UGANDA MARTYRS UNIVERSITY

CPA (U LEVEL TWO

FINANCIAL MANAGEMENT - PAPER 8

DATE: TUESDAY 23/5/2023

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours 15 minutes.**

   The first 15 minutes of this examination have been designated for reading time. You may not start to write your answer during this time.

2. Section **A** has **one** compulsory question carrying 40 marks.

3. Section **B** has **four** questions and only **three** questions are to be attempted. Each question carries 20 marks.

4. Relevant formulae and tables are provided on pages 10 - 12

5. Write your answer to each question on a fresh page in your answer booklet.

6. Please, read further instructions on the answer booklet, before attempting any question.

SECTION A

This section has one compulsory question to be attempted

Question 1

Mr. John Bernard is an investor from the Ssese Islands. He came to Uganda after listening to the President's Nation address to Ugandans in the Diaspora living in the United States of America. During the address, CEO invited Ugandans and any other interested persons to come and enjoy the conducive investment environment in Uganda. Mr. Bernard picked interest and wants to invest in the manufacturing industry. However, he is at crossroads on whether to start his own company or to partner with existing companies. In addition, is apprehensive about the cost of capital, the financial capability and going concern of the existing companies in Uganda. Mr. Bernard has contacted Uganda Investment Authority (UIA) to assist him with information about potential companies that he can partner with. UIA has identified two companies; Aban Industries Limited (Aban) and Bena Holdings Limited (Bena). He intends to choose one depending on its liquidity, solvency and profitability. Mr. Bernard has identified you as a financial expert to analyze the performance ofthe two companies and advise on the better option. Additionally, Mr. Bernard also wants to know the cost of capital in Uganda. Some information about the two companies and industrial ratios has been obtained and their summarized financial statements for the year ended 31 December, 2022 are as follows:

Statements of comprehensive income for the year ended

	ABAN	BENA
	Shs 'million'	Shs 'million'
Sales	20,000	30,000
Cost of sales	(7,000)	(15,000)
Gross profit	13,000	15,000
Other expenses	(2,000)	(5,000)
Administrative expenses	(1,000)	(2,000)
Profit before interest and tax	10,000	8,000
Interest	(1,000)	(1,200)
Profit after interest before tax	9,000	6,800
Tax (at 30%)	(2,700)	(2,040)
Profit after tax	6,300	4,760

Statement of financial position as at 31 December:

	ABAN Shs 'million'	BENA Shs 'million'
Non-current assets:		
Property plant & equipment	13,400	17,000
Current assets:		
Receivables	9,500	12,200
Inventory	8,200	6,000
Cash	6,000	2,360
Total assets	37,100	37,560
Equity & liabilities:		
Ordinary shares	9,200	10,200
Reserves	8,300	6,160
Total equity	17,500	16,360
Non-current liabilities:		
Long-term debt	5,000	6,000
Current liabilities:		
Other accounts payable	8,000	6,200
Accruals	6,600	9,000
	14,600	15,200
Total equity & liabilities	37,100	37,560

The following selected ratios are also provided:

Ratio	Industry average
Current ratio	2:1
Quick/ acid test ratio	1:1
Net profit margin	25%
Debt to equity ratio	40%
Interest coverage ratio	4 times
Receivables days	60 days

You may assume 360 days in a year.

Mr. Bernard is also aware that he can use preference shares as one of the sources of finance. One potential investor has offered to buy 10% redeemable preference shares of Shs 20,000 each at Shs 25,000 and these shares will be redeemed after 10 years at par. Mr. Bernard has been has indicated that he is ready to embark on any project that comes his way provided it fits within his capital investment budget.

Required:

Mr. Bernard has shared with you the information in his possession and is seeking guidance on the following issues:

(a) Using the industry ratios as a benchmark, advise on which company to partner with. **(15 marks)**

(b) Explain the limitations of ratio analysis. **(5 marks)**

(c) (i) Explain the importance of investment appraisal in investment decision. **(6 marks)**

(ii) Recommend **one** investment appraisal technique, giving at least **three** reasons to support your choice. **(4 marks)**

(d) (i) Calculate the cost of preference shares. **(5 marks)**

(ii) Explain the advantages of debt capital. **(5 marks)**

(Total 40 marks)

Question 2

Kampala Beverages Limited (KBL) produces a wide range of soft drinks and distributes them in many business centres across the country. Their summarized statement of financial position as at 30 June, 2022 is as follows:

	Shs '000'
Non-current assets	690,000
Trade receivables	250,000
Cash at bank	50,000
Inventory	50,000
Total assets	1,140,000
Equity & liabilities:	
Trade payables	100,000
Bond	100,000
Issued capital	890,000
Retained earnings	50,000
Total equity & liabilities	1,140,000

The following information relates to the forecasts for the last six months of the financial year ending 31 December 2022:

Month	Sales	Purchases	Overheads
	Shs '000'	Shs '000'	Shs '000'
July	300,000	400,000	40,000
August	310,000	500,000	50,000
September	400,000	550,000	50,000
October	500,000	450,000	55,000
November	600,000	500,000	55,000
December	200,000	500,000	55,000

Additional information:

1. It is estimated that;
   - (i) 70% of the sales are credit sales.
   - (ii) 60% of the receivables are recovered in the month following the sale and 40% in the subsequent month.
   - (iii) All debtors prior to July 2022 are to pay in August 2022.
   - (iv) The suppliers are paid in the month following delivery.
   - (v) Payables as at 30 June 2022 are to be cleared in September 2022.
2. Assets Shs 90 million are planned to be purchased in August 2022.
3. Rent Shs 200 million for the year 2022 is to be paid in September 2022.
4. Inventory Shs 250 million is to remain at the end of December 2022.

Required:

(a) Prepare, for KBL, a:
   - (i) Cash budget for the months, July - December 2022. **(11 marks)**
   - (ii) forecast statement of comprehensive income for the period ending 31 December 2022. **(5 marks)**

(b) Discuss any **four** ethical issues in financial management. **(4 marks)**

(Total 20 marks)

Question 3

Mr. Tony Kendo is a local investor who is considering either setting up a Ravage Treatment plant (RTP) or a Risky waste transportation company, (RWTC) Whichever maximizes return and minimizes risk. The plan is to have the company operate in the Albertine Graben where Uganda has discovered oil and gas reserves.Mr. Kendo has contracted you as a financial management expert to help him with issues of risk and return assessment. He has separately intimated to you that he is desirous to have his new company listed on the Uganda Securities Exchange (USE) in less than three years from now. He thinks this approach will enable him generate more funds for expansion.Mr. Kendo has also provided you with the following information obtained from his investment advisor:

State of the economy Possible returns (Shs '000')

	RTP	RWTC	Probability
Strong	200	500	0.20
Moderate	150	400	0.30
Weak	100	200	0.50

Required:

(a) Calculate the risk and return for both RTP and RWTC **(10 marks)**

(b) Explain to Mr. Kendo the:

(i) different types of risks that may affect the realization of returns. **(5 marks)**

(ii) procedures for listing on Uganda Securities Exchange. **(5 marks)**

(Total 20 marks)

Question 4

(a) Talale Services Ltd (TSL), a road construction company operating in Northern Uganda, has its main camp site in Soroti Municipal Council. The company on average requires 2,000 litres of fuel per day to run all their machines and equipment. Their fuel supplier is Fuel Masters, a petrol station based in Soroti. A fixed cost of Shs 30,000 is incurred for placing an order of 2,000litres and Shs 500 to carry a 20-litre jerrycan to its fuel depots. The lead-time is 2 days. In January 2018, Uganda was hit by fuel shortage and this affected all fuel stations including Fuel Masters which caused inability to supply fuel to their clients including TSL. During the weekly management meeting, the finance manager of TSL suggested that TSL should think of buying shares in one of the big fuel companies in Uganda that are listed on the Securities Exchange in order to ensure reliable fuel supply.

Required:

As a management consultant, compute and advise TSL on the:

(i) economic order quantity. **(4 marks)**

(ii) total ordering costs. **(2 marks)**

(iii) total carrying costs. **(2 marks)**

(iv) re-order level. **(2 marks)**

(b) Discuss the:

(i) roles of a finance manager in an organization. **(5 marks)**

(ii) various sources of finance for capital investment projects. **(5 marks)**

(Total 20 marks)

Question 5

Bayle Uganda Limited (BUL) is a newly built hospital in Uganda specializing in treatment of heart related complications including surgeries. The company plans to purchase and install a modern high-tech machine to help in open heart surgeries. BUL is however, faced with financial difficulties and is considering approaching Prime Commercial Bank (PCB) for debt finance to help fund the proposed investment At its executive committee (EXCO) meeting, the company's chief finance officer(CFO) proposed that the company should explore the viability of financing the proposed investment using Islamic finance. However, given that the Islamic finance is still new in Uganda, the CFO was not well conversant with how it practically works and implored the meeting to consider engaging a financial consultant with knowledge in Islamic finance to advise the company on the practicability of using Islamic finance to fund investments similar to that of BUL.

Required

You have been engaged as a financial consultant of RUL, explain to the management of BUL the:

(a) Differences between conventional and Islamic banking. **(8 marks)**

(b) Advantages of Islamic banking. **(6 marks)**

(c) Principles of Islamic banking. **(6 marks)**

(Total 20 marks)