

**Section One**  
**Answer ALL questions**  
**Multiple choice questions**  
**(Each question is worth two marks)**

**First Section:**

- 1- Which of the following provides the best definition of a firm's primary financial objective?
  - A. To achieve long-term growth in earnings.
  - B. To maximise the level of annual Dividends.
  - C. To maximise the wealth of its Ordinary shareholders.
  - D. To maximise the level of annual profits.
- 2- The principal objectives of macroeconomic policy include which of the following?
  - 1- Full employment of resources
  - 2- Price stability
  - 3- Economic growth
  - 4- Balancing the government budget
  - A. 1 and 2 only
  - B. 1 and 3 only
  - C. 1 , 2 and 3 only
  - D. 1 , 2 , 3 and 4
- 3- Which of the following is not a key role played by money markets?
  - A. Providing short- term trade liquidity to companies, banks and the public sector.
  - B. Providing short term trade finance.
  - C. Allowing an organisation to manage its exposure to foreign currency risk and interest rate risk.
  - D. Dealing in long-term funds and transactions.
- 4- Which of the following would not be a key aspect of a company accounts receivable credit policy?
  - A. Assessing credit worthiness.
  - B. Checking credit limits.
  - C. Invoicing promptly and collecting overdue debts.
  - D. Delaying payments to obtain "Free" sources of finance.
- 5- The main purpose of corporate governance is?
  - A. To separate ownership and management control of organisations.
  - B. To maximise shareholder value.
  - C. To facilitate effective management of organisation and to make organisation more visibly accountable to a wider range of stakeholders.
  - D. To ensure that regulatory frameworks are adhered to.

- 6- The agency problem is a driving force behind the growing importance attached to sound corporate governance.  
In this context, who are the agents?
- Customers.
  - Shareholders.
  - Managers.
  - External auditors.
- 7- Which of the following statements about the accounting rate of return (ARR) method and the payback method is true?
- Both methods are affected by changes in the cost of capital.
  - The ARR does not take account of returns over the entire life of the project.
  - The payback method is based on the project's cash flows.
  - A requirement for an early payback can reduce a company's liquidity.
- 8- The equity shares of N plc have a beta value of 0.80. The risk free rate of return is 6% and the market risk premium is 4%. Corporation tax is 30%  
What is the required return on the shares of N plc?
- 7.7%
  - 8.8%
  - 9.2%
  - 13.1%
- 9- There are two main types of financial markets: capital and money markets and within each of these are primary and secondary markets.  
Which of the following statements is false?
- Primary market allows the realisation of investments before their maturity date by selling them to other investors.
  - Primary market deals in new issues of loan able funds.
  - Capital market consists of stock markets for alcovs and loan bond markets.
  - Money market provides short term debt finance and investment.
- 10- Which of the following statements in part of the traditional theory of gearing?
- There must be taxes.
  - There must exist a minimum WACC.
  - Cost of debt increases as gearing decreases.
  - Cost of equity increase as gearing decreases.
- 11- Which of the following statements concerning a right issue are correct?
- The new shares are normally issued at a discount to the existing price.
  - There will be no change in shareholders wealth.
  - The main purpose of a right issue is raise finance.
  - The new shares must be issued to the existing shareholders.
- (1) , (2) , (3) only
  - (2) , (3) , (4) only
  - (1) , (3) , (4) only
  - (1) , (2) , (4) only

- 12- Which of the following statements concerning a bonus issue is correct?
- A. The new shares are issued at par value.
  - B. Earnings per share are expected to rise.
  - C. The main purpose of a bonus issue is to raise finance.
  - D. The bonus shares do not carry voting rights.
- 13- Which of the following is the least likely to be a reason for seeking a stock market listing?
- A. Enhancement of the company's image.
  - B. Transfer of capital to other users.
  - C. Improving existing owner's control over the business.
  - D. Access to wider pool of finance.
- 14- Company (G) has an accounts receivable turnover of 10.5 times, an inventory turnover of 4 times and payables turnover of 8 times.  
What is (G's) cash operating cycle (assume 365 days in a year)?
- A. 80.83 days.
  - B. 6.5 days.
  - C. 22.5 days.
  - D. 171.64 days.
- 15- In relation to finance lease, which of the following statements is not true?
- A. The lease agreement cannot be cancelled.
  - B. One lease exists for the whole of useful life of the asset.
  - C. The lessor retains the risk and rewards of ownership.
  - D. The lessee is responsible for repairs and maintenance.
- 16- The difference between the price of a future contract and the spot price on a given date is known as?
- A. The initial margin.
  - B. Basis.
  - C. Hedge efficiency.
  - D. The premium.
- 17- Which of the following action is most likely to increase shareholders wealth?
- A. The average cost of capital is increased by a recent financing decision.
  - B. The firm's cash operating cycle becomes longer.
  - C. The board of directors decides to invest in a project with a quick payback period.
  - D. The annual report declares full compliance with corporate governance code.
- 18- Which of the following statements is correct?
- A. Direct taxes are levied on one set of individuals or organisations but may be partly or wholly passed to others and are largely related to consumption not income.
  - B. Indirect taxes are levied on income receivers whether they are individuals or organisations.
  - C. A balanced budget occurs when total expenditure is matched by total taxation.
  - D. A deficit budget occurs when total expenditure is less than total taxation income.

**19- Which of the following statement is correct?**

**Scrp issue with perfect information will lead to:**

- A. Decrease earning per share.
- B. Decrease the debt/equity ratio of the company.
- C. Increases individual shareholder wealth.
- D. Increases the market price of a share.

**20- Which of the following statements is correct?**

- A. Profit maximization results in shareholders wealth maximization.
- B. Divorce of ownership and control can lead to agency costs.
- C. Maximising earnings per share results in shareholders wealth maximization.
- D. Increasing market share will lead to increased shareholders wealth.

**(Total 40 marks)**

**Second Section**  
**Answer all questions in this section**

**Question one:**

Zad Co is an e-business which trades solely over the internet. In the last year the company had sales of \$15 million. All sales were on 30 days' credit to commercial customers.

Extracts from the company's most recent statement of financial position relating to working capital are as follows:

	\$000
Trade receivables	2,466
Trade payables	2,220
Overdraft	3,000

In order to encourage customers to pay on time, Zad Co proposes introducing an early settlement discount of 1% for payment within 30 days, while increasing its normal credit period to 45 days. It is expected that, on average, 50% of customers will take the discount and pay within 30 days, 30% of customers will pay after 45 days, and 20% of customer will not change their current paying behaviour.

Zad Co currently orders 15,000 units per month of product Z, demand for which is constant. There is only one supplier of product Z and the cost of product Z purchases over the last year was \$540,000. The supplier has offered a 2% discount for orders of product Z of 30,000 units or more. Each order costs Zad Co \$150 to place and the holding cost is 24 cents per unit per year.

**Required:**

**A- Calculate the net benefit or cost of the proposed changes in trade receivables policy and comment on your findings.**

(6 marks)

**B- Calculate whether the bulk purchase discount offered by the supplier is financially acceptable and comment on the assumptions made by your calculation.**

(6 marks)

**C- Identify and discuss the factors to be considered in determining the optimum level of cash to be held by a company.**

(3 marks)

(Total: 15 marks)

## **Question two:**

Kricab Co is a division of Aboualella trading group which requires each of its divisions to achieve a rate of return on capital employed of at least 10% pa. for this purpose, capital employed is defined as fixed capital and investment in inventories. This rate of return is also applied as a hurdle rate for new investment projects. Divisions have limited borrowing powers and all capital projects are centrally funded.

The following is an extract from Kricab's divisional accounts:

Balance sheet for year ended 31 Dec 2014:

	\$m
Sales revenue	120
Cost of sales	<u>(100)</u>
Operating profit	<u>20</u>

### **Assets employed as at 31 December 2014:**

	\$m	\$m
Non-current assets (NBV)		75
Current assets (including inventories \$25m))	45	
Current liabilities	<u>(32)</u>	
		<u>13</u>
Net capital employed		<u>88</u>

Kricab's production engineers wish to invest in a new computer-controlled machine equipment cost is \$14m. The residual value is expected to be \$2m after four years operation, when the equipment will be shipped to a customer in South Africa.

The new machine is capable of improving the quality of the existing product and also of producing a higher volume. The firm's marketing team is confident of selling the increased volume by extending the credit period.

The expected additional sales are:

Year1	2,000,000 units
Year2	1,800,000 units
Year3	1,600,000 units
Year4	1,600,000 units

Sales volume is expected to fall over time due to emerging competitive pressures. Competition will also necessitate a reduction in price by \$0.50 each year from the \$5 per unit proposed in the first year. Operating costs are expected to be steady at \$1 per unit, and allocation of overheads (none of which are affected by the new project) by the central finance department is set at \$0.75 per unit.

Higher production levels will require additional investment in inventories of \$0.5m, which would be held at this level until the final stages of operation of the project. Customers at present settle account after 90 days on average.

### **Required:**

**A- Determine whether the proposed capital investment is attractive to Kricab, using the average rate of return on capital method, as defined as average profit-to-average capital employed, ignoring receivables and payables taxes.**

(10 marks)

**B- (i) Suggest three problems which arise with the use of the average return method for appraising new investment.**

(3 marks)

**(ii) In view of the problems associated with the ARR method, why do companies continue to use it in project appraisal?**

(2 marks)

(Total: 15 marks)

### **Question three:**

The following are summary financial statements for international supplies Co.:

#### **Statement of financial position information:**

	<b>2004</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
Non-current assets	115	410
Current assets	<u>650</u>	<u>1,000</u>
Total assets	<u>765</u>	<u>1,410</u>
Capital and reserves	210	<u>270</u>
Non-current liabilities	42	158
Current liabilities	<u>513</u>	<u>982</u>
Total equity and liabilities	<u>765</u>	<u>1,410</u>

#### **Income statement:**

Sales revenue	1,200	3,010
Cost of sales, expenses and interest	<u>(1,102)</u>	<u>(2,860)</u>
Profit before tax	98	150
Tax and distributions	<u>(33)</u>	<u>(133)</u>
Retained earnings	<u>65</u>	<u>17</u>

Notes: Cost of sales was \$530,000 for 2004 and \$1,330,000 for 2009.

Trade receivables are 50% of current assets, trade payables 25% of current liabilities for both years.

#### **Required:**

You are a consultant advising international supplies Co. using suitable financial ratios, and paying particular attention to growth and liquidity, write a report on the significant change faced by the company since 2004 to 2009.

The report should be comment on the capacity of the company to continue trading, together with any other factors considered appropriate. An appendix to the report should be used to outline your calculations.

(15 marks)

**(Total: 15 marks)**

### **Question four:**

Two neighboring countries have chosen to organize their electricity supply in different ways.

In country A, governmental electricity supplies are provided by a nationalized industry. In country B electricity supplies are provided by a number of private sector companies.

#### **Required**

**A- Explain how the objectives of the nationalized industry in country A might differ from those private sector companies in county B.**

(8 marks)

**B- Briefly discuss whether investment planning and appraisal techniques are likely to differ in the nationalized (or governmental) industry and private sector companies.**

(7 marks)

**(Total: 15 marks)**

“End of questions paper”