Institute of Actuaries of India

Subject
CT2 – Finance and Financial Reporting

For 2018 Examinations

Aim

The aim of the Finance and Financial Reporting subject is to provide a basic understanding of corporate finance including a knowledge of the instruments used by companies to raise finance and manage financial risk and to provide the ability to interpret the accounts and financial statements of companies and financial institutions.

Links to other subjects

Subject CT1 – Financial Mathematics: uses this subject to provide a grounding in financial mathematics and investments.

Subject CA1 – Actuarial Risk Management: develops some of the concepts introduced in this subject.

Subjects ST5 – Finance and Investment Specialist Technical A, ST6 – Finance and Investment Specialist Technical B, SA5 – Finance Specialist Applications and SA6 – Investment Specialist Applications: develop the technical and practical applications of topics introduced in this subject.

Objectives

On completion of this subject the candidate will be able to:

(i) Demonstrate a knowledge and understanding of the principal terms in use in investment and asset management.

(ii) Demonstrate an awareness of the key principles of finance.

1. Outline the relationship between finance and the real resources and objectives of an organisation.

2. Outline the relationship between the stakeholders in an organisation (including lenders and investors).

3. Outline the role and effects of the capital markets.

4. Outline agency theory.

5. Outline the theory of the maximisation of shareholder wealth.

(iii) Describe the structure of a joint stock company and the different methods by which it may be financed.

1. Outline the distinctive characteristics of sole traders, partnerships and limited companies as business entities.

2. Describe the different types of loan and share capital.

3. Distinguish between authorised and issued share capital.

4. Discuss the economic advantages and disadvantages of a limited company as a business entity.

5. Outline the main differences between a private and public company.

6. Outline the different types of medium term company finance:

    - hire purchase
    - credit sale
    - leasing
    - bank loans

7. Describe the following different types of short term company finance:

    - bank overdrafts
    - trade credit
    - factoring
    - bills of exchange
    - commercial paper

(iv) Describe the basic principles of personal and corporate taxation.

1. Describe the basic principles of personal taxation.

2. Describe the basic principles of the taxation of capital gains.

3. Describe the basic principles of company taxation.

4. Explain the different systems of company taxation from the points of view of an individual shareholder and the company.

5. Outline the basic principles of double taxation relief.

(v) Demonstrate a knowledge and understanding of the characteristics of the principal forms of financial instrument issued or used by companies and the ways in which they may be issued.

1. Outline the reasons a company might have for seeking a quotation on the stock exchange.

2. Describe the characteristics of:

    - debenture stocks
    - unsecured loan stocks
    - Eurobonds
    - preference shares
    - ordinary shares
    - convertible unsecured loan stocks

- convertible preference shares
- warrants
- floating rate notes
- subordinated debt
- options issued by companies

3. Describe the characteristics and possible uses by a non-financial company of:

   - financial futures
   - options
   - interest rate and currency swaps

4. Outline the following methods of obtaining a quotation for securities:

   - offer for sale
   - offer for sale by tender
   - offer for subscription
   - placing
   - introduction

5. Describe the following types of new issues to existing shareholders:

   - scrip issue
   - rights issue

6. Describe the role of underwriting in the issue of securities.

(vi) Discuss the factors to be considered by a company when deciding on its capital structure and dividend policy.

1. Describe the effect that the capital structure used by a company will have on the market valuation of the company.

2. Describe the effect of taxation on the capital structure used by a company.

3. Discuss the principal factors that a company should consider in setting dividend policy.

4. Discuss alternative ways of distributing profits, such as buybacks.

5. Discuss the effect that the dividend policy will have on the market valuation of a company.

(vii) Define what is meant by a company's cost of capital and discuss how its cost of capital interacts with the nature of the investment projects it undertakes.

1. Describe how to calculate a company's weighted average cost of capital.

2. Discuss the different methods used for project evaluation.

3. Describe methods commonly used to evaluate risky investments including probability trees, simulation and certainty equivalents.

4. Discuss the issues in establishing the required rate of return for a capital project.

(viii) Describe the major types of financial institution operating in the financial markets.

1. Describe the main features of the following institutions and analyse their influence on the financial markets:

   - central banks
   - investment exchanges
   - investment banks

2. Describe the role played in financial markets by each of the following institutions:

   - clearing banks
   - building societies
   - investment trusts
   - unit trusts
   - investment management companies
   - self-administered pension funds
   - life insurance companies
   - general insurance companies

(ix) Describe the basic construction of accounts of different types and the role and principal features of the accounts of a company.

1. Explain why companies are required to produce annual reports and accounts.

2. Explain the fundamental accounting concepts which should be adopted in the drawing up of company accounts.

3. Explain the purpose of a:

   - statement of financial position
   - statement of comprehensive income
   - cash flow statement

   and of the notes to the accounts.

4. Construct simple statements of financial position and statements of profit or loss; understand and interpret cash flow statements.

5. Understand the structure and content of insurance company accounts.

6. Explain what is meant by the terms subsidiary company and associated company.

7. Explain the purpose of consolidated accounts.

8. Explain how goodwill might arise on the consolidation of group accounts.

9. Explain how depreciation is treated in company accounts.

10. Explain the function of the following accounts – share capital, other reserves and retained earnings.

(x) Interpret the accounts of a company or a group of companies and discuss the limitations of such interpretation.

1. Calculate and explain priority percentages and gearing.

2. Calculate and explain interest cover and asset cover for loan capital.

3. Describe the possible effects of interest rate movements on a highly geared company.

4. Calculate and explain price earnings ratio, dividend yield, dividend cover and EBITDA.

5. Explain net earnings per share.

6. Calculate and explain accounting ratios which indicate:

   - profitability
   - liquidity
   - efficiency

7. Discuss the shortcomings of historical cost accounting.

8. Discuss the limitations in the interpretation of company accounts.

9. Discuss the ways that reported figures can be manipulated to create a false impression of a company's financial position.

(xi) Show how financial techniques can be used in the assessment of capital investment projects.

1. Discuss the principal methods that may be used to determine the viability of a capital project.

2. Discuss the factors underlying the choice of discount rate within project assessment including:

   - the assumptions and limitations in the use of the weighted average cost of capital
   - the allowance for leverage
   - the allowance for risk.

3. Discuss the methods that may be used for identifying the risks that may be present for different types of project.

4. Discuss suitable techniques for ascertaining the probability of occurrence of different risks over varying timescales and the financial impact of occurrence.

5. Discuss suitable techniques for ascertaining the distribution of the possible financial outcomes of a capital project.

END OF SYLLABUS