



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JULY 2017

(AA31) FINANCIAL ACCOUNTING AND REPORTING

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

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

15-07-2017  
Morning  
[8.45 – 12.00]

No. of Pages : 09  
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.**

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**SECTION A**

Four (04) compulsory questions

(Total 20 marks)

**Question 01**

The conceptual framework for financial reporting deals with the objectives of financial statements, qualitative characteristics that determine the usefulness of information in financial statements, definition, recognition and measurement of the elements from which financial statements are constructed and concepts of capital and maintenance of capital.

- (a) **State** two(02) qualitative characteristics that enhance the usefulness of information. (02 marks)
- (b) **State** the recognition criteria for income. (03 marks)
- (Total 05 marks)

**Question 02**

- (a) **State** three(03) legislations / Acts relevant to companies in Sri Lanka. (03 marks)
- (b) **State** two(02) objectives for setting up of the Securities and Exchange Commission of Sri Lanka. (02 marks)
- (Total 05 marks)

### Question 03

- (a) **Define** the term “Qualifying Asset” as per LKAS 23 – Borrowing cost. (02 marks)
- (b) **State** three(03) conditions to be satisfied for recognition of the revenue from the sale of goods according to LKAS 18 - Revenue. (03 marks)
- (Total 05 marks)

### Question 04

The statement of cash flows shall report cash flows during the period classified by operating activities, investing activities and financing activities.

- (a) **State** three(03) examples of cash flows arising from investing activities. (03 marks)
- (b) **State** two(02) non-cash transactions which are excluded from the statement of cash flows. (02 marks)
- (Total 05 marks)

End of Section A

### **SECTION B**

Three (03) compulsory questions

(Total 30 marks)

### Question 05

- (a) The financial statements for the year ended 31<sup>st</sup> March 2017 of **ABC Company Ltd.** were authorized for issue by the Board of Directors on 15<sup>th</sup> May 2017.

The following information is relevant to **ABC Company Ltd.:**

- (1) The company has recognized certain Inventory at cost of Rs.750,000/- as at 31<sup>st</sup> March 2017. This inventory was sold on 20<sup>th</sup> April 2017 for Rs.700,000/-.
- (2) On 30<sup>th</sup> April 2017, a major production plant of the company has been destroyed by a fire. The damage was estimated to be Rs.5.5 million.

**You are required to:**

**State** with reasons as to how you are going to account for the above events in accordance with LKAS 10 – Events after the reporting period. (04 marks)

- (b) **KYC Company Ltd.** (lessor) sells a machinery to a customer (lessee) under the finance lease agreement for 5 years lease term on 01<sup>st</sup> April 2016. The cash selling price of the machinery was Rs.3 million and cost of the machinery was Rs.2.4 million.

The interest rate applicable to the lease facility was 18% per annum and the value of the annual lease installment was Rs.959,325/-. First lease installment was paid by the lessee on 31<sup>st</sup> March 2017.

**You are required to:**

**Prepare** the extracts of the statement of financial position as at 31<sup>st</sup> March 2017 and the statement of comprehensive income for the year ended 31<sup>st</sup> March 2017 of the lessor in respect of the above lease transactions. (06 marks)

(Total 10 marks)

**Question 06**

The statements of Financial Position of **Divine Holdings Ltd.** as at 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2016 are as follows:

**Divine Holdings Ltd.**  
**Statements of Financial Position** (Rs. '000)

	As at 31 <sup>st</sup> March 2017	As at 31 <sup>st</sup> March 2016
<b><u>Assets</u></b>		
<b>Non-Current Assets:</b>		
Property, Plant and Equipment (at cost)	11,000	10,100
Accumulated Depreciation	(2,400)	(1,950)
Carrying Value	<b>8,600</b>	<b>8,150</b>
<b>Current Assets:</b>		
Inventories	9,070	8,400
Trade and Other Receivables	8,200	6,900
Cash and Cash Equivalentents	470	600
	<b>17,740</b>	<b>15,900</b>
<b>Total Assets</b>	<b>26,340</b>	<b>24,050</b>
<b><u>Equity and Liabilities</u></b>		
<b>Equity:</b>		
Stated Capital	6,000	6,000
Retained Earnings	16,610	13,910
<b>Total Equity</b>	<b>22,610</b>	<b>19,910</b>
<b>Non-Current Liabilities:</b>		
Employee Benefits (provision for Gratuity)	1,300	1,200
Long-Term Loans	-	1,100
	<b>1,300</b>	<b>2,300</b>
<b>Current Liabilities:</b>		
Short Term Loans	200	300
Trade Payables	1,370	800
Interest Payables on loans	260	240
Income Tax Payable	600	500
	<b>2,430</b>	<b>1,840</b>
<b>Total Equity and Liabilities</b>	<b>26,340</b>	<b>24,050</b>

The following additional information is also provided:

- (1) Income tax expense for the year ended 31<sup>st</sup> March 2017 was Rs.300,000/-.
- (2) Total interest expense for the year ended 31<sup>st</sup> March 2017 was Rs.250,000/-.
- (3) Rs.250,000/- has been paid as gratuity during the year.
- (4) There was no other comprehensive income for the year ended 31<sup>st</sup> March 2017, and no dividends were paid or declared during the year.
- (5) There were no disposal of Property, Plant and Equipment during the year.

**You are required to:**

**Prepare** the Cash Flow statement of **Divine Holdings Ltd.** for the year ended 31<sup>st</sup> March 2017 using indirect method. (10 marks)

### Question 07

You are the newly recruited Accountant of **PG Holdings (Pvt) Ltd.** You have been asked by the Managing Director of the company to submit a report on the following matters comparing the previous year:

- Liquidity of the company.
- Profitability of the company.
- Efficiency of the working capital management.

You have computed the following ratios for the years ended 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2016 to include when preparing the report:

Ratio	2017	2016
Current Ratio	1.2 times	2 times
Quick Assets Ratio	0.25 times	1.2 times
Gross Profit Ratio	23%	35%
Net Profit Ratio	15%	20%
Debt collection period	45 days	30 days
Creditors' settlement period	20 days	15 days

**You are required to:**

**Prepare** a report to be submitted to the Managing Director of the company commenting on the liquidity, profitability and efficiency of the working capital management of the company using the above computed ratios. (10 marks)

\_\_\_\_\_ *End of Section B* \_\_\_\_\_

## SECTION C

Two (02) compulsory questions.

(Total 50 marks)

### Question 08

The Trial Balance of **Royal PLC** as at 31<sup>st</sup> March 2017 is given below:

<b>Royal PLC</b>		<i>(Rs.'000)</i>	
<b>Trial Balance as at 31<sup>st</sup> March 2017</b>		<b>Dr.</b>	<b>Cr.</b>
Stated Capital - 2,000,000 Ordinary Shares			20,000
Retained Earnings as at 01 <sup>st</sup> April 2016			3,880
<b>Property, Plant and Equipment - at cost:</b>			
Land and Building (Land value – Rs.7,500,000/-)	12,500		
Motor Vehicles	18,000		
Office Equipment	6,000		
Furniture and Fittings	2,400		
<b>Accumulated Depreciation - as at 01<sup>st</sup> April 2016:</b>			
Building			1,920
Motor Vehicles			3,600
Office Equipment			1,200
Furniture and Fittings			1,440
Inventory as at 31 <sup>st</sup> March 2017 (at cost)	1,500		
12.5% Bank Loan			5,000
Trade Receivables / Trade Payables	11,700	8,210	
Allowance for Trade Receivables as at 01 <sup>st</sup> April 2016			600
Tax Payable for the year of assessment 2015/16			1,400
Cash at bank	400		
Cash in hand	140		
Cost of Sales / Sales	52,000	78,200	
Other Income			800
Interim Dividend Paid	1,600		
Administration Expenses	6,800		
Distribution Expenses	8,750		
Finance Expenses	2,460		
Income Tax Paid	2,000		
	<b>126,250</b>	<b>126,250</b>	

The following additional information is also provided:

- (1) On 30<sup>th</sup> September 2016, the company has sold a Lorry for Rs.800,000/-. This lorry had been purchased on 01<sup>st</sup> April 2013 at cost of Rs.1,400,000/-. The sale proceeds of Rs.800,000/- has been credited to Other Income Account. Other than that no entries were made in respect of the disposal of this Lorry.

- (2) During the year, the company has purchased the following assets:

Date	Asset	Value (Rs.)
01.12.2016	Book Racks	600,000
01.03.2017	Heavy Duty Printer	900,000

- (3) Depreciation is calculated on the straight line basis at cost. The useful life of Property, Plant and Equipment is as follows:

Building	:	25 years
Motor Vehicles	:	5 years
Office Equipment	:	5 years
Furniture & Fittings	:	10 years

- (4) During the year, the company has recovered Rs.100,000/- from a debtor who had been written-off as a bad debt in the previous year and this amount was credited to trade receivable account. Further at the end of the year, an additional doubtful debt provision of Rs.280,000/- has to be made.

- (5) As at 31<sup>st</sup> March 2017, the following expenses have not been accrued in the books of accounts:

	Rs.
Fuel charges	685,000
Electricity and water	68,000

- (6) Loan installment of Rs.100,000/- for the month of March 2017 was in arrears as at 31<sup>st</sup> March 2017. The interest portion included in the loan installment was Rs.60,000/-.  $\frac{1}{4}$ <sup>th</sup> of the loan outstanding balance as at 31<sup>st</sup> March 2017 is repayable in the following year.
- (7) On 30<sup>th</sup> March 2017, a supplier of the company has filed a case against the company for the breach of terms of a contract with him. The court ordered to pay Rs.150,000/- as a compensation to the supplier on 31<sup>st</sup> May 2017.
- (8) The Income Tax Liability of the company for the year of assessment 2016/17 is estimated to be Rs.900,000/-.
- (9) The closing stock was valued at Rs.1,450,000/- at net realizable value.
- (10) At the Board Meeting held on 20<sup>th</sup> May 2017, the Board of Directors of the company have decided to pay a final dividend of Rs.1.50 per share for the ordinary shares held on 31<sup>st</sup> March 2017.
- (11) The financial statements were authorized for issue by the Board of Directors on 05<sup>th</sup> June 2017.

**You are required to:**

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

- (a) Statement of Comprehensive Income for the year ended 31<sup>st</sup> March 2017. (11 marks)
- (b) Statement of Financial Position as at 31<sup>st</sup> March 2017. (06 marks)
- (c) Statement of Changes in Equity for the year ended 31<sup>st</sup> March 2017. (03 marks)
- (d) Statement showing movements of Property, Plant and Equipment for the year ended 31<sup>st</sup> March 2017. (05 marks)

(Total 25 marks)

## Question 09

- (a) The following statements of financial position were extracted from the books of **Mega Supplies (Pvt) Ltd. (MSL)** and **Smart Technologies (Pvt) Ltd. (STL)** as at 31<sup>st</sup> March 2017:

### Statements of Financial Position

as at 31<sup>st</sup> March 2017

(Rs.'000)

	Mega Supplies (Pvt) Ltd. (MSL)	Smart Technologies (Pvt) Ltd. (STL)
<b>Assets</b>		
<b>Non-Current Assets:</b>		
Property, Plant and Equipment – at cost	50,000	21,500
Accumulated Depreciation	(15,000)	(7,500)
Carrying Value	35,000	14,000
Investment in STL	20,000	-
	<b>55,000</b>	<b>14,000</b>
<b>Current Assets:</b>		
Inventories	12,100	10,900
Trade Receivables	36,400	9,600
	<b>48,500</b>	<b>20,500</b>
<b>Total Assets</b>	<b>103,500</b>	<b>34,500</b>
<b>Equity and Liabilities</b>		
<b>Equity:</b>		
Stated Capital	40,000	15,000
Retained Earnings	22,500	14,600
<b>Total Equity</b>	<b>62,500</b>	<b>29,600</b>
<b>Non-Current Liabilities:</b>		
Bank Loans	20,400	-
<b>Current Liabilities:</b>		
Trade and Other Payables	5,500	2,500
Bank Overdrafts	15,100	2,400
	<b>20,600</b>	<b>4,900</b>
<b>Total Equity and Liabilities</b>	<b>103,500</b>	<b>34,500</b>

The following additional information is also provided:

- (1) On 01<sup>st</sup> April 2016, **MSL** acquired 80% of the ordinary share capital of **STL**.
- (2) The fair value of the Property, Plant and Equipment of **STL** on the date of acquisition was Rs.19 million.
- (3) On the date of acquisition, the fair value of the non-controlling interest was Rs.9 million and retained earnings that appeared in the books of **STL** were Rs.10 million.
- (4) Both companies depreciate Property, Plant and Equipment at the rate of 20% per annum on the straight-line basis.
- (5) During the month of March 2017, **MSL** sold a stock worth Rs.500,000/- at a profit margin on cost of 20% to **STL** out of which 25% of the stocks remained unsold as at 31<sup>st</sup> March 2017.
- (6) Trade Receivables of **MSL** include Rs.200,000/- which is due from **STL** for transactions made during the year.

Using the above information,

**You are required to:**

- (i) **Compute** the Goodwill arising from the consolidation. (05 marks)
  - (ii) **Compute** the non-controlling interest as at 31<sup>st</sup> March 2017. (03 marks)
  - (iii) **Prepare** the consolidated statement of financial position as at 31<sup>st</sup> March 2017. (11 marks)
- (b) Three important financial ratios calculated for **ABC Company Ltd.** for the year ended 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2016 are given below:

	2017	2016
(1) Gearing Ratio	65%	40%
(2) Return On Capital Employed (ROCE)	9%	6%
(3) Stock turnover ratio	15 times	10 times

**You are required to:**

**State** two(02) possible reasons for the increase in each of the above ratios in 2017 when compared with the previous year. (06 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.