

## PRELIM EXAM QUESTIONS II

23 OCTOBER 2014



### Lesson Description

In this lesson we:

- Revise CASH FLOW STATEMENT AND RELATED QUESTIONS



### Summary

- Cash flow effects of OPERATIONS
- Cash flow effects of FINANCING ACTIVITIES
- Cash flow effects of INVESTING ACTIVITIES
- FINANCIAL INDICATORS
- THEORY



### Test Yourself

#### Question 1

How many categories are there in the cash flow statement?

- A One
- B Two
- C Three
- D Four

#### Question 2

Liquidity deals with the ability of an enterprise to settle:

- A Short term debts
- B Non current liabilities
- C All debts
- D Long term debts

#### Question 3

Positive gearing means that:

- A Long term debts are greater than current debts
- B  $ROTCE > \text{interest rates}$
- C  $\text{Interest rates} > ROTCE$
- D  $ROTCE < \text{interest rates}$

### Question 4

When an enterprise is highly geared it means that:

- A It has low risk
- B The company will receive a loan easily
- C Own capital > Foreign capital
- D Foreign capital > Own capital

### Question 5

How many liquidity ratios are there?

- A Five
- B Three
- C Four
- D Six



## Improve your Skills

### Question 1

#### CASH FLOW STATEMENT, ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

(73 marks; 50 minutes)

You are provided with information for the financial year ended 28 February 2014 taken from the books of RGW Ltd, a public company listed on the Johannesburg Securities Exchange (JSE).

- 1.1 Refer to the Fixed Asset Note and Information D.  
Prepare the Asset Disposal Account on 28 February 2014. (8)
- 1.2 Complete the Fixed Asset Note. (16)
- 1.3 Prepare the Cash Flow Statement for the year ended 28 February 2014 (show all calculations/workings). (19)
- 1.4 Calculate the financial indicators/figures below for the financial year ending 28 February 2014. (Round off your calculation to one decimal point or nearest cent where applicable).
  - 1.4.1 Net asset value per share (3)
  - 1.4.2 Return on average shareholders' equity (5)
  - 1.4.3 Debt: Equity ratio (3)
- 1.5 Refer to information F (financial indicators) below to answer the following questions.
  - 1.5.1 Comment on the liquidity of the company. Quote TWO relevant financial indicators and accompanying figures to support your comment. (4)
  - 1.5.2 The shareholders are happy with their return, earnings and dividends. Quote and explain THREE financial indicators (with figures) to support their opinion. (6)
  - 1.5.3 The company issued 500 000 additional shares for R3,60 per share during the year. Do you think that the existing shareholders would be happy with this issue price? Quote ONE financial indicator with figures to support your opinion. (3)

1.5.4 Refer to the Cash Flow Statement.

Mention THREE major decisions made by the Company Directors. (Quote the relevant figures.) Also explain how these decisions would benefit the company in the future. (6)

**INFORMATION:**

A Extract from the Income Statement for 2014

Sales	R 2 500 000
Interest expense	135 000
Net profit before tax	1 179 800
Income tax	352 800
Net profit after tax	827 000

B Extract from the Balance Sheet on 28 February

	2014	2013
<b>Fixed Assets (carrying value)</b>	?	?
Land & buildings (cost)	3 315 000	2 000 000
Vehicles (cost)	2 100 000	?
Equipment (cost)	810 000	800 000
Accumulated depreciation on vehicles	?	720 000
Accumulated depreciation on equipment	?	390 000
Fixed Deposit FS Bank (12% p.a.)	1 100 400	300 000
<b>Current Assets</b>	<b>890 680</b>	<b>689 500</b>
Inventory	365 900	379 100
Debtors and other receivables	419 000	349 500
SARS (income tax)	0	14 200
Cash and cash equivalents	105 780	12 600
<b>Shareholders' equity</b>	<b>5 148 000</b>	<b>3 226 000</b>
Share capital	4 800 000	3 000 000
Retained income	348 000	226 000
Mortgage Loan: TKO Bank	800 000	200 000
<b>Current Liabilities</b>	<b>537 500</b>	<b>489 900</b>
Creditors and other payables	136 800	151 300
SARS (Income tax)	25 700	0
Shareholders for dividends	375 000	240 000
Bank overdraft	0	98 600

C Incomplete Fixed Asset Note

	Land & Buildings	Vehicles	Equipment
<b>Carrying value at the beginning of the year</b>	<b>2 000 000</b>		<b>410 000</b>
Cost	<b>2 000 000</b>		<b>800 000</b>
Accumulated depreciation	<b>0</b>	<b>(720 000)</b>	<b>(390 000)</b>
<b>Movements</b>			
Additions	<b>1315 000</b>	<b>500 000</b>	<b>100 000</b>
Disposals	<b>0</b>	<b>0</b>	
Depreciation	<b>0</b>		
<b>Carrying value at the end of the year</b>	<b>3 315 000</b>		
Cost	<b>3 315 000</b>		<b>810 000</b>
Accumulated depreciation	<b>0</b>		

D Fixed Asset

**Vehicles**

With the exception of the delivery truck bought for R500 000 on 31 October 2013, the business has had all other vehicles for four years (including this year). No vehicles were sold during the year.

Depreciation on vehicles is written off at 15% p.a. on the cost price method and this rate has been maintained over the years since the business came into operation.

**Equipment**

An old printer bought on 1 June 2011 for R? was sold for cash on 31 August 2013 at carrying value and in its place a new printer for R100 000 was bought on 1 September 2013.

Depreciation on equipment is written off at 20% p.a. on the diminishing balance method.

E Share Capital and Dividends

The company's authorised share capital consists of 2 000 000 ordinary shares. By 28 February 2014 a total of 1 500 000 ordinary shares were issued as follows

- 1 000 000 ordinary shares issued in 2011 for R3 a share.
- 500 000 ordinary shares issued during the financial period for R3,60 each.

All shares qualify for the interim dividend.

- An interim dividend of 22 cent per share was declared and paid during the year.
- A final dividend of 47 cent per share was declared at the end of the year.

notes for...

F Financial indicators

	2014	2013
Net profit after tax on sales	?	24,5%
Operating expenses on sales	18,0%	22,0%
Operating profit on sales	27,5%	25,5%
Current ratio	0,7: 1	1,4 : 1
Acid test ratio	0,97:1	0,6 : 1
Rate of stock turn over	6 times	4 times
Return on shareholders' equity	?	17,0%
Return on total capital employed	28,4%	23,2%
Earnings per share	48 cents	42 cents
Dividends per share	47 cents	43 cents
Debt/equity ratio	?	0,08 : 1
Net asset value per share	?	223 cents
Market value per share	370 cents	345 cents

[73]

notes for...

## ANSWER BOOK

### Question 1

1.1

#### ASSET DISPOSAL

2013 Aug	31			2013 Aug	31		

#### 1.2 FIXED ASSET NOTE

	Land and Buildings	Vehicles	Equipment
Carrying value at the beginning of the year	2 000 000		410 000
Cost	2 000 000		800 000
Accumulated depreciation	0	(720 000)	(390 000)
<b>Movements</b>			
Additions (at cost)	1 315 000	500 000	100 000
Disposals (at carrying value)	0	0	
Depreciation	0		
<b>Carrying value at the end of the year</b>	<b>3 315 000</b>		
Cost price	3 315 000		810 000
Accumulated depreciation	0		

notes for...

1.3	RGW LIMITED CASH FLOW STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 2014	R
	<b>Cash effects of operating activities</b>	
	Cash generated from operations	1 470 000
	<b>Cash effects of investing activities</b>	
	<b>Cash effects of financing activities</b>	
	Proceeds from shares issued	1 800 000
	<b>Net change in cash and cash equivalents</b>	
	<b>Cash and cash equivalents at beginning of year</b>	
	<b>Cash and cash equivalents at end of year</b>	105 780

notes for...

1.4	Calculate the following financial indicators for the year ended 28 February 2014. Where applicable, round off your calculation to one decimal point or the nearest cent.
1.4.1	Calculate the net asset value per share.

1.4.2	Calculate the average return on shareholders' equity.
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1.4.3	Calculate the debt: Equity ratio
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notes for...

1.5	Refer to information F (financial indicators) and respond to the questions that follow.
1.5.1	Comment on the liquidity of the company. Quote TWO relevant financial indicators and accompanying figures.

1.5.2	The shareholders are happy with their return, earnings and dividends. Quote and explain THREE financial indicators (with figures) to support their opinion.
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1.5.3	The company issued 500 000 additional ordinary shares for R3.60 during the year. Do you think that the existing shareholders would be happy with this issue price? Quote ONE financial figures with figures to support your opinion.
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*notes for...*

1.5.4

Refer to the Cash Flow Statement and mention **THREE** major decisions the Company Directors took and how these decisions would benefit the company in the future. Quote figures to support your decision.

Decisions	Benefits