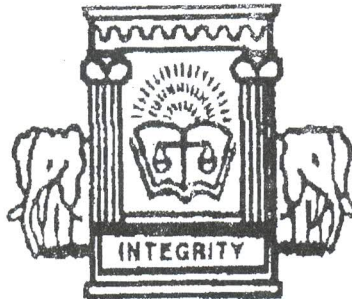


THE INSTITUTE OF CHARTERED  
ACCOUNTANTS (GHANA)



MAY 2010 EXAMINATIONS  
(PROFESSIONAL)

**PART 3**

**FINANCIAL MANAGEMENT**  
(Paper 3.4)

**Attempt ALL Questions**

**TIME ALLOWED:**

Reading & Planning	-	15 Minutes
Workings	-	3 Hours

## QUESTION 1

- a) The influence of the various parties with interest in the firm results in the firm adopting many non-financial objectives.

You are required to explain **five (5)** non-financial objectives of a firm.

(5 marks)

- b) Explain the difference between an Interest Rate Swap and a Foreign Currency Swap.  
(5 marks)
- c) The Treasury bill rate is 24% and the expected risk premium on the equity of your firm is 10%. If the expected return on the market portfolio is 5%, what is the beta of your company?  
(5 marks)
- d) Comment on the following "Since interest rates are high now, firms seeking to raise funds should not sell bonds. Rather they should issue equity".  
(5 marks)

(Total: 20 marks)

## QUESTION 2

Okukuseku Ltd is financed by three types of capital:

- a) One million of 50p ordinary shares each having current market value of GH¢5.20 cum div. The current dividend, which is due to be paid shortly, is 20p per share. The dividend has grown steadily in the past at a compound annual rate of 15% and is generally expected to continue doing so indefinitely.
- b) 200,000 GH¢1 irredeemable 8% preference shares, each having a current market value of 50p ex div.
- c) GH¢2 million 10% Loan (debenture), redeemable in 20 years at a price GH¢110. The current market value is GH¢80 ex int.

Okukuseku is considering a new project having the same risk characteristics as existing projects, which would require an immediate outlay of GH¢150,000 and would produce annual net cash inflow of GH¢30,000 indefinitely.

*You are required to:*

Prepare calculations showing whether acceptance of the new project is worthwhile.

20 marks

### QUESTION 3

- a) Identify and explain **five (5)** ways in which the incremental cash flows associated with a foreign establishment can diverge from its actual cash flows. (5 marks)
- b) The Chinese Government is willing to provide the Government of Ghana a loan of \$10 million at 5% to build a recycling plant. The loan will be paid off in equal annual installments over a 5 year period.

*You are required:*

- i. To calculate the value of the interest subsidy if the market interest rate for such an investment is 14%. (10 marks)
- ii. To explain the difference between translation exposure and transaction exposure. (5 marks)

(Total: 20 marks)

### QUESTION 4

Restwell Ltd, a hotel and leisure company, is currently considering taking over a smaller private limited company, Staygood Ltd. The board of Restwell is in process of making a bid for Staygood but first needs to place a value on the company. Restwell has gathered the following data:

<u>Restwell</u>	
Weighted average cost of capital	12%
P/E ratio	12
Shareholders' required rate of return	15%

<u>Staygood</u>	
Current dividend payment	27p
Past five years' dividend payments	15p, 17p, 18p, 21p 23p
Current EPS	37p
Number of ordinary shares	5 million

It is estimated that the shareholders in Staygood require a rate of returns 20% higher than the shareholders of Restwell due to the higher level of risk associated with Staygood. Restwell estimates that cash flows at the end of the first year will be GH¢2.5 million and these will

grow at an annual rate of 5%. Restwell also expects to raise GH¢5 million in two years' time by selling off hotels of Staygood that are surplus to its needs.

Given the above information, estimate values for Staygood using the following valuation methods:

- a) Price/earnings ratio valuation
- b) Gordon growth model
- c) Discounted cash flow valuation

**20 marks**

### **QUESTION 5**

Your company has issued 1000 shares. The shares are trading at GH¢10 each. You need to raise additional money and the decision is to issue 100 additional shares at GH¢9 to your existing shareholders.

***Required:***

- (i) Under Ghanaian rules, as recently exhibited by the Ghana Commercial Bank and others, how many **rights** will be issued?  
(2 marks)
- (ii) If you previously held 20 shares, how many rights will you receive?  
(2 marks)
- (iii) Having received your rights in (ii) you decided not to buy additional shares. How much can you reasonably expect to sell the rights for?  
(10 marks)
- (iv) If all the rights are exercised, how much money did your firm raise? There are no transaction costs.  
(1 mark)
- (v) Give the critical reason for selling the additional shares at GH¢9 instead of GH¢10.  
(5 marks)

**(Total: 20 marks)**