



**ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA**

**AA3 EXAMINATION - JANUARY 2019**

**(AA31) FINANCIAL ACCOUNTING AND REPORTING**

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

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

26-01-2019  
Morning  
[8.45 – 12.00]

No. of Pages : 11  
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**

**Siriwardane**, a sole proprietor commenced his wholesale business in 2016. The net assets of his business as at 01<sup>st</sup> April 2017 was Rs. 3.2 million and as at 31<sup>st</sup> March 2018 it was Rs.4.5 million. During the financial year ending 31<sup>st</sup> March 2018, he made drawings of Rs.0.5 million. Further, during the year under review, he introduced an additional capital totaling to Rs. 1 million from time to time.

**You are required to:**

- (a) **Differentiate** financial capital maintenance concept from physical capital maintenance concept in arriving at profit. (03 marks)
- (b) **Calculate** the earned profit of **Siriwardane's** business based on the financial capital maintenance concept. (02 marks)

(Total 05 marks)

## Question 02

Sustainability reporting enables organization to consider the impact of wide range of sustainability issues enabling them to be more transparent about the risks they face and opportunities.

**You are required to:**

- (a) **Explain** what is "Sustainability Report". (03 marks)
  - (b) **State** two(02) benefits of Sustainability Reporting. (02 marks)
- (Total 05 marks)

## Question 03

**Mr.Punyasiri**, the accountant of **Saubhagya Holdings Ltd. (SHL)** has come across the following incidents.

- (a) **SHL** has invoiced their products worth of Rs. 7.5 million to its major customer dated 31<sup>st</sup> March 2018 in the year end. However, those items had not been delivered to the particular customer until 10<sup>th</sup> April 2018.
- (b) **SHL** received a dividend of Rs. 2.7 million on the investment in shares of **Reliance Bank PLC** on 20<sup>th</sup> April 2018. However, the General Meeting of **Reliance Bank PLC** was held on 30<sup>th</sup> March 2018 for the shareholders' approval for the dividend.
- (c) **SHL** entered into a service agreement with **Perera Ltd.** to provide services for 4 years service period on 01<sup>st</sup> April 2017. Initial service charge for the 4 year period was Rs.1 million and Rs.150,000/- was incurred as cost for the year ended 31<sup>st</sup> March 2018. Cost of Rs.450,000/- will be incurred within the next 03 years.

**You are required to:**

**Explain** whether each of the above incidents should be recognized as revenue for the year ended 31<sup>st</sup> March 2018 as per the LKAS 18 – Revenue. (05 marks)

#### Question 04

Extract of Statement of Comprehensive Income of **Tokyo Trading Ltd.** for the year ended 31<sup>st</sup> March 2018 is as follows:

**Tokyo Trading Ltd.**  
**Extract of Statement of Comprehensive Income**  
**for the year ended 31<sup>st</sup> March 2018**

	<b>Rs.</b>
Sales	760,000
Cost of sales	(643,000)
<b>Gross Profit</b>	<b>117,000</b>
Other Income - Investment Income	850
Distribution Expenses	(30,000)
Administration Expenses	(32,000)
Finance Expenses	(6,500)
<b>Profit Before Tax</b>	<b>49,350</b>

Balances extracted from the statements of Financial Position of **Tokyo Trading Ltd.** as at 31<sup>st</sup> March 2018 and 31<sup>st</sup> March 2017 are as follows:

	<b>As at 31<sup>st</sup> March 2018</b> <b>(Rs.)</b>	<b>As at 31<sup>st</sup> March 2017</b> <b>(Rs.)</b>
Inventory	132,000	125,000
Trade Receivables	205,000	218,000
Trade Payables	142,000	135,000
Income Tax Payable	3,500	2,000

The following additional information is also provided:

- (1) Depreciation charges for the year ended 31<sup>st</sup> March 2018 was Rs.12,500/-.
- (2) Finance expenses represent the interest paid to Debenture holders.
- (3) Income tax expenses for the year ended 31<sup>st</sup> March 2018 was Rs.8,000/-.
- (4) All the purchases and sales were made on credit basis.

Using the above information,

**You are required to:**

**Prepare** Cash Flows from operating activities of **Tokyo Trading Ltd.** for the year ended 31<sup>st</sup> March 2018 using the Direct Method. (05 marks)

End of Section A

## **SECTION B**

Three (03) compulsory questions

(Total 30 marks)

### **Question 05**

The following information has been extracted from the Financial Statements of **Eco Protect Lanka (Pvt) Ltd.** as at / for the year ended 31<sup>st</sup> March 2018 and 31<sup>st</sup> March 2017:

**Eco Protect Lanka (Pvt) Ltd.**  
**Extracts from the Financial Statements** *(Rs.'000)*

<b>For the year ended</b>	<b>31<sup>st</sup> March 2018</b>	<b>31<sup>st</sup> March 2017</b>
Turnover	220,650	199,500
Cost of Sales	147,835	137,655
Gross Profit	72,815	61,845
Profit before interest and income tax	17,750	18,220
Profit for the year	15,620	15,820
<b>As at</b>	<b>31<sup>st</sup> March 2018</b>	<b>31<sup>st</sup> March 2017</b>
Inventories	12,200	10,550
Trade Receivables	28,200	22,500
Shareholders' Equity	121,030	105,410
Bank Loans	9,950	10,350
Stated Capital (1,000,000 ordinary shares)	100,000	100,000

The following industry averages have also been identified:

Gross profit ratio	40%
Net profit ratio	12%
Return of Capital Employed (ROCE)	8%
Stock turnover ratio	10 times
Debtors' turnover ratio	9 times
Debtors' collection period	40 days

Assume that all sales were made on credit terms and there was no other comprehensive income for the year.

**You are required to:**

**Analyse** the performance of **Eco Protect Lanka (Pvt) Ltd.** for the year ended / as at 31<sup>st</sup> March 2018, considering the industry averages identified above. (10 marks)

## Question 06

The statements of Financial Position as at 31<sup>st</sup> March 2017 and 31<sup>st</sup> March 2018 and extracts of statement of comprehensive income for the year ended 31<sup>st</sup> March 2018 of **Siyasto Creations (Pvt) Ltd.** are as follows:

**Siyasto Creations (Pvt) Ltd.**  
**Statements of Financial Position** (Rs. '000)

As at 31 <sup>st</sup> March	2018	2017
<b>Assets:</b>		
<b>Non-Current Assets:</b>		
Property, Plant and Equipment at cost	4,740	4,300
Accumulated Depreciation	(2,060)	(1,410)
<b>Carrying Value</b>	<b>2,680</b>	<b>2,890</b>
<b>Current Assets:</b>		
Inventories	2,370	1,415
Trade Receivables	4,450	2,536
Cash and Cash Equivalents	2,280	1,320
	<b>9,100</b>	<b>5,271</b>
<b>Total Assets</b>	<b>11,780</b>	<b>8,161</b>
<b>Equity and Liabilities:</b>		
<b>Equity:</b>		
Stated Capital – Ordinary shares	2,000	2,000
Retained Earnings	3,660	1,460
	<b>5,660</b>	<b>3,460</b>
<b>Non-Current Liabilities</b>		
Long Term Loans	1,000	-
Employee benefits (Provision for gratuity)	590	500
Deferred Tax Liabilities	720	500
	<b>2,310</b>	<b>1,000</b>
<b>Current Liabilities:</b>		
Trade Payables	2,760	2,851
Income Tax Payables	1,050	850
	<b>3,810</b>	<b>3,701</b>
<b>Total Equity and Liabilities</b>	<b>11,780</b>	<b>8,161</b>

**Extract of the Statements of Comprehensive Income**  
**for the year ended 31<sup>st</sup> March 2018**

	Rs. '000
Profit before interest and income tax	2,900
Interest expenses	(250)
<b>Profit Before Income Tax</b>	<b>2,650</b>
Income tax	(450)
<b>Profit for the year</b>	<b>2,200</b>

The following additional information is also provided:

- (1) Income tax for the year includes the deferred tax expense for the year ended 31<sup>st</sup> March 2018.
- (2) An equipment costing Rs.550,000/- has been disposed during the year ended 31<sup>st</sup> March 2018 for Rs.400,000/-. The carrying value of the equipment as at the date of disposal was Rs.200,000/-.
- (3) There was no other comprehensive income for the year ended 31<sup>st</sup> March 2018. Further, there were no accrued interest expenses as at the year end.
- (4) No payments for gratuity was made during the year ended 31<sup>st</sup> March 2018.

**You are required to:**

**Prepare** the Statement of Cash Flows of **Siyasto Creations (Pvt) Ltd.** for the year ended 31<sup>st</sup> March 2018 under the indirect method. (10 marks)

### Question 07

- (A) **KEL Leasing Company (KEL)** sold a Motor Vehicle to **Perera** under a finance lease agreement for a 5 year lease term on 01<sup>st</sup> January 2017. The cash selling price of the motor vehicle was Rs.2.5 million. Annual lease installment of Rs.781,409.75 is to be paid on 31<sup>st</sup> December each year at an annual lease interest rate of 17%. **Perera** has paid the lease installment on due date.

**You are required to:**

**Prepare** the following accounts as appearing in the books of **KEL** as at / for the year ended 31<sup>st</sup> December 2018:

- (a) Lease Debtors Account.
- (b) Un-earned Finance Income Account. (06 marks)

- (B) **Reliance Partners (Pvt) Ltd. (RPL)** is in the business of manufacturing soap. The financial statements for the year ended 31<sup>st</sup> March 2018 of **RPL** were authorized for issue on 10<sup>th</sup> May 2018.

The following information is relevant to **RPL**:

- (1) It was revealed on 05<sup>th</sup> May 2018 that there had been a fraud of inventories taken place from previous year which was committed by the Finance Manager and the Stores Manager jointly. It is estimated that, a loss of Rs. 35.5 million was incurred due to this incidence and stock value has been overstated by the same amount due to the fraud.
- (2) A performance incentive for employees of Rs. 4 million had been approved by the Board of Directors of **RPL** on 15<sup>th</sup> April 2018 out of the profits for the year ended 31<sup>st</sup> March 2018. This had not been considered in preparing the draft financial statements.

**You are required to:**

**Explain** how each of the above instances would be recognized in the financial statements for the year ended 31<sup>st</sup> March 2018 of **RPL** as per the LKAS 10 – Events after the reporting period.

(04 marks)

(Total 10 marks)

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End of Section B

## SECTION C

Two (02) compulsory questions.

(Total 50 marks)

### Question 08

**Green Garden PLC** is a company listed in the Colombo Stock Exchange. The Trial Balance of the company as at 31<sup>st</sup> March 2018 is given below:

**Green Garden PLC**  
**Trial Balance as at 31<sup>st</sup> March 2018** (Rs.'000)

	Dr.	Cr.
Ordinary Share Capital- 2,000,000 shares		40,000
Retained Earnings as at 01 <sup>st</sup> April 2017		2,500
<b>Property Plant and Equipment at Cost:</b>		
Land and Buildings (value of the land – Rs. 20 million)	30,000	
Motor Vehicles	10,000	
Office Equipment	3,500	
<b>Accumulated Depreciation as at 01<sup>st</sup> April 2017:</b>		
Buildings		6,000
Motor Vehicles		2,000
Office Equipment		950
Capital work-in-progress	600	
Inventory as at 31 <sup>st</sup> March 2018 (at cost)	25,000	
Trade Receivables / Trade Payables	62,000	45,000
Allowance for Trade Receivables as at 01 <sup>st</sup> April 2017		700
Accrued Expenses		1,000
Income Tax Payable for the Year of Assessment 2016/17		1,200
Bank Loan		3,000
Cash in hand and Cash at bank	200	
Bank Overdraft		300
Cost of Sales / Sales	174,500	262,500
Interim Dividend paid for Ordinary Shareholders	1,000	
Administration Expenses	20,200	
Distribution Expenses	26,500	
Other Operational Expenses	1,850	
Finance Expenses	3,800	
Income Tax Paid	6,000	
	<b>365,150</b>	<b>365,150</b>

The following additional information is also provided:

- (1) On 31<sup>st</sup> October 2017, the company disposed a delivery lorry for Rs.200,000/- which met with an accident on 30<sup>th</sup> June 2017 while delivering goods to a customer. The lorry was purchased for Rs.1.2 million and the accumulated depreciation as at 01<sup>st</sup> April 2017 was Rs.600,000/-. The company has received an insurance claim which is equivalent to  $\frac{1}{4}$  of the purchase cost of the lorry as the damage. The insurance claim and the disposal proceeds were credited to the sales account. Other than that no entries have been made in the books of accounts regarding the disposal of the lorry.
- (2) On 01<sup>st</sup> June 2017, the company acquired a new computer software for the value of Rs.1.5 million. On the same day, the company had to incur a further cost of Rs.300,000/- to develop it to make it suitable for their business. The purchase price and the development cost of the computer software have been recorded under the purchases account.
- (3) The company obtained a loan of Rs.3,000,000/- on 01<sup>st</sup> October 2017 to construct a separate building and on the same day, construction was started. As at 31<sup>st</sup> March 2018, Rs.600,000/- had been incurred for the building and it was classified as capital work-in-progress. Interest rate for the loan was at 12% per annum. No repayment was made for the above loan during the year and interest on the loan for the current year has been debited to finance expenses and credited to accrued expenses.
- (4) Depreciation of Property, Plant and Equipment is calculated on the straight line basis at cost. The useful life of Property, Plant and Equipment is as follows:

Buildings	:	20 years
Motor Vehicles	:	05 years
Office Equipment	:	05 years
Computer software	:	03 years
- (5) Part of the inventory held as at 31<sup>st</sup> March 2018 costing Rs.500,000/- was found to be obsolete and this was sold on 30<sup>th</sup> April 2018 for Rs.100,000/-.
- (6) One of the customers who owed Rs.2,000,000/- to the company as at 31<sup>st</sup> March 2018 has been declared bankrupt on 05<sup>th</sup> May 2018. Therefore, the entire amount due from him becomes irrecoverable. Further, a general provision of 5% has to be made from the remaining trade receivable balance as at 31<sup>st</sup> March 2018.
- (7) A customer of the company had filed a case against the company during the year 2017/18. According to the judgment given on 05<sup>th</sup> May 2018 the company has to pay Rs.260,000/- as compensation to the customer.
- (8) Insurance expenditure includes Rs.110,000/- worth of insurance payment relevant for the month of April 2018 and it was recorded under administration expenses.
- (9) The Income tax liability of the company for the year of assessment 2017/18 is estimated to be Rs.6,500,000/-.
- (10) The board of directors of the company decided to pay Rs.1/- per share as the final dividend for the ordinary shares held on 31<sup>st</sup> March 2018 at the board meeting held on 30<sup>th</sup> April 2018.
- (11) The Financial Statements were authorized for issue by the Board of Directors on 30<sup>th</sup> May 2018.



Considering the above information,

**You are required to:**

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

- The Statement of Profit or Loss and Other Comprehensive Income (Statement of Comprehensive Income) for the year ended 31<sup>st</sup> March 2018. (10 marks)
  - Statement of Financial Position as at 31<sup>st</sup> March 2018. (07 marks)
  - Statement of Changes in Equity for the year ended 31<sup>st</sup> March 2018. (03 marks)
  - Statement showing movement of Property, Plant and Equipment for the year ended 31<sup>st</sup> March 2018. (05 marks)
- (Total 25 marks)

### Question 09

- (A) The following Statements of Financial Position were extracted from **Indochem PLC (ICL)** and **Takasago (Pvt) Ltd. (TL)** as at 31<sup>st</sup> March 2018:

#### Statements of Financial Position

as at 31<sup>st</sup> March 2018

(Rs. '000)

	ICL	TL
<b>Non-Current Assets:</b>		
Property, Plant and Equipment at cost	55,000	15,000
Accumulated Depreciation	(12,000)	(6,000)
Carrying Value	43,000	9,000
Investment in TL	25,000	-
<b>Current Assets:</b>		
Inventories	20,100	20,500
Short Term Loans given to TL	5,500	-
Trade Receivables	34,750	10,500
Cash and Cash equivalents	6,500	4,600
<b>Total Assets</b>	<b>134,850</b>	<b>44,600</b>
<b>Equity:</b>		
Stated Capital – Ordinary shares	82,000	20,000
Retained Earnings	15,750	6,700
<b>Non-Current Liabilities:</b>		
Bank Loans	10,200	-
<b>Current Liabilities:</b>		
Trade Payables	13,100	8,000
Bank loan	5,200	-
Short Term Loan from ICL	-	5,500
Other Payables	8,600	4,400
<b>Total Equity and Liabilities</b>	<b>134,850</b>	<b>44,600</b>

The following additional information is also provided:

- (1) **ICL** acquired 80% of the ordinary share capital of **TL** on 01<sup>st</sup> April 2017 for Rs.25 million.
- (2) The fair value of non-controlling interest as at the date of acquisition was Rs. 4.42 million. As at the date of acquisition, retained earnings were Rs. 2.1 million and the fair value of identifiable net assets of **TL** was equal to its book value.
- (3) As at 31<sup>st</sup> March 2018, **TL** held an unsold stock worth of Rs. 3 million bought from **ICL**. **ICL** has sold the goods to **TL** with a profit margin of 20% on selling price.
- (4) **TL** has obtained a loan of Rs. 5.5 million on 01<sup>st</sup> April 2017 from **ICL** at the rate of 15% per annum. Interest for the year has been paid and no capital repayment was made during the year.
- (5) Trade receivables of **ICL** included an amount of Rs.2.5 million receivable from **TL**. **TL** raised a cheque for Rs.1 million and sent it to **ICL**. **ICL** did not receive this cheque until 31<sup>st</sup> March 2018.
- (6) Retained earnings of **ICL** includes an interim dividend of Rs. 1 million received from **TL** on 01<sup>st</sup> March 2018. Dividends were paid by **TL** using the profit for the year.

**You are required to:**

- (a) **Compute** the Goodwill arising from the consolidation. (05 marks)
  - (b) **Prepare** the Consolidated Statement of Financial Position as at 31<sup>st</sup> March 2018. (14 marks)
- (B) The following additional information is also extracted for the year ended 31<sup>st</sup> March 2018 from **Indochem PLC (ICL)** and **Takasago (Pvt) Ltd. (TL)**:

	<b>ICL</b> <b>(Rs.'000)</b>	<b>TL</b> <b>(Rs.'000)</b>
Sales	175,000	89,000
Purchases	64,000	36,000

- (1) Credit purchases is 80% from the total purchase.
- (2) Trade payables as at 31<sup>st</sup> March 2017 of **ICL** and **TL** were Rs.12 million and Rs.6 million respectively.

**You are required to:**

**Compute** the following ratios for both companies:

- (a) Current Assets Ratio.
- (b) Gearing Ratio.
- (c) Creditors' Turnover Ratio. (06 marks)

(Total 25 marks)

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*End of Section C*

## 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.