

**W1-2-60-1-6**

## JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY

**UNIVERSITY EXAMINATIONS 2018/2019**

**YEAR 2 SEMESTER 1 EXAMINATIONS FOR THE DEGREE OF MASTER OF SCIENCE IN FINANCE AND ACCOUNTING**

**HBAA 3205: FINANCIAL STATEMENTS ANALYSIS AND FORECASTING**

**DATE: AUGUST 2019 TIME: 3 HOURS**

**INSTRUCTIONS: ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS**

**QUESTION ONE (30 MARKS)**

a) Financial statements analysis is important for various reasons. Describe four such reasons

(4 marks)

b) The following is the income statement and statement of financial position of incubator limited for the year ended 31st December 2018.

Income statement Sh. “000” Sh. “000”

Revenue 42,000

Cost of goods sold (28,000)

Gross profit 14000

Operating expenses

Selling and administration cost 7,100

Depreciation 1,700

Total operating costs (8,800)

Income before income taxes 5,200

Income tax expenses (1,560)

Net income 3,640

Statement of financial position as at 31st December

2018 2017

Assets Sh “000” Sh “000”

Cash 6000 4,400

Accounts receivable (Net) 4,540 4,400

Inventory 3,200 2,400

Property, plant and Equipment 19,200 16,000

Less:- Accumulated Depreciation (8,100) (6,400)

24,840 21,200

Liabilities and shareholders equity:-

Accounts payable 2,900 2,600

Income tax payable 2,940 3,400

Other payables 1,900 1,000

Long-term debt 0 2,000

Common stock 9,260 8,000

Retained earnings 7,840 4,200

24,840 21,200

**Required:**

i) Statement of cashflow for the year ended 31st December 2018, using the direct method

(6 marks)

ii) Show the cashflows from activities for incubators limited for the year ended 31st December 2018 using the indirect method (6 marks)

b) The income statement of JUJA ltd for the year 2018 reported net sales of Sh. 48 million and net income of Sh.8 million. The following table shows the company’s comparative statements of financial position for the years 2017 and 2018.

2017 2018

Sh. “000” Sh. “000”

Assets

Cash 3,000 3,800

Accounts receivable 7,000 5,000

Inventory 9,000 7,000

Property, plant and Equipment 24,000 21,200

Total Assets 43,000 37,000

Liabilities and Equity

Current liabilities 9,600 8,300

Bonds payable 12,000 12,000

Paid up share capital 10,000 10,000

Retained earnings 11,400 6,700

43,000 37,000

Some industry averages for Juja Ltd’s line of business:

Inventory turnover 5 litres

Average collection period 25 days

Asset turnover 1.8 times/turnover

Day sales in inventory 70 days

**Required:**

Assess Juja’s Assets management relative to its industry (Hint: Use efficiency ratios) (8 marks)

c) In the context of IAS 10: Events after the reporting period, differentiate between adjusting and non-adjusting events giving two examples in each case (4 marks)

d) Explain any two adjustments that might be necessary to make financial statements comparable (2 marks)

**QUESTION TWO (20 MARKS)**

a) Examine the warning signs that might indicate that the financial statements of a company are of poor quality (8 marks)

b) Morine Solo, an investment and financial analyst at Faida capital investment services has prepared the following proforma income statement for pinball ltd for the year ended 31st September 2018.

Sh. “million”

Net sales 6,000

Cost of goods sold (2,850)

Gross profit 3,150

Selling, general and administrative expenses (1,780)

Depreciation (280)

Goodwill amortization (25)

Operating income 1065

Interest expense (170)

Income before taxes 895

Income tax (300)

Net income 595

Diluted Earnings per share (EPS) (sh) 2.29

Average shares outstanding (million) 260

Dividends per share (DPS) (sh) 0.64

Morine solo is interested in forecasting the earnings per share (EPS) for the year 2019 and has made the following assumptions for the year 2019, compared with the year 2018.

i. Unit sales will rise by 7% but prices will remain the same

ii. Synergies from acquisition will add an additional sh. 200 million to net sales.

iii. Gross margin as a percentage of net sales will improve by 1.5%

iv. Selling, general and administration expenses as a percentage of sales will improve by 0.7%

v. Depreciation expenses will rise by 5%

vi. Goodwill amortization will rise by sh. 10 million

vii. Long-term debt will remain the same

viii. Interest rate will decrease, reducing interest expenses by sh. 10 million

ix. The income tax rate will rise by 0.5%

x. Average shares outstanding will remain the same.

xi. Dividends per share (DPS) will rise by 10%

**Required:-**

Projected income statement for Pin Ball Ltd for the year ended 30th September, 2019. (12 marks)

**QUESTION THREE (20 MARKS)**

a) Discuss the limitations of segment reporting requirements (8 marks)

b) The following income statement related to Helex Limited and its investments companies. Sharova Limited and Alpha Limited for the year ended 31st March 2018.

Helex Sarova Alpha

Ltd Ltd Ltd

Sh. “million” Sh. “million” Sh. “million”

Revenue 700 500 300

Cost of sales (300) (150) (100)

Gross profit 400 350 200

Investment Income:

Dividends Shalova Ltd 40 - -

Apha Ltd 16 - -

456 350 200

Distribution costs (100) (60) (50)

Administrative expenses (150) (80) (40)

Finance costs (50) (20) (10)

Profit before tax 156 190 100

Income tax expense (50) (80) (30)

Profit after tax for the period 106 110 70

Number of ordinary shares 100 million 50 million 50 million

Dividends paid (sh) 50 million 50 million 40 million

Shareholding of Helex Ltd - 80% 40%

**Required:-**

1. Group consolidated income statement for the year ended 31st March 2018 (10 marks)
2. Earnings per share (EPS) for each company and the group. (2 marks)

**QUESTION FOUR (20 MARKS)**

a) While giving relevant examples clearly distinguish between technical analysis and fundamental analysis. (6 marks)

b) Identify and explain the major building blocks of financial statements analysis. (6 marks)

c) Distinguish between security analysis and credit analysis. (4 marks)

d) Explain the term earnings per share (EPS). (4 marks)

**QUESTION FIVE (20 MARKS)**

a) Explain the role of ratios analysis in the interpretation of financial statements (8 marks)

b) With the help of information given below:-

Prepare a common size income statement and statement of financial position and analyse it.

(12 marks)

Income Statement 2017 2018

Sh. “000” sh. “000”

Sales 1000 1500

Cost of goods sold 400 600

Gross Margin 600 900

Salaries and wages 250 375

Office rent 50 80

Suppliers 10 20

Utilities 20 30

Other expenses 90 110

Total expenses 420 615

180 285

Statement of financial position

2017 2018

Sh. “000” sh. “000”

Cash 100 80

Accounts receivable 350 525

Inventory 150 275

Total current assets 600 880

Fixed assets 400 800

1,000 1,680

Current liabilities

Account payable 180 300

Accrued liabilities 70 120

250 420

Long term liabilities

Notes payable 300 525

Total liabilities 550 945

Capital stock 200 200

Retained earnings 250 535

Total equity 450 735

Total liabilities 1,000 1,680