

CHUKA



UNIVERSITY

**UNIVERSITY EXAMINATIONS
RESIT/SPECIAL EXAMINATION**

**EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE
BCOM 334: FINANCIAL STATEMENT ANALYSIS**

STREAMS: BCOM Y3S1

TIME: 2 HOURS

DAY/DATE: THURSDAY 31/08/2023

11.30 A.M – 1.30 P.M.

INSTRUCTIONS:

- **ANSWER QUESTION ONE AND ANY OTHER TWO.**

QUESTION ONE

a) According to the Accounting Standards businesses are required to prepare financial statements that will help users in making informed decisions. Explain the various types of financial statements that are prepared by a business (10 marks)

b) Discuss the importance of analysing and interpreting comparative financial statements of companies (10 marks)

c) Assume that you are a financial manager in your company and that your company has made plans for the next year. It is estimated that the company will employ total assets of sh 2,000,000, 40% of the assets being financed by a loan from AGM Bank at an interest cost of 12 % per year. The company expects to generate sales revenue that is 180% of direct costs. The direct costs are estimated to be sh 800,000 and other operating costs will be sh 200,000. Tax is charged at 30%.

Required; Calculate

Net profit Margin (2 marks)

Return on assets (2 marks)

Return on Equity (2 marks)

Total assets turnover (2 marks)

Debt ratio (2 marks)

QUESTION TWO

a) Discuss the limitations involved in carrying out ratio analysis (4 marks)

b) You are provided with the following information relating to Makuu Ltd for the year ended 31st December 2021

Preference dividends	105,000
Profit before tax	555,000
Sales	3,000,000
Current assets	1,320,000
Net Fixed Assets	4,080,000

Financial leverage Multiplier 4.08

Tax rate 30%

Required:

Use DuPont system of analysis to determine

- (i) The Net Profit Margin (2 marks)
- (ii) Return on Total Assets (2 marks)
- (iii) Total Assets turnover (2 marks)
- (iv) Return on Equity (2 marks)

c) Discuss the advantages of Dupont System of Analysis (8 marks)

Question Three

a) Discuss the main objectives of conducting financial statement analysis. (6 marks)

b) Comparative income statements for Adobey Company are given below

Year	2016	2015
Net sales	1,650,000	1,220,000
Cost of goods sold	<u>600,000</u>	<u>583,000</u>
Gross Profit	1,050,000	637,000
Operating Expenses:		
Administration Expenses	108,000	202,000
Marketing Expenses	<u>125,000</u>	<u>165,500</u>
Total Operating Expenses	233,500	367,500
Income from Operations	816,500	269,500
Interest Expense	<u>150,000</u>	<u>80,000</u>
Income before tax	666,500	189,500
Income tax expense	<u>188,550</u>	<u>60,850</u>
Net Income	<u>477,950</u>	<u>128,650</u>

Required: Prepare a vertical income statements analysis for the company and interpret the changes to the income statement (8 Marks)

c) Discuss some of the parties interested with the information contained in financial statements (6 marks)

Question Four

a) Describe the additional sources of information for financial statement analysis (6 marks)

b) Explain the importance of preparing a cash flow statement to a firm (4 marks)

Star Company
Statement of Cash Flows
For the Year Ended 31 December 2020

Operating Activities:		
Net Income		150,000
<u>Adjustments:</u>		
Depreciation	15,000	
Gain on asset disposal	8,000	
Increase in accounts receivable	10,000	
Increase in inventory	(8,000)	
Decrease in accounts payable	<u>31,000</u>	<u>56,000</u>
Cash provided by operating activities		206,000
Cash flows from Investing activities:		
Purchase of Land	(250,000)	
Sale of building	300,000	
Sale of equipment	<u>120,000</u>	
Sale of Debenture	<u>550,000</u>	
Cash used by investing activities		720,000
Cash flows from financing activities:		
Issuance of bonds	180,000	
Payment of cash dividends	<u>(12,000)</u>	
Interest paid	<u>(10,000)</u>	
Cash provided by financing activities		<u>158,000</u>
Net increase in cash		<u>1,084,000</u>

Additional Information;

Tax Paid	18000
Preference Dividend	9000
Average common stockholders' Equity	800,000
Number of ordinary shares	30,000

Provide an analysis of the statement of cash flows paying attention to:

- (i) Cash debt coverage ratio
- (ii) Cash Dividend coverage ratio
- (iii) Cashflow return on Equity
- (iv) Cashflow return on Assets
- (v) Cashflow per share

(10 marks)
