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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: 07/04/2021 TIME: 12.00-2.00 PM**

**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. Outline the cost associated with disclosure of financial information. ( 4 marks)
2. Discuss the main weakness of ratio analysis as a financial analysis tool. ( 6 marks)
3. You are provided with the following financial statements from Gimsat Limited for the year ending 31 December 2019 and 2020. Rearrange the figure in a comparative form and study the profitability of the concern

Gimsat Limited

Income statements for the years ended 30the December 2019 and 2020.

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | 2019 | 2020 |
|  | Sales revenue  | 78,500 | 90,000 |
|  | Cost of goods sold  | 45,000 | 500,000 |
|  | Gross profit  | 33,500 | 400,000 |
|  | Operating expenses  |  |  |
|  | Administrative costs  | 70,000 | 72,000 |
|  | Selling and distribution cost  | 80000 | 90,000 |
|  | Operating profit  | 185,000 | 238,000 |
|  | Interest cost  | 25,000 | 30,000 |
|  | Income tax expense  | 70,000 | 80,000 |
|  |  | 90,000 | 128,000 |

Gimsat Limited

Statement of financial position for the tears ended 30 December 2019 and 2020.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Assets | 2019 | 2020 | Equities and liabilities | 2019 | 2020 |
| Land and building | 270,000 | 170,000 | Share capital | 500,000 | 700,000 |
| Plant and machinery | 400,000 | 600,000 | Revenue and other reserves | 330,000 | 222,000 |
| Furniture | 20,000 | 25000 | 8% debentures | 200,000 | 300,000 |
| Other fixed assets | 25,000 | 30,000 | Long term bank loan | 100,000 | 150,000 |
| Cash and cash equivalents | 20,000 | 40,000 | Bills payables | 50,000 | 45000 |
| Bills receivables | 100,000 | 80,000 | Sundry creditors | 100,000 | 120,000 |
| Sundry debtors | 200,000 | 250,000 | Accruals and provisions | 5,000 | 10,000 |
| Inventories | 250,000 | 350,000 |  |  |  |
| prepayments |  | 2000 |  |  |  |
|  | **128,5000** | **154,7000** |  | **128,5000** | **154.7000** |

You are required to Prepare

1. Comparative income statement ( 5 marks)
2. Comparative statement of financial position ( 5 marks)
3. Comment on your answer in 1 and 11 above. ( 2 marks)
4. You are given the financial statements of Mr Hashim Limited (Ltd) and Mr. Hussein Limited

**Statement of financial position** **as at 31 December 2018**

|  |  |  |
| --- | --- | --- |
|  | Mr Hashim | Mr. Hussein |
| **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 2018

|  |  |  |
| --- | --- | --- |
|  | 2017 | 2018 |
| 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)

**QUESTION TWO**

1. Discuss five factors that affect the supply of financial information. ( 5 marks)
2. The following data relates to Rekha Gupta ltd for the year ended 31st December 2015 to 2018

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 2015 | 2016 | 2017 | 2018 |
| Net sales  | 200,000 | 190,000 | 249,000 | 260,000 |
| Less : cost of goods sold  | 120,000 | 117,800 | 139,200 | 145,000 |
| Gross profit  | 80,000 | 72,000 | 100,800 | 114,400 |
| Less expenses  | 20,000 | 19,400 | 22,000 | 24,000 |
| Net profit  | 60,000 | 52,800 | 78,800 | 90,400 |

**Required**

1. Calculate trend percentages ( 4 marks)
2. Interpret your results in a above ( 2 marks)
3. The following trial balance was extracted from the accounting records of Opel Ltd as at 30th Nov 2013

|  |  |  |
| --- | --- | --- |
|  | Dr  | Cr  |
|  | Shs.  | Shs.  |
| Ordinary share capital (sh. 20 each) |  | 2,500,000 |
| Inventories (1.12.2013) | 250,000 |  |
| Plant and machinery (cost) | 2,500,000 |  |
| Motor vehicles (cost) | 800,000 |  |
| Provision for depreciation of plant and machinery  |  | 200,000 |
| Provision for depreciation of motor vehicles  |  | 160,000 |
| Purchase  | 3,600,000 |  |
| Sales  |  | 6,000,000 |
| Sales return  | 400,000 |  |
| Purchases returns |  | 200,000 |
| Wages and salaries  | 600,000 |  |
| Discount  | 50,000 | 40,000 |
| Carriage inwards  | 25,000 |  |
| Carriage outwards  | 30,000 |  |
| Postage and telephone | 75,000 |  |
| Water and electricity  | 86,000 |  |
| Bad debts written off | 15,000 |  |
| Allowances for bad debts  |  | 10,000 |
| General expenses  | 85,000 |  |
| Rent and rates  | 150,000 |  |
| Debtors  | 550,000 |  |
| Creditors  |  | 466,000 |
| Cash in hand  | 60,000 |  |
| Cash at bank  | 300,000 |  |
|  |  |  |
|  | **9,576,000** | **9,576,000** |

You are given the following additional information:

1. Closing stock on 30 November 2013 was valued at sh. 225,000
2. Depreciation is to be charged at 10% of cost of plant and machinery and 20% of cost of motor vehicles
3. Accrued rent of sh. 30,000 and prepaid rates are sh.. 10,000
4. Outstanding electricity expenses is sh. 6,000
5. Provision for bad debts is to be increased by sh. 3,000

**Required**

1. Compile the financial statement. ( 3 marks)
2. Compute the following ratio
3. Liquidity ratio. ( 2 marks)
4. Capital gearing ratio. ( 2 marks)
5. Profitability ratio. ( 2 marks)

**QUESTION THREE**

1. A company has 100 million ksh. 10 shares in issue. It also has 2 million ksh. 100 convertible bonds. The bond has an interest rate of 8%. The tax rate is 30%. Each bond will be convertible into 10 shares. Earnings for the period were ksh.740 million

Required

1. Calculate the diluted EPS ( 2 marks)
2. Calculate the diluted EPS ( 5 marks)
3. 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. ( 5 marks)
3. Highlight six common examples of potential ordinary shares. ( 6 marks)

**QUESTION FOUR**

1. Highlight five indicators of financial distress. ( 5 marks)
2. The balance sheet of tribulation Ltd for the year 2011 is as follows

|  |  |  |  |
| --- | --- | --- | --- |
| Fixed assets  |  | Ksh 000 |  |
| Intangible  |  | 123,000 |  |
| Tangible  |  | 2,079,500 |  |
| Investment  |  | 10,000 |  |
|  |  | 2,212,500 |  |
|  |  |  |  |
| Current assets  |  |  |  |
| Stock  |  | 479,000 |  |
| Debtors  |  | 1,774,500 |  |
| Cash and short term investment  |  | 5,000 |  |
|  |  | 2,258,500 |  |
|  |  |  |  |
| **Current liabilities**  |  |  |  |
| Trade creditor  |  | 956,500 |  |
| Bank overdraft  |  | 504,000 |  |
| Other current liabilities  |  | 152,500 |  |
|  |  | 1,613,500 |  |
| Networking capital  |  | 645,500 |
| Total assets  |  | **2,858,000** |
| Long term loans  |  | 124,000 |  |
| Other long term liabilities  |  | 33,000 |  |
| Total noncurrent liabilities  |  | **157,000** |  |
|  |  |  |  |
| Share capital (10 million shares of ksh. 30 each  |  | 300,000 |  |
| Profit and loss account Brought forward |  | 1,896,500 |  |
|  |  |  |  |
| Retained for year  |  | 504,500 |  |
| Shareholder fund  |  | 2,701,000 |  |
| total liabilities and shareholders’ funds  |  | **2,858,000** |  |
| Income statement of tribulations Limited for the year to December 31 2011 | **Ksh. 000** |  |  |
| Sales revenue  | 1,900,000 |  |  |
| Less cost of sales  | (880,000) |  |  |
| Gross profit  | **1,020,000** |  |  |
| Less operating expenses  | (270,000) |  |  |
| Earnings before interest and taxes  | 750,000 |  |  |
| Interest expenses  | (130,000) |  |  |
| Profit before tax  | 620,000 |  |  |
| Less income tax expenses  | (92,000) |  |  |
| Profit after tax  | 528,000 |  |  |
| Less proposed dividends  | (23,500) |  |  |
| Retained earnings  | 504,500 |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |

Assume that the market value of the company’s stocks at the year-end was ksh 300 per share and the company generated a negative cash flow in the the year amounting to ksh 93 million

Required

Use the following models to assess the financial strength or otherwise of the company.

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1. Altman’s Z score model ( 5 marks)
2. The springate model ( 5 marks)
3. Fulmer model. ( 5 marks)

Hint: Z= 1.2X1 + 1.4 X2 + 3.3 X3 + 0.6 X4 + 1.0 X5

Z= 1.03 X1 + 3.07 X2 + 0.66 X3 + 0.4X4

H= 5.528 V1 + 0.212 V2 + 0.073 V3 +1.270 V4 – 0.120 V5 +2.335 V6 + 0.575 V7 + 1.083 V8 + 0.894 V9 – 6.075

**QUESTION FIVE**

1. Analysis of financial statements reveals important facts concerning managerial performance and the efficiency of the firm. Outline the objectives of analysis of financial statements. ( 4 marks)
2. Financial analysis is useful and significant to different users. Describe any six different users and how they use financial analysis. ( 4 marks)
3. Discuss 3 macro level factors and three industrial level factors that cause financial distress. ( 12 marks)