UNIVERSITY OF BOLTON

INSTITUTE OF MANAGEMENT

MSC ACCOUNTANCY AND FINANCIAL MANAGEMENT

SEMESTER ONE EXAMINATIONS 2022-2023

ADVANCED FINANCIAL MANAGEMENT (AFM)

MODULE NO: ACC7504

Date: Jan 2023 **Time:10am-1pm**

INSTRUCTIONS TO CANDIDATES:

There are THREE questions on this paper in two sections.

Answer all questions.

University of Bolton
Institute of Management
Semester One 2022-2023
Advanced Performance Management
Module No. ACC 7504

Section A – This ONE question is compulsory and must be attempted

Question One

Q1) HER MAJESTY INC

Assume that 'now' is December 20X3.

Her Majesty Inc, a US-based conglomerate, has agreed to undertake an 18-month construction project in the country of Surkaya. There have been some protests from environmentalists over the plans but Her Majesty Inc has been assured that it has full planning approval.

Payments to Her Majesty Inc will be made 25% as an immediate down payment, 25% in six months' time, 15% in one year's time and the balance upon completion. The purchaser in Surkaya has no access to US dollars or other leading currencies as the country is experiencing balance of payments problems, cannot readily borrow internationally, and has only small foreign currency reserves. Payment for the project is therefore to be made in the local currency, the Surkayan franc. The total price of the construction is 8 billion (8,000 million) Surkayan francs.

Inflation in Surkaya is currently at the rate of 250% per year, which is not expected to significantly change in the near future. Inflation in the USA is 5% per year.

The management of Her Majesty Inc when costing the construction project allowed for a 100% contribution to variable costs at each payment stage, at 1 December 20X3 spot exchange rates. Almost all variable costs are incurred in US dollars. Fixed costs are negligible. The company's discount rate for this construction project is 12%.

Spot rate 1 December1 20X3: 2,400 Surkayan francs/$1

No forward market exists beyond three months, and Her Majesty Inc has no access to Surkayan money or capital markets.

Question 1 continued over the page

Question 1 continued

Required:

(a) **Estimate the likely financial result for Her Majesty Inc of the construction project.**

State clearly any assumptions that you make. (6 marks)

(b) **Suggest what actions Her Majesty Inc might have taken prior to agreeing the contract to reduce foreign exchange risk. (6 marks)**

(c) **Discuss whether and how environmental costs and benefits should be incorporated into the investment appraisal procedure. (8 marks)**

(Total: 20 marks)

(d) **Explain and set out the key risks the project is carrying and suggest how these can be mitigated.**

(10 marks)

(e) **Set out a summary of the roles and responsibilities of a Financial Manager**

(6 marks)

(f) **Explain how the implementation of risk management processes may help to increase the shareholders value.(10 marks)**

(g) **Discuss briefly what is a transfer price and the possible practical problems of such a change in transfer price.**

(10 marks)

(h) **Professional marks will be awarded for the layout and presentation of the report**

(4 marks)

(60 Marks)

Please turn the page

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Section B – BOTH questions are compulsory and MUST be attempted

QUESTION 2

Q2) ASTON MARTIN CO

Aston Martin Co, a medium-sized internet trading company, has conducted a review of its monthly operating cash flow. Its monthly average operating cash flow has been $14,400 with an observed monthly volatility over the previous five years of trading of 13%. There has been no growth in the trend of operating cash flow over the last 12 months and there is great concern among the small group of shareholders about the credit risk to which the company is exposed. The company has $1.5 million of borrowing repayable in five years and pays an effective interest rate of 8% per annum on the debt. Interest is paid monthly. The company has $8,500 of cash in hand or on deposit. The bank has first call upon the assets of the firm. The company estimates the proportion of its loan that would be recoverable in the event of default to be 90% of the outstanding debt value including accrued interest. The inter-bank offered rate is 5.5% per annum and the bank normally seeks to recover a risk adjustment of 34 basis points above the spread required to compensate for the expected loss on the loan.

Required:

(a) **On the basis of the annualised operating cash flow after interest and its volatility, estimate the probability of default within 12 months on the assumption that the company has no other lines of credit available.**

(10 marks)

(b) **Using the probability of default estimated in (a) discuss the issues that the bank would consider when making a loan of this type and demonstrate how an annual charge of 8% on this loan would be justified.**

(10 marks)

(Total: 20 marks)

Please turn the page

QUESTION 3

Q3) HGV LTD

HGV Ltd is a privately owned toy manufacturer based in a country in the European Union, but which is not in the European Common Currency Area (ECCA). It trades internationally both as a supplier and a customer. Although HGV Ltd is privately owned, it has revenue and assets equivalent in amount to some publicly listed companies. It has a large number of shareholders, but has no intention of seeking a listing at the present time. In fact, the major shareholders have often expressed a wish to buy out some of the smaller investors.

The entity has a long history of sound, if unspectacular, profitability. The directors and shareholders are reasonably happy with this situation and are averse to adopting strategies that they think might involve a substantial increase in risk, for example, acquisition or setting up manufacturing capability overseas, as some of HGV Ltd's European competitors have done. As a consequence, HGV Ltd accepts its growth rate will be relatively low, compared with some of its competitors.

The entity is financed 70% equity and 30% debt (based on book values). The debt is a mixture of secured and unsecured bonds carrying interest rates of between 7% and 8.5% and repayable in 5 to 10 years' time. Inflation in HGV Ltd's country is near zero and interest rates are low and possibly falling. The Company Treasurer is investigating the opportunities for, and consequences of, refinancing.

HGV Ltd's main financial objective is simply to increase dividends each year. It has one non-financial objective, which is to treat all stakeholders in the organisation with 'fairness and equality'. The Board has decided to review these objectives. The new finance director believes maximisation of shareholder wealth should be the sole objective, but the other directors do not agree and think a range of objectives should be considered, for example profits after tax and return on investment and performance improvement across a number of operational areas.

Question 3 continued over the page

Question 3 continued

Required:

(a) Evaluate the appropriateness of HGV Ltd's current objectives and the finance director's suggestion, and discuss the issues that the HGV Ltd Board should consider when determining the new corporate objectives. Conclude with a recommendation.

(12 marks)

(b) Discuss the factors that the treasury department should consider when determining financing, or re-financing strategies in the context of the economic environment described in the scenario and explain how these might impact on the determination of corporate objectives.

(8 marks)

(Total: 20 marks)

END OF QUESTIONS