



MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

FOURTH YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS

BACHELOR OF COMMERCE

BAC 407: FINANCIAL STATEMENT ANALYSIS

DATE: 26/7/2019

TIME: 2.00-4.00 PM

INSTRUCTIONS: Attempt Question One and any other Two Questions

1. a) In stock valuation, state two ways in which errors may occur if statements are not audited and not necessarily prepared in accordance with IFRS or GAAP (2 marks)
- b) When collecting data for financial statements analysis how can you conclude that financial statements have been distorted. (4 marks)
- c) A company is capitalised as follows:
Sh. 600,000 7% preference shares of sh. 1 each
Sh. 1,600,000 7% ordinary shares of sh. 1 each

The following information is relevant for the year just ended dec 2017.

Profits after taxation @ 40% sh. 42,000

Ordinary dividend paid 20 %

Market price of ordinary share sh. 4

Required.

- (i) The dividend yield on ordinary shares (2 marks)
- (ii) Dividend covers (4 marks)

- (iii) The earnings yield (2 marks)
- (iv) The price earnings ratio (2 marks)
- (d) Distinguish between an operating lease and a financing lease (2 marks)
- (e) When analyzing financial statements, what should you confirm about management systems on (3 marks)
- (i) Good debtors
- (ii) Bad debts
- (iii) Doubtful debts
- (g) State and briefly explain three tools used for financial analysis (8 marks)

2. (a) The following is a summarised balance sheet at XYZ Co. Ltd. As of Dec 31st 2014 and 1st Dec 2015.

Balance sheet of XYZ Ltd.

	31st Dec 2015	31st Dec 2014
Assets	Sh “000”	Sh “000”
Plant and equipment	2000	1030
Land and buildings	1000	1000
Short term investments	560	600
Sundry debtors	2200	2500
Inventories	1500	1300
Interest receivable	100	60
Cash in hand	300	500
Cash at bank	<u>1290</u>	<u>780</u>
	<u>8950</u>	<u>7770</u>
Liabilities	Sh “000”	Sh “000”
Contributed capital	2600	2200
Reserve and surplus	660	100
15% debentures	2000	1800
Deferred tax liability	600	500
Sundry creditors	400	600
Wages outstanding	40	20

Income Tax Payable	400	450
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Accumulated depreciation on

Plant and equipment	900	800
Land and buildings	600	100
Provision for dividend	<u>800</u>	<u>800</u>
	<u>8,950</u>	<u>7,770</u>

Income statement for XYZ Ktd for the year ended 31/12/2015

Sh “000”

Sales revenue	45,000
Less: cost of goods sold	<u>(38,920)</u>
Gross profit	6,580

Less: **Expenses**

Depreciation	570
Selling and administration expenses	3200
Interest expense	300 (<u>4070</u>)
	2510
AAdd:Income from tax expenses	80
Dividend income	100
Insurance settlement received	10
Profit on sale of equipment	20
Profit before tax	2720
Less: Income tax expenses	(600)
Net profit	<u>2120</u>

Additional information

- 15 % of sh.200 was redeemed during Year 2015
- Equipment costing Sh.500 having an accumulated depreciation of sh.420 was sold for sh.100

- c) During the year 2015 sh 1560 (including interim dividend of sh.760) was distributed as dividends

Required:

Prepare a cash flow statement as required under IAS7 using indirect method (15 marks)

b) when doing financial statement analysis, how can you conclude the financial statement have been compromised (5 marks)

QUESTION THREE

The following are the financial statements of Kakamega Ltd. For the year ended 31st December, 2005.

Statement of Financial Position as at 31st December,2005:

	Sh.		Sh.
Cash.	480,000	Trade creditors	860,000
Debtors	640,000	Short-term notes Payable	840,000
Stock	2,080,000	Long-term debt	1,600,000
Equipment	1,600,000	Shareholders' equity	1,500,000
	<u>4,800,000</u>		<u>4,800,000</u>

Income Statement for the year ended 31st December,2005

	Sh.	Sh.
Sales		6,000,000
Less: Cost of sales		3,600,000
Gross profit		2,400,000
Deduct: Selling expenses	600,000	
Administrative & gen. Expenses	1,120,000	
Interest charges	235,600	
Profit before taxation	444,400	
Taxation	177,760	
Net profit	<u>266,640</u>	

The following industry ratios are also provided to you:

Industry Averages

Current ratio	2.5 times
Acid test ratio	1.1 times
Stock turnover ratio	2.4 times
Total assets turnover ratio	1.4 times
Times interest earned ratio	3.5 times
Net profit margin	4.0 %
Return on investment	5.6 %
Total assets to shareholders equity	3.0 %

Return on shareholders equity 16.8 %

Required:

- a) Calculate the ratios shown above for Kakamega Ltd.(14 marks)
- b) Comment upon the following about Kakamega Ltd averages(6 marks)
 - i) Liquidity position
 - ii) Financial risk
 - iii)Overall performance

QUESTION FOUR (20 MARKS)

The following information relates to Laki Manufacturing Company for the month of September 2013.

Opening stock were 500 units at £ 100 each

Purchases

6th Sep 100 units @ 105 each

20th Sep 600 @ £ 110 each

21st Sep 400 @ £ 108 each

23rd Sep 1000 units @ £ 112 each

30th Sep 200 units @ 110 each

Sales

9th Sep 100 units @ £ 108 each

15th Sep 300 units @ £ 110 each

22nd Sep 400 units @ £ 106 each

24th Sep 250 units @ 115 each

28th Sep 200units @ £ 114 each

29th Sep 200 units @ £116 each

Required

- i. Record the above transactions assuming the business uses continuous records under LIFO and weighted average methods. (12 marks)
- ii. Using the two methods above, prove that different stock valuation methods have different impact on profit. (5 marks)
- iii. As per the international financial reporting standard No 2 (MRS 2), explain how the stocks are valued. (3 marks)

QUESTION FIVE

- a) one of the major concerns in analysis of financial statements is identifying whether the institution has any asset that is potentially impaired.explain how you Can identify a potentially impaired asset (5 marks)
- b) Explain the statement that different stock valuation methods result to a different value of profit. Give atleast one example . (5 marks).
- c) Explain the following terminologies as used in the preparation of cashflow statements.Give examples in each case. (10 marks)
 - Cash flow from operating activities
 - Cashflow from investing activities
 - Cash flow from financing activities.