

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

FINANCIAL ANALYSIS – PAPER 9

CPA (U) EXAMINATIONS

LEVEL TWO

18 DECEMBER 2001

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Attempt all questions in Section **A**, any three questions from Section **B** and **one** question from Section **C**.
3. Section **A** has **ten** compulsory questions; each carrying 2 marks.
4. Section **B** has **four** questions and only **three** questions are to be attempted. Each question carries 20 marks.
5. Section **C** has **two** questions and only **one** question is to be attempted. Each question carries 20 marks.
6. Please read further instructions on the answer book

SECTION A

Question 1:

- (i) In the budget speech for the financial year 2001/2002, the Honorable Minister of Finance, Planning and Economic Development projected a total deficit of Shs 1.225 billion. Which of the following options is the most appropriate for financing the deficit?
- (a) Restructure the public service and reduce expenditure.
 - (b) Privatisation of Uganda Commercial Bank Ltd and other parastatals.
 - (c) Borrow both domestically and externally.
 - (d) Borrowings and grants.
- (ii) What is the major drawback of weighted average cost of capital in evaluating an investment project?
- (a) It is historical.
 - (b) It assumes the same risk for all the projects.
 - (c) It ignores time value of money.
 - (d) It is difficult.
- (iii) Mandela National Stadium is considering investing in a gymnasium as a way to broaden the income base. The feasibility report has indicated the following:

State	Probability	Projected Income Shs million
Large number of clients	20%	40
Medium number of clients	30%	60
Small number of clients	50%	20

What income should management of Mandela stadium expect?

- (a) Shs 120 million.
 - (b) Shs 36 million.
 - (c) Shs 20 million.
 - (d) Shs 100 million.
- (iv) Which of the following statements is false about trade credit as a source of finance?
- (a) It requires no collateral.
 - (b) It is a cost free source of finance.
 - (c) Most small scale business cannot do without trade credit
 - (d) It is a reward for a customer's loyalty.

- (v) The market price of Uganda Clays Ltd shares is Shs 100 per share, the subscription price is Shs 900. A rights issue of shares has been declared at four shares for every one right held at the rate of Shs 900 per share.

Calculate the theoretical value of a right when a share is sold cum-right.

- (a) 40.
 - (b) 30.
 - (c) 20.
 - (d) 60.
- (vi) Given that the Bank of Uganda interest rate prior to 1 July 2001 was 6%. Caroline Ltd. is interested in investing in a flower project whose average risk as indicated by the Beta is 1.80 and has a market rate of return of 16%. Calculate the cost of capital using the Capital Asset Pricing Model.
- (a) 34%.
 - (b) 24%.
 - (c) 14%.
 - (d) 8%.
- (vii) Which of the following is a mismatch?
- (a) Credit creation.
 - (b) Savings, current account and deposit account.
 - (c) Line of credit.
 - (d) Open market operations (OMO).
- (viii) The Capital Markets Authority (CMA) Statute was enacted in 1996. Which of the following statements is correct?
- (a) Capital Markets Authority is charged with the regulation and promotion of the development of securities.
 - (b) It advises the Privatisation Unit on which parastatal to list for privatization.
 - (c) The main aim of its creation was to create employment.
 - (d) It is a market for securities.
- (ix) Ratios that indicate the ability of the firm to meet its long term obligations are:
- (a) Activity ratios.
 - (b) Gearing ratios.
 - (c) Liquidity ratios.
 - (d) Profitability ratios.

- (x) Which of the following is the correct statement about interest cover?
- (a) Interest cover is given as profit after tax and it shows the business risk of a firm interest payable.
 - (b) Interest cover is given by profit before tax interest payable.
 - (c) Interest cover is given by profit before interest and tax and it indicates how interest is paid.
 - (d) Interest cover is given by profit before interest and tax and it indicates the number of times the available profit can cover interest payment.

SECTION B

Question 2:

- (a) Explain what you understand by the term venture capital and give the sources from which it can be obtained. **(8 marks)**
 - (b) What is warrant? State two applications of warrants. **(3 marks)**
 - (c) Explain what is meant by the term pre-emptive rights. Give a theoretical example. **(3 marks)**
 - (d) Define and explain the concept of capital rationing. **(6 marks)**
- (Total 20 marks)**

Question 3

Write short notes on the following:

- (a) Working capital and its determinants. **(12 marks)**
 - (b) The decision areas of a financial analyst. **(8 marks)**
- (Total 20 marks)**

Question 4:

- (a) Define the following:
(i) Capital structure.
(ii) Weighted Average Cost of Capital. **(4 marks)**
- (b) Give two reasons why the Capital Asset Pricing Model would be a superior method of evaluating the cost of capital than the weighted average cost of capital. **(4 marks)**
- (c) ICPAU Ltd has the following capital structure:

	Shs million
20% Long term irredeemable loan stock	40
10% Preference shares par Shs 100	10
Ordinary shares	30
Retained earnings	<u>20</u>
	<u>100</u>

ICPAU Ltd anticipates that dividends on ordinary shares will be Shs 5,000/= per share and the market price per share is Shs 22,000 ex-div. It is expected that the dividends will grow at a rate of 6% annually forever. The market value of debt is Shs 100 per stock unit and that of preference shares is Shs 105 per share. The corporation tax rate of 30%.

Required:

Determine the weighted average cost of capital. (Put it to the nearest decimal point). **(12 marks)**

(Total 20 marks)

Question 5

- (a) What is cash planning and how useful is it to the Financial Manager? **(4 marks)**
- (b) Nice Ltd, manufacturers of plastic items, has been facing cash flow problems and has hired you as an expert to advise on estimating its needs for cash during the period December 2001 to June 2002.

The estimated sales in millions of shillings are:

December	January	February	March	April	May	June
50	40	60	100	90	80	60

It is company policy that 20% of sales are on cash, 40% of the credit sales are collected in the month following the sale and the remainder of the credit sales in the second month following the sale. October and November 2001 sales were Shs 70 million and Shs 60 million respectively. The company also incurs the following expenses:

- (i) Rent: Shs 4.2 million per month.
- (ii) Salary: Shs 9 million per month.
- (iii) The company plans to pay for raw materials as follows:

December	January	February	March	April	May	June
50	60	70	40	30	20	100

Required:

Given that the company has zero cash balance (SHS 0) on 20 November 2001:

- (i) Prepare a cash budget.
- (ii) Advise the management on three possible ways of financing the expected deficit and one way of handling any surplus.

(16 marks)

(All assumptions and workings for (i) above must be shown)

(Total 20 marks)

SECTION C

Question 6

Write short notes on the following:

- (a) Net Present Value (NPV) bringing out two advantages and three disadvantages as a technique for investment appraisals. **(8 marks)**
 - (b) Efficiency ratios. Give two examples. **(3 marks)**
 - (c) Investment ratios. Give two examples. **(3 marks)**
 - (d) Limitations of ratio analysis **(6 marks)**
- (Total 20 marks)**

SECTION C

Question 7:

- (a) (i) Explain what you understand by the term business risk and clearly indicate the risks associated with a business. **(7 marks)**
 - (ii) State three possible risks associated with obtaining funds from external sources of the economy. **(3 marks)**
 - (b) Write short notes on the following:
 - (i) Basis of ratios comparison. **(6 marks)**
 - (ii) Limitations of Pay Back Period as a tool of investment appraisal. **(4 marks)**
- (Total 20 marks)**