

EASTERN UNIVERSITY, SRI LANKA
FACULTY OF COMMERCE AND MANAGEMENT

**Final Year First Semester Examination in Bachelor of Commerce / Bachelor of
Commerce (Specialization in Accounting and Finance)-2017/2018(January 2020)**

(Proper/Repeat)

DAF 4013 Financial Reporting and Statement Analysis

Answer All Questions

Time Allowed: 03 Hours

Non Programmable Calculators are permitted.

- (I) Explain the claim: *Financial statement analysis is an integral part of business analysis.*
(04 Marks)
- (II) Describe the different types of business analysis. Identify the category of users of financial statements that applies to each different type of business analysis.
(04 Marks)
- (III) Identify and discuss the four primary financial statements of a business.
(04 Marks)
- (IV) State the four specialized financial analysis tools.
(04 Marks)
- (V) Discuss the advantages and limitations of ratio analysis.
(04 Marks)
- (Total 20 Marks)**

- (I) The Comparative Income Statement of HNP plc for years ended December 31, 2019 and 2018 are as follows:

	2019 Rs.	2018 Rs.
Sales	720,000	535,000
Cost of Sales	475,200	280,340
Gross Profit	244,800	254,660
Operating Expenses	151,200	103,790
Net Income	93,600	150,870

Required:

Express the above income statement information in common-size percents and assess whether this company's situation is favorable or unfavorable.

(04 Marks)

- (II) The Statement of Financial Position of MBC plc as at 31st December 2019, 2018, and 2017 are as follows:

	2019	2018	2017
	Rs.000	Rs.000	Rs.000
Property, plant, etc	277,500	255,000	229,500
Merchandise inventory	111,500	82,500	53,000
Accounts receivable, net	88,500	62,500	49,200
Prepaid expenses	9,700	9,375	4,000
Cash	30,800	35,625	36,800
Total Assets	518,000	445,000	372,500
Equity Capital (Rs.10 PS)	162,500	162,500	162,500
Retained Earnings	129,100	104,750	78,200
Long-term Loans mortgaged on plant assets	97,500	102,500	82,500
Accounts payable	128,900	75,250	49,200
Total liabilities and equity	518,000	445,000	372,500

Required:

Compare the year-end short-term liquidity position and the long-term risk and capital structure positions of this company at the end of 2019, 2018, and 2017 by computing the: (a) current ratio, (b) acid-test ratio, and (c) total debt /equity ratio. Comment on the ratio results.

(08 Mar)

- (III) KDS Company and ADS Company are similar firms that operate in the same industry. ADS began operations in 2014 and KDS in 2008. In 2019, both companies pay interest on their debt to creditors. The following additional information is available:

	KDS			ADS	
	2019	2018	2017	2019	2018
Total Asset Turnover	3.0	2.7	2.9	1.6	1.4
Return on Total Assets (%)	8.9	9.5	8.7	5.8	5.5
Net Profit Margin (%)	2.3	2.4	2.2	2.7	2.9
Sale (Rs.000)	400	370	386	200	160

Required:

Write a one-half page report comparing KDS and ADS using the available information. Your discussion should include their ability to use assets efficiently to produce profits. Also comment on their success in employing financial leverage in 2019.

(08 Marks)**(Total 20 Marks)**

Two companies competing in the same industry are being evaluated by a bank that can lend money to only one of them. Summary information from the financial statements of the two companies follows:

Data from the current year-end statement of financial position

Liabilities and Equity	DTC	STC	Assets	DTC	STC
Equity Shares (Rs.5 PS)	175,000	205,000	Plant and equipment, net	284,000	303,400
Retained Earnings	119,300	139,150	Merchandise inventory	83,440	131,500
Long-term notes payable	79,800	100,000	Accounts receivable, net	36,400	56,400
Current Liabilities	60,340	92,300	Notes receivable (trade)	8,100	6,200
			Prepaid expenses	4,000	5,950
			Cash	18,500	33,000
Total Liabilities and Equity	434,440	536,450	Total Assets	434,440	536,450

Current year's income statement data (Rs.)		
	DTC	STC
Sales	660,000	780,200
Cost of Sales	485,100	532,500
Interest expense	6,900	11,000
Income tax	12,800	19,300
Net income	67,770	105,000
Basic Earnings per share	1.94	2.56

Beginning-of-year data (Rs.)		
	DTC	STC
Merchandise inventory	54,600	106,400
Accounts receivable, net	28,800	53,200
Notes receivable (trade)	0	0
Total asset	388,000	372,500
Equity Shares (Rs.5 PS)	175,000	205,000
Retained earnings	94,300	90,600

Required:

- (a) Compute the current ratio, acid-test ratio, accounts (including notes) receivable turnover, inventory turnover, days' sales in inventory, and days' sales in receivables for both companies.

- (b) Identify the company that you consider to be the better short-term credit risk and explain why.
- (c) Compute the net profit margin, total asset turnover, return on total assets, and return on common stockholders' equity for both companies.
- (d) Assuming that each company paid cash dividends of Rs.1.50 per share and each company's share can be purchased at Rs.25 per share, compute their price-earnings ratios and dividend yields.
- (e) Identify which company's stock you would recommend as the better investment and explain why.

(15 Mar)

(II) Key comparative figures (Rupees in millions) for both NIKE and Reebok follow:

Key Figures	NIKE	Reebok
Net Sales	-	36,436
Revenue	95,531	-
Cost of Sales	60,655	22,940
Income taxes	2,534	125
Retained earnings	30,434	11,453

Key Figures	NIKE	Reebok
Merchandise inventory	13,966	5,100
Accounts receivable, net	16,744	5,100
Cash and equivalents	1,086	2,100
Total asset	53,974	17,300

Required:

- (a) Compute common-size percents for both companies using the data provided.
- (b) Which company incurs a higher percent of their revenues (net sales) in income taxes?
- (c) Which company retains a higher portion of cumulative net income in the company?
- (d) Which company has a higher gross margin ratio on sales?
- (e) Which company holds a higher percent of its total assets as inventory?

(05 Mar)

(Total 20 Mar)

(I) Compare and contrast effects of the FIFO and LIFO inventory costing methods on earning during a period of inflation.

(04 Marks)

(II) STM plc is a retailer buying and selling a single product. Beginning inventory is 350 units with the value of Rs.297,500 as at 1st of January, The following purchases are made during the year:

Month	No. of Units	Cost (Rs.)
January	250	218,750
March	375	346,875
June	825	841,500
October	470	538,150
December	325	391,625

Ending inventory as at December 31 is 820 units. Selling price per unit is Rs.2,100. Operating expenses for the year are Rs.850,000. The company has shareholders' equity (including current year net income) of Rs.1500,000. Total Assets, including inventories (based on market value), amount to Rs.2,250,000, of which Rs.500,000 are current. Current liabilities amount to Rs.250,000, and long-term liabilities equal Rs.500,000.

Required:

(a) Compute the net income for the year using each of the following inventory accounting methods. Assume income tax rate at 20%.

- (i) First In First Out (FIFO)
- (ii) Last In First Out (LIFO)
- (iii) Average Cost (weighted average)

(b) Evaluate the effects of each of inventory accounting methods given above by computing the relevant ratios on the profitability in relation to sales, profitability in relation to investment, short term solvency, capital leverage, and inventory management efficiency.

(16 Marks)

(Total 20 Marks)

05. (I) Capital Structure and Earnings for Year 2019 of FSR plc are as follows:

Number of ordinary shares outstanding on 31.12.2018.....	5,000,
Number of ordinary shares issued on 30.09.2019.....	1,000,
Number of 10% Convertible debentures of Rs.100 each.....	100,
Ordinary Shares of issuable on conversion per debenture.....	1,000,
Interest for the year.....	Rs.12,000,
Net income for Year 2019.....	
Tax rate relating to interest.....	

Required:

Calculate the following:

- (a) Basic Earnings Per Share
- (b) Diluted Earnings Per Share

(06 Mar

(II) The financial statements of DRG Plc for the years ended 31 December 2019 and 2018 produced as follows:

Income Statements for the years ended 31st December

	2018	2019
	Rs.000	Rs.000
Sales	1,636	1,782
Less: Cost of goods sold and operating expenses	1,473	1,599
Operating profit	163	184
Less: Interest expense	22	21
Pretax Profit	141	163
Less: Tax expense	52	59
Net income	89	104

Statements of Financial Position as at 31st December

Shareholders' Equity and Liabilities	2018	2019	Assets	2018	2019
	Rs.000	Rs.000		Rs.000	Rs.000
Ordinary Shares	414	414	Non-Current Assets		
Additional paid-in- capital	19	19	Property, plant, & equip	1,539	1,633
Retained earnings	437	541	Goodwill	7	7
treasury stock	(201)	(201)	Marketable securities	6	57
Total Shareholders' Equity	669	773	Investments in unconsolidated subsidiaries	34	62
Long Term Liabilities			Total Non-Current Asset	1,586	1,759
Long-term debt	507	474	Current Assets		
Pension and OPEB liabilities	744	852	Inventory	204	257
Total Long Term Liabilities	1,251	1,326	Accounts receivable	178	183
Current Liabilities			Marketable securities	38	44
Notes payable	8	14	Cash	115	72
Accounts payable	139	155	Total Current Assets	535	556
Taxes payable	24	13			
Current maturities of long-term debt	30	34			
Total Current Liabilities	201	216			
Total Shareholders' Equity and Liabilities	2,121	2,315	Total Assets	2,121	2,315

Required: Calculate the followings for the years 2018 and 2019

1. Net Operating Assets (NOA)
2. Net Financial Obligations (NFO)
3. $NOA = NFO + \text{Shareholders' Equity (SF)}$
4. Effective Tax Rate (ETR)
5. Effective Tax Expenses
6. Net Operating Profit After Tax (NOPAT)
7. Average Net Operating Asset for 2019
8. Return on Net Operating Assets (RNOA) for 2019
9. Return on Equity (ROE) for 2019

(14 Marks)

(Total 20 Marks)