CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

TUESDAY: 22 April 2025. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Examine **FOUR** non-financial objectives of a firm. (4 marks)

(b) Evaluate **THREE** principles of stakeholder's theory in relation to finance. (6 marks)

(c) Betam Enterprises, a medium size manufacturing company, is evaluating a strategic investment decision involving a new manufacturing plant. The project requires an initial capital outlay of Sh.500,000 and is expected to generate cash inflows of Sh.150,000 per annum for the next five years. The company applies a discount rate of 10% to assess the viability of long-term projects.

In addition to this investment opportunity, Betam Enterprises has an alternative option to invest in a portfolio of government bonds that provide a guaranteed annual return of 6%. The board of directors needs a robust analysis to determine whether the company should proceed with the riskier manufacturing plant investment or opt for the safer bond investment.

Required:

(i) Calculate the net present value (NPV) of the manufacturing plant investment. (3 marks)

(ii) Calculate the payback period of investment in manufacturing plant. (2 marks)

(iii) Highlight **ONE** advantage and **ONE** limitation of payback period in the context of Betam Enterprises' strategic objectives. (2 marks)

(iv) Advise the board on the preferred investment option incorporating considerations of the time value of money, risk-trade-off and alignment with the company's long-term strategy. (3 marks)

(Total: 20 marks)

QUESTION TWO

(a) Highlight **FOUR** functions of the budget committee in an organisation. (4 marks)

(b) Salama Ltd. is preparing its master budget for the upcoming quarter in the year 2025. The following information is available:

1. **Sales Forecast**
   April: 10,000 units at Sh.50 per unit
   May: 12,000 units at Sh.50 per unit
   June: 15,000 units at Sh.50 per unit

2. **Production Budget**
   Desired ending inventory: 10% of next month's sales
   Beginning inventory (April 2025): 1,000 units

3. **Direct Material Budget**
   Each unit requires 2 kg of raw materials at Sh.5 per kg.
   Desired ending inventory of raw materials: 20% of next month's production needs.
   Beginning inventory (April 2025): 4,000kg.

Required:
Prepare the following budget for the second quarter of the year 2025 for Salama Ltd:

(i) Sales budget. (2 marks)

(ii) Production budget. (2 marks)

(iii) Direct materials budget (in units and value). (3 marks)

(c) The existing capital structure of IMK Ltd. is given as follows:

	Sh."000"
Ordinary share capital (Sh.100 par value)	80,000
Retained earnings	30,000
14% debentures (Sh.1,000 par value)	50,000
12% preference share capital (Sh.25 par value)	40,000
	200,000

Additional information:
1. Ordinary shares of IMK Ltd. are currently selling at Sh.150 each.
2. The 14% debentures and 12% preference shares are currently selling at Sh.1,200 and Sh.45 respectively.
3. The most recent ordinary dividend paid by the company is Sh.5. This is expected to grow at the rate of 10% each year in perpetuity.
4. The corporate tax rate is 30%.

Required:
Compute the following:

(i) Cost of ordinary shares. (2 marks)

(ii) Cost of 14% debentures. (2 marks)

(iii) Cost of 12% preference shares. (2 marks)

(iv) The weighted average cost of capital (WACC) of the company using book values. (3 marks)
(Total: 20 marks)

QUESTION THREE

(a) Summarise **FOUR** reasons why a company might choose to raise equity finance instead of debt finance. (4 marks)

(b) Explain **FOUR** characteristics a firm should possess to be able to issue commercial papers on a regular basis. (4 marks)

(c) Alphamax Technologies Ltd., reported a net profit of Sh.12 million for the financial year ended 31 December 2024. The company is evaluating its dividend policy to align with its strategic goals and shareholder expectations. The following information is provided:

1. The company has a stable cash flow with cash reserves of Sh.5 million.
2. The company has an opportunity to invest in a new project requiring Sh.4 million with an expected rate of return of 18%.
3. The company's target payout ratio is 40% of earnings.
4. There are 15 million ordinary shares outstanding.
5. The board of directors is considering whether to maintain, increase or decrease the dividend payout.

Required:

(i) Evaluate **FOUR** factors that the board should consider when making the dividend decision for Alphamax Technologies Ltd. (4 marks)

(ii) Calculate the maximum dividend per share (DPS) that could be distributed assuming the company adheres to its target payout ratio. (2 marks)

(iii) Discuss the potential impact of adopting a residual dividend policy on Alphamax Technology Ltd.'s capital structure and financial flexibility. (4 marks)

(iv) Recommend a dividend policy that would balance shareholder expectations and the company's growth objectives. Justify your recommendation with strategic insights. (2 marks)
(Total: 20 marks)

QUESTION FOUR

(a) Describe **FIVE** types of financial statements citing the importance of each. (5 marks)

(b) Summarise **FOUR** ways in which poor inventory management could negatively affect a firm profitability. (4 marks)

(c) John Haraka has just received a bonus of Sh.5 million from coffee sales. He does not have immediate current expenditure needs for the money. He has approached you to provide guidance on the following two mutually exclusive investment proposals:

Option 1
Deposit the money with TYM Bank at an interest rate of 15% per annum. The bank is willing to compound the interest payments half yearly. This deposit is for two-year period.

Option 2
Use the money to purchase a 3-year treasury bill with an annual interest rate of 10% payable on a quarterly basis.

Required:
Advise John Haraka on the best investment option to consider. (4 marks)

(d) Usambara Ltd. is a company quoted on the securities exchange and is experiencing a period of rapid growth. Due to this, a momentous growth of 15% per annum is anticipated during the next 5 year. Thereafter, a normal growth rate of 5% per annum is expected indefinitely. The shareholders of the company require a return of 10% per annum on their investments. The company during the previous year paid Sh.4 per share as dividends.

Required:
Advise an investor interested in Usambara Ltd. on the maximum price to pay per share. (7 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Describe **THREE** red flags that may indicate that financial statements are of poor quality. (6 marks)

(b) The following financial statements were obtained from the financial records of Kwekwe Ltd. for the year ended 31 March 2024 and 31 March 2025:

Statements of profit or loss of Kwake Ltd. for the year ended 31 March:

	2025 Sh."000"	2024 Sh."000"
Revenue	11,500	10,500
Cost of sales	(6,000)	(5,150)
Gross profit	5,500	5,350
Other income	400	250
Distribution cost	(600)	(500)
Administrative expenses	(2,150)	(2,000)
Finance cost	(400)	360
Profit before tax	2,750	2,740
Income tax expenses	(1,150)	(1,100)
Profit after tax	1,600	1,640
Preference dividends	(140)	(140)
Ordinary dividends	(250)	(250)
Retained profit for the year	1,210	1,250

Required:
Horizontal common size analysis of the profit or loss statement for the year ended 31 March 2024 and 31 March 2025. (8 marks)

(c) Maxo Ltd. is a large motor vehicle manufacturing company that specialises in customised sports car. Despite steady sales growth, the company has been facing liquidity challenges due to inefficient working capital management. The company's financial statements reveal high levels of inventory, delayed receivables and strained relationships with suppliers due to delayed payments.

Required:
Explain **THREE** working capital financing policies that you could recommend to the senior management of Maxo Ltd. for consideration to address the problem. (6 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 2 December 2024. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Summarise **FOUR** disadvantages of retained earnings as a source of finance. (4 marks)

(b) Discuss **THREE** challenges encountered when making capital investment decisions. (6 marks)

(c) The following information relates to a capital project in Toto Limited:

	Sh."000"
Project cost	130,000
Annual cash flows (after tax)	45,000
Project economic life	5 years
Minimum required rate of return	12%

Required:
Assess the suitability of the capital project using the following methods:

(i) Net present value (NPV). (4 marks)

(ii) Internal rate of return (IRR). (6 marks)
(Total: 20 marks)

QUESTION TWO

(a) Highlight **FOUR** limitations of financial ratios. (4 marks)

(b) Explain **THREE** objectives of working capital management in an organisation. (6 marks)

(c) The following information relates to Uzima Ltd. for the four months given below:

		Sh."000"
Sales:	September	240
	October	240
	November	280
	December	360

All sales will be made on credit. Half of the debtors are expected to pay within the month of sale and are also expected to claim 8% cash discount. The remaining debtors are expected to pay by the beginning of the following month.

Raw materials purchases	**Sh."000"**
September	80
October	160
November	160
December	120

The firm plans to pay its creditors in full in the month following that of purchase.

Wages and salaries	**Sh."000"**
September	48
October	60
November	68
December	52

Additional information:

1. All employees are paid in the month in which the wage or salary is earned.
2. Rent of Sh.40,000 for each quarter is paid in the month of March, June, September and December.
3. Other cash overheads of Sh.8,000 per month are payable.
4. A new plant due for delivery in September will be paid in November at a cost of Sh.100,000.
5. On 1 October, the firm plans to have Sh.40,000 in the bank.

Required:

A cash budget for the months of October, November and December. (10 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain **FOUR** factors that could affect the success of a rights issue. (4 marks)

(b) Propose **FOUR** ways of solving conflict between shareholders and auditors in relation to agency theory of a firm. (4 marks)

(c) The following is an extract from the financial statements of Alpha Ltd. and Beta Ltd. as at 31 March 2024:

	Alpha Ltd.	**Beta Ltd.**
	Sh.“000”	**Sh.“000”**
Ordinary share capital (Sh.15 par value)	60,000	45,000
Retained earnings as at 1 July 2023	15,600	7,000
15% preference share capital (Sh.25 par value)	12,400	32,000
12% loan stock	32,000	36,000
	120,000	120,000

Additional information:

1. The profit before interest and tax for the year ended 31 March 2024 for Alpha Ltd. and Beta Ltd. amounted to Sh.42.8 million each.
2. The ordinary shares of Alpha Ltd. and Beta Ltd. are currently quoted at the securities exchange at Sh.58 and Sh.87 respectively.
3. Both Alpha Ltd. and Beta Ltd. did not declare any dividends for the year ended 31 March 2024.
4. The corporation tax applicable to both firms is 30%.

Required:

Calculate the following financial ratios for Alpha Ltd. and Beta Ltd. and interpret your answer in each case.

(i) Debt ratio. (3 marks)

(ii) Earnings per share (EPS). (3 marks)

(iii) Price earnings (P/E) ratio. (3 marks)

(iv) Return on equity (ROE). (3 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Describe **FOUR** roles of cost of capital to a firm. (4 marks)

(b) Evaluate **FOUR** reasons for the time preference for money. (4 marks)

(c) Highlight **SIX** reasons for valuation of securities. (6 marks)

(d) Stephen Mwakwesi borrowed Sh.2,000,000 from Huduma Bank at an annual compound interest rate of 12% on the reducing balance basis. The loan was repayable in annual instalments over a period of four years. The instalments were payable at the end of the year.

Required:

Prepare a loan amortisation schedule for the bank. (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) In relation to time value of money, explain the following terms:

(i) Compounding techniques. (2 marks)

(ii) Discounting techniques. (2 marks)

(iii) A growing annuity. (2 marks)

(b) Discuss **THREE** mechanisms that could be used to ensure that managers act in the best interest of shareholders. (6 marks)

(c) Sukuma Ltd. has the following capital structure:

Debt	30%
Equity	50%
Preference shares	20%

The management of the company has provided the data below:

Pre-tax cost of debt	10%
Corporate tax rate	30%
Growth rate of ordinary dividend	9%
Market price per ordinary share	Sh.30
Dividend price per ordinary share	Sh.2.50
Market price per preference share	Sh.120
Floatation cost per preference share	Sh.10
Dividend per preference share	Sh.8

Required:

Calculate the following:

(i) After tax cost of debt. (2 marks)

(ii) Cost of ordinary share. (2 marks)

(iii) Cost of preference shares. (2 marks)

(iv) The weighted average cost of capital (WACC). (2 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 19 August 2024. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Summarise **FOUR** unethical financial practices in organisations. (4 marks)

(b) Explain **THREE** ways through which goals of a firm may conflict with one another. (6 marks)

(c) Simon Kimani borrowed Sh.1,000,000 from XYZ commercial bank at an interest rate of 12% per annum. The loan shall be repaid over a period of five years. The interest on the loan shall be compounded at the end of each year.

Required:

(i) The amount payable and cumulative interest payable after five years. (3 marks)

(ii) Assuming interest is compounded semi-annually, determine the total amount and cumulative interest payable after five years. (3 marks)

(iii) Assuming interest is compounded continuously, calculate the total amount and cumulative interest payable after five years. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) Discuss **FOUR** advantages of using term loans as a source of finance for an organisation. (4 marks)

(b) Describe **THREE** methods of issuing ordinary shares. (6 marks)

(c) Kanda Limited intends to invest in either Project TR or Project ZK. The following are the expected net cash flows from the two projects:

	Expected cash flow	
Year	**Project TR**	**Project ZK**
	Sh.	**Sh.**
0	(4,500,000)	(500,000)
1	1,200,000	1,500,000
2	1,400,000	1,800,000
3	1,250,000	1,600,000
4	2,000,000	1,800,000

Additional information:

1. The projects have estimated scrap values as follows:

	Sh.
Project TR	300,000
Project ZK	500,000

2. The company's cost of capital is 12%.

Required:

(i) Calculate the profitability index (P1) of each project. (8 marks)

(ii) Advise the management on the project to invest in. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain the following theories of valuation:

(i) Technical theory. (2 marks)

(ii) Fundamental theory. (2 marks)

(iii) Random walk theory. (2 marks)

(b) Lima Limited paid a dividend of Sh.15 per share in the last accounting year. The dividends are expected to grow at the rate of 10% for the first 4 years and at the rate of 12% thereafter in perpetuity.

The investors' expected rate of return is 15%.

Required:
Determine the intrinsic value of Lima Limited's ordinary share. (6 marks)

(c) Tinga Limited manufactures and sells a single product named "T140".

The following information relates to the product:

	Sh.
Selling price per unit	180
Variable cost per unit	80
Fixed costs per annum	5,000,000

Required:

(i) Breakeven point in units and in shillings. (4 marks)

(ii) The number of units to be produced to earn a profit of Sh.1,200,000. (4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Matunda Limited intends to raise capital as follows:

- Issue 2,000,000 ordinary shares with a par value of Sh.20 at Sh.25. Floatation cost is 10% of the issue price.
- Issue 1,000,000 8% preference shares of Sh.10 at Sh.20 each.
- Issue 200,000 10% debentures of Sh.100 at Sh.110 each.
- Utilise Sh.15,000,000 from the retained earnings.

Additional information:

1. Ordinary shareholders expect a dividend of Sh.5 per share with a growth rate of 6% per annum.
2. Corporation tax rate is 30%.

Required:

(i) Cost of ordinary shares. (2 marks)

(ii) Cost of retained earnings. (1 mark)

(iii) Cost of preference shares. (2 marks)

(iv) Cost of debentures. (2 marks)

(v) Weighted average cost of capital (WACC) using book values. (3 marks)

(b) Ngana Ltd. has a cost of equity of 10%. Currently, the company has 250,000 ordinary shares which are quoted at the securities exchange at Sh.120 per share. The company's earnings per share is Sh.10 and it intends to maintain a dividend payout ratio of 50% at the end of the current financial year.

The expected net income for the current year is Sh.3 million and the available investment proposals are estimated to cost Sh.6 million.

Required:
Using the Modigliani and Miller (MM) model determine:

(i) The price of a share at the end of the year if dividend is not paid. (2 marks)

(ii) The price at the end of the year if dividend is paid. (2 marks)

(iii) The number of shares to be issued if dividends are not paid. (3 marks)

(iv) The number of shares to be issued if dividends are paid. (3 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Summarise **FOUR** costs of disclosing financial information. (4 marks)

(b) The following information relates to Nile Ltd. for the year ended 31 December 2023:

Earnings yield	25%
Dividend for the year	Sh.4
Market price per share	Sh.150

Required:

(i) Earnings per share (EPS). (2 marks)

(ii) Dividend cover (DC). (2 marks)

(iii) Price-earnings (P/E) ratio. (2 marks)

(c) The projected monthly working capital requirements for Bahari Ltd. for the year ending 31 December 2024 is as follows:

Month	**Amount of working capital required Sh.“000”**
January	5,500
February	5,500
March	7,250
April	9,000
May	12,500
June	17,750
July	23,000
August	26,250
September	17,750
October	10,750
November	9,000
December	7,250

The expected cost of short-term funds is 25% while that of long-term funds is 30%. Ignore taxation.

Required:

(i) A schedule showing the amount of permanent and seasonal working capital requirements for each month. (2 marks)

(ii) The average amount of long-term and short-term finance that would be required monthly. (2 marks)

(iii) The total cost of working capital finance, if the firm adopted an aggressive financing strategy. (2 marks)

(iv) The total cost of working capital finance, if the firm adopted a conservative financing strategy. (2 marks)

(v) The total cost of working capital using the matching policy. (2 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 22 April 2024. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Highlight **FIVE** advantages of issuing preference shares as a source of finance for a company. (5 marks)

(b) Explain **FIVE** challenges that may be encountered when preparing budgets. (5 marks)

(c) Luna Ltd. is contemplating raising an additional Sh.5 million to finance an expansion programme. The firm's capital structure which is considered to be optimal is given as follows:

	Sh."000"
Ordinary share capital (Sh.50 par value)	10,000
Reserves	6,000
12% debenture capital (Sh.100 par value)	8,000
14% preference share capital (Sh.25 par value)	12,000
	36,000

Additional information:

1. New ordinary shares will be issued at Sh.70 each to a floatation of 10% of issue price. The firm's dividend policy is that future dividends are expected to grow at 8% each year in perpetuity. The firm paid dividend of Sh.4 per share in the current year.
2. New 12% irredeemable debentures will be issued at Sh.120 each. Floatation cost of Sh.10 per unit issued will be incurred.
3. New 14% preference shares will be issued at Sh.30. A floatation cost of Sh.3 per share issued will be incurred.
4. The corporation tax rate is 30%.

Required:

(i) Cost of retained earnings. (2 marks)

(ii) Cost of ordinary shares. (2 marks)

(iii) Cost of 12% debenture capital. (2 marks)

(iv) Cost of 14% preference shares. (2 marks)

(v) Weighted marginal cost of capital (WMCC) of the firm. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain **FOUR** ways of resolving conflict between the government and shareholders. (4 marks)

(b) ABC Ltd. plans to borrow Sh.12 million, which it will use to repurchase shares. The following information is given:

1. Share price at time of share repurchase was Sh.60.
2. The earnings after tax was Sh.6.6 million.
3. Earnings per share (EPS) before share repurchase was Sh.3.
4. Price earnings ratio (P/E) = 60/3 = 20.
5. Earnings yield (E/P) = 3/60 x 100 = 5%.
6. Shares outstanding was 2.2 million.
7. Planned share repurchase was 200,000 shares.

Required:

(i) The earnings per share (EPS) after the share repurchase assuming the after-tax cost of borrowing is the company's customary after tax borrowing rate of 5%. (2 marks)

(ii) The earnings per share (EPS) after the share repurchase, assuming the company's borrowing rate increase to 6% because of the increased financial risk of borrowing Sh.12 million. (2 marks)

(c) Kola Limited leased a machinery under a 5 year lease requiring equal year-end annual payments of Sh.4,000,000. The lessee's incremental borrowing rate is 14%.

Required:

(i) Determine the amount the lessee's would report as asset and liability at the date of the lease. (2 marks)

(ii) Prepare a lease amortisation schedule. (10 marks)

(Total: 20 marks)

QUESTION THREE

(a) Discuss **FOUR** advantages of a company using retained earnings as a source of finance. (4 marks)

(b) (i) Highlight **FOUR** factors that affect the value of a bond in the secondary market. (4 marks)

(ii) Jackson Kiilu has been offered a 10 year 6% coupon of Sh.1,000 par value bond at a price of Sh.900.

Required:

Determine the rate of return on the bond. (4 marks)

(c) Vuka Limited intends to invest in a project. The following information relates to the project:

Initial investment (Sh.)	3,885,000
Estimated life	10 years
Annual cash inflows (Sh.)	1,000,000
Cost of capital	12%

Required:

(i) Determine the internal rate of return of the project using 12% and 24%. (6 marks)

(ii) Advise the management whether to invest in the project or not. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Summarise **FOUR** assumptions of Walter's dividend theory. (4 marks)

(b) The following information relates to Maji Limited for the year 2023:

Current dividend per share	Sh.3.25
Growth rate	6% per year
Market return	12%
Return on treasury bills	9% per annum
Asset beta	1.5

Required:

(i) Determine the value of Maji's share using Gordon Growth Model. (5 marks)

(ii) State whether the shares are overvalued or undervalued if the current market value of Maji's shares is Sh.60. (1 mark)

(c) Makinika Ltd.'s share has a nominal value of Sh.100. The company pays 10% of the nominal value of the share as dividend for the year. The current market price of the share is Sh.160 with 20% earnings yield.

Required:

(i) Compute earnings per share. (2 marks)

(ii) Calculate dividend cover. (2 marks)

(iii) Compute price earnings ratio. (2 marks)

(iv) Determine market value to book value ratio. (2 marks)

(v) Using your answer in (c) (iv) above, advise the shareholders on whether there is value creation or not. Justify your answer. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Summarise **FOUR** functions of a finance manager. (4 marks)

(b) The following information relates to Umoja Limited for the month of March 2024:

Sales (Sh.)	20,000,000
Sales commission	10% of sales
Advertising expenses	Sh.500,000 + 12% of sales
Miscellaneous selling expenses	Sh.100,000 + 1% of sales
Office salaries	Sh.700,000
Travel and entertainment	Sh.400,000
Miscellaneous administration expenses	Sh.175,000

Required:

Prepare a selling and administrative budget. (6 marks)

(c) Ubunifu Limited uses 50kgs of material K20 per day. The ordering costs are Sh.300 per order. The material costs are Sh.150 per Kg and the carrying costs are 20% per year. The company operates for 250 working days in a year.

Determine:

(i) Economic order quantity (EOQ).

(ii) Number of orders per year.

(iii) Average inventory.

(iv) Total relevant inventory costs.

(10 marks)

(Total: 20 marks)

CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 4 December 2023. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Highlight **FOUR** advantages of the Net Present Value (NPV) technique in capital budgeting. (4 marks)

(b) Discuss **FOUR** limitations of the profit maximisation goals of a firm. (4 marks)

(c) The board of directors of Ukweli Ltd. is considering a review of the company's dividend policy. The following information is provided.

1. The company paid Sh.3 million as dividend in the previous financial year.
2. The profit after tax for the last financial year was Sh.12 million.
3. The company has not issued any preference shares.
4. The company has been having a constant growth rate of 10% per annum for the past 10 years.
5. The expected profit after tax for the current year is Sh.18 million.
6. The company anticipates investment opportunities worth Sh.2 million in the current financial year.
7. The capital structure of the company consists of 60% equity and 40% debts.

Required:

The optimal total dividend for the current financial year if the company wishes to adopt the following independent dividend policies:

(i) Constant payout ratio policy. (3 marks)

(ii) Stable predictable dividend policy. (3 marks)

(iii) Pure residual dividend policy. (3 marks)

(iv) Low dividend plus extra dividend policy. (3 marks)

(Total: 20 marks)

QUESTION TWO

(a) Enumerate **FOUR** differences between factoring and pledging as sources of finance. (4 marks)

(b) Describe **THREE** working capital financing policies. (6 marks)

(c) The following is an extract from the financial position of MG Limited relating to its equity and liability as at 30 September 2023:

	Sh."000"
Ordinary shares capital (Sh.10 each)	10,000
Capital reserves	40,000
Revenue reserves	100,000
10% debentures	60,000
	210,000

Additional information:

1. The profit after tax for the year ended 30 September 2023 was Sh.6,000,000.
2. The dividend pay-out ratio for the year ended 30 September 2022 was 60%.
3. The market price per share as at 30 September 2023 was Sh.36.
4. The corporation tax is 30%.

Required:

(i) Debt to Equity ratio. (2 marks)

(ii) Dividend Yield (DY). (2 marks)

(iii) Return on Capital Employed (ROCE). (2 marks)

(iv) Earnings Per Share (EPS). (2 marks)

(v) Times Interest Covered ratio. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Highlight **FOUR** assumptions of cost-volume-profit (CVP) analysis. (4 marks)

(b) Describe **THREE** principles that govern the stakeholder's theory. (6 marks)

(c) Kings Limited is considering raising Sh.8,000,000 for its expansion.

The management estimates to use the following financing mix:

	Sh.
12% bank Loan	4,000,000
Ordinary shares (Sh.20 par value)	2,000,000
Retained earnings	2,000,000
	8,000,000

Additional information:

1. The market value of the ordinary shares is Sh.40.
2. The ordinary shareholders expect a dividend of Sh.4 per share with an expected growth rate of 6% per annum to perpetuity.
3. Floatation costs are Sh.2 per share.
4. Corporation tax rate is 30%.

Required:

Calculate the weighted average cost of capital (WACC) of the company. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Examine **TWO** reasons why money has time value. (4 marks)

(b) Trade credit as a source of finance of a firm has distinct advantages for buyers and sellers.

Required:

In relation to the above statement and the management of creditors, summarise **THREE** costs to an organisation of:

(i) Taking trade credit. (3 marks)

(ii) Not taking trade credit. (3 marks)

(c) Demo Ltd. is evaluating an investment project which requires the importation of a new machine at a cost of Sh.4,400,000. The machine has a useful life of six years.

Additional information:

1. The following additional costs would be incurred in relation to the machine:

	Sh."000"
Installation costs	600
Modification costs	500
Import duty	1,500
Freight charges	360

2. The machine is expected to increase the company's annual cash flows (before tax) as shown below:

Year	**1**	**2**	**3**	**4**	**5**	**6**
Annual cash flow (Sh."000"):	2,992	2,312	1,785	1,530	1,428	1,290

3. The machine is to be fully depreciated over its useful life using the straight line method.

4. An investment in working capital amounting to Sh.1 million will be required on commencement of the project.
5. The firm pays corporation tax at the rate of 30%.
6. Cost of capital is 12% per annum.

Required:

(i) Total initial costs. (3 marks)

(ii) The annual net cash flow after tax. (4 marks)

(iii) The net present value (NPV). (3 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Distinguish between “a flexible budget” and a “static budget”. (4 marks)

(b) Discuss **THREE** factors that influence the credit period extended by a company to its customers. (6 marks)

(c) The shares of Maweni Ltd. are currently trading at Sh.60 each at the securities exchange. Maweni Ltd’s price earnings ratio is 10 times. The company adopts a constant 60% payout ratio as its dividend policy. It is predicted that the company’s dividend will grow at an annual rate of 15% for the first two years, 10% for the next two years and thereafter at a constant rate of 6% per annum in perpetuity. The investor’s minimum required rate of return is 10%.

Required:

The intrinsic value of the shares of Maweni Ltd. (10 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 21 August 2023. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Explain **THREE** financing decisions made by the Board and management in an organisation. (6 marks)

(b) Describe **THREE** benefits that may accrue to a firm from preparing a cash flow statement. (6 marks)

(c) Texa Limited practices a strict residual dividend policy. It maintains a capital structure of 60% debt and 40% equity. Earnings for the year are Sh.10,000,000.

Required:

(i) Using the debt ratio, determine the maximum amount of capital expenditure possible without selling new equity. (3 marks)

(ii) Suppose that the planned investment outlay for the coming year is Sh.20,000,000, evaluate whether the company will pay a dividend. (5 marks)

(Total: 20 marks)

QUESTION TWO

(a) Summarise **FOUR** users of financial statements, citing the information need. (4 marks)

(b) Describe **THREE** internal factors that could influence financing decisions in an organisation. (6 marks)

(c) The following information was extracted from the financial statements of Kwekwe Ltd. for the year ended 31 December 2022:

	Sh. "million"
Cash and cash equivalent	500
Fixed assets	1,600
Sales (all on credit terms)	5,000
Net income	250
Current liabilities	600
Current ratio	3 times
Debtors collection period	40.55 days
Return on shareholders equity	25%

Assume 365 days in a year.

Required:

Calculate the following for the year ended 30 December 2022:

(i) Accounts receivable. (2 marks)

(ii) Current assets. (2 marks)

(iii) Return on total assets as a percentage. (2 marks)

(iv) Total shareholders equity. (2 marks)

(v) Quick ratio. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Highlight **FOUR** objectives of accounting. (4 marks)

(b) The following trial balance was extracted from the books of Sunlight Ltd. as at 31 March 2023:

	Sh."000"	Sh."000"
Gross profit		100,000
Other operating income		16,000
Administrative expenses	52,000	
Distribution cost	24,000	
General operating expenses	6,200	
Interim ordinary dividend paid	8,000	
Corporation tax (1 April 2022)		2,000
Ordinary share capital (Sh.50 par value)		40,000
10% preference share capital (Sh.100 par value)		36,000
10% debentures		32,000
Land and building (net book value)	100,000	
Plant and machinery (net book value)	32,000	
Motor vehicle (net book value)	8,000	
Inventory	24,000	
Trade receivables and trade payables	80,000	76,000
Cash at bank	16,400	
Capital redemption reserve fund		24,000
Share premium		16,000
Retained profit (1 April 2022)		12,000
Debenture interest paid	1,600	
Preference dividend paid	1,800	
	354,000	354,000

Additional information:

1. A building whose net book value was Sh.20 million as at 31 March 2023 was to be revalued to Sh.36 million.
2. The corporation tax for the year is estimated at Sh.10 million.
3. The directors have proposed a final dividend of 20% on the ordinary shares.
4. The directors have agreed to transfer Sh.2 million to capital redemption reserve fund.

Required:

(i) Prepare statement of profit or loss for the year ended 31 March 2023. (6 marks)

(ii) Statement of financial position as at 31 March 2023. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Enumerate **FOUR** causes of soft capital rationing as used in capital budgeting. (4 marks)

(b) A company is considering undertaking a capital investment project that is expected to generate annual cash flows of Sh.1 million for 5 years. The cash flows shall grow at a rate of 5% per year. The cost of capital for the company is 10%.

Required:

Compute the present value of cash flows. (4 marks)

(c) The following was the capital structure of Ushindi Ltd. as at 31 December 2022:

	Sh."000"
Ordinary share capital (Sh.20 par value)	12,000
12% preference share capital (Sh.25 par value)	5,760
10% debentures (Sh.1,000 par value)	5,040
Total	22,800

Additional information:

1. The current market prices per share is Sh.25. The most recent dividend paid by the company is Sh.2.50. Dividends are expected to grow at an annual rate of 10% per year.
2. New preference shares will be issued at Sh.35 per share subject to a floatation cost of Sh.5 per share.
3. New debentures will be issued at Sh.1,200 per debenture with a discount of Sh.30 and floatation cost of Sh.30 per debenture.
4. Corporation tax rate is 30%.

Required:

(i) The cost of ordinary share capital. (2 marks)

(ii) The cost of preference share capital. (2 marks)

(iii) The cost of debenture capital. (2 marks)

(iv) The weighted average cost of capital (WACC) using market value weights. (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Describe **THREE** red flags that could indicate that financial statements are of poor quality. (6 marks)

(b) Explain the following theories of dividend:

(i) Information signalling theory. (2 marks)

(ii) Tax differential theory. (2 marks)

(c) The following are the forecasted assets and liabilities of Ngurue Limited as at 30 June 2024:

Budget proposal for Ngurue Limited for the year ending 30 June 2024:

Assets:	**Sh.**
Cash	150,000
Accounts receivable	800,000
Inventory	1,200,000
Land	7,000,000
Buildings	19,000,000
Goodwill	2,600,000
Liabilities:	
Accounts payable	430,000
Salaries payable	70,000
Taxes payable	190,000
Mortgage payable	800,000
Ordinary shares	10,000,000
Retained earnings	820,000

Required:

Determine the company's budgeted net working capital requirement. (4 marks)

(d) The following information was extracted from the financial statement of Usawa Ltd.:

Net income (earnings after tax)	Sh.30 million
Number of ordinary shares	Sh.3 million
Capitalisation rate	12%
Payout ratio	60%
Internal rate of return	16%

Required:

Calculate the intrinsic value of a share under:

(i) Gordon's growth model. (3 marks)

(ii) Walter's model. (3 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 24 April 2023. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Enumerate **FOUR** reasons for the valuation of securities or firms. (4 marks)

(b) Zatex Ltd. paid an ordinary dividend of Sh.3.60 per share for the year ended 31 September 2022. The management of the company projects that the earnings of the company will increase in the coming years as follows:

Year ending 31 December	**Projected earnings growth rate per annum (%)**
2023	20
2024	20
2025	15
2026	15
2027 and subsequent years	10

The minimum required rate of return is 12%

Required:

Calculate the intrinsic value of the share using Gordon's growth model. (6 marks)

(c) Wauzaji Ltd. presented the following financial statements for the year ended 31 December 2022:

Statement of profit or loss for the year ended 31 December 2022

		Sh.	Sh.
Sales			9,040,000
Cost of sales:	Opening inventory	2,500,000	
	Purchases	6,820,000	
		9,320,000	
	Closing inventory	(2,860,000)	6,460,000
Gross profit			2,580,000
Expenses			(2,640,000)
Net loss			(60,000)

Statement of financial position as at 31 December 2022:

	Sh.	Sh.
Non-current assets:		
Premises	5,600,000	
Fixtures and fittings (NBV)	500,000	
Motor vehicles (NBV)	1,040,000	7,140,000
Current assets:		
Stock	2,860,000	
Debtors	3,260,000	
	6,120,000	
Current liabilities:		
Trade creditors	2,900,000	
Bank overdraft	2,800,000	
	5,700,000	
Net current assets		420,000
Net assets		7,560,000

	Sh.	Sh.
Financed by:		
Ordinary share capital		2,000,000
Retained profit		3,160,000
Long term loans		2,400,000
Capital employed		7,560,000

Assume a 360 day year

Required:
Compute.

(i) Current ratio. (2 marks)

(ii) Quick ratio. (2 marks)

(iii) Gross profit margin ratio. (2 marks)

(iv) Debtors collection period. (2 marks)

(v) Creditors payment period. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain **FOUR** reasons why the cost of capital is important to a firm. (4 marks)

(b) Discuss **THREE** benefits of working capital management. (6 marks)

(c) The following information relates to product X which is manufactured and sold by Neema Ltd.:

	Sh.
Selling price per unit	2,000
Direct material cost per unit	600
Direct labour cost per unit	300
Variable manufacturing overhead per unit	200
Variable marketing cost per unit	250
Total fixed manufacturing overhead	500,000

Required:
Calculate the level of profits in the following independent situations:

(i) The level of output is 1,000 units. (2 marks)

(ii) The level of output is 750 units. (2 marks)

(iii) The selling price per unit falls to Sh.1,900 and the level of output produced increases to 1,500 units. (3 marks)

(iv) Direct material unit cost falls to Sh.500, selling price falls to Sh.1,900 per unit and the output produced rises to 1,750 units. (3 marks)

(Total: 20 marks)

QUESTION THREE

(a) Describe the following categories of agency conflicts:

(i) Managers versus shareholders. (2 marks)

(ii) Creditors versus shareholders. (2 marks)

(iii) Shareholders versus employees. (2 marks)

(b) Discuss **FOUR** reasons why accounting profits might not be the best measure of a company's performance. (8 marks)

(c) Kelly Neno borrowed Sh.1,000,000 from a local bank at an interest rate of 15% per annum to be repaid in equal annual repayments for the next six years.

Required:
Prepare a loan amortisation schedule. (6 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Highlight **SIX** factors that might influence a company's capital structure. (6 marks)

(b) Jawabu Ltd.'s capital structure as at 1 October 2022 was as follows:

	Sh."000"
Ordinary share capital (Sh.10 each)	373,000
Retained earnings as at 1 July 2022	27,000
18% debentures	400,000
	800,000

The company is considering the acquisition of an investment project that will cost Sh.270 million. In order to finance the investments project, the company would be required to raise additional capital.

Additional information:

1. The above capital structure is considered optimal.
2. The company can obtain additional debentures at an interest rate of 18% per annum.
3. The dividend for the year ended 30 September 2022 was expected to be Sh.2.40 per share.
4. Additional ordinary shares can be issued in the securities exchange at a price of Sh.54 per share net of floatation cost of Sh.6 per share.
5. Dividends are expected to grow at a rate of 8% per annum for the foreseeable future.
6. Corporation tax is 30%.
7. The company will utilise 100% of its retained earnings.

Required:
Calculate:

(i) The cost of debentures. (1 mark)

(ii) The cost of retained earnings. (1 mark)

(iii) The cost of ordinary shares. (2 marks)

(iv) The amount of equity to be financed through the issue of new ordinary shares if the company is to maintain the optimal capital structure. (2 marks)

(v) Amount to be raised through debentures. (2 marks)

(c) Wauza Piki Ltd. planned to manufacture 2,000 units of motorcycles in 2,200 hours. However, it took 2,000 hours to manufacture 2,000 units of motorcycles. The variable cost items are as follows:

	Budgeted cost per direct labour hour	**Cost incurred**
	Sh.	**Sh.**
Direct labour	8	9,700
Direct material	1	1,200
Other variable costs	1	1,300
	10	12,200

Required:
Using the principles applicable to flexible budgeting, prepare in tabular format a performance report to the management of Wauza Piki Ltd. showing:

(i) Budget based on 2,200 actual hours. (2 marks)

(ii) Budget based on 2,000 hours allowed. (2 marks)

(iii) Total budget variance. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Analyse **TWO** characteristics of good investment evaluation criteria. (4 marks)

(b) Mahari Ltd. is considering its capital budget for the year 2024. The following information relates to four mutually exclusive projects that the management is contemplating about:

Projects	**Cash outflows (Sh.“000”)**	**Cash inflows (“Sh.000”)**		
		Year 1	**Year 2**	**Year 3**
A	(8,000)	2,000	4,000	6,000
B	(10,000)	4,000	6,000	6,000
C	(20,000)	8,000	12,000	10,000
D	(16,000)	6,000	10,000	8,000

Additional information:

1. The firm has a capital budget ceiling of Sh.20 million.
2. The cost of capital for Mahari Ltd. is 10%
3. The cash flows are assumed to occur at the end of each year.

Required:

Advise the management of Mahari Ltd. on the project to undertake using each of the following investments appraisal techniques:

(i) Net present value (NPV). (6 marks)

(ii) Profitability index (PI). (4 marks)

(c) A firm has a total investment of Sh.500 million in assets and 5 million outstanding ordinary shares at Sh.100 per share (par value). It earns a rate of 15% on its investment and has a policy of retaining 50% of the earnings. If the appropriate discount rate of the firm is 10%, determine the price of its share using Gordon’s Model.

(i) At a payout of 50%. (2 marks)

(ii) At a payout of 80%. (2 marks)

(iii) At a payout of 20%. (2 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 5 December 2022. Afternoon Paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Highlight **THREE** advantages of issuing shares through private placement. (3 marks)

(b) Describe **THREE** circumstances under which a firm might find it appropriate to use retained earnings as a source of finance. (6 marks)

(c) Magharibi limited is evaluating a change in its credit policy.
Presently, 70% of sales are on credit. The gross profit margin is 20%. The following information relates to the company:

	Current Credit policy	**New Credit policy**
Sales	Sh.8,000,000	Sh.10,000,000
Collection expenses	3% of credit sales	4% of credit sales
Collection period	72 days	90 days
Number of days in a year	360 days	360 days

Required:

(i) Change in gross profit. (3 marks)

(ii) Change in collection expenses. (3 marks)

(iii) Change in average accounts receivable. (3 marks)

(iv) Using the results in (c) (i) - (iii) above, advise the management whether or not to change the current credit policy if the borrowing rate is 16% per annum. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) Examine **THREE** ethical issues facing financial managers. (6 marks)

(b) Highlight **FOUR** arguments in favour of wealth maximisation objective. (4 marks)

(c) The following information relates to Upendo Technologies Ltd:

Paid-up equity capital	Sh.2,000,000
Earnings of the company	Sh.200,000
Dividend paid	Sh.160,000
Price-earning (P/E) ratio	12.5 times
Number of shares outstanding	20,000

Required:
Determine the following:

(i) Earnings per share (EPS). (2 marks)

(ii) Dividend per share (DPS). (2 marks)

(iii) The intrinsic value of a share using Walter's model. (3 marks)

(iv) Whether the company's dividend pay-out ratio is optimal using Walter's model. (3 marks)

(Total: 20 marks)

QUESTION THREE

(a) Outline **FOUR** reasons for time preference for money. (4 marks)

(b) Explain **THREE** characteristics of capital investment decisions. (6 marks)

(c) Arthur Kiplangat holds a 5-year, 12%, Sh.1,000 debenture par value.

Determine the value of the above debenture. (4 marks)

(d) The following details relate to a capital project in Furaha Ltd:

Initial cash outlay	Sh.104,000,000
Annual net operating cash flow (after tax)	Sh.33,600,000
Useful life of project	6 years
Minimum required rate of return	16%

Required:
Assess the suitability of the capital project using the following methods:

(i) Net present value (NPV). (2 marks)

(ii) Internal rate of return (IRR). (4 marks)
(Total: 20 marks)

QUESTION FOUR

(a) Describe **FOUR** benefits that might accrue to a company by having its shares quoted in the securities exchange. (4 marks)

(b) Explain **TWO** ways in which a company could issue new shares to its existing shareholders. (4 marks)

(c) Describe **TWO** costs associated with disclosure of financial statements information. (4 marks)

(d) The management of Makadilio Ltd. has decided to prepare a cash budget.

The following projections and other information are drawn from their balances:

1. The opening cash balance on 1 February 2023 is expected to be Sh.30,000,000.
2. The projected sales are as follows:

	Sh. "000"
December 2022	80,000
January 2023	90,000
February 2023	75,000
March 2023	75,000
April 2023	80,000

3. Analysis of books shows that accounts receivables are settled as follows:
   60% within the month of sale
   25% the month following
   15% the month following (second month after the month of sale)
4. Projected purchases were as follows:

	Sh. "000"
January 2023	60,000
February 2023	55,000
March 2023	45,000
April 2023	55,000

5. All purchases are on credit and past experience shows that 90% are settled on the month of purchase and the balance settled the month after.
6. Wages are Sh.15 million per month and overhead of Sh.20 million per month (including Sh.5 million depreciation) are settled monthly.
7. Taxation of Sh.8 million has to be settled in March 2023 and the company will receive settlement of an assurance claim of Sh.25 million in April 2023.

Required
Prepare a cash budget for the month of February, March and April 2023. (8 marks)
(Total: 20 marks)

QUESTION FIVE

(a) Examine **TWO** reasons why a company may prefer debt capital to equity capital. (4 marks)

(b) Discuss **THREE** importance of capital budgeting to a company. (6 marks)

(c) (i) Simon Nyaga intends to save a certain amount of money every year for five years in a bank paying 10% interest annually in order to raise college fee of Sh.5,000,000 for his daughter.

Required:
Determine the annual deposit that Simon Nyaga makes. (3 marks)

(ii) Janet Pendo has acquired a 20-month auto loan of Sh.6,000,000 at an annual interest rate of 12%.

Required:
Determine the amount of monthly loan repayments that Janet Pendo makes. (3 marks)

(d) The following information relates to product K produced and sold by Poka Limited.

	Sh.
Selling price	12,000
Variable cost per unit	8,000
Fixed costs per annum	20,000,000

Required:
Determine the following:

(i) Break-even point in shillings. (2 marks)

(ii) Number of units to be produced and sold in order to achieve a profit of Sh.30,000,000. (2 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

PILOT PAPER

FINANCE FOR DECISION MAKING

December 2021. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) The functions of a finance manager have evolved due to the dynamic nature of the business environment. Highlight some of the emerging roles of finance management. (4 marks)

(b) Outline the practical difficulties faced by small scale enterprises wishing to obtain finance to expand production. (4 marks)

(c) ABC Ltd. is in the agricultural industry. The company's balance extract as at 31 March 2020 is as below:

	Sh."million"
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:

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 at Sh.5. The DPS is expected to grow at 5% p.a. in future. The current MPS is Sh.40.

Required:

(i) Calculate the market weighted cost of capital for this firm. (8 marks)

(ii) Outline the weaknesses of using the weighted average cost of capital as a discounting rate. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) Distinguish between convertible debentures and non-convertible debentures. (2 marks)

(b) Company XYZ Ltd. has sold 10,000 ordinary shares of Sh.30 (partly called up) plus 20,000 Sh.45 preference shares, which are convertible. Compute the total number of ordinary shares after conversion. (4 marks)

(c) Outline the constraints to the growth of Venture Capital in Kenya. (6 marks)

(d) For each of the companies described below, advice the company on the most appropriate dividend policy to be adopted by the company.

(i) A company with a large proportion of inside ownership, all of whom are high income individuals. (2 marks)

(ii) A growth company with an abundance of good investment opportunities. (2 marks)

(iii) A company experiencing ordinary growth, has high liquidity and much unused borrowing capacity. (2 marks)

(iv) A dividend-paying company that experiences an unexpected drop in earnings from the trend. (2 marks)

(Total: 20 marks)

QUESTION THREE

The following financial statements relate to the ABC Company:

Assets	**Sh.**	**Liabilities & Net worth**	**Sh.**
Cash	28,500	Trade creditors	116,250
Debtors	270,000	Notes payable (9%)	54,000
Stock	649,500	Other current liabilities	100,500
Total current assets	948,800	Long term debt (10%)	300,000
Net fixed assets	285,750	Net worth	663,000
	1,233,750		1,233,750

Income Statement for the year ended 31 March 1995

	Sh.
Sales	1,972,500
Less cost of sales	1,368,000
Gross profit	604,500
Selling and administration expenses	498,750
Earning before interest and tax	105,750
Interest expense	34,500
	71,250
Estimated taxation (40%)	28,500
Earnings after interest and tax	42,750

Required:

(a) Calculate:

(i) Inventory turnover ratio. (2 marks)

(ii) Times interest earned ratio. (2 marks)

(iii) Total assets turnover. (2 marks)

(iv) Net profit margin. (2 marks)

(Note: Round your ratios to one decimal place)

(b) The ABC Company operates in an industry whose norms are as follows:

Ratio	**Industry Norm**
Inventory turnover	6.2 times
Times interest earned ratio	5.3 times
Total assets turnover	2.2 times
Net profit margin	3%

Required:

(i) Comment on the revelation made by the ratios you have computed in part (a) above when compared with the industry average. (4 marks)

(ii) Explain the limitations of using financial ratios in decision making. (8 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Distinguish between Capital structure and financial structure of a firm. (4 marks)

(b) Roca Real Estate Developers purchased a machine five years ago at a cost of Sh.7,500. The machine had an expected economic life of 15 years at the time of purchase and a zero estimated salvage value at the end of 15 years. It is being depreciated on a straight line basis and currently has a book value of Sh.5,000. The Financial Manager has conducted a feasibility study aimed at acquiring a new machine for Sh.12,000 and is depreciated over its 10 years useful life. The new machine will expand sales from Sh.10,000 to Sh.11,000 per annum and will reduce labour and materials usage sufficiently to cut operating cost from Sh.7,000 to Sh.5,000. The salvage value of the new machine is Sh.2,000 at the end of useful life. The current market value of the old machine is Sh.1,000 and tax is 40%. The firms cost of capital is 10%. The financial manager wishes to make a decision on whether to replace the old machine with a new one and he seeks your held.

Required:

(i) Compute the NPV of incremental cash flows and advice the company on whether to replace the old machine with a new machine. (10 marks)

(ii) Discuss the advantages of using NPV techniques in evaluating investments. (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain the concept of crowdfunding and highlight relevant examples. (4 marks)

(b) Explain the significance of valuation securities. (4 marks)

(c) XYZ Ltd is expected to pay a DPS of Sh.6 in one year's time. The dividend payout ratio is 60% and the Return on Equity is 15%. Determine whether the share is overvalued if the MPS is Sh.40. (4 marks)

(d) Highlight the defensive tactics against a hostile takeover bid. (8 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

WEDNESDAY: 15 December 2021. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) In a digital economy, the role of finance manager is pervasive in all activities of the firm.

Required:
In light of the above statement, discuss four main managerial roles played by a finance manager. (8 marks)

(b) In relation to working capital management, distinguish between "over-capitalisation" and "under-capitalisation". (4 marks)

(c) The following information relates to two companies: Alpha Ltd. and Beta Ltd. for the year ended 31 December 2020:

	Alpha Ltd.	**Beta Ltd.**
Annual sales (Sh."000")	15,000	10,000
Percentage of gross profit on sales	25%	22%
Average stock (Sh."000")	800	650
Current liabilities (Sh."000")	1,000	800
Current ratio	3:1	2.6:1
Closing stock (Sh."000")	820	600
Receivables at year end (Sh."000")	2,000	1,250

Required:
Using the above information calculate the following:

(i) Stock turnover ratio. (2 marks)

(ii) Acid test ratio. (2 marks)

(iii) Receivables turnover. (2 marks)

(iv) Average age of receivables in months. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) Highlight five sources of finance in their order of preference according to the pecking order theory. (5 marks)

(b) The following information relates to profits reported by Donnet Ltd. for the last four years.

	2017	**2018**	**2019**	**2020**
Profit after tax (Sh."million")	6.0	6.2	6.3	6.3

The firm's earnings yield is 12%.

Required
The market value of Donnet Limited. (5 marks)

(c) The following information was extracted from the statement of financial position of ZAP Limited:

	Sh."000"
Ordinary Shares (Sh.0.50 each)	2,500
12% unsecured bonds	1,000

Additional information:
1. The ordinary shares are currently quoted at Sh.1.30 each.
2. The 12% bonds are trading at Sh.72.
3. The ordinary dividend of Sh.0.15 has just been paid with an expected growth rate of 10%.
4. The corporation tax rate 30%.

Required
The weighted average cost of capital(WACC) for the company. (10 marks)
(Total: 20 marks)

QUESTION THREE

(a) Mathew Wakili intends to start a small business enterprise.
Advise Mathew Wakili on four external sources of finance that may be available to him. (8 marks)

(b) Pambo Limited Purchased a special machine 1 year ago at a cost of Sh.1,200,000. At that time, the machine was estimated to have a useful life of 6 years and no salvage value. The annual operating costs for the old machine are estimated at Sh.400,000.

A new machine has just been introduced to the market which will do the same job but with an annual operating cost of Sh.340,000. The new machine costs Sh.2,100,000 and has an estimated useful life of 5 years with zero salvage value.

The old machine can be sold for Sh.1,000,000.

Additional information:
1. The company uses straight line method of depreciation.
2. The corporation tax rate is 30%.
3. The company's cost of capital is 10%.

Required:
(i) The initial investment for new machine. (2 marks)

(ii) The incremental cash inflow after tax. (2 marks)

(iii) The Net Present Value (NPV) of the new machine. (2 marks)

(iv) Advise the management whether to invest in the new machine. (2 marks)

(c) The following information has been extracted from the books of Kawaida Ltd. for the year ended 31 December 2020:

Profit after tax	Sh.15 million
Total dividend paid	Sh.9 million
Number of shares outstanding	2 million
Cost of equity capital	20%
Rate of return on investment	25%

Required:
The current theoretical market value of the company's share using the Walters Model. (4 marks)
(Total: 20 marks)

QUESTION FOUR

(a) With respect to working capital management, describe four possible methods of easing cash shortages in an organisation. (4 marks)

(b) XYZ Ltd. has a dividend capitalisation rate of 12% on its investment of Sh 600,000 in assets. The company has 600,000 outstanding ordinary shares at Sh.10 per share each. The company's rate of return is 10% and it has a policy of retaining 40% of the earnings.

Required:

(i) Using Gordon's model, determine the price of the company's share. (3 marks)

(ii) Critique Gordon's Model as a method of valuing securities. (3 marks)

(c) Fred Onyango visited his local bank in search for additional working capital and proposes to borrow Sh.120,000 repayable in six months. The credit analyst at the bank upon interviewing Fred Onyango discovers that although the customer's cash inflows have been averagely steady over the last few years, his business experiences a boom twice a year at intervals of six months. The end of the next six months coincides with the end of the proposed loan's tenure. A partially amortising loan with Sh.60,000 being paid at the end of the sixth month is recommended.

Required:

Prepare a loan amortisation schedule for the two options to assist Fred Onyango in understanding the repayments.

Note: The bank charges an interest rate of 14.40% per annum. (10 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Budgets are not prepared in isolation and then filed away but are the fundamental components of what is known as the budgetary planning and control system.

In line with this statement:

(i) Explain the meaning of the term "budgetary planning and control system". (1 mark)

(ii) State five objectives of a budgetary planning and control system. (5 marks)

(b) JNS Manufacturers Limited manufactures two products namely; "Skyline" and "Digitex". The company is in the process of preparing the year 2022 budgets. Both products are made by the same grade of labour, grade C. The company currently holds 800 units of Skyline and 1,200 units of Digitex in inventory but 250 units of Digitex have been discovered by auditors to have deteriorated in quality and must therefore be scrapped. Budgeted annual sales of Skyline are 3,000 units and of Digitex are 4,000 units, provided that the company maintains finished goods inventories at a level equal to three months sales.

Grade C labour was originally expected to produce one unit of Skyline in two hours and one unit of Digitex in three hours at an hourly rate of Sh.250 per hour. However, in discussions with Wafanyikazi trade union negotiators, it has been agreed that the hourly wage rate should be raised by Sh.50 per hour provided that the times to produce Skyline and Digitex are reduced by 20%.

Required:

(i) Production budget for the year 2022. (6 marks)

(ii) Direct labour budget for the year 2022 indicating the direct labour cost per hour. (4 marks)

(c) Summarise four assumptions of the Walter's dividend relevance model. (4 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 1 August 2022. Afternoon paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Highlight five limitations of profit maximisation objective of a firm. (5 marks)

(b) Explain five assumptions of cost volume profit analysis. (5 marks)

(c) The projected weekly working capital requirements for Uwezo Ltd. for the second week of August 2022 is as follows:

Day	**Amount of working capital required Sh."000"**
Monday	9,000
Tuesday	9,000
Wednesday	12,500
Thursday	16,000
Friday	23,000
Saturday	33,500
Sunday	44,000

The expected cost of short term funds is 20% while that of long term funds is 25%.
Ignore taxation.

Required:

(i) A schedule showing the amount of permanent and seasonal working capital requirement for each day. (4 marks)

(ii) The average amount of long term and short term finance that would be required daily. (2 marks)

(iii) The total cost of working capital finance if the firm adopted an aggressive financing strategy. (2 marks)

(iv) The total cost of working capital finance, if the firm adopted a conservative financing strategy. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain the following terms as used in valuation:

(i) Book value. (2 marks)

(ii) Replacement value. (2 marks)

(b) Discuss three importance of capital investment decisions. (6 marks)

(c) The capital structure of Maziwa Ltd. which is considered optimal as at 31 May 2022 was as follows:

	Sh."000"
Ordinary share capital	225,000
Retained earnings	75,000
8% preference share capital (Sh.100 par value)	75,000
12% debenture (Sh.1,000 par value)	125,000
	500,000

The company intends to raise additional funds for investing in a new project which is estimated to cost Sh.150 million.

Additional information:

1. Any new ordinary shares issued will incur a 15% floatation cost per share.
2. The most recent ordinary dividend paid by the company was Sh.5 per share. Dividend is expected to grow at the rate of 8% per annum.
3. The current dividend yield is 6.25%.
4. The company expects to raise a maximum of Sh.22,500,000 from retained earnings to finance the project.
5. Additional 8% preference shares can be issued at the current market price of Sh.120 per share.
6. A new 12% debenture can be issued at Sh.960 per debenture.
7. Corporation tax rate is 30%.

Required:

(i) The current market price per ordinary share. (2 marks)

(ii) The number of ordinary shares that should be issued to finance the project. (2 marks)

(iii) The cost of retained earnings. (1 mark)

(iv) The cost of ordinary shares. (1 mark)

(v) The cost of preference shares. (1 mark)

(vi) The cost of debenture capital. (1 mark)

(vii) The company's weighted marginal cost of capital. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Cyrus Mwavuli borrowed Sh.1,000,000 from Hakika Bank at an annual interest rate of 12% on reducing balance. The loan was repayable in annual instalments over a period of four years. The instalments were payable at the end of the year.

Required:

A loan amortisation schedule. (4 marks)

(b) Discuss three factors that could influence a firm's capital structure decisions. (6 marks)

(c) The following data was extracted from the books of Banda Ltd. for the year ended 31 December 2021:

Total sales	Sh.40,000,000
Total asset turnover	2 times
Total debt to total assets	30%
Current ratio	3 times
Inventory turnover	5 times
Average collection period	18 days
Fixed assets turnover	5 times
Gross profit margin	25%

Assume 360 days in a year.

Required:

Banda Ltd.'s statement of financial position as at 31 December 2021. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Explain each of the following dividend policies:

(i) Stable dividend. (2 marks)

(ii) Constant dividend payout ratio. (2 marks)

(iii) Residual dividend. (2 marks)

(b) Discuss three causes of conflict between shareholders and creditors. (6 marks)

(c) The shares of Ukweli Limited are currently trading at Sh.60 each at the securities exchange. Ukweli Limited's price earning (P/E) ratio is 6 times. The company adopts 50% payout ratio as its dividend policy. It is predicted that the company's dividends will grow at an annual rate of 25% for the first three years, 20% for the next 2 years and thereafter at a constant rate of 10% per annum in perpetuity. The investor's minimum required rate of return is 16%.

Required:

(i) Current intrinsic value of the shares of Ukweli Limited. (6 marks)

(ii) Advise a prospective investor whether or not to buy the shares of Ukweli Limited. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Summarise two differences between "master budget" and "cash budget". (4 marks)

(b) Argue four cases in favour of factoring as a source of finance. (4 marks)

(c) The directors of Sports Wear Ltd. is considering the selection of a project from two mutually exclusive projects each with an estimated productive life of five years.

Project Alpha will cost Sh.4,960,000 and is expected to generate annual cash flows of Sh.1,200,000 with an estimated residual value of Sh.1,180,000.

Project Beta will cost Sh.2,400,000 and is expected to generate annual cash flows of Sh.600,000 with an estimated residual value of Sh.405,000.

The company employs a straight line depreciation policy. The company's cost of capital is 12% per annum.

Required:

(i) Pay back period for each project. (4 marks)

(ii) Net present value (NPV) of each project. (6 marks)

(iii) Advise the board of Sports Wear Ltd. on which project to undertake under each of the investment evaluation method in (c) (i) and (c) (ii) above. (2 marks)

(Total: 20 marks)

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CS ADVANCED LEVEL

FINANCE FOR DECISION MAKING

MONDAY: 4 April 2022. Afternoon paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

(a) Summarise six factors that a finance manager could consider when selecting the source of finance. (6 marks)

(b) Discuss four methods of issuing ordinary shares. (4 marks)

(c) Enzyl Ltd. has provided the following statements of profit or loss for the year ended 31 December 2020 and 31 December 2021 for your review:

Statement of profit or loss for the year ended 31 December

	2021	**2020**
	Sh."000"	**Sh."000"**
Revenue	3,875	3,625
Cost of sales	(2,500)	(2,287.5)
Gross profit	1,375	1337.5
Other income	100	62.5
Distribution costs	(150)	(125)
Administrative expenses	(537.5)	(500)
Finance cost	(100)	(90)
Profit before tax	687.5	685
Income tax expense	(287.5)	(275)
Profit after tax	400	410
Preference dividends	(35)	(35)
Ordinary dividends	(62.5)	(62.5)
Retained profit for the year	302.5	312.5
Retained profit brought forward	1,350	1,037.5
Retained profit carried forward	1,652.5	1,350

Required:

Horizontal analysis of the statement of profit or loss for the year ended 31 December 2020 and 31 December 2021. (10 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain four factors that influence a firm's cost of capital. (4 marks)

(b) Nimeal Ltd. produces and sells a single product N20.

The following information relates to the company:

Budgeted sales (units)	10,000
Sales price (Sh.)	1,200
Variable cost per unit (Sh.)	400
Fixed costs per annum (Sh.)	5,600,000

Required:

(i) The break-even point in units and in shillings. (4 marks)

(ii) The number of units to be sold in order to achieve a profit of Sh.2,000,000. (2 marks)

(iii) The margin of safety in percentage. (2 marks)

(c) Discuss four limitations of budgeting in a firm. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) Distinguish between the terms "compounding" and "discounting" in relation to time value of money. (2 marks)

(b) Firms strive to achieve goals which at times compliment and conflict with each other.
With reference to the above statement, explain four ways in which goals of a firm may conflict with each other. (8 marks)

(c) Sanitizer Ltd. currently owns 100,000 outstanding ordinary shares with a market price of Sh.10 per share. The firm has Sh.1,000,000 earnings after tax and intends to invest Sh.2,000,000 during the year 2022. The firm is also considering declaring a dividend of Sh.5 per share at the end of the year. The firm's cost of capital is 10%.

Required:

(i) The price of the share at the end of the year 2022 if dividend is not declared. (2 marks)

(ii) The price of the share at the end of the year 2022 if dividend is declared. (2 marks)

(iii) The number of new shares to be issued in (c) (i) and (c) (ii) above. (6 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Explain the following securities valuation models:

(i) Book value. (2 marks)

(ii) Intrinsic value. (2 marks)

(b) Buyrite Ltd. has recently issued Sh.1,000, 10% convertible bond. The bond can be converted into 30 ordinary shares at the end of five years.
The current market price of the shares of Buyrite Ltd. is Sh.25 per share. The price is expected to grow at a rate of 10% per annum:

The investors required rate of return is 12%.

Required:
The current value of the bond. (6 marks)

(c) The following is the capital structure of Maendeleo Limited as at 31 December 2021:

	Sh.
200,000 ordinary shares (each Sh.20)	4,000,000
10% debentures (Sh.100 par value)	1,000,000
8 % preference shares (Sh.20 each)	1,600,000
	6,600,000

Additional information:

1. The current market value of ordinary shares is Sh.40 while the preference shares are trading at Sh.50 per share.
2. The ordinary shareholders have been paid a dividend of Sh.2 per shares for the year 2021. The dividends are expected to grow at an annual growth rate of 10% for the foreseeable future.
3. The debentures have a market value of Sh.120.
4. Corporation tax rate is 30%.

Required:
Maendeleo limited's weighted average cost of capital (WACC). (10 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain the following types of capital rationing:

(i) Hard capital rationing. (2 marks)

(ii) Soft capital rationing. (2 marks)

(b) Discuss three factors that influence the formulations of the working capital policy of a firm. (6 marks)

(c) Fridel Ltd. finance director has provided the following details for their upcoming investment project. The company has a policy of recouping its investments within four years. The industry required rate of return is 10% and the current commercial interest rate is 12%. The estimated cost of the project is Sh.24,000,000. It is expected to generate 5 years annual cash flows as follows:

Year	1	2	3	4	5
Cash flow (Sh.)	7,800,000	6,000,000	4,200,000	7,400,000	9,200,000

Required:

(i) The Net Present Value (NPV) of the project. (5 marks)

(ii) The Internal Rate of Return (IRR). (5 marks)

(Total: 20 marks)

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