

EXAMINATIONS

11 September 2001 (pm)

Subject 108 — Finance and Financial Reporting

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. *Mark allocations are shown in brackets.*
3. *Attempt all 19 questions. From question 11 onwards begin each answer on a separate sheet.*

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>
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For questions 1–10 indicate in your answer booklet which one of the answers A, B, C or D is correct.

- 1** Which of the following is subject to taxation in the UK?
- A social security benefits
 - B winnings from gambling
 - C profits from an ISA
 - D dividends from a UK company
- [2]
- 2** Which of the following statements is **NOT** true of investment trusts?
- A an investment trust is a company
 - B they raise equity and debt capital
 - C they never invest in the shares of other UK companies
 - D most investment trusts are listed on the stock exchange
- [2]
- 3** When a firm announces a two-for-one scrip issue investors should expect that, (in the absence of other new information):
- A earnings per share will fall but the stock price will remain the same
 - B the stock price will fall but the earnings per share will remain the same
 - C both the earnings per share and the stock price will remain the same
 - D both the earnings per share and the stock price will fall
- [2]
- 4** The nominal value of a bond is received by the bondholder:
- A at the time of purchase
 - B annually
 - C whenever coupon payments are made
 - D at maturity
- [2]
- 5** The net present value method of capital budgeting assumes that cash flows are reinvested at:
- A the firm's cost of capital
 - B the firm's dividend yield
 - C no rate — they are not reinvested
 - D the rate of return of the project
- [2]

- 6** The payback method can lead to the wrong decision being made because:
- A it ignores income beyond the payback period
 - B the payback period is difficult to calculate
 - C the returns in later years are uncertain
 - D of the emphasis placed on the interest factor
- [2]

- 7** Which of the following changes in working capital will result in an improvement in a company's net cash inflow from operating activities?
- A increase in creditors
 - B increase in stock
 - C increase in debtors
 - D decrease in other current liabilities
- [2]

- 8** The following ratios were calculated from the financial statements of G plc, a major manufacturing company.

Stock turnover	12 days
Debtors turnover	42 days
Creditors turnover	46 days

For how long, on average, does G plc have cash tied up in any particular piece of stock?

- A 8 days
 - B 12 days
 - C 54 days
 - D 100 days
- [2]

- 9 H plc's summary financial statements are as follows:

Profit and loss account

For the year ended 31 March 2001 £000

Profit before tax and interest	2,000
Interest	(300)
Taxation	<u>(500)</u>
	1,200
Dividend	<u>(700)</u>
Retained for year	500
Balance brought forward	<u>4,700</u>
Balance carried forward	<u><u>5,200</u></u>

Balance sheet

As at 31 March 2001 £000

Total assets less current liabilities	35,200
Long term loans	<u>(3,000)</u>
	<u><u>32,200</u></u>
Share capital	27,000
Profit and loss account	<u>5,200</u>
	<u><u>32,200</u></u>

Calculate H plc's return on capital employed.

- A 3.7%
- B 4.3%
- C 5.7%
- D 7.4%

[2]

- 10 Which of the following statements is **NOT** true of double taxation relief (DTR)?

- A The UK has a double taxation agreement with many countries.
- B The maximum offset is the rate of tax that would have been paid in the UK.
- C DTR is available on revenue of a capital nature.
- D DTR is only available on income received from abroad.

[2]

- 11 Explain why the net present value criterion is superior to other methods of investment appraisal.

[6]

- 12** Explain the influence of a central bank (e.g. the Bank of England) on the government bond market. [6]
- 13** Explain how a company's capital structure might influence its share price. [6]
- 14** Describe the role building societies play in investment markets. [4]
- 15** Discuss the interests of four user groups of financial statements and explain why some of the groups' interests may conflict. [8]
- 16** Explain how a company's UK corporation tax liability is calculated and when it must be paid. [6]
- 17** Describe the factors that must be determined when selecting a company's depreciation policy. [4]
- 18** D plc is in the process of making a 1 for 4 rights issue. The rights letters have just been sent to shareholders. The company currently has 20m £1 shares in issue and the current market price is £4.50 per share.

The rights letter gives shareholders the right to buy their new shares for £3.50 each. D plc plans to use the cash raised to build a major extension to its factory, thereby doubling production capacity.

The finance director has received an angry letter from a shareholder. The shareholder complains that he cannot afford to invest in new shares. He is, therefore, likely to suffer a loss because the fact that the market will be flooded with cheap shares will almost certainly decrease the value of his holding.

Required:

- (a) Calculate the value at which the share price is likely to settle after the rights issue. [2]
- (b) Explain whether the shareholder's complaint is justified with particular reference to the difference between the rights price and the current market price. [4]
- (c) Explain whether the share price is likely to settle at the figure calculated in (a) above. [4]
- (d) Discuss the advantages and disadvantages of financing the extension by issuing loan stock. [5]
- (e) Discuss the advantages and disadvantages of financing with a commercial mortgage. [5]

[Total 20]

- 19** The following information has been extracted from the bookkeeping records of Z plc:

Z plc

Trial Balance as at 30 June 2001.

	£000	£000
Administrative expenses	25	
Advertising	200	
Bank		6
Creditors		54
Debtors	140	
Interest	120	
Land and Buildings — cost	983	
Land and Buildings — depreciation		45
Loan		600
Manufacturing overheads	35	
Plant and Machinery — cost	550	
Plant and Machinery — depreciation		150
Profit and loss as at 1 July 2000		180
Purchases	450	
Sales		1,200
Share capital		200
Share premium		300
Stock as at 1 July 2000	18	
Wages — administrative staff	44	
Wages — distribution staff	30	
Wages — manufacturing	140	
	<u>2,735</u>	<u>2,735</u>

Notes:

- (i) Closing stock was counted at the year end and was valued at £19,000.
- (ii) Depreciation is to be charged on the following bases:
 - Factory — 2% of cost
 - Plant and Machinery — 25% of reducing balance
- (iii) The directors have decided to pay a dividend of £80,000 for the year.
- (iv) The corporation tax charge has been estimated at £22,000 for the year.
 - (a) Prepare Z plc's profit and loss account for the year ended 30 June 2001 and its balance sheet as at that date. These should be in a form suitable for publication insofar as this is possible from the information provided. [15]
 - (b) Comment on any notable features of Z plc's dividend policy, as revealed by your answer to (a) above. [5]

[Total 20]