

CPA PART II SECTION 3

CS PART II SECTION 3

CCP PART II SECTION 3

FINANCIAL MANAGEMENT

WEDNESDAY: 19 May 2021.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Explain four categories of capital investment projects.

(4 marks)

(b) Nyakati Limited intends to invest in a four-year mini project whose initial outlay is Sh.32,000,000. The project is expected to generate the following cash flows at the end of each year:

Year Cash flows (Sh. "000")

1 12.000 2 15,000 , LOOK

4 6,000

The cost of capital is 12%.

Ignore taxation.

Required:

Advise the management on whether to undertake the project using the internal rate of return (IRR) method. (4 marks)

(c) (i) Describe four reasons for valuing financial assets.

(4 marks)

(ii) Hazi Limited expects to any a dividend of Sh.5.40 per share in one year's time.

Additional information:

- 1. The company's dividend payout ratio is 60%.
- 2. The shareholders' required rate of return on equity is 15%.
- 3. Dividends have been growing at a constant rate in perpetuity.
- 4. The company's shares are currently trading at Sh.64.50 per share at the Securities Exchange.

Required:

Advise an investor who holds shares in Hazi Limited whether to buy more shares or to sell the shares.

(4 marks)

(d) Propose four factors to consider when choosing between long term loan capital and ordinary share capital as a source of finance. (4 marks)

(Total: 20 marks)

OUESTION TWO

(a) The role of a finance manager in a modern organisation is pervasive in all the activities of any business firm.

In light of the above statement, highlight four roles of a finance manager in an organisation.

(4 marks)

(b) Describe four factors that could affect a company's dividend policy.

(4 marks)

(c). Examine five roles of the Capital Markets Authority (CMA) or a similar institution in your country.

(5 marks)

(d) Eliud Mwaniki is considering investing in Security A and Security B in equal proportions. The following forecasts have been provided:

State	Probability	Returns (%)						
		Security A	Security B					
Recession	0.30	12	6					
Stable	0.40	15	7.5					
Expansion	0.30	10	5					

Required:

(i) Expected return for the portfolio.

(4 marks)

(ii) Standard deviation for security A.

(3 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain the following concepts in the context of Islamic Finance:

(i)	Takaful.		(2 marks)
(ii)	Riba.	(5.0)	(2 marks)
(iii)	Mudarabah financing.	was a second	(2 marks)
(iv)	Murabahah financing.	asily	(2 marks)

(b) The following are extracts from Riziki Ltd.'s statement of financial position as at 30 March 2021:

Book values	Sh. "Milli	on"
Ordinary shares (Sh.50 par value)	9,600	
6% preference shares (Sh.100 par value)	7,900	
4.8% debenture (Sh.100 par value)	_6,400	
	23,900	

Additional information:

- 1. The ordinary shares of Riziki Ltd. are currently quoted at Sh.72 per share (cum dividend).
- 2. The most recently declared divident was Sh.2 per share and will be paid in a years' time. The dividend growth rate is 5%.
- 3. The dividend will continue to grow at the rate of 5% into the foreseeable future.
- 4. The preference shares currently trade at Sh. 80 per share. There is no preference dividend owing at this point in time.
- 5. The debentures are incideemable and currently trade at 120% of their nominal value.
- 6. The corporation tax rate is 30%.

Required:

(i) The cost of capital for each source of finance for Riziki Ltd.

(4 marks)

(ii) The weighted average cost of capital (WACC) for Riziki Ltd.

(4 marks)

(c) ABC Limited's current annual sales are Sh.1.8 million with a cost of sales of 80% and bad debts average 1% of total sales.

The current debt collection period is one month and the management considers that if credit terms were eased (Option A), the effects would be as follows:

	Present Policy	Option A
Additional sales (%)	<u>-</u>	25%
Average collection period	l month	2 months
Bad debts (% of sales)	1%	3%

Additional information:

- 1. The company requires a 20% return on its investments.
- 2. The cost of sales are 75% variable and 25% fixed.

Required:

Advise the management on whether or not to ease the credit terms.

(4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Outline four factors that could hinder the success of a rights issue.

(4 marks)

(b) Alpha Ltd. intends to introduce a new product, branded "Q" into the market. This will require an initial investment in machinery costing Sh.4,800,000. The machinery will be installed at a cost of Sh.200,000 and is estimated to have a useful life of four years and a salvage value of Sh.800,000.

Additional information:

- 1. Capital allowance will be provided on the machinery on a reducing balance basis.
- 2. Annual profits from the sale of Product "Q" will amount to Sh.1,920,000 before deducting depreciation on machinery.
- 3. An investment in working capital amounting to \$h.340,000 will be required commencement of the project.
- 4. The firm pays corporation tax at the rate of 30%.
- 5. Cost of capital is 15% per annum.

Required:

(i) The annual depreciation rate. (3 marks)

(ii) The total initial cash outlay. (2 marks)

(iii) The total terminal cash flows. (2 marks)

(iv) The annual net operating cash flows. (5 marks)

(v) Using the net present value approach, advise the management of this company on the suitability or otherwise of the project. (4 marks)

(Total: 20 marks)

QUESTION FIVE

- Discuss four factors that a firm should consider in formulating a working capital policy on the management of trade receivables. (4 marks)
- (b) Phoenix Ltd. is considering amendments to its current inventory management policy.

The following information relates to the proposed ordering policy:

- 1. The current policy is to order 200,000 units when the inventory level falls to 70,000 units.
- 2. Forecast demand to meet production requirements during the next year is 1,250,000 units.
- 3. The cost of placing and processing an order is Sh.500, while the cost of holding a unit is Sh.1 per unit per year. Both costs are expected to be constant during the next year.
- 4. Orders are received two weeks after being placed with the supplier.
- 5. Assume one year has 50 weeks.

Required:

(i) The cost of the current ordering policy. (3 marks)

(ii) Determine the savings that could be made by using the economic order quantity (EOQ) model. (3 marks)

The following data was extracted from the financial statements of Mbuni Ltd. for the year ended 31 December 2020: (c)

Statement of financial position as at 31 December 2020:

(d)

State	ment of financial pos	ition as at 31 Dece	mber 2020:		
		Sh."000"		Sh."000"	
Cash		?	Notes payable	100,000	
Accou	ınts receivable	?	Long term debt	?	
Plant	and equipment	?	Ordinary shares	100,000	
	• •		Retained earnings	100,000	
Total	Assets	?	Total Liabilities	?	
Addit	ional information:				
•	Long term debt to equ	ity ratio	0.5 to 1.0		
• ′	Total assets turnover		2.5 times		
• ,	Average collection per	riod (Assume 360 d	ays in a year		
8	and that all sales are o	n credit)	18 days		
	nventory turnover	•			
	Acid test ratio		l to l		
	Gross profit margin		0.1	on	
Requi	red:			a's.	
	nine the following:		.*	200	
(i)	Long term debt.			astipar	(1 mark)
(ii)	Total liabilities and	shareholders' equit	ty.	50	(1 mark)
(iii)	Cost of sales.	S ection 1	1.treet		(1 mark)
(iv)	Inventory.		Sun,		(1 mark)
(v)	Accounts receivabl	e.	9 times 1 to 1 0.1 Exp. Sition of Mbuni Ltd. for the v	;	(1 mark)
(vi)	Cash.		a contra		(1 mark)
(vii)	Complete the states figures obtained in			ear ended 31 Dec	ember 2020 using the (2 marks)
Ork L maturi	imited has an outstan	ding Sh.23 million f	ace value bond with a 14% c	oupon rate and 3	years remaining until
Interes	t payments are made	emi-annually.			
Requi	red:				i i
		ning the nominal an	nual required rate of return is 1	12%.	(2 marks)

(Total: 20 marks)

Present Value of 1 Received at the End of *n* Periods:

PVIF =	$1/(1+r)^{n} =$	= (l+·r)-"
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Period	1%	2%	3%	4%	5%	6%	7%	D#/		4.00/										
								8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	9259	.9174	.9091	.8929	8772	.8696	.8621	.8475	.8333	.8065	.7813	.7576	.735
2 3	.9803 .9706	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	5739	.540
4	.9610	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	4348	.39
5		.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.292
3	. 9 515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	5194	.4972	.4761	.4371	.4019	.3411	.2910	2495	.21
6	.9420	.8880	.8375	.7903	.7462	.7050	:6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	2274	.1890	.15
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	3996	.3759	.3538	.3139	.2791	.2218	1776	.1432	.13
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.08
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.06
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	.04
, 11	.8963	8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	0470	0.7
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	1869	1685	.1372	.1122	.0757	.0517	.0472 .0357	.03
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0357	.02
14	.8700	.7579	.6611	.5775	,5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.01
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	.00
16	8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	0541	0220	0400	2442	
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	1.	.0320 .0258	.0193	.0118	.00
18	.8360	.7002	.5574	.4936	.4155	.3503	.2959	2502	.2120	.1799	.1300	.0946	.0808	.0691	.0500	.0376	.0208	.0150	.0089	.00
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703		C0431	.0376	.0168	.0118	.0068	.00
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584		.1784	.1486	1037	.0728	.0611		.0365	.0261	.0135	.0092 .0072	.0051	.00
25	7700	COOF	4770											*O _(0,)						, 0
	7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	0378	.0304	-)	.0160	.0105	.0046	.0021	.0010	00
	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.01510	.0116	.0070	.0042	.0016	.0006	.0002	.00
	.6717	.4529	.3066	.2083	.1420	.0972	.0668	0460	.0318	0221	.0107	.0053	0037	.0026	.0013	.0007	.0002	.0001		
	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	2009	.0006	.0003	.0001				٠.
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.000	.0002	.0001		,	• '			

^{*} The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:
$$PVIF_{rt} = \sum_{j=1}^{n} \frac{1}{(1+r)^{j}} = \frac{1}{(1+r)^{j}}$$

							16												
Dahmeura urmices of	1%	2%	3%	4%	5%	6%	2/ ⁷ %	8%	9%	10%	12%	14%	15%	16%	18%	20%	244		
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.0004					10%	20 /4	24%	28%	32%
2	1.9704	1.9416	1.9135	1.8861	1.8594	773	1.8080			0.9091		0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
3	2.9410	2.8839	2.8286			×/			2.5313	1.7355		1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
4	3.9020	3.8077	3.7171				3.3872			2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1,9813	1.8684	1.7663
5	4.8534	4.7135	4.5797					3.3121 3.9927	3.2397	3.1699	3.0373			2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
					دوستان	7.2124	4.1002	3.9921	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454		2.3452
6	5,7955	5.6014	5.4172	5 2421	5.0757	4.9173	4.7665	4 6000											
7	6.7282	6.4720				5.5824	5.3893		4.4859	4.3553		3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
8	7.6517	7.3255		6.7327		6.2098			5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	
9	8.5660	8.1622		7.4353			5.9713		5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3,4212	3.0758	2.7860
10	9.4713			8,1109	7.7217	6.8017	6.5152		5.9952		5.3282		4.7716	4.6065	4.3030	4.0310	3,5655	3.1842	
	0.1110	0.5020	0.5502	0,1103	1.1211	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819		2.9304
11	10 3676	9.7868	9 2526	B 7605	8.3064	7 0000													2.0004
12		10.5753				7.8869	7.4987	7.1390	6.8052			5.4527	5.2337	5.0286	4.6560	4.3271	3,7757	3.3351	2.9776
		11.3484			8.8633	8.3838	7.9427			6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3,8514	3.3868	3.0133
					9.3936	8.8527	8.3577		7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	
		12.1062				9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
13.	13.0031	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755			4.0013		3.0764
16	447470	40													-11.	1.5700	4.0013	3.4034	3.0764
17	14.7179	13.5///	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3 5000	
• •	13.3623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436		7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5026	_
18	16,3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122			
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0799	3.5294	3.1039
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136		6.6231	6.2593	5.9288	5.3527		4.0967	3.5386	3.1090
												3.4201	9.2000	3.3200	3.3321	4.8696	4.1103	3.5458	3 1129
25	22.0232	19.5235	17,4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5 4600	4 6 4 7 6	4 4 4 7 :		
30	25.8077	22.3965	19,6004	17.2920	15.3725	13,7648	12,4090	11.2578	10 2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9476		3.5640	3.1220
40	32.8347	27.3555	23.1148	19.7928	17.1591	15,0463	13.3317	11 9246	10 7574	9 7791	8.2438	7.1050	6.6418	6.2335			4.1601		3 1242
50	39.1961	31.4236	25,7298	21.4822	18.2559	15.7619	13.8007	12 2335	10 9617	9 91 4 8	0.2045	7.1327	6.6605		5.5482	4.9966	4.1659		3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9 9672	P 3240	7.1327		6.2463	5.5541	4.9395	4.1666	3.5714	
										0.0012	0.3240	1.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3 1250