



# **GRETSA UNIVERSITY - THIKA**

## **UNIVERSITY EXAMINATIONS JANUARY –APRIL 2025 SEMESTER**

### **BACHELOR OF COMMERCE**

**COURSE CODE: BCFI303**

**COURSE TITLE: FINANCIAL STATEMENT ANALYSIS**

**DATE:**

**TIME:**

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#### **INSTRUCTIONS TO CANDIDATES**

1. SECTION A IS **COMPULSORY**.
2. SECTION B: ANSWER ANY OTHER **TWO** QUESTIONS.
3. **DO NOT** WRITE ANYTHING ON THIS QUESTION PAPER AS IT WILL BE AN EXAM IRREGULARITY.
4. ALL ROUGH WORK SHOULD BE AT THE BACK OF YOUR ANSWER BOOKLET AND CROSSED OUT.

**CAUTION:** *All exam rooms are under CCTV surveillance during the examination period.*

## **SECTION A: COMPULSORY**

### **Question One**

- a) The success of any business organization is dependent on the decisions that finance manager make, using specific examples of decision that finance managers make, describe the 4 managerial functions of finance **[10 marks]**
- b) Describe four factors that influence the capital structure of a business **[10 marks]**
- c) Discuss the 5 economic advantages of leasing as a method of business financing **[10 marks]**

## **SECTION B: ANSWER ANY TWO QUESTIONS**

### **Question Two**

- a) Discuss the 6 assumptions of divided irrelevance theory by Modigliani and Miller **[12marks]**
- b) Explain the 4 disadvantages of using cash flow statements **[8 marks]**

### **Question three**

Kithino coffee millers Ltd. have decided to install a new milling machine. The machine costs shs. 2,000, 000 and it would have a useful life of five years with a salvage value of shs. 400, 000 at the end of the fifth year. Additional cash flows from the machine would be shs. 800, 000 a year for five years. A decision has now to be taken on the method of financing the project. Two methods of finance are being considered.

- (i) The company could purchase the machine for cash, using bank loan facilities on which the current rate of interest is 13% before tax.
- (ii) The company could lease the machine under an agreement which would entail payment of shs. 480, 000 at the end of each year for the next five year. The company's weighted average cost of capital, normally used for project evaluating, is 12% after tax. The rate of company income tax is 30%. If the machine is purchased, the company will be able to claim an annual tax depreciation allowance of 25% on cost.

**Required:**

- a) Advise the management on whether to acquire the machine [2 marks]
- b) Determine The most economical method of financing [10 marks]
- c) Explain the 4 advantages of cash budgeting [8 marks]

**Question Four**

a) Explain why the weighted average cost of capital of a firm that uses relatively more debt capital is generally lower than that of a firm that uses relatively less debt capital. [6 marks]

b) The total of the net working capital and fixed assets of Faida Ltd as at 30 April 2003 was Sh.100,000,000. The company wishes to raise additional funds to finance a project within the next one year in the following manner.

Sh.30,000,000 from debt

Sh.20,000,000 from selling new ordinary shares.

The following items make up the equity of the company:

Sh. 3,000,000 fully paid up ordinary shares	30,000,000
Accumulated retained earnings	20,000,000
1,000,000 10% preference shares	20,000,000
200,000 6% long term debentures	30,000,000

The current market value of the company's ordinary shares is Sh.30. The expected dividend on ordinary shares by 30 April 2004 is forecast at Sh.1.20 per share. The average growth rate in both earnings and dividends has been 10% over the last 10 years and this growth rate is expected to be maintained in the foreseeable future.

The debentures of the company have a face value of Sh.150. However, they currently sell for Sh.100. The debentures will mature in 100 years. The preference shares were issued four years ago and still sell at their face value. Assume a tax rate of 30%

Required:

- (i) Calculate The expected rate of return on ordinary shares. [2 marks]
- (ii) The effective cost to the company of:
  - a) Calculate the Debt capital [2 marks]
  - b) Calculate Preference share capital [2 marks]
- (iii) Calculate the company's existing weighted average cost of capital. [4 marks]

- a) Calculate the company's marginal cost of capital if it raised the additional Sh.50,000,000 as intended. [4 marks]

### Question Five

Explain the following terms using examples:

- i) Venture capitalist [4 marks]
- ii) Capital rationing [4 marks]
- iii) Derivatives [4 marks]
- iv) Financial leverage [4 marks]
- v) Factoring [4 marks]