac{0.04}{1 - 0.04} \times \frac{360}{(45 - 20)} = 60\%.$$
16. D A firms' safety stock represents the reorder point that considers lags and uncertainties.
17. A Spontaneous liabilities generally occur during the normal course of business operations where a company will usually have a ready access to certain sources for financing its current assets. But a company is required to take proper initiative for the sources of finance as mentioned in the other options to finance its current assets.
18. B In case of non-recourse factoring, the factor offers short-term finance, sales ledger administration as well as credit protection simultaneously. It is not available in any other mode of factoring.
19. B Approximate percentage cost = $\frac{2}{98} \times \frac{360}{35} = 0.209913$.
- $$\text{Accounts payable} = \frac{1,59,621}{0.209913} = \text{Rs. } 7,60,415.$$
20. 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 favor 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.
21. A **Method I**
- | | | |
|--|---|---------------------------------------|
| 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 |
| | = | Rs.660 × 0.75 = Rs.495 lakh. |
22. 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.

23. D Raw material storage period = $\frac{\text{Average stock of raw materials}}{\text{Average daily consumption of raw materials}}$

Average stock of raw materials = $\frac{\text{Opening stock} + \text{closing stock}}{2}$

= $\frac{2,500 + 2,000}{2} = 2,250$

Average daily consumption = $\frac{\text{Annual consumption}}{360}$

= $\frac{13,500}{360} = 37.5$

Raw material storage period = $\frac{2,250}{37.5} = 60 \text{ days.}$

Hence (d) is the correct answer.

24. B Ordering costs are independent of the size of the order; hence they remain more or less constant irrespective of the size of the order.

25. E Total costs associated with inventory = Ordering cost + Carrying cost = $\frac{U}{Q} \times F + \frac{QPC}{2}$

Where

U is the annual usage

Q is the quantity ordered

F is fixed cost per unit

P is the purchase price per unit

C is the carrying cost expressed as a percentage of the purchase price.

Hence, $900 = \frac{U}{6,000} \times 100 + \frac{6000 \times 10 \times 0.02}{2}$

U = 18,000 units.

26. C The economic order quantity is defined as: $Q^* = \sqrt{\frac{2UF}{PC}}$

Here, U = 3,000 units, F = Rs.2,000, P = Rs.8,000 and C = 25 percent of the inventory value.

So, $Q^* = \sqrt{\frac{2 \times 3,000 \times 2,000}{2,000}} = 78 \text{ units}$

Hence, the required economic order quantity is 78 units.

Number of orders = $3,000 \text{ units} / 78 \text{ units} = 38.46 \text{ times} = 38 \text{ times.}$

27. E Net benefit cost ratio = $\frac{NPV}{I}$

Or $0.4 = \frac{4000}{I}$

Or $0.4 \times I = 4000$

Or $I = 4000 / 0.4$

Thus initial investment = Rs.10,000

The present value of cash inflows = Rs.10,000 + Rs.4000 = Rs.14,000

28. E Economic exposure can be managed by the techniques, market selection and product mix.

29. A The economic order quantity (EOQ) is directly related to the annual usage and the fixed cost per order while inversely related to the carrying cost of the inventories. An increase in the carrying cost for the inventories will decrease the EOQ for a company while the conditions as mentioned in the other options will increase the economic order quantity. Hence, the option (a) is the correct one.
30. 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.
31. C The average cash outflows = $\frac{10,000 + 18,000 + 24,000 + 28,000}{4} = \text{Rs.}20,000$.
Safety level = $4 \times 20,000 = \text{Rs.}80,000$
Hence (c) is the correct answer.
32. B Average payment period = $\frac{\text{Average balance of trade creditors}}{\text{Average daily purchase}}$
Average balance of trade creditors = $\frac{\text{opening creditors} + \text{closing creditors}}{2} = 27,80,000$
Average daily purchases = $\frac{\text{Annual Credit Purchases}}{\text{Number of days in a year}} = \frac{86,94,000}{360} = 24150$
Average payment period = $\frac{27,80,000}{24,150} = 115.11 \text{ days} \approx 115 \text{ days}$
33. C In ABC inventory classification system, class 'A' items are the most costly or the slowest turning item of the inventory. It may require frequent deliveries. It analyzes the items according to their respective values not according to their importance in the production process. Hence option (c) is correct.
34. E The purpose of receivables is directly connected with the company's objectives of making credit sales, Which are
I. To increase total sales; because when a company sells goods on credit, it will be in a position to sell more goods than if it insists on immediate cash payment.
II. To increase profits; because this results in an increase in sales not only in volume, but also because companies charge a higher margin of profit on credit sales as compared to cash sales.
III. To meet increasing competition; and for this the company may have to grant better credit facilities than those offered by its competitors.
35. D That there is no foreign currency transaction cost involved is one of the additional assumptions of absolute form of PPP. All others are assumptions of Law of One Price.
36. C If credit standards are made more stringent, sales are likely to reduce as the customers are expected to fulfill the rigid credit standards specified by the company. With the decrease in the sales, the money blocked in receivables also reduce. Hence statement (a) is true.
If credit standards are made liberal, sales may increase but the company is more likely to be saddled with a large quantum of money locked up in receivables, higher incidence of bad debt losses and increased expenses on collection front. Statement (b) is true.
If credit period is lengthened, more customers are induced to take the credit and the sales tend to increase and there are more chances of bad debts occurring. Sales are likely to increase but bad debt losses are likely to decrease. Hence statement (c) is not true.
If credit period is shortened, sales are likely to decrease and reduce investment in receivables and reduce the incidence of bad debt loss. Statement (d) is true.
If cash discount is increased, the amounts of discounts paid tend to increase even when same proportion of customers avail the discount. As many customers tend to avail the discount and pay within the discount period, amount blocked in receivables will be less. Statement (e) is true.
Thus, (c) is the answer.

37. A Incremental Contribution = $25,000 \times 10 = \text{Rs } 2,50,000$
Variable cost to sales ratio = $\frac{40}{50} = 0.80$
Incremental cost of receivables =
 $= \frac{2-1}{12} \times 50,00,000 \times 0.25 + \frac{2}{12} \times 12,50,000 \times 0.8 \times 0.25 = \text{Rs. } 1,45,833.$
Net gain to the firm = Incremental profit – Incremental cost = $\text{Rs. } 2,50,000 - 1,45,833$
= $\text{Rs. } 1,04,167.$
38. A The average collection period may be calculated by multiplying the percent of customers that pay at various intervals with their respective pay period and summing the values.
 $ACP = 0.30 \times 10 + 0.40 \times 30 + 0.30 \times 40 = 27 \text{ days.}$
39. A Ageing schedule is used to monitor the status of the receivables. Outstanding creditors in the balance sheet indicate the position of accounts payable 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.
40. E A company generally chooses the liquidity mix on the basis of the level of uncertainty in the cash flows. Nature of control with the managers, extent of leverage, marginal cost of capital and the quality of the products of the company do not play any role in this respect.
41. A
$$C = \sqrt{\frac{2FT}{I}}$$

C = Cash balance for the period
T = Total demand for cash over the specified period
F = Fixed transaction cost associated with a transaction
I = Interest rate on marketable securities for the period.

$$C = \sqrt{\frac{2 \times 2000000 \times 200}{0.04}}$$

 $C = 1,41421.3562 \approx 1,41,421$
42. B Net float = payment float – collection float. Statement (b) is true.
When net float is positive, the balance in the books of the company is less than in the bank's books. When the net float is negative, the book balance of the company is more than that in the bank's books. Statement (a) is not true.
When a company has a 'positive net float', it may issue cheques to the extent that the amount shown in the company's books, even if the company's books indicate an overdrawn position. The company is said to be playing the float. When the net float is negative, the company cannot play the float, as the balance in the bank's book is less than that in the firm's books. Statements (c) and (d) are not true.
The amount of cheques deposited by a company in the bank awaiting clearance is called collection float. Statement (e) is not true.
Therefore, (b) is the answer.
43. A Under speculative motive, firms maintain cash balances in order to take advantage of opportunities that do not arise in the ordinary course of business. Hence, option (a) is correct.
Precautionary motive indicates the amount of cash maintained to meet some unexpected contingencies and transaction motive indicates the amount of cash that is maintained to meet the day-to-day transactions of the firm.
44. D Whether or not to avail of term loans and to what extent is related with the borrowing policy of a firm; it is not related with cash management.
45. B The reason for holding marketable securities is to keep idle cash in the form of cash equivalents so as to earn some return as well as to have the facility of conversion into cash as and when desired. Given this, length of maturity, default risk, marketability and liquidity are more important than the return earned on these securities.

46. D The economic appraisal of projects is an exercise to assess the costs and benefits entailing from the project, from the point of view of the society as a whole (d) and not any particular entity like shareholders (a), short-term lenders (b), long-term lenders (c) or suppliers (e).
47. E Capital expenditure decisions have the following characteristics:
 These decisions have far-reaching consequences, which extend over a considerably long-period, which influences the risk complexion of the firm.
 They involve huge amounts of money.
 They are irreversible in nature.
 They are among the most difficult decisions to make when the company is faced with various potentially viable investment opportunities.
 Hence, option (e) is the correct choice.
48. B 2/10, net 30 implies a 2% cash discount can be taken for payment within 10 days from the date of sales.
 Hence (b) is the correct answer.
49. D The benefit-cost ratio measures the present value per rupee of outlay.
50. B The discount rate that equates the present value of cash flows with the initial outlay is called. The internal rate of return.
51. B Average conversion period = $\frac{\text{Average stock of work - in - process}}{\text{Average daily cost of production}}$

$$\text{Average conversion period} = \frac{5,00,000}{\text{Average daily cost of production}}$$

$$\text{Average daily cost of production} = \frac{4,50,00,000}{360}$$

$$\text{Average daily cost of production} = 1,25,000$$

$$\text{Average conversion period} = \frac{5,00,000}{1,25,000} = 4 \text{ days.}$$
52. B The collection program consists of the following:
- Dispatch of letters to customers whose due date is approaching.
 - Monitoring the state of receivables.
 - Telegraphic and telephonic advice to customers around the due date.
 - Threat of legal actions to overdue accounts.
 - Legal action against overdue accounts.
53. B
$$\text{NPV} = -45 + \frac{11.00}{1.14} + \frac{13.50}{(1.14)^2} + \frac{14.50}{(1.14)^3} + \frac{15.50}{(1.14)^4} + \frac{16.50}{(1.14)^5}$$

$$= -45 + 9.65 + 10.39 + 9.78 + 9.18 + 8.57 = \text{Rs.}2.57 \text{ crore.}$$
54. C The discounted payback is determined by the amount of time required for the project to return the initial investment with discounted cash flows.

$$= -10,000 + \frac{3500}{1.12} + \frac{4500}{(1.12)^2} + \frac{5000}{(1.12)^3} + \frac{4000}{(1.12)^4}$$

$$= -10,000 + 3125 + 3587.4 + 3559 + 2542$$

$$= -10,000 + 3125 + 3587 + 3287.6/3559 = 2.92 \text{ years.}$$

55. C The objective of cash management can be regarded estimating cash position, finding avenues for financing during periods when cash deficits are anticipated and arranging for repayment/investments during periods when cash surpluses are anticipated with a view to minimizing idle cash. Towards this end short-term forecasts of cash receipts and payments are made in the structured form of cash budgets, information is monitored at appropriate intervals for the purpose of control and taking suitable measures as warranted.
- Statement (c) is not true and all other statements are true.
- Hence (c) is the correct answer.
56. A
- $$\begin{aligned} (\text{Rs./Euro})_{\text{bid}} &= (\text{Rs./\$})_{\text{bid}} \times (\$/\text{£})_{\text{bid}} \times (\text{£/Euro})_{\text{bid}} \\ &= 43.50 \times 1.7874 \times 0.6921 = 53.81 \\ (\text{Rs./Euro})_{\text{ask}} &= (\text{Rs./\$})_{\text{ask}} \times (\$/\text{£})_{\text{ask}} \times (\text{£/Euro})_{\text{ask}} \\ &= 43.52 \times 1.7876 \times 0.6923 = 53.86 \\ \text{Rs./Euro} &= 53.81/86 \end{aligned}$$
57. E Statements in options (a), (b), (c) and (d) are the functions of World Trade Organization.
- (e) Short-term financing for development of trade among member countries is not a function of World Trade Organization.
58. E Interest rate parity (IRS) implies that the difference in interest rates in different currencies for securities of similar risk and maturity should be consistent with the forward rate discount or premium for the foreign currency.
59. B
- $$\text{Average daily usage} = \text{Annual usage} / 360 = \frac{9000}{360} = 25 \text{ tonnes}$$
- $$\text{Reorder level} = 475 = 25 \times 10 + F \sqrt{25 \times 100 \times 10}$$
- $$F = \frac{250}{158.11} = 1.58 \approx 1.6$$
- Hence, (b) is the answer.
60. C In balance of payments statement, current account deficits are offset by capital account surplus.
61. B
- $$\frac{1 + 0.04}{1 + r_f} = \frac{0.70}{0.68}$$
- $$r_f = 1.03\%$$
62. D **Imitation-Gap Theory:** According to this theory, the improvement in technology is a continuous process and the resulting inventions and innovations in existing products give rise to trade between such countries.
- According to the theory of absolute advantage proposed by Adam Smith, international trade takes place because one country may be more efficient in producing a particular good than another country, and that other country may be capable of producing some other good more efficiently than the first one.
- According to the Heckscher-Ohlin model, there are two types of products – labor intensive and capital intensive. The reason for two countries benefiting from the trade is the differences in their factor endowments.
- According to the theory of Comparative advantage, each country should produce that good in which it has comparative advantage.
- International product life cycle theory, explains the various stages in the life of a new product and the resultant international trade.

63. D **Marketing strategies:**
- Market selection
 - Pricing strategy
 - Promotional strategy
 - Product strategy.
- Production strategies:**
- Input mix
 - Product sourcing
 - Plant location
 - Raising productivity.
64. D The exchange rates under floating exchange rate system are determined by the demand and supply position for the currencies in the foreign exchange market.
- (a) When a group of countries get together and agree to maintain the exchange rates between the currencies within a certain band around fixed central exchange rates, then it is called a target zone arrangement.
- (b) A crawling peg system is a hybrid of fixed and flexible exchange rate system. Under this system, while the value of a currency is fixed in terms of a reference currency, this peg itself keeps changing in accordance with the underlying economic fundamentals.
- (c) Under fixed exchange rate system, the value of a currency in terms of another is fixed and it is determined by Governments or Central banks of the respective countries.
- (e) Under a currency board system, a country fixes the rate of its domestic currency in terms of a foreign currency and its exchange rate in terms of other currencies depends on the exchange rates between the other currencies and the currency to which the domestic currency is pegged.
65. C
- $$\text{Average stock of finished goods} = \frac{\text{Rs.2,82,000} + 2,50,000}{2}$$
- $$= \text{Rs.2,66,000}$$
- 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.
- $$= 2,82,000 + 5,16,800 + 2,950 + 5,000 - 2,50,000$$
- $$= \text{Rs.5,56,750}$$
- $$\text{Daily cost of sales} = \frac{5,56,750}{360} = 1546.52$$
- $$\text{The finished goods storage period} = \frac{\text{Average stock of finished goods}}{\text{Daily cost of sales}}$$
- $$= \frac{2,66,000}{1546.52} = 172 \text{ days.}$$
66. C Both the parties have to deposit margins with the exchange, whether he is buying or selling.
67. C The option will be exercised if the spot price moves above Rs.55. The maximum possible gain per share when spot price exceeds strike price of Rs.55 is $(55 - 50 + 2) = \text{Rs.7.}$
68. A A callable swap gives the holder, i.e. the fixed rate payer, the right to terminate the swap at any time before its maturity. Should the interest rates fall, the fixed rate payer exercises his right and terminates the swap since the funds will be available at a lower rate. Hence, (a) is the answer.
69. B Forward swaps are different from Deferred Rate Swaps. Deferred Rate Swaps allow the fixed rate payer to enter into a swap at any time up to a specified future date. Forward swaps are attractive to those who do not need funds immediately but would like to benefit from the existing interest rates.
70. B Net investment = Rs.50,000 – Rs.5,000 + Rs.5,000 (0.36) = Rs.46,800.

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