



**Riara School of Business**

*Nurturing business innovators*

**SEPTEMBER – DECEMBER 2016 TRIMESTER  
EXAMINATION FOR BACHELOR OF BUSINESS ADMINISTRATION**

**DAY PROGRAMME**

**BAC 404: FINANCIAL STATEMENT ANALYSIS**

**DATE: AUGUST 2017**

**TIME: 2HOURS**

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**INSTRUCTIONS**

- i) Answer question one and any other two**
  - ii) Marks allocated to each question are shown at the end of the question**
  - iii) Arrange your work neatly and indicate the questions answered in the Examination booklet**
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**QUESTION ONE (COMPULSORY – (30 MARKS))**

- (a) State three main limitations of the current ratio as a measure of liquidity. **(3marks)**
- (b) A partial Statement of financial position and income statement for Joseph Gitau Corporation follow:

**Joseph Gitau Corporation  
Partial Statement of Financial position  
As at December 31, 2016**

Assets	
Current assets:	Shs
Cash	33,493
Marketable securities	215,147
Trade receivables, less allowance of sh6, 000	255,000
Inventories, LIFO	523,000
Prepaid expenses	26,180
Total current assets	1, 052,820

Liabilities	
Current liabilities:	
Trade accounts payable	103, 689
Notes payable (primarily to banks) and commercial paper	210,381
Accrued expenses and other liabilities	120,602
Income taxes payable	3,120
Current maturities of long-term debt	22,050
Total current liabilities	459,842

**Joseph Gitau Corporation**  
**Partial Statement income statement**  
**For Year Ended December 31, 2016**

Net sales	3, 050,600
Miscellaneous income	45,060
sh3, 095,660	
Costs and expenses:	
Cost of sales	2, 185,100
Selling, general, and administrative expenses	350,265
Interest expense	45,600
Income taxes	300,000
2,880,965	
Net income	214, 695

Additional information:

The trade receivables at December 31, 2015, were \$280,000, net of an allowance of shs.8, 000, for a gross receivables figure of sh288, 000. The inventory at December 31, 2015, was shs565, 000.

Required:

- (i) Compute **FIVE** key liquidity ratios and (2marks each)  
(ii) comment on the liquidity of the company (2 marks)

(c)

**XYZ LTD COMPANY**  
**STATEMENT OF FINANCIAL POSITION**  
**AS AT THE END OF YEAR 2006 THROUGH YEAR 2011**

(shs millions)	Year 11	Year 10	Year 9	Year 8	Year 7	Year 6
<b>Assets</b>						
Current assets	shs	shs	shs	shs	shs	shs
Cash and cash equivalents	178.90	80.70	120.90	85.80	145.00	155.10
Other temporary investments	12.80	22.50	26.20	35.00	280.30	238.70
Accounts receivable	527.40	624.50	538.00	486.90	338.90	299.00
Inventories.....	706.70	819.80	816.00	664.70	623.60	610.50

Prepaid expenses....	92.70	118.00	100.40	90.50	50.10	31.50
Total current assets.	1,518.50	1,665.50	1,601.50	1,362.90	1,437.90	1,334.80
Plant assets, (net)	1,790.40	1,717.70	1,540.60	1,508.90	1,349.00	1,168.10
Intangible assets (net)	435.50	383.40	466.90	496.60	—	—
Other assets.....	404.60	349.00	323.10	241.20	310.50	259.90
Total assets.....	<b>4,149.00</b>	<b>4,115.60</b>	<b>3,932.10</b>	<b>3,609.60</b>	<b>3,097.40</b>	<b>2,762.80</b>

- (a) Prepare a vertical common size analysis for 2006 through 2011. Use total assets as a base. **(7marks)**
- (b) Prepare a horizontal common size analysis for 2006 through 2011. Use 2006 as a base. **(6marks)**
- (c) Comment on significant trends that appear in (a) and (b) above **(2marks)**

## QUESTION TWO

- a) You are in charge of making forecasts. You have been supplied with cost and revenue forecasts and details of payment as follows:

### 1. Forecast of Cash receipts and Payments for the quarter ending 31 March 2016

	January Shs.	February Shs.	March Shs.
<b>Direct</b>			
Materials (purchases)	112,000	100,000	135,000
Wages	90,000	80,000	100,000
<b>Overhead</b>			
Production	34,000	32,000	40,000
Administration	22,000	20,000	27,000
Selling and distribution	13,000	11,000	18,000
 Sales	 360,000	 350,000	 440,000

### 2. Forecast of revenue and costs for the quarter ending 30 June 2016

	April Sh.	May Sh.	June Sh.
<b>Direct</b>			
Materials (purchases)	90,000	67,000	79,000
Wages	72,000	54,000	63,000
<b>Overhead</b>			
Production	45,000	36,000	40,000
Administration	22,000	25,000	27,000
Selling and distribution	13,000	11,000	16,000

Sales	350,000	360,000	360,000
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Cash balance on 1 April 2016	Sh. 90,000
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**Additional information**

1. Period of credit allowed by suppliers averages two months.
2. Bonds to the value of Shs. 125,000 are being issued in May 2016 and the amount is expected to be received during the month.
3. A new machine is being installed at the end of March 2016 at a cost of Sh 150,000 and payment is promised in early May 2016.
4. Sales commission of 3% is payable within one month of sales.
5. A dividend of Sh 100,000 is to be paid in June 2016.
6. There is a delay of one month in the payment of overheads. There is also a delay in payment of wages averaging a quarter of a month.
7. Twenty per cent of the debtors pay cash, receiving a cash discount of 4% and 70% of debtors pay within one month and receive a cash discount of 2 ½%. The other debtors pay within two months

The Finance manager approaches the bank for approval of short term financing to cover additional funding needs. The bank's loan officer requires the finance manager to prepare a *cash forecast* for the six months ending June 30, Year 1, along with *pro forma financial statements* for that period, to process her request. The loan officer also requests that ABC Ltd specify its uses of cash and its sources of funds for loan repayment.

The finance manager recognizes the importance of a cash forecast and proceeds to compile data necessary to comply with the loan officer's request.

Required: prepare a cash forecast on a monthly basis from the second quarter of the year 2016. **(20 marks)**

**QUESTION THREE**

(a)

**Kerai Ltd**  
**Partial statement of financial position**  
**As at December 2011 through 2016**

<b>2011</b>	(shs millions)	2016	2015	2014	2013	2012
Long-term liabilities						
Notes payable	757.8	792.9	610.3	507.1	358.8	346.7
Capital lease obligation.	14.8	12.9	18.9	18.7	2.1	15.6
Total long-term debt	772.6	805.8	629.2	525.8	380.2	362.3
Deferred income taxes*	129.3	117.6	109.0	140.3	124.0	99.6
Other long-term liabilities	23.0	28.5	19.6	15.6	15.8	16.3
Total long-term liabilities.	924.9	951.9	757.8	681.7	520.0	478.2
Current liabilities†	1,278.0	1,298.1	1,232.1	863.3	693.8	626.1
Total liabilities	2,202.9	2,250.0	1,989.9	1,545.0	1,213.8	1,104.3
Equity capital						

Common shareholders' equity	1,793.4	1,691.8	1,778.3	1,895.0	1,736.1	1,538.9
Minority interests	23.5	56.3	54.9	29.3	23.5	20.1
Deferred income taxes*	129.2	117.5	109.0	140.3	124.0	99.5
Total equity capital	1,946.1	1,865.6	1,942.2	2,064.6	1,883.6	1,658.5
Total liabilities and equity	4,149.0	4,115.6	3,932.1	3,609.6	3,097.4	2,762.8
For analytical purposes, 50% of deferred income taxes are considered debt and the remainder equity.						
† Including the current portion of notes payable.						

**Required:**

- (i) Determine the **THREE** key ratios for solvency analysis for year 2015 and 2016.  
Comment on the solvency of the company **(8marks)**
- (ii) Perform common size(vertical analysis) for year 2015 and 2016 of the capital structure **(4 marks)**
- (b) Explain **SIX** general Steps used in evaluating the Quality of Financial Reports **(8marks)**

**Question four**

- (a) Explain the following terms: **(2marks each)**
- (i) Financial analysis
  - (ii) Liquidity analysis
  - (iii) Solvency analysis
  - (iv) Prospective analysis
  - (v) Cash flow analysis
- (b) Explain fundamental analysis process in relation to investment analysis **(5marks)**
- (c) Explain technical analysis process in relation to investment analysis **(5marks)**