UNIVERSITI MALAYSIA TERENGGANU

FINAL EXAMINATION

SEMESTER I SESSION 2025/2026 (BACHELOR DEGREE)

COURSE	**:**	**FINANCIAL STATEMENT ANALYSIS**
COURSE CODE	**:**	**FNC4113**
DURATION	**:**	**3 HOURS**

MATRIC NO.	**:**	______________________
PROGRAMME	**:**	______________________
SEAT NO.	**:**	______________________

<u>INSTRUCTIONS TO CANDIDATES</u>

i. This paper consists of **TWO (2)** parts: Part A and Part B. Part A consists of 32 multiple choice questions while Part B consists of 3 structure questions. Answer **ALL** questions.

ii. Part A must be answered in the OMR form, while Part B must be written in the answer booklet provided.

DO NOT OPEN THE QUESTION PAPER UNTIL INSTRUCTED

THIS QUESTION PAPER CONSISTS OF TWELVE (12) PRINTED PAGES

PART A (40 Marks)

Please choose the most appropriate answer for each question in this part.

1. Analyse the connection between accounting analysis and financial analysis in making reliable business decisions. (1.25 marks)

   A. Financial analysis comes first because it shows if the reported figures need adjustment.
   B. Accounting analysis depends on financial analysis, which guides how statements are prepared.
   C. Accounting analysis must come before or alongside financial analysis to check if the numbers truly represent the company's performance, making the financial evaluation trustworthy.
   D. The two analyses are separate; accounting analysis only ensures compliance with accounting standards.

2. Differentiate the analytical focus of a credit analyst from the financial exposure faced by an equity investor when a company experiences severe financial distress leading to potential liquidation. (1.25 marks)

   A. The equity investor emphasizes liquidity (short-term ability to pay) while the credit analyst emphasizes potential for unlimited upside when the company prospers.
   B. The credit analyst is primarily concerned with profitability as a margin of safety, while the equity investor is the last to absorb losses because they receive a residual interest only after all other claims are paid.
   C. The credit analyst's emphasis is on risk and solvency (long-term ability to pay debt obligations), while the equity investor bears higher risk and is the first to absorb losses in liquidation, often limited only to the amount invested.
   D. Both parties bear similar risks, but the credit analyst uses fundamental analysis (economy, industry, company) while the equity investor solely uses technical analysis (charting historical price patterns).

3. Evaluate how the Prudence and Cost principles should guide the treatment of an unrealized gain on property and a probable loss from a lawsuit in the financial statements. (1.25 marks)

   A. Record both the gain and the loss immediately to show the current market situation.
   B. Record neither item because both must wait until cash is received or paid.
   C. Record the gain to show the higher property value but ignore the loss until payment is made.
   D. Record the expected loss but not the unrealized gain, following prudence and cost principles, even if this reduces reported profit.

4. Analyse the following statements to determine which **correctly** reflect the limitations of financial statements. (1.25 marks)

   I. Financial statements are historical and may not reflect current or future conditions.
   II. They are fully forward-looking and can replace analyst reports for investment decisions.
   III. Estimates and judgments used in preparing financial statements can affect reliability.
   IV. Non-financial information, such as customer satisfaction or brand value, is often omitted.
   V. Financial statements are always released in real-time, making them overwhelming.

   A. I, III and IV only.
   B. II and V only.
   C. I, II, III and IV only.
   D. All of the above.

5. Evaluate the following options to determine which **correctly** reflects the consistency concept in accounting. (1.25 marks)

   A. A company should use the same accounting policies from one period to another, and changes in policies should be disclosed in the financial statements.
   B. Accounting methods can be changed frequently to show higher profits, and consistency only applies within the same fiscal year.
   C. A company should use the same accounting policies from one period to another, changes in policies should be disclosed, and consistency only applies within the same fiscal year.
   D. All accounting methods can be changed at any time without disclosure.

6. Differentiate the effects of the Straight-Line and Declining-Balance depreciation methods on the first year's depreciation expense and net book value. (1.25 marks)

   A. Both methods give the same total depreciation over the asset's life, but Straight-Line shows a higher book value at the end of Year 1.
   B. The Declining-Balance Method gives higher depreciation in the first year, resulting in a lower book value compared to Straight-Line.
   C. Straight-Line gives higher depreciation in the first year and therefore a lower book value.
   D. Both methods produce the same depreciation and book value each year.

7. Both goodwill and patents are classified as long-term intangible assets, recorded at historical cost. However, the required accounting treatment (amortization vs. impairment testing) differs significantly between them. Analyse the fundamental accounting rationale that determines this difference in treatment for these two intangible assets. (1.25 marks)

   A. Patents are carried at acquisition cost and amortized because they have an indefinite legal life. Goodwill is tested for impairment because it has a finite legal life.
   B. Goodwill must be amortized over a 20-year period because it arises from the acquisition price exceeding the fair value of net assets. Patents are only tested for impairment annually.
   C. Goodwill is reviewed only for impairment annually because it is deemed to have an indefinite life. Patents are amortized over the shorter of their legal or useful life because they possess a finite life (20 years) under legal rights.
   D. Patents are always amortized over their legal life (20 years) regardless of their useful life, while Goodwill is only amortized if the company follows U.S. GAAP.

8. Analyse the following statements to determine which one is **not true** in relation to intangible assets. (1.25 marks)

   A. Research and development usually represents a significant intangible on the financial statements.
   B. Goodwill arises from the acquisition of a business for a sum greater than the physical asset value.
   C. Purchased goodwill is not amortized but is subject to annual impairment reviews.
   D. Intangibles are usually amortized over their useful lives or legal lives, whichever is shorter.

9. Analyse Vita Lita Berhad's financing strategy given that it reports total assets of RM100,000 and total liabilities of RM60,000. (1.25 marks)

   A. The company is primarily financed through debt.
   B. The company's owners have invested RM40,000 in equity.
   C. The company has no financial leverage.
   D. The company's liabilities exceed its assets.

10. Analyse why are Current Assets presented in the order: Cash → Marketable Securities → Accounts Receivable → Inventories on the Balance Sheet? (1.25 marks)

   A. Inventories are last because they are measured conservatively (lower of cost or market), unlike Cash and Marketable Securities.
   B. The order reflects liquidity: Cash is immediately usable; Marketable Securities can be sold quickly; Accounts Receivable requires collection; Inventories must be sold and then collected.
   C. The sequence depends on allowance accounts: Account Receivable has allowances, Marketable Securities do not, so Account Receivable is less liquid.
   D. The order follows the accounting equation, prioritizing tangible assets (Inventory) over non-physical assets (Account Receivable).

11. Analyse which of the following items would be classified as operating revenue or expense on the income statement of a manufacturing firm. (1.25 marks)

    A. Interest expense
    B. Advertising expense
    C. Equity income
    D. Dividend income

12. Distinguish which special income statement item is reported net of income tax. (1.25 marks)

    A. Discontinued Operations
    B. Unusual or Infrequent Items
    C. Equity Earnings of Nonconsolidated Subsidiaries
    D. Other Operating Revenue

13. Which of these items would be categorized under 'Other Income or Expense'? (1.25 marks)

    A. Gain from the sale of a factory building.
    B. Cost of sales for a retailer.
    C. Lease revenue for a real estate company.
    D. Salaries for the accounting department.

14. Determine how misclassifying Sales Commissions as an Administrative Expense impacts a multiple-step income statement. (1.25 marks)

    A. Income Before Taxes would be overstated because total Operating Expenses appear lower.
    B. Operating Income stays the same, but ratios measuring sales efficiency are distorted.
    C. Gross Profit decreases because Selling Expenses are above Gross Profit.
    D. Net Income is understated because taxes would decrease due to the misclassification.

15. Examine why the multiple-step income statement provides better financial analysis than the single-step format. (1.25 marks)

    A. It calculates Net Income more accurately by separating taxes.
    B. It totals all revenues before subtracting expenses, making Income Before Taxes easier to compute.
    C. It separates Gross Profit and Operating Income, helping analysts evaluate core efficiency separately from overall performance.
    D. It is the only format that shows special items like restructuring charges or other gains/losses.

16. Infer the analytical insight an analyst can draw by combining the Statement of Cash Flows (SCF) and balance sheet data, given a significant increase in cash used for operating activities and rising inventory levels. (1.25 marks)

    A. The SCF alone shows the exact level of inventory the company holds.
    B. Rising inventory, combined with cash used in operations, suggests that cash was tied up in unsold goods, potentially affecting liquidity.
    C. The increase in cash from operations indicates that management efficiently reduced inventory levels.
    D. The SCF directly reveals which liabilities were reduced during the period, independent of balance sheet changes.

17. Examine which of the following could lead to cash flow problems? (1.25 marks)

    A. Tightening of credit by suppliers
    B. Easing of credit by suppliers
    C. Reduction of inventory
    D. Improved quality of accounts receivable

18. Determine which of the following current asset or current liability accounts is not included in the computation of cash flows from operating activities? (1.25 marks)

    A. Change in accounts receivable
    B. Change in accounts payable
    C. Change in accrued wages
    D. Change in notes payable to banks

19. Examine which internal policy management is most likely reviewing, given a sustained period of high cash outflows for the purchase of property, plant, and equipment. (1.25 marks)

    A. Dividend policy, because heavy equipment purchases directly consume the funds available for dividends.
    B. Cash generated by operations, to ensure that the cash inflows from sales of debt or equity securities of other corporations are sufficient to cover the investment.
    C. Investing and financing policy, to determine if the long-term investment strategy (acquisition of long-term assets) aligns with planned capital expenditures and sustainable funding sources.
    D. External financing structure, because purchasing property, plant, and equipment generates cash inflows from the sale of equity securities, reducing the need for debt.

20. Both the Direct and Indirect methods calculate the same operating cash flows but present them differently. Which statement **best** elucidates the difference in supplemental disclosures and why they are required? (1.25 marks)

    A. The Direct Method is discouraged because it requires disclosure of cash paid for interest and taxes.
    B. The Indirect Method requires a reconciliation of net income to cash from operations to align with cash basis.
    C. The Direct Method shows cash-based income items, while the Indirect Method starts with Net Income, so it needs supplemental disclosure of cash paid for taxes and interest.
    D. The Direct Method converts accrual net income to cash basis and requires reconciliation because net income is the primary indicator for external users.

21. An analyst observes that a company provides complete, accurate, and timely financial disclosures. However, the external auditor issues an opinion suggesting the financial statements might not be free from material misstatement. Determine which key benefit, resulting from the combination of high-quality disclosures and reliable audits, is most compromised when the audit opinion is unreliable despite strong disclosure practices. (1.25 marks)

    A. The ability of the company to strictly adhere to established accounting standards (Compliance).
    B. The reduction of information asymmetry, which in turn reduces risk in investment decisions.
    C. The definition of financial disclosure as the process of providing information to external users.
    D. The necessity for the internal audit function to improve internal controls and detect irregularities.

22. Differentiate the principal goal of the external audit from that of the internal audit. (1.25 marks)

    A. The internal audit utilizes only substantive procedures, while the external audit is confined to analytical procedures.
    B. The external audit assesses the fair value of assets during M&A, whereas the internal audit is solely responsible for compliance with GAAP.
    C. The internal audit focuses on ensuring that financial statements are free from material misstatement, while the external audit focuses on improving internal controls.
    D. The external audit is designed to provide an independent assessment to enhance the credibility of reported data, whereas the internal audit is designed to improve internal controls and detect irregularities within the organization.

23. After a large acquisition using the Purchase Method, a company's assets are recorded at fair value and significant goodwill is recognized. Analysts notice that ratios like Return on Assets (ROA) are lower compared to prior periods. Identify the aspect of the Purchase Method that primarily causes this distortion in ROA. (1.25 marks)

    A. Preparing pro forma financials for comparability
    B. Auditor assessment of M&A disclosures
    C. Recording acquired assets at fair value and recognizing goodwill on the balance sheet
    D. Adjusting for non-recurring acquisition expenses

24. A financial analyst uses cash flow analysis to compare reported net income with actual operating cash flows. Unlike Benford's Law or ratio analysis, this technique focuses on detecting discrepancies between profits and cash movements. Determine the type of manipulation this technique is primarily designed to uncover. (1.25 marks)

    A. Irregular numeric patterns across accounts, as detected by Benford's Law.
    B. Abnormal or outlier financial ratios, such as unusually high inventory turnover.
    C. Hidden liabilities or off-balance-sheet financing.
    D. Intentional misstatement of revenue or expenses that inflates net income without corresponding cash inflows.

25. An external auditor detects inconsistencies in revenue recognition but finds no direct evidence of fraud. Management insists the discrepancies are due to timing differences. Analyse how the inherent limitations of an audit might affect the auditor's ability to detect and respond to potential fraud in this situation. (1.25 marks)

    A. Audits are designed to reduce, but not eliminate, the risk of material misstatement; therefore, timing differences or subtle manipulations may go undetected.
    B. Auditors have complete authority to investigate all management decisions and can always detect fraud if it exists.
    C. External audits focus solely on internal controls and do not examine financial statements for accuracy.
    D. Once management provides an explanation, auditors are required to accept it without further review.

26. Company A recognizes revenue when goods are shipped, while Company B recognizes it when cash is received. Based on the revenue recognition principle, which company is applying the concept **correctly**, and why? (1.25 marks)

    A. Company A, because ownership has been transferred
    B. Company B, because cash flow confirms realizability
    C. Both, because timing depends on business policy
    D. Neither, because revenue should only be recognized at production.

27. Analyse the revenue recognition treatment for a company that delivers goods to a customer, but the customer has the right to return up to 10% of the goods. (1.25 marks)

    A. Revenue should be recognized immediately in full, because delivery occurred.
    B. Revenue can be recognized net of expected returns, because reliable estimates exist.
    C. Revenue cannot be recognized at all until the return period expires.
    D. Revenue should be recognized only when cash is collected.

28. Entity X records utilities expense for the month when the bill is received, while Entity Y records utilities expense for the month it is incurred, even if the bill is received later. Determine which entity is following the matching principle and justify your answer. (1.25 marks)

    A. Entity X, because expenses are only recognized when the invoice is received.
    B. Entity Y, because expenses are matched to the period in which they are incurred.
    C. Both, because expense timing depends on company policy.
    D. Neither, because utilities should be recorded only at the end of the fiscal year.

29. Identify which of the following is **not** a limitation commonly encountered when interpreting financial ratios. (1.25 marks)

    A. Difficulty in identifying an appropriate industry category.
    B. Differences in accounting practices among firms.
    C. Seasonality.
    D. Differences in financial year end among companies.

30. Infer what a company's lower-than-industry-average collection period may indicate about its credit and collection policies. (1.25 marks)

    A. Enforcing loose credit conditions upon its customers.
    B. Allowing its customers too much time to pay their bills.
    C. Too strict in collecting its accounts.
    D. A and B.

31. Determine which financial ratio **best** measures the overall effectiveness of management. (1.25 marks)

    A. Leverage ratio
    B. Return on assets
    C. Current ratio
    D. Inventory turnover

32. Discriminate between the correct and incorrect statements about financial ratios. (1.25 marks)

    A. Ratios are fractions expressed in percent or times per year.
    B. A ratio can be computed from any pair of numbers.
    C. A very long list of meaningful ratios can be derived.
    D. There is one standard list of ratios.

PART B (60 Marks)

Please answer all questions.

1. TrailBlaze Berhad begins operations with RM4,000 cash to manufacture electric scooters, signing sales contracts for 1,600 units at RM12 each, producing 1,400 scooters at a cost of RM9 per unit (paid immediately), delivering 1,200 units, collecting cash for 1,000 units, and incurring sales commissions of 8% on collected sales and delivery costs of RM0.25 per unit, with all prices and costs expected to remain constant over time.

    a. Analyse the impact of recognizing revenue at the time of shipment, at the time of collection, and at the time of production on TrailBlaze Berhad's first-month financial statements. (16 marks)
    b. Examine why TrailBlaze Berhad is likely to prefer the collection method (installment method) for tax purposes. (2 marks)

2. BrightStone Solutions intends to expand its commercial operations and has applied for a business loan from SME Bank. SME Bank plans to assess BrightStone Solutions' potential as a borrower. The company's financial statements for the year ended December 31, 2024, are presented below.

BrightStone Solutions
Income Statement for the Year Ended December 31, 2024

	RM
Sales revenue	160,000
Less: Costs of goods sold	106,000
Gross profit	54,000
Less: Operating Expenses	
Selling expense	16,000
General and administrative expense	10,000
Lease expense	1,000
Depreciation expense	10,000
Total operating expense	37,000
Operating profits	17,000
Less: Interest expense	6,100
Net profits before taxes	10,900
Less: Taxes (30%)	3,270
Net Income	7,630

BrightStone Solutions
Balance Sheet December 31, 2024

	RM
Assets	
Cash	500
Marketable securities	1,000
Accounts receivable	25,000
Inventories	45,500
Total current assets	72,000
Land	26,000
Buildings and equipment	90,000
Less: Accumulated depreciation	38,000
Net fixed assets	78,000
Total assets	**150,000**
Liabilities and Stockholders' Equity	
Accounts payable	22,000
Notes payable	47,000
Total current liabilities	69,000
Long term debt	22,950
Common stock	31,500
Retained earnings	26,550
Total liabilities and Stockholders' Equity	**150,000**

Ratios	Industry Average	Actual 2023	Actual 2024
Current ratio	1.80	1.84	
Quick ratio	0.70	0.78	
Inventory turnover (times)	2.50	2.59	
Average collection period	37.5 days	36.5 days	
Debt ratio (%)	65	67	
Times interest earned (%)	3.8	4.0	
Gross profit margin (%)	38	40	
Net profit margin (%)	3.5	3.6	
Return on total asset (%)	4.0	4.0	
Return on common equity (%)	9.5	8.0	

a. As a credit analyst in the bank, calculate and analyse the company's present position based on the ratios below.

   i. Liquidity ratios - Quick ratio and Current ratio. (4 marks)
   ii. Profitability ratios - Gross profit margin, Net profit margin, Return on assets and Return on common equity. (8 marks)
   iii. Solvency ratios - Debt equity ratio and Times interest earned. (4 marks)
   iv. Efficiency ratios - Inventory turnover and Average collection period. (4 marks)

b. Based on your analysis of the company's creditworthiness, elucidate whether the bank should approve the RM1 million loan. (3 marks)

3. In the process of equity analysis and valuation, analysts often recast financial statements to obtain a clearer picture of a company's performance.

   a. Determine the purpose of recasting the income statement for analysis. (4 marks)
   b. Analyse **three (3)** actual forms of earnings management and their effects on reported earnings. (9 marks)
   c. Differentiate between the two main types of transitory (nonrecurring) gains and losses, operating and nonoperating, based on their relation to a company's normal business activities. (6 marks)

Formula

Quick ratio	= Current Assets / Current Liabilities
Current ratio	= (Current Assets – Inventories) / Current Liabilities
Gross Profit Margin	= (Gross Profit / Sales) × 100
Net Profit Margin	= (Net Income / Sales) × 100
Return on Total Assets (ROA)	= (Net Income / Total Assets) × 100
Return on Common Equity (ROE)	= (Net Income / Common Equity) × 100
Debt-to-Equity Ratio	= Total Debt / Total Equity
Times Interest Earned (TIE)	= EBIT / Interest Expense
Inventory Turnover	= COGS / Average Inventory
Average Collection Period	= (Accounts Receivable / Sales) × 365

End of Question Paper