



(The University of Choice)

**MASINDE MULIRO UNIVERSITY OF
SCIENCE AND TECHNOLOGY
KISUMU CAMPUS**

**UNIVERSITY EXAMINATIONS
2015/2016 ACADEMIC YEAR**

SECOND YEAR FIRST SEMESTER EXAMINATIONS

**FOR DEGREE
IN
BACHELOR OF COMMERCE**

COURSE CODE: BCF 200

COURSE TITLE: FINANCIAL ACCOUNTING

DATE: JUNE **TIME: 2 HOURS**

INSTRUCTIONS TO CANDIDATES

Answer question **One** and any other two questions

TIME: 2 HOURS

MMUST observes ZERO tolerance to examination cheating

Question 1.

a)

Mr. Mwalimu a medical doctor by profession is currently employed as a general manager by a referral hospital in Kisumu County. Upon resuming his duties, he decided to hold management meeting to discuss with his team how well the hospital could meet its long term objectives. Assume you are in attendance as a finance manager. During your turn, the director has asked you to state and explain any key four functions of a finance manager.(10 marks)

Answer

- i. Investment decision-relates to allocation of funds among investment projects
 - a. Also refers to the firm commitment of funds to purchase fixed asset for future generation of positive cash flows.
- ii. Financing decision-support in decision to source for funds to finance investment projects
- iii. Division of earnings - support the management in deciding on the amount to be distributed to shareholders as dividend, preference shareholders or reserve creation.
- iv. Liquidity decision-support the firm on measures to be undertaken to cover current liabilities when they fall due

b) State and explain any four goals of the firm (10 Marks)

Profit maximization- generation of profit to reward shareholders interest, plough back profit for growth, or expansion or research.

Customers satisfaction- provision of quality products, consider place, time and possession utilities, after sales services.

Social responsibility, i.e supporting on social amenities like schools, hospitals, electrification, provision of water etc

Wealth maximization- deals with growing in value of shares over time, growth in dividends, and growth in productive investment

Responsibility to all stakeholder- taking into accounts factors related to government, employees affairs, competitors through avoidance of conflict of interests, creditors through honoring credit terms etc

Question 2.

Discuss the four major problems that might exist between the following relationships in a Limited liability company and ways of minimizing such problems. (20 marks)

Shareholders and managers;

- a. Managers may not work hard to maximize shareholders wealth if they perceive that they will not share the benefit. Solution to this effect is to carry on monitoring of managers activities, restructure the management to improve on internal control or segregation of duties.
- b. Managers may award themselves huge salaries and other benefits. Solution to this problem would be offering managers good salary, rewarding them offering them with share to become part and parcel of the firm, or offer profit based salaries.
- c. Managers may maximize leisure time at the expense of working hard. Incur agency cost through auditing of financial behavior, ethical concerns as well as extent of corporate social responsibility
- d. Managers may undertake projects which improves their image at the expense of profitability- threat of firing, auditing of investment decisions, periodic review of financial performance

Debt holders and shareholders

- i. Firm may increase the ratio of debt thereby increasing risk complexity of the firm
- ii. May invest in very risky or speculative projects which may collapse
- iii. May declare huge dividends which may threaten liquidity
- iv. May influence corporate restructuring which may influence debt repayment
- v. May fail to honor credit obligation

Solution

- i. Apply restrictive covenants in credit indenture; i.e no disposal of assets before consultation, no additional debt before consultation e.t.c
- ii. Recall loans on short notice
- iii. Use corporate governance
- iv. Apply legal actions where necessary
- v. Charge high interest rate to discourage borrowing

Question 3

a) Discuss any four features of investment decision. 8 Marks

- i. Usually have long term characteristics
- ii. Usually involve large fund outlay
- iii. Are quite hard to reverse once implemented
- iv. Have relatively high risk / high return relationship
- v. Usually long period in operation

b) As a finance manager of Upendo Ltd. The shareholders have requested for your advice on two viable investments with the following characteristics;

Year	Project A cash flow	Project B cash flow
1	500,000	600,000
2	500,000	600,000
3	400,000	600,000
4	300,000	1000,000
5	300,000	2000,000

You are allowed to plan an investment with Kshs. 2000,000 in each case applying a discount rate of 10% where applicable.

Required;

Advise the management on which project to undertake using the following techniques;

- i. Payback period (4marks)
- ii. Net Present Value (4marks)
- iii. Profitability Index (4 marks)

Solutions

	Project A	Project B
Payback period	$= \text{Initial Outlay/Cash flows}$ $= 2000,000 / (500,000 + 500,000 + 400,000 + 300,000 + 300,000)$ $= 5 \text{ years}$	$= \text{Initial Outlay/Cash flows}$ $= 2000,000 / (600,000 + 600,000 + 600,000 + 200,000)$ $= 3 \text{ years } 2 \text{ months}$
Decision	Accept all the project since they both cover the cost of cash outlay	
NPV	$500,000 / (1.1) = 454,545$	$600,000 / (1.1) = 545,454$
	$500,000 / (1.1)^2 = 413,223$	$600,000 / (1.1)^2 = 495,867$
	$400,000 / (1.1)^3 = 300,525$	$600,000 / (1.1)^3 = 450,788$
	$300,000 / (1.1)^4 = 204,904$	$1000,000 / (1.1)^4 = 683,013$
	$200,000 / (1.1)^5 = 124,184$	$2000,000 / (1.1)^5 = 124,1842$
	Sum = 1,497,381 Less I/O = (2,000,000)	Sum = 3,416,964 Less I/O = (2,000,000)

	NPV= (502,619)	NPV= 1,416,964
Decision under NPV	Reject the project because of negative NPV	Accept the project because of positive NPV
Profitability Index	PI= Cash flow/Initial Outlay =1,497,381/2000,000 =0.75	PI= Cash flow/Initial Outlay =3,416,964/2000,000 =1.71
Decision	Reject the project PI is less than 1	Accept the project PI is greater than 1

Question 4

- a) As a finance consultant, your client has requested for your advice over cost of debt that he is almost undertaking. The content of his concern regarding financing decision are as follows;
- i. Face value/par value=10,000
 - ii. Cost of debt=10%
 - iii. Maturity period =15 years
 - iv. Market price =12,000

Required; using the formula approach, advice the client. 5 marks

$$K_d = \frac{i + (M - B_0)/n}{(m + B_0)/2} = \frac{1,000 + (10,000 - 12,000)/15}{22,000/2} = \frac{866.67}{11,000} = 7.88\%$$

$$(m + B_0)/2 = 22,000/2$$

- b) Describe five factors that affect dividends decision policies of a limited company(15 marks)

Solutions

- i. legal constrains
- ii. internal constrain
- iii. Growth prospect
- iv. shareholders consideration
- v. Market consideration

Question 5

- a) As a finance student, you are approached by a potential investor who is willing to understand the meaning of portfolio. Kindly help out by defining the term, "portfolio) 2 marks

Solution

A portfolio is a combination of assets held by an investment for investment purposes

- b) Capital Asset Pricing Model is one of the models that specify the relationship between risk and required Rate of return. Given the following details calculate the Expected return of the investment.3 Marks

- i. Risk free asset 8%
- ii. Expected return at the market 12%
- iii. Beta=1.1

$$\text{Solution } R = 8 + (12 - 8)1.1 = 13.2\%$$

Describe the importance of managing working capital by a company of your choice (15 Marks)

Solution

- i. It helps management maintain solid balance between growth, profitability and liquidity
- ii. It helps in facilitating liquidity position of the company

- iii. Minimizes the cost of short term borrowing
- iv. It helps in planning for future management of working capital
- v. It minimizes intuition in management approach

