

1. comment on the following. Attempt any four

- (i) Financial gearing is a fair weather friend **[Q. 23 of H.L. Gupta Sir book-I; page- 4.10; Capital structure]**

Ans.

- Financial gearing expresses the relationship between EBIT (Earning Before Interest and Tax) and EBT (Earning Before Tax)
- It measures the ability of the organization to meet the financial risk.
- It helps in ascertaining the ability to honour its fixed financial charges like interest and preference share dividend.
- High financial leverage may result in high EPS.
- High financial leverage also denotes the ability to cover fixed charges.
- Thus financial gearing is a fair weather friend.

- (ii) Deferred payment of taxes is a source of working capital. **[basic concept of deferred payment of taxes & working capital]**

Ans.

Tax deferral refers to instances where a taxpayer can delay paying **taxes** to some future period. In theory, the net taxes paid should be the same. Taxes can sometimes be deferred indefinitely, or may be taxed at a lower rate in the future, particularly for deferral of income taxes. It is a general fact of taxation that when taxpayers can choose when to pay taxes, the total amount paid in tax will likely be lower.

Working capital is a capital which is used for sound operation of the business like stock of raw material, work in progress, stock of finished goods, debtor. Deferred tax payment can be used as a source of working capital

- (III) The device of capital rationing is adopted to control capital expenditure **[Q. 7 of H.L. Gupta Sir book-II; page- 9.2; Capital budgeting]**

Ans.

- There may be situations where a firm has a number of projects that yield a positive NPV.
 - However, the most important resource in investment decisions, i.e. funds, are not fully available to undertake all the projects. This is considered as a Resource Constraint situation.
 - In case of restricted availability of funds, the objective of the firm is to maximize the wealth of shareholders with the available funds. Such investment planning is called Capital Rationing.
- There are two possible situations of capital Rationing.
- Generally firms fix up the maximum amount that can be invested in capital projects, during a given period of time, say a year. This budget ceiling imposed internally is called as **Soft Capital Rationing**.
 - There may be a market constraint on the amount of funds available for investment during a period. This inability to obtain funds from the market, due to external factors is called **Hard Capital Rationing**.

Whenever Capital rationing situation arises, the firm should allocate the limited funds available in such a way that maximizes the NPV of the firm

- (iii) A stable dividend policy is always preferable to a fluctuating dividend policy **[Q. 3 of H.L. Gupta Sir book-II; page- 5.2; Dividend policy]**

Ans.

- Stable means something which lacks fluctuation.
- Fluctuations i.e. abruptly increase or decrease in price may cause adverse effect.
- Efforts should be made to have a stable dividend policy.
 - Stable payout ratio (say 60% payout)
 - Stable amount of dividend (say Rs. 2/- share or 20%)

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- Stable low dividend + an extra premium in case of high profits.
- A stable dividend policy is the one most recommended.
- It is liked by investors since it lacks fluctuations.
- It is a reliable policy and generates trust in the company.
- It boosts the confidence of the investor as it does away with the element of uncertainty and unreliability.
- Abruptly low or high payment of dividend on the other hand ushers the confidence of the investors.

(IV) Intrinsic value of a security is valid for a given set of conditions. **Basic concept of intrinsic value**

Ans.

Intrinsic value is a topic discussed in philosophy wherein the worth of an object or endeavor is derived in-and-of-itself - or in layman's terms, independent of other extraneous factors. A stock also is capable of holding intrinsic value, outside of what its perceived market price is, and is often touted as an important aspect to consider by value investors when picking a company to invest in.

Why Intrinsic Value Matters

Why does intrinsic value matter to an investor? In the listed models above, analysts employ these methods to see if whether or not the intrinsic value of a security is higher or lower than its current market price - allowing them to categorize it as "overvalued" or "undervalued." Typically, when calculating a stock's intrinsic value, investors can determine an appropriate margin of safety, where the market price is below the estimated intrinsic value. By leaving a 'cushion' between the lower market price and the price you believe it's worth, you limit the amount of downside that you would incur if the stock ends up being worth less than your estimate.

For instance, suppose in one year you find a company that you believe has strong fundamentals coupled with excellent cash flow opportunities. That year it trades at \$10 per share, and after figuring out its DCF, you realize that its intrinsic value is closer to \$15 per share - a bargain of \$5. Assuming you have a margin of safety of about 35%, you would purchase this stock at the \$10 value. If its intrinsic value drops by \$3 a year later, you are still saving at least \$2 from your initial DCF value and have ample room to sell if the share price drops with it.

For a beginner getting to know the markets, intrinsic value is a vital concept to remember when researching firms and finding bargains that fit within his or her investment objectives. Though not a perfect indicator of the success of a company, applying models that focus on fundamentals provide a sobering perspective on the price of its shares.

2.(a) **[Q. 40 of H.L. Gupta Sir book-I; page- 3.16; Cost Of capital]** Three companies A, B & C are in the same type of business and hence have similar operating risks. However, the capital structure of each of them is different and the following are the details: (°)

Particulars	A	B	C
Equity share capital (face value `10 per share)	4,00,000	2,50,000	5,00,000
Market value per share	15	20	12
Dividend per share	2.70	4	2.88
Debentures (face value per debenture `100)	Nil	1,00,000	2,50,000
Market value per debenture	-	125	80
Interest rate	-	10%	8%

Assume that the current levels of dividends are generally expected to continue indefinitely and the income-tax rate at 50%. You are required to compute the weighted average cost of capital of each company.

Sol.

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Name of company	Equity			Debt		
		%	Cost of equity		%	Cost of debt
A	6,00,000	100	$2.7/15=0.18 = 18\%$	---	---	
B	5,00,000	80	$4.0/20=0.20 = 20\%$	1,25,000	20	$\frac{10}{125} \times (1-0.5) = 0.04 = 4\%$
C	6,00,000	75	$2.88/12=0.24 = 24\%$	2,00,000	25	$\frac{8}{80} \times (1-0.5) = 0.05 = 5\%$

Calculation of weighted average cost of capital

K_o (at market values) = (Cost of Equity X % of Equity) + (Cost of Debt x % of Debt)

A = $(18\% \times 1.00) = 18\%$
 B = $(20\% \times 0.80) + (4\% \times 0.20) = 16.8\%$
 C = $(24\% \times 0.75) + (5\% \times 0.25) = 19.25\%$

(b) **Q. 6 of H.L. Gupta Sir book-II; page- 13.9 ; Derivative** Equity shares of Bright India Ltd. are being currently sold for `90 per share. Both the call option and put option for a 3-month period are available for a strike price of `97 at a premium of `3 per share and `2 per share respectively. An investor wants to create a straddle position in this share.

Find out his net payoff at expiration of the option period, if the share price on that day happens to be `90 to `105

Sol. Calculation of net pay off. of straddle investor.

Lps= lapse; Exe= exercise; Pre=Premium; G.P. = Grosse profit; N.P.= Net profit

MPS	90	91	92	93	94	95	96	97	98	99	100	101	102	103	104	105
E.P.	97	97	97	97	97	97	97	97	97	97	97	97	97	97	97	97
Put	Exe	Exe	Exe	Exe	Exe	Exe	Exe	Lps	Lps	Lps	Lps	Lps	Lps	Lps	Lps	Lps
Call	Lps	Lps	Lps	Lps	Lps	Lps	Lps	Lps	Exe	Exe	Exe	Exe	Exe	Exe	Exe	Exe
G.P.	7	6	5	4	3	2	1	0	1	2	3	4	5	6	7	8
Pre	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5
N.P.	2	1	9	-1	-2	-3	-4	-5	-4	-3	-2	-1	0	1	2	3

2.(c) **Q. 71 of H.L. Gupta Sir book-II; page- 5.18; Dividend policy**

An investor is holding 1,000 shares of Fatlax Company. Presently the rate of dividend being paid by the company is `2 per share and the share is being sold at `25 per share in the market. However, several factors are likely to change during the course of the year as indicated below:

Particulars	Existing	Revised
Risk free rate	12%	10%
Market risk premium	6%	4%
Beta value	1.4	1.25
Expected growth rate	5%	9%

In view of the above factors whether the investor should buy, hold or sell the shares? And why?

Ans. The Expected Rate of Return can be calculated by applying Capital Asset Pricing Model as follows:

$$K_e = R_f + \beta_i(R_m - R_f)$$

Existing Rate of Return = $12\% + 1.4 (6\%)$

Revised Rate of Return = $10\% + 1.25 (4\%)$

Original Share Price

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$$P_0 = \frac{D(1+g)}{K_e - g} = \frac{2(1.05)}{0.204 - 0.05} = \frac{2.10}{0.154} = \text{Rs. 13.63}$$

Revised Share Price

$$P_0 = \frac{D(1+g)}{K_e - g} = \frac{2(1.09)}{0.15 - 0.09} = \frac{2.18}{0.06} = \text{Rs. 36.33}$$

Analysis

- Under the existing growth rate of 5% the share price is expected to be ` 13.63, but the existing share price is ` 25, which is over priced. If growth rate remains same at 5%, under equilibrium process, it is expected that share price would fall from ` 25 to ` 36.33.
- Under the revised growth rate of 9%, the expected share price is ` 36.33. The current market price of share is ` 25. Therefore, the shareholder can hold the shares and wait for further appreciation in the share price.

Q 3(a). **[Q. 1 of H.L. Gupta Sir book-II; page- 9.4; capital budgeting]** Raghu Electronics wants to take up a new project involving manufacture of an electronic device which has good market prospects. Further details are given below:

	(` in lakhs)
(i) Cost of the project (as estimated) :	
- Land (to be incurred at the beginning of the year 1)	2.00
- Buildings (to be incurred at the end of the year 1)	3.00
- Machinery (to be incurred at the end of the year 2)	10.00
- Working capital (margin money)	
(to be incurred at the beginning of the year 3)	<u>5.00</u>
	20.00

The project will go into production from the beginning of year 3 and will be operational for a period of 5 years. The annual working results are estimated as follows:

	(` in lakhs)
Sales	24
Variable cost	8
Fixed cost (excluding depreciation)	5
Depreciation of assets	2

- (ii) At the end of the operational period, it is expected that the fixed assets can be sold for `5 lakh without any profit).
- (iii) Cost of capital of the firm is 10%. Applicable tax rate is 33.33% inclusive of surcharge and education cess, etc.

You are required to evaluate the 'proposal using the net present value approach and advise the firm.

(10 marks)

Sol. Calculation of net present value (NPV)

Year	Cash flow (`)	PVF @ 10%	P.V. of cash inflow (`)
0	- 17,11,700	1	- 17,11,700
3 to 6	8,00,000	2.6197	20,95,760
7	18,00,000	0.5136	9,24,480
Net present value			13,08,540

Since NPV is positive, hence it is better decision to install the machine.

W/N 1; calculation of P.V. of cash outflow.

Land		=`2,00,000
Building	`3,00,000 x 0.909	= 2,72,700
Plant & machinery	`10,00,000 x 0.826	= 8,26,000
Introduction of working capital	`5,00,000 x 0.826	= <u>4,13,000</u>
Total P.V. of cash out flow		= <u>17,11,700</u>

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W/N 2; calculation of P.V. of operating cash inflow

Sales revenue	₹24,00,000
Less: variable cost	8,00,000
Fixed cost	5,00,000
Depreciation	<u>2,00,000</u>
Earning before tax	₹9,00,000
Less: tax 33.33%	<u>3,00,000</u>
Earning after tax	₹6,00,000
Add: depreciation	<u>2,00,000</u>
Operating cash inflow	<u>₹8,00,000</u>

W/N 3: calculation of terminal cash inflow

Operating cash inflow	₹8,00,000
Add: Realisation of working capital	5,00,000
Realisation of fixed assets	<u>5,00,000</u>
Terminal cash inflow	<u>₹18,00,000</u>

3(b) [Q. 71 of H.L. Gupta Sir book-II; page- 11.27; Forex] Green Ltd." engaged in the production of synthetic yarn is planning to expand its operations. In this context, the company is planning to import a multi-purpose machine from Japan at a cost of ₹(Yen) 2,460 lakh. The company is in a position to borrow funds from its bank in India to finance import at the interest rate of 12% per annum with quarterly rests. Sumitomo Bank in Tokyo has also offered to extend credit of 90 days at 2% per annum against opening of an irrevocable letter of credit.

Other information is as under :

Present exchange rate	₹100 = ₹246
90 Days forward rate	₹100 = ₹250

Commission charges for letter of credit is @ 4% per 12 months.

Advise whether the offer from Sumitomo Bank should be accepted.

Ans. Evaluation of total expenditure as per Indian bank loan option.

Rupee require to purchase Yen 2460 lakhs at spot rate ₹246 = ₹100

$$₹2460 = \frac{100}{246} \times 2460 = ₹1000 \text{ lakhs}$$

For quarterly rest, time 90 days = 3 months $= \frac{3}{12} \times 4 = 1$; interest rate = 12%/4 = 3%

Amount require to pay after 3 months $= ₹1000(1+0.03)^1 = ₹1030 \text{ lakhs}$

Evaluation of net payment as per letter of credit option

Commission require to pay for L.C. $= \frac{1000 \times 4 \times 3}{12 \times 100} = 10 \text{ lakhs}$

Amount require to pay after 3 months $= ₹10(1+0.03)^1 = ₹10.30 \text{ lakhs}$

Amount require to pay sumitomo Bank after 3 months $= ₹2460(1 + \frac{0.02}{12} \times 3) = ₹2472.3$

Equivalent ₹ for ₹2472.3 at 90 days forward rate $₹250 = ₹100$

$$= ₹2472.3 = \frac{100 \times 2472.3}{250} = ₹988.92$$

Total cost of import as per L.C. option = ₹988.92 + ₹10.30 = ₹999.22

L.C. option is better decision because it has lower cost than Indian bank loan options

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Q4. Distinguish between the following. Attempt any four :

- (i) 'Liquidity management' and treasury management'. [Q. 4 H.L. Gupta Sir book-II; page- 18.2; treasury management]

Ans.

- 'Liquidity management ensures that the right amount of cash is available, at the right time and in the right place, is firmly positioned as a pivotal task for every treasurer.
- Liquidity management is in fact a part of treasury management.
- Over the past few years, many treasurers have made substantial progress towards increasing the visibility of their cash flow and centralizing cash within countries or regions.
- However, liquidity management and particularly cash flow forecasting remain the greatest challenges facing treasurers.
- With credit more expensive and elusive for many companies, it is now imperative to tackle these challenges effectively.
- Liquidity management of a financial institution or bank or company is somehow different to that of other trading units.
- The process starts with trapping of funds at lower rate in share/ deposits/ borrowing and ends with investing the same in higher rate to earn profit out-of business with a margin of small portion of cash-in-hand kept to meet day to day operation.

- (ii) 'Financial aspects' and 'economic aspects' of project appraisal. [Q.6 H.L. Gupta Sir book-II; page- 19.2; project management]

Ans. The Financial Aspects of Project Appraisal

The financial aspects of the project are analyzed under the following heads:-

- Amount of resources required to bring the project into operation and the sources from which finance will be obtained.
- Equity-Debt ratio.
- Profitability and Cash flow.
- Security.

Economic Aspects of Project Appraisal

An economic analysis of industrial projects is made on the basis of the following techniques of economic appraisal.

There are three measures commonly used for economic appraisal:-

- 1) Economic Rate of Return (ERR)
- 2) Domestic Resources Cost (DRC)
- 3) Effective Rate of Protection (ERP)

- (iii) 'Current account' and 'capital account' in balance of payment. [Q.13 H.L. Gupta Sir book-II; page- 11.5; forex]

Ans.

Current Account	Capital Account
The current account under Balance of Payment (BOP) includes trade in goods & services.	Capital account basically comprise of cross broader flow of funds that is associated with financial or other assets in trading countries.
Thus is take into account export, import and net foreign income from unilateral transfers.	It takes into account the direct and portfolio investment made by foreign investors in India, are captured by capital account balance of the GOP.

- (iv) 'Capital structure' and 'financial structure'. [Q.10 H.L. Gupta Sir book-II; page- 4.6; capital structuring]

Ans.

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- Capital, structure relates to deployment of funds for creation of long term asset where as financial structure involves creation of both long term and short term assets.
- Capital structure is the main source of financial structure. Capital structure refers to the funds for the long term. Where the firm has no current liabilities, then the capital structure of the firm is equal to the financial structure.
- Capital structure can be considered as one of the major component of financial structure. So capital structure is narrower in sense as compared to financial structure which is broader and includes current liabilities also.
- The financial structure of a firm is considered to be a balanced one in case the amount of current liabilities is less than the capital structure net of outside debt.
- Capital structure & its component can be deployed in acquisition of fixed assets as well as current assets but the current liabilities should not be used to finance acquisition of fixed asset. This would result in an asset liability mismatch

(v) 'Dematerialisation' and 'immobilisation' [Q.5 H.L. Gupta Sir book-II; page- 20.; source of financial]

Ans. There are following two models of depository:-

Immobilization

Where physical share certificates are kept in vaults with the depository for safe custody. All subsequent transactions in these securities take place in book entry form. The actual owner has the right to withdraw his physical securities as and when desired. The immobilization of fresh issue may be achieved by issuing a jumbo certificate representing the entire issue in the name of depository, as nominee of the beneficial owners.

Dematerialization

No physical scrip in existence, only electronic records maintained by depository. This type of system is cost effective and simple and has been adopted in India.

(5 marks each)

5.(a) [Q. 62 of H.L. Gupta Sir book-II; page- 5.33; Dividend policy] A company belongs to a risk class for which the appropriate capitalisation rate is 10%. It currently has outstanding 25,000 shares selling at `100 each. The company is contemplating the declaration of dividend of `5 per share at the end of the current financial year. The company expects to have a net income of `2.5 lakh and has a proposal for making new investment `5 lakh. You are required to show under the Modigliani and Miller (MM) assumptions, whether payment of dividend affects the value of the company .

Ans. 5(a) Calculation of value of the company when dividend is paid and dividend is not paid

Particular	Dividend paid	Dividend not paid
Total number of existing share	25,000	25,000
$P_1 = P_0(1+K_e) - D_1$	$P_1 = `100(1+0.10) - 5 = `105$	$P_1 = `100(1+0.10) = `110$
Total income	`2,50,000	`2,50,000
Dividend paid	$25000 \times `5 = `1,25,000$	----
Retained Earning A	`1,25,000	`2,50,000
New investment required B	`5,00,000	`5,00,000
Fresh capital require B-A	`3,75,000	`2,50,000
Number of new equity shares	$`3,75,000 / `105$	$`2,50,000 / `110$
Total number of share C	$25,000 + `3,75,000 / `105$	$25000 + `2,50,000 / `110$
Value of firm = $P_1 \times C$	`30,00,000	`30,00,000

Thus, whether dividends paid or not, the value of the firm remains the same. Hence the payment of dividend doesn't effect the value of the company.

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5. (b) **[Q. 10 of H.L. Gupta Sir book-II; page- 8.3; inventory management]** Laxmi Ltd. produces an auto part with a monthly demand of 4,000 units .. The product requires- Component-X which is purchased at `20. For every finished product, one unit of Component-X is required. The ordering cost is `120 per order and the holding cost is 10% per annum.

You are required to calculate -

- Economic order quantity (EOQ)
- If the minimum lot size to be supplied is 4,000 units, what is the extra cost, the company has to incur ?
- What is the minimum carrying cost, the company has to incur ?

(10 marks)

Ans. 5 (b): $EOQ = \sqrt{\frac{2AO}{C}}$

(i). where,

EOQ = Economic Order Quantity

A = Annual Consumption = 12 months × 4,000 = 48,000 units

O = Fixed Cost per order = ` 120

C = Carrying cost per unit = 10% of ` 20 = ` 2 per unit

$$EOQ = \sqrt{\frac{2 \times 48,000 \times \text{Rs.}120}{\text{Rs.}2}} = 2,400 \text{ units}$$

(ii). Extra Cost to be incurred if lot size is 4,000 units

		Lot size (4,000 units)	Lot size (2,400 units)
a.	Annual requirement (Units)	48,000.00	48,000.00
b.	Order Size (Units)	4,000.00	2,400.00
c.	No. of orders [(a) / (b)]	12.00	20.00
d.	Purchase price per unit (₹)	20.00	20.00
e.	Purchase Cost [(a) × (d)]	9,60,000.00	9,60,000.00
f.	Ordering Cost [(c) × 120]	1,440.00	2,400.00
g.	Carrying Cost [(b)/2 × (d) × 10%]	4,000.00	2,400.00
h.	Total Cost [(e) + (f) + (g)]	9,65,440.00	9,64,800.00

∴ The extra cost to be incurred by the company = ` 9,65,440 – ` 9,64,800 = ` 640

(III) the minimum carrying cost , the company has to incur $\frac{24,00}{2} \times 2 = `2400$

6. **[Q. Mix of 2 & 4 of H.L. Gupta Sir book-III; page- 23; Working Capital]**

A company has prepared its annual budget, relevant details of which are reproduced below:

- Sales `46.80 lakh (25% cash sales and balance on credit) 78,000 units
- Raw material cost 60% of sales value
- Labour cost `6 per unit
- Variable overheads `1 per unit
- Fixed overheads `5,00,000 (including `1,10,000 as depreciation)
- Budgeted stock levels
 - Raw materials 3weeks
 - Work-in-progress 1 week (material 100% labour and overheads 50%)
 - Finished goods 2 week

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- (vii) Debtors are allowed credit 4 weeks
 (viii) Creditor allow 4 weeks credit
 (ix) Lag in payment of overheads 2 week
 (x) Cash in hand required `50,000
 (xi) Wages are paid as follows
 (xii) (a) for 1st and 2nd week :
 (b) for 3rd and 4th week :

Prepare working capital budget (requirement) for a year for the company. Assume one year = 52 weeks.

Ans. Sales revenue = `46,80,000 (25% cash sales); production unit = 78,000

Raw material cost = 60% of sales = 60% of `46,80,000 = `28,08,000

Labour cost per unit = `6 variable overhead cost per unit = `1

Fixed overheads = `5,00,000 (including `1,10,000 as a depreciation)

Budgeted stock level :

Raw material = 3weeks ; work in progress =1 week (material 100%;labour & overheads 50%)

Finished goods = 2weeks; debtors are allowed credit = 4 weeks; creditors= 4weeks

Lag in payment of overheads = 2 weeks; cash in hands = `50,000

Lag in payment of wages = 2 weeks; 1year = 52 weeks

Estimation of net working capital on cash cost basis

Current Assets			`
Stock of Raw Material	$\frac{28,08,000}{52} \times 3$		1,62,000
Work-in-progress			
Material	$\frac{28,08,000}{52} \times 1$	54,000	
Labour	$\frac{4,68,000}{52} \times 1 \times 0.5$	45,00	
Overheads	$\frac{4,68,000}{52} \times 1 \times 0.5$	45,00	63,000
Stock of finished goods	$\frac{37,44,000}{52} \times 2$		1,44,000
Debtors	$\frac{37,44,000}{52} \times 4 \times (1 - 0.25)$		2,16,000
Cash & Bank			50,000
Total Current Assets	(A)		6,35,000
Current liability			`
Creditors	$\frac{28,08,000}{52} \times 4$		2,16,000
Outstanding wages	$\frac{4,68,000}{52} \times 2$		18,000
Outstanding overhead	$\frac{4,68,000}{52} \times 2$		18,000
Total Current liability	(B)		2,52,000
Working capital = Current Assets – Current Liability = (A) – (B)			3,83,000

Working Note

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Calculation of cost of production and cost of sales on cash basis			
Raw Material	=	28,08,000	
Wages	=	4,68,000	
Prime cost		32,76,000	
Add: Overheads	variable OHs $78,000 \times 1 = 78,000$		
	Cash fixed OHs $5,00,000 - 1,10,000 = 3,90,000$	=	4,68,000
Cost of Production		37,44,000	Add:
Selling overhead		Nil	
Cost of sale		37,44,000	

Note : 1. depreciation is none cash cost hence it is ignored on calculation of working capital on cash basis

2.Wage is paid in the interval of two weeks

(i) **7. write notes on the following. Attempt any four:**

(i) **Sensitivity analysis in capital budgeting: Capital budgeting practical based question]**

Sensitivity analysis is used in capital budgeting for measuring the risk more precisely future being always uncertain and estimations are always subject to error, sensitivity analysis takes care of estimation errors by using a number of possible outcomes in evaluating a project. The methodology adopted here is to evaluate a project by using a number of estimated cash flows so as to provide to the decision maker an insight into the variability of outcome. Thus, it a underlying factors like selling price, quantity sold, return from an investment etc. However, it should not be viewed as the method to remove the risk or uncertainty, it only a tool to analyze and measure the risk and uncertainty. In terms of capital budgeting the

possible cash flows are based on three assumptions (namely):-

- Cash flows may be worst (Pessimistic).
- Cash flows may be most likely
- Cash flows may be most optimistic.

Sensitivity analysis involves following three steps:-

- Identification of all the variables.
- Definition of the underlying quantitative relationship among the variables, and
- Analysis of the impact of the changes in each

(ii) **Stock index futures [derivative]**

Ans:- Stock futures are financial contracts where the underlying asset is an individual stock. Stock future contract is an agreement to buy or sell a specified quantity of underlying equity share for a future date at a price agreed upon between the buyer and seller. The contracts have standardized specifications like market lot, expiry day, unit of price quotation, tick size and method of settlement.

Index futures are the future contracts for which the underlying is the cash market index. In a normal contract for purchase of equity shares, physical quantity of shares is delivered but in a futures contract, there is nothing to be delivered.

In India, futures on both BSE Sensex and NSE Nifty are traded.

Any eligible investors who can trade in the cash market, can trade in the futures market. For every buyer there is a seller of the futures. What makes them agree on the contract value is the divergence of their views on the likely value of the index future at the expiry of the contract

(iii) Secured premium notes [Q. 16 H.L. Gupta Sir book-II; page- 17.6; source of financ]

Ans.

- These instruments are issued with detachable warrants and are redeemable after a notified period say 4 to 7 years.
- The warrants enable the holder to get equity shares allotted provided the secured premium notes are fully paid.
- During the lock in period no interest is paid.
- The holder has an option to sell back the SPN to the company at par value after the lock in period. If the holder exercises this option, no interest/premium is paid on redemption.

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- In case the holder keeps it further, he is repaid the principal amount along with the additional interest/premium on redemption in installments as per the terms of the issue.
- The terms of the SPN were so formulated that the return on investment was treated as capital gain and not regular income. Consequently, the rate of tax applicable was lower.

(iv) Internal treasury control **[Q. 7 H.L. Gupta Sir book-II; page- 18.3; Treasury Managment]**
Ans.

- Internal treasury control is a process of self improvement.
- It is concerned with all flows of funds, cash and credit and all financial aspects of operations.
- From time to time and on regular basis, the internal treasury control is exercised on financial targets. The control aims at operational efficiency and removal of wastages and inefficiencies and promotion of cost effectiveness in the firm.
- The control is exercised under phases of planning and budgeting.
- These phases include setting up of targets, laying down financial standards, evaluation of performance as per these norms and reporting in a standard format.
- Following principles of internal control need to be mentioned here:-
 - Control should be at all levels of management. The management control can be decentralized or decentralized.
 - There has to be a system of building up of effective communication from top to bottom and bottom to the top.
 - The control should be built upon the management information system.

(v) Benefits of depository system. **[Q. 6 H.L. Gupta Sir book-II; page- 20.4; financial services]**
Ans.

Depository refers to an organisation in which securities of the shareholder is held in the form of electronic accounts.

They help in transferring securities without handling them in physical form and thus leading to the development of scripless trading system and forming basis for dematerialised system.

Benefits of Depository System are as follows:-

- 1) It helps in elimination of bad deliveries. - In depository system as the securities are traded in dematerialised form so there are no chances of bad delivery.
- 2) Immediate transfers and registration of securities – In depository system the dematerialised security once bought or sold are transferred immediately. There is no further need to send it to the company is register for registration.
- 3) Depository system helps in faster disbursement of non cash corporate benefits like right issue / bonus etc.
 In depository system all the non cash corporate benefits are directly credited to the investor account thus helps in faster disbursement.
- 4) Depository system helps in elimination of problem related to the change in address of investor, transmission etc.
 In case of change of address the investors need not report the same to the Company register; they need to report only to the DP.
- 5) It helps to reduce the handling of huge volume of papers and periodic status reports to the investors on their holding and transactions, leading to better control.
- 6) Brokerage cost charged by the broker is also less in trading in dematerialised form.
- 7) Elimination of all the risk associated with trading in physical securities.

Dealing in physical securities involves too much risk including the risk of theft, mutilation of securities or loss of certificates during movements through or from the registrars. Investors are saved from all these risk by trading in dematerialised form. **(5 marks each)**

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