KENYATTA UNIVERSITY

SPECIAL/SUPPLEMENTARY EXAMINATIONS 2023/2024

EXAMINATION FOR DEGREE OF MASTER OF BUSINESS ADMINISTRATION

BAC 819: FINANCIAL ANALYSIS

APRIL/MAY 2024 **TIME: 3 HOURS**

INSTRUCTIONS: ***Answer all the question in the separate booklet provided.***

Clearly show all your workings in he booklet.

QUESTION ONE

(a) Identify any four limitations of using accounting ratios for the purposes of analyzing financial statements. **(4 marks)**

(b) Wanderland Ltd. prepares its financial statements as at 31 December each year Given below are the comparative income statements and balance sheets for the years ended 31 October 2022 and 20303.

Income statement for the year ended 31-December

	2023 Sh000	2022 Sh000
Sales	3600	3000
Cost of sales	2400	2400
Gross profit	1200	600
Administration expenses	300	180
Selling and distribution expenses	175	90
Interest	25	30
	500	300
Profits before tax	700	300
Tax	280	120
Profits after tax	420	180
Dividends paid	200	100
Retained profit	220	80

Statement of financial position as at 31-December

	2023 Sh000	2022 Sh000
Assets:		
Non-current assets		
Land and buildings	560	630
Machinery and equipment	400	480
Furniture	300	240
	1260	1350
Current assets		
inventory	240	130
Accounts receivable	200	240
Prepayments	130	60
Cash in hand and at bank	40	20
	710	450
Total assets	1970	1800
Equity and liabilities:		
Capital unit reserves		
Ordinary share capital	500	500
Share premium	200	200
General reserve	150	150
Retained profits c/d	670	450
	1520	1300
Non-current liability		
Long-term loan	200	300
Current liabilities		
Trade creditors	180	140
Accruals	70	60
	250	200
Total equity and liabilities	**1970**	**1800**

Required:

Calculate the following ratios for the two years ended 31 December 2022 and 2023 and comment of the profitability, efficiency, liquidity and long term solvency of Wanderland Ltd from the calculated ratios.

(i) Gross profit to sales (2 marks)
(ii) Net profit to fixed charges. (2 marks)
(iii) Inventory turnover (closing stock on 31 December 2021 was Sh. 110 million). (2 marks)
(iv) Current ratio. (2 marks)
(v) Acid test ratio (2 marks)
(vi) Trade receivables' collection period. (Assume there are 360 days in a year and that all sales are made on credit). (2 marks)

(vii) Gearing ratio (2 marks)
(viii) Return on capital employed. (2 marks)

(Total: 20 marks)

QUESTION TWO

The statement of financial position for the year ended 31 –December 2023 was as follows

	sh	sh
Non-current assets	10,000,000	
Current assets	26,000,000	
Total assets		36,000,000
Current liabilities		
Accounts payable	4,000,000	
Notes payable	4,800,000	
Other current liabilities	4,800,000	(13,600,000)
		22,400,000
Equity		
Ordinary share capital	8,000,000	
Retained earnings	10,,400,000	18,400,000
Noncurrent liabilities		
Long-term loan		4000,000
		11,400,000

Additional information

1. The profit after tax margin was 6% and the company sales for the year ended31-December 2023 was 40 million
2. Sales are expected to grow by 12%
3. The notes payable were paid off.

Required

Using the percentage of sales method of financial forecasting:

- **i.** Determine the external financial requirements for the year ending December 31 2028. **(8 marks)**
- **ii.** Prepare a Proforma statement of financial position as at 31-December 2028. **(4 marks)**
- **iii.** Discuss any two limitations of the percentage of sales method as a tool of financial forecasting. **(3 marks)**

(Total: 15 marks)

QUESTION THREE

a) Identify any five indicators of financial distress in a firm. **(5 marks)**

b) The accuracy of the Z-score models in predicting bankruptcy has been of 72-80% reliability meaning the percentage of companies that are correctly classified in a sample of estimations. These Z-score models measure the financial health of companies and are believed to be a good diagnostic tool to predict a bankruptcy of a company. The models have gained wide acceptance for the past two decades by auditors, management consultants, courts of law and even used in database systems used for loan evaluations.

Required:

i. Discuss **five** advantages that practitioners argue for use of z-score models approach in predicting corporate failure. **(5 marks)**

ii. Evaluate the limitations of the Z-score models. **(5 marks)**

(Total: 15 marks)

QUESTION FOUR

Watuwetu Ltd is preparing its budget for the four months commencing 1st April 2024. The company makes and sells a single product. The details of the product are as follows:

- Selling price sh. 800 per unit
- Direct material sh100 per unit
- Direct labor sh. 200 per unit
- Variable overhead sh. 120 per unit

The following schedule shows the actual sales and production units for the months of February and March 2024 and the forecasted units for the next four months to july 31-2024.

	February	March	April	May	June	July
Sales (units)	1300	1500	1700	1500	1800	1800
Production (units)	1400	1500	1800	2000	2200	2200

The following information is also available:

1. Fixed overhead is budgeted at sh. 140,000 per month including depreciation of sh. 20,000
2. Wages are paid 75% during the month in which they are earned and 25% the month following
3. Variable overhead is paid in the month in which its incurred
4. Material costs are paid two months after the material is used in production.

5. There is a tax liability of sh. 280,000 to be settled in February.
6. The company will purchase a new machine for sh. 400,000 in April 2024. The present machine will be sold for sh. 60,000 receivable in June 2024.
7. 5% of the monthly sales are for cash. The remainder will be sold on credit with debtors settling one month after the sales
8. The cash balance on 1st April 2024 is expected to be sh20,000

Required:

a) Prepare the cash budget for the four months commencing on 1st April 2024.**(10 marks)**