



MAASAI MARA UNIVERSITY

**REGULAR UNIVERSITY EXAMINATIONS
2023/2024 ACADEMIC YEAR
FOURTH YEAR FIRST SEMESTER**

**SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF COMMERCE**

COURSE CODE: BCM 4104-1

**COURSE TITLE: FINANCIAL STATEMENT
ANALYSIS**

DATE: 13/12/2023

TIME: 1100-1300 HRS

INSTRUCTIONS TO CANDIDATES

- *Answer question ONE (compulsory) and any other TWO questions.*
- *Question one carries 20 marks*
- *All other questions carry 15 marks*

QUESTION ONE

- a) (i) Describe financial statement analysis **(1 Mark)**
(ii) Explain **three (3)** of its objectives. **(2 Marks)**
- b) In relation to reporting on assets and liabilities in the financial statements; discuss the accounting treatment of the following items in financial statement analysis.
- (i) Change in accounting estimates and errors **(2 Marks)**
 - (ii) Events after the reporting period **(2 Marks)**
 - (iii) Non-current assets held for sale and discontinued operations **(2 Marks)**
 - (iv) Leases and off-balance sheet financing/debt **(2 Marks)**
- c) The preparation and analysis of comparative balance sheets and income statements are commonly applied tools of financial statement analysis and interpretation.

Required:

- (i) Discuss the inherent limitations of analyzing and interpreting financial statements for a single year. Include in your discussion the extent that these limitations are overcome by use of comparative financial statements computed over more than one year. **(2 Marks)**
- (ii) A year-to-year analysis of comparative balance sheets and income statements is a useful analysis tool. Still, without proper care, such analysis can be misleading. Discuss factors or conditions that contribute to such a possibility. How can additional information and supplementary data (beyond financial statements) help prevent this possibility? **(2 Marks)**
- iii) The following income statement relates to Harbison Corporation

HARBISON CORPORATION		
Comparative Income Statement		
<u>For Years Ended December 31, 2006 and 2005</u>		
	2006	2005
	Shs.	Shs.
Sales	720,000	535,000
Cost of goods sold	<u>(475,200)</u>	<u>(280,340)</u>
Gross profit	244,800	254,660

Operating expenses	(151,200)	
(103,790)Net income		<u>93,600</u>
<u>150,870</u>		

Required

Prepare Harbison Corporation common-size income statement and assess whether this company's situation is favorable or unfavorable. (5 Marks)

QUESTION TWO

Emerson Electric is engaged in design, manufacture, and Emerson Electric sale of a broad range of electrical, electromechanical, and electronic products and systems. The following shows Emerson's net income and net income before extraordinary items for the past 20 years (in millions):

Year	Net Income	Net Income before extraordinary Items
	Sh.(Millions)	Sh.(Millions)
1	201,000	201,000
2	237,700	237,700
3	273,300	273,300
4	300,100	300,100
5	302,900	302,900
6	349,200	349,200
7	401,100	401,100
8	408,900	408,900
9	467,200	467,200
10	528,800	528,800
11	588,000	588,000
12	613,200	613,200
13	631,900	631,900
14	662,900	662,900
15	708,100	708,100
16	788,500	904,400
17	907,700	929,000
18	1,018,500	1,018,500
19	1,121,900	1,121,900
20	1,228,600	1,228,600

Emerson has achieved consistent earnings growth for more than 160 straight quarters (more than 40 years).

Required:

- a) What earnings strategy do you think Emerson has applied over the years to maintain its record of earnings growth? **(4 Marks)**
- b) Describe the extent you believe Emerson’s earnings record reflects business activities, excellent management, and/or earnings management. **(4 Marks)**
- c) Describe how Emerson’s earnings strategy is applied in good years and bad years. **(4 Marks)**
- d) Identify years where Emerson likely built hidden reserves and the years it probably drew upon hidden reserves. **(3 Marks)**

QUESTION THREE

- a) Discuss how the lessee reflects the cost of leased equipment in the income statement for;
 - (i) Assets leased under operating leases and **(2Mark)**
 - (ii) Assets leased under capital leases. **(2 Mark)**

- b) Selected comparative financial statements of Cohorn Company is as follows:

COHORN COMPANY
Comparative Income Statement (000)
For Years Ended December 31, 2000–2006

	2022	2021	2020	2019	2018	2017	2016
	Shs'000'	Shs'000'	Shs'000'	Shs'000'	Shs'000'	Shs'000'	Shs'000'
Sales	1,594	1,396	1,270	1,164	1,086	1,010	828
Cost of goods sold	<u>(1,146)</u>	<u>(932)</u>	<u>(802)</u>	<u>(702)</u>	<u>(652)</u>	<u>(610)</u>	<u>(486)</u>
Gross profit	448	464	468	462	434	400	342
Operating expenses	<u>(340)</u>	<u>(266)</u>	<u>(244)</u>	<u>(180)</u>	<u>(156)</u>	<u>(154)</u>	<u>(128)</u>
Net income	<u>108</u>	<u>198</u>	<u>224</u>	<u>282</u>	<u>278</u>	<u>246</u>	<u>214</u>

COHORN COMPANY
Comparative Balance Sheet (sh.000)
December 31, 2000-2006

	2022	2021	2020	2019	2018	2017	2016
	Shs'000'	Shs'000'	Shs'000'	Shs'000'	Shs'000'	Shs'000'	Shs'000'
Assets							
Cash	68	88	92	94	98	96	99
Accounts receivable, net	480	504	456	350	308	292	206
Merchandise inventory	1,78	1,264	1,104	932	836	710	515
Other current assets	46	42	24	44	38	8	19
Long-term investments .	0	0	0	136	136	136	136
Plant and equipment, net	<u>2,120</u>	<u>2,114</u>	<u>1,852</u>	<u>1,044</u>	<u>1,078</u>	<u>960</u>	<u>825</u>
Total assets	<u>4,452</u>	<u>4,012</u>	<u>3,528</u>	<u>2,600</u>	<u>2,494</u>	<u>2,232</u>	<u>1,800</u>
Liabilities and Equity							
Current liabilities	1,120	942	618	514	446	422	272
Long-term liabilities	1,194	1,040	1,012	470	480	520	390
Common stock	1,000	1,000	1,000	840	840	640	640
Other contributed capital	250	250	250	180	180	160	160
Retained earnings	<u>888</u>	<u>780</u>	<u>648</u>	<u>596</u>	<u>548</u>	<u>490</u>	<u>338</u>
Total liabilities and equity	<u>4,452</u>	<u>4,012</u>	<u>3,528</u>	<u>2,600</u>	<u>2,494</u>	<u>2,232</u>	<u>1,800</u>

Required:

- (i) Compute trend percents for the individual items of both statements using 2000 as the base year. **(8 Marks)**
- (ii) Analyze and comment on the financial statements and trend percents from part (i) above **(3 Marks)**

QUESTION FOUR

You have been presented with the following selected information taken from the financial statements of Matrix Ltd.

MATRIX LTD
Statement of financial position (selected figures)

	2016	2015
	Sh."000"	Sh."000"
Total current assets	5,460	4,650
Non-current assets	<u>27,250</u>	<u>25,100</u>
Total assets	<u>32,700</u>	<u>29,750</u>
Current liabilities	7,120	5,760
Non-current liabilities	<u>18,500</u>	<u>16,200</u>
Total liabilities	25,620	21,960
Equity	<u>7,080</u>	<u>7,790</u>
Total liabilities and equity	<u>32,700</u>	<u>29,750</u>
 Other information	 <u>2013</u>	 <u>2012</u>
Profit before interest and tax	2,710	2,670
Interest expense	450	390
Cash, marketable securities and receivables	2,860	3,145

(a) Calculate each of the following for 2016 and 2015.

- (i) Working capital. **(3 Marks)**
- (ii) Current ratio. **(3 Marks)**
- (iii) Quick ratio. **(2 Marks)**
- (iv) Debt to total assets ratio. **(3 Marks)**
- (v) Times interest earned. **(2 Mark)**

(b) Comment on the trend in each of the ratios. **(2 Marks)**

QUESTION FIVE

- a) Distinguish among the **three (3)** activities reported in the statement of cash flows. **(6 Marks)**

b) Condensed financial data of Takahashi Electronics Pty Ltd follow.

TAKAHASHI ELECTRONICS PTY LTD
Statement of financial position
as at 30 June 2017

	2017	2016
	Shs.	Shs.
Assets		
Cash	47,500	23,625
Accounts receivable	43,400	28,500
Inventory	60,950	51,325
Investments (long term)	42,300	43,500
Plant and equipment	125,000	102,500
Accumulated depreciation	<u>(27,750)</u>	<u>(20,000)</u>
Total	<u>294,400</u>	<u>229,450</u>
Liabilities and equity		
Accounts payable	26,350	24,140
Accrued expenses payable	6,050	9,415
Debentures payable	50,000	35,000
Share capital	125,000	100,000
Retained earnings	<u>87,000</u>	<u>60,985</u>
Total	<u>294,400</u>	<u>229,450</u>

TAKAHASHI ELECTRONICS PTY LTD
Statement of profit or loss
for the year ended 30 June 2017

	Shs.
Sales	150,000
Gain on sale of equipment	<u>4,375</u>
	154,375
Less:	
Cost of sales	49,730
Operating expenses, excluding depreciation expense	7,335
Depreciation expense	24,850
Income tax	3,635
Interest expense	<u>2,720</u>
	<u>88,</u>
270 Profit	<u>66,105</u>

Additional information:

- (i) New equipment and machinery were purchased for cash during the year.
- (ii) Investments were sold at cost.
- (iii) Equipment costing sh.23 500 was sold for sh.7775, resulting in a gain of sh.4375.
- (iv) A cash dividend of sh.40 000 was declared and paid during the year.
- (v) Accounts payable pertain to inventory creditors.

Required

Prepare a statement of cash flows using the indirect method. **(9 Marks)**

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