



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JULY 2019

**(AA31) FINANCIAL ACCOUNTING AND REPORTING**

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

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

20-07-2019  
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**

Conceptual Framework for financial reporting identifies the underlying assumption made in preparing financial statements. It also deals with the definition, recognition and measurement of the elements from which the financial statements are constructed.

**You are required to:**

- (a) **Explain** the underlying assumption in preparing the financial statements as per the Conceptual Framework. (03 marks)  
 (b) **State** the recognition criteria of a liability. (02 marks)  
 (Total 05 marks)

**Question 02**

Integrated reporting explains how the various types of capital contribute to the value creation process of the organization. Further, the integrated report includes eight key components that are fundamentally linked to each other.

**You are required to:**

**State five(05) key components of an integrated report.** (05 marks)

### Question 03

- (a) **State** a criteria to be met to recognize an asset as an intangible asset. (02 marks)
- (b) **EPL Ltd.** has developed a new product during the year ended 31<sup>st</sup> March 2019 and started commercial operation in May 2019. Cost incurred for the new product during the year 2018/19 were as follows:
- (1) A research was done for the new product and incurred Rs.1 million during the year.
  - (2) The company registered the patent right for the new product during the year and fee on registration for patent right was Rs.100,000/-.
  - (3) Costs of Rs.300,000/- for advertising and promotional activities were spend on the new product.

**You are required to:**

**Explain** whether each of the above costs could be recognized as intangible assets as per LKAS 38 - Intangible Assets. (03 marks)

(Total 05 marks)

### Question 04

Balances extracted from the Statement of Financial Position of **Lanka Teas (Pvt) Ltd.** as at 31<sup>st</sup> March 2019 and 31<sup>st</sup> March 2018 are as follows:

| As at 31 <sup>st</sup> March            | 2019           | 2018           |
|-----------------------------------------|----------------|----------------|
| <b>Non-Current Assets:</b>              |                |                |
| Property, Plant and Equipment (at cost) | 2,000,000      | 1,800,000      |
| Accumulated Depreciation                | (1,400,000)    | (1,500,000)    |
| Intangible Assets                       | 35,000         | -              |
| Investment in Other Companies (at cost) | 165,000        | -              |
|                                         | <b>800,000</b> | <b>300,000</b> |
| <b>Current Assets:</b>                  |                |                |
| Inventories                             | 65,000         | 90,000         |
| Trade Receivables                       | 17,000         | 21,000         |
|                                         | <b>82,000</b>  | <b>111,000</b> |
| <b>Total Assets</b>                     | <b>882,000</b> | <b>411,000</b> |

The following additional information is also provided:

- (1) Depreciation for the year ended 31<sup>st</sup> March 2019 was Rs.500,000/-.
- (2) A motor vehicle was sold for cash on 31<sup>st</sup> March 2019. Cost of the motor vehicle and accumulated depreciation as at 31<sup>st</sup> March 2019 were Rs.1,200,000/- and Rs.600,000/- respectively. Profit on disposal of this motor vehicle was Rs.200,000/-.
- (3) The company acquired a new motor vehicle on 31<sup>st</sup> March 2019.
- (4) Intangible Assets represent patent rights acquired on 31<sup>st</sup> March 2019.

Using the above information,

**You are required to:**

**Prepare** the Cash Flows from investing activities of **Lanka Teas (Pvt) Ltd.** for the year ended 31<sup>st</sup> March 2019. (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 **Sabco Ltd.** as at / for the year ended 31<sup>st</sup> March 2019 and 31<sup>st</sup> March 2018:

#### Extract of Statement of Comprehensive Income (Rs.'000)

| For the year ended             | 31 <sup>st</sup> March 2019 |
|--------------------------------|-----------------------------|
| Turnover                       | 220,700                     |
| Cost of sales                  | 143,780                     |
| Gross Profit                   | 76,920                      |
| Profit before Interest and Tax | 34,760                      |
| Profit After Tax               | 16,177                      |

#### Extract of Statement of Financial Position (Rs.'000)

| As at             | 31 <sup>st</sup> March 2019 | 31 <sup>st</sup> March 2018 |
|-------------------|-----------------------------|-----------------------------|
| Inventories       | 25,250                      | 16,400                      |
| Trade Receivables | 27,580                      | 19,850                      |
| Equity            | 125,600                     | 118,000                     |
| Long-term Loan    | 12,000                      | 15,600                      |

Assume that all sales are on credit basis.

**You are required to:**

(a) **Compute** the following ratios based on the above information for the financial year ended 31<sup>st</sup> March 2019:

- (i) Gross Profit Ratio.
- (ii) Debtors' Collection Period.
- (iii) Stock Residence Period.
- (iv) Return on Capital Employed (ROCE). (06 marks)

(b) **List** two(02) possible actions each for further improvements of below ratios:

- (i) Gross Profit Ratio.
- (ii) Debtors' Collection Period. (04 marks)

(Total 10 marks)

## Question 06

The Statements of Financial Position of **Europa Quality Foods (Pvt) Ltd.** as at 31<sup>st</sup> March 2019 and 31<sup>st</sup> March 2018 are as follows:

| <b>Europa Quality Foods (Pvt) Ltd.</b>     |               |               |
|--------------------------------------------|---------------|---------------|
| <b>Statements of Financial Position</b>    |               |               |
| <i>(Rs.'000)</i>                           |               |               |
| <b>As at 31<sup>st</sup> March</b>         | <b>2019</b>   | <b>2018</b>   |
| <b>Assets:</b>                             |               |               |
| <b>Non-Current Assets:</b>                 |               |               |
| Property, Plant and Equipment              | 22,050        | 22,300        |
| Accumulated Depreciation                   | (10,090)      | (10,020)      |
| <b>Carrying Value</b>                      | <b>11,960</b> | <b>12,280</b> |
| <b>Current Assets:</b>                     |               |               |
| Inventories                                | 5,935         | 3,320         |
| Trade and Other Receivables                | 10,920        | 11,580        |
| Cash and Cash Equivalent                   | 2,205         | 2,560         |
|                                            | <b>19,060</b> | <b>17,460</b> |
| <b>Total Assets</b>                        | <b>31,020</b> | <b>29,740</b> |
| <b>Equity and Liabilities:</b>             |               |               |
| <b>Equity:</b>                             |               |               |
| Stated Capital - Ordinary Share Capital    | 10,000        | 10,000        |
| Retained Earnings                          | 16,270        | 13,820        |
|                                            | <b>26,270</b> | <b>23,820</b> |
| <b>Non-Current Liabilities:</b>            |               |               |
| Long Term Loans                            | 1,000         | -             |
| Employee Benefits (Provision for gratuity) | 540           | 490           |
|                                            | <b>1,540</b>  | <b>490</b>    |
| <b>Current Liabilities:</b>                |               |               |
| Trade Payables                             | 1,040         | 980           |
| Short Term Loans                           | 1,800         | 3,425         |
| Interest Payables                          | 220           | 75            |
| Income Tax Payable                         | 150           | 950           |
|                                            | <b>3,210</b>  | <b>5,430</b>  |
| <b>Total Equity and Liabilities</b>        | <b>31,020</b> | <b>29,740</b> |

The following additional information is also provided:

- (1) A motor vehicle was disposed for Rs.600,000/- on 31<sup>st</sup> March 2019. The cost of the motor vehicle was Rs.750,000/- while the carrying value as at the date of disposal, was Rs.350,000/-.
- (2) Interest expense for the year ended 31<sup>st</sup> March 2019 was Rs.590,000/-.

- (3) The income tax expenses of the company for the year ended 31<sup>st</sup> March 2019 was Rs.125,000/-.
- (4) No gratuity payments have been made during the year.
- (5) No dividends were paid or declared during the year.

**You are required to:**

**Prepare** the Statement of Cash Flows of **Europa Quality Foods (Pvt) Ltd.** for the year ended 31<sup>st</sup> March 2019 using indirect method. (10 marks)

### Question 07

- (A) The following information was extracted from **X Ltd.'s** books of accounts for the year ended 31<sup>st</sup> March 2019:

(1)

| Item      | Accounting Carrying Value<br>(written Down Value) (Rs.) | Tax Base<br>(Rs.) |
|-----------|---------------------------------------------------------|-------------------|
| Buildings | 6,000,000                                               | 5,000,000         |
| Vehicles  | 2,500,000                                               | 2,000,000         |

- (2) There was no balance in deferred tax asset / liability account as at 01<sup>st</sup> April 2018.
- (3) Provision for Gratuity as at 31<sup>st</sup> March 2019 was Rs.700,000/-.
- (4) Corporate Tax Rate applicable for **X Ltd.** is 28%.

**You are required to:**

- (a) **Identify** temporary differences as at 31<sup>st</sup> March 2019. (03 Marks)
- (b) **Compute** the Deferred Tax Asset / Liability as at 31<sup>st</sup> March 2019. (02 Marks)

- (B) The following information related to inventories were extracted from **Delta Ltd.'s** books of accounts for the month ending 31<sup>st</sup> December 2018.

- Inventories as at 01<sup>st</sup> December 2018 were 2,000 units and per unit cost was Rs.10/-.
- Receipts during the month:
  - 15<sup>th</sup> December 2018 – 5,000 units at Rs.9.30, per unit
  - 20<sup>th</sup> December 2018 – 6,000 units at Rs.11/-, per unit
- Issues during the month:
  - 16<sup>th</sup> December 2018 – 4,000 units
  - 25<sup>th</sup> December 2018 – 7,000 units

**You are required to:**

**Calculate** the closing stock value as at 31<sup>st</sup> December 2018 using the Weighted Average Cost (WAC) basis. (05 marks)

(Total 10 marks)

End of Section B

## SECTION C

Two (02) compulsory questions.

(Total 50 marks)

### Question 08

The following trial balance was extracted from the books of **Omega PLC** as at 31<sup>st</sup> March 2019:

| <b>Omega PLC</b>                                                  |                |                |
|-------------------------------------------------------------------|----------------|----------------|
| <b>Trial Balance as at 31<sup>st</sup> March 2019</b>             |                |                |
| <i>(Rs. '000)</i>                                                 |                |                |
|                                                                   | <b>Dr.</b>     | <b>Cr.</b>     |
| <b>Property Plant and Equipment at Cost:</b>                      |                |                |
| Land                                                              | 50,000         |                |
| Buildings                                                         | 25,000         |                |
| Motor Vehicles                                                    | 21,000         |                |
| Office Equipment                                                  | 7,200          |                |
| Capital work-In-Progress                                          | 7,600          |                |
| <b>Accumulated Depreciation as at 01<sup>st</sup> April 2018:</b> |                |                |
| Buildings                                                         |                | 8,500          |
| Motor Vehicles                                                    |                | 11,500         |
| Office Equipment                                                  |                | 2,200          |
| Pre-payments                                                      | 240            |                |
| Inventory as at 31 <sup>st</sup> March 2019                       | 41,500         |                |
| Stated Capital (800,000 ordinary shares)                          |                | 80,000         |
| Retained Earnings as at 01 <sup>st</sup> April 2018               |                | 6,450          |
| Revaluation Reserve                                               |                | 2,100          |
| Trade Receivables / Trade Payables                                | 24,520         | 31,200         |
| Cash in hand and Cash at Banks                                    | 3,280          |                |
| Income Tax Paid                                                   | 800            |                |
| Interim Dividend Paid - Ordinary shares                           | 4,000          |                |
| Cost of Sales / Sales                                             | 192,300        | 274,500        |
| Other Income                                                      |                | 2,900          |
| Income Tax Payable for the year of assessment 2017/18             |                | 650            |
| Administration Expenses                                           | 32,700         |                |
| Distribution Expenses                                             | 13,980         |                |
| Finance Expenses                                                  | 1,400          |                |
| Allowance for Trade Receivable as at 01 <sup>st</sup> April 2018  |                | 520            |
| Bank Loan                                                         |                | 5,000          |
|                                                                   | <b>425,520</b> | <b>425,520</b> |

The following additional information is also provided:

- (1) Inventory as at 31<sup>st</sup> March 2019 included some damaged stocks costing Rs.3,500,000/-. The net realizable value of these stocks is Rs.2,800,000/- and no adjustments were made in the books of accounts in this regard.
- (2) Entire revaluation reserve of Rs.2,100,000/- represents the land revaluation made 03 years ago. The revaluation carried out on 31<sup>st</sup> March 2019 revealed that the land value has been increased by Rs.3,000,000/- and no adjustments were made in the books of accounts in this regard.
- (3) On 30<sup>th</sup> September 2018, the company has sold a delivery van for Rs.2,900,000/-. This van was purchased on 01<sup>st</sup> April 2015 at a cost of Rs.4,500,000/-. The entire sales proceed was debited to cash book and credited to other income account and no other entries have been recorded in respect of this transaction.
- (4) Depreciation on 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 | : | 10 years |
- (5) The income tax liability of the company for the year of assessment 2018/19 is estimated to be Rs.900,000/-.
- (6) It has been brought to the notice of the company that a customer owing Rs.420,000/- was declared bankrupt on 31<sup>st</sup> March 2019 and a full provision has been made in the previous financial year in respect of the said customer's balance. A general provision has to be made at 2% from the remaining trade receivables balance as at 31<sup>st</sup> March 2019.
- (7) The company obtained a Rs. 5 million bank loan at an interest rate of 10% per annum on 01<sup>st</sup> April 2018 to construct a new factory building. As at 31<sup>st</sup> March 2019, construction is in progress and it was expected to finalize the construction by 31<sup>st</sup> December 2019. Cost incurred on constructions was recorded under capital work-in-progress account. Further, no repayments were made for the above loan during the year and interest for the year on the above loan was debited to finance expenses and credited to trade payables account.  $\frac{1}{4}$ <sup>th</sup> of the bank loan as at 31<sup>st</sup> March 2019 should be settled during the next year.
- (8) Pre-payment account represents rent payment made for entire calendar year 2019.
- (9) The Board of Director of the company decided to pay Rs.2/- per share as the final dividend for ordinary shares held on 31<sup>st</sup> March 2019 at the board meeting held on 15<sup>th</sup> April 2019.
- (10) The Financial Statements were authorized for issue by the Board of Directors on 02<sup>nd</sup> June 2019.

Considering the above information,

**You are required to:**

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

- (a) The Statement of Profit or Loss and Other Comprehensive Income (Statement of Comprehensive Income) for the year ended 31<sup>st</sup> March 2019. (10 marks)
  - (b) Statement of Financial Position as at 31<sup>st</sup> March 2019. (08 marks)
  - (c) Statement of Changes in Equity for the year ended 31<sup>st</sup> March 2019. (03 marks)
  - (d) Statement showing movement of Property, Plant and Equipment for the year ended 31<sup>st</sup> March 2019. (04 marks)
- (Total 25 marks)

### Question 09

- (A) On 01<sup>st</sup> April 2018, **Sigma PLC** acquired 75% of **Beta PLC's** 1,000,000 (1 million) ordinary shares for Rs.290 million. On the date of acquisition, the fair value of the identifiable net assets of **Beta PLC** was Rs.340 million. The market value of a share as at 01<sup>st</sup> April 2018 of **Beta PLC** was Rs.365/-.

The statements of Comprehensive Income of **Sigma PLC** and **Beta PLC** for the year ended 31<sup>st</sup> March 2019 are as follows:

| <b>Statements of Comprehensive Income</b>      |                  | <i>(Rs.'000)</i> |
|------------------------------------------------|------------------|------------------|
|                                                | <b>Sigma PLC</b> | <b>Beta PLC</b>  |
| Sales                                          | 250,000          | 150,000          |
| Cost of Sales                                  | (150,000)        | (90,000)         |
| <b>Gross Profit</b>                            | <b>100,000</b>   | <b>60,000</b>    |
| <b>Other Income:</b>                           |                  |                  |
| Interest Income                                | 1,200            | 950              |
| Dividend Income                                | 500              | -                |
| Other Income                                   | 150              | 1,250            |
|                                                | <b>101,850</b>   | <b>62,200</b>    |
| <b>Expenses:</b>                               |                  |                  |
| Distribution Expenses                          | (12,000)         | (7,000)          |
| Administration Expenses                        | (60,000)         | (46,000)         |
| Finance Expenses                               | (6,000)          | (4,000)          |
| <b>Profit before Tax</b>                       | <b>23,850</b>    | <b>5,200</b>     |
| Income Tax Expense                             | (6,500)          | (1,550)          |
| <b>Profit for the Year</b>                     | <b>17,350</b>    | <b>3,650</b>     |
| Other Comprehensive Income                     | -                | -                |
| <b>Total Comprehensive Income for the Year</b> | <b>17,350</b>    | <b>3,650</b>     |



The following additional information is also provided:

- (1) During the year, **Sigma PLC** sold goods costing Rs.5,000,000/- to **Beta PLC** with a profit margin of 10% on cost. As at 31<sup>st</sup> March 2019, the closing inventory of **Beta PLC** included Rs.1,100,000/- worth of goods purchased from **Sigma PLC**.
- (2) Two Years ago, **Beta PLC** invested Rs.5,000,000/- on debentures issued by **Sigma PLC** which will be matured in 05 years and annual interest rate is 10%. Interest income of **Beta PLC** included the interest received for the year on debentures.
- (3) **Sigma PLC** has occupied the stores belongs to **Beta PLC** from 01<sup>st</sup> April 2018 and annual rent of Rs.50,000/- was paid by **Sigma PLC** to **Beta PLC**.
- (4) On 01<sup>st</sup> April 2018, **Beta PLC** sold a machine to **Sigma PLC** for Rs.5,000,000/-. The machine had a carrying value of Rs.4,000,000/- in **Beta PLC's** books on that date. The useful life of the machine as at 01<sup>st</sup> April 2018 was 10 years.

**You are required to:**

- (a) **Calculate** the Goodwill arising on acquisition. (05 marks)
  - (b) **Prepare** the Consolidated Comprehensive Income Statement of **Sigma PLC** for the year ended 31<sup>st</sup> March 2019. (14 marks)
- (B) **Explain** three(03) limitations of ratio analysis. (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<br/>Comprehension</b><br><br>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<br/>Application</b><br><br>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<br/>Analysis</b><br><br>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.                          |