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 COMMERCE

BAC 407: FINANCIAL STATEMENT ANALYSIS

DATE: 27/9/2019 **TIME: 2:00 – 4:00 PM**

INSTRUCTIONS: Attempt Question One and any other Two Questions

QUESTION ONE

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:	79,000	42,000
Cash	65,000	96,000
Short-term investments	120,000	100,000
Accounts receivable, net	250,000	265,000
Inventory	514,000	503,000
Total Current Assets		
Plant Assets:	400,000	350,000
Store equipment, net	45,000	50,000
Office Equipment, net	625,000	675,000
Buildings, net	100,000	
Land	1,170,000	100,0001,175,000
Total plant assets	1,684,000	1,678,000
Total Assets		
Liabilities:		
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	400,000	420,000
Buildings)	665,000	712,000
Total Liabilities		
Stockholders' Equity	475,000	475,000
Common Stock, Shs.50 par value	544,000	491,000
Retained Earnings	1019,000	996,000
Total Stockholders' Equity	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) Compute the following ratios for the year ended 31 December 2015.
   - Current ratio
   - Acid test ratio
   - Accounts receivable turnover
   - Days' sales uncollected
   - Inventory turnover

- Debt ratio
- Debt to equity ratio
- Times interest earned ratio
- Profit margin ratio
- Total Assets turnover
- Return on total Assets
- Return on common stockholders' equity.
  (6Marks)

d) Based on the results of (a), (b) and (c) above, comment on the financial health of Precision Co. Ltd. (6 marks)

QUESTION TWO (20 MARKS)

The following information relates to Lake Universal Traders Ltd. for the month of September 2016.

Opening stock were 500 units at £ 100 each

Purchases	Sales
6th Sep 100 units @ 115 each	9th Sep 100 units @ £ 118 each
20th Sep 600 @ £ 120 each	15th Sep 300 units @ £ 120 each
21st Sep 400 @ £ 118 each	22nd Sep 400 units @ £ 116 each
23rd Sep 1000 units @ £ 122 each	24th Sep 250 units @ 125 each
30th Sep 200 units @ 120 each	28th Sep 200units @ £ 124 each
	29th Sep 200 units @ £126 each

Required

i. Record the above transactions assuming the business uses continuous records under LIFO c and weighted average methods. (12 marks)

ii. Using the two methods above, prove that different stock valuation methods have different impact on profit. (8 marks)

QUESTION THREE

The following is a summarised balance sheet of XYZ Co. Ltd. 31st Dec 2015.

Balance sheet of XYZ Ltd.

	31st Dec 2015
Assets	**Sh "000"**
Plant and equipment	2000
Land and buildings	1000
Short tem investments	560
Sundry debtors	2200
Inventories	1500
Interest receivable	100
Cash in hand	300
Cash at bank	1290
	8950

Liabilities	**Sh "000"**
Ordinary Share capital	2600
Reserve and surplus	660
15% debentures	2000
Deffered tax liability	600
Sundry creditors	400
Wages outstanding	40
Income Tax Payable	400
Accumulated depreciation on	
Plant and equipment	900
Land and buildings	600
Provision for dividend	800
	8,950

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

	Sh "000"	
Sales revenue	45,000	
Less: cost of goods sold	**(38,920)**	
Gross profit	6,580	

Less: **Expenses**

Depreciation	570	
Selling and administration expenses	3200	
Interest expense	300	(4070)
		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	2120	

Additional information

a) 15 % of sh.200 was redeemed during Year 2015
b) 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 divindends
d) Market Value of Equity is Shs.3,000,000

Required:

(i) Using the Altmans Z-score model assess the financial health of the company. (16 marks)

(ii) Based on your results above how would you advice an investor who was in a dilemma about investing in XYZ Co. Ltd? (4 marks)

QUESTION FOUR

a) The information below relate to Excell ltd. For the Financial Year ended 31 December 2017.

Profits after taxes (at 50%)	Shs.1084,000
Ordinary Dividend paid	20%
The Market price of ordinary shares	Shs.80

Issued Share Capital

7% Preference Shares of Shs.20 each,	Shs.1,200,000
Ordinary Share s of Shs.20 each,	3,200,000

Required:

Calculate

i) Dividend Cover for Preference shares (3 marks)

ii) Dividend Cover for ordinary shares (3 marks)

iii) EPS (3 marks)

iv) Price Earnings Ratio (3 marks)

b) Give and explain briefly four examples of expense recognition errors or interpretations that can distort comparability or mistake profitability. (8 marks)

QUESTION FIVE (20 marks)

a) ABC ltd has 2 000,000 ordinary shares of Sh.10 each fully paid on 1st January 2015, the company issued a further 1 000,000 shares of Sh.10 each at a market price of Sh. 15 each. As at 31st December 2015 the shares were 50% paid up. The average market price per share during the year was Sh. 20. The net profit for the year 2015 was Sh.8m.

Required:

i) Basic EPS (5marks)

ii) Diluted EPS (5 marks)

b) Corporate failure means a company ceasing 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, in ability to compete, or even insufficient marketing.

Identify and explain five symptoms of normal business failure. (10 marks)