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: Capital Budgeting at XYZ Ltd. (6 Marks)

Scenario:
XYZ Ltd. is evaluating three projects—Project A, Project B, and Project C. The projects have the following cash flows and costs of capital:

- **Project A:** Initial Investment: ₹5 lakhs, Cash Inflows: ₹2 lakhs per year for 4 years, Cost of Capital: 10%
- **Project B:** Initial Investment: ₹7 lakhs, Cash Inflows: ₹3 lakhs per year for 4 years, Cost of Capital: 12%
- **Project C:** Initial Investment: ₹6 lakhs, Cash Inflows: ₹2.5 lakhs per year for 5 years, Cost of Capital: 8%

Questions:

1. What is the formula for calculating Net Present Value (NPV)?
   (a) Initial Investment - Discounted Cash Inflows
   (b) Sum of Discounted Cash Inflows - Initial Investment
   (c) Total Cash Inflows - Total Cash Outflows
   (d) Total Cash Inflows × Discount Factor
2. Which project should be selected if the decision is based on the highest NPV?
   (a) Project A
   (b) Project B
   (c) Project C
   (d) Cannot be determined without calculations
3. What does a Profitability Index (PI) greater than 1 indicate?
   (a) The project is not profitable.
   (b) The project's present value is less than its cost.
   (c) The project generates a return above its cost of capital.
   (d) The project should be rejected.
4. What is the primary limitation of the Payback Period method?
   (a) It considers the time value of money.
   (b) It ignores cash flows after the payback period.
   (c) It is complex to calculate.
   (d) It always gives a positive result.
5. Which of the following techniques accounts for the time value of money?
   (a) Payback Period
   (b) Accounting Rate of Return (ARR)

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(c) Net Present Value (NPV)
(d) Profitability Index (PI)

6. The Internal Rate of Return (IRR) is the discount rate at which:
(a) The NPV of a project equals zero.
(b) The cash inflows equal the initial investment.
(c) The Payback Period is minimized.
(d) The Profitability Index equals 1.

General MCQs (4 Marks)

7. Opportunity cost is:
(a) Always irrelevant to investment decisions.
(b) The benefit foregone by choosing one alternative over another.
(c) A sunk cost included in cash flows.
(d) Ignored in capital budgeting decisions.
8. The Discounted Payback Period is:
(a) Longer than the traditional Payback Period.
(b) Equal to the traditional Payback Period.
(c) Shorter than the traditional Payback Period.
(d) Not related to the time value of money.
9. Which method directly measures the profitability of a project?
(a) ARR
(b) Payback Period
(c) NPV
(d) PI
10. Incremental cash flows in capital budgeting refer to:
(a) All cash flows of a project.
(b) The additional cash flows from a new project.
(c) Sunk costs of the project.
(d) Depreciation of the project assets.

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Section B – Practical and Descriptive Questions (40 Marks)

Question 1: NPV and IRR Calculation (10 Marks)

Scenario:
ABC Ltd. is evaluating a project requiring an initial investment of ₹12 lakhs. The project's expected cash inflows are as follows:

- Year 1: ₹3 lakhs
- Year 2: ₹4 lakhs
- Year 3: ₹5 lakhs
- Year 4: ₹6 lakhs

The cost of capital is 10%.

(a) Calculate the Net Present Value (NPV) of the project. (6 Marks)
(b) Explain the decision rule for NPV. (2 Marks)
(c) What is the Internal Rate of Return (IRR), and how does it differ from NPV? (2 Marks)

Question 2: Payback Period and Profitability Index (10 Marks)

Scenario:
XYZ Ltd. is analyzing a project requiring an initial investment of ₹8 lakhs. The cash inflows are as follows:

- Year 1: ₹2 lakhs
- Year 2: ₹3 lakhs
- Year 3: ₹4 lakhs
- Year 4: ₹5 lakhs

The cost of capital is 10%.

(a) Calculate the Payback Period. (4 Marks)
(b) Calculate the Profitability Index (PI). (4 Marks)
(c) Discuss the limitations of the Payback Period method. (2 Marks)

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Question 3: Cash Flow Estimation (10 Marks)

Scenario:
ABC Ltd. is considering a project with the following details:

- Initial Investment: ₹15 lakhs
- Annual Cash Inflows (before tax): ₹4 lakhs for 5 years
- Depreciation: ₹3 lakhs per year
- Tax Rate: 30%

(a) Calculate the Cash Flow After Tax (CFAT) for each year. (6 Marks)
(b) Explain the importance of estimating accurate cash flows in capital budgeting decisions. (4 Marks)

Question 4: Comparison of Capital Budgeting Techniques (10 Marks)

(a) Compare and contrast the Payback Period, NPV, and IRR methods of project evaluation. (6 Marks)
(b) Discuss how capital budgeting techniques help in long-term decision-making. (4 Marks)

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