

CHUKA



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CHUKA & EMBU

**EXAMINATION FOR THE AWARD OF
DIPLOMA IN PROCUREMENT AND LOGISTICS MANAGEMENT, DIPLOMA IN
BUSINESS MANAGEMENT AND DIPLOMA IN ACCOUNTING**

DIAC 0231: FINANCIAL MANAGEMENT

STREAMS: DPLM, DIBM, DIAC

TIME: 2 HOURS

DAY/DATE: FRIDAY 09/08/2019

2.30 PM – 4.30 PM

INSTRUCTIONS:

Answer Question One and any other Two Questions

QUESTION ONE

- (a) Agency conflict exist when agents pursue their own interest rather than the interest of the principals. From this context discuss
- (i) Explain the term agency relationship. [2 marks]
- (ii) The three causes of conflicts between shareholders and auditors and the solutions to the conflicts. [6 marks]
- (b) Discuss five non-financial goals of a firm. [5 marks]
- (c) Differentiate between capital budgeting decisions and dividend decisions. [4 marks]
- (d) Suppose that Peter receives sh 80,000 at the end of each year for 13 years. Determine the present value of the cashflows if the interest rate is 20%. [3 marks]
- (e) A project costing sh 320,000 yields annual cashflows of sh. 50,000 each year. Determine the payback period and the limitations of payback period. [4 marks]

(f) ABC limited has set the minimum cash balance of sh 20,000 the standard deviation of the cashflows is 2000 and the interest rate on marketable securities is 25% per annum. The transaction cost is sh 50. Required

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|-------|----------------------|-------------|
| (i) | Target cash balance | [1 ½ marks] |
| (ii) | Upper limit | [1 ½ mark] |
| (iii) | Average cash balance | [1 ½ marks] |
| (iv) | The spread | [1 ½ marks] |

QUESTION TWO

(a) A company is considering investing in a project costing sh 350,000 and promises the following profit before depreciation and tax

Years	Profit before depreciation and tax (sh)
1	120,000
2	100,000
3	90,000
4	75,000
5	85,000
6	110,000
7	70,000

Additional information:

- (i) Cost of capital is 12%
- (ii) Depreciation is on straight line method and tax rate is 30%

Required

NPV, PI and IRR and advise the company on whether they should invest in the project or not. [15 marks]

(b) Outline the features of a good investment appraisal technique. [5 marks]

QUESTION THREE

(a) Explain the significance of a company determining its cost of capital. [4 marks]

(b) State the functions of money markets in Kenya. [4 marks]

(c) Distinguish between bank overdraft and commercial paper sources of finance. [3 marks]

(d) The following is the capital structure of a particular company

	Sh
Ordinary shares (sh 120 par)	12,000,000
12% preference shares (sh 60 par)	9, 000,000

Retained earnings	4, 000,000
15% debentures (sh 200 par)	<u>10,000,000</u>
	<u>35,000,000</u>

Additional information:

- (i) The company currently pays a dividend of sh 15 per share which is expected to grow at 20% and the ordinary shares are currently selling for sh 150 per share
 - (ii) The preference shares will mature in 30 years and currently sell for sh 90
 - (iii) The debentures will mature in 100 years and currently sell for sh 300
 - (iv) Tax rate is 30%
- Required: weighted average cost of capital [9 marks]

QUESTION FOUR

- (a) Describe the fundamental theory of valuation. [3 marks]
 - (b) Explain the various approaches that a firm uses in financing its current assets. [6 marks]
 - (c) A company currently pays on ordinary dividend of sh 20 per share which is expected to grow at 5% for 2 years, 10% for 3 years and 8% for 3 years after which it will fall to a constant rate of 12%. Calculate the intrinsic value of the share if the required rate of return is 15%. [11 marks]
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