



**JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY**

**SCHOOL OF MATHEMATICS AND ACTUARIAL SCIENCE**

**UNIVERSITY EXAMINATION FOR DEGREE OF BACHELOR OF SCIENCE**

**ACTUARIAL**

**4<sup>TH</sup> YEAR 1<sup>ST</sup> SEMESTER 2016/2017 ACADEMIC YEAR**

**REGULAR (MAIN)**

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**COURSE CODE: SAC 407**

**COURSE TITLE: PRINCIPLES OF FINANCIAL MANAGEMENT**

**EXAM VENUE:**

**STREAM: (BSc. Actuarial)**

**DATE:**

**EXAM SESSION:**

**TIME: 2.00 HOURS**

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**Instructions:**

- 1. Answer question 1 (Compulsory) and ANY other 2 questions**
- 2. Candidates are advised not to write on the question paper.**
- 3. Candidates must hand in their answer booklets to the invigilator while in the examination room.**

## QUESTION ONE

- a) (i) Explain what is meant by the term “associate company”. [2 marks]  
(ii) Explain how associates are treated on consolidation. [5 marks]
- b) (i) Identify two accounting concepts.  
(ii) Explain how each assists in the preparation of financial statements. [5 marks]
- c) Simon established an actuarial practice several years ago. The business has been successful. One of Simon’s longest-serving actuaries has started to look for alternative employment and Simon is considering offering her a partnership in the practice.  
Discuss the implications for Simon of making this employee a partner. [4 marks]
- d) Give and explain five characteristics of a good tax. [5 marks]
- e) Explain how market forces would discipline the managers of a quoted company if they were not performing in a satisfactory manner. [5 marks]
- f) Give five roles of a financial manager in an organization? [4 marks]

## QUESTION TWO

- a) Explain why it may not be appropriate for management to choose the least expensive source when raising fresh finance. [5 marks]
- b) Describe the process by which a holding company will construct a set of consolidated financial statements. [5 marks]
- c) Explain how there could be a conflict between the interests of directors and shareholders over the raising of additional finance, where the directors would prefer the company to issue equity and the shareholders would prefer the company to borrow. [6 marks]
- d) Describe the purpose of a cash flow statement. [4 marks]

## QUESTION THREE

- a) Assume that the personal allowance is 5000 and that the marginal tax rates are 20% for the first 40000 and 40% for taxable income above this. Assuming there are no adjustments to total income, how much tax will a single person earning 50000% pay? [4 marks]
- b) Discuss the main functions of financial institutions? [5 marks]
- c) A company’s directors are considering issuing redeemable preference shares as an alternative to borrowing. They believe that the company is too close to its borrowing capacity and so equity is preferable to debt. Outline the implications for the company of issuing redeemable preference shares in these circumstances. [6 marks]

- d) Many large companies issue debentures as a means of raising long term finance. These are often quoted on the stock exchange. Describe the risks associated with investing in such debentures. [5 marks]

#### QUESTION FOUR

- a) The following two projects A and B require an investment of Kshs. 200,000 each. The income return after taxes for the projects are as follows

Year	A(Kshs:)	B(Kshs:)
1	80000	20000
2	80000	40000
3	40000	40000
4	20000	40000
5	-	60000
6	-	60000

Using the following criteria, determine which of the projects is preferable.

- i. 8 years payback.
  - ii. Net present value approach.
  - iii. Profitability index if the company's rate of return is 10%. [7 marks]
- b) Briefly discuss the FOUR basic types of taxation. [8 marks]
- c) Describe the role of the external auditor in financial reporting. [5 marks]

#### QUESTION FIVE

Harris is a manufacturing company that has recently developed a new product that is likely to be a major commercial success. Harris must raise £8m in order to put this product into production. The company's most recent statement of financial position is as follows:

Harris Statement of Financial Position as at 31<sup>st</sup> March 2011 in millions

##### Assets

Property, plant and equipment	22
Current assets	3
	25

##### Equity

Share capital	8
Retained earnings	5
	11

##### Liabilities

Non-current liabilities	11
Current liabilities	<u>1</u>
	12

Property, plant and equipment comprises £10m of land and buildings and £12m of manufacturing equipment. All of Harris' non-current assets are valued at cost less depreciation.

Harris had its land and buildings revalued as at the year end. The valuer's report indicated that the buildings were of a specialized nature, but that the property could nevertheless be marketed for approximately £17m.

Non-current liabilities comprise a bank loan that has a covenant in place that forbids Harris from taking out further borrowings that would increase the company's gearing ratio (measured as debt over debt plus equity) to more than 50%.

- a) Explain why a bank might be interested in a borrower's gearing ratio. [4 marks]
- b) Calculate Harris' gearing ratio under each of the following conditions;
  - Using the unadjusted figures according to the most recent statement of financial position.
  - assuming that Harris had borrowed the £8m required to fund the expansion and that the company had revalued its land and buildings in accordance with the valuer's report. [6 marks]
- c) Explain why the directors of limited companies are likely to take great care when deciding whether to revalue property. [5 marks]
- d) Explain why the shareholders might prefer to have the property revalued rather than shown at cost less depreciation. [5 marks]