UNIVERSITY OF BRADFORD

ACCOUNTING & FINANCE

MAN4154M

10 January 2013 **16:00 – 17:00 hours**

Main

This is a **CLOSED BOOK** examination

SECTION A
Multiple choice questions
(Answer **ALL** questions)

Section B
Answer **ONE** question only from this section

Section A

Answer ALL 10 multiple choice questions on the ANSWER GRID provided.
Worth 20% weighting for the examination. No negative marking.

Question 1

Bear plc has 12 million shares in issue and the last reported earnings per share of 20p. It is expected that debentures will be converted into equity resulting in the issue of a further 3 million shares. What is the diluted earnings per share?

A 6.67p

B 12p

C 15p

D 16p

Question 2

RB uses the reducing balance method of depreciation at a rate of 25%. A non-current asset that cost €120,000 to purchase and a further €40,000 to install was bought 2 years ago. What is the charge for depreciation in relation to this non-current asset for year 3?

A €16,875

B €22,500

C €30,000

D €40,000

Question 3

A higher value for closing inventory leads to which of the following?

i) Lower reported profit

ii) Lower working capital

iii) Higher reported profit

iv) Higher working capital

A (iii) and (iv)

B (i) and (ii)

C (i) and (iv)

D (ii) and (iii)

Question 4

The annual audit for a European quoted company is carried out by:-

A A government audit organisation

B An internal audit team

C An external, not-for-profit audit team

D An external, for-profit audit team

Question 5

Which two ratios, when combined, give the Return on Capital Employed (ROCE)?

A Earnings per share and Current ratio

B Return on Sales and Asset Utilisation

C Earnings per share and Net Book Value

D Return on Sales and Current ratio

Question 6

The traditional view of gearing suggests that at a higher level of gearing than the optimal point a company should:-

A Increase equity and decrease debt

B Decrease equity and decrease debt

C Increase equity and increase debt

D Decrease equity and increase debt

Question 7

On 1 January 2012 inventory totalled £550,000. One year later it was £700,000. This would be shown in the cash flow statement as:

A increase in inventory £150,000

B increase in inventory £700,000

C increase in inventory (£150,000)

D increase in inventory (£700,000)

Question 8

Accounting for Research and Development produces a conflict between which two accounting concepts?

i) Going concern

ii) Accruals

iii) Consistency

iv) Prudence

A (i) and (iii)

B (ii) and (iii)

C (ii) and (iv)

D (iii) and (iv)

Question 9

A company issued its 10% irredeemable debentures at 95. The current market price is 90. The company is paying corporation tax at a rate of 28%.

What is the current net cost of capital per annum of these debentures?

A 11.1%

B 10.0%

C 8.0%

D 7.6%

Question 10

Which of the following is a valid criticism of the Internal Rate of Return (IRR) method of project appraisal?

A It ignores the time value of money

B It does not consider the whole life of the project

C It is hard to understand

D The reinvestment rate is over optimistic

Section B

Answer ONE question only from this section

All questions carry equal weighting.

Question 1

You are looking at calculations in relation to a proposed investment. The recommendation given is that the investment should go ahead.

All figures in €'000		Year 1	Year 2	Year 3	Year 4
Sales		1,200	1,500	1,650	800
Profit on Sale of machinery		50			
Less:					
Materials		150	180	190	100
Power		25	30	35	28
Dividends		500	500	500	500
Salaries		200	220	240	200
Research		135			
Profit/(Loss)		240	570	685	(28)

Upon further investigation you discover the following information:

1) The €5m required to fund this investment would be raised from issuing new shares. Equity investors require an annual return of 10% and have expressed their preference for this to be delivered in the form of dividends. Machinery would be bought straight away for €4,500,000 and sold for €1,000,000 at the end of Year 4.

2) Old machinery with a net book value (NBV) of €250,000 would be sold for €300,000 cash at the same time as the new machinery is bought. If it was not sold now, then it would be sold for €100,000 at the end of year 4.

3) The materials figure in the table relates to the actual consumption for each year. In addition to this, a working capital total at the start of the year is required as follows:

Year 1	€40,000
Year 2	€50,000
Year 3	€35,000
Year 4	€20,000

At the end of Year 4 all the working capital will be recovered.

4) Research costing €55,000 has already been carried out, but the money to pay for this has not yet left the bank account due to technical difficulties at the bank. These have now been resolved. If the project goes ahead, then a further €80,000 will be spent (and paid for) in Year 1.

5) It is thought that the new project will lead to an increase in sales (with an overall net present value of €75,000) in other parts of the company's business.

6) The company usually applies a discount rate of 8% when assessing projects.

Discount rates with discount factor:

	8%
Period 1	0.926
2	0.857
3	0.794
4	0.735
5	0.681

Required:

a) Do you think that the company should go ahead with the project? Explain how you have dealt with items 1-5 and set out your calculations and assumptions clearly.

50% of marks

b) Discuss why a "profitable" project might be rejected by a company.

30% of marks

Total: 80%

Question 2

Highlight some of ways in which the financial accounts could be legally manipulated.

(40% of marks)

Discuss some of the advantages and disadvantages associated with a stricter rule based system of accounting.

(40% of marks)

Total: 80%

Question 3

Windy plc is a company listed on the London stock Exchange which is looking to expand its operations across Europe. The company has grown rapidly in recent years with annual dividends having seen consistent growth as follows:

2008	2009	2010	2011	2012
10.00p	12.00p	13.50p	14.50p	15.75p

The company expects dividends to continue to grow for the foreseeable future in line with this recent dividend profile. Extracts from the company's most recent balance sheet at 31 May 2012 are set out below:

	£'000	£'000
Ordinary £1 shares	14,000	
5.5% £1 irredeemable preference shares	10,000	
Retained earnings	19,400	
Total equity		43,400
7% irredeemable debentures (at nominal value)	50,000	
Total non-current liabilities		50,000

The current ex-dividend ordinary share price is £3.50, whilst the current ex-dividend preference share price is £0.77. The irredeemable debentures have a current ex-interest market price of £86.50 per £100 debenture. The company pays corporation tax at a rate of 28%.

Regarding the company's proposed expansion plans, the chief executive has expressed his preference for any financing requirements to come from increasing debt rather than increasing equity in order to move towards minimising the company's weighted average cost of capital.

Required:

a) From the information available calculate, using market values, the company's weighted average cost of capital

50% of marks

b) Discuss the preference of the chief executive for any financing requirements to come from increasing debt rather than increasing equity in order to move towards minimising the company's weighted average cost of capital.

30% of marks

Total: 80%