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COURSE MATERIAL

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SUBJECT CODE: 8A, MATERIAL NO: 7
FINANCIAL MANAGMENT _41e

(NEW EDITION THOROUGHLY REVISED & UPDATED UPTO NOV 2018. APPLICABLE FOR MAY/ NOV 2019 EXAMINATIONS UNDER NEW SYLLABUS OF CA INTER. THIS MATERIAL IS SYNCHRONISED WITH JULY 2017 EDITION OF ICAI SM. THIS MATERIAL IS ISSUED ON 21.08.19)

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HOURS ALLOTMENT FOR PREPARATION OF FINANCIAL MANAGEMENT

S.No.	Chapter Name	1st Revision for Weekend Exams	2nd Revision for Revision Exams	3rd Revision for Pre Final Exam	4th Revision on Day Before Exam
1.	Time value of money	1 hour	3 hours	½ hour	15 minutes
2.	Investment Decisions	7- 8 hours	15 – 17 hours	6 hours	2 hours

CHAPTER WISE ANALYSIS OF PREVIOUS EXAMINATIONS (PROBLEMS)

(AS PER IPCC SCHEME)

CHAPTER NAME	N-13	M-14	N-14	M-15	N-15	M-16	N-16	M-17	N-17	M-18 (OLD)	M-18 (NEW)	N-18 (OLD)	N-18 (NEW)	Expected Marks for Nov 2018
Time value of money	-	-	-	-	-	5	-	-	5	-	-	-	-	0 – 4
Investment Decisions (Capital Budgeting)	8	8	-	8	8	8	-	8	8	8	18	8	10	12 – 16
Advanced concepts in Capital Budgeting / supplementary Material on capital Budgeting														
Cost of capital	-	3	3	8	5	8	13	-	-	5	-	8	-	0 – 4
Capital Structure	5	-	3	-	8	-	8	8	5	-	10	4	5	8 – 10
Leverages	7	8	4	5	5	5	5	5	8	8	5	5	10	4 – 8
Management of working capital	8	8	8	13	12	8	8	13	8	8	10	12	20	12 – 16
Ratio Analysis	8	5	8	8	8	8	8	8	8	8	5	5	5	4 – 8
Lease Financing (Taken from CA Final)	10	-	-	8	8	-	-	8	8	-	10	-	4	8 – 12
Risk analysis in capital budgeting (Taken from CA Final)	12	19	15	15	-	22	16	9	8	-	-	-	7	8 – 12
Dividend Decision (Taken from CA Final)	8	14	13	5	10	16	-	5	8	-	-	-	5	8 – 12

HIGHLIGHTS OF THIS MATERIAL

1. **QUESTION PAPERS OF RECENT 2 EXAMS:** At the beginning of this material we have included the question papers of recent exams. This will help to analyse the previous exam trends in a better manner and to assess whether our material is able to cater the needs of the examinations or not.

2. **EXAMINATION TRENDS:** At the beginning of each chapter we have given a table called **MODEL - WISE ANALYSIS OF PREVIOUS EXAMINATIONS**. This analysis will help you to judge the relative importance of each model in each chapter. Based on that analysis you can easily pay more attention on relatively more important models / problems.

   We have also given a table with the title **"SIGNIFICANCE OF EACH PROBLEM COVERED IN THIS MATERIAL".** In this table we have indicated various sources in which same / similar problem is covered. With this students can easily understand the relative importance of each problem.

   Similarly at the beginning of the material we have included a table called **CHAPTER WISE ANALYSIS OF PREVIOUS EXAMINATIONS**. This analysis will help you to judge the relative importance of each chapter and you can pay more attention on relatively more important chapters.

3. **ONE STOP SOLUTION:** Selective Problems from Old SM & Old PM, All the problems from New SM, RTPs of 5 recent examinations and MTPs of 2 recent examinations under old syllabus, RTP and MTP of May 18 under new syllabus i.e., CA Inter. All the problems given in 10 recent examinations have been covered in our material. Our material is like a one stop solution. In the public exam you can expect atleast 90% of the Problems to come from our material.

   For each problem we have given the reference of Study Material (SM), RTPs, MTPs and previous examinations of IPCC. This will help you to assess the relative importance of each problem from examination point of view.

4. **SPACE TO NOTE DOWN IMPORTANT POINTS:** After each problem we have given some space to note down the key points related to that problem. This will help you to synchronize the preparation well, at the time of revision.

5. **APPROACH TO SOLVE PROBLEMS:** We have provided procedural formats (i.e. steps for solving problem) for standard models. This will help to solve the problems quickly.

6. **ABC ANALYSIS:** At the end of each Problem we have indicated ABC categorization. Which will help to pay more attention on relatively more important problems, while listening to the classes itself . Since it is a professional course it is very difficult to provide ABC analysis. But we recommend the students to take the decision based on availability of time, their skills and the amount of risk that they are ready to take. For example, if they have enough time to prepare then it is always beneficial to prepare A, B as well as C category problems.

7. **ASSIGNMENT PROBLEMS:** For every problem in Classroom Discussion there will be a clone in the Assignment Problems. Once a particular problem in Classroom discussion gets finished then the student shall solve corresponding problem in Assignment Problems, on his own. We call this as REWORK. This approach will help you solve an unknown problem in a very easy manner which is a very important skill required to face examinations of professional courses.

8. **PRINTED SOLUTIONS:**
   - For early completion of syllabus we have provided with printed solutions to some selective problems in few chapters.
   - While teaching those problems, faculty will not dictate notes to such problems to students. Faculty will directly explain the printed solution provided in the material and students need to refer the same.
   - For those problems students need not write anything in their notebooks during the class time. But they need to update their notebooks at home i.e. solve those problems in their notebooks at home.

9. **MODEL NAMES:** We have segregated the problems in each chapter into various models. We tried our level best to continue the same model names in Classroom Discussion Problems as well as Assignment Problems for easy identification.

10. **FM THEORY:** There will be a separate material exclusively designed for FM Theory.

CA INTER NOV 2018 QUESTION PAPER
PAPER - 8 FINANCIAL MANAGEMENT

Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his/her answers in Hindi will not be valued.

SECTION - A **Marks: 60**

Question No. 1 is compulsory.

Candidates are also required to answer any four questions from the remaining five questions.

Working notes should form part of the respective answers.

1.

a) Y Limited requires Rs.50,00,000 for a new project. This project is expected to yield earnings before interest and taxes of Rs.10,00,000. While deciding about the financial plan, the company considers the objective of maximizing earnings per share. It has two alternatives to finance the project — by raising debt Rs.5,00,000 or Rs.20,00,000 and the balance, in each case, by issuing Equity Shares. **5M**

The company's share is currently selling at Rs.300, but is expected to decline to Rs.250 in case the funds are borrowed in excess of Rs.20,00,000. The funds can be borrowed at the rate of 12 percent upto Rs.5,00,000 and at 10 percent over Rs.5,00,000. The tax rate applicable to the company is 25 percent.

Which form of financing should the company choose?

b) Following information relating to Jee Ltd. are given: **5M**

Particulars	
Profit after tax	10,00,000
Dividend payout ratio	50%
Number of Equity Shares	50,000
Cost of Equity	10%
Rate of Return on Investment	12%

i) What would be the market value per share as per Walter's Model?

ii) What is the optimum dividend payout ratio according to Walter's Model and Market value of equity share at that payout ratio?

c) The following is the information of XML Ltd. relate to the year ended 31-03-2018: **5M**

Gross Profit	20% of Sales
Net Profit	10% of Sales
Inventory Holding period	3 months
Receivable collection period	3 months
Non-Current Assets to Sales	1: 4
Non-Current Assets to Current Assets	1: 2
Current Ratio	2: 1
Non-Current Liabilities to Current Liabilities	1: 1
Share Capital to Reserve and Surplus	4: 1
Non-current Assets as on 3IS March, 2017	50,00,000

Assume that:

i) No change in Non-Current Assets during the year 20 17-18

ii) No depreciation charged on Non-Current Assets during the year 2017- 18.

iii) Ignoring Tax

You are required to Calculate cost of goods sold, Net profit, Inventory, Receivables and Cash for the year ended on 3 March, 2018

d) From the following details relating to a project, analyse the sensitivity of the project to changes in the Initial Project Cost, Annual Cash Inflow and Cost of Capital: **5M**

Particulars	
Initial Project Cost	Rs.2,00,00,000
Annual Cash Inflow	Rs.60,00,000
Project Life	5 years
Cost of Capital	10%

To which of the 3 factors, the project is most sensitive if the variable is adversely affected by 10%?

Cumulative Present Value Factor for 5 years for 10% is 3.791 and for 11% is 3.696.

2. Following is the Balance Sheet of Soni Ltd. as on 31st March 2018. **10M**

Liabilities	**Amount in Rs.**
Shareholder's Fund	
Equity Share Capital (10 each)	25,00,000
Reserve and Surplus	5,00,000
Non-Current Liabilities (12% Debenture)	50,00,000
Current Liabilities	20,00,000
Total	1,00,00,000
Assets	**Amount in Rs.**
Non-Current Assets	60,00,000
Current Assets	40,00,000
Total	1,00,00,000

Additional Information:

i) Variable Cost is 60% of Sales.

ii) Fixed Cost p.a. excluding interest 20,00,000.

iii) Total Asset Turnover Ratio is 5 times.

iv) Income Tax Rate 25%

You are required to:

1. Prepare Income Statement

2. Calculate the following and comment:

- **a)** Operating Leverage
- **b)** Financial Leverage
- **c)** Combined Leverage

3. PD Ltd. an existing company, is planning to introduce a new product with projected life of 8 years. Project cost will be 2,40,00,000. At the end of 8 years no residual value will be realized. Working capital of 30,00,000 will be needed. The 100% capacity of the project is 2,00,000 units p.a. but the Production and Sales Volume is expected are as under: **10M**

Year	**Number of Units**
1	60,000 units
2	80,000 units
3 - 5	1,40,000 units
6 - 8	1,20,000 units

Other Information:

i) Selling price per unit 200

ii) Variable cost is 40% of sales.

iii) Fixed cost p.a. 30,00,000.

iv) In addition to these advertisement expenditure will have to be incurred as under:

Year	**1**	**2**	**3—5**	**6—8**
Expenditure (Rs.)	50,00,000	25,00,000	10,00,000	5,00,000

v) Income Tax is 25%.

vi) Straight line method of depreciation is permissible for tax purpose.

vii) Cost of capital is 10%.

viii) Assume that loss cannot be carried forward.

Present Value Table

Year	1	2	3	4	5	6	7	8
PVF @ 10%	0.909	0.826	0.751	0.683	0.621	0.564	0.513	0.467

Advise about the project acceptability.

4. MN Ltd. turnover of 30,00,000 p.a. Cost of Sale is 80% of turnover and Bad Debts are 2% of turnover, Cost of Sales includes 70% variable cost and 30% Fixed Cost, while company's required rate of return is 15%. MN Ltd. currently allows 15 days credit to its customer, but it is considering increase this to 45 days credit in order to increase turnover. It has been estimated that this change in policy will increase turnover by 20%, while Bad Debts will increase by 1%. It is not expected that the policy change will result in an increase in fixed cost and creditors and stock will be unchanged. **10M**

Should MN Ltd. introduce the proposed policy? (Assume a 360 days year)

5. The following data relate to two companies belonging to the same risk class: **10M**

Particulars	A Ltd.	B Ltd.
Expected Net Operating Income	18,00,000	18,00,000
12% Debt	54,00,000	-
Equity Capitalization Rate	-	18%

Required:

a) Determine the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming no taxes as per M.M. Approach.

b) Determine the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming 40% taxes as per M.M. Approach.

6. Answer the following: **1 x 4 = 4M**

a) Explain in brief following Financial Instruments:

i) Euro Bonds

ii) Floating Rate Notes

iii) Euro Commercial paper

iv) Fully Hedged Bond

b) Discuss the Advantages of Leasing. **4M**

c) Write two main objectives of Financial Management. **2M**

OR

Write two main reasons for considering risk in Capital Budgeting decisions.

CA INTER MAY 2018 QUESTION PAPER
PAPER - 8 FINANCIAL MANAGEMENT

Answers are to be given only in English, except in the case of the candidates who have opted for Hindi Medium. If a candidate has not opted for HINDI Medium, his/her answers in Hindi will not be evaluated.

SECTION - A **MARKS: 60**

Question No. 1 is compulsory.

Candidates are also required to answer any four questions from the remaining five questions.

In case, any candidates answers extra question(s)/sub-question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question(s) shall be ignored. Working Notes should form part of the answers.

1.

a) Stopgo Ltd, an all equity financed company, is considering the S repurchase of 200 lakhs equity and to replace it with 15% debentures of the same amount. Current market value of the company is 1140 lakhs and it's cost of capital is 20%. It's Earnings before Interest and Taxes (EDIT) are expected to remain constant in future. It's entire earnings are distributed as dividend. Applicable tax rate is 30 per cent.

You are required to calculate the impact on the following on account of the change in the capital structure as per Modigliani and Miller (MM) Hypothesis:

(i) The market value of the company

(ii) It's cost of capital, and

(iii) It's cost of equity **5M**

b) The following data have been extracted from the books of LM Ltd: **5M**

Sales — 100 lakhs

Interest Payable per annum — 10 lakhs

Operating leverage — 1.2

Combined leverage — 2.16

You are required to calculate:

(i) The financial leverage,

(ii) Fixed cost and

(iii) PIV ratio.

c) The accountant of Moon Ltd. has reported the following data: **5M**

Gross profit	Rs. 60,000
Gross Profit Margin	20 per cent
Total Assets Turnover	0.30:1
Net Worth to Total Assets	0.90:1
Current Ratio	1.5:1
Liquid Assets to Current Liability	1:1
CredIt Sales to Total Sales	0.80:1
Average Collection Period 60 days	60 days

Assume 360 days in a year

You are required to complete the following:

Balance Sheet of Moon Ltd.

Liabilities	Rs.	Assets	Rs.
Net Worth		Fixed Assets	
Current Liabilities		Fixed Assets	
		Debtors	

		Cash	
Total Liabilities		Total Assets	

d) Sun Ltd. is considering two financing plans.

Details of which are as under:

i) Fund's requirement - t 100 Lakhs

ii) Financial Plan

Plan	Equity	Debt
I	100%	—
II	25%	75%

iii) Cost of debt - 12% p.a.

iv) Tax Rate - 30%

v) Equity Share 10 each, issued at a premium of Z 15 per share

vi) Expected Earnings before Interest and Taxes (EBIT) Z 40 Lakhs

You are required to compute:

i) EPS in each of the plan

ii) The Financial Break Even Point

iii) Indifference point between Plan I and II

2.

a) XYZ Ltd. is presently all equity financed, The directors of the company have been evaluating investment in a project which will require 270 laths capital expenditure on new machinery. They expect the capital investment to provide annual cash flows of Rs. 42 lakhs indefinitely which is net of all tax adjustments. The discount rate which it applies to such investment decisions is 14% net.

The directors of the company believe that the current capital structure fails to take advantage of tax benefits of debt, and propose to finance the new project with undated perpetual debt secured on the company's assets. The company intends to issue sufficient debt to cover the cost of capital expenditure and the after tax cost of issue.

The current annual gross rate of interest required by the market on corporate undated debt of similar risk is 10%. The after tax costs of issue are expected to be 10 lakhs. Company's tax rate is 30%.

You are required to calculate:

i) The adjusted present value of the investment,

ii) The adjusted discount rate and

iii) Explain the circumstances under which this adjusted discount rate may be used to evaluate future investments.

b) What are Masala Bonds?

3. Maruti Ltd. requires a plant costing 200 Lakhs for a period of 5 years. The company can use the plant for the stipulated penod through leasing arrangement or the requisite amount can be borrowed to buy the plant. In case of leasing. the company received a proposal to pay annual lease rent of 48 Lalchs at the end of each year for a period of 5 years.

In case of purchase the company would have a 12%,5 years loan years loan to be paid in equated annual installment, each installment becoming due in, the beginning of each year. It is estimated that plant can be sold for 40 Lakhs at the end of 5th year. The company uses straight line method of depreciation. Corporate tax rate is 30%. Cost of Capital after tax for the company is 10%.

The PV]F @ 10% and 12% for the five years are given below:

Year	1	2	3	4	5
PVIF @ 10%	0.909	0.826	0.751	0.683	0.621
PVIF @ 12%	0.893	0.797	0.712	0.636	0.567

You are required to advise whether the plant should be purchased or taken on lease.

4. A company is evaluating a project that requires initial investment of Rs. 60 lakhs in fixed assets and Z 12 laks towards additional working capital.

The project is expected to increase annual real cash inflow before taxes by Rs. 24,00,000 during its life. The fixed assets would have zero residual value at the end of life of 5 years. The company follows straight line-method of depreciation which is expected for tax purposes also. Inflation is expected to be 6% per year. For evaluating similar projects, the company uses discounting rate of 12% in real terms. Company's tax rate is 30%.

Advise whether the company should accept the project, by calculating NPV in real terms.

PVIF (12%, 5 Yrs)		PVIF (6%, 5 Yrs)	
Year 1	0.893	Year 1	0.943
Year 2	0.797	Year 2	0.890
Year 3	0.712	Year 3	0.840
Year 4	0.636	Year 4	0.792
Year 5	0.567	Year 5	0.747

5. Day Ltd., a newly formed company has applied to the Private Bank for the first time for financing it's Working Capital Requirements. The following informations are available about the projections for the current year:

Estimated Level of Activity	Completed Units of Production 31200 plus Units of Work in Progress 12000
Raw Material & Cost	Rs.40 per unit
Direct Wages Cost	Rs. 15 per unit
Overhead	Rs. 40 per unit (inclusive of Depreciation Rs.10 per unit)
Selling Price	Rs. 130 per unit
Raw Material in Stock	Average 30 days consumption
Work in Progress Stock	Material 100% and Conversion Cost 50%
Finished Goods Stock	24000 Units
Credit Allowed by the Suppliers	30 days
Credit Allowed to Purchasers	60 days
Direct Wages (Lag in payment)	15 days
Expected Cash Balance	Rs. 2,00,000

Assume that production is carried on evenly throughout the year (360 days) and wages and overheads accrue similarly. All sales are on the credit basis.

You ate required to calculate the Net Working Capital Requirement on Cash Cost Basis.

6. Answer all.

a) What are the sources of short term financial requirement of the comapny?

b) What is certainty Equivalent?

c) What are the roles of Finance Executive in Modem World?

OR

What are the two main aspects of the Finance Functions