

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA (U) EXAMINATIONS

LEVEL TWO

FINANCIAL ANALYSIS – PAPER 9

TUESDAY, 11 DECEMBER 2007

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. Tables are provided on page 9.
7. Please read further instructions on the answer book.

SECTION A

Question 1

- (i) Gearing can best be defined as a company's:
- (a) equity expressed as a percentage of its debt capital.
 - (b) debts expressed as a percentage of its equity capital.
 - (c) revenues expressed as a percentage of its equity capital.
 - (d) revenues expressed as a percentage of its total capital.
- (ii) Which of the following statements is **FALSE**?
- (a) A private company is a limited liability company.
 - (b) A private company has a minimum of two shareholders and a maximum of fifty.
 - (c) A private company has no restrictions on the transfer of shares.
 - (d) A private company cannot be listed on the stock exchange.
- (iii) Zeus Ltd is an all equity financed company whose shares are currently trading at Shs 480 per share. It is also able to borrow at a rate of 10%. The Company has recently paid a dividend of Shs 72 per share which is consistent with investor expected growth rate in earnings of 6%.

What is the expected rate of return of Zeus Ltd's investors?

- (a) 15%
 - (b) 10%
 - (c) 22%
 - (d) 6%
- (iv) Which of the following decisions do **NOT** fall within the functions of a finance manager?
- (a) Investment decisions.
 - (b) Financing decisions.
 - (c) Dividend decisions.
 - (d) Pricing decisions.
- (v) Financial markets can be classified into money markets and capital markets to reflect the nature of financial securities being traded in.

Which of the following is **NOT** a capital market security?

- (a) Secured debentures.
- (b) Ordinary share capital.
- (c) Preferred stock.
- (d) Short-dated Government bonds.

- (vi) Kapere Ltd needs to raise Shs 500 million for its construction project. The company, however, will not be able to generate enough annual cash flows to pay the annual coupon. It is, therefore, proposing to pay all amounts owing at the end of a 5 year period.

What is the minimum value an investor will accept given that returns on straight debt are currently at 12% per annum?

- (a) Shs 683,500,000.
 - (b) Shs 881,170,000.
 - (c) Shs 703,000,000.
 - (d) Shs 583,500,000.
- (vii) Which of the following does **NOT** relate to soft capital rationing?
- (a) Restrictions on capital expenditure budgets.
 - (b) Restrictions on bank lending due to government control.
 - (c) Management's reluctance to issue additional shares.
 - (d) Management's fear of dilution of earnings per share.
- (viii) In analyzing the working capital needs of an organisation, various tools are needed to estimate the trading cycle.

Which of the following would be of limited use?

- (a) The current ratio.
 - (b) The debtor's payment period.
 - (c) The stock turnover period.
 - (d) The creditors' turnover period.
- (ix) Mr. Innocent Okello has an opportunity to invest in securities currently worth Shs 400,000. These have an annual yield of 12% but will be earned quarterly.

What should be the value of his investment at the end of five years?

- (a) Shs 704,800.
 - (b) Shs 722,444.
 - (c) Shs 627,200.
 - (d) Shs 640,000.
- (x) Which of the following is **NOT** an indicator of an efficient market?
- (a) Share prices change quickly to reflect all new information.
 - (b) There is full competition as no individual dominates the market.
 - (c) Transaction costs for trading in securities do not discourage trading.
 - (d) The government is able to fix prices for some securities.

SECTION B**Question 2**

- (a) Mebo Ltd is a successful privately owned company in Uganda that has been in existence for over 20 years. At a recent Board meeting, the chairman, Mr. Otim who also doubles as the majority shareholder recently proposed to his colleagues that the company should go public so as to participate in the primary and secondary markets. He argued that this will enable the company to enjoy the benefits of listed companies. His proposal was passed unanimously. The management team was instructed to prepare for listing on the Uganda Securities Exchange (USE).

Required:

You are part of the team preparing Mebo Ltd for listing on the Uganda Securities Exchange and you are required to explain the meaning of the following terms:

- (i) Primary markets.
- (ii) Secondary markets.
- (iii) Initial public offering (IPO).
- (iv) Prospectus.
- (v) Public company.

(10 marks)

- (b) Recently, the Capital Markets Authority (CMA) organised a young entrepreneurs' competition among university students by allocating Shs 1,500,000 to each selected group of students. The participants were drawn from Makerere University, Kyambogo University, Kampala International University and Makerere University Business School among others. The students were expected to be innovative and creative.

Required:

State and explain **five** roles that CMA plays in Uganda's economic development.

(10 marks)**(Total 20 marks)**

Question 3

Below is the balance sheet of Quedrup Ltd. The company has only been in existence for the last 3 years and is seeking to entice other investors to inject more funds into the business if it is to match the competition.

	2005 Shs	2004 Shs
Non-current assets		
Land and buildings	33,685,611	32,465,272
Machinery	2,994,250	3,008,509
Vehicles	1,255,024	1,309,163
Investments	1,183,208	1,295,350
Current assets		
Inventory	1,760,982	1,779,456
Trade receivables	1,975,768	1,071,368
Other receivables	4,652,112	4,550,198
Bank and cash	96,570	388,575
Current liabilities		
Trade payables	4,521,148	2,532,675
Provisions	2,318,202	3,078,566
Bank & short term loans	1,204,164	1,204,250
<u>Capital employed</u>	39,560,010	39,052,398
Share capital	1,882	1,882
10% Preferred stock	21,475,118	21,475,118
Retained earnings/(losses)	<u>(905,480)</u>	<u>(1,404,007)</u>
Shareholders' interest	20,571,520	20,072,994
Long term liabilities	18,988,491	18,979,404

Required:

- (a) Calculate the following for each year:
- (i) Gearing ratio. (2 marks)
 - (ii) Current ratio. (2 marks)
 - (iii) Acid test ratio. (2 marks)
 - (iv) Equity to assets ratio. (2 marks)
- (b) Comment on the profitability of Quedrup Ltd. (4 marks)
- (c) State and explain **four** limitations associated with the use of ratios in financial analysis. (4 marks)

- (d) It is possible for a company to have a healthy current ratio but still fail to meet its obligations as and when they fall due.

State and explain **two** reasons why a company can have a healthy current ratio but fail to meet its obligations.

(4 marks)

(Total 20 marks)

Question 4

Muddu Wholesalers Ltd (MWL) is a company dealing in general merchandise, located in Kampala, Uganda. Its financial year end is 31 December. The company prepares cash budgets for periods of four months. The following information relates to the months of November 2007 to April 2008:

- (i) Estimated sales and purchases

Month	Nov. Shs million	Dec. Shs million	Jan. Shs million	Feb. Shs million	Mar Shs million	April Shs million
Sales	400	580	420	430	445	410
Purchases	420	400	300	320	300	300

- (ii) It is a policy of MWL that 50% of sales are on cash basis and 50% on credit. 30% of the credit sales are collected in the month following the sale and the remainder in the second month following the sale. Cash sales and receipts from debtors are shown separately in the budget.
- (iii) 40% of the purchases are paid for in the month of purchase, 40% in the month following the purchase and the remainder in the second month following the purchase. Cash purchases and payments to creditors are shown separately in the budget.
- (iv) The company pays monthly overheads equivalent to 20% of that month's sales.
- (v) Salaries and wages for 2007 have been Shs 20 million per month. These are expected to increase by 20% with effect from January 2008. Employees are entitled to a bonus of 60% of one month's salary at the end of each year. The bonus is paid on 31 January of the following year.
- (vi) On 30 April 2008, the company expects to pay tax which is estimated at 30% of the average of the 6 months' sales for the months of November 2007 to April 2008.
- (vii) The company also expects to receive commissions of Shs 1,500,000 and Shs 1,200,000 in January and April 2008 respectively for introducing customers to other traders.
- (viii) The company further expects to pay dividends of Shs 20 million on 15 March 2008.

- (ix) The company expects to have a cash balance of Shs 100 million on 31 December 2007.

Required:

Prepare a cash budget for MWL for the period January to April 2008.

(20 marks)

Question 5

The Federation of Uganda Football Associations (FUFA) is perturbed by Uganda's failure to qualify for the African Cup of Nations to be held in Ghana in 2008. FUFA believes that one of the major causes of the failure to qualify is the large sums of money owned by the three leading clubs; Kasasiro FC, Karamoja Young and Manafwa United. These clubs mainly hire foreign players as opposed to Ugandans, which denies the local players the chance to perfect their skills.

FUFA has urged the three clubs to prepare for listing on the Uganda Securities Exchange (USE). FUFA is also interested in knowing the relationship between national performance and the clubs' wealth.

The following information relates to the three clubs:

	Expected wealth	Probability	Net cash flow Shs million
Kasasiro FC	High	0.5	400
	Medium	0.4	800
	Low	0.1	2,000
Karamoja Young	High	0.6	700
	Medium	0.3	900
	Low	0.1	300
Manafwa United	High	0.6	800
	Medium	0.3	1,000
	Low	0.1	300

FUFA also believes that each of the clubs will make an initial investment of Shs 400 million in a bid to remain competitive.

Bank of Uganda's risk-free lending rate is 15% and the anticipated return on the market as a whole is 30%. The beta factor for all clubs is 0.2.

Required:

- (a) Compute the expected net cash flow for each of the three clubs.

(3 marks)

- (b) Compute the appropriate discount rate using the capital asset pricing model (CAPM).
(3 marks)
 - (c) Compute the NPV of each of the three clubs using the discount rate calculated in (b) above.
(12 marks)
 - (d) If you were an investor, which club would invest in and why?
(2 marks)
- (Total 20 marks)

SECTION C

Question 6

Write short notes on the following:

- (a) Mutually exclusive projects.
(5 marks)
 - (b) Trade credit as a source of finance.
(5 marks)
 - (c) Differences between invoice discounting and factoring.
(6 marks)
 - (d) **Four** ways in which commercial banks contribute to Uganda's economic development.
(4 marks)
- (Total 20 marks)

Question 7

Write short notes on the following:

- (a) **Four** stakeholders of a firm.
(4 marks)
 - (b) The concept of time value of money.
(4 marks)
 - (c) Stock split and reverse split:
(4 marks)
 - (d) Venture capital.
(4 marks)
 - (e) Motives of holding money by people and businesses.
(4 marks)
- (Total 20 marks)

Table 1: PVIF- Present Value of Shs 1 Due at the End of n Periods

Period	9%	10%	11%	12%	13%	14%	15%	16%	18%	20%
1	0.917	0.909	0.901	0.893	0.885	0.877	0.870	0.862	0.847	0.833
2	0.842	0.826	0.812	0.797	0.783	0.769	0.756	0.743	0.718	0.694
3	0.772	0.751	0.731	0.712	0.693	0.675	0.658	0.641	0.609	0.579
4	0.708	0.683	0.659	0.636	0.613	0.592	0.572	0.552	0.516	0.482
5	0.650	0.621	0.593	0.567	0.543	0.519	0.497	0.476	0.437	0.402
6	0.596	0.564	0.535	0.507	0.480	0.456	0.432	0.410	0.370	0.335
7	0.547	0.513	0.482	0.452	0.425	0.400	0.376	0.354	0.314	0.279
8	0.502	0.467	0.434	0.404	0.376	0.351	0.327	0.305	0.266	0.233
9	0.460	0.424	0.391	0.361	0.333	0.308	0.284	0.263	0.225	0.194
10	0.422	0.386	0.352	0.322	0.295	0.270	0.247	0.227	0.191	0.162
11	0.388	0.350	0.317	0.287	0.261	0.237	0.215	0.195	0.162	0.135
12	0.356	0.319	0.286	0.257	0.231	0.208	0.187	0.168	0.137	0.112
13	0.326	0.290	0.258	0.229	0.204	0.182	0.163	0.145	0.116	0.093
14	0.299	0.263	0.232	0.205	0.181	0.160	0.141	0.125	0.099	0.078
15	0.275	0.239	0.209	0.183	0.160	0.140	0.123	0.108	0.084	0.065

Table 2: PVAF - Present Value of an Annuity of Shs 1 per Period for n Periods

Period	9%	10%	11%	12%	13%	14%	15%	16%	18%	20%
1	0.917	0.909	0.901	0.893	0.885	0.877	0.870	0.862	0.847	0.833
2	1.759	1.736	1.713	1.690	1.668	1.647	1.626	1.605	1.566	1.528
3	2.531	2.487	2.444	2.402	2.361	2.322	2.283	2.246	2.174	2.106
4	3.240	3.170	3.102	3.037	2.974	2.914	2.855	2.798	2.690	2.589
5	3.890	3.791	3.696	3.605	3.517	3.433	3.352	3.274	3.127	2.991
6	4.486	4.355	4.231	4.111	3.998	3.889	3.784	3.685	3.498	3.326
7	5.033	4.868	4.712	4.564	4.423	4.288	4.160	4.039	3.812	3.605
8	5.535	5.335	5.146	4.968	4.799	4.639	4.487	4.344	4.078	3.837
9	5.995	5.759	5.537	5.328	5.132	4.946	4.772	4.607	4.303	4.031
10	6.418	6.145	5.889	5.650	5.426	5.216	5.019	4.833	4.494	4.192
11	6.805	6.495	6.207	5.938	5.687	5.453	5.234	5.029	4.656	4.327
12	7.161	6.814	6.492	6.194	5.918	5.660	5.421	5.197	4.793	4.439
13	7.487	7.103	6.750	6.424	6.122	5.842	5.583	5.342	4.910	4.533
14	7.786	7.367	6.982	6.628	6.302	6.002	5.724	5.468	5.008	4.611
15	8.061	7.606	7.191	6.811	6.462	6.142	5.847	5.575	5.092	4.675