SRI LANKA

Association of Accounting Technicians of Sri Lanka

July 2018 Examination - AA3 Level

Questions and Suggested Answers
Subject No : AA31

FINANCIAL ACCOUNTING AND REPORTING (FAR)

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AA3 Examination - July 2018
(AA31) Financial Accounting and Reporting

SUGGESTED ANSWERS

SECTION – A

Four (04) compulsory questions.
(Total 20 marks)

Suggested Answers to Question One:

1. **Comparability** - Is a quality to characteristics to enable users to identify and understand similarities in, and differences, among items.
2. **Timeliness** - Is having information available to decision makers in time to be capable of influencing their decisions.
3. **Verifiability** - Verifiability helps assure users that information faithfully represent the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consessus although not neccessarily complete agreement that a particular depiction is a faithful representation.
4. **Understandability** - Classifying, characterising and presenting information clearly and consistently makes it understandable. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently.

(05 marks)

Suggested Answers to Question Two:

Key areas in business model:

1. Vision, Mision of the organization
2. Strategic objectives, key risks and opportunities
3. The organization structure, business activities and processes, key inputs into the business and resulting output and outcomes.
4. All six capitals

Organizational overview and external environment

Organizational overview:

→ Market positioning

→ Macro and Micro Economic conditions

→ Effect of technology change

→ Key quantitative information

→ Ownership and operating structure

→ Principal activities and markets

→ Market positioning

External environment:

→ The legitimate needs and interests of key stakeholders

→ Macro and Micro economic conditions

→ Market forces

→ Effects of technology challenges

→ The legislative and regulatory environment in which the organization operates

→ Political environment in country

(05 marks)

Suggested Answers to Question Three:

Extract of Statement of Financial Position, as at 31st March 2018

Leased Vehicle	6,500,000	
Less: Depreciation	(1,300,000)	5,200,000
Non-current Liabilities:		
Lease creditor	3,393,483	
Current Liabilities:		
Lease Creditor	857,558	

Extract of Statement of Comprehensive Income for the year ended 31st March 2018

Depreciation	1,300,000
Lease interest	725,000

Workings

Year	Opening Capital	Interest 14.5%	Capital Payment	Closing Capital
1	5,000,000	725,000	748,959	4,251,041
2	4,251,041	616,401	**857,558**	**3,393,483**
3	3,393,483	492,055	981,904	2,411,579
4	2,411,579	349,679	1,124,280	1,287,299
5	1,287,299	186,658	1,287,301	-

(05 marks)

Suggested Answers to Question Four:

Net Cash Flow from financing activities:

Money received with applications for shares	720,000
Cash returned with excess applications	(120,000)
Bank loan	5,000,000
Bank loan payments	(233,865)
Staff loan given	(1,000,000)
Net cash from financing activities	**4,366,135**

(05 marks)
(Total 20 marks)

End of Section A

SECTION –B

Three (03) compulsory questions
(Total 30 marks)

Suggested Answers to Question Five:

			2018	2017	
a)	Gross Profit Ratio	=	$\frac{39,000}{127,500} \times 100$	$\frac{33,800}{105,000} \times 100$	
		=	**30.5%**	**32%**	**1.5 ↓**
b)	Net Profit Ratio	=	$\frac{8,020}{127,500} \times 100$	$\frac{8,130}{105,000} \times 100$	
		=	**6.3%**	**7.7%**	**1.4 ↓**
c)	Quick Assets Ratio	=	(20,470 - 2,680) : 13,200	(26,260 - 11,530) : 17,875	
		=	17,790 : 13,200		
		=	**1.34 : 1**	**0.82 : 1**	
d)	Debtors Collection Period	=	$\frac{\text{Average debtors} \times 365}{\text{Credit Sales}}$		
		=	$\frac{14,840}{70,125} \times 365$	$\frac{16,560}{57,750} \times 365$	
		=	**77 Days**	**104.6 Days**	
e)	Creditors Settlement Period	=	$\frac{6,250}{55,755} \times 365$	$\frac{7,270}{44,856} \times 365$	
		=	**40.9 Days**	**59.2 Days**	

a) **Gross Profit Ratio:**

The company reports a 1.5% decrease in the gross profit ratio for year 2018 when compared with that ratio for the year 2017. This may be due to the lower profit margin charged by the company during the year.

b) **Net Profit Ratio:**

The company recorded a net profit ration of 7.7% in the year 2017. whereas it is only 6.3% in the year 2018, which shows a marginal decrease of 1.4% when compared to the previous year. This may also be due lower profit margins. Further, this indicates that other expenses have not varied much during the years considered.

c) **Quick Asset Ratio:**

For the year 2017, quick asset ratio was 0.82 : 1 whereas for the year 2018 1.34 : 1. This shows a significant improvement in the quick assets ratio during the period under review. The main reason for this is that the closing inventory has been reduced by 77% in the year 2018, when compared to the previous year.

d) **Debtors' Collection Period:**

Debtors collection period (in days) for the year 2017 was 104, whereas for the 2018 it is 77. This shows 26% improvement when compared to the last year. During the period under review, working capital has been managed properly. Further, credit sales has also been improved by 22% compared to the last year.

e) **Creditors Settlement Period:**

For the year 2017, Creditor's settlement period (in days) was 59, whereas for the year 2018, it is 41 days. This shows that the company is settling its creditors 18 days earlier when compared to the previous year. It should be noted that if the company continues to settle its dues this earlier, there will be a possibility of facing short-term working capital management issues, specially cash flow problems. However, we should not forget the fact that in the same way, the company has improved in collecting its dues during the period under review.

(10 marks)

Suggested Answers to Question Six:

Seven Roses Ltd

Statement of Cash Flow

For the year ended 31.03.18

Profit for the year		3,650,000
Depreciation	10,000,000	
Disposal Profit / Loss	0	10,000,000
Operating profit before working capital changes		13,650,000
(Increase) in inventories	(10,200,000)	
(Increase) in trade receivables	(4,100,000)	
(Decrease) in trade payables	(2,100,000)	(16,400,000)
Cash generated from operating activities		(2,750,000)
Income tax paid		(750,000)
Net Cash Flow from operating activities		(3,500,000)
Cash Flow from Financing Activities		
Sale proceeds from disposal of machinery	4,000,000	4,000,000
Net Cash Flow from Financing Activities		
Interim dividend paid	(2,000,000)	(2,000,000)
Net cash flow decrease during the period		(1,500,000)
Cash and cash equivalents as at 01st April 2017		5,000,000
Cash and cash equivalents as at 31st March 2018		**3,500,000**

Workings:

(W-01)

Disposal of Asset

Asset	10,000	Cash	4,000
		Depreciation	6,000
	10,000		**10,000**

(W-02)

Income Tax

Cash	750	B/B/F	400
B/C/F	100	P & L	450
	850		**850**

(10 marks)

Suggested Answers to Question Seven:

a) Change in useful life of Plant and Machinery is considered as a change in accounting estimate. Therefore, the adjustment is made prospectively.

		(Rs. '000)	
Cost	=	8,000	
Less: Accumulated depreciation	=	(3,200)	
Carrying Value	=	**4,800**	← Depreciated over 08 years

Annual Depreciation → $\frac{4,800}{8}$ = 600

For the year ended 31st March 2018, Rs. 600,000/- should be charged as the depreciation.

(04 marks)

b) 1. **Provision to be made:**
   - Goods sold under warranty - present obligation
   - Repair cost for goods with a warranty - Outflow of resources.

   Warranty provision to be made for Rs. 30 million @ 2% → **Rs. 600,000/-**

2. This is a provision. Rs. 2,000,000/- should be recognized as income tax liability in the current year.

3. This is a contingent liability. Disclosure in the financial statements is only required.

(06 marks)

(Total 10 marks)

End of Section B

SECTION –C

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

Suggested Answers to Question Eight:

Golden PLC
The Statement of Profit or Loss and other Comprehensive Income
for the Year Ended 31st March 2018

(Rs. '000)

Description	**Note**	**Amount**
Sales		545,000
Less: Cost of Sales		(420,000)
Gross Profit		125,000
Other Income **(W-1)**		4,000
		129,000
Expenses:		
Distribution **(W-7)**	49,160	
Administration **(W-8)**	38,047.50	
Finance expenses (1,350 + 250) **(W-10)**	1600	
Other expenses - Loss on disposal **(W-1)**	107.50	(88,915)
Profit Before Tax		40,085
Taxation		(9,000)
Profit After Tax		31,085
Other comprehensive Income - Revaluation		1,500
Total Comprehensive Income		**32,585**

(10 marks)

b)

Golden PLC
Statement of Financial Position
as At 31st March 2018

			(Rs. '000)
Description			**Amount**
Assets			
Non-Current Assets			
Property Plant & Equipment			59,695
Current Assets			
Inventory		30,000	
Trade Receivable (87,000 - 1,500)	85,500		
Less: Allowance for receivables (W-5)	(1,710)	83,790	
Other receivables (W-9)		1,250	
Short-term investments		25,000	
Cash and cash equivalents		1,800	141,840
Total Assets			**201,535**
Equity & Liabilities			
Equity:			
Stated Capital		50,000	
Revaluation reserve		1,500	
Retained Earnings		39,435	90,935
Non-Current Liabilities			
Bank Loan		3,750	3,750
Current Liabilities			
Trade Payables		101,850	
Accrued expenses		800	
Bank loan		1,250	
Loan interest payable (500 + 250)		750	
Income tax payable (W-6)		2,200	106,850
			201,535

(07 marks)

c) Golden PLC

Statement of Changes in Equity

For the Year Ended 31st March 2018

Description	Ordinary Shares	Revaluation	Retained Earnings	Total
B/B/F	50,000	-	13,350	63,350
Revaluation of land	-	1,500	-	1,500
Interim dividend	-	-	(5,000)	(5,000)
Profit for the year	-	-	31,085	31,085
Balance as at 31.03.2018	**50,000**	**1,500**	**39,435**	**90,935**

(03 marks)

d) Golden PLC

Statement of movements of PPE for the year ended 31st March 2018

	Land	Building	Motor Vehicles	Office Equipment	Total
Cash as at 01.04.2017	30,000	5,000	28,000	8,000	71,000
Addition	-	5,500	-	-	5,500
Revaluation	1,500	-	-	-	1,500
Disposal	-	-	-	(300)	(300)
	31,500	**10,500**	**28,000**	**7,700**	**77,700**
Acc. Depreciation as at 01.04.2016	-	4,000	6,000	1,500	11,500
Depreciation for the year	-	255	5,600	792.50	6,647.50
Disposal	-	-	-	(142.5)	(142.5)
	-	**4,255**	**11,600**	**2,150**	**18,005**
Carrying value as at 31.03.2018	**31,500**	**6,245**	**16,400**	**5,550**	**59,695**

(05 marks)

Workings:

(W-1)

Cost	300	Dep.	142.5
		Other receivables	50
		P & L	107.5
	300		**300**

(W-2)

Borrowing cost to be capitalized

Borrowing Cost → 5,000 x 15% x 8/12 = **500**

(W-3)

Depreciation on disposal computers

On disposed computers → 300,000 x 10% x 4 9/12 = **142.5**

(W-4) - Depreciation

770,000 x 10% + (300 x 10% x 9/12) = **792.5**

Building →	5,500 x 4%	=	200
New	5,500 x 4% x 3/12	=	55
			255

(W-5) **Allowance for Receivables Account**

		Balance B/f/d	1,150
B/c/d	1,710	P & L	560
	1,710		**1,710**
			1,710

(W-6) **Income Tax Account**

Cash	8,800	B/b/fd	2,000
B/c/d	2,200	P & L	9,000
	11,000		**11,000**

(W-7) - Distributing Expenses

TB	41,500
Bad debts	1,500
Provision on debts	560
Depreciation MV (28,000/5)	5,600
	49,160

(W-8) - Administration Expenses

TB	37,000
Depreciation - building	255
- Office equipment	792.5
	38,047.5

(W-9) - Other Receivables

Computer sales	50
Investment income	1,200
	1,250

(W-10) - Loan interest

Finance Expense (Loan interest) = 5,000 x 15% x 4/12

= **250**

(Total 25 marks)

Suggested Answers to Question Nine:

(A) a) Goodwill Calculation

Investment	20,000
NCI	5,000
Net Assets (20,000 + 1,200)	(21,200)
Goodwill	**3,800**

(05 marks)

b)

MEGA Trading (Pvt) Ltd,

Consolidated Statement of Financial Position

for the year ended 31st March 2017 **(Rs. '000)**

NCP		
PPE (60,000 + 15,000 - 1,500) **(W-1)**		73,500
Depreciation (12,000 + 6,000 - 100) **(W-2)**		(17,900)
		55,600
Goodwill		3,800
Current Assets:		
Inventories (15,100 + 18,000 - 50) **(W-3)**	33,050	
Trade Receivables (40,250 + 10,500 - 25)	50,725	83,775
		143,175
Equity:		
Stated capital	78,000	
Retained Earnings	10,010	88,010
NCI		5,690
NCL:		93,700
Bank loan		10,600
Current Liabilities:		
Trade payables (15,100 + 10,500 - 25)	25,575	
Bank Loan	4,800	
Bank overdrafts	8,500	38,875
		143,175

Workings

(W-1) - Profit on Disposal Account

Cost	2,500	Depreciation	1,000
P & L	1,500	Cash	3,000
	4,000		**4,000**

(W-2) - Over Depreciation

500 x 20% = 100

(W-3) - Unrealized Profit

TT → MT

(600,000 / 120) x 20 → 100,000 / 2 → 50,000

Consolidated Retained Earnings Account

Unrealized Profit disposal	1,500	B/b/f	8,750
Unrealized profit	40	Over dep.	80
B/c/f	10,010	**TT** - Profit	2,720
	11,550		**11,550**

NCI Account

Unrealized Profit	10	B/b/f	5,000
B/b/f	5,690	Over dep.	20
		TT - Profit	680
	5,700		**5,700**

(14 marks)

(B) Gaining Ratio

- Obtaining new loans during the current year.
- Issuing debentures in the current year.

Return On Capital Employee (ROCE)

- Turnover has been reduced in the current year.
- Expenses have been increased in the current year.
- Closing stock has been decreased in the current year.
- New shares have been issued in the current year.
- New loans have been obtained.
- Trade payables have been reduced.

Assets Turnover Ratio

- Disposal of major fixed assets during the year.
- Reduced closing inventory balances
- Increase in sales during the year
- Lower cash in hand and at bank balances as at the year-end.

(06 marks)

(Total 25 marks)

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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