

2804/303
BUSINESS FINANCE
March/April 2025
Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

DIPLOMA IN ACCOUNTANCY

BUSINESS FINANCE

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of SIX questions.
Answer any FIVE questions in the answer booklet provided.
All questions carry equal marks.
Candidates should answer the questions in English.*

This paper consists of 4 printed pages.

**Candidates should check the question paper to ascertain that
all the pages are printed as indicated and that no questions are missing.**

1. (a) Explain five contents of a partnership deed. (8 marks)
- (b) Explain five ways in which the central bank controls the operations of commercial banks in Kenya. (10 marks)
2. (a) Explain four advantages of using preference shares as a source of finance. (8 marks)
- (b) Riki Limited is considering a project that will require an initial investment of Ksh 5,000,000. The annual benefits from the project would be a fixed annual income of Ksh 2,500,000 for the next 4 years. The project will make a cost saving of Ksh 600,000. in year 1. The cost savings are expected to increase at the rate of 5% per annum.
- Running costs are expected to be Ksh 1,200,000 in the first year and then increase by 10% each year.
- The Company's cost of capital is 14%.
- (i) Calculate the Net Present Value (NPV) of the project.
- (ii) Based on the results in (i) above, advise the management whether to invest in the project or not. (12 marks)
3. (a) Explain four functions of the Capital Markets Authority. (8 marks)
- (b) Wakiri Limited leased an equipment under a 5-year lease period. The lease requires payments of Ksh 2,000,000 at the end of each year. The lessee's incremental borrowing rate is 14%.
- Prepare a lease amortization schedule. (12 marks)
4. (a) Explain four limitations of using ratios to analyse financial statements of a firm. (8 marks)

- (b) The following information relates to ATO Limited and Buku Limited as at 31 December 2024.

	ATO Limited Ksh.	Baku Limited Ksh.
Credit Sales	12,000,000	15,000,000
Cost of sales	5,000,000	8,000,000
Accounts receivable	2,500,000	4,000,000
Accounts payable	1,000,000	1,500,000
Inventory	2,800,000	3,000,000
Purchases	3,500,000	3,800,000

Take a year = 365 days

Calculate the working capital cycle for each company.

5. (a) Explain five circumstances under which it would be appropriate to operate a business as a public company. (10 marks)
- (b) (i) Kenzi Limited invested a certain amount in a fixed deposit account earning interest at the rate of 9% per annum. Determine the effective interest rate if interest is compounded:
I. Semi-annually
II. Quarterly (6 marks)
- (ii) Maganga intends to invest in a 10%, 5 year government bond of Ksh 10,000,000. The interest is paid semi-annually. Determine the Present Value of the bond. (4 marks)
6. (a) Explain four reasons that make it necessary for a firm to prepare a statement of cash flow. (8 marks)
- (b) The following is the capital structure of Wema Limited as at 31 December 2024:

	Ksh.
7% Debentures of Ksh 1,000 each	3,000,000
10% Preference shares (Par value Ksh10)	2,400,000
Ordinary shares (Par value Ksh 40)	4,000,000
Retained earnings	<u>6,600,000</u>
	<u>12,000,000</u>

Additional information:

- I. Ordinary shareholders have received a dividend of Ksh 4 per share. The dividends are expected to grow at a rate of 6% per annum.
- II. The market price of an ordinary share is Ksh 45.
- III. Corporation tax rate is 30%.

Using the market values, calculate the:

- (i) Cost of debentures;
- (ii) Cost of preference shares;
- (iii) Cost of equity;
- (iv) Weighted Average Cost of Capital (WACC)

(12 marks)

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