



Association of Accounting Technicians of Sri Lanka

July 2020 Examination – Level III

Suggested Answers (301)

(301) Financial Reporting

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

Level III Examination-July 2020

(301) Financial Reporting

SUGGESTED ANSWERS

Four (04) Compulsory Questions
(Total 20 Marks)

SECTION - A

Suggested Answers to Question One:

Chapter 01- Governance Structure, Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

(a)

The main purpose of the Sustainability Report is to provide information to stakeholders on past performance of the organization and a view to the future in respect of environmental, social and governance (ESG) initiatives.

(03 marks)

(b)

An integrated report includes eight Components that are fundamentally linked to each other and are not mutually exclusive:

1. Business model:
2. Organizational overview and external environment:
3. Capital Management
4. Stakeholder Relationships
5. Strategy and resource allocation:
6. External Outlook:
7. Governance:
8. Risks Management and Internal control

(02 marks)

(Total 05 marks)

Suggested Answers to Question Two:

Chapter 01- Governance Structure, Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

1. Adapting to new technology

Some jobs done by accountant can be easily done through IT. Therefore, IT becomes a huge challenge to the accountant.

2. Trend for outsourcing

Some works such as book keeping, payroll which are normally done by accountant are outsourced. It will be beneficial to company. As a result it will result to decrease the role of accountant.

3. Changes in reporting and disclosure requirements

With the globalization, there are changes in time to time in accounting standards and auditing standards. Accounting profession has to be complied with these changes when preparing accounts as well as auditing the financial statements.

4. Comply with professional ethics

As a member of professional body he/ she should comply with applicable professional ethics. When meeting with client or employer this requirement would be a challenge.

5. Accountants need to diversify their skills

Accountants need to diversify their skills with changes in tax law and other laws relevant to accounting according to the dynamic environment changes. Tax act and other acts are being changed time to time. Therefore, they have a knowledge on changes. In addition to that they should acquire knowledge on new technology, communications skills etc.

(05 marks)

Suggested Answers to Question Three:

Chapter 2- Regulatory Requirements, and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

1. When it expects to realize the asset or intends to sell or consume it, in its normal operating cycle.
2. When it holds the asset primarily for the purpose of trading.
3. When it expects to realize the asset within 12 months after the reporting period.
4. When the asset is cash or cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.

(03 marks)

(b)

1. Changes in revaluation of surplus
2. Actuarial gain and losses on employee defined benefit plans
3. Gaining and losses from transacting financial statements of a foreign operations
4. Gains and losses on re-measuring available for sale of financial assets
5. Effective portion of gains/losses on heading instrument in a cash flow hedge

(02 marks)

(Total 05 marks)

Suggested Answers to Question Four:

Chapter 2- Regulatory Requirements, and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements
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(a)

1. Evidence is available of absence or physical damage of an asset.
2. Asset's value has declined significantly than expected.
3. Significant changes with an adverse effect on the entity in the technology, market, economic or legal environment.
4. Market interest rates or other market rate of return on investment have increased during the period and those changes are likely to affect decrease to assets recoverable amount.
5. The carrying amount of the net assets of the entity is more than its market capitalization.
6. Significant changes with an adverse effect on the entity have taken place during the period. These changes include the asset becoming idle, plans to discontinue or restructure operation.
7. Economic Performance of an asset is worse than expected.

(02 marks)

(b)

The Recoverable value is the higher of Fair Value Less Cost to Sell or Value in Use

Fair value less cost to sell-**2 Million**

Value in use is **2.5 Million**

Higher is the Value in use which is **2.5 Million – 2.5 Million is the recoverable amount**

Therefore;

Impairment loss = Carrying value – Recoverable value

$$= 3.5-2.5$$

$$= \underline{\underline{1 \text{ Million}}}$$

(03 marks)

(05 marks)

(Total 20 marks)

End of Section A

Suggested Answers to Question Five:

Chapter 3- Financial Statements for a limited liability company

Royal (Pvt) Ltd

Statement of Cash Flows

For the year ended 31st March 2020

(Rs'000)

Cash flow from Operating Activities		
Net Profit Before Tax (140+205+100)		445
Adjustment for		
Interest expenses	295	
Profit on disposal of PPE (W-1)	(550)	
Depreciation (2,090+1,250-1,810)	1,530	1,275
Operating profit before working capital changes		1,720
Income Taxes Paid(W2)		(435)
		1,285
Working Capital Changes		
(Increase) in inventories	(400)	
(Decrease) in trade debtors	182	
Decrease in trade payables	105	(113)
Net cash flows from operating activities		1,172
Cash flow from investment activities		
Sale proceeds on disposal of PPE	1,800	
Purchase of PPE (3,838-2,500-4,205)	(2,867)	(1,067)
Dividend paid	(100)	
loan obtained	800	
loan paid	(650)	
Interest paid (W-3)	(215)	(165)
Net cash flows for the year		(60)
Cash & cash equivalents at the beginning of the year		457
Cash & cash equivalents at the end of the year		397

Workings:

(W-01) Disposal Account

Cost	2,500	Accumulated Depreciation	1,250
Profit	550	Cash	1,800
	<u>3,050</u>		<u>3,050</u>

(W-02) Income Tax

Cash	435	B/B/F	450
B/C/F	220	P&L	205
	<u>655</u>		<u>655</u>

(W-03) Loan Interest Account

Cash	215	B/B/F	100
B/C/F	180	P&L	295
	<u>395</u>		<u>395</u>

(Total 10 marks)

Suggested Answers to Question Six:

Chapter 2- Regulatory Requirements, and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

1. This is an adjusting event as per LKAS 10, **bankruptcy of customer after reporting period will require an adjustment to the financial statement. So, this 7 million should be recognized as bad debts in the books.**
2. This is an adjusting event as per LKAS 10, **there is a constructive obligation on TAL , as this was declared each and every year. Therefore, the annul bonus of 12 million should be accounted in the financial statements.**

(04 marks)

(b)

Chapter 2- Regulatory Requirements, and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

Extract of Statement of Financial Position

Non-Current Assets	
Right to use asset (3,281,945+400,000)	3,681,945
Non- Current Liabilities	
Lease creditors -More than one year	1,240,111
Current Liabilities	
Lease creditors -within one year	1,087,719

Workings

Cash Flow	DF	PV
1,413,600	0.8772	1,240,000
1,413,600	0.7695	1,087,765
1,413,600	0.675	<u>954,180</u>
		<u>3,281,945</u>

Alternative Method to calculate by PV

$$\frac{1,413,600}{1.14} = \underline{\underline{1,240,000}}$$

$$\frac{1,413,600}{1.14^2} = \underline{\underline{1,087,719}}$$

$$\frac{1,413,600}{1.14^3} = \underline{\underline{953,846}}$$

	Interest	Installment	Capital	O/S
3,281,945	459,472	1,413,600	954,128	2,327,817
2,327,817	325,894	1,413,600	1,087,706	1,240,111
1,240,111	173,615	1,413,600	1,239,984	-

(06 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

Chapter 2- Regulatory Requirements, and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

1. Land = There is no temporary difference
2. Tax base-Plant & Equipment = 40,000-16,300 =23,700
 Temporary difference = 32,500-23,700 =8,800
 Differed tax asset = 8,800 X 14%
 = 1,232

AWDV	TWDV	Temporary difference
32,500	23,700	8,800

Differed tax liability = 8,800 X14%
1,232

3. Gratuity - deductible temporary difference

Gratuity Provision	TWDV	Temporary difference
(12,000)	-	(12,000)

Differed tax liability =12,000 X14%
1,680

(06 marks)

(b)

Differed Tax Liability Account

(Rs.000)

P&L	1,680	B/B/F	810
B/C/F	<u>362</u>	P&L	<u>1,232</u>
	<u>2,042</u>		<u>2,042</u>

(04 marks)

(Total 10 marks)

End of Section B

Suggested Answers to Question Eight:**Chapter 4 - Interpretation of Financial and Non-Financial Data and Information**

Preparation of a summary report to the management incorporating, the financial position, performance and operating efficiency of an entity using ratios and non-financial data and information.

(a)

<u>Ratio</u>	<u>Formula</u>	<u>Formula</u>	<u>Ratio</u>
(i) Gross Profit Ratio	Gross Profit/sales * 100	29,600/92,500*100	32%
(ii) Net Profit Ratio	Net profit before tax / sales *100	5,500/92,500*100	6%
(iii) Debtors Collection Period	Average debtors / sales * 365	((11,700+12,700)/2)/92,500*365	48 Days
(iv) Debtors collection	Average inventories / cost of sales * 365	((15,000+16,500)/2)/62,900*365	91Days
(v) Current ratio	current assets : current liabilities	31,300 : 19,000	1.65:1
(vi) Interest cover	PBIT / interest	10,700/2,200	4.86 Times

(06 marks)

(b)

Chapter 4 - Interpretation of Financial and Non-Financial Data and Information**1. Profitability**Gross Profit Ratio

The gross profit ratio of the company stood at 32% and the same for the year 2019 was 30%, (increase by 2%) and this shows that the company was capable of improving its profitability. This might be due to increased selling price or improved efficiency in relation to the manufacturing cost. In the absence of information, it is highly likely that the economies of scale have improved the profitability of the company.

Net Profit Ratio

The net profit (After Tax) has reduced dramatically, in the last year NP ratio was 10% and the same for the current year is silently higher than 50% of the last year, which is 6%.(4% decrease) It is very important to consider non-manufacturing overhead and other sales related expenses, which are the main factors which will reduce the gross profit. The important point is to note, is that the GP was not reduced by 4.05 but the improvement in GP was also removed by this drop, so the overall drop is 6.05%. therefore, management needs to implement strong control over those expenses.

2. Efficiency

Debtors Collection Period:

Debtors' collection period has increased from 45 days to 48 days. This shows the inefficiencies in collecting debts. Therefore the company should adopt different strategies to collect debts from debtors without making long dues.

Inventory Residence Period:

Inventory residence period is 91 days compared to 85 days in last year. This means that a significant time is taken to convert stocks into sales. This may be due to slow down in trading. Specifically, the demand for products during the current year has been reduced.

3. Liquidity

Current Ratio

This ratio shows the strength of the business in settling current liabilities using total current assets. Acceptable one is 2:1. For this year it was 1.65 : 1 when compared to the previous year 1.94 : 1.

The current ratio is at danger zone and a red flag to management, the company might be trying an aggressive working capital strategy (maximum creditors). It will be very much important for the Company to maintain sufficient current assets to meet obligation, the last year might be a ratio. Still the current strategy will be successful, if the management executes the approach in the current manner. Anyhow the company is in a better position if the company strengthen its current assets.

4. Investment

Interest Cover

This indicates whether the business would earn sufficient profit to pay interest to its lenders. The interest cover ratio has improved in this year despite of NP reduction, it is important to see the interest rate associated with the loan. The company might have obtained loans at variable rates that may be the reason for the improved interest cover in the current year. It shows the strength of the company in paying interest to lenders.

(06 marks)
(Total 12 marks)

Suggested Answers to Question Nine:

Chapter 5 - Consolidated Financial Statements

(a)

	<i>Rs'000</i>
Goodwill calculation	
investment	40,000
Fair Value of NCI	<u>10,000</u>
	50,000
Less: Net Asset	
Stated Capital	(40,000)
Retained Earnings	<u>(5,000)</u>
Goodwill	<u>5,000</u>

(03 marks)

(b)

Sun PLC

Consolidated Statements of Financial Position

As at 31st March 2020

(Rs. 000)

Assets			
Non-Current Assets			
Property Plant and Equipment (80,000+42,000-1,800)		120,200	
Accumulated Depreciation (34,000+6,000-200)		<u>(39,800)</u>	80,400
Goodwill			<u>5,000</u>
			85,400
Current Assets			
Inventories '(12,000+13,500-300)		25,200	
Trade debtors '(8,000+9,000-3600)		13,400	
Cash		<u>4,500</u>	43,100
Total Assets			128,500
Equity and Liabilities			
Equity			
Stated Capital		70,000	
Retained earnings (W-2)		<u>17,220</u>	87,220
NCI (W-1)			10,580
Liabilities			
Current liabilities			
Trade & other payable '(21,300+13,000-3,600)			30,700
Total Equity and Liabilities			128,500

Workings

(W-1)- Non-Controlling Interest

(Rs.'000)

Unrealized profit on stock (W3)	60	Investments	10,000
B/C/F	10,580	Retained Earnings (8,000-5,000)*20%	600
		Depreciation	40
	<u>10,640</u>		<u>10,640</u>

(W-2)- Consolidated Retained Earnings**(Rs.'000)**

Unrealized profit on stock (W3)	240	B/B/F	16,700
Profit on disposal	1,800	Depreciation	160
B/C/F	17,220	R/E-M-3,000X80%	2,400
	<u>19,260</u>		<u>19,260</u>

(W-3) -Unrealized Profit

$$=3,000 \times 120\% \times 50\% = 1,800$$

$$=1,800 / 120 \times 20$$

$$= \underline{\underline{300}}$$

(W-4)-Profit on disposal

$$=5,000 + 800 - 4,000$$

$$= \underline{\underline{1,800}}$$

(10 marks)**(Total 13 marks)*****Suggested Answers to Question Ten:*****Chapter 3 - Financial Statements for a Limited Liability Company****(a)****Diana Ltd****Statement of Profit or Loss and Other Comprehensive Income****For the year ended 31st March 2020****"in LKR 000"**

Sales		281,900
Cost of sales (198,500+500)		(199,000)
Gross Profit		82,900
Other income (3,000+1,500)		4,500
Less Expenses :		
Administration Expenses (W-2)	(30,040)	
Distribution Expenses (W-1)	(24,785)	
Finance Expenses (8,400-450)	(7,950)	(62,775)
Profit Before Tax		24,625
Income Tax (W-3)		(2,300)
Profit After Tax		22,325
<u>Other comprehensive income</u>		
Revaluation surplus of land		3,700
		<u>26,025</u>

(10 marks)

(b)

Chapter 3 - Financial Statements for a Limited Liability Company

Diana Ltd
Statement of Financial Position
As at 31st March 2020

"in LKR 000"

<u>Non-Current Assets</u>		
Property , Plant & Equipment		42,035
Capital work in progress (8,200+450)		8,650
<u>Current Assets</u>		
Inventories (39,400-500)	38,900	
Trade Receivables (28,100+1,500-2,960)	26,640	
Prepayment & other receivables	900	
Cash and cash equivalents	10,700	77,140
Total Assets		127,825
<u>Equity & Liabilities</u>		
<u>Equity</u>		
Stated Capital	50,000	
Revaluation Surplus	3,700	
Retained earnings	34,325	88,025
<u>Non-Current Liabilities</u>		
12% bank loan -non-current portion	3,000	
Employee Benefits	4,500	7,500
<u>Current Liabilities</u>		
Trade payable	29,100	
Current tax	1,750	
Bank loan -current portion	1,000	
Accrued Expenses	450	32,300
Total Equity & Liabilities		127,825

(8 marks)

(c.)

Diana Ltd
Statement of Changes in Equity
For the year ended 31st March 2020

"in LKR 000"

Description	Stated Capital	Retained Earnings	Revaluation	Total
Balance as at 01.04.2019	50,000	17,000	-	67,000
Revaluation	-	-	3,700	3,700
Dividends paid	-	(5,000)	-	(5,000)
Profit for the year	-	22,325	-	22,325
	50,000	34,325	3,700	88,025

(3 marks)

(d)

Diana Ltd
Statement of movements of Property Plant and Equipment
For the year ended 31st March 2020

"In LKR 000"

Description	Land	Building	Motor vehicle	Computer software	Total
Cost					
Balance as at 01.04.2019	20,000	12,000	7,300	5,000	44,300
Additions	-	-	-	9,000	9,000
Revaluation	3,700	-	-	-	3,700
Balance as at 31.03.2020	23,700	12,000	7,300	14,000	57,000
Depreciation					
Balance as at 01.04.2019	-	4,800	3,200	3,000	11,000
Acc. Depreciation	-	240	1,825	1,900	3,965
Balance as at 31.03.2020	-	5,040	5,025	4,900	14,965
Carrying Value as at 31.03.2020	23,700	6,960	2,275	9,100	42,035

(4 marks)

Workings

W-1 Distribution Expenses

TB	23,400
Depreciation-MV	1,825
Overcharged of debtor's provision	<u>(440)</u>
	<u>24,785</u>

W-2 Administration Expenses

TB	30,350
Software	(2,000)
Depreciation –Building	240
-Software (W 4)	1,900
Insurance	(900)
Accrued	<u>450</u>
	<u>30,040</u>

W-3 Income Tax

Cash	1,300	B/B/F	750
B/C/F	<u>1,750</u>	P&L	<u>2,300</u>
	<u>3,050</u>		<u>3,050</u>

W-4 Depreciation on Software

Software (5,000/5)	1,000
Additions (9,000x20%x1/2)	<u>900</u>
	<u>1,900</u>

(Total 25 marks)

End of Section C

Notice:

These answers compiled and issued by the Education and Training Division of AAT Sri Lanka constitute part and parcel of study material for AAT students.

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