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ACCA – Paper F9 Financial Management June 2015 Revision Mock

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Notice to Markers

- 1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

<ul style="list-style-type: none">• Time management	<ul style="list-style-type: none">• Handwriting	<ul style="list-style-type: none">• Presentation and layout	<ul style="list-style-type: none">• Use of English
<ul style="list-style-type: none">• Points clearly and concisely made	<ul style="list-style-type: none">• Relevance of answers to question	<ul style="list-style-type: none">• Coverage and depth of answer	<ul style="list-style-type: none">• Accuracy of calculations
<ul style="list-style-type: none">• Calculations cross-referenced to workings	<ul style="list-style-type: none">• All parts of the requirement attempted	<ul style="list-style-type: none">• Length of answers equates to marks available	<ul style="list-style-type: none">• Read the question carefully

- 2 For each question, please provide suitable constructive comments

Question Number	General Comments	Exam Technique Comments

ACCA REVISION MOCK

Financial Management

June 2015

Time allowed

Reading and planning: **15 minutes**

Writing: **3 hours**

This paper is divided into two sections:

SECTION A – ALL TWENTY questions are compulsory and MUST be attempted

SECTION B – ALL FIVE questions are compulsory and MUST be attempted

ALL questions are compulsory and MUST be attempted

Formulae sheet, Present value and Annuity tables are on pages 3, 4 and 5.

Do NOT open this paper until instructed by the supervisor.

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Paper F9

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FORMULAE SHEET

Economic order quantity

$$= \sqrt{\frac{2C_oD}{C_H}}$$

Miller-Orr model

$$\text{Return point} = \text{Lower limit} + \left(\frac{1}{3} \times \text{spread}\right)$$

$$\text{Spread} = 3 \left[\frac{\frac{3}{4} \times \text{Transaction cost} \times \text{Variance of cash flows}}{\text{Interest rate}} \right]^{\frac{1}{3}}$$

The capital asset pricing model

$$E(r)_j = R_f + \beta_j (E(r_m) - R_f)$$

The asset beta formula

$$\beta_a = \left(\frac{V_e}{(V_e + V_d(1-T))} \beta_e \right) + \left(\frac{V_d(1-T)}{(V_e + V_d(1-T))} \beta_d \right)$$

The growth model

$$P_0 = \frac{D_0(1+g)}{(r_e - g)}$$

Gordon's growth approximation

$$g = br_e$$

The weighted average cost of capital

$$\text{WACC} = \left(\frac{V_e}{V_e + V_d} \right) k_e + \left(\frac{V_d}{V_e + V_d} \right) k_d(1-T)$$

The Fisher formula

$$(1+i) = (1+r)(1+h)$$

Purchasing power parity and interest rate parity

$$S_1 = S_0 \times \frac{(1+h_c)}{(1+h_b)} \quad F_0 = S_0 \times \frac{(1+i_c)}{(1+i_b)}$$

PAPER F9 : FINANCIAL MANAGEMENT

Present value table

Present value of 1 i.e. $(1 + r)^{-n}$

Where r = discount rate

n = number of periods until payment

Periods Discount rates (r)

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	2
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	3
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	4
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	5
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	6
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	7
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	8
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	9
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	10
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350	11
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	12
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	13
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	14
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	2
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	3
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	4
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	5
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	6
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	7
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	8
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	9
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	10
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	11
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	12
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	13
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	14
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	15

Annuity table

Present value of an annuity of 1 i.e. $\frac{1-(1+r)^{-n}}{r}$

Where r = discount rate

n = number of periods

Periods Discount rates (r)

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736	2
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487	3
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170	4
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791	5
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355	6
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868	7
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335	8
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759	9
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145	10
11	10.37	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495	11
12	11.26	10.58	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814	12
13	12.13	11.35	10.63	9.986	9.394	8.853	8.358	7.904	7.487	7.103	13
14	13.00	12.11	11.30	10.56	9.899	9.295	8.745	8.244	7.786	7.367	14
15	13.87	12.85	11.94	11.12	10.38	9.712	9.108	8.559	8.061	7.606	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528	2
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106	3
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589	4
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991	5
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326	6
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605	7
8	5.146	4.968	4.799	4.639	4.487	4.344	4.207	4.078	3.954	3.837	8
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031	9
10	5.889	5.650	5.426	5.216	5.019	4.833	4.659	4.494	4.339	4.192	10
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327	11
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	4.793	4.611	4.439	12
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533	13
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611	14
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675	15

SECTION A

Each question is worth two marks.

1 Which of the following are true in respect of using expected values in net present value calculations?

- 1 Appropriate for one-off events
 - 2 Does not necessarily represent what the outcome will be
 - 3 Eliminates uncertainty
 - 4 Hides risk
- A 4 only
B 1 and 2
C 2 and 4 only
D 2, 3 and 4

2 BL Co is considering investing \$57,000 in a new delivery van that will last for four years, after which time it will be sold for \$10,000. Depreciation is charged on a straight-line basis. Forecast operating profits/(losses) to be generated by the machine are as follows.

<i>Year</i>	<i>\$</i>
1	18,100
2	25,400
3	10,500
4	(1,700)

What is the return on capital employed (ROCE) for the van (using the average investment method)?

- A 56%
B 20%
C 46%
D 39%

3 Which of the following relate to finance leases as opposed to operating leases?

- 1 Maintained and insured by the lessee
 - 2 Asset appears on statement of financial position of the lessor
 - 3 Equipment leased for a shorter period than its expected useful life
- A 1 only
B 1 and 2
C 2 and 3
D 3 only

4 Which of the following statements is incorrect?

- A Money markets are markets for short-term capital.
- B Money markets are operated by banks and other financial institutions.
- C Money market instruments include equities and corporate bonds.
- D Money market instruments are traded over the counter between institutional investors.

5 Mary decides to plot past share price movements to help spot patterns and create an investment strategy.

What does Mary believe the stock market is?

- A Completely inefficient
- B Weak form efficient
- C Semi-strong form efficient
- D Strong form efficient

6 Which of the following is true of the payback period method of investment appraisal?

- A It is profit based, rather than cash flow based
- B It measures the potential impact on shareholder wealth
- C It considers the time value of money
- D It tends to bias in favour of short-term projects

7 Lolly Co has \$100 million to invest. It is considering investing in 4 divisible projects.

	<i>Initial cost (\$m)</i>	<i>NPV (\$m)</i>
Project A	30	5
Project B	30	6
Project C	50	4
Project D	60	6

What is the NPV generated from the optimum investment programme?

- A \$15 million
- B \$17 million
- C \$9 million
- D \$21 million

PAPER F9 : FINANCIAL MANAGEMENT

- 8 The treasury department in Aloha Co has calculated, using the Miller-Orr model, that the lowest cash balance they should have is \$2m, and the highest is \$11m. If the cash balance goes above \$11m they transfer the cash into money market securities.

Which of the following is/are true?

- 1 When the balance reaches \$11m they would buy \$6m of securities
 - 2 When the balance falls to \$2 they will sell \$3m of securities
 - 3 If the variance of daily cash flows increases, the spread between upper and lower limit will be increased
- A 1 and 2 only
B 3 only
C 2 and 3 only
D 1, 2 and 3
- 9 The following is a summary of Baka Co's statement of financial position.

	\$m
Non-current assets	5
Net current assets	3
	———
	8
	———
Financed by:	
\$1 ordinary shares	1
Reserves	5
Loan notes	2
	———
	8
	———

Non-current assets include machinery which cost \$12 million which was purchased 8 years ago and has a useful life of 10 years. Baku Co uses straight-line depreciation. These assets were recently professionally valued at \$1 million.

What is the value per share using the realisable value basis of valuation?

- A \$6.00
B \$4.60
C \$3.60
D \$7.40

- 10** March Co is a listed company with a share price of \$2.60 per share. It announces a 1 for 4 rights issue at \$2 per share.

What is the theoretical ex-rights price?

- A \$3.10
 - B \$2.08
 - C \$4.60
 - D \$2.48
- 11** The current spot rate for US dollars against UK sterling is 1.4537 – 1.4547 \$/£ and the one month forward rate is quoted as 1.4572 – 1.4587.

A UK exporter expects to receive \$375,000 in one month. If a forward exchange contract is used, how much will be received in sterling?

- A \$257,962
- B \$257,785
- C \$257,078
- D \$257,342

- 12 A government follows an expansionary monetary policy.**

How would this typically affect businesses?

- A Higher tax rates, lower exchange rates and lower interest rates
- B Lower tax rates, higher demand from customers but less government subsidies
- C Higher interest rates, lower demand from customers and less available credit
- D Lower interest rates, higher demand from customers and increased availability of credit

- 13** Penfold Co has in issue 8% irredeemable loan notes, currently traded at 96% cum-interest.

If the tax rate changes from 30% to 20% for the company, the cost of irredeemable debt:

- A Increases to 7.3%
- B Increases to 6.7%
- C Decreases to 7.3%
- D Decreases to 6.7%

- 14 What are the two key risks for the borrower associated with short-term working capital finance?**

- A Maturity mismatch and renewal risk
- B Renewal risk and inflexibility
- C Inflexibility and rate risk
- D Rate risk and renewal risk

PAPER F9 : FINANCIAL MANAGEMENT

15 Which of the following is NOT a drawback of the Economic Order Quantity model?

- A Assumes constant and known lead times
- B Assumes certainty in demand
- C Assumes a small number of close suppliers
- D Ignores hidden costs such as the risk of obsolescence

16 G Co decides to offer a 2.5% early settlement discount that half of all customers take up. They pay in one month instead of the usual two months. G Co pays 8% per year for its overdraft facility.

What impact will this have?

	<i>Cash operating cycle</i>	<i>Reported profits</i>
A	Unaffected	Reduce
B	Reduce	Reduce
C	Unaffected	Increase
D	Reduce	Increase

17 Cup Co is considering purchasing Saucer Co. Both are listed companies. Recent information:

	<i>Cup Co</i>	<i>Saucer Co</i>
Earnings	\$5m	\$3m
P/E ratio	19	14

Cup Co believes that if they were to purchase Saucer Co the combined group would have earnings of \$9 million (after synergies) and a P/E ratio of 17.

What is the maximum Cup Co should pay for Saucer Co?

- A \$83m
- B \$53
- C \$111m
- D \$58m

- 18 A company's capital structure is as follows:

	\$m
20m ordinary shares (50c)	10
Reserves	6
10% loan notes 20X4	7

The loan notes are redeemable at nominal value in 20X4. Current market prices for the company's securities are: 50c ordinary shares, 280c; 10% loan notes 20X4, 100. The company is paying corporation tax at a rate of 30%. The cost of the company's equity capital has been estimated at 12% pa.

What is the company's per annum weighted average cost of capital for investment appraisal purposes?

- A 6.1%
 - B 12.6%
 - C 10.2%
 - D 11.4%
- 19 A US company owes a European company €3.5m due to be paid in 3 months' time. The spot exchange rate is \$1.96 – \$2 : €1 currently. Annual interest rates in the two locations are as follows:

	<i>Borrow</i>	<i>Deposit</i>
US	8%	3%
Europe	5%	1%

What will be the equivalent US\$ value of the payment using a money market hedge?

- A \$6,965,432
- B \$7,122,195
- C \$6,979,750
- D \$7,485,149

PAPER F9 : FINANCIAL MANAGEMENT

20 The following is an extract from Enya Co's recent statement of financial position.

	\$m	\$m
Total assets		1,100

\$1 ordinary share capital	100	
Retained earnings	400	

Total equity	500	
Loan notes	600	

		1,100

The ordinary shares are currently quoted at \$5.75 and loan notes are trading at \$145 per \$100 nominal.

What is Enya Co's financial gearing ratio (debt/ debt + equity) using market values?

- A 66%
- B 60%
- C 72%
- D 86%

SECTION B

ALL FIVE questions are compulsory and MUST be attempted

- 1** Play Co manufactures safety surfacing for children's playgrounds. The main raw material required is rubber particles and these are currently purchased from an outside supplier for \$3.50 per tonne. This price is contractually guaranteed for the next four years. If the contract is terminated within the next two years, Play Co will be charged an immediate termination penalty of \$150,000 which will not be allowed as a tax deductible expense.

The directors are considering investing in equipment that would allow Play Co to manufacture these particles in house by using recycled tyres.

The machine required to process the tyres will cost \$400,000, and it is estimated that at the end of year four the machine will have a second-hand value of \$50,000.

The costs associated with the new venture are as follows:

Variable costs (per tonne produced)	\$0.80
Fixed costs (per annum)	\$192,500

The additional fixed costs include maintenance costs of \$40,000 and the additional depreciation charge (calculated on a straight-line basis over the life of the asset) relating to the machine.

All of the above are quoted in current day terms. Inflationary increases are expected as follows:

Variable costs:	3% per annum
Maintenance costs:	5% per annum
Other fixed costs:	2% per annum

The annual demand for the particles (based on the sales forecasts of the company) is:

	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>
Demand (in tonnes)	100,000	110,000	130,000	160,000

Corporation tax of 30% per year will be payable one year in arrears. Tax-allowable depreciation on a 25% reducing balance basis could be claimed on the cost of the equipment, with a balancing allowance being claimed in the fourth year of operation when the machine is disposed of.

Required:

- (a) Using 15% as the after-tax discount rate, advise Play Co on the desirability of purchasing the equipment. (Your workings should be shown to the nearest \$000.)
(12 marks)
- (b) Identify and discuss the limitations of Net Present Value techniques when applied to investment appraisal.
(3 marks)

(Total: 15 marks)

PAPER F9 : FINANCIAL MANAGEMENT

- 2** Harry's Motors (HM) is a luxury car dealership. The company's opening bank balance at the beginning of January 2014 is \$250,000 overdrawn, and the bank has warned HM, that if they are to remain overdrawn by the end of April, then action will be taken to recover any money outstanding. This is likely to result in bankruptcy.

Actual and forecasted sales volumes are as follows:

Month	Oct (actual)	Nov (actual)	Dec (actual)	Jan (forecast)	Feb (forecast)	Mar (forecast)	Apr (forecast)
Units	25	27	29	30	38	34	35

The average selling price per car is \$50,000 with customers required to make a 20% deposit when placing an order, the remaining balance being payable in one month, however at present customers are in fact taking a further 3 months to pay, i.e. January sales are settled in April.

The contribution on each car is 20% of the selling price; the cost of each car must be paid to the car manufacturer within 2 months of the sale.

The sales team comprises 6 members who are paid a basic annual salary of \$36,000 paid evenly across the year. An additional commission of 2% of the selling price is paid in the month of sale to the person responsible. All other operating costs are fixed and total \$40,000 per month (this includes depreciation of \$5,000).

Additional cash outflows include an annual franchise payment of \$100,000 in March, and a disputed tax bill of \$250,000 must be settled in April.

Required:

- (a) Prepare a cash budget for the period January through to April 2014, clearly detailing each item of income and expenditure for each month, together with the opening and closing cash balances, commenting on the company's position. **(11 marks)**
- (b) Explain the motives for holding cash for a small company such as HM. **(4 marks)**
- (Total: 15 marks)**

- 3** Gad Co, a listed company, operates a fleet of fishing trawlers. In the last financial year it reported profit after tax of \$420,000.

The company has recently signed a long-term contract to supply a large supermarket chain with fresh fish. The new contract will increase profits significantly, but it requires investment in a processing and packaging warehouse costing \$2 million. The expected return on investment is 15% per annum.

There are two options being considered to finance the required investment.

- (1) A one for two rights issue
- (2) An issue of 8% irredeemable loan stock at par.

Gad Co currently has 500,000 \$1 ordinary shares in issue with a market price of \$11 and has no long term debt finance. Over 50% of the shares are owned by members of the founding Gadus family. The company pays tax at a rate of 30% per year.

Required:

Evaluate the two financing options being considered, supporting your evaluation with both analysis and critical discussion. Refer to any wider factors that should be considered.

(Total: 10 marks)

- 4 VAL Co is a listed company with a stated objective of maximisation of shareholder wealth. It has 70 million ordinary shares in issue with a par value of \$1, has no debt finance and currently has nearly \$100m in the bank.

Financial information relating to VAL Co for the past three years ending 31 March is as follows:

	2009	2010	2011	2012
Profit for the period (\$m)	21.7	27.2	34.6	40.3
Share price	4.40	5.25	6.42	6.90
Total cash dividend	15.4	15.4	15.4	-

The dividend in respect of the year ending 31 March 2012 has yet to be declared.

VAL Co is considering a major new investment that will be financed using retained earnings and is expected to generate an NPV of \$65 million. Information regarding this project has not yet been made public.

AVL Co is a very similar but significantly larger company. AVL Co has 250 million ordinary shares which are currently trading at \$4.60. The most recent accounts of AVL Co showed a profit after tax of \$85 million.

Required:

- (a) Analyse and discuss whether VAL Co has achieved its stated objective of maximisation of shareholder wealth. (4 marks)
- (b) Calculate an earnings based value of VAL Co in total and per share and discuss your result. (6 marks)

(Total: 10 marks)

- 5 IRQ Co has recently taken out a new variable rate bank loan to fund an expansion programme into the Middle East.

Interest rates have risen in recent times and the company is paying more interest on the variable rate bank loan than was originally expected. The directors of IRQ Co are keen to understand how interest rates are determined and how they could hedge the interest rate risk on any future borrowings.

Required:

- (a) Explain the theoretical factors which determine the term structure of interest rates and hence the interest rates faced by a company such as IRQ Co. (4 marks)
- (b) Explain briefly the over-the-counter and exchange traded methods that IRQ Co could use to hedge against future interest rate risk. Provide illustrative calculations of how a forward rate agreement could be used to protect the cost of future borrowings. (6 marks)

(Total: 10 marks)