SRI LANKA

Association of Accounting Technicians of Sri Lanka

July 2017 Examination - AA3 Level

Questions and Suggested Answers
Subject No : AA31

FINANCIAL ACCOUNTING AND REPORTING (FAR)

Association of Accounting Technicians of Sri Lanka
No. 540, Ven. Muruththettuve Ananda Nahimi Mawatha,
Narahenpita, Colombo 05.

Tel : 011-2-559 669

A publication of the Education and Training Division

THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

EDUCATION AND TRAINING DIVISION

AA3 Examination - July 2017
(AA31) Financial Accounting and Reporting

SUGGESTED ANSWERS

SECTION – A

Four (04) compulsory questions.

(Total Marks 20)

Suggested Answers to Question One:

(a) 1. Timeliness
2. Verifiability
3. Comparability
4. Understandability *(02 marks)*

(b)

1. Income has resulted in the increase in future economic benefits related to an increase in assets or decrease in liability.
2. The income can be measured reliabily *(03 marks)*

(Total 05 marks)

Suggested Answers to Question Two:

(a) 1. Companies Act 07 of 2007
2. Inland Revenue Act
3. Sri Lanka Accounting & Auditing Standards No. 15 of 1995 Act
4. Employees' Provident Fund Act
5. Finance Act No. 38 of 1971 *(03 marks)*

(b) 1. the protection of the financial interest of investors
2. the regulation of the securities market and to ensure that professional standards are maintained in such market.
3. the creation and maintenance of a market in which securities can be issued and traded in an orderly and fair manner
4. To create a market for securities where trading can be done in an orderly and fair manner.

(02 marks)

(Total 05 marks)

Suggested Answers to Question Three:

(a)

A qualifying asset is an asset that necessarily takes substantial period of time to get ready for its indented use or sale.

(02 marks)

(b)

1. The amount of Revenue can be measured reliably
2. It is probable that the economic benefit associated with transaction will flow to the entity.
3. Significant risk and rewards of the ownership of the goods were transfer to the buyer.
4. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

(03 marks)

(Total 05 marks)

Suggested Answers to Question Four:

(a)

1. Cash payments to acquire Property, Plant and Equipment, intangibles and other long term assets.
2. Cash receipts from sales of Property, Plant and Equipment, intangibles and other long-term assets.
3. Cash payments to acquire equity or debt instruments of other entities and interests in joint venture.
4. Cash receipts from sales of equity or debt instruments of other entities and interests in joint venture.
5. Cash advances and loans made to other parties.
6. Cash receipts from the payment of advances and loans made to other parties.

(03 marks)

(b)

1. The acquisition of assets either by assuming directly related liabilities or by means of a finance lease.
2. The acquisition of an entity by means of an equity issue.
3. The conversion of debt to equity.

(02 marks)

(Total 05 marks)

End of Section A

SECTION –B

Three (03) compulsory questions
(Total 30 marks)

Suggested Answers to Question Five:

(a)

1. This is an adjusting event for the year ended 31st March 2017. Inventory was recognized on 31st March 2017 at a cost of Rs. 750,000/- but sold for Rs. 700,000/- on 20.04.2017. It appears that the net realizable value of the inventory (i.e. Rs. 700,000/-) is Rs. 50,000/- less compared to the cost of those as at 31st March 2017. LKAS 02 requres inventory to be recognized at the lower of cost or NRV. Therefore the accounts should be adjusted by reducing the inventory value by Rs. 50,000/- and increasing the cost of sales by Rs. 50,000/-.
2. THis is not an adjusting event and it is only a disclosure to the financial statements. The destruction caused by fire on 30.04.2017 amounting to Rs. 5.5 million. The fire destruction caused on 30.04.2017 does not give any additional evidence for the state of the asset on 31.03.2017. Therefore, this is a non-adjusting event.

(04 marks)

(b) Extract of Statement of Comprehensive income.

1. Disposal Details

Sales Proceed	=	3,000,000.00
Cost	=	(2,400,000.00)
Profit	=	600,000.00

1. Finance Income

Interest Income	=	540,000.00

Extract of Statement of Financial Position

Current Lease Receivables	=	494,803.50
Non-Current Lease Receivables	=	2,085,871.00
Total	=	2,580,675.50

Yrs	Opening Bal	Int	Cap Payment	Closing Bal
1	3,000,000.00	540,000.00	(959,325.00)	2,580,675.00
2	2,580,675.00	464,521.50	(959,325.00)	2,085,871.50
3	2,085,871.50	375,456.87	(959,325.00)	1,502,003.37
4	1,502,003.37	270,360.61	(959,325.00)	813,038.98
5	813,038.98	146,347.02	(959,325.00)	60.99

(06 marks)

(Total 10 marks)

Suggested Answers to Question Six:

Divine Holdings

Statement of Cash Flows For the Year Ended 31st March 2017

Cash Flow From Operating Activities		
Profit Before Tax		**3,000,000**
Adjustment For		
Depreciation	450,000	
Provision For Gratuity	350,000	
Interest Expenses	250,000	1,050,000
Operating Profit Before Working Capital Changes		**4,050,000**
Increase In Inventories	(670,000)	
Increase In Trade & Other Receivables	(1,300,000)	
Increase In Trade & Other Payable	570,000	(1,400,000)
Cash Generated From Operating Activities		**2,650,000**
Gratuity Paid	(250,000)	
Income Tax Paid	(200,000)	
		(450,000)
Net Cash Flow From Operating Activities		**2,200,000**
Cash Flow From Investing Activates		
Acquisition of Property, Plant & Equipment	(900,000)	
Net Cash Flow From Investing Activates		**(900,000)**
Cash Flow From Financing Activities		
Repayment of Loans (Short and Long)	(1,200,000)	
Interest paid	(230,000)	
Net Cash Flow From Financing Activates		**(1,430,000)**
Net Cash Increase During the Period		**(130,000)**
Cash & Cash Equivalent beginning		**600,000**
Cash & Cash Equivalent End		**470,000**

Workings:

Gratuity Provision

Cash	250,000	B/B/F	1,200,000
B/C/F	1,300,000	P & L	350,000
	1,550,000		**1,550,000**

Income Tax

Cash	200,000	B/B/F	500,000
B/C/F	600,000	P & L	300,000
	800,000		**800,000**

Interest Paid

Cash	230,000	B/B/F	240,000
B/C/F	260,000	P & L	250,000
	490,000		**490,000**

(10 marks)

Suggested Answers to Question Seven:

From : Accountant
To : Managing Director
Subject : Financial Performance of PG Holding (Pvt) Ltd.

Dear Sir,

I am pleased to submit a report on the above caption matter for the financial year 31st March 2017, the report covers the areas, such a profitability, liquidity and efficiency. The data for the above analysis was extracted from the draft financial statement and the audited accounts, the draft accounts were tabled to the board of directors on 20th May 2017. The calculated ratios were also enclosed for your kind consideration.

In the year under review the profitability of the company has deteriorated drastically, the GP ratio was deteriorated from 35% to **23%** , the main contributors for such kind of significant reduction might be the reduction is the selling price or offering of significant trade discounts to increase the market share. Another view is that the direct cost of manufacturing might has increased dramatically to allow the company to cater increased sales volumes. The management shall take necessary action to consider the composition of the manufacturing cost has implement initiatives to minimize the cost of production, such can be assignment of shift work to avoid the overtimes, implementation zero wastage policies, Lean production concepts, usage of alternative energy, etc will reduce the manufacturing cost to a manageable level. In relation to the pricing, the marketing and sales team, shall develop different pricing strategies such as setting premium pricing for high end market, discount slabs rather than bulk discounts etc. the Other profitability ration, NP has reduced from 20% to 15%, as per the normal view the NP has reduced but when we compared the GP drop with NP drop, we can see 3% improvement in the NP. Despite of such 3%, the main contributors of the reduction in NP might be due to high cash discount, bad debts and debt collection cost as such is evident from the debtor's ratios.

The efficiency of the company for the year has reduced and showed an adverse situation the debtors collection has increased from 30 days to 45 days and creditors from 15 days to 20 days, this shows that the company money is tied up with the debtors, the extension for the debtors might have been given to achieve a sales volume growth, but such deteriorated the profitability ratios. To counter the increased debtor's collection period the creditors period was also increased, but such increase is not sufficient to negate the adverse effect from debtors. So, the management can consider in hedging the debtor's collection with creditors settlement in short run to overcome the problems.

The liquidity ratios showed a worsen position, where management should attend immediately to overcome the short-term liquidity, the current ratio has reduced from 2 to 1.2and the quick ratio from 1.2 to .25. when considering a general norm these values are far lower than the expectation.

By considering the ratio, the management shall immediately react to the liquidity crisis to overcome the problems and can gradually attend to the reduced profitability and efficiencies. I make myself available for any clarification which is sought in this regard.

(10 marks)

End of Section B

SECTION –C

Two (02) compulsory questions.
(Total 50 marks)

Suggested Answers to Question Eight:

(a)

Royal PLC

Statement of Comprehensive Income

For the Year Ended 31/03/2017

		(Rs. '000)
Sales	78,200	
Cost of Sales (52,000 + 50)	(52,050)	
Gross Profit		**26,150**
Other Income (-800 + 800 + 100 + 380) (W1)		480
		26,630
Expenses		
Distribution (W3)	(13,175)	
Administration (W2)	(8,303)	(21,478)
		5,152
Finance Expenses (W5)		(2,520)
		2,632
Other expenses		(150)
Profit Before Tax		**2,482**
Income Tax (W4)		(900)
Net Profit		**1,582**

(11 marks)

Workings:

(W1)

Depreciation on disposal Lorry	=	(1,400 / 5) x 3 =	840
	=	(1,400 / 5) x 1/2=	140
		=	**980**

Disposal of Lorry

Cost	1,400	Cash	800
P & L	380	Depreciation	980
	1,780		**1,780**

(W2)

Administration Expenses

Depreciation	- Building	200
	- Office Equipment	1,035
	- Furniture and Fittings	200
Electricity		68
TB		6,800
		8,303

(W3)

Distribution Expenses

Depreciation	- Motor vehicle	3,460
Bad debts provision		280
Fuel		685
TB		8,750
		13,175

Royal PLC
Statement of Financial Position
As At 31/03/2017

(Rs. '000)

Description	**Note**	**Amount**
Assets		
Non-Current Assets		
Property Plant & Equipment	N 05	25,425
Current Assets		
Inventories	1,450	
Trade Receivables (11,800 - 880)	10,920	12,370
Cash at Bank		400
Cash in Hand		140
Total Assets		**38,335**
Equity & Liabilities		
Equity		
Stated Capital	N 06	20,000
Other Components of Equity		-
Retained Earnings		3,862
Total Equity		23,862
Non-Current Liabilities		
12.5 % Loan	N 07	3,750
Current Liabilities		
Trade Payable		8,210
Current Portion of Loan	N 07	1,250
Income Tax Payable		300
Accrued Expense		753
Compensation Payable		150
Accrued Interest		60
Total Equity & Liabilities		**38,335**

(06 marks)

(c)

Royal PLC

Statement of Changes in Equity

For the Year Ended 31/03/2017

(Rs. '000)

Description	**Stated Capital**	**Retained Earnings**	**Total**
Balance as at 01.04.2016	20,000	3,880	23,880
Div. Paid - Interim		(1,600)	(1,600)
Profit for the year		1,582	1,582
Balance as at 31.03.2017	**20,000**	**3,862**	**23,862**

(03 marks)

(d)

Note 05

Movement - PPE **(Rs. '000)**

Cost

Description	**Land**	**Buildings**	**Motor Vehicles**	**Equipment's**	**Furniture's**	**Total**
Balance as at 01.04.2016	7,500	5,000	18,000	5,100	1,800	37,400
Addition				900	600	1,500
Disposal			(1,400)			(1,400)
Balance as at 31.03.2017	**7,500**	**5,000**	**16,600**	**6,000**	**2,400**	**37,500**
Acc. Dep						
Balance as at 01.04.2016		1,920	3,600	1,200	1,440	8,160
Charged		200	3,460	1,035	200	4,895
Removed			(980)			(980)
Balance as at 31.03.2017	**-**	**2,120**	**6,080**	**2,235**	**1,640**	**(12,075)**
Caring Value	**7,500**	**2,880**	**10,520**	**3,765**	**760**	**25,425**

Note 01 - Other Income

Disposal profit	380.00
	380.00

(W5)

Note 02 Finance Expenses

From TB	2,460.00
Interest March	60.00
Total	**2,520.00**

Note 03 Profit Before Tax

Profit Before tax is derived after charging

Depreciation	4,895.00
Inventory Loss	50.00
Director Remuneration	
Auditors Remuneration	

(W4)

Current year Tax	900.00
Total	**900.00**

Note 06 Stated Capital

2,000,000 No of Shares	20,000.00

Note 08 - Dividends

The Directors have recommended Rs 1.5 /= per share as final dividends at the board meeting held on 20th May 2017.

Workings 01 Expenses Analysis

Description	**Admin**	**Distribution**	**Other**
Disposal Loss			-
Depreciation	1,435.00	3,460.00	
Accrued - Fuel		685.00	
Accrued - Electricity & water	68.00		
Compensation			150.00
Bad debts provision		280.00	
From TB	6,800.00	8,750.00	
Total	**8,303.00**	**13,175.00**	**150.00**

Working 02 Depreciation & Disposal

Motor vehicle Disposed	1,400 / 5 * 3.5		980.00
Therefore			
Sales Proceed			800.00
Less Net Book Value			
Cost		1,400.00	
- Acc. Depreciation		(980.00)	(420.00)
			380.00
Dep. Buildings	5,000 / 25		200.00
Motor Vehicle	16,600 / 5		3,320.00
Motor Vehicle - Disposed	1,400 / 5 *.5		140.00
O. Equipment	5,100 / 5		1,020.00
O. Equipment - Purchased	900 / 5 * (1/12)		15.00
Furniture	1,800 / 10		180.00
Furniture - Purchased	600 / 10 * (4/12)		20.00
Total			**4,895.00**

(Total 25 marks)

Suggested Answers to Question Nine:

(i)

Goodwill calculation

Investment Made by Parent	20,000	
Fair Value of NCI	9,000	
Total		**29,000**
Less		
Stated Capital	(15,000)	
Pre - Retained Earnings	(10,000)	
Pre - Revaluation (19,000 - 18,300)	(700)	(25,700)
Gain on Bargain Purchases - GBP		**(3,300)**

(05 marks)

Book value as at 01.04.2016	=	21,500 x 20%
	=	4,300 + 14,000
	=	**18,300**

Consolidated RE

URP	25	BBF	22,500
		Retained Earnings	3,680
		Over charged depreciation	400
SFP	26,555		
	26,580		**26,580**

Non-Controlling Interest

B/C/F	10,020	Fair Value	9,000
		Retained Earnings	920
		Over charged depreciation	100
	10,020		**10,020**

(03 marks)

iii)

MEGA Suppliers (Pvt) Ltd,

Consolidated Statement of Financial Position

As At 31/03/2017 **(Rs. '000)**

Assets		
Non-Current Assets		
Property Plant & Equipment (35,000 + 14,000 + 700 + 500)		50,200
Goodwill		3,300
Current Asset		
Inventories (12,100 + 10,900 - 25)	22,975	
Trade Receivables (36,400 + 9,600 - 200)	45,800	68,775
Total Assets		**122,275**
Equity and Liabilities		
Equity		
Stated Capital	40,000	
Retained Earnings	26,555	66,555
Non-Current Liability		
NCI		10,020
Bank Loan		20,400
Current Liabilities		
Trade Payables (5,500 + 2,500 - 200)	7,800	
Bank Overdraft (15,100 + 2,400)	17,500	25,300
Total Equity and Liabilities		**122,275**

Working

Consolidated Retained Earnings

		B/B/F	22,500
Unrealized Profit	25	Retained earnings	3,680
B/C/F	26,555	Overcharged depreciation	400
	26,580		**26,580**

(b)

1. Gearing Ratio - Increase

- Obtaining new loans
- Reduction in equity

2. ROCE - Increase

- Reduction in profit margin. (exceeding any growth in assets turnover ratio)
  i.e. a reduction in PBIT
- Inefficient utilization of assets led to a fall in assets turnover ratio.

3. Stock Turnover Ratio - Increase

- Increase in demand or sales for the product
- Under stocking of inventory

(06 marks)

(Total 25 marks)

End of Section C

Notice :

These answers complied and issued by the Education and Training Division of AAT Sri Lanka constitute part and parcel of study material for AAT students.
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".
The fundamental objective of this publication is to add completeness to its series of study texts, designs especially for the benefit of those students who are engaged in self-studies. These are intended to assist them with the exploration of the relevant subject matter and further enhance their understanding as well as stay relevant in the art of answering questions at examination level.