



# **MAASAI MARA UNIVERSITY**

**REGULAR UNIVERSITY EXAMINATIONS  
2022/2023 ACADEMIC YEAR  
FOURTH YEAR SECOND SEMESTER**

**SCHOOL OF BUSINESS AND ECONOMICS  
BSC FINANCIAL ECONOMICS**

**COURSE CODE: ECF 4207**

**COURSE TITLE: FINANCIAL STATEMENT  
ANALYSIS**

**DATE: 18/4/2023**

**TIME: 1430-1630 HRS**

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## **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) Describe the **three (3)** major activities the statement of cash flows reports. Cite examples of cash flows for each activity. **(6 Marks)**
- b) You work for ABC, a limited liability company, which seeks growth through acquisitions. You are a member of a team that is investigating the possible purchase of XYZ, a limited liability company that manufactures a product complementary to the products currently being sold by ABC. Your team leader wants you to prepare a report for the team evaluating the recent performance of XYZ and the quality of its management, and has given you the following financial information which has been derived from the financial statements of XYZ for the three years ended 31 March 2016, 2017 and 2018.

<b>Financial year ended 31 March</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Turnover (Sh. million)	2,243	2,355	2,237
Cash and cash equivalents (Sh. million)	50	81	97
Return on equity	13%	22%	19%
Sales revenue to total assets	2.66	2.66	2.01
Cost of sales to sales revenue	85%	82%	79%
Operating expenses to sales revenue	11%	12%	15%
Net income to sales revenue	2.6%	4.3%	4.2%
Current/Working Capital ratio (to 1)	1.12	1.44	1.06
Acid test ratio (to 1)	0.80	1.03	0.74
Inventory turnover (months)	0.6	0.7	1.0
Credit to customers (months)	1.3	1.5	1.7
Credit from suppliers (months)	1.5	1.5	2.0
Net assets per share (cents per share)	0.86	0.2	0.97
Dividend per share (cents per share)	10.0	14.0	14.0
Earnings per share (cents per share)	11.5	20.1	18.7

### Required:

Use the above information to prepare a report for your team leader which:

- i. Reviews the performance of XYZ as evidenced by the above ratios; **(5 Marks)**
- ii. Makes recommendations as to how the overall performance of XYZ could be improved. **(5 Marks)**
- c) Discuss any **five (5)** limitations in your analysis. **(5 Marks)**
- d) The current ratio and the quick ratio are both measures of liquidity. Explain how the quick ratio overcomes some of the limitations of the current ratio. **(4 Marks)**

## QUESTION TWO

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

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

	2020	2019
	Sh.	Sh.
<b>Assets</b>		
Current assets	1,020,000	945,000
Plant assets (net)	800,000	632,500
Intangible assets	<u>15,000</u>	<u>17,500</u>
<b>Total assets</b>	<b><u>1,835,000</u></b>	<b><u>1,595,000</u></b>
<b>Liabilities</b>		
Current liabilities	344,500	303,000
Long-term liabilities	<u>487,500</u>	<u>497,000</u>
<b>Total liabilities</b>	<b>832,000</b>	<b>800,000</b>
<b>Stockholders' Equity</b>		
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>
<b>Total liabilities and stockholders' equity</b>	<b><u>1,835,000</u></b>	<b><u>1,595,000</u></b>

**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	<u>(1,281,000)</u>	<u>(1,140,000)</u>
<b>Gross profit</b>	<b>816,000</b>	<b>697,000</b>
<b>Less: Operating expenses</b>		
Selling expenses	253,000	211,500
Administrative expenses	104,000	108,500
Total operating expenses	<u>357,000</u>	<u>320,000</u>
<b>Income from operations</b>	<b>459,000</b>	<b>377,000</b>
<b>Add: Other revenues and gains</b>		
Interest and dividends	9,000	11,000
<b>Less: Other expenses and losses</b>		
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>
<b>Net income</b>	<b><u>263,800</u></b>	<b><u>208,500</u></b>

**Required**

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

**QUESTION THREE**

Provided below are comparative statement data for Spencer Ltd and Forrester Ltd, twocompetitors. All data relating to the statement of financial position are as at 30 June, theend of the reporting period for both entities.

	Spencer Ltd		Forrester Ltd	
	2016 Sh	2015 sh	2016 sh	2015 sh
Net sales	1250 000		410 000	
Cost of sales	690 000		257 000	
Operating expenses	321 000		62 000	
Finance costs	6 000		1 200	
Income tax expense	69 900		26 940	
Profit	163 100		62 860	
Current assets	325 975	312 410	188 000	180 000
Non-current assets	521 310	500 000	240 000	216 000
Current liabilities	79 595	75 815	36 000	32 000
Non-current liabilities	108 500	90 000	27 000	24 000
Share capital, @ sh.10	500 000	500 000	320 000	300 000
Retained earnings	159 190	146 595	45 000	40 000

**Required**

- Prepare a vertical analysis of the 2016 statement of profit or loss data for both entities. **(11 Marks)**
- Comment on the relative profitability of the entities by calculating the return on assets and the return on ordinary shareholders' equity for both entities. **(4 Marks)**

**QUESTION FOUR**

- Two popular methods of financial statement analysisare horizontal analysis and vertical analysis. Discuss the difference between these two methods. **(6 Marks)**

b) The following data is available for White Ltd and Wong Ltd.

		<b>White 2016</b>	<b>White 2015</b>	<b>Wong 2016</b>	<b>Wong 2015</b>
		<b>Sh.000</b>	<b>Sh.000</b>	<b>sh.000</b>	<b>sh.000</b>
Cost of sales	17 988	18 038	15 762		16 002
Current assets	9 998	10 151	9 130		10 200
Cash + receivables + marketable securities	6 800	6 870	6 547		7 300
Net receivables	3 995	4 389	3 725		3 500
Inventory	3 100	2 290	1 926		2 001
Total assets	35 648	34 628	29 930		33 000
Current liabilities	7 770	7 753	6 860		7 200
Total liabilities	18 231	17 394	14 562		12 450

### Required

- Calculate all the intra-entity comparisons in relation to liquidity that the data allows for White Ltd. **(6 Marks)**
- Discuss the principal purpose of using each of the three bases of comparison: intra-entity, inter-entity and industry comparisons when evaluating an entity? **(3 Marks)**

### QUESTION FIVE

- Describe the computation of free cash flow and explain its relevance to financial analysis? **(3 Marks)**
- The information below relates Reynolds Company for the year 2021 and 2022.

#### REYNOLDS COMPANY Comparative Balance Sheets December 31 2022

<b>Assets</b>	<b>2022 2021</b>	
	<b>Sh.</b>	<b>Sh.</b>
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	(28,000)	(10,000)
<b>Totals</b>	<b><u>569,000</u></b>	<b><u>386,000</u></b>

**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>
<b>Totals</b>	<b><u>569,000</u></b>	<b><u>386,000</u></b>

**REYNOLDS COMPANY**  
**Income Statement**  
**For the Year Ended December 31, 2022**

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Sales revenue		Sh. 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 2022.
- 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 a cost of sh.41,000 and a book value of sh.36,000 was sold for sh.34,000 cash.
- vi. Bonds of sh.10,000 were redeemed at their face value for cash. Bonds of sh.30,000 were converted into common stock.
- vii. Common stock (sh.1 par) of sh.130,000 was issued for cash.
- viii. 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 Operating Cash Flow to Sales Ratio **(3 marks)**

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