



INSTITUTE OF ACTUARIAL
& QUANTITATIVE STUDIES

Subject: Business finance

Chapter: Unit 1

Category: Practice question

MCQ questions**1. CB1 April 2019 Question 3**

Martin has just been admitted to a long established business partnership. He has bought 20% of the partnership equity, although he has not paid for this yet. He will be entitled to 15% of the partnership profit. If the firm incurs any liability, what proportion of that liability will be Martin's legal responsibility?

- A. 0%
- B. 15%
- C. 20%
- D. 100%

Answer – D

2. CB1 April 2019 Question 5

Which of the following statements describes the agency problem?

- A. Agents may feel that they cannot trust their principals.
- B. Agents may have insufficient authority to manage their principals' affairs.
- C. Principals may feel that they cannot trust their agents.
- D. Principals may not have the necessary expertise to manage their own businesses.

Answer – C

3. CB1 September 2020 Question 2

How should the directors of a quoted company view agency problems?

- A. Agency problems are inevitable and so they should be ignored.
- B. Agency problems are perceived, but do not exist in reality.
- C. Agency problems concern the shareholders and not the directors.
- D. Agency problems may be reduced through transparency and accountability.

Answer – D

4. CB1 September 2020 Question 3

In many countries, capital gains are not taxed until the assets on which the gain has arisen are sold. Which of the following is the most logical explanation of this practice?

- A. It assists taxpayers in their tax planning.
- B. It ensures the maximum possible revenue into government funds.
- C. It is easier to determine an objective tax expense.
- D. It is unfair to tax capital gains.

Answer – C

5. CB1 April 2021 Question 2

Which of the following is an agency cost?

- A. Board meetings
- B. Directors' salaries
- C. External audit of a company's financial statements
- D. Interest on corporate debt.

Answer – C

6. CB1 April 2021 Question 3

A parent company has a foreign subsidiary located in a host country that does not have a double tax arrangement with the parent's home country. The foreign subsidiary pays regular dividends to the parent company. Which of the following will apply?

- A. The subsidiary will not be taxed on profits earned in its host country and the parent will pay tax on dividends in its home country.
- B. The subsidiary will pay tax on profits earned in its host country and the parent will not be required to declare the dividends as taxable income in its home country.
- C. The subsidiary will pay tax on profits earned in its host country and the parent will pay tax on dividends received in its home country.
- D. The subsidiary will pay tax on profits earned in its host country and the parent will pay tax on dividends received in the subsidiary's host country.

Answer - C

7. CB1 September 2021 Question 1

Which of the following best explains a 'comply or explain' approach to codifying the principles of sound corporate governance?

- A. Directors who do not comply will be fined.
- B. Market forces can encourage compliance.
- C. Stakeholders do not care about compliance.
- D. There is no agreement on the principles.

Answer – B

8. CB1 September 2021 Question 8

Which of the following best explains why the UK does not tax income from certain types of investment, such as an Individual Savings Account (ISA)?

- A. Income from investments such as ISAs is difficult to measure and so tax.
- B. Returns paid on investments such as ISAs are too low to tax.
- C. Taxpayers would otherwise transfer their savings offshore.
- D. The UK Government wishes to encourage citizens to save.

Answer – D

9. CB1 September 2022 Question 2

A sole trader's current account has a balance of \$200 and an overdraft facility of \$1,000. What is the maximum that the account holder can withdraw from this account?

- A. \$200
- B. \$800
- C. \$1,000
- D. \$1,200

Answer – D

10. CB1 September 2022 Question 3

Which of the following explains why depreciation is not an allowable expense for tax purposes in many countries?

- A. Depreciation cannot be determined objectively.
- B. Depreciation does not involve a cash flow.
- C. Governments do not wish to encourage loss of value.
- D. Tax relief is already granted on asset operating costs.

Answer – A

11. CB1 September 2022 Question 4

A company has 100% ownership of an overseas subsidiary that consistently earns profit.

The effect of Double Taxation Relief (DTR) on this group means that it will be taxed:

- A. at the higher of the two countries' tax rates.
- B. at the lower of the two countries' tax rates.
- C. in whichever country it chooses.
- D. on the net income received from the subsidiary.

Answer – A

12. CB1 April 2023 Question 6

Unit 1

PRACTICE QUESTION

Which of the following explains why tax law often makes a taxpayer's main private residence free from capital gains tax?

- A. taxpayers would refuse to pay
- B. in order to encourage home ownership
- C. not all taxpayers are homeowners
- D. the tax could easily be avoided by renting

Answer – B

13. CB1 September 2023 Question 2

A limited liability partnership (LLP) is facing bankruptcy because its managing partner had recklessly taken a loan to invest in a new IT system for the LLP. The LLP is now struggling to service this loan. The LLP has three other partners who work in client-facing roles and take no active part in the LLP's management. Which of the following statements is correct?

- A. Creditors have no further rights once the LLP's assets have been exhausted.
- B. Only the lender who financed the IT system can claim partners' personal assets.
- C. The four partners are jointly and severally liable for the LLP's debts.
- D. The LLP's creditors have a strong claim against the managing partner's personal assets.

Answer – D

14. CB1 September 2023 Question 3

Company D, based in Country H, paid taxes in Country L of \$2 million on the \$10 million that it earned from its activities in that country. Company D pays tax of 15% in Country H.

What is the maximum offset that Company D can claim in respect of double taxation relief on taxes incurred in Country L?

- A. nil
- B. \$0.5 million
- C. \$1.5 million
- D. \$2 million.

Answer – C

15. CB1 April 2024 Question 2

Company S wishes to remunerate its executive directors in a manner that aligns their interests with those of the shareholders. Which form of remuneration will achieve that objective?

- A. A generous annual salary

- B. A percentage of reported profit
- C. An annual allocation of shares
- D. The use of a company car.

Answer – C

16. CB1 April 2024 Question 4

Which of the following explains the purpose of Double Taxation Relief (DTR)?

- A. DTR enables countries to receive more tax
- B. DTR prevents profit from being taxed twice
- C. DTR safeguards countries' economic interests
- D. DTR simplifies the calculation of tax liabilities.

Answer – B

17. CB1 September 2024 Question 2

How should the potential conflict between the board's duty to maximise shareholder wealth and its ethical duty to other stakeholders be addressed?

- A. Ethical duties always take priority over the maximisation of shareholder wealth.
- B. Shareholder wealth should always be maximised regardless of other impacts.
- C. The board is required to seek the shareholders' guidance with respect to ethical duties.
- D. The pursuit of shareholder wealth may be constrained by ethical duties.

Answer – D

18. CB1 April 2019 Question 4

When does a bondholder receive the nominal value of a bond?

- A. At the time of purchase.
- B. Annually.
- C. Whenever coupon payments are made.
- D. At maturity.

Answer – D

19. CB1 April 2021 Question 4

A company has issued subordinated debt securities. Which of the following reflects the priority that would apply in the event of default?

- A. Mortgage loans first, followed by preference shares, then equity shares, then subordinated debt.
- B. Mortgage loans first, followed by preference shares, then subordinated debt, then equity shares.

- C. Mortgage loans first, followed by subordinated debt, then preference shares, then equity shares.
- D. Subordinated debt first, followed by mortgage loans, then preference shares, then equity shares.

Answer – C

20. CB1 September 2023 Question 5

An airline requires the use of an aircraft for the next 3 years. The aircraft's purchase price is \$60 million. H Bank has agreed to lease the aircraft to the airline for 3 years. The airline will have exclusive use of the aircraft for 3 years, after which it will be returned to H Bank. The lease payments have a present value of \$20 million. What type of finance is the airline using?

- A. Bank loan
- B. Credit sale
- C. Finance lease
- D. Operating lease.

Answer - D

Long questions

1. CT2 April 2011 Question 11

Comment on the suggestion that the interests of shareholders and lenders can conflict.

2. CT2 April 2011 Question 12

Simon established an actuarial practice several years ago. The business has been successful. One of Simon's longest-serving actuaries has started to look for alternative employment and Simon is considering offering her a partnership in the practice.

Discuss the implications for Simon of making this employee a partner.

3. CT2 April 2011 Question 14

Explain why tax legislation does not permit depreciation as an expense for tax purposes but grants a capital allowance instead.

4. CT2 April 2012 Question 14

Four engineers have established a company to manufacture a new product that

they have patented. Each of the directors owns 25% of the company's equity. They have employed a qualified accountant to manage the company's record-keeping and to engage with potential lenders on the company's behalf. Describe the respective legal responsibilities of both the company's directors and its accountant in relation to record-keeping and lenders.

5. CT2 April 2012 Question 11 (updated)

Explain why, from a tax perspective, many individual shareholders prefer to earn a return from an increase in the share price rather than payment of a dividend.

6. CT2 October 2012 Question 12

Discuss the implications of the threat of a takeover for the behaviour of a quoted company's directors.

7. CT2 October 2012 Question 11

Two actuaries are considering establishing a consultancy business and are considering incorporating as a limited company. The company will have to borrow in order to raise sufficient finance to get started. The actuaries would have to pledge personal guarantees before a bank will grant a loan to their company.

Discuss the benefits of incorporating as a limited company in these circumstances.

8. CT2 October 2012 Question 14

Describe the implications for companies if it is not clear whether a significant expense is permissible for tax purposes.

9. CT2 April 2013 Question 12

Sarah recently inherited a substantial sum of money. Her friend Tom is a successful businessman who owns a small factory. Tom is a sole trader. He has offered Sarah the opportunity to become a sleeping partner in his business. She will invest £200,000 of her inheritance in return for a partnership share of 30% of all future profits. She will not take any part in the running of the business. The business is profitable and is struggling to keep up with demand, so the expansion will probably be successful.

Describe the risks that Sarah will be taking on if she enters into this arrangement with Tom.

10. CT2 September 2013 Question 11

Describe the advantages of establishing a business as a limited liability partnership rather than a traditional partnership.

11. CT2 September 2013 Question 19 (part)

Paul has developed and patented a new product. He requires finance in order to put the product into production. A venture capital company has offered to finance Paul on the basis that Paul will incorporate his business as a limited company. The venture capitalist will provide all of the funding necessary to commence the manufacture and sale of the new product in return for 51 % of the equity in this new company. The venture capitalist will appoint a board member and Paul will also be a director of the company. Paul will sign a five years employment contract with the company.

Paul's role with the company will be to work on improvements to the original product and to develop new products for sale by the company. In addition to working full-time as an employee, he must patent any new ideas in the company's name.

The company will be independently valued at the end of its first five years. The venture capitalist will then offer Paul the opportunity to buy its 51 % holding for that proportion of the independent valuation plus 20%. If Paul does not take that offer then the venture capital company will retain its shareholding and the question of Paul's contract will be reviewed by both, sides.

Discuss the benefits of this arrangement to both Paul and the venture capitalist.

12. CT2 September 2014 Question 11

Explain why the market prices of shares are generally regarded as unbiased reflections of the shares' "true" value.

13. CT2 April 2015 Question 11

In many countries capital gains are only taxed when the taxpayer disposes of the asset on which the gain has arisen. Describe the implications of delaying the taxation of capital gains until the asset has been sold.

14. CT2 April 2015 Question 20 (part)

Exesses is a family-owned company that is in the process of recovering from a major corporate scandal. Exesses is a substantial business that is not quoted.

None of its shareholders owns more than 5% of the equity shares. None of the shareholders is able to take an active role in the company's management.

Exesses' directors were all forced to step down because of the discovery that the directors had been overstating reported profits, which had the effect of inflating their profit-related bonuses. The directors also provided themselves with lavish lifestyles at the company's expense. For example, the company provided chauffeur-driven limousines to transport the directors on both business and personal travel.

The entire board of Exesses has resigned. The shareholders have met and have appointed a new chairman and a chief executive. Neither of these appointees have had anything to do with Exesses in the past. They have both agreed that their first priority is to appoint a new board and to structure the management arrangements so that the shareholders' confidence is restored.

The chairman has suggested that the new board should be structured as follows:

- The chairman will work on a part-time basis and will be responsible for the management of the board, including chairing board meetings. The chairman will be paid a fixed annual salary that offers an appropriate rate for the time that he is expected to commit to the company.
- The chief executive will be employed on a full-time basis to manage the company itself and will receive both a substantial salary and a profit-related bonus.
- Four additional full-time directors will be appointed to take charge of particular areas such as marketing and finance. Each will receive a similar package to the chief executive.
- Two part-time directors will be appointed to participate in board meetings and to review corporate strategy. They will be paid a fixed salary.
- The chief executive and each of the full-time directors will receive a 5% shareholding after satisfactorily completing three years on Exesses' board.
- The chairman and the two part-time directors will appoint a new external audit firm. They will negotiate a contract with a much larger firm than the outgoing auditor and will pay a larger fee for the new auditor's services.

Discuss the suitability of the proposals for the appointment and remuneration of the new board of directors from the perspective of maintaining shareholder confidence.

15. CT2 September 2015 Question 16

Describe ways in which governments can use taxation to incentivize pensions

Unit 1

PRACTICE QUESTION

saving.

16. CT2 April 2016 Question 11

Describe the role of tax in determining whether an individual shareholder would prefer to receive a dividend or a capital gain.

17. CT2 September 2016 Question 11

Describe why a country might enter into double taxation agreements with other countries.

18. CT2 September 2016 Question 15

Describe the role of the capital markets in disciplining company performance.

19. CT2 April 2017 Question 13

Describe why some individual taxpayers may prefer to receive investment returns in the form of capital growth rather than dividend.

20. CT2 April 2018 Question 11

Joan is an actuarial consultant who has operated as a sole trader for several years. She has decided to bring Frank, a colleague, into the business.

Describe the advantages to Joan of a traditional partnership over a limited company for the business arrangement with Frank.

21. CB1 April 2019 Question 11

Discuss the proposition that businesses should take account of social responsibility when conducting their operations.

22. CB1 September 2020 Question 11

Describe how guidance such as that contained in the UK Corporate Governance Code might reduce concerns arising from agency theory.

23. CB1 April 2022 Question 14

Describe the implications of agency theory for the regulation of corporate

governance.

24. CB1 September 2022 Question 11

Explain the advantages and disadvantages of a quoted company remunerating its directors on a performance-related basis.

25. CB1 September 2022 Question 14

There is a rumour on the stock exchange that a quoted food manufacturer is planning to bid to acquire a competing brand through an exchange of shares. Describe the agency issues that such an acquisition would involve.

26. CB1 September 2022 Question 20

M is a quoted mining company that owns the rights to mine for ore in a developing country. The company has discovered a large deposit in a remote area that is close to a vast government-owned wildlife park. M's directors are considering building a mine to extract this deposit.

Opening up the ore deposit will cost \$900 million and will require many thousands of tonnes of soil and rock to be dumped nearby. If the ore is found to be of good quality then it will be extracted by digging out a strip of land covering an area of 400 hectares and reaching a depth of hundreds of metres.

M will build a railway link from the mine to the nearest seaport 120 kilometres away so that it can export the ore by ship for processing into metal. The government has given permission for the railway to pass through the wildlife park.

The total investment in the mine will be \$4.5 billion, including the initial opening up of the land, the heavy equipment that will be required and the railway line, locomotives and wagons.

(ii) Evaluate the agency issues associated with M's directors' decision to proceed with this project to extract the ore.

27. CB1 April 2024 Question 11

Explain the implications of information asymmetries for sound corporate governance.

28. CB1 April 2024 Question 15

A retailer operates as a sole trader. The retailer is considering incorporating the business as a limited company.

Explain the advantages and disadvantages of incorporating this business.

29. CB1 September 2024 Question 12

A recently established partnership trades as a retailer. The business wishes to arrange trade credit in order to fund the purchase of inventory.

Explain the features of trade credit that may make it difficult for the partnership to obtain funding from this source.

30. CB1 September 2024 Question 13

Countries adopt a variety of different approaches to protect individuals when levying tax.

Explain two of the ways in which countries can do this.

31. CB1 September 2024 Question 20

Company M is a multinational insurance company that specialises in car insurance. It has extensive operations in several European and Asian countries. Company M also has a subsidiary in North America that has consistently generated 3% of Company M's profits since it was purchased for \$300 million in 2015.

Company M's board is considering selling the North American subsidiary. It has held confidential discussions with a North American insurance company that is prepared to offer \$260 million for the subsidiary.

(ii) Discuss the agency concerns that may be raised by Company M's shareholders if the board accepts the buyer's offer of \$260 million.

32. CB1 April 2025 Question 11

Company Q is a quoted company that manufactures steel. The company's Chief Financial Officer (CFO) is an executive director who is responsible for the strategic management of Company Q's finances. Company Q employs a treasurer to monitor and manage cash flows and to maintain an effective working relationship with the banks that are Company Q's lenders.

Discuss the importance of the working relationship between Company Q's CFO and its treasurer.

33. CT2 April 2010 Question 13

Unit 1

PRACTICE QUESTION

An unquoted company wishes to raise a large loan in order to invest in a major new project. The finance director has proposed issuing bonds that have a significant number of warrants attached.

Describe the advantages and disadvantages to the company's existing shareholders of attaching warrants to the bond issue.

34. CT2 September 2010 Question 11

Explain why a small business should take great care in managing its overdraft.

35. CT2 September 2010 Question 13

Explain why Eurobonds tend to offer investors a higher rate of return than traditional loan stock.

36. CT2 April 2011 Question 13

Explain why preference shares are generally accounted for as debt rather than equity.

37. CT2 September 2011 Question 11

Trade credit and debt factoring are both used to provide businesses with short term finance. Describe the main features of each.

38. CT2 September 2011 Question 13

A company requires finance in order to expand. Explain how the company's tax position may affect the decision to use debt rather than equity.

39. CT2 September 2011 Question 17

Explain why it may not be appropriate for management to choose the least expensive source when raising fresh finance.

40. CT2 April 2012 Question 12

Martha is seeking funding for a company that she wishes to establish. Her plans involve too much risk for a conventional bank loan but a venture capital company has offered to invest in convertible loan stock.

Discuss the disadvantages to Martha of funding her company by issuing convertible loan stock to a third party

41. CT2 April 2012 Question 15

Explain how a lessee can take on the risks and rewards of ownership of an asset, even though the leased asset remains the property of the lessor.

42. CT2 April 2012 Question 16

Explain how there could be a conflict between the interests of directors and shareholders over the raising of additional finance, where the directors would prefer the company to issue equity and the shareholders would prefer the company to borrow.

43. CT2 April 2013 Question 11

Explain whether a loss-making company should allow for the effects of tax when deciding whether to raise fresh finance through debt or equity.

44. CT2 April 2013 Question 13

A company's directors are considering issuing redeemable preference shares as an alternative to borrowing. They believe that the company is too close to its borrowing capacity and so equity is preferable to debt.

Outline the implications for the company of issuing redeemable preference shares in these circumstances.

45. CT2 April 2013 Question 14

Explain why finance leases have to be accounted for on the basis that the asset and an associated liability must appear in the lessee's statement of financial position, even though the lessee does not own the asset.

46. CT2 April 2014 Question 11

A quoted company has raised finance using both debt and equity instruments that are publicly traded. One of the company's major investment projects has failed. As expected, the market value of the equity shares has declined in response to this news, but the value of its debt instruments has remained unchanged.

Explain why it is possible that debt would not decline in value in these circumstances.

47. CT2 September 2014 Question 12

Unit 1

PRACTICE QUESTION

Discuss the circumstances in which non-recourse factoring might be an appropriate means of obtaining finance.

48. CT2 April 2015 Question 12

Describe the advantages and disadvantages of issuing debenture stocks in order to raise finance.

49. CT2 April 2015 Question 13

A software development company is considering raising funds to expand the business. The company's only significant asset is the office block that it uses to accommodate its programming and administrative functions.

Explain the potential implications of raising funding through a sale and leaseback arrangement on the company's office block.

50. CT2 September 2015 Question 13

Discuss the potential advantages and disadvantages of using a finance lease to acquire an asset rather than borrowing the cost of the asset in order to purchase it outright.

51. CT2 April 2016 Question 12

Describe the advantages and disadvantages to existing shareholders of funding expansion using convertible loan stock.

52. CT2 April 2018 Question 12

Describe the usefulness of bank overdrafts in managing a company's working capital requirements.

53. CB1 April 2019 Question 12

Describe whether preference shares should be treated as debt rather than equity when evaluating a company's gearing.

54. CB1 April 2024 Question 12

H is a software designer who is working on a program that has a large potential market. H requires a large injection of funding to complete the development and

fund the marketing of their program. They are considering offering convertible loan stock to potential investors.
Explain the advantages and disadvantages to H of issuing convertible loan stock.



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