THE INSTITTUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF PAKISTAN
(ICPAP)

Stage	**Specialization**	Course Code	**SP-603**
Examination	**Winter-2011**	Course Name	**Advanced Financial Management**
Time Allowed	**03 Hours**	Maximum Marks	**100**

NOTES:
1. All questions are to be attempted.
2. Answers are expected to the precise, to the point and well written.
3. Neatness and style will be taken into account in marking the papers.

Question No 1:

a) "Liquidity and profitability are competing goals for the finance manager." Comment. **(5 marks)**

b) "Depreciation is a part of cost of production and is at the same time an important source of internal finance." Discuss this statement. **(5 marks)**

c) "Retained earnings have no cost." Do you agree? Give reasons for your answer.
. **(5 marks)**

d) "Efficient cash management will aim at maximizing the availability of cash inflows by decentralizing collections and decelerating cash outflows by centralizing disbursements." Discuss. **(5 marks)**

Question No 2:

a) Explain the concept of 'Working Capital Leverage' and comment on its usefulness in assessing the operating risk of a firm.
(10 marks)

b) The following data of Ex. Ltd and EM ltd. Are available:

(Rs. Thousand)

	Ex Ltd.	Em Ltd.
Current assets	350	50
Net fixed assets	50	350
EBIT	75	75
Sales	3500	500

a) Calculate the Working Capital Leverage for the two companies for a given percentage change in current assets and comment on the results.

b) Comment on the appropriateness of the investment strategies of the two firms.
(10 marks)

Question No 3:

Solar Supermarkets, a listed company, is reviewing the approach that it should take to remunerating its executive directors and other senior managers. Over the years, the company's share price has performed well although there is now concern that price and cost competition from overseas entrants into the domestic market will have a significant impact on the firm's profitability. As a result, the directors believe that large investment in new technologies and markets will be required over the next five years. Traditionally, management has been rewarded by salary, a generous system of benefits, and a bonus scheme that has taken up to 4% of turnover. The directors are considering introducing a generous share option scheme with a five year vesting period.

There is also a view, expressed by some of the company's principal equity investors, that the company should consider returning cash to them through the sale of its property holdings. The company has over 200 stores nationally and 15 overseas, of which all except five are owned by the company. In the domestic economy, growth in the value of commercial property has averaged 8% per annum in recent years whilst retail growth has remained static at 5.5%. A sale and leaseback, or the flotation of a separate property company that would rent the stores to Solar Supermarkets at commercial rates, are two suggestions that have been made at investor meetings. Either approach, it is suggested, would return value to investors and create a supply of capital for further expansion. There have been press rumours, possibly fed from sources within the investor community, that the company may be a target for a private equity acquisition. However, no formal approach has been made to the company.

The only other area of controversy to emerge about the company which has concerned the directors followed an announcement about the company pension scheme. Although the scheme is well funded the directors took the decision to close the current final salary scheme to new employees and to replace it with a money purchase scheme.

Current employees would not be affected.

Required:

Discuss the strategic, financial and ethical issues that this case presents and the merits of the proposed share option and sale and leaseback schemes.

(20 marks)

Question No 4:

Slow Fashions Ltd is considering the following series of investments for the current financial year 2009:

Project bid proposals (Rs'000) for immediate investment with the first cash return assumed to follow in 12 months and at annual intervals thereafter.

Project	Now	2010	2011	2012	2013	2014	2015	NPV	IRR
P0801	–620	280	400	120				55	16%
P0802	–640	80	120	200	210	420	–30	69	13%
P0803	–240	120	120	60	10			20	15%
P0804	–1000	300	500	250	290			72	13%
P0805	–120	25	55	75	21			19	17%
P0806	–400	245	250					29	15%

There is no real option to delay any of these projects. All except project P0801 can be scaled down but not scaled up. P0801 is a potential fixed three-year contract to supply a supermarket chain and cannot be varied. The company has a limited capital budget of Rs1.2 million and is concerned about the best way to allocate its capital to the projects listed. The company has a current cost of finance of 10% but it would take a year to establish further funding at that rate. Further funding for a short period could be arranged at a higher rate.

Required:

a) Draft a capital investment plan with full supporting calculations justifying those projects which should be adopted giving:
   i. The priorities for investment,
   ii. The net present value and internal rate of return of the plan; and
   iii. The net present value per dollar invested on the plan.

(12 marks)

b) Estimate and advice upon the maximum interest rate which the company should be prepared to pay to finance investment in all of the remaining projects available to it.

(8 marks)

Question No 5:

a) Prepare working capital forecast and projected profit and loss account and balance sheet from the following information:

	Rs
Issued equity share capita	50, 00,000
Preference share capital	15, 00,000
Fixed assets	30, 66,667

Production during the previous year was 10, 00,000 units which is expected to be maintained during the current year. The expected ratios of cost to selling price are?

Raw material	40%
Direct wages	20%
Overheads	20%

Raw material ordinarily remains in stock for 3 months before production. Every unit of production remains in process for 2 months. Finished goods remain in stock for 3 months. Creditors allow 3 months for payment and debtors are allowed 4 months credit. Estimated minimum cash to be held will be Rs. 2, 00,000. Lag in payment of wages and overheads are expected to be half a month. The selling price will be Rs. 8 per unit. The production is in continuous process and sales are in regular cycle.

(15 marks)

b) How does 'outsourcing' benefit the company?

(5 marks)

<<THE END>>