# Chapter 9
# Analysis and Communication of Accounting Information

## Working capital cycle

This ratio calculates the time taken between a business making payments for good received and the receipts of cash from customers for the sale of the goods. The shorter the time between the business laying out cash for the purchase of goods and the collection of cash for the sales of the goods, the better for the business, since less finance from other sources is needed

| | |
|---|---|
| Working Capital Cycle (in days) | Trade Receivables Turnover (in days) + Inventory Turnover (in days) – Trade Payables Turnover (in days)<br>**or**<br>Average Collection Period + Inventory Turnover (in days) – Average Payment Period |

## Net working assets to sales

This calculation shows the proportion of sales revenue that is tied up in the less liquid net current assets, in other words, the value of the net working assets that is not immediately available for use in the business

| | |
|---|---|
| Net Working Assets to Revenue (Sales) | Net Working Assets = Inventories + Trade Receivables – Trade Payables<br>$\frac{\text{Net Working Assets}}{\text{Revenue (Sales)}} \times 100$ |

## Income gearing

Income gearing shows the ratio of interest paid on borrowings expressed as a percentage of profit from operations

| | |
|---|---|
| Income Gearing | $\frac{\text{Interest Expense}}{\text{Profit Before Interest and Tax (PBIT)}} \times 100$ |

## Gearing ratio

Gearing is the relationship that exists between fixed cost capital and total capital
The ordinary shareholder's return may be at risk if the company's capital is provided mainly by debentures holders and preference shareholders
The degree of risk is measures by the gearing ratio

| | |
|---|---|
| Gearing Ratio | $\frac{\text{Fixed Cost Capital}}{\text{Total Capital}}$<br>which is:<br>$\frac{\text{Non-Current Liabilities + Preference Share Capital}}{\text{Issued Ordinary Share Capital + All Reserves + Non-Current Liabilities + Preference Shares}}$ |

## Earning per share

**Earnings** are the profit for the year after taxation and preference dividend; that is, earnings that belong totally to the ordinary shareholders

| | |
|---|---|
| Earnings per share | $\frac{\text{Net Profit} - \text{Preference Share Dividend}}{\text{Number of issued Ordinary Shares}}$ |

## Price earnings ratio

The P/E ratio relates the market price of the share to the earnings per share. It represents the number of years; earnings that investors are prepared to pay to purchase one of the company's shares

| | |
|---|---|
| Price Earnings Ratio | $\frac{\text{Market Price per share}}{\text{Earnings per share}}$ |

## Dividend yield

Shareholders invest in a company in order to gain a return on their investment
The dividend yield expresses the actual dividend received by the shareholder as a percentage of the market price of the share. It shows the actual percentage return an investor can expect based on the current market price of the shares

| | |
|---|---|
| Dividend yield | $\frac{\text{Dividend paid and proposed}}{\text{Market Price of share}}$ |

## Dividend coverage

This ratio indicates how likely it is that the company can continue to pay its current rate of ordinary dividend in the future

| | |
|---|---|
| Dividend cover | $\frac{\text{Profit available to pay ordinary dividend}}{\text{Ordinary dividend paid}}$ |

## Summary of Financial Ratios

| | |
|---|---|
| Working Capital Cycle (in days) | Trade Receivables Turnover (in days) + Inventory Turnover (in days) – Trade Payables Turnover (in days)<br>**or**<br>Average Collection Period + Inventory Turnover (in days) – Average Payment Period |
| Net Working Assets to Revenue (Sales) | Net Working Assets = Inventories + Trade Receivables – Trade Payables<br>$\frac{\text{Net Working Assets}}{\text{Revenue (Sales)}} \times 100$ |
| Income Gearing | $\frac{\text{Interest Expense}}{\text{Profit Before Interest and Tax (PBIT)}} \times 100$ |
| Gearing Ratio | $\frac{\text{Fixed Cost Capital}}{\text{Total Capital}}$<br>which is:<br>$\frac{\text{Non-Current Liabilities + Preference Share Capital}}{\text{Issued Ordinary Share Capital + All Reserves + Non-Current Liabilities + Preference Shares}}$ |

## Summary of Investment Ratios

| | |
|---|---|
| Earnings per share | $\frac{\text{Net Profit – Preference Share Dividend}}{\text{Number of issued Ordinary Shares}}$ |
| Price Earnings Ratio | $\frac{\text{Market Price per share}}{\text{Earnings per share}}$ |
| Dividend yield | $\frac{\text{Dividend paid and proposed}}{\text{Market Price of share}}$ |
| Dividend cover | $\frac{\text{Profit available to pay ordinary dividend}}{\text{Ordinary dividend paid}}$ |
| Dividend per share | $\frac{\text{Ordinary dividend paid}}{\text{Number of issued Ordinary Shares}}$ |

## Note

Calculate ratios using year-end balances where appropriate, unless the question specifies the use of average figures.
Calculate ratios to the number of decimal places required by the question.

## Book value per share

Book value per share = Equity/ No of ordinary shares issued

## Past Paper Questions

**Q # 1.** The final accounts for Abercrombie plc for the year ended 30 April 2012 had been prepared. Due to a fire it is now necessary to prepare them again from limited information.

The accountant provides you with the following details:

| | |
|---|---|
| Rate of inventory turnover | 10 times |
| Gross profit ratio | 35% |
| Net profit ratio | 15% |
| Income gearing | 12.5% |

The administrative expenses for the year were twice as much as the distribution costs.
The taxation charge for the year was equal to half of the interest charge.
The inventories at 30 April 2012 were valued at $81 250 which was 25% higher than the inventories valuation at 1 May 2011.

REQUIRED

**(a)** Prepare the income statement for the year ended 30 April 2012. [18]

**Additional information**

1 The non-current asset turnover was 2.
2 The current ratio was 1.9:1.
3 Current assets also included the bank balance and the only current liability was trade payables.
4 Trade receivables turnover was 34 days. All sales were on credit.
5 Trade payables turnover was 59 days. All purchases were on credit.
6 Interest was paid on a 10% debenture redeemable in 2020.
7 No interim dividends were paid but a final dividend of $0.05 per share was proposed.
8 The total proposed dividend was $10 000, ordinary shares are $1 nominal value and there was no share premium.
9 The balance on the retained earnings account at 1 May 2011 was $23 756 credit.
10 There was a revaluation reserve which was the balancing figure.

REQUIRED

(b) Prepare the statement of financial position at 30 April 2012. [20]
(c) State how a proposed final dividend should be dealt with in the accounts. [2]

**November 2012**

**Q # 2** The directors of Wotknot Limited provided the following information.
Equity and liabilities (balances) at 1 May 2013

| | $ |
|---|---|
| Share capital, 200000 ordinary shares of $0.50 each | 100000 |
| General reserves | 40000 |
| Retained earnings | (40000) |
| 10% debenture | 50 000 |

At 30 April 2014 inventory was valued at $80000. This was 100% more than the inventory valuation at 30 April 2013.

The following information is available for the year ended 30 April 2014.

| | |
|---|---|
| Inventory turnover | 10 times |
| Gross profit margin | 40% |
| Operating expenses to sales ratio | 21% |
| Administrative expenses | $140000 |
| Transfer to general reserves | $20000 |
| Dividends paid | $0.08 per share |
| Non-current asset turnover | 0.2 times |
| Trade receivables turnover | 40 days |
| Trade payables turnover | 35 days |

The only current assets were inventory and trade receivables. All sales and purchases were on a credit basis.

REQUIRED

(a) Prepare, in as much detail as possible, the income statement for the year ended 30 April 2014 [10]
(b) Prepare the statement of changes in equity for the year ended 30 April 2014. [5]
(c) Prepare, in as much detail as possible, the statement of financial position at 30 April 2014. [12]

**Additional information**

The following information is available for Siri Limited, a similar business, for the year ended 30 April 2014.

| | |
|---|---|
| Inventory turnover | 15 times |
| Gross profit margin | 45% |
| Operating profit margin | 15% |
| Current ratio | 2:1 |
| Trade receivables turnover | 35 days |
| Trade payables turnover | 28 days |
| Dividend yield | 12% |
| Gearing | 60% |

(The market value of Wotknot Limited's shares at 30 April 2014 was $1.60)

REQUIRED

(d) Compare the performance of Wotknot Limited with Siri Limited for the year ended 30 April 2014. [13]

**Nov 2014**

**Q # 3** Chandra is considering investing in ordinary shares. He has obtained the summarised financial statements of two companies, Richards Limited and Sobers Limited.

The following data is available.

| | Richards Limited | Sobers Limited |
|---|---|---|
| | $ | $ |
| **Income Statements** | | |
| Gross profit | 85 000 | 65 000 |
| Profit from operations | 66 000 | 48 000 |
| Finance charges | (6 000) | (8 000) |
| Profit before tax | 60 000 | 40 000 |
| Tax | (30 000) | (20 000) |
| Profit after tax | 30 000 | 20 000 |
| **Statements of Financial Position** | | |
| Total assets | 500 000 | 400 000 |
| Equity | | |
| $1 ordinary shares | 150 000 | 100 000 |
| Share premium | 15 000 | 20 000 |
| Retained earnings | 105 000 | 85 000 |
| | 270 000 | 205 000 |
| Non-current liabilities | | |
| 8% debentures (2022) | 75 000 | 100 000 |
| Current liabilities | 155 000 | 95 000 |
| Total equity and liabilities | 500 000 | 400 000 |

Both companies have non-current assets equal in value to their current assets.

The market value of an ordinary share in Richards Limited is $1.80.
The market value of an ordinary share in Sobers Limited is $2.40.
Neither company has paid any dividends during the year.
Richards Limited proposes a final dividend of $0.06 per ordinary share and Sobers Limited $0.09 per ordinary share.

REQUIRED

(d) Calculate the following ratios for both companies.
(i) Current ratio
(ii) Return on capital employed
(iii) Gearing ratio
(iv) Income gearing
(v) Earnings per share

(vi) Price earnings ratio
(vii) Dividend yield. [14]

(e) Advise Chandra which company he should invest in. Base your answer on your calculations for the return on capital employed, gearing ratio and income gearing only. [6]

**June 2015**

**Q # 4** Five friends each have $20000 to invest and are considering whether to invest in ABC plc or DEF plc. The following information is available from the latest financial statements of ABC plc.

**Summarised income statement**

| | $ |
|---|---|
| Revenue | 4700000 |
| Cost of sales | 2115000 |
| Gross profit | 2585000 |
| Expenses | 1645000 |
| Profit from operations | 940000 |
| Debenture interest | 50000 |
| Profit for the year | 890000 |

**Summarised statement of financial position**

| | $ | $ |
|---|---|---|
| Non-current assets | | 2100000 |
| Current assets | | |
| Inventory | 880000 | |
| Trade receivables | 480000 | |
| Cash and cash equivalents | 10000 | 1370000 |
| Total assets | | 3470000 |
| 1000000 ordinary shares of $1 each | | 1000000 |
| Share premium | | 400000 |
| Revaluation reserve | | 800000 |
| Retained earnings | | 450000 |
| | | 2650000 |
| Non-current liabilities – debentures | | 500000 |
| Current liabilities – trade payables | | 320000 |
| | | 3470000 |

Other information about ABC plc is as follows:

**1** The dividends paid in the year amounted to $440 000.

**2** All sales and purchases are made on credit.

**3** The value of inventory has remained stable over several years.

**4** The market value of one share is $5.60.

The following information is also available about DEF plc.

| | |
|---|---|
| Earnings per share | $0.57 |
| Dividend per share | $0.48 |
| Gearing ratio | 43.4% |
| Income gearing | 17.7% |
| Trade payables payment period | 97 days |
| Price earnings ratio | 7.18 |
| Dividend cover | 1.19 times |
| Dividend yield | 11.7% |
| Par value of one share | $1 |

The five friends all have different criteria for their investment decision.
Jazgul is an ethical investor and is concerned that suppliers get their money in good time.
Jackson needs a good cash flow and seeks a high return in terms of cash in the short term.
Khan seeks capital growth.
Madge wishes to be confident in a company's ability to maintain earnings in the future.
Bernard is risk averse and wants to invest in a company which is on a sound financial footing.

**REQUIRED**

**(a)** Identify and calculate for **each** potential investor the ratio for ABC plc which would **particularly interest** him or her. [10]
**(b)** Explain what the ratio you have calculated for **each** investor shows the investor. [10]
**(c)** Decide which is the most suitable investment for **each** investor. [5]

**SP 2016**

**Q # 5** Johnson plc commenced trading on 1 January 2010. On that date there was an issue of 600000 ordinary shares. Each share had a nominal value of $0.50 and was issued at $0.75.
At the same time there was a share issue at par of 100 000 5% non-redeemable preference shares of $0.25 each. On 1 January 2015 Johnson plc issued $100 000 12% debentures repayable in 2027.

**On 31 December 2015:**

- The total assets were $582 000 of which current assets totalled $25 000
- The current assets to current liabilities ratio was 2.5:1
- The market value of one ordinary share was $2.50 and of one preference share was $1.25
- The retained earnings for the year ended 31 December 2015 were calculated as follows.

| | $ |
|---|---|
| Profit from operations | 192 000 |
| Finance costs | (12 000) |
| Taxation | (36 000) |
| Profit after taxation | 144 000 |
| Ordinary share dividend | (54 000) |
| Preference dividend | (2 000) |
| Retained earnings for the year | 88 000 |

**REQUIRED**

**(a)** Prepare the equity and liabilities section of the statement of financial position at 31 December 2015. [5]

**(b)** Calculate for the year ended 31 December 2015:
**(i)** The dividend cover [2]
**(ii)** The gearing ratio [2]
**(iii)** The return on capital employed. [2]

**Additional information**

Samuel plc is a successful company in the same industry sector as Johnson plc. Both companies are considering issuing ordinary shares in 2016
The following ratios have been calculated for Samuel plc for the year ended 31 December 2015.

| | |
|---|---|
| Dividend cover | 2.1 times |
| Gearing ratio | 67.4% |
| Return on capital employed | 28.5% |
| Ordinary dividend per share | $0.20 |
| Earnings per share | $0.28 |

**REQUIRED**

**(c)** Analyse the performance of **both** companies. Use **all** information available. [9]
**(d)** Recommend which company would provide the better return on an investment in ordinary shares. Justify your answer. [5]

**March 2016**

**Q # 6** Winterbottom plc and Ramsey plc are two similar trading companies which have been successfully trading for many years. Their financial statements prepared for internal purposes are shown below:

Income statements for the year ended 30 June 2015

| | Winterbottom | Ramsey |
|---|---|---|
| | $000 | $000 |
| Revenue | 6 279 | 4 527 |
| Cost of sales | (2 075) | (1 254) |
| Gross profit | 4 204 | 3 273 |
| Depreciation | (1 285) | (720) |
| Other expenses | (1 227) | (992) |
| Profit on disposal of non-current assets | 28 | 15 |
| Profit from operations | 1 720 | 1 576 |
| Finance charges | (300) | (180) |
| Profit before taxation | 1 420 | 1 396 |
| Taxation | (317) | (312) |
| Retained profit for the year | 1 103 | 1 084 |

Statements of financial positions at 30 June 2015

| | Winterbottom $000 | Ramsey $000 |
|---|---|---|
| Non-current assets | 9 864 | 6 192 |
| Current assets | | |
| Inventories | 782 | 451 |
| Trade receivables | 1 362 | 742 |
| Cash and cash equivalents | 135 | 98 |
| | 2 279 | 1 291 |
| Total assets | 12 143 | 7 483 |
| Equity and liabilities | | |
| Equity | | |
| Ordinary share capital ($1 each) | 4 500 | 2 500 |
| Share premium | 200 | – |
| Retained earnings | 1 447 | 1 244 |
| | 6 147 | 3 744 |
| Current liabilities | | |
| Trade payables | 679 | 427 |
| Taxation | 317 | 312 |
| | 996 | 739 |
| Non-current liabilities | | |
| 6% Debentures (2024) | 5 000 | 3 000 |
| Total equity and liabilities | 12 143 | 7 483 |

**Additional information**

1 Neither company has paid an interim dividend during the year ended 30 June 2015.
2 The directors of Winterbottom plc propose a dividend of $0.20 per share and those of Ramsey plc $0.35 per share for the year ended 30 June 2015.
3 At 30 June 2015, the market value of an ordinary share in Winterbottom plc is $3.50 and in Ramsey plc $2.75.

**REQUIRED**

**(a)** Calculate the following ratios for **both** companies to **two** decimal places.
**(i)** Income gearing
**(ii)** Earnings per share
**(iii)** Price earnings ratio
**(iv)** Dividend yield
**(v)** Dividend cover [10]

**Additional information**

Alfredo is considering investing in one of the companies but is uncertain which will offer the best return.

Recent industry averages were as follows:

| | |
|---|---|
| Income gearing | 20.25% |
| Earnings per share | $0.33 |
| Price earnings ratio | 12.50 |
| Dividend yield | 10.45% |
| Dividend cover | 1.20 times |

**REQUIRED**

**(b)** Analyse the performance of **both** companies compared to the industry averages. [10]
**(c)** Advise Alfredo which company he should invest in. Justify your answer. [5]

**June 2016**

**Q # 7** The directors of Corim plc are using accounting ratios to analyse the performance of the company.

**REQUIRED**

**(a)** Explain **two** benefits of using accounting ratios. [4]

**Additional information**

All sales and purchases of Corim plc are on credit.
The following are the income statement and statement of financial position for Corim plc

Income Statement
for the year ended 31 December 2015

| | $ |
|---|---|
| Revenue | 843 000 |
| Cost of sales | (425 800) |
| Gross profit | 417 200 |
| Operating expenses | (321 000) |
| Profit from operations | 96 200 |
| Finance costs | (66 000) |
| Profit for the year | 30 200 |

Statement of Financial Position
at 31 December 2015

| | $ |
|---|---|
| **Assets** | |
| Non-current assets | |
| Plant and equipment | 884 000 |
| Current assets | |
| Inventory | 88 800 |
| Trade receivables | 132 400 |
| Cash and cash equivalents | 14 800 |
| | 236 000 |
| Total assets | 1 120 000 |
| Equity and liabilities | |
| Equity | |
| Ordinary share capital (of $2 each) | 400 000 |
| Retained earnings | 77 000 |
| Total equity | 477 000 |
| Non-current liabilities | |
| 12% loan | 550 000 |
| Current liabilities | |
| Trade payables | 93 000 |
| Total equity and liabilities | 1 120 000 |

**Additional information**

1 Inventory at 1 January 2015 was $76 000.
2 The market price of one ordinary share at 31 December 2015 was $2.60.

**REQUIRED**

**(b)** Calculate the following ratios for Corim plc:
**(i)** Return on capital employed
**(ii)** Gearing
**(iii)** Income gearing
**(iv)** Working capital cycle (in days)
**(v)** Price earnings.
Calculation should be to **two** decimal places where appropriate. [14]

**Additional information**

Takie plc is the major competitor of Corim plc. Takie plc's capital employed was $1 025 000 at 31 December 2015 including a 8% loan of $100 000.

Some of its comparative ratios are:

| | |
|---|---|
| Return on capital employed | 9.32% |
| Gearing | 9.76% |
| Income gearing | 8.38% |

**REQUIRED**

**(c)** Compare **each** company's gearing and income gearing ratios. [4]

**Additional information**

Chen has surplus fund and is considering whether or not to invest in the shares of either Takie plc or Corim plc.

**REQUIRED**

**(d)** Identify which company Chen should invest in. Justify your answer. [3]

**June 2016**

**Q # 8** Alpha plc and Beta plc both operate in the same industry. Both have the **same annual sales** revenue. Neither have any preference shares in issue.
The following additional information is provided:

| | Alpha plc | Beta plc |
|---|---|---|
| Profit for the year | $160 000 | $100 000 |
| Profit margin | ? | 10% |
| Finance charges | $16 000 | ? |
| Profit from operations | ? | ? |
| Income gearing | ? | 20% |
| Number of ordinary shares | 400 000 | ? |
| Earnings per share | ? | $0.20 |
| Price earnings ratio | ? | 4.2 |
| Market value of one share | $1.20 | $0.84 |
| Dividend per share | $0.07 | ? |
| Dividend yield | ? | 7.14% |
| Total dividend paid | ? | ? |
| Dividend cover | ? | ? |

**REQUIRED**

**(a)** Calculate for Alpha plc:
**(i)** Profit margin
**(ii)** Income gearing
**(iii)** Earnings per share
**(iv)** Price earnings ratio
**(v)** Dividend yield
**(vi)** Total dividend paid
**(vii)** Dividend cover

Clearly label each answer and show your workings. [14]

**(b)** Suggest **one** reason for the difference between the two companies for **each** of the following:
**(i)** Profit margin
**(ii)** Income gearing
**(iii)** Earnings per share
**(iv)** Price earnings ratio
**(v)** Dividend yield
**(vi)** Market value of one share [6]

**Additional information**

Amit is considering purchasing shares in either Alpha plc or Beta plc.

**REQUIRED**

**(c)** Suggest, with reasons, in which company Amit should invest. [5] **Nov 2016**

**Q # 9** James has recently retired and received some cash which he wishes to invest in a company. There are two options. He could invest in either LM plc or AB plc.
The summarised information for the two companies extracted from their financial statements at 31 March 2017 is as follows:

| | LM plc | AB plc |
|---|---|---|
| | $ | $ |
| Ordinary share capital | 300 000 | 500 000 |
| 4% non-redeemable preference shares of $1 each | 100 000 | 150 000 |
| Retained earnings 1 April 2016 | 50 000 | 125 000 |
| 10% debentures (2025) | 150 000 | 50 000 |
| Profit for the year | 125 000 | 175 000 |

The nominal value of the ordinary shares of LM plc is $0.50 and of AB plc $1.
The market price of the ordinary shares at 31 March 2016 of both companies was $2.
At 31 March 2017, this had fallen by 10% for LM plc but increased by 10% for AB plc.
Both companies paid a dividend per share of $0.10 for the year ended 31 March 2017.

**REQUIRED**

**(a)** Calculate the following ratios for **both** companies. Give your answers to **two** decimal places.
**(i)** Earnings per share

**(ii)** Price earnings
**(iii)** Dividend yield
**(iv)** Dividend cover [4]

**(b)** Evaluate the performance of **each** company using **each** of the ratios calculated in part **(a)**. [8]

**Additional information**

The industry average gearing ratio is 25%.

**REQUIRED**

**(c) (i)** Explain what do you understand by gearing [2]
**(ii)** Calculate the gearing ratio for both companies to two decimal places [2]
**(iii)** Analysis the gearing ratios of LM plc and AB plc [5]

**(d)** Advise James which company he should invest in. Give reasons for your answer. [4]

**June 2017**

**Q # 10** The summarised statement of financial position of M plc at 31 December 2016 was as follows:

| | $000 |
|---|---|
| Non-current assets | 4220 |
| Net current assets | 2080 |
| | 6300 |
| Share capital and reserves | |
| Ordinary shares of $5 each | 5000 |
| Share premium | 500 |
| Retained earnings | 800 |
| | 6300 |

Retained earnings for the year ended 31 December 2016 were $160 000, after the payment of dividends which represented 60% of the profit for the year.
The market price of one ordinary share was $6.40 on 31 December 2016.

REQUIRED

(a) Calculate to two decimal places the following ratios at 31 December 2016:
(i) Return on capital employed
(ii) Earnings per share
(iii) Price earnings ratio
(iv) Dividend cover
(v) Dividend yield [8]

**Additional information**

It is estimated that the profit for the year ending 31 December 2017 will be same as 2016. The capital employed will also remain unchanged.

On 1 January 2017, M plc has the opportunity to invest $1 200 000 in a project which will bring an additional annual profit of $185000. The directors are considering an issue of ordinary shares at a premium of 20% to finance this project. The rate of dividend paid is expected to remain at 60% of the profit for the year.

REQUIRED

(b) Prepare a statement to show the forecast share capital and reserves at 31 December 2017. [6]

(c) Calculate to two decimal places the following expected ratios for the year ending 31 December 2017:
(i) Return on capital employed
(ii) Earnings per share [6]

(d) Advise the directors whether or not M plc should invest in the project. Justify your answer. [5]
**June 2017**

**Q # 11** The following information has been extracted from the books of account of M plc at 31 December 2016:

| | $ |
|---|---|
| Profit for the year | 550000 |
| Ordinary shares ($1) | 900 000 |
| 6% Preference shares (non-redeemable) | 200 000 |
| 5% Debentures (2025) | 100 000 |

The market price of one ordinary share at 31 December 2016 was $1.75.
Dividends of $0.08 per ordinary share have been paid during the year ended 31 December 2016.

REQUIRED

(a) State two advantages of ratio analysis to a user of the financial statements. [2]

(b) Calculate the following ratios at 31 December 2016 to two decimal places:
(i) earnings per share
(ii) price earnings ratio
(iii) dividend yield
(iv) dividend cover. [5]

**Additional information**

For the year ended 31 December 2016:

1 The profit for the year was 10% greater than the previous year.
2 There had been a share issue of 300000 ordinary shares.
3 The dividend per share had fallen by 20%.

REQUIRED

(c) Calculate the same four ratios as in part (b) at 31 December 2015 to two decimal places.

The market price of one ordinary share at 31 December 2015 was $1.50. [4]

Additional information

An investor, Bevin, is considering acquiring ordinary shares in M plc. He has been advised that the directors intend to raise extra funds by issuing a further 5% debenture (repayable 2027).

REQUIRED

(d) (i) Analyse the performance of M plc over the two years 2015 and 2016 using the ratios calculated in parts (b) and (c). [8]

(ii) Advise Bevin whether or not he should make the intended investment. Justify your answer. [6]

**Nov 2017**

**Q # 12** Summarised financial information for E Limited for the year ended 31 August 2016 is as follows:

Summarised Income Statement

| | $000 |
|---|---|
| Revenue | 8800 |
| Cost of sales | 5045 |
| Gross profit | 3755 |
| Expenses | 2175 |
| Profit from operations | 1580 |
| Finance costs | 235 |
| Profit for the year | 1345 |

Summarised Statement of Financial Position

| Assets | $000 |
|---|---|
| Non-current assets | 4815 |
| Current assets | 3210 |
| Total assets | 8025 |
| | |
| 3000000 ordinary shares of $0.50 each | 1500 |
| Share premium | 500 |
| Retained earnings | 2540 |
| | 4540 |
| | |
| Non-current liabilities – 8% debentures repayable 2020 | 2935 |
| Current liabilities – trade payables | 550 |
| | 8025 |

Additional information

1 The market value of one ordinary share at 31 August 2016 was $1.55.

2 Dividends paid for the year ended 31 August 2016 were $325000.

**REQUIRED**

**(a)** Calculate the following ratios to **two** decimal places:
**(i)** Income gearing
**(ii)** Gearing
**(iii)** Dividend cover
**(iv)** Price earnings [5]

**Additional information**

The directors of E Limited had expansion plans and on 1 September 2016 raised $2000000 by issuing 10% debentures repayable in 2026. The profit from operations for the year ended 31 August 2017 was $1600000 and the market price of one ordinary share on that date was $1.30. Dividends paid for the year were $275000.

REQUIRED

(b) (i) Prepare an extract from the income statement for the year ended 31 August 2017, starting with the profit from operations. [2]
(ii) Prepare the equity and non-current liabilities section of statement of financial position at 31 August 2017. [2]

(c) (i) Calculate the same ratios as in part (a) at 31 August 2017 to two decimal places. [4]
(ii) Assess the effect of the new debenture issue on these ratios. [8]

(d) Discuss two disadvantages to the company of the issue of the debentures. [4]

**Nov 2017**

**Q # 13** YGP Traders Limited has been trading for several years and has a year end of 31 December. It buys and sells a single product and makes all its transactions on a credit basis. It has a large bank overdraft and the directors are concerned about the working capital position of the business.

The following information is available for 2017:

1 Every month 1000 units were sold at a selling price of $80 each.
2 Payment for half of all credit sales was received in the month following sale. The other half was received two months after sale.
3 The company purchased 14 000 units during the year.
4 The purchase price has been $50 per unit for some years.
5 At 31 December, 3500 units were in inventory.
6 Trade payables at the end of the year amounted to $62000.

Required

(a) Calculate for 2017:
(i) Revenue for the year [1]
(ii) Cost of sales for the year [1]
(iii) Trade receivables at the year end [1]

(iv) Average inventory at cost price. [3]
(b) State what is measured by the working capital cycle [2]
(c) Calculate the working capital cycle for the year. [7]

**Additional information**

The directors of the business are considering a new strategy of increasing the selling price to $90 per unit and offering 10% cash discount for payment in the month following sale. The directors believe that demand will be unchanged and that all customers will take the discount offered.

(d) Calculate a revised working capital cycle for 2017 if this strategy had been implemented from the start of the year. [5]

(e) Advise the directors whether or not they should proceed with this strategy. Justify your answer. [5]

**June 2018**

**Q # 14** The directors of H Limited provide the following information:

Profit from operations for the year ended 30 September 2017 was $568 000.
8% Debentures (2023) for $500 000 were issued in 2012.
6% Debentures (2028) for $200 000 were issued on 1 May 2017.
The tax charge for the year was 20% of the profit before tax.

(d) Prepare a summarised income statement for the year ended 30 September 2017. [5]

Additional information

The share capital of H Limited has been unchanged for a number of years and consists of 500 000 ordinary shares of $1 each. Dividend cover has been 5 times and is not expected to change. Roy, a prospective investor, is considering purchasing some shares in H Limited.

(e) Advise Roy whether or not he should invest in H Limited. Justify your answer using relevant calculations. [6]

**Nov 2018**

**Q # 15** The equity and reserves of J plc at 31 December 2017 were as follows:

| | $ |
|---|---|
| Ordinary shares of $2 each | 800 000 |
| General reserve | 50 000 |
| Retained earnings | 72 000 |
| | 922 000 |

The following information is also available.

1 Equity and reserves at 1 January 2017 were $838 000.
2 On 1 January 2017, J plc issued a 10% debenture (2022□24) of $100 000.
3 On 1 August 2017, an interim dividend of $0.12 per share was paid.
4 On 31 December 2017, the general reserve was created.

5 On 31 December 2017, a final dividend of $0.03 per share was proposed.
6 The market price of each share at 31 December 2017 was $3.00.
7 There was no issue of ordinary shares during the year ended 31 December 2017.
Required

(a) Prepare the statement of changes in equity for the year ended 31 December 2017. A total column is not required. [5]

(b) Calculate the following ratios:
(i) Earning per share [1]
(ii) Price earnings ratio [1]
(iii) Dividend yield [1]
(iv) Dividend cover [1]
(v) Return on capital employed. [2]

**Additional information**

The following industry averages have been provided for the year ended 31 December 2017:

| | |
|---|---|
| Price earnings ratio | 7 |
| Earning per share | $0.20 |
| Dividend cover | 1.50 |
| Return on capital employed | 12% |

(c) Analyse the performance of J plc with reference to industry averages. Suggest reasons for the differences. [9]

**Additional information**

The directors of J plc are planning to expand the business in 2018. This will require an investment of $300 000 and generate an additional annual profit of $80 000. The directors are considering taking an 8% loan to fully finance this expansion.

(d) Advise the directors whether or not the company should take the loan. Justify your answer with reference to the impact on the company's return on capital employed and any other relevant information. [5]

**Nov 2018**

**Q # 16** The following information for F Limited is available at 31 March 2018.

| | $ |
|---|---|
| Closing inventory | 240 000 |
| Purchases | 680 000 |
| Sales revenue | 994 000 |
| Trade payables | 52 100 |
| Trade receivables | 137 500 |

All purchases and sales were on credit basis.

The value of the closing inventory was 20% higher than at 1 April 2017.

Required

(a) Calculate the working capital cycle in days. [5]

**Additional information**

The company allows its customers 60 days credit
The company is allowed 30 days credit by its suppliers
The inventory turnover ratio for the previous year was 104 days
The net working assets to revenue ratio has risen from 27.85% to 32.74%
Trade payables had fallen and trade receivables had risen since 31 March 2017

(b) Analyse the liquidity of F Limited. [5]

(c) Analyse the change in the net working assets to revenue ratio of F Limited. [6]

**Additional information**

Blair, an investor, wishes to invest in either F Limited or a competitor, C Limited. The market value of one ordinary share in both companies is $1.50.
Blair's main requirement is a regular income from the investment.
Relevant information for the two companies is as follows:

| | F Limited | C Limited |
|---|---|---|
| Gearing | 20% | 25% |
| Earnings per share | $0.18 | $0.21 |
| Dividend cover | 3 times | 4 times |
| Dividend per share | $0.09 | $0.12 |

(d) Advise Blair in which company he should invest. Justify your answer. [9]

**March 2019**

**Q # 17** The directors of M plc have provided the following information from the financial statements for the year ended 30 June 2018

Ordinary share capital consists of 1000000 shares of $1 each.
Profit for the year was $180 000.
Dividends paid during the year totalled $80 000.
Dividend yield was 5%

(a) Calculate the market price of one ordinary share. [2]

(b) Calculate the following to two decimal places:
(i) earnings per share
(ii) price earnings ratio
(iii) dividend cover [3]

Additional information

V plc is a competitor of M plc.

The directors of V plc also prepare accounts to 30 June. The following information for both companies for the year ended 30 June 2018 is available

| | M plc | V plc |
|---|---|---|
| Gross margin | 50% | 45% |
| Profit margin | 18% | 20% |
| Return on capital employed | 15% | 18% |
| Gearing ratio | 0% | 15% |
| Market price per share | from **(a)** | $2.50 |
| Earnings per share | from **(b) (i)** | $0.20 |
| Price earnings ratio | from **(b) (ii)** | 12.5 times |
| Dividend cover | from **(b) (iii)** | 4 times |

(c) Analyse the performance of both companies by considering only the gross margin, profit margin and return on capital employed. [6]

(d) Analyse the performance of both companies by considering the other ratios. [9]

**Additional Information**

Pepe, an investor, is considering investing in either M plc or V plc. He is looking for a low risk investment which pays him a regular income with the potential for growth in both annual dividend and share price.

(e) Advise Pepe in which of the two companies he should invest. Justify your answer. [5]

**May 2019**

**Q # 18** V plc had capital of 450 000 ordinary shares of $1 each. The following information was available at 31 December 2018

1 The market price of one ordinary share was $2.40.

2 Dividend yield was 5%.

3 Dividend cover was 2.5 times

(a) Calculate the profit for the year ended 31 December 2018. [3]

**Additional information**

The following information was also available for the year ended 31 December 2018.

1 Sales revenue for the year was $876 000. All the sales were on credit and had earned a gross margin of 45%.

2 All purchases of goods were on credit.

3 Current assets at 31 December comprised inventory, trade receivables and cash at bank.

4 Current liabilities at 31 December comprised trade payables only. The current ratio was 3:1

5 Other accounting ratios were:

| | |
|---|---|
| Inventory turnover | 60 days |
| Trade receivables turnover | 50 days |
| Trade payables turnover | 64 days |

6 Other balances were:

| | 1 January 2018 | 31 December 2018 |
|---|---|---|
| | $ | $ |
| Share premium | 70 000 | 70 000 |
| Retained earnings | 74 000 | ? |
| Inventory | 78 105 | ? |

7 Non-current assets at 31 December 2018 were $505 272.

(b) Prepare the statement of financial position at 31 December 2018. (Cash at bank is the balancing figure.) [15]

(c) Calculate the price earnings ratio. [2]

**Additional information**

T plc, a major competitor of V plc, had the following information for the year ended 31 December 2018.

| | |
|---|---|
| Gross margin | 42% |
| Inventory turnover | 65 days |

(d) Assess the performance of V plc and T plc in terms of profitability and efficiency in managing inventory. [5]

**May 2019**

**Q # 19** J plc commenced trading on 1 January 2016.
On that date there was a share issue of 800 000 ordinary shares with a nominal value of $0.50 each, at an issue price of $0.75.

During the year ended 31 December 2018 the following took place.

1 On 1 January 2018 a 12% debenture of $250 000 repayable in 2027 was issued.

2 The company made a rights issue of 1 ordinary share for every 4 shares held. The rights issue was fully subscribed raising $225000 in total.

The following information was available for the year ended 31 December 2018

| | $ |
|---|---|
| Profit from operations | 382 000 |
| Profit for the year | 204 000 |
| Ordinary dividend paid | 45 000 |
| Cash and cash equivalents | 55 000 |

At 31 December 2018

1 The total assets were $1 582 000, of which current assets totalled $420 000.

2 The current ratio was 1.75: 1

3 The market value of one ordinary share was $2.50

(a) Prepare the equity and liabilities section of the statement of financial position at 31 December 2018. [5]

(b) Calculate the following to two decimal places for the year ended 31 December 2018.

(i) Dividend cover [2]
(ii) Gearing ratio [2]
(iii) Price earnings ratio [3]

(c) Analyse the financial performance of J plc. [8]

**Additional information**

A group of shareholders have said they will propose at the Annual General Meeting that the directors pay an extra cash dividend of $0.30 per share because of the high profit for the year.

(d) Advise the directors whether or not they should pay the extra cash dividend. Justify your answer by considering other options available to the directors. [5]

**Nov 2019**

**Q # 20** The summarised statement of financial position of J plc at 31 December 2019 was as follows:

| | $000 |
|---|---|
| Non-current assets | 3360 |
| Current assets | 1320 |
| Total assets | 4680 |
| | |
| Equity and liabilities | |
| Equity | |
| $1 ordinary shares | 2000 |
| Share premium | 260 |
| Retained earnings | 840 |
| Total equity | 3100 |
| Non-current liabilities | |
| 6% debentures | 800 |
| | |
| Current liabilities | 780 |
| Total equity and liabilities | 4680 |

The following information is also available.

1 J plc's profit from operations for the year ended 31 December 2019 was $588000.

2 A dividend of $0.12 per share was paid during the year and a dividend of $0.08 per share was proposed at 31 December 2019.

3 The market price of one ordinary share was $3.20 on 31 December 2019

(a) Calculate, to two decimal places, the following ratios:

(i) earnings per share [2]

(ii) price earnings ratio [1]

(iii) dividend cover [1]

(iv) dividend yield. [1]

**Additional information**

The directors of J plc aim to maintain a higher dividend cover in the coming three years.

(b) Explain why the directors wish to maintain a higher dividend cover. [3]

**March 2020**