CA/CS/CMA – Financial Management mock paper

Financial Management (60 Questions -1 mark each)

1. 'Shareholder wealth' in a firm is represented by

a) the number of people employed in the firm.

b) the book value of the firm's assets less the book value of its liabilities

c) the amount of salary paid to its employees.

d) the market price per share of the firm's common stock.

2. Which one of the following is not the duty of Finance Manager?

a) Forecasting of cash flow

b) Forecasting of business future

c) Raising Fund

d) Forecasting of Profits

3. ____________ and _____________ are the two versions of goals of the financial management of the firm.

a) Production maximisation, Sales maximisation

b) Profit maximisation, Wealth maximisation

c) Sales maximisation, Profit maximization

d) Value maximisation, Wealth maximisation

4. Which one of the following is not a discounted cash flow technique of Capital Budgeting?

a) Net Present Value method

b) Internal rate of return

c) Profitability Index

d) Average Rate of Return

5. Which of the following statements is correct?

a) If the NPV of a project is greater than 0, its PI will equal 0.

b) If the IRR of a project is 0%, its NPV, using a discount rate, k, greater than 0, will be 0.

c) If the PI of a project is less than 1, its NPV should be less than 0.

d) If the irr of a project is greater than the discount rate, k, its PI will be less than 1 and its nPV will be greater than 0.

6. **What is the earning per share (EPS) for a company that earned ` 100,000 last year in after-tax profits, has 200,000 common shares outstanding and ` 1.2 million in retained earning at the year end?**

   a) ` 100,000

   b) ` 0.50

   c) ` 6.00

   d) ` 6.50

7. **Indicate the cost of equity capital, based on capital asset pricing model, with the following information:**

   Beta coefficient – 1.40 Risk-

   free rate of interest – 9%

   Expected Rate of Return on equity in the market – 16%

   a) 18.8%

   b) 9.8%

   c) 18%

   d) 16%

8. **The degree of super-leverage/combined leverage would be calculated by:**

   a) Adding DOL (Degree of Operating Leverage) and DFL (Degree of Financial Leverage)

   b) Dividing DOL with DFL

   c) Subtracting DOL from DFL

   d) Multiplying DOL and DFL

9. **Who formulated the following model for estimating the market price of equity share ?**

   $P = D + R_a/R_c\ (E – D)/Rc$

   Where, P = Market price of equity share

   D=DPS

   E=EPS

   E – D = Retained earning per share

   R_a = Internal rate of return on investment

   R_c = Cost of capital

   a) Modigliani-Miller

   b) Myron-Gordon

   c) James E. Walter

   d) Clarkson and Elliot

10. **Which one of the following is not a assumption of the Modigliani-Miller model ?**

   a) Perfect capital market

b) Equivalent risk classes

c) Unity for dividend payout ratio

d) Absence of taxes

11. Which one of the following is most suitable coverage ratio for deciding the debt capacity of a firm ?

a) Interest Coverage Ratio

b) Cash Flow Coverage Ratio

c) Debt Service Coverage Ratio

d) Fixed Assets Coverage Ratio

12. Which one of the following is the most popular method for estimating the cost of equity ?

a) Capital asset pricing model

b) Dividend yield method

c) Gordon's dividend discount model

d) Earnings yield method

13. Which one of the following is not the internal factor affecting the weighted average cost of capital of a firm?

a) Investment policy of the firm

b) Capital structure of the firm

c) Dividend policy followed

d) Market risk premium for the firm

14. Most common approach for analysing the capital structure of a firm is

a) Ratio Analysis

b) Cash Flow Analysis

c) Comparative Analysis

d) Leverage Analysis

15. Financial leverage in a firm is positively affected by which of the following?

a) Intensity of tangible assets

b) Operating leverage

c) Profitability

d) Tax Rate

16. Which combination of the following two statements (A) and (R) is correct ?

Assertion (A) : The IRR of a project is the discount rate which reduces its NPV to zero.

Reason (R) : A project is worth accepting if the IRR exceeds the cost of capital.

Codes

a) (A) is right, but (R) is wrong.

b) Both (A) and (R) are correct.

c) (A) is wrong, but (R) is correct.

d) Both (A) and (R) are wrong.

17. Which combination of the following two statements (A) and (R) is correct ?

Assertion (A) : A company should pay minimum dividend to its shareholders.

Reason (R) : Dividends are heavily taxed than capital gains.

Codes:

a) Both (A) and (R) are correct.

b) Both (A) and (R) are incorrect.

c) (A) is not correct, but (R) is correct.

d) (A) is correct, but (R) is wrong.

18. Dividend irrelevance hypothesis is implied in the

a) Traditional Model

b) Walter Model

c) Gordon Model

d) M.M. Model

19. Palo Alto Industries has a debt-to-equity ratio of 1.6 compared with the industry average of 1.4. This means that the company

a) will not experience any difficulty with its creditors.

b) has less liquidity than other firms in the industry.

c) will be viewed as having high creditworthiness.

d) has greater than average financial risk when compared to other firms in its industry.

20. To increase a given present value, the discount rate should be adjusted

a) Upward

b) Downward

c) Either downward or upward, doesn't matter

d) Constant

21. If a company issues bonus shares, the debt equity ratio

a) Remain unaffected

b) Will be affected

c) Will improve

d) None of the above

22. The following information is given in Suryansh Limited, calculate the operating cycle period

- **Average stock of raw material ` 2,00,000**

- **Average stock of work in progress ` 3,00,000**
- **Average stock of finished goods inventory ` 180000**
- **Average receivable ` 3,00,000**
- **Average payable ` 1,80,000**
- **Average raw material store purchase on credit and consumed per day ` 10,000**
- **Average work in progress value of raw material committed per day ` 12,500**
- **Average cost of goods sold per day ` 18000**
- **Average sale per day ` 20000**

a) 69 days

b) 54 days

c) 57 days

d) 51 days

23. Risk of two securities with different expected return can be compared with

a) Coefficient of variation

b) Standard deviation of securities

c) Variance of Securities

d) None of the above

24. A portfolio having two risky securities can be turned risk less if

a) The securities are completely positively correlated

b) If the correlation ranges between zero and one

c) The securities are completely negatively correlated

d) None of the above.

25. Capital Asset Pricing Model (CAPM) accounts for:

a) Unsystematic risk

b) Systematic risk

c) Both a and b

d) None of the above

26. A portfolio comprises two securities A and B. The expected return from both securities 12% and 16% respectively. Determine return of portfolio if security A constitutes 40% of total portfolio.

a) 12.4%

b) 13.4%

c) 14.4%

d) 15.4%

27. Net income available to common stockholders divided by common equity is used to calculate

a) return on earning power

b) return on investment

c) return on common equity

d) return on interest

28. In weighted average cost of capital, a company can affect its capital cost through

a) policy of capital structure

b) policy of dividends

c) policy of investment

d) all of the above

29. A risk associated with project and way considered by well diversified stockholder is classified as

a) expected risk

b) beta risk

c) industry risk

d) returning risk

30. If future return on common stock is 14% and rate on T-bonds is 5% then current market risk premium will be

a) 0.19

b) 0.09

c) 9

d) 19

31. If payout ratio is 0.45 then retention ratio will be

a) 0.55

b) 1.45

c) 1.82

d) 0.45

32. What is the payback period (in years) for a project that costs ` 1,20,000 and would yield after tax cash flows of Rs. 20,000 the first year, Rs. 22,000 the second year, ` 25,000 the third year, ` 27,000 the fourth year, ` 48,000 the fifth year and ` 50,000 the sixth year.

a) 3.93

b) 4.08

c) 4.50

d) 4.84

33. What is the net present value of the project (in `) with a 3 year life and a cost of ` 32,000 generates revenues of ` 8,000 in year 1, ` 12,000 in year 2 and ` 17,000 in year 2. If the discount rate is 5 %

a) 1288

b) 1118

c) 1188

d) 1818

34. Calculate the breakeven point for a company with sales of 1,00,000 units @ ` 10/- per unit, Variable costs are ` 5,00,000/-, Contribution is ` 5,00,000, Fixed Cost is ` 3,00,000 and Net Profit is ` 2,00,000

a) 2,00,000

b) 4,00,000

c) 6,00,000

d) 8,00,000

35. A firm with high operating leverage is characterized by __________ while one with high financial leverage is characterized by __________.

a) low fixed cost of production; low fixed financial costs

b) high variable cost of production; high variable financial costs

c) high fixed costs of production; high fixed financial costs

d) low costs of production; high fixed financial costs

36. Flotation costs should:

a) Be ignored when analyzing a project because flotation costs are not an actual cost of the project.

b) Be averaged over the life of the project thereby reducing the cash flows for each year of the project.

c) Only be considered when two projects have the same net present value.

d) Be included in the initial cost of a project before the net present value of the project is computed

37. Mr. Verma is evaluating two conventional, independent capital budgeting projects (X and Y) by making use of the risk-adjusted discount rate (RADR) method of analysis. Projects X and Y have internal rates of return of 16 percent and 12 percent, respectively. The RADR appropriate to Project X is 18 percent, while Project Y's RADR is only 10 percent. The company's overall, weighted-average cost of capital is 14 percent. Mr. Verma should

a) Accept Project X and accept Project Y

b) Accept Project X and reject Project Y. [IRR of pro X(16%) is less than RADR (18%)so, reject the IRR of pro Y is greater than RADR(10%)so accept]

c) Reject Project X and accept Project Y

d) Reject Project X and reject Project Y

38. A firm's degree of operating leverage (DOL) depends primarily upon its

a) Sales variability

b) Level of fixed operating costs

c) Closeness to its operating break-even point

d) Debt-to-equity ratio

39. An EBIT-EPS indifference analysis chart is used for

a) Evaluating the effects of business risk on EPS

b) Examining EPS results for alternative financing plans at varying EBIT levels

c) Determining the impact of a change in sales on EBIT

d) Showing the changes in EPS quality over time

40. In the context of operating leverage break-even analysis, if selling price per unit rises and all other variables remain constant, the operating break-even point in units will:

a) Fall

b) Rise

c) Stay the same

d) Still be indeterminate until interest and preferred dividends paid are known

41. ABC Ltd. has cash of Rs. 100,000 that will be invested in an equity investment that has a beta of 2.25. The current risk-free rate in the market is 2.5%, and the market requires an 8%risk premium for equity securities. What return should ABC Ltd. expect to earn?

a) ` 8,000

b) ` 18,000

c) ` 23,625

d) ` 20,500

42. Retained earnings are

a) An indication of a company's liquidity.

b) The same as cash in the bank.

c) Not important when determining dividends.

d) The cumulative earnings of the company after dividends

43. Given the following two stocks A and B

	Expected rate of return	**Beta**
A	**0.12**	**1.2**
B	**0.14**	**1.8**

If the expected market rate of return is 0.09 and the risk-free rate is 0.05, which security would be considered the better buy and why?

a) A because it offers an expected excess return of 1.2%.

b) B because it offers an expected excess return of 1.8%.

c) A because it offers an expected excess return of 2.2%.

d) B because it offers an expected return of 14%.

44. Which of the following statements is consistent with dividend irrelevance theory?

a) Investment decisions are the sole determinant of shareholder wealth

b) Making homemade dividends causes investors to incur transaction costs

c) Companies with stable dividend policies build up shareholder clienteles

d) Investors like to maintain the real value of their dividend payments.

45. The __________ is the proportion of earnings that are paid to common shareholders inthe form of a cash dividend.

a) retention rate

b) Marginal rate

c) growth rate

d) dividend payout ratio

46. Chand Communications' CFO has provided the following information:

- **The company's capital budget is expected to be ` 5,000,000**
- **The company's target capital structure is 70 percent debt and 30 percent equity**
- **The company's net income is ` 4,500,000**

If the company follows a residual dividend policy, what portion of its net income should it pay out as dividends this year?

a) 33.33%

b) 40.00%

c) 60.00%

d) 66.67%

47. Which of the following statements are TRUE?

I. The beta of a stock is primarily determined by its correlation with the market

V. The risk-free rate defines where the SML intersects the Y axis.

a) I and III only

b) I ,III and V only

c) I, II, and V only

d) I, II, IV, and V only

48. The expected market return is 15% next year and the risk-free rate is 7%. If the expected return on a stock is 17.40%, what is the beta of the stock?

a) 1.40

b) 1.74

c) 1.71.

d) 1.30

49. The covariance of the market's returns with the stock's returns is .008. The standard deviation of the market's returns is 8% and the standard deviation of the stock's returns is 11%. What is the correlation coefficient between the stock and market's returns?

a) +0.50

b) + 0.91

c) + 1

d) +1.25

50. As you increase the number of stocks in a portfolio, the systematic risk will:

a) Remain constant.

b) Increase at a decreasing rate.

c) Decrease at a decreasing rate.

d) Decrease at an increasing rate

51. Current ratio is 4:1. Net Working Capital is ` 30,000. Find the amount of Current Assets.

a) ` 10,000

b) ` 40,000

c) ` 24,000

d) ` 6,000

52. Which of the following would not be financed from working capital?

a) Cash float

b) Accounts receivable

c) Credit sales

d) A new personal computer for the office

53. When total current assets exceeds total current liabilities it refers to.

a) Gross Working Capital

b) Temporary Working Capital

c) Both a and b

d) Working Capital

54. In the balance sheet amount of total assets is Rs.10 lakhs, current liabilities Rs.5 lakhs & capital & reserves are Rs.2 lakhs. What is the debt equity ratio?

a) 1:1

b) 1.5:1

c) 2:1

d) none of the above

55. **A project has an up-front cost of `100,000. The project's WACC is 12 percent and its net present value is ` 10,000. Which of the following statements is most correct?**

a) The project should be rejected since its return is less than the WACC.

b) The project's internal rate of return is greater than 12 percent.

c) The project's modified internal rate of return is less than 12 percent.

d) All of the statements above are correct

Information: Use the following to answer question 56:

The following data are available relating to the performance of High Variance Stock fund and the market portfolio:

High Variance Market Portfolio

Average Return 19% ; 12%

Standard Deviation of Returns 35% ; 15%

Beta 1.5 ; 1.0

Residual standard deviation 3.0% ; 0.0%

The risk-free return during the sample period was 6%.

56. **What is the Sharpe measure of performance evaluation for High Variance Stock Fund?**

a) 1.33%

b) 8.67%

c) 31.43%

d) 37.14%

57. **Suppose you own two stocks, A and B. In year 1, stock A earns a 2% return and stock B earns a 9% return. In year 2, stock A earns an 18% return and stock B earns an 11% return. Which stock has the higher geometric average return?**

a) stock A

b) stock B

c) the two stocks have the same geometric average return

d) at least three periods are needed to calculate the geometric average return.

58. **Investors may be willing to pay a premium for stable dividends because of the informational content of __________, the desire of investors for __________, and certain __________.**

a) Institutional considerations; dividends; current income

b) Dividends; current income; institutional considerations

c) Current income; dividends; institutional considerations

d) Institutional considerations; current income; dividends

59. **Which of the following factors is most likely to explain why a company decides to increase its annual dividend?**

a) A firm belief by management that dividends represent a residual payment

b) A large number of desirable projects.

c) A large proportion of its shares are owned by institutional investors

d) Pecking order theory

60. Project Financing is appropriate for which kind of projects?

a) Labour Intensive Projects

b) Capital Intensive Projects

c) Both of them

d) None of these