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University Examinations 2013/2014

STAGE FIVE EXAMINATION FOR THE DIPLOMA IN INFORMATION TECHNOLOGY

CED 0305: FINANCIAL MANAGEMENT

DATE: DECEMBER 2013 **TIME: 1½ HOURS**

INSTRUCTIONS: *Answer question* ***One*** *and any other* ***Two.***

QUESTION ONE (30 MARKS)

a) Explain the functions of a Finance Manager. (6 marks)

b) Set out ways in which capital market authority ensures protection of Investors interest. (6 marks)

c) Identify the fundamental features that distinguish ordinary share capital and debt finance. (8 marks)

d) Discuss the assumptions of weighed average cost of capital. (10 marks)

QUESTION TWO (20 MARKS)

a) What are the limitations of financial ratios? (8 marks)

b) A Company's Capital structure is as follows:

	Kshs. (M)
10 million Kshs./ordinary shares	10
Reserves	4
13% Loan stock 20 x4	7
	21

The loan stock is redeemable at par in 20 x 4. Current market prices for the company's securities are as follows:

Kshs./ordinary shares	280 cents
13% Loan stock 20 x4	Kshs.100

The company is paying corporation tax at a rate of 28%. The cost of the company's equity capital has been estimated at 12% per annum.

i) What is the company's per annum weighted averaged cost of capital for capital investment purposes? (12 marks)

QUESTION THREE (20 MARKS)

a) Duncan bought a share 15 years ago for Kshs.10. It is now selling for Kshs.27.60. What is the compound annual rate in the price of the share? (8 marks)

b) Within the context of financial management, explain and give solutions to the conflicts that might exist in the relationship between:

   i) Shareholders and Managers. (6 marks)

   ii) Shareholders and Creditors. (6 marks)

QUESTION FOUR (20 MARKS)

1. Discuss the factors that determine the working capital needs of a firm. (8 marks)
2. The cashflow of two mutually exclosure projects is as under:

Year	Project A (Kshs.000)	Project B (Kshs.000)
0	(40,000)	(20,000)
1	13,000	7,000
2	8,000	13,000
3	14,000	12,000
4	12,000	
5	11,000	
6	15,000	

Required:

i) Estimate the Net Present Value (NPV) of Project A and B using 12% as the cost of capital. (5 marks)

ii) Estimate the Accounting Rate of Return (ARR) of Project A and B. (5 marks)

iii) Why is there a conflict in the project choice by using NPV and ARR criterion. (2 marks)

QUESTION FIVE (20 MARKS)

a) Define cost of capital and explain its significance in financial decision making. (8 marks)

b) Meru Limited company is preparing its cash budget for the six months of 2013. The sales data for the year 2012 and sales forecast for January to July are:

Actual Sales 2012	
Month	**Kshs.**
November	350,000
December	400,000
Sales forecast 2013	
Month	**Kshs.**
January	450,000
February	500,000
March	700,000
April	800,000
May	600,000
June	450,000
July	800,000

Additional information:

1. All sales are made on credit with 70% collected in the first month following the sales and 30% in the second month.
2. Purchases are 60% of the following month's sales and are paid in the following month.
3. Monthly expenses equal 30% of the current month's sales and are paid currently cash month.
4. Beginning cash is Kshs.100,000 and should not be permitted to fall below Kshs.100,000 in any of the following months.
5. Bank borrowing is used to bring back to the kshs.100,000 level. Whenever cash exceeds Kshs.100,000, the excess is used to pay off any bank loan outstanding.

Required:

i) Formulate the cash budget for the month of January to June 2012. (12 marks)