

EXAMINATIONS

April 1999

Subject B — Economics and Finance

Paper Two

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *Write your surname in full, the initials of your other names and your Candidate's Number on the front of the answer booklet.*
2. *Begin your answers to Parts One, Two and Three on a separate sheet.*
3. *Mark allocations are shown in brackets.*
4. *Attempt all 32 questions.*

Graph paper is not required for this paper.

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet and this question paper.

<p><i>In addition to this paper you should have available Actuarial Tables and an electronic calculator.</i></p>
--

PART ONE

For questions 1–14 indicate in your answer booklet which one of the answers A, B, C or D is correct.

The following information relates to Questions 1–3:

The following information was extracted from the books of Miss Fitt at 31 December 1998.

	£
Sales	18,955
Cost of sales	11,334
Salaries and Wages	2,447
Motor Expenses	664
Rent	456
Rates	120
Insurance	146
Packing Expenses	276
Lighting and Heating Expenses	665
Sundry Expenses	115
Motor Vehicles	2,400
Fixtures and Fittings	600
Stock as at 31 December 1998	4,998
Debtors	4,577
Creditors	3,045
Cash in bank	3,876
Cash in hand	120
Capital	10,794

Ignore depreciation on fixed assets.

1 The current liabilities figure in the balance sheet at 31.12.98 will be:

- A £2,939
- B £3,045
- C £3,151
- D £15,885

[1]

2 The fixed assets figure as at 31.12.98 will be:

- A £3,000
- B £10,974
- C £18,536
- D £29,330

[2]

- 3** The net profit for the year to 31.12.98 will be:
- A £2,481
 - B £2,681
 - C £2,732
 - D £4,940
- [3]
- 4** Tom holds 20,000 £1 shares in a limited company. These are 75% paid up. If the company goes into liquidation, the maximum amount of cash that Tom could be asked to contribute towards the settlement of the company's debts is:
- A zero
 - B £5,000
 - C £15,000
 - D £20,000
- [1]
- 5** Eurobond markets are regulated by:
- A The London Stock Exchange
 - B The Bank of England
 - C The European Union
 - D None of the above
- [1]
- 6** The largest proportion of the funds invested on the Stock Exchange come from:
- A individuals
 - B investment trusts
 - C pension funds
 - D unit trusts
- [1]
- 7** Sarah wishes to create a limited company. Which of the following would prevent her from incorporating it as a public limited company?
- A she has only three fellow investors, giving a total of only four shareholders
 - B she and her fellow investors cannot afford to contribute £50,000 of share capital
 - C neither she nor her fellow investors have prior experience of being on the board of a limited company
 - D she is not seeking a Stock Exchange quotation for the company
- [1]

- 8** A company must raise medium term finance in order to acquire a new machine. Which of the following is most likely to require that additional security should be pledged by the company?
- A lease the machine from a finance company
 - B purchase the machine on hire purchase from the supplier
 - C borrow the cost of the machine from a bank
 - D purchase the machine by cheque, using part of the company's overdraft facility [1]
- 9** Which of the following defines a limited company's relationship with the outside world?
- A articles of association
 - B memorandum of association
 - C share certificates
 - D debenture certificates [1]
- 10** A company is seeking additional long term finance. Which of the following would normally be the most expensive?
- A convertible preference shares
 - B debenture stock
 - C ordinary shares
 - D preference shares [1]
- 11** A company received a dividend of £120, which was grossed up to £160. What rate of tax will the company pay on this dividend?
- A 0%
 - B 20%
 - C 25%
 - D 40% [1]
- 12** A taxpayer paid £25,000 for an asset in June 1992 when the Retail Price Index (RPI) was 137.5. The asset was sold in April 1998 for £42,000 when the RPI was 162.6. What is the chargeable gain on this sale?
- A £9,335
 - B £10,515
 - C £12,437
 - D £13,140 [2]

13 The following figures were extracted from the accounts of a company:

	<i>1999</i>	<i>1998</i>
	£	£
Operating profit	12,000	15,000
Depreciation	4,000	4,000
Working capital (stock + debtors – creditors)	7,500	4,500

What is the company's cash inflow from operating activities for the year ended 1999?

- A £9,000
 - B £13,000
 - C £16,000
 - D £19,000
- [2]

14 A company plans to make a 3 for 5 rights issue at 140p. If the price of the shares on the day that the allotment letters were posted was 180p, what price would you expect the share to trade at immediately after the issue?

- A 155p
 - B 165p
 - C 175p
 - D 180p
- [2]

In questions 15-24 one or more of the options may be correct. Answer in your booklet by selecting according to the following code:

- A if I and II only are correct*
- B if II and III only are correct*
- C if I only is correct*
- D if III only is correct*

15 A company's profit for corporation tax purposes is different from its profit for accounting purposes. Which of the following could account for this?

- I depreciation is not allowed as an expense for tax purposes
 - II taxable profit is calculated for the tax year and not the accounting year
 - III taxable profit is calculated on a totally different basis from accounting profit
- [2]

16 Alpha plc owns shares in three companies, Bravo Ltd (40% holding), Charlie Ltd (60% holding) and Delta Ltd (25% holding). Alpha has a contractual right to appoint two thirds of the board of Bravo Ltd. Alpha has used its voting rights to appoint all of the directors of Charlie Ltd. Alpha was invited by the board of Delta Ltd to appoint one member of that company's board. Which of the following are subsidiaries of Alpha plc?

- I Bravo Ltd
 - II Charlie Ltd
 - III Delta Ltd
- [2]

17 Which of the following types of financial instruments are likely to be purchased by a discount house?

- I Shares in quoted companies
 - II Treasury bills
 - III Bills of exchange
- [2]

18 Which of the following statements are true of traded options?

- I traded options are more risky than conventional share options
 - II traded options are available for all quoted companies
 - III traded options are available as both call and put options
- [2]

- 19** The following are true of unit trusts:
- I they are quoted on the Stock Exchange
 - II they are not companies
 - III they do not raise equity or debt capital
- [2]
- 20** Which of the following activities would a merchant bank undertake:
- I issuing Eurobonds
 - II providing management for unit trusts
 - III borrowing from clearing banks on a short term basis
- [2]
- 21** Which of the following are valid reasons for seeking a Stock Exchange quotation?
- I a quotation provides an immediate inflow of capital
 - II a quotation enhances the company's visibility and credibility
 - III a quotation provides the existing shareholders with additional flexibility
- [2]
- 22** Which of the following types of financial instrument can give their holders virtually unlimited opportunity for capital growth?
- I ordinary shares
 - II convertible loan stock
 - III debenture loan stock
- [2]
- 23** Which of the following are recognised characteristics of swaps?
- I They allow institutions to change the nature of their assets and liabilities
 - II They are priced so that the present value of the cash flows is slightly negative for one party and slightly positive for the other
 - III They enable both parties to reduce their financial risks
- [2]
- 24** Which of the following are true of price limits in the futures markets?
- I they are set in relation to the fundamentals of the underlying assets
 - II they protect the clearing house from excessive credit risk
 - III the market must close if the future price falls outside of the price limits
- [2]

PART TWO

- 25** The board of Alfa plc wish to increase the company's issued share capital by making an issue to the existing shareholders. Describe the characteristics of both scrip issues and rights issues and describe the advantages and disadvantages of each. [6]
- 26** Explain how goodwill can arise on consolidation and how it would be treated in the accounts. [6]
- 27** The indexation allowance is an important element in the taxation of capital gains. Explain why it is used and how is it calculated. [4]
- 28** A machine which had a cost of £20,000 and had accumulated depreciation of £17,200 was sold during 1999 for £4,800. The total cost of machinery shown in the December 1998 balance sheet was £180,000 and the related accumulated depreciation was £92,000. The company uses 10% straight line depreciation on machinery and no depreciation is charged in the year in which an asset is sold.
- Calculate the gain or loss on the disposal of this machine and explain what the gain or loss on the disposal of a fixed asset represents. [4]
- 29** Discuss the role of the Stock Exchange in the United Kingdom. [8]
- 30** Mr and Mrs Patterson own a small limited company. They wish to purchase two vans costing £12,000 each. Advise them of three methods of finance which might be appropriate for this purpose. [8]
- 31** Explain the potential benefits of convertible securities to the investor. [4]

PART THREE

- 32** T plc and W plc both operate in the same industry. Their most recent financial statements are shown below:

	<i>T plc</i>	<i>W plc</i>
	<i>£000</i>	<i>£000</i>
Sales	400	600
Cost of sales	<u>-160</u>	<u>-210</u>
Gross profit	240	390
Operating expenses	-100	-110
Interest	<u>-75</u>	<u>-72</u>
Net profit	<u><u>65</u></u>	<u><u>208</u></u>

Balance Sheets as at 31 December 1998

	<i>T plc</i>	<i>W plc</i>
	<i>£000</i>	<i>£000</i>
Fixed Assets	1000	1400
Current Assets		
Stock	10	14
Debtors	<u>37</u>	<u>70</u>
	47	84
Current Liabilities		
Overdraft	-26	-21
Creditors	<u>-13</u>	<u>-26</u>
	-39	-47
Loan	<u>-500</u>	<u>-600</u>
	<u><u>508</u></u>	<u><u>837</u></u>
Share capital	300	450
Profit and loss	<u>208</u>	<u>387</u>
	<u><u>508</u></u>	<u><u>837</u></u>

Required:

Compare and contrast the performance of the two companies in terms of profitability, liquidity and gearing. You should support your answer with ratios.

[20]