CA Inter FM
MCQ's
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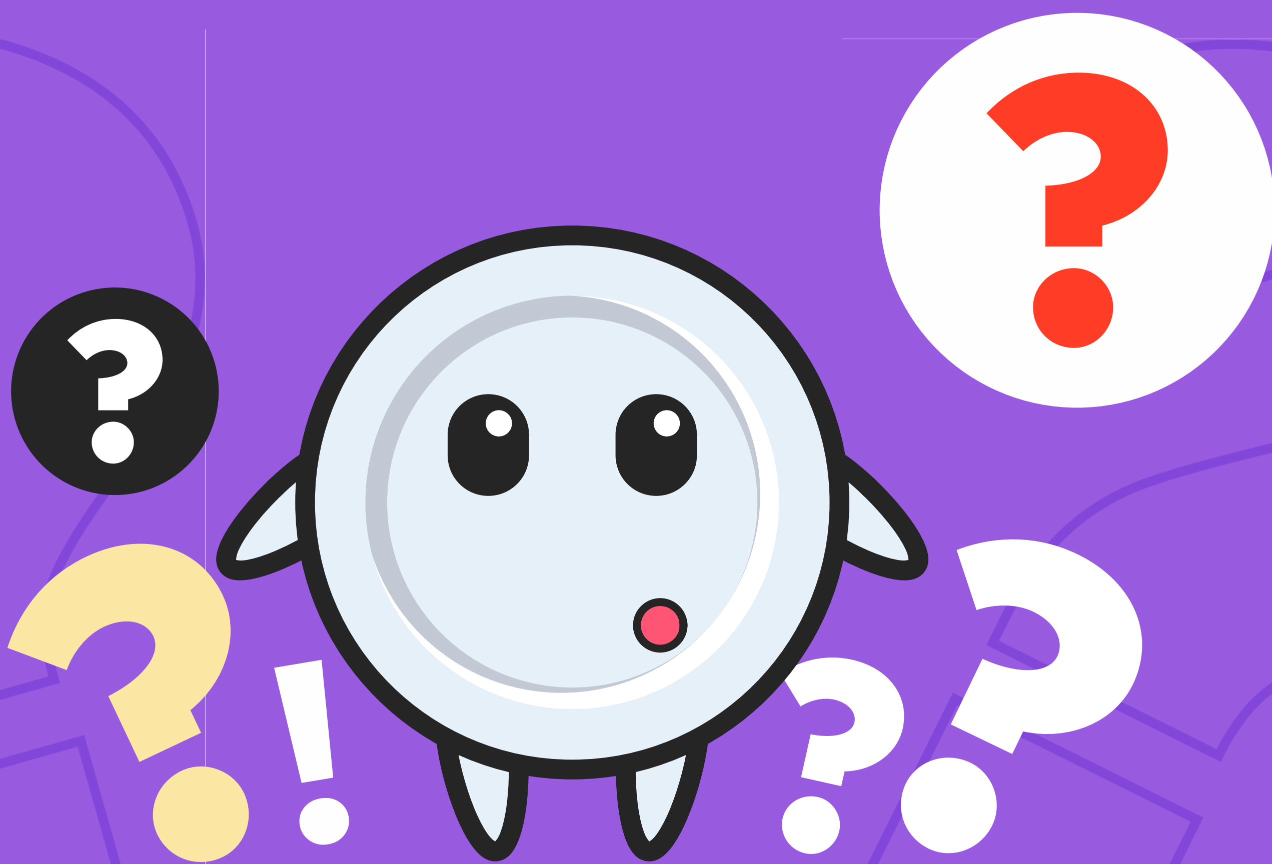

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(For Jan 26 & Onwards)

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F.A.S.T first attempt success tutorials

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"Let's fall in love..
With every chapter, With every page, With every concept.
Let's make it more interesting & fun in our own ways.
Let's open our hearts for this book in a new way."

1 CHAPTER INTRODUCTION TO FINANCIAL MANAGEMENT

Q.N.	Questions
1.	**Management of all matters related to an organisation's finances is called**
	(a) Cash inflows and outflows (b) Allocation of resources (c) Financial management (d) Finance
2.	**Which of the following activities are performed by CFOs now in addition to those performed by past CFOs**
	(a) Budgeting (b) Forecasting (c) Risk Management (d) Treasury management
3.	**Which of the following need not be followed by the finance manager for measuring and maximising shareholders' wealth**
	(a) Accounting profit analysis (b) Cash Flow approach (c) Cost benefit analysis (d) Application of time value of money
4.	**"Shareholders Wealth" in a firm is reflected 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
5.	**Financial Management is mainly concerned with the**
	(a) Acquiring and developing assets to forfeit its overall benefit (b) Acquiring, financing and managing assets to accomplish the overall goal of a business enterprise (c) Efficient management of the business (d) Sole objective of profit maximisation
6.	**Which of the following are microeconomic variables that help define and explain the discipline of finance**
	(a) Risk and return (b) Capital structure (c) Inflation

(d) All of the above

7.	**Which of the following is the common connection in financing, investing decisions**
	(a) Investment instruments type should be same as financing instrument type (b) Investments will definitely grow in line with financing (c) Debt Equity ratio should be same for investments and financing actions (d) Risk Return Trade off
8.	**The main objective of financial management is to**
	(a) Secure profitability (b) Maximise shareholder wealth (c) Enhancing the cost of debt (d) None of above
9.	**Wealth maximisation approach is based on the concept of**
	(a) Cost benefit analysis (b) Cash flow approach (c) Time value of money (d) All of the above
10.	**The shareholder value maximisation model holds that the primary goal of the firm is to maximise its**
	(a) Accounting profit (b) Liquidity (c) Market value (d) Working capital
11.	**Which of the following is the disadvantage of having shareholders wealth maximisation goals**
	(a) Emphasizes the short-term gains (b) Ignores the timing of returns (c) Requires immediate resources (d) Offers no clear relationship between financial decisions and share price
12.	**Decision about mergers, takeovers, expansion, liquidiation were covered in financial management under phase of Financial Management**
	(a) Traditional (b) Transitional (c) Modern (d) None
13.	**Reserves & Surplus are which form of financing**
	(a) Security Financing (b) Internal Financing (c) Loans Financing (d) International Financing
14.	**Which of following activities will not lead to increase in shareholders wealth?**
	(a) Investing in projects with high cash flows (b) Raising funds through sources which have low cost

(c) Regular growth in dividends
(d) Maintaining high levels of cash at bank

15. Focus of financial management is mainly concerned with the decision related to

(a) Financing
(b) Investing
(c) Dividend
(d) All of above

1.	(c)	**2.**	(c)	**3.**	(a)	**4.**	(d)	**5.**	(b)
6.	(d)	**7.**	(d)	**8.**	(b)	**9.**	(d)	**10.**	(c)
11.	(d)	**12.**	(a)	**13.**	(b)	**14.**	(d)	**15.**	(d)

Q. N	THEORY QUESTIONS
1.	**For starting business what are the major decisions an entrepreneur has to go through ?**
	The Various Stages are:- Stage 1:- Decide which assets (premises, machinery, equipment etc.) to buy. Stage 2:- Determining what is total investment (since assets cost money) required for buying assets. Stage 3:- Apart from buying assets the entrepreneur would also need to determine how much cash he would need to run the daily operations (payment for raw material, salaries, wages etc.). In other words this is also defined as Working Capital requirement. Stage 4:- The next stage is to decide what all sources, does the entrepreneur need to tap to finance the total investment (assets and working capital). The sources could be Share Capital (Including Entrepreneur's own funds) or Borrowing from Banks or Investment from Financial Institutions etc.
2.	**What is the meaning of Financial Management & What are the three major decisions in Financial Management?**
	Financial management is that managerial activity which is concerned with planning and controlling of the firm's financial resources. In other words it is concerned with acquiring, financing and managing assets to accomplish the overall goal of a business enterprise (mainly to maximise the shareholder's wealth). "Financial Management comprises of forecasting, planning, organizing, directing, co-ordinating and controlling of all activities relating to acquisition and application of the financial resources of an undertaking in keeping with its financial objective. Any business enterprise requiring money and the 3 key questions being enquired into **1.** Where to get the money from? (Financing Decision) **2.** Where to invest the money? (Investment Decision) **3.** How much to distribute amongst shareholders to keep them satisfied? (Dividend Decision)
3.	**What are various sources of raising funds?**
	Some of the sources of funds:- **(a) Equity:** The funds raised by the issue of equity shares are the best from the risk point of view for the firm, since there is no question of repayment of equity capital except when the firm is under liquidation. **(b) Debentures:** Debentures as a source of funds are comparatively cheaper than the shares because of their tax advantage. The interest the company pays on a debenture is free of tax, unlike a dividend payment which is made from the taxed profits.

(c) Funding from Banks: Commercial Banks play an important role in funding of the business enterprises. Apart from supporting businesses in their routine activities (deposits, payments etc.) they play an important role in meeting the long term and short term needs of a business enterprise.
(d) International Funding: Funding today is not limited to domestic market. With liberalization and globalization a business enterprise has options to raise capital from International markets also. Foreign Direct Investment (FDI) and Foreign Institutional Investors (FII) are two major routes for raising funds from foreign sources besides ADR's (American depository receipts) and GDR's (Global depository receipts).

(e) Angel Financing: Angel Financing is a form of an equity-financing where an angel investor is a wealthy individual who provides capital for start-up or expansion, in exchange for an ownership/equity in the company. Angel investors have idle cash available and are looking for a higher rate of return than what is given by traditional investments.

4. What do you mean by effective utilisation of Funds ?

The finance manager is also responsible for effective utilisation of funds. He has to point out situations where the funds are being kept idle or where proper use of funds is not being made. All the funds are procured at a certain cost and after entailing a certain amount of risk. If these funds are not utilised in the manner so that they generate an income higher than the cost of procuring them, there is no point in running the business. Hence, it is crucial to employ the funds properly and profitably. Some of the aspects of funds utilization are:
(a) Utilization for Fixed Assets: The funds are to be invested in the manner so that the company can produce at its optimum level without endangering its financial solvency. For this, the finance manager would be required to possess sound knowledge of techniques of capital budgeting.
(b) Utilization for Working Capital: The finance manager must also keep in view the need for adequate working capital and ensure that while the firms enjoy an optimum level of working capital they do not keep too much funds blocked in inventories, book debts, cash etc

5. Explain evolution of Financial Management or various stages of financial management.

The three stages of its evolution are:
The Traditional Phase: During this phase, Financial Management was considered necessary only during occasional events such as takeovers, mergers, expansion, liquidation, etc. Also, when taking financial decisions in the organisation, the needs of outsiders (investment bankers, people who lend money to the business and other such people) to the business was kept in mind.

The Transitional Phase: During this phase, the day-to-day problems that financial managers faced were given importance. The general problems related to funds analysis, planning and control were given more attention in this phase.

The Modern Phase: Modern phase is still going on. The scope of Financial Management has greatly increased now. It is important to carry out financial analysis for a company. This analysis helps in decision making. During this phase, many theories have been developed regarding efficient markets, capital budgeting, option pricing, valuation models and also in several other important fields in financial management.

6. Explain Long term and Short term Finance Functions.

Value of a firm will depend on various finance functions/decisions. It can be expressed as :

The finance functions are divided into long term and short term functions/decisions

Long term Finance Function Decisions

(a) **Investment decisions (I)**: These decisions relate to the **selection of assets in which funds will be invested by a firm.** Funds procured from different sources have to be invested in various kinds of assets. Long term funds are used in a project for various fixed assets and also for current assets. The investment of funds in a project has to be made after careful assessment of the various projects through capital budgeting.

(b) **Financing decisions (F):** These decisions relate to **acquiring the optimum finance** to meet financial objectives and seeing that fixed and working capital are effectively managed. The financial manager needs to possess a good knowledge of the sources of available funds and their respective costs and needs to ensure that the company has a sound capital structure, i.e. a proper balance between equity capital and debt.

(c) **Dividend decisions (D):** These decisions relate to the **determination as to how much and how frequently cash can be paid out of the profits** of an organisation as income for its owners/shareholders. The owner of any profit-making organization looks for reward for his investment in two ways, the growth of the capital invested and the cash paid out as income; for a sole trader this income would be termed as drawings and for a limited liability company the term is *dividends*.

All three types of decisions are interrelated, the first two pertaining to any kind of organisation while the third relates only to profit-making organisations, thus it can be seen that financial management is of vital importance at every level of business activity, from a sole trader to the largest multinational corporation.

Short-term Finance Decisions/ Function

Working Capital Management (WCM): Generally short term decision are reduced to management of current asset and current liability (i.e., working capital Management)

7. Explain importance of Financial Management

The best way to demonstrate the importance of good financial management is to describe some of the tasks that it involves:-

- Taking care not to over-invest in fixed assets.
- Balancing cash-outflow with cash-inflows
- Ensuring that there is a sufficient level of short-term working capital.
- Setting sales revenue targets that will deliver growth.
- Increasing gross profit by setting the correct pricing for products or services
- Controlling the level of general and administrative expenses by finding more cost-efficient ways of running the day-to-day business operations
- Tax planning that will minimize the taxes a business has to pay.

8.	**What are responsibilities of Finance Executive ?**
	His responsibilities include: **(a) Financial analysis and planning:** Determining the proper amount of funds to employ in the firm, i.e. designating the size of the firm and its rate of growth. **(b) Investment decisions:** The efficient allocation of funds to specific assets. **(c) Financing and capital structure decisions:** Raising funds on favourable terms as possible i.e. determining the composition of liabilities. **(d) Management of financial resources (such as working capital).** **(e) Risk management:** Protecting assets.
9.	**Explain role of Finance executive in today's world**
	Today, the role of Financial Executive, is no longer confined to accounting, financial reporting and risk management. Some of the key activities that highlight the changing role of a Finance Executive are as follows:- • Budgeting • Forecasting • Managing M & As • Profitability analysis relating to customers or products • Pricing Analysis • Decisions about outsourcing • Overseeing the IT function. • Overseeing the HR function. • Strategic planning (sometimes overseeing this function). • Regulatory compliance. • Risk management.
10.	**What is scope of Financial Management**
	Based on financial management guru Ezra Solomon's concept of financial management, following aspects are taken up in detail under the study of financial management: (a) Determination of size of the enterprise and determination of rate of growth. (b) Determining the composition of assets of the enterprise. (c) Determining the mix of enterprise's financing i.e. consideration of level of debt to equity, etc. (d) Analysis, planning and control of financial affairs of the enterprise.
11.	**Explain two objectives of Financial Management**
	The two objectives are (i) profit Maximisation and (ii) Wealth Maximisation Profit Maximisation It has traditionally been argued that the primary objective of a company is to earn profit; hence the objective of financial management is also profit maximisation. This implies that the finance manager has to make his decisions in a manner so that the profits of the concern are maximised. Each alternative, therefore, is to be seen as to whether or not it gives maximum profit. However, profit maximisation cannot be the sole objective of a company. It is at best a limited objective. **If profit is**

given undue importance, a number of problems can arise. Some of these have been discussed below:

(i) **The term profit is vague. It does not clarify what exactly it means.** It conveys a different meaning to different people. For example, profit may be in short term or long term period; it may be total profit or rate of profit etc.

(ii) **Profit maximisation has to be attempted with a realisation of risks involved.** There is a direct relationship between risk and profit. Many risky propositions yield high profit. Higher the risk, higher is the possibility of profits. If profit maximisation is the only goal, then risk factor is altogether ignored.

(iii) **Profit maximisation as an objective does not take into account the time pattern of returns.** Proposal A may give a higher amount of profits as compared to proposal B, yet if the returns of proposal A begin to flow say 10 years later, proposal B may be preferred which may have lower overall profit but the returns flow is more early and quick.

(iv) **Profit maximisation as an objective is too narrow.** It fails to take into account the social considerations as also the obligations to various interests of workers, consumers, society, as well as ethical trade practices. If these factors are ignored, a company cannot survive for long. Profit maximization at the cost of social and moral obligations is a short sighted policy.

Wealth Maximisation/ Value Creation

Wealth = Present value of benefits – Present Value of Costs

We will first like to define what is Wealth Maximization Model. Shareholders wealth are the result of cost benefit analysis adjusted with their timing and risk i.e. time value of money.

So, It is important that benefits measured by the finance manager are in terms of cash flow. Finance manager should emphasis on Cash flow for investment or financing decisions not on Accounting profit. The shareholder value maximization model holds that the primary goal of the firm is to maximize its market value and implies that business decisions should seek to increase the net present value of the economic profits of the firm. So, for measuring and maximising shareholders wealth finance manager should follow:

- **Cash Flow approach not Accounting Profit**
- **Cost benefit analysis**
- **Application of time value of money.**

12. Explain Advantages & Dis-advantages of Profit & Wealth maximisation method

Goal	Objective	Advantages	Disadvantages
Profit Maximization	Large amount of profits	(i) Easy to calculate profits (ii) Easy to determine the link between financial decisions andprofits.	(i) Emphasizes the short term gains (ii) Ignores risk or uncertainty (iii) Ignores the timing of returns Requires immediateresources.
Shareholders Wealth Maximisation	Highest market value of shares.	(i) Emphasizes the long term gains (ii) Recognises risk or uncertainty (iii) Recognises the timing of returns (iv) Considers	(i) Offers no clear relationship between financial decisionsand share price. Can lead to management anxiety and frustration.

		shareholders' return.	

13. Why Wealth Maximisation works ?

To answer this question it is important to first understand and know what other goals a business enterprise may have. Some of the other goals a business enterprise may follow are:-

- ♦ Achieving a higher growth rate
- ♦ Attaining a larger market share
- ♦ Gaining leadership in the market in terms of products and technology
- ♦ Promoting employee welfare
- ♦ Increasing customer satisfaction
- ♦ Improving community life, supporting education and research, solving societal problems, etc.

14. Explain linking of FM with Accounts.

The relationship between financial management and accounting are closely related to the extent that accounting is an important input in financial decision making. In other words, accounting is a necessary input into the financial management function.

Financial accounting generates information relating to operations of the organisation. The outcome of accounting is the financial statements such as balance sheet, income statement, and the statement of changes in financial position. The information contained in these statements and reports helps the financial managers in gauging the past performance and future directions of the organisation.
Though financial management and accounting are closely related, still they differ in the treatment of funds and also with regards to decision making. Some of the differences are:-

Treatment of Funds

In accounting, the measurement of funds is based on the accrual principle i.e. revenue is recognised at the point of sale and not when collected and expenses are recognised when they are incurred rather than when actually paid. The accrual based accounting data do not reflect fully the financial conditions of the organisation.

Decision–making

The purpose of accounting is to collect and present financial data of the past, present and future operations of the organization. The financial manager uses these data for financial decision making. It is not that the financial managers cannot collect data or accountants cannot make decisions, but the chief focus of an accountant is to collect data and present the data while the financial manager's primary responsibility relates to financial planning, controlling and decision making. Thus, in a way it can be stated that financial management begins where accounting ends.

15. How to address agency problem?

The agency problem arises if manager's interests are not aligned to the interests of the debt lender and equity investors. The agency problem of debt lender would be addressed by imposing negative covenants i.e. the managers cannot borrow beyond a point. This is one of the most important concepts of modern nday finance and the application of this would be applied in the Credit Risk Management of Bank, Fund Raising, Valuing distressed companies. Agency problem between the managers and shareholders can be addressed if the interests of the managers are aligned to the interests of the share-holders. It is easier said than done.

However, following efforts have been made to address these issues:

♦ Managerial compensation is linked to profit of the company to some extent and also with the long term objectives of the company.

♦ Employee is also designed to address the issue with the underlying assumption that maximisation of the stock price is the objective of the investors.

♦ Effecting monitoring can be done.

2 CHAPTER — TYPES OF FINANCING

Q.N	QUESTIONS	
1.	**_____ bonds give the investor an option back to the company before maturity.**	
	(a) Callable	(b) Puttable
	(c) Both	(d) Foreign
2.	**Marketable securities are primarily**	
	(a) short-term debt instruments	(b) short-term equity securities
	(c) long-term debt instruments	(d) long-term equity securities
3.	**Equity Share**	
	(a) Have an unlimited life, and voting rights and receive dividends	
	(b) Have a limited life, with no voting rights but receive dividends	
	(c) Have a limited life, and voting rights and receive dividends	
	(d) Have an unlimited life, and voting rights but receive no dividends	
4.	**Debt capital refers to:**	
	(a) Money raised through the sale of shares.	(b) Funds raised by borrowing & must be repaid
	(c) Factoring accounts receivable	(d) Inventory loans
5.	**Which of the following marketable securities is the obligation of a commercial bank**	
	(a) Commercial paper	(b) Negotiable certificate of deposit
	(c) Repurchase agreement	(d) T-bills
6.	**External sources of finance do not include**	
	(a) Debentures	(b) Retained earnings
	(c) Overdrafts	(d) Leasing
7.	**External Commercial Borrowings can be accessed through ....**	
	(a) only automatic route	
	(b) only approval route	
	(c) both automatic and approval route	
	(d) neither automatic nor approval route	
8.	**The most popular source of short-term funding is**	
	(a) Factoring	(b) Trade credit
	(c) Family and friends	(d) Commercial banks