# UNIVERSITY OF RUHUNA
## FACULTY OF MANAGEMENT AND FINANCE
## Bachelor of Business Administration Degree Programme 3000 Level

**Semester I End Examination (Repeat/Old Syllabus)**

**November /December 2021**

**ACC 3112–Financial Reporting** **Duration: Three hours**

**Instructions:**
- **Answer all questions.**
- **Calculators are permitted**

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1. (A). Outline the main regulatory requirements for financial reporting in Sri Lanka

(03Marks)

(B). Briefly explain what is conceptual framework and its role in financial reporting?

(03 Marks)

(C). Apex (Pvt.) Ltd is in the business of real estate development and sale. The Company has a property which was constructed for the purpose of head office premises.

The construction was completed during the current year at a cost of Rs. 8 million. Apex (Pvt.) Ltd obtained Rs. 8 million loan with an interest rate of 15% on 01 April 2020, to finance the construction of this property.

Construction commenced on 01 June 2020 and, the construction was completed and ready for use as the head office building from 28 February 2021. On this date, it was estimated that the property has a useful life of 50 years. The building was vacant until 01 April 2021 as it took one month to shift from the old premises to the new building. Due to a shortage of imported material, the construction of the new building was suspended during the month of August 2020. The proceeds of the loan were temporarily invested and earned an interest income of Rs. 300,000 until construction was completed. Out of such interest earned, Rs. 80,000 was earned before the commencement of construction and a further Rs. 20,000 was earned during the month of August when the construction activity was suspended.

Required:

Prepare extracts of Apex (Pvt.) Limited's Income Statement and Statement of Financial Position for the year ended 31 March 2021 in respect of the above property.

(08 Marks)

(Total Marks 14)

2. (A) Briefly explain the accounting treatment for the accounting policy changes according to LKAS 08 -Accounting Policies, Changes in Accounting estimates and Errors.

(02 Marks)

(B). The following information is also provided with reference to Irosh Ltd. for the year ended 31st March 2021:

i. A competitor has filed a legal case against the Irosh Ltd. regarding the advertisement published insulting the competitor's product. The compensation claim is Rs.50 million and up to the date of authorization of the financial statements for the year ended 31st March 2021 (on 15th May 2021) the company's lawyers have advised that it is probable the company will not be found liable.

ii. On 15$^{th}$ December 2020, the directors of Irosh Ltd decided to close down a division making a particular product. On 20 December 2020 detailed plan for closing down the division was agreed by the board of directors. Warning letters sent to the customers to seek an alternative source of supply. Further, the redundancy notices sent to the staff of the division. Until the end of financial year, company was unable to implement the decision.

Required:
Explain how each of the above circumstances could be recognized in the financial statements for the year ended 31st March 2021 as per LKAS 37 - Provisions, Contingent Assets and Contingent Liabilities.

(06 Marks)

(C). Metro is a major computer manufacturer. The entity has incurred the following expenditure during the year ended 31 March 2021.

i. Rs. 130,000 paid to the Faculty of Computer Science, University of Colombo to sponsor a research project which will investigate the properties of a new material that may have some uses in manufacturing high-capacity computer storage devices.

ii. Rs.2.6 million on the design of a new computer screen which provides a larger clearer display than existing monitors and at lower selling price. The screen is to be launched at a major technology fair in the coming year of 2022 and will be sold to the general public immediately thereafter.

iii. Metro spent Rs. 1.2 million sending its staff on training courses during the year. This has already led to an improvement in the company's efficiency and resulted in cost savings. The organizer of the course has stated that the benefits from the training should last for a minimum of three years.

Classify each of these projects as research or as development as defined by LKAS 38 Intangible Assets and explain how it should be accounted for.

(06 Marks)
(Total Marks 14)

3. (A) A) Discuss the circumstances under which borrowing costs should be capitalized in accordance with LKAS 23.

(04 Marks)

(B) The Finance Manager of Vinsara Ltd. has found the following incidents occurred during the year ended 31st March 2021:

i. Vinsara Ltd. had introduced a new accounting system SAP B1 with effect from $01^{st}$ April 2020 and accounting policy of valuing inventory has been changed at that date. Up to $31^{st}$ March 2020, the company has valued its inventory on FIFO basis, as per the new Accounting system inventory is to be valued on WAC basis. It was noticed that stocks have been overvalued by Rs.6.7 million than stock value shown in the financial statements as at $31^{st}$ March 2020 due to the change in accounting policy of inventory valuation.

ii. Assistant Accountant of Vinsara Ltd. has failed to account for depreciation in last financial year (2019/20) in respect of office equipment of Rs.500,000/- acquired on $31^{st}$ December 2019. The company depreciates office equipment at cost on the straight-line basis and useful life time of the office equipment is 5 years.

iii. The company has reviewed the useful life of Plant and Machinery on $01^{st}$ April 2020. As per the review it was decided to change the useful life time of the Plant and Machinery from 3 years to 8 years from $01^{st}$ April 2020. Cost and accumulated depreciation of Plant and Machinery as at $01^{st}$ April 2020 were Rs.8,000,000/- and Rs.3,200,000/- respectively.

Required :

Explain the accounting treatment for the year ended 31st March 2021 for the above instance as per the LKAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors.

(06 Marks)

(C). MPC Ltd. has developed a new product during the year ended 31st March 2020 and started commercial operation in May 2020. Cost incurred for the new product during the year 2019/20 were as follows:

(i) A research was done for the new product and incurred Rs.1 million during the year.

(ii) The company registered the patent right for the new product during the year and fee on registration for patent right was Rs.100,000/-.

(iii) Costs of Rs.300,000/- for advertising and promotional activities were spend on the new product.

Required:

Explain whether each of the above costs could be recognized as intangible assets as per LKAS 38 - Intangible Assets.

(04 Marks)
(Total Marks 14)

4. (A) Discuss the circumstances under which borrowing costs should be capitalized in accordance with LKAS 23.

(02 Marks)

(B) A Cash generating unit was reviewed for impairment at 31st March 2021 as required by LKAS 36 impairment of Assets. The impairment review revealed that the cash generating unit had a value in use of Rs 245 million and fair value less cost to sell of Rs 230 million. The carrying values of the net assets of the cash generating unit immediately prior to impairment review were as follows:

| | Rs. 000 |
|---|---|
| Goodwill | 50,000 |
| Property Plant and equipment | 180,000 |
| Net current assets | 40,000 |
| | 270,000 |

The review indicated that an item of plant (included the above figure of Rs.180 million with a carrying value of Rs.12 million and had been severely damaged and was virtually worthless. There was no other evidence of obvious impairment to specific assets.

What is the carrying value of the goodwill relating to the unit immediately after the results of the impairment review have been reflected in accordance with LKAS 36.

(06 Marks)

(B) The following details are related to PDC Plc

| | 2019 | 2020 | 2021 |
|---|---|---|---|
| **Profit outstanding to ordinary equity holders of parent entity** | Rs1,100,000 | Rs1,500,000 | Rs1,800,000 |

On 1st January 2019, number of shares outstanding before right issue 500,000 shares. During 2018 the company announced a right issue with the following details.

**Right Issue -** One new issue for each five outstanding shares (100,000 new shares total)

Exercise price Rs.5.00

Last date to exercise right 1st March 2020

Market price of one ordinary share immediately before exercise on March 2020 Rs. 11.00

Reporting Date 31 December

Required:

Calculate the Earnings per Share for 2019, 2020 and 2021

(06 Marks)
(Total 14Marks)

5 . "Fast Foods" is a food and beverage company listed in the Colombo Stock Exchange. You are the newly appointed chief financial officer of the company. You have been asked by the directors to look into the following matters when preparing financial statements for the year ended 31 March 2021.

You are required to discuss the accounting effect of following scenarios for the financial position and performance of Fast Foods for the year ended 31 March 2021.

(A). The Fast Foods initiated a research and development project on 01 April 2020 to introduce a new item of "pizza" to the market. The company spent Rs. 250,000 per month on research work until 30 September 2020, at which date the project passed into the development stage. From this date, the company spent Rs. 350,000 per month until the end of May 2020. The Fast Foods received a Rs. 600,000 government grant relating to the equipment which was Rs. 2.4 million and had a useful life of six years. However, the directors of Fast Foods were not confirmed that the new product would be a commercial success until 31 March 2021.

(04 Marks)

(B). On 01 September 2020, the company undertakes a franchise from a foreign holding company, which owns the very popular worldwide name of 'Burger King'. The franchise fee paid to the overseas holding company for the use of the brand name of Burger Kingwas Rs. 15 million. During the financial year, the company incurred additional costs of Rs. 75,000 to train the staff for the new outlets of Burger King and Rs. 1.5 million to promote the brand.

(04 Marks)

(C). At the end of year 2019, the consumer protection authority filled a case against the company claiming a compensation of Rs. 1.5 million in relating to selling an unhealthy food product to the consumers. As at 31 March 2021, the proceedings of the case had not been finalized. The company lawyer is of the opinion that there is a probability that the company will have to pay the compensation.

(04 Marks)

(D). On 12 December 2020, the directors of Fast Foods decided to close down a division making a particular product. On 20 December 2020 a detailed plan for closing down the division was agreed by the board of directors. Warning letters sent to customers to seek an alternative source of supply. Further, the redundancy notices sent to the staff of the division. Until the end of financial year, company was unable to implement the decision.

(02 Marks)
(Total Marks 14)

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