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**University Examinations 2015/2016**

THIRD YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE

OF

BACHELOR OF COMMERCE

**BFB 3330: FINANCIAL STATEMENT ANALYSIS**

**DATE: APRIL 2016 TIME: 2 HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two***questions.

**QUESTION ONE (30 MARKS)**

1. Discuss the main advantages of the budgetary system (6 marks)
2. Discuss the major limitations of ratio analysis (7 marks)
3. Discuss the measures a firm in distress can take to reduce its impact (7 marks)
4. The following is a balance sheet of Miss Gitari Ltd as at 31st Dec 2009 and 2008.

Balance sheet

|  |  |  |
| --- | --- | --- |
| **Details** | **2009** | **2008** |
| Cash | 82,000 | 30,000 |
| Accounts receivable | 120,000 | 100,000 |
| Inventory (Stock) | 87,000 | 82,000 |
| Land | 101,000 | 90,000 |
| Equipment | 110,000 | 100,000 |
| Accumulated | (17,000) | (15,000) |
| Depreciation | (17,000) | (15,000) |
| Total Assets | 483,000 | 387,000 |
| Account payable | 76,000 | 60,000 |
| Wages payable | 33,000 | 17,000 |
| Notes payable | 50,000 | 50,000 |
| Ordinary share capital | 170,000 | 160,000 |
| Retained earnings | 154,000 | 100,000 |
| Total liabilities | 483,000 | 387,000 |

**Required:**

Carry out a vertical analysis for the company’s balance sheet. (10 marks)

**QUESTION TWO (20 MARKS)**

The balance sheet of Grand Limited, a wholesaler, at 31 December 2005 and 2006 were as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 2005 | | 2006 | |
|  | £000 | £000 | £000 | £000 |
| Tangible fixed assets |  |  |  |  |
| Cost of valuation | 126,300 |  | 162,400 |  |
| Aggregate depreciation |  | 76,300 |  | 98,400 |
| Current Liabilities |  |  |  |  |
| Stock | 12,000 |  | 15,000 |  |
| Debtors | 10,500 |  | 14,000 |  |
| Cash |  |  | 2,000 |  |
|  |  |  |  |  |
| Current liabilities |  |  |  |  |
| Trade creditors | 6,800 |  | 9,400 |  |
| Corporation tax | 3,400 |  | 5,000 |  |
| Proposed dividend |  |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  | 86,000 |  | 109,000 |
| Loans (due for repayment 1999) |  |  |  |  |
|  |  |  |  |  |
| Called up share capital |  | 6,000 |  | 10,000 |
| Share premium |  | 1,000 |  | 3,000 |
| Revaluation reserve |  | - |  | 8,000 |
| Profit and loss account |  |  |  |  |
|  |  |  |  |  |

The stock at 31 December 2004 was £10,000,000.

The summarized profit and loss accounts for the company for the years ended 31 December 2005 and 2006 were:

|  |  |  |
| --- | --- | --- |
|  | **Year ended 31 December** | |
|  | **1995** | **1996** |
|  | **£000** | **£000** |
| Sales | 64,000 | 108,000 |
| Cost of sales |  |  |
| Gross profit | 24,000 | 32,400 |
| Expenses |  |  |
| Net profit before tax |  |  |

Required:

1. Calculate the following accounting ratios for both years:

* The gross profit percentage
* The current ratio and the quick ratio (or acid test)
* Debtors’ collection period in days
* Trade creditors’ payment period in days (based on purchases figures which are to be calculated)
* Gearing ratio.

Show your full workings. (10 marks)

1. Explain what you can deduce from the ratios as at 31 December 1996 and from comparing them with those for 1995. (5 marks)
2. State two points which could cause the movement in the gross profit percentages between the two years and explain how they could bring the change about. (2 marks)
3. State the extent to which you agree to disagree with the following and give brief reasons for your answers.
4. The current ratio and the quick ratio help to assess whether a company is able to meet its debts as they fall due. Therefore the higher these ratios are the better placed the company is.
5. A high gearing ratio is advantageous to shareholders, because they benefit from the income produced by investing the money borrowed. (3 marks)

**QUESTION THREE (20 MARKS)**

1. Discuss any four forms of financial distress (8 marks)
2. The following statement of financial position and income statement relates to Muthigi industries Ltd.

**Statement of Financial Position**

|  |  |  |
| --- | --- | --- |
|  | ‘000’ | ‘000’ |
| Non-current Assets |  |  |
| Land | 1,000 |  |
| Plant | 5,000 |  |
| Equipment | 8,000 |  |
| Current Assets |  | 14,000 |
| Inventories/stock | 4,000 |  |
| Accounts receivable/debtors | 3,000 | 7,400 |
| Cash | 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 |  |
| Debentures | 6,000 | 10,000 |
| Current liabilities |  |  |
| Accounts payable | 5,000 | 6,000 |
| Notes payable | 1,000 | 21,400 |
|  |  |  |
| Income Statement |  |  |
| Sales | 6,000 |  |
| Cost of Sales | (3,500) |  |
| Selling and administration expenses | (1,000) |  |
| EBIT | 1,500 |  |
| Interest | (1,100) |  |
| EBT | 400 |  |
| Tax 30% | 120 |  |
| PAT/EAT | 280 |  |

Required

Altman’s Z-Score and interpret its meaning (12 marks)

**QUESTION FOUR (20 MARKS)**

1. Discuss the main limitations of financial statement analysis (8 marks)
2. The following information is provided regarding two companies X and Y which are quoted at the Nairobi Securities Exchange

|  |  |  |
| --- | --- | --- |
| **Details** | **Company X** | **Company Y** |
| Revenues | 500 | 900 |
| EBIT | 35 | 100 |
| Interest Expense | 5 | 0 |
| EBT | 30 | 100 |
| Taxes | (10) | (40) |
| E.A.T (Net income) | 20 | 60 |
| Total assets | 250 | 300 |
| Total debt | (100) | (50) |
| Owners equity (Shareholders) funds | 150 | 250 |

Required:

Calculate the ROE for both companies using the extended five parts Du point analysis and explain the critical factors that account for the difference in the two companies ROE. (12 marks)

**QUESTION FIVE (20 MARKS)**

1. Differentiate between fundamental and technical analysis by giving relevant examples.

(6 marks)

1. Discuss the most common financial acts of manipulation of financial statements (Creative accounting) (8 marks)
2. Discuss the main objectives/purposes of financial statement analysis (6 marks)