MACHAKOS UNIVERSITY

University Examinations for 2016/2017 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARMENT OF BANKING, ACCOUNTING & FINANCE

FOURTH YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF COMMERCE

BAC 407: FINANCIAL STATEMENT ANALYSIS

DATE: 31/7/2017 **TIME: 2 HOURS**

INSTRUCTIONS:

Answer Question One and Any Other Two Questions

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Explain the significance of Analysis of Financial Statements. (3 marks)

b) Financial Statement Analysis is useful and significant to different users. Identify FIVE of such users and indicate in which ways, is financial analysis useful to them. (5 marks)

c) The following are the financial statements of Alpha Ltd for the year ended 31st December 2015. Statement of Financial Position as at 31st Dec.2015.

	Sh.”000”		Sh.”000”
Cash	480,000	Trade creditors	860,000
Debtors	640,000	Short term notes	840,000
Stock	2,080,000	Long term debt	1,600,000
Equipment	1,900,000	Shareholder’s equity	2,000,000
Motor Vehicles	1,200,000	Retained earnings	1,000,000
	6,300,000		6,300,00

Income Statement for the year ended31st 2015:

	Sh.''000''	**Sh.''000''**
Sales		6,000,000
Less: cost of sales		3,400,000
Gross profit		2,600,000
Less selling expenses	600,000	
Admin & general expenses	1,120,00	
Interest charges	235,600	1,955,600
Profit before tax		644,400
Taxation		177,760
Net profit		466,640

Additional information:

The firm has 100,000 ordinary shares. The current market price per share is Sh.25.

Required:

Using Altman's Z-Score assess the firm's probability of failure. (10 marks)

d) The following information is relevant to Ngonda Ltd as at the end of the financial year just ended Dec.2014

Profit after taxes at 50% Sh. 1,084,000

Ordinary dividend paid 20%

The market price of ordinary shares Sh. 8.00

Total capital commitments Sh. 480,000

Issued Share capital:

7% preference shares@2.00 each Sh.1,200,000

Ordinary shares of Sh.2.00 each Sh.3,200,000

Required:

i) Calculate the dividend yield on the ordinary shares and explain fully the usefulness of this yield. (3 marks)

ii) Dividend covers for both ordinary and preference shares (4 marks)

iii) Earnings yield. (3 marks)

iv) Price Earnings ratio (2 marks)

QUESTION TWO (20 MARKS)

The following financial statements relate to XYZ Company

Assets	**Shs**	**Liabilities and net worth**	**Shs**
Cash	28,500	Trade creditors	116,250
Debtors	270,000	Notes payable (9%)	54,000
Stock	649,500	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 31/03/2005

	Shs.
Sales	1,972,500
Less: Cost of goods sold	1,368,000
Gross profit	604,500
Selling and administration expenses	498,750
Earnings before interest and tax	105,750
Interest expense	34,500
	71,250
Estimated taxation (40%)	28,500
Earnings after interest and tax	42,750

a) **Required:** calculate:

i) Current ratio and return on equity (2 marks)

ii) Inventory turnover ratio (2 marks)

iii) Time interest earned ratio (2 marks)

iv) Total assets turnover (2 marks)

v) Net profit margin (2 marks)

b) The above company operates in an industry whose norms are as follows:

Ratio	Industry norm
Inventory turnover	6.2 times
Time interest earned ratio	5.3 times
Total Assets turnover	2.2 times
Net profit margin	3%

Required:

Comment on the revelation made by the ratio that you have computed on part (a) above, when compared with industry average. (4 marks)

c) Explain the following ratios giving their importance and how they are computed. (6 marks)

i) Return on capital employed

ii) Acid test ratio

iii) Gearing ratios

iv) Collection period of debtors.

QUESTION THREE (20 MARKS)

K.LTD entered into an agreement to lease a motor vehicle from M.LTD:

Cash price for the vehicle was sh.100,000 and the lease payments were to done in 5 installments of Sh.25,710. This amount was to be paid in arrears.

Required:

i) Determine how much of this finance charge will appear in each year's profit and loss as an expense.

ii) Determine the implicit rate of interest using the actuarial method.

iii) Determine the outstanding liability and establish the finance charge for each year.

iv) Prepare the necessary accounts in the books of the lessee.

QUESTION FOUR (20 MARKS)

Your client is interested in acquiring a 30% shareholding in the ordinary share capital of Kumekucha Ltd, a private company. The following is the latest balance sheet of the co. as at 31st August 2006.

	Shs.	Shs.
Fixed Assets		
Freehold property at cost		555,000
Plant and Machinery	1,530,000	
Less: depreciation to date	450,000	1,080,000
		1,635,000
Current Assets		
Stock	1,515,000	
Debtors	2,055,000	

Cash		630,000		
		4,200,00		
Current liabilities				
Creditors	2,661,000			
Taxation	570,000			
Proposed dividend	234,000	(3,465,000)		735,000
Net assets			2,370,000	
Financed by:				
Authorized and issued share capital:				
22,500 10%preference share@Shs.20			450,000	
22,500 10%preference shares@.20			450,000	
Profit and loss account			750,000	
12% debentures 2005/10			720,000	
			2,370,000	

You are also given the following information;

Year ending	**Net profits**	**Rate of dividend**
2004	Shs. 810,000	Nil
2005	Shs. 573,000	25%
2006	Shs. 1,196,250	45%
2007	Shs. 1,350,000	Directors forecast

A professional valuation estimated that the current market value of freehold property is at Shs930,000. The plant and machinery is considered fairly valued at net book figures. Debentures are secured by a fixed charge. The Directors have anticipated that, it will be their policy for the foreseeable future to retain 75% of the available profit. The corporation tax rate is 35%.

Required:

a) Compute a value for the 30% holding in the ordinary shares of the company using:

   i) The dividend yield method. Assume a dividend yield of 20% gross. (4 marks)

   ii) Net Asset Basis. (5 marks)

   iii) Price-earnings ratio basis. Assume a price earnings ratio of 2.5. (5 marks)

b) State three factors which would affect the dividend yield required by the potential investors in Kumekucha Ltd. (6 marks)

QUESTION FIVE (20 MARKS)

Cool company uses a perpetual inventory system for its one product. Its beginning inventory, purchases and sales during the year 2011were as follows:

Date	Activity	units acquired @cost		Units sold at retail	Units inventory
Jan.1	Beg. inventory	400@1,400=560,000			400
Jan.15	Sales			200units@3,000	200
March10	Purchases	200@1,500=300,000			400
April1	Sales			200units @3000	200
May 9	Purchases	300@1,600=480,000			500
Sept.22	Purchases	250@2,000=500,000			750
Nov.1	Sales			300units@3,500	450
Nov.28	Purchases	100@2100=210,000			550
	Total	1250 units	2,050,000	700units	

Required:

a) Calculate the cost of goods available for sale. (3 marks)

b) Applying LIFO and WAM methods, calculate closing inventory and cost of goods sold under each method. (14 marks)

c) Compute the gross profit earned by the company for each of the two methods. What is the effect of each method on the gross profit? (3 marks)