



**UNIVERSITY OF RUHUNA**

**FACULTY OF MANAGEMENT AND FINANCE**

**Bachelor of Business Administration Degree Programme 4000 Level Semester I End  
Examination (February/March 2021)**

**Academic Year 2020/2021**

**ACC 4111 – Financial Statement Analysis**

**Duration: Three hours**

**The Question Paper contains 04 questions.**

**Answer All Questions**

**Calculators are permitted.**

1. (a) (i) What are the purposes of financial statement analysis (02 marks)
- (ii) List out different sources of information available for financial analysis. (02 marks)
- (iii) Explain the difference between intra - firm and inter - firm comparisons of financial statement analysis. (02 marks)
- (iv) Piyal Silva is considering to invest some of his savings in ordinary shares of Ruhunu Seafood Company. He expects your support to analyze trends of financial Performance. The following data are extracted from the comprehensive income statements of the company.

	2016	2017	2018	2019	2020
Net Sales (Rs.)	500,000	475,000	620,000	650,000	690,000
Cost of goods sold (Rs.)	(300,000)	(294,500)	(348,000)	(360,000)	(380,000)
Gross profit (Rs.)	200,000	180,500	272,000	290,000	310,000
Operating expenses (Rs.)	(50,000)	(85,000)	(55,000)	(60,000)	(65,000)
Net profit before tax (Rs.)	150,000	95,500	217,000	230,000	245,000

1. You are required to make a trend analysis based on information given.

(03 marks)

2. Do the trends signify a favourable or unfavourable situation? Explain

(02 marks)

(b) (i) What is the difference between “borrowing income from future” and “savings income for the future”?

(02 marks)

(ii) Describe the term “Accounting quality” and explain how does “ Accounting” become low quality?

(03 marks)

(iii) “ Earnings management is a manipulation of financial statements”

Discuss the above statement by focusing on the earnings management techniques with suitable examples.

(04 marks)

(Total marks 20)

2. The following information have been extracted from the books of Dakshina Lanka PLC. The Directors of the company consider about the profitability, financial position and capital market indicators during the past two years. Financial analyst has decided to make a ratio analysis with your support for this purpose.

	<b>(Rs. Thousands)</b>	
	<b>31.03.2020</b>	<b>31.03.2019</b>
Stated ordinary share capital (Rs.10 each)	45,000	42,000
Retained Earnings	6,800	5,200
Sales (80% on credit)	60,000	40,000
Cost of Sales	34,000	24,000
Operating expenses	10,800	8,600
Non – current assets( net)	27,000	15,800

Inventory	19,800	10,200
Debtors (net)	20,000	8,400
Non- current Liabilities	8,000	10,600
Current Liabilities	14,200	14,500
Interest expenses	960	670
Cash at bank	12,600	7,200

#### Additional Information

1. The balances of the net debtors and inventory as at 01.04.2018 were Rs.4,800,000 and Rs.9,800,000 respectively.
2. Corporate tax rate is 30% on profit before tax.
3. Dakshina Lanka PLC paid Rs. 3,150,000 and Rs. 3,960,000 in dividends for years of 2018/19 and 2019/20 respectively.
4. The market price per ordinary share of the company as at 31<sup>st</sup> March 2020 and 2019 were Rs.20 and Rs.15 respectively.
5. Company credit policy is "net 60".
6. The following are the industry averages available for the year 2019/2020.

	<b>Ratios</b>	<b>Industry Averages</b>
(i)	Return on sales ratio	15%
(ii)	Return on equity ratio	20%
(iii)	Current ratio	2: 1
(iv)	Quick ratio	1: 1
(v)	Debtors turnover ratio	5 times
(vi)	Average collection period	75 days
(vii)	Inventory turnover ratio	4 times
(viii)	Debt equity ratio	48%
(ix)	Interest coverage ratio	15 times
(x)	Earnings per share ratio	Rs.5
(xi)	Dividend yield ratio	10%
(xii)	Dividend pay-out ratio	40%

**Required**

(a) (i) Calculate the above ratios for the Dakshina Lanka PLC for the both years ended 31<sup>st</sup> March 2019 and 2020.

(12 marks)

(ii) Based on the calculated ratios, discuss the Dakshina Lanka PLC's profitability, financial position and capital market ratios with the industry averages.

(05 marks)

(b) Briefly explain the limitations of the ratio analysis with suitable examples

(03 marks)

(Total marks 20)

(03) (a) What is the difference between expensing inventory cost and capitalizing inventory cost?

(03 marks)

(b) Monaco company is importing and distributing a medicinal product called "Immugrow. Assume that company expects a markup of Rs. 250 on cost. The following are the inventory and gross profit values calculated by using FIFO and LIFO methods.

	<b>Purchases in Units</b>	<b>Sales in units</b>
November year - 2020	100	-
December year - 2020	50	50
January year - 2021	50	75
February year - 2021	100	75

FIFO inventory values

	<b>December year- 2020 (Rs.)</b>	<b>January year- 2021 (Rs.)</b>	<b>February year- 2021 (Rs.)</b>
Sales	700	1,500	1,875
Cost	(500)	(875)	(1,275)
Gross profit	200	625	600

LIFO inventory values

	December year- 2020 (Rs.)	January year- 2021 (Rs.)	February year- 2021 (Rs.)
Sales	700	1,500	1,875
Cost	(750)	(1,150)	(1,500)
Gross profit	(50)	350	375

**Required**

- (i) Calculate the gross profit for each month using the average cost method  
(04 marks)
- (ii) Interpret your answer and briefly discuss the effect of inventory accounting methods on financial statement analysis.  
(03 marks)

- (c) Euro Lanka PLC is going to identify the LIFO consequences of a changing purchasing policy and company purchases. The following information has been given by the company for the year 2020.

Period / Month	Purchases in units	Purchase price (Rs.)
January to July	13,500	Rs.8.00
August to November	10,800	Rs.9.00
December	6,500	Rs.10.00

Ending inventory equals 4,500 units and it is valued under LIFO method. Total sales for the year is Rs.250, 000 and company has decided to purchase 8,500 units in December as a purchasing policy change.

**Required**

Identify the LIFO consequences of changing policy at the end of the year 2020.

(05 marks)

(Total marks 15)

- (04). (i) Briefly explain the methods of recording “uncollectible receivables” with an example.  
(03 marks)
- (ii) What are the differences between “percent of sales method” and “analysis of receivables methods”?  
(03 marks)
- (iii) What is the meaning of “disposing receivables” and list out the reasons for disposing Receivables?  
(03 marks)
- (iv) Briefly explain the two factors considered in analyzing receivables?  
(03 marks)
- (v) Briefly describe the types of marketable securities  
(03 marks)
- (Total marks 15)

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