MAY 2017 PROFESSIONAL EXAMINATIONS
FINANCIAL MANAGEMENT (PAPER 2.4)
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME

EXAMINER'S GENERAL COMMENTS

The level of preparations appeared better. There was an improvement in the answers given. This demonstrates that students prepared adequately. Basic Finance terms and terminologies were responded to quite well and most answers provided exhibited some level of basic fluency in Finance terminologies. Majority of candidates concentrated their time and answers more on the straight forward questions especially the written ones that fetched them the maximum marks to improve their chances of passing.

STANDARD OF PAPER

The standard of the Financial Management paper for May 2017 exams was generally satisfactory, balanced and well spread. Based on the performance of the students, the questions were generally understood and well answered in most cases by students. Feedback from other examiners and overall pass rate by students were consistent with this observation.

The question paper was well spread and cutting across most subject areas. Both quantitative and theory aspect of the exams were covered with the theory questions considered straight forward for well-prepared students to handle without any difficulties. The questions appeared precise, unambiguous and measured up to the standard expected at level 2 of the examination except questions 4 and 5 which students found to be a bit ambiguous. No typographical errors were noticed and no errors were found in the questions. The area requiring improvement was the provision of alternative solutions in the marking scheme for questions that could be answered from a different perspective outside the marking schemes provided.

No sub-standard question was noticed in the paper and all questions were found to be of good standard to meet the standards expected at that level. Mark allocations conformed to the syllabus weightings and in few cases where it was observed not to be fairly allocated, they were slightly modified at the co-ordination level to ensure a balance in the allocation.

PERFORMANCE OF CANDIDATES

The performance of the students was the best in recent times. Half of students passed the paper compared to the prior highest of 33% and less than 10% historically for the paper. This was a remarkable improvement over the recent past sittings and the best performance in recent memory. It was further observed that there was a general improvement in pass rate across all the centers compared to the past with Accra/Kumasi/Cape coast centers showing better performance. This can be partially attributed to the nature of questions set and improvement in the level of teaching and preparations generally. Students also maximised the marks on the straight forward theory and quantitative questions to score the critical marks needed to achieve pass rate to balance the low marks averagely recorded in the question 4 and 5 which were the worst answered questions.

NOTABLE STRENTHGS AND PERFORMANCE OF STUDENTS

The 50% of students who did well exhibited the following strengths:

- Reading and understanding of the questions
- Spending more time on the first three questions that carried the most marks (70 marks) which were a bit better and straight forward.
- Spending less time on the last 2 questions which were difficult but carried only 30 marks of 15 each.
- Well planned responses to the questions in line with the requirements of questions
- Improvement in handwriting making reading and marking easier and better
- Exhibited a good level of preparation in both quantitative and written questions.
- The strengths spread better by more students in this sitting than the prior sittings where it was limited to few students.
- Ability to think broad and respond to questions that required innovative thinking

Observed weaknesses demonstrated by students

- Some level of weak understanding of Finance principles by some students was still noticed although this was better than previous sitting.
- Spending more time on difficult questions that carried low marks
- Poor numbering of questions and spreading answers erratically across so many pages making marking difficult for examiners
- Wrong numbering of answers to questions making it difficult for examiners
- So much irrelevant answers provided especially written questions making answers so long and unnecessary
- Poor handwriting and faded pens still persisted.

QUESTION ONE

a) Bhim is a not-for-profit non-governmental organisation aimed at supporting alleged witches to have an empowered livelihood. The organisation is developing a proposal to the Ministry of Gender and Social Protection to secure funding to improve basic healthcare and sanitation at three alleged witches' camps. They have consulted you to help them develop the section on value for money (VfM) in their proposal.

Required:

i) Briefly explain the following value for money concepts :
- Economy
- Efficiency
- Effectiveness

(6 marks)

ii) Compare and contrast ***value for money*** and ***corporate value maximization***. **(4 marks)**

b) One of the important sustainability requisite for the accelerated development of an economy is the existence of a dynamic financial market. Financial markets can be found in nearly every nation in the world. Some are very small, with only a few participants, while others, like the New York Stock Exchange (NYSE) and the forex markets, trade trillions of dollars daily.

Required:

What is a financial market? **(1 mark)**

c) Explain the difference between the following financial markets;

i) Debt market and Equity market. **(3 marks)**

ii) Money market and Capital market **(3 marks)**

iii) Forex market and Interbank market **(3 marks)**

(Total: 20 marks)

QUESTION TWO

a) SAFOO Ltd has in issue 5 million shares with a market value of GH¢ 3.81 per share. The equity beta of the company is 1.2. The yield on short- term government debt is 23% per year and equity risk premium is 5% per year. The debt finance of SAFOO Ltd consists of bonds with a total book value of GH¢2 million. These bonds pay annual interest before tax of 25%. The par value and market value of each bond is GH¢100. The Company pays tax at 25%.

Required:

Calculate SAFOO Ltd Weighted Average cost of Capital. **(10 marks)**

b) Choosing an appropriate source of business finance can be a difficult and time-consuming task. This is due to the sheer amount of funding options available. Financing can come in the form of debt or investment, and finance terms can vary significantly. The criteria and implications of each source require critical analysis before proceeding, and it is essential to weight the cost versus benefits of each source before making a decision.

Required:

i) Discuss **FOUR** factors that a company should consider when choosing a source of debt finance. **(6 marks)**

ii) Explain **THREE** factors that may be considered by providers of finance in deciding how much to lend to a company. **(3 marks)**

c) A company with 20 million shares in issue announces a 2 for 5 rights issue at a price of GH¢3 per share. The market price of the existing shares before the rights issue is GH¢3.70.

Required:

i) What is the theoretical ex-right price? **(3 marks)**

ii) What is the theoretical value of the rights? **(3 marks)**

(Total: 25 marks)

QUESTION THREE

a) Payback method refers to the period of time it takes for the cash flows to cover the initial cost of investment or recoup the initial cost of investment. The period is usually calculated in years.

Required:

Identify **TWO** advantages and **TWO** disadvantages of using the payback method in investment appraisal? **(4 marks)**

b) DÉCOR Ltd is analyzing the purchase of a new machine to produce product Z. The machine is expected to cost GH¢2,000,000. Production and sales of product Z is forecast as follows:

Year	1	2	3	4
Production & Sales (units/year)	70,000	106,000	150,000	72,000

The current selling price is GH¢30 per unit and is expected to increase by 5% a year. The current variable cost is GH¢18 per unit and is expected to increase by 6% per year. Fixed cost will remain the same but increase in working capital is required. Analysis of historical data of the levels of working capital of product Z indicates that, at the start of each year investment in working capital will need to be 10% of sales revenue of that year.

The company pays tax at 25% per year in the year in which taxable profit occurs. The tax liability is reduced by the capital allowance on the machinery and DÉCOR Ltd can claim on straight line basis over the four year life of the proposed investment (capital allowance rate of 25% per anum). The new machine will have zero scrap value at the end of the four years. The cost of capital is at 15% per year.

Required:
Calculate the Net Present Value of the proposed investment and advice whether the proposed investment should be undertaken. **(11 marks)**

c) An American company sells goods to a Ghanaian buyer for US$280,000 when the exchange rate is $1 = GH¢4.20. The Ghanaian buyer is allowed three months' credit, and when the American company eventually receives the US dollars three months later, and exchanges them for dollars, the exchange rate has moved to $1 = $4.60.

Required:
i) What was the foreign exchange loss to the Ghanaian buyer? **(3 marks)**
ii) Explain Currency risk in relation to the above. **(2 marks)**
iii) Explain Transaction risk in relation to the above. **(2 marks)**
iv) What will be the effect of the above on the company's trading profits? **(3 marks)**

(Total: 25 marks)

QUESTION FOUR

a) Factoring and Invoice Discounting are both financial services that can release the funds tied up in your unpaid invoices, involving a provider who agrees to advance money against outstanding debtor balances. However, factoring is not the same as invoice discounting.

Required:
Differentiate between ***factoring*** and ***invoice discounting***. **(5 marks)**

b) ATA Ghana Ltd is a Company in Ghana engaged in the trading of commodities. The annual sales are at GH¢ 24 million. The average age of debtors is one month and the percentage of bad debts is 1%.

A new Marketing Director has been hired by the Company to improve its sales. The new Marketing Director proposed that sales could be increased up to GH¢ 30 million if new customers were taken on. Taking on new customers will lengthen the average credit period to 2 months and increase bad debts to 1.5% of sales.

The Finance Manager provided that, variable cost is 70% of the selling price and the Company's cost of capital is 20%.

Required:
Advise whether the Company should take on the new customers. **(10 marks)**

(Total: 15 marks)

QUESTION FIVE

a) Recent financial information of FCH Bank Ltd. a listed company, is as follows:

		GH₵m	GH₵m
Profit after tax (earnings)		66.6	
Dividends		40.0	
Statement of financial position information			
Non-current assets			595
Current assets			125
Total assets			**720**
Current liabilities			70
Equity			
Ordinary share (GH₵1 nominal)		80	
Reserves		410	490
Non current liabilities			
6% Bank loan		40	
8% Bonds (GH₵100 nominal)		120	160
			720

Financial analysts have forecasted that the dividends of FCH Bank Ltd. will grow in the future at a rate of 4% per year. This is slightly less than the forecast growth rate of the profit after tax (earnings) of the company, which is 5% per year. The finance director of FCH Bank Ltd. thinks that, considering the risk associated with expected earnings growth, an earnings yield of 11% per year can be used for valuation purposes.

FCH Bank Ltd. has a cost of equity of 10% per year and a before-tax cost of debt of 7% per year. The 8% bonds will be redeemed at nominal value in six years' time. FCH Bank Ltd. pays tax at an annual rate of 30% per year and the ex-dividend share price of the company is GH¢8·50 per share.

Required:
Calculate the value of FCH Bank Ltd. using the following methods:

i) Net asset value method; **(3 marks)**
ii) Dividend growth model; **(3 marks)**
iii) Earnings yield method. **(3 marks)**

b) Kantamanso Ltd which operates in the Distribution sector in Ghana has provided the following information for the year ended 31 December 2015

	No of Shares	Market Value (GH¢)
10% cum preference shares	18,000	30
Ordinary Shares	15,000	45

The proposed dividend for the year is GH¢0.3 for the preference shares and GH¢0.45 for ordinary shares each. The company's chargeable profit was GH¢40,000 and the profit before taxation was GH¢38,000. The Tax rate is 25% for both the Company and the individual.

Required:

Calculate in respect of ordinary shares:

i) Dividend cover **(2 marks)**

ii) Earnings per share **(2 marks)**

iii) Price/earning ratio **(2 marks)**

(Total: 15 marks)

MARKING SCHEME

QUESTION ONE

a) Bhim

(i) Value for money (3Es/4Es)

Value for money (VfM) is the process of ensuring that resources applied to achieve optimal results in the most sustainable way and also for the right target. The key elements of value for money are

- Economy
- Efficiency
- Effectiveness
- Equity

The three key elements (sometimes referred to as the 4Es) are discussed below;

- **Economy** – this measures the acquisition of inputs at the highest quality, at the lowest cost and within acceptable time for achieving a given output
- **Efficiency** – this measures the amount of resources used to achieve a giving output. It also considers the proficiency and appropriateness of the process used for converting the input into output.
- **Effectiveness** – this measures the extent to which stated objectives are achieved, and to the extent that
- **Equity** – ensuring fair distribution that targets the needs of vulnerable groups and most deprived entities.

(2 points for any element well explained up to a total of 3 points=6 marks)

ii) Similarities and differences between VfM and value maximization

Similarities

- VfM and value maximization are both corporate objectives which can be used to measure performance of managers.
- As performance measure benchmark, they ensure resources are utilized efficiently for the acquisition of inputs to yield best results.
- Achieving VfM and ensuring corporate value maximization all have positive social impact

(Any 2 points for 2 marks)

Differences

- VfM is an objective for not-for-profit entities whereas value maximization is emphasized in profit making entities
- Whereas VfM considers social welfare at large, value maximization focuses on the interest of the shareholders (few owners of the business)
- VfM may sacrifice economic benefit for overall social good, especially for vulnerable groups but value maximization focuses on economic returns to the owners for every resource utilised.

(Any 2 points for 2 marks)

b) **A financial market** is a broad term describing any marketplace where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives. Financial markets are typically defined by having transparent pricing, basic regulations on trading, costs and fees, and market forces determining the prices of securities that trade. **(1 mark)**

c)

i**) Equity markets** allow investors to buy and sell shares in publicly traded companies. They are one of the most vital areas of a market economy as they provide companies with access to capital and investors with a slice of ownership in the company and the potential of gains based on the company's future performance.

Debt market is where an investor loans money to an entity (corporate or governmental), which borrows the funds for a defined period of time at a fixed interest rate. Bonds which are mostly used in debt markets are used by companies, municipalities, states and U.S. and foreign governments to finance a variety of projects and activities. Bonds can be bought and sold by investors on credit markets around the world. This market is alternatively referred to as the credit or fixed-income market. It is much larger in nominal terms that the world's stock markets. **(3 marks)**

ii) **The money market** is a segment of the financial market in which financial instruments with high liquidity and very short maturities are traded. The money market is used by participants as a means for borrowing and lending in the short term, from several days to just under a year. Money market securities consist of negotiable **certificates of deposit** (CDs), banker's acceptances, commercial paper, municipal notes, federal funds and repurchase agreements (repos). Money market investments are also called cash investments because of their short maturities.

A capital market is one in which individuals and institutions trade financial securities. Organizations and institutions in the public and private sectors also often sell securities on the capital markets in order to raise funds. Any government or corporation requires capital (funds) to finance its operations and to engage in its own long-term investments. To do this, a company raises money through the sale of securities - stocks and bonds in the company's name. These are bought and sold in the capital markets. **(3 marks)**

iii) **The interbank market** is the financial system and trading of currencies among banks and financial institutions, excluding retail investors and smaller trading parties. While some interbank trading is performed by banks on behalf of large customers, most interbank trading takes place from the banks' own accounts.

The forex market is where currencies are traded. The forex market is the largest, most liquid market in the world with an average traded value that exceeds $1.9 trillion per day and includes all of the currencies in the world. The forex is the largest market in the world in terms of the total cash value traded, and any person, firm or country may participate in this market. **(3 marks)**

(Total: 20 marks)

EXAMINER'S COMMENTS

This question was a total theory or essay question that centred on the value for money concept (VFM), and various aspects of financial markets. Almost all students attempted this question and it was straight forward and generally well answered. The students optimised marks in answering this question which carried a total of 20 marks from (a) to (c). It was one the questions that contributed to improved pass rate in this sitting.

All average students got a pass in this question and good students scored excellent mark boosting the chances of obtaining a pass rate in this paper.

QUESTION TWO

(a) Calculation of weighted average cost of capital.

Cost of equity = 23 + (1.2 x 5) = 29%.

The company's bonds are trading at par and therefore the before tax cost of debt is the same as the interest rate on the bonds which 25%.

After tax cost of debt = 25% x (1-0.25) = 18.75%.

Market value of equity = 5m x 3.81 = GH¢ 19.05 million
Market value of debt is equal to its par value of GH¢ 2 million.

Sum of Market value of equity and debt = 19.05 million + 2 million = GH¢ 21.05 million.

Weighted Average Cost of Capital (WACC) = (0.29 X 19.05/21.05) + (0.1875 X 2/21.05)
= (0.2900 X 0.905) + (0.1875 X 0.095)
= 0.2625+0.178
= 0.2803 or 28.03%

(10 marks)

b)

i) **Factors to consider when choosing source of debt finance**

- Cost: both issue cost, interest rate and repayment terms
- Maturity. This should be carefully matched with the cash flow structure and also flexibility of short term debt against long term debt
- Financial risk. Debt increases gearing and hence financial risk of the company and how investors would view that.

- Availability of financing. This depends on size of borrowing relative to the size of the firm, relationship with bankers and other financiers

(4 points for 6 marks)

ii) **Factors to consider by providers of finance**

- Security. Are there available assets to be used to secure exposure? The size of debt or finance depends also on size of collateral available. Additionally, interest rate charge by lenders is a function of whether is a secured exposure or unsecured exposure
- Risk and ability to meet financial obligations.
- Legal restrictions on borrowing
- Management capacity and track record in the past and future expectation of their ability to perform and survive in challenging market environments

(Any 3 points for 3 marks)

c) **The theoretical ex-rights price can be calculated as follows.**

i)

Market value of 5 existing shares (5 × GH¢3.70)	18.50
Issue price of 2 shares in the rights issue (2 × GH¢3.00)	6.00
Theoretical value of 7 shares	24.50
Theoretical ex-rights price (= GH¢24.50/7)	**GH¢3.50**

(3 marks)

ii) The value of rights

In theory, the holder of five shares in the company in the previous example could buy two new shares in the rights issue for GH¢3 each, and these two shares will be expected to rise in value to GH¢3.50, a gain of GH¢0.50 for each new share or GH¢1.00 in total for the five existing shares.

We can therefore say that the theoretical value of the rights is:

GH¢0.50 for each new share issued, or

GH¢0.20 (GH¢1.00/5 shares) for each current share held.

(3 marks)

(Total: 25 marks)

EXAMINER'S COMMENTS

Question 2 carried a total of 25 marks and one of the 2 questions that carried the highest allocated marks covering both theory and calculations. It consisted (a) to (c). The (a) part concentrated on the calculation of weighted average cost of capital expecting students to calculate for both equity and debt separately before determining the weighted average cost. This carried 10 marks and most students scored the maximum marks.

The (b) covered factors considered by both providers and users of funds in making lending or borrowing decision which was straight forward question requiring straight forward answers which was well answered.

The (c) aspect also covered rights issue with the students expected to calculate the theoretical ex-right price and the value of the right. This was again well answered except a few students who couldn't score the maximum marks.

Overall it was an excellent performance with the highest 25 Marks. This also contributed significantly to the high pass rate.

QUESTION THREE

(a)

Advantages of Payback:

- Simple and easy to use
- It gives indication of the liquidity. The earlier the payback period the better the liquidity
- It broadly measures the risk of the project. The earlier the payback period the better the risk
- Is faster to compute

(2 points for 2 marks)

Disadvantages:

- It ignores the time value of money
- Ignores the cash flows after the payback period and may discriminate against projects that have significant cash flows after the payback period
- It ignores the residual value and total economic life of the project
- Determination of the payback period upfront could be subjective and discretionary
- It measures mainly recovery of capital and not profitability of the project

(2 points for 2 marks)

b)

In GH¢

Year	0	1	2	3	4
Sales Revenue		2,100,000	3,339,000	4,962,000	2,500,560
Variable cost		(1,260,000)	(2,022.480)	(3,033,000)	(1,543,680)
Contribution		840,000	1,316,520	1,929,000	956,880
Capital Allowance		(500,000)	(500,000)	(500,000)	(500,000)
Taxable profit		340,000	816,520	1,429,000	456,880
Tax @ 25%		(85,000)	(204,130)	(357,250)	(114,220)
Profit after tax		255,000	612,390	1,071,750	342,660
Capital Allowance		500,000	500,000	500,000	500,000
After tax cash flows		755,000	1,112,390	1,571,750	842,660
Initial Investment	(2,000,000)				
Working Capital	(210,000)	(123,900)	(162,300)	246,144	250,056
Net cash flow	(2,210,000)	631,100	950,090	1,817,894	1,092,716
Discount factor @ 15%	1	0.8696	0.7561	0.6575	0.5718
Present value	(2,210,000)	548,805	718,363	1,195,265	624,815
NPV	**877,248**				

The decision is to recommend that the project be undertaking based on the positive NPV results. This will add value to share holders' wealth.

(11 marks)

ALTERNATIVE SOLUTION TO QUESTION 3B USING YEAR 0 (ZERO) AS THE CURRENT YEAR

Year	0	1	2	3	4
Selling Price	30	30	30	30	30
Inflation (1+g)^n		1.05	1.10	1.16	1.22
		31.500	33.08	34.73	36.47
Sales Units		70,000	106,000	150,000	72,000
Sales Value (GH¢)		**2,205,000**	**3,506,480**	**5,209,500**	**2,625,840**
VC/unit	18	18	18	18	18
Inflation (1+g)^n		1.06	1.12	1.19	1.26

		19.08	20.22	21.44	22.72
Total VC		**1,335,600**	**2,143,320**	**3,216,000**	**1,635,840**
Working Capital (10%*Sales)		220,500	350,648	520,950	262,584
Working Capital	(220,500)	(130,148)	(170,302)	258,366	262,584
Investment Cost		2,000,000	2,000,000	2,000,000	2,000,000
Depreciation @25%		500,000	500,000	500,000	500,000
Tax Savings on Depn. @25%		**125,000**	**125,000**	**125,000**	**125,000**

CALCULATION OF NET PRESENT VALUE

Year	0	1	2	3	4
Sales		2,205,000	3,505,480	5,209,500	2,625,840
Total VC		(1,335,600)	(2,143,320)	(3,216,000)	(1,635,840)
Taxable Cash Flow		869,400	1,363,160	1,993,500	990,000
Tax @25%		(217,350)	(340,790)	(498,375)	(247,500)
Tax Savings on Depn.		125,000	125,000	125,000	125,000
Capital Investment					
Initial Investment	(2,000,000)				
Working Capital	(220,500)	(130,148)	(170,302)	258,366	262,584
Free Cash Flow	(2,220,500)	646,902	977,068	1,878,491	1,130,084
Discount Factor @15%	1	0.870	0.756	0.658	0.572
Discounted Cash Flows	**(2,220,500)**	**562,805**	**738,663**	**1,236,047**	**646,980**

NPV 963,995

The decision is to recommend that the project be undertaking based on the positive NPV results. This will add value to share holders' wealth.

(11 marks)

c)

i) The original expectation would have been that the amount to payback would be \$280,000 x GH¢4.2 = GH¢1,176,000. However, during the time that it was exposed to the currency risk, the exchange rate has moved in an adverse direction, and the actual payments are \$280,000 x GH¢4.6 = GH¢1,288,000. The 'FX loss' has been GH¢112,000. **(3 marks)**

ii) **Currency risk** arises from exposure to the consequences of a rise or fall in an exchange rate. Here, the Ghanaian company was exposed to the risk of a fall in the value of the cedi.
Currency risk is a two-way risk, and exposure to risk can lead to either losses or gain from movements in an exchange rate. In this example, the exchange rate could have moved the other way. For example, if the exchange rate after three months had been \$1= GH¢4.0, the Ghanaian company would have paid GH¢1,120,000 instead of GH¢1,288,000. **(2 marks)**

iii) **Transaction risk** arises only when the settlement of the transaction (and receipt/payment) will occur at a future date. An exposure lasts for a period of time. Here, the exposure lasts from when the goods were sold on credit until the time that the customer eventually pays. **(2 marks)**

iv) Trading profits for companies engaged in foreign trade can be significantly affected by currency movements. **When exchange rates** are volatile and unpredictable, the gain or loss on currency exchange could possibly be even bigger than the expected gross profit from the transaction. **(3 marks)**

(Total: 25 marks)

EXAMINER'S COMMENTS

Question 3 was a mixture of theory and calculations. It covered (a) to (c) also with (a) considered one of the easiest requiring students to state the advantages and disadvantages of payback period. This was well answered by almost all students.

The (b) aspect covered NPV determination and investment decision making. This part was averagely answered. Students understood differently the current selling price and variable cost that were to form the basis for the projected prices and the variable cost. Some understood the current year to be year zero and others year one and based their projections based on their understanding of which year should be the starting year. The examiners provided alternative solution to cover this ambiguity.

The (c) part which covered mainly currency risk and losses was well answered.

Overall this question which carried a total of 25 marks was generally well answered.

QUESTION FOUR

a) **Differences between Factoring and Invoice Discounting**

- The essential difference between Factoring and Invoice Discounting lies in who **takes control of the sales ledger and responsibility for collecting payment**:
  With Factoring, the provider takes the role of managing the sales ledger, credit control and chasing customers for settlement of their invoices whilst with Invoice Discounting, your business retains control of its own sales ledger and chases payment in the usual way.

- Another difference between Factoring and Invoice Discounting is in **the area of confidentiality:** With Factoring, the customer settles their invoice directly with the Factoring Company; so customers are more likely to be aware of your Factoring arrangement. With Invoice Discounting, your customers still pay you directly; there is no need for them to know that a third party is involved.

(2 points for 5 marks)

b)

Present Position:	GH¢
Sales	24,000,000
30% contribution	7,200,000

Cost:
Bad debts 1% x 24,000,000 x 70% = 168,000

Cost of Debtors:
Variable cost of debtors:
24,000,000/12 x 1 = 2,000,000 x 70% = 1,400,000
Hence cost of debtors = 20% x 1,400,000 = 280,000

NB// Debtors could also be valued at selling price.

Proposed policy

Sales	30,000,000
30% contribution	9,000,000

Cost:
Bad debts 1.5% x 30,000,000 x 70% = 315,000

Cost of Debtors
Variable cost of debtors:
30,000,000/12 X 2 = 5,000,000 X 70% = 3,500,000

Hence cost of Debtors 20% = 3,500,000 x 20% = 700,000

Assessment of New Policy by ATA Ghana Ltd.

Increased contribution (9,000,000 -7,200,000)	=	1,800,000
Increased bad debts (315,000-168,000)	=	(147,000)
Increased cost of debtors (700,000 -280,000)	=	(420,000)
Net benefit		**1,233,000**

Decision:
The company should pursue the policy of taking in the new customers.

(10 marks)

ALTERNATIVE SOLUTION TO QUESTION 4B

OLD POLICY

	GH'000	GH'000
Sales		24,000
VC of Sales		16,800
Contribution		7,200
Cost of Debtors:		
Int. Foregone (1/12*24m*20%)	400	
Bad Debt (1%*24m)	240	640
Net Contribution		**6,560**

NEW POLICY

	GH'000	GH'000
Sales		30,000
VC of Sales		21,000
Contribution		9,000
Cost of Debtors:		
Int. Foregone (2/12*30m*20%)	1,000	
Bad Debt (1.5%*24m)	450	1,450
Net Contribution		**7,550**

ANALYSIS

Net Contribution of New Policy	7,550
Net Contribution of old Policy	(6,560)
Net Benefit from New Policy	**990**

Alternatively	
increased Contribution	1800
increased cost of bad debt	(210)
increased financing cost (interest)	(600)
Net Benefit from New Policy	**990**

Decision:
The company should pursue the policy of taking in the new customers.

(10 marks)

(Total: 15 marks)

EXAMINER'S COMMENTS
This was a mix question of both theory and calculations. The (a) portion which was on factoring and invoice discounting was averagely answered.

The (b) portion which was on decision making on extension policy on credit sales was a challenge to students. This was poorly answered and one of the questions poorly answered. It however had a total of only 15 marks minimising its negative impact on students pass rate. The standard of the question was ok.

QUESTION FIVE

a)
(i) Net asset valuation
In the absence of any information about realisable values and replacement costs, net asset value is on a book value basis. It is the sum of non-current assets and net current assets, less long-term debt, i.e. 595 + 125 – 70 – 160 = GH¢490 million.

(3 marks)

(ii)**Dividend growth model**
Total dividends of GH¢40 million are expected to grow at 4% per year and FCH Bank Ltd. has a cost of equity of 10%. Value of company = (40m x 1·04)/(0·1 – 0·04) = GH¢693 million. **(3 marks)**

(iii) Earnings yield method
Profit after tax (earnings) is GH¢66·6 million and the finance director of FCH Bank Ltd. thinks that an earnings yield of 11% per year can be used for valuation purposes. Ignoring growth, value of company = 66·6m/0·11 = GH¢606 million
Alternatively, profit after tax (earnings) is expected to grow at an annual rate of 5% per year and earnings growth can be incorporated into the earnings yield method

using the growth model. Value of company = (66 ·6m x 1 ·05)/ (0 ·11 – 0 ·05) = GH¢1,166 million. **(3 marks)**

b) Katamanso Ltd

(i) Dividend cover

Earnings / Dividend
= 24,600/6,750 =3.64

(2 marks)

(ii) Earnings per share

Earnings available to equity holders/no of ordinary shares
24,600/15000 = 1.64
= 0.0484

(2 marks)

(iii) Price/earnings ratio

Price per share/earning per share = 45/2.18

= 20.64

(2 marks)

(Total: 15 marks)

EXAMINER'S COMMENTS

Question 5 was the most difficult of all for students and students scored very poor marks in this question. The poor performance was however mitigated by the total score of 15 marks compared to 20 and 25 marks in 3 questions of the paper.

The (a) part tested students on 3 methods of valuations namely net assets method, dividend growth method and Earnings yield method. This part received fairly better answers than the (b) part of the question.
The (b) part expected the students to calculate dividend cover, earnings per share and price/earnings ratio from a given data that required tax computation as well.

Students generally performed poorly in answering the question.
Overall the difficult questions carried the lowest marks of 30 marks for the question 4 and 5 whilst the straight forward questions from question 1 to 3 carried 70 marks.
This distribution still made students who concentrated on the first 3 questions that had the marks perform better on overall basis lifting the pass rate to around 50%.

CONCLUSION

Overall performance was excellent and a significant improvement in recent times. The question paper was fairly standard and easier relative to the prior questions. Good performance attributable to allocation of more marks to the first 3 questions that were straight forward.