



EASTERN UNIVERSITY, SRI LANKA
FACULTY OF COMMERCE AND MANAGEMENT

**Final Year Second Semester Examination in Bachelor of Commerce/ Bachelor of
Commerce (Specialization in Accounting and Finance)/ Bachelor of
Commerce/Business Administration-2009/2010 (August 2011)**
DAF 4213 Financial Reporting and Statement Analysis

Answer All Questions

Time Allowed: 03 Hours

Non Programmable Calculators are permitted.

- a) Discuss the four major activities of a business enterprise.

(04 Marks)

 - b) Explain why financial statements are important to the decision making process in financial statement analysis.

(04 Marks)

 - c) Discuss the "Building Blocks" of financial statement analysis

(04 Marks)

 - d) Explain the Hierarchy of Accounting Qualities.

(04 Marks)

 - e) Discuss the implications of the Efficient Market Hypothesis (EMH) for financial statement analysis

(04 Marks)
- (Total 20 Marks)**

02. (I) The following are the information related to financial statements of a company:

Gross Profit	Rs.54000
Shareholders' Equity	Rs 600000
Gross Profit Margin	20%
Credit Sales to Total sales	80%
Total Asset Turnover	0.3
Stock Turnover	4
Average Collection Period(360 day year)	20 days
Current Ratio	1.8
Long-term Debt to Equity	0.4

Required:

Construct the Balance sheet of the Company using the information available.

(10 M)

(II) Comparative Financial statements of SDL plc, a wholesale distributor of electric for the years 2009 and 2010 are reproduced below:

Comparative Balance Sheets

	2010	2009
	Rs	Rs
Non-Current Assets	99,285	97,878
Investments	7,504	7,035
Total Non-Current Assets	106,789	104,913
Stock	61,661	63,167
Debtors	86,784	61,601
Prepaid Expenses	2,667	1,433
Cash	19,550	14,376
Total Current Assets	170,662	140,577
Total Assets	277,451	245,490
Owner's Capital	208,812	181,341
Creditors	65,994	62,229
Accrued Expenses	2,645	1,920
Total Liabilities	277,451	245,490

Required:

(a) Prepare common-size statements showing a column reporting the percent of increase or decrease of year 2010 relative to year 2009

(b) Interpret the trend shown in your percent calculations. What areas should be a matter of managerial concern?

(10 Marks)

(Total 20 Marks)

13. (I) Describe the major disclosure requirements regarding short term debt of firms.

(05 Marks)

(II) Discuss the required disclosures for postretirement benefit obligations of firms.

(05 Marks)

(III) A balance sheet, which is intended to present fairly the financial position of a company, is frequently criticized for not reflecting certain liabilities. Similarly, the balance sheet is faulted for not reflecting certain assets.

Required:

List five examples of assets that are not presently included on balance sheets, and discuss their implications for financial statement analysis.

(05 Marks)

(IV) What are factors that should be considered in determining whether investments in marketable equity securities should be classified as current or non-current?

(05 Marks)

(Total 20 Marks)

04. (I) FCM plc purchases its merchandise, a standard item, at the current market price resells the same product at a price 20 percent higher. The purchase price remains constant throughout the year. Data on number of units in inventory at the beginning of the year, unit purchases, and unit sales are shown below:

Number of units in beginning inventory @ Rs100	1000 units
Number of units Purchased during year @ Rs150	1000 units
Number of units sold during year @ Rs 170	1000 units

The beginning-of-year balance sheet for FCM plc lists the following:

	Rs.		Rs.
Equity	100000	Inventory (1000 units @ Rs100)	100000
	100000		100000

Required:

- (a) Calculate the after – tax profit for FCM plc using the (1) FIFO and (2) LIFO methods of inventory valuation if the company has no expenses other than cost of goods sold and it computes income taxes using a 50 percent rate. Taxes are accrued currently and paid the following year.
- (b) If all sales and purchases are for cash, construct the balance sheet at the end of the year using the (1) FIFO and (2) LIFO methods of inventory valuation
- (c) Describe the significance of each these methods of inventory valuation for profit determination and financial position in a period of increasing prices

(15 Ma

(II) Identify the cases requiring consolidated financial statements:

- (a) Parent company has a two-fifths ownership of a subsidiary.
- (b) Parent company has temporary but absolute control over a subsidiary.
- (c) Parent company has a controlling interest in a subsidiary but plans to dispose it.
- (d) Parent company is to relinquish control of a subsidiary in the near future because of a minority shareholder's legal suit.
- (e) A conglomerate parent company has majority interest in diversified subsidiaries.
- (f) Parent company has a 100 percent interest in a foreign subsidiary located in a country where governmental authorities severely restricted conversion of currencies and transfer of funds.
- (g) Parent company has a 100 percent interest in a subsidiary whose principal business is leasing properties to the parent company and its affiliates.

(05 Marks)

(Total 20 Marks)

05. (I) JCM plc sells primarily two products: (A) consumer cleaners, and (B) in purifiers. Its gross margin components for the past two years are:

	2010	2009
	Rs.	Rs.
Sales Revenue:		
Product A	600000	350000
Product B	300000	450000
Total	900000	800000
Less: Cost of goods sold:		
Product A	500000	280000
Product B	195000	270000
Total	695000	550000
Gross Margin	205000	250000

In year 2009, the selling price of A is Rs.50 per unit, while in year 2010 it is Rs. unit. Product B sells for Rs.500 per unit in both years. Security analysts a business press expressed surprise at company's 12.5 percent increase in sal Rs.45000 decrease in gross margin for the year 2010.

Required:

Prepare an analysis statement of the decline in gross margin, and discuss and sh effects of changes in quantities, prices, costs, and product mix on gross margin.

(10)

- (II) Financial data for WRD plc are reproduced below:

	Rs.
Short-term liabilities	500000
Long-term liabilities	800000
Equity Capital	1200000
Cash from operations	300000
Pre-tax income	200000
Interest expense	40000

Required:

Indicate the effect that each of WRD plc transactions or events(a through f) has on each of the four ratios below.(Each transaction or event is independent of others- consider only the immediate effect). Use "I" for increase,"D" for decrease, and "NE" for no effect.

A. Total Debt to Equity

B. Long-term Debt to Equity

C. Earnings to Fixed Chargers (exceeds 1.0 before transactions or events)

D. Cash flow to Fixed Chargers (exceeds 1.0 before transactions or events)

		A	B	C	D
a.	Increase in tax rate				
b.	Retire bonds- paid in cash				
c.	Issue bonds to finance expansion				
d.	Issue preferred stock to finance expansion				
e.	Depreciation expense increases				
f.	Collect accounts receivable				
g.	Refinance debt resulting in higher interest cost				
h.	Capitalize higher proportion of interest expense				
i.	Convert convertible debt into common stock				
j.	Acquire inventory on credit.				

(10 Marks)

(Total 20 Marks)