**Possible Question no 01**

(a) Hansini has carried out many discussions with a Chinese investor, Hasen Lee and came up with the following conclusion to the board of CAPL

"Lee agreed to invest with us to start up the production of essential oils, Herbal beauty products and healthcare products mainly focusing on overseas market. Initial investment required to start the production and distribution of these productions was estimated to be Rs. 500 million. He proposed two options. We need to evaluate these two options and inform him of the preferred one within two weeks. Therefore, I want you to carefully study the two options and prepare a briefing note on the financial reporting implications arising from each option separately".

The two options are as follows:

**Option 1** CAPL & Lee to set up a separate legal entity for the purpose of manufacturing and distributing of identified products to the local and international markets. The main contractual terms would be as follows:

- Both parties would equally invest in the new entity.
- The new entity will own the manufacturing plant and all other assets that will be purchased using the funds invested by the two parties.
- CAPL & Lee would not be liable for debts, liabilities, or obligations of the new entity. If the new entity is unable to pay any of its debts or other liabilities to third parties, the liabilities of both parties will be limited to the unpaid amount of each party's capital contribution.
- If CAPL & Lee want to exit from the investment, they can do so by selling their interest in the new entity.
- The profit or loss generated by the new entity will be shared between the two parties in accordance with each party's interest in the new entity.

**Option 2** A separate company will be established and CAPL will own 60% of the ordinary share capital of this entity while Lee will hold the balance. A total investment of Rs. 500 million will be paid by each party as follows:

- Rs. 330 million immediately upon signing the contract (50% will be paid by each party).

- CAPL will pay Rs. 120 million of cash after one year from the date of signing the contract.

- CAPL will pay Rs. 50 million of cash after two years from the date of signing the contract depending on a range of contingent events. It is highly likely that this amount will be paid.

- As tentatively agreed, Lee is responsible for major operating and capital decisions of the new entity due to the specialist knowledge it possesses. Therefore, Lee can appoint or approve the majority of key management personnel of the new entity.

CAPL can appoint one director to the board enabling participation in policy making decisions. (Assume the contract will be signed on 1 July 2022 and the discount rate is 13% for any calculations required).

***Required:*** **Prepare a briefing note that includes an analysis of the arrangements given in the two options, together with the financial reporting implications in accordance with applicable financial reporting standards. (25 marks)**

(b) as explained in the pre seen, CAPL is planning to list its ordinary shares on the Colombo Stock Exchange (diri savi board) at the end of 2022.

***Required:*** **Assess the board balance and appointments to the board of the existing governance structure of the company. (6 marks)**

(c) Hansini called the group CFO and said, "since CAPL is currently a privately owned company, it is not required to prepare financial statements in full compliance with SLFRSs/LKASs. If we don't prepare financial statements not full compliance with SLFRSs/LKASs, we can save the fee that would otherwise be paid to the auditors and other experts.

***Required:*** **Evaluate the ethical responsibility of the CFO in respect of the Hansini's statement above.**

**(6 marks)**