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FINANCIAL MANAGEMENT**July 2019****Time: 3 hours****THE KENYA NATIONAL EXAMINATIONS COUNCIL****DIPLOMA IN BUSINESS MANAGEMENT
DIPLOMA IN INVESTMENT MANAGEMENT
DIPLOMA IN HUMAN RESOURCE MANAGEMENT****FINANCIAL MANAGEMENT****3 hours****INSTRUCTIONS TO CANDIDATES**

This paper consists of SEVEN questions.

Answer any FIVE questions in the answer booklet provided.

All questions carry equal marks.

Candidates should answer the questions in English.

This paper consists of 4 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) Explain **four** external factors that may affect the dividend policy of a company. (8 marks)
- (b) Dema Limited required Ksh 10,000,000 to cover transaction costs in the coming year. The interest rate on securities is currently at 40% per annum. The cost of converting securities into cash is Ksh 1,000, per transaction.

Using the Baumol cash management model, determine;

- (i) optimal cash conversion size;
 (ii) average cash balance;
 (iii) the number of days it takes to convert securities into cash.
 (Take one year to be 360 days)

(12 marks)

2. (a) Explain **four** benefits that may accrue to a firm that uses retained earnings as a source of finance. (8 marks)
- (b) Maso Limited borrowed Ksh 500,000 from a bank to be repaid in 5 years. The interest rate is at the rate of 15% per annum.

- (i) Determine the annual instalments.
 (ii) Prepare a loan amortisation schedule.

(12 marks)

3. (a) Outline **five** goals of financial management in an organisation. (10 marks)
- (b) On 31 December 2018, Zakuu Limited had the following capital structure.

	Ksh
100,000 ordinary shares of Ksh 15 each	1,500,000
Retained earnings	2,000,000
100,000 10% preference shares of Ksh 10 each	1,000,000
1,000 8% debentures of Ksh 1,000 each	1,000,000
Long term loan	500,000

Additional information:

- Dividend in ordinary shares is 18%.
- Interest on long term loan is 25%.
- The corporation tax rate is 30%.

Determine the weighted average cost of capital.

(10 marks)

4. (a) Explain **four** functions of the Central Bank of Kenya. (8 marks)
- (b) The following information relates to Lomwa Limited for the year ended 31 December 2018.

	Ksh
Ordinary share capital at Ksh 20 each	6,000,000
10% preference shares of Ksh 10 each	2,500,000
Interest on loan	50,000
Net profit before tax	1,500,000
Corporation tax @ 30%	
Total assets	8,000,000

The company paid a dividend of 10% per share on ordinary shares. The market price per ordinary share was Ksh 40.

Calculate each of the following ratios:

- (i) Return on Assets (ROA);
- (ii) Return on Equity (ROE);
- (iii) Preference dividend cover;
- (iv) Dividend yield;
- (v) Price Earnings ratio. (12 marks)

5. (a) Explain **four** advantages of borrowing money through commercial paper. (8 marks)
- (b) Riika intends to invest Ksh 2,500,000 in either Project Pama or Project Nama. The expected cash inflows from the projects are as follows:

Year	Project Pama	Project Nama
	Ksh	Ksh
1	1,200,000	800,000
2	800,000	800,000
3	750,000	800,000
4	600,000	750,000
5 Scrap	—	50,000

The company's cost of capital is 10%.

- (i) Determine the Net Present Value for each project.
- (ii) Advise the management on the project to invest in. (12 marks)

6. (a) Explain **four** factors that should be considered by a company before establishing a subsidiary company in a foreign country. (8 marks)
- (b) The following information was extracted from the books of Taya Limited for the year ended 31 December 2018.

	Ksh
Proceeds from leased machine	120,000
Dividend paid	60,000
Interest paid	20,000
Proceeds from investment	45,000
Addition to machinery	280,000
Cash received from debtors	1,000,000
Cash paid to suppliers	820,000
Proceeds from disposal of investment	200,000
Interest received	80,000
Receipts from issue of shares	100,000
Dividend received	35,500
Cash balance (1 January 2018)	519,500
(31 December 2018)	420,000

Prepare a statement of cash flow for the year ended 31 December 2018. (12 marks)

7. (a) Explain **four** disadvantages of Internal Rate of Return (IRR) as a method of investment appraisal. (8 marks)
- (b) Malisa Limited is considering to invest in three independent projects, C D and E. The projects are divisible. The following information relates to the project.

Projects	Initial investment	NPV	NPVI (PI)
	Ksh	Ksh	Ksh
C	100,000	500,000	5
D	50,000	500,000	10
E	800,000	1,200,000	1.5

The company has Ksh 300,000 available for investment.

Determine the optimal investment plan. (12 marks)

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