PGDM, 2016-18

Financial Statement Analysis

DM-313/IB-313

Trimester – IV, End-Term Examination: March 2017

Time Allowed: 2 Hrs 30 mins **Max Marks: 50**

Sec A

(Answer any three questions out of five. Each question carries five marks)

1. Discuss the implication for Efficient Market Hypothesis (EMH) on financial statement analysis.

2. What are the two types of conservatism? Which type of conservatism is more useful for analysis?

3. 'Accounting income has elements of both permanent income and economic income. Explain this statement.' – Critically examine this statement.

4. What gives rise to accounting distortions? Explain.

5. What is meant by earnings quality? Why do users assess earnings quality? What major factors determine earnings quality?

Sec B

(Answer any two questions out of three. Each question carries ten marks)

6. Describe factors that bring about managerial discretion for preparing financial statements.

7. i) It is often asserted: *From an operational point of view, management focuses on cash rather than working capital.* Do you agree with this statement? Why or why not?

ii) Why are short-term cash forecasts important for the analysis of financial statements? What limitations are associated with short-term cash forecasting? (5 marks x 2)

8. Describe the steps in forecasting the income statement.

Sec C

(Compulsory)

9. Following are the selected financial data from Consolidated Technologies, Inc., at December 31, Year 1:

Cash	$ 70,000
Accounts receivable	150,000
Inventory	65,000
Fixed assets	200,000
Accumulated depreciation	43,000
Accounts payable	130,000
Notes payable	35,000
Accrued tax liability	18,000
Capital stock	200,000

The following additional information is reported for the year ended December 31, Year 1:

Sales	$750,000
Cost of sales	520,000
Purchases	350,000
Depreciation	25,000
Net income	20,000

Consolidated Technologies anticipates 10% growth in sales for Year 2. All revenue and expense items are expected to increase by 10%, except for depreciation, which remains the same. All expenses are paid in cash as they are incurred, and Year 2 ending inventory is projected at $150,000. By the end of Year 2, Consolidated Technologies expects to have notes payable of $50,000 and a zero balance in accrued taxes. The company maintains a minimum cash balance of $50,000 as a managerial policy.

i) Consolidated Technologies is considering a change in credit policy where ending accounts receivable reflect 90 days of sales. What impact does this change have on the company's cash balance? Will this change affect the company's need to borrow?

ii) What if Consolidated Technologies worked to achieve an *average* accounts receivable turnover of 4.0 (instead of using *ending* receivables as in the previous case)? What impact does this change have on the company's cash balance?

(15 marks)