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UNIVERSITY EXAMINATIONS
2022/2023 ACADEMIC YEAR
MAIN EXAMINATIONS
BACHELOR OF COMMERCE

COURSE CODE: BCF 321

COURSE TITLE: FINANCIAL STATEMENT ANALYSIS

DATE: 10TH AUGUST /2023 8.00-11.00 AM TIME: 2 HOURS

INSTRUCTIONS TO CANDIDATES

1. Answer a total of **three** questions; question **one** and any other **two** questions.
2. Question **one** carries **30** marks and each of the other two questions carry **20** marks each.



Question One (Compulsory)

- a) As a Finance Manager of Green Always Limited, your shareholders have been compelled to comply with Company Act Cap 476 with regard to preparation of financial statements.

Write a memorandum to the Shareholders clearly explaining the purpose of financial statements. **[10 marks]**

- b) You have been appointed as the Finance Analyst of Ocean Blue Limited. The Company Accountant has submitted half year results for the year ending 31st December 2023. The Chief Executive Officer has reviewed these financials but is unable to understand how some elements of the financial statements had been measured.

Required

Provide five bases of measurement of elements of financial statements.

[5 marks]

- c) The Senior Management of Four Towers Limited has provided you with the following financial statements relating to its two divisions, alpha and beta, for the year ended 30 June 2012:

Income statement for the year ended 30th June 2012				
	Alpha		Beta	
	Kshs '000	Kshs '000	Kshs '000	Kshs '000
Revenue		4000		6000
Cost of sales		-3000		-4800
Gross profit		1000		1200
Expenses				
Distribution costs	-200		-150	
Administration expenses	-290		-250	
Interest paid	-10	-500	-400	-800
Profit before tax		500		400
Income tax expense		-120		-90
Profit after tax		<u>380</u>		<u>310</u>
Dividend paid		-150		-100
Retained profit		<u>230</u>		<u>210</u>
Retained profit b/f		<u>220</u>		<u>2480</u>
Retained profit carried forward		450		2,690

Statement of financial position as at 30th June 2012

	Kshs '000	Kshs '000	Kshs '000	Kshs '000
Non-Current Assets				
Land and buildings		1,200		5,000
Furniture and motor vehicles		600		1,000
		1,800		6,000
Current assets				
Inventory	400		800	
Trade receivables	850		750	
Financial assets	100		230	
Cash at bank	0	<u>1,350</u>	100	<u>1,880</u>
Total Assets		<u>3,150</u>		<u>7,880</u>
Equity and Liabilities				
Ordinary share capital(1 sh par value)		1,000		1,600
Retained profit		450		2,690
		1,450		4,290
<u>Non Current Liabilities</u>				
Bank loans		500		3,000
<u>Current liabilities</u>				
Accounts payable	1080		590	
Bank overdraft	120	<u>1,200</u>		<u>590</u>
		<u>3,150</u>		<u>7,880</u>

Additional information:

1. The two divisions sell goods on both cash and credit terms. On average, the credit sales account for 80% of the total sales while purchases account for 90%
2. The cash flow from operating activities for the two divisions are sh.750 million and sh.800 million respectively.

Required:

- (i) Common size income statement for the year ended 30th June 2012 **[5 marks]**
- (ii) Common size statement of financial position as at 30th June 2012 **[3 marks]**
- (iii) Comment on the performance of the two divisions and state which division and state is better **[2 marks]**

- d) i) As a Financial Analyst, distinguish between fraud and error in financial reporting. **[2 marks]**
- ii) Explain three ways in which financial misstatements may be accomplished. **[3 marks]**

Question Two

- a) Define fair value and Identify three valuation technics. **[4 marks]**
- b) Evaluate the advantages of fair value accounting **[8 marks]**
- c) Zimile Company that has Kshs 100 million in assets funded by Kshs 50 million each of debt and equity. The company suffers a major downturn in its business during the financial year ending December 2022. Because of this, the fair value of its assets drops down to Kshs 40 million. Note that because of limited liability, equity holders cannot be liable for more than their investment in the firm of Kshs 50 million. Consequently, debt holders will have to incur a Kshs10 million loss in value. Consequently, the market value of the company's debt drops to Kshs 40 million.

Required

Post the relevant entries in the appropriate financial statements using the fair value accounting technique. **[8 marks]**

Question Three

- a) Identify specific components of analysis of equity **[4 marks]**
- b) You have been provided with the financial statements of Maili Mbili Limited as below:

Maili Mbili Statement of Financial Position

	2010	2011
	Kshs'000	Kshs'000
<u>Non Current Assets</u>		
Plant and equipment	2,731	2,880
<u>Current assets</u>		
Cash	84	98
Accounts receivable	165	188
Inventory	393	422
Total	642	708
Total assets	3,373	3,588
<u>Liabilities and owners equity</u>		
<u>Current liabilities</u>		
Accounts payable	312	344
Notes payable	231	196
Total	543	540
Long term debt	531	457
Owners Equity		
Common stock	500	550
Retained Earnings	1,799	2,041
Total	2,299	2,591
Total Liabilities and Equity	3,373	3,588

Maili Mbili Income statement for 2011

	Kshs'000
Sales	2,311
Cost of goods sold	1,344
Gross profit	967
Depreciation	276
EBIT	691
Interest paid	141
Taxable income	550
Taxes paid @ 34%	187
Net Income	363
Dividend paid	121
Retained Income	242

- c) The reliability of cash forecast depends on the quality of the sales forecast. Identify five areas of financial statement analysis that are relevant in forecasting sales. **[5 marks]**