J.K. SHAH®
TEST SERIES
Evaluate Learn Succeed

SUGGESTED SOLUTION

# INTERMEDIATE M'19 EXAM

**SUBJECT- FM & ECONOMICS**

## Test Code –CIM 8087

**(Date : )**

**Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.**

**Tel : (022) 26836666**

## ANSWER-1

**Preparation of Financial Statements**

| **Particulars** | **%** | **(Rs.)** |
|---|---|---|
| Share capital | 50% | 1,00,000 |
| Other shareholders funds | 15% | 30,000 |
| 5% Debentures | 10% | 20,000 |
| Trade creditors | 25% | 50,000 |
| Total | 100% | 2,00,000 |

Land and Buildings = Rs. 80,000

Total Liabilities = Total Assets

Rs. 2,00,000 = Total Assets

Fixed Assets = 60% of Total Gross Fixed Assets and Current Assets

= Rs. 2,00,000 Rs. 60/100

= Rs. 1,20,000

**Calculation of Additions to Plant & Machinery**

| | Rs. |
|---|---|
| Total Fixed Assets | 1,20,000 |
| Less: Land and Building | 80,000 |
| Plant and Machinery (after providing depreciation) | 40,000 |
| Depreciation on Machinery up to 31-3-2013 | 15,000 |
| Add: Further Depreciation | 5,000 |
| **Total** | **20,000** |

Current Assets = Total Assets – Fixed Assets

= Rs. 2,00,000 – Rs. 1,20,000 = Rs. 80,000

**Calculation of Stock**

Quick Ratio $= \dfrac{\text{Current Assets - Stock}}{\text{Current Liabilities}} = 1$

$$= \frac{Rs.80,000 - Stock}{Rs.50,000} = 1$$

Rs. 50,000 = Rs. 80,000 – Stock

Stock = Rs. 80,000 – Rs. 50,000

= Rs. 30,000

Debtors = 4/5th of Quick Assets

= (Rs. 80,000 – 30,000) Rs. 4/5

= Rs. 40,000

**Debtors Turnover Ratio**

$$= \frac{40{,}000 \text{ x } 12}{\text{Credit Sales}} = \text{ 2 months}$$

2 Credit Sales = 4,80,000

Credit Sales = 4,80,000/2

= 2,40,000

Gross Profit (15% of Sales)

Rs. 2,40,000 Rs. 15/100 = Rs. 36,000

**Return on Networth (profit after tax)**

Networth = Rs. 1,00,000 + Rs. 30,000

= Rs. 1,30,000

Net Profit = Rs. 1,30,000 Rs. 10/100 = Rs. 13,000

Debenture Interest = Rs. 20,000 Rs. 5/100 = Rs. 1,000

**Projected Profit and Loss Account for the year ended 31-3-2014**

| | | | |
|---|---|---|---|
| To Cost of Goods Sold | 2,04,000 | By Sales | 2,40,000 |
| To Gross Profit | 36,000 | | |
| | **2,40,000** | | **2,40,000** |
| To Debenture Interest | 1,000 | By Gross Profit | 36,000 |
| To Administration and Other Expenses | 22,000 | | |
| To Net Profit | 13,000 | | |
| | **36,000** | | **36,000** |

**Ganesha Limited**

**Projected Balance Sheet as on 31st March, 2014**

| **Liabilities** | **Rs.** | **Assets** | | **Rs.** |
|---|---|---|---|---|
| Share Capital | 1,00,000 | Fixed Assets | | |
| Profit and Loss A/c | 30,000 | Land & Buildings | | 80,000 |
| (17,000+13,000) | | Plant & Machinery | 60,000 | |
| 5% Debentures | 20,000 | Less: Depreciation | 20,000 | 40,000 |
| Current Liabilities | | Current Assets: | | |
| | | Stock | 30,000 | |
| Trade Creditors | 50,000 | Debtors | 40,000 | |
| | | Bank | 10,000 | 80,000 |
| | **2,00,000** | | | **2,00,000** |

## Answer 2

**(A) Meaning :** There is demand for Money primarily due to two reasons -

(i) People desire to hold money [called Liquidity Preference for Money]

(ii) Demand for Money is a decision about how much of one's given Stock of Wealth should be held in the form of Money rather than as other Assets like Land, Bonds, etc. even if it gives little or no Return.

**OR**

(i) People wish to have command over Real Goods and Services with the use of Money [i.e. Derived Demand].

(ii) Money is demanded for its Purchasing Power. Individuals, Households & Firms hold Money because it is liquid and offers the most convenient way to accomplish their day to day transactions.

(a) Thus, Demand for Money is actually a demand for Liquidity and demand to store Value.

(b) Demand for Money has an important role in the determination of Interest, Prices and Income in an Economy.

**(B) Purposes of measuring National Income (Any Four point are required to answer from followings)**

Measurement of National Income is important from the perspective of Governments, Research Scholars, Economists, Accountants, Business Entities, and aids their decision – making. The Following are the specific purposes –

1. To provide a complete accounting and conceptual framework for analysing and evaluating the short – run performance of an economy.

2. To give a clear picture of the Economy regarding the GDP, National Income, Per – Capita Income, Saving Ratio, Production, Consumption, Disposable Income, Capital Expenditure, etc.

3. To evaluate the living standards, Income Levels, Expenditure and Consumption patterns of the people.

4. To indicate the level of economic activity, economic development and aggregate demand for goods and services, i.e. to indicate the way in which an economy functions.

5. To help the Government in determining the National Priorities, such as Education, Inflation, Unemployment, Defence, Social Development, and Industrialisation, etc. in Long – Term and Medium – Term Planning.

6. To determine the level of economic welfare, i.e. the amount and distribution of National Income, Per Capita Income, and its growth over a period of time.

7. To inter – relate different sectors of the Economy, and the significance of each Sector to the overall economy, by analyzing the composition and structure of National Income over various sectors, changes therein and the shifts in sectoral contribution over a period of time.

8. To provide a quantitative database for macro – economic modelling and analysis, for – (a) assessing and choosing economic policies, (b) objective evaluation of the chosen economic policies.

9. To determine the Monetary, Fiscal and Trade Policies towards growth, by using National Income data, along with financial and monetary data.

10. To make key projections on the future development of the economy at the macro level, i.e. economic forecasting.

11. To assess future consumption patterns and thereby determine the pattern of demand for goods and services, and enable Business Firms to forecast the demand for their products, at micro – economic level.

12. To make comparisons of structural statistics, e.g. ratio of Investments, Taxes, Government Expenditure etc. to GDP, pattern of Income distribution, comparison with other world countries' data, etc.

**( C )**

**Inflation Target :**

(i) Inflation Target is to be set by every 5 years.

(ii) Central Government has notified 4% Consumer Price Index (CPI) Inflation as the target for the period from 05.08.2016 to 31.03.2021 (Upper Tolerance Limit – 6%, Lower Tolerance Limit – 2%]

**Answer 3**

**(A)**

**(i)** **Primary Objectives :** The most common objectives of Monetary Policy of the Central Banks across the World are –

| | |
|---|---|
| **(a) Price Stability** | Establishment and Maintenance of stability in Price (or controlling Inflation) |
| **(b) Economic Stability** | Maintenance of Full Employment and achievement of high level of economy's growth. |

**(ii)** **Other Objectives :** Other Objectives, which flow out of the Primary Objectives, include -

a. Rapid Sustainable, Economic Growth,
b. Debt Management

c. Balance of Payments Equilibrium,
d. Exchange Rate Stability,
e. Adequate Flow of Credit to the productive Sectors,
f. Stability of Long – Term Interest Rates to encourage Investments,
g. Creation of an efficient Market for Government Securities.

**(B)**

**Note :** Bankers' Deposits with RBI is not relevant here. It is relevant only for "Reserve Money".

| | **Rs. Crores** |
|---|---|
| Currency with the public | 7,000 |
| **Add :** Demand Deposits with the Banking System | 13,000 |
| **Add :** Other Deposits with the RBI | 4,000 |
| **New Monetary Aggregate 1 ( denoted as NM1)** | **24,000** |
| **Add :** Short Term Time Deposits of **Residents** (including and upto Contractual Maturity of 1 Year) | 28,000 |
| **New Monetary Aggregate 2 (denoted as NM2)** | **52,000** |
| **Add :** Long Term Time Deposits of Residents | 64,000 |
| **Add :** Call /Term Funding from Financial Institutions | 10,000 |
| **New Monetary Aggregate 3 (Denoted as MN3)** | **1,26,000** |
| **Add :** All Deposits with Post Office Savings Banks (excluding National Savings Certificates) 19,000 – 3,000 | 16,000 |
| **Liquidity Aggregate 1 (Denoted as L1)** | **1,42,000** |
| **Add :** Term Deposits with Term Lending Institutions and Re – Financing Institutions | 9,000 |
| **Add :** Term Borrowing by Financing Institutions and certificates of Deposits issued by Financing Institutions | 5,000 |
| **Liquidity Aggregate 2 (Denoted as L2)** | **1,56,000** |
| **Add :** Public Deposits of Non – Banking Financial Companies | 12,000 |
| **Liquidity Aggregate 3 (Denoted as L3)** | **1,68,000** |

**Answer 4**

**(A)**

**Significance of Measuring Money Supply**

Empirical Analysis of Money Supply is important for the following reasons –

1. **Macro – Economic Impact :** Money Supply is considered as a very important Macro – Economic Variable responsible for changes in many other significant Macro – Economic Variables in an Economy.
2. **Economic Stability :** Economic Stability requires that the Supply of Money at any time should be maintained at an Optimum Level. This can be achieved by accurately estimating the Stock of Money Supply on a regular basis, and appropriately regulating it in accordance with the Monetary Requirements of the Country.
3. **Analysis :** Money Supply analysis facilitates analysis of Monetary Developments to provide a better understanding of the causes of Money Growth.
4. **Monetary Policy :** Analysis of Money Supply is essential from the Monetary Policy viewpoint, as it provides a framework to –
   (a) Evaluate whether the Stock of Money is consistent with the Standards for Price Stability, and
   (b) Understand the nature of deviations from this Standard.

5. **Money Supply and Monetary Policy :** The Central Banks all over the World adopt Monetary Policy to stabilize Price Level and GDP Growth by directly controlling the Supply of Money. This is achieved mainly by managing the Quantity of Monetary Base. The success of Monetary Policy depends to a large extent on the controllability of Money Supply.

**(B)**

## Procedure :

| Step | Description |
|---|---|
| 1. | Identify the **Total Factor Payments** made out by all Production Units within the Domestic Territory of the Country, under the heads of – (a) Rent, (b) Wages, (c) Interest, and (d) Profits. |
| 2. | Compute **Total Factor Incomes** within Domestic Territory = $NDP_{FC}$ = $\sum$ factors payments as per Step 1 above.<br>For this purpose, $NDP_{FC}$ = Total of the following items –<br>(a) Operating Surplus = Rent + Interest + Profits (including Undistributed Profits of Corporations).<br>(b) Compensation of Employees = Wages.<br>(c) Mixed Income of Self – Employed (as per Note below) |
| 3. | Compute **National Income** (i.e. $NNP_{FC}$) = $NDP_{FC}$ as per Step 2(+) Net Factor Income from Abroad. |

**Note :** While applying Income Method, care must be taken to include "Mixed Income of the Self – Employed" in cases where –

(a) individual provide both labour and capital services, and it is difficult to differentiate between Labour Element and Capital Element of Incomes, e.g. Doctors, Chartered Accountants, Proprietors, Traders, etc.

(b) there is subsistence production or small commodity production etc.

**Answer 5**

**(A)**

1. In a Four Sector Economy (Households, Business, Government and Foreign Sectors), we have the equation,
   **Y = C + I + G + (X – M) = C + S + T,** where
   C = Consumption, I = Investment, G = Govt. Spending, X = Exports, M = Imports, S = Savings and T = Taxes.
2. Here, on the Aggregate Demand Side Y = C + I + G + (X – M).
3. Substituting the values, we have Y = 700 + 0.8Y + 1,200 + Nil + 100.
   **On Solving Y = 10,000.**

**(B) Repo vs Reverse Repo :**

| | Repurchase Transaction (Repo) | Reverse Repurchase (Reserve Repo) |
|---|---|---|
| **Meaning** | Instrument for borrowing Funds by selling Securities with an agreement to re – purchase them on a mutually agreed future date at an agreed price which includes Interest for the Funds borrowed. | Instrument for lending Funds by purchasing Securities with an agreement to resell them on a mutually agreed future date at an agreed price which includes interest for the funds lent. |

| | | |
|---|---|---|
| **Process** | Repo Operation takes place when other Banks borrow Money from RBI by giving Securities to the RBI. | Reverse Repo Operation takes place when RBI borrows Money from Banks by giving them Securities. |
| **Impact** | Repo Operations inject Liquidity into the system. | This operation absorbs the Liquidity in the system. |
| **[Note]** | Interest Rate charged by RBI for this transaction is called the 'Repo Rate'. Higher than Reverse Repo Rate. | Interest Rate paid by RBI for such transactions is called the 'Reverse Repo Rate'. Less than Repo Rate. |
| **Presently** | Repo Rate is 6.25% | Reverse Repo Rate is 6%. |

**( C )**

**1. Concept :**

(a) $GDP_{MP}$ is the measure of the Market Value of all final goods and services, without subtracting Depreciation, produced within the "domestic" territory of a country, in a specified time period (e.g. a year).

(b) Thus, $GDP_{MP}$ is the Total Value Added by all producing units in the "domestic" territory, and includes value addition by Foreign Residents and Foreign Firms.

**2. Computation :** $GDP_{MP}$ = Value of Output in Domestic Territory (-) value of Intermediate Consumption.

Thus, $GDP_{MP}$ is the sum of Value Added in "Domestic Territory".

**Note :** $GDP_{MP}$ excludes the following items –

(a) value Added/ Value of Output produced by a country's Citizens/ Firms abroad,

(b) Transfer payments, e.g. Payments by Government towards Pensions, Unemployed Youth, etc.

(c) Value of transactions which cannot be expressed in monetary form,

(d) Non – Reported Output, Value of illegal transactions, etc.