

RCM COLLEGE

ATD LEVEL III

FUNDAMENTALS OF FINANCE

Time Allowed: 2 hours.

1. Which of the following factors is **LEAST** likely to influence the investment decisions of a firm?
 - A. Market trends
 - B. Cost of capital
 - C. Regulatory requirements
 - D. Employee salaries(2 marks)
2. Core Capital Agribusiness, a recently incorporated Small and Medium Enterprise (SME), is looking for ways to improve its access to finance. Which one of the following statements is **NOT** a potential benefit of diversifying their financing channels?
 - A. Reducing dependence on any single source of funding
 - B. Accessing different types of financing with varying terms and conditions
 - C. Lowering overall financing costs
 - D. Increased administrative burden due to managing multiple financing sources(2 marks)
3. Farmers Ltd. is considering a project that requires an initial investment of Sh.100,000,000 and is expected to generate cash flows of Sh.40,000,000 per year for 5 years. The cost of capital for the company is 8%. What is the net present value (NPV) of the project?
 - A. Sh.15,443,500
 - B. Sh.21,543,500
 - C. Sh.59,708,500
 - D. Sh.41,543,500(2 marks)
4. You need to accumulate Sh.15,000,000 in 5 years for a down payment on a house. How much should you invest today at an annual interest rate of 7%, compounded annually, to reach your goal? (Rounding off to the nearest 2 decimal places)
 - A. Sh.10,461,460
 - B. Sh.10,694,800
 - C. Sh.11,055,640
 - D. Sh.11,365,680(2 marks)
5. Jason Ireri has a loan with an outstanding balance of Sh.12,000,000, an annual interest rate of 9% and monthly payments of Sh.250,000. How long will it take to fully repay the loan?
 - A. 54 months
 - B. 60 months
 - C. 62 months
 - D. 66 months(2 marks)
6. Aisha Mbeleva invests Sh.50,000 today in a savings account with an annual interest rate of 6%, compounded monthly. She plans to withdraw the entire amount five years from now and use it to invest in agricultural processing units. After five years, what will be the purchasing power of her savings considering an expected inflation rate of 3% per year?
 - A. Sh.63,872.15
 - B. Sh.66,090.00
 - C. Sh.59,106.46
 - D. Sh.56,459.89(2 marks)

Use the following information to answer question 7, question 8 and question 9.

Alice Gikenye invests Sh.500,000 in a saving account that offers 7% annual interest compounded quarterly. She intends to withdraw the entire amount after 5 years.

7. What will be the total amount that Alice Gikenye will receive at the end of 5 years?
- A. Sh.707,389
 - B. Sh.741,375
 - C. Sh.750,250
 - D. Sh.759,516
- (2 marks)

8. If Alice Gikenye needs Sh.1,000,000 in 3 years, how much additional money should she invest today?
- A. Sh.264,900
 - B. Sh.285,347
 - C. Sh.312,083
 - D. Sh.337,482
- (2 marks)

9. Alice Gikenye is considering two options for her additional investment: a lump sum deposit today or monthly contributions for 3 years. If the monthly interest rate remains 1.75% (quarterly compounding), which one of the following options would be more beneficial and why?
- A. Lump sum deposit since it benefits from longer compounding over 3 years
 - B. Monthly contributions as they allow flexibility and avoid risking a large sum upfront
 - C. There is no difference in total value for either option at the same interest rate
 - D. It depends on Alice Gikenye's financial situation and risk tolerance
- (2 marks)

10. The following information has been extracted from the books of Bidii Company as at 31 December 2023

- Receivable days: 58
- Inventory turnover: 10 times per annum
- Payable days: 45
- Non-current asset days: 36

What is the length of the cash operating cycle of Bidii Company as at 31 December 2023?

- A. 23 days
 - B. 49.5 days
 - C. 85.5 days
 - D. 139.5 days
- (2 marks)

11. Deral Limited is deciding on whether to offer a 2% early settlement discount that half of all customers take up. This will encourage the customers to pay in 1 month instead of the usual 2 months. Deral Limited pays 10% per annum for its overdraft facility.

What will be the impact of the 2% early settlement discount on the cash operating cycle and reported profits?

- | | Cash operating cycle | Reported profits |
|----|-----------------------------|-------------------------|
| A. | Reduce | increase |
| B. | Unaffected | increase |
| C. | Reduce | reduce |
| D. | Unaffected | reduce |
- (2 marks)

12. Wema Investments Company has a current ratio of 2. Outstanding trade receivables of Sh.3,000,000 and current liabilities amounting to Sh.2,000,000. Assume a year has 365 days.

Determine inventory days for Wema Investments Company if cost of sales is Sh.10,000,000 per annum?

- A. 36.5 days
 - B. 91.25 days
 - C. 14.6 days
 - D. 243.3 days
- (2 marks)

13. Zion Traders has annual credit sales of Sh.20 million and accounts receivable of Sh.4 million. Working capital is financed by an overdraft at 12% interest per year. Assume a year has 365 days. What is the annual financial effect if management reduces the collection period to 60 days by offering an early settlement discount of 1% that all customers adopt?
- Sh.85,479 benefit
 - Sh.114,521 cost
 - Sh.85,479 cost
 - Sh.285,479 benefit
- (2 marks)
14. Four mutually exclusive projects; K,L,M and N, have been appraised by Ann Njoka, a financial manager with Kevote Investments using net present value (NPV), internal rate of return (IRR), return on capital employed (ROCE) and payback period (PP). Kevote Investments' objective is to maximise shareholder wealth. Which of the following projects should be chosen by Ann Njoka?
- | | NPV | IRR | ROCE | PP |
|--------------|-----------------|-----|------|-----------|
| A. Project K | Sh. 1 million | 40% | 34% | 4 years |
| B. Project L | Sh. 1.1 million | 24% | 35% | 2.5 years |
| C. Project M | Sh. 0.9 million | 18% | 25% | 3 years |
| D. Project N | Sh. 1.5 million | 12% | 18% | 7 years |
- (2 marks)
15. Afya Inc., a pharmaceutical company, experiences delays in clinical trials due to unexpected regulatory changes by health authorities. This primarily represents which type of risk?
- Operational risk
 - Technology risk
 - Political and economic risk
 - Environmental risk
- (2 marks)
16. What is the primary goal of a dividend policy for a company?
- Maximising share price
 - Maximising dividends
 - Minimising taxes
 - Minimising debt
- (2 marks)
17. Which of the following terms is **NOT** a type of dividend payment?
- Cash dividend
 - Stock dividend
 - Bond dividend
 - Property dividend
- (2 marks)
18. Securities dividend is a payment made _____.
- in the form of additional company shares
 - in cash to shareholders
 - in the form of company bonds
 - in kind, such as assets or products
- (2 marks)
19. Which one of the following dividend policy emphasises on a steady and predictable payout ratio?
- Constant dividend pay-out policy
 - Residual dividend policy
 - Stable dividend policy
 - Irregular dividend policy
- (2 marks)
20. Which one of the following statements refers to the primary advantage of a stock repurchase programme for a company?
- Increased leverage
 - Tax advantage for shareholders
 - Enhancement of earnings per share
 - Reduced volatility in stock prices
- (2 marks)
21. The primary purpose of working capital management is _____.
- managing long-term investment
 - maximising shareholder wealth
 - managing short-term assets and liabilities
 - minimising tax liabilities
- (2 marks)

22. Which one of the following channels of financing is considered a remedy for Small and Medium Enterprise (SME) challenges?
- A. It limits the options available to SMEs
 - B. It reduces the complexity of financial management
 - C. It increases dependence on a single source
 - D. It provides alternative sources in case of one source failure
- (2 marks)
23. The cash conversion cycle measures the time it takes for _____.
- A. collecting accounts payable
 - B. paying accounts receivable
 - C. converting cash into inventory
 - D. collecting accounts receivable
- (2 marks)
24. Factoring contributes to working capital management by _____.
- A. increasing inventory turnover
 - B. accelerating cash inflows from receivables
 - C. delaying payments to creditors
 - D. reducing short-term borrowing
- (2 marks)
25. In Islamic finance, which one of the following terminologies is used instead of interest on loans?
- A. Profit-sharing
 - B. Riba
 - C. Dividends
 - D. Zakat
- (2 marks)
26. The primary driver behind the development of Islamic finance is _____.
- A. profit maximisation
 - B. social justice and ethical principles
 - C. technological advancement
 - D. political influence
- (2 marks)
27. Which one of the following crowdfunding model allows investors backers to receive a share of the profits or revenue generated by the project they support?
- A. Reward-based crowdfunding
 - B. Equity crowdfunding
 - C. Donation-based crowdfunding
 - D. Debt-based crowdfunding
- (2 marks)
28. Which one of the following statements explains the primary purpose of a smart contract in the context of blockchain technology?
- A. Exchanging physical goods
 - B. Automating contract execution
 - C. Enhancing cybersecurity
 - D. Generating new cryptocurrencies
- (2 marks)
29. The long-run objective of financial management is to maximise _____.
- A. earnings per share
 - B. the value of the firm's securities
 - C. return on investment
 - D. market share
- (2 marks)
30. What is the earnings per share (EPS) for a company that earned Sh.100,000 last year in after tax profit, has 200,000 common shares outstanding and Sh.1,200,000 in retained earnings at the end of the year?
- A. Sh.100,000
 - B. Sh.6.0
 - C. Sh.0.50
 - D. Sh.6.50
- (2 marks)

31. Baramwezi Industries is a company specialising in manufacturing sustainable clothing and is currently facing a sudden drop in consumer demand due to a competitor launching a similar line at a cheaper price. Which one of the following types of risk is highlighted in this scenario?
- A. Financial risk
 - B. Competitive risk
 - C. Market and opportunity risk
 - D. Political and economic risk
- (2 marks)
32. The decision function of financial management can be broken down into the _____ decisions.
- A. financing and investment
 - B. investment, financing and asset management
 - C. financing and dividend
 - D. capital budgeting, cash management and credit management
- (2 marks)
33. An examination of the sources and application of funds statement is part of _____.
- A. forecasting technique
 - B. fund flow analysis
 - C. a ratio analysis
 - D. calculations for preparing of financial statements
- (2 marks)
34. In proper capital budgeting analysis, we evaluate incremental _____.
- A. accounting income
 - B. cash flows
 - C. earnings
 - D. operating profits
- (2 marks)
35. Tax authorities allow the full installed cost of an asset to be written off for tax purposes. This amount is called assets' _____.
- A. depreciable basis
 - B. initial cash outlay
 - C. cost of capital
 - D. sunk cost
- (2 marks)
36. Baraka Limited is considering automation of its production processes. The following information relates to purchase of proposed machine:
1. The purchase of the machine will cost Sh.950,000.
 2. Shipping and installation would cost Sh.10,000.
 3. The automation would result in savings of Sh.90,000 a year due to reduced scrap and Sh.130,000 a year due to reduced labor costs.
 4. The machine has useful life of 4 years.
 5. The estimated final salvage value of the machine is Sh.240,000.
 6. The firms' marginal tax rate is 34%.
- Determine the incremental cash flow at time period.
- A. Sh.560,000
 - B. Sh.760,000
 - C. Sh.960,000
 - D. Sh.1,060,000
- (2 marks)
37. Profitability Index (PI) of 0.70 means that the _____.
- A. project return 70 cents in present value for each current shilling invested
 - B. payback period is less than one year
 - C. project's Net Present Value (NPV) is greater than 0
 - D. present value of benefits is 70% greater than the project cost
- (2 marks)
38. Jitegemee Ltd. is considering a project that calls for an initial outlay of Sh.50,000,000. The expected net cash flows from the project are Sh.7,791,000 for each of the 10 years. What is the internal rate of return (IRR) of the project?
- A. 9%
 - B. 8%
 - C. 7%
 - D. 6%
- (2 marks)

39. Which one of the following statements is **CORRECT** in relation to project evaluation?
- A. If the Net Present Value of a project is greater than 0, its Profitability Index would be 0
 - B. If the Internal Rate of Return of a project is 0%, its Net Present Value using a discount rate k , greater than 0 would be 0
 - C. If the Profitability Index of a project is less than 1, its Net Present Value should be less than 0
 - D. If the Internal Rate of Return of a project is greater than the discount rate, k , Profitability Index will be less than 1 and its Net Present Value will be greater than 0 (2 marks)
40. A project's profitability Index (PI) is equal to the ratio of the _____ of a project's future cash flows to the project's _____.
- A. net present value, initial cash outlay
 - B. present value, initial cash outlay
 - C. present value, depreciable basis
 - D. net present value, depreciable basis (2 marks)
41. Two mutually exclusive investment proposals have a 'scale difference' that is the cost of the project differs. Ranking these projects on the basis of the Internal Rate of Return, Net Present value and Profitability Index methods _____ give contradictory result.
- A. may
 - B. will always
 - C. will never
 - D. will generally (2 marks)
42. The _____ method provides correct ranking of mutually exclusive projects when the firm is not subject to capital rationing
- A. net present value
 - B. internal rate of return
 - C. payback period
 - D. profitability index (2 marks)
43. The actual market value of a right's issue will differ from its theoretical value for all of the following reasons **EXCEPT** for the _____.
- A. size of the firm's marginal tax rate
 - B. amount of transaction costs incurred
 - C. investor's speculation
 - D. irregular exercise and sale of rights over the subscription period (2 marks)
44. What is the term used to describe a situation where the investment banker bears the risk of not being able to sell a new security at the established price?
- A. A best effort offering
 - B. Underwriting
 - C. Shelf registration
 - D. Making a market (2 marks)
45. To say that there is "asymmetric information" in issuing of securities or debt means that the _____.
- A. investor has nearly perfect information
 - B. market has nearly perfect information
 - C. investor has more accurate information than the management
 - D. management has more accurate information than the investor (2 marks)
46. The market price of JKL Ltd. share is Sh.60 per share and each share gives its owner one subscription right. Four rights are required to purchase an additional share at the subscription price of Sh.54 per share. What would be the theoretical value of a right if the share is currently selling "right on"?
- A. Sh.0.96
 - B. Sh.1.20
 - C. Sh.1.50
 - D. Sh.6.00 (2 marks)

47. Which of the following statements **BEST** describes financial intermediaries?
- A. They do not invest in new long-term securities
 - B. They include insurance companies and pension funds
 - C. They include the national and regional stock exchanges
 - D. They are usually underwriting syndicates
- (2 marks)
48. Kameni Paul wants to buy an ordinary annuity that will pay Sh.4,000,000 a year for the next 20 years. He expects that the annual interest rate will be 8% over that time period. What is the maximum price that Kameni Paul would be willing to pay for the annuity?
- A. Sh.32,000,000
 - B. Sh.39,272,400
 - C. Sh.40,674,000
 - D. Sh.80,000,000
- (2 marks)
49. Patel Shah is considering investing a zero- coupon bond that sells for Sh.500. At maturity in 16 years, it will be redeemed for Sh.2,000. What approximate annual rate of growth would this represent?
- A. 8%
 - B. 9%
 - C. 12%
 - D. 25%
- (2 marks)
50. In estimating after tax incremental cash flows for a project, you should include all of the following **EXCEPT** _____.
- A. sunk costs
 - B. opportunity costs
 - C. changes in working capital resulting from the project, net of spontaneous change in current liabilities
 - D. effects of inflation
- (2 marks)
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