



MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

FOURTH YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF COMMERCE (FINANCE OPTION)

BACHELOR OF ECONOMICS AND FINANCE

BAC 407: FINANCIAL STATEMENT ANALYSIS

DATE: 9/8/2021

TIME: 8.30-10.30 AM

INSTRUCTIONS:

Answer question ONE and any other TWO questions

QUESTION ONE (COMPULSORY) (30 MARKS)

- a) The following financial statement relate to ABC Ltd.
Statement of financial position as at 31/03/2013

ASSETS	SH	LIABILITIES AND NETWORTHY	SH
Cash	28,500	Trade payables	116,250
Receivable	270,000	Notes payables (9%)	54,000
Inventory	649,000	Other current liabilities	100,500
Total current assets	948,800	Long term debt (10%)	300,000
Net fixed assets	285,750	Net worth	663,000
	1,233,750		1,233,750

Income statement for the year ended 31/03/2013

	Shs
Sales	1,972,500
Less: cost of goods sold	1,368,000
GROSS PROFIT	604,500
Less: selling and administration expenses	498,750
Earnings before interest & tax	105,750
Interest expense	34,500
Taxation @40%	71,250
Earnings after tax	42,750

Required:

- i. Net profit margin (2 marks)
- ii. Time interest earned ratio (2 marks)
- iii. Total Assets turnover (2 marks)
- iv. Inventory turnover ratio (2 marks)

Interpret the above ratios given that the industry average ratios are as given below

- I. Net profit margin -4% (1 mark)
- II. Time interest earned ratio -2 times (1 mark)
- III. Total assets turnover - 2 times (1 mark)
- IV. Inventory turnover -3 times (1 mark)

- b) Explain the following terminologies as used in cash flow statements (IAS 7) giving two examples in each case statements
- i. Cash flow from operating activities (2 marks)
 - ii. Cash flow from investing activities (2 marks)
 - iii. Cash flow from financing activities (2 marks)
- c) The following is the paid up capital structure of XYZ Ltd as at 31st December 2015.

	sh
4,000,000 8% cumulative preference shares of Sh.10 each	40,000,000
40,000,000 ordinary shares of sh.10	400,000,000

The profit after-tax for the year ended 31/12/2015 was sh.403, 200,000 .On 1st Oct 2015, the company issued sh.120, 000,000 6% convertible debentures. The debentures were convertible into 12 ordinary shares per sh.1000 of the convertible debentures. The tax rate is 30%.

Required;

- i. Basic EPS (3 marks)
 - ii. Diluted EPS (4 marks)
- d) As financial statement analyst, explain five circumstances under which you can conclude that financial statements have been compromised (5 marks)

QUESTION TWO (20 MARKS)

- a) Chicken feed Ltd specializes in the whole selling of chicken feed. It has 5 employees whose monthly wages and salaries amount to sh.6, 400. The company owns a lorry bought two years ago at a price of sh.193, 000. The current book value of the lorry is sh.96, 000. The company

uses straight line method of depreciation. All other expenses amount to sh.4, 800 per month.

During the month of October 2012, the company had the following transactions.

PURCHASES

DATE	BAGS RECIEVED	PRICE	VALUE	DATE	BAGS SOLD	PRICE	VALUE
October 2012		Shs	Shs	October 2012		Shs	
2 nd	400	150	60,000	8 th	300	170	51,000
10 th	600	165	99,000	15 th	500	180	90,000
24 th	700	170	119,000	26 th	800	200	160,000
27 th	500	180	90,000	30 th	500	?	100,000

NB: There was an opening stock of 200 bags valued at sh.28, 000 each bag been bought at sh.140.

Required

- i. Prepare stores ledger cards using the following stock valuation methods:-
 - FIFO valuation method. (6 marks)
 - LIFO valuation method. (6 marks)
- ii. Prove that different stock valuation methods give rise to different profit by preparing income statements based on the two methods. (4 marks)
- iii. During the exercise of understanding the statement of financial position, state four issues or questions that you would consider in the analysis of inventory. (4 marks)

QUESTION THREE (20 MARKS)

The following financial statements belong to Precision Co. Ltd for the years 2015 and 2014 respectively.

Income Statements for the years ended 31st December:

	2015 Shs. '000'	2014 Shs. '000'
Sales	2,486,000	2,075,000
Cost of goods sold	1,523,000	1,222,000
Gross profit	963,000	853,000
Operating Expenses:		
Advertising expense	145,000	100,000
Sales salaries expense	240,000	280,000
Office salaries expense	165,000	200,000
Insurance expense	100,000	45,000
Depreciation expense	86,000	75,000
Supplies expense	26,000	35,000

Miscellaneous expense	17,000	15,000
Total operating expenses	778,000	750,000
Operating income	185,000	103,000
Interest Expense	44,000	46,000
Income before taxes	141,000	57,000
Income taxes	47,000	19,000
Net income	94,000	38,000

Earnings per share..... Shs. 9.9

Shs. 4.

Balance Sheets for the years ended 31 December:

	2015 Shs. '000'	2014 Shs. '000'
Assets		
Current Assets		
Cash	79,000	42,000
Short-term investments	65,000	96,000
Accounts receivable, net	120,000	100,000
Inventory	250,000	265,000
Total Current Assets	514,000	503,000
Non-Current Assets; Plant ,net	400,000	350,000
Store equipment, net	45,000	50,000
Office Equipment, net	625,000	675,000
Buildings, net	100,000	100,000
Total non-current assets	1,170 000	1,175,000
Total Assets	1,684,000	1,678,000
Current Liabilities:		
Accounts payable	164,000	190,000
Short-term notes payable	75,000	90,000
Taxes payable	26,000	12,000
Total Current Liabilities	265,000	292,000
Long-Term Liabilities:		
Notes payable(Secured by mortgage on Buildings	400,000	420,000
Total Liabilities	665,000	712,000
Stockholders' Equity	475,000	475,000
Common Stock, Shs.50 per value	544,000	491,000
Total Stockholders' Equity and liabilities	1,684,000	1,678,000

From the above financial statements, you are required to:

- a) Prepare comparative income statements showing the percentage increase or decrease for the year 2015. (8 marks)

- b) Prepare common Size Balance sheets. for the years 2015 (8 marks)
- c) Under what circumstances can you identify a potentially impaired asset (4 marks)

QUESTION FOUR (20 MARKS)

- a) ABC Ltd had the following capital structure in 2017.

	Sh
100,000 ordinary shares of sh1.00 each	100,000
50,000 8% preference shares of sh 1.00 each	<u>50,000</u>
	<u>150,000</u>

The market price as at 31/12 of ordinary shares was sh.3, declared dividend was 10% . In the year, total earnings were Sh68,000 and tax rate was 50% calculate.

- i. Dividend yield (2 marks)
 - ii. Dividend cover (2 marks)
 - iii. Earnings per share (2 marks)
 - iv. Price earnings ratio (2 marks)
 - v. Earnings yield (2 marks)
- b) Corporate failure means that a company ceases operations following its inability to make profit or generate enough revenue to cover its expenses. This can occur as a result of poor management skills, inability to complete or even insufficient marketing. Identify and explain five symptoms of normal business failure. (10 marks)

QUESTION FIVE (20 MARKS)

- a) The following are financial statements of Mango Ltd for the year ended 31/12/2016 The income statement for the year ended 31/12/2016

	Shs
Sales	
Less: Cost of goods sold	6000
Less: Selling and administration costs	(3500)
Less: Selling and administration costs	<u>(1000)</u>
EBIT	1500
Less: Interest expense	<u>(1100)</u>
EBT	400
Less: taxes	(120)
Profit for the year	<u>280</u>

STATEMENT OF FINANCIAL POSITION AS AT 31/12/2016

CURRENT ASSETS	SHS
Accounts receivable	3000
Cash	400
Stock	4000
TOTAL CURRENT ASSETS	7400
NON-CURRENT ASSETS	
Premises	1000
Motor vehicle	5,000
Equipment	8,000
TOTAL ASSETS (CURRENT & NON-CURRENT)	21,400
EQUITY & LIABILITIES	
Accounts payable	5,000
Notes payable	1,000
TOTAL CURRENT LIABILITIES	6,000
Mortgage	4000
Debentures	6000
TOTAL NON-CURRENT LIABILITIES	10,000
Preference shares (100 shares)	1,000
Ordinary shares (500 shares)	1,000
Share premium	2000
Retained earnings	1400
	21400

Additional information

- i) The current market price per share is sh. 6. Given that $Z = 1.2x_1 + 1.4x_2 + 3.3x_3 + 0.6x_4 + 1.0x_5$

Required: Calculate the Altman's Z score (10 marks)

- b) Distinguish between a finance lease and an operating lease (5 marks)
- c) During the examination of income statement for accounting risk, what issues/questions would you consider in the determination of whether expenses are understated