

## **SUBJECT 108: FINANCE AND FINANCIAL REPORTING**

### **Aim**

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

### **Objectives**

On completion of the course the trainee actuary will be able to:

#### **(i) 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 principal items that need to be included in documents covering the setting up and running of the business entities listed in (i) 1 above.
3. Describe the different types of loan and share capital.
4. Distinguish between authorised and issued share capital.
5. Discuss the economic advantages and disadvantages of a limited company as a business entity.
6. Outline the main differences between a private and public company.
7. Outline the different types of medium term company finance:
  - hire purchase
  - credit sale
  - leasing
  - bank loans
8. Describe the following different types of short term company finance:
  - bank overdrafts
  - trade credit
  - factoring
  - bills of exchange
  - commercial paper

#### **(ii) Describe the basic principles of personal and corporate taxation.**

1. Describe the basic principles of income tax.
2. Describe the basic principles of capital gains tax.
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. Define franked investment income.
6. Outline the basic principles of double taxation relief.
7. Outline the basic principles of the taxation of a life insurance company.
8. Outline the basic principles of the taxation of a general insurance company and other companies which are classified as .traders in securities..

**(iii) 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, from an issuer's point of view of:
  - debenture stocks
  - unsecured loan stocks
  - Eurobonds
  - preference shares
  - ordinary shares
  - convertible unsecured loan stocks
  - convertible preference shares
3. Describe the 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.

**(iv) 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 the effect that the dividend policy will have on the market valuation of a company.

**(v) 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.

**(vi) Describe the major types of financial institution operating in 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

## **FINANCIAL REPORTING AND INTERPRETATION OF ACCOUNTS**

### **(vii) 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:
  - balance sheet
  - profit and loss account
  - cash flow statement
4. Construct simple balance sheets, profit and loss accounts and cash flow statements.
5. Explain what is meant by the terms subsidiary company and associated company.
6. Explain the purpose of consolidated accounts.
7. Explain how goodwill might arise on the consolidation of group accounts.
8. Explain how depreciation is treated in company accounts.
9. Explain the function of the following reserves - share premium account, revaluation reserve and profit and loss account.

### **(viii) Describe the principal features of the financial statements issued by pension funds and insurance companies.**

1. Describe the principal features of the financial statements issued by pension funds.
2. Describe the principal features of the financial statements issued by insurance companies.

### **(ix) 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 income 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 and dividend cover.
5. Explain net and nil distribution earnings per share.
6. Calculate and explain accounting ratios which indicate:
  - profitability
  - liquidity
  - efficiency
7. Discuss the shortcomings of historic cost accounting.
8. Discuss the limitations in the interpretation of company accounts.

**The Main Reading:** UK Institute of Actuaries Core Reading for subject 108 Finance and Financial Reporting

**Additional Reading:**

1. Brigham, Eugene F and Houston, Joel F., *Fundamentals of financial management*. 9th ed. Harcourt Brace, 2000 ISBN 0030314615
2. Holmes, Geoffrey and Sugden, Alan, *Interpreting Company reports and accounts*. 7th ed. Prentice Hall, 1999 ISBN 027364615X.
3. Samuels, J M; Wilkes, F M; Brayshaw, R E., *Management of company finance*. 6th ed. International Thomson, 1995 ISBN 1861522290.
4. Brealey, Richard A and Myers, Stewart C., *Principles of corporate finance*. 6th ed. McGraw-Hill, 1999 ISBN 0077095650