



MAASAI MARA UNIVERSITY
REGULAR UNIVERSITY EXAMINATIONS
2020/2021 ACADEMIC YEAR
FOURTH YEAR SECOND SEMESTER
SCHOOL OF BUSINESS AND ECONOMICS
BSC FINANCIAL ECONOMICS

COURSE CODE: ECF 4207

**COURSE TITLE: FINANCIAL
STATEMENT ANALYSIS**

DATE:

TIME:

INSTRUCTIONS TO CANDIDATES

- *Answer question ONE (compulsory) and any other THREE questions.*
- *Question one carries 25 marks*
- *All other questions carry 15 marks*

QUESTION ONE

- a) Discuss any 5 uses of financial statement analysis information **(5 Marks)**
- b) Distinguish among the following activities undertaken by business organizations
- i. Operating activities. **(3 Marks)**
 - ii. Investing activities. **(3 Marks)**
 - iii. Financing activities. **(3 Marks)**
- c) The following historical information is an extract from the 2019 annual report of HHT Ltd. All figures are in thousands of shillings.

	2019	2018	2017	2016	2015
Sales revenue	3,308,396	3,127,792	2,959,253	2,731,320	2,327,266
Profit after tax	116,632	104,641	109,695	118,652	94,438

- i) What is the purpose of horizontal analysis? **(2 Marks)**
- ii) Describe the limitations of horizontal analysis. **(2 Marks)**
- iii) Using horizontal analysis describe the trend in sales revenue and profit using the year 2015 as the base year **(3 Marks)**
- d) Discuss any 4 objectives of financial statement analysis **(4 Marks)**

QUESTION TWO

- a) Discuss any 5 limitations of Ratio analysis **(5 Marks)**
- b) The statement of financial position and income statement for Chico Electronics are reproduced below (tax rate is 40%).

CHICO ELECTRONICS
Statement of financial position
As of December 31

	2019	2020
	<u>sh."000"</u>	<u>Sh."000"</u>
Assets		
Current assets		
Cash	683	325
Accounts receivable	1,490	3,599
Inventories	1,415	2,423
Prepaid expenses	<u>15</u>	<u>13</u>
Total current assets	3,603	6,360
Property, plant and equipment, net	1,066	1,541

Other assets	<u>123</u>	<u>157</u>
Total assets	<u>4,792</u>	<u>8,058</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Notes payable to bank	—	875
Current portion of long-term debt	38	116
Accounts payable	485	933
Estimated income tax liability	588	472
Accrued expenses	576	586
Customer advance payments	<u>34</u>	<u>963</u>
Total current liabilities	1,721	3,945
Long-term debt	122	179
Other liabilities	<u>81</u>	<u>131</u>
Total liabilities	<u>1,924</u>	<u>4,255</u>
Shareholders' equity		
Common stock, sh1.00 par value; 1,000,000 shares authorized; 550,000 and 829,000 outstanding, respectively	550	829
Preferred stock, Series A 10%; sh.25 par value; 25,000 authorized;20,000 and 18,000 outstanding, respectively	500	450
Additional paid-in capital	450	575
Retained earnings	1,368	1,949
Total shareholders' equity	<u>2,868</u>	<u>3,803</u>
Total liabilities and shareholders' equity	<u>4,792</u>	<u>8,058</u>

CHICO ELECTRONICS
Income Statement
For Years Ending December 31

	2019	2020
	<u>Sh."000"</u>	<u>Sh."000"</u>
Net sales	7,570	12,065
Other income, net	<u>261</u>	<u>345</u>
Total revenues	7,831	12,410
Cost of goods sold	4,850	8,048
General, administrative, and marketing expense	1,531	2,025
Interest expense	<u>22</u>	<u>78</u>
Total costs and expenses	6,403	10,151
Net income before tax	1,428	2,259

Income tax	(628)	(994)
Net income	<u>800</u>	<u>1,265</u>

Required:

Compute and interpret the following financial ratios of the company for 2020

- i. Acid-test ratio. (1 Mark)
- ii. Return on assets. (1 Mark)
- iii. Return on common equity. (1 Mark)
- iv. Earnings per share. (1 Mark)
- v. Gross profit margin ratio. (1 Mark)
- vi. Times interest earned. (1 Mark)
- vii. Days to sell inventory. (1 Mark)
- viii. Long-term debt to equity ratio. (1 Mark)
- ix. Total debt to equity. (1 Mark)
- x. Sales to end-of-year working capital. (1 Mark)

QUESTION THREE

a) The following shows excerpts from financial information relating to Aspen Company and Bergamot Company.

	<u>Aspen</u>	<u>Bergamot</u>
	Sh.	Sh.
Net cash flows from operating activities	320,000	486,900
Total assets	450,400	625,000
Net income	300,000	550,200
Sales revenue	463,500	875,000
Capital expenditures	120,750	250,000
Dividend payments	25,000	65,700
Debt	150,000	157000

Required

Compute and interpret the following for both companies. Compare your results.

- i. Free cash flow (4 Marks)
- ii. Operating Cash Flow to Sales Ratio (2 Marks)
- iii. Free Cash Flow/Operating Cash Flow (FCF/OCF) Ratio (2 Marks)
- iv. Cash Flow Coverage Ratio (2 Marks)

b) Explain why free cash flow often provides better information than “Net cash provided by operating activities (5 Marks)

QUESTION FOUR

The information below relates Reynolds Company for the year 2014 and 2015.

REYNOLDS COMPANY
Comparative Balance Sheets
December 31 2015

Assets	2015	2014
	Sh.	Sh.
Cash	54,000	37,000
Accounts receivable	68,000	26,000
Inventory	54,000	-0-
Prepaid expenses	4,000	6,000
Land	45,000	70,000
Buildings	200,000	200,000
Accumulated depreciation—buildings	(21,000)	(11,000)
Equipment	193,000	68,000
Accumulated depreciation—equipment	<u>(28,000)</u>	<u>(10,000)</u>
Totals	<u>569,000</u>	<u>386,000</u>
Liabilities and Stockholders' Equity		
Accounts payable	23,000	40,000
Accrued expenses payable	10,000	-0-
Bonds payable	110,000	150,000
Common stock (sh.1 par)	220,000	60,000
Retained earnings	<u>206,000</u>	<u>136,000</u>
Totals	<u>569,000</u>	<u>386,000</u>

REYNOLDS COMPANY
Income Statement
For the Year Ended December 31, 2015

		Sh.
Sales revenue		890,000
Cost of goods sold	465,000	
Operating expenses	221,000	
Interest expense	12,000	
Loss on disposal of equipment	<u>2,000</u>	<u>700,000</u>
Income before income taxes		190,000
Income tax expense		<u>65,000</u>
Net income		<u>125,000</u>
Additional information:		

- i. Operating expenses include depreciation expense of sh.33,000 and charges from prepaid expenses of sh.2,000.
- ii. Land was sold at its book value for cash.
- iii. Cash dividends of sh.55,000 were declared and paid in 2015.
- iv. Interest expense of sh.12,000 was paid in cash.
- v. Equipment with a cost of sh.166,000 was purchased for cash.
Equipment with
- vi. a cost of sh.41,000 and a book value of sh.36,000 was sold for sh.34,000 cash.
- vii. Bonds of sh.10,000 were redeemed at their face value for cash. Bonds of sh.30,000 were converted into common stock.
- viii. Common stock (sh.1 par) of sh.130,000 was issued for cash.
- ix. Accounts payable pertain to merchandise suppliers.

Required

- a) Prepare the cashflow statement using the indirect method **(9 marks)**
- b) Evaluate the company on the basis of the following;
 - i. Operating Cash Flow to Sales Ratio **(3 marks)**
 - ii. Free Cash Flow/Operating Cash Flow (FCF/OCF) Ratio **(3 Marks)**

QUESTION FIVE

The following data presents the vertical analysis of Quality Department Store Incorporation's comparative statement of comprehensive statement of comprehensive income and financial position for the year 2019 and 2020.

**QUALITY DEPARTMENT STORE INC.
Condensed Balance Sheets
December 31**

	2020	2019
Assets	Sh.	Sh.
Current assets	1,020,000	945,000
Plant assets (net)	800,000	632,500
Intangible assets	<u>15,000</u>	<u>17,500</u>
Total assets	<u>1,835,000</u>	<u>1,595,000</u>
Liabilities		
Current liabilities	344,500	303,000
Long-term liabilities	<u>487,500</u>	<u>497,000</u>
Total liabilities	832,000	800,000
Stockholders' Equity		
Common stock, sh.1 par	275,400	270,000

Retained earnings	727,600	525,000
Total stockholders' equity	<u>1,003,000</u>	<u>795,000</u>
Total liabilities and stockholders' equity	<u>1,835,000</u>	<u>1,595,000</u>

QUALITY DEPARTMENT STORE INC.
Condensed Income Statements
For the Years Ended December 31

	2020	2019
	Sh.	Sh.
Sales revenue	2,195,000	1,960,000
Sales returns and allowances	(98,000)	(123,000)
Net sales	2,097,000	1,837,000
Cost of goods sold	(1,281,000)	(1,140,000)
Gross profit	816,000	697,000
Less: Operating expenses		
Selling expenses	253,000	211,500
Administrative expenses	104,000	108,500
Total operating expenses	<u>357,000</u>	<u>320,000</u>
Income from operations	459,000	377,000
Add: Other revenues and gains		
Interest and dividends	9,000	11,000
Less: Other expenses and losses		
Interest expense	36,000	40,500
Income before income taxes	432,000	347,500
Income tax expense	<u>168,200</u>	<u>139,000</u>
Net income	<u>263,800</u>	<u>208,500</u>

Required

- a) Prepare Quality Department Store Inc.'s common-size comparative statement of financial as at 31 December, 2019 and 2020. **(5 Marks)**
- b) Prepare Quality Department Store Inc.'s common-size comparative statement of comprehensive statement for the year ended 31 December, 2019 and 2020. **(6 marks)**
- c) In each case provide and interpretation of the performance of the Company in 2020. **(4 Marks)**

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