PGDM / PGDM (IB), 2020-22

Advanced Financial Statement Analysis

DM-311 / IB-311

Trimester – III, End-Term Examination: April 2021

Time allowed: 2 Hrs 30 Min

Roll No: ____________

Max Marks: 50

Instruction: Students are required to write Roll No on every page of the Answer Sheet. All other instructions on the question paper / notifications should be followed meticulously.

Instruction: Show all the steps involved in solving the problems.

Section A (30 marks)

1. A) i) Discuss the inherent limitations of analyzing and interpreting financial statements for a single year. Include in your discussion the extent that these limitations are overcome by use of comparative financial statements computed over more than one year.
ii) A year-to-year analysis of comparative balance sheets and income statements is a useful analysis tool. Still, without proper care, such analysis can be misleading. Discuss factors or conditions that contribute to such a possibility. How can additional information and supplementary data (beyond financial statements) help prevent this possibility?
(5 marks x 2) (CILO 2)

OR

1. B) Frank Collins observes the following data for two companies:

	Company A	**Company B**
Revenue	4500	6000
Net income	50	1000
Current Assets	40000	60000
Total Assets	100000	700000
Current Liabilities	10000	50000
Total debt	60000	150000
Shareholders’ equity	30000	500000

Which of the following choices best describes reasonable conclusions that Collins might make about the two companies’ ability to pay their current and long – term obligations? **Explain with reasons**

A. Company A’s current ratio of 4.0x indicates it is more liquid than Company B, whose current ratio is only 1.2x, but Company B is more solvent, as indicated by its lower debt - to - equity ratio.

B. Company A’s current ratio of 25 percent indicates it is less liquid than Company B, whose current ratio is 83 percent, and Company A is also less solvent, as indicated by a debt - to - equity ratio of 200 percent compared with Company B’s debt - to – equity ratio of only 30 percent.

C. Company A’ s current ratio of 4.0x indicates it is more liquid than Company B, whose current ratio is only 1.2x, and Company A is also more solvent, as indicated by a debt - to - equity ratio of 200 percent compared with Company B’s debt - to – equity ratio of only 30 percent.

(5 marks) (CILO 2)

ii) Brown Corporation had an average days' sales outstanding of 19 days in 2005. Brown wants to decrease its collection period in 2006 to match the industry average of 15 days. Credit sales in 2005 were $300 million, and Brown expects credit sales to increase to $390 million in 2006. To achieve Brown's goal of decreasing the collection period, what should be the change in the average accounts receivable balance from 2005 to 2006 that must occur?
(5 marks) (CILO 2)

2. A

You are an analyst reviewing Foxx Company. The following data are available for your financial analysis (unless otherwise indicated, all data are as of December 31, Year 2):

Current ratio	2
Accounts receivable turnover	16
Beginning accounts receivable	INR 50000
Return on end-of-year common equity	20%
Sales (all on credit)	INR 1000000
Day's sales in inventory	36 days
Gross profit margin ratio	50%
Expenses (excluding cost of goods sold)	INR 450000
Total debt to equity ratio	1
Noncurrent asset	INR 300000

Required:
Using these data, construct the December 31, Year 2, balance sheet for your analysis. Current assets consist of cash, accounts receivable, and inventory. Balance sheet classifications include cash, accounts receivable, inventory, total noncurrent assets, total current assets, total current liabilities, total noncurrent liabilities, and equity. (10 marks) (CILO 1)

OR

2. B)
i) '*Conservatism* involves reporting the least optimistic view when faced with uncertainty in measurement' – Critically discuss the statement along with the significance of this statement.
ii) 'Supporters strongly believe that accrual accounting is superior to cash accounting, both for measuring performance and financial condition.' – Do you agree with this statement? Critically discuss.
(5 marks * 2) (CILO 1)

3. A) i) '*Accounting distortions* are deviations of reported information in financial statements from the underlying business reality. Accounting standards are sometimes responsible for distortions.' – Critically discuss this statement. (CILO 2) (5 marks)
ii) 'Why are earnings announcements made in advance of the release of financial statements? What information
do they contain and how are they different from financial statements? (CILO 2) (5 marks)

OR

3. B) Financial statement users often liken accounting standard setting to a political process. One user asserted that: *My view is that the setting of accounting standards is as much a product of political*

action as of flawless logic or empirical findings. Why? Because the setting of standards is a social decision. Standards place restrictions on behavior; therefore, they must be accepted by the affected parties. Acceptance may be forced or voluntary or some of both. In a democratic society, getting acceptance is an exceedingly complicated process that requires skillful marketing in a political arena. Many parties affected by proposed standards intervene to protect their own interests while disguising their motivations as altruistic or theoretical. People often say, "If you like the answer, you'll love the theory." It is also alleged that those who are regulated by the standard-setting process have excessive influence over the regulatory process. One FASB member declared: "The business community has much greater influence than it's ever had over standard setting. I think it's unhealthy. It is the preparer community that is really being regulated in this process, and if we have those being regulated having a dominant role in the regulatory process, that's asking for major trouble."
Required:
Discuss the relevance of the accounting standard-setting process to analysis of financial statements. (10 marks) (CILO 2)

Section B (20 marks)
Important: Please demonstrate all the steps for computation

4. Ameya Ltd is a listed public company which has net fixed assets of INR 2000. Most of the items are Plant and machinery. It also has a land and building which is under construction worth INR 200. During the year, one office building was vacated and was sold, as new office was purchased at more convenient location. This new office was purchased at INR 300. Turnover of last few years had been INR 3000, INR 2700 & INR 3200 for financial years 2018-19, 2019-2020, 2020-21 respectively. Ebitda was 30% and depreciation was INR 50, interest was INR 100, amortisation was INR 20. Tax on balance profits was 25%. Financial liabilities were INR 1000, while trade payable were INR 600 while trade receivable were double of that. Inventory no of days 1 month of turnover. Normally INR 50 had been old inventory, which is unsaleable lying due to design change. It is very likely that it will get sold at half the cost. Bank guarantees issued were INR 300 for tender. Legal claims likely INR 40. Latest valuation shows that one of the asset in balance sheet worth INR 40 has totally impaired. Equity share capital and reserves and surplus are 1:2 ratio. Intangible assets were valued are INR 190 of which only software worth INR 90 are in balance sheet. Other assets like brand cannot be shown in balance sheet, as per Ind AS.

(Question 1 is compulsory having 6 marks, and remaining 7 questions are of 2 marks each)

Q 1. Draw Profit and Loss Account and Balance Sheet based on available figures above along with notes on contingent liabilities

Q 2. Show financial liabilities presentation presuming 20% repayable in next 12 months

Q 3. Prepare ratio analysis of at least 10 ratios

Q 4. Analyse above ratios and draw conclusions

Q 5. If competitors are paying 30% dividend on share capital, how much dividend Amey should be paying if only 50% of distributable surplus is to be spent or 20% whichever is higher.

Q 6. Bank asked for MIS considering impact of impairments, 20% of legal claims and 10% of guarantees and fair valuations of other off balance sheet items. Draw revised balance sheet for MIS purpose.

Q 7. For 20-21, this company holds 20% market share, and market leader had 32% market share and other 3 players were to hold equal share of balance. In current year 20-21, what should have been turnover amount, if total market was to remain same but only leader's share was to drop and will be captured by Amey captures and other 3 companies grab that in ratio of 3:1:1:1.

Q 8 what would have been the EBITDA of Amey in amount & percentage, if it was to become market leader as per above calculation and if 30% of costs before EBITDA were fixed cost?

(CILO 3)