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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR THREE**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 314**

**COURSE TITLE: FINANCIAL STATEMENTS ANALYSIS**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 24/08/2021 TIME: 09.00-11.00 AM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) 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 SEVEN (7) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. Financial analysis is a process by which an accountant or other interested parties identifies the financial strength or position of a company. Account for ‘other interested parties’ to financial statement information. (5 marks)
2. Highlight five indicators of financial distress. (5 marks)
3. Explain the impact of inflation on financial statements. (4 marks)
4. The following arc the statements of financial statements of Gau Ltd. as at 30. September 2019 and 30 September 2020

Gau Limited

Income Statement for the year ended 30 September 2019 and 2020.

 **2019**  **2020**

Net sales 660,000 580,000

Cost of goodwill 352,000 254,000

Gross profit 148,000 86,000

Operating expenses 79, 000 54,000

Net operating profit 79, 000 42,100

Interest expenses 45,000 35,000

Profit before tax 65,000 59,000

Provision for taxes 65,000 44,000

Profit after tax 60,000 45,000

Gau Limited

Statement of Financial Position for the year ended 30 September 2019 and 2020

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **2019** | **2020**  |  |  |
| **Assets**  |  | **Sh. “000”** | **Sh. “000”** |  |  |
| **Non-current assets:**  |  |  |  |  |
| Property, plant and equipment  | 38,180  | 57,612  |  |  |
| Investments available for sale  | 2,500 |  1,000 |  |  |
|  |  | 40,680  | 58,612 |  |  |
| **Current assets:**  |  |  |  |  |  |
| Inventories  |  |  8,280 | 10,350  |  |  |
| Trade receivables  |  | 40,140  |  5,038  |  |  |
| Cash in hand and bank  |  1,700  |  - |  |  |
|  |  | 14,120  | 15,388 |  |  |
| **Total assets**  |  | 54,800  | 74,000  |  |  |
| **Equity and liabilities:**  |  |  |  |  |
| Ordinary share capital  | 31,600  | 45.400  |  |  |
| Share premium  |  |  2,760  |  5,520  |  |  |
| Retained profit  |  |  6,900 | 11,040 |
|  |  | 41,260  | 61,960 |  |  |
| **Non-current liabilities:**  |  |  |  |  |
| 10% debentures  |  |  5,260  |  1,000  |  |  |
| **Current liabilities:**  |  |  |  |  |
| Trade payables  |  |  2,760  | 4,140  |  |  |
| Taxation  |  |  3,450  | 4,140 |  |  |
| Dividends  |  |  2,070  | 2,070  |  |  |
| Bank overdraft  |  |  - |  690 |  |  |
|  |  |  8,280 | 11,040 |  |  |
| Total equity and liabilities  | **54,800**  | **74,000** |  |  |

1. Prepare a comparative statement of financial position for Gau limited and make a brief comment. (10 marks)
2. Prepare a comparative income statement for Gau limited and make a brief comment. (6 marks)

**QUESTION 2**

1. Summarize four limitations of ratio analysis. (4 marks)
2. The following financial statements were extracted from the books of Fala Ltd. for the year**s** ended 31 December 2019 and 2020:

**Income statements for the years ended 31 December:**

|  |  |  |
| --- | --- | --- |
|  | **2019** | **2020** |
|  | **Sh. ‘000’** | **Sh. ‘000’** |
| Sales (all on credit) Cost of sales Gross profit ExpensesNet profitDividendsRetained profit Balance carried forward Balance brought forward | 200,000(120000)80,000(60,000)20,00020,000-25,00025,000 | 200,000(100,000)100,000(60,000)40,000(20,000)20,00025,00045,000 |

**Statements of financial position as at 31 December:**

|  |  |  |
| --- | --- | --- |
|  | **2019** | **2020** |
|  | **Sh. ‘000’** | **Sh. ‘000’** |
| **Non-current assets:** Land Plant and machinery at cost Buildings at cost Investments at cost **Current assets:** Inventory Trade receivables **Current liabilities:** Trade payables Proposed dividend Bank balance **Net current assets** **Net assets** Financed by: Ordinary share capital Share premium Revaluation reserve Revenue reserve 10% debentures  | 63,0006,00079,00080,000228,00065,00050,000115,00060,00020,0004,000(84,000)31,000259,00050,00014,00020,00025,000150,000259,000 | 44,0008,50060,00053,000165,50055,00040,00095,00040,00020,0002,500(62,500)32,500198,00040,00013,00045,000100,000198,000 |

**Additional information:**

1. Ordinary shares with a nominal value of Sh.1 0,000,000 were repurchased at a premium during the year. All necessary approvals were obtained for this transaction.
2. Part of the debentures was redeemed at par during the year.
3. Ignore taxation.

**Required:**

The following ratios for Fala Ltd. for the years ended 31December 2019 and 2020:

1. Gross profit margin. (2 marks)
2. Net profit margin. (2 marks)
3. Trade receivables turnover. (2 marks)
4. Acid test ratio. (2 marks)
5. Dividend cover. (2 marks)
6. Gearing ratio. (2 marks)
7. Return on capital employed (ROCE) (2 marks)
8. Compile brief report for the management on your interpretations of the performance of the company. (2 marks)

**QUESTION THREE**

1. In the recent past, the government has been aggressively wooing multinational companies to come and invest their resources in Kenya. Analyse the key decision areas that a financial analyst would have to advise a company that is considering making direct investment in Kenya and discuss the risks involved. (6 marks)
2. Briefly explain the important of cash flow statement to a business entity. (4 marks)
3. Stupid Ltd. has presented the following financial statements:

**Income statement for the year ended 31 August 2020**

|  |  |
| --- | --- |
|  | **Sh.** |
| Sales Cost of sales Gross profit Investment income Distribution cost Administrative expenses Operating profit Finance cost Profit before tax Income tax expense Profit for the year  | 11,510,100 (5,928,500) 5,581,60022,680 (1,963,680) ( 1,363,520) 2,277,080(316,000) 1,961,080 (631,480)1,329,600 |

**Statement of financial position as at 31 August:**

|  |  |  |
| --- | --- | --- |
|  | **2019****Sh.** | **2020****Sh.** |
| **Assets:** Non-current assets at cost Accumulated depreciation Net book value **Current assets:** Inventory Trade receivables Cash and cash equivalents **Equity and liabilities:** Ordinary share capital Share premium Revaluation reserve Retained earnings **Non-current liabilities:** 9% loan stock **Current liabilities:** Trade payables Taxation  | 26,100,540 (5,919,340) 20,181,2006,601,760 2,485,500 237,840 9,325, 100 29,506,3008,400,000 3,156,800 2,981,600 7,989,60022,528,0002,693,6003,802,200 482,500 4,284,700 29,506,300 | 21,410,160 (5,003,760) 16,406,4005,825,920 3,465,280 214,1609,505,360 25,911,7606,000,000 2,570,000 1,636,800 7,276,00017,482,8003,530,0004,380,480 518,480 4,898,960 25,911,760 |

**Additional information:**

1. The company made a profit of Sh.26, 400 on tile sale of equipment whose cost was Sh.359, 220 and whose accumulated depreciation was Sh.79, 220.
2. The only revaluation on non-current assets was for a piece of freehold land.
3. An interim dividend of Sh.616, 000 had been declared and paid in the course of the year.

**Required:**

Statement of cash flow in accordance with International Accounting Standard (IAS) 7 "Statement of Cash Flows" for the year ended 31 August 2020. (10 marks)

**QUESTION FOUR**

1. Explain the four main objectives of financial analysis (4 Marks)
2. The following statements relates to Shida Ltd for the period ended 31st December, 2020.

Statement of Financial position for year ending 31st December, 2020.

Non-Current Assets Sh. “Million”

Land 1,000

Plant 5,000

Equipment 8,000

 14,000

Current Assets

Inventory 4,000

Account Receivables 3,000

Cash 400 7,400

Total Assets. **21,400**

Capital and Liabilities

Preference share capital 1,000

Ordinary share Capital 1,000

Paid in Capital in excess 2,000

Retained Earnings 1,400

 5,400

Non-Current Liabilities

Mortgage 4,000

Debenture 6,000

 10,000

Current Liabilities

Account Payables 5,000

Notes Payables 1,000 6,000

 **21,400**

Income Statement for the year ended 31st December 2020

|  |
| --- |
|  **Sh. 000**Sales 6,000Cost of sales (3,500)Selling and administration expenses (1,000)EBIT 1,500Interest (1,100) EBT 400Tax 30% 120 PAT/EAT **280** |

**Required:**

1. Predict the company’s failure using
2. Altman’s Z-score and interpret its meaning (6 marks)
3. Springate Model and interpret your answer. (6 marks)
4. Explain five options in dealing with financial distress in the corporate sector (4 marks)

**QUESTION FIVE**

1. Highlight six common examples of potential ordinary shares. (4 marks)
2. You are given the financial statements of Mr Nani Limited (Ltd) and Mr. Huyu Limited

**Statement of financial position** **as at 31 December 2020**

|  |  |  |
| --- | --- | --- |
|  | Mr Nani | Mr. Huyu |
| **Liabilities** |  |  |
| Preference share capital | 120,000 | 150,000 |
| Equity share capital | 140,000 | 410,000 |
| Reserves and supplies | 24,000 | 28,000 |
| Long term loans | 110,000 | 120,.000 |
| Bills payables | 7000 | 1,000 |
| Sundry creditors | 12,000 | 3,000 |
| Outstanding expenses | 15,000 | 6,000 |
| Proposed dividend | 10,000 | 90,000 |
|  | 438,000 | 808,000 |
| Land and building | 80000 | 123,000 |
| Plant and machinery | 334,000 | 600,000 |
| Temporary investment | 5000 | 40,000 |
| Investment  | 6000 | 20,000 |
| Sundry debtors | 4000 | 13000 |
| Prepaid expenses | 1000 | 2000 |
| Cash and bank balance | 8,000 | 10,000 |
|  | 438000 | 808000 |

**Income statement as at 30 December 2020**

|  |  |  |
| --- | --- | --- |
|  | Mr. Nani | Mr. Huyu |
| Sales | 500,000 | 700,00 |
| Miscellaneous income | 20,000 | 15,000 |
|  | 520,000 | 715,000 |
| Expenses |  |  |
| Cost of sales | 330,000 | 510,000 |
| Office expenses | 20,000 | 30,000 |
| Interest | 25,000 | 30,000 |
| Selling expenses | 30,000 | 40,000 |
|  | 405,000 | 610,000 |
| Net profit  | 115,000 | 105,000 |
|  | 520,000 | 715,000 |

**You are required to Prepare**

1. Common size income statement (4 marks)
2. Common size statement of financial position (4 marks)
3. Comment on your answer in 1 and 11 above. (2 marks)
4. XYZ ltd makes a net income of sh. 10 million, and has 1,000,000 common shares issued. Assume that the company has granted 100,000 stock options for it is employees. 50,000 of which were issued with an exercise price of sh. 100 per share and the other 50,000 of which have an exercise price of sh. 500. Each stock option is convertible to 10 common stocks. Further, assume that the current market price of the stock is to be sh. 200 per share.

**Required.**

1. Calculate the basic earnings per share (2 marks)
2. Calculate diluted earnings per share. (4 marks)