

DIAC 0231

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

**SECOND YEAR EXAMINATION FOR THE AWARD OF DIPLOMA IN
PROCUREMENT AND LOGISTICS MANAGEMENT, BUSINESS MANAGEMENT,
HUMAN RESOURCE MANAGEMENT AND ACCOUNTING**

DIAC 0231: FINANCIAL MANAGEMENT

STREAMS: DIAC (Y2S1)

TIME: 2 HOURS

DAY/DATE: TUESDAY 11/04/2023

2.30 P.M. – 4.30 P.M.

INSTRUCTIONS: Answer question ONE and any other TWO questions

QUESTION ONE

- (a) A company is considering investing in a project that promises profit before depreciation and tax of sh 60,000 each year for 5 years. The cost of the project is sh 250,000 with a salvage value of sh 50,000. Tax rate is 40%, depreciation is on straight line method.

Required:

- (i) Accounting rate of return [7 marks]
- (ii) State the disadvantages of accounting rate of return [3 marks]
- (b) Ian deposited sh 22,000 at the end of each year for 8 years at an interest rate of 14%. How much will he have if he wanted to withdraw the money after 8 years. [3 marks]
- (c) Explain the following sources of funds [6 marks]
- (i) Retained earnings
- (ii) Debentures
- (iii) Commercial paper

DIAC 0231

- (d) Fahari limited makes cash payment of sh 300,000 in a year. The interest rate on marketable securities is 18% and every time the company sells the marketable securities it incurs a cost of sh. 30.

Required:

Calculate optimal amount of cash, number of transfers, average cash balance and the total cost of maintaining the cash balance. [6 marks]

- (e) Discuss the factors that influence the working capital needs of a firm. [5 marks]

QUESTION TWO

- (a) The following is the capital structure of Mwanzele limited company

	Sh
Ordinary shares (sh 120 par)	15,000,000
Retained earnings	5,000,000
15% Preference shares (sh 80 par)	8,000,000
18% Debentures (sh 180 par)	9,000,000
	37,000,000

Additional information:

- (i) The company currently pays a dividend of sh 15 per share which is expected to grow at 8%. The current market price of the ordinary shares is sh 160
- (ii) The 15% preference shares currently sell for sh 100
- (iii) The 18% debentures currently sell for sh 220 and will mature in 20 years
- (iv) The tax rate is 40%

Required

- (i) Calculate the weighted average cost of capital (WACC) [10 marks]
 - (ii) State the significance of cost of capital [4 marks]
- (b) Explain the functions of the secondary markets in Kenya. [6 marks]

QUESTION THREE

- (a) A project with an initial outlay of sh 540,000 promises the following profit before depreciation and tax.

Years	Profit before depreciation and tax
1	180,000
2	170,000
3	160,000
4	150,000
5	130,000
6	110,000

Depreciation is on straight line method, tax rate is 30%, and the cost of capital is 12%.

Determine the NPV, PI and IRR. [14 marks]

- (b) Highlight the features of investment decisions. [3 marks]
- (c) Explain the routine finance functions. [3 marks]

QUESTION FOUR

- (a) A company currently pays a dividend of 25 per share. The dividend is expected to grow at 6% for 4 years, 8% for 2 years and 12% for 3 years after which it will fall to a constant rate of 9%. Calculate the intrinsic value of the share if the required rate of return is 13%.

[12 marks]

- (b) There are certain conflicts that exist between shareholders and managers. Describe the ways of solving the conflicts between the two. [5 marks]
- (c) State the advantages of profit maximization goal. [3 marks]
