Name	Index No
2906/306 FINANCIAL MANAGEMENT	Candidate's Signature
July 2015	Date



## THE KENYA NATIONAL EXAMINATIONS COUNCIL

# DIPLOMA IN BUSINESS MANAGEMENT MODULE III

FINANCIAL MANAGEMENT

#### 3 hours

## INSTRUCTIONS TO CANDIDATES

Write your name and index number in the spaces provided above. Sign and write the date of the examination in the spaces provided above.

This paper consists of SEVEN questions.

Answer any FIVE questions in the spaces provided in this question paper.

All questions carry equal marks.

Time: 3 hours

Marks to each part of a question are as indicated.

Do NOT remove any pages from this question paper.

Candidates should answer the questions in English.

### For Examiner's Use Only

Question	1	2	3	4	5	6	7	TOTAL SCORE
Candidate's Score	·							

This paper consists of 26 printed pages.

Candidates should check the question paper to ascertain that all the pages are printed as indicated and that no questions are missing.

1. (a) (b)		Explain <b>five</b> factors that should be considered when estimating the working capital requirements of an organization.				
		Highlight five differences between ordinary shares and debentures.				
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2.	(a)	Explain <b>four</b> challenges that may be faced when borrowing funds from international financial markets.	(8 marks)						
	(b)	On 31 December 2014, Ngaho Limited had an optimal capital structure with weighted average cost of capital of 7.5%. On 1 January 2015, the company proposed to raise additional capital as follows:							
	•	<ul> <li>To issue 250,000 ordinary shares of Ksh 8 at Ksh 10 each.</li> <li>To issue 80,000 10% preference shares of Ksh 10 at Ksh 12 each.</li> <li>To issue 10,000 9% debentures of Ksh 100 at Ksh 90 each.</li> </ul>							
		Additional information:							
		<ul> <li>The company will pay a 5% ordinary dividend.</li> <li>The corporation tax rate is 30%.</li> </ul>							
		(i) Determine the amount of money that will be realized by the propose	d plan;						
		(ii) Calculate the company's marginal cost of capital;							
		(iii) Advise the management on the viability of this proposal.	(12 marks)						
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3.	(a)	Explain <b>four</b> advantages of the internal rate of return (IRR) method of project appraisal. (8 marks)
	(b)	Gamma intends to purchase a house that will cost Ksh 4,200,000 at the end of three years. To raise this amount he intends to adopt the following investment strategy.
•		<ul> <li>At the beginning of year 1, invest Ksh 1,500,000 at an annual interest rate of 12% compounded semi-annually.</li> <li>At the beginning of year 2 invest Ksh 1,200,000 at an annual interest rate of 14% compounded quarterly.</li> </ul>
		Determine the amount of money that he should invest at the beginning of year 3 at an annual simple interest rate of 16% in order to realize his planned investment.  (12 marks)
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4. (	a)			reumstane e of financ		hich it ma	ay be appr	ropriate to u	ise finance	e (8 marks)
(	b)							in either ma		
i		Year		TAC Ksh	MAC Ksh					
		1	(1	10,000)	340,00	0				
		2		80,000	(80,000					
		3	4	150,000	480,00	0				
		4	5	550,000	530,00	0				
		The con	npany's	cost of cap	pital is 14%	6.				
			Evaluate methods		lity of each	of the m	achines u	nder the foll	lowing ap	praisal
		(	(I) p	oay back n	nethod;					
•		(	(II) p	profitability	y index me	thod.				
		(ii)	Advise t	he manage	ement on th	ne machir	ne to inve	st in.		(12 marks)
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5.	(a)	Explain the role played by commercial banks in the economic development of a country. (10)	marks)	
	(b)	Explain five factors that should be considered when designing a dividend policy. (10	olicy. (10 marks)	
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- 6. (a) Highlight **four** limitations of using ratios to analyse the finance statement of a firm. (8 marks)
  - (b) The following are summarized financial statement of Zedi Limited.

Income statement for the year ended 31 December

	2014 Ksh	2013 Ksh
Sales	4,600,000	5,300,000
Cost of sales	1,800,000	2,200,000
	2,800,000	3,100,000
Less operating expenses	700,000	850,000
	2,100,000	2,250,000
Less finance interest	150,000	300,000
	1,950,000	1,950,000
Less corporation tax	585,000	585,000
	1,365,000	1,365,000
Less dividends	435,000	335,000
	930,000	1,030,000

Statement of financial position as at 31 December

	2014 Ksh	2013 Ksh
Non current assets at cost	2,200,000	2,500,000
Less acc. dep.	575,000	570,000
•	1,625,000	1,930,000
Current assets		
Inventory	560,000	540,000
Trade receivables	220,000	180,000
Bank	480,000	460,000
	1,260,000	1,180,000
Less current liabilities		,
Trade payable	185,000	125,000
Taxation	585,000	385,000
Proposed dividends	335,000	300,000
	1,105,000	1,010,000
Working capital	155,000	170,000
	1,780,000	2,100,000
Ordinary shares of Ksh 24 each	600,000	600,000
Retained profit	1,030,000	1,200,000
-	1,630,000	1,800,000
10% bank loan	150,000	300,000
	1,780,000	2,100,000
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For each of the years ended 31 December 2013 and 31 December 2014. Calculate:

(i)

Calculate:

		<ul> <li>(I) gross profit margin;</li> <li>(II) acid test ratio;</li> <li>(III) rate of stock turnover;</li> <li>(IV) average collection period (1 year = 365 days);</li> <li>(V) capital gearing ratio.</li> </ul>
	(ii)	Based on the gross profit percentage, comment on the company's performance.
	(iii)	Advise the management on two measures to put in place regarding the average collection period. (12 marks)
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7.	(a)	Explain five functions of financial management in an organization.	(10 marks)
	(b)	Capital budgeting decisions require careful considerations before being un Explain five reasons for such consideration.	dertaken. (10 marks)
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