



UNIVERSITY OF RUHUNA  
FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration Degree Programme 3000 Level Second Semester End  
Examination March 2022  
Academic year 2020/2021

ACC 32123 – Financial Reporting

Duration: Three hours

The question paper contains 05 questions.

Answer all questions.

Show all the workings related to the questions clearly with the final answers

01.

- A. List three (3) mandatory sources of GAAP in Sri Lanka (03 Marks)
  - B. Identify three (3) stakeholders and the information they expect from financial reports (03 Marks)
  - C. Explain the 'due process' used for developing IFRSs (04 Marks)
  - D. "The information must be both relevant and faithfully represented if it is to be useful." Comment on this statement. (04 Marks)
- (Total Marks 14)**

02.

- A. Alpha Properties Ltd acquired a retail park on 1<sup>st</sup> August 2020 at the cost of Rs. 10 million. The company incurred transaction costs of Rs.500,000 on the purchase. On 31<sup>st</sup> December 2020, the property was determined by an external valuer to have a fair value of Rs. 10.8 million.

In 2021, there was a market-wide fall in property prices, and the fair value of the retail park on 31<sup>st</sup> December 2021 was Rs. 10.6 million. Alpha Properties Ltd applies the LKAS 40 fair value model.

**Required**

- i. Prepare relevant extracts from the financial statements of Alpha Properties Ltd for the years ended 31<sup>st</sup> December 2020 and 2021. (03 Marks)
- B. Matara Development PLC owns a building that has five floors. Four floors of the building are used for office purposes of Matara Development PLC, and the fifth floor has been leased out (under a finance lease) to JFC restaurants, a popular chain of restaurants around the world.
    - i. How can Matara PLC recognize the above building in its financial statements? Your answer should refer to the relevant accounting standard/s. (03Marks)
- C. On 1<sup>st</sup> August 2015, Alpha PLC bought a machine for Rs. 500 000 which is used for manufacturing tiles. The following expenses were incurred in addition to the purchase price to bring the machine to its intended condition. The machine was ready for use by 1<sup>st</sup> October 2015.

Expense	Rs.000
Delivery and handling costs	10
Installation and assembly costs	15
Cost of opening the new facility the machine was fixed	50
General overheads	5
Cost of testing (1 <sup>st</sup> batch of tiles)	20

**Additional information ~**

- The 1<sup>st</sup> batch of tiles was sold for Rs. 10,000.00 immediately after production.
- The useful life of the asset is 10 years.
- On 1<sup>st</sup> October 2020, management of the Alpha PLC did some modifications to machine, which enhanced the machine's production capacity. The modification amounted to Rs. 25,000.00.

**Required**

- i. Calculate the initial cost of the machine (03 Marks)
- ii. Calculate the depreciation expense for the year ended 31.03.2021 (02 Marks)
- iii. Show an extract of the statement of financial position and profit or loss statement for year ended 31.03.2021 (03 Marks)

(Total Marks)

03.

- A. Delta Limited is in the business of real estate development and sale. The company has a new constructed head office premises. Construction was completed during the current year at the cost of Rs. 8 million. Delta Limited issued debentures valued at Rs. 6 million on 1<sup>st</sup> April 2020 with an effective finance cost of 15% per annum.

Delta obtained a bank loan for Rs. 4 million on 1<sup>st</sup> January 2020 at 12% interest per annum. 50% of the loan was utilized to construct head office premises.

Construction commenced on 1<sup>st</sup> April 2020 and was completed and ready for use as the head office building from 30<sup>th</sup> November 2020. It was estimated that the property had a useful life of 44 years on this date. The building was vacant until 1<sup>st</sup> January 2021 as it took one month to shift from the old premises to the new building.

The proceeds of the debenture were temporarily invested, and an interest income of Rs. 240,000 was earned during the period of construction. Rs. 140,000 out of this interest was earned before 1<sup>st</sup> April 2020.

**Required**

- i. Calculate the net borrowing cost that should be capitalized as part of the cost of head office property and the finance cost that should be expensed in the Income Statement for the year ended 31.03.2021. (04 Marks)
- ii. Show an extract of the statement of financial position as at 31.03.2021. (04 Marks)

- B. A cash-generating unit was reviewed for impairment on 31<sup>st</sup> March 2020 as required by LK 36; impairment of Assets. The impairment review revealed that the cash-generating unit had a carrying 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 before impairment review were as follows:



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

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

**Required**

- i. Calculate the carrying values of the net assets after adjusting for any changes from the impairment review. (06 Marks)

(Total Marks 14)

04.

- A. Suwasetha, a hospital in Matara District, received a government grant for Rs.400,000 to install a water purification system in the hospital. The machine costs Rs.2,000,000. It has a useful life of 5 years.

**Required**

Show the extracts of financial statements at the end of the 1<sup>st</sup> year under the income approach discussed in LKAS 20. (03 Marks)

- B. Alpha Ltd has 100 employees in officer grade. Each employee is entitled to 5 working days of sick leave that can be carried forward one year if unused. Sick leave is taken on a last in first out basis. On 31<sup>st</sup> December 2020, the average unused sick leave was 2 per employee. The company expects 92 employees will not take more than 5 days of sick leave and the remaining 8 to take 6.5 days of sick leave in 2021. One day of sick leave costs Rs.2000 to the company.

**Required**

Briefly explain the accounting treatment applicable to the above scenario. (03 Marks)

- C. Alpha PLC is a holding company. It has a subsidiary named Beta PLC and an associate named Delta PLC. Mr. Mathew is the CEO of Alpha PLC.

a. Mr. Jones is key management of both Alpha and Delta and shares his time 60% with entity Alpha and 40% with entity Delta. Each company pays him a salary to reflect the services he provides. He has a separate contract of employment with each one.

b. Alpha owns 100% of Beta. Mr. Willium is a director of Alpha and also a director of Beta. Mr. Willium receives compensation from each of the entities, Alpha and Beta.

c. Alpha's largest customer, Omega PLC, accounts for 45% of Alpha's revenue. Omega PLC has just completed negotiations with Alpha for a special 5% discount on all sales.

d. During the accounting period, Mr. Mathew purchased a property from Alpha for Rs. 5,000,000. Alpha had previously declared the property surplus to its requirements and had valued it at Rs.7,500,000.

**Required**

Explain the extent to which each of the above incidents (a,b,c,d) should be classified and disclosed by referring to LKAS 24, related party disclosures.

(08 Marks)

(Total Marks 14)

05.

A. The following information is related to Alpha PLC for 2021 and 2022.

Profit after tax	Rs. 25 million
Number of ordinary shares on 1 <sup>st</sup> January 2021	10 million
Number of irredeemable cumulative preference shares	5 million

**Additional Information**

**For 2021**

- Alpha PLC issued 500,000 shares on 1<sup>st</sup> July 2021 for Rs.100 each.
- Fixed dividends are paid on the preference shares at a rate of 2% of the carrying value.

**For 2022**

- Alpha PLC is planning to issue 3.5 million bonus shares through a 1 for 3 bonus issue on 1<sup>st</sup> July 2022.
- Alpha predicts that the profit for 2022 will amount to Rs.30 million.

**Required**

- Calculate the basic earnings per share for the year ended 31.12.2021. (03 Marks)
- Calculate the basic earnings per share for 2022 based on the predicted profit. (02 Marks)
- Calculate the adjusted earnings per share for 2021 after considering the details of the planned bonus share issue. (01 Mark)

B. Beta PLC changed its accounting policy for inventory from LIFO to FIFO in 2021. This change was made after a management review that revealed that the FIFO basis would reflect more reliable and relevant information about the effects of transactions in financial statements. Beta identified that a cost of Rs. 15,000 should be reversed from the final stock value in 2020 and Rs. 55,000 should be reversed from previous accounting periods.

It was also noted that during 2020 the company had overstated operating expenses by Rs 150,000 in the income statement.

Extracts of financial statements for Beta PLC before adjusting for the above changes are as follows.

	2021 (Rs.)	2020 (Rs.)
Profit before interest and tax	450,000	150,000
Tax (30%)	(135,000)	(45,000)
Retained earnings	1,665,000	1,350,000

**Required**

- Briefly explain why Beta PLC is changing its inventory valuation policy by referring to LKAS 08. (01 Mark)
- Show an extract of the income statement and statement of changes in equity after adjusting for the above changes. (07 Marks)

(Total Marks 14)