SRI LANKA

Association of Accounting Technicians of Sri Lanka

January 2016 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 - January 2016
(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

(a) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

(b) A liability is recognized;

- When it is probable that an outflow of resources embodying economic benefit will result from the settlement of present obligation.
- The amount at which the settlement will take place can be measured reliably.

Suggested Answers to Question No. 02

Borrowing Rate $= \dfrac{7 \times 12\% + 8 \times 15\% + 10 \times 11\%}{(7 + 8 + 10)}$

$= \mathbf{12.56\%}$

Borrowing cost to be capitalized for 2015 $= 15m \times 12.56\% \times 7/12$

$= \mathbf{1.099}$

$= 15m \times 12.56\% \times 9/12$

$= \mathbf{1.413}$

$= \underline{\underline{\mathbf{2.512mm}}}$

Suggested Answers to Question No. 03

(a) EPS

$$= \frac{\text{Earning attributable to ordinary shareholders / Profit after tax}}{\text{Weighted average no. of ordinary shares}}$$

$$= \frac{23,000,000}{100,000}$$

$$= \underline{\underline{\text{Rs. } 230}}$$

(b) PE

$$= \frac{\text{Market price per share}}{\text{Earnings per share}}$$

$$= \frac{25}{230}$$

$$= \underline{\underline{0.109 \text{ times}}}$$

(c) Earning yeild

$$= \frac{\text{Earnings per share}}{\text{market price per share}}$$

$$= \frac{230}{25} \times 100$$

$$= \underline{\underline{\text{Rs. } 920\%}}$$

Suggested Answers to Question No. 04

Duties of specified Business Enterprises

1. Prepare its financial statements in compliance with the Sri Lanka Accounting Standards and take all necessary measures to ensure that the financial statements are audited in accordance with the Sri Lanka Auditing Standards with the object of presenting a true and fare view of the financial performance and financial position of such enterprise.
2. Have the financial statements audited by members of the Institute of Chartered Accountants of Sri Lanka holding a certificate to practice issued by the institute.
3. Submit the annual audited financial statements of the enterprises to the Sri Lanka Accounting and Auditing Standards Monitoring Board, to enable the Board to determine whether the financial statements have been prepared in compliance with the Sri Lanka Accounting Standards.
4. Furnish to the board or to any person authorized by the Board any information pertaining to its financial statements as may be required by the Board or any person authorized by the board within such time, as may be specified in a notice issued by the Board or any person authorized.

End of Section A

SECTION B

All three (03) questions of this section to be answered.
(30 Marks)

Suggested Answers to Question No. 05

(a) An intangible asset shall be recognized if and only if;

- The cost of the assets can be measured reliably.
- It is probable that the expected future economic benefits that are atributable to the assets will flow to the entity.

(b) i. According to LKAS - 38, internally generated board name shall not quality as an intangible assets, therefore cannot ne recognized (para 09 of LKAS - 38)

$\therefore$ MS cannot recognize this brand in their books. Since it is an internally generated brand and the cost of which cannot be measured reliably.

ii According to LKAS - 38, if an intangible asset is acquired at the time of business combination, the intangible asset can be recognized at it's fair value. (para 33)

$\therefore$ MR can recognize this brand in their consolidated financial statements since **it is an acquired brand**. This has **to be recognized separately from the goodwill and subsequently authorized over the determined useful life**.

(c) The research expenses of Rs. 50,000,000 shall be recorded as an expense to profit or loss in the period in which it is incurred.

1. Product is in the research phase.
2. Cannot capitalize but the development phase can be capitalized subject to relevant conditions are met.
3. Research phase expenditure should be charged to profit and loss.

Suggested Answers to Question No. 06

Royal Knit Wear Ltd

Statement of cashflow for the year ended 31.03.15		**Rs.**
Profit before taxation		883,000
Adjustments for;		
Finance Expenses - Ordinary dividend paid	467,000	
Interest income	(560,000)	
Depriciation	563,000	
Incentive Payable	(90,000)	
Provision for gratuity	120,000	500,000
Operating profit before working capital cheques		1,383,000
Working capital changes;		
Increase in inventory	(250,000)	
Decrease in trade receivables	400,000	
Increase in trade payables	398,000	
Increase in accrued expenses	11,000	559,000
Cash generated from operating activities		1,942,000
Interest paid	(220,000)	
Tax paid	(169,000)	(389,000)
Net cash from operating activities		**1,553,000**

Suggested Answers to Question No. 07

(a) i Carrying value for accounting;

Cost	=	2,000,000
(-) acc. dep.	=	(500,000)
	=	1,500,000

Tax written down value;

Cost	=	2,000,000
(-) acc. capital allowance	=	(2,000,000) / 0

Taxable temporary difference = Accounting written down value - Taxable written down value

= 1,500,000 - 0

= 1,500,000

Deferred tax liability =1,500,000 x 28%

= **420,000**

Double entry;

Tax expenses / profit or loss a/c	Dr	420,000	
Deffered tax liability			420,000

OR

As at 31st March 2016

Tax Base	: Nill
Accounting Base	: 2,000,000 - 500,000
	: 1,500,000
Temporary Difference	: 1,500,000
∴ Differed Tax Liability	: 1,500,000 × 28%
	: **420,000**

ii. In the future years (3 years), the depriciation will reverse the deferred tax liability.

Accounting written down value - tax written down value = deferred tax

y_2	(2,000,000 - 1,000,000 *) - 0	= 1,000,000 x 28%	= 280,000
y_3	(2,000,000 - 1,500,000) - 0	= 500,000 x 28%	= 140,000
1/4	(2,000,000 - 2,000,000) - 0	= 0 x 28%	= 0

* Annual depriciation = 2,000,000 x 25% = 500,000

OR

	31.03.2017	**31.03.2018**	**31.03.2019**
Accounting Base	1,000,000	500,000	0
Temporary Difference	1,000,000	500,000	0
Differed Tax Liability	280,000	140,000	Nill

LIability get reversed over the period.

Double entries;

deferred tax liability	Dr	140,000	
tax expenses / profit or loss			140,000
(year 2, deferred tax reversal)			
deferred tax liability	Dr	140,000	
tax expenses / profit or loss			140,000
(year 3, deferred tax reversal)			
deferred tax liability	Dr	140,000	
tax expenses / profit or loss			140,000
(year 4, deferred tax reversal)			

Deferred tax liability a/c

B/C/F	420,000	Tax expenses	420,000
	420,000		420,000
Tax expenses	140,000	B/B/F	420,000
C/F	280,000		
	420,000		420,000
Tax expenses	140,000	B/B/F	280,000
C/F	140,000		
	280,000		280,000
		B/B/F	140,000
Tax expenses	140,000		
	140,000		140,000

(b) i. **Transfer of Ownership**

If legal ownership of the asset ultimately transfer to the lessee, either during or at the end of the lease term, then the agreement will usually be classified as a finance lease.

ii. **Purchase Options**

The existence of a purchase option that is reasonably certain to be exercised, based on facts and circumstances at inception of the lease, means that title to the asset is expected to transfer. Therefore, a lease with such an option is normally classified as a finance lease.

iii. **Major part of economic life**

If he lease term is for the major part of the economic life of the leased asset, then the agreement would normally be classified as a finance lease.

iv. **Present value of minimum lease payment is substantially equal to the fair value**

If at inception of the lease the present value of the minimum lease payments amounts to substantially equal to the fair value of the leased asset, then the agreement would normally be classified as finance lease.

v. **Specialized nature of asset**

If a leased asset is so specialied that only the lessee can use it without major modification, then the agreement would normally be classified as a finance lease.

End of Section B

SECTION C

Both the euqstion of this section should be answered.
(50 Marks)

Suggested Answers to Question No. 08

(a) **Bheem PLC**

Statement of Comprehensive Income

For the year ended 31st March 2015

		Note	Rs.
Sales			92,650,000
Cost of sales	(W 2)		(56,508,000)
Gross Profit			36,142,000
Other Income		01	1,261,000
Administrative expenses	(W 3)		(12,102,600)
Selling and Distribution expenses	(W 3)		(14,704,000)
Other expenses (2100 + 126)			(2,226,000)
Finance expenses		02	(2,775,000)
Profit before taxation			5,595,400
Taxation		04	(750,000)
Profit for the year			4,845,400
Other comprehensive income			0
Total comprehensive income for the year			4,845,400

(b) **Bheem PLC**

Statement of Financial Position

As at 31st March 2015

			Rs. '000
Assets			
Non-current assets			
Property, Plant and Equipment			13,680.4
Investment		15,000	
Less - Provision for impairment (diminution of value)		(950)	14,050
			27,730.4
Current Assets			
Trading Inventories			3,800
Trade receivables	24,516		
(-) Provision for doubtful Debts	(408)	24,108	
Cash & Cash Equivalents		600	28,508
Total assets			**56,238.4**
Equity and Liabilities			
Equity			
Stated capital			
Ordinary share capital - 2 million shares		25,000	
Retained Earnings		5,830.4	30,830.4
Non-current liabilities			
13% Debentures			7,500
Current Liabilities			
Trade Payables		14,600	
Accrued Expenses		868	
Debenture Int. Payable		975	
Income Tax Liability of the year		365	
Bank overdraft		1,100	17,908
Total Equity and Liabilities			**56,238.4**

(c) **Bheem PLC**

Statement of Changes in Equity

For the year ended 31.03.2015

(Rs.)

	Stated Capital	**Retained Earnings**	**Total**
Balance as at 01/04	25,000,000	2,020,000	27,020,000
Prior year adjustment	-	(35,000)	(35,000)
Interim dividend paid	-	(1,000,000)	(1,000,000)
Profit for the year	-	4,845,400	4,845,400
Balance as at 31.03.2015	**25,000,000**	**5,830,400**	**30,830,400**

(d) **Note 05 PPE**

	Motor vehicle	**Office equipment**	**Furniture & Fittings**	**Total**
Bal. as at 01/04	26,500,000	8,515,000	3,082,000	38,097,000
Additions	1,350,000	135,000	18,000	1,503,000
Disposal / derecognition	(1,920,000)	(110,000)	-	(2,030,000)
Bal. as at 31/03	25,930,000	8,540,000	3,100,000	37,570,000
Bal. as at 01/04	10,600,000	6,488,000	1,860,000	18,948,000
Charge	5,243,000	842,750	309,850	6,395,600
Removed	(1,344,000)	(110,000)	-	(1,454,000)
Bal as at 31/03	14,499,000	7,220,750	2,169,850	23,889,600
Carrying value	11,431,000	1,319,250	930,150	13,680,400

Note 01 **Other Income**

Bad debts recovery	61,000
As reported from T/B	1,200,000
	1,261,000

Note 02 **Finance expenses**

Debenture interest (7,500 x 13%)	975,000
As reported from T/B	850,000
Impairment of Investment Inco.	950,000
	2,775,000

Note 04 **Taxation**

Current year tax	750,000

Note 06 **Stated Capital**

2,000,000 no. of ordinary shares

25,000,000

Note 08 **Proposed dividends**

Directors decided to pay Rs. 1 final dividend for ordinary shares at the board meeting held on 20.05.15 which cumulated to 2,000,000

Note 09 **Tax payable**

Income tax 2013/14	360,000
Income tax 2014/15	750,000
(-) Income tax paid	(745,000)
	365,000

Workings

(W 1) **Depriciation and disposal of assets;**

Furniture and fittings	3,082,000 x 10%	=	308,200
	18,000 x 10% x 11/12	=	1,650
			309,850
Office equipment	(8,515,000 - 110,000) x 10%	=	840,500
	135,000 x 10% x 2/12	=	2,250
			842,750
Motor vehicle	(26,500,000 - 1,920,000) / 5	=	4,916,000
	1,920,000 x 20% x 6/12	=	192,000
	1,350,000 x 20% x 6/12	=	135,000
			5,243,000

M/V exchange a/c

M/V	1,920,000	Acc. dep.	1,344,000
Cash paid for the new vehicle purchase	900,000	Value of the new Van	1,350,000
		Disposal loss	126,000
	2,820,000		2,820,000

The motor vehicle is used for 3 1/2 years. Therefore cost is;

$$\left[\frac{576,000}{(5 - 3.5)} \right] \times 5 = 1,920,000$$

(W 2) **Cost of Sales;**

Reported from T/B	57,443,000	
(-) Motor vehicle payment	(900,000)	
Prior period adjustment	(35,000) *	*Assumed material*
	56,508,000	

(W 3) **Expenses Analysis**

	Administrative expenses	Selling & distribution
As reported from T/B	10,150,000	9,300,000
Depriciation (W 1)	1,152,600	5,243,000
Disposal loss (W 1)	-	-
Bad debts prov. / allowance	-	93,000
Accured expenses 31/03	800,000	68,000
Impairment of FA	-	-
	12,102,600	**14,704,000**

(W 4) **Debtors and bad debt**

Description	Debtors	Allowance for receivable
Reported from T/B	24,500,000	360,000
Bad debts - already prov. made	(45,000)	(45,000)
Bad debts recovered	61,000	-
Bad debts prov. for the year	-	93,000
	24,516,000	**408,000**

Suggested Answers to Question No. 09

(a) **Anula PLC**

Consolidated Statement of Financial Position

as at 31.03.2015

(Rs. '000)

<u>Assets</u>		
property, Plant and Equipment		39,530
(28,600 + 9,550 + 1,500 - 160 + 140)		
Goodwill (2,100 - 60)		2,040
<u>Current Assets</u>		
Inventory (5,650 + 3,00 - 11)	8,939	
Trade receivable (6,430 + 4,425)	10,855	
Cash (1,210 + 525)	1,735	21,529
Total Assets		**63,099**
Stated capital		
General reserve - group	41,000	
Retained earnings - group	1,260	
Parents equity	5,061	
Non- controlling interest	4,208	
Total equity		51,529
<u>Non-current liability</u>		
Bank loan		860
<u>Current liability</u>		
Trade payable (8,500 + 1,350)	9,850	
Accrued expenses (550 + 155)	705	
Income tax (120 + 35)	155	10,710
Total		**63,099**

Goodwill on Consolidation

Investment		13,500
Non-controlling interest		3,900
Total		17,400
(-) Net assets in subsidiary		
Stated capital	13,000	
Pre retained earnings	400	
Pre revaluation reserve	1,500	
Pre general reserve	400	(15,300)
		2,100

Non Controlling Interest

Impairment of goodwill	12	B/F	3,900
		Post general reserve (200 × 20%)	40
C/F	4,208	Post retained earnings (1400 × 20%)	280
	4,220		4,220

Group retained earnings

Impairment	48	B/F	4,120
URP - Inventory	11	Post retained earnings	1,150
URP - PPE	160	Depreciation	40
B/C/F	5,061		
	5,280		5,280

Pre retained earnings

Goodwill	400	B/F	400
	400		400

Post retained earnings

Group retained earnings	1,152	B/F	1,400
NCI	288	Excess dep.	40
	1,440		1,440

Revaluation reserve

Goodwill	1,500	Land - PPE	1,500
	1,500		1,500

Group Gen. reserve

		B/F	1,100
C/F	1,260	Post gen. reserve	160
	1,260		1,260

Pre gen. reserve

Goodwill	400	B/F	400
	400		400

Post gen. reserve

Group gen. reserve	160	B/F	200
NCI	40		
	200		200

Workings

(W 1)	URP - Inventory	= 66,000 / 120 x 20%	=	**11,000**
(W 2)	URP - PPE	= 1,760,000 - 1,600,000	=	**160,000**
	Excess depriciation	= 1,600,000 x 25%	=	400,000
		= 1,700,000 x 25%	=	440,000
		Difference	=	40,000

(b) i. A parent - The entity that has one or more subsidiaries

ii. A Subsidiary - A subsidiary is an entity, including an unincorporated entity such as a partnership that is controlled by another entity (known as the partner)

(C) **Limitations of Ratio Analysis**

1. Inflation is not considered when preparing financial statements. Therefore the real picture will not reflected through rations.

2. Financial Statements are prepared based on the historical concept. Therefore the decisions made consideting the ratios may not reflect the implications on the future.

3. Ratios are calculated based on statistics.

4. Comparison between business is difficult if policy is changed.

End of Section C

Notice :

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These should be understood as Suggested Answers to question set at AAT Examinations and should not be construed as the "Only" answers, or, for that matter even as "Model Answers".

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