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CPA

Financial Management

April 2026

Level: Intermediate Level

Question 1a

 Overview of financial management

Corporate governance is an important mechanism for ensuring accountability and transparency in organisations.

Required:
Discuss FOUR principles of good corporate governance.

✓ Answer for Question 1a

- **Accountability**
  - Directors and managers are answerable for their actions and decisions
  - Must justify use of resources to shareholders and stakeholders
- **Transparency**
  - Full, accurate, and timely disclosure of financial and non-financial information
  - Enhances trust and reduces information asymmetry
- **Fairness**
  - Equal treatment of all shareholders, including minority shareholders
  - Decisions should not favour one group unfairly over others
- **Responsibility**
  - Directors act in the best interest of the company and stakeholders
  - Ensures compliance with laws, regulations, and ethical standards
- **Independence**
  - Decisions are made without undue influence or conflicts of interest
  - Separation of roles (e.g., CEO and Chairperson) promotes objectivity
- **Integrity**
  - Honest and ethical behaviour in all corporate dealings
  - Helps prevent fraud, corruption, and misuse of resources
- **Stakeholder recognition**
  - Consider interests of employees, customers, suppliers, regulators, and community
  - Moves beyond focusing only on shareholders
- **Risk management**
  - Identification, assessment, and control of business risks
  - Protects the organisation from uncertainties and potential losses

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Financial Management

August 2025

Level: Intermediate Level

Question 1b

 Business/Financial asset Valuation models , Introduction to capital structure decisions

Shabana Ltd. is intending to raise additional capital to finance a new project. The current market price per share (MPS) of the company is Sh.44 Cum-Div of the year 2024 declared but not yet paid. For the past six years, the company paid the following stream of dividends:

Year	2019	2020	2021	2022	2023	2024
Dividend per share (Sh.)	3.0	3.2	3.4	3.6	3.8	4.0

The existing capital structure of the firm is as follows:

	Sh."000"
Ordinary share capital (Sh.20 par value)	60,000
Reserves	20,000
14% debenture (Sh.100 par value)	30,000
10% preference share capital (Sh.30 each)	20,000
	130,000

Additional information:
1. The existing 14% debentures are currently selling at Sh.124 cum-interest.
2. The existing 10% preference shares are currently trading at Sh.25 each.
3. Corporation tax rate is 30%.

Required:
Compute the company’s existing overall weighted average cost of capital (WACC).

✓ Answer for Question 1b

Market data:

- MPS (ordinary shares) = **Sh.44 cum-div**
- D_0 (2024 dividend) = **Sh.4.00**
- Debentures selling at **Sh.124 cum-interest**
- Preference shares trading at **Sh.25 each**
- Corporate tax rate = **30%**

Determine market values of each component

We use **market values** (not book values) for WACC weighting.

(a) Ordinary shares

- Par value = Sh.20
- Total ordinary share capital = 60,000,000
  → No. of shares = 60,000,000 / 20 = **3,000,000 shares**
- MPS (ex-div) = 44 − 4 = **Sh.40** (since it is cum-div)
- Market value of equity = 3,000,000 × 40 = **Sh.120,000,000**

(b) Preference shares

- Par value = Sh.30
- Total pref. share capital = 20,000,000
  → No. of shares = 20,000,000 / 30 = **666,667 shares**
- Market price = Sh.25

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Financial Management

April 2025

Level: Intermediate Level

Question 2a

 The financing decision , Dividend decision

Distinguish between the following terms as used in finance:

(i) “Finance lease” and “Operating lease”.

(ii) “Capital structure” and “Financial structure”.

(iii) “Scrip issue” and “rights issue”.

✓ Answer for Question 2a

(i) “Finance Lease” vs. “Operating Lease”

Feature	Finance Lease (Capital Lease)	Operating Lease (Service Lease)
Nature & Purpose	A method of financing the purchase of an asset. It is essentially a loan in the form of an asset.	A rental agreement for the temporary use of an asset.
Rights & Risks	Substantially all risks and rewards of ownership are transferred from the lessor (owner) to the lessee (user).	Risks and rewards of ownership remain with the lessor.
Balance Sheet Treatment	The asset is capitalized (recorded as an asset) and the lease obligation is recorded as a liability on the lessee's balance sheet.	It is an off-balance sheet financing. Payments are treated as operating expenses.
Term	Non-cancellable for most of the asset's economic life.	Short-term and can often be cancelled by the lessee.
Maintenance	Responsibility of the lessee.	Responsibility of the lessor.
Example	Leasing a specialized machine for its entire 10-year useful life.	Renting a car for 6 months or leasing office space.

(ii) “Capital Structure” vs. “Financial Structure”

Feature	Capital Structure	Financial Structure
Definition	The mix of long-term sources of funds. It is a part of the financial structure.	The mix of all sources of funds, i.e., both long-term and short-term debt and equity.

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Financial Management

December 2024

Level: Intermediate Level

Question 2b

 Introduction to capital budgeting decisions

Kugoh Ltd. is considering whether or not to purchase a new machinery on 15 December 2024.

Additional information:

1. The machinery will cost Sh.4,000,000 and it would have a useful life of four years, after which it would be sold for Sh.500,000.
2. The machinery would attract tax allowable depreciation at the rate of 25% per annum on a reducing balance basis which could be claimed against taxable profits of the current year.
3. A balancing allowance or charge would arise on disposal. The tax rate is 30% per annum. Half of the tax is payable in the current year and the balance the following year in arrears.
4. The machinery would create annual cost savings of Sh.1,400,000.
5. The after tax cost of capital of Kugoh Ltd. is 8%.
6. Depreciation is first claimed against year zero profits.

Required:

(i) Compute the annual after tax cash flows associated with purchasing the machinery.

(ii) Compute the net present value (NPV) of purchasing the machinery.

✓ Answer for Question 2b

Initial setup

- Machine cost = Sh. 4,000,000
- Life = 4 years
- Salvage value = Sh. 500,000
- Tax depreciation = 25% reducing balance
- Tax rate = 30%
- Half tax paid in current year, half next year
- Annual cost savings = Sh. 1,400,000
- After-tax cost of capital = 8%
- Depreciation first claimed in year 0 (purchase year)

Tax depreciation schedule (25% reducing balance)

Year	Opening WDV (Sh.)	Depreciation	Closing WDV (Sh.)
0	4,000,000	1,000,000	3,000,000
1	3,000,000	750,000	2,250,000
2	2,250,000	562,500	1,687,500
3	1,687,500	421,875	1,265,625
4	Disposal → balancing adjustment		

Year 4:
Sale for 500,000
WDV at start of year 4 = 1,265,625
Balancing allowance = 1,265,625 − 500,000 = 765,625
(This is an additional tax deduction in year 4.)

Year	0 (Sh.'000)	1 (Sh.'000)	2 (Sh.'000)	3 (Sh.'000)	4 (Sh.'000)	5 (Sh.'000)

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Financial Reporting

August 2024

Level: Intermediate Level

Question 3a

 Accounting for Specialized Transactions

Alfa Ltd. has an year end of 30 June. On 25 April 2024, Alfa Ltd. bought goods from a Mexican supplier for 286,000 Pesos. The goods were still in inventory at year end.

The following exchange rates are applicable:

Exchange rates	Pesos to Ksh.
25 April 2024	11.16
16 May 2024	10.87
30 June 2024	11.02

Required:

Show the accounting entries for the transaction in each of the following events:

(i) On 16 May 2024, Alfa Ltd. pays the Mexican supplier in full.

(ii) The supplier remains unpaid at the year ended 30 June 2024.

✓ Answer for Question 3a

Foreign Currency Transaction Accounting

Given:

- Purchase: 286,000 Pesos on 25 April 2024
- Exchange rates:
  - 25 April 2024: **11.16 Ksh./Peso**
  - 16 May 2024: **10.87 Ksh./Peso**
  - 30 June 2024: **11.02 Ksh./Peso**

(i) Payment made on 16 May 2024

Step 1: Initial Purchase (25 April 2024)

$$286,000 \text{ Pesos} \times 11.16 = \text{Ksh. } 3,191,760$$

Journal Entry:

```
Dr Inventory          3,191,760
  Cr Payable          3,191,760
```

Step 2: Payment (16 May 2024)

Payment amount:

$$286,000 \times 10.87 = \text{Ksh. } 3,108,820$$

Exchange gain:

$$3,191,760 - 3,108,820 = \text{Ksh. } 82,940$$

Journal Entry:

```
Dr Payable            3,191,760
  Cr Cash             3,108,820
  Cr Exchange Gain       82,940
```

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Financial Management

April 2024

Level: Intermediate Level

Question 3b

 Introduction to capital budgeting decisions

The directors of Bandala Ltd. are reviewing the options relating to a machine that is a key part of the company's production process.

Option 1: Replace the machine:
The cost of the new machine would be Sh.1,000 million payable immediately.

Maintenance cost would be payable at the end of each year of the project.

The first maintenance payment for the new machine is Sh.51 million although this is expected to rise by 8% per year.

Option 2: Overhaul the existing machine:
The alternative to replacement is a complete overhaul of an existing machine, the cost of which would be Sh.650 million also payable immediately. This would be classified as capital expenditure.

However, under this option, the annual maintenance cost will be higher at Sh.81 million in year 1, with expected annual increase of 11%.

As the new machine is likely to reduce the variable costs, the contribution will be different depending on which machine is used.

The contribution from each machine (excluding maintenance costs) is tabulated as follows, with the inflows of funds assumed to be at the end of each year:

Year	1	2	3	4	5
Contribution of new machine (Sh."000")	310,000	330,000	380,000	420,000	440,000
Contribution of overhauled machine (Sh."000")	260,000	300,000	310,000	320,000	320,000

The cost of capital is 12%. Ignore taxation.

Required:
(i) Calculate the net present value (NPV) of each option.

(ii) Estimate the internal rate of return (IRR) of each option.

(iii) Interpret the result that you have obtained in (b) (i) and (b) (ii) above and recommend which alternative should be chosen.

✓ Answer for Question 3b

(i) Net Present Value (NPV) Calculation

The Net Present Value (NPV) is calculated as:

$$\text{NPV} = \sum_{t=1}^{n} \frac{\text{Cash Flow}_t}{(1+r)^t} - \text{Initial Investment}$$

Where Cash Flow_t= Contribution_t - $\text{Maintenance Cost}_t$.

Option 1: Replace the Machine

- Initial Investment: Sh. 1,000,000 ('000)
- Initial Maintenance Cost: Sh. 51,000 ('000)
- Maintenance Growth Rate: 8%

Year (t)	Contribution (Sh. '000')	Maintenance Cost (Sh. '000') $51 \times (1.08)^{t-1}$	Net Cash Flow (Sh. '000')	PV Factor @ 12%	Present Value (Sh. '000')
0			(1,000,000.00)	1.0000	(1,000,000.00)
1	310,000	51,000.00	259,000.00	0.8929	231,046.10
2	330,000	55,080.00	274,920.00	0.7972	219,139.75
3	380,000	59,486.40	320,513.60	0.7118	228,095.53
4	420,000	64,245.31	355,754.69	0.6355	225,972.58
5	440,000	69,384.94	370,615.06	0.5674	210,707.31
NPV					**114,961.27**

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Financial Management

December 2023

Level: Intermediate Level

Question 3c

Time-value of money

An investor plans to borrow a loan of Sh.3 million to purchase a piece of land for his family. The interest rate agreed upon is discounted at a rate of 10% per annum. The loan is repayable in 4 years of equal instalments.

Required:
(i) Amount payable per instalment.

(ii) A loan amortisation schedule.

✓ Answer for Question 3c

(i) Amount Payable Per Installment

The annual equal installment (A) is calculated by finding the annuity payment that has a present value equal to the loan principal.

- Loan Principal (PV): Sh. 3,000,000
- Interest Rate (r): 10% per annum (0.10)
- Loan Period (n): 4 years

We use the Present Value of an Annuity (PVA) formula:

$$PV = A \times [\frac{1-(1+r)^{-n}}{r}]$$

1. Calculate the Present Value Interest Factor of an Annuity (PVIFA):

$$\text{PVIFA}_{10\%,4} = \frac{1-(1.10)^{-4}}{0.10}$$

$$\text{PVIFA}_{10\%,4} = \frac{1-0.683013}{0.10} = \frac{0.316987}{0.10} \approx 3.16987$$

2. Calculate the Annual Installment (A):

$$A = \frac{PV}{\text{PVIFA}}$$

$$A = \frac{\text{Sh. }3,000,000}{3.16987}$$

$$A = 946,412.41$$

The amount payable per equal annual installment is **Sh. 946,412.41**.

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Financial Management

August 2023

Level: Intermediate Level

Question 4a

 Personal financial management

Financial planning is one of the most crucial steps for any person, regardless of whether they earn any income or not. While many people understand the importance of financial planning, it is still one of the steps that are postponed or skipped:

With regards to the above statement, summarise FOUR benefits of financial planning to an individual.

✓ Answer for Question 4a

Benefits of Financial Planning to an Individual

Financial planning is the process of managing one's finances to achieve life goals. Its primary benefits are:

1. Provides a Roadmap and Sense of Direction

- It transforms vague wishes (e.g., "I want to be rich someday") into **specific, actionable goals** with a clear timeline (e.g., "I will save Sh. 50,000 per month for a down payment in 3 years").

2. Enhances Cash Flow Management

- Through budgeting and tracking, it helps an individual understand where their money is going, **reduces unnecessary expenses**, and frees up cash for saving and investing.

3. Helps Achieve Life Goals

- It is a structured way to fund major life objectives, such as buying a home, funding children's education, starting a business, or enjoying a comfortable retirement.

4. Prepares for Emergencies

- A core part of financial planning is building an **emergency fund**. This creates a financial buffer for unexpected events like job loss, medical emergencies, or major repairs, preventing debt.

5. Ensures Financial Security for Retirement

- It forces individuals to save and invest consistently for the long term, ensuring they can **maintain their desired lifestyle** even after they stop earning a regular income.

6. Manages Risk Effectively

- Planning involves identifying potential financial risks (e.g., death, disability, critical illness) and mitigating them through appropriate **insurance coverage**, protecting the individual and their family.

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Financial Management

April 2023

Level: Intermediate Level

Question 4b

 Introduction to portfolio analysis

Outline FOUR roles of mutual funds as investment avenues.

✓ Answer for Question 4b

Mutual Funds

A **mutual fund** is a professionally managed investment vehicle that pools money from many investors to purchase a diversified portfolio of securities such as stocks, bonds, and other assets.

Roles of Mutual Funds

- **Professional Management**
  You get expert management for your money. Skilled fund managers research the market and make all the investment decisions on your behalf, so you don't have to.
- **Diversification and Risk Reduction**
  It helps you avoid putting all your eggs in one basket. By owning a single share of a fund, you instantly own a small piece of every company in its portfolio, which spreads out your risk.
- **Accessibility and Affordability**
  It makes expensive investments affordable. You can own a piece of a large, diversified portfolio with a small amount of money, making it accessible to almost everyone.
- **Liquidity**
  Your money is never locked in. You can easily buy or sell your mutual fund units on any business day, giving you quick access to your cash when you need it.
- **Variety and Choice**
  It offers a fund for every financial goal. Whether you are saving for retirement, a house, or your child's education, there are funds designed for different risk levels and objectives.
- **Convenience and Administrative Ease**
  It handles all the complicated paperwork. The fund company takes care of tracking investments, collecting dividends, and maintaining records, making it a hassle-free way to invest.
- **Regulation and Transparency**
  It operates with a high level of oversight. Mutual funds are regulated by government authorities and must regularly disclose their holdings, which helps protect investors and ensures transparency.

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Financial Management

December 2022

Level: Intermediate Level

Question 4c

 Working capital management

The following are the summary statement of profit and loss and statement of financial position for Miranda Ltd. for the year ended 31 October 2022.

Summary Statement of profit and loss	
	Sh."000"
Sales (150,000 units)	15,000
Variables costs	(13,500)
Fixed costs	(600)
Profit	900

Statement of financial position		
	Sh."000"	**Sh."000"**
Non-current assets		22,500
Current assets:		
Trade receivables	3,000	
Inventory	1,200	
Bank	360	
Trade payables	(900)	3,660
		26,160
Financed by:		
Equity capital		15,000
12% long- term debt		3,840
6% preference share capital		7,320
		26,160

Additional information:

1. Return on investment (ROI) is 4.8%.

2. All sales are on credit and the company operates a very strict credit control system.
3. A suggestion has been made that a relaxation of credit policy would increase sales by 40%, if the company were to introduce a 2% discount (at present no discount is given) on accounts paid within 10 days.
4. It is envisioned that 70% of the customers would take advantage of the discount and the average collection period of the remainder would be half of what it is at present.
5. Bad debts would remain at 2% of firm's credit sales. 6. Investors required rate of return is 10%. Assume 360 days in a year.

Required:

(i) The current average collection period.

(ii) The new level of profits after change in credit policy.

(iii) Explain the effect of the new level of investment in account receivable.

✓ Answer for Question 4c

(i) The Current Average Collection Period (ACP)

The ACP measures how quickly the company collects payment from its credit sales.

$$\text{Current ACP} = \frac{\text{Trade Receivables}}{\text{Annual Credit Sales}} \times \text{Days in a Year}$$

- Trade Receivables: Sh. 3,000 "000"
- Annual Credit Sales: Sh. 15,000 "000"
- Days in a Year: 360

$$\text{Current ACP} = \frac{\text{Sh. } 3,000}{\text{Sh. } 15,000} \times 360 \text{ days}$$

$$\text{Current ACP} = 0.20 \times 360 \text{ days} = \mathbf{72} \text{ days}$$

The current average collection period is **72 days**.

(ii) Net benefit/loss from the proposed credit policy for Miranda Ltd.

Key Data and Calculations:

- **Variable Cost Ratio** = 13,500 / 15,000 = 0.9 or 90%
- **Required Return on Investment** = 10%

1. Current Policy:

- Sales (Sh.'000) = 15,000
- Variable Costs = 15,000 × 0.9 = 13,500

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Financial Management

August 2022

Level: Intermediate Level

Question 5a

 Introduction to capital budgeting decisions

Hamsa Manufacturing Ltd. is considering two alternative investment proposals. The first proposal requires a major renovation of the company's manufacturing facility. The second proposal involves replacing a few obsolete items of equipment in the manufacturing facility. The company is only able to select one of the two proposals.

The cash flows associated with each proposal are shown below:

Year	Proposal I (Renovation)	Proposal II (replacement of some items)
	Sh."000"	Sh."000"
0	–9,000	–1,000
1	3,500	600
2	3,000	500
3	3,000	400
4	2,800	300
5	2,500	200

The firm discounts cash flows at the rate of 15%.

Required:

(i) Rank the two investment proposals using the net present value (NPV) approach.

(ii) Rank the two investment proposals using the internal rate of return (IRR) approach.

(iii) Compare the rankings under the NPV and IRR approaches and comment on any differences.

✓ Answer for Question 5a

(i) Ranking using Net Present Value (NPV)

The NPV is calculated by discounting all future cash flows (Years 1–5) at the firm's cost of capital (15%) and subtracting the initial investment (Year 0).

$$\text{NPV} = \sum_{t=1}^{n} \frac{\text{Cash Flow}_t}{(1+r)^t} - \text{Initial Investment}$$

Year	Proposal I (CF)	Proposal II (CF)	PV Factor	PV I	PV II
	Sh.“000”	Sh.“000”	(15%)	Sh.“000”	Sh.“000”
0	(9,000)	(1,000)	1.0000	(9,000.00)	(1,000)
1	3,500	600	0.8696	3,043.60	521.76
2	3,000	500	0.7561	2,268.30	378.05
3	3,000	400	0.6575	1,972.50	263.00
4	2,800	300	0.5718	1,601.04	171.54
5	2,500	200	0.4972	1,243.00	99.44
NPV				**1,128.44**	**433.79**
	Ranking			**1**	**2**

PV): Proposal I is ranked **1** because it has the highest positive NPV.

(ii) Ranking using Internal Rate of Return (IRR)

The IRR is the discount rate that makes the NPV of the project equal to zero.

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Financial Management

April 2022

Level: Intermediate Level

Question 5b

 Islamic finance

Explain two differences between "conventional finance" and "islamic finance".

✓ Answer for Question 5b

The core difference lies in their foundational principles. Conventional finance is primarily based on the **time value of money and risk-reward**, while Islamic finance is governed by **Shariah (Islamic law)**, which prohibits certain elements and promotes risk-sharing and asset-backing.

Key Differences:

Feature		Conventional Finance	Islamic Finance
1	Core Principle	**Time Value of Money.** Money is a commodity that can be rented out (lent) for a price (interest).	Asset-Based & Risk-Sharing. Money is a medium of exchange, not a commodity. Profit must be generated from a legitimate trade or asset.
2	Treatment of Interest (Riba)	**Central and Permissible.** Interest (Riba) is the price of credit and the cornerstone of lending.	Strictly Prohibited. Earning a guaranteed, pre-determined return on a loan (Riba) is forbidden as it is considered exploitative.
3	Risk & Reward Structure	**Risk Transfer.** The lender transfers the risk of the enterprise to the borrower in exchange for a fixed return (interest).	Risk Sharing. The provider of capital and the entrepreneur share the business risk. Returns are based on actual profit, not a fixed interest rate.
4	Link to Real Economy	**Not Necessarily Linked.** Funds can be created for purely speculative financial activities that do not involve a real asset.	Must Be Asset-Backed. Every financial transaction must be linked to a tangible, identifiable underlying asset or real economic activity (e.g., a property, a commodity, a service).
5	Prohibited Activities	No religious-based prohibitions. Focus is on creditworthiness and regulatory limits.	Prohibits financing activities related to: • **Alcohol** • **Gambling (Maysir)** • **Excessive Uncertainty (Gharar)**

CPA

Financial Management

December 2021

Level: Intermediate Level

Question 5c

 Working capital management

Jasmine Limited generates Sh.100,000 per month excess cash which it intends to invest in short-term securities. The interest rate it can expect to earn on its investment is 10% per annum. The transaction costs associated with each separate investment of funds is constant at Sh.500.

Required:

(i) The optimal amount of cash to be invested in each transaction.

(ii) The number of transactions per annum.

(iii) The total cost of making the transactions in (c) (ii) above.

(iv) The opportunity cost of holding cash per annum.

✓ Answer for Question 5c

The excess cash generated per month (Sh. 100,000) represents the total annual cash required to be invested, which is equivalent to the **Demand (D)** in the Baumol Model.

Given Data:

- **Annual Demand (D):** Sh. 100,000 × 12 months = Sh. 1,200,000
- **Interest Rate / Opportunity Cost (i):** 10% per annum (or 0.10)
- **Transaction Cost per Investment (b):** Sh. 500

(i) The optimal amount of cash to be invested in each transaction

The optimal amount of cash to invest in each transaction, denoted as C, is calculated using the Baumol Model formula (analogous to the Economic Order Quantity, EOQ, model):

$$C = \sqrt{\frac{2Db}{i}}$$

- $$C = \sqrt{\frac{2 \times 1,200,000 \times 500}{0.10}}$$
- $$C = \sqrt{\frac{1,200,000,000}{0.10}}$$
- $C = \sqrt{12,000,000,000}$
- $C \approx \text{Sh. } 109,544.51$

The **optimal amount of cash to be invested in each transaction** is Sh. 109,544.51.

(ii) The number of transactions per annum