ஸ்ரீ-ல-ஸ்ரீ காசிவாசி சுவாமிநாத சுவாமிகள் கலைக் கல்லூரி

திருப்பனந்தாள் – 612504

S.K.S.S ARTS COLLEGE, THIRUPPANANDAL - 612504

QUESTION BANK

Title of the Paper

FINANCIAL MANAGEMENT

Course: III B.Com.,

Subject Code: 16CCCCM13

Semester: VI

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CORE COURSE – XIII

FINANCIAL MANAGEMENT

UNIT – I

Financial Management: Meaning and scope – Objectives: Profit maximization, Wealth Maximization – Functions – Financial decisions – Time value of money: Present value and Compound value – Cost of capital – Cost of debt – Cost of preference share capital – Cost of equity – Cost of retained earnings – Weighted average cost of capital.

UNIT – II

Capital structure – Meaning and features – Factors determining capital structure – EBIT EPS Relationship – Indifference point of EBIT – Theories of capital structure: Net income approach, Net operating income approach, MM approach and Traditional approach.

UNIT – III

Leverage – Meaning, significance and types – Operating leverage - Financial leverage – Combined leverage – Dividend policy – Determinants of dividend policy – Theories: relevance and irrelevance with value of firm – Forms of dividend – Stock dividend – Bonus issue – Stable dividend.

UNIT – IV

Working capital management – Determinants of working capital – Forecasting of working capital requirements – Cash management – Motives of holding cash – Stages in cash management: Cash planning, Collection and disbursement of cash, Optimum cash balance – Boumul model – Investment of surplus cash.

UNIT – V

Receivables management – Objectives – Factors influencing size of receivables – Credit policy – Credit standard – Credit term – Collection policy – Incremental analysis – Inventory management – Meaning – Types of inventory – Purpose of holding inventory – Excess or inadequate inventory – EOQ – Levels of stock: reorder level, minimum level and maximum level– Techniques – ABC, VED, FSN and HML analysis.

UNIT – I

CHOOSE THE CORRECT ANSWER

1. The concept of financial management is
   A. Profit maximization
   B. All features of obtaining and using financial resources for company operations
   C. Organization of funds
   D. Effective Management of every company

2. Investment is
   A. Person's dedication to purchasing a car
   B. Use of capital on assets to receive returns
   C. Usage of money on a production process of products and services
   D. Net additions made to the nation's capital stocks

3. What is the primary goal of financial management?
   A. To minimize the risk
   B. To maximize the return
   C. To maximize the owner's wealth
   D. To raise profit

4. The finance manager is accountable for.
   A. Earning capital assets of the company
   B. Effective management of a fund
   C. Arrangement of financial resources
   D. Proper control of funds

5. CAPM stands for.
   A. Capital Asset Pricing Model.
   B. Capital Amount Printing Model.
   C. Capital Amount Pricing Model.
   D. Capital Asset Printing Model.

6. The company's cost of capital is called
   A. Leverage
   B. Hurdle rate
   C. Risk rate
   D. Return rate

7. Which of the following would be considered a risk-free investment?
   A. Gold
   B. Equity in a house
   C. High-grade corporate bonds
   D. Treasury bills

8. Cost of retained earnings is equal to
   A. Cost of equity
   B. Cost of debt
   C. Cost of bank loan
   D. Cost of term loans

9. The cost of capital of a long term debt is generally.
   A. Lower than the owned funds
   B. Equal to that of owned funds
   C. More or less than owned funds
   D. Higher than that of owned funds

10. ERI Stands for
    A. Effective Rate of Interest
    B. Effective Revenue interest
    C. Estimate rate of interest
    D. Estimate rate of initial

Answers : 1.B 2.B 3.B 4.C 5.A 6.B 7.D 8.A 9.A 10.A

SHORT QUESTIONS (2 MARKS)

11. What do you mean by financial management?
12. State any two characteristics of financial management
13. State the formula for calculating cost of debt.
14. What do you mean by retained earnings?
15. What is investment decision?
16. What are the functions of finance manger?
17. What is cost of capital?
18. How to calculate weighted average cost of capital?
19. What do you understand by time value of money?
20. Give the meaning of doubling period?

PARAGRAPH QUESTIONS (5 MARKS)

21. Enlist the functions of financial management
22. Write the objectives of financial management
23. A limited company issued Rs.50,000, 8% debentures at par. The tax rate applicable to the company 50%. Compute the cost of debt capital.
24. Janaki Ltd., issued 12,000 10% Debentures of Rs.100 each at par. The tax rate is 50%. Calculate before tax and after tax of debt.
25. KKL Ltd., issued 10% Debentures of Rs.5,00,000 are realized at 4,85,000 after allowing 3% commission to brokers. The debentures are due to maturity at the end of the 10^{th} year. You are required to calculate the effective cost of debt before tax.
26. Samyo Ltd., issued 11,000 11% preference shares of Rs.100 each. The shares redeemable after 11 years at a premium of 5%. The issue expenses are Rs.3 per share. You are asked to find out the cost of redeemable preference share capital.
27. Calculate the cost of equity capital from the following particulars presented by X Ltd: The current market price of a equity share of the company is Rs.80. The current dividend per share is Rs.6.40. Dividend is expected to grow @ 8%.
28. A company's shares with a face value of Rs.10 each are quoted at Rs.50 in the stock market, Current rate of dividend is 50% and this expected to grow at a steady rate of 50% p.a. Calculate the cost of equity capital of the company.

29. A company's cost of equity capital is 12%. The brokerage cost of purchase of securities is 2%. The personal tax rate of shareholders is 50%. Compute the cost of retained earnings.
30. Mr. Manoj invests Rs.1,00,000 in a bank at 10% for 5 years. Calculate the maturity value if interest is compounded annually. Will he get more if interest is compounded half-yearly?

ESSAY TYPE QUESTIONS (10 MARKS)

31. Explain the basic financial decisions in detail.
32. Discuss the organization of financial management
33. Discuss the approaches to calculate cost of capitals
34. Explain the changing scenario of financial management in India
35. Discuss the role of Time Value of Money in Financial Managment
36. Sri Ram Industries Ltd. issued 10,000 10% Debentures of Rs. 100 each. The tax rate is 50%. Calculate the before tax and after tax cost of debt if the debentures are issued (a) at par ; (b) at a premium of 10% and (c) at a discount of 10%.
37. Alpha Ltd. issued 10% Redeemable preference shares of Rs. 100 each, redeemable after 10 years. The flotation costs are 5% of the nominal value. Compute the effective cost to the company if the issue is made at (a) par; (b) a premium of 5% and (c) a discount of 5%.
38. Your company's share is quoted in the market at Rs. 20 currently. The company pays a dividend of Re. 1 per share and the investor expects a growth rate of 5% per year. Compute:

a) The company's cost of equity capital
b) If the anticipated growth rate is 6% p.a., calculate the indicated market price per share
c) If the company's cost of capital is 8% and the anticipated growth rate is 5% p.a., calculated the indicated market price if the dividend of Re. 1 per share is to be maintained.

39. The capital structure and after tax cost of different sources of funds are given below:

Sources of Funds	***Book Value Rs.***	***Market Value***	***After tax Cost %***
Equity share capital	7,20,000	19,00,000	15
Retained earnings	6,00,000	-	14
Preference share capital	4,80,000	4,80,000	10
Debentures	6,00,000	6,00,000	8

You are required to compute the Weighted Average Cost of Capital using of book value and market value.

40. Sir Vignesh Industries Ltd. offers 12% interest on fixed deposits. What is the effective rate of interest if compounding is done (a) half-yearly; (b) quarterly and (c) monthly?

UNIT – II

CHOOSE THE CORRECT ANSWER

1. Financial plan refers to
   A. Panning of financial requirements
   B. Planning of production needs
   C. Planning of Human needs
   D. Panning of services

2. Financial plan is a
   A. Continues process
   B. Onetime process
   C. Short time process
   D. Annual process

3. Long term capital sources are.
   A. Retained earnings only
   B. Debentures only
   C. Share capital only
   D. All of the above

4. Short term sources are
   A. Bank credit only
   B. Public deposit only
   C. Commercial papers only
   D. All of the above

5. The term ‘Capital Structure’ refers to
   A. Long term debt, preferred stock and common stock equity
   B. Current Assets and Current Liabilities
   C. Total Assets minus Liabilities
   D. Share Holders Equity

6. Which is not debt?
   A. Debentures
   B. Equity shares
   C. Loans
   D. Bonds

7. NOI stands for
   A. Net Office Income
   B. Nil Operating Income
   C. Net Operating Insurance
   D. Net Operating Income

8. According to the traditional approach, cost of capital affected by
   A. Debt-Equity Mix
   B. Debt-Capital Mix
   C. Equity Expenses Mix
   D. Debt-Interest Mix

9. EBIT is usually the same thing as.
   A. Funds provided by non operations
   B. Earnings before taxes
   C. Net income
   D. Operating profit

10. The arbitrary process is the behavioral foundation for the
   A. MM approach
   B. XX approach
   C. Gorder approach
   D. Traditional approach

Answers : 1.A 2.A 3.D 4.D 5.A 6.B 7.D 8.A 9.D 10.A

SHORT QUESTIONS (2 MARKS)

11. What do you mean by capital structure?
12. What is balanced capital structure?
13. Define 'Trading on Equity'
14. What is financial plan?
15. Define 'capital structure planning'
16. State the essentials of an appropriate capital structure
17. State any tour factors to be kept in mind while determining the capital structure of a firm?
18. What is NOI approach to capital structure?
19. Define 'Traditional Approach' to capital structure
20. Define 'capitalization'

PARAGRAPH QUESTIONS (5 MARKS)

21. Write the characteristics of a sound financial planning.
22. Explain the traditional approach of capital structure.
23. A firm requires total capital funds of Rs.50 lakhs has two options; All equity; and Half equity and Half 15% debt. The equity shares can be currently issued at Rs. 100 per share. The expected EBIT of the company is Rs. 5,00,000 with the tax rate at 40%. Find out the EPS under both the financial mix.
24. A company expects a net operating income of Rs. 1,00,000. It has Rs. 5,00,000 6% debentures. The overall capitalization rate is 10%. Calculate the value of the firm and the equity capital rate according to the NOI approach.
25. Razak Ltd., has a capital structure consisting of equity capital only. It has 50,000 equity shares of Rs. 10 each. Now the company wants to raise a fund for Rs. 1,25,000 for its various investment purposes after considering the following three alternative methods of financing.
    i. If it issues 12,500 equity shares of Rs. 10 each.
    ii. If it borrows a debt of Rs. 1,25,000 at 8% interest and
    iii. If it issues 1,250 8% preference shares of Rs. 100 each.

    Show the effect of EPS under various methods of financing if EBIT (after additional investment) are Rs. 1,56,250 and rate of taxation is @ 50%

26. A company has 1,00,000 shares currently selling at Rs. 100 each. The capitalization ratio is 10%. It proposes to declare Rs. 5 as dividend at the end of the current financial year. What will be the price of the share at the end of the year under MM approach, if the dividend is declared and not declared?

27. Universal Ltd., wants to implement a project for which Rs.60 lakhs is to be raised. The following financial plans are under evaluation:

Plan A : Issue of 6 lakhs equity share of Rs. 10 each

Pan B : Issue of 30,000 10% non-convertible debentures of Rs. 100 each and issue of 3 lakhs equity share of Rs. 10 each.

Assuming a corporate tax of 55%, calculate the indifference point.

28. Krishna Ltd is expecting an annual EBIT of Rs.2, 00,000. The company has Rs.7,00,000 in 10% debentures. The cost of equity capital or capitalization rate is 12.5%. You are required to calculate the total value of the firm under NI approach also ascertain the overall cost of capital.
29. Explain the advantages and limitations of MM approach.
30. Zen Ltd. has earnings before interest and taxes (EBIT) of Rs.80,000. It expects a return on investment of 16%. Find out the value of the firm according to the Modigliani-Miller (MM) approach

ESSAY TYPE QUESTIONS (10 MARKS)

31. What are the factors to keep in mind while determining the capital structure? Explain.
32. Discuss the assumptions of capital structure therories
33. Good shape Company has currently an ordinary share capital of Rs. 25 lakhs, consisting of 25,000 shares of Rs. 100 each. The management is planning to raise another Rs. 20 lakhs to finance a major programme of expansion through one of four possible financing plans. The options are as under:
    a) Entirely through ordinary shares
    b) Rs. 10 lakhs through ordinary shares and Rs. 10 lakhs through long term borrowings at 15% interest per annum.
    c) Rs. 5 lakhs through ordinary shares and Rs. 15 lakhs through long term borrowings at 16% interest per annum.
34. Jack Ltd. is consisting two plans to finance a project consisting Rs. 100 lakhs. The details are:

Particulars	***Plan X (Rs. in lakhs)***	***Plan Y (Rs. in lakhs***
Equity share capital (Rs. 100 per share) 10% Debentures	50 50	25 75
	100	100

Sales for the first three years of operations are projected at Rs. 200, Rs. 250 and Rs. 300 lakhs respectively. EBIT is expected to be 10% of sales. Corporate taxation is 50%. Calculated the EPS in each of the plans for the three years.

35. Rudra Ltd. is expecting annual earnings before the payment of interest and taxes of Rs. 2 lakhs. The company in its capital structure has Rs. 8n lakhs in 10% Debentures. The cost of equity or capitalization rate is 12.5%. You are require to calculate the value of firm according to NI Approach. Also compute the overall cost of capital.
36. Skylekha Ltd. has an EBIT of Rs. 2,50,000. The cost of debt is 8% and the outstanding debt is Rs. 10,00,000. The overall capitalization rate(k_o) is 12.5%. Calculate the total value of the firm and equity capitalization rate under NOI Approach.
37. Companies M and N are identical in every respect except that the former does not use debt in its capital structure, while the latter employs Rs. 12,00,000 of 15% debt. Assuming that (a) the corporate tax rate is 35%, (b) EBIT is Rs.4,00,000 and (c) the equity capitalization of the unlevered company is 20% what will be the value of both companies under NI and NOI approach?
38. From the following data relating to Vasan Ltd. calculated the market value of the company and overall cost of capital:

Net operating income	Rs. 1,20,000
Total Investment	Rs. 6.00,000

Equity capitalization rate:

a) If the company uses no debt = 10%
b) If the company uses a debt of Rs. 2,40,000 = 11%
c) If the company uses a debt of Rs. 3,60,000 = 12%

The debt Rs. 2,40,000 can be raised at 5% rate of interest, while the debt of Rs. 3,60 ,000 can be raised at 7%.

39. Two firms M and N are identical in all respects except the degree of leverages. Firm M does not use any debt in its financing (unlevered). Firm N has 8% debentures of Rs. 6,00,000(levered). The firms have earnings before interest and taxes (EBIT) of Rs. 2,00,000 and the equity capitalization rate is 12.5%.
Assuming the corporate tax at 50%. Calculate the value of firms using MM approach.
40. Merry Ltd. has earnings before interest and taxes (EBIT) of Rs. 30,00,000 and 40% tax rate. Its required rate of return on equity in the absence of borrowing is 18%. In the absence of personal taxes, what is the value of the company in MM approach (i) with Rs. 40,00,000 in debt and (ii) with Rs. 70, 00,000 in debt?

UNIT – III

CHOOSE THE CORRECT ANSWER

1. How does financial leverage measured?
   A. No change with EBIT and EPS
   B. The sensibility of EBIT with % change with respect to output
   C. The sensibility of EPS with % change in the EBIT level
   D. % variation in the level of production

2. Operating leverage measures
   A. Business risk
   B. Financial risk
   C. Both risks
   D. Production risk

3. Financial leverage helps to estimate
   A. Business risk
   B. Financial risk
   C. Both risks
   D. Production risk

4. Operating leverage x Financial leverage =
   A. Combined Leverage
   B. Financial Leverage
   C. Operating Leverage
   D. Fixed leverage

5. When a company uses debt fund in its capitall structure, it will lead to a change in
   A. Financial leverage
   B. Operating leverage
   C. Money market leverage
   D. Stock market leverage

6. Variable cost per unit.
   A. Varies with the level of output
   B. Remains constant irrespective of the level of output
   C. Changes with the growth of the firm
   D. Does not change with value of production

7. Dividends are paid.
   A. Monthly
   B. Quarterly
   C. Semi-annually
   D. Yearly

8. If a preferred stock issue is cumulative, this means.
   A. Dividends are paid at the end of the year
   B. Dividends is legally binding on the corporation
   C. Unpaid dividends will be paid in the future
   D. Unpaid dividends are never repaid

9. Bonus share are not permitted unless the ____________ shares, if any, are made fully-paid.
   A. Partly Paid
   B. Right
   C. Fully Paid
   D. Preference

10. A company having easy access to the capital markets can follow a ____________ dividend policy
   A. Liberal
   B. Formal
   C. Strict
   D. Varying

Answers : 1.C 2.A 3.B 4.A 5.A 6.B 7.D 8.C 9.A 10.A

SHORT QUESTIONS (2 MARKS)

11. What is meant by leverage?
12. What do you mean by operating leverage?
13. What do you understand by financial leverage?
14. What is combined leverage? How is it measured?
15. How is the degree of financial leverage measured?
16. What do you mean by dividend?
17. What is meant by dividend policy?
18. Write a short note on stable dividend policy.
19. How to calculate Market Price per share under Gordon's mode?
20. What is MM hypothesis of dividend?

PARAGRAPH QUESTIONS (5 MARKS)

21. Explain the different types of leverages
22. Explain the main determinants of a dividend policy.
23. Calculate operating leverages from the following particulars:
    Units sold 5,000 Selling price per unit Rs. 30
    Variable cost per unit Rs.20 EBIT Rs. 30,000
    10% Public debt Rs. 1,00,000
24. The capital structure of Balaji Ltd. consists of Equity share capital of Rs. 5,00,000 and 9% Debentures of Rs. 2.50,000. The fixed cost is Rs. 50,000. You are required to ascertain operating leverage and financial leverage when EBIT is Rs. 1,00,000.
25. Compute the operating, financial and combined leverages from the given data:
    Sales 50,000 Units at Rs. 12 per Unit
    Variable cost at Rs. 8 per unit
    Fixed cost Rs. 90,000 (including 10% interest on Rs. 2,50,000)
26. Find out degree of operating leverages from the information given below:
    EBIT (2018) Rs. 50,000 Sales (2018) 20,000 units
    EBIT (2019) Rs. 60,000 Sales (2018) 28,000 units
27. Hensman Ltd. earns Rs. 15 per share. The company is capitalized at a rate of 12% and has a return on investment of 18%. According to Walter's formula, what should be the price per share at 60% dividend payout ratio?
28. The earnings per share of a company are Rs. 24. The cost of equity capital is 10 %, the rate of return on investment is 15%. Compute the market price per share under Walter's model, if the payout is a). 50% b).75%
29. The cost of capital and rate of return on investment of Bob Ltd. are 20% and 30% respectively. The company has 1,50,000 equity shares of Rs. 10 each outstanding and EPS is Rs. 10. Calculate the value of the company in the following situations. Use Walter's model and comment on the results: (i). No retention ;(ii). 50% retention; (iii). 100% retention.
30. The following information relates to Raha Ltd.
    Earnings per share = Rs. 12; Cost of capital = 12%; Rate of return = 18%. Determine the market price per share under the Gordon's model if retention is (a).50%; (b).60%; (c).10%.

ESSAY TYPE QUESTIONS (10 MARKS)

31. How is the degree of leverages measured? Explain
32. Describe the different types of dividend policy.
33. Calculate the operating leverage, financial leverage and the combined leverage for the following firms and interpret the results:

Particulars	***P***	***Q***	***R***
Output (units)	3,00,000	75,000	5,00,000
Fixed cost per unit (Rs.)	3,50,000	7,00,000	75,000
Variable cost per unit(Rs.)	1	0.10	0.10
Interest expenses (Rs.)	25,000	40,000	-
Unit selling price (Rs.)	3	25	0.50

34. The share capital of a company is Rs.10,00,000 with shares of face value of Rs. 10. The company has debt capital of Rs. 6,00,000 at 10% rate of interest. The sales of the firm are 3,00,000 units per annum at a selling price of Rs. 5 per unit and the variable cost is Rs. 3 per unit. The fixed cost amounts to Rs. 2,00,000. The company pays tax at 35%. If the sales increases by 10% calculate:
    i. Percentage increase in EPS
    ii. Operating leverage at the two levels and
    iii. Financial leverage at the two levels.
35. The capital structure of Hindustan Corporation Ltd., consists of equity share capital of Rs. 10,00,000 (shares of Rs. 100 each) and Rs. 10,00,000 of 10% debentures. Sales have increased from 1,00,000 units to 1,20,000 units, the selling price is Rs. 10 per unit and fixed expenses amount of Rs. 2,00,000. The income tax rate is assumed to be 50%. You are required to calculate the following:
    a) Percentage increase in earnings per share
    b) Operating leverage at 1,00,000 units and 1,20,000 units
    c) Financial leverage at 1,00,000 units and 1,20,000 units

36. The following projections have been given in respect of companies X and Y

Particulars	***Company X***	***Company Y***
Volume of output & sales	80,000 units	1,00,000 units
Variable cost per unit	Rs. 4	Rs. 3
Fixed cost	Rs. 2,40,000	Rs. 2,50,000
Interest burden on debt	Rs. 1,20,000	Rs. 50,000
Selling price per unit	Rs.10	Rs. 8

On the basis of above information, calculate (a) Operating leverage, (b) Financial leverage, (c) Combined leverage, (d) Operating break-even point and (e) Financial break-even point.

37. From the following balance sheet, calculate the 3 leverages of the company

Liabilities	Rs.	Assets	Rs.
Equity capital (at Rs. 10)	1,20,000	Net fixed assets	3,00,000
10% long term debt	1,60,000	Current assets	1,00,000
Retained earnings	40,000		
Current liabilities	80,000		
	4,00,00		4,00,000

The company total assets turnover ratio is 3, its fixed operating costs are Rs. 2,00,000 and its variable operating costs ration is 40%. The tax rate is 50%.

38. From the following particulars, calculate the value of an equity share, applying Walter's formula when dividend payout ratio is
(a) 50% (b) 75% and (c) 25%
r = 15%, K_e = 10% and EPS = Rs. 8

39. Determine the value of its shares based on Gordon's model assuming the following:

D/P Ratio	Retention Ratio
a) 10%	90%
b) 40%	60%
c) 70%	30%

Rate of return on investment = 12%
Capitalization rate = 11%
Earnings per share = Rs. 20

40. The cost of capital and rate of return on investment of Rafael Ltd. are 10% and 18% respectively. The company has 5 lakh equity shares of Rs. 10 each outstanding and earnings per share are Rs. 20. Compute the market price per share and value of firm in the following situations. Use Walter Model and comment on the results.
(i) No retention, (ii) 40% retention, (iii) 80% retention

UNIT – IV

CHOOSE THE CORRECT ANSWER

1. Working capital means the funds available for
A. Day to day operations
B. Purchase of Fixed Assets
C. Repayment of long term debt
D. Investments

2. Current capital is also known as
A. Initial capital
B. Circulating capital
C. Fixed capital
D. Venture capital

3. Operating cycle of trading firms include
   A. Cash only
   B. Debtors only
   C. Finished goods only
   D. All the above

4. Permanent Working Capital
   A. Varies with seasonal needs
   B. Includes fixed assets
   C. The amount of current assets required to meet a firm's long term minimum needs
   D. Includes accounts payable

5. Net working capital is the excess of current asset over
   A. Current liability
   B. Net liability
   C. Total payable
   D. Total liability

6. Which of the following is not true about a cash budget?
   A. A cash budget sets out all cash receipts and payments that a business expects to make over a period of time
   B. Cash budgets are usually prepared on a month to month basis
   C. Cash budgets shows the expected bank balance at the end of the month
   D. Cash budgets include personal cash receipts and expances.

7. Cash management refers to the cash
   A. Collection only
   B. Concentration only
   C. Disbursement only
   D. All the above

8. The cash inflows and outflows expected in a budget period is called
   A. Financial budget
   B. Cash budget
   C. Monthly budget
   D. Production budget

9. Closing balance is calculated in cash budget
   A. Asset – Liability
   B. Savings – Expenses
   C. Receipts – Payments
   D. None of the above

10. Customers are advised to mail their payments to special post office boxes called
   A. Lock box system
   B. Post box system
   C. Mail box system
   D. Secrete box system

Answers : 1.A 2.B 3.D 4.C 5.A 6.D 7.D 8.B 9.C 10.A

SHORT QUESTIONS (2 MARKS)

11. What is meant by working capital?
12. What do you understand by fixed working capital?
13. What do you mean by variable working capital?
14. What are advantages of having adequate working capital in a firm?
15. What is gross working capital?
16. Mention the types of working capital
17. Give the meaning of cash
18. What do you understand by cash management?
19. What is meant by cash budget?
20. What do you mean by Lockbox system?

PARAGRAPH QUESTIONS (5 MARKS)

21. What are the sources of working capital?
22. Explain the various method to prepare cash budget.
23. Estimate the requirements of working capital from the following information.
    i. Projected annual sales 100000 units
    ii. Selling price Rs. 8 per unit
    iii. Net profit ratio on sales – 25%
    iv. Average credit period allowed to customer – 8 weeks
    v. Average credit period allowed to suppliers – 4 weeks
    vi. Average stock holding in terms of sales requirements – 12 weeks
    vii. Allow - 10% for contingencies
24. From the following balance sheet compute gross working capital and net working capital.

Liabilities	Rs.	Assets	Rs.
Share Capital	13, 50,000	Fixed assets	10,50,000
Reserves	1,50,000	**Current assets:**	
Current liabilities:		Cash	90,000
Bank loan	1, 50,000	investments	1,50,000
Creditors	90,000	Debtors	2,10,000
Bills payable	60,000	Inventory	3,00,000
	18,00,000		18,00,000

25. X Co. desires to purchase a business and has consulted you and one point on which you are asked to advice them is the average amount of working capital which will be required in the first year's working

You are given the following estimates and are instructed to add 10% to your computed figures to allow for contingencies.

Particulars	***Figure for the year***
(i). Average amount locked up in stocks	*Rs.*
Stock of finished goods	5,000
Stock of stored materials	8,000
(ii). Average credit given:	
Inland sales – 6 weeks	3,12,000
Export sales – 1 ½ weeks	78,000
(iii). Lag in payment of wages and other outgoings:	
Wages – 1 ½ weeks	2,60,000
Stores, material etc. 1 ½ months	48,000
Rent, royalties etc. – 6 months	10,000
Clerical staff salary – ½ month	62,400
Manager salary – ½ month	4,800
Miscellaneous expenses – 1 ½ months	48,000
(iv). Payment in advance:	
Sundry expenses (Paid quarterly in advance)	8,000
(v). Undrawn profits on the average thought the year	11,000

Set up your calculations for the average amount of working capital required.

26. Meraz Ltd. is engaged in large scale customer retailing. From the following information, you are required to forecast its working capital requirements for the year 2015-2016.

Projected annual sales	Rs. 65 lakhs
Percentage of net profits on cost of sales	20%
Average credit allowed to debtors	10 weeks
Average credit allowed to creditors	4 weeks
Average stock carrying (in terms of sales requirements)	8 weeks

Add 10% to computed figures to allow contingencies

27. Ghandy Ltd. has total sales of Rs. 80 lakhs a year, of which 80% are credit sales. The firm has an investment opportunity in the money market to earn a income of 15% per annum. In case, the firm could reduce its float by 2 days, what would be the annual savings for it?
28. Calculate operating cycle from the following data:

Particulars	***Rs.***
Sales	12,00,000
Purchase	8,50,000
Cost of goods sold	8,75,000
Average debtors	1,80,000
Average creditors	90,000
Average stock	1,60,000

All sales and purchases are made on credit and assume 360 days in a year.

29. From the following, prepare a cash budget for the month of January, 2010

Cash in hand (estimated) on January, 1 2010	Rs.20,000
Sales – December, 2009	Rs. 50,000
January, 2010	Rs. 80,000

80% amount is recovered in the month of sales and the balance is received in the subsequent month. Purchases for the month of December, 2009 and January, 2010
are estimate to be Rs.20,000 and Rs. 30,000 respectively. No credit period is allowed by suppliers. A sale commission of 5% is paid in cash in the month of sale itself.

30. Prepare a cash budget for the month of April 2010 from the following data:
Cash in hand (Estimated) on 1st April, Rs. 5,000
Sales for March Rs. 1, 90,000 and for April Rs. 2,00,000
Purchase for March Rs. 1,50,000 and for April Rs. 1,60,000
Wages paid for March Rs. 15,000 and for April Rs. 20,000
75% of sales are recovered in the month of sale and the remaining in next month. Credit allowed by suppliers in one month.

ESSAY TYPE QUESTIONS (10 MARKS)

31. Explain the determinants of working capital.
32. From the following information, prepare a statement showing the estimated working capital requirements:
Budgeted sales – Rs. 2,60,000 p.a
Analysis of cost and profit of each unit

	Rs.
Raw materials	4
Labour	4
Overheads	2
Profit	1
Selling price per unit	10

33. Cost sheet of a company provides the following particulars:
Element of cost

Raw materials	:	40%
Labour	:	10%
Overheads	:	30%

The following particulars are also available

i. Raw materials remain in stock for 6 weeks
ii. Processing time : 4 weeks
iii. Finished goods are in stock for 5 weeks
iv. Period of credit allowed to debtors: 10 weeks
v. Lag in payment of wages: 2 weeks
vi. Period of credit allowed by creditors: 4 weeks
vii. Selling price: Rs. 50 per unit
viii. Production in units: 13,000 p.a

Prepare an estimate of working capital.

34. Cost sheet of a company provides the following data:

Cost per unit (Rs.)

Raw materials	50
Direct labour	20
Overheads (including Depreciation of Rs. 10)	40
Total Cost	110
Profit	20
Selling price	130

35. A client of yours care Ltd. is about to commence a new business and finance has been provided in respect of fixed assets. They have, however, asked you to advise the additional amount which they should make available for working capital.

They provide you with the following estimate for the first year and inform you that they have arranged an overdraft limit with their bank of Rs. 1,50,00,000.

	Average period	*Estimated for of credit the first year*
Purchase of raw materials	6 weeks	26,00,000
Wages	1.5 weeks	19,50,000
Overheads, Rent etc.	6 months	1,00,000
Directors and Manager's salaries	1 month	3,60,000
Travellers& office salaries	2 weeks	4,55,000
Travellers commission	3 months	2,00,000
Other overheads	2 months	6,00,000

Sales: cash Rs. 1,40,000

Credit Rs. 65,00,000 (7 weeks)

Average amount of stock and W.I.P – Rs. 3,00,000

Average amount of undrawn profit – Rs. 3,10,000

Sales were made of at an even rate for the year. You are required to prepare from the above figures and information, a table for submission to your client giving an estimate of the average amount of working capital which they provide.

36. The following are the extracts from the balance sheet of company as on 31.12.2019. You are required to compute the additional working capital required by the company for the next year.

Balance Sheet (Extract) as on 31.12.2019

	Rs.	Rs.	Rs.
Fixed Assets:			
Land & Buildings	5,00,000		
Plant & Machinery	3,00,000		8,00,000
Working Capital:			
Current Assets:			
Stock	8,00,000		
Debtors	3,00,000		
Cash at bank	2,00,000	13,00,000	
Less: Current Liabilities:			
Creditors	3,40,000		
Taxation	80,000		
Bank overdraft	1,40,000		
Outstanding liabilities	1,60,000	7,20,000	5,80,000
			13,80,000

37. From the following information, prepare a cash budget for the period from January to April.

Month	Expected sales (Rs.)	Expected purchases (Rs.)
January	60,000	48,000
February	40,000	45,000
March	45,000	31,000
April	40,000	40,000

Wages to be paid to workers will be Rs. 5,000 per month. Cash balance on 1st January may be assumed to be Rs. 8,000.

38. Using the information given below, prepare a cash budget showing expected cash receipts and disbursements for the month of May and balance expected at May,31 1986. Budgeted cash balance, May 1, 1986 Rs. 60,000.

Sales:

March	Rs. 5,00,000
April	Rs. 3,00,000
May	Rs. 8,00,000

Half collected in the month of sale, 40% in the next month, 10% in the third month.

Purchases:

April	Rs.2,50,000
May	Rs. 4,00,000

40% paid in the month of purchases, 60% in the next month. Wages due in May for Rs. 88,000. Three years insurance policy due in May for renewal Rs. 2,000 to be paid in cash. Other expenses for May payable in May Rs. 44,000. Depreciation for the month of May Rs. 2,000. Accrued taxes for May, payable in December Rs. 6,000. Fixed deposit receipts due May 15, Rs. 1,75,000 plus Rs. 10,000 interest.

39. From the following data, prepare a cash budget for the months commencing 1st June 1996, when the bank balance was Rs. 1,00,000

Month	Sales Rs.	Purchases Rs.	Wages Rs.	Production Expenses Rs.	Admin. Expenses Rs.
April	80,000	41,000	5,600	3,900	10,000
May	76,500	40,500	5,400	4,200	14,000
June	78,500	38,500	5,400	5,100	15,000
July	90,000	37,000	4,800	5,100	17,000
August	95,000	35,000	4,700	6,000	13,000

There is two months period allowed to customers and received from suppliers. Wages, production expenses and administration expenses are payable in the following month.

40. A company is expecting to have Rs. 25,000 cash in hand on 1.4.1995 and it requires you to prepare a cash budget for three months, April to June 1995. The following information is supplied to you:

Month	Sales Rs.	Purchases Rs.	Wages Rs.	Expenses Rs.
February	70,000	40,000	8,000	6,000
March	80,500	50,500	8,000	7,000
April	92,500	52,500	9,000	7,000
May	1,00,000	60,000	10,000	8,000
June	1,20,000	55,000	12,000	9,000

Other information:

i. Period of credit allowed by suppliers: 2 months
ii. 25% of sales is for cash and the period of credit allowed to customers for credit sales is one month.
iii. Delay in payment of wages and expenses: 1 month
iv. Income tax Rs. 25,000 is to be paid in June, 1995.

UNIT – V

CHOOSE THE CORRECT ANSWER

1. Receivables are one of the major components of
   A. Fixed capital
   B. Working capital
   C. Initial capital
   D. Long term capital

2. Purpose of maintaining receivables in the firm
   A. Increase in sales only
   B. Increase profits only
   C. Meeting competition only
   D. All the above

3. Maintenance of receivables involves
   A. Marketing cost
   B. Production cost
   C. Collection cost
   D. Finance cost

4. Cash discount is offered to induce
   A. Delay payment
   B. Prompt payment
   C. Sales
   D. Non payment

5. Sources to collect credit information from
   A. Bank reference only
   B. Trade reference only
   C. Past experience only
   D. All the above

6. Inventory includes
   A. Raw materials only
   B. Work in progress only
   C. Finished goods only
   D. All the above

7. Inventory management refers to the
   A. Management of stocks
   B. Management of cash
   C. Management of all assents
   D. Management of liabilities

8. EOQ Stands for
   A. Economic Order Quality
   B. Economic Order Quantity
   C. Essential Order Quality
   D. Essential Order Quantity

9. VED Analysis stands for
   A. Vital, Essential and Desirable
   B. Vital, Elective and Desirable
   C. Value, Essential and Desirable
   D. Value , Essential and Discount

10. Inventory items are classified according to Fast Moving, Slow moving and Non moving is called
   A. ABC Analysis
   B. VED Analysis
   C. FSN Analysis
   D. All the above

Answers : 1.B 2.D 3.C 4.B 5.D 6.D 7.A 8.B 9.A 10.C

SHORT QUESTIONS (2 MARKS)

11. What do you understand by receivables?
12. What is meant by receivable management?
13. List the objectives of receivable management
14. Write a short note on collection policy
15. What are the costs associated with receivables?
16. What is inventory?
17. Write components of inventory
18. Write a note on EOQ
19. What is meant by VED Analysis?
20. What is ABC Analysis

PARAGRAPH QUESTIONS (5 MARKS)

21. Discuss the various aspect and dimensions of receivable management.
22. What are the problems in inventory management?
23. From the following information, you are required to calculate debt collection period:

Total sales for the year	Rs. 1,75,000
Cash sales	20% of total sales
Sales return out of credit sales	Rs. 10,000
Sundry debtors :	
Opening balance	Rs. 8,000
Closing balance	Rs. 12,000

24. A company sells goods on cash as well as on credit. The following particulars are extracted from the book of the company:

		Rs.
Gross Sales	=	4,00,000
Cash sales	=	80,000
Sales Return	=	28,000
Debtors at the end	=	36,000
Bills receivables at the end	=	8,000
Provisions for doubtful debts	=	3,000

Calculate average collection period.

25. From the following information, calculate
(a) Debtors turnover ratio; (b) Average collection period.

	Rs.
Total sales during the year	4,20,000
Cash sales during the year	1,50,000
Returns inward	20,000
Debtors in the beginning	55,000
Debtors at the end	45,000
Provision for bad debts	5,000

26. Super star Ltd. decides to liberalize credit to increase its sales. The liberalized credit policy will bring additional sales of Rs. 3,00,000. The variable cost will be

60% of sales and there will be 10% risk for non-payment and 5% collection cost. Will the company benefit from the new credit policy?

27. Annual usage 80,300 units
    Cost of raw materials Rs. 8 per unit
    Ordering cost Rs. 20 per unit
    Carrying cost of one unit Rs. 1.12.
    Calculate the Economic Order Quantity.
28. Find out the Economic Order Quantity from the following
    Annual usage Rs. 2,40,000; Cost of placing an order Rs. 15;
    Annual carrying cost 20% of inventory value.
29. Semi-annual demand for an item X is 7,200 units. The unit is Rs. 12.50 and the quarterly carrying cost is 3%. If the cost of one procurement is Rs. 75, determine. (a).EOQ (b).No. of orders per year (c).Time between two consecutive orders.
30. The following are the particulars related to inventory of ABC Ltd.
    a) Order must be placed in multiples of 100 units
    b) Annual requirement is (360 days) 3,00,000 units
    c) Purchase price per unit Rs. 3
    d) Carrying cost 25% of the purchase price of the goods
    e) Cost per order placed is Rs. 20
    f) Desired safety stock is 10,000 units
    g) 3 days are required for delivery (Lead time)

    Calculate (i).EOQ (ii).How many orders should the company place every year? (iii).At what inventory level should an order be placed?

ESSAY TYPE QUESTIONS (10 MARKS)

31. What is inventory management? Discuss in detail the objectives and techniques of inventory management.
32. A company plans to extend credit facilities to the following categories of customers.
    A. Customers with a 10% risk of non-payment, and
    B. Customers with a 30% of non-payment.

    The incremental sales expected in the case of category (A) are Rs. 40,000 while in the case of category (B) they are Rs. 50,000

    The cost of production and selling cost are 60% of sales, while collection cost amounts to 5% of sales in the case of category (A) and 10% of sales in the case of category (B).

    You are required to advice the firm about extending credit facilities to each of the above categories of customers.
33. Glaxo Ltd. is considering relaxing its present credit policy and is in the process of evaluating 2 proposed policies. Given the following information, which is a better option?

	Present policy	***Option I***	***Option II***
Credit sales	5,00,000	6,00,000	6,75,000
A/c. receivables turnover	4 times	3 times	2.4 times
Bad debts	Rs. 15,000	30,000	45,000

The company's variable costs are 70% of sales. Required rate of return is 25%.

34. Goodwill Sports Ltd. dealing in sports goods has an annual sale of Rs. 5,00,000 and is currently extending 30 days credit. The company wants to pursue a more liberal policy to improve sales. The following information is available.

Credit policy	***Average collection period***	***Annual sales***
A	45 days	5,60,000
B	60 days	6,00,000
C	75 days	6,20,000
D	90 days	6,30,000

The average collection period is now 30 days.
Variable cost 80% of sales, fixed cost Rs. 60,000 p.a. Required rate of return (pre-tax) 20%

Assume 360 days in a year, determine which policy should the company adopt?

35. Radians Garments Ltd. manufactures readymade garments and sells them on credit basis through a network of dealers. Its present sales are Rs. 60 lakh per annum with 20 days credit period. The company is contemplating an increase in the credit period with a view to increasing sales. Present variable cost is 70% of sales and the total fixed cost is Rs. 8 lakh per annum. The company expects pre-tax return on investment @ 25%. Some other details are given as under:

Present credit policy	***Average collection Period(days)***	***Expected Annual sales (Rs. Lakh)***
I	30	65
II	40	70
III	50	74
IV	60	75

You are required to find out which credit policy should the company adopt? Present your answer in a tabular form. Assume 360 days a year. Calculations should be made upto two digits after decimal.

36. X Ltd. currently has an annual turnover of Rs. 20 lakh and an average collection period of 4 weeks. The company proposed to introduce a more liberal credit policy which they hope will generate additional sales, as shown below:

Proposed credit policy	***Collection period by***	***Increase in Sales (Rs.)***	***Percentage of default***
1	2 weeks	2,00,000	2%
2	4 weeks	2,50,000	3%
3	6 weeks	3,50,000	5%
4	8 weeks	5,00,000	8%

The selling price of the product is Rs. 10 and the variable cost per unit is Rs. 7. The current bad debt loss is 1% and the desired rate of return on investment is 20%. For the purpose of calculation, a year is to be taken to comprise of 52 weeks.

Indicate which of the above policies you would recommend the company to adopt.

37. Ace Ltd. manufacture a product and the following particulars are collected for the year ended March 2016.

Monthly demand	1,000 units
Cost of placing an order	Rs. 100
Annual carrying cost	Rs. 15 per unit
Normal usage	50 units per week
Minimum usage	25 units per week
Maximum usage	75 units per week
Re-order period	4-6 weeks

You are required to calculate (i). Re-order quantity, (ii). Re-order level, (iii). Minimum level, (iv). Maximum level and (v). Average stock level.

38. The following data relate to particular stock item:

Normal usage	110 per day
Minimum usage	50 per day
Maximum usage	140 per day
Lead time	25-30 days
EOQ previously calculated	5,000

Using the above data, calculated stock levels.

39. From the following information, calculate

1. Maximum stock level 2. Minimum stock level 3. Re-order level.

Minimum consumption	240 units per day
Normal consumption	300 units per day
Maximum consumption	420 units per day
Re- order quantity	3,600 units
Re-order period	10 to 15 days
Normal order period	12 days

40. Calculate the minimum stock level, maximum stock level and re-order level from the following information.

Minimum consumption 100kg per day, Maximum consumption 150 kg per day; Normal consumption 120kg per day; Re-order period 10-15 days; Re-order quantity 1,500 kg; Normal re-order period 12 days; Time for emergency supplies 3 days.

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