**cover page**

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**FINANCIAL MANAGEMENT FINAL EXAMINATION**

Define the followings terms as used in Financial Management

Accounting

ANSWER: Accounting also refers to the process of summarizing, analyzing and reporting these transactions to oversight agencies, regulators and tax collection entities. The financial statements that summarize a large company's operations, financial position and [cash flows](https://www.investopedia.com/terms/c/cashflow.asp) over a particular period are a concise summary of hundreds of thousands of financial transactions it may have entered into over this period.

Budgeting

ANSWER: *Budgeting*is a process. This means budgeting is a number of activities performed in order to prepare a [budget](https://www.accountingcoach.com/blog/what-is-a-budget). A *budget*is a quantitative plan used as a tool for deciding which activities will be chosen for a future time period.

In a business, the budgeting for operations will include the following:

preparing estimates of future sales

preparing estimates of future cash collections and disbursements

preparing estimates of the future day-to-day activities of the organization

summarizing these estimates into an income statement and [balance sheet](https://www.accountingcoach.com/blog/balance-sheet)

The budgeted income statement and balance sheet are also known as [*pro-forma financial statements*](https://www.accountingcoach.com/blog/pro-forma-financial-statements). Once prepared and approved, the budgeted income statement and balance sheet are used to control the future activities of the business.

Financial reporting standards

ANSWER: ACCOUNTING one of a set of [rules](https://dictionary.cambridge.org/dictionary/english/rule) [created](https://dictionary.cambridge.org/dictionary/english/create) by the Accounting Standards Board that [state](https://dictionary.cambridge.org/dictionary/english/state) how a company's [financial](https://dictionary.cambridge.org/dictionary/english/finance) [information](https://dictionary.cambridge.org/dictionary/english/information) has to be [shown](https://dictionary.cambridge.org/dictionary/english/shown):

*The*[report](https://dictionary.cambridge.org/dictionary/english/report) [assumes](https://dictionary.cambridge.org/dictionary/english/assume) *that Financial Reporting Standard 3, Reporting Financial Performance, has been put into*[*effect*](https://dictionary.cambridge.org/dictionary/english/effect)*. furthermore,* International **Financial Reporting Standards**, usually called IFRS, are **standards** issued by the IFRS Foundation and the International **Accounting Standards** Board (IASB) to provide a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.

GAAP

ANSWER: Generally Accepted Accounting Principles (**GAAP**) is a framework of accounting standards, rules and procedures **defined** by the professional accounting industry, which has been adopted by nearly all publicly traded U.S. companies.

b. Giving examples what are the advantages of financial ratios (10 marks)

ANSWER: The Advantages of Financial Ratios

Financial ratios are tools used to assess the relative strength of companies by performing simple calculations on items on income statements, balance sheets and cash flow statements. Ratios measure companies' operational efficiency, liquidity, stability and profitability, giving investors more relevant information than raw financial data. Investors and analysts can gain profitable advantages in the stock market by using the widely popular, and arguably indispensable, technique of ratio analysis.

Comparison

Financial ratios provide a standardized method with which to compare companies and industries. Using ratios puts all companies on a relatively equal playing field in the eyes of analysts; companies are judged on their performance rather than their size, sales volume or market share. Comparing the raw financial data of two companies in the same industry offers only limited insight. Ratios go beyond the numbers to reveal how good a company is at making a profit, funding the business, growing through sales rather than debt and a wide range of other factors.

An older company, for example, might boast 50 times the revenue of a new small business, which would make the older company seem stronger at first glance. Analyzing the two companies with ratios such as return on equity (ROE), return on assets (ROA) and net profit margin may reveal that the smaller company operates much more efficiently, generating substantially more profit per dollar of assets employed.

Industry Analysis

Ratios can reveal trends in particular industries, creating benchmarks against which the performance of all industry players can be measured. Small businesses can use industry benchmarks to craft organizational strategy and clearly measure their own performance against the industry as a whole.

As an example, analysis may reveal that the average debt-to-equity ratio in the widget industry is .85; a company with a debt-to-equity ratio of 1.3 would be much more heavily leveraged than other widget manufacturers, even though its total debt may be vastly smaller than larger players' debt.

Stock Valuation

The common language and understanding of ratios helps investors and analysts to evaluate and communicate the strengths and weaknesses of individual companies or industries. Fundamental analysis is the term given to the use of financial ratios in determining the relative strength of companies for investing purposes. A careful analysis of a company's ratios can reveal which companies have the fundamental strength to increase their stock value over time & potentially profitable opportunity; while pointing out the weaker players in the market as well.

Planning and Performance

Ratios can provide guidance to entrepreneurs when creating business plans or preparing presentations for lenders and investors. Using industry trends as a baseline, small-business owners can set time-bound performance goals in terms of specific ratios to give investors a glimpse into the potential of the new company. Ratios can also serve as an impetus for strategic change within an organization, providing management with relevant guidance and feedback as ratio valuations shift in response to organizational changes. Ratios keep managers on their toes by revealing financial weaknesses and opportunities.

A) Outline the features of a sound investment appraisal technique [4 Marks]  
ANSWER: Appraisal techniques

It's important to estimate the benefits of the investment in financial terms.

The main techniques you can use are:

accounting rate of return

payback period

discounted cash flow

investment risk and sensitivity analysis

When using these techniques you should ignore any sunk costs (costs that you've already incurred or would spend regardless). These aren't part of your specific investment.

Accounting rate of return

Accounting rate of return or 'ARR' compares the profits you expect to make from an investment to the amount you need to invest.

It's normally calculated as the average annual profit you expect over the life of an investment project, compared with the average amount of capital invested.

Payback period

Payback period is a simple technique for assessing an investment by the length of time it would take to repay it. It's usually the default technique for smaller businesses and focuses on cash flow, not profit.

Discounted cash flow

Discounted cash flow applies a discount rate to work out the present-day equivalent of a future cash flow. There are two types of discounting methods of appraisal - the net present value (NPV) and internal rate of return (IRR).

Investment risk and sensitivity analysis

Investment risk and sensitivity analysis is a realistic assessment of risks is essential. In practice, the biggest risk for many investments is the disruption they can cause.

The benefits of investing in your business

Spending money on your business can have many benefits, including:

greater flexibility and quality of production

faster time-to-market, resulting in a bigger market share

improved company image, better staff morale and job satisfaction, leading to greater productivity

quicker decisions due to better availability of information

It can also contribute to what your business is trying o do overall, sometimes called 'strategic objectives'.

Often, one of the key benefits of spending money can be the skills your business learns and the future opportunities that may arise. A useful test is to think about your alternatives.

(b) Clearly distinguish between the following terms as used in a financial system  
  
(i) Money Market and Capital Market

ANSWER:

two of the most commonly used are [money markets](https://www.investopedia.com/terms/m/moneymarket.asp) and [capital markets](https://www.investopedia.com/terms/c/capitalmarkets.asp).

Money markets are used by government and corporate entities as a means for borrowing and lending in the short term, usually for [assets](https://www.investopedia.com/terms/a/asset.asp) being held for up to a year. Conversely, capital markets are more frequently used for long-term assets, which are those with maturities of greater than one year.

Capital markets include the [equity](https://www.investopedia.com/terms/e/equity.asp) (stock) market and [debt](https://www.investopedia.com/terms/d/debt.asp) (bond) market. Together, money markets and capital markets comprise a large portion of the financial market and are often used together to manage liquidity and risks for companies, governments and individuals.

Capital Markets

Capital markets are perhaps the most widely followed markets. Both the stock and bond markets are closely followed, and their daily movements are analyzed as proxies for the general economic condition of the world markets. As a result, the institutions operating in capital markets – [stock exchanges](https://www.investopedia.com/financial-edge/1212/stock-exchanges-around-the-world.aspx), [commercial banks](https://www.investopedia.com/terms/c/commercialbank.asp) and all types of corporations, including non-bank institutions such as insurance companies and mortgage banks – are carefully scrutinized.

The institutions operating in the capital markets access them to raise capital for long-term purposes, such as for a merger or acquisition, to expand a line of business or enter into a new business, or for other capital projects. Entities that are raising money for these long-term purposes come to one or more capital markets. In the bond market, companies may issue debt in the form of [corporate bonds](https://www.investopedia.com/terms/c/corporatebond.asp), while both local and federal governments may issue debt in the form of [government bonds](https://www.investopedia.com/terms/g/government-bond.asp).

Similarly, companies may decide to raise money by issuing equity on the stock market. Government entities are typically not publicly held and, therefore, do not usually issue equity. Companies and government entities that issue equity or debt are considered the sellers in these markets. (See also: [What Are the Differences Between Debt and Equity Markets?](https://www.investopedia.com/ask/answers/071415/what-are-differences-between-debt-and-equity-markets.asp))

The buyers (or the investors) buy the stocks or bonds of the sellers and trade them. If the seller (or [issuer](https://www.investopedia.com/terms/i/issuer.asp)) is placing the securities on the market for the first time, then the market is known as the [primary market](https://www.investopedia.com/terms/p/primarymarket.asp).

Conversely, if the securities have already been issued and are now being traded among buyers, this is done on the [secondary market](https://www.investopedia.com/terms/s/secondarymarket.asp). Sellers make money off the sale in the primary market, not in the secondary market, although they do have a stake in the outcome (pricing) of their securities in the secondary market.

The buyers of securities in the capital market tend to use funds that are targeted for longer-term investment. Capital markets are risky markets and are not usually used to invest short-term funds. Many investors access the capital markets to save for [retirement](https://www.investopedia.com/terms/r/retirement.asp) or education, as long as the investors have lengthy time horizons. (For related reading, see [Types of Financial Markets and Their Roles](https://www.investopedia.com/walkthrough/corporate-finance/1/financial-markets.aspx).)

Money Market

The money market is often accessed alongside the capital markets. While investors are willing to take on more risk and have patience to invest in capital markets, money markets are a good place to "park" funds that are needed in a shorter time period – usually one year or less. The financial instruments used in capital markets include stocks and bonds, but the instruments used in the money markets include [deposits](https://www.investopedia.com/terms/d/deposit.asp), collateral loans, acceptances and [bills of exchange](https://www.investopedia.com/terms/b/billofexchange.asp). Institutions operating in money markets are central banks, commercial banks and acceptance houses, among others.

Money markets provide a variety of functions for either individual, corporate or government entities. Liquidity is often the main purpose for accessing money markets. When [short-term debt](https://www.investopedia.com/terms/s/shorttermdebt.asp) is issued, it's often for the purpose of covering operating expenses or [working capital](https://www.investopedia.com/terms/w/workingcapital.asp) for a company or government and not for capital improvements or large-scale projects. Companies may want to invest funds overnight and look to the money market to accomplish this, or they may need to cover payroll and look to the money market to help.

(ii) Primary Market and Secondary Market

ANSWER:

n the primary capital market, [investors buy directly](https://www.investopedia.com/ask/answers/012615/whats-difference-between-primary-and-secondary-capital-markets.asp) from the issuing company. In the secondary market, investors trade securities among themselves.

When a company goes public, it sells new stocks and bonds for the first time. Usually, that sale takes the form of an [initial public offering](https://www.investopedia.com/terms/i/ipo.asp). Companies hire [investment bankers](https://www.investopedia.com/terms/i/investmentbanker.asp) to obtain buying commitments from large institutional investors for the IPO, often engaging in elaborate marketing strategies to secure these commitments.

The secondary markets include the [New York Stock Exchange](https://www.investopedia.com/terms/n/nyse.asp), the London Stock Exchange and the [Nasdaq](https://www.investopedia.com/terms/n/nasdaq.asp). Individual investors with little money are more likely to buy and sell on the secondary market, where anyone can trade, even if they only make small transactions.

Investors on the secondary market use brokers to make their purchases. Prices and demand fluctuate daily, but the prices paid by investors no longer stem directly from the IPO. Unless a company is buying back its shares, it has nothing to do with sales in the secondary market between two investors.

(c) Explain briefly the factors that are considered when establishing a dividend policy for an organization by its directors. [5 Marks]

ANSWER:

factor: 1. General State of Economy

factor: 2. Capital Market Considerations

Factor: 3. Legal, Contractual Constraints and Restrictions

Factor: 4. Tax Policy/Tax Consideration

Factor: 5. Inflation

Factor: 6. Stability of Dividends

Factor: 7. Dividend Pay-Out (D/P) Ratio

Factor:8. Owner’s Considerations

a) Discuss the types of foreign exchange risks that a company operating  
internationally may be exposed to. (10marks)

ANSWER:

**Foreign exchange risk** describes the **risk** that an investment's value may change due to changes in the value of two different **currencies**. It is also known as **currency risk**, FX **risk** and **exchange**-rate **risk**. Economic **exposure**, or forecast **risk**, refers to when a company's market value is impacted by **currency** volatility.  
  
b) Explain each of the following currency risk it can be used to mitigate  
  
foreign exchange risks.  
  
a) Currency forward contracts. (3marks)  
b) Currency futures contract. (3marks)  
c) Currency options (3marks)  
d) Currency swaps (3marks)

ANSWRS :

Investing in foreign assets has proven the merits of diversification, and most individual investors take advantage of the benefits of international assets. However, unless you invest in foreign securities issued in U.S. dollars, your portfolio will gain an element of currency risk. Currency risk is the risk that one currency moves against another currency, negatively affecting your overall return. Investors can accept this risk and hope for the best, or they can mitigate it or eliminate it completely. Below are three different strategies to lower or remove a portfolio's currency risk.

Hedge the Risk with Specialized Exchange-Traded Funds

There are many exchange-traded funds (ETFs) that focus on providing long and short exposures to many different currencies. For example, the Pro Shares Short Euro Fund (NYSEARCA: EUFX) seeks to provide returns that are the inverse of the daily performance of the euro. A fund like this can be used to mitigate a portfolio's exposure to the performance of the euro.

If an investor purchased an asset that is based in Europe and denominated in the euro, the daily price swings of the U.S. dollar versus the euro will affect the asset's overall return. The investor would be going "long" with the euro in this case. By also purchasing a fund like the Pro Shares Short Euro Fund, which would effectively "short" the euro, the investor would cancel out the currency risk associated with the initial asset. Of course, the investor must make sure to purchase an appropriate amount of the ETF, to be certain that the long and short euro exposures match 1-to-1.

ETFs that specialize in long or short currency exposure aim to match the actual performance of the currencies on which they are focused. However, the actual performance often diverges due to the mechanics of the funds. As a result, not all of the currency risk would be eliminated, but a vast majority can be. As of April 2016, there were ETFs that provide long and short exposure for the U.S. dollar, the Japanese yen, the European euro, the Australian dollar, the Swiss franc, the Chinese yuan and others.

Use Forward Contracts

Currency forward contracts are another option to mitigate currency risk. A forward contract is an agreement between two parties to buy or sell a specific asset on a specific future date, at a specific price. These contracts can be used for speculation or hedging. For hedging purposes, they enable an investor to lock in a specific currency exchange rate. Typically, these contracts require a deposit amount with the currency broker. The following is a brief example of how these contracts work.

As of April 1, 2016, one U.S. dollar equaled 111.97 Japanese yen. If a person is invested in Japanese assets, has exposure to the yen and plans on converting that yen back to U.S. dollars in six months, he can enter into a six-month forward contract. Imagine that the broker gives the investor a quote to buy U.S. dollars and sell Japanese yen at a rate of 112, roughly equivalent to the current rate. Six months from now, two scenarios are possible: The exchange rate can be more favorable for the investor, or it can be worse. Suppose the exchange rate is worse, at 125. It now takes more yen to buy 1 dollar, but the investor would be locked in to the 112 rate and would exchange the predetermined amount of yen at dollars at that rate, benefiting from the contract. However, if the rate had become more favorable, such as 105, the investor would not get this extra benefit because he would be forced to conduct the transactions

Use Currency Options

Currency options give the investor the right, but not the obligation, to buy or sell a currency at a specific rate on or before a specific date. They are similar to forward contracts, but the investor is not forced to engage in the transaction when the contract's expiration date arrives. In this sense, if the options exchange rate is more favorable than the current spot market rate, the investor would exercise the option and benefit from the contract. If the spot market rate was more favorable, then the investor would let the option expire worthless and conduct the foreign exchange trade in the spot market. This flexibility is not free, and the options can represent expensive ways to hedge currency risk.

The purpose of currency swaps is to hedge against risk exposure associated withexchange rate fluctuations, ensure receipt of foreign monies and to achieve better lending rates. Currency swaps are comprised of two notional principals that are exchanged at the beginning and end of the agreement.

Effects of Taxation on Multinational Corporations

Outward Direct Investment and the U.S. Economy Comment  The Effects of Outbound Foreign Direct Investment on the Domestic Capital Stock Comment  Why Is There Corporate Taxation in a Small Open Economy? The Role of Transfer Pricing and Income Shifting Comment  The Impact of International Tax Rules on the Cost of Capital Comment The Tax Sensitivity of Foreign Direct Investment: Evidence from Firm-Level Panel Data Comment The Alternative Minimum Tax and the Behavior of Multinational Corporations Comment  Accounting Standards, Information Flow, and Firm Investment Behavior Comment  Taxes, Technology Transfer, and the R&D Activities of Multinational Firms Comment Do Repatriation Taxes Matter? Evidence from the Tax Returns of U.S. Multinationals Comment Interest Allocation Rules, Financing Patterns, and the Operations of U.S. Multinationals Comment Contributors Author Index Subject Index

The tax rules of the United States and other countries have intended and unintended effects on the operations of multinational corporations, influencing everything from the formation and allocation of capital to competitive strategies. The growing importance of international business has led economists to reconsider whether current systems of taxing international income are viable in a world of significant capital market integration and global commercial competition.

This volume examines the effect of tax policy on international investment choices by presenting in-depth analyses of the interaction of international tax rules and the investment decisions of multinational enterprises. Ten papers assess the role of investment by multinational firms in the U.S. economy and the design of international tax rules for multinational investment; analyze channels through which international tax rules affect the costs of international business activities; and examine ways in which international tax rules affect financing decisions of multinational firms. As a group, the papers demonstrate that international tax rules have significant effects on firms’ investment and other financing decisions.

This state-of-the-art volume will be of interest to researchers in public finance and international economics and to policymakers concerned with tax policy and international investment issues.

Martin Feldstein is the George F. Baker Professor of Economics at Harvard University and president of the National Bureau of Economic Research. James R. Hines, Jr., is an associate professor of public policy at the John F. Kennedy School of Government of Harvard University and a faculty research fellow of the National Bureau of Economic Research. R. Glenn Hubbard is the Russell L. Carson Professor of Economics and Finance at the Graduate School of Business of Columbia University and a research associate of the National Bureau of Economic Research.  
  
c) How may global taxation affect the behavior of a transnational  
company? (6marks)

3.Define and explain the relevance of the following accounting concepts:  
 a) Accrual concept (3marks)  
 b) Consistency principle (3marks)  
 c) Economic entity assumption (3 marks)  
 d) Going concern (3marks)

ANSWERS:

Accrual of something is, in finance, the adding together of interest or different investments over a period of time. It holds specific meanings in accounting, where it can refer to accounts on a balance sheet that represent liabilities and non-cash-based assets used in accrual-based accounting

The consistency principle states that, once you adopt an accounting principle or method, continue to follow it consistently in future accounting periods. Only change an accounting principle or method if the new version in some way improves reported financial results. if you make such a change, fully document its effects and include this documentation in the notes accompanying the financial statements.

Auditors are especially concerned that their clients follow the consistency principle, so that the results reported from period to period are comparable. This means that some audit activities will include discussions of consistency issues with the management team. An auditor may refuse to provide an opinion on a client's financial statements if there are clear and unwarranted violations of the principle.

The consistency principle is most frequently ignored when the managers of a business are trying to report more revenue or profits than would be allowed through a strict interpretation of the accounting standards. A telling indicator of such a situation is when the underlying company operational activity levels do not change, but profits suddenly increase.

Similar Terms

The consistency principle is also known as the consistency concept.

Definition: The economic entity assumption is an accounting principle that states that all transactional data associated with a specific entity is assumed to be clearly attributed to the entity, and does not include other transactional data associated with the entity’s owners or business partners. While this assumption applies to all varieties of businesses, it most notably applies to sole proprietorships, for which the transactional records are maintained by the entity’s owners.

going concerning assumption definition

An accounting guideline which allows the readers of financial statements to assume that the company will continue on long enough to carry out its objectives and commitments. In other words, the accountants believe that the company will not liquidate in the near future. This assumption also provides some justification for accountants to follow the cost principle.