
CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

THIRD YEAR EXAMINATION FOR THE AWARD OF DEGREE
OF BACHELOR OF COMMERCE

BCOM 334: FINANCIAL STATEMENTS ANALYSIS

STREAMS: BCOM (Y3S1)

TIME: 2 HOURS

DAY/DATE: WEDNESDAY 15/04/2020

2.30 P.M. – 4.30 P.M.

INSTRUCTIONS: Answer question ONE and any TWO other questions

QUESTION ONE (30 MARKS)

- (a) Outline two types of information which would be obtained from the following sources:
- (i) Proxy statement
 - (ii) Corporate press release
 - (iii) Annual reports to regulators [6 marks]
- (b) List four statements that a complete set financial statement should include [4 marks]

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- (c) Rafiki Hardware Tools company limited sells plumbing fixtures on terms of 2/10 net 30. Its financial statements for the last three years are as follows:

	1998	1999	2000
	Sh. '000'	Sh. '000'	Sh. '000'
Cash	30,000	20,000	5,000
Account receivables	200,000	260,000	290,000
Inventory	400,000	480,000	600,000
Net fixed assets	<u>800,000</u>	<u>800,000</u>	<u>800,000</u>
	1,430,000	1,560,000	1,695,000
Accounts payable	230,000	300,000	380,000
Accruals	200,000	210,000	225,000
Bank loan, short term	100,000	100,000	140,000
Long term debt	300,000	300,000	300,000
Common stock	100,000	100,000	100,000
Retained earnings	<u>500,000</u>	<u>550,000</u>	<u>550,000</u>
	1,430,000	1,560,000	1,695,000
Additional information			
Sales			
Cost of goods sold	4,000	4,300,000	3,800,000
Net profit	3,200,000	3,600,000	3,300,000
	300,000	200,000	100,000

Required:

- (i) For each of the three years, calculate the following ratios: Acid test ratio, average collection period, inventory turnover, total debt; equity, net profit margin and return on assets [17 marks]
- (ii) From the ratios calculated above, comment on the liquidity, profitability and gearing positions of the company. [3 marks]

QUESTION TWO (20 MARKS)

- (a) In the context of the International Accounting standards board's framework for the preparation and presentation of financial statements, identify and briefly explain any five qualitative characteristics of financial statements. [10 marks]

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- (b) The following data relates to a company in the telephone communication industry for the year ended 31 December 2019

	Shs. '000'
Sales	8050
Total assets	25,678
Retained earnings	177
Total liabilities	5,044
Working capital	1,777
Earnings before interest and tax	2,605
Market value of equity	10,098
Book value of total liabilities	5,044

Required:

Using the Altmans Z-score model, assess the financial health of the company [10 marks]

QUESTION THREE (20 MARKS)

- (a) Briefly explain the significance of cash flow statements [10 marks]
- (b) The following is a comparative income statement for DHL ltd

	Year	
	2018	2019
Net sales	990000	810000
Cost of sales	574000	461000
Gross profit	416000	348300
Operating expenses		
Selling and distribution	30,000	132000
General expenses	<u>122500</u>	<u>1125500</u>
Total operating expenses	<u>252500</u>	<u>257500</u>
Income for operations	163500	90800
Interest expense	24000	24000
Income before tax	139500	66800
Tax liability	<u>36360</u>	<u>17368</u>
Net income	<u>103140</u>	<u>49432</u>

Required:

Prepare a common size financial statement. Hence give a possible explanation for changes in gross profit and net income across the periods [10 marks]

QUESTION FOUR (20 MARKS)

- (a) Briefly explain five limitations of ratios in analyzing financial statements [10 marks]
- (b) Explain the following terms as applied in financial reporting
- (i) Creative accounting
 - (ii) Window dressing
 - (iii) Earnings management [3 marks]
- (d) Shadrack Magu, a financial analyst at Beta capital has gathered information about ABC limited for the year ended 31st December 2017
- (i) Net income for the year was ksh. 130 M
 - (ii) Outstanding number of ordinary shares for the entire year was 3M
 - (iii) The company had 1.2M, 9% sh 100 par value preference shares for the entire year with preferred share being convertible into 5 ordinary shares
 - (iv) The corporate tax rate is 30%

Required:

- (a) Basic earnings per share (EPS) [3 marks]
- (b) Diluted earnings per share [4 marks]
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