EASTERN UNIVERSITY, SRI LANKA
FACULTY OF COMMERCE AND MANAGEMENT
Final Year First Semester Examination in Bachelor of Commerce Honours / Bachelor of Commerce Honours in Accounting and Finance-2021/2022
(February 2024) (Proper/Repeat)
DAF 4133 Financial Reporting and Statement Analysis

Answer All Questions **Time Allowed: 03 Hours**
Non Programmable Calculators are permitted.

PART 1

Choose a correct answer.

1. What does Business Analysis include?
   (a) Equity Analysis and Credit Analysis.
   (b) Accounting Analysis and Financial Analysis.
   (c) Ratio Analysis and Comparative Analysis.
   (d) Index Number Series Analysis and Ratio Analysis.
   (e) Economic Analysis and Industry Analysis.

2. What does financial statement analysis refer to?
   (a) Accounting Analysis, Financial Analysis, and Risk Analysis.
   (b) Accounting Analysis, Financial Analysis, and Prospective Analysis.
   (c) Financial Analysis, Cash Flow Analysis, and Profitability Analysis.
   (d) Ratio Analysis, Comparative Analysis, and Trend Analysis.
   (e) Profitability Analysis, Liquidity Analysis, and Solvency Analysis.

3. What are the four types of business activities that financial statements can report?
   (a) Planning, Operating, Accounting, and Financing Activities.
   (b) Operating, Investing, Financing, and Accounting Activities.
   (c) Planning, Operating, Investing, and Financing Activities.
   (d) Manufacturing, Administrating, Buying, and Selling Activities.
   (e) Planning, Organizing, Directing, and Controlling Activities.

4. Which of the following specifies an advantage of ratio analysis?
   (a) Usefulness of ratios depends on the reliability of the numbers.
   (b) Providing with detailed figures about financial conditions.
   (c) Ensuring fair presentation of data in the financial statements.
   (d) Revealing important relations and bases of comparison in uncovering conditions and trends.
   (e) The numbers underlying ratio computations are always appropriate.

5. What of the following can be identified as a shortcoming of ratio analysis?
   (a) Providing with insights into underlying conditions.
   (b) Identifying areas requiring further investigation.
   (c) Useless for forecasting future trend and magnitude of items.
   (d) Revealing important relations and bases of comparison in uncovering conditions and trends.
   (e) Usefulness of ratios depends on the reliability of the numbers.

6. Which of the following best refers to the internal users of financial statements?
   (a) Owners and Managers.
   (b) Investors and Managers.
   (c) Employees and Customers.
   (d) Financial Analysts and Creditors.
   (e) Accountants and Suppliers.

7. Which of the following best indicates a group of external users of financial statements?
   (a) Creditors, Equity Investors, Merger and Acquisition Analysts, Managers, and Board of Directors.
   (b) Equity Investors, Creditors, Financial Analysts, Auditors, and Regulatory Agencies.
   (c) Regulatory Agencies, Managers, Suppliers, Intermediaries, and Customers.
   (d) Debtors, Employees, Suppliers, Owners, and Customers.
   (e) Government, Employees, Suppliers, Intermediaries, and Managers.

8. What are additional sources of financial reporting information (beyond financial statements) that are useful for analysis?
   (a) Statement of Profit or Loss, Management Report, Auditor Report, and Explanatory Notes.
   (b) Supplementary Information, Social Responsibility Reports, Explanatory Notes, and Statement of Changes in Equity.
   (c) Statement of Profit or Loss, Management Report, Auditor Report, and Statement of Cash Flow.
   (d) Management's Discussion and Analysis, Management Report, Auditor Report, and Proxy Statement.
   (e) Management's Discussion and Analysis, Statement of Financial Position, Auditor Report, and Sustainability Report.

9. Which type of reports provides information on accounting principles and methods employed, detailed disclosures regarding individual financial statement items, commitments and contingencies, business combinations, transactions with related parties, stock option plans, legal proceedings, and significant customers?
   (a) Management's Discussion and Analysis.
   (b) Supplementary Information.
   (c) Explanatory Notes.
   (d) Auditor Report.
   (e) Sustainability Report.

10. What are the four general categories of financial analysis tools?
   (a) Year-to-Year Change Analysis, Common-Size Financial Statement Analysis, Ratio Analysis of FSs, and Specialized Analysis Tools.
   (b) Comparative Financial Statement Analysis, Common-Size Financial Statement Analysis, Ratio Analysis of FSs, and Specialized Analysis Tools.
   (c) Index-Number Trend Series Analysis, Common-Size Financial Statement Analysis, Ratio Analysis of FSs, and Specialized Analysis Tools.
   (d) Comparative Financial Statement Analysis, Year-to-Year Change Analysis, Index-Number Trend Series Analysis, Common-Size Financial Statement Analysis, and Ratio Analysis of FSs.
   (e) Horizontal Analysis, Vertical Analysis, Ratio Analysis of FSs, and Year-to-Year Change Analysis.

11. What is the main concern/s in analysis of accounts receivable?
   (a) It is important to analyze receivables because of their impact on a company's asset position and income stream.
   (b) Assessment of earnings quality is often affected by an analysis of receivables and their collectability.
   (c) Analysis must be alert to changes in the allowance account—computed relative to sales, receivables, or industry and market conditions.
   (d) Analysis must recognize the possibility of error in judgment as to their ultimate collection.
   (e) All of these.

12. What is effect of the FIFO inventory costing method on earnings during a period of inflation?
   (a) In periods of rising prices, FIFO produces higher gross profits than LIFO because lower cost inventories are matched against sales revenues at current market prices.
   (b) In periods of rising prices, FIFO produces lower gross profits than LIFO because lower cost inventories are matched against sales revenues at current market prices.
   (c) In periods of rising prices, FIFO produces lower gross profits than LIFO because higher cost inventories are matched against sales revenues at current market prices.
   (d) In periods of rising prices, FIFO produces higher gross profits than LIFO because higher cost inventories are matched against sales revenues at current market prices.
   (e) None of these.

13. What does the concept of Economic Income refer to?
   (a) Cash flow plus the change in the fair value of net assets.
   (b) Both realized and unrealized gains and losses.
   (c) Changes in shareholder value.
   (d) Measuring the financial effects of all events for the period in a comprehensive manner.
   (e) All of these.

14. What are the components of Accounting Income?
   (a) Permanent, transitory, and value irrelevant components.
   (b) Recurring, non-recurring, and special items components.
   (c) Permanent, recurring, and value irrelevant components.
   (d) Permanent, recurring, and non-recurring components.
   (e) Recurrent, transitory, and special items components.

15. Earned inflows or prospective earned inflows of cash arising from transactions and events unrelated to a company's ongoing business activities are termed as
   (a) Revenue
   (b) Gain
   (c) Cash inflow
   (d) Operating profit
   (e) Non-operating profit

16. What is the main difference between the terms "Expenses" and "Losses"?
   (a) Expenses are incurred outflows, prospective outflows, or allocations of past outflows of cash that arise from a company's ongoing business operations, but in contrast, Losses are decreases in a company's net assets arising from peripheral or incidental operations of a company.
   (b) Expenses are decreases in a company's net assets arising from peripheral or incidental operations of a company, but in contrast, Losses are incurred outflows, prospective outflows, or allocations of past outflows of cash that arise from a company's ongoing business operations.
   (c) Expenses are operating costs that arise from a company's ongoing business operations, but in contrast, Losses are deficit of income over expenses arising from peripheral or incidental operations of a company.
   (d) Expenses are operating costs that arise from a company's ongoing business operations, but in contrast, Losses are deficit of income over expenses arising from both ongoing business and peripheral or incidental operations of a company.
   (e) Expenses are operating and non- operating expenses of a company, but in contrast, Losses are impairment losses of assets of a company.

17. Which of the followings are features of Operating Income measure?

A. Operating income pertains only to income generated from operating activities.
B. Operating income focuses on income for the company as a whole rather than for debt and equity holders.
C. Operating income pertains only to ongoing business activities.
D. Operating income includes financing revenues and expenses (mainly interest expense) also.

(a) A and B only.
(b) A, B, and C only.
(c) B, C, and D only.
(d) A and C only.
(e) All of these.

18. Purposeful intervention by management in the earnings determination process, usually to satisfy selfish objectives, is termed as

(a) Income Smoothing.
(b) Accounting Manipulations.
(c) Earnings Management.
(d) Cosmetic Earnings Management.
(e) Window-dressing financial statements.

19. What is the meaning of Accounting Distortions?

(a) Changing accounting methods.
(b) Changing accounting estimates and policies that determine accounting numbers.
(c) Adjusting accounting numbers, particularly income, for personal gain, thereby reducing their quality.
(d) Deviating reported information in financial statements from the underlying business reality.
(e) Increasing a period's reported income to portray a company more favorably.

20. Which of the following is not an example for potential ordinary shares to be taken into the calculation of diluted earnings per share?

(a) Financial liabilities that are convertible into ordinary shares.
(b) Preference shares that are convertible into ordinary shares.
(c) Bonus shares
(d) Options and warrants.
(e) Shares that would be issued upon the satisfaction of conditions resulting from contractual arrangements, such as the purchase of a business or other assets.

(02 x 20 = 40 Marks)

PART II

01. (I) The Statement of Financial Position of MBC plc as at 31st December 2023 and 2022 are as follows:

	2023	2022
	Rs.000	**Rs.000**
Property, Plant and Equipment	277,500	255,000
Merchandise inventory	111,500	82,500
Accounts receivable, net	88,500	62,500
Prepaid expenses	9,700	9,375
Cash	30,800	35,625
Total Assets	**518,000**	**445,000**
Equity Capital (Rs.10 PS)	162,500	162,500
Retained Earnings	129,100	104,750
Long-term Loans mortgaged on plant assets	97,500	102,500
Accounts payable	128,900	75,250
Total liabilities and equity	**518,000**	**445,000**

Required:

Express the above statements of financial position information in Common-Size Percent and assess the company's structure of financial position.

(08 Marks)

(II) The following are the information related to a statement of financial position of a company:

Statement of Financial Position as at 31.12.2023

Liabilities	Rs.	Assets	Rs.
Ordinary Share Capital	?	Land	?
Retained Earnings	100,000	Buildings	?
Current Liabilities	?	Inventory	50,000
		Accounts Receivable	?
		Cash	?
	?		?

Additional Information:

Total Assets minus Current Liabilities equals Rs.600,000; Shareholders' Equity equals three times of Current Liabilities; Carrying amount of Land equals one thirds of the buildings; Acid-test ratio is 1.25; Ending inventory turnover is 15; Gross Profit is 44 percent of the cost of goods sold; Days' sales in accounts receivable is 20. Operating days are 360.

Required:

Construct the Statement of Financial Position using the additional information given above.

(08 Marks)

(III) The following three companies, A, B, and C, are operating in the same industry. The following data are available for those companies for the financial year ended 31st December 2023:

	Companies		
	A	B	C
Net sales(Rs.)	500,000	?	?
Net Profit (Rs.)	25,000	30,000	?
Total Assets (Rs.)	100,000	?	250,000
Total Asset Turnover(Times)	?	?	0.4
Net Profit Margin (%)	?	4	5
Return on Total Assets (%)	?	2	?

Required:

Find out the missing data (?) in the above, and comment on the relative performance of each company.

(04 Marks)

(Total 20 Marks)

02. (I) FCN Plc purchases its merchandise at current market costs and resells the product at a price 20 percent higher. Its inventory costs are constant throughout the current year 2023. Data on the number of units in inventory at the beginning of the year, unit purchases, and unit sales are shown below:

	Unit Price (Rs.)	Units
Inventory at the beginning of the year 2023	1000	1000
Purchased during the year 2023	1500	1000
Sales during the year 2023	1800	1500

The beginning of the year 2023 the statement of financial position for FCN Plc reports the following:

	Rs.
Inventory	1000,000
Other assets	1500,000
Total equity	1200,000
Other liabilities	1300,000

Required:

(a) Determine the after tax net income for the year 2023 using each of the following inventory accounting methods. Assume an operating cost of Rs.120,000 and 40% income taxes which are accrued currently and paid in the following year.

(i) First In First Out (FIFO)

(ii) Last In First Out (LIFO)

(iii) Weighted Average

(b) If all sales, purchases, and operating cost are for cash, construct the statement of financial position at the end of the year 2023 separately for the (i) FIFO (ii) LIFO, and (iii) WA methods of inventory valuation.

(15 Marks)

(II) Excerpts from the annual report of LDM plc are given for the two years:

	2023	2022
	Rs.	Rs.
Inventory (LIFO)	219,700	241,100
Cost of sales	754,600	675,200
Net income	31,200	64,100

If the First-In-First-Out (FIFO) method of accounting for inventory had been used, inventory would have been Rs.269,700 and Rs.251,500 at end of Year 2023 and Year 2022 respectively. What would net income for the year ended Year 2022, and 2023 have been had FIFO been used?

(05 Marks)

(Total 20 Marks)

03. (I) Information concerning the capital structure of DCS plc is reproduced below:

	31.12.2022	31.12.2023
Equity Shares	80,000	100,000
Convertible Preference Shares	10,000	10,000
8% Convertible Debentures	Rs.1,000,000	Rs.1,000,000
Accumulated Profits	Rs.312,000	Rs.496,000

During the year 2023, DCS plc pays dividends of Re.1 per share on its old equity shares and Rs.2.40 per share on its preference share. 20,000 additional new shares were issued at 01.10.2023. The preference share is convertible into 20,000 equity shares. The 8% convertible debentures are convertible into 35,000 equity shares. The income tax rate is 40%.

Required:

(a) Compute the Basic Earnings Per Share for the year ended 31.12.2023.

(b) Compute the Diluted Earnings Per Share for the year ended 31.12.2023.

(08 Marks)

(II) Capital Structure and Earnings for Year 2023 of BMS plc are as follows:

Number of ordinary shares outstanding as at 01.01.2023	2,000,000
Number of ordinary shares issued as at 01.04.2023	666,667
Number of ordinary shares outstanding as at 31.12.2023	2,666,667
Weighted-average market price per share during Year 2023	Rs.25
Options outstanding during 2023: Number of shares issuable on exercise of option	250,000
Exercise price	Rs.20
Convertible bonds outstanding (Issue date: 31.12.2019): Number of convertible bond	5,000
Ordinary Shares of issuable on conversion (per bond)	20
Coupon rate	5.0%
Proceeds per bond at issue (at par value)	Rs.1,000
Net income After Tax for Year 2023	Rs.7,750,000
Tax rate for Year 2023	20.0%

Required:

Calculate the following:

(a) Basic Earnings Per Share

(b) Diluted Earnings Per Share

(12 Marks)

(Total 20 Marks)