Financial Strategy

Cima F3

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QUESTION NO: 1

On 31 October 20X3:

• A company expected to agree a foreign currency transaction in January 20X4 for settlement on 31 March 20X4.

• The company hedged the currency risk using a forward contract at nil cost for settlement on 31 March 20X4.

• The transaction was correctly treated as a cash flow hedge in accordance with IAS 39 Financial Instruments: Recognition and Measurement.

On 31 December 20X3 the financial year end the fair value of the forward contract was $10 000 (asset).

How should the increase in the fair value of the forward contract be treated within the financial statements for the year ended 31 December 20X3?

A. Not recognised in 20X3 as the forward contract is not settled until after the year end.

B. Not recognised in 20X3 as the gain will be offset by a loss on the hedged transaction.

C. A $10 000 profit will be recognised within the Income Statement.

D. A $10 000 profit will be recognised within other comprehensive income.

ANSWER: D

QUESTION NO: 3

A company generates and distributes electricity and gas to households and businesses.

Forecast results for the next financial year are as follows:

The Industry Regulator has announced a new price cap of $1.50 per Kilowatt.

The company expects this to cause consumption to rise by 10% but costs would remained unaltered.

The price cap is expected to cause the company's net profit to fall to:

A. $47.5 million profit

B. $27.5 million profit

C. $20.0 million profit

D. $35.0 million loss

ANSWER: A

QUESTION NO: 4

A company plans to acquire new machinery.

It has two financing options; buy outright using a bank loan or a finance lease.

Which of the following is an advantage of a finance lease compared with a bank loan?

A. It is "off-balance sheet" and will not affect the company's gearing.

B. The interest rate offered might be more favourable because the lessor has the security of the asset.

C. Tax depreciation allowances may be passed on to the company by the lessor.

D. The lessor provides maintenance of the asset.

ANSWER: B

QUESTION NO: 5

Which THREE of the following remain unchanged over the life of a 10 year fixed rate bond?

A. The coupon rate

B. The yield

C. The market value

D. The nominal value

E. The amount payable on maturity

ANSWER: A D E

QUESTION NO: 6

Company X is based in Country A whose currency is the A$.

It trades with customers in Country B whose currency is the B$.

Company X aims to maintain its revenue from exports to Country B at 25% of total revenue.

Company A has the following forecast revenue:

The forecast revenue from Country B has assumed an exchange rate of A$1/B$2 that is A$1 = B$2.

If the B$ depreciates against the A$ by 10% the ratio of revenue generated from Country B as a percentage of total revenue will:

A. fall to 23.3%.

B. rise to 27.0%.

C. rise to 30.3%.

D. fall to 22.7%.

ANSWER: A

QUESTION NO: 7

Company A is a listed company that produces pottery goods which it sells throughout Europe. The pottery is then delivered to a network of self employed artists who are contracted to paint the pottery in their own homes. Finished goods are distributed by network of sales agents.The directors of Company A are now considering acquiring one or more smaller companies by means of vertical integration to improve profit margins.

Advise the Board of Company A which of the following acquisitions is most likely to achieve the stated aim of vertical integration?

A. A company in a similar market to Company A.

B. A pottery factory in the Middle East.

C. A company that produces accessories.

D. A listed international logistics firm.

ANSWER: D

QUESTION NO: 8

A company is currently all-equity financed.

The directors are planning to raise long term debt to finance a new project.

The debt:equity ratio after the bond issue would be 30:60 based on estimated market values.

According to Modigliani and Miller's Theory of Capital Structure without tax the company's cost of equity would:

A. stay the same.

B. decrease.

C. increase.

D. increase or decrease depending on the bond's coupon rate.

ANSWER: C

QUESTION NO: 9

Hospital X provides free healthcare to all members of the community funded by the central Government.

Hospital Y provides healthcare which has to be paid for by the individual patients. It is a listed company owned by a large number of shareholders.

In comparing the above two organisations and their objectives which THREE of the following statements are correct?

A. X is a not-for-profit organisation while Y is a for-profit organisation.

B. X and Y have the same primary financial objective - to maximise shareholder wealth.

C. The performance of X will be appraised primarily on the basis of value for money.

D. Only Y is likely to have a mixture of financial and non-financial objectives.

E. X and Y will have the same primary non financial objective - provision of quality of health care.

ANSWER: A C E

QUESTION NO: 10

A company's gearing (measured as debt/(debt + equity)) is currently 60% and it is investigating whether an optimal gearing structure exists within the industry.

It has analysed the capital structure of similar companies in the industry and it would appear that there is evidence supporting the traditional theory of capital structure.

Companies with the lowest WACC in the industry have gearing of around 45% to 50%.

Which of the following actions would result in the company achieving a more optimal capital structure?

A. Undertaking a rights issue of equity to repay some of its debt.

B. Refinancing to replace some of its short term debt with long term debt.

C. Increasing the level of dividend to return more cash to shareholders.

D. Using retained cash to undertake a buyback of some of its equity.

ANSWER: A

QUESTION NO: 11

A company based in Country D whose currency is the D$ has an objective of maintaining an operating profit margin of at least 10% each year.

Relevant data:

• The company makes sales to Country E whose currency is the E$. It also makes sales to Country F whose currency is the F$.

• All purchases are from Country G whose currency is the G$.

• The settlement of all transactions is in the currency of the customer or supplier.

Which of the following changes would be most likely to help the company achieve its objective?

A. The D$ strengthens against the E$ over time.

B. The F$ weakens against the D$ over time.

C. The D$ strengthens against the G$ over time.

D. The D$ weakens against the G$ over time.

ANSWER: C

QUESTION NO: 12

A company has:

• A price/earnings (P/E) ratio of 10.

• Earnings of $10 million.

• A market equity value of $100 million.

The directors forecast that the company's P/E ratio will fall to 8 and earnings fall to $9 million.

Which of the following calculations gives the best estimate of new company equity value in $ million following such a change?

A)

B)

C)

D)

A. Option A

B. Option B

C. Option C

D. Option D

ANSWER: A

QUESTION NO: 13

Which of the following explains an aim of integrated reporting in accordance with The International Framework as issued by the International Integrated Reporting Council?

A. To highlight the need for greater reporting of performance to stakeholders in a greater level of detail than at present.

B. To support decision making and actions that focus on creating value over the short medium and long term.

C. To integrate the various accepted accounting practices of member bodies into a single unified code of accounting principles.

D. To highlight the separation of strategy governance and financial performance in a social environmental and economic context.

ANSWER: B

QUESTION NO: 14

Holding cash in excess of business requirements rather than returning the cash to shareholders is most likely to result in lower:

A. liquidity.

B. vulnerability to a takeover bid.

C. net profit.

D. return on equity.

ANSWER: D

QUESTION NO: 15 - (FILL BLANK)

Company A is unlisted and all-equity financed. It is trying to estimate its cost of equity.

The following information relates to another company Company B which operates in the same industry as Company A and has similar business risk:

Equity beta = 1.6

Debt:equity ratio 40:60

The rate of corporate income tax is 20%.

The expected premium on the market portfolio is 7% and the risk-free rate is 5%.

What is the estimated cost of equity for Company A?

Give your answer to one decimal place.

ANSWER: 12.3, 12.30