Roll No……..……..

Membership No……

The Institute of Chartered Accountants of India
Forex & Treasury Management Certificate Course
Evaluation Test Booklet

Paper 1

24th January, 2016

Duration- 3 Hours **Total Marks- 100**

INSTRUCTIONS:

1. Please read the instructions carefully given in the question paper and solve it in the space provided.
2. The candidates are not allowed to carry the evaluation test booklet with them. This should be tied up with sheets provided to answer the question Paper.
3. Use Blue/Black pen only.
4. Do not write your Roll No. or Name or other identification other than in the space (perforated) provided on this sheet.
5. Please show Identity Card to the invigilator for verification of your identity, when asked.
6. The candidates may use the simple calculator.
7. In order to get full credit on the problems, the candidates must show all their rough work/ other workings.

(Participant Signature) (Invigilator Signature)

PLEASE RETURN THIS BOOKLET BEFORE LEAVING THE EXAMINATION HALL

Date : 24th Jan, 2016
Centre : Noida/ Mumbai /Chennai/Kolkata & Kanpur/Bangalore

(Do not write your Roll No. and Membership number anywhere in the answer sheet except as mentioned above)

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CERTIFICATION COURSE ON FOREX AND TREASURY MANAGEMENT

S. No.	Total Number of Questions	Questions to be answered	Total Marks	Marks Obtained
Multiple Choice - Section A	65	65	65	
Short Notes – Section B	7	5	25	
Case Study – Section C	2	1	10	
Total	**74**	**71**	**100**	

Section A

Number of questions: 65

Marks: 65

Multiple choices: Please [✔] mark for the correct answer.

Part A: Answer all questions. **1 mark each**

1. A cash manager at a retailer forecasts a positive collected cash position for the end of the current day. The company has an overdraft facility at 10%, a separate investment account earning 8% before taxes, an earnings credit rate of 8% and an outstanding single payment note at 9.5% maturing in 1 week. This month's bank service fees are expected to exceed the earnings credit. Which of the following intra-day options would be the MOST economically positive for the company?
   (A) Leave the funds in the account.
   (B) Redeem the single payment note.
   (C) Prepay administrative expenses.
   (D) Transfer funds to the investment account

2. Which of the following can be considered key responsibilities of daily cash management?
   I. Overseeing compensation for bank services
   II. Management of short-term borrowing and investing
   III. Projecting future cash shortages and surpluses
   (A) I only
   (B) I and II only
   (C) II and III only
   (D) I, II, and III

3. The treasurer of a corporation is negotiating with one of his/her suppliers to allow the corporation to have 30 days to pay the supplier's invoices. The treasurer is arranging:
   (A) Short-term financing.
   (B) Revolving credit agreement.
   (C) Factoring of receivables.
   (D) Uncommitted line of credit.

4. A main characteristic of a company with regional offices using a centralized treasury function is:
   (A) Increased borrowing costs
   (B) High level of control.
   (C) Centrally determined depository accounts.
   (D) Increased operating costs.

5. Treasury management systems and ERP systems allow companies to do all of the following EXCEPT:
   (A)Increase productivity through seamless exchange of data
   (B) Migrate external data into G/L infrastructure.
   (C) Reduce cash processing costs
   (D) Reduce redundant data entry errors.

6. Netting is used by which of the following as a cross-border payment technique?
   (A) European giro providers
   (B) Foreign subsidiaries of a company
   (C) Counterparties in a letter of credit transaction
   (D) TARGET participants

7. In which of the following international cash management methods is title for goods transferred for intercompany sales?
   (A) Pooling
   (B) Internal factoring
   (C) Multilateral netting
   (D) Re-invoicing

8. Which of the following is NOT a key area to consider when establishing treasury policies?
   (A) Equity method investments accounting
   (B) Medium-term financing
   (C) Management reporting
   (D) Foreign currency management

9. A daily short-term forecast and variance analysis for LMN, Inc. is updated with relevant trends and actual data every Monday. Upon review, the treasurer assessed that sales were higher than forecasted, inventory was up and yields being earned on excess cash were lower. The MOST important reason for this cash forecast process is:
   (A) Financial control
   (B) Managing costs.
   (C) Capital budgeting.
   (D) Liquidity management.

10. A French exporter sells goods to a foreign buyer in Euros and wants to guarantee that payment is made by the buyer. The exporter would MOST LIKELY require a(n):
    (A) bankers' acceptance.

(B) Documentary collection.
(C) Letter of credit.
(D) open account

11. ABC Company's treasury department outsourced its overnight investment duties to XYZ Money Management. XYZ placed the funds received from ABC into corporate commercial paper, which has recently gone into default after numerous ratings downgrades. The investment policy of ABC Company states that all investments must be in investment grade commercial paper; however, the agreement gives XYZ the ability to make exceptions with the approval of the treasurer of ABC Company. The treasurer was never notified of the ratings downgrades. What role or responsibility, if any, was violated with regards to the investment policy?
(A) Exposure horizon monitoring
(B) Valuation of investment vehicles
(C) Policy approvals and exception management
(D) No violation occurred

12. The MOST common way that companies structure their treasury operations is as a(n):
(A) cost center.
(B) Profit center.
(C) Shared service center.
(D) In-house bank.

13. Which of the following is not an assumption of the Theory of Comparative Advantage?
(A) In both the markets perfect competition exists
(B) Technological innovation is a continuous process in both the markets
(C) The marginal product of labor is constant
(D) Labour is perfectly mobile within the country

14. D & B Services Ltd. Offers credit to C&A Manufacturing Ltd. On terms"8/15, net 90". For a particular transaction, C & A Manufacturing Ltd. makes the payment within a period of 15 days. Which of the following is true?
(A) C & A Manufacturing Ltd. has to pay only 90% of the total billed amount.
(B) C & A Manufacturing Ltd. will get a cash discount of 15% on the transaction immediately.
(C) C&A Manufacturing Ltd. will get a cash discount of 15% on the transaction, payable after 90 days.
(D) C&A Manufacturing Ltd. will get a cash discount of 8% on the transaction.

15. Making payments through electronic payments networks can be a part of a treasury management system's functionality, but it is subject to numerous constraints. Which of the following is a true statement of those constraints?
(A) The process is easy for the payee but very intensive manually for the payer.
(B) Negotiation of trade terms is required, but float terms are excluded.

(C) Remittance detail, whether a lot or a little, can be easily included with all payment forms.
(D) Collecting payment-routing details, and populating these into the software, is a significant task.

16. Which of the following is a ratio that is often used by commercial banks to measure a company's leverage and does not include the effect of assets that are difficult to value or are NOT easily converted to cash?
(A) Long-term debt to capital
(B) Debt to tangible net worth
(C) Total liabilities to total assets
(D) Cash flow to total debt

17. All of the following are advantages of using traditional financial ratios for analysis EXCEPT?
(A) They can easily be computed from the information found in publicly available financial reports.
(B) They usually reflect accounting rather than economic values.
(C) They can be used to view historical trends and availability over time.
(D) They allow comparisons to be made between like companies

18. The single purchase or sale of a currency for future delivery is called?
(A) Spot transactions
(B) FX swaps.
(C) Outright forward transactions
(D) Reverse transactions

19. The _____ is the price at which the trader is willing to buy foreign currency?
(A) Offer
(B) Bid
(C) Spread
(D) Cross Rate

20. Calculate the forward per annum premium or discount given the following quotes. Spot £1 = $1.4000; 3 months forward £1 = $1.4200?
(A) The $ is at a discount of 5.71 per cent
(B) The $ is at a discount of 1.43 per cent
(C) The $ is at a premium of 1.43 per cent
(D) The $ is at a premium of 5.71 per cent

21. When a central bank is trying to maintain an overvalued currency by buying its own currency on the foreign exchange market, sterilization of that transaction means for it to?

(A)Buy foreign currency
(B)Sell foreign currency
(C)Buy domestic bonds
(D)Sell domestic bonds

21. Economies teach that?
(A) Exchange rates should be determined by transactions that are included in the current account of the balance of payments.
(B) Foreign Exchange markets are always efficient
(C) Exchange rates move rapidly to return to equilibrium positions.
(D) Exchange rates should be determined by the market fundamentals.

22. In Deep Market?
(A) There is no scope for arbitrage
(B) There are many sudden large movements of the exchange rate.
(C) Speculators are almost certain to lose.
(D) **There are few sudden large movements of the exchange rate**

23. Discounted cash flow techniques refer to forecasting the _____ of a competitive method into the future?
(A) **Cash Flows**
(B) Capital
(C) Balance Sheet
(D) Assets

24. Popps Ltd is considering the purchase of an asset for Rs. 120,000. This asset will generate the following cash flows :
Year 1 Rs. 15,000
Year 2 Rs. 25,000
Year 3 Rs. 40,000
Year 4 Rs. 40,000
Year 5 Rs. 35,000
Year 6 Rs. 30,000
Using a discount rate of 20% the discounted payback period would be
(A) The investment does not pay back
(B) 5 years
(C) 4 Years
(D) 6 Years

25. If a coupon bond sells at a large discount from par, then which of the following relationships holds true? (P_0 > represents the price of a bond and YTM is the bond's yield

to maturity)?

(A) P_0 < par and YTM > the coupon rate.

(B) P_0 > par and YTM > the coupon rate

(C) P_0 > par and YTM < the coupon rate.

(D) P_0 < par and YTM < the coupon rate

26. 1 day VaR of a portfolio is Rs. 500,000 with 95% confidence level. In a period of six months (125 working days) how many times the loss on the portfolio may exceed Rs. 500,000?

(A) 4 Days

(B) 5 Days

(C) 6 Days

(D) 7 Days

27. An increase in cash reserve ratio will cause yield curve to?

(A) Shift Downward

(B) Remain unchanged

(C) Become Steeper

(D) Become Flatter

28. If the short term interest rates are temporarily higher than the long term interest rates, the yield curve?

(A) Slopping Upward

(B) Inverted

(C) Zig-Zag

(D) Horizontal

29. Which of the following is an example of Secondary Reserves?

(A) Cash on hand and Balances with other banks in current account

(B) Balances with RBI for CRR

(C) Investment in Government Securities for SLR

(D) Investment in Commercial Paper

30. According to the system of pre-authorized debts?

(A) The vendor submits a list of debit items to the bank who debits customer accounts

(B) The vendor can receive his own payments by drawing funds from the buyers bank account

(C) The bank is authorized to receive payments from creditors of its customers

(D) The payer authorizes its bank to debit its account and credit the account of its payee

31. Which of the following investments has / have no default risk?

(A) Inter-Corporate Deposits.

(B) Treasury Bills.
(C) Commercial Papers.
(D) Money Market Mutual Fund

32. If interest rate parity holds and the transaction costs are zero, covered foreign financing will result in an effective borrowing rate that is?

(A) Less than the domestic interest rate
(B) Greater than the domestic interest rate
(C) Equal to the domestic interest rate
(D) Greater than the domestic interest rate if the forward rate exhibits a premium and less than the domestic interest rate if the forward rate exhibits a discount.

33. The price of treasury notes and treasury bonds without including accrued interest is classified as?

(A) clean price
(B) full price
(C) dirty price
(D) accrued price

34. In primary markets, the property of shares which made it easy to sell newly issued security is considered as?

(A) increased liquidity
(B) decreased liquidity
(C) money flow
(D) large funds

35. The type of market in which securities with less than one year maturity are traded is classified as?

(A) capital market
(B) money market
(C) transaction market
(D) global market

36. In capital markets, the major suppliers of trading instruments are?

(A) manufacturing corporations
(B) liquid corporations
(C) instrumental corporations
(D) government and corporations

37. Which of the following is also known as the Big Board?

(A) NASDAQ
(B) New York Stock Exchange
(C) Tokyo Stock Exchange
(D) London Stock Exchange

38. Which of the following might be found in a bond indenture?

(A) A dividend restriction clause
(B) A Sinking Fund Clause
(C) A subordination clause
(D) all of the above

39. A fall in interest rates will make prices of Government Securities?

(A) Go Down
(B) Go Up
(C) Remain unchanged
(D) None of these

40. 11% Govt. of India security is quoted at Rs.110. If the interest rates go down by 1% the market price of the security will be?

(A) Rs. 110
(B) Rs. 109
(C) Rs. 122.20
(D) Rs. 130

41. Company X, a Singapore based multi-national is exploring the option of locating a subsidiary in another country where there has been some historical risk of expropriation of local assets of foreign corporations. Therefore, as part of the risk assessment process the company must specifically quantify the:
(A) Political risk.
(B) Physical security risk.
(C) Financial institution risk.
(D) Property risk.

42. XYZ Company has a well established commercial paper (CP) program that they use to fund operations. The company is expanding by purchasing a new factory. The CFO is worried about the time and expense needed to issue long-term debt and decides to use the funds they raise in the CP market to pay for the purchase of the factory. This strategy will be successful if:
(A) An interest rate swap is used.
(B) A credit default swap is employed.

(C) A commodities future is purchased.
(D) The yield curve remains upward sloping.

43. Money market funds are able to obtain very competitive trading terms because:
(A) There is no diversification.
(B) Of the economies of scale.
(C) Invested funds are locked in for a specific period of time.
(D) The investment manager only purchases high yielding instruments.

44. Securities sold by companies in an initial public offering (IPO) are:
(A) A specific type of security sold by a public company for the first time.
(B) Debt securities sold on the open market.
(C) Public securities sold by a private company for the first time.
(D) Securities sold by a private company to a limited number of investors.

45. A company has grown quickly in the euro zone market. It wants to maximize its excess cash. Which would be the BEST method of concentrating funds?
(A) Bank Overlay
(B) Notional Pooling
(C) Physical Pooling
(D) Scheduled Transfer

46. The treasurer for XYZ Manufacturing, Inc. recently exchanged a portion of its euro holdings into U.S. dollars to purchase gas futures contracts. This was done in anticipation of an assumed rise in gas prices due to the continued weakening of the U.S. dollar. Which of the following types of risk is being mitigated?
(A) Commodity price
(B) Operational
(C) Sovereign
(D) Foreign exchange

47. A _____ Contract is a arrangement whereby the coupon rate on a note moves in the opposite direction of some variable rate index?
(A) Inverse floating rate
(B) Reverse floating rate
(C) Backward floating rate
(D) Defensive Floating rate

48. One of the following is not the characteristics of GDR?

(A) 1 GDR = n Shares , Where ‘n’ must be an integer
(B) It is a fixed income security
(C) The issuing company has no foreign exchange liabilities

(D) It is subject to two-way fungibility

49. A treasury bill which matures in 62 days for £250,000 is currently trading at 248,000. The rate of discount on this bill is?

(A) 0.8 %
(B) 0.806%
(C) 4.74 %
(D) 4.7%

50. On which of the following instruments is the rate of return calculated on a 'discount basis'?

1. Certificates of deposit.
2. Interbank deposits.
3. Commercial paper.
4. Repurchase agreements.
5. Commercial bills

(A) 2 & 4
(B) 2, 3 & 5
(C) 3 & 5
(D) 1 & 3

51. Which of the following is not a Eurocurrency?

(A) US $ held in Tokyo
(B) French francs held Paris
(C) Japanese Yen held in New York
(D) Deutschemarks held In Paris

52. Arbitrageurs in foreign exchange markets?

(A) Attempt to make profits by outguessing the market.
(B) Make their profits through the spread between bid and offer rates of exchange
(C) Take advantage of the small inconsistencies that develop between markets
(D) Need foreign exchange in order to buy foreign goods

53. Overshooting models of the exchange rate are an attempt to explain?

(A) Why exchange rates are so volatile.
(B) Why forward rates of exchange are not good predictors of future spot rates of exchange
(C) Why the foreign exchange market is never in equilibrium

(D) Why purchasing power parity plays no role in determining the value of a currency

54**.** Floating rate euro bonds become popular?

(A) When investors are particularly concerned about income risk
(B) When exchange rates are very volatile
(C) When interest rates are very volatile
(D) during crises in the newly emerging markets

55. The term 'commercial hot money' is used to describe?

(A) The international movement of funds by companies in order to reduce their tax payments.
(B) Speculation based on expected future changes in exchange rates
(C) The repatriation of profits by transnational corporations
(D) The movement of funds to profit from changes in short-term interest rates.

56**.** If the yield to maturity (YTM) of bond X is greater than the yield to maturity of bond Y, with the same coupon rate and maturity, then which of the following is/are **true**?
1. The price of bond X will change more than the price of Bond Y for a given change in YTM
2. The market price of bond Y is more than that of X
3. The current yield of both the bonds would be same
(A) Only (I) above
(B) Both (I) and (II) above
(C) Both (I) and (III) above
(D) Both (II) and (III) above

57. Which of the following services does a factor provide under nonrecourse basis?

(A) Purchasing of the accounts receivables
(B) Collecting the accounts receivables
(C) Assuming the losses arising from bad debts.
(D) All of the above

58. Which of the following is **not** a diversifiable risk?

(A) Lock-out in a company due to workers demanding a wage hike
(B) Recession in the economy
(C) Lack of strategy for the management of a company
(D) A change in the product portfolio of a company

59. Which of the following money market instrument(s) require(s) statutory Credit rating?

(A) TBs
(B) Ad hoc TBs
(C) CPs

(D) CDs

60. An English company creates and stages firework displays in many countries across Europe. It has won a number of contracts for the following month and expects to receive €500,000 over that period. However, many of the fireworks it makes use of in the displays are imported from China and it currently has orders outstanding to the value of US$125,000. All of its other expenses are denominated in sterling.

Which of the following best describes the company's position in terms of foreign currency?

(A) It is long in dollars
(B) It is short in dollars and long in euro
(C) It is long in dollars and short in euro
(D) It is short in euro

61. The fundamental credit analysis approach consists of?

(A) 4 Steps
(B) 6 Steps
(C) 3 Steps
(D) 8 Steps

62. A bank holds a security that is rated A+. The rating of the security migrates to A. What is the risk that the bank has faced?

(A) Credit Risk
(B) Market Risk
(C) Operational Risk
(D) Market liquidation risk

63. Which of the following is a source of short-term financing?
(A) Bond issuance
(B) Factoring of accounts receivable
(C) Issuance of common stock
(D) Retaining profits

64. Investors who completely ignore an asset's variance and only consider the asset's expected return are called?

(A) Risk Averters
(B) Risk Neutral Investors
(C) Risk Seekers
(D) Growth Oriented investors

65. Which of the following sequences lists financial assets from least risky to most risky?

(A) Derivatives, bonds, stocks
(B) Stocks, bonds, derivatives
(C) Bonds, stocks, derivatives
(D) Derivatives, stocks, bonds

Section B

Number of questions: 7

Marks: 25

Note: Answer any five questions. Each answer will carries 5 marks

[Unrelated answers & answers exceeding the brief will attract negative marks]

1.What do you understand by "PIP"?

Ans.: It is related to the currency rates. It depends on the currency exchange rates and it is measured in terms of points based on the fluctuation in the currency exchange rates between two currencies. The minimum incremental move that of which is made possible by a currency pair is otherwise known as a pip, which simply stands for price interest point. For example, a move in the EUR / USD currency pair from *1.2545 to 1.2560 would be equivalent to 15 pips*, whereas a move in the USD / JPY currency pair from *112.05 to 113.05 would be equivalent to 105 pips*.

2. How Oracle Treasury can be used for DEAL Management?
Ans.: Oracle Treasury can be used to manage financial transactions and deals both short term and long term including investments and borrowings. This management capability allows the organization to better manage results to achieve improved overall operation of its treasury management process. For Deal Management, Oracle Treasury allows you to:

- Create portfolios to manage short term and long term deals that are controlled through deal rate tolerances.
- Create the products you need to relate to the deals you trade in. Define stocks and bonds.
- Setup your deals and manage them both in terms of risk and record appropriate journal entries to the General Ledger.
- Create confirmation templates that you can send out deal confirmations to the trading parties that you control.
- Manage the settlement process with trading parties using EDI and related technologies.
- Define audit requirements to help manage your internal audit requirements in the corporate treasury environment.

3. Write a short note on VaR – Duration and Mecaulay Duration?

Ans. VaR measures the possible adverse change in market value of a financial instrument, based on what is regarded as the largest likely adverse move in rates or prices over a given timeframe. It also includes the correlation between different financial instruments to measure the volatility of a financial portfolio of instruments.

Mecaulay Duration is the weighted average term to maturity of the cash flows from a bond. The weight of each cash flow is determined by dividing the present value of the cash flow by the price, and is a measure of bond price volatility with respect to interest rates.

Macaulay duration can be calculated by:

$$\text{Macaulay Duration} = \frac{\sum_{t=1}^{n} \frac{t * C}{(1+y)^t} + \frac{n * M}{(1+y)^n}}{\text{Current Bond Price}}$$

Where:

t = respective time period

C = periodic coupon payment

y = periodic yeild

n = total number of periods

M = maturity value

The metric is named after its creator, Frederick Macaulay. Macaulay duration is frequently used by portfolio managers who use an immunization strategy. Macaulay duration is also used to measure how sensitive a bond or a bond portfolio's price is to changes in interest rates.

4. What are the basic objectives of portfolio management?

Ans.: Some of the broad objectives of portfolio management are listed as under:

1. ***Safety of fund***: *Safety* of fund is the primary objective of portfolio management. While making investment decisions pertaining to securities, it is a must for investors/portfolio managers to ensure that their investment is safe and it will return with appreciation in value.
2. ***Liquidity*** *:* Investors are very much interested in the liquidity aspect of securities in the portfolio. An investor shall make investment in those securities which can be encashed without any difficulty or involvement of time to meet urgent need for funds.
3. ***Reasonable Return***: *Reasonable* return on securities is another important aspect of portfolio management. A sound investor or portfolio manager before making investment would like to judge the interest/dividend paying capacity/rate of the companies in which investment opportunities exist. The investor is very much concerned with the appreciation in value of securities because it will ultimately determine the profitability of his investment. (Capital gains plus dividends/interest together determine the return on investment).

4. ***Minimum Risk:*** The portfolio investments are subject to certain unforeseen risks and it is the judgment and intelligence of the portfolio manager to reduce this element of risk to minimum. Practically, portfolio managers achieve this objective of minimizing risk by effective investment planning and periodical review of the market situation and economic environment affecting the financial markets.

5. Briefly explain the mechanics of Factoring?

Ans : ***Mechanics of factoring***

Factoring offers a very flexible mode of cash generation against receivables. Once a line of credit is established, availability of cash is directly geared to sales so that as sales increase so does the availability of finance. The dynamics of factoring comprises of the sequence of events outlined in figure.

1. Seller (client) negotiates with the factor for establishing factoring relationship.
2. Seller requests credit check on buyer (client).
3. Factor checks credit credentials and approves buyer. For each approved buyer a credit limit and period of credit are fixed.
4. Seller sells goods to buyer.
5. Seller sends invoice to factor. The invoice is accounted in the buyers account in the factor‘s sales ledger.
6. Factor sends copy of the invoice to buyer.
7. Factor advices the amount to which seller is entitled after retaining a margin, say 20%, the residual amount paid later.
8. On expiry of the agreed credit period, buyer makes payment of invoice to the factor.
9. Factor pays the residual amount to seller

6. Explain the difference between each of the following pairs of terms:

   a) Effective and real exchange rates;
   b) long and short positions in dollars;
   c) covered and uncovered.

Ans. a) an **effective** exchange rate is a weighted average of a currency's exchange rates with currencies that are of most importance from the point of view of trade.

A **real** exchange rate is the spot exchange rate adjusted to take into account the differences in the rates of inflation in the two countries concerned and thus to provide a measure of what is happening to the competitiveness of the two countries in trade.

b) A trader with a **long** position in dollars is holding more dollars than she needs and thus will have to sell dollars at some future date (her assets in dollars are greater than her liabilities in dollars). She will thus lose should the dollar fall in value while she is long in dollars.

A **short position** is the reverse. The holder of a short position in dollars must acquire dollars in the future and thus runs the risk that the dollar will rise in value. Bears (who believe the dollar is likely to fall in value) go short in dollars.

c) A **covered** position is protected against risk - assets and liabilities in the currency in question are equal (the trader is neither long nor short in the currency).

An **uncovered** position is subject to risk. Long and short positions are both uncovered.

7. Write a Short note on 'Futures Market'?

Ans.: Future Forex currency markets are specific types constitute the forward outright deals which in general take up small part of the foreign exchange currency trading market. Since future contracts are derivatives of spot price, they are also known as derivative instruments. They are specific with regard to the expiration date and the size of the trade amount. In general, the forward outright deals which get mature past the spot delivery date will mature on any valid date in the two countries whose currencies are being traded, standardized amounts of foreign currency futures mature only on the third Wednesday of March, June, September, and December.

Although the futures and spot markets trade closely together, certain differences between the two occur, thus giving away the arbitraging opportunities. Gaps, volume, and open interest are important technical analysis tools solely available in the futures markets. Because of these benefits, currency futures trading regularly attract a large number of forex traders into this market. The most common pages regarding future markets are available with Reuters, Bridge, Telerate, and Bloomberg. The rates are presented on composite pages by the Telerate, while the currency futures are represented on individual pages showing the convergence between the futures and spot prices by Reuters and Bloomberg.

Section C

Number of questions: 2

Marks: 10

Note: Case Studies. Answer any one. Max 10 marks

1. You have been appointed as corporate treasurer of Lanco Infratech ltd. Since the company is going through its restructure phase-, as a Corporate Treasurer you are being entrusted with a task to assist the board of directors to form a new investment/treasury policy manual for the company. Explain the areas/points to be covered in the policy manual

Ans.: People should behave rationally, especially when it comes to finance. They often do not. One of the big ways to prevent this from happening in your investment portfolio is writing, implementing, and abiding by something known as an investment policy manual. In essence, it is a set of ground rules and guidelines about how a specific pool of assets will be managed. It details the parameters under which a portfolio will be established, managed, tracked, and protected. It can range from a very simple, five page document, which is probably all we need, to an extremely complex book.
In this case since LANCO is going through the phase of restructuring in terms and debts and finance structure .it requires more care and emphasis on drafting a investment policy which ensures that the investment of the company are safe and provides good amount return also . At present the company is not in a situation to invest in areas which contains high risk and high return so in this case a comprehensive Investment or Treasury policy manual covers following areas:
1**. Purpose**: The Investment Policy document of an organization sets forth policies and procedures to guide day today administration of all investment activities.

2. **Responsibility**: The Board of Directors is responsible for the formulation and implementation of investment policies. The Board may delegate its decision making authority with respect to specific investments to the President, for implementing investment policies and consistent with its policy document. The Board may also appoint an Investment Committee to act as a liaison between the Board and Management. The main functions of the committee will be:

- Working with management on investment issues and problems.
- Monitoring and reviewing for investing in financial institutions.
- Monitor investment decisions for compliance with the Policy Document, and
- Review the Policy Document and recommend changes to the Board when appropriate.

3. **Investment Objective**: The Investment policy document will enumerate the financial and investment objectives of the organization in details and the boundaries within which the investments can be made by the treasurer.

4. **Portfolio Composition**: In the light of the investment objective, the policy document should prescribe the portfolio composition e.g. the portfolio should be comprised of securities with the following characteristics:

- A low degree of default risk.
- A low degree of interest risk resulting from changes in the level of interest rates.
- A high degree of liquidity.

The policy documents may further contain guidelines related to Authorized types of Investments, Maturity of Investments (Short term or long term), Diversification requirements etc.

2. A firm has bond outstanding Rs. 3, 00, 00,000. The bond has 12 years remaining until maturity, has a 12.5% coupon and is callable at Rs. 1,050 per bond; it has floatation costs of Rs. 4, 20, 000, which are being amortized at Rs. 30,000 annually. The floatation costs for a new issue will be Rs. 9, 00,000 and the current interest rate will be 10%. The after tax cost of the debt is 6%. You are to suggest that should the firm refund the outstanding debt? Consider corporate income – tax rate at 50 %.

Answer: (1) Calculation of present value of saving in interest by issue of new bonds replacing new bonds

Interest on bond outstanding p.a. = 3,00,00,000*12.5/100 = Rs. 37,50,000

Interest on new bonds p.a. = 3,00,00,000*10/100 = Rs. 30,00,000

Savings in interest by issue of new bonds = (37,50,000 – 30,00,000) (1 – 0.50) = Rs. 3,75,000

P.V of savings in interest (@6% for 12 years) = 3,75,000 * 8.38 = Rs. 31,44,000

(2) Saving of call premium

Call premium per bond = callable value – face value = 1,050 - 1,000 = Rs. 50

Or = 50/1000*100 = 5%

Total Call Premium = (3,00,00,000*5/100) (1 – 0.50) = Rs. 7,50,000

The call premium can be written off as an expense in the year the call is made.

(3) Floatation costs

The floatation cost of issue of new callable bonds to mobilize Rs. 300 lakhs will be Rs. 9,00,000.

Amortisation of floatation cost p.a. (after tax) = (9,00,000/12) (1 – 0.50) = Rs. 37,500

P.V. of floatation cost amortised (@6% p.a. for 12 years) = 37,500*8.384 = Rs. 3,14,400

(4) P.V. of tax saving by amortisation of outstanding bonds

P.V. of immediate tax savings = Rs. 1,80,000

P.V. of tax savings if outstanding debt is continued = 30,000*0.50*8.384 = Rs. 1,25,760

P.V. of net tax saving = 1,80,000 – 1,25,760 = Rs. 54,240

Calculation of total net savings by replacing outstanding bonds with new issue of callable bonds

		(Rs).
P.V. of Interest savings		31, 44,000
P.V. Of tax savings on floatation cost amortised of old bonds		3,14,000
P.V. Of tax savings by amortization of old debt		54,200
		35,12,640
Less: Cash outflow on floatation cost	9,00,000	
Call premium	7,50,000	16,50,000
P.V. of net savings if outstanding bonds are replaced with callable bonds		18,62,000