Mock Test Paper - Series I: September, 2026

Date of Paper: 11th September, 2026

Time of Paper: 2 P.M. to 5 P.M.

FINAL COURSE: GROUP – I

PAPER – 2: ADVANCED FINANCIAL MANAGEMENT

Time Allowed – 3 Hours **Maximum Marks – 100**

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case Scenario based MCQs (30 Marks)

Part I is compulsory.

Case Scenario I

During the early 1990s, the investment fund of Riverside Organisation earned exceptionally high returns under its Treasurer, Jonathan Reed. Although he had limited knowledge of financial instrument trading, Reed adopted aggressive investment practices to earn higher returns from movements in interest rates. The strategy involved borrowing funds at short-term rates to buy high-yielding long-term bonds. The strategy performed extremely well during 1992 and 1993, generating returns significantly higher than other organisations' funds in the state.

Encouraged by these results, several nearby organisations and public agencies invested their funds with Riverside Organisation, increasing the total fund size to nearly $8 billion. Reed further expanded the exposure of the fund by borrowing extensively through short-term financing arrangements and investing large amounts in complex derivative structured notes linked to interest rate movements.

However, in 1994, the central banking authority increased interest rates multiple times. As a result, the value of the Organisation's investments declined sharply, leading to substantial margin requirements from brokers and lenders. The Organisation struggled to arrange cash to meet these obligations, and lenders eventually started selling the pledged securities in the market. This created panic among investors, who began withdrawing their funds.

Ultimately, the Organisation suffered losses of nearly $1.6 billion, amounting to about 20% of the fund value. Jonathan Reed resigned from his position, and the Organisation later declared insolvency. Following investigations, Reed was found guilty of financial mismanagement and sentenced to imprisonment along with a monetary penalty.

From the information given above, choose the correct answer to the following questions:

1. The facts presented in the above case scenario resemble which of the following real-life cases?

   (a) Riverside County Case

   (b) Orange County Case

   (c) Barings Bank Case

   (d) Procter & Gamble (P&G) and Gibson Greetings Case **(1 Marks)**

2. Based on the facts of the above case scenario, the treasurer in the real-life case used which of the following derivative structured notes?

   (a) Speculative long position in Nikkei Futures

   (b) A leveraged swap

   (c) Straddle option strategy

   (d) Inverse Floater **(2 Marks)**

3. Which type of risk was most evident in the case of Riverside Organisation?

   (a) Political Risk

   (b) Currency Risk

   (c) Interest Rate Risk

   (d) Sovereign Risk **(1 Mark)**

4. Which of the following is the most important lesson that can be learned from the above case scenario?

   (a) Do not invest in derivative products that are not fully understood

   (b) Specify appropriate risk limits

   (c) Ensure separation of front, middle, and back-office functions

   (d) Conduct stress testing and scenario analysis regularly **(1 Mark)**

Total = 5 Marks

Case Scenario II

Rohan, a retail investor, is analyzing the daily price movements of the shares of XYZ Ltd. using candlestick charts. He understands that a candlestick chart presents four important prices for a trading day—Opening Price, Closing Price, Highest Price, and Lowest Price.

On examining the price data of XYZ Ltd. for five consecutive trading days, he obtains the following information:

Day	Opening Price (₹)	Highest Price (₹)	Lowest Price (₹)	Closing Price (₹)
Monday	150	165	145	160
Tuesday	162	168	155	158
Wednesday	158	170	150	158
Thursday	160	175	159	172
Friday	173	178	165	167

Based on the above information, answer the following questions.

5. Which of the following days would be represented by a White Candlestick?

   (a) Tuesday only

   (b) Monday and Thursday only

   (c) Wednesday only

   (d) Friday only **(1 Mark)**

6. Which of the following days would be represented by a Black Candlestick?

   (a) Tuesday and Friday only

   (b) Monday and Thursday only

   (c) Wednesday and Friday only

   (d) Tuesday, Wednesday and Friday **(1 Mark)**

7. Which day would most likely be represented by a Doji Candlestick?

   (a) Monday

   (b) Tuesday

   (c) Wednesday

   (d) Friday **(1 Mark)**

8. What is the trading range on Thursday?

   (a) ₹ 12

   (b) ₹ 14

   (c) ₹ 16

   (d) ₹ 18 **(1 Mark)**

Total = 4 Marks

Case Scenario III

Suppose you are a risk manager at a financial institution, and your company has loaned a significant amount of ₹ 500 crore to a company X Ltd. for a period of 3 years at 6-month at MCLR plus 200 bps. You are concerned about X Ltd.'s ability to repay the debt due to recent market volatility. To protect your institution from potential default, you decide to purchase a Credit Default Swap (CDS) from ABC Bank Ltd. for same notional amount at a premium quoted at 1% per year through cash settlement.

On the respective reset dates for the same period actual MCLR interest rate comes out as follows:

Reset	MCLR
1	9.75%
2	10.00%
3	10.25%
4	10.35%
5	10.50%
6	10.60%

Based on the above information answer the following questions:

9. The primary purpose of a Credit Default Swap (CDS) is..................

   (a) to increase the value of bonds.

   (b) to protect against default risk of a debt obligation.

   (c) to provide guaranteed profit to the buyer.

   (d) to create a new form of loan. **(1 Mark)**

10. Which of the following statements is true about CDS contracts?

    (a) CDS contracts cannot be used for speculation.

    (b) CDS contracts are governed by government regulations.

    (c) CDS contracts are private agreements between two parties.

    (d) CDS contracts eliminate all risks for the buyer. **(1 Mark)**

11. Which organization publishes the guidelines and rules for conducting Credit Default Swap transactions?

    (a) Federal Reserve

(b) International Swap and Derivative Association (ISDA)

(c) Securities and Exchange Commission (SEC)

(d) World Trade Organization (WTO) **(1 Mark)**

12. Assuming no default occurs the total premium your company will pay during the designated loan period shall be........

(a) ₹ 5 crore

(b) ₹ 10 crore

(c) ₹ 15 crore

(d) ₹ 30 crore **(2 Marks)**

13. Suppose if the lender defaults somewhere in the beginning of third year of loan (after payment of interest upto 2 years) and the market value of a reference loans falls to 75% of its par value, then ABC Bank will pay your company ....in a cash settlement.

(a) ₹ 15 crore

(b) ₹ 30 crore

(c) ₹ 125 crore

(d) ₹ 500 crore **(2 Marks)**

Total = 7 Marks

Case Scenario IV

ABC Inc., a U.S. firm, will require £ 600,000 in 6 months and is evaluating different strategies to hedge against currency risk. The available market data is as follows:

Current Spot Rate: 1 £ = $ 2.50

6-months Forward Rate: 1 £ = $ 2.45

Interest Rates:

- **UK (per annuam):**
  - Deposit Rate: 9.00%
  - Borrowing Rate: 10.00%
- **US (per annuam):**
  - Deposit Rate: 10%
  - Borrowing Rate: 11.00%

Option Contract:

- Call option available on £, expiring in 6 months with:
  - Exercise price: $ 2.46
  - Premium: $ 0.05

ABC Inc. has forecasted the following probabilities for spot rates after 6 months:

Spot Rate	Probability
$ 2.39	25%
$ 2.44	60%
$ 2.56	15%

From the information given above, choose the correct answer to the following questions:

14. Since ABC Inc. will require £ 600,000 in future, it is said to be…………………..

    (a) Long in £

    (b) Short in £

    (c) Long in $

    (d) Neutral in currency **(2 Marks)**

15. Under a forward contract, the dollar cost of £ 600,000 is…………………

    (a) certain but flexible

    (b) uncertain but capped

    (c) certain and fixed

    (d) nil **(2 Marks)**

16. Which hedging technique allows ABC Inc. to benefit if the Pound depreciates while protecting against appreciation?

    (a) Forward contract

    (b) Money market hedge

    (c) Call option on £

    (d) Futures contract **(1 Mark)**

17. If the spot rate after 6 months happens to be $ 2.39/£, ABC Inc. under option hedge will...........

    (a) exercise the option.

    (b) let the option lapse.

    (c) cancel the contract.

    (d) incur loss equal to intrinsic value. **(1 Mark)**

18. Which of the following hedging methods involves borrowing and lending in two currencies simultaneously?

    (a) Forward hedge

    (b) Option hedge

    (c) Money market hedge

    (d) Futures hedge **(1 Mark)**

Total = 7 Marks

Case Scenario V

XYZ Ltd. is planning to expand its business and therefore raising fund by issuing a Convertible Bond of ₹ 10 crore. An investor "Mr. A" is interested to invest in the bond of XYZ Ltd. Mr. A has following data related to the Convertible Bond.

The data given below relates to a convertible bond:

Face value	₹ 1000
Coupon rate	12%
No. of shares per bond	20
Market price of share	₹ 48
Straight value of bond	₹ 940
Market price of convertible bond	₹ 1060
Maturity	5 Years

From the information given above, choose the correct answer to the following questions:

19. The conversion value of the convertible bond is.................

    (a) ₹ 960

(b) ₹ 1000

(c) ₹ 1060

(d) ₹ 940 **(1 Mark)**

20. The conversion premium of the bond in absolute terms is…………….

(a) ₹ 60

(b) ₹ 100

(c) ₹ 120

(d) ₹ 80 **(2 Marks)**

21. The floor value of the convertible bond is represented by…………

(a) Market price of share

(b) Conversion value

(c) Straight value of bond

(d) Face value of bond **(1 Mark)**

22. The upside potential of the convertible bond primarily depends on…………….

(a) Coupon rate of the bond

(b) Face value of the bond

(c) Market price movement of the equity shares

(d) Remaining maturity of the bond **(1 Mark)**

23. By approximately what percentage the market price of the share should rise so that the investor is indifferent between buying the share from the market and taking conversion route.

(a) 12.77%

(b) 10.42%

(c) 5.11%

(d) 9.23% **(2 Marks)**

Total = 7 Marks

PART – II DESCRIPTIVE QUESTIONS

Question No.1 is compulsory. Candidates are required to answer any four questions from the remaining five questions.

Working notes should form part of the answers.

Maximum Marks – 70 Marks

1. (a) Alpha Green Energy Ltd. (AGEL), a listed company engaged in manufacturing renewable energy equipment, is evaluating the establishment of a new manufacturing facility for high-efficiency solar modules. The project will be financed through a combination of equity, subsidized government debt, and market borrowings.

The Board has decided that the project should be evaluated using the Adjusted Present Value (APV) approach because the financing package contains several financing side effects.

The Finance Director has gathered the following information.

Investment Details

Cost of land and building:	₹ 120 crore
Cost of plant and machinery:	₹ 240 crore
Initial working capital requirement:	₹ 30 crore

- The project has an economic life of 5 years.
- The working capital will be fully recovered at the end of Year 5.
- The land is expected to be sold at ₹150 crore at the end of Year 5.
- Plant and machinery are expected to have a salvage value of ₹ 24 crore at the end of Year 5.

Depreciation under the Income-tax Act is allowable on Plant and Machinery using the Written Down Value (WDV) method @ 25% p.a.

Ignore depreciation on land and building.

Operating Forecast

The expected operating results (before depreciation and interest) are:

Year	1	2	3	4	5
Revenue (₹ Cr.)	220	255	290	315	330
Operating Cost (excluding dep.) (₹ Cr.)	125	138	155	170	178

Additional Information

- Annual maintenance expenditure of ` 6 crore is included in operating costs.
- Inflation has already been incorporated in all cash flow estimates.
- Corporate tax rate is 30%.
- Taxes are paid in the same year.

Financing Plan

The project will be financed as follows:

(A) Government Soft Loan

Amount: ₹ 100 crore

Interest rate: 5% p.a.

Market borrowing rate for similar type of loan: 10% p.a.

Principal repayable in one lump sum at the end of Year 5.

(B) Term Loan from Bank

Amount: ₹ 120 crore

Interest rate: 10% p.a.

Principal is repayable equally over Years 2 to 5.

Interest is payable annually on the outstanding balance.

(C) Equity

Remaining investment will be financed through equity.

Financing Side Effects

Issue Cost Saving

If the company financed the project entirely with equity, flotation cost would have been 4% of equity raised. Because of debt financing, equity issue is reduced accordingly.

Assume flotation cost saving occurs immediately.

Government Capital Subsidy

The Government will provide a capital subsidy of ₹ 20 crore immediately after commencement of commercial production (end of Year 1).

The subsidy is not taxable.

Financial Distress Cost

Management estimates that due to increased leverage, there is a 10% probability that the company may incur financial distress costs amounting to
₹ 30 crore at the end of Year 5.

Asset Sale

The sale proceeds of land and machinery at the end of Year 5 will be taxable based on applicable tax provisions.

Cost of Capital

Unlevered Cost of Equity = 14%

Market Value Debt Ratio of comparable unlevered firms = Nil

Discount operating cash flows using 14%.

Required:

(i) Compute the Base Case NPV assuming the project is entirely equity financed.

(ii) Compute the Present Value of Tax Shields arising from interest on:

- Government soft loan
- Commercial term loan

(iii) Compute the Present Value of the Interest Subsidy arising from the concessional government loan.

(iv) Compute the Present Value of Flotation Cost Savings.

(v) Compute the Expected Present Value of Financial Distress Costs.

(vi) Determine the Adjusted Present Value (APV) of the project.

(vii) Comment whether the project should be accepted.

Note: (1) Relevant Present Value (PV) factors shall be used up to four decimal places for all calculations.

(2) All calculations shall be presented in ₹ crore and rounded off to two decimal places. **(12 Marks)**

(b) List the different areas of focus that a VC would communicate to the intermediary or its employees during the deal origination process. **(2 Marks)**

2. (a) XYZ Ltd., an Indian company engaged in both export and import business, has secured a service contract in the United States. Under the terms of the contract, the entire contract value of USD 1,000,000 will be received 18 months from today.

The spot and forward exchange rates prevailing today are as follows:

Spot - USD = INR 92 /92.10

Six months Forward - USD = INR 91.90 /92.00

As per the existing guidelines, forward contracts cannot be booked for a period exceeding six months. Consequently, the Treasury Department of XYZ Ltd. is exploring alternative strategies to hedge the foreign exchange risk associated with this future receivable.

The Head of the Treasury Department is of the opinion that the foreign exchange exposure may be left unhedged because the company has another contract under which it is required to make a payment of USD 100000 after one year, and no hedging action has been taken for that exposure.

Additional Information:

After 6 months the actual exchange rate happens to be:

Spot - USD = INR 91.70 /91.80

6-months Forward - USD = INR 91.60 /91.70

After 12 months (1 year) the actual exchange rate happens to be:

Spot - USD = INR 91.40 /91.50

6-months Forward - USD = INR 90.90 /91.00

After 18 months the actual exchange rate happens to be:

Spot - USD = INR 90.70 /90.80

Money Market Interest Rates (per annum)

	Deposit	Loan
$	6.50%	7.00%
INR	6.40%	7.30%

Suppose you have been appointed as Financial Consultant to advise the company on various finance related matters.

(i) Do you agree with the view of the Head of the Treasury Department that the USD 1 million receivable may be left unhedged? Justify your answer with appropriate reasons.

(ii) Recommend any two suitable hedging alternatives to manage the foreign exchange risk associated with the receivable.

(iii) Critically evaluate the recommended alternatives and advise the company on the most appropriate course of action, giving suitable reasons.

Notes: (1) Interest in the money market is compounded at six-monthly intervals.

(2) Assume that the above money market interest rates will remain unchanged for at least the next two years.

(3) Use all exchange rates up to two decimal places only and round off all calculations to the nearest whole number. **(12 Marks)**

(b) Explain the different assumptions of Sustainable Growth Rate Model. **(2 Marks)**

3. (a) Following is the information available pertaining to shares of O Ltd.:

Current Market Price (₹)	₹ 840.00
Maximum Expected Price (₹) in 6 Months, with a 45% Probability	₹ 1050.00
Minimum Expected Price (₹) in 6 Months	₹ 756.00
Continuously Compounded Rate of Interest (p.a.) (%)	7.00%

Required:

(i) Assuming that a 6-month European call option on the shares of O Ltd. is available with a strike price of ` 900.00, calculate the value of the call option using the Replicating Portfolio Approach and the Risk-Neutral Valuation Method.

(ii) Examine whether the given probability can be applied to determine the value of the option using the Risk-Neutral Valuation Method.

Note: (1) $e^{0.035}$ =1.0356

(2) Round off all calculations upto 2 decimal points. **(10 Marks)**

(b) Mr. X has ₹ 1 crore available for investment. He is considering investing this amount in the ratio of 3:2 in two positively correlated securities, A and B. The relevant details of the two securities are as follows:

Particulars	Security A	Security B
Daily Standard Deviation	2%	3%

Assuming that daily returns are normally distributed, determine the amount that the portfolio is expected to be worth after one week, even after incurring the maximum loss at the 95% confidence level.

Note: Z-value at 95% confidence level = 1.645 and number of trading days in a week is 5. **(4 Marks)**

4. (a) Suppose a Gratuity Fund needs to make a payment of ₹ 1.70 crore after three years from now. You as a finance advisor wonder how to construct the portfolio to fund future payments. At present two kinds of bonds are available in the market:

❖ The first one is Zero-Coupon GOI Bonds, with a face value of ₹ 10,000, at current price of ₹ 7,773 and remaining life of 4 years.

❖ The second one is 6.50% Corporate Bond, with a face value of ₹ 10,000 each currently priced at par and remaining life of 2 years.

Assume all debt has the same level of default risk. The benchmark yield curve for fixed-income investments of the same riskiness is flat at a level of 6.50% p.a.

Required:

(i) Suggest a portfolio of investments in both categories of bonds that is immuned to both price risk and reinvestment risk.

(ii) Demonstrate this strategy can shield the portfolio from interest risk if interest rate rises by 50 bps after 3 years.

Note: The values of the Present Value Factors shall be rounded off to four decimal places, while all other calculations shall be rounded off to two decimal places.

(10 Marks)

Either

(b) Both tokenization and securitization involve converting illiquid assets into financial products that are liquid and tradable, thereby making them similar in certain respects. Explain. **(4 Marks)**

Or

Explain why pricing of weather derivative is quite challenging. **(4 Marks)**

5. (a) The following information is provided relating to the acquiring company E Ltd., and the target company H Ltd:

Particulars	**E Ltd. (₹)**	**H Ltd. (₹)**
Number of shares (Face value ₹ 10 each)	20 Lakhs	15 Lakhs
Market Capitalization	1000 Lakhs	1500 Lakhs
P/E Ratio (times)	10.00	5.00
Reserves and surplus in ₹	600.00 Lakhs	330.00 Lakhs
Promoter's Holding (No. of shares)	9.50 Lakhs	10.00 Lakhs

The Board of Directors of both the companies have decided to give a fair deal to the shareholders. Accordingly, the weights are decided as 40%, 25% and 35% respectively for earnings (EPS), book value and market price of share of each company for swap ratio.

Calculate the following:

(i) Market price per share, earnings per share and Book Value per share;

(ii) Swap ratio;

(iii) Promoter's holding percentage after acquisition;

(iv) EPS of E Ltd. after acquisitions of H Ltd;

(v) Expected market price per share and market capitalization of E Ltd.; after acquisition, assuming P/E ratio of E Ltd. remains unchanged; and

(vi) Free float market capitalization of the merged firm. **(10 Marks)**

(b) Projected financial statements provide potential investors with an overview of the expected financial performance and position of a start-up. Explain the basic documents that comprise a start-up's projected financial statements. **(4 Marks)**

6. (a) P Ltd. is contemplating to borrow an amount of ₹ 60 crores for a period of 6 months in the coming 3 months' time from now. The current rate of interest is 9% p.a., but it may go up in 3 month's time. The company wants to hedge itself against the likely increase in interest rate.

The Company's Bankers quoted an FRA (Forward Rate Agreement) at 9.10%-9.20% p.a.

What will be the Final settlement amount, if the actual rate of interest after 6 months happens to be (i) 9.50% p.a. and (ii) 8.70% p.a.? **(6 Marks)**

Note: Round off all calculations upto whole numbers.

(b) Rahul Ltd. has surplus cash of ₹100 lakhs and wants to distribute 27% of it to the shareholders. The company decides to buy back shares. The Finance Manager of the company estimates that its share price after re-purchase is likely to be 10% above the buyback price-if the buyback route is taken. The number of shares outstanding at present is 10 lakhs and the current EPS is ₹ 3.

You are required to determine:

(i) The price at which the shares can be re-purchased, if the market capitalization of the company should be ₹ 210 lakhs after buyback,

(ii) The number of shares that can be re-purchased. **(4 Marks)**

(c) Explain why traditional methods of valuing business cannot be applied in case of new age startups. **(4 Marks)**