MACHAKOS UNIVERSITY

University Examinations 2021/2022 Academic Year

SCHOOL OF BUSINESS, ECONOMICS AND HOSPITALITY AND TOURISM MANAGEMENT

DEPARTMENT OF BUSINESS ADMINISTRATION AND FINANCE

FOURTH YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF COMMERCE (FINANCE OPTION)

BACHELOR OF ECONOMICS AND FINANCE

BAC 407: FINANCIAL STATEMENT ANALYSIS

DATE: 22/8/2022 **TIME: 8.30-10.30 AM**

INSTRUCTIONS

- Answer question **ONE (Compulsory)** and any other **TWO questions**

QUESTION ONE (COMPULSORY) (30 MARKS)

a) The following is a summarized income statement of a particular company for the year ended 31st December 2018

	Sh
Profits after tax	5,000,000
Less minority interest	(500,000)
	4,500, 000
Less preference dividends	(720,000)
	3,780,000
Less ordinary dividends	(1000,000)
Retained profit for the year	2,780,000

As at 1st Jan 2018, the company had 700,000 ordinary shares of sh.10 each and 400,000 cumulative preference shares of sh.10 each. The company made a bonus issue of one ordinary share for every 5 ordinary shares held on 31st march 2018.the earnings per share of 2017 was sh 2.50.

Required

i. Basic earnings per share (3 marks)

ii. Restated earnings per share. (4 marks)

b) The following information relates to EXCELL limited for the financial year ended 31st December 2017.

Profits after taxes	Sh 1,084,000
Ordinary dividend paid	20%
The market price of ordinary shares is	Shs. 80

Issued share capital

7% Preference shares of Shs 20 each	shs 1,200,000
Ordinary shares of shs 20 each	shs 3,200,000

Required; calculate

i. Earnings per share. (3 marks)

ii. Price earnings ratio. (2 marks)

iii. Dividend cover for preference shares. (2 marks)

iv. Dividend cover for ordinary shares. (2 marks)

c) Distinguish between a financial lease and an operating lease (4 marks)

d) As a financial statement analyst, you have the duty to examine the income statement for accounting risk. State four questions or issues to consider when determining whether expenses are understated. (2 marks)

e) Assume that as a financial analyst registered as Kamau and associates got a contract to examine the books of Baraka Company limited of p.o box 10300-00100 Nairobi Kenya for the last five years 2016-2020.During the examination, you discover that ;

i. The accounts have not been prepared in accordance with the IFRS

ii. In your opinion, the accounts don't show a true and fair view for the purpose of the prospectus.

iii. No accounts have been submitted to the members of the company subsequent to 31st Dec 2020

iv. That you have been the auditors of the company for the last four years ended 31st Dec 2017

v. With respect to the accounting policies, you discover that the accounts have been prepared on historical cost basis, inventories have been valued at the lower of cost and net realisable value, non-current assets have been depreciated at reducing balance basis at the following rates: plant and machinery @10%, motor vehicles @15%, turnover represents the sales which is the net aggregate amount receivable for goods supplied net of VAT.

vi. In the notes to the accounts, the management has also stated that: freehold property had been revalued upwards by ksh 20m ,that on 2nd Jan the company issued 300,000 ordinary shares of sh 10 each, that the company maintained a constant dividend pay-out ratio of 5% throughout the five year period.

Required

From the above information write an accountants report in relation to the prospectus. (8 marks)

QUESTION TWO (20 MARKS)

a) The following information was extracted from the accounts of Baraka Ltd, for the year ended 31st December 2017. Comparable figures for the previous year are also shown.

Profit statement for the year ended 31st December.

	2017	2016
	Sh.000	**Sh.000**
Sales	115,200	72,000
Cost of sales	(70,800)	(42,000)
Gross profit	44,400	30,000
Less trading expenses	(19,800)	(16,200)
	24,600	**13,800**
Less debenture interest	(900)	(900)
Net profit before taxation	23,700	12,900
Less corporation tax	(11,520)	(5760)
Net profit after taxation	12,180	7,140
Less ordinary share dividend	(6,300)	(4500)
Undistributed profit for the year	**(5,880)**	**(2640)**

Statement of Financial Position as at 31 December				
		2017		**2016**
		Sh. 000		**Sh. 000**
Fixed assets at cost		44,400		33,600
Depreciation		(9000)		(7200)
		35,400		26,400
Current Assets				
Inventory	19,800		14,400	
Accounts receivable	12,600		9,000	
Cash	32 400		26,280	
		67,800	52,680	
Less Current Liabilities				
Accounts payable	7,200		5,220	
Taxation	11,520		5,760	
Proposed dividends	6,300		4,500	
Bank Overdraft	2,340	(27,360)		(15,480)
		75,840		63,600
Financed by:				
Ordinary share capital:		18,000		18,000
Undistributed profits		16,080		10,200
		34,080		28,200
Long-term loan:		35,400		26,400
10% Debentures (secured)		6,360		9,000
		75,840		63,600

Required:

a) Compute the following ratios for each year:

i. Gross profit margin, (1 mark)

ii. Return on capital employed, (1 mark)

iii. Quick ratio (1 mark)

iv. Debtors turn over (1 mark)

v. Debt equity ratio. (1 mark)

vi. Current ratio (1 mark)

vii. Net profit margin (1 mark)

viii. Fixed asset turn over (1 mark)

ix. Return on ordinary shareholders equity (1 mark)

b) Interpret the above ratios using trend analysis (5 marks)

c) State five limitations of ratio analysis. (5 marks)

QUESTION THREE (20 MARKS)

The summarized financial statements of Beta Company limited for the year ended 30th June 2008 and 30th June 2009 were as follows;

Income statement for the year ended 30th June

	2008	2009
	Sh'000"	Sh"000"
Sales	240,000	320,000
Cost of sales	180,000	231,000
Gross profit	60,000	89,000
Operating expenses	(20,000)	(29,600)
Profit from operations	40,000	60,000
Interest payable	(4,000)	(8,000)
Net profit before tax	36,000	52,000

Statement of financial position as at 30th June.

	2008	2009
	Sh"000"	sh"000"
Non-current assets at cost	280,000	288,000
Accumulated depreciation	(70,000)	(43,200)
	210,000	244,800
Current assets		
Inventory	72,000	80,000
Trade receivables	80,000	84,000
Prepaid expenses	16,000	15,200
	168,000	179,200
Total assets	378,000	424,000
	2008	**2009**
	Sh"000"	sh"000"
Equity and liabilities.		

Capital and reserves		
Ordinary shares of sh 20 each	160,000	160,000
Share premium	22,000	22,000
General reserves	32,000	36,000
Retained earnings	28,000	34,000
	242,000	252,000
Long term liabilities		
10% debentures	40,000	80,000
Current liabilities		
Trade payables	64,000	68,000
Bank overdraft	32,000	24,000
	136,000	172,000
Total equity and liabilities	378,000	424,000

From the above financial statements, you are required to;

i. Prepare comparative income statements showing the % ge increase or decrease for the year 2009. (8 marks)

ii. Prepare common size balance sheets for the year 2009. (8 marks)

b) As a financial statement analyst, how can you identify a potentially impaired asset.(4 marks)

QUESTION FOUR (20 MARKS)

a) As a financial statement analyst, how can you conclude that financial statements have been compromised (4 marks)

b) 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 "000"
Sales	12,000
Less: Cost of goods sold	6000
Less: Selling and administration costs	(3500)
Less: Selling and administration costs	(1000)
EBIT	1500
Less: Interest expense	(1100)
EBT	400

Less: taxes	(120)
Profit for the year	280

STATEMENT OF FINANCIAL POSITION AS AT 31/12/2016

CURRENT ASSETS	Shs **"000"**
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**
200,000 8% Preference shares of sh 5.00 each	1,000
500,000 Ordinary shares of sh 2.00 each	1,000
Share premium	2000
Retained earnings	1400
	21400

The firm has 500,000 ordinary shares and the current market price per ordinary share is sh 5.00.

Required

Using the Altman's Z-SCORE, assess the firm's probability of failure and interpret the results. (10 marks)

c) State and briefly explain the three types of corporate failure (6 marks)

QUESTION FIVE (20 MARKS)

a) XYZ Ltd specializes in the whole selling of chicken feed. It has 5 employees and each gets a monthly wages and salaries amounting to sh.6, 400. The company owns a lorry bought two years ago at a price of sh.200, 000. The current book value of the lorry is sh.110, 000. The company uses straight line method of depreciation. All other expenses amount to sh.6, 000 per month. During the month of November 2017, the company had the following transactions.

PURCHASES **SALES**

DATE	BAGS RECIEVED	PRICE	VALUE	DATE	BAGS SOLD	PRICE	VALUE
NOVEMBER 2017		Shs	Shs	NOVEMBER 2017		Shs	
2nd	600	150	90,000	8th	400	170	68,000
10th	800	165	132,000	15th	600	180	108,000
24th	900	170	153,000	26th	900	200	180,000
27th	700	180	126,000	30th	600	?	120,000

NB: There was an opening stock of 500 bags valued at sh.70, 000 each bag been bought at sh.140

Required

a) Prepare stores ledger cards using the following stock valuation methods: -

- FIFO valuation method. (6 marks)
- LIFO valuation method. (6 marks)

b) Prove that different stock valuation methods give rise to different profit by preparing income statements based on the two method (4 marks)

c) 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)