



Part C – Essay Questions

Answer **three (03)** questions **including question number 01** in this part.

- Show your all workings very clearly.
- Marks allocation: 50 Marks

01.

a) Describe the usefulness and limitations of a company's annual report to the company's lenders.

(05 marks)

b) Explain the likely implication that will arise from a company preparing financial statements, which do not comply with relevant accounting standards.

(05 marks)

c) The directors of Charith Ltd are in the process of conducting a risk assessment of the financial aspects of the management of their business. They have decided to analyse ratios relating to liquidity and gearing and to compare the results with those of similar businesses.

The company's latest statement of financial as follows:

Charith Ltd

Statement of financial position as at 31st March 2012

ASSETS	Rs.000
Non – current assets	2,500
Current assets	
Inventories	200
Trade receivables	150
	<u>350</u>
Total assets	<u>2,850</u>
EQUITY AND LIABILITIES	
Ordinary share capital	500
Preference share capital	300
Revaluation reserve	200
Retained earnings	<u>400</u>



Total equity	1,400
Non-current liabilities	
Long – term borrowings	1,200
Current liabilities	
Trade payables	120
Current tax payable	100
Bank overdraft	30
Total equity and liabilities	<u>2,850</u>

The directors have obtained the following averages for ratios based on their competitors' financial statements:

- i) Gearing (based on borrowings/total long term finance) - 35%
- ii) Current ratio - 2:1
- iii) Quick ratio - 1:1

The directors have a secondary reason for their interest in the gearing ratio. The company's long-term borrowings are in the form of a bank loan. A condition of the loan was that the company's gearing ratio would be kept below a specific percentage.

If the gearing ratio exceeds that limit then the bank has the right to demand immediate repayment.

The directors have already evaluated the company's profitability. Charith Ltd's return on capital employed is in line with the industry average. The directors are satisfied that they are as efficient and profitable as the other companies in their industry.

You are required to:

- i) Calculate Charith Ltd's gearing ratio, current ratio and quick ratio.
(04 marks)
- ii) Explain the implications of the ratios and other information provided for the assessment of the risks faced by Charith Ltd.
(10 marks)
- iii) Explain why a bank would impose a loan condition that set a maximum level for a borrower's gearing ratio.
(06 marks)

(Total – 30 Marks)

02. Explain the role of fair value accounting in the context of emerging economies.

(10 Marks)

03. "Conceptual framework for financial reporting helps to maintain uniformity among the financial statements of different entities".

You are required to:

Discuss the significance of a conceptual framework for financial reporting; what does framework cover, its contents and issues.

(10 Marks)

04.

a) Explain the disclosure requirements in financial statements in accordance with LKAS 18 – Revenue.

(05 marks)

b) An entity issues 7,500 award credits. It expects 80% of these award credits to be redeemed, and estimates the fair value of the 7,500 award credits to be Rs. 3,000 and defers revenue of this amount. By the end of year one, 1,500 award credits have been redeemed.

i) Calculate the amount of revenue recognition for year one

(02 marks)

ii) By the end of year two, a further 800 award credits have been redeemed, bringing the total award credits redeemed to date to 2,300. Management now expects 85% of the issued award to be redeemed.

Compute the value of revenue recognition for the year two

(03 marks)

(Total – 10 Marks)

