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UNIVERSITY EXAMINATIONS 2024/2025

SECOND YEAR FIRST SEMESTER EXAMINATION FOR DEGREE OF BACHELOR OF SCIENCE IN COMMERCE, BACHELOR OF BUSINESS INFORMATION TECHNOLOGY, THIRD YEAR FIRST SEMESTER EXAMINATION FOR BACHELOR OF PURCHASING AND SUPPLIES MANAGEMENT

BFC 3226: INTRODUCTION TO FINANCIAL MANAGEMENT/FINANCIAL MANAGEMENT

DATE: DECEMBER 2024 **TIME: 2 HOURS**

INSTRUCTIONS: Answer Question ONE and any other TWO questions.

QUESTION ONE (30 MARKS)

a) Discuss the limitations of using weighted average cost discounting rate. (8 marks)

b) PPP limited wishes to expand its output by purchasing a new machine worth 170,000 and installation costs are estimated at 40,000/=. In the 4th year, this machine will call for an overhaul to cost 80,000/=. Its expected inflows are:

	Shs.
Year 1	60,000
Year 2	72,650
Year 3	35,720
Year 4	48,510
Year 5	91,630
Year 6	83,715

This company can raise finance to purchase machine at 12% interest rate.

Compute NPV, PI and payback period and advise management accordingly. (12 marks)

c) Discuss the main functions of a finance manager in a profit making organization (10 marks)

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QUESTION TWO (20 MARKS)

a) Discuss any Five factors that can affect the cost of acquiring capital for an organization (10 marks)

b) Centenary Company has been dumping in the local council waste collection centre some 30,000 Kg. of unusable chemicals each year. In addition to being an eyesore, the residents of a nearby estate have started complaining of bad odour emanating from the dump and suspect that the company is to blame.

The company has received information that these chemicals can be recycled at relatively little cost. The equipment to do it is however rather expensive and, in addition, the chemicals recovered are of a relatively poor quality. Investigations have shown that these chemicals can be sold to another firm at an average price of Sh.35 per Kg. The direct cost of recycling has been calculated at Sh.15 per Kg. but this is before depreciation and taxes.

The equipment for this process has an expected life of 10 years and a current cost of Sh.2 million. At the end of the ten years, it will be virtually worthless.

For financial analysis, the company uses the straight line method of depreciation and an average tax rate of 40%. It has a required rate of return of 15%.

REQUIRED:

i. Compute the project's net present value (N.P.V). (3marks)

ii. Compute the payback period and the accounting rate of return. (2marks)

iii. Compute the internal rate of return (IRR). (3marks)

iv. Should this project be undertaken? Explain. (2marks)

QUESTION THREE (20 MARKS)

The following is the capital structure of XYZ Ltd as at 31/12/2002.

	Shs. M
Ordinary share capital Sh.10 par value	400
Retained earnings	200
10% preference share capital Sh.20 par value	100
12% debenture Sh.100 par value	200
	900

Additional information

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1. Corporate tax rate is 30%
2. Preference shares were issued 10 years ago and are still selling at par value MPS = Par value
3. The debenture has a 10-year maturity period. It is currently selling at Sh.90 in the market.
4. Currently the firm has been paying dividend per share of Sh.5. The DPS is expected to grow at 5% p.a. in future. The current MPS is Sh.40.

Required

a) Determine the WACC of the firm.

b) Explain why market values and not book values are used to determine the weights.

c) Discuss the differences between debt finance and equity finance. (5 marks)

QUESTION FOUR (20 MARKS)

a) Exactly 20 years from now, Kitheremende a former forest guard will start receiving a pension of sh 100,000 per year. The payments will continue for 20 years. How much is the pension worth now assuming a cost of capital of 12%. (8 marks)

b) Discuss the main advantages of the budgetary system when it is used by an organization (12 marks)

QUESTION FIVE(20MARKS)

The JWJ Company Ltd. has been considering the criteria that must be met before a capital expenditure proposal can be included in the capital expenditure programme.

The screening criteria established by management are as follows:

No project should involve a net commitment of funds for more than four years.

Accepted proposals must offer a time adjusted or discounted rate of return at least equal to the estimated cost of capital. Present estimates are that cost of capital as 15 percent per annum after tax.

Accepted proposals should average over the life time, an unadjusted rate of return on assets employed (calculated in the conventional accounting method at least equal to the average

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rate of return on total assets shown by the statutory financial statements included in the annual report of the company.

A proposal to purchase a new lathe machine is to be subjected to these initial screening processes. The machine will cost Sh.2,200,000 and has an estimated useful life of five years at the end of which the disposal value will be zero. Sales revenue to be generated by the new machine is estimated as follows:

Year	Revenue (Sh.'000')
1	1,320
2	1,440
3	1,560
4	1,600
5	1,500

Additional operating costs are estimated to be Sh.700, 000 per annum. Tax rates may be assumed to be 35% payable in the year in which revenue is received. For taxation purpose the machine is to be written off as a fixed annual rate of 20% on cost.

The financial accounting statements issued by the company in recent years shows that profits after tax have averaged 18% on total assets.

Required

Present a report which will indicate to management whether or not the proposal to purchase the lathe machine meets each of the selection criteria. (20 marks)

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