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**University Examinations 2014/2015**

THIRD YEAR, SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

**HBF 2202: FINANCIAL STATEMENT ANALYSIS**

**DATE: DECEMBER 2014 TIME: 2 HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two*** *questions*

**QUESTION ONE**

1. Explain the limitations of financial statement analysis (5 marks)
2. Beta. Co. has a loan covenant requiring it to maintain a current ratio of 1.5 or better. As Beta approaches year-end, current assets are Ksh 20 million (ksh. 1 million in cash, ksh. 9 million in accounts receivable, and ksh. 10 million in inventory) and current liabilities are ksh. 13.5 million.
3. Calculate Beta’s current ratio and quick ratio (3 marks)
4. Which of the following transactions would Beta Co. most likely enter to meet its loan covenant? (4 marks)

* Sell Ksh. 1 million in inventory and deposit the proceeds in the company’s checking account.
* Borrow ksh. 1 million short term and deposit the funds in their checking account
* Sell ksh. 1 million in inventory and pay of some of its short-term creditors.

1. If Beta sells ksh. 2 million in inventory on credit, how will this affect its current ratio? (3 marks)
2. If Beta sells ksh. 1 million in inventory and pays off accounts payable, how will this affect its quick ratio? (3 marks)
3. Discuss the application of Z score in business (4 marks)
4. Explain any four standards for financial statement analysis (8 marks)

**QUESTION TWO**

1. The data below relates from the books of Nyama choma limited for the year ending 31 December, 2013

shs.

Equity 2,280,000

Long-term debt 1,520,000

Current liabilities 600,000

Fixed assets 3,600,000

Current assets 800,000

Retained earnings 100,000

Dividends issued 100,000

Cost of sales 800,000

Sales 1,000,000

Additional information

1. Nyama choma expects the dividend payout ratio, and the proportion of cost of sales to sales to remain at the current rates
2. A projected 20% increase in sales is expected

**Required:**

1. Prepare a pro-forma income statement and a balance sheet based on the above forecasts. Are there additional funds needed? (10 marks)
2. Explain the advantages and limitations of ratios as tool of financial statement analysis

(10 marks)

**QUESTION THREE**

The following statements relates to Shida Ltd for the period ended 31st December, 2013.

**Statement of Financial position for year ending 31st December, 2013**

|  |
| --- |
| **Non-current Assets shs “million”** |
| Land 1,000 |
| Plant 5,000 |
| Equipment 8,000  **14,000** |
| **Current assets** |
| Inventory/stock 4,000 |
| Accounts receivable/debtors 3,000 |
| Cash 400  **7,400** |
| **Total assets 21,400** |
| **Capital and liabilities** |
| Preference share capital 1,000 |
| Ordinary share capital 1,000 |
| Paid in capital in excess 2,000 |
| Retained earnings 1,400  **5,400** |
| Non-current liabilities |
| Mortgage 4,000 |
| Debenture 6,000  **10,000** |
| Current liabilities |
| Accounts payable 5,000 |
| Notes payable 1,000  **6,000** |
| 21,400 |

Income Statement

|  |
| --- |
| **Shs 000**  Sales 6,000  Cost of sales (3,500)  Selling and administration expenses (1,000)  EBIT 1,500  Interest (1,100)  EBT 400  Tax 30% 120  PAT/EAT **280** |

**Required:**

1. Predict the company’s failure using Altman’s Z-score and interpret its meaning

(10 marks)

1. Explain five options in dealing with financial distress in the corporate sector

(10 marks)

**QUESTION FOUR**

1. What are the costs associated with forecasting or not forecasting (4 marks)
2. A food processing company uses moving average to forecast next month’s demand. Past actual demand (in units) as shown below:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Month** | **43** | **44** | **45** | **46** | **47** | **48** | **49** | **50** | **51** |
| **Actual demand** | **105** | **106** | **110** | **110** | **114** | **121** | **130** | **128** | **137** |

**Required:**

1. Compute a simple 5 month moving average to forecast demand for month 52

(3 marks)

1. Compute a weighted 3 month moving average where the weights are highest for the latest months and descend in order of 3,2,1 (6 marks)
2. Use ordinary least square method to recast the demand for month 52 (7 marks)

**QUESTION FIVE**

1. Discuss the implication of efficient market hypothesis to investors (6 marks)
2. By use of examples, explain the differences between technical and fundamental analysis

(8 marks)

1. Write explanatory notes on the following form of market efficiency
2. Weak form (2 marks)
3. Semi strong form (2 marks)
4. Strong form (2 marks)