

THE OPEN UNIVERSITY OF SRI LANKA
FACULTY OF MANAGEMENT STUDIES
BACHELOR OF MANAGEMENT STUDIES HONOURS IN
ACCOUNTING AND FINANCE
SEMESTER I
FINAL EXAMINATION - 2026
AFU5420 INTERNATIONAL FINANCIAL MANAGEMENT
DURATION - 03 HOURS



Date : 14.06.2026

Time: 9.30am – 12.30pm

Instructions:

- Answer **Question No. 1 in Part A** and **any three (03) questions in Part B**.
- Numbering of the answers in your answer script should follow the numbers assigned to the questions in the paper.
- Illegible hand writing is liable to loose marks.
- Use of non-programmable calculators are allowed.

Part A

Question No. 1 (Compulsory Question)

Sigma Multinational PLC, a multinational company established in Sri Lanka, is considering the feasibility of launching operations in the United States by establishing a subsidiary to manufacture and export motor vehicle tyres. The project is expected to last for four years. You have been appointed as a financial analyst at Sigma Multinational PLC to evaluate the feasibility of the proposed project. The following estimates have been made in relation to the project.

- Sigma Multinational PLC will invest USD 300,000 in property, plant, and equipment required for this project. The spot exchange rate is LKR 300/USD. The subsidiary will borrow USD 16,000 to purchase a plant for this project. On this loan, it will make an interest payment at 6% annually and will pay the principal amount at the end of Year 4. It is expected that the investment would have a scrap value of USD10,000 at the end of year 4.
- The followings are the estimates of income and expenses of the project.

(Amounts are in USD)

	Year 1	Year 2	Year 3	Year 4
Sales	312,500	344,000	401,100	301,700
Variable cost	93,750	129,230	155,000	123,430
Fixed production overheads	67,500	67,500	67,500	67,500

- The LKR/USD exchange rates over the next four years are projected as follows.

	Year 1	Year 2	Year 3	Year 4
LKR/USD rate	320	325	340	350

The annual fixed production overheads include depreciation charges on the investment in property, plant and equipment of USD 31,000. The income tax rate in the United States is 20%, and a 10% withholding tax applies on cash remitted from the U.S. subsidiary to the Sri Lankan parent. The Sri Lankan government grants a full foreign tax credit, so that no further tax is due on the earnings remitted to the parent company in Sri Lanka. The capital allowance for the investment in property, plant and equipment is 25% per year on the straight-line basis for tax purposes. At the end of the year 4, the U.S. government expects to acquire the subsidiary for USD 40,000, tax-free. The risk-free rate of interest and market rate of return in Sri Lanka are 5% and 10% respectively. The beta value applicable for this international project is 1.2. An additional risk premium of 5% is considered to cover the country-specific risk in the United States.

You are required to;

- (a) Prepare a forecast of the annual net cash flows to be remitted to the parent company in LKR.
- (b) Calculate the cost of capital applicable for the project.
- (c) Compute the Net Present Value (NPV) of the project and advise whether Sigma Multinational PLC should proceed with the subsidiary investment in the United States.
- (d) Considering the current economic and political environment in the United States, briefly discuss two (02) potential risks that Sigma Multinational PLC may encounter when undertaking this investment.

(Total Marks: 40)

Part B

Question No. 2

- (a) Explain the importance of international financial management for multinational corporations operating globally. **(06 Marks)**
- (b) Explain two (02) features that distinguish international financial management from domestic financial management. **(06 Marks)**
- (c) Discuss how a deficit of the Balance of Payments affects a country's exchange rates. Support your answer with appropriate examples from the Sri Lankan context. **(08 Marks)**

(Total Marks: 20)

Question No. 3

- (a) Explain three (03) characteristics of a floating exchange rate system. **(06 Marks)**
- (b) "Differences in inflation rates across countries influence exchange rate movements." Discuss this statement with appropriate examples. **(06 Marks)**

- (c) Consider a country operating under a fixed exchange rate system is currently experiencing high inflation and low interest rates. The country intends to shift from a fixed exchange rate system to a floating exchange rate system. Discuss how this transition may affect the value of the country's home currency relative to foreign currencies. Support your answer with appropriate examples and illustrations.

(08 Marks)

(Total Marks: 20)

Question No. 4

- (a) Explain three (03) characteristics of a currency forward contract.
- (b) Discuss two (02) applications of currency put options by multinational corporations with appropriate examples.
- (c) Suppose a Sri Lankan company is required to pay Euro (EUR) 180,000 in 90 days for the importation of machinery from a European supplier. Since the company faces a risk of depreciation of LKR relative to EUR, it has decided to hedge its foreign exchange exposure using a currency call option with a strike price of LKR 405/EUR. The option premium is LKR 10 per Euro, and each option contract covers EUR 30,000.
- (i) Calculate the gain or loss to the company on this option contract if the spot rate on the contract's expiration date is LKR 409/EUR.
- (ii) Prepare a contingency graph for the currency option given in this scenario.

(08 Marks)

(Total: 20 Marks)

Question No. 5

Write short notes on the following.

- (a) Relative Purchasing Power Parity Theory
- (b) Managed floating exchange rate system
- (c) Characteristics of a currency forward contract
- (d) Operational and financial hedging for managing economic exposure

(Total: 20 Marks)

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PRESENT VALUE TABLE

Present value of \$1, that is $(1+r)^{-n}$ where r = interest rate; n = number of periods until payment or receipt.

Periods (n)	Interest rates (r)									
	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
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.768	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.458	0.377	0.312	0.258	0.215	0.178	0.149

Periods (n)	Interest rates (r)									
	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
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.079	0.065
16	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026