



Association of Accounting Technicians of Sri Lanka

Level III Examination - January 2023

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

A publication of the Education and Training Division

Level III Examination - January 2023

(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)

(i)

- Existing Investors
- Potential Investors
- Lenders
- Creditors
- Customers
- Government
- Competitors
- Management
- Employees



(01 mark)

(ii)

Existing and potential investors

- Decisions on further investments in the entity.
- Decisions on withdrawing the existing investments.
- Decisions on investment returns.

Existing and potential lenders

- Decisions on granting new lending to the entity.
- Decisions on recoverability of the existing lending to the entity.

Existing and potential creditors

- Decisions on future supply of materials.
- Decisions on recovering existing credit balances from the entity.
- Decisions on discounts.
- Decisions on credit periods.

Existing and potential employees

- Decisions on continuation of employment.
- Decisions on joining the entity as an employee.
- Decisions on employee benefits.

Government

- Decisions on tax charged on the entity.
- Decisions on tax recoverability.
- Decisions on tax concessions.

Existing and potential customers

- Decisions on purchases.
- Decisions on repayment of the credit amounts.
- Decisions on credit periods.

Management

- Decisions on asset utilization.
- Decisions on profitability.
- Decisions on liquidity.
- Pricing decisions.
- Strategic business decisions.

(02 marks)

(b)

A reporting entity is an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity. Companies, Partnerships, Sole proprietorships are examples for reporting entities.

(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)

- To provide information to stakeholders on past performance of the organization and a view to the future in respect of environmental, social and governance (ESG) initiatives.
- Measuring and evaluating sustainable performance in relation to rules, standards, and performance standards
- Demonstrate how an organization influences sustainable development expectations and how such expectations influence the organization.
- Comparing performance over time and between different organizations.
- Providing historic review of opportunities and risks.

(02 marks)

(b)

Sustainability Report is a report that analyzes the impact on the economy, society, and the environment due to day-to-day activities of an organization. It covers three areas: profit, people, and planet. Also, It presents the organization's values and governance model and demonstrates the link between its corporate strategy and commitment to a global sustainable economy. Further Sustainability report helps the organization to measure, understand and communicate organizational performance on economic, environmental, social and governance aspect while setting goals, and then managing changes more effectively.

(03 marks)
(Total 05 marks)

Suggested Answers to Question Three:

Chapter 05 - Consolidated Financial Statements

(a)

Description	Rs. Million
Investment	90
Fair Value of Non-Controlling Interest	30
(-) Fair Value of Identifiable Net Assets of Subsidiary at Acquisition	(105)
Goodwill at Acquisition	15

(03 marks)

(b)

Subsidiary company is the business or businesses which are under the control of parent in a business combination. For an example when ABC Ltd acquired Y Ltd, Y Ltd is considered as a Subsidiary of ABC Ltd as it's under the control of parent.

(02 marks)
(Total 05 marks)

Suggested Answers to Question Four:

Chapter 02 – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

- As per Section 148 of Companies Act every company must prepare the financial statements. Thereby, all the entities registered under the Companies Act No. 07 of 2007 must prepare their financial statements.
- As per Section 166 of Companies Act every company must prepare and present their financial statements within 06 months from the reporting date. This requirement

satisfies the timeliness of financial information as within 06 months from reporting date financial statements shall be issued.

- As per Section 167 of Companies Act, financial statements shall be provided to all the shareholders 15 days prior to the annual general meeting. This regulation provides sufficient time for shareholders to analyze and understand financial performance and position.
- Financial statements shall be prepared in accordance with Sri Lanka Accounting standards.

(05 marks)



End of Section A

Suggested Answers to Question Five:

Chapter 02 – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(A)

(a)

	Machinery	Motor Vehicles	Gratuity	Total
Carrying Value	10,000,000	6,000,000	(500,000)	15,500,000
(-) Tax Base	(9,000,000)	(5,500,000)	0	(14,500,000)
Temporary Difference	1,000,000	500,000	(500,000)	1,000,000
Nature of Temporary Difference				Taxable TD
Tax Rate				14%
Deferred Tax Liability as at 31.03.2022				140,000

(03 marks)

(b) Tax Expense

Income Tax Expense (W1)	= 112,000
Deferred Tax Expense (W2)	= 290,000
Total Tax Expense	= <u>402,000</u>

Workings

W1-Current Tax Expense

Taxable Profit	= 800,000
Tax Rate	= 14%
Current Tax Expense	= <u>112,000</u>

W2-Deferred Tax Expense

Closing Deferred Tax Liability	= 140,000
Opening Deferred Tax Asset	= 150,000
Deferred Tax Expense	= <u>290,000</u>

(02 marks)

(B)

(1) Non-Adjusting Event

As per LKAS 10 Events after the reporting period standard the ordinary share final dividend cannot be recognized. Instead, the per share dividend, total dividend, approved date shall be disclosed mandatorily. Hence a disclosure in the financial statement as a note should be made.

(2) Adjusting Event

The legal case was existed as of the reporting date as a contingent liability. However, the case was finalized not in favour of the company during the after-reporting period. This removes the contingency status of the liability. Therefore, a provision of Rs. 2.5 million is required in the financial statements as per LKAS 10.

(3) Adjusting Event

The inventory held as at the reporting period has been measured at cost. However, subsequently the inventory has been realized at a value lower than the cost. Therefore, such loss shall be provided as per LKAS 10.

(4) Non-Adjusting Event

The damage caused by the fire indicates an event occurred after the reporting period. Therefore, this loss shall not be adjusted in financials ended 31/3/22.

(5) Adjusting Event

The cash fraud was already occurred as at the reporting date. It was discovered later by an event after the reporting period. Therefore, the loss shall be adjusted to the financial statements as a loss of cash.

(05 marks)
(Total 10 marks)

Suggested Answers to Question Six:

(A)

Chapter 02 – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

Lease Receivable					
1/4/21	Cash	2,400,000	31/3/22	Cash	1,205,375
31/3/22	Finance Income	576,000	31/3/22	B/C/F	1,770,625
		2,976,000			2,976,000
31/3/22	B/B/F	1,770,625			

(04 marks)

(b)

Unearned Finance Income					
31/3/22	Profit or Loss	576,000	31/3/21	Lease Receivable	576,000
		576,000			576,000

(02 marks)

Workings

W1- Present Value of Lease Receivable

Lease Installment	= 1,205,375
Annuity Factor	= $(1-(1/1+r)^n)/r = (1-(1/1.24^3))/0.24 = 1.9813$
Present Value of Lease Receivable	= 2,388,213

Note – The fair value 2,400,000 will be considered as equivalent to the present value of lease receivable as the 2,388,213 is almost like fair value Rs.2,400,000.

Working : Interest Income

Opening Lease Receivable	= 2,400,000
Interest Rate	= 24%
Interest Income	= 576,000

Debit Lease Receivable	576,000
Credit Unearned Finance Income	576,000

W2-Lease Installment

Debit Cash	1,205,375
Credit Lease Receivable	1,205,375

(B)

Chapter 02 – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

Carrying Value of the Motor Vehicle	= 3,600,000
(-) Recoverable Value (W1)	= <u>(3,000,000)</u>
Impairment Loss	= <u>600,000</u>

Workings

W1-Recoverable Value

Fair Value less Cost of Disposal	= 2,800,000
Value in Use	= 3,000,000
Recoverable Value (Higher)	= 3,000,000

(04 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

(a)

Chapter 03 part II – Financial Statements for a Limited Liability Company for Publication Purpose

**Chula Trading Ltd.
Cash Flow Statement
For the year ended 31st March 2022**

Rs.000

Operating Activities		
Profit before tax (150 + 110 + 300)	560	
+/- Adjustments		
Profit on disposal of machinery	(250)	
Interest Expense	125	
Gratuity Provision (W5)	100	
Depreciation	550	
Operating Cash Flow before Working Capital Changes	1,085	
Working Capital Changes		
Decrease in Inventory	400	
Decrease in Trade and Other Receivables	640	
Increase in Trade and Other Payables	150	
	2,275	
(-) Gratuity Paid	(40)	
(-) Tax Paid	(150)	
Cash Flows from Operating Activities		2,085
Investment Activities		
Disposal of Machinery	1,500	
Purchase of Land ((7,500-(6,500-1,600))	(2,600)	
Cash Flows from Investing Activities		(1,100)
Financing Activities		
Dividend Paid	(300)	
Bank Loan paid (1,200-1,000)	(200)	
Loan Interest paid (W3)	(75)	
Cash Flow from Financing Activities		(575)
Net Cash Flow for the Year		410
Opening Cash and Cash Equivalents		700
Closing Cash and Cash Equivalents		1,110

Workings

W1 – Tax Expense for the year

Debit	Tax Expense (Retained Earnings)	110	
Credit	Tax Payable		110

Tax Payable

Cash	150	Balance B/F	130
Balance C/D	90	Tax Expense	110
	<u>240</u>		<u>240</u>

Retained Earnings

Tax Expense	110	Balance B/F	600
Dividend	300	Profit before Tax	560
Balance C/D	750		
	<u>1,160</u>		<u>1,160</u>

W2 – Disposal of Machinery

Property Plant and Equipment

Balance B/F	6,500	Disposal Gain/Loss	1,600
Cash	2,600	Balance C/D	7,500
	<u>9,100</u>		<u>9,100</u>

Accumulated Depreciation

Disposal Gain/Loss	350	Balance B/F	1,000
Balance C/D	1,200	Depreciation	550
	<u>1,550</u>		<u>1,550</u>

Disposal Gain or Loss

Machinery	1,600	Accumulated Dep.	350
Profit or Loss	250	Cash	1,500
	<u>1,850</u>		<u>1,850</u>

Cost of Disposed Machinery

Debit	Disposal Gain or Loss	1,600	
Credit	Machinery		1,600

W3 – Interest Expense

Interest Payable			
Cash	75	Balance B/F	100
Balance C/D	150	Interest Expense	125
	225		225

W4 – Dividend Paid

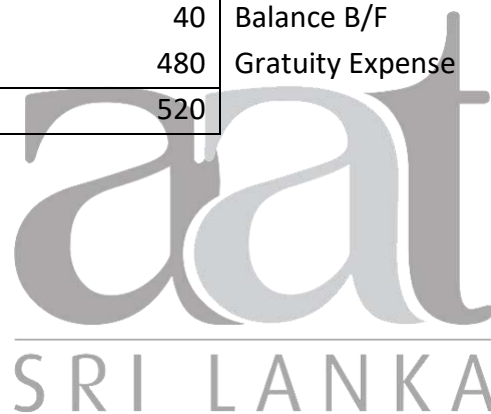
Debit	Dividend Expense (Retained Earnings)	300	
Credit	Cash		300

W5 – Gratuity Expense

Debit	Gratuity Expense	100	
Credit	Gratuity Provision	100	

Gratuity Provision			
Cash	40	Balance B/F	420
Balance C/D	480	Gratuity Expense	100
	520		520

(Total 10 marks)



End of Section B

Suggested Answers to Question Eight:

Chapter 03 part I – Financial Statements for a Limited Liability Company for Publication Purpose

(a)

**Nido Lanka Ltd.
Statement of Comprehensive Income
For the Year Ended 31st March 2022**

	(Rs.'000)
Revenue (239,500-5,400)	234,100
Cost of Sales	(135,000)
Gross Profit	99,100
Other Income (W1)	11,400
	110,500
Less Expenses:	
Distribution Expenses (W5)	(37,350)
Administration Expenses (W5)	(38,710)
Finance Expenses (W2)	(22,083)
Profit Before Tax	12,357
Tax Expense (W10)	(9,750)
Profit After Tax	2,607
Other Comprehensive Income	-
Total Comprehensive Income	2,607

(10 marks)

(b)

**Nido Lanka Ltd.
Statement of Financial Position
As at 31st March 2022**

	(Rs.'000)	
Assets		
Non-Current Assets		
Property Plant and Equipment (W3)	78,000	
Capital Work in Progress (14,000+917)	14,917	92,917
Current Assets		
Inventory	35,000	
Trade Receivables (W4)	26,550	
Pre-Payments - Insurance	9,000	
Cash and Cash Equivalents	26,000	96,550

Total Assets		<u>189,467</u>
Equity		
Stated Capital	120,000	
Revaluation Reserve	5,000	
Retained Earnings	12,607	137,607
Non-Current Liabilities		
Long Term Loan	10,000	10,000
Current Liabilities		
Trade Payables	34,000	
Tax Payable (8,500-750)	7,750	
Accrued Expenses (75+35)	110	41,860
Total Equity and Liabilities		<u>189,467</u>

(09 marks)

(c)

Nido Lanka Ltd.
Statement of Changes in Equity
For the Year Ended 31st March 2022

	(Rs '000)			
	Stated Capital	Revaluation Reserve	Retained Earnings	Total
Balance as at 1/4/2021	120,000	5,000	10,000	135,000
Profit for the Year			2,607	2,440
Balance as at 31/3/2022	120,000	5,000	12,607	137,440

(02 marks)

(d) Workings

W1 - Other Income

Motor Vehicle Disposal Gain	=	2,400
Other Income	=	9,000
Total	=	11,400

W2 - Finance Expenses

Finance Expense (23,000-917)	=	22,083
Interest = $10,000 \times 10\% \times 11/12$	=	917

W3 - Property, Plant and Equipment

Cost/Revaluation	Land	Buildings	Machinery	Motor Vehicles	Total
Opening Balance	50,000	30,000	20,000	10,000	110,000
Additions					
Disposals				(6,000)	(6,000)
Revaluations					
<i>Closing Balance</i>	<i>50,000</i>	<i>30,000</i>	<i>20,000</i>	<i>4,000</i>	<i>104,000</i>
Accumulated Depreciation					
Opening Balance		12,000	8,000	4,000	24,000
Depreciation for the Year		600	3,000	1,400	5,000
Disposals				(3,000)	(3,000)
Revaluations					
<i>Closing Balance</i>	<i>-</i>	<i>12,600</i>	<i>11,000</i>	<i>2,400</i>	<i>26,000</i>
Carrying Value	50,000	17,400	9,000	1,600	78,000

W4- Trade Receivables

Trade Receivables (-500) = 29,500

(-) Provision for Doubtful Debts (+500 - 1,950) = (2,950)

Closing Balance = 26,550

W5-Detail Expenditure Statement

Description	Administration	Distribution
Building Depreciation	600	
Machinery Depreciation	3,000	
Motor Vehicle Depreciation		1,400
Doubtful Debt Expense		1,950
Tax Over Provision		
Electricity Expense	75	
Water Expense	35	
Insurance Prepayment	(9,000)	
Insurance Expense	12,000	
As per Trial Balance	32,000	34,000
Total	38,710	37,350

W6-Depreciation

Asset	Building	Machinery	Motor Vehicle
Cost as per Trial Balance	30,000	20,000	10,000
(-) Accumulated Depreciation of Machinery		(8,000)	
(-) Cost of Disposed Motor Vehicle			(6,000)

Cost/NBV of the assets prevailed throughout Useful Life/Remaining Useful Life	30,000 50	12,000 4	4,000 5
Depreciation for the Assets held throughout Depreciation of the Disposed Motor Vehicle 6,000/5X6/12	600	3,000	800 600
Total Depreciation	600	3,000	1,400

W7-Disposal of Motor Vehicle

Disposal Gain or Loss

Motor Vehicle	6,000	MV Accumulated Depreciation	3,000
Other Income	2,400	Sales	5,400
	<u>8,400</u>		<u>8,400</u>

Accumulated Depreciation of Disposed Motor Vehicle

$$6,000/5 \times 2.5 = 3,000$$

W8- Borrowing Cost Capitalized

$$\text{Interest} = 10,000 \times 10\% \times 11/12 = \underline{917}$$

W9- Provision for Doubtful Debt

$$\text{Trade Receivables } 30,000 - 500 = 29,500$$

$$\text{Provision for Doubtful Debts} = 10\%$$

$$\text{Closing Doubtful Debts Provision} = 2,950$$

$$\text{Opening Doubtful Debts Provision (1,500-500)} = 1,000$$

Provision for doubtful debts

B/B/F	1,000		
P&L	1,950	B/C/D	2,950
	<u>2,950</u>		<u>2,950</u>

W10-Tax Expense

$$\text{Current Year Tax Expense} = 9,750$$

$$\text{Tax Expense as per Trial Balance} = 10,500$$

$$\text{Tax Expense Over Provision} = 750$$

W11-Insurance Pre-payments

$$\text{Insurance Paid} = 12,000$$

$$\text{Prepaid Period} = 9/12$$

$$\text{Insurance Prepayment} = 9,000$$

(04 marks)
(Total 25 marks)

Suggested Answers to Question Nine:

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

(A)

Ratio	Formula	2022
(a) Gross Profit Margin	Gross Profit / Sales × 100	= 253,660/568,900 × 100 = <u>44.59%</u>
(a) Quick Assets Ratio	(Current Assets – Inventory) : Current Liabilities	= (182,400 – 90,000) : 17,250 = <u>5.36 : 1</u>
(b) Inventory Residence Period	365/Cost of Sales × Average Inventory	= 365/315,240 × (90,000+84,500)/2 = <u>101 Days</u>
(c) Debtors Collection Period	365/Credit Sales × Average Debtors	= 365/568,900 × 75% × (121,500+109,500)/2 = <u>99 Days</u>
(d) Earnings Per Share	Profit Attributable to Ordinary Shareholders/Number of Ordinary Shares	= 26,750/7,500 = <u>3.57 per share</u>

(05 marks)

(B)

To : Board of Directors of Lanka Bio PLC
From : Financial Consultant
Subject : Summary Report on Lanka Bio PLC vs Industry averages for the year ended 31 March 2022
Date : 24/2/2023

Profitability

It can be observed that the gross profit margin of both Lanka Bio PLC and the Industry are at an average 44%. This may indicate that all the entities in the industry may maintain the same pricing and same manufacturing cost structure. May be industry has fixed pricing policy with either government intervention or industry decision.

However, the earnings per share shows a decline of Rs.4.5 in Industry vs Rs.3.6 in Lanka Bio PLC. This may be due to higher administration, distribution, finance, and tax expenses at Lanka Bio PLC compared to other entities in industry. Further, this may cause with the difference in number of shares issued in Lanka Bio PLC and other entities in Industry.

Liquidity and Working Capital

The quick asset ratio of Lanka Bio PLC is surprisingly high of 5.3 : 1 compared to 1:1 : 1 in industry. Though, this may be beneficial from liquidity point of view, we can clearly observe

the inventory holding period is 40 days higher and debt collection period is 55 days higher than the industry. This may indicate that company has excessive inventory and debtors. Lanka Bio may be a company engaged in Bio products therefore, having excessive inventory may create inventory expiries, cost of holding inventory, declining value of inventory. At the same time higher debt collection period indicates higher risk of debtor impairment and cash getting tied up in debtors and inventory. Therefore, clear working capital issue can be observed.

(10 marks)
(Total 15 marks)

Suggested Answers to Question Ten:

Chapter 05 part II - Consolidated Financial Statements

Ganga Group Consolidated Statement of Comprehensive Income For the Year Ended 31st March 2022

	(Rs.'000)
Revenue (435,000 + 245,000 - 60,000)	620,000
Cost of Sales (269,700 + 147,000 - 60,000 + 5,000)	(361,700)
Gross Profit	258,300
Other Income	
Rent Income (1,200 + 6,000 - 1,000)	6,200
Dividend Income (600 - 600)	-
Profit on Disposal of Property Plant and Equipment (2,400 + 1,320 - 1,000)	2,720
	267,220
Expense	
Distribution Expenses (27,500 + 16,000)	(43,500)
Administration Expenses (56,000 + 36,500 + 1,000 - 200)	(91,300)
Other Expenses (- Impairment of Goodwill)	(2,000)
Finance Expenses (11,500 + 16,500)	(28,000)
Profit Before Tax	102,420
Income Tax (12,500 + 8,400)	(20,900)
Profit After Tax	81,520
Other Comprehensive Income (1,200 - 1,300)	(100)
Total Comprehensive Income	81,420

Working

$$\text{Unrealized Profit} = \frac{30,000}{120} \times 20 = 5,000$$

(10 marks)
(Total 10 marks)

End of Section C



Notice:

These answers compiled 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.



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