GARISSA UNIVERSITY

UNIVERSITY EXAMINATION 2017/2018 ACADEMIC YEAR THREE FIRST SEMESTER EXAMINATION

SCHOOL OF BUSINESS AND ECONOMICS

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 314

COURSE TITLE: FINANCIAL STATEMENT ANALYSIS

EXAMINATION DURATION: 3 HOURS

DATE: 07/12/17   TIME: 09.00-12.00 PM

INSTRUCTION TO CANDIDATES

- **The examination has FIVE (5) questions**

- **Question ONE (1) is COMPULSORY**

- **Choose any other THREE (3) questions from the remaining FOUR (4) questions**

- **Use sketch diagrams to illustrate your answer whenever necessary**

- **Do not carry mobile phones or any other written materials in examination room**

- **Do not write on this paper**

This paper consists of SIX (6) printed pages   *please turn over*

QUESTION ONE (COMPULSORY)

(a) Financial Statement Analysis is the process of critically examining in detail, accounting information given in financial statements and reports. Highlight the 6 steps followed in financial statement analysis. **[6 Marks]**

(b) Briefly describe the specific objectives of analyzing financial statements. **[5 Marks]**

(c) Discuss the interests of the following parties on financial statements

    i.   Customers **[3 Marks]**

    ii.   Lenders **[3 Marks]**

    iii.   Employees **[3 Marks]**

(d) Identify using examples at least FIVE indicators of financial distress **[5 Marks]**

QUESTION TWO

The 2016 financial statements for Nguvu Nyingi Limited is summarized below:

Nguvu Nyingi Ltd.

Ksh. 000

Statement of financial position

Assets

Cash	35,000
Accounts receivable (net)	40,000
Inventory	100,000
Intangible assets	85,000
Property, plant and equipment (net)	140,000
Total assets	400,000

Liabilities and Equity

Accounts payable	100,000
Long-term debt (10%)	60,000
Share Capital (par Ksh.10)	150,000
Share premium	30,000
Retained earnings	60,000
Total liabilities and stockholder's equity	400,000

	Ksh.000

Statement of comprehensive income

Sales revenue ($^1/_3$ on credit)	450,000
Cost of goods sold	(245,000)
Expenses (including interest and income tax)	(160,000)
Net income	45,000

Selected data from the 2015 statements   **Ksh.000**

Accounts receivable (net)	20,000
Inventory	92,000
Long-term debt	60,000

Other data

Par share price at end of 2016 (offering price)	Ksh. 18
Average income tax rate	30%
Dividends paid in 2016	36,000,000

Required:

A client of yours has the opportunity to buy 10 per cent of the shares in the company at the par share prices given and has decided to invest in one of the companies.

a) Using the data provided above, compute the following ratios;

i.	Working Capital Ratio	**[1 mark]**
ii.	Current Ratio	**[1 mark]**
iii.	Quick Ratio or Acid Test Ratio	**[1 mark]**
iv.	Average Collection Period	**[1 mark]**
v.	Accounts Receivable Turnover	**[1 mark]**
vi.	Debt to Equity Ratio	**[1 mark]**
vii.	Profit Margin (Return On Sales Ratio)	**[1 mark]**
viii.	Total Assets Turnover	**[1 mark]**
ix.	Return on Total Assets (ROA)	**[1 mark]**
x.	Return on Common Stock Holders' Equity(ROE)	**[1 mark]**

b) Describe the major limitations of Financial Ratio Analysis   **[5 Marks]**

QUESTION THREE

(a) Outline the common causes of business failure **[5 Marks]**

(b) The following are summarized financial statements of Shida Products Ltd., which is facing financial difficulties:

Income statement for financial year ended 31 December 2016 **(Figures in Sh. "000")**

Turnover	1,209,000
Earnings before interest and tax (EBIT)	84,000
Interest	(39,000)
Profit before tax	45,000
Less tax	(15,000)
Profit after tax (PAT)	30,000
Dividends	(33,000)
Retained earnings	(3,000)

Statement of financial position as at 31 December 2016 **(Figures in Sh. "000")**

ASSETS

Non - current assets (Net book value)

Land and buildings		411,000
Plant & machinery		284,000
Others		96,000
Current assets		
Inventory	303,000	
Trade receivables	63,000	
Bank balance	9,000	375,000
Total assets		**1,266,000**

EQUITY & LIABILITIES

Ordinary share capital (Sh.25 each)		147,000
Retained earnings		222,000
		369,000
Current liabilities		
Trade payables	381,000	
Taxation	15,000	
Dividends	24,000	420,000
Long term liabilities		
Bank Loan		183,000
10% debentures		294,000
Total equity and liabilities		**1,266,000**

Additional information:

i. Corporation tax rate is 30%

ii. The company's shares are currently trading at shs.30 per share at the securities exchange

iii. The company's cost of capital is 12%

iv. Interest rate on the bank loan is 12%

The Altman's model for predicting corporate failure is as follows

$Z = 1.X1 + 1.4X2 + 3.3X3 + 0.6X4 + X3$

Where:

X1 = Net working capital/ Total assets

X2 = Retained Earnings / Total assets

X3 = EBIT/Total assets

X4 = Market value of equity /Book value of debt

X5 = Revenue/Total assets

Required:

The company's Z score. Comment on the results **[10 Marks]**

QUESTION FOUR

(a) Discuss the role of Regulatory authorities in the provision of financial statement information

[5 Marks]

(b) Express the following data in percentages using 2012 as the base year **[5 Marks]**

Year	2016	2015	2014	2013	2012
	Sh.million	Sh.million	Sh.million	Sh.million	Sh.million
Sales	1,015	980	910	805	700

(c) In the recent past we have witnessed corporations making voluntary disclosure of information. What would force the management to disclose more than the bare minimum requirement

[5 Marks]

QUESTION FIVE

(a) Discuss four limitations of financial statement analysis.   **[4 Marks]**

(b) State and explain any two differences between financial statement analysis and business analysis.

[4 Marks]

(c) Briefly explain the parties interested in analysis of financial statements.   **[7 Marks]**