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Answer Paper	
ADVANCED FINANCIAL MANAGEMENT	Duration: 75
Details: Test 1 (Ch-1, 3 and 8)	Marks: 45

Instructions:

- All the questions are compulsory
- Properly mention test number and page number on your answer sheet, Try to upload sheets in arranged manner.
- In case of multiple choice questions, mention option number only Working notes are compulsory wherever required in support of your solution
- Do not copy any solution from any material. Attempt as much as you know to fairly judge your performance.

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Ans.1

(i) Statement Showing the Net Present Value of Project M

Year end	Cash Flow (Rs.) (a)	C.E. (b)	Adjusted Cash flow (Rs.) (c) = (a) × (b)	Present value factor at 6% (d)	Total Present value (Rs.) (e) = (c) × (d)
1	9,00,000	0.8	7,20,000	0.943	6,78,960
2	10,00,000	0.7	7,00,000	0.890	6,23,000
3	10,00,000	0.5	5,00,000	0.840	4,20,000
					17,21,960
Less: Initial Investment					17,00,000
Net Present Value					21,960

Statement Showing the Net Present Value of Project N

Year end	Cash Flow (Rs.) (a)	C.E. (b)	Adjusted Cash flow (Rs.) (c) = (a) × (b)	Present value factor (d)	Total Present value (Rs.) (e) = (c) × (d)
1	9,00,000	0.9	8,10,000	0.943	7,63,830
2	9,00,000	0.8	7,20,000	0.890	6,40,800
3	10,00,000	0.7	7,00,000	0.840	5,88,000
					19,92,630
Less: Initial Investment					16,50,000
Net Present Value					3,42,630

Decision: Since the net present value of Project N is higher, so the project N should be accepted.

(ii) Since Certainty - Equivalent (C.E.) Co-efficient of Project M (2.0) is lower than Project N (2.4), Project M is riskier than Project N and as "higher the riskiness of a cash flow, the lower will be the CE factor". Thus if risk adjusted discount rate (RADR) method is used, Project M would be analysed with a higher rate.

(6 Marks)

Ans.2

Constant Ratio Plan:

Stock Portfolio NAV (Rs.)	Value of Conservative Portfolio (Rs.)	Value of aggressive Portfolio (Rs.)	Total value of Constant Ratio Plan (Rs.)	Revaluation Action	Total No. of units in aggressive portfolio
40.00	10,00,000	10,00,000	20,00,000	-	25000
25.00	10,00,000	6,25,000	16,25,000	-	25000
	8,12,500	8,12,500	16,25,000	Buy 7500 units	32500
36.00	8,12,500	11,70,000	19,82,500		32500
	9,91,250	9,91,250	19,82,500	Sell 4965.2 units	27534.72
32.00	9,91,250	8,81,111.04	18,72,361.04	-	27534.72
38.00	9,91,250	10,46,319.36	20,37,569.36	-	27534.72
	10,18,784.68	10,18,784.68	20,37,569.36	Sell 724.60 units	26810.12
37.00	10,18,784.68	9,91,974.44	20,10,759.12	-	26810.12
42.00	10,18,784.68	11,26,025.04	21,44,809.72	-	26810.12
43.00	10,18,784.68	11,52,835.16	21,71,619.84	-	26810.12

Hence, the ending value of the mechanical strategy is Rs. 21,71,619.84 and buy & hold strategy is Rs. 21,50,000.

(6 Marks)

Ans.3

In the post-pandemic era, the role of CFOs has evolved significantly beyond traditional responsibilities such as governance, compliance, control, and business ethics. They are now actively involved in strategic and operational decision-making. The key areas where their role has expanded include:

Risk Management: CFOs are now expected to oversee the entire risk management framework of the organization, ensuring business continuity and resilience against uncertainties.

Supply Chain Management: Post-pandemic challenges in the supply chain have highlighted the importance of CFOs in assessing and ensuring the financial viability and sustainability of supply chain systems.

Mergers, Acquisitions, and Corporate Restructuring: With an increase in M&A activities to sustain growth and gain market share, CFOs play a critical role in evaluating these strategic decisions, as any misstep can jeopardize the entire business.

Environmental, Social, and Governance (ESG) Financing: CFOs have shifted from traditional financing roles to embracing sustainability financing, aligning financial strategies with ESG goals.

(6 Marks)

Ans.4

(i) Dividend Plan

(a) Average Annual gain over a period of 5 Years	27748.60
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(b) Total gain over a period of 5 years (a × 5)	138743
(c) Initial Investment	920000
(d) Total value of investment (b + c)	1058743
(e) NAV as on 31.3.2020	49
(f) Number of units at the end of the period as on 31.03.2019 (d/e)	21607

	1	2	3	4 (2 x 3)	5	6 $\frac{(1 \times 4)}{(4+5)}$	7
Period	Units held	Rate	Unit value	Dividend	NAV	New Units*	Balance Units Pre Dividend
31.03.2019	21607	0.15	10	1.5	45	697	20910
31.03.2018	20910	0.1	10	1	50	410	20500
31.03.2017	20500	0.12	10	1.2	48	500	20000

Issue Price as on 01.04.2015 Investment 920000/ Units purchased 20000 (c /i) = Rs. 46

* Let the units issued be X

$$X = (\text{Closing Units} / \text{NAV} + \text{Dividend}) \times \text{Dividend}$$

(ii) Bonus Plan

(a) Average Yield	0.064
(b) Investment	1000000
(c) Gain over a period of 5 years (a * b * 5)	320000
(d) Market Value as on 31.03.2019 (b + c)	1320000

(e) NAV as on 31.03.2020	44
(f) Total units as on 31.03.2020 (d/e)	30000
(g) No of units as on 31.03.2018 Pre bonus = $30000 * 5 / (5 + 1)$	25000
(h) No of units as on 31.12.2016 Pre bonus = $25000 * 4 / (4 + 1)$	20000
(i) Issue Price as on 01.04.2015 Investment 1000000 / Units purchased 20000 (b/h)	50

(8 Marks)

Ans.5

Working Notes:

(1) Expected Sales

Year	Expected Sales
1	Rs. 100 lakhs
2	Rs. 120 lakhs
3	Rs. 140 lakhs
4	Rs. 160 lakhs
5	Rs. 180 lakhs

(2) Expected Expenses excluding Depreciation

Year	Exp.
1	Rs. 40 lakhs
2	Rs. 48 lakhs

3	Rs. 56 lakhs
4	Rs. 64 lakhs
5	Rs. 72 lakhs

(3) Cash Inflow from the Project

Let P be the cost of the plant then chargeable depreciation for each year shall be 0.20P.

Accordingly, annual cash flow from the project shall be computed as follows:

Year	Expected Sales Rs. lakhs	Exp. Rs. lakhs	Dep. (3)	Profit Before Tax	Tax @30%	Profit After Tax
1	100	40	0.20P	60 - 0.20P	18 - 0.06P	42 - 0.14P
2	120	48	0.20P	72 - 0.20P	21.6 - 0.06P	50.4 - 0.14P
3	140	56	0.20P	84 - 0.20P	25.2 - 0.06P	58.8 - 0.14P
4	160	64	0.20P	96 - 0.20P	28.8 - 0.06P	67.2 - 0.14P
5	180	72	0.20P	108 - 0.20P	32.4 - 0.06P	75.6 - 0.14P

Year	Profit After Tax	Dep. Added Back	Cash Inflow
1	42 - 0.14P	0.20P	42 + 0.06P
2	50.40 - 0.14P	0.20P	50.40 + 0.06P
3	58.80 - 0.14P	0.20P	58.80 + 0.06P
4	67.20 - 0.14P	0.20P	67.20 + 0.06P
5	75.60 - 0.14P	0.20P	75.60 + 0.06P

Total	294 + 0.30P
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Since NPV will be Zero the required comes as follows:

Sum of Cash Inflows – Plant Cost = 0

$$294 + 0.30P - P = 0$$

$$P = 420$$

Thus, the required investment to be made in plant shall be ` 420 lakhs.

Alternative solution if a discount rate of 10% is applied, though students may solve the question using a rate other than 10%.

Working Notes: (1) Expected Sales

Year	Expected Sales
1	Rs. 100 lakhs
2	Rs. 120 lakhs
3	Rs. 140 lakhs
4	Rs. 160 lakhs
5	Rs. 180 lakhs

(2) Expected Expenses excluding Depreciation

Year	Exp.
1	Rs. 40 lakhs
2	Rs. 48 lakhs
3	Rs. 56 lakhs

4	Rs. 64 lakhs
5	Rs. 72 lakhs

(3) Cash Inflow from the Project

Let P be the cost of the plant then chargeable depreciation for each year shall be 0.20P.

Accordingly, annual cash flow from the project shall be computed as follows:

Year	Expected Sales Rs. lakhs	Exp. Rs. lakhs	Dep. (3)	Profit Before Tax	Tax	Profit After Tax
1	100	40	0.20P	60 - 0.20P	18 - 0.06P	42 - 0.14P
2	120	48	0.20P	72 - 0.20P	21.6 - 0.06P	50.4 - 0.14P
3	140	56	0.20P	84 - 0.20P	25.2 - 0.06P	58.8 - 0.14P
4	160	64	0.20P	96 - 0.20P	28.8 - 0.06P	67.2 - 0.14P
5	180	72	0.20P	108 - 0.20P	32.4 - 0.06P	75.6 - 0.14P

Year	Profit After Tax	Dep. Added Back	Cash Inflow	PVF @ 10%	PV of Cash Inflow
1	42 - 0.14P	0.20P	42 + 0.06P	0.909	38.178 + 0.05454P
2	50.40 - 0.14P	0.20P	50.40 + 0.06P	0.826	41.6304 + 0.04956P
3	58.80 - 0.14P	0.20P	58.80 + 0.06P	0.751	44.1588 + 0.04506P
4	67.20 - 0.14P	0.20P	67.20 + 0.06P	0.683	45.8976 + 0.04098P
5	75.60 - 0.14P	0.20P	75.60 + 0.06P	0.621	46.9476 + 0.03726P
Total					216.8124 + 0.2274P

Since NPV will be Zero the required comes as follows:

Sum of Cash Inflows – Plant Cost = 0

$216.8124 + 0.2274P - P = 0$

$P = 280.63$

Thus, the required investment to be made in plant shall be Rs. 280.63 lakhs.

(8 Marks)

Ans.6

Corporate Level Strategy focuses on decisions related to the selection and coordination of various businesses in which the company operates. It answers three key questions:

- Suitability: Will the strategy help achieve the overall corporate objectives?
- Feasibility: Are the required resources available?
- Acceptability: Will stakeholders find it satisfactory both financially and non-financially?

Business Unit Level Strategy applies to individual Strategic Business Units (SBUs), which are independent profit centres. This level aims at gaining and sustaining a competitive advantage through coordinated efforts of various operating units.

Functional Level Strategy deals with the execution of business strategies through specific functions like marketing, finance, operations, HR, and R&D. It ensures alignment of departmental goals with higher-level strategies and involves translating corporate or business unit strategies into actionable plans.

Significance of Finance in Strategic Planning: Among all functional areas, finance holds the most critical role during strategic planning. At the corporate level, finance is essential for resource deployment, while at the functional level, financial planning ensures mobilization and efficient use of funds, the most critical resource for any business. Adequate financial

resources enable the firm to mobilize other necessary inputs, making finance a cornerstone for both strategy formulation and execution.

(6 Marks)

MCQs:-

1. C) $SGR = ROE \times (1 - \text{Dividend Payment Ratio})$

Explanation: This formula combines return on equity and earnings retention to estimate sustainable internal growth.

2. C) The actual net cash flow stream after deflating for inflation will be lower due to reduced profitability.

Explanation: Inflation impacts capital budgeting decisions in various ways. In this scenario, considering an inflation rate of 8% per year, the nominal revenues and costs will increase over time. However, the actual purchasing power of these cash flows will be lower due to inflation. Specifically, nominal revenues and costs will increase, but the real value of the net cash flows (after deflating for inflation) will decrease.

Let's break down the calculations:

- Initial outlay: Rs. 100,000

- Annual revenues (nominal): Year 1 = Rs. 80,000, Year 2 = Rs. 80,000 $(1 + 0.08) =$ Rs. 86,400, and so on.

- Annual costs (nominal): Year 1 = Rs. 30,000, Year 2 = Rs. 30,000 $(1 + 0.08) =$ Rs. 32,400, and so on.

- Depreciation remains the same since it's based on historical costs.

- Taxable profit changes due to inflation's impact on revenues and costs.

- Actual net cash flows (real) are calculated by subtracting the inflation rate from the nominal cash flows.

As a result, the real net cash flows after deflating for inflation will be lower than the net cash flows without considering inflation, leading to reduced profitability. This aligns with option C.

3. B) Sell holdings of MF X and MF Y and invest in MF Z

Explanation: If past returns of all three schemes will continue for next one year, the investor should redeem the units of MFs 'X' and 'Y' and invest the proceeds in MF 'Z'.

4. D) The company's financial policy should be closely aligned with its strategic objectives, as financial decisions have a significant impact on the overall organizational performance and direction of growth.

Explanation: The provided content emphasizes the importance of the interface between financial policy and strategic management. It highlights that financial policies cannot be formulated in isolation from the overall organizational performance and direction of growth. The financial policy decisions, such as sources of finance, capital structure, investment and fund allocation, and dividend policy, have a direct impact on the company's ability to achieve its strategic objectives.

The content states, "Financial policy and corporate strategy have a close interface," and "attention of the corporate planners must be drawn while framing the financial policies not at a later stage but during the stage of corporate planning itself." This indicates that financial policy decisions should be made in alignment with the company's strategic goals and objectives from the outset.

Option a) is incorrect because the content suggests that financial policy decisions cannot be made independently without considering the company's strategic goals.

Option b) is incorrect because the content emphasizes the importance of long-term strategic objectives and not just short-term profitability.

Option c) is incorrect because the content highlights the interdependence between financial policy and strategic management, suggesting that they should not be completely separate processes.

Option d) is the correct answer as it accurately reflects the importance of aligning the company's financial policy with its strategic objectives, as emphasized in the provided content.

5. C) Life

Explanation: Project is most sensitive to life factor as 10% variation in life has led to maximum impact on NPV

(5 x 1 = 5 Marks)