

**UNIVERSITY OF SWAZILAND
DEPARTMENT OF ACCOUNTING**

MAIN EXAMINATION PAPER 2014

- COURSE TITLE** : PRINCIPLES OF INSURANCE, STOCK EXCHANGE AND BANKING
- COURSE CODE** : AC 314/IDE AC 314
- DEGREE/DIPLOMA** : DIPLOMA IN COMMERCE
- TIME ALLOWED** : THREE (3) HOURS
- INSTRUCTIONS** :
1. TOTAL NUMBER OF QUESTIONS ON THE PAPER: FOUR (4)
 2. ATTEMPT ALL FOUR (4) QUESTIONS
 3. THE MARKS AWARDED FOR A QUESTION ARE INDICATED AT THE END OF EACH QUESTION
 4. WHERE APPLICABLE, ALL WORKINGS ARE TO BE SHOWN
 5. CALCULATIONS ARE TO BE MADE TO TWO DECIMAL PLACES OF ACCURACY, UNLESS OTHERWISE INSTRUCTED.
- SPECIAL REQUIREMENTS** : NONE
- NOTE** : YOU ARE REMINDED THAT IN ASSESSING YOUR WORK, ACCOUNT WILL BE TAKEN OF THE ACCURACY OF LANGUAGE, THE GENERAL QUALITY OF EXPRESSION, TOGETHER WITH THE LAYOUT AND PRESENTATION OF YOUR FINAL ANSWER.

THIS QUESTION PAPER SHOULD NOT BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.

QUESTION 1

The board of directors of Predator Co, a listed company, is considering making an offer to purchase Target Co, a private limited company in the same industry. If Target Co is purchased it is proposed to continue operating the company as a going concern in the same line of business.

Summarized details from the most recent set of financial statements for Predator and Target are shown below:

STATEMENT OF FINANCIAL POSITION	PREDATOR AS AT 31 MARCH		TARGET STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH	
	Em	Em	E000	E000
Freehold property		33		460
Plant & equipment		58		1,310
Inventory	29		330	
Receivables	24		290	
Cash	3		20	
Less current liabilities	(31)	25	(518)	122
		116		1,892
Financed by:				
Ordinary shares		35		160
Reserves		43		964
Shareholders' funds		78		1,124
Medium-term bank		38		768
Loans		116		1,892

Predator Co 50 cents ordinary shares, Target Co, 25 cents ordinary shares.

Year	Predator Co		Target Co	
	PAT Em	Divident Em	PAT E,000	Divident E,000
T5	14.30	9.01	143	85.0
T4	15.56	9.80	162	93.5
T3	16.93	10.67	151	93.5
T2	18.42	11.60	175	102.8
T1	20.04	12.62	183	113.1

T5 if five years ago and T1 is the most recent year.

Target's shares are owned by a small number of private individuals.

Its managing director who receives an annual salary of E120,000 dominates the company. This is E40,000 more than the average salary received by managing directors of similar companies. The managing director would be replaced, if Predator purchases Target.

The freehold property has not been revalued for several years and is believed to have a market value of E800,000.

The balance sheet value of plant and equipment is thought to reflect its replacement cost fairly, but its value if sold is not likely to exceed E800,000. Approximately E55,000 of inventory is obsolete and could only be sold as scrap for E5,000.

The ordinary shares of Predator are currently trading at 430 cents ex-div. A suitable cost of equity for Target has been estimated at 15%.

Both companies are subject to company tax at 30%.

Required:

a) Estimate the value of Target Co using the

- (i) Dividend Valuation Model and advise the board of Predator as to how much is should offer for Target's shares.
- (ii) Net Asset Valuation

(18 MARKS)

b) Discuss the characteristics of a good stock market index

(7 MARKS)

TOTAL (25 MARKS)

QUESTION 2

- a) On 1 January a UK firm enters into a contract to buy a piece of equipment from the US for \$300,000. The invoice is to be settled on 31 March.

The exchange rate on 1 January is \$1.6/£ (i.e. \$1.6 = £1).

However by 31 March, the Pound may have

- 1 strengthened to \$1.75/£ or
- 2 depreciated to \$1.45/£

Explain the risk faced by the UK firm.

(6 MARKS)

- b) Discuss any three functions performed by commercial banks

(12 MARKS)

- c) Discuss any three functions performed by the central bank of Swaziland

(7 MARKS)

TOTAL 25 MARKS

QUESTION 3

For a risk to be insurable, a number of features must be present

- a) Discuss these features giving examples in each case

(18 MARKS)

- b) Explain the phrase Risk Analysis within an insurance contract context

(7 MARKS)

(25 MARKS)

QUESTION 4

Write short explanatory notes on the following:-

a) Standard & Poor's 500 index (S & p 500)

(6 MARKS)

b) Material fact within an insurance contract context

(7 MARKS)

c) Fixed exchange rates

(6 MARKS)

d) Bank insolvency

(6 MARKS)

TOTAL MARKS (25 MARKS)