

UNIVERSITY OF BOLTON
FACULTY OF WELL-BEING & SOCIAL SCIENCES
BA (Hons) ACCOUNTANCY
SEMESTER ONE EXAMINATION 2011/2012
FINANCIAL MANAGEMENT
MODULE NO ACC3015

Date: Tuesday 17th January 2012

Time: 10:00 – 13:00

INSTRUCTIONS TO CANDIDATES:

There are **FOUR** questions.

Answer **ALL** questions

All questions carry equal marks.

Present value and Annuity tables are included at the back of this examination paper.

Candidates are advised that the examiners attach importance to legibility of writing and clarity of expression.

This examination carries 70% of the marks for this module.

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Question 1 (25 marks)

Stannon Limited is a manufacturer of stair lifts which as a result of an aging population have become more popular with demand outstripping supply.

To take advantage of this change in the market the management team feels that the time is right to upgrade the current dated production facilities.

After receiving tenders from a number of suppliers the Management Accountant has been asked to consider the financial implications of purchasing production facilities from a UK Supplier, Brown Brothers or a Chinese Company, Kowloon Limited.

The cost quoted by Brown Brothers is £450,000 and Kowloon Limited have quoted £500,000.

Due to the fast speed of technological advances it is anticipated that the life of the new production facilities will be only two years after which the scrap value will be £20,000 whichever supplier is procured.

Whilst at face value Brown Brothers appears to have quoted the lower bid Kowloon Limited's specification is higher with the ability for greater capacity.

After consulting the Marketing Director the Management Accountant has put together the following probable increased income flows for both purchase options:

Brown Brothers Limited

| Year 1 (2011/2012) | | Year 2 (2012/2013) | |
|--------------------------------|-------------|--|-------------|
| Increase in net cash flows (£) | Probability | Increase in net cash flows (£) | Probability |
| 250,000 | 30% | (if in year 1 net cash flows increase by £250,000) | |
| | | 210,000 | 60% |
| | | 260,000 | 40% |
| 180,000 | 70% | (if in year 1 net cash flows increase by £180,000) | |
| | | 160,000 | 70% |
| | | 210,000 | 30% |

**Question 1 continues over the page.....
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Kowloon Limited

| Year 1 (2011/2012) | | Year 2 (2012/2013) | |
|--------------------------------|-------------|--|-------------|
| Increase in net cash flows (£) | Probability | Increase in net cash flows (£) | Probability |
| 250,000 | 30% | (if in year 1 net cash flows increase by £250,000) | |
| | | 240,000 | 60% |
| | | 300,000 | 40% |
| 180,000 | 70% | (if in year 1 net cash flows increase by £180,000) | |
| | | 180,000 | 30% |
| | | 243,400 | 70% |

The expenditure will attract capital allowances, but will be excluded from the general pool.

This means that it attracts 25% (reducing balance) tax allowances in the year of expenditure and in every subsequent year of being owned by the company, except the last year.

In the last year, the difference between the equipments written down value for tax purposes and its disposal proceeds will be:

Either

(i) Allowed to the company as an additional tax relief if the disposal proceeds are less than the tax written down value

or

(ii) be charged to the company if the disposal proceeds are more than the tax written down value.

You should assume that all cash flows occur on the last day of each trading year.

Stannon Ltd pays corporation tax at a rate of 22% on its taxable profits, payable at the end of the year in which profits are earned. The Management Accountant has determined that a discount rate of 12 % per annum would be reasonable for appraising the investment.

Question 1 continues over the page....

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Question 1 continued....

Required:

- a) Using a discount rate of 12% per annum give your advice as to whether the purchase of new production facilities should go ahead and if so which supplier would you recommend.

Your advice should be supported by workings and include any concerns that you might have. **(20 marks)**

- b) Critically evaluate the use of investment appraisal techniques that are commonly used by Accountants to support business decisions. **(5 marks)**

(Total 25 marks)

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Question 2

Wexford plc

The capital structure of Wexford plc is as follows:

| | £ 000 s |
|--|---------|
| 800,000 Ordinary Shares of £0.50 each | 400 |
| 300,000 Preference Shares 8% £ 1.00 each | 300 |
| Share Premium Account | 45 |
| Retained Earnings | 15 |
| 5 % Debentures | 70 |

The Debenture interest for the current year has just been paid. Interest is payable at the end of the next four years, and all of the loan stock is to be redeemed in cash at a 10% premium at the end of five years.

A dividend of 22 pence per share has just been paid to the Ordinary Shareholders and the Board of Directors anticipates that future dividends will grow at a rate 4% per annum.

The Ordinary Share price has been quoted in today's Financial Times as £2.35 ex dividend.

In the same paper the Preference Shares were quoted at a price of £4.75 with the Debentures available for purchase at £90 per block of £100 nominal.

Wexford plc currently pays corporation tax at a rate of 22 % on its profits.

Required:

- a) Calculate the weighted average after tax - cost of capital of Wexfords plc on a market value basis. Explain your workings and any assumptions that you have taken into account. **(15 marks)**
- b) Critically evaluate any possible difficulties that may be experienced when calculating the Weighted Average Cost Of Capital. **(10 marks)**

(Total 25 marks)

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Question 3

Research of recent mergers and acquisitions has come to the conclusion that the wealth of shareholders of the bidding company has not been significantly increased as a result of taking over another company. However there is and remains significant activity in terms of business involvement in mergers and acquisitions.

- a) Evaluate what a company should be looking for (in economic terms) when seeking to either acquire or merge with another company. **(5 Marks)**
- b) Critically review four ways a takeover or merger may lead to an increase in wealth for the bidding company or the majority shareholder. **(10 Marks)**
- c) Critically review four reasons why a takeover or merger may fail to deliver an expected increase in wealth for the bidding company or majority shareholder. **(10 Marks)**

(Total 25 Marks)

QUESTION 4

- a) Companies very often have different policies with regard to the distribution of dividends to their shareholders. For example some may distribute all the profits generated, some may have a policy of not distributing any of the profits, some repurchase the capital from shareholders and some offer further shares in lieu of cash.

You are required to critically evaluate the advantages and disadvantages of each of the above policies. **(15 marks)**

- b) You are required to critically evaluate the use of the dividend growth model and the capital asset pricing model when estimating the valuation of share capital. **(10 marks)**

(Total 25 Marks)

END OF PAPER

Present Value Table

Present value of 1 i.e. $(1 + r)^{-n}$

Where r = discount rate

n = number of periods until payment

| Periods (n) | Discount rate (r) | | | | | | | | | |
|--------------------|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | 1% | 2% | 3% | 4% | 5% | 6% | 7% | 8% | 9% | 10% |
| 1 | 0.990 | 0.980 | 0.971 | 0.962 | 0.952 | 0.943 | 0.935 | 0.926 | 0.917 | 0.909 |
| 2 | 0.980 | 0.961 | 0.943 | 0.925 | 0.907 | 0.890 | 0.873 | 0.857 | 0.842 | 0.826 |
| 3 | 0.971 | 0.942 | 0.915 | 0.889 | 0.864 | 0.840 | 0.816 | 0.794 | 0.772 | 0.751 |
| 4 | 0.961 | 0.924 | 0.888 | 0.855 | 0.823 | 0.792 | 0.763 | 0.735 | 0.708 | 0.683 |
| 5 | 0.951 | 0.906 | 0.863 | 0.822 | 0.784 | 0.747 | 0.713 | 0.681 | 0.650 | 0.621 |
| 6 | 0.942 | 0.888 | 0.837 | 0.790 | 0.746 | 0.705 | 0.666 | 0.630 | 0.596 | 0.564 |
| 7 | 0.933 | 0.871 | 0.813 | 0.760 | 0.711 | 0.665 | 0.623 | 0.583 | 0.547 | 0.513 |
| 8 | 0.923 | 0.853 | 0.789 | 0.731 | 0.677 | 0.627 | 0.582 | 0.540 | 0.502 | 0.467 |
| 9 | 0.914 | 0.837 | 0.766 | 0.703 | 0.645 | 0.592 | 0.544 | 0.500 | 0.460 | 0.424 |
| 10 | 0.905 | 0.820 | 0.744 | 0.676 | 0.614 | 0.558 | 0.508 | 0.463 | 0.422 | 0.386 |
| 11 | 0.896 | 0.804 | 0.722 | 0.650 | 0.585 | 0.527 | 0.475 | 0.429 | 0.388 | 0.350 |
| 12 | 0.887 | 0.788 | 0.701 | 0.625 | 0.557 | 0.497 | 0.444 | 0.397 | 0.356 | 0.319 |
| 13 | 0.879 | 0.773 | 0.681 | 0.601 | 0.530 | 0.469 | 0.415 | 0.368 | 0.326 | 0.290 |
| 14 | 0.870 | 0.758 | 0.661 | 0.577 | 0.505 | 0.442 | 0.388 | 0.340 | 0.299 | 0.263 |
| 15 | 0.861 | 0.743 | 0.642 | 0.555 | 0.481 | 0.417 | 0.362 | 0.315 | 0.275 | 0.239 |

| (n) | 11% | 12% | 13% | 14% | 15% | 16% | 17% | 18% | 19% | 20% |
|---------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1 | 0.901 | 0.893 | 0.885 | 0.877 | 0.870 | 0.862 | 0.855 | 0.847 | 0.840 | 0.833 |
| 2 | 0.812 | 0.797 | 0.783 | 0.769 | 0.756 | 0.743 | 0.731 | 0.718 | 0.706 | 0.694 |
| 3 | 0.731 | 0.712 | 0.693 | 0.675 | 0.658 | 0.641 | 0.624 | 0.609 | 0.593 | 0.579 |
| 4 | 0.659 | 0.636 | 0.613 | 0.592 | 0.572 | 0.552 | 0.534 | 0.516 | 0.499 | 0.482 |
| 5 | 0.594 | 0.567 | 0.543 | 0.519 | 0.497 | 0.476 | 0.456 | 0.437 | 0.419 | 0.402 |
| 6 | 0.535 | 0.507 | 0.480 | 0.456 | 0.432 | 0.410 | 0.390 | 0.370 | 0.352 | 0.335 |
| 7 | 0.482 | 0.452 | 0.425 | 0.400 | 0.376 | 0.354 | 0.333 | 0.314 | 0.296 | 0.279 |
| 8 | 0.434 | 0.404 | 0.376 | 0.351 | 0.327 | 0.305 | 0.285 | 0.266 | 0.249 | 0.233 |
| 9 | 0.391 | 0.361 | 0.333 | 0.308 | 0.284 | 0.263 | 0.243 | 0.225 | 0.209 | 0.194 |
| 10 | 0.352 | 0.322 | 0.295 | 0.270 | 0.247 | 0.227 | 0.208 | 0.191 | 0.176 | 0.162 |
| 11 | 0.317 | 0.287 | 0.261 | 0.237 | 0.215 | 0.195 | 0.178 | 0.162 | 0.148 | 0.135 |
| 12 | 0.286 | 0.257 | 0.231 | 0.208 | 0.187 | 0.168 | 0.152 | 0.137 | 0.124 | 0.112 |
| 13 | 0.258 | 0.229 | 0.204 | 0.182 | 0.163 | 0.145 | 0.130 | 0.116 | 0.104 | 0.093 |
| 14 | 0.232 | 0.205 | 0.181 | 0.160 | 0.141 | 0.125 | 0.111 | 0.099 | 0.088 | 0.078 |
| 15 | 0.209 | 0.183 | 0.160 | 0.140 | 0.123 | 0.108 | 0.095 | 0.084 | 0.074 | 0.065 |

Annuity Table

Present value of an annuity of 1 i.e. $\frac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate
 n = number of periods

| Periods (n) | 1% | 2% | 3% | 4% | 5% | 6% | 7% | 8% | 9% | 10% |
|----------------|--------|--------|--------|--------|--------|-------|-------|-------|-------|-------|
| 1 | 0.990 | 0.980 | 0.971 | 0.962 | 0.952 | 0.943 | 0.935 | 0.926 | 0.917 | 0.909 |
| 2 | 1.970 | 1.942 | 1.913 | 1.886 | 1.859 | 1.833 | 1.808 | 1.783 | 1.759 | 1.736 |
| 3 | 2.941 | 2.884 | 2.829 | 2.775 | 2.723 | 2.673 | 2.624 | 2.577 | 2.531 | 2.487 |
| 4 | 3.902 | 3.808 | 3.717 | 3.630 | 3.546 | 3.460 | 3.387 | 3.312 | 3.240 | 3.170 |
| 5 | 4.853 | 4.713 | 4.580 | 4.452 | 4.329 | 4.212 | 4.100 | 3.993 | 3.890 | 3.791 |
| 6 | 5.795 | 5.601 | 5.417 | 5.242 | 5.076 | 4.917 | 4.767 | 4.623 | 4.486 | 4.355 |
| 7 | 6.728 | 6.472 | 6.230 | 6.002 | 5.786 | 5.582 | 5.389 | 5.206 | 5.033 | 4.868 |
| 8 | 7.652 | 7.325 | 7.020 | 6.733 | 6.463 | 6.210 | 5.971 | 5.747 | 5.535 | 5.335 |
| 9 | 8.566 | 8.162 | 7.786 | 7.435 | 7.108 | 6.802 | 6.515 | 6.247 | 5.995 | 5.759 |
| 10 | 9.471 | 8.983 | 8.530 | 8.111 | 7.722 | 7.360 | 7.024 | 6.710 | 6.418 | 6.145 |
| 11 | 10.370 | 9.787 | 9.253 | 8.760 | 8.306 | 7.887 | 7.499 | 7.139 | 6.805 | 6.495 |
| 12 | 11.260 | 10.580 | 9.954 | 9.385 | 8.863 | 8.384 | 7.943 | 7.536 | 7.161 | 6.814 |
| 13 | 12.130 | 11.350 | 10.630 | 9.986 | 9.394 | 8.853 | 8.358 | 7.904 | 7.487 | 7.103 |
| 14 | 13.000 | 12.110 | 11.300 | 10.560 | 9.899 | 9.295 | 8.745 | 8.244 | 7.786 | 7.367 |
| 15 | 13.870 | 12.850 | 11.940 | 11.120 | 10.381 | 9.712 | 9.108 | 8.559 | 8.061 | 7.606 |

| (n) | 11% | 12% | 13% | 14% | 15% | 16% | 17% | 18% | 19% | 20% |
|-----|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1 | 0.901 | 0.893 | 0.885 | 0.877 | 0.870 | 0.862 | 0.855 | 0.847 | 0.840 | 0.833 |
| 2 | 1.713 | 1.690 | 1.668 | 1.647 | 1.626 | 1.605 | 1.585 | 1.566 | 1.547 | 1.528 |
| 3 | 2.444 | 2.402 | 2.361 | 2.322 | 2.283 | 2.246 | 2.210 | 2.174 | 2.140 | 2.106 |
| 4 | 3.102 | 3.037 | 2.974 | 2.914 | 2.855 | 2.798 | 2.743 | 2.690 | 2.639 | 2.589 |
| 5 | 3.696 | 3.605 | 3.517 | 3.433 | 3.352 | 3.274 | 3.199 | 3.127 | 3.058 | 2.991 |
| 6 | 4.231 | 4.111 | 3.998 | 3.889 | 3.784 | 3.685 | 3.589 | 3.498 | 3.410 | 3.326 |
| 7 | 4.712 | 4.564 | 4.423 | 4.288 | 4.160 | 4.039 | 3.922 | 3.812 | 3.706 | 3.605 |
| 8 | 5.146 | 4.968 | 4.799 | 4.639 | 4.487 | 4.344 | 4.207 | 4.078 | 3.954 | 3.837 |
| 9 | 5.537 | 5.328 | 5.132 | 4.946 | 4.772 | 4.607 | 4.451 | 4.303 | 4.163 | 4.031 |
| 10 | 5.889 | 5.650 | 5.426 | 5.216 | 5.019 | 4.833 | 4.659 | 4.494 | 4.339 | 4.192 |
| 11 | 6.207 | 5.938 | 5.687 | 5.453 | 5.234 | 5.029 | 4.836 | 4.656 | 4.486 | 4.327 |
| 12 | 6.492 | 6.194 | 5.918 | 5.660 | 5.421 | 5.197 | 4.988 | 4.793 | 4.611 | 4.439 |
| 13 | 6.750 | 6.424 | 6.122 | 5.842 | 5.583 | 5.342 | 5.118 | 4.910 | 4.715 | 4.533 |
| 14 | 6.982 | 6.628 | 6.302 | 6.002 | 5.724 | 5.468 | 5.229 | 5.008 | 4.802 | 4.611 |
| 15 | 7.191 | 6.811 | 6.462 | 6.142 | 5.847 | 5.575 | 5.324 | 5.092 | 4.876 | 4.675 |