



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JANUARY 2017

(AA31) FINANCIAL ACCOUNTING AND REPORTING

• **Instructions to candidates** (Please Read Carefully):

- (1) **Time Allowed:** Reading : 15 minutes  
Writing : 03 hours.

21-01-2017  
Morning  
[8.45 – 12.00]

No. of Pages : 10  
No. of Questions : 09

- (2) **All questions should be answered.**  
 (3) **Answers should be in one language, in the medium applied for, in the booklets provided.**  
 (4) **Submit all workings and calculations. State clearly assumptions made by you, if any.**  
 (5) **Use of Non-programmable calculators is only permitted.**  
 (6) **Action Verb Check List with definitions is attached. Each question will begin with an action verb. Candidates should answer the questions based on the definition of the verb given in the Action Verb Check List.**  
 (7) **100 Marks.**

**SECTION A**

Four (04) compulsory questions

(Total 20 marks)

**Question 01**

“The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.”

- (a) **Define** an asset as per the Conceptual Framework for Financial Reporting. (02 marks)  
 (b) **State** three(03) key areas covered in the scope of Conceptual Framework for Preparation and Presentation of Financial Statements. (03 marks)  
 (Total 05 marks)

**Question 02**

“An entity shall prepare a statement of cash flows in accordance with the requirements of Sri Lanka Accounting Standard – LKAS 7 and shall present it as an integral part of the financial statements of the entity.”

- (a) **State** three(03) benefits of cash flow statement for an entity in making business decisions. (03 marks)  
 (b) **State** two(02) items that could be considered as cash and cash equivalents as per the LKAS 07:- Statement of Cash Flows. (02 marks)  
 (Total 05 marks)

### Question 03

**Sadharitha (Private) Limited (SPL)** is engaged in the business of manufacturing and exporting of garments. **Perera**, the Managing Director of **SPL** is planning to conduct a market research for the development of a new waterproof and stainless Nano Technology T-shirt for the overseas market. He has inquired the Accountant on the following matters for the detailed analysis:

- (1) It is required to recruit special skilled employees on permanent basis for the development of the product and remuneration of Rs.500,000/- per month have to be paid to such employees.
- (2) A software for a cost of Rs.2.5 million to be installed before starting the commercial production of T-shirts.
- (3) **SPL** needs to apply for the one-off export license once the commercial production is completed for a cost of Rs.1 million.

**Identify** whether each of the above items could be recognized as intangible assets or not with reasons. (05 marks)

### Question 04

**Auto Care (Pvt) Ltd.** has a raw material stock of 16,000 units as at 01<sup>st</sup> April 2016 according to the stock verification carried out on such date. The stores clerk had identified the cost per unit as Rs.16/-. The company values its inventory under the Weighted Average Cost (WAC) method.

The following information has been extracted from the stores for the quarter ended 30<sup>th</sup> June 2016:

Purchases during the quarter were as follows:

Date	No. of Units	Per Unit Cost (Rs.)
20.04.2016	10,000	17
15.05.2016	37,000	15
10.06.2016	41,000	18

Stocks issued to production floor during the quarter were as follows:

Date	No. of Units
10.04.2016	5,000
25.05.2016	30,000
29.06.2016	8,000

**You are required to:**

**Compute** the cost of the raw material stock as at 30<sup>th</sup> June 2016 under the WAC method. (05 marks)

End of Section A

## **SECTION B**

Three (03) compulsory questions

(Total 30 marks)

### Question 05

Statements of Financial Position of **Spiritual Trading PLC** as at 31<sup>st</sup> March 2016 and 31<sup>st</sup> March 2015 are as follows:

**Spiritual Trading PLC**  
**Statements of Financial Position** (Rs. '000)

	As at 31 <sup>st</sup> March 2016	As at 31 <sup>st</sup> March 2015
<b>Assets</b>		
<b>Non-Current Assets:</b>		
Property, Plant and Equipment	5,500	5,200
(-) Accumulated Depreciation	(1,200)	(950)
Carrying Value	4,300	4,250
Investments	120	120
	4,420	4,370
<b>Current Assets:</b>		
Inventories	5,800	2,400
Trade and Other Receivables	6,900	7,420
Cash and Cash Equivalents	400	350
	<b>13,100</b>	<b>10,170</b>
<b>Total Assets</b>	<b>17,520</b>	<b>14,540</b>
<b>Equity and Liabilities</b>		
<b>Equity:</b>		
Stated Capital	3,000	3,000
Retained Earnings	9,600	8,200
<b>Total Equity</b>	<b>12,600</b>	<b>11,200</b>
<b>Non-Current Liabilities:</b>		
Provision for Gratuity	1,650	1,200
Long Term Loans	500	700
	2,150	1,900
<b>Current Liabilities:</b>		
Short Term Loans	100	500
Trade Payables	1,850	520
Interest Payables	250	120
Income Tax Payable	570	300
	<b>2,770</b>	<b>1,440</b>
<b>Total Equity and Liabilities</b>	<b>17,520</b>	<b>14,540</b>

The following additional information is also provided:

- (1) Total income tax expense for the year ended 31<sup>st</sup> March 2016 was Rs.450,000/-.
- (2) A fixed asset with a cost of Rs.300,000/- was sold for Rs.200,000/- on 01<sup>st</sup> April 2015. As at the date of disposal the accumulated depreciation of such asset was Rs.50,000/-.
- (3) Total interest expense for the year ended 31<sup>st</sup> March 2016 was Rs.200,000/-.
- (4) There were no gratuity payments made during the year.
- (5) There was no other comprehensive income for the year ended 31<sup>st</sup> March 2016 and no dividends were paid or declared during the year.

**You are required to:**

**Prepare** the Net Cash Flows from Operating Activities of **Spiritual Trading PLC** for the year ended 31<sup>st</sup> March 2016 using indirect method. (10 marks)

### Question 06

Balances extracted from the Statements of Comprehensive Income for the year ended 31<sup>st</sup> March 2016 and 31<sup>st</sup> March 2015 and balances extracted from the Statements of Financial Position as at 31<sup>st</sup> March 2016 and 31<sup>st</sup> March 2015 of **Superior Manufacturing (Pvt) Ltd.** are given below:

<b>For the year ended</b>	<b>31<sup>st</sup> March 2016 (Rs.'000)</b>	<b>31<sup>st</sup> March 2015 (Rs.'000)</b>
Turnover	14,500	12,200
Cost of Sales	10,400	9,150
Interest Expense	240	220
Income Tax Expense	250	175
Profit After Tax	2,450	1,750
Other Comprehensive Income	50	150
Total Comprehensive Income for the year	2,500	1,900

	<b>as at 31<sup>st</sup> March 2016 (Rs.'000)</b>	<b>as at 31<sup>st</sup> March 2015 (Rs.'000)</b>
Current Assets (excluding inventory and pre-payments)	4,100	4,850
Current Liabilities	2,900	2,720
Inventory	2,000	2,100
Pre-payments	450	300
Equity	6,700	5,200
Debentures	2,000	2,000

No. of Weighted Average Ordinary Shares ('000)	1,500	1,500
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**You are required to:**

**Compute** the following ratios based on the above information for the financial year ended / as at 31<sup>st</sup> March 2016:

- (a) Gross Profit Ratio.
- (b) Quick Assets Ratio.
- (c) Current Ratio.
- (d) Stock Residence period.
- (e) Earnings Per Share.
- (f) Return On Capital Employed (ROCE). (10 marks)

**Question 07**

- (a) **SPL Ltd. (SPL)** has entered into a finance lease agreement with a leasing company on 01<sup>st</sup> April 2015 to purchase a vehicle for a value of Rs. 8.5 million. Leasing company has agreed to finance 60% of the value of the vehicle (Rs.5,100,000/-). The initial deposit of Rs.536,000/- was paid to the leasing company on 01<sup>st</sup> April 2015.

The terms of the lease agreement are as follows:

Lease term	5 years
Interest Rate	16% per annum
Annual Lease rental	Rs.1,376,880/-
Lease rental due date	Last date of each year

The useful lifetime of the vehicle is 8 years and the company uses the straight line basis to depreciate the vehicles.

**You are required to:**

**Prepare** the extracts of the Statement of Financial Position as at 31<sup>st</sup> March 2016 and the Statement of Comprehensive Income for the year ended 31<sup>st</sup> March 2016 in respect of the above lease transactions.

*(Note: Assume that lease rentals were paid on due dates.)* (06 marks)

- (b) The following information have been given in relation to **Haritha Lanka Ltd.:**

The company has reviewed the useful lives of its depreciable assets on 01<sup>st</sup> April 2015. According to the review, it was decided to change the useful lives of the assets from 01<sup>st</sup> April 2015.

**You are required to:**

**Explain** the accounting treatment for the above instance according to LKAS 08 - Accounting Policies, Changes in Accounting Estimates and Errors. (04 marks)

(Total 10 marks)

End of Section B

## SECTION C

Two (02) compulsory questions.

(Total 50 marks)

### Question 08

The following Trial Balance as at 31<sup>st</sup> March 2016 was extracted from the books of **Suhada Holdings PLC**:

<b>Suhada Holdings PLC</b>		<i>(Rs.'000)</i>	
<b>Trial Balance as at 31<sup>st</sup> March 2016</b>		<b>Dr.</b>	<b>Cr.</b>
<b>Property, Plant and Equipment - at cost / revaluation:</b>			
Freehold Land and Building (Land value - Rs.5,000,000/-)	20,000		
Building – Work-in-progress	3,000		
Furniture and Fittings	4,400		
Motor Vehicles	7,500		
<b>Accumulated Depreciation – as at 01<sup>st</sup> April 2015:</b>			
Building			2,600
Furniture and Fittings			2,550
Motor Vehicles			3,500
Inventory	15,040		
Trade Receivables / Trade Payables	6,850	5,400	
Pre-payments	680		
Short-Term investments	360		
Cash at Bank	390		
Cash in hand	20		
Loans obtained from <b>ABI Bank</b>			10,000
Term Loan at 12%			5,000
Interest Payable			960
Sales			77,200
Cost of Sales	52,748		
Administration Expenses	4,150		
Distribution Expenses	5,400		
Other Income			2,740
Directors' fees	1,000		
Audit fees	500		
Interest Expenses	960		
Income Tax Over provision in previous year			150
Stated Capital (600,000 ordinary shares)			6,000
Retained Earnings as at 01 <sup>st</sup> April 2015			7,898
Interim Dividend Paid	1,000		
	<b>123,998</b>	<b>123,998</b>	

The following additional information is also provided:

- (1) On 31<sup>st</sup> March 2016, the company has revalued its land and the value of the land has been increased by Rs.1,500,000/-. This has been correctly recorded in the asset account and has been credited to other income account.

- (2) The company has disposed a motor vehicle on 31<sup>st</sup> December 2015 which was purchased on 01<sup>st</sup> January 2014 for a cost of Rs.3.5 million. The money received from disposal amounting to Rs. 2 million has been debited to cash book and credited to Trade Payables account. Other than that no entries were made in respect of the disposal of this motor vehicle.
- (3) Depreciation is calculated on the straight-line basis at cost or revalued amount. The useful life of Property, Plant and Equipment is as follows:

Building	:	20 years
Furniture & Fittings	:	5 years
Motor Vehicles	:	5 years

- (4) The company had following loans outstanding as at 01<sup>st</sup> April 2015 obtained from **ABI Bank** to construct a new building:

	Repayable on	Rs.
Loan 1 - @ 10%	31 <sup>st</sup> December 2016	8,000,000
Loan 2 - @ 8%	31 <sup>st</sup> March 2017	2,000,000

The effective interest rates of loans were equal to the coupon interest rate. No capital repayment was made for the above two loans during the year and interest on those loans for the year has been accrued in the books of accounts.

The company has started to construct the new building on 01<sup>st</sup> January 2016 and it is expected to complete the construction activities by 31<sup>st</sup> December 2017. As at 31<sup>st</sup> March 2016, the company has spent Rs.3,000,000/- on construction activities as follows and it is recorded in the Building work-in-progress Account:

	Rs.
01 <sup>st</sup> January 2016	1,700,000
01 <sup>st</sup> March 2016	1,300,000
	<b>3,000,000</b>

- (5) Pre-payment account consists of the annual membership fee paid for the trade association for the calendar year 2016.
- (6) During the month of April 2016, it was confirmed that, one of the customers who owed a balance of Rs.500,000/- to the company had gone missing and it is doubtful to recover the due amount from him.
- (7) The company obtained the term loan of Rs. 5 million on 01<sup>st</sup> March 2016 for the expansion of the business. This should be repaid in sixty (60) equal monthly installments with interest starting from 01<sup>st</sup> April 2016.
- (8) As at 31<sup>st</sup> March 2016, the following expenses have not been accrued in the books of accounts:
- Electricity bill for the month of March 2016 - Rs.68,000/-.
  - Telephone bills for the month of March and February 2016 - Rs.24,000/-.
- (9) Income tax for the year of assessment 2015/16 was estimated at Rs.480,000/-.
- (10) The Board of Directors of the company has decided to pay a final dividend of Rs.2.50 per share for the ordinary shares held on 31<sup>st</sup> March 2016, at the board meeting held on 15<sup>th</sup> May 2016.
- (11) The financial statements were authorized for issue by the Board of Directors on 10<sup>th</sup> June 2016.

**You are required to:**

**Prepare** the following, in a form suitable for publication for **Suhada Holdings PLC:**

- (a) Statement of Comprehensive Income for the year ended 31<sup>st</sup> March 2016. (10 marks)
- (b) Statement of Financial Position as at 31<sup>st</sup> March 2016. (08 marks)
- (c) Statement of Changes in Equity for the year ended 31<sup>st</sup> March 2016. (03 marks)
- (d) Statement showing movements of Property, Plant and Equipment for the year ended 31<sup>st</sup> March 2016. (04 marks)
- (Total 25 marks)

### Question 09

- (a) **KDL Ltd. (KDL)** acquired 60% of the Ordinary Share Capital of **Saubhagya Trading Ltd. (STL)** on 01<sup>st</sup> April 2015 for an investment of Rs.100 million. On that day, the fair value of identifiable net asset of **STL** was equal to its book value.

The statements of financial position of **KDL** and **STL** as at 31<sup>st</sup> March 2016 are given below:

#### Statements of Financial Position

as at 31<sup>st</sup> March 2016

(Rs. '000)

	KDL	STL
<b><u>Assets</u></b>		
<b>Non-Current Assets:</b>		
Property, Plant and Equipment	95,000	19,500
Investment in <b>STL</b>	100,000	-
<b>Current Assets:</b>		
Inventories	10,000	10,000
Trade Receivables	210,000	212,000
Short Term Investments	35,000	-
Cash and Cash Equivalents	5,700	1,450
	<b>260,700</b>	<b>223,450</b>
<b>Total Assets</b>	<b>455,700</b>	<b>242,950</b>
<b><u>Equity and Liabilities</u></b>		
<b>Equity:</b>		
Stated Capital – Ordinary Shares	200,000	100,000
General Reserve	20,000	7,500
Retained Earnings	123,700	61,450
<b>Total Equity</b>	<b>343,700</b>	<b>168,950</b>
<b>Current Liabilities:</b>		
Trade Payables	112,000	74,000
	<b>112,000</b>	<b>74,000</b>
<b>Total Equity and Liabilities</b>	<b>455,700</b>	<b>242,950</b>

The following additional information is also provided:

- (1) As at 31<sup>st</sup> March 2016, inventories of **STL** includes an inventory with a value of Rs.5,000,000/- which was purchased from **KDL** with a profit margin of 25% on cost.
- (2) Fair value of the non-controlling interest as at the date of acquisition was Rs.50,000,000/-.
- (3) The following ledger balances were appeared in the books of **STL** as at 01<sup>st</sup> April 2015:

	<b>Rs.</b>
General Reserve	5,000,000
Retained Earnings	40,000,000

- (4) Trade Receivable of **KDL** includes an amount of Rs.2,000,000/- receivable from **STL**. As per **STL** records, Rs.1,500,000/- has been paid to **KDL** but the cheque has not been received by **KDL** as at 31<sup>st</sup> March 2016.
- (5) On 01<sup>st</sup> April 2015, **STL** sold an item of fixed asset to **KDL** for Rs.200,000/-. The carrying value of that item at the date of disposal was Rs.120,000/-. Remaining life time of the said asset at the date of disposal was 4 years. However, this has not been recorded in the books of accounts of both the companies.

**You are required to:**

- (i) **Compute** the goodwill arising from the consolidation.  
  
(ii) **Prepare** the Consolidated Statement of Financial Position as at 31<sup>st</sup> March 2016.  
(21 marks)
- (b) **Explain** two(02) actions that could be taken by the Accounting and Auditing Standards Monitoring Board in exercising its investigation powers in relation to Specified Business Enterprises.  
(04 marks)  
(Total 25 marks)

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*End of Section C*

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## ACTION VERB CHECK LIST

Knowledge Process	Verb List	Verb Definitions
<b>Level 01 Comprehension</b>  Recall & explain important information	<b>Define</b>	Describe exactly the nature, scope, or meaning.
	<b>Draw</b>	Produce (a picture or diagram).
	<b>Identify</b>	Recognize, establish or select after consideration.
	<b>List</b>	Write the connected items one below the other.
	<b>Relate</b>	To establish logical or causal connections.
	<b>State</b>	Express something definitely or clearly.
	<b>Calculate/Compute</b>	Make a mathematical computation
	<b>Discuss</b>	Examine in detail by argument showing different aspects, for the purpose of arriving at a conclusion.
	<b>Explain</b>	Make a clear description in detail revealing relevant facts.
	<b>Interpret</b>	Present in an understandable terms.
	<b>Recognize</b>	To show validity or otherwise, using knowledge or contextual experience.
	<b>Record</b>	Enter relevant entries in detail.
<b>Summarize</b>	Give a brief statement of the main points (in facts or figures).	

Knowledge Process	Verb List	Verb Definitions
<b>Level 02 Application</b>  Use knowledge in a setting other than the one in which it was learned / Solve closed-ended problems	<b>Apply</b>	Put to practical use.
	<b>Assess</b>	Determine the value, nature, ability, or quality.
	<b>Demonstrate</b>	Prove, especially with examples.
	<b>Graph</b>	Represent by means of a graph.
	<b>Prepare</b>	Make ready for a particular purpose.
	<b>Prioritize</b>	Arrange or do in order of importance.
	<b>Reconcile</b>	Make consistent with another.
	<b>Solve</b>	To find a solution through calculations and/or explanation.

Knowledge Process	Verb List	Verb Definitions
<b>Level 03 Analysis</b>  Draw relations among ideas and compare and contrast / Solve open-ended problems.	<b>Analyze</b>	Examine in detail in order to determine the solution or outcome.
	<b>Compare</b>	Examine for the purpose of discovering similarities.
	<b>Contrast</b>	Examine in order to show unlikeness or differences.
	<b>Differentiate</b>	Constitute a difference that distinguishes something.
	<b>Outline</b>	Make a summary of significant features.