

SOLUTIONS TO HOMEWORK: SESSION 6**TOPIC: COMPANIES - INTERPRETATION OF FINANCIAL STATEMENTS****QUESTION 1**

1.1 Tool to analyse liquidity position of company – show why there has been a change in the balance in the bank account from one year to another. ✓✓ (2)

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1.2

GR8 XPECTATIONS LIMITED
CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2009

<i>Full marks for answer – if incorrect, look at workings</i>		R	
Cash flows from operating activities	(a)	(76 140)	✓
Cash generated from operations		1 516 595	
Interest paid	(b)	(276 875)	✓
Dividends paid	(c)	(897 500)	☑
or 927 500 <i>If any one part correct</i> [530 000 ✓ – (1 325 000 x 0,7) ✓ – 500 000 ✓]			
Taxation paid		(418 360)	
Cash flows from investing activities		(906 250)	
Purchase of non-current assets	(d)	(1 000 000)	✓
Proceeds from sale of non-current assets	(e)	343 750	☑
16 104 775 ✓ – (15 117 500 ✓ + 1 000 000 ✓ – 356 475 ✓)			
Increase in investments		(250 000)	
Cash flows from financing activities		1 935 000	✓
Proceeds from issue of shares	(g)	1 685 000	☑
14 725 000 ✓ – 13 040 000 ✓			
Proceeds from long-term borrowings		250 000	

Net change in cash and cash equivalents	(h)	952 610	☑
Cash and cash equivalents at beginning of year		(789 035)	
Cash and cash equivalents at end of year	(i)	163 757	✓
			[18]

1.3 Study the completed cash flow statement and the notes to the cash flow statement and answer the following questions:

1.3.1 Good=2 Satisfactory=1 incorrect=0

Depreciation is a **non-cash item** and has no influence on the cash flow of the entity – it is added to the profit before taxation to cancel the affect it had on the profit of the entity. ✓✓

(2)

1.3.2 Why was more shares issued when the company made a profit?

Any one ✓✓

A profit does not necessarily generate “cash” as it can include accrued income and accrued expenses.

Cash was needed to finance the dividend and the purchase of non-current assets

(2)

1.4 Calculate (to one decimal place) the following financial indicators for the year ended 30 June 2009

Ratios must be in correct order

1.4.1 Mark-up percentage (gross profit percentage) on cost of sales

$$\begin{aligned} & \frac{\text{Gross profit}}{\text{Cost of Sales}} \times \frac{100}{1} \\ = & \frac{2\,907\,600 \checkmark}{4\,386\,400 \checkmark} \times \frac{100}{1} \\ = & 66,3\% \checkmark \end{aligned}$$

Give method mark for operation if one of components is correct. Accept only %

(3)

1.4.2 Percentage return on average shareholders' equity (after tax)

$$\begin{aligned} & \frac{\text{Net income after tax}}{\text{Average shareholders' equity}} \times \frac{100}{1} \\ = & \frac{915\,180 \checkmark}{\frac{1}{2}(16\,941\,490 + 14\,581\,310)} \times \frac{100}{1} \\ = & \frac{915\,180}{15\,761\,400 \checkmark\checkmark} \times \frac{100}{1} \\ = & 5,8\% \checkmark \end{aligned}$$

Give method mark for operation if one of components is correct. Accept only % (4)

1.4.3 Earnings per share

$$\begin{aligned} & \frac{\text{Net income after tax}}{\text{Number of shares issued}} \times \frac{100}{1} \\ = & \frac{915\,180}{10\,600\,000 \div R8} \times \frac{100}{1} \\ = & \frac{915\,180 \checkmark}{1\,325\,000 \checkmark} \times \frac{100}{1} \\ = & 69,1 \text{ cents } \checkmark \end{aligned}$$

Give method mark for operation if one of components is correct (3)

1.4.4 Net asset value per share

$$\begin{aligned} & \frac{\text{Ordinary shareholders' equity}}{\text{Number of shares issued}} \times \frac{100}{1} \\ = & \frac{16\,941\,490 \checkmark}{1\,325\,000 \checkmark} \times \frac{100}{1} \\ & \text{As per 5.4.3} \\ = & 1278,6 \text{ cents } \checkmark \end{aligned}$$

Give method mark for operation if one of components is correct (3)

1.4.5 Debt/equity ratio

$$\begin{aligned} & \text{Non-current liabilities : Shareholders' equity} \\ & 1\,250\,000 \checkmark : 16\,941\,490 \checkmark \\ & 0,07 : 1 \checkmark \end{aligned}$$

Give method mark for operation if one of components is correct. (3)

1.5 Profitability

- 1.5.1** Any *THREE* – one mark each ✓ ✓ ✓
 Inventory (stock) being stolen.
 Inventory taking not accurate.
 Selling prices incorrectly calculated.
 Old inventory not being written off but only excluded from inventory taking.
 Merchandise being sold for less than marked prices.
 Money being stolen.
Any other acceptable answer (3)

- 1.5.2** Any *three* – one mark each ✓ ✓ ✓
 Security scanners at door.
 Security check-point at door – check slip / invoice against items.
 Closed-circuit cameras
 Security check-point for employees.
Any other acceptable answer (3)

1.6 Liquidity:

- 1.6.1** The current ratio assesses the relationship between current assets and current liabilities to identify whether the business is likely to experience liquidity problems. ✓

 Acid-test ratio tests the ability of the business to settle short-term obligations without having to rely on the selling of inventory (which is less liquid than the other current assets), especially in conditions when the business is experiencing economic depression, a drastic decline in sales, etc. ✓ (2)

- 1.6.2 Any three indicators – one mark each ✓ ✓ ✓
 Trends quoted for each – one mark each ✓ ✓ ✓
 Accept one figure quoted plus description of trend

Current ratio	–	0,72 : 1 to 1,95 : 1
Acid-test ratio	–	0,40 : 1 to 1,12 : 1
Inventory (stock) turnover rate	–	5,9 times to 3,3 times
Average debtors' collection	–	77,5 days to 66,5 days
Average creditors' payment	–	100,7 days to 60,4 days
General comment	✓✓✓	

Can show separately for each indicator

Good=2 Satisfactory=1

Liquidity improved – indicators improved from 2008 to 2009. **(9)**

- 1.7 Any two indicators – one mark each ✓ ✓
 Description of trend – one mark each ✓ ✓
 Indicators quoted – one mark each ✓ ✓

% return on shareholders equity – improved from 4,6% to 5,8%.

Net asset value per share – improved from 1 223 cents to 1278,6 cents.

Earnings per share – improved from 62,1 cents to 69,1 cents.

Market price of 1100 cents – less than issued price of 1272 cents.

Market price of 1100 cents – less than net asset value of 1278,6 cents. **(6)**

1.8

1.8.1 How many shares would I.M. Ntrouble own on 30 July 2009?

$$50 + 95 + 165$$

$$= 310 \text{ shares } \checkmark\checkmark\checkmark$$

(3)

1.8.2 Calculate the total dividend she would have received in the 2009 financial year.

$$310 \text{ shares} \times 70 \text{ cents}$$

$$= 21\,700 \text{ cents} / R217,00 \checkmark\checkmark\checkmark$$

Give method mark for operation if one of components is correct.

(3)

1.8.3 310 shares x 1100 cents

$$= 341\,000 \text{ cents} / R3\,410 \checkmark$$

Give method mark for operation if one of components is correct.

(3)

1.8.4 Any one valid point – three marks

Excellent=3 Good = 2 Satisfactory = 1

E.g.

Motivation to employees to buy into the success of company –
one of shareholders (owners) of company – will share in
dividends.

(3)

TOTAL MARKS: 75