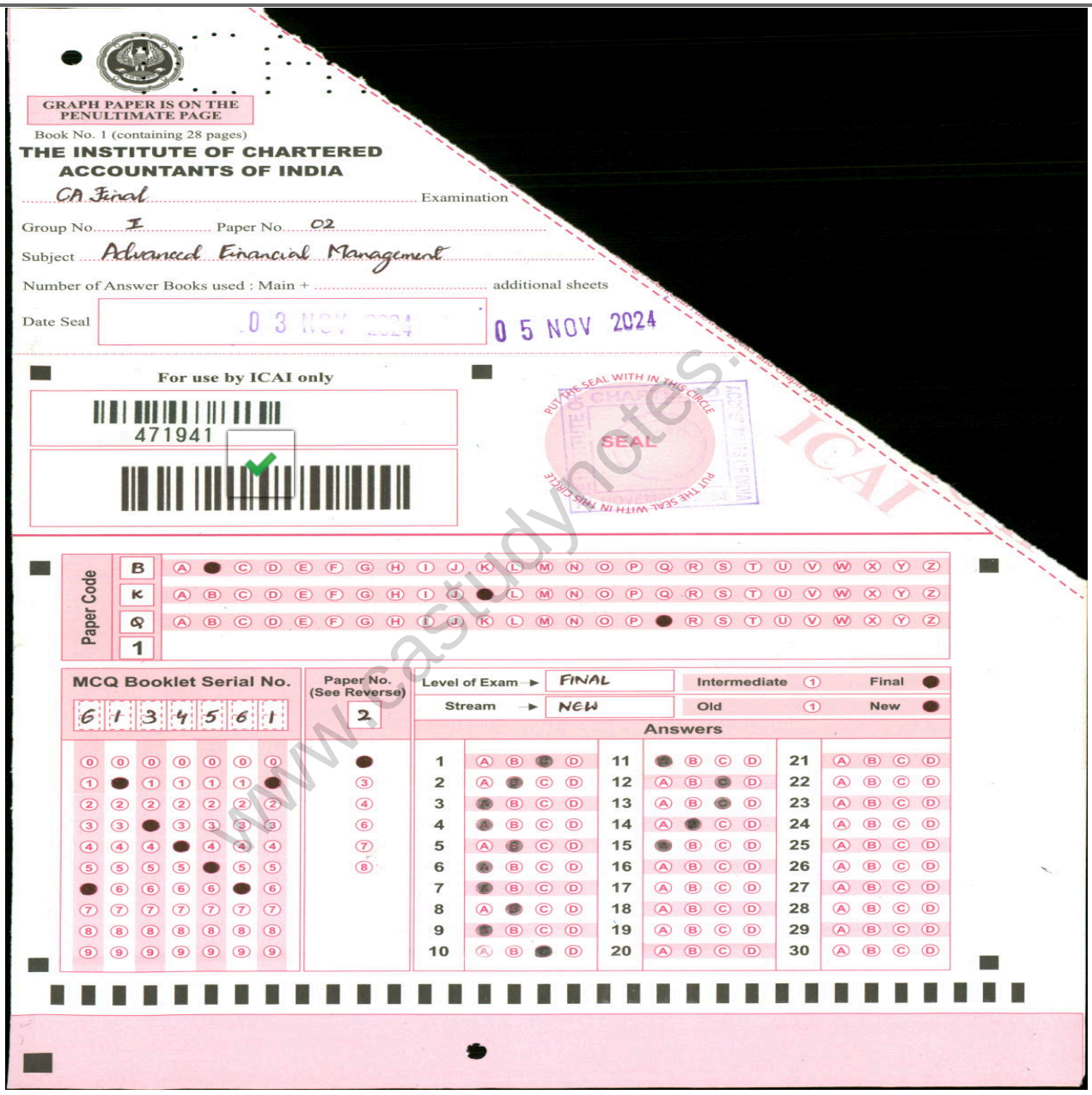
The Institute of Chartered Accountants of India

Code:	**FN2AF471941**	**Total Marks:**	**70**
Subject :	**02 Advanced Financial Management**	**Marks Obtained :**	**69**



GRAPH PAPER IS ON THE PENULTIMATE PAGE

Book No. 1 (containing 28 pages)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

CA Final Examination

Group No. I Paper No. 02

Subject Advanced Financial Management

Number of Answer Books used : Main + additional sheets

Date Seal 03 NOV 2024 05 NOV 2024

For use by ICAI only

471941

Paper Code: B K Q 1

MCQ Booklet Serial No. 6 1 3 4 5 6 1

Paper No. (See Reverse) 2

Level of Exam ► FINAL Intermediate ① Final ●

Stream ► NEW Old ① New ●

Answers

1		B		D	11		B	C	D
2	A		C	D	12	A	B		D
3		B	C	D	13	A	B		D
4		B	C	D	14	A		C	D
5	A		C	D	15		B	C	D
6		B	C	D	16	A	B	C	D
7		B	C	D	17	A	B	C	D
8	A		C	D	18	A	B	C	D
9		B	C	D	19	A	B	C	D
10	A	B		D	20	A	B	C	D

21	A	B	C	D
22	A	B	C	D
23	A	B	C	D
24	A	B	C	D
25	A	B	C	D
26	A	B	C	D
27	A	B	C	D
28	A	B	C	D
29	A	B	C	D
30	A	B	C	D

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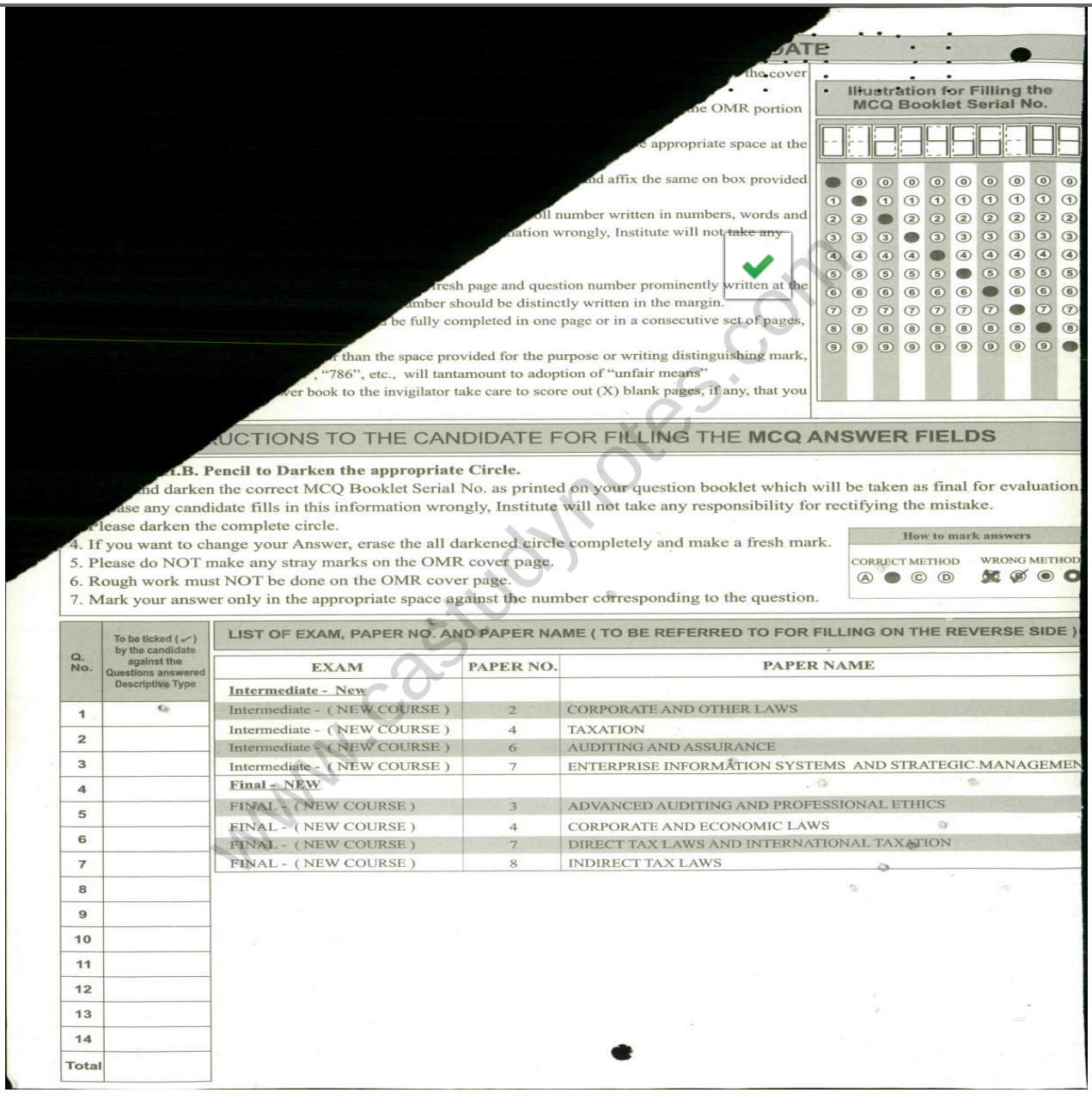

...the cover
...the OMR portion
...appropriate space at the
...affix the same on box provided
...number written in numbers, words and
...wrongly, Institute will not take any
...fresh page and question number prominently written at the
...should be distinctly written in the margin.
...be fully completed in one page or in a consecutive set of pages,
...than the space provided for the purpose or writing distinguishing mark,
..., "786", etc., will tantamount to adoption of "unfair means"
...book to the invigilator take care to score out (X) blank pages, if any, that you

Illustration for Filling the MCQ Booklet Serial No.

...UCTIONS TO THE CANDIDATE FOR FILLING THE **MCQ ANSWER FIELDS**

...B. Pencil to Darken the appropriate Circle.
...darken the correct MCQ Booklet Serial No. as printed on your question booklet which will be taken as final for evaluation.
...any candidate fills in this information wrongly, Institute will not take any responsibility for rectifying the mistake.
Please darken the complete circle.
4. If you want to change your Answer, erase the all darkened circle completely and make a fresh mark.
5. Please do NOT make any stray marks on the OMR cover page.
6. Rough work must NOT be done on the OMR cover page.
7. Mark your answer only in the appropriate space against the number corresponding to the question.

How to mark answers
CORRECT METHOD WRONG METHOD
Ⓐ ● Ⓒ Ⓓ Ⓐ Ⓑ ● Ⓓ

Q. No.	To be ticked (✓) by the candidate against the Questions answered Descriptive Type
1	
2	
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
Total	

LIST OF EXAM, PAPER NO. AND PAPER NAME (TO BE REFERRED TO FOR FILLING ON THE REVERSE SIDE)

EXAM	PAPER NO.	PAPER NAME
Intermediate - New		
Intermediate - (NEW COURSE)	2	CORPORATE AND OTHER LAWS
Intermediate - (NEW COURSE)	4	TAXATION
Intermediate - (NEW COURSE)	6	AUDITING AND ASSURANCE
Intermediate - (NEW COURSE)	7	ENTERPRISE INFORMATION SYSTEMS AND STRATEGIC MANAGEMEN
Final - NEW		
FINAL - (NEW COURSE)	3	ADVANCED AUDITING AND PROFESSIONAL ETHICS
FINAL - (NEW COURSE)	4	CORPORATE AND ECONOMIC LAWS
FINAL - (NEW COURSE)	7	DIRECT TAX LAWS AND INTERNATIONAL TAXATION
FINAL - (NEW COURSE)	8	INDIRECT TAX LAWS

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03

[Question 1a]

SD (market) = 1.2

Stock	(A) Standard deviation (%)	(B) Coulation with market	Beta = (B) x (A) / SD (market)
A	2.5	0.840	1.75
B	2	0.540	0.9
C	0.8	0.975	0.65

Market Risk premium = Market Return - Risk free Rate → $(R_m - R_f)$
= 14% - 9%
= 5%

Required Return as per Capital Asset Pricing model
= $R_f + \beta(R_m - R_f)$

Stock	CAPM Workings	(R_e) Required Return	E(R) Expected Return
A	9% + 1.75 (5%)	17.75%	19%
B	9% + 0.9 (5%)	13.5%	13.5%
C	9% + 0.65 (5%)	12.25%	11%

1aStep1 3

Thus,

Stock	Remarks	Value	Strategy
A	E(R) > R_e	Undervalued	BUY
B	E(R) = R_e	Correctly valued	HOLD
C	E(R) < R_e	Overvalued	SELL

1aStep2 3

1a 6

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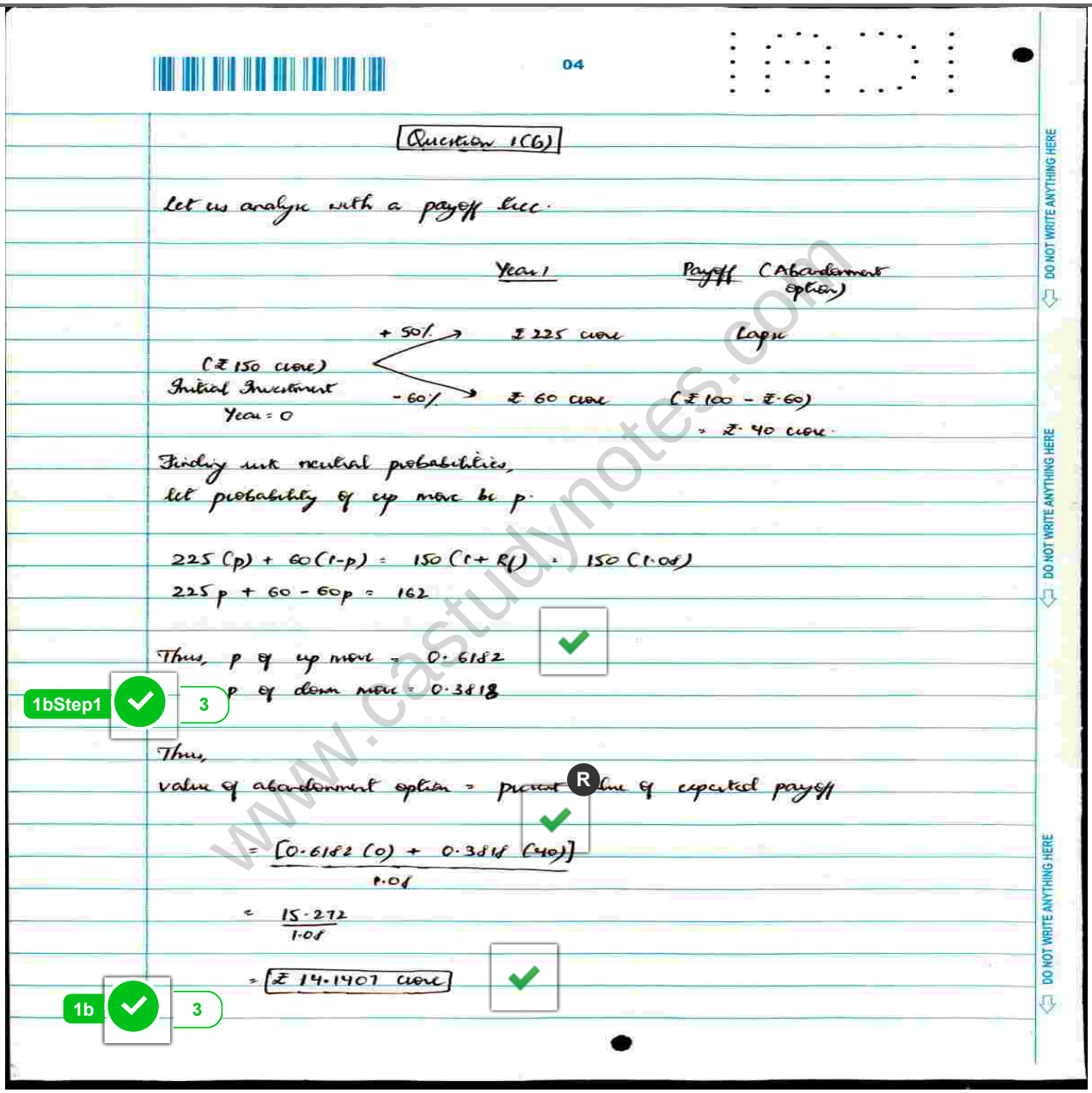

04

Question 1(6)

Let us analyse with a payoff tree.

Year 1 Payoff (Abandonment option)

(₹ 150 crore) Initial Investment, Year = 0

+ 50% → ₹ 225 crore — Lapse

- 60% → ₹ 60 crore — (₹ 100 - ₹ 60) = ₹ 40 crore

Finding risk neutral probabilities,

Let probability of up move be p.

225 (p) + 60 (1-p) = 150 (1 + R_f) = 150 (1.05)

225 p + 60 - 60p = 162

Thus, p of up move = 0.6182

p of down move = 0.3818

1bStep1 3

Thus,

value of abandonment option = present value of expected payoff

= [0.6182 (0) + 0.3818 (40)] / 1.05

= 15.272 / 1.05

= ₹ 14.1407 crore

1b 3

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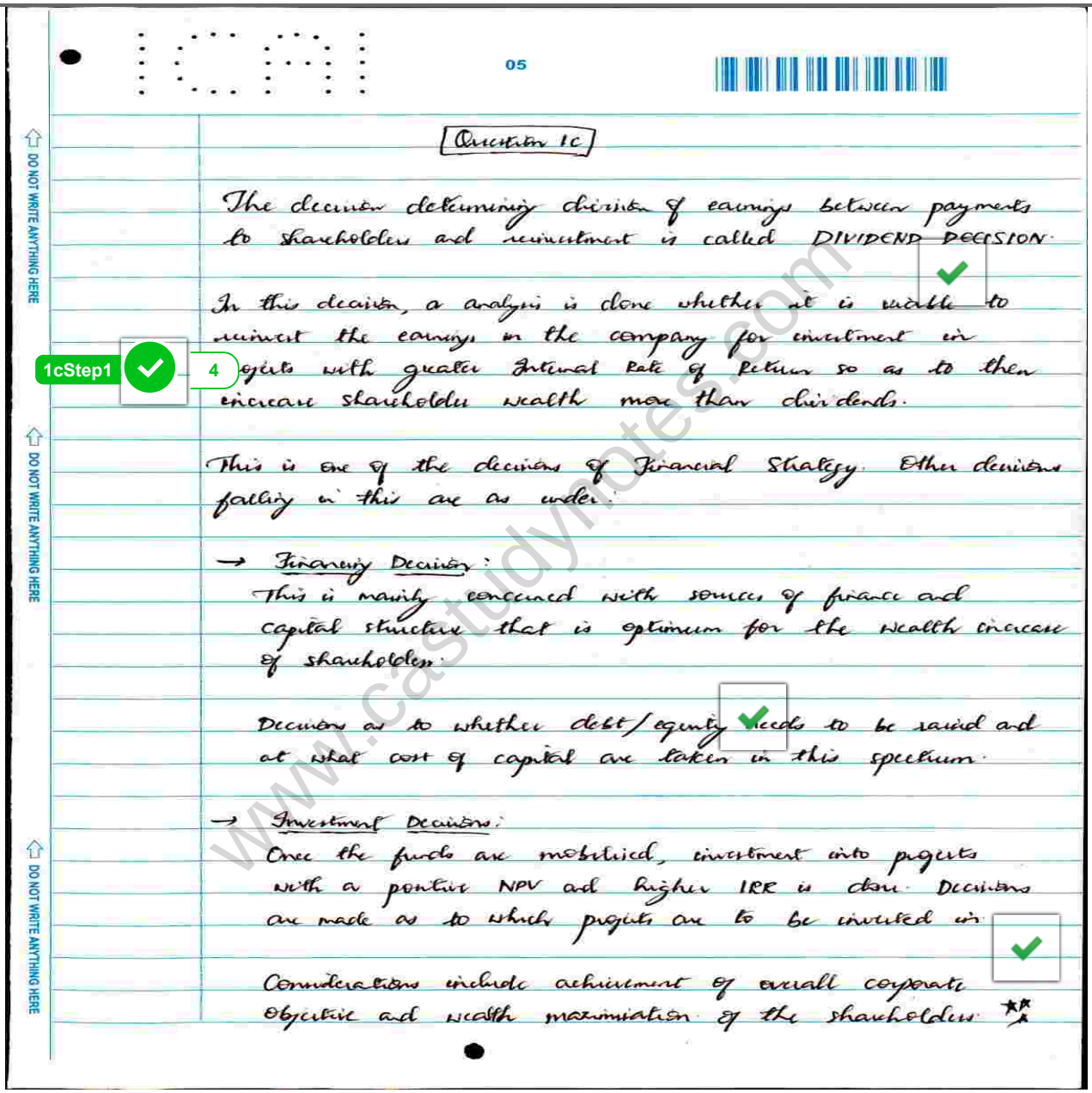

05

Question 1c

The decision determining division of earnings between payments to shareholders and reinvestment is called DIVIDEND DECISION.

In this decision, a analysis is done whether it is viable to reinvest the earnings in the company for investment in projects with greater Internal Rate of Return so as to then increase shareholder wealth more than dividends.

This is one of the decisions of Financial Strategy. Other decisions falling in this are as under:

→ Financing Decision:
This is mainly concerned with sources of finance and capital structure that is optimum for the wealth increase of shareholders.

Decisions as to whether debt/equity needs to be raised and at what cost of capital are taken in this spectrum.

→ Investment Decisions:
Once the funds are mobilised, investment into projects with a positive NPV and higher IRR is done. Decisions are made as to which projects are to be invested in.

Considerations include achievement of overall corporate objective and wealth maximisation of the shareholders.

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1cStep1 4

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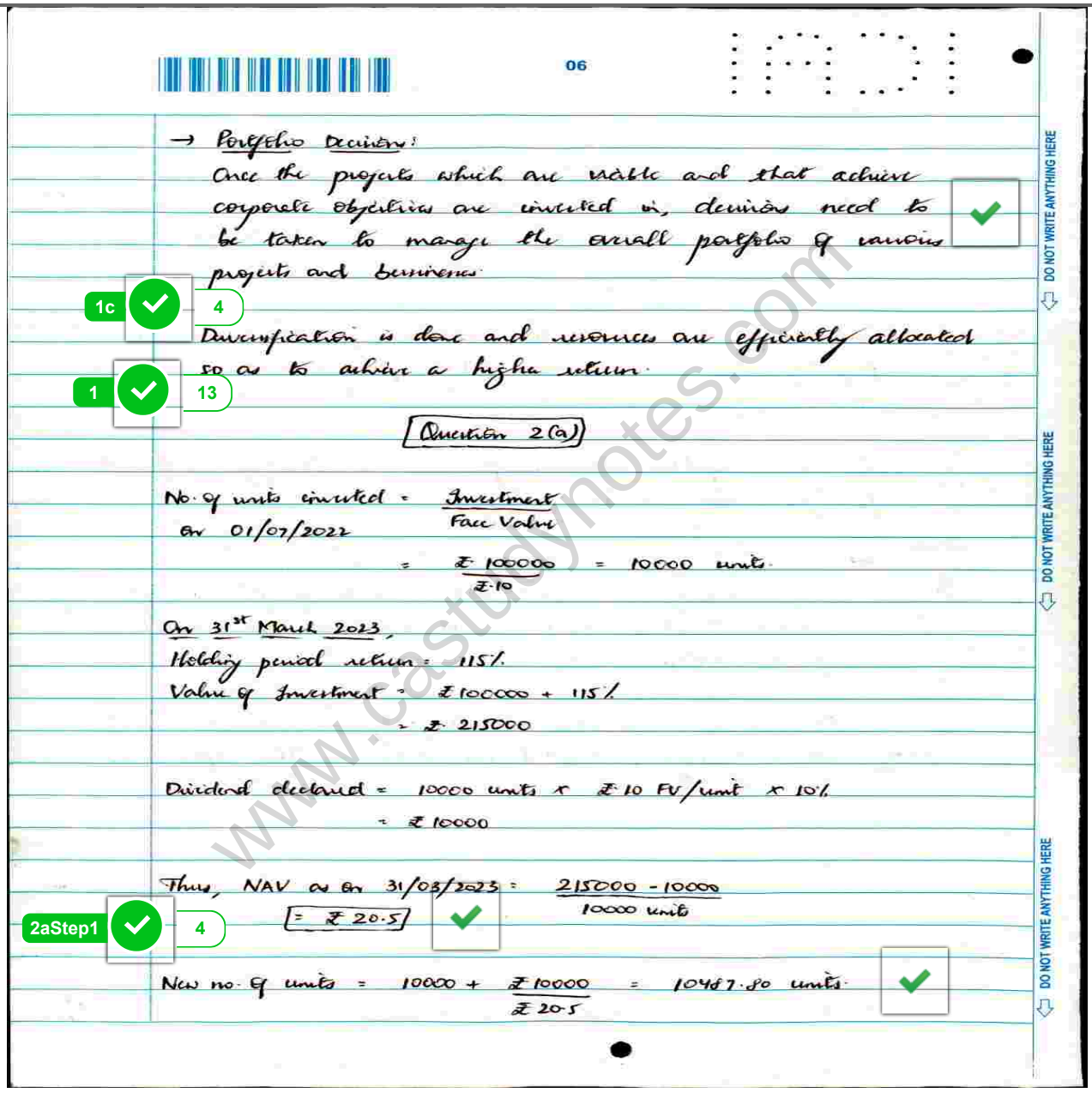

06

→ Portfolio Decision:
Once the projects which are viable and that achieve corporate objectives are invested in, decisions need to be taken to manage the overall portfolio of various projects and businesses.

1c 4

Diversification is done and resources are efficiently allocated so as to achieve a higher return.

1 13

Question 2(a)

No. of units invested = Investment / Face Value
on 01/07/2022
= ₹ 100000 / ₹ 10 = 10000 units.

On 31st March 2023,
Holding period return = 115%
Value of Investment = ₹ 100000 + 115%
= ₹ 215000

Dividend declared = 10000 units × ₹ 10 FV/unit × 10%
= ₹ 10000

Thus, NAV as on 31/03/2023 = (215000 − 10000) / 10000 units
= ₹ 20.5

2aStep1 4

New no. of units = 10000 + ₹ 10000 / ₹ 20.5 = 10487.80 units.

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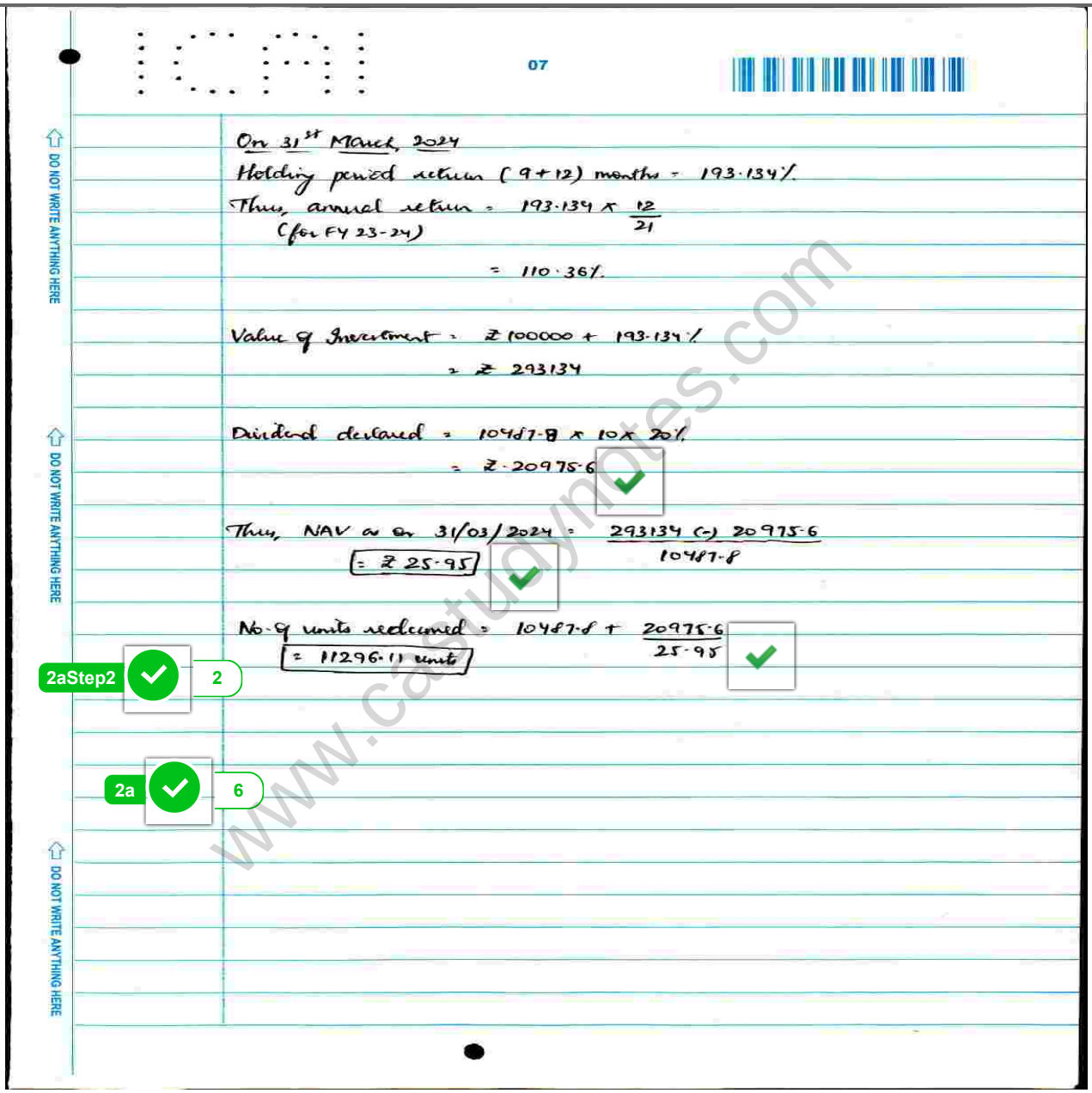

07

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On 31st March, 2024

Holding period return (9+12) months = 193.134%

Thus, annual return (for FY 23-24) = $193.134 \times \frac{12}{21}$

= 110.36%

Value of Investment = ₹100000 + 193.134%

= ₹293134

Divided declared = 10487.8 × 10 × 20%

= ₹20975.6

Thus, NAV as on 31/03/2024 = $\frac{293134 - 20975.6}{10487.8}$

= ₹25.95

No. of units redeemed = $10487.8 + \frac{20975.6}{25.95}$

= 11296.11 units

2aStep2 2

2a 6

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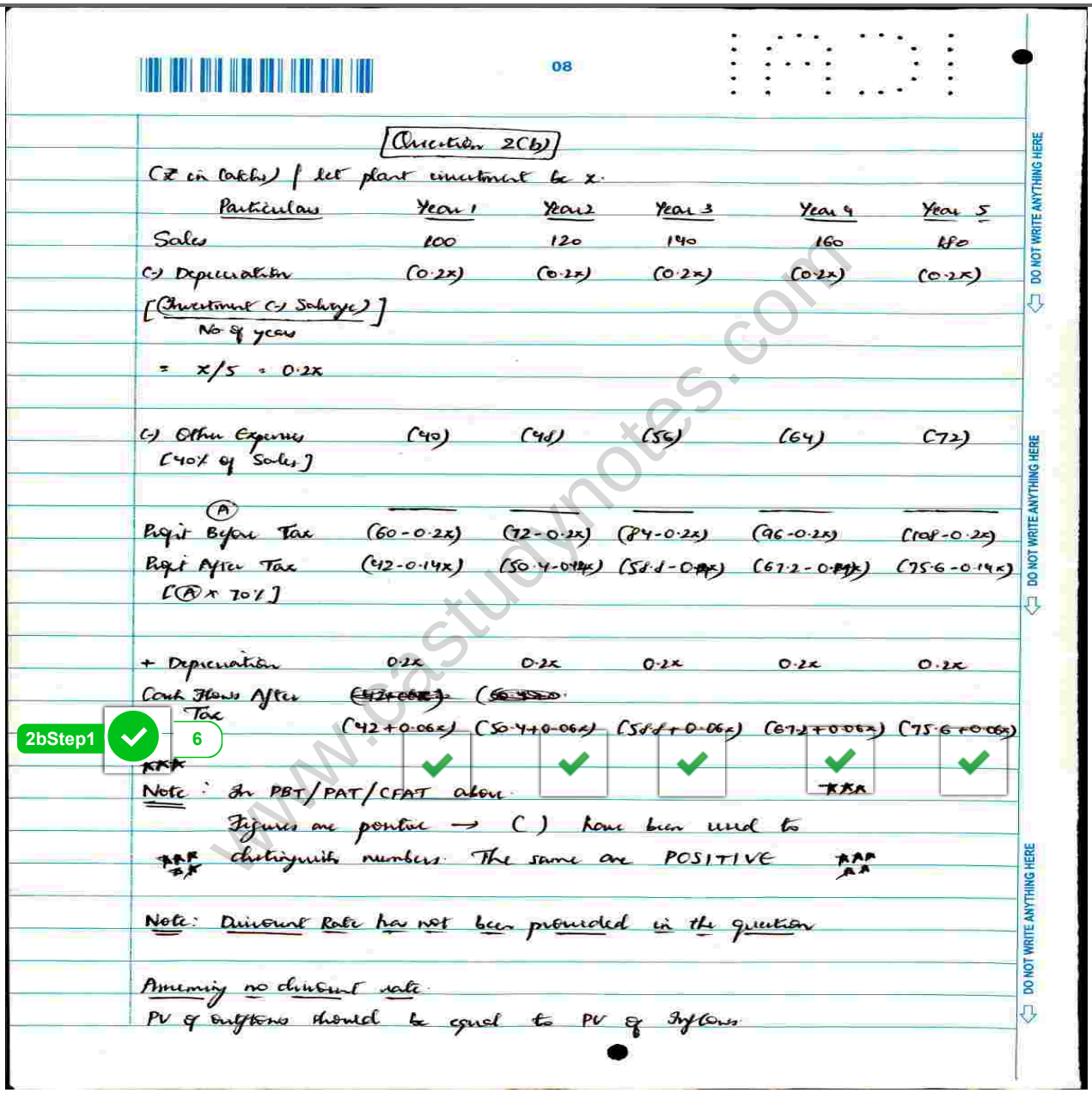

08

Question 2(b)

(₹ in lakhs) / let plant investment be x.

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Sales	100	120	140	160	180
(-) Depreciation [(Investment (-) Salvage) / No of years]	(0.2x)	(0.2x)	(0.2x)	(0.2x)	(0.2x)
	= x/5 = 0.2x				
(-) Other Expenses [40% of Sales]	(40)	(48)	(56)	(64)	(72)
(A) Profit Before Tax	(60-0.2x)	(72-0.2x)	(84-0.2x)	(96-0.2x)	(108-0.2x)
Profit After Tax [(A) × 70%]	(42-0.14x)	(50.4-0.14x)	(58.8-0.14x)	(67.2-0.14x)	(75.6-0.14x)
+ Depreciation	0.2x	0.2x	0.2x	0.2x	0.2x
Cash Flows After Tax	(42+0.06x)	(50.4+0.06x)	(58.8+0.06x)	(67.2+0.06x)	(75.6+0.06x)

2bStep1 6

Note : In PBT/PAT/CFAT above figures are positive → ( ) have been used to distinguish numbers. The same are POSITIVE

Note: Discount Rate has not been provided in the question

Assuming no discount rate

PV of outflows should be equal to PV of inflows

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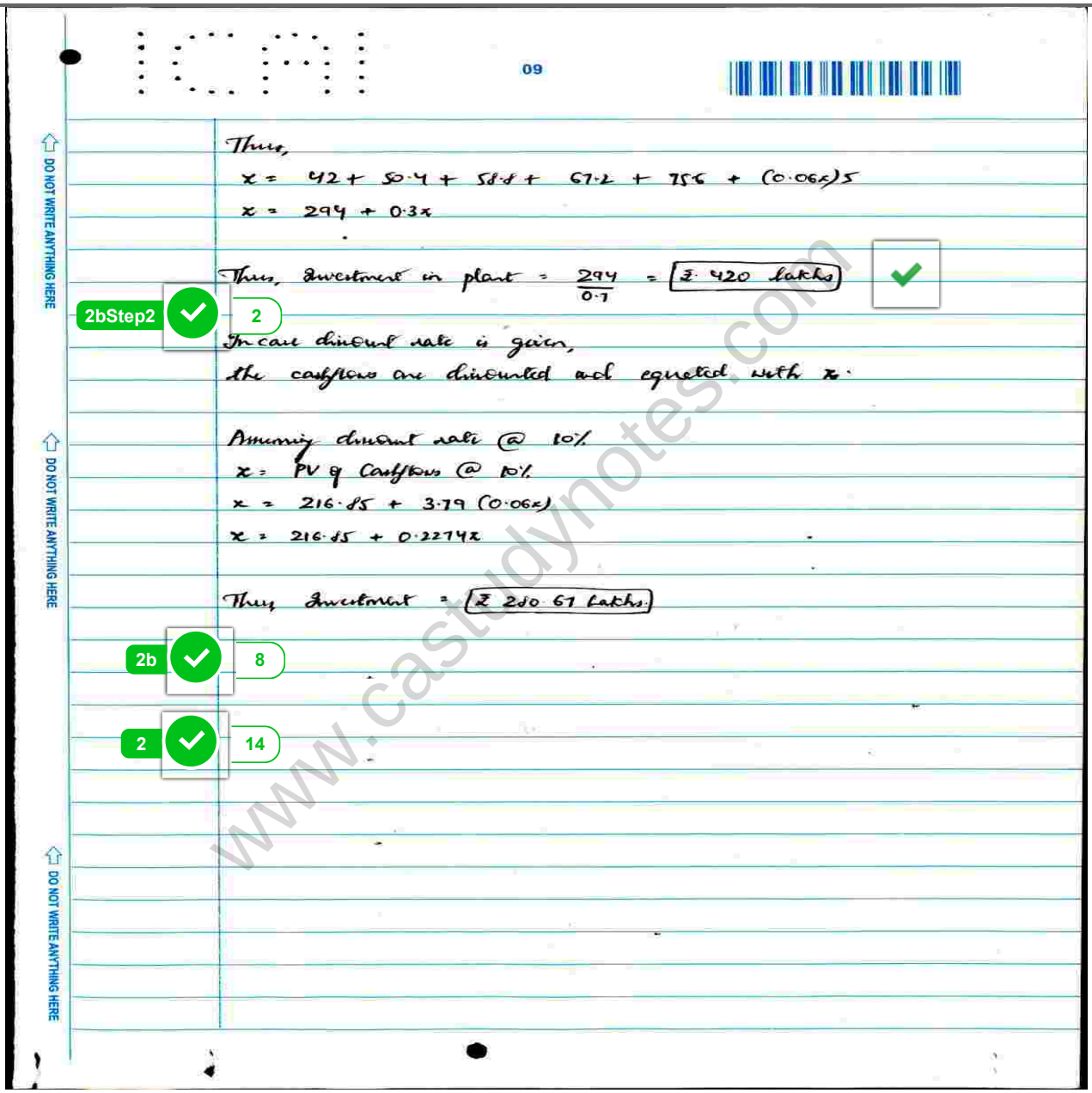

09

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Thus,

$x = 42 + 50.4 + 58.8 + 67.2 + 75.6 + (0.06x)5$

$x = 294 + 0.3x$

Thus, investment in plant = $\frac{294}{0.7}$ = ₹ 420 lakhs

2bStep2 2

In case discount rate is given, the cashflows are discounted and equated with x.

Annuity discount rate @ 10%

x = PV of Cashflows @ 10%

$x = 216.85 + 3.79 (0.06x)$

$x = 216.85 + 0.2274x$

Thus, Investment = ₹ 280.67 Lakhs.

2b 8

2 14

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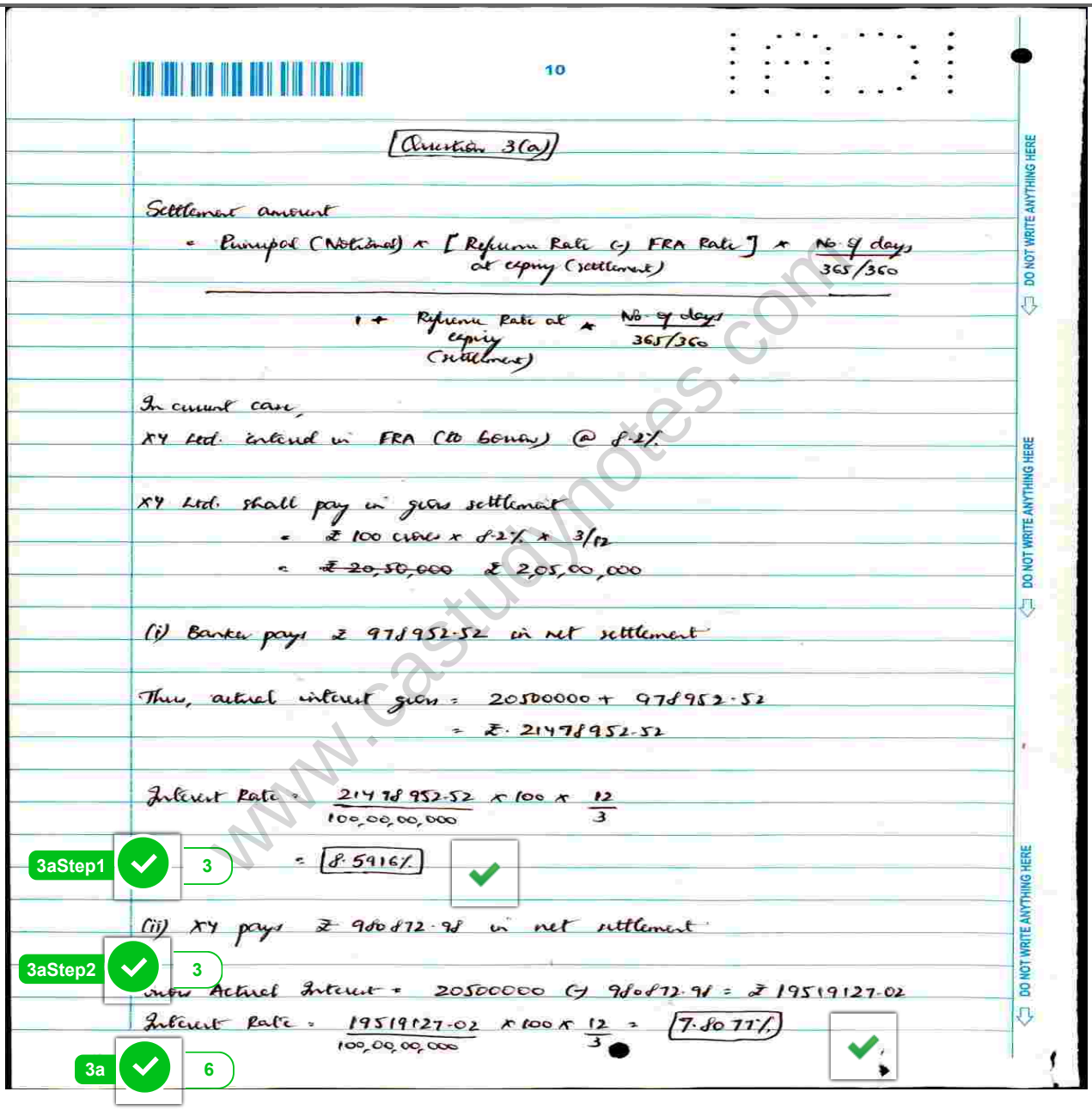

10

Question 3(a)

Settlement amount

= Principal (Notional) × [Return Rate at expiry (settlement) − FRA Rate] × No. of days/365/360

1 + Return Rate at expiry (settlement) × No. of days/365/360

In current case,

XY Ltd. entered in FRA (to borrow) @ 8.2%

XY Ltd. shall pay in gross settlement

= ₹ 100 crore × 8.2% × 3/12

= ~~₹ 20,50,000~~ ₹ 2,05,00,000

(i) Bank pays ₹ 978952.52 in net settlement

Thus, actual interest given = 20500000 + 978952.52

= ₹ 21478952.52

Interest Rate = 21478952.52 / 100,00,00,000 × 100 × 12/3

= 8.5916% ✓

3aStep1 ✓ 3

(ii) XY pays ₹ 980872.98 in net settlement

3aStep2 ✓ 3

Now Actual Interest = 20500000 − 980872.98 = ₹ 19519127.02

Interest Rate = 19519127.02 / 100,00,00,000 × 100 × 12/3 = 7.8077% ✓

3a ✓ 6

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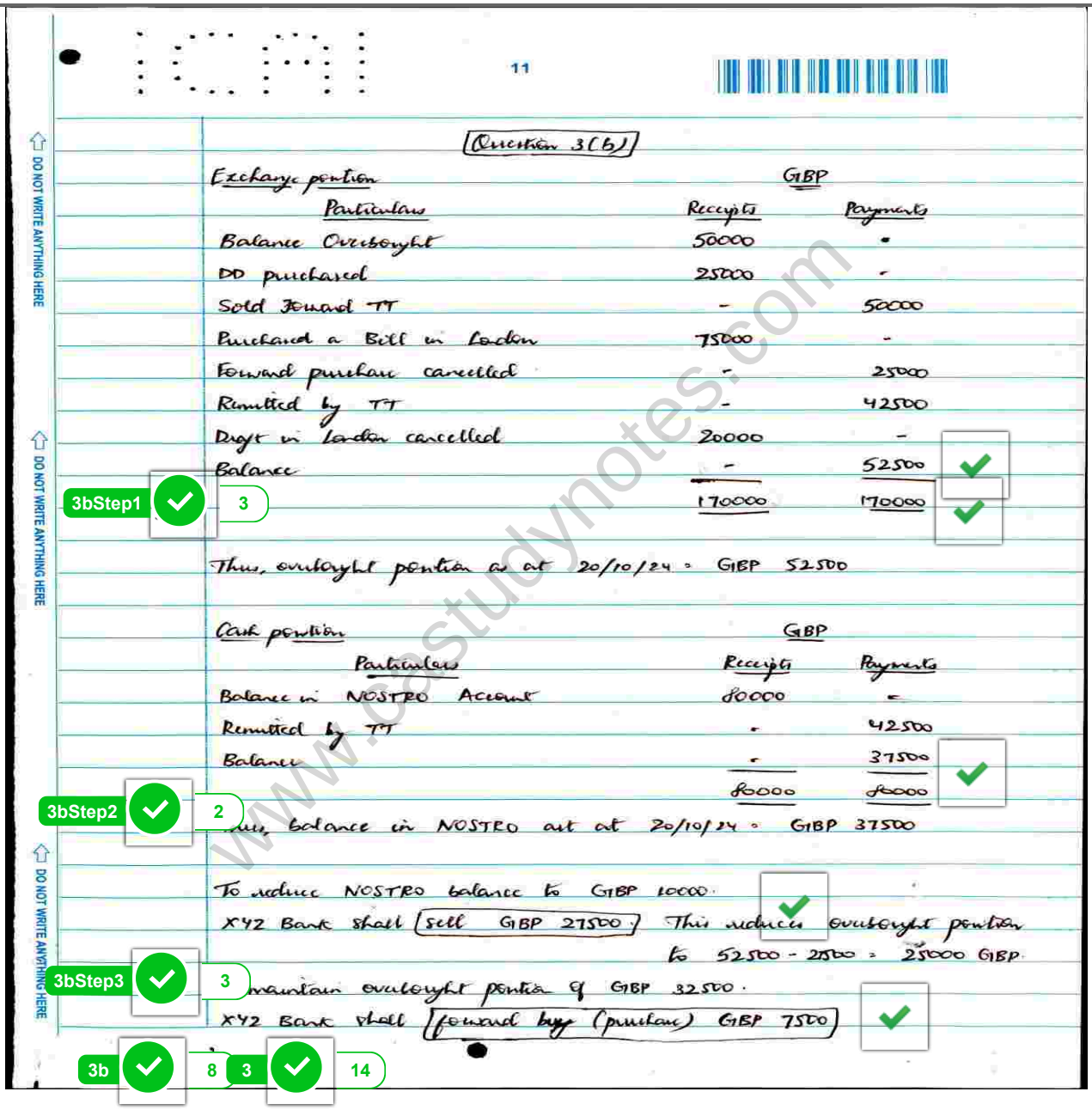

11

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(Question 3(b))

Exchange position

Particulars	Receipts (GBP)	Payments (GBP)
Balance Overbought	50000	-
DD purchased	25000	-
Sold forward TT	-	50000
Purchased a Bill in London	75000	-
Forward purchase cancelled	-	25000
Remitted by TT	-	42500
Buyer in London cancelled	20000	-
Balance	-	52500
	170000	170000

3bStep1 3

Thus, overbought position as at 20/10/24 : GBP 52500

Cash position

Particulars	Receipts (GBP)	Payments (GBP)
Balance in NOSTRO Account	80000	-
Remitted by TT	-	42500
Balance	-	37500
	80000	80000

3bStep2 2

Thus, balance in NOSTRO as at 20/10/24 : GBP 37500

To reduce NOSTRO balance to GBP 10000.

XYZ Bank shall sell GBP 27500. This reduces overbought position to 52500 - 25000 = 25000 GBP

3bStep3 3 maintain overbought position of GBP 32500.

XYZ Bank shall forward buy (purchase) GBP 7500

3b 8 3 14

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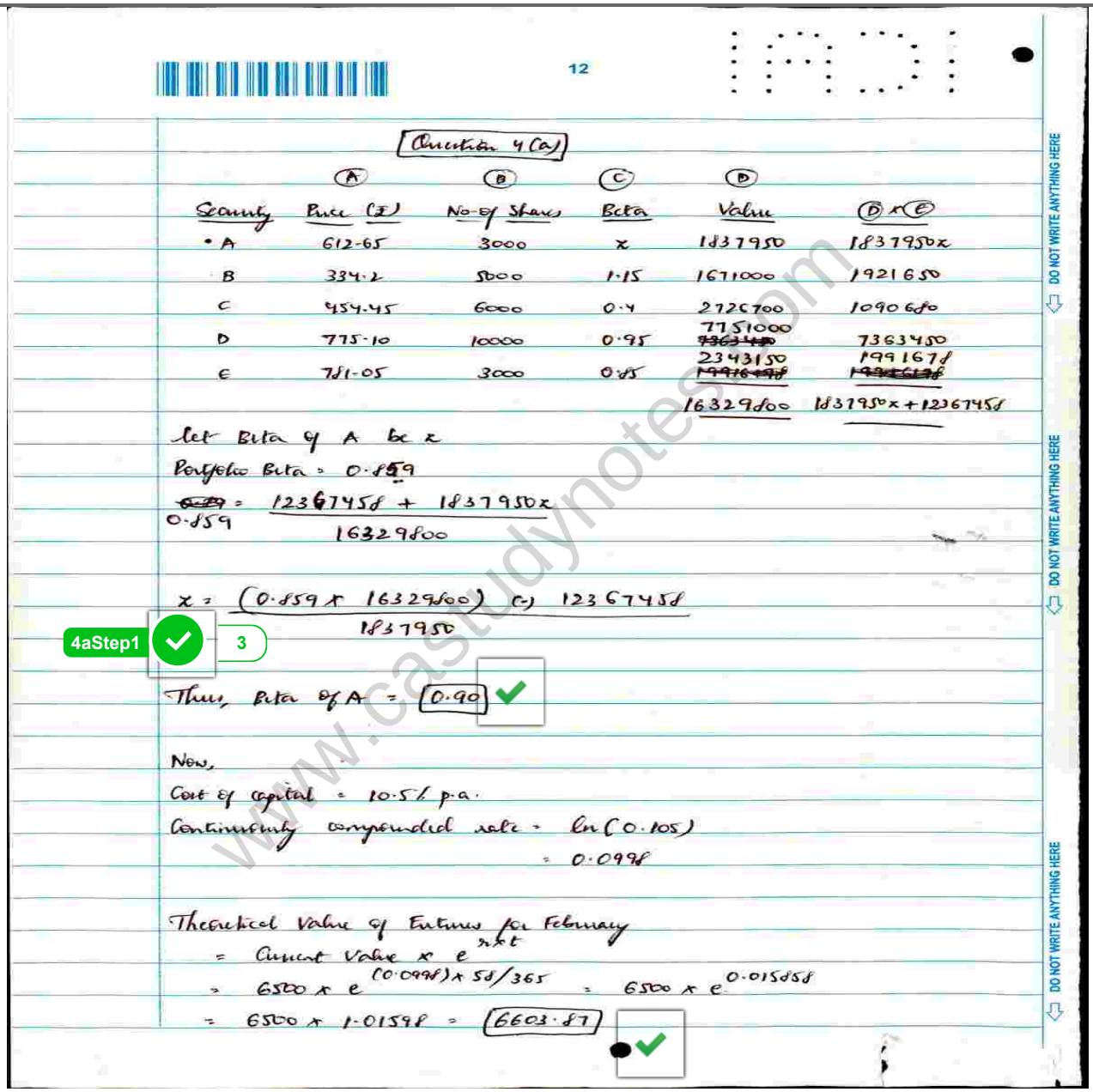

12

Question 4(a)

Security	Price (₹) (A)	No. of Shares (B)	Beta (C)	Value (D)	(D)×(C)
A	612·65	3000	x	1837950	1837950x
B	334·2	5000	1·15	1671000	1921650
C	454·45	6000	0·4	2725700	1090680
D	775·10	10000	0·95	7751000	7363450
E	781·05	3000	0·85	2343150	1991677
				16329800	1837950x + 12367457

Let Beta of A be x

Portfolio Beta = 0·859

$0.859 = \frac{12367457 + 1837950x}{16329800}$

$x = \frac{(0.859 \times 16329800) - 12367457}{1837950}$

4aStep1 3

Thus, Beta of A = 0·90

Now,

Cost of capital = 10·5% p.a.

Continuously compounded rate = ln(0·105)
= 0·0998

Theoretical Value of Futures for February
= Current Value × e^{rxt}
= 6500 × $e^{(0.0998) \times 58/365}$ = 6500 × $e^{0.015858}$
= 6500 × 1·01598 = 6603·87

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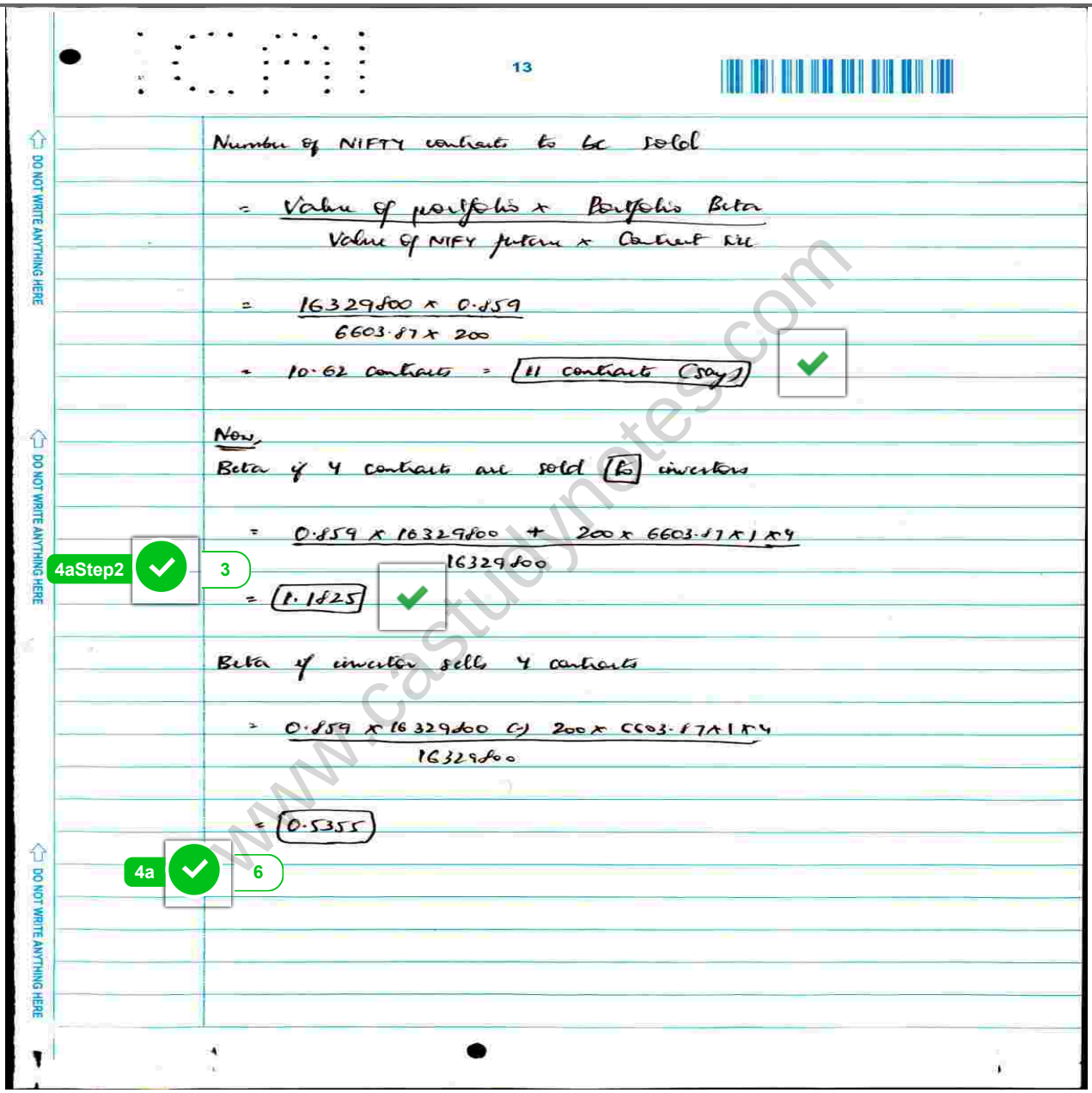

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Number of NIFTY contracts to be sold

$$= \frac{\text{Value of portfolio} \times \text{Portfolio Beta}}{\text{Value of NIFY future} \times \text{Contract size}}$$

$$= \frac{16329800 \times 0.859}{6603.87 \times 200}$$

$$= 10.62 \text{ contracts} = \boxed{11 \text{ contracts (say)}}$$

Now,

Beta of 4 contracts are sold to investors

$$= \frac{0.859 \times 16329800 + 200 \times 6603.87 \times 1 \times 4}{16329800}$$

$$= \boxed{1.1825}$$

4aStep2 3

Beta of investor sells 4 contracts

$$= \frac{0.859 \times 16329800 - 200 \times 6603.87 \times 1 \times 4}{16329800}$$

$$= \boxed{0.5355}$$

4a 6

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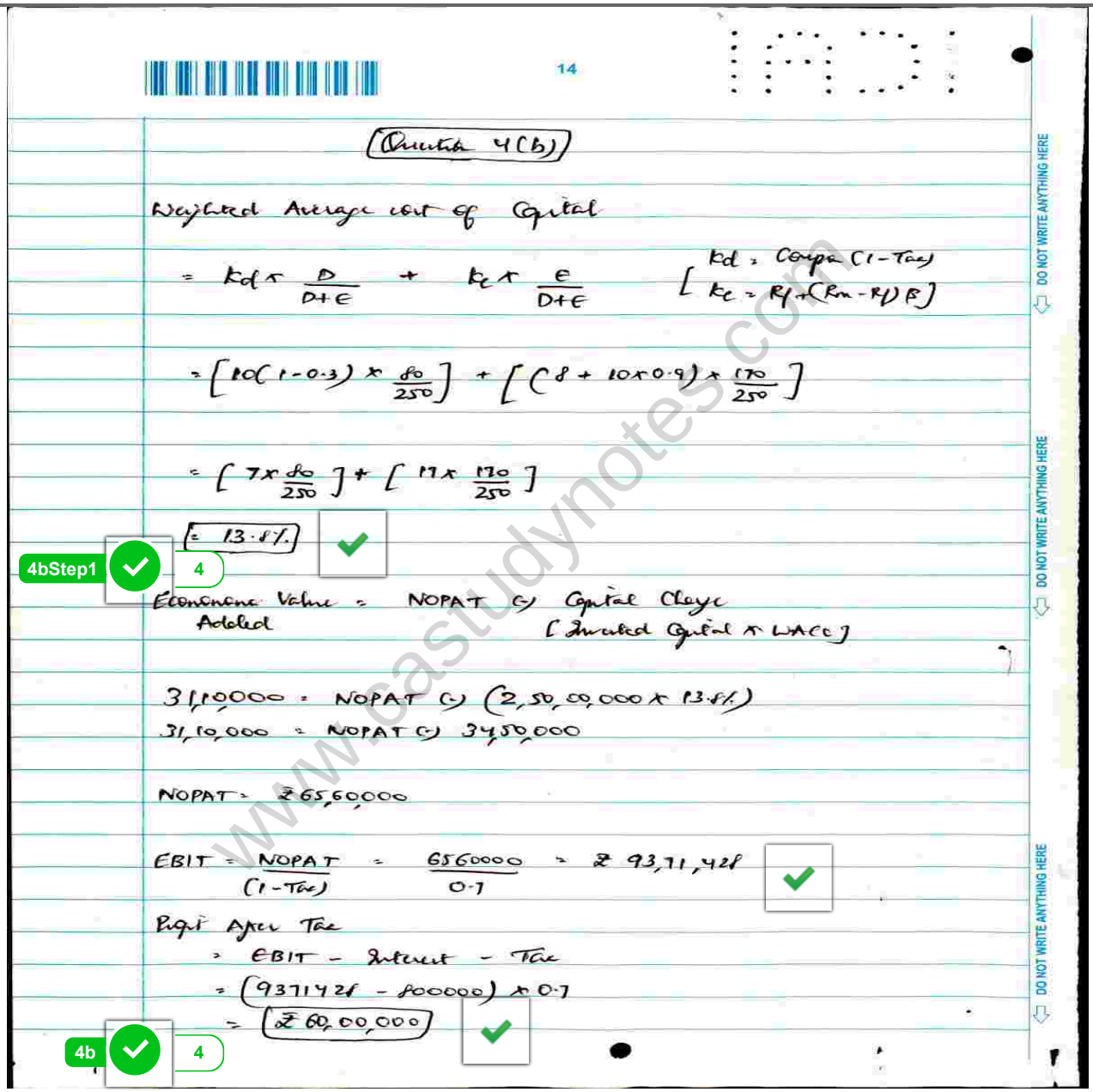

14

Question 4(b)

Weighted Average cost of Capital

$= K_d \times \frac{D}{D+E} + K_e \times \frac{E}{D+E}$ [K_d = Compn (1-Tax) $K_e = R_f + (R_m - R_f)\beta$]

$= [10(1-0.3) \times \frac{80}{250}] + [(8 + 10 \times 0.9) \times \frac{170}{250}]$

$= [7 \times \frac{80}{250}] + [17 \times \frac{170}{250}]$

$= 13.8\%$

4bStep1 4

Economic Value Added = NOPAT (-) Capital Charge [Invested Capital × WACC]

31,10,000 = NOPAT (-) (2,50,00,000 × 13.8%)

31,10,000 = NOPAT (-) 3450000

NOPAT = ₹ 65,60,000

EBIT = $\frac{NOPAT}{(1-Tax)} = \frac{6560000}{0.7}$ = ₹ 93,71,428

Profit After Tax

= EBIT − Interest − Tax

= (9371428 − 800000) × 0.7

= ₹ 60,00,000

4b 4

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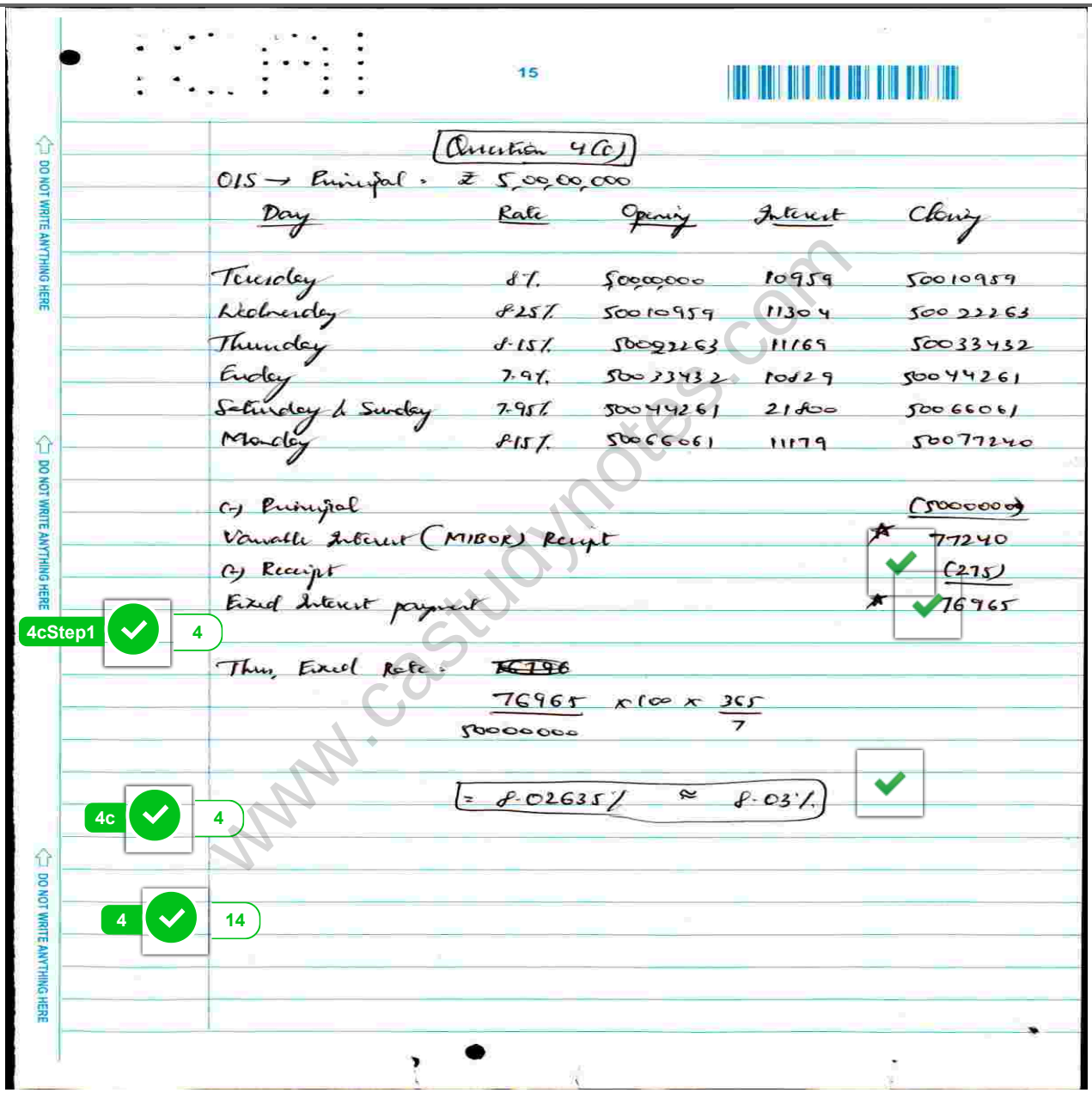

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Question 4(c)

OIS → Principal : ₹ 5,00,00,000

Day	Rate	Opening	Interest	Closing
Tuesday	8%	50000000	10959	50010959
Wednesday	8.25%	50010959	11304	50022263
Thursday	8.15%	50022263	11169	50033432
Friday	7.9%	50033432	10829	50044261
Saturday & Sunday	7.95%	50044261	21800	50066061
Monday	8.15%	50066061	11179	50077240

c) Principal (50000000)

Variable Interest (MIBOR) Receipt 77240

c) Receipt (275)

Fixed Interest payment 76965

4cStep1 4

Then, Fixed Rate: ~~76796~~

$\frac{76965}{50000000} \times 100 \times \frac{365}{7}$

= 8.02635% ≈ 8.03%

4c 4

4 14

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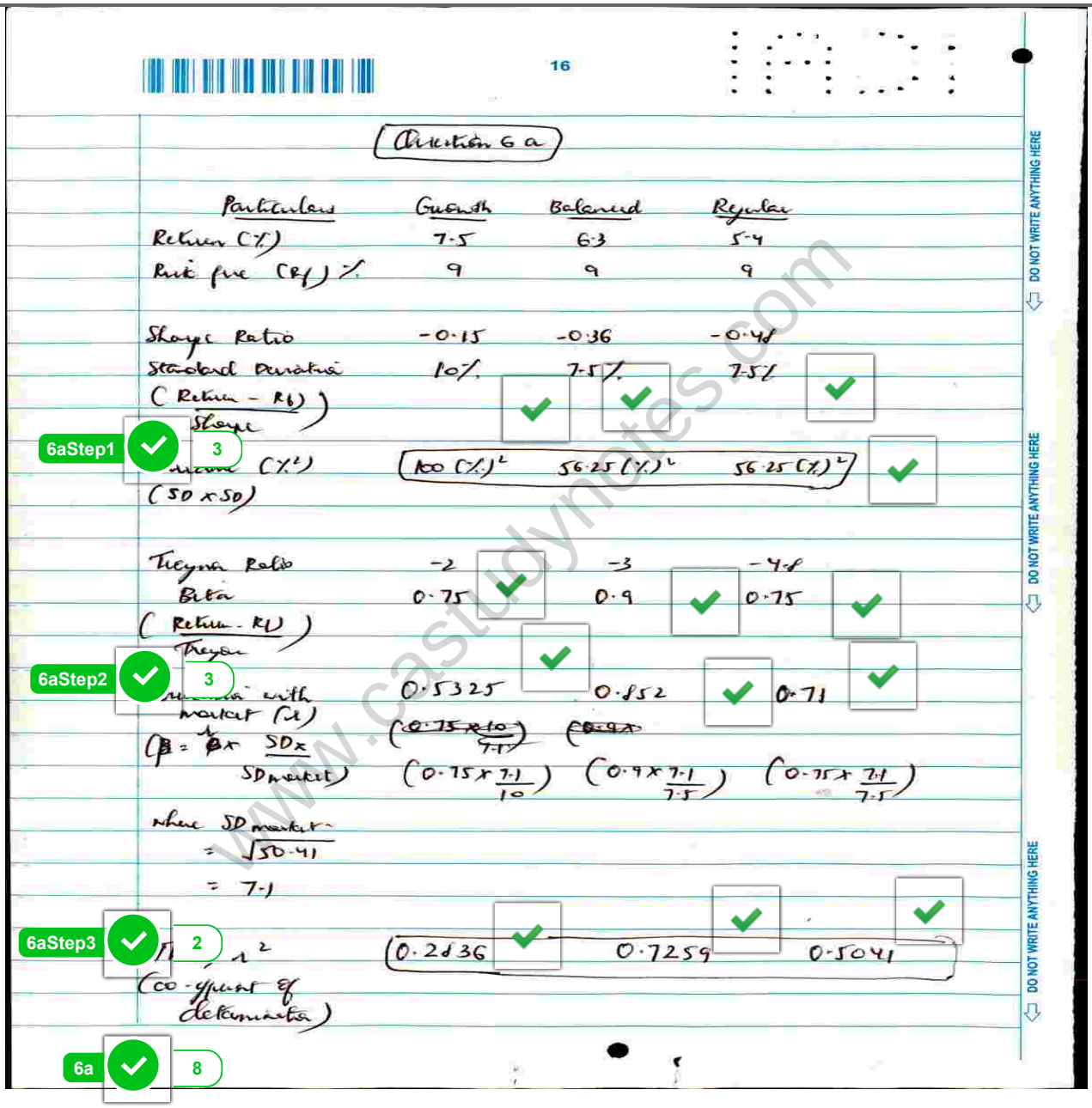

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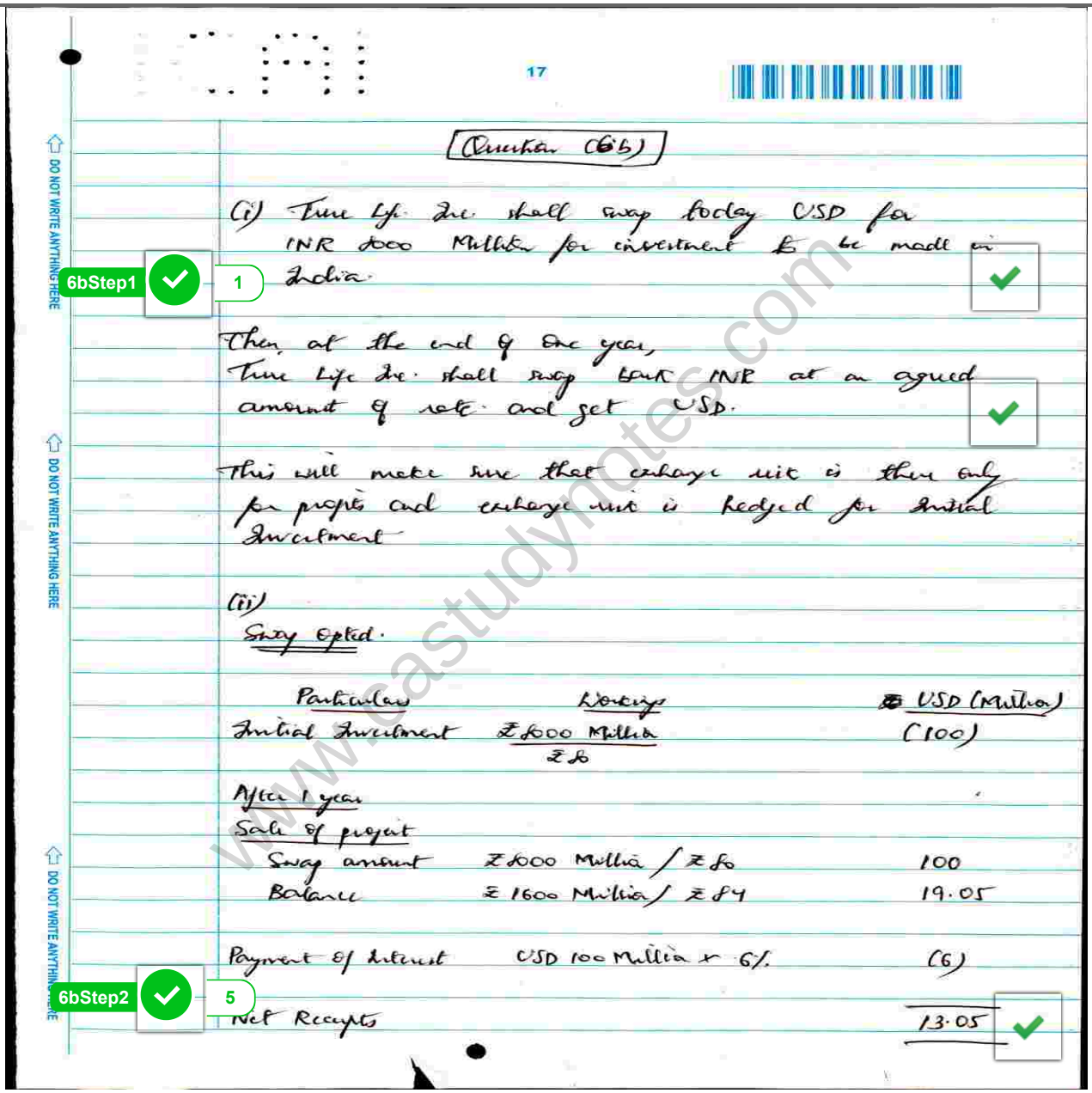

17

(Question 6(b))

(i) Time Life Inc. shall swap today USD for INR 4000 Million for investment to be made in India.

6bStep1 1

Then, at the end of one year, Time Life Inc. shall swap back INR at an agreed amount of rate and get USD.

This will make sure that exchange risk is there only for profit and exchange risk is hedged for initial investment

(ii)

Swap Opted.

Particulars	Workings	USD (Million)
Initial Investment	₹4000 Million / ₹40	(100)
After 1 year		
Sale of project		
Swap amount	₹4000 Million / ₹40	100
Balance	₹1600 Million / ₹84	19.05
Payment of Interest	USD 100 Million × 6%	(6)
Net Receipts		13.05

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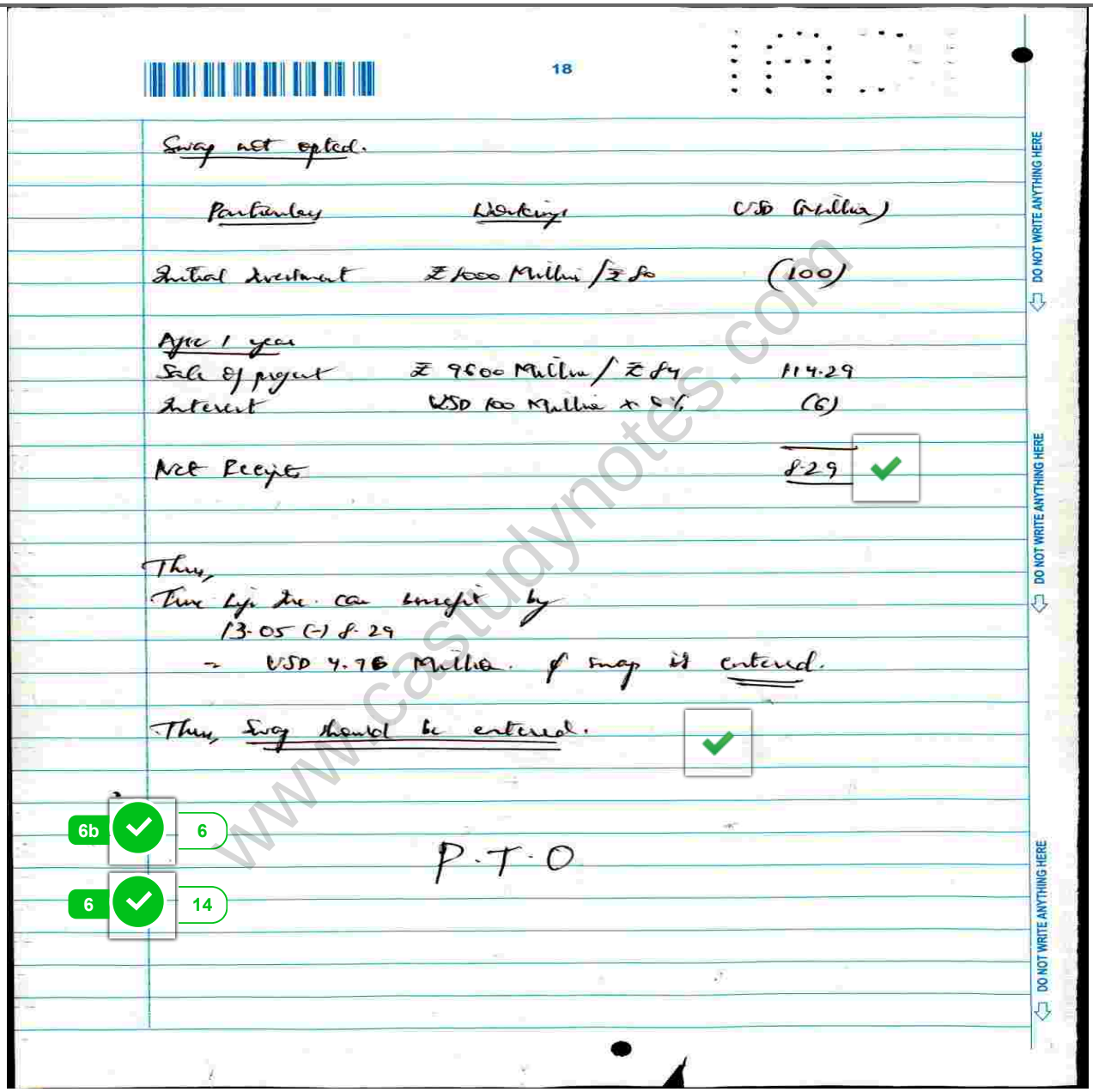
Subject :	**02 Advanced Financial Management**	**Marks Obtained :**	**69**



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Swap not opted.

Particulars	Working	USD (Million)
Initial Investment	₹ 1000 Million / ₹ 80	(100)
After 1 year		
Sale of project	₹ 9800 Million / ₹ 84	114.29
Interest	USD 100 Million × 8%	(6)
Net Receipt		8.29

Thus,
The Ly the Co. can benefit by
13.05 (-) 8.29
= USD 4.76 Million. if swap is entered.

Thus, Swap should be entered.

P.T.O

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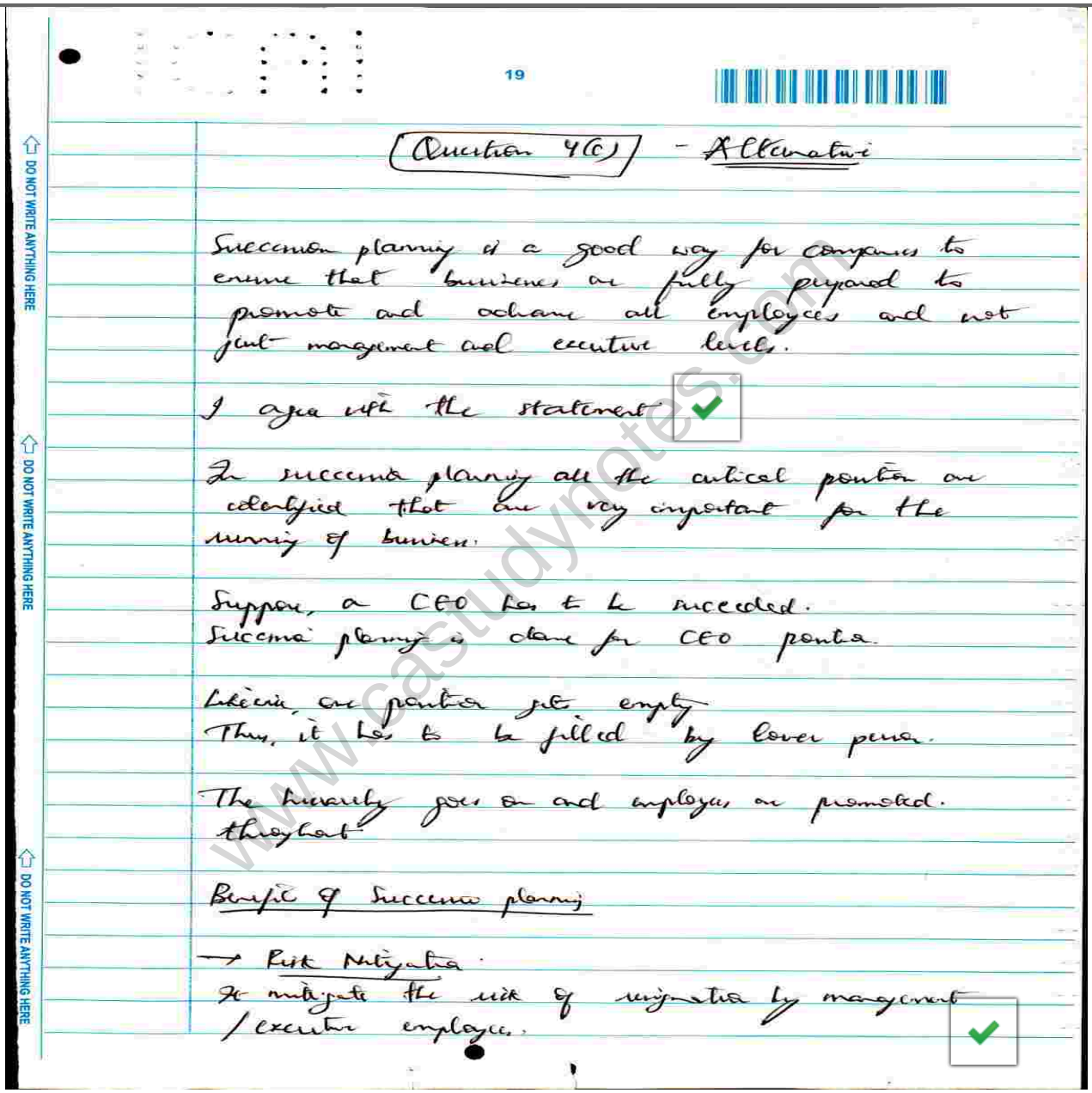

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Question 4(c) - Alternative

Succession planning is a good way for companies to ensure that businesses are fully prepared to promote and advance all employees and not just management and executive levels.

I agree with the statement ✔

In succession planning all the critical points are identified that are very important for the running of business.

Suppose, a CEO has to be succeeded.
Succession planning is done for CEO posts.

Likewise, other posts get empty
Thus, it has to be filled by lower persons.

The hierarchy goes on and employees are promoted. thoughout

Benefit of Succession planning

→ Risk Mitigation.
It mitigate the risk of migration by management / executive employees. ✔

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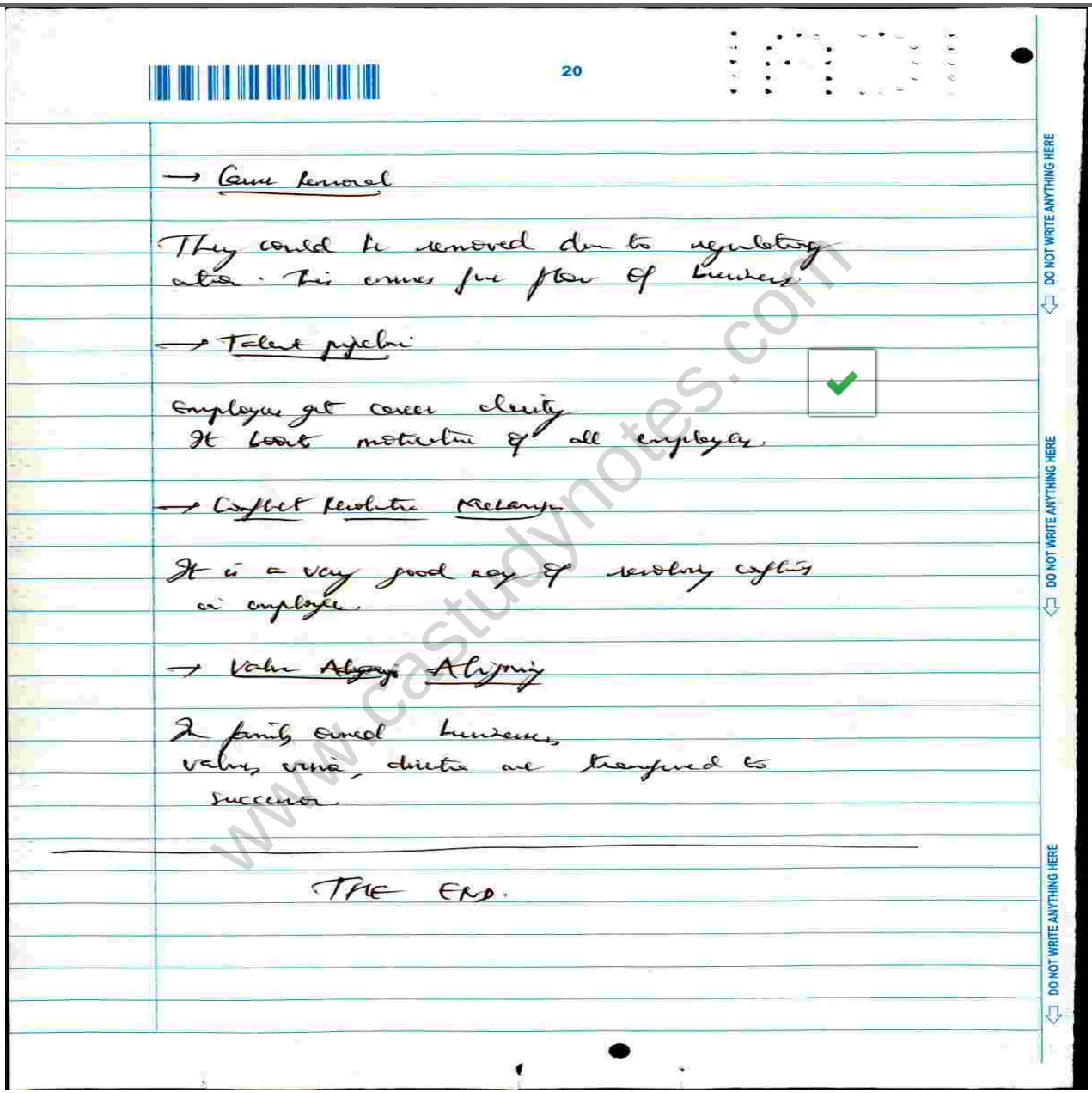

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→ Core Removal

They could be removed due to regulatory action. This causes the flow of business.

→ Talent pitching

Employees get career clarity
It boost motivation of all employees.

→ Collect Resolution Mechanism

It is a very good way of resolving conflicts in employee.

→ Value Always Aligning

In family owned business, values, vision, duties are transferred to succesor.

THE END.

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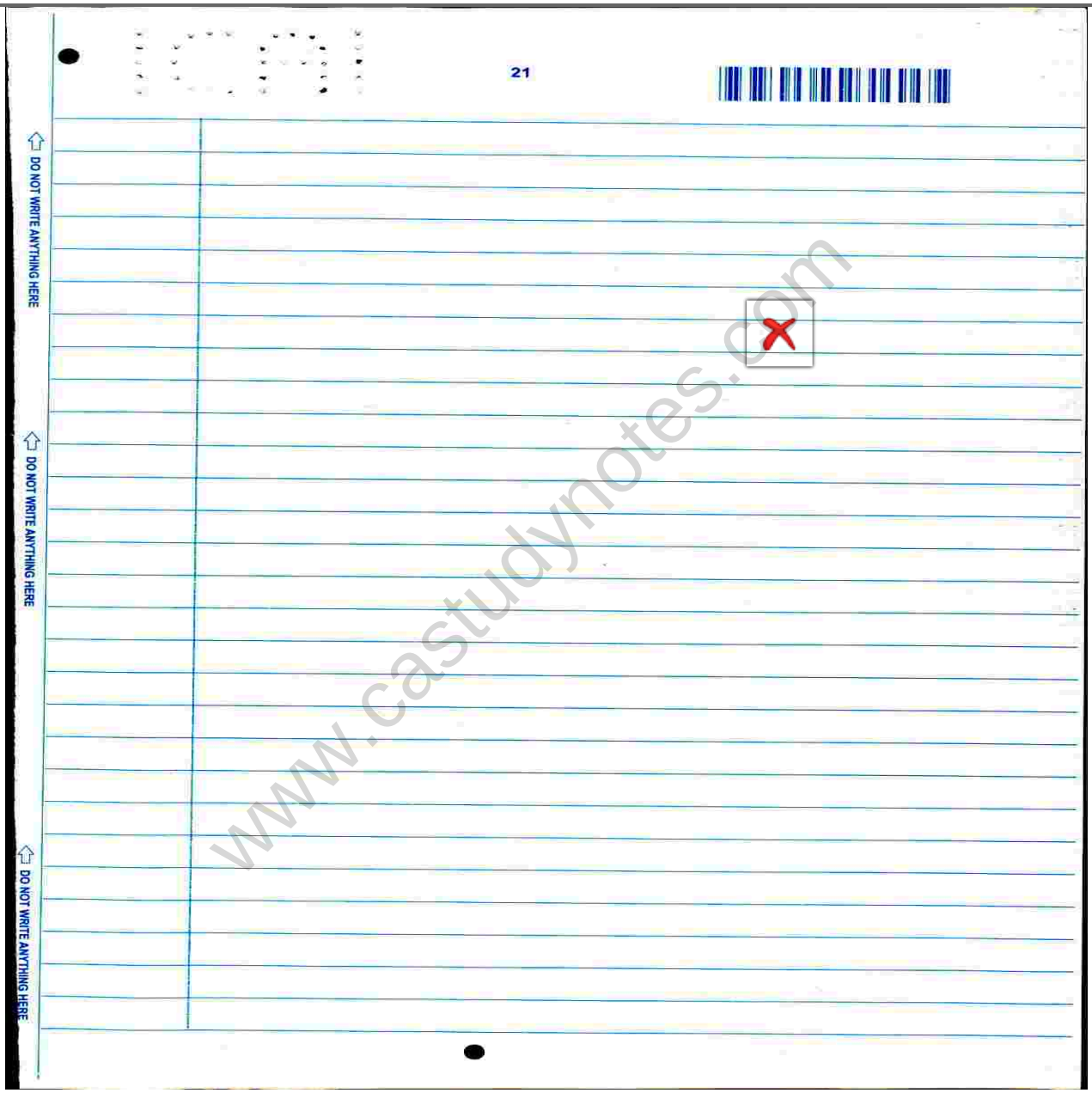

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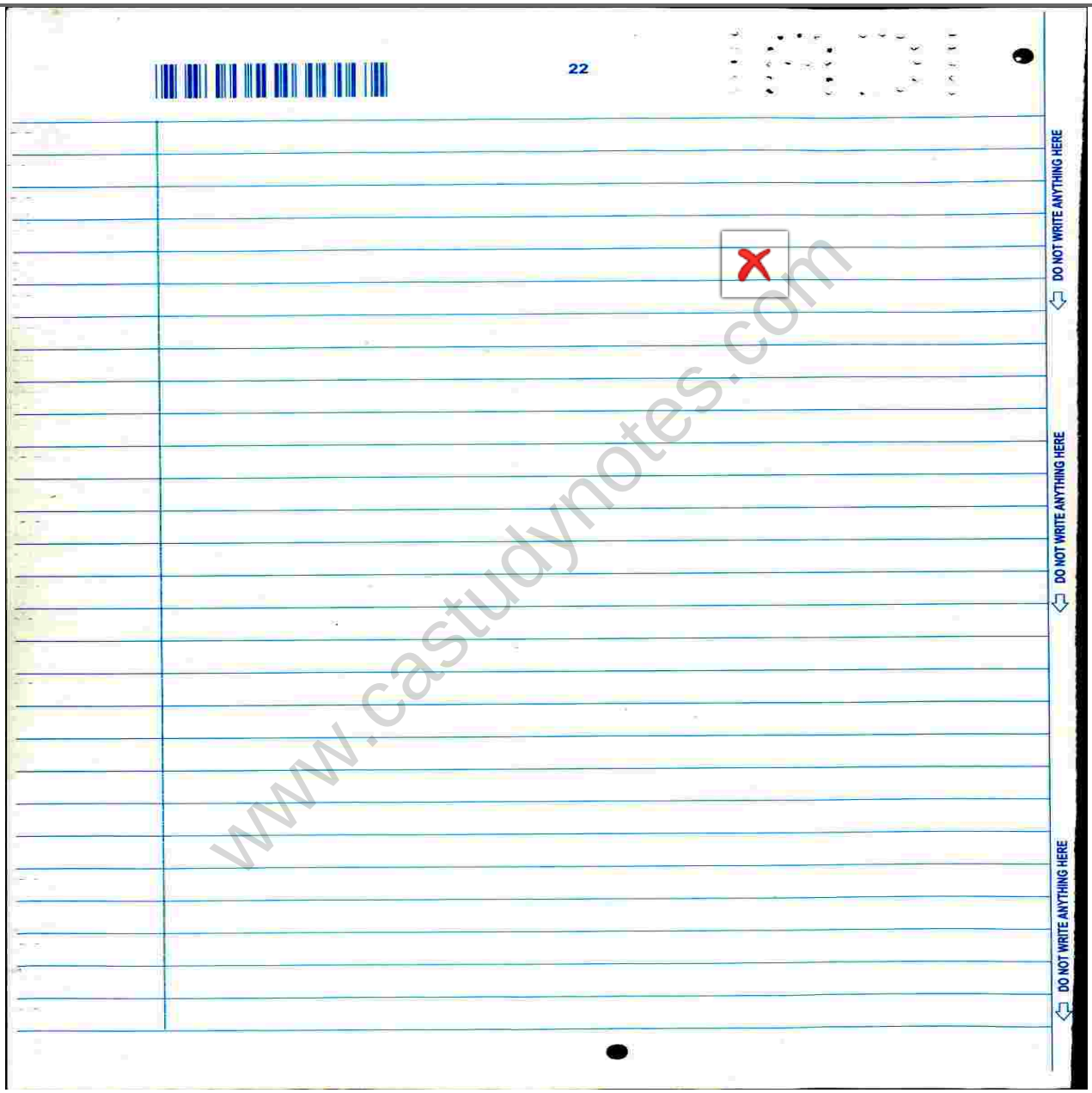

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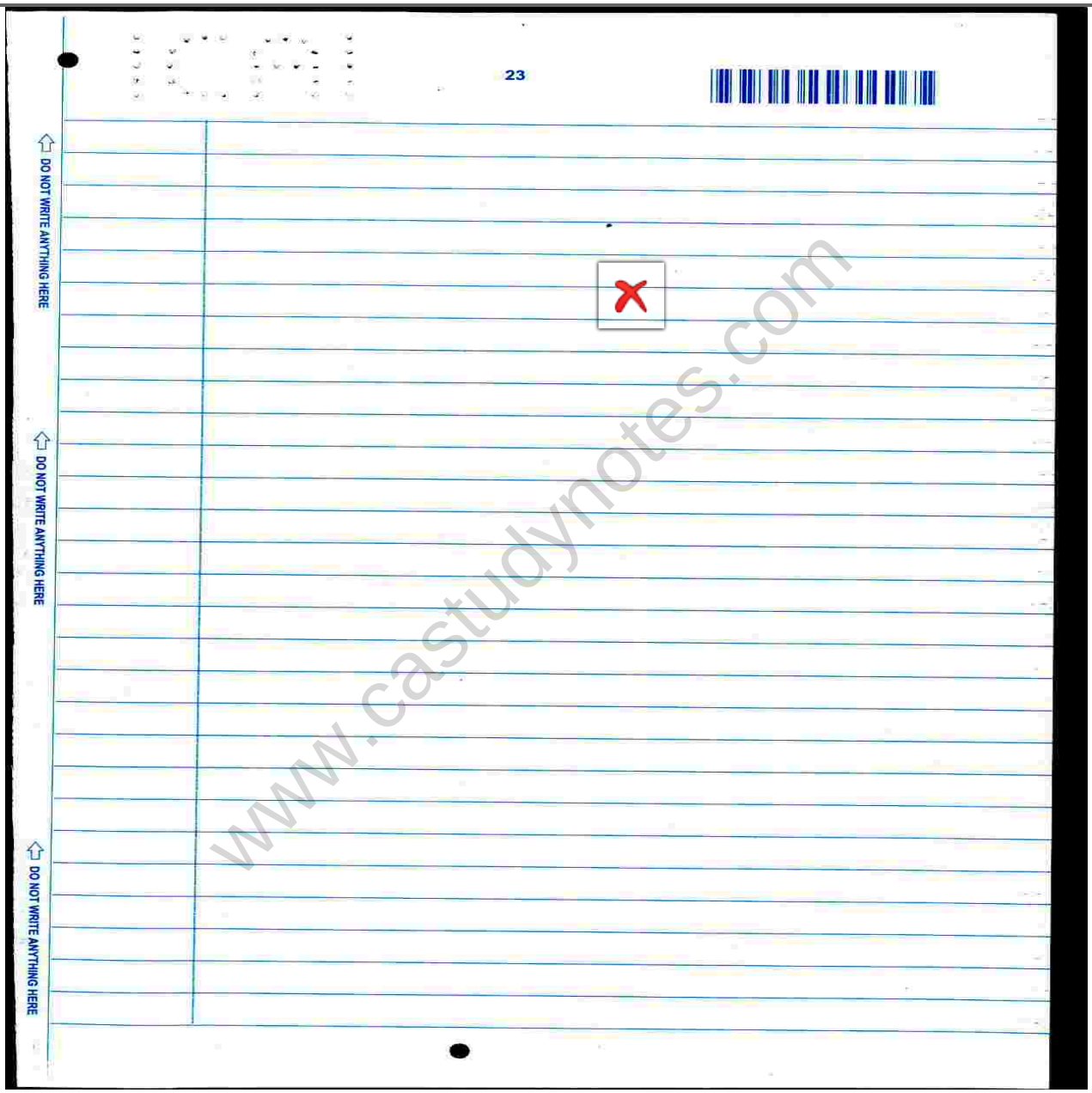

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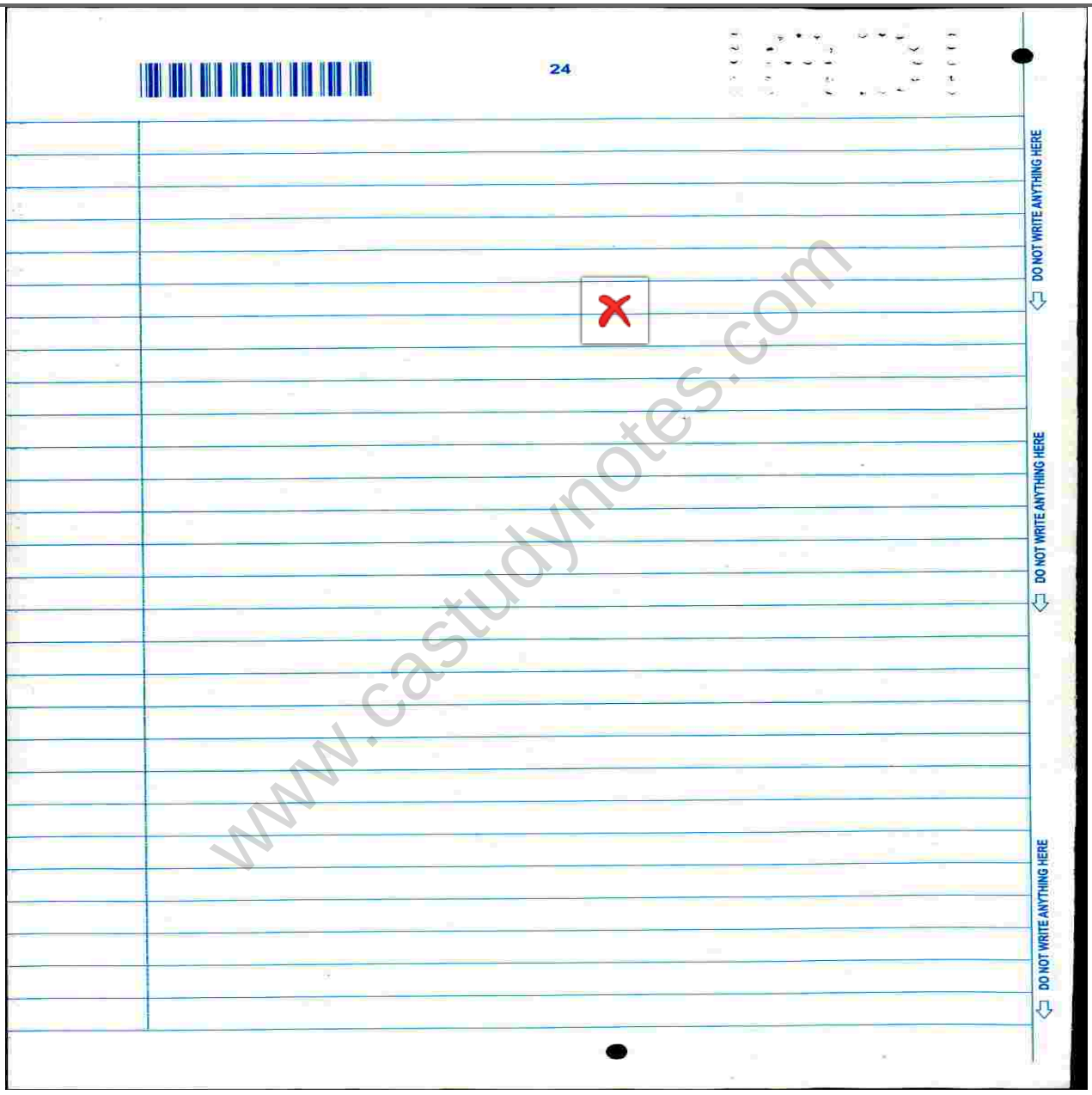

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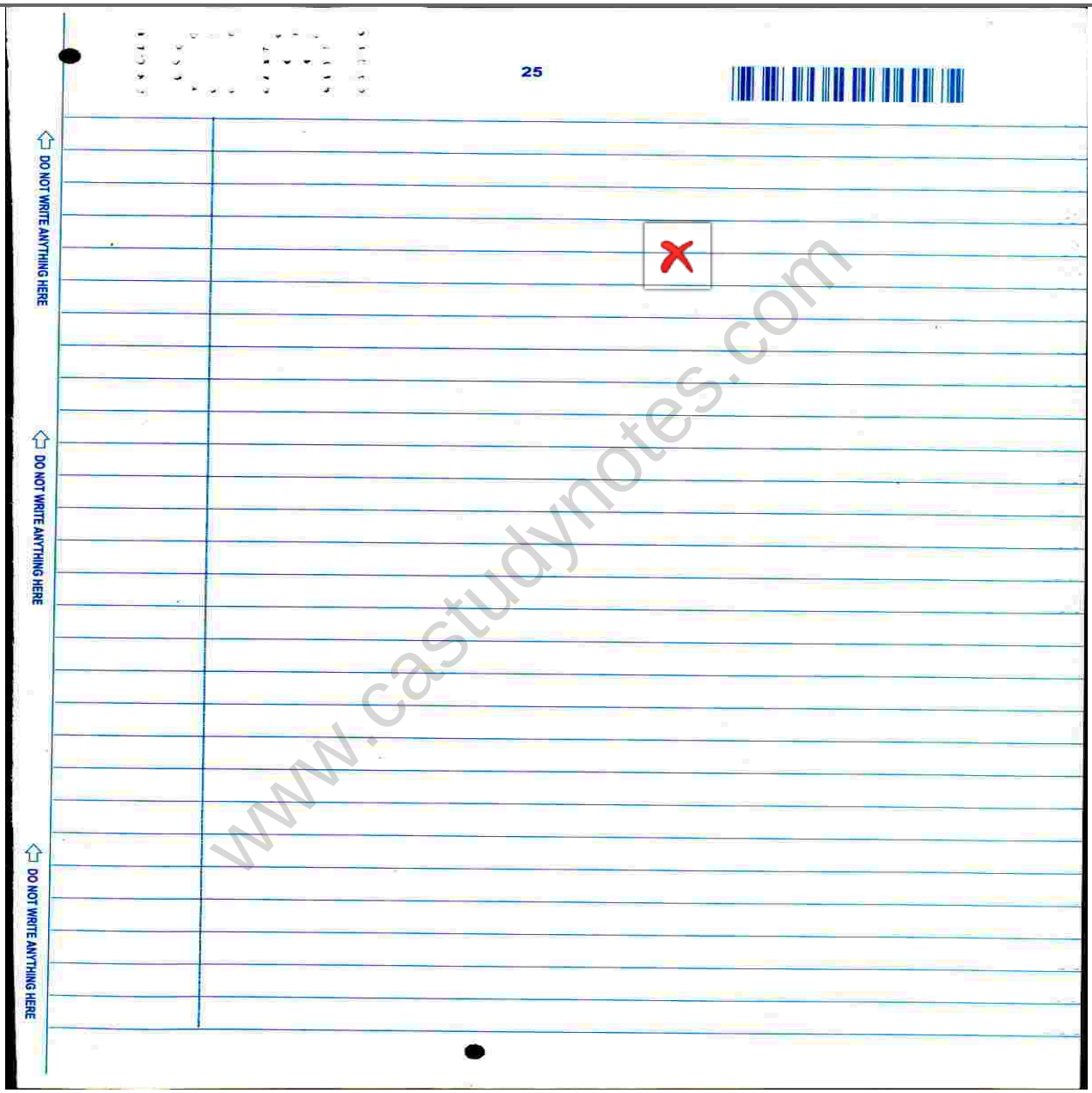

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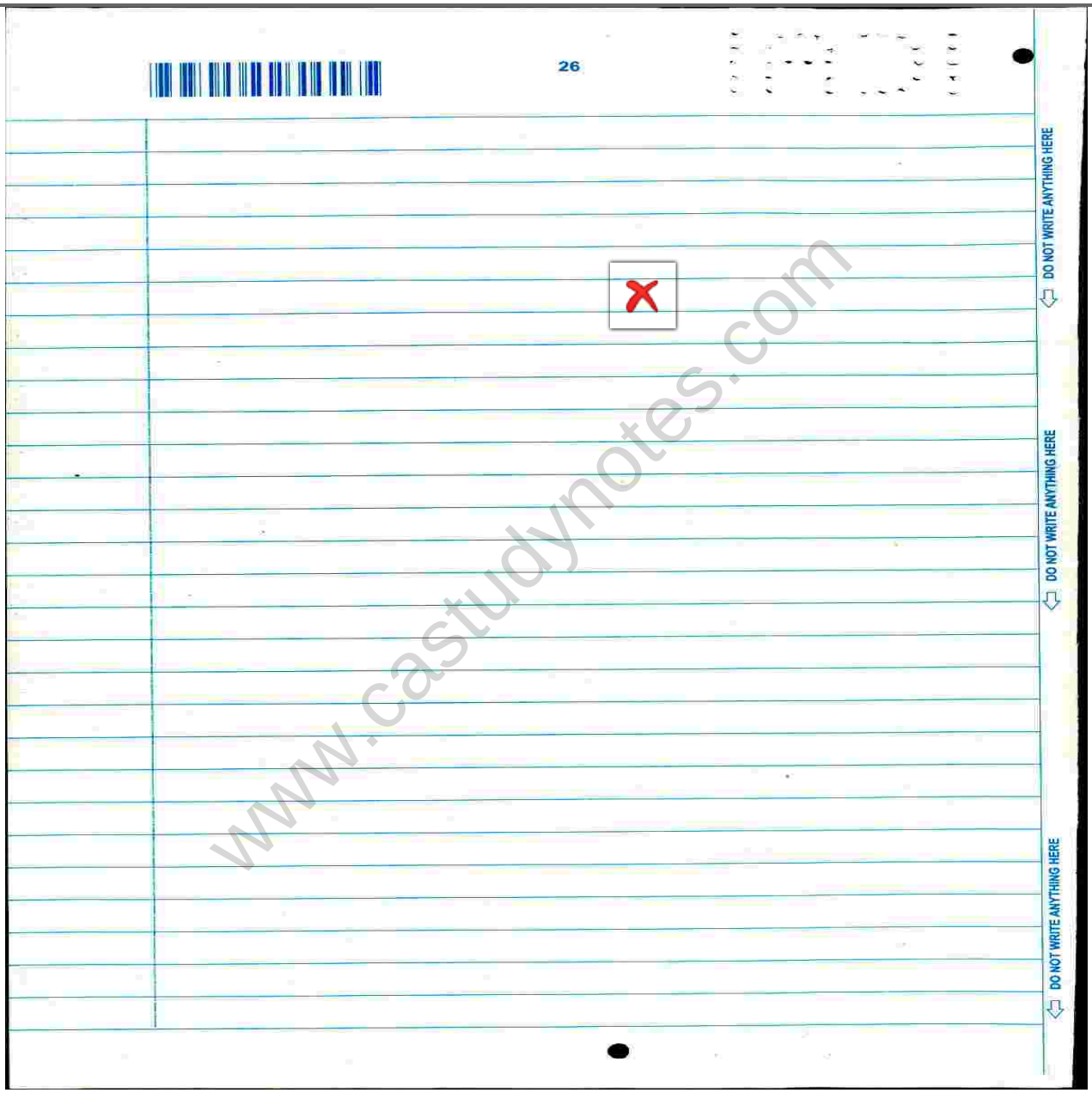

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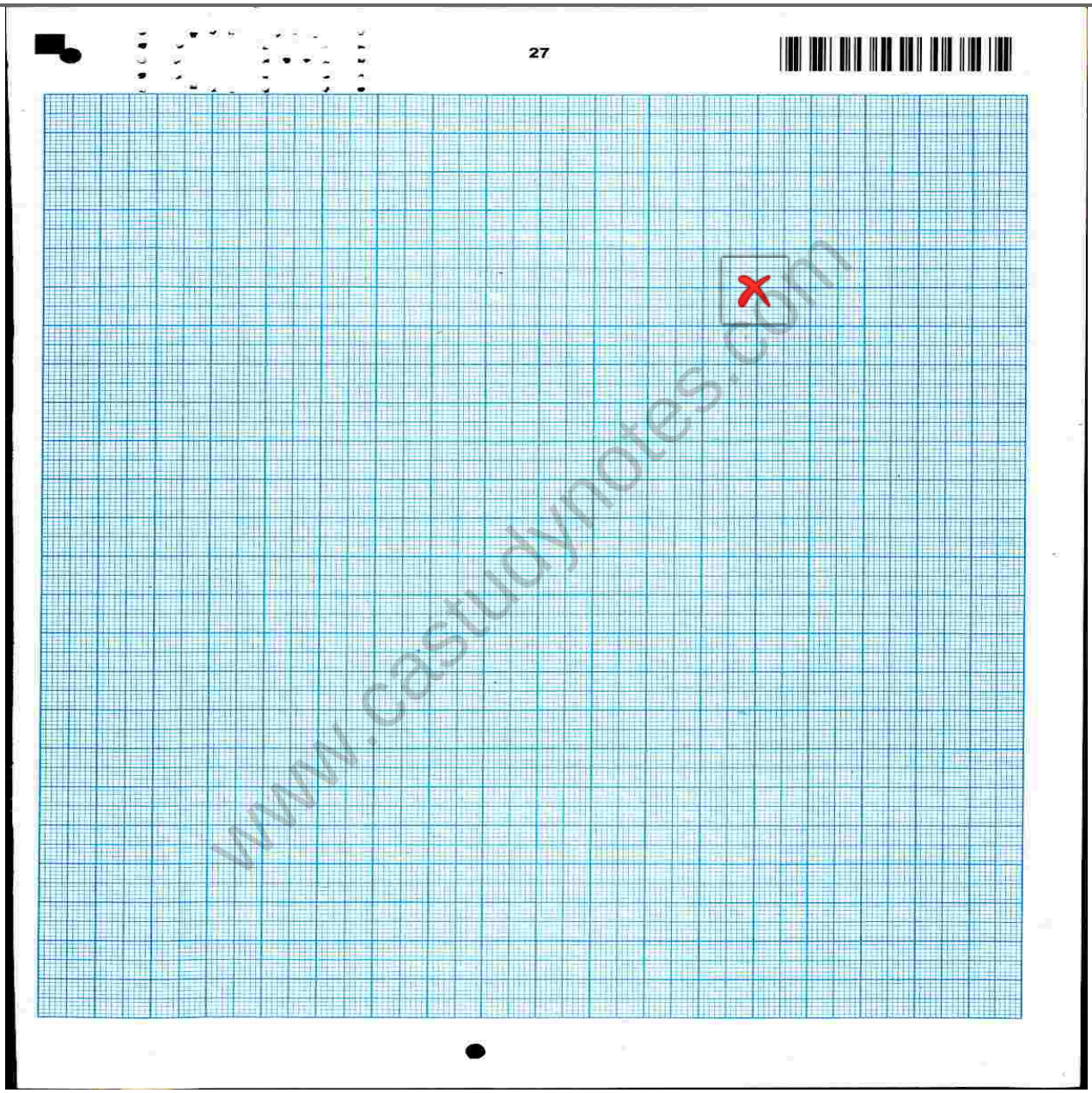

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Subject : 02 Advanced Financial Management Marks Obtained : 69