

## ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

## AA3 EXAMINATION - JANUARY 2018

## (AA31) FINANCIAL ACCOUNTING AND REPORTING

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

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

20-01-2018  
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 fundamental qualitative characteristics of useful financial information are relevance and faithful representation.

**Explain** “Relevance” and “Faithful Representation” of financial information. (05 marks)

**Question 02**

The following balances as at 31<sup>st</sup> March 2017 were extracted from the Statement of Financial Position of ABC Ltd.:

	As at 31 <sup>st</sup> March 2017 (Rs.)
Assets:	
Plant and Machinery at Cost	5,000,000
Accumulated Depreciation on Plant and Machinery	(2,500,000)
<b>Carrying value of Plant and Machinery</b>	<b>2,500,000</b>

Cumulative depreciation on Plant and Machinery for tax purposes as at 31<sup>st</sup> March 2017 was Rs.3,000,000/-. There was no balance in deferred tax asset / liability account as at 01<sup>st</sup> April 2016.

**You are required to:**

- (a) **Identify** temporary differences of ABC Ltd. as at 31<sup>st</sup> March 2017. (02 marks)
- (b) **Calculate** the deferred tax liability of ABC Ltd. as at 31<sup>st</sup> March 2017. (03 marks)
- (Assume corporate income tax rate applicable to ABC Ltd. as 28%) (Total 05 marks)

### Question 03

Integrated Reporting is influencing the way organizations think, plan and report the activities of their businesses. An integrated report includes eight components that are fundamentally linked to each other and are not mutually exclusive.

**You are required to:**

(a) **State** an objective of Integrated Reporting. (02 marks)

(b) **State** three(03) key components of an Integrated Report. (03 marks)

(Total 05 marks)

### Question 04

The following balances were extracted from the Statement of Comprehensive Income for the year ended 31<sup>st</sup> March 2017 and the Statements of Financial Position as at 31<sup>st</sup> March 2017 of **Lison Auto (Pvt) Ltd.:**

For the year ended	31 <sup>st</sup> March 2017 (Rs.'000)
Profit on disposal of machinery	500
Depreciation for the year on machinery	1,250

	As at 31 <sup>st</sup> March 2017 (Rs.'000)	As at 31 <sup>st</sup> March 2016 (Rs.'000)
Cost of machinery	3,000	2,500
Accumulated depreciation of machinery	(2,000)	(1,500)

Cost of disposed machinery during the year ended 31<sup>st</sup> March 2017 was Rs.1,000,000/-. Depreciation for the current year includes the depreciation of disposed machinery up to date of disposal. New machinery has been purchased on 31<sup>st</sup> March 2017 and no depreciation has been provided on that machinery for the year ended 31<sup>st</sup> March 2017.

**You are required to:**

**Prepare** the Net Cash Flows generated from investing activities for the year ended 31<sup>st</sup> March 2017 showing separately cash received from the disposal of old machinery and cash paid to purchase of new machinery. (05 marks)

End of Section A

## **SECTION B**

Three (03) compulsory questions

(Total 30 marks)

### **Question 05**

- (a) **Chemichem PLC**, a manufacturing company has developed a new product during the year ended 31<sup>st</sup> March 2017. A research was done for the new product and the company has incurred Rs.3 million for the research during the year. The company registered the patent right for the new product in March 2017 and started commercial production in April 2017. Other costs incurred for the new product during the year 2016/17 were as follows:

	<b>Rs.</b>
Registration fee to register the new product (patent right)	25,000
Cost incurred to train the staff	300,000
Cost of sales promotions	50,000
Professional fees incurred to generate the new product	250,000

**You are required to:**

**Assess** the amount to be charged as expenditure for the year ended 31<sup>st</sup> March 2017 and the amount to be capitalized as an intangible asset in the Financial Statements of **Chemichem PLC**.

(06 marks)

- (b) **ABC Company** has obtained a bank loan of Rs.20 million on 01<sup>st</sup> April 2016 at the interest rate of 15% per annum to construct a Manufacturing Plant. The construction of the manufacturing plant has been started on 01<sup>st</sup> May 2016 and completed on 31<sup>st</sup> March 2017.

The un-used amount of the bank loan was temporarily invested and earned an interest income of Rs.300,000/- during the year ended 31<sup>st</sup> March 2017.

**You are required to:**

**Compute** the borrowing cost that could be capitalized on the new manufacturing plant as at 31<sup>st</sup> March 2017.

(04 marks)

(Total 10 marks)

## Question 06

Extracts of the Statements of Comprehensive Income for the years ended 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2016 and the extracts of the Statements of Financial Position as at 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2016 of **Diyasen Manufacturing PLC (DM)** are as follows:

### Extracts of Statements of Comprehensive Income (Rs.'000)

For the year ended	31 <sup>st</sup> March 2017	31 <sup>st</sup> March 2016
Sales	28,750	27,050
Cost of sales	20,400	18,750
Gross Profit	8,350	8,300
Interest expense	540	220
Income Tax	1,240	1,070
Profit for the year	5,220	6,085

### Extracts of Statements of Financial Position (Rs.'000)

as at	31 <sup>st</sup> March 2017	31 <sup>st</sup> March 2016
Current assets	10,470	8,260
Current liabilities	3,200	3,875
Trade receivables	3,460	2,220
Inventory	5,240	4,920
Shareholders' equity	22,030	15,410
Debentures	3,500	2,000

Assume that credit sales is 70% of total sales of **DM**.

The following computed ratios have been extracted from the books of **Migara Manufacturing PLC (MM)**, a competitor of **DM** for the year ended / as at 31<sup>st</sup> March 2017:

Gross Profit Ratio	30%
Net Profit Ratio	25%
Return on Capital Employed (ROCE)	32.4%
Quick Assets Ratio	2.08 times
Debtors' collection period	60 days

**You are required to:**

**Analyze** the performance of **DM** and **MM** for the year ended / as at 31<sup>st</sup> March 2017.

(Hint: You may compute the above ratios for **DM** as well.)

(10 marks)

## Question 07

The Statements of Financial Position as at 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2016 of **ABC Company Ltd.** are given below:

**ABC Company Ltd.**  
**Statements of Financial Position** (Rs.'000)

	As at 31 <sup>st</sup> March 2017		As at 31 <sup>st</sup> March 2016	
<b>Assets</b>				
<b>Non-Current Assets:</b>				
Property, Plant and Equipment (at cost)	10,000		10,000	
Accumulated Depreciation	(4,500)		(4,000)	
Carrying Value		5,500		6,000
<b>Current Assets:</b>				
Inventories	5,500		6,000	
Trade and Other Receivables	8,100		5,160	
Cash and Cash Equivalentents	250	13,850	300	11,460
<b>Total Assets</b>		<b>19,350</b>		<b>17,460</b>
<b>Equity and Liabilities</b>				
<b>Equity:</b>				
Ordinary Share Capital		10,000		10,000
Irredeemable Preference Share Capital		4,000		2,500
Retained Earnings		2,300		400
<b>Total Equity</b>		<b>16,300</b>		<b>12,900</b>
<b>Non-Current Liabilities:</b>				
Bank Loan		350		1,250
<b>Current Liabilities:</b>				
Bank Loan	750		750	
Trade and Other Payables	1,660		2,300	
Loan Interest Payable	40		60	
Income Tax Payable	250	2,700	200	3,310
<b>Total Equity and Liabilities</b>		<b>19,350</b>		<b>17,460</b>

The following additional information is also provided:

- (1) Income tax expense for the year ended 31<sup>st</sup> March 2017 was Rs.600,000/-.
- (2) Interest expense on bank loan for the year ended 31<sup>st</sup> March 2017 was Rs.380,000/-.
- (3) There were no disposals or purchases of Property, Plant and Equipment during the year.
- (4) No dividends are paid or declared during the year.

**You are required to:**

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

End of Section B

## SECTION C

Two (02) compulsory questions.

(Total 50 marks)

### Question 08

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

<b>Gajaba PLC</b>		<i>(Rs.'000)</i>	
<b>Trial Balance as at 31<sup>st</sup> March 2017</b>		<b>Dr.</b>	<b>Cr.</b>
Ordinary Share Capital - 2,000,000 Ordinary Shares			20,000
Redeemable Preference Share Capital (1,000,000 shares)			5,000
Retained Earnings as at 01 <sup>st</sup> April 2016			6,500
<b>Property, Plant and Equipment – (at cost):</b>			
Land and Building (Land value – Rs.20,000,000/-)	25,000		
Motor Vehicles	15,000		
Office Equipment	4,000		
<b>Accumulated Depreciation - as at 01<sup>st</sup> April 2016:</b>			
Building			2,000
Motor Vehicles			6,000
Office Equipment			2,600
Inventory as at 31 <sup>st</sup> March 2017 (at cost)	9,500		
Trade Receivables / Trade Payables	11,000	6,000	
Income Tax Payable for the year of assessment 2015/16			400
Bank Loan			3,000
Cash at bank	3,000		
Cash in hand	200		
Allowance for Trade Receivables as at 01 <sup>st</sup> April 2016			1,500
Cost of Sales / Sales	107,000	160,000	
Interim Dividends Paid - Ordinary Shares	2,000		
Dividends Paid on Redeemable Preference Shares	500		
Administration Expenses	11,460		
Distribution Expenses	16,740		
Finance Expenses	5,600		
Income Tax Paid	2,000		
	<b>213,000</b>		<b>213,000</b>

The following additional information is also provided:

- (1) During the year, the company disposed of the following asset:

Date of purchase	Asset	Cost (Rs.)	Date of Disposal	Sale Proceeds (Rs.)
01.10.2013	Delivery Van	2,300,000	31.12.2016	1,200,000

The sales proceeds have been debited to bank account and credited to sales account. Other than that no entries were made in respect of the disposal of van.

- (2) On 31<sup>st</sup> March 2017, the company has revalued its building and the value of the building has increased by Rs.2 million due to the revaluation. This has not been recorded in the books of accounts.
- (3) The net realizable value of the stock as at 31<sup>st</sup> March 2017 was Rs.9,375,000/-:
- (4) 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	:	25 years
Motor Vehicles	:	04 years
Office Equipment	:	08 years

- (5) The following adjustments have to be made in respect of Trade Receivables:
- A Trade Receivable balance of Rs.100,000/- has become bad debt during the year. However, this particular trade receivable balance has been provided for in the books of accounts as doubtful debts in the previous year.
  - A general provision of 5% is to be made from the remaining trade receivables as at 31<sup>st</sup> March 2017.
- (6) As at 31<sup>st</sup> March 2017, the following expenses have to be accrued in the books of accounts:

	Rs.
Telephone and Electricity	60,000
Advertising	200,000

- (7) ½ of the bank loan outstanding as at 31<sup>st</sup> March 2017 should be settled during the next year.
- (8) The income tax liability of the company for the Year of Assessment 2016/17 is estimated as Rs.3,500,000/-.
- (9) The Board of Directors of the company have taken the decision to pay a final dividend of Rs.1/- per share for the Ordinary Shares held on 31<sup>st</sup> March 2017 at the board meeting held on 31<sup>st</sup> May 2017.
- (10) The financial statements were authorized for issue by the Board of Directors on 15<sup>th</sup> June 2017.

**You are required to:**

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

- (a) The Statement of Profit or Loss and Other Comprehensive Income (Statement of Comprehensive Income) for the year ended 31<sup>st</sup> March 2017. (10 marks)
- (b) Statement of Financial Position as at 31<sup>st</sup> March 2017. (07 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) (a) **Gamunu PLC** acquired 70% of the Share Capital of **Beema Ltd.** on 01<sup>st</sup> April 2016 for an investment of Rs. 12 million. On that day, the fair value of identifiable net assets of **Beema Ltd.** was equal to its book value and fair value of the non-controlling interest was Rs. 3 million.

At the date of acquisition, the following ledger balances appeared in the books of **Beema Ltd.:**

	Rs. ('000)
Stated capital – Ordinary shares	7,000
General Reserves	1,800
Retained Earnings	2,000

**You are required to:**

**Calculate** the goodwill arising from the consolidation.

(05 marks)

- (b) The Statements of Comprehensive Income of **Gamunu PLC** and **Beema Ltd.** for the year ended 31<sup>st</sup> March 2017 are as follows:

### Statements of Comprehensive Income for the year ended 31<sup>st</sup> March 2017

(Rs. '000)

	Gamunu PLC	Beema Ltd.
Sales	250,000	110,000
Cost of Sales	(140,000)	(72,000)
<b>Gross Profit</b>	<b>110,000</b>	<b>38,000</b>
<b>Other Income:</b>		
Interest Income	800	250
Dividend Income	1,600	45
Other Income	1,550	-
	<b>113,950</b>	<b>38,295</b>
<b>Expenses:</b>		
Distribution Expenses	(40,000)	(13,500)
Administration Expenses	(10,000)	(3,000)
Finance Expenses	( 8,000)	(2,000)
<b>Profit Before Tax</b>	<b>55,950</b>	<b>19,795</b>
Income Tax	(14,500)	(2,000)
<b>Profit for the year</b>	<b>41,450</b>	<b>17,795</b>
Other Comprehensive Income	-	-
<b>Total Comprehensive Income for the year</b>	<b>41,450</b>	<b>17,795</b>

The following additional information is also provided:

- (1) During the year, **Gamunu PLC** has sold inventory for Rs.2,000,000/- to **Beema Ltd.** with a profit margin of 25% on cost. As at 31<sup>st</sup> March 2017, the closing inventory of **Beema Ltd.** included Rs.500,000/- worth of goods purchased from **Gamunu PLC**.
- (2) **Beema Ltd.** paid Rs.50,000/- per month from 01<sup>st</sup> April 2016 to **Gamunu PLC** as the rent for the stores of **Beema Ltd.** located at the factory premises of **Gamunu PLC**.
- (3) **Beema Ltd.** has obtained a loan of Rs.5,000,000/- on 31<sup>st</sup> March 2016 from **Gamunu PLC** at a rate of 12% per annum. The Interest for the year 2016/17 has been fully paid to **Gamunu PLC**. No capital repayment was made for the loan during the year.
- (4) Dividend income of **Gamunu PLC** includes interim dividend of Rs.500,000/- received from **Beema Ltd.** and dividends were paid by **Beema Ltd.** using the profit of the year.
- (5) On 01<sup>st</sup> January 2017 **Gamunu PLC** sold a land costing Rs.1,000,000/- to **Beema Ltd.** for Rs.1,400,000/-.

**You are required to:**

**Prepare** the Consolidated Comprehensive Income Statement for the year ended 31<sup>st</sup> March 2017. (14 marks)

- (B) The following computed ratios have been extracted from **XYZ Ltd.** for the years ended 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2016:

year ended 31 <sup>st</sup> March	2017	2016
Current Ratio	1.2	1.5
Debt collection period	75 days	45 days
Stock residence period	35 days	25 days

**You are required to:**

**State** two(02) possible reasons for the above variation 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.