



MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

SECOND YEAR FIRST SEMESTER EXAMINATION FOR

MASTER OF BUSINESS ADMINISTRATION

BAC 819: FINANCIAL ANALYSIS

DATE: 18/8/2021

TIME: 9.00-12.00 PM

INSTRUCTIONS:

- *Answer any FOUR Questions*

QUESTION ONE

The Kenyan steel company produces metal fabrications for the motor industry. Early in quarter three, the CEO sent the following MEMO to the Commercial director.

TO: Peter Kaindi

FROM: John Maina

SUBJECT: Accounting policies and adjustments

Quarter two was a difficult period for us, and the outlook for the coming quarters is likely to be a continuation of hard times. We seem to have hurt our performance by following some accounting policies that I think are not appropriate. These are as follows:

- 1) Several years ago you convinced me to change from FIFO to LIFO inventory method. Since inflation is now down, and balance sheet strength is important; I estimate we can improve our performance by returning back to FIFO in third quarter. This adjustment is real and crucial for the company.
- 2) We depreciate most fixed assets over estimated life using accelerated methods and shorter life of assets. A switch to straight line will be good for our balance sheet and even leverage our profitability in coming quarters if business picks up.
- 3) Due to change in accounting rules, the company is required to capitalize software costs rather than expense them as they occur.

These actions would favorably affect our performance as shown in the pro forma income statement. Please give your reaction to my proposal.

Yours sincerely, CEO.

	Kenyan steel company Pro forma Income Statement		
	Kshs. Mills	Actual	
	Quarter 1	Quarter 2	Quarter 3 (Estimate)
Net Sales	50.6	42.3	29.0
Net Income (loss)	2.0	(5.7)	0.7
Net profit margin	4.0%	-	0.3%
Dividends	0.7	0.6	0.0
Return on assets	11.3%	-	0.4%
Shareholders' equity	17.1	11.4	11.5
Book value/ share	78	66	76

Required:

- i. Assume you are Peter Kaindi, assess each of the CEO's proposals for accounting adjustments on account of their reasonableness and acceptance. (5 marks)
- ii. Evaluate and assess the effect of each proposed accounting or business decision on earnings. Do you agree with the CEO? Justify your answer. (5 marks)
- iii. Explain the difference between accounting distortion and earnings management, by assessing the CEO's proposals and intent (to distort or manage earnings). (6 marks)
- iv. Discuss each proposal and conclude on potential effect of each proposal on the steel company's reporting of operating results. Support your answers with quarter 3 estimates. (9 marks)

QUESTION TWO (25 MARKS)

- a) KOKA Company and KOLA Company are similar firms that operate in the same industry. A bank is evaluating the two companies so that it can lend one of them money (only one company can get the money). As a hired analyst, you have come up with the following summary ratio analysis for three years.

Financial Ratio	KOKA			KOLA		
	2012	2013	2014	2012	2013	2014
Year Ended 31 December						
Current Ratio	2.0	1.7	1.6	1.8	2.6	3.1
Acid Test Ratio	1.1	1.0	0.9	1.5	2.4	2.7
Account Receivables Turnover	28.2	24.2	29.5	15.0	14.2	15.4
Inventory Turnover	16.1	20.9	23.2	11.6	12.0	13.5
Cash to Income	9.2	12.3	11.7	22.8	27.6	23.7
CFO to Total Liabilities	18.3	15.6	17.9	42.9	44.6	46.2

Required:

Write a ONE-page report comparing Koka and Kola companies using available information.

Identify the company that you consider a better investment for the bank loan and explain why? Your discussion should include liquid, asset efficiency and short term credit risk.

(10 marks)

- b) Traditionally, accounting has used the historical cost concept for measuring and recording the values of assets and liabilities. However, standard setters (IFRS) are increasingly moving to an alternative form of recording assets/liabilities values based on the concept of fair value.

Required:

- i. Discuss the conceptual difference between historical and fair value accounting. (6 marks)
- ii. State and explain one key limitation of each measurement base. (4 marks)
- iii. Which of the two measurement bases reports accounting numbers that have representational faithfulness and why? (5 marks)

QUESTION THREE (25 MARKS)

a) The following is a Horizontal Common-size statement of Income for MAN.

MAN Consolidated Statement of Income				
Item	Year ended June 30,	2014	2013	2012
Revenue		121.0	108.8	100
Cost of sales		120.2	109.8	100
Gross Margin		117.1	107.7	100
Selling & Adm exp		119.1	106.1	100
Interest exp (net)		n/a	n/a	n/a
Others (net)		n/a	n/a	100
IBIT		118.3	115.2	100
Income taxes		109.3	115.6	100
Net Income		123.1	114.9	100

Required:

- Evaluate the performance of MAN by providing key highlights (9 marks)
- b) “The external auditor’s opinion is an integral part of the financial statements”. Explain the value of auditor’s information in enhancing decision usefulness of financial statements. (6 marks)
- c) A comparison of a Company’s performance over-time can be done by computing absolute Shilling changes between periods or percentage changes. Which one is generally a better measure of change and why? (5 marks)
- d) Identify and explain any three fundamental shortcomings of using the Balance Sheet to summarize the values of all assets owned by an enterprise. (5 marks)

QUESTION FOUR (25 MARKS)

a) You are provided with the following relating to Over the Counter Ltd

Over the Counter Ltd. Summary Profit statements 2014 – 2016

	Kshs. '000		
	2014	2015	2016
Sales	250	280	300
Less: Cost of sales	<u>170</u>	<u>180</u>	<u>210</u>
Gross profit	80	100	90
Less: Operating Expenses and depreciation	40	45	50
Net profit before tax	40	55	40
Less: Taxation	15	20	17
Net Profit after tax	25	35	23
Less: dividends	10	10	7
Retained profit	15	25	16
Industry average (Turnover)	250	300	350
Current ratio	1.5	1.8	1.1
Debt Ratio (%)	38	40	45

REQUIRED

- a) Prepare a common-size inter-period analysis (Horizontal & Vertical) of these statements and evaluate significant changes in the company's performance through each analysis. (10 marks)
- b) Which analysis lends itself to easy interpretation, discuss (5 marks)
- c) Assume OTC company wants a revolving credit of Kshs. 10 million. Should this loan be made? Undertake a credit risk analysis. (10 marks)

QUESTION FIVE (25 MARKS)

- a) An analyst collected performance data of two Smartphone companies for the last six years. Use the financial information to answer the following questions.

Samsung (in Millions Korean Won – KRW)

Year Ended 31 December	2009	2010	2011	2012	2013	2014
Revenues	7,759	12,327	18,243	25,265	31,888	31,168
Gross profit	1,666	2,722	4,106	5,218	6,443	5,746
Net Income	518	944	1,460	1,666	2,177	1,246

Huawei (in Millions USA – \$)

Year Ended 31 December	2009	2010	2011	2012	2013	2014
Revenues	9,833	7,081	5,941	6,134	7,983	5,363
Gross profit	968	1,368	1,479	1,781	2,250	1,337
Net Income	-816	-1,045	309	601	786-25	

REQUIRED:

Compute both growth analysis and trend analysis and therefore Evaluate the results of the Phone Companies (14 marks)

- b) Write short notes on following concepts:
- Management discussions & analysis (MD&A) (5 marks)
 - Accounting policy disclosure (3 marks)
 - Vertical analysis (3 marks)