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Institute of Certified Management Accountants of Sri Lanka
Foundation Level
November 2014 Examination

Examination Date : 23rd November 2014
Examination Time: 1.30 p.m. – 3.30 p.m.

Number of Pages : 08
Number of Questions : 50

Instructions to Candidates

1. Time allowed is **two (2) hours**.
2. Total: **100 Marks**.
3. Answer **all** questions.
4. Write the number of the part of the question and the selected answer by stating the relevant English letter, in your answer booklet. **E.g. (1) (relevant English letter), (2) (relevant English letter) etc...** in your answer booklet.
5. Section **A**: Business Economics and Section **B**: Business Finance Fundamentals.
6. The answers should be in **English Language**.

<u>Subject</u>	<u>Subject Code</u>
Business Economics & Business Finance Fundamentals	(BEF / FL 5 - 105)

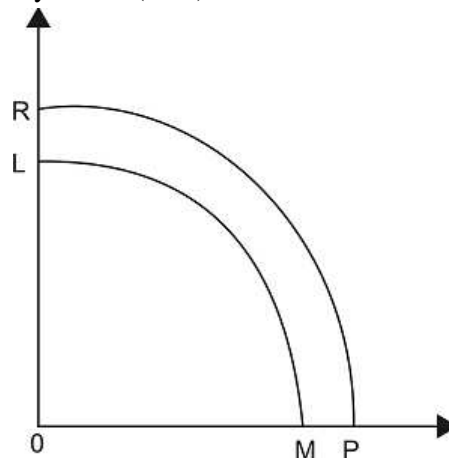
Section A: Business Economics

- (1) A free market economy differs from a planned economy in a number of ways
- (i) The working of the price mechanism
 - (ii) Economic inequality
 - (iii) Profit motivation
 - (iv) State enterprise

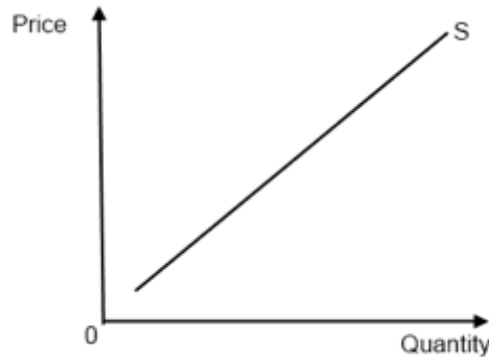
Which of the above are correct?

- (a) (i) & (ii) only.
- (b) (i), (ii) & (iii) only.
- (c) (i), (ii) & (iv) only.
- (d) (ii) & (iv) only.

- (2) When the Production Possibility Curve (PPC) has shifted from RP to LM, it indicates

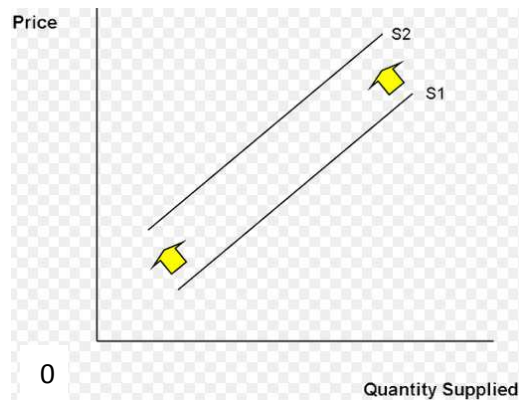


- (a) there is an economic growth.
 - (b) there is an efficiency.
 - (c) Negative growth.
 - (d) Constant costs.
- (3) The Southern Highway and the Katunayake Expressway are:
- (a) merit goods.
 - (b) public goods.
 - (c) Private goods.
 - (d) free goods.
- (4) If the supply curve is a straight line which starts from the origin and the quantity supplied varies exactly in the same proportion as that of the price change, it indicates that the price elasticity is:



- (i) 1
 - (ii) More than 1
 - (iii) Less than 1
 - (iv) Infinity
- Which of the above are correct?
- (a) (i) only.
 - (b) (i) & (ii) only.
 - (c) (iii) only.
 - (d) (ii) & (iv) only.
- (5) A minimum price is introduced to encourage the producer, it is;
- (a) a price ceiling.
 - (b) a price above the equilibrium price.
 - (c) a price below the equilibrium price.
 - (d) a fluctuating price.
- (6) Degree of response in demand to good X due to a change in price of good X is:
- (a) Price elasticity of demand.
 - (b) A perfectly elastic demand.
 - (c) Income elasticity of demand.
 - (d) Cross elasticity of demand.
- (7) Complementary goods are those goods:
- (a) that go together, like needles & sewing thread.
 - (b) that are substitutes like tea or coffee.
 - (c) that are normal goods like beef or chicken.
 - (d) that are inferior goods like bread or matches.

- (8) In the diagram given below the supply curve has shifted to the left from S1 to S2 because:



- (a) the producer is earning a bigger profit.
 - (b) the government has imposed a specific tax.
 - (c) the producer has to pay an ad valorem tax.
 - (d) the producer is making a loss.
- (9) A change in price will bring about a change in demand (*ceteris paribus*) and cause the:
- (a) demand curve to shift to the right.
 - (b) demand curve to shift to the left.
 - (c) movement on the same demand curve.
 - (d) movement on the same supply curve.
- (10) In a perfectly competitive market, where there are many firms, the firm is a:
- (a) price maker.
 - (b) earns abnormal profits.
 - (c) price taker.
 - (d) earns supernormal profits.
- (11) Giffen goods are a special type of:
- (a) Normal goods.
 - (b) Inferior goods.
 - (c) Articles of ostentation.
 - (d) Speculative goods.
- (12) The kinked demand curve is a unique feature of a:
- (a) Perfect market.
 - (b) monopoly.
 - (c) oligopoly.
 - (d) Monopolistic competition.
- (13) A chocolate firm buys a cocoa plantation, it will be an example of:
- (a) Horizontal integration.
 - (b) Vertical forward integration.
 - (c) Vertical backward integration.
 - (d) Lateral integration.
- (14) A popular measurement of economic growth is:
- (a) Rate of population growth
 - (b) Per capita income
 - (c) Rate of unemployment
 - (d) The death rate

- (15) A budget deficit occurs, when the:
- (a) Import expenditure is more than export earnings.
 - (b) Government borrowings are high.
 - (c) Government expenditure is more than the government revenue.
 - (d) Government is in debt to the world bank.
- (16) The bank that has the sole monopoly of the note issue is the:
- (a) Commercial Bank
 - (b) Central Bank
 - (c) Savings Bank
 - (d) Mortgage Bank
- (17) Inflation is caused by an excessive growth of the money supply as explained by the:
- (a) Keynesian
 - (b) Classical economists
 - (c) Neo-classical economists
 - (d) Monetarists
- (18) Market expansion will take place if:
- (a) Highways are built
 - (b) People are living comfortably
 - (c) Children have adequate schooling
 - (d) People have adequate health care
- (19) When a country receives profits and dividends where will it be shown in the balance of payments?
- (a) Goods account
 - (b) Financial account
 - (c) Services account
 - (d) Income account
- (20) A deficit or a surplus will only be shown in the:
- (a) Balance of payment account.
 - (b) Current account.
 - (c) Capital account.
 - (d) Financial account.
- (21) Income distribution in a country can be illustrated in a:
- (a) Production Possibility Curve (PPC).
 - (b) Lorenz Curve.
 - (c) Laffer Curve.
 - (d) Philips Curve.
- (22) There are injections and leakages to an economy. Where will Foreign Direct Investments (FDI) be included?
- (a) Injections
 - (b) Leakages
 - (c) Current account
 - (d) Income account
- (23) What brings about the difference between Gross Domestic Product (GDP) and Gross National Product (GNP) of an economy?
- (a) Taxes and subsidies
 - (b) Depreciation
 - (c) Net property income from abroad
 - (d) Trade

- (24) Privatization and de-regulation are significant policies according to:
- (a) Keynesian policies.
 - (b) Supply side policies.
 - (c) Demand side policies.
 - (d) Classical economies.
- (25) To get real per capita income:
- (a) GDP must be divided by the population.
 - (b) GNP must be divided by the population.
 - (c) Real GNP must be divided by the mid-year population.
 - (d) Real GNP must be divided by the current price index.
- (26) It is useful to have injections into an economy, because it will create:
- (a) A surge of employment opportunities.
 - (b) An increase in aggregate demand.
 - (c) An upward multiplier process.
 - (d) A downward multiplier process.
- (27) To get out of a recession, what policies are described to be better and which were followed in the US in 2009?
- (a) Supply-side policies.
 - (b) Demand-side policies.
 - (c) Monetary policy.
 - (d) Exchange rate policy.
- (28) BRIC countries are:
- (a) Burma, Russia, Indonesia and China
 - (b) Brazil, Russia, India and China
 - (c) Bangkok, Rumania, India and China
 - (d) Brazil, Rangoon, India and China
- (29) The comparative cost theory shows how:
- (a) developing countries specialize in technology.
 - (b) developed countries specialize in capital intensive methods.
 - (c) developing countries provide the markets.
 - (d) developed countries provide raw materials.
- (30) In a floating exchange rate system that:
- (a) there is an automatic depreciation or appreciation of the exchange rate.
 - (b) there can be devaluation.
 - (c) there can be revaluation.
 - (d) a deficit in the payments account.
- (31) Sri Lanka has an exchange rate system which can be called a:
- (a) Fixed exchange rate system.
 - (b) Floating exchange rate system.
 - (c) Gold standard.
 - (d) Pegged exchange rate system.
- (32) The main injections into the circular flow of income are:
- (a) Savings, taxes and imports.
 - (b) Savings, exports and investments.
 - (c) Government expenditure, investments and exports.
 - (d) Government expenditure, imports and taxes.

- (33) Which of the following characteristics that developing economies display?
- (a) Full employment, high per capita income.
 - (b) Unemployment, low population.
 - (c) Unemployment, low per capita income.
 - (d) High population, full employment.
- (34) Hambantota port and the Mattala Airport have been built to make that region the hub of South East Asia. But the authorities have failed to consider:
- (a) Will there be market failures?
 - (b) Will there be enough business?
 - (c) Will they earn profits to justify their expenditure?
 - (d) Will they become total losers?
- (35) Which of the following are considered negative externalities?
- (i) Destruction of forests and vegetation.
 - (ii) Destruction and chasing away of wild life and birds.
 - (iii) The huge amount of money spent.
 - (iv) Soil erosion pollution.
- (a) (iii) only
 - (b) (ii) and (iii) only
 - (c) (i), (ii) and (iv) only
 - (d) (ii), (iii) and (iv) only

Section B: Business Finance Fundamentals

- (36) Finance Manager could influence key areas of a business to maximize shareholder wealth. What are they?
- (i) Dividend Policies
 - (ii) Working Capital Management
 - (iii) Investment Strategies
 - (iv) Capital Structure
- (a) (i) and (ii) only
 - (b) (ii), (iii) and (iv) only
 - (c) (iii) and (iv) only
 - (d) All of the above
- (37) Economic value added is calculated
- (a) Company's market value - Invested capital
 - (b) Company's market value / Invested capital
 - (c) Net Operating Profit after Tax – (Weighted Average Cost of Capital × Capital)
 - (d) Net Operating Profit after Tax – (Weighted Average Cost of Capital / Capital)
- (38) Agency problem arises due to the;
- (a) relationship between shareholders and the management.
 - (b) conflict of interest between shareholders and prospective investors.
 - (c) agents work to their self-interest with the knowledge of the principals.
 - (d) conflict between principal and the agent.
- (39) Which of the following statement is true?
- (i) Proxy fight is a mechanism through which unhappy shareholders can act to replace the existing management.
 - (ii) Proxy vote is a vote given by one individual as the authorized representative of the management.
 - (iii) Inefficiently managed companies are not prone to takeovers/ acquisitions.
 - (iv) In wealth maximization, Finance Manager should maximize the present value of all the expected cash inflows of the firm.

- (a) (i) only
 - (b) (ii) and (iii) only
 - (c) (i), (ii) and (iii) only
 - (d) (iii) and (iv) only
- (40) Central Bank of Sri Lanka performs agency functions. What are they?
- (i) Currency Issue
 - (ii) Regional Development
 - (iii) Foreign Exchange Management
 - (iv) Financial Intelligence
- (a) (i), (iii) and (iv) only
 - (b) (iii) and (iv) only
 - (c) (ii), (iii) and (iv) only
 - (d) All of the above
- (41) Which of the following statements are **false**?
- (i) Treasury bills are government securities with zero coupon.
 - (ii) Commercial papers are usually sold at a discount, but some are interest bearing.
 - (iii) Corporate bond market provide short term funding of private expenditure.
 - (iv) Corporate bonds backed by specific assets are called debentures.
- (a) (i) and (ii) only
 - (b) (iii) and (iv) only
 - (c) (ii), (iii) and (iv) only
 - (d) All of the above
- (42) Seek Plc has issued preference shares with an annual dividend of Rs.6.50 per annum forever. Amal, an investor requires a 13% rate of return from this type of investments and he wishes to know how much would he pay for a share now?
- (a) Rs.78/-
 - (b) Rs.84.50
 - (c) Rs.50/-
 - (d) Rs.34.50
- (43) What is the difference between 'Primary and Secondary markets'?
- (a) Primary market is to trade existing securities and secondary market is for new issues of shares.
 - (b) Primary market is for short term investments and secondary market is for long –term investments.
 - (c) Secondary market is to trade existing securities and primary market is for new issues of shares.
 - (d) Primary market is to issue new debt securities and secondary market is to issue new securities.
- (44) Which of the statement given below is **true**?
- (a) Standard deviation does not measures the risk.
 - (b) Standard deviation measures the deviation from the expected or average value.
 - (c) Standard deviation considers the Discounted Cash flow (DCF) into account.
 - (d) Coefficient of variation cannot be used when the expected returns on two shares are not the same.
- (45) Anticipated rate of inflation is 6% and the real rate of interest is expected to be 2%. What is the nominal interest rate?
- (a) 9.65%
 - (b) 3.77%
 - (c) 8.12%
 - (d) 10.45%

- (46) Which of the following statement is **false**?
- (a) Under perfect positive correlation no risk reduction could be achieved.
 - (b) Under Zero correlation diversification would reduce the risk of a portfolio below the weighted average of the total risk of the individual securities.
 - (c) Under perfect negative correlation portfolio risk would come down even to the level of zero.
 - (d) All of the above statements.
- (47) Which of the following statement is **true**?
- (a) Objective of diversification of investment is to reduce exposure to risk.
 - (b) Risk averse investor will not diversify their investment portfolios.
 - (c) Diversification reduces only the downside potential of the performance of investments.
 - (d) Unsystematic risk can be diversified away.
- (48) Identify two assumptions used for CAPM model.
- (i) Measuring most appropriate estimate of the risk free rate.
 - (ii) There are no taxes.
 - (iii) There are no brokerage charges for buying and selling shares.
 - (iv) Determining the best estimate of an asset's beta.
- (a) (ii) & (iv) only.
 - (b) (ii) & (iii) only.
 - (c) (iii) & (iv) only.
 - (d) (i) & (ii) only.
- (49) Which of the following statement is correct?
- (a) Return required for any share is equal to the risk –free rate.
 - (b) A shares specific risk cannot be eliminated by diversification.
 - (c) Expected return on an investment is the mean value of the probability distribution of its possible returns.
 - (d) Share with a high beta factor is less volatile than an average share and share with a low beta factor is more volatile than an average share.
- (50) Which of the following statement is correct?
- (i) A share plotting above the Security Market Line is overvalued.
 - (ii) Total risk of a share determines its contribution to the risk of a well-diversified portfolio.
 - (iii) Security Market Line shows the relationship between shares' risks and rates of return.
 - (iv) Beta of a portfolio is the simple average of the beta factors of the individual shares in the portfolio.
- (a) (iii) only.
 - (b) (i) only.
 - (c) (iv) only.
 - (d) (ii) only.

(50 × 2 Marks = Total 100 Marks)

End of Question Paper
