



Association of Accounting Technicians of Sri Lanka

Level III Examination - January 2021

Suggested Answers

(301) FINANCIAL REPORTING (FAR)

Association of Accounting Technicians of Sri Lanka

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Level III Examination-January 2021

(301) Financial Reporting

SUGGESTED ANSWERS

Four (04) Compulsory Questions
(Total 20 Marks)

SECTION - A

Suggested Answers to Question One:

Chapter 1- Governance Structure, the Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

(a)

(1) It is inherent to the accounting profession:

Accounting and ethics go hand in hand with accounting profession. As accountants, it is important that we make neutral unbiased that held to clients. As part of the ethics code, it is important that the information provided is not subject to an external influence.

(2) Information needs to remain confidential:

Disclosure of confidential information by an accounting professional violates the ethical code. The ethics code prevents a firm or organization from doing this unless there is a legal reason for doing so.

(3) The integrity of the employees

Ethics code ensures that all the members of the company demonstrate integrity and honesty in their work with clients and other professional relationship. The ethics code also prevents accountants from associating themselves with any information that could be misleading or damaging the client or the organization.

(4) The company's reputation:

The code of ethics state that accountants need to abide by all the rules and regulations listed by the governing body. This will help the company to maintain professionalism and ensures that financial statements are a fair and accurate presentation of the company's position. Failure to comply with ethics can affect the reputation of the company.

(5) Enhance trust with stakeholders:

The code of ethics helps to ensure that there is no miss presentation of the information provided to the stakeholders in the company. It builds trust with stakeholders.

(05 marks)

Suggested Answers to Question Two:

Chapter 1- Governance Structure, the Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

Relevance

Relevant financial information is capable of making a difference in the decisions made by users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both. The predictive value and confirmatory value of financial information are interrelated. Information has the quality of relevance when it influences the economic decisions of users.

Faithful representation

General purpose financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only be relevant, it must also represent faithfully the phenomena it purports to represent. A faithful representation seeks to maximize the underlying characteristics of completeness, neutrality and freedom from error.

(05 marks)

Suggested Answers to Question Three:

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

$$\text{PQR Bank} - 15,000,000 \times 14\% \times \frac{10}{12} = 1,750,000$$

$$\text{General} - 15,000,000 \times 14\% \times \frac{10}{12} = \underline{1,750,000}$$
$$\underline{\underline{3,500,000}}$$

Workings:

$$\text{ABC Bank} - 10,000,000 \times 12\% = 1,200,000$$

$$\text{Debentures} - 10,000,000 \times 16\% = \underline{1,600,000}$$

$$\underline{\underline{2,800,000}}$$

$$\text{WACC} - \frac{2,800,000}{20,000,000} \times 100 = 14\%$$

(Note: PQR loan is specifically taken for project, but utilized for 10 months. ABC Bank Loan & Debenture were used proportionately; we need to find the weighted average rate for these loans.)

(05 marks)

Suggested Answers to Question Four:

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

1. Staff Training cost incurred by the company is considered as general overhead, it does not fulfill the criteria to recognize as an intangible asset as per LKAS 38. Generally future actions of staff is not within the control of the entity, therefore it should be charged to the income statement and should not be capitalized.
2. As per LKAS 38, the cost incurred at the research phase, before developing the product should not be capitalized as intangible asset; it should be expensed to the Income Statement. Accordingly, the total of 3 Million incurred for research should be expensed to income statement.

(03 marks)

(b)

1. The technical feasibility of completing the intangible asset. So that it will be available for use or sale.
2. Intention to complete and use or sell the asset.
3. The availability of adequate technical, financial and other recoveries to complete the development and use or sell the intangible asset.
4. Existence of a market or, if to be used internally, the usefulness of the asset
5. The cost of the asset can be measured reliably.
6. How the intangible assets will generate probable future economic benefits.

(02 marks)

(Total 05 marks)

End of Section A

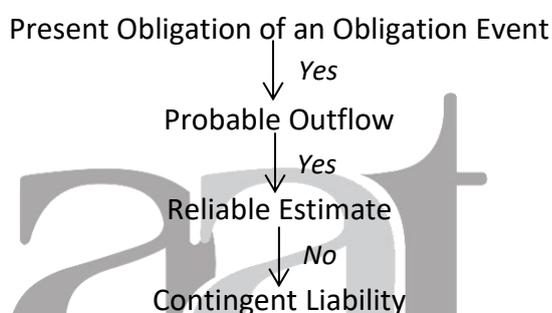
Suggested Answers to Question Five:

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

(a)

1. A case filed by a customer to claim Rs.10 million from the company for poor quality of the products should be treated as a contingent liability. Though the lawyers have confirmed a high probability of making this compensation payment, a reliable estimation cannot be made with certainty. Therefore, as per LKAS 37, a disclosure should be made in the financial statements.

Alternative Answer:



If the amount cannot be estimated reliably, a disclosure is only required in the financial statements.

2. The Warranty clause will create an obligation on the entity, as a high probability is involved, we can use the best estimation of the obligation. Therefore, a provision of Rs.540,000/- should be made.

No Defects	=	70%	×	0	=	—
Minor Defects	=	25%	×	1,200,000	=	300,000
Major Defects	=	5%	×	4,800,000	=	240,000
Total	=	<u>100%</u>			=	<u>Rs.540.000</u>

(05 marks)

(b)

Financial Assets	Financial Liabilities
Cash in hand	Bank overdraft
Trade receivables	Trade payables
Investment in shares	Debentures
Bank balance	Short and Long term bank loans
Investment with less than 6 months	Salary payable
Investment in treasury bills	
Employees loan receivables	

(05 marks)
(Total 10 marks)

Suggested Answers to Question Six:

(a)

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

Description	Amount
Initial Cost (FOB Price)	3,000,000
Freight charges	250,000
Marine insurance	50,000
Import duties	300,000
Non-refundable taxes	30,000
Engineering cost	80,000
Dismantle Cost (Assumed PV and for Current Asset)	75,000
Test run	55,000
Total Cost	<u>3,840,000</u>

(06 marks)

(b)

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

1. To grant a licence to a body corporate to operate as a stock exchange and ensure the proper conduct of its business.
2. To grant licence to a managing company to operate a unit and to ensure the proper conduct of the business of such unit trust.
3. To grant compensation to any investor who suffers pecuniary loss arising as a result of any licensed stock broker or licensed stock dealer being found incapable of meeting his contractual obligations.
4. To advise the government on the development of the securities market.
5. To cancel or suspend the listing of any securities or the trading of any listed securities or to suspend the trading of all listed securities for not more than three days at a time, for the protection of investors.
6. To request the Registrar of Companies, in the exercise of the powers conferred on it by section 227 of the Companies Act, to call upon a private limited liability company to become a public limited company.

7. To inquire and conduct investigations into any activity of a licensed stock exchange or a licensed managing company.
8. To inquire and conduct investigations into any activity of a licensed stock broker or licensed stock dealer or a trustee of a unit trust.

(04 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

Chapter 3 part 11 – Financial Statements for a Limited Liability Company for Publication Purpose

Gamage (Pvt) Ltd
Statement of Cash Flows
For the Year ended 31.03.2020 (Rs.'000)

Cash flows from operating activities		
Net profit before tax (740+110+200)		1,050
Adjustments for ;		
Interest expenses	120	
Profit on disposal	(600)	
Depreciation [1090-(810-650)]	<u>930</u>	<u>450</u>
Operating profit before changes in working capital		1,500
Changes in working capital		
Decrease in Inventory	400	
Increase in Trade Receivables	(415)	
Increase in Trade Payables	<u>85</u>	<u>70</u>
Cash generated from operating activities		1,570
Income tax paid (W2)	<u>(340)</u>	<u>(340)</u>
Net cash flow from operating activities		1,230
Cash flows from investing activities		
Sales proceeds (W3)	2,050	
Acquisition of PPE [(3,205-(2,838-2,100)]	<u>(2,467)</u>	
Net cash flows from investing activities		(417)
Cash flow from financing activities		
Interim dividend paid	(200)	
Repayment of loan	(450)	
Interest paid (W1)	<u>(20)</u>	
Net cash flow from financing activities		<u>(670)</u>
Net cash increase during the period		143
Cash & cash equivalent at the beginning of the year		457
Cash & cash equivalent at the end of the year		<u><u>600</u></u>

Workings:

W1

Interest Payable Account

Cash	20	B/C/F	100
B/C/F	200	P & L	120
	<u>220</u>		<u>220</u>

W2

Income Tax Payable Account

Cash	340	B/B/F	450
B/C/F	220	P & L	110
	<u>560</u>		<u>560</u>

W3

Disposal Account

Cash	2,100	B/B/F	650
P & L	600	Cash	2,050
	<u>2,700</u>		<u>2,700</u>

(Total 10 marks)

End of Section B



Suggested Answers to Question Eight:

Chapter 4 – Interpretation of Financial and Non-financial Data and Information

(a)

	2019/20	2018/19
(i) Gross Profit Ratio $\frac{GP}{Sales} \times 100$	$\frac{120,040}{300,100} \times 100 = 40\%$	$\frac{122,500}{275,000} \times 100 = 44.54\%$
(ii) Net Profit Ratio $\frac{PAT}{Sales} \times 100$	$\frac{27,500}{300,100} \times 100 = 9.16\%$	$\frac{23,500}{275,000} \times 100 = 8.54\%$
(iii) Quick Assets Ratio	71,000 – 32,000 : 45,700 = 0.85 : 1	63,200 – 30,000 : 31,400 = 1.057 : 1
(iv) ROCE $\frac{\text{Profit before Interest and Tax}}{\text{Equity + Long Term Loan}} \times 100$	$\frac{44,500}{(105,300 + 45,000)} \times 100 = 29.6\%$	$\frac{32,000}{(95,800 + 56,000)} \times 100 = 21.08\%$
Alternative Answer: ROCE $\frac{\text{Profit after Tax}}{\text{Stated Capital Reserves}} \times 100$	$\frac{27,500}{105,300} \times 100 = 26.12\%$	$\frac{23,500}{95,800} \times 100 = 24.5\%$
(v) Gearing Ratio $\frac{\text{Equity: Fixed Interest}}{\text{Bearing Loans}}$	105,300 : 45,000 = 2.34 : 1	95,800 : 56,000 = 1.71 : 1
(vi) EPS $\frac{\text{Net Profit After Tax}}{\text{No. of Ordinary Shares}}$	$\frac{27,500}{9,000} = 3.055$	$\frac{23,500}{9,000} = 2.61$

(06 marks)

(b)

Profitability

GP Ratio:

The Gross profit margin stood at 44.54% in 2019 and has deteriorated to 40% in 2020, the extent of increase in cost of sales was higher than that of sales, and such has deteriorated the previously sustained margin levels by 4.5%, it is important for the management to investigate such considerable increase in cost of sales.

Net Profit Ratio:

Though GP ratio decreased compared to 2018/19, Net profit Ratio has increased in 2019/20. It is very much important to revisit the cost minimization strategies practice at this non-production overhead and such can be replicated in the cost of sales area.

ROCE:

Further the primary profitability & investor ratios showed a dramatic improvement, where the ROCE showed an improvement of 8.5 % from 2019 (21.08%). This indicates the total return of the company as a percentage of the total amount of capital employed.

Liquidity:

Quick assets ratio represents the liquidity of the business and it is calculated to indicate the company's ability to settle the current liabilities using quick assets. When considering the quick ratio, the 2020 ratio has deteriorated marginally and stood at 0.85: 1, this triggers an alert to the management to be vigilant about the possible defaults. As long as, the management can honor the payments, these ratios will not have a material impact. Further it indicates that the business cannot settle their current liabilities using quick assets.

Investment:**EPS**

If the EPS is high, it indicates that the business's operation is good. EPS is high in 2019/20 (3.055) when comparing with 2018/19 (2.61). The main reason for such improvement is due to the repayment of loan together with the improve volume in sales, this has improved these ratios.

Gearing Ratio

This explains the relationship between equity capital and loan capital. The loans have been settled during the year under review and such has improved the gearing ratio, and such ratio stood at 2.34: 1. Gearing ratio has increased in 2019/20 comparing with 2018/19 and the situation can be identified as low gearing.



(06 marks)
(Total 12 marks)

Suggested Answers to Question Nine:

Chapter 5 part II - Consolidated Financial Statements

(a)

Goodwill Calculation	(Rs.'000)
Investment by Parent	85,000
FV of NCI	<u>25,000</u>
	110,000
FV of NV acquired	<u>(95,000)</u>
Goodwill	<u>15,000</u>

(04 marks)

(b)

Alpha PLC
Consolidated Statement of Profit or Loss
for the year ended 31.12.2020

(Rs.'000)

Sales (W1)	459,000
Cost of Sales (W2)	<u>(234,400)</u>
Gross Profit	224,600
Other Income	
Rent Income (W3)	-
Other Income (W4)	<u>500</u>
	225,100
Expenses	
Distribution Cost (W5)	(38,800)
Administration Cost (W6)	(71,400)
Finance Cost (W7)	<u>(4,300)</u>
Profit Before Tax	110,600
Income Tax (W8)	<u>(14,500)</u>
Profit After Tax	96,100
Other Comprehensive Income	-
Total Comprehensive Income	<u>96,100</u>

Workings:

	A	B	Adjustment	CONSOLIDATED	Reason for Adjustment
1	325,000	140,000	(6,000)	459,000	Inter-Company Sales
2	(180,000)	(60,000)	6,000	(234,400)	Inter-Company Purchases
				225,000	
				* (400)	URP on Sales
				224,600	
3	600		(600)	-	Inter-Company Rent
4	500	500	*(500)	500	URP on Disposal
5	(26,000)	(12,800)		(38,800)	Inter-Company Distribution Expenses
6	(48,000)	(24,000)	600	(71,400)	Inter-Company Administration Expenses
7	(2,500)	(1,800)		(4,300)	Inter-Company Finance Expenses
8	(8,500)	(6,000)		(14,500)	Inter-Company Income Tax

*** Unrealized profit on unsold goods**

$$A \longrightarrow B \quad \frac{6,000,000}{125} \times 25 = 1,200$$

$$URP = 120/3 = 400$$

***Unrealized profit on land sale**

$$B \longrightarrow A$$

$$5,000 \quad 5,000 \longrightarrow URP = 500$$

(09 marks)

(Total 13 marks)

Suggested Answers to Question Ten:

Chapter 3 part I – Financial Statements for a Limited Liability Company for Publication Purpose

(a)

Diamond PLC
Statement of Profit or Loss and Other Comprehensive Income
for the year ended 31 March 2020

		(Rs.'000)
Sales		281,000
Less : Cost of Sales (W1)		<u>(205,425)</u>
Gross Profit		75,575
Other Income (W2)		<u>7,340</u>
		82,915
Less Expenses:		
Distribution Expenses (W3)	24,900	
Administration Expenses (W3)	40,500	
Finance Expenses(W4)	2,400	
Other Expenses (W3)	<u>140</u>	(67,940)
Profit before tax		14,975
Income tax (W5)		<u>(3,300)</u>
Profit after tax		11,675
Other comprehensive income – Revaluation surplus		<u>2,000</u>
Total Comprehensive Income		<u>13,675</u>

(10 marks)

(b)

Diamond PLC
Statement of Financial Position
as at 31st March 2020

(Rs.'000)

Assets:		
<u>Non - Current Assets</u>		
Property, Plant & Equipment		49,160
<u>Current Assets</u>		
Inventories (W6)	34,875	
Trade Receivables(W7)	15,840	
Pre- Payments	4,500	
Cash and Cash Equivalent	<u>8,350</u>	<u>63,565</u>
Total Assets		<u>112,725</u>
Equity & Liabilities:		
<u>Equity</u>		
Stated Capital	60,000	
Other Reserves	2,000	
Retained Earnings	<u>24,475</u>	86,475
<u>Non - Current Liabilities</u>		
Bank Loan	1,250	
Employee Benefits	<u>4,400</u>	5,650
<u>Current Liabilities</u>		
Trade Payables	17,100	
Current Portion Of Bank Loan 1/2	1,250	
Audit Fee Payable	400	
Income Tax Payable	<u>1,850</u>	20,600
Total Equity and Liabilities		<u>112,725</u>

(08 marks)

(c)

Diamond PLC
Statement of Changes in Equity
for the year ended 31st March 2020

Description	Stated Capital	General Reserve	Revaluation Reserve	Retained Earnings	Total
Balance as at	60,000	-	-	19,300	79,300
Share Issue	-	-	-	-	-
Revaluation / OCI	-	-	2,000	-	2,000
Profit	-	-	-	11,675	11,675
Dividends Ordinary Shares	-	-	-	(6,500)	(6,500)
	60,000	-	2,000	24,475	86,475

(03 marks)

(d)

Diamond PLC
Statement of movements of PPE for the year ended 31st March 2020

(Rs.'000)

	Land	Buildings	Plant & Machinery	Office Equipment	Total
Cost:					
Balance as at	38,000	7,000	10,250	6,300	61,550
Error in ledger posting	-	-	350	-	350
Revaluation Surplus	2,000	-	-	-	2,000
Disposal	-	-	(500)	-	(500)
Balance as at 31.03.2020	40,000	7,000	10,100	6,300	63,400
Acc. Depreciation:					
Balance as at	-	4,500	3,700	2,100	10,300
Depreciation	-	140	2,650	1,260	4,050
Disposal	-	-	(250)	-	(250)
Impairment Loss	-	-	-	140	140
	-	4,640	6,100	3,500	14,240
Carrying value as at 31.03.2020	<u>40,000</u>	<u>2,360</u>	<u>4,000</u>	<u>2,800</u>	<u>49,160</u>

(04 marks)

(Total 25marks)

Workings:

W1 – Cost of Sales

Cost of Sales	205,000
Inventories Written Off	<u>425</u>
	<u>205,425</u>

W2 - Other Income

From TB	6,000
Profit of disposal	* 100
Provision for D/D	* <u>1,240</u>
	<u>7,340</u>

W3 -Expenses

Description	Distribution Expenses	Administration Expenses	Other Expenses
Bad Debts	500		
Audit Fee		400	
Insurance		1,500	
Depreciation		* 4,050	
Impairment Loss			140
From TB	<u>24,400</u>	<u>34,550</u>	-
	<u>24,900</u>	<u>40,500</u>	<u>140</u>

W4 – Net Finance Income or Expense

Interest Expense 2,400

W5 – Taxation

Cash	4,200	B/B/F	2,750
B/C/F	1,850	P & L	3,300
	<u>6,050</u>		<u>6,050</u>

W6 – Inventories

Inventory as at 31 st March 2020	35,300
Inventories Written Off	<u>(425)</u>
	<u>34,875</u>

W7 – Trade Receivables

Trade Receivables	17,600
Allowance for debts	<u>(1,760)</u>
Net Trade Receivables	<u>15,840</u>

*** Disposal Account**

Cost	500	Cash	350
P & L	100	Accumulated Depreciation	250
	<u>600</u>		<u>600</u>

*** Allowance for Doubtful Debts**

Provision as at 01.04.2019	3,000
Provision as at 31.03.2020	1,760
Over Provision	(1,240)

*** Depreciation**

Buildings (7,000/50)	140
Plant & Machinery (10,250 + 350) /4	2,650
Office Equipment (6,300/5)	1,260
	4,050

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.

These should be understood as Suggested Answers to question set at AAT Examinations and should not be construed as the “Only” answers, or, for that matter even as “Model Answers”. The fundamental objective of this publication is to add completeness to its series of study texts, designs especially for the benefit of those students who are engaged in self-studies. These are intended to assist them with the exploration of the relevant subject matter and further enhance their understanding as well as stay relevant in the art of answering questions at examination level.



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