



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JANUARY 2016

(AA31) FINANCIAL ACCOUNTING AND REPORTING

• **Instructions to candidates** (Please Read Carefully):

- (1) **Time Allowed:** Reading : 15 minutes
Writing : 03 hours.

30-01-2016
Morning
[8.45 – 12.00]

No. of Pages : 10
No. of Questions : 09

- (2) **All questions should be answered.**
- (3) **Answers should be in one language, in the medium applied for, in the booklets provided.**
- (4) **Submit all workings and calculations. State clearly assumptions made by you, if any.**
- (5) **Use of Non-programmable calculators is only permitted.**
- (6) **Action Verb Check List with definitions is attached. Each question will begin with an action verb. Candidates should answer the questions based on the definition of the verb given in the Action Verb Check List.**
- (7) **100 Marks.**

SECTION A

Four (04) compulsory questions

(Total 20 marks)

Question 01

- (a) **Define** a liability as per the conceptual framework for financial reporting. (02 marks)
- (b) **State** the recognition criteria of a liability. (03 marks)
- (Total 05 marks)

Question 02

ABC Ltd. has obtained the following loans from **PQ Bank** during the year ended 31st December 2015:

Loan No.	Date of Loan	Loan Amount (Rs.)	Interest Rate
578510020	01.01.2015	7 million	12%
578500004	15.03.2015	8 million	15%
578508903	30.04.2015	10 million	11%

On 01st June 2015, **ABC Ltd.** has started to construct a new plant and it is expected to finish the construction activities by 30th September 2016. On completion, the plant will cost Rs.15 million. The Board of Directors of the company has decided to fund this investment of constructing of the plant using the loans obtained during the year ended 31st December 2015.

Compute the amount to be capitalized as borrowing cost.

(05 marks)

Question 03

Following information have been extracted from the annual report of **Aviva PLC** for the year ended 31st March 2015.

	Rs.(million)
Profit After Tax	23
Dividends - Ordinary Shares	0.5

Following additional information has also been provided:

- (1) Current market price of an ordinary share is Rs.25/-.
- (2) Number of weighted average ordinary shares held as at 31st March 2015 is 100,000.

You are required to,

Compute the following:

- (a) Earning Per Share (EPS).
- (b) Price Earning Ratio (PE).
- (c) Earning Yield Ratio. (05 marks)

Question 04

State any three(03) duties of Specified Business Enterprises (SBE) with regards to preparation and presentation of their financial statements. (05 marks)

End of Section A

SECTION B

Three (03) compulsory questions
(Total 30 marks)

Question 05

- (a) **State** two(02) recognition criteria of an intangible asset. (02 marks)
- (b) **MM PLC** is considering to acquire **MS Ltd.** which is engaged in the manufacture of high-end fashion-ware for women. **MS Ltd.** does not have large balance sheet assets due to its business nature. The CEO of **MS Ltd.** recently mentioned the media that **MS Ltd.’s** most valuable asset is its business “Brand Name” developed over past 20 years, and the brand name was valued at Rs.1 billion.
 - (i) **State** whether **MS Ltd.** can recognize this brand name in their financial statements. (02 marks)
 - (ii) **State** the correct accounting treatment of this brand in **MM PLC’s** consolidated financial statements, if **MM PLC** acquires **MS Ltd.** (03 marks)

- (c) **MM PLC's** research team is conducting a research on developing a new fabric which is resistant to dust and sweat. If they succeed, that will be a ground breaking achievement and future revenue source to **MM PLC**.

MM PLC's management is spending a huge amount of money on this research. The total cost of the research has been estimated to be Rs.100 million, of which Rs.50 million has already been incurred.

State the accounting treatment for this Rs.50 million spent already. (03 marks)

(Total 10 marks)

Question 06

The Statements of Financial Position as at 31st March 2015 and 31st March 2014 and the Statement of Comprehensive Income for the year ended 31st March 2015 of **Royal Knit Wear Ltd.** are given below:

Royal Knit Wear Ltd.
Statements of Financial Position (Rs.'000)

	as at 31 st March 2015		as at 31 st March 2014	
Assets				
Non-Current Assets:				
Property, Plant and Equipment:				
Property, Plant and Equipment	15,280		14,000	
Less: Accumulated Depreciation	(5,113)	10,167	(4,550)	9,450
Investments		2,240		1,900
		12,407		11,350
Current Assets:				
Inventories	850		600	
Trade Receivables	2,500		2,900	
Investment Income Receivable	39		50	
Cash and Cash Equivalents	80	3,469	76	3,626
Total Assets		15,876		14,976
Equity and Liabilities				
Equity:				
Stated Capital - Ordinary Share Capital		10,800		9,000
General Reserve		200		2,000
Retained Earnings		1,753		1,020
		12,753		12,020
Non-Current Liabilities:				
Bank Loan		1,200		1,450
Provision for Gratuity		420		300
		1,620		1,750
Current Liabilities:				
Trade Payables		1,357		959
Accrued Expenses		95		174
Income Tax Payable		46		65
Bank Loan Interest Payable		5		8
		1,503		1,206
Total Equity and Liabilities		15,876		14,976

Royal Knit Wear Ltd.
Statement of Comprehensive Income
for the year ended 31st March 2015 (Rs.'000)

Sales	22,000
Cost of sales	(13,800)
Gross Profit	8,200
Other Income:	
Investment income	560
	8,760
Less: Expenses	
Distribution expenses	4,680
Administration expenses	2,730
Finance expenses	467
Profit Before Tax	883
Less: Taxation	150
Profit After Tax	733
Other Comprehensive Income	-
Total Comprehensive Income for the year	733

The following additional information is also provided:

- (1) The bank loan interest expenditure for the year was Rs.217,000/-. Balance finance expenses shows ordinary dividends paid during the year, which has erroneously been shown under finance expenses.
- (2) Incentive payable to sales staff as at 31st March 2015 was Rs.90,000/- This amount has not been provided for in the books of accounts.
- (3) The company has not paid any amount as gratuity during the year.

You are required to:

Prepare the Net Cash Flows from Operating Activities of **Royal Knit Wear Ltd.** for the year ended 31st March 2015 using indirect method. (10 marks)

Question 07

- (a) On 01st April 2015, **STV Company** acquired a machinery at a cost of Rs.2,000,000/- . The economic useful life time of the machinery is 4 years and no residual value is expected at the end of 4th year. The company is entitled to claim capital allowances for this machinery fully (i.e. 100% allowance) in the year of purchase. Corporate tax rate of the company is 28%.
 - (i) **Compute** the amount of deferred tax asset / liability arising from this transaction as at 31st March 2016.
 - (ii) **Explain** how you would account for the answer (a) - (i) above in future years. (07 marks)
- (b) **Identify** three(03) indicators that would lead to a lease being classified as a finance lease. (03 marks)

(Total 10 marks)

End of Section B

SECTION C

Two (02) compulsory questions.

(Total 50 marks)

Question 08

Bheem PLC is a company listed in Colombo Stock Exchange. The Trial Balance of the company as at 31st March 2015 is as follows:

Bheem PLC
Trial Balance as at 31st March 2015 (Rs. '000)

	Dr.	Cr.
Stated Capital - Ordinary Share Capital (2 million shares)		25,000
Retained Earnings as at 01 st April 2014		2,020
13% Debentures		7,500
Property, Plant and Equipment – at cost		
Motor Vehicles	26,500	
Office Equipment	8,650	
Furniture and Fittings	3,100	
<u>Provision for Depreciation as at 01st April 2014</u>		
Motor Vehicles		10,600
Office Equipment		6,488
Furniture and Fittings		1,860
Investment in shares (at fair value through profit or loss)	15,000	
Inventories	3,800	
Trade Receivables / Trade Payables	24,500	14,600
Income Tax Account for the year of assessment 2013/14		360
Bank Overdraft		1,100
Cash in Hand	600	
Allowance for doubtful debts as at 01 st April 2014		360
Cost of Sales / Sales	57,443	92,650
Investment Income		1,200
Ordinary Dividend Paid - Interim	1,000	
Administration Expenses	10,150	
Selling and Distribution Expenses	9,300	
Other Operational Expenses	2,100	
Finance Expenses	850	
Income Tax Paid	745	
	163,738	163,738

The following additional information is also provided:

- (1) On 30th September 2014, company exchanged one of its old vans for a new van. The book value of the old van as at the date of exchange was Rs.576,000/-. The old van was purchased on 01st April 2011. The company paid Rs.900,000/- as the balance payment for the new van which represents 2/3 of the market value of the new van. Cash payment has been recorded under purchases. Other than that, no entries have been made in the books of account in this respect.

- (2) During the year, the company purchased the following assets:

Date	Name of Asset	Value (Rs.)
30.04.2014	3 Executive chairs	18,000
01.02.2015	Printer	135,000

- (3) During the year, following asset was removed from company usage:

Date of Removal	Name of Asset	Purchase Cost (Rs.)	Accumulated Depreciation as at 01.04.2014 (Rs.)
31.12.2014	Laptop computer	110,000	110,000

- (4) Depreciation is calculated on the straight-line basis at cost or revalued amount. The useful life of Property, Plant and Equipment is as follows:

Motor Vehicles : 5 years
 Office Equipment : 10 years
 Furniture & Fittings : 10 years

- (5) Following adjustments have to be made in relation to debtors:

- A customer who owed Rs.45,000/- to the company has been declared as bankrupt. A doubtful debt provision was made for this amount in the previous year.
- A bad debt of Rs.61,000/- which was written off during the year 2013/14 has been received by the company during the current year. This amount has been credited to trade receivables account.
- An additional provision of Rs.93,000/- has to be made for the current year.

(6) Accrued expenses as at 31st March 2015 are to be provided as follows:

	Rs.
Office rent	800,000
Bonus to sales staff	68,000

(7) The debenture interest for the year has not been paid or provided for in the financial statements.

(8) At the end of the year, the company recognized that the value of the investment has been impaired by Rs.950,000/-.

(9) It was identified that the previous year closing stock had been over valued by Rs.35,000/- and it has to be adjusted.

(10) The company tax liability for the year of assessment 2014/15 is estimated as Rs.750,000/-.

(11) The Board of Directors of the company have decided to pay a final dividend of Rs.1/- per share for the ordinary shares held on 31st March 2015 at a board meeting held on 20th May 2015.

(12) The financial statements were authorized for issue by the Board of Directors on 20th June 2015.

You are required to:

Prepare the following, in a form suitable for publication for **Bheem PLC**:

(a) Statement of Comprehensive Income for the year ended 31st March 2015. (08 marks)

(b) Statement of Financial Position as at 31st March 2015. (08 marks)

(c) Statement of Changes in Equity for the year ended 31st March 2015. (03 marks)

(d) Notes to Property, Plant and Equipment. (06 marks)

(Total 25 marks)

Question 09

- (a) **Anula PLC** acquired 80% of the ordinary share capital of **Khema Ltd.** on 01st April 2014.

Statements of Financial Position of **Anula PLC** and **Khema Ltd.** as at 31st March 2015 are given below:

Statements of Financial Position as at 31st March 2015

(Rs. '000)

	Anula PLC	Khema Ltd.
Assets:		
Non-Current Assets (at written down value):		
Property, Plant and Equipment	28,600	9,550
	28,600	9,550
Investment:		
Ordinary shares of Khema Ltd.	13,500	-
Current Assets:		
Inventories	5,650	3,300
Trade Receivables	6,430	4,425
Cash and Cash Equivalents	1,210	525
	13,290	8,250
	55,390	17,800
Equity and Liabilities:		
Equity:		
Stated Capital - Ordinary Shares	41,000	13,000
Reserves:		
General Reserve	1,100	600
Retained Earnings	4,120	1,800
	5,220	2,400
Liabilities:		
Non-Current Liabilities:		
Bank Loan	-	860
Current Liabilities:		
Trade Payables	8,500	1,350
Accrued Expenses	550	155
Income Tax Payable	120	35
	9,170	1,540
	55,390	17,800

The following additional information is also provided:

- (1) On the date of acquisition, **Khema Ltd.** had revalued its assets. From the revaluation, it was observed that the fair value of the land was more by Rs.1.5 million than its book value. This fair value adjustment was not incorporated in the books of account. Fair value of other assets remain unchanged.
- (2) On the date of acquisition, fair value of non-controlling interest was valued at Rs.3,900,000/-.
- (3) Following ledger balances were appeared in the books of **Khema Ltd.** as at 01st April 2014:

General Reserve	-	Rs.400,000/-
Retained earnings	-	Rs.400,000/-
- (4) On 31st March 2015 **Anula PLC** identified that the Goodwill on consolidation had been impaired by Rs.60,000/-.
- (5) **Anula PLC** sells goods to **Khema Ltd.** at a profit margin of 20% on cost. Rs.66,000/- worth of stock purchased from **Anula PLC** was included in the inventory of **Khema Ltd.** as at 31st March 2015.
- (6) On 02nd April 2014 **Anula PLC** sold a motor car having a carrying value of Rs.1,600,000/- to **Khema Ltd.** for Rs.1,760,000/-. Motor vehicles of both the companies are depreciated on the straight-line basis at 25% on cost.

You are required to:

Prepare the Statement of Consolidated Financial Position of **Anula PLC** as at 31st March 2015.

(18 marks)

- (b) **Define** the following terms as per LKAS 27 – Consolidated and Separate Financial Statements:

(i) a parent.

(ii) a subsidiary.

(04 marks)

- (c) **State** three(03) limitations of ratio analysis.

(03 marks)

(Total 25 marks)

End of Section C

ACTION VERB CHECK LIST

Knowledge Process	Verb List	Verb Definitions
Level 01 Comprehension Recall & explain important information	Define	Describe exactly the nature, scope, or meaning.
	Draw	Produce (a picture or diagram).
	Identify	Recognize, establish or select after consideration.
	List	Write the connected items one below the other.
	Relate	To establish logical or causal connections.
	State	Express something definitely or clearly.
	Calculate/Compute	Make a mathematical computation
	Discuss	Examine in detail by argument showing different aspects, for the purpose of arriving at a conclusion.
	Explain	Make a clear description in detail revealing relevant facts.
	Interpret	Present in an understandable terms.
	Recognize	To show validity or otherwise, using knowledge or contextual experience.
	Record	Enter relevant entries in detail.
Summarize	Give a brief statement of the main points (in facts or figures).	

Knowledge Process	Verb List	Verb Definitions
Level 02 Application Use knowledge in a setting other than the one in which it was learned / Solve closed-ended problems	Apply	Put to practical use.
	Assess	Determine the value, nature, ability, or quality.
	Demonstrate	Prove, especially with examples.
	Graph	Represent by means of a graph.
	Prepare	Make ready for a particular purpose.
	Prioritize	Arrange or do in order of importance.
	Reconcile	Make consistent with another.
	Solve	To find a solution through calculations and/or explanation.

Knowledge Process	Verb List	Verb Definitions
Level 03 Analysis Draw relations among ideas and compare and contrast / Solve open-ended problems.	Analyze	Examine in detail in order to determine the solution or outcome.
	Compare	Examine for the purpose of discovering similarities.
	Contrast	Examine in order to show unlikeness or differences.
	Differentiate	Constitute a difference that distinguishes something.
	Outline	Make a summary of significant features.