AJA Commerce Academy
CA - Intermediate
***Test Series* – FINANCIAL MANAGEMENT**

Time Allowed – 1.5 Hours | Maximum Marks – 50

Section A – Multiple Choice Questions (10 Marks)

Case Scenario: Leverage Analysis at ABC Ltd. (6 Marks)

Scenario:
ABC Ltd. produces electronics and faces stiff market competition. To enhance profitability, the management wants to evaluate the company's operating, financial, and combined leverage. The financial details are:

- Sales: ₹10 crores
- Variable cost: ₹4 crores
- Fixed cost: ₹3 crores
- Interest on debt: ₹1 crore
- Tax rate: 30%

Questions:

1. The degree of operating leverage (DOL) is:
   (a) 1.4
   (b) 1.67
   (c) 2.5
   (d) 3.0
2. The degree of financial leverage (DFL) is:
   (a) 1.5
   (b) 2.0
   (c) 2.5
   (d) 3.33
3. Combined leverage is calculated as:
   (a) DOL × DFL
   (b) EBIT ÷ Sales
   (c) Contribution ÷ PBT
   (d) Fixed Cost ÷ Variable Cost
4. What does a high operating leverage indicate?
   (a) Low fixed costs
   (b) High fixed costs and higher business risk
   (c) Low variable costs
   (d) Lower contribution margin
5. Financial leverage represents:
   (a) The relationship between sales and EBIT.
   (b) The relationship between EBIT and EBT.

(c) The ratio of sales to total assets.
(d) The ratio of fixed costs to variable costs.

6. A firm has a DFL greater than 1. This means:
(a) The firm has no financial risk.
(b) A 1% change in EBIT results in a greater than 1% change in EPS.
(c) The firm has no operating risk.
(d) EBIT is unaffected by sales fluctuations.

General MCQs (4 Marks)

7. If the Degree of Combined Leverage (DCL) is 2, and sales increase by 10%, EPS will:
(a) Increase by 5%
(b) Increase by 10%
(c) Increase by 20%
(d) Decrease by 10%
8. Which of the following contributes to financial leverage?
(a) Equity financing only
(b) Variable costs
(c) Fixed interest payments on debt
(d) Depreciation
9. Break-even sales can be calculated using:
(a) Fixed Cost ÷ Contribution Margin Ratio
(b) EBIT ÷ Fixed Cost
(c) Sales ÷ Variable Cost
(d) Total Costs ÷ Sales
10. If a firm's EBIT equals its interest expense, the firm is at:
(a) Financial break-even
(b) Operating break-even
(c) Combined break-even
(d) Total break-even

Section B – Practical and Descriptive Questions (40 Marks)

Question 1: Operating and Financial Leverage (10 Marks)

Scenario:
XYZ Ltd. has the following financial details:

- Sales: ₹50,00,000
- Variable cost: ₹20,00,000
- Fixed cost: ₹10,00,000
- Interest expense: ₹2,00,000

(a) Calculate the Degree of Operating Leverage (DOL), Degree of Financial Leverage (DFL), and Degree of Combined Leverage (DCL). (6 Marks)
(b) Interpret the results and their implications for XYZ Ltd. (4 Marks)

Question 2: Break-Even Analysis and Margin of Safety (10 Marks)

Scenario:
ABC Ltd. produces and sells a product with the following data:

- Selling price per unit: ₹100
- Variable cost per unit: ₹60
- Fixed costs: ₹6,00,000
- Current sales volume: 12,000 units

(a) Calculate the break-even sales in units and the margin of safety percentage. (6 Marks)
(b) Explain the significance of the margin of safety for business risk management. (4 Marks)

Question 3: Financial Leverage as a Double-Edged Sword (10 Marks)

Scenario:
XYZ Ltd. is considering two financing options for its expansion:

1. All equity financing.
2. Debt-equity mix with ₹50 lakhs at 10% interest and the remaining through equity.

The company expects an EBIT of ₹40 lakhs and faces a tax rate of 30%.

(a) Calculate the EPS under both options. (6 Marks)
(b) Discuss why financial leverage is considered a "double-edged sword." (4 Marks)

Question 4: Combined Leverage and Risk Management (10 Marks)

(a) Explain the interrelationship between operating, financial, and combined leverage. (6 Marks)
(b) How can a company use leverage analysis to manage business and financial risks? (4 Marks)