SRI LANKA

Association of Accounting Technicians of Sri Lanka

Level III Examination - January 2022

Suggested Answers

(301) FINANCIAL REPORTING (FAR)

Association of Accounting Technicians of Sri Lanka
No.540,Ven. Muruththettuve Ananda Nahimi Mawatha,
Narahenpita, Colombo 05.
Tel : 011-2-559 669

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

Level III Examination - January 2022

(301) Financial Reporting

SUGGESTED ANSWERS

Four (04) Compulsory Questions
(Total 20 Marks)

SECTION - A

Suggested Answers to Question One:

Chapter 01 - Governance Structure, the Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

(a)

1. **Timeliness**

Timeliness means that information is available to decision-makers in time to be capable of influencing their decisions.

2. **Understandability**

Classifying, characterizing and presenting information clearly and concisely makes it understandable. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyze the information diligently.

3. **Comparability**

Comparability is the qualitative characteristic that enables users to identify and understand similarities in and differences among items.

4. **Verifiability**

Verifiability means that different knowledgeable and independent observers could reach consensus although not necessarily complete agreement that a particular depiction is a faithful representation.

(03 marks)

(b)

1. Historical cost
2. Fair value
3. Value in Use (Fulfillment value)
4. Current Cost

(02 marks)
(Total 05 marks)

Suggested Answers to Question Two:

Chapter 01 - Governance Structure, the Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

(a)

Sustainability reporting is the disclosure and communication of the overview of company's economic, environmental and social impacts caused by its everyday activities. It presents the values of the organization and governance structure. Particularly, Sustainability reporting has become a very important part of integrated reporting which combines financial and non-financial parameters. It is a triple bottom line reporting and can be used in reporting on corporate social responsibility.

(03 marks)

(b)

1) Mission and Vision of the organization
2) Organizational structure
3) Business activities and processes
4) Basic business inputs and outputs and outcomes
5) Strategic goals, main risks and opportunities
6) All six types of capital
7) External factors
8) Governance
9) Performance
10) Outlook

(02 marks)
(Total 05 marks)

Suggested Answers to Question Three:

Chapter 04 – Interpretation of Financial and Non-financial Data and Information

(a)

1) It helps in forecasting and planning for the future.
2) It gives a clear understanding of the level of liquidity, gearing and profitability of the business.
3) It helps to estimate the budget.
4) It evaluates the financial performance (profitability) and financial position of the business.
5) It can be used to compare with previous year results.
6) It can be used to compare with industry averages.
7) It provides significant information to users of organization to facilitate decision making.
8) It helps to identify the business risks and weak performing areas, and what causes them along with the relevant steps to address and rectify those weaknesses.

(03 marks)

(b)

1. Details available in the financial statements are based on historical cost concept.
2. Inflationary effects are not considered when comparing the current year performance with previous years.
3. The differences in accounting policies between different business entities when comparing the ratio among entities which make the ratios less comparable.
4. Making decisions regarding the future periods based on historical data by ignoring the fact that past economic condition, business environment and internal factors are not stable and dynamic.
5. Some ratios are based on the position and numbers prevailing at the financial reporting date. However, these numbers are not constant throughout the year.
6. Intentional manipulation (window dressing) may be reflected in the financial statements.

(02 marks)
(Total 05 marks)

Suggested Answers to Question Four:

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

LKAS 38 prescribe the accounting treatments for the following transactions as follows

1. The **research expenses of Rs.1,500,000/- does not meet the definition of intangible** assets. Also **no intangible asset is arising from research expenses.** Therefore the cost incurred on research shall be recognized as an expense and need to be charged to profit and loss statement for the year ended 31st March 2021.
2. **Patent for the value of Rs.200,000/- meets the definition of intangible assets (since the recognition criteria of intangible assets have been met). Hence the expenses incurred on patent rights can be recognized as an intangible asset**.
3. **Entertainment expenses of Rs.2,000,000/- does not meet the definition of intangible assets,** even though the Company is expecting that the customer relationship will bring more sales revenue. **Hence this cannot be recognized as an intangible asset** and total of Rs.2,000,000 should be charged as an expense to profit and loss statement for the year ended 31st March 2021.

(05 marks)

End of Section A

Three (03) Compulsory Questions (Total 30 Marks)	SECTION - B

Suggested Answers to Question Five:

Chapter 3 part 11 – Financial Statements for a Limited Liability Company for Publication Purpose

Arya (Pvt) Ltd
Statement of Cash Flows
For the year ended 31 March 2021 **(Rs.'000)**

Cash flow from operating activities		
Net profit before tax (863 + 105)		968
Adjustment For		
Depreciation (5,600 – (4,800 + 2,500)) **(W5)**	3,300	
Interest on loan	450	
Loss on disposal	750	
Provision for gratuity	760	5,260
Operating profit before changes in working capital		**6,228**
Changes in working capital		
Increase in inventory	(500)	
Decrease in trade receivables	410	
Increase in trade payables	420	330
Cash generated from operating activities		**6,558**
Income tax paid **(W1)**	(718)	
Gratuity paid	(360)	(1,078)
Net cash generated from operating activities		**5,480**
Cash flow from investing activities		
Purchase of PPE	(7,400)	
Sales proceed of disposal **(W2)**	1,850	
Net cash flow from investing activities		**(5,550)**
Cash flow from financing activities		
Repayment of loan	(1,300)	
Loan interest paid **(W3)**	(420)	
Loan obtained	2,000	
Net cash flow from financing activities		**280**
Net change in cash and cash equivalent		**210**
Cash and cash equivalent at beginning of the period		**990**
Net movement of cash and cash equivalents		210
Cash and cash equivalent at the end of the period		**1,200**

Workings

W1

Income Tax Account

Cash	**718**	B/B/F	763
		P & L	105
B/C/D	150		
	868		868

W2

Disposal Account

Cost	5,100	Depreciation	2,500
		P & L	750
		Cash	**1,850**
	5,100		5,100

W3

Loan Interest Account

Cash	**420**	B/B/F	70
		P & L	450
B/C/D	100		
	520		520

W4

Property Plant and Equipment Account

B/B/F	8,200	Disposal	5,100
Assets exchange	1,850		
Cash	**5,550**		
		B/C/F	10,500
	15,600		15,600

W5

Depreciation Account

Disposal	2,500	B/B/F	4,800
B/C/D	5,600	**Depreciation Expenses**	**3,300**
	8,100		8,100

(10 marks)

Suggested Answers to Question Six:

Chapter 2 Part I – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(A) (a)

Assets	**Carrying Value**	**Tax Base**	**Temporary Difference**
Building	10,000,000	12,000,000	
Machinery	6,000,000	5,000,000	
Total	**16,000,000**	**17,000,000**	**1,000,000**

Total Deductible Difference (16,000,000 - 17,000,000) = 1,000,000
Tax rate = 14%
Differed Tax Assets (1,000,000 × 14%) = 140,000

(03 marks)

(b)

Differed Tax Liabilities/ Assets Account

B/B/F	125,000		
P & L	15,000	B/C/F	140,000
	140,000		140,000

Current tax (600,000 × 14%) = 84,000

Reversal of Differed Tax = (15,000)

Income tax expenses for the year = 69,000

(02 marks)

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(B)

1. **Non-payments of Income Tax = 1.3 million**

   This has to be provided in the financial statement as a provision.

   However, for the amount of the penalty of Rs.1.4 million, no provision should be made and **it should be disclosed as a contingent liability in the financial statements** because there is a possible obligation that arises from past events is not wholly within the control of the entity.

2. **The claim of Rs.2,000,000 by the ex-employee is a contingent liability,** As per the lawyer, there were solid evidence to prove that the employee has committed the fraud. Hence it can be stated that the case will turn positive to the company. **However, under such circumstances it will be appropriate to make a disclosure in the financial statement**.

(05 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

Accumulated Depreciation	=	7,200,000		
Number of years depreciated as at 01.04.2020	=	7,200,000/600,000	=	12 years
Remaining lifetime			=	28 years
Useful lifetime increased by 32	=	28 + 32	=	60 years
Depreciation for the year	=	16,800,000 /60	=	Rs.280,000
Accumulated Depreciation	=	7,200,000 + 280,000	=	**Rs.7,480,000**
Carrying Value of the building as at 31st March 2021	**=**	**Cost – Accumulated Depreciation**		
	=	24,000,000 - 7,480,000		
	=	**Rs.16,520,000**		

(04 marks)

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(b)

Extract of Comprehensive Income Statement **(Rs.)**

Depreciation (3,000/3)	1,000,000
Lease interest	240,000

Extract of Statement of Financial Position **(Rs.)**

Non-Current Assets	
Property Plant & Equipment – Right to use asset (3,000 – 1,000)	2,000,000
Non-Current Liabilities	
Lease Creditors	743,604
Current Liabilities	
Lease Creditors	663,751

Working:

Lease Amortization Schedule

Year	Amount	Interest	Capital	Installment	O/S
1	2,000,000	240,000	592,635	832,635	1,407,365
2	1,407,365	168,884	663,751	832,635	743,614
3	743,614	89,234	743,401	832,635	-

Non-Current Assets – Carrying Value = 3,000 – 1,000 = **2,000**

(06 marks)
(Total 10 marks)

End of Section B

Three (03) Compulsory Questions
(Total 50 Marks)

SECTION - C

Suggested Answers to Question Eight:

Chapter 3 part I – Financial Statements for a Limited Liability Company for Publication Purpose

(a)

Richi PLC
The Statement of Profit or Loss and Other Comprehensive Income
for the year ended 31.03.2021 **(Rs.'000)**

	Notes		
Sales			150,000
Cost of Sales			(81,000)
Gross Profit			**69,000**
Other Income	**01**		2,480
Less: Expenses			
Distribution Expenses **(W4)**		(21,000)	
Administration Expenses **(W4)**		(42,950)	
Other Expenses **(W4)**		(1,850)	
Finance Expenses	**02**	(4,825)	(70,625)
Profit Before Tax			**855**
Income Tax **(W3)**			(5,300)
Profit After Tax			**(4,445)**

(10 marks)

(b)

Richi PLC
Statement of Financial Position
As at 31.03.2021 **(Rs.'000)**

Assets	**Notes**		
Non-Current Assets			
Property Plant & Equipment			53,550
Capital Work in Progress (18,000 + 1,375) **(W6)**			19,375
Current Assets			
Inventory		28,000	
Trade Receivables	**03**	19,080	
Prepayments		9,000	
Cash & Cash Equivalent		25,100	81,180
Total Assets			**154,105**

Equity And Liabilities :			
Stated Capital & Reserves			
Stated Capital		100,000	
Retained Earnings		17,555	
Revaluation Reserve		3,000	120,555
Total Equity			
Non-Current Liabilities			
Bank loan			11,250
Current Liabilities			
Trade payables		15,600	
Accrued Audit Fee		600	
Bank loan		3,750	
Compensation payable		750	
Income Tax Payable **(W3)**		1,600	22,300
Total Equity and Liabilities			**154,105**

(09 marks)

(c)

Richi PLC
Statement of Changes of Equity
For the year ended 31.03.2021

Description	Stated Capital	Retained Earnings	Revaluation Reserve	Total
Balance as at 01.04.2020	100,000	22,000	3,000	125,000
Profit / (Loss) for the year		(4,445)		(4,445)
Balance as at 31.03.2021	**100,000**	**17,555**	**3,000**	**120,555**

(02 marks)

(d)

Richi PLC
Movement of Property, Plant & Equipment
For the year ended 31.03.2021

Description	Land	Building	Machinery	Computer Software	Total
Cost/ Revalued Amount					
As at 01.04.2020	44,000	18,000	14,000	3,000	79,000
Balance as at 31.03.2021	**44,000**	**18,000**	**14,000**	**3,000**	**79,000**
Acc. Depreciation					
Balance as at 01.04.2020	-	12,000	6,000	1,200	19,200
Depreciation (W1)		900	3,500	750	5,150
Impairment (W5)			1,100		1,100
Balance as at 31.03.2021		**12,900**	**10,600**	**1,950**	**25,450**
Carrying Value 31.03.2021					**53,550**

(04 marks)

Notes:

Note 01 - Other Income

TB	2,100
Reversal of bad debts (W2)	380
Total	**2,480**

Note 02 - Finance Expenses

Finance Expenses	6,200
Interest to be capitalized (15,000 × 10% × 11/12)	1,375
Total	**4,825**

Note 03 - Trade Receivables

Trade Debtors (21,700-500)	21,200
10% Provision **(W2)**	(2,120)
Total	**19,080**

Workings:

W1 – Depreciation

	Cost	Useful Life	Charge for the year	Dep. 1.4.2021	Acc. Dep.
Buildings (62,000-44,000)	18,000	20	900	12,000	12,900
Machinery	14,000	4	3,500	6,000	9,500
Software	3,000	4	750	1,200	1,950

W2

Allowance for Trade Receivables

Bad Debt	500	B/B/F	3,000
P & L	380		
B/C/D	2,120		
	3,000		3,000

W3

Income Tax Payable

Cash	7,200	B/B/F	3,500
B/C/D	1,600	P & L	5,300
	8,800		8,800

W4 - Expense Schedule

	Distribution	Administration	Other
As per TB	21,000	34,200	-
Depreciation Building		900	
Depreciation Machinery		3,500	
Depreciation Software		750	
Compensation			750
Impairment Loss (W5)			1,100
Rent		3,000	
Audit fee		600	
	21,000	**42,950**	**1,850**

W5 - Impairment Loss

Fair Value 3,000
Value in Use 3,400

3,400 Recoverable Amount

Impairment Loss = Carrying Value – Recoverable Amount

= 4,500 – 3,400
= 1,100

W6 - Interest to be capitalized

= 15,000 × 10% × 11/12
= 1,375

(Total 25 marks)

Suggested Answers to Question Nine:

Chapter 4 – Interpretation of Financial and Non-financial Data and Information

(a)

(i) Gross Profit Ratio

$$= \frac{\textbf{Gross Profit}}{\textbf{Sales}} \times \textbf{100}$$

$$= \frac{168{,}900}{372{,}400} \times 100 = \underline{\underline{\textbf{45.35\%}}}$$

(ii) Quick Asset Ratio

= **(Current Assets – Inventory) : Current Liabilities**

= (151,400 – 95,400) : 47,400

= **1.18 : 1**

(iii) Stock Resident Period

$$= \frac{\textbf{Average Inventory}}{\textbf{Cost of Sales}} \times 365$$

$$= \frac{(95{,}400+88{,}400)/2}{203{,}500} \times 365$$

$$= \frac{91{,}900}{203{,}500} \times 365$$

= **165 Days**

(iv) Creditors Settlement Period

$$= \frac{\textbf{Average creditors}}{\textbf{Purchases}} \times 365$$

$$= \frac{(38{,}300+25{,}900)/2}{210{,}500} \times 365$$

$$= \frac{32{,}100}{210{,}500} \times 365$$

= **56 Days**

(v) Earnings per Share

$$= \frac{\textbf{Profit attributable to ordinary shareholders}}{\textbf{Weighted average number of ordinary shares}}$$

$$= \frac{22{,}700}{5{,}500}$$

= **Rs.4.13 per share**

(05 marks)

(b)
Profitability

GP Ratio
Industry's average GP ratio is 52%, whereas company's GP ratio is somewhat below the GP of industry and stood at 45.35%. The GP ratio of the company is 7% behind the industry average. When it is compared with that of the industry, the main reason for such drop might be due to lower selling prices or excessive cost of production.
It is very much important that the management should take prompt action to investigate such reason and reinstate the GP in par with/above industry average. This can be achieved by reducing the sales discounts, implementing a strong cost minimization strategy in manufacturing and minimizing the production wastages.

Liquidity

Quick Asset Ratio
Industry Quick asset ratio is better than the Company's Quick asset ratio of 1.18. However, the company is also maintaining a better position regarding liquidity.

Efficiency

Stock Residency Period
Stock residency period of the company is 165 days, whereas in the industry it is only 35 days. This indicates that company is facing working capital problems since inventory is piling up. There is a high possibility that company will have to incur excessive costs on holding the stock in longer run. Further there is a risk that stock may be obsolete.

Creditors Settlement Period
In terms of creditor's settlement period, though industry is better compared to the company, it is not a bad situation.

Investment
Earnings per share
Industry Earnings per share (EPS) is Rs.7.50, whereas company's EPS is only Rs.4.13. It shows that the total earning attributable to shareholders is less in the company compared to the industry.

(05 marks)
(Total 10 marks)

Suggested Answers to Question Ten:

Chapter 5 part II –Consolidated Financial Statements

(a)

Goodwill Calculation

		(Rs.'000)
Investment		40,000
NCI		20,000
		60,000
Retained Earnings	13,000	
Stated Capital	40,000	(53,000)
Goodwill		**7,000**

(04 marks)

(b)

Hiru Ltd.

Consolidated Statement of Financial Position

As at ended 31st March 2021

(Rs.'000)

Assets:		
Non-Current Assets		
Property Plant & Equipment		112,600
(60,000 + 55,000 - 3,000 + 600) **(W4)**		
Goodwill		7,000
Current Assets		
Inventory (13,000 + 18,000 -1,000) **(W3)**	30,000	
Trade Receivables (20,000 +15,000 - 12,000)	23,000	
Cash & Cash Equivalent	27,000	80,000
Total Assets		**199,600**
Equity and Liabilities :		
Equity:		
Stated Capital	60,000	
Retained Earnings	14,540	74,540
NCI **(W2)**		20,760
Non-Current Liabilities		
Bank loan (16,000 + 32,000)		48,000
Current Liabilities		
Trade Payables (54,500 + 13,800 - 12,000)	56,300	56,300
Total Equity and Liabilities		**199,600**

Workings

W1

Consolidated Retained Earnings

Profit on disposal	3,000	B/B/F	14,500
Unrealized profit	800	Pre-acquisition profit (4,200 × 80%)	3,360
B/C/D	**14,540**		480
	18,060		18,060

W2

NCI

Unrealized profit	200	Investment	20,000
		Over depreciation	120
B/C/D	**20,760**	Post-acquisition profit (4,200 × 20%)	840
	20,960		20,960

W3 - Unrealized Profit

Unrealized Profit = 10,000 × 120% = 12,000

50% = 6,000

$$= \frac{6,000 \times 20}{120} = \underline{\underline{1,000}}$$

W4 – Disposal of Assets

Disposal of Assets

Cost	5,000	Sale Proceed	6,000
Profit	3,000	Ac. Depreciation	2,000
	8,000		8,000

(11 marks)

(Total 15 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". 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.