SRI LANKA

Association of Accounting Technicians of Sri Lanka

July 2015 Examination - AA3 Level

Questions and Suggested Answers
Subject No : AA31

FINANCIAL ACCOUNTING AND REPORTING (FAR)

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

EDUCATION AND TRAINING DIVISION

AA3 Examination - July 2015
(31) Financial Accounting and Reporting

SUGGESTED ANSWERS

SECTION A

Answers are expected for all the questions.
(Total Marks 20)

Suggested Answers to Question No. 01

1.1 (a) i Objective of Financial Statements.
ii Qualitative characteristics of Financial Statements.
iii Definitions, Recognition and Measurement of Elements of Financial Statements.

(b) General purpose Financial Statements

Financial Statements prepared and presented and directed towards the common information needs of a wide range of users who are unable to understand financial statements including those who are having specific information needs.

1.2 Value of Stock as at 31.03.2015 = Cost of unit x No. of units held at the stores
= 50.58 x 4,000
= Rs. 202,320

Workings :

Arriving at unit cost				Rs.
Cost of material consumed	=	$\frac{\text{Total cost}}{\text{Actual production}}$	$= \frac{500,000}{32,000}$	= 16.53
Direct labour cost	=	$\frac{\text{Total cost - Idle labour}}{\text{Actual production}}$	$= \frac{550,000 - 20,000}{32,000}$	= 16.57
Variable overhead	=	$\frac{\text{Total variable overhead}}{\text{Actual production}}$	$= \frac{380,000}{32,000}$	= 11.88
Fixed overhead	=	$\frac{\text{Total Fixed overhead}}{\text{Normal capacity}}$	$= \frac{260,000}{40,000}$	= 6.50
				= 50.58

The standard recognizes the following costs as the costs that should not be taken into account when computing the unit cost.

Idle labour cost	20,000
Administrative overhead	240,000

These should be recognized as expenses in the comprehensive Income Statement.

1.3 (a) As per LKAS 10 - Events after the reporting period - there are two such events, namely,

- Those events which provide further evidence to the conditions that prevail at the reporting date
- Those events which represent the conditions that arose after the reporting date.

Accordingly, bankruptcy of a debtor (Trade Receivable) after the reporting date who existed at the reporting date should be recognized as "an event which provides further evidence to the conditions that prevented at the reporting date". So these type of events are recognized as events which need adjustments in the financial statements, though these occured after the reporting date.
So, as per the question, bankruptcy of the Debtor (Omega) on 31.05.2015 provides further evidence to the conditions existed at the reporting date, and hence it should be adjusted in the financial statements for the period 2014/2015.
The amount receivable from Omega, i.e. Rs. 28,000/- should be recognized as a bad debt in the year 2014/2015 and should be written off to the Income Statement.

Relevant Double entry:-

Bad debt A/c / Comprehensive Income Statement	Dr.	28,000		
Relevant Debtor A/C (Omega)			Cr.	28,000

(b) As per LKAS 37, following 3 conditions should be satisfied in order to recognize a 'provision' in the financial statements.

i Existence of a present obligation as a result of a past event.
ii Reliable estimation can be made regarding such obligation.
iii It is probable that the assets embodying economic benefits will flow out of the entity in the settlement of that obligation.

As per the question, as at 31.03.2015, though the first two conditions have been met, condition (iii) has not been met and therefore 'provision' cannot be made and only 'a contingent liability' can be recognized. However, after 31.03.2015, i.e. on 31.05.2015, the court ordered the company to pay the compensation and as on that date all three criteria to recognize 'a provision' have been met. According to LKAS 10, 'Events after the reporting period', it should be identified as 'an event which provides further evidence to the conditions that prevail at the reporting date', and therefore should be adjusted for in the financial statement.

Relevant Double Entry

Comprehensive Income Statement	Dr.	100,000		
Provision for employee compensation		Cr.		100,000

1.4 **Obligation of a company to prepare Financial Statements.**

The board of every company shall ensure that, they prepare the financial statements of the company within 6 months or within such extended period, which are;

a) Completed in relation to the company and that balance sheet date.

b) Certified by the person responsible for the preparation of the financial statements that it is in compliance with the requirements of the Companies Act.

c) Dated and signed on behalf of the board by two directors of the company or if the company has only one director, by that Director.

If the board fails to comply with those requirements, every Director of the company who is in default shall be guilty of an offence and be liable on conviction to a fine not exceeding Rs. 100,000/-.

End of Section A

SECTION B

Answers to all questions are expected.
(Total Marks 32)

Suggested Answers to Question No. 02

	2013/2014	2014/2015
(a) Gross Profit Ratio $\frac{\text{Gross profit} \times 100}{\text{Sales}}$	$\frac{33{,}500}{110{,}000} \times 100$ **= 30.45%**	$\frac{48{,}400}{148{,}000} \times 100$ **= 32.70%**
(b) Return On Capital Employed $\frac{\text{Operating profit}}{\text{Total Equity + Interest bearing loan}} \times 100$	$\frac{7{,}750}{39{,}771 + 8{,}329} \times 100$ **= 16.11%**	$\frac{14{,}464}{49{,}249 + 10716} \times 100$ **= 24.12%**
(c) Assets Turnover Ratio $\frac{\text{Sales}}{\text{Average total assets}}$	$\frac{110{,}000}{(62{,}658 + 61{,}000) / 2}$ $= \frac{110{,}000}{61{,}829}$ **= 1.78 times**	$\frac{148{,}000}{(61{,}000 + 71{,}850) / 2}$ $= \frac{148{,}000}{66{,}425}$ **= 2.23 times**
(d) Average stock residency period $\frac{\text{Average inventory} \times 365}{\text{Cost of sales}}$	$\frac{(11{,}600 + 12{,}000) / 2 \times 365}{76{,}500}$ $= \frac{11{,}800 \times 365}{76{,}500}$ **= 56 days**	$\frac{(12{,}000 + 14{,}000) / 2 \times 365}{99{,}600}$ $= \frac{13{,}000 \times 365}{99{,}600}$ **= 47.6 ≃ 48 days**
(e) Average debt collection period $\frac{\text{Average Debtors} \times 365}{\text{Credit sales}}$	$\frac{(10{,}558 + 13{,}750) / 2 \times 365}{110{,}000}$ $= \frac{12{,}154 \times 365}{110{,}000}$ **= 40.3 ≃ 40 days**	$\frac{(13{,}750 + 12{,}750) / 2 \times 365}{148{,}000}$ $= \frac{13{,}250 \times 365}{148{,}000}$ **= 32.7 ≃ 33 days**

Suggested Answers to Question No. 03

(a) i

Leased Motor Vehicle Account

14.4.1	Lease creditor	1,000,000	15.3.31	Balance C/F	1,000,000
15.4.1	Balance B/F	1,000,000			

GOGO Finance PLC (Lease Creditor) Account

15.3.31	Bank (Installment 1)	155,854	14.4.1	Leased M/V	1,000,000
15.3.31	Balance C/F	844,146		Differed Interest	
		1,000,000			1,000,000
			15.4.1	Balance B/F	844,146

Lease Interest Account

15.3.31	Differed Interest	125,000	15.3.31	Comprehensive I/statement	125,000

Leased M/V depreciation Account

15.3.31	Provision for depreciation	200,000	15.3.31	Comprehensive I/statement	200,000

Leased M/V provision for depreciation Account

15.3.31	Balance C/F	200,000	15.3.31	Depreciation	200,000
			15.4.1	Balance B/F	200,000

ii

Dudley and Sons PLC
Comprehensive Income Statement
for the year ended 31.03.2015

(Rs.)

Distribution expenses	
Depreciation on leased M/V	200,000
Finance Expenses	
Interest on finance lease	125,000

Dudley and Sons PLC
Statement of Financial Position
As at 31.03.2015

(Rs.)

Assets		
Non-current Assets		
Motor Vehicles		1,000,000
Accumulated Depreciation		(200,000)
		800,000
Current Assets		
Total Assets		xxx
Equity and Liabilities		
Liabilities		
Non-current liabilities		
More than 5 years		
GOGO Finance PLC		
Differed Interest	-	
More than 1 year and less than 5 years		
GOGO Finance PLC	844,146	
Differed Interest	(175,336)	668,810
Current Liabilities		
GOGO Finance PLC	280,854	
Differed Interest	(105,518)	175,336
		xxx

Workings (Rs.) :-

Minimum lease payment = Initial deposit + Total of installements
= - + (280,854 x 5)
= Rs. **1,404,270**

Total Interest = Minimum lease payment - Fair value
= 1,404,270 - 1,000,000
= Rs. **404,270**

Amortizing Interest over Installments Rs.

Opening balance of the lease	Interest (12.5%)	Instalment	Capital position	Closing balance of the lease
1,000,000	125,000	280,854	155,854	844,146
844,146	105,518	280,854	175,336	668,810

$$\text{Depreciation for 2014/2015} = \frac{\text{Cost - Scrap value}}{\text{Useful life time}}$$

$$= \frac{1{,}000{,}000 - 0}{5}$$

$$= \textbf{Rs. 200,000}$$

(b) <u>Constructive Obligation</u>

This is an obligation that is derived from an entities action where;

- By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities, and
- As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

Eg :- A company sells motor vehicles, provides free services during the first year for those vehicles as a past practice. So, it is obvious that this company has an obligation to provide free services for the motor vehicles sold by them during the first year since they have already created a valid expectation in their customers' mind regarding their past practice.

Suggested Answers to Question No. 04

(a) **i Journal Entries**

Depreciation of revalued office equipment from 01.04.2015 to 30.06.2015

Depreciation of office equipment	Dr.	4,500	
Provision for Depreciation of office equipment	Cr.		4,500

Transferring accumulated depreciation as at date of revaluation to relevant assets A/C

Provision for Depreciation of office equipment	Dr.	27,000	
Office equipment A/C	Cr.		27,000

Recognizing revaluation loss as an expense

Comprehensive Income statement	Dr.	23,000	
Office equipment A/C	Cr.		23,000

ii

Office equipment - at cost / at revalued amount	411,000
Accumulated depreciation	(171,050)
Carrying value as at 30.06.2015	239,950

Workings (Rs.) :

Office Equipment Account

3.31	Balance	461,000	6.30	Provision for depreciation A/c	27,000
				Comprehensive Income Statement	23,000
				Balance C/F	411,000
		461,000			461,000

Provision for depreciation of Office Equipment Account

6.30	Office Equipment	27,000	3.31	Balance	175,000
	Balance C/F	152,500		Depreciation	4,500
		179,500			179,500

Depreciation of revalued office equipment from 01.04.2015 to 30.06.2015= 90,000 x 20% x 3/12

= 4,500

∴ Accumulated depreciation upto the date of revaluation = (90,000 - 67,500) + 4,500

= 22,500 + 4,500

= **27,000**

Revaluation profit / loss

Revalued amount	= 40,000
Carrying value (90,000 - 27,000)	= 63,000
Revaluation loss	= **23,000**

(b) Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

Prospective application of a change in accounting policy and of recognizing the effect of a change in an accounting estimation, respectively are;

- Applying the new accounting policy to transactions, other events and conditions occuring after the date as at which the policy is changed.
- Recognizing the effect of the change in the accouting estimate in the current and future periods affected by the change.

End of Section B

SECTION C

Answers for all the questions are expected.
(Total marks 28)

Suggested Answers to Question No. 05

(a) **Micro PLC**

Statement of Comprehensive Income

For the year ended 31.03.2015

(Rs. '000)

Sales			105,500
Cost of sales	W1		(70,265)
Gross profit			35,235
Other income			-
Distribution income	W2	15,532	
Administration expenses	W3	17,508	
Other expenses	W4	3,400	
Finance expenses	W5	1,005	(37,445)
Loss before tax			(2,210)
Tax	W6		(460)
Loss for the year			(2,670)
Other comprehensive income			-
Total comprehensive income			(2,670)

(b) **Micro PLC**

Statement of Financial Position

As at 31.03.2015

(Rs. '000)

Assets			
<u>Non-current assets</u>			
Property, plant and equipment	Note 1		23,450
Building work-in-progress			1,300
			24,750
<u>Current Assets</u>			
Inventory	W7	7,300	
Trade receivables	W8	21,988	
Other current assets		-	
Cash and cash equivalents		1,081	30,369
Total assets			55,119
Equity and Liabilities			
Equity			
<u>Capital and Reserves</u>			
Stated capital			23,100
Reserves			-
Retained loss			(1,945)
Total equity			21,155
Liabilities			
<u>Non-current liabilities</u>			
Bank loan		1,567	
Preference share capital		9,000	10,567
<u>Current Liabilities</u>			
Trade Payables		21,806	
Current position of Bank Loan		800	
Tax Payable		85	
Accrued Expenses	W9	706	23,397
Total Equity and Liabilities			55,119

(c) **Micro PLC**

Statement of Changes in Equity

For the year ended 31.03.2015

(Rs. '000)

	Stated Capital (Ordinary shares)	Retained Profit	Total
Balance as at 01.04.2014	23,100	725	23,825
Loss for the year	-	(2,670)	(2,670)
Balance as at 31.03.2015	23,100	(1,945)	21,155

(d) **Notes to the account (Rs. '000)**

01. **Property, Plant and Equipment**

	Land	Building	Motor Vehicle	Office Equipment	Furniture & Fittings	Total
Cost						
Balance as at 01.04.14	16,800	11,300	8,450	1,740	2,040	40,330
Additions	-	-	1,250	900	160	2,310
Disposals	-	-	(950)			(950)
Balance as at 31.03.15	16,800	11,300	8,750	2,640	2,200	41,690
Depreciation						
Balance as at 01.04.14		8,475	4,550	1,584	1,100	15,709
Depreciation for the year		565	1,720	513	208	3,006
Disposals			(475)	-	-	(475)
Balance as at 31.03.15	-	9,040	5,795	2,097	1,308	18,240
Carrying Value	16,800	2,260	2,955	543	892	23,450

02. Board of Directors has proposed a dividend of cents 50 per share for Oedinary Shares at a meeting held on 15.05.2015.

03. Authorization for issue of Financial Statement was made on 20.06.2015.

Assumptions :

1. Motor Vehicles have been used for distribution activities.
2. As per the standard "Financial Instruments", preference shares have been considered as a made of fund generation and do not bear the characteristics of ordinary shares.

Workings (Rs. '000) :

W1	**Cost of Sales**		
	Cost of sales as per TB		70,015
	Writing off to NRV		250
			70,265
W2	**Distribution Expenses**		
	Depreciation - Motor Vehicles		1,720
	Bad debts		117
	Provision for doubtful debts		345
	Selling and distribution expenses		13,350
			15,532
W3	**Administration Expenses**		
	Depreciation	- Buildings	565
		- Office Equipment	513
		- Furniture and Fittings	208
	Auditing and professional fees		255
	Administration Expenses (15,950 + 17)		15,967
			17,508
W4	**Other Expenses**		
	Loss from exchange of motor vehicle		25
	Other Operating Expenses		3,375
			3,400
W5	**Finance Expenses**		
	Premium on redemption of debentures		175
	Debenture Interest		560
	Preference share dividend		50
	Finance Expenses		220
			1,005
W6	**Taxes**		
	Tax for the year		510
	Over provided tax		(50)
			460

W7 **Inventories**

Inventory as per TB	7,550
Writing off to NRV	(250)
	7,300

W8 **Trade Receivables**

Trade Receivables (22,450 - 117)	22,333
Provision for doubtful debts	(345)
	21,988

W9 **Accrued Expenses**

Accrued Expenses as per TB	434
Audit fee and other professional fee	255
Telephone, Water and Electricity	17
	706

Adjustment 01

Redemption of Debentures A/C

Cash paid (Trade payables)	4,235	Debentures	3,500
		Premium	175
		Interest on debentures	560
	4,235		4,235

Trade payables A/C

		Balance	17,571
Balance C/F	21,806	Redemption of Debentures	4,235
	21,806		21,806

Adjustment 02

Motor Vehicles A/C

Balance	9,250	M/V Exchange	950
Exchange	450	Balance C/F	8,750
	9,700		9,700

Provision for depreciation of M/V A/C

M/V Exchange	475	14.4.1 Balance	4,550
		9.30 Depreciation	95
Balance C/F	5,795	3.31 Depreciation	1,625
	6,270		6,270

Exchange of Motor Vehicles A/C

Motor Vehicles	950	Provision for Depreciation	475
		M/V (Exchange)	450
		C. Income statement (Loss)	$\boxed{25}$
	950		950

Depreciation on the disposed lorry from 01.04.2012 to 01.04.2014	= (950/5) x 2	= 380
Depreciation on the disposed lorry from 01.04.2014 to 30.09.2014	= (950/5) x 6/12	= 95
		= 475
Depreciation on other M/Vehicles for 2014/2015		
	= 8750 - 1250	
	= 7500 / 5	= 1500
	= 1250 / 5 x 6/12	= 125
		= 1625

Depreciation of Office Equipment	= 1740 / 5	= 348
For New Purchases	= 900 / 5 x 11/12	= 165
		= 513

Depreciation of Furniture and Fittings	= 2040 / 10	= 204
	= 160 / 10 x 3/12	= 4
		= 208

Adjustment 09

Tax Account

Provision for Tax	510	Over provision of tax	50
		C. Income Statement	460
	510		510

Prov^{N} for Tax A/C

Tax paid	775	01.04 Balance	400
Over provision of tax	50	Tax for the year	510
Balance C/F	85		
	910		910

Suggested Answers to Question No. 06

(a) **(i) Consolidated Financial Statements :**

Are the financial statements of a group presented as those of a single economic entity.

(ii) Non-Controlling Interest :

Is the equity in a subsidiary not attributable, directly or indirectly, to a parent.

(iii) Control :

Is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

(b) **Calculation of Goodwill**

		(Rs. '000)
Investment	=	5,000
Non-Controlling Interest as at date of acquisition (400 x 15 x 25%)	=	1,500
	=	6,500
Fair value of the net assets of the subsidiary as at the date of acquisition	=	(6,100)
	=	400

Non-Controlling Interest Account **(Rs. '000)**

Under depreciation	70	Net asset as at the date of acquisition	1,500
Write off of Goodwill	37.5	Retained Earnings	75
Balance C/F	1,467.5		
	1,575		1,575

Consolidated Income Statement / Retained Earnings Account **(Rs. '000)**

Under Depreciation	210	Balance	2,375
Write-off of Goodwill	112.5	Retained Earnings	225
Unrealized profit	88		
Balance C/F	2,189.5		
	2,600		2,600

(c) **Alfa PLC**

Consolidated Statement of Financial Position

As at 31.03.2015

		(Rs. '000)
Assets		
<u>Non-current assets</u>		
Property, Plant & Equipment (14,500 + 2,845 + 700 - 280)		17,765
Goodwill		250
		18,015
<u>Current Assets</u>		
Inventory (6,300 + 3,950 + 88)	10,162	
Trade & Other Receivables (3,540 - 350 + 1590)	4,780	
Cash and Cash Equivalents (450 + 350 + 260)	1,060	16,002
Total Assets		**34,017**
Equity and Liabilities		
Equity		
<u>Capital and Reserves</u>		
Stated capital		20,000
Retained profit		2,189.5
Parent's Interest		22,189.5
Non-controlling Interest		1,467.5
Total Equity		**23,657**
Liabilities		
<u>Non-current Liabilities</u>		
Bank Loan		2,450
<u>Current Liabilities</u>		
Trade payables	7,275	
Accrued Expenses	635	7,910
Total Equity and Liabilities		**34,017**

Workings (Rs. '000)

Unrealized profit

Closing Inventory			= (440 / 125) x 25
			= **88**

Revaluation profit

Carrying value as of date of acquisition			= 6,100
Fair value as of date of acquisition - Stated capital		4,000	
	Retained earnings	1,400	= (5,400)
Revaluation profit of the machinery			= **700**
Under depreciation	= 700 x 20%		= **280**

Suggested Answers to Question No. 07

(a) **Brandhouse PLC**

Cash Flow Statement

For the year ended 31.03.2015

(Rs. '000)

Cashflows from operating activities			
Profit before Tax			1,667
Adjustments			
Depreciation		956	
Profit from sale of office equipment		(60)	
Investment Income		(175)	
Provision for impairment		100	
Interest on Bank Loan and Debentures		488	
Provision for gratuity		200	1,509
Operating profit before working capital changes			3,176
Working Capital Changes			
Increase in Inventory		(55)	
Decrease in Trade Receivables		140	
Increase in Trade Payables		1,848	
Increase in Accrued Expenses		10	1,943
Cashflows generated from operating activities			5,119
Gratuity paid	W5	(150)	
Tax paid	W4	(497)	(647)
Net cash flows generated from operating activities			4,472
Cashflows from Investment Activities			
Sale of office equipment	W1	108	
Purchase of a lorry		(1,250)	
Receipt of Investment Income	W2	182	
Net cashflows generated from investment activities			(960)
Cashflows from Financing activities			
Bank loan Interest paid	W3	(125)	
Debenture Interest paid		(375)	
Redemption of debentures		(2,500)	
Settlement of Bank Loan		(500)	
Net cashflows generated from financing activities			(3,500)
Net change in cash and cash equivalents during the year			12
Opening cash and cash equivalents			55
Net change in cash and cash equivalents during the year			12
Closing cash and cash equivalents			67

Workings (Rs. '000) :

W1 Cash received from sale of office equipment

Sale of Office Equipment Account

O/Equipments	160	Acc. depreciation	112
Profit	60	Cash	$\boxed{108}$
	220		220

Acc. depreciation as at 30.09.2014 = 160 / 5

= 32 x 3 1/2 = 112

W2 Receipt of Investment Income

Investment Income Account

01.04.2014 Balance	25	Cash	$\boxed{182}$
Income statement	175	31.03.15 Balance C/F	18
	200		200

W3 Bank Loan Interest paid

Interest on Bank Loan Account

Cash	$\boxed{125}$	01.04.2014 Balance	38
31.03.2015 Balance C/F	26	Income statement (488-375)	113
	151		151

W4 Tax paid

Tax Account

Cash	$\boxed{497}$	01.04.2014 Balance	35
31.03.2015 Balance C/F	48	Income statement	510
	545		545

W5 Gratuity paid

Provision for Gratuity Account

Cash	$\boxed{150}$	01.04.2014 Balance	550
31.03.2015 Balance	600	Income statement	200
	750		750

End of Section C