



APPLICATION LEVEL EXAMINATION

2024-2029 Syllabus

Mock Exam

FINANCIAL MANAGEMENT

Paper 2.4

QUESTION ONE

- a) The financial sector is one of the most highly regulated sectors of any country. Notably, each industry under the financial sector has a special regulatory framework consisting of statutes to shape the conduct of participants in the industry and a regulator to foresee compliance and promote fairness and efficiency.

Required:

- i) Identify **THREE** functions the Securities and Exchange Commission of Ghana (SEC) is expected to perform towards achieving fairness and efficiency in the securities industry. **(3 marks)**
- ii) State **TWO** implications of the regulatory functions of the SEC for corporate investing and financing activities. **(2 marks)**
- b) A colleague has been taken ill. Your managing director has asked you to take over from the colleague and to provide urgently-needed estimates of the discount rate to be used in appraising a large new capital investment. You have been given your colleague's working notes, which you believe to be numerically accurate.

Working notes: Estimates for the next five years (annual averages)

Stock market total return on equity	16%
Own company dividend yield	7%
Own company share price rise	14%
Standard deviation of total stock market return on equity	10%
Systematic risk of own company return on equity	14%
Growth rate of own company earnings	12%
Growth rate of own company dividends	11%
Growth rate of own company sales	13%
Treasury bill yield	12%

The company's gearing level (by market values) is 1 : 2 debt to equity, and after-tax earnings available to ordinary shareholders in the most recent year were GH¢54,000,000, of which GH¢21,400,000 was distributed as ordinary dividends.

The company has 1 million issued ordinary shares which are currently trading on the Stock Exchange at GH¢321.00. Corporate debt may be assumed to be risk-free. The company pays tax at 30% and personal taxation may be ignored.

Required:

Estimate the company's weighted average cost of capital using:

- i) The dividend valuation model;
- ii) The capital asset pricing model.
- (Note: state clearly any assumptions that you make).*
- iii) Under what circumstances would these models be expected to produce similar values for the weighted average cost of capital? **(15 marks)**

(Total: 20 marks)

QUESTION TWO

Sabir Company is considering whether to invest in a project whose details are as follows. The project will involve the purchase of equipment costing GH¢2,000,000. The equipment will be used to produce a range of products for which the following estimates have been made.

Year	1	2	3	4
Average unit sales price	GH¢73.55	GH¢76.03	GH¢76.68	GH¢81.86
Average unit variable cost	GH¢50	GH¢50	GH¢45	GH¢45
Sales volume (units)	65,000	110,000	125,000	80,000

Incremental fixed costs are GH¢1,200,000 per annum.

The sales prices allow for expected price increases over the period. However, cost estimates are based on current costs, and do not allow for expected inflation in costs. Inflation is expected to be 3% per year for variable costs and 4% per year for fixed costs. The incremental fixed costs are all cash expenditure items. Tax on profits is at the rate of 30%, and tax is payable in the same year in which the liability arises.

Sabir Company uses a four-year project appraisal period, but it is expected that the equipment will continue to be operational and in use for several years after the end of the first four-year period.

The company's cost of capital for investment appraisal purposes is 10%. Capital projects are expected to pay back within two years on a non-discounted basis and within three years on a discounted basis. Tax allowable depreciation will be available on the equipment at the rate of 25% per year on a reducing balance basis. Any balancing allowance or balancing charge is not attributed to a project unless the asset is actually disposed of at the end of the project period.

Required:

- Calculate the *net present value* of the project. (11 marks)
- To the nearest month, calculate the non-discounted payback period and the discounted payback period (4 marks)
- Explain the meaning of *market volatility* in financial markets. (3 marks)
- Explain the difference between a *bull* and *bear* market. (2 marks)

(Total: 20 marks)

QUESTION THREE

Legon LTD has used a foreign supplier for the first time for the purchase of some materials and is required to make a payment of US\$400,000 in six months' time to the supplier.

The finance manager is aware of exchange rate risk and the possibility that the value of the dollar may increase against the cedi during the next six months. He therefore wants to take some measure to hedge the exchange risk. The following information is available from the company's bank:

Spot rate (GH¢/\$)	5.2 ± 0.15
Six months forward rate (GH¢/\$)	5.4 ± 0.16

Money market rates available to Lupin:

	Borrowing	Deposit
One year cedi interest rate	12%	10%
One year dollar interest rate	3.2%	2.8%

The company has no surplus cash.

Required:

- a) Estimate the cost of the following three methods of hedging the exchange risk for the US dollar amount payable:
 - i) money market hedge
 - ii) six-month forward exchange contract
 - iii) making a lead payment.

Identify which of these three methods is the cheapest way of fixing the payment in cedi.

(9 marks)

- b) The Central Bank is expected to make a substantial increase in the base rate of interest in order to reduce a high rate of inflation.

Required:

Explain the possible consequences for a supplier of fashion goods in the following areas if this happens:

- i) sales;
- ii) operating costs; and,
- iii) earnings (profit after tax).

(6 marks)

- c) Rapid growth in the accessibility and use of digital financial services (DFS) has extended the reach and usability of financial services and fundamentally changed the way consumers interact with financial products and services. The fact that DFS trends and risks are dynamic and continually evolving means that traditional rules-based frameworks quickly become out of touch with the realities faced by DFS consumers.

Required:

Identify **FIVE** unfair digital practices in the financial sector.

(5 marks)

(Total: 20 marks)

QUESTION FOUR

Donkor plc is a manufacturer of car care products. It carries insignificant amounts of inventory. Revenue and profits after tax for last year are GH¢145 million and GH¢40 million respectively.

Donkor plc's shares are currently quoted at GH¢440, the lowest price for five years. The directors believe that this is because the company is not growing as fast as the market expects. They believe that the fastest way to grow, and as a result improve the share price performance, is to acquire another company in a similar line of business with a lower P/E ratio. They are therefore evaluating Esam plc on the basis that its earnings can be 'bootstrapped' i.e., on the assumption that, once the merger has been completed, the combined company's P/E ratio will be the same as Donkor plc's current ratio.

Esam plc's results for the past three years and its directors' own estimate for this year are as follows:

Year to 31 December	Revenue GH¢ million	Profit after tax GH¢ million
2020 actual	95	12.1
2021 actual	100	12.5
2022 actual	106	13.5
2023 estimate	120	14.0

Esam plc's dividend payout ratio has been maintained at 50% for the past eight years. The company pays only one dividend per year at the end of December. Its shares are currently being traded at GH¢126.

Summary statements of financial position at 31 December 2022 for the two companies are as follows:

	<i>Donkor plc</i> GH¢ million	<i>Esam plc</i> GH¢ million
Non-current assets (net of depreciation)	60.0	75.0
Net current assets	30.0	25.0
Total assets less current liabilities	90.0	100.0
Capital and reserves		
Called up share capital	25.0 ^{Note 1}	50.0 ^{Note 2}
Reserves	65.0	50.0
	90.0	100.0

Notes

- (1) 1 million ordinary shares.
- (2) 1 million ordinary shares.

If the merger goes ahead, one of Esam plc's properties will not be needed following the merger and will be sold at the end of the first year of operations. The estimated sales receipt from this asset at the time of sale is GH¢25 million, which will also be the written-down book value at that time. No other savings or synergies have been identified by the directors of Donkor plc at this stage.

Donkor plc's financial advisors believe that its directors are over-valuing Esam plc's future earnings post-tax. They advise that, in their opinion, the merged company should be more prudently valued and suggest that Esam plc's growth for the foreseeable future is likely to be maintained at no more than the average of the last four years.

The cost of capital for Donkor plc is 14% and for Esam plc is 12%.

Required:

- a) Estimate the maximum price, in total and per share, that Donkor plc might bid for the whole of the share capital in Esam plc under both of the following assumptions:
 - i) the directors of Donkor plc are correct,
 - ii) the financial advisors are correct,and comment briefly on the weaknesses of the methods of valuation you have used;
(9 marks)
- b) Advise the directors of Donkor plc on an initial bid price and a maximum price which they should offer for the shares of Esam plc;
(6 marks)
- c) Value for Money (VFM) is derived from the optimal balance of benefits and costs on the basis of total cost of ownership. The nature of public financial management is such that it involves discretionary decision taking on behalf of government at all levels. Value for Money is therefore not a choice of goods or services which is based on the lowest bid price but a choice based on the whole life costs of the project or service.

Required:

Identify and explain **FOUR** mechanisms that can be used to achieve *value for money* in public sector management.
(5 marks)

(Total: 20 marks)

QUESTION FIVE

- a) Explain how *factoring* can help a company with the management of its accounts receivable. (5 marks)
- b) A factoring company has offered to take over the administration of the receivables ledger for Cape Coast Imports LTD on a non-recourse basis. The annual fee would be 2.5% of credit sales. The factor is confident that it will be able to achieve an average collection period of 30 days for receivables. The factor would also advance to Cape Coast Imports Ltd 80% of the face value of the amounts receivable, charging interest at 8% per year.

Cape Coast Imports LTD estimates that by using the factor's services, it would reduce its annual administration costs by GH¢500,000 and eliminate irrecoverable debts of GH¢300,000 per year.

Cape Coast Imports LTD's sales for the year were GH¢51,000,000 and its average receivables were GH¢6,000,000. Cape Coast Imports LTD has a bank overdraft on which it pays interest at a variable rate which averages to 6%.

Required:

Calculate whether the company would benefit financially from factoring its accounts receivable. State any assumptions that you make in your calculations. (10 marks)

- c) Section 92 (1) of the Public Procurement Act, 2003 (Act 663) provides that any person who contravenes any provision of the Act commits an offence and where no penalty has been provided for the offence, the person is liable on summary conviction to a fine not exceeding 1000 penalty units or a term of imprisonment not exceeding five years or to both.

Required:

Explain **FOUR** circumstances that may constitute an offence as provided by the Public Procurement Act 2003, (Act 663). (5 marks)

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a)

i) **Functions of the SEC of Ghana**

The SEC of Ghana is expected to perform the following functions:

- to advise the Minister responsible for Finance on all matter relating to the securities industry
- to maintain surveillance over activities in securities to ensure orderly, fair and equitable dealings in securities;
- to register, licence, authorise or regulate stock exchanges, investment advisers, unit trust schemes, mutual funds, securities dealers, and their agents and to control and supervise their activities with a view to maintaining proper standards of conduct and acceptable practices in the securities business;
- to formulate principles for the guidance of the industry;
- to monitor the solvency of licence holders and take measures to protect the interest of customers where the solvency of any such licence holder is in doubt;
- to protect the integrity of the securities market against any abuses arising from the practice of insider trading;
- to adopt measures to minimize and supervise any conflict of interests that may arise for dealers;
- to review, approve and regulate takeovers, mergers, acquisitions and all forms of business combinations;
- to examine and approve of the new issue of securities on the stock exchange (i.e., IPO);
- to create the necessary atmosphere for the orderly growth and development of the capital market;

[3 functions @ 1 marks each = 3 marks]

ii) **Implications of the regulatory functions of SEC for corporate financing decisions**

The regulatory functions of the SEC have the following implications for corporate financing:

- When making securities offers, companies must ensure that the offer is fair and equitable. For instance, all potential buyers must be treated equally, and communications relating to the offer should be true and fair.
- The company, its members, and directors cannot trade securities based on insider information.
- The company cannot engage in any form of business combination without the approval of the SEC.
- The company will need approval from the SEC when making an IPO.

[Marks allocation: 2 implications @ 1 marks each = 2 marks]

b) (i) Dividend valuation model

If we assume a constant growth in dividends, we may estimate the cost of equity by using:

$$K_e = \frac{D_1}{MV_{\text{Ex div}}} + g = \frac{GH\text{¢}21,400,000 \times 1.11}{GH\text{¢}321,000,000} + 0.11 = 0.184 \text{ or } 18.4\%$$

Cost of debt (K_d), as corporate debt is assumed to be risk free, is 12%, the Treasury bill yield.

The after-tax cost is $12(1 - 0.30) = 8.4\%$

The weighted average cost of capital (WACC) is found as follows:

$$WACC = \left(K_E \times \frac{MV_E}{MV_{\text{TOTAL}}} \right) + \left(K_D \times \frac{MV_D}{MV_{\text{TOTAL}}} \right)$$

$$WACC = \left(18.4\% \times \frac{2}{3} \right) + \left(8.4\% \times \frac{1}{3} \right) = 15.1\%$$

(ii) Capital asset pricing model

Cost of equity may be estimated using:

$$R_E = R_{RF} + \beta(R_M - R_{RF})$$

The beta value of the security may be found using:

$$\beta = \frac{\sigma_S}{\sigma_M} = \frac{14\%}{10\%} = 1.4$$

$$R_E = 12\% + 1.4(16\% - 12\%) = 17.6\%$$

$$K_d = 7.8\% \text{ as in part (i)}$$

$$WACC = \left(17.6\% \times \frac{2}{3} \right) + \left(8.4\% \times \frac{1}{3} \right) = 14.53\%$$

If the stock market is in equilibrium, and the inputs into the models are correctly specified (e.g., the dividend valuation model reflects only systematic risk), then the cost of equity K_e from the dividend valuation model should approximately equal the expected return on equity $E(re)$ of the CAPM.

(15 marks evenly spread using ticks)

(Total: 20 marks)

QUESTION TWO

(a) Workings

Year	Written down value	Tax allowable depreciation	Tax benefit (30%)
	GH¢000	GH¢000	GH¢
1	2,000 (500) -----	500	150
2	1,500 (375) -----	375	113
3	1,125 (281) -----	281	84
4	844 (211) -----	211	63
c/fwd	633 -----		

NPV calculation

Year	1	2	3	4
	GH¢	GH¢	GH¢	GH¢
Average sales price	73.55	76.03	76.68	81.86
Average variable cost	51.50	54.08	49.17	50.65
Contribution per unit	22.05	21.95	27.51	31.21
Sales units	65,000	110,000	125,000	80,000
	GH¢000	GH¢000	GH¢000	GH¢000
Total contribution	1,433	2,415	3,439	2,497
Fixed costs	(1,248)	(1,298)	(1,350)	(1,404)
Taxable cash flow	185	1,117	2,089	1,093
Tax (30%)	(56)	(335)	(627)	(328)
	129	782	1,462	765
Tax benefits	150	113	84	63
Net cash flow	279	895	1,546	828
Discount factor, 10%	0.909	0.826	0.751	0.683
Present values	254	739	1,161	566

	GH¢000
Total present values of net cash flows	2,720
Year 0 Capital outlay	(2,000)

Project four-year NPV	720

Note: There is no balancing allowance for the equipment for tax purposes because the equipment will not be disposed of after four years. It would be reasonable to suggest that some terminal value should be included for the equipment at the end of Year 4, but there is insufficient information available on which to make such a valuation.

If the terminal value of the equipment is assumed to be its written down value at the end of Year 4, this could be included in the project cash flows and would increase the project NPV.

(11 marks evenly spread using ticks)

(b) **Payback and discounted payback**

Year	Cash flow	Cumulative cash flow	Discounted cash flow	Cumulative discounted cash flow
	GH¢000	GH¢000	GH¢000	GH¢000
0	(2,000)	(2,000)	(2,000)	(2,000)
1	279	(1,721)	254	(1,746)
2	895	(826)	739	(1,007)
3	1,546	720	1,161	154
4	828	1,548	566	720

Non-discounted payback period = 2 years + $[(826/826 + 1,546) \times 12 \text{ months}] = 2 \text{ years } 4 \text{ months}$

Discounted payback period = 2 years + $[(1,007/1,007 + 1,161) \times 12 \text{ months}] = 2 \text{ years } 6 \text{ months}$

(4 marks evenly spread using ticks)

(c) **Market volatility**

Market volatility in financial markets is a measure of the extent to which the price of a financial security (such as a share's market price), or a market as a whole, or an interest rate, or a currency, or a commodity changes over time.

High volatility means rapid and large changes in a price or rate over a short period of time. Low volatility means smaller and less frequent price changes.

Volatility refers to price movements in both directions, up and down. If prices move over time always in the same direction (either up or down, but not both) this does not

mean high volatility. Volatility implies uncertainty about the way that prices will move next, and by how much.

High volatility creates high financial risk. Investors will want higher returns to invest in financial instruments where price volatility is high.

(3 marks)

(d) Bull and bear markets

In a bull market, prices on the whole move upwards continually over time. For example, in a bull stock market, share prices on the whole continue to rise over time.

In a bear market, prices on the whole move downwards continually over time. For example, in a bear stock market, share prices on the whole continue to fall over time.

(2 marks)

(Total: 20 marks)

QUESTION THREE

(a) **Money market hedge**

Buy dollars now and put them on deposit so that the amount purchased plus interest will amount to \$400,000 in six months' time. Since the company has no surplus cash, it will have to borrow cedi to buy the dollars. The cost of this hedge will be calculated as a cost after six months, by adding six months interest on the borrowed cedi to the initial cost.

It is assumed that the interest cost for six months, and the interest on deposits for six months, will be one half of the annual interest rates given in the question.

6 months' interest on dollar deposits = $2.8\% / 2 = 1.4\%$

6 months' interest on cedi borrowing = $12\% / 2 = 6\%$.

Dollars required now to have \$400,000 after six months = $\$400,000 / 1.014 = \$394,477$

Spot rate for buying dollars from bank = $5.2 + 0.15 = 5.35$.

Cost of buying \$394,477 spot = $\$394,477 \times 5.35 = \text{GH}\text{¢}2,110,452$.

Cost of buying cedi plus interest cost for 6 months = $\text{GH}\text{¢}2,110,452 \times 1.06 = \text{GH}\text{¢}2,237,079$.

Forward exchange contract

Forward rate for buying \$400,000 in six months' time = $5.4 + 0.16 = 5.56$

Cost of forward contract, payable in six months' time = $\$400,000 \times \text{GH}\text{¢}5.56 = \text{GH}\text{¢}2,224,000$.

Lead payment

Pay \$400,000 now

Cost in cedi to buy the dollars spot = $\$400,000 \times 5.35 = \text{GH}\text{¢}2,140,000$.

The cedi will be borrowed.

Cost after six months, allowing for interest on the borrowed cedi = $\text{GH}\text{¢}2,140,000 \times 1.06 = \text{GH}\text{¢}2,268,400$.

Comparing the three methods of hedging on a comparable basis, which is the cost in six months' time, a forward exchange contract would be the least-cost method.

(9 marks evenly spread)

(b) **A substantial interest rate increase may have several consequences for a supplier of luxury goods.**

(i) It is likely that such a company would experience a sharp decrease in sales as a result of the increase in interest rates. One reason for this is that sales of luxury goods are more sensitive to changes in disposable income than sales of basic necessities, and disposable income is likely to fall as a result of the interest rate increase.

Furthermore, a substantial interest rate increase will have a negative effect on demand as the cost of consumer credit increases.

(ii) The company may experience an increase in operating costs as a result of the substantial interest rate increase, although this is likely to be a smaller effect and one that occurs more slowly than a decrease in sales. As the higher cost of borrowing moves through the various supply chains in the economy, producer prices may increase and material and other input costs for the company may rise by more than the current rate of inflation. Labour costs may also increase sharply if the recent sharp rise in inflation leads to high inflationary expectations being built into wage demands. Acting against this will be the deflationary effect on consumer demand of the interest rate increase.

If the Central Bank has made an accurate assessment of the economic situation when determining the interest rate increase, both the growth in consumer demand and the rate of inflation may fall to more acceptable levels, leading to a lower increase in operating costs.

(iii) Earnings (profit after tax) are likely to fall as a result of the interest rate increase. In addition to the decrease in sales and the possible increase in operating costs discussed above, the company would experience an increase in interest costs from any borrowing. The combination of these effects is likely to result in a sharp fall in earnings.

(2 marks each = 6 marks)

c)

- The increases in *fraud risks* such as cybercrime, identity fraud, social engineering, SIM swap fraud, hoaxes and scams heighten the need for sound *prudential regulation* and *cybersecurity*.
- Increasing pressure to share data needs to be balanced with effective *privacy and data protection* to manage *data misuse risks* such as algorithmic bias; unfair sales and marketing practices; privacy intrusions; and breaches of personal data.
- *Inadequate redress risks* such as unclear, expensive, or time-consuming complaint procedures and unsatisfactory dispute resolutions are addressed by giving consumers a more direct voice through various *dispute and redress* channels.
- *Lack of transparency risks* such as misleading advertisements, hidden charges and complex or confusing interfaces or languages can be combatted through the *disclosure of information* and through *financial education*.
- *Responsible conduct* extends from the service provider to also cover the provider's agents and the associated *agency risks* such as the manipulation or unfair treatment of customers, insufficient liquidity and gender norms.

(5 points for 5 marks)

(Total: 20 marks)

QUESTION FOUR

- a) Since the directors believe that the combined company will have the same P/E ratio as Donkor plc's present one, their maximum valuation for Esam plc should be on the basis that its P/E ratio is also equal to Donkor plc's.

The market value of Donkor plc's equity is GH¢440,000,000 (1,000,000 shares at GH¢440) and its earnings are given as GH¢40,000,000.

Therefore, the PE ratio is 11.

Applying this to Esam Plc's estimated 20X3 earnings of GH¢14 million, gives a total valuation of $11 \times 14\text{m} = \text{GH¢}154$ million. The estimate excludes the proceeds from the sale of the assets, which will occur at the end of the first year. The sale will yield GH¢25 million. The net present value of this amount depends on the relevant cost of capital. Assuming that this remains at 14%, the NPV of the sale proceeds equals GH¢22m ($\text{GH¢}25\text{m}/1.14$).

The maximum valuation that the directors of Donkor should place on Esam plc will therefore be approximately $\text{GH¢}154\text{m} + \text{GH¢}22\text{m} = \text{GH¢}176$ million. Esam Plc has 1,000,000 shares in issue so this approach results in a valuation of GH¢176 per share. This values the shares at a significant premium to the current market price of GH¢126).

The main weakness of this approach is the use of the P/E ratio derived from the price of Donkor plc's shares. This cannot be said to represent the worth of a business purchased as a whole.

- (ii) The implication of the financial advisors' views is that the dividend valuation model should be used:

$$MV_{\text{Ex div}} = \frac{D_1}{K_E - g}$$

$$MV_{\text{Ex div}} = \frac{\text{GH¢}14 \times 50\%}{0.12(\text{given}) - 0.05} = \text{GH¢}100 \text{ million}$$

Again the NPV of the sale proceeds of the redundant assets should be added to the price, giving a final figure of GH¢122 million, or GH¢122 per share (slightly lower than the current market price of GH¢126).

The main weakness here is the extrapolation of past growth into the future. There is no guarantee that Esam will continue to grow at 5%. The assumption that the cost of capital will remain at 12% is also a weak one.

(9 marks evenly spread)

- b) The lower of the two prices calculated above was GH¢122 million. However, this is too low for an initial bid as it is below the market price. The directors should therefore set an initial price slightly above this target. Normally initial bids are made at about 10% more than the market price, which would give a price of about GH¢139 per share.

The maximum price which the Donkor directors should be prepared to pay is lower than the GH¢176 million calculated above. At GH¢176 million, the acquisition would result in a no gain, no loss deal.

(6 marks)

- c) **Value for Money** is concerned with obtaining the best possible combination of services from the least resources. It is thus, the pursuit of economy, efficiency and effectiveness.

Below are the mechanisms used to achieve value for money:

- **Economy**

Economy is the term and condition under which an organization acquires human and material resources of the appropriate quality and standard at the lowest cost. From this procurement will be a purchasing activity whose purpose is to give the purchaser best value for money and that for complex purchases, value may imply more than just price since quality issues also need to be addressed.

- **Efficiency**

Efficiency as the relationship between goods and services produced and resources used to produce them. An efficient operation produces the maximum output for any given set of resource inputs; or, it has a minimum input for any given quantity and quality of services provided. In addition, efficiency implies practicality, especially in terms of compatibility with the government's administrative resources and professionalism.

- **Transparency & Accountability (Ethical Standards)**

Good procurement holds its practitioners responsible for enforcing and obeying the rules. It makes them subject to challenge and to sanction, if appropriate, for neglecting or bending those rules. Accountability is at once a key inducement to individual and institutional probity, a key deterrent to collusion and corruption, and a key prerequisite for procurement credibility.

- **Accountability and fairness in public procurement**

Accountability and fairness are three cardinal pillars that procurement reforms seek to achieve in that a very fair and accountable procurement system helps in the efficient utilization of the state resources judiciously. Procurement practitioners need to be very fair in their day-to-day dealings with their suppliers and potential bidders and the public at large in order to earn the trust of the various actors within the procurement system. Accountability refers to the process of holding an individual or an organization fully responsible for actions and functions they are engaged in and over which they have authority to exercise those functions.

- **Competition**

Competition has been regarded as one of the most important factors in attaining value for money in Public sector. This is on the premise that competition amongst bidders can lead to improvements in pricing and alternative means of delivering VFM. Competition can either be for the market (i.e. in the bidding process) or competition/contestability in the market which occurs after the contract is concluded and is in operation. On the contrary, the absence of competition or potential entry would lead to difficulties in attaining higher efficiency and value for money.

(4 points well explained @ 1.25 marks each = 5 marks)

(Total: 20 marks)

QUESTION FIVE

- a) Factoring of trade receivables involves handing over the administration of the receivables ledger to an external 'specialist'. As part of the factoring arrangement, the factoring company will usually agree to make an advance payment, typically about 70% to 80% of the unpaid receivables for which they are responsible for collecting payment. The balance of the payment, less fees and interest charges, is made when payment is eventually received.

A factoring service therefore assists with the management of receivables in two ways. It shortens the average cash cycle because 70% to 80% of the money is paid soon after the invoice is issued by the factor. The factor also takes on the administrative burden of receivables accounting. In addition, with a non-recourse factoring arrangement a factor will (in return for a fee) insure against non-payment of any amount receivable. If the money is not collected, the factor bears the loss, not the client company.

(5 marks)

- b) Using the factor is expected to reduce the average receivables because the average collection time is expected to fall to 30 days. This will reduce the amount of financing required for current assets as follows:

Reduction in receivables: interest saving	GH¢000
Current receivables	6,000
Average receivables with factor (GH¢51 million × 30/365)	4,192
Reduction in average receivables	1,808

Interest saving at 6%	108
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The factor will finance 80% of the receivables, but will charge interest at 8%. This is more than the 6% cost of financing current assets with a bank overdraft.

Net costs and benefits of using a factor	GH¢000	GH¢000
Extra interest cost on finance provided by factor (GH¢4,192,000 × 80% × 2% higher interest)		67
Annual fee: 2.5% × GH¢51,000,000 annual credit sales		1,275
Additional costs		1,342
Interest saving from reduction in receivables	108	
Savings in administration costs	500	
Reduction in irrecoverable debts	300	
Savings		908
Net incremental annual cost of using a factor		434

Using the factor would cost around GH¢434,000 extra per year. Cape Coast Imports Ltd should not use the factor as the benefits offered are outweighed by the extra costs that would be incurred.

(10 marks evenly spread using ticks)

c) The following constitute offences under the Public Procurement Act 2003 (Act 663) Act:

- (a) entering or attempting to enter into a collusive agreement, whether enforceable or not, with any other supplier or contractor where the prices quoted in their respective tenders, proposals or quotations are or would be higher than would have been the case has there not been collusion between the persons concerned;
- (b) directly or indirectly influencing in any manner or attempting to influence in any manner the procurement process to obtain an unfair advantage in the award of a procurement contract;
- (c) altering any procurement document with intent to influence the outcome of a tender proceeding and this includes but is not limited to
 - (i) forged arithmetical correction;
 - (ii) insertion of documents such as bid security or tax clearance certificate which were not submitted at bid opening; and
- (d) request for clarification in a manner not permitted under this Act.

(4 points @ 1.25 marks each= 5 marks)

(Total: 20 marks)