SRI LANKA

Association of Accounting Technicians of Sri Lanka

Level III Examination - July 2022

Suggested Answers

(301) FINANCIAL REPORTING (FAR)

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

Level III Examination - July 2022

(301) Financial Reporting

SUGGESTED ANSWERS

Four (04) Compulsory Questions
(Total 20 Marks)

SECTION - A

Suggested Answers to Question One:

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

(a)

(1) To sell shares

(2) To buy shares

(3) To provide the loans to the company

(4) To ensure whether job security of the company is available

(5) To decide on the continuity of the business

(6) To identify the performance of the business

(7) To provide goods and services on credit

(8) To purchase goods and services from the company

(02 marks)

(b)

Completeness means that information of financial statements should not exclude any transaction. In other words, financial information should be free from omissions and misstatements as per the quality of completeness.

Comparability is the degree to which accounting standards and policies are constantly applied from one period to the another enabling those to be compared with prior periods, with industry and with competitors.

(03 marks)

(Total 05 marks)

Suggested Answers to Question Two:

Chapter 02 - Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

a) Changing the depreciation method from reducing balance to straight line

Depreciation method is an accounting estimate. Change in depreciation method is a change in accounting estimates. Therefore, the change shall be adjusted prospectively to the current year and future years, without changing the past information.

b) Borrowing cost of building

As per Sri Lanka Accounting Standards for Small and Medium Enterprises, the borrowing cost of assets cannot be capitalized. Therefore, those shall be charged to profit or loss as a finance expense.

c) Changing inventory valuation methods from First In First Out to Weighted Average Method

Inventory valuation formula is an accounting policy. Therefore, changing from first in first out method to weighted average method is a change in accounting policy. Since it's a voluntary change in accounting policy, the change shall be retrospectively applied. The entity needs to adjust the financials to reflect as if the entity has been applying the weighted average method of inventory valuation from the inception.

(05 marks)

Suggested Answers to Question Three:

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

(a) Integrated Report

Integrated report can be defined as a concise communication about how an organization's strategy, governance, performance and prospects in the context of its external environment, lead to the creation of value over the short, medium and long term.

Also an Integrated report portrays the financial capital contribution and the total value creation process through integrated thinking to decision makers by going beyond traditional financial capital.

(02 marks)

(b) Contents of an Integrated report

Three out of following is required.

- Business model
- Organisational overview and external environment
- Performance (Management of Capital)
- Relationship with Stakeholders
- Strategy and resource allocation
- Governance
- Risk and opportunities
- Preparation and presentation
- Outlook

(03 marks)
(Total 05 marks)

Suggested Answers to Question Four:

Chapter 02 Part I – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a) Specified Business Enterprises

Three out of following is required.

- Companies licensed under the Banking Act, No. 30 of 1988.
- Companies authorized under the Control of Insurance Act, No. 25 of 1962, to carry on insurance business.
- Companies carrying on leasing business.
- Factoring companies.
- Companies registered under the Finance Companies Act, No. 78 of 1988.
- Companies licensed under the Securities and Exchange Commission Act, No. 36 of 1987, to operate unit trust.
- Fund Management Companies.
- Companies licensed under the Securities and Exchange Commission Act, No. 36 of 1987, to carry on business as stockbrokers or stock dealers.
- Companies licensed under the Securities and Exchange Commission Act, No. 36 of 1987, to operate a Stock exchange.
- Companies listed in a Stock Exchange licensed under the Securities and Exchange Commission Act, No. 36 of 1987.
- Other Companies
    - Which have a turnover in excess of Rupees 500 Million;
    - Which at the end of the previous financial year, had shareholders equity in excess of Rupees 100 Million;
    - Which at the end of the previous financial year, had gross assets in excess of Rupees 300 Million;

- Which at the end of the previous year had liabilities to banks and other financial institutions in excess of Rupees 100 Million;
- Which have a staff in excess of 1000 employees.

- Public corporations engaged in the sale of goods or the provision of services.
- A group of companies, any one of which fall within any of the above categories. For this purpose, ”a group of companies” means a holding company and its subsidiaries, the accounts of which have to be consolidated under section 147 of the Companies Act, No.17 of 1982.

(03 marks)

(b) Powers of the Sri Lanka Accounting and Auditing Standards Monitoring Board.

- Obtaining the copies of financial statements from specified business enterprises.
- Requesting to provide information during a specified time period.
- Call for an inquiry, questioning, investigate and examine any director, officer or an auditor.

(02 marks)

(Total 05 marks)

End of Section A

Three (03) Compulsory Questions (Total 30 Marks)	SECTION - B

Suggested Answers to Question Five:

Chapter 03 part 11 – Financial Statements for a Limited Liability Company for Publication Purpose

Manel (Pvt) Ltd.
Statement of Cash Flows
For the year ended 31st March 2022

(Rs.'000)

Cash Flows from operating activities			
Profit before tax	**W1**		45
Adjustments For:			
Interest Expense	**W2**	350	
Gratuity Expense	**W3**	600	
Machinery Disposal Gain	**W4**	(900)	
Depreciation	**W4**	1,100	1,150
Operating Profit before changes in working capital			**1,195**
(-) Gratuity Paid	**W3**	(100)	
(-) Income Tax Paid		(85)	(185)
Changes in working capital			
Decrease in Inventory		1,240	
Decrease in Trade and Other Receivables		950	
Decrease in Trade and Other Payables		(750)	1,440
Net Cash generated from Operating Activities			2,450
Cash Flows from Investing Activities			
Proceeds from Disposal of Machinery	**W4**	1,500	
Purchase of Machinery	**W4**	(2,300)	
Net Cash generated from Investing Activities			**(800)**
Cash flows from Financing Activities			
Proceeds from Bank Loan obtained	**W6**	900	
Interest Paid	**W2**	(320)	
Repayment of Bank Loan	**W6**	(690)	
Net cash generated from financing activities			**(110)**
Net movement of Cash and Cash and Cash Equivalents			**1,540**
Opening Cash and Cash Equivalents			860
Closing Cash and Cash Equivalents			**2,400**

Workings

W1 - Profit before Tax

Retained Earnings

Tax Expense	145	Balance B/F	2,790
Balance C/D	2,690	**Profit before Tax**	**45**
	2,835		2,835

W2 – Interest Expense and Interest Paid

Debit	Interest Expense	350	
Credit	Interest Payable		350

Interest Account

Cash	320	Balance B/F	120
Balance C/D	150	Interest Expense	350
	470		470

W3 – Gratuity Expense and Gratuity paid

Debit	Gratuity Expense	600	
Credit	Gratuity Provision		600

Gratuity Provision

Cash	100	Balance B/F	1,250
Balance C/D	1,750	Gratuity Expense	600
	1,850		1,850

W4 – Machine Acquisition, Disposal and Gain on Disposal

Disposal Gain or Loss

Machinery	1,100	Accumulated Dep.	500
Profit or Loss	**900**	**Cash (Machine Disposal)**	**1,500**
	2,000		2,000

Property Plant and Equipment

Balance B/F	6,000	Disposal Gain/ (Loss)	1,100
Cash (Machine Acquisition)	**2,300**	Balance C/D	7,200
	8,300		8,300

Accumulated Depreciation

Disposal Gain/Loss	500	Balance B/F	3,500
Balance C/D	4,100	**Depreciation**	**1,100**
	4,600		4,600

W5 - Tax Paid

Debit	Tax Expense (Retained Earnings)	145	
Credit	Tax Payable		145

Tax Payable

Cash	**85**	Balance B/F	150
Balance C/D	210	Tax Expense	145
	295		295

W6 – Bank Loan obtained and Bank loan repayment

Debit	Cash	900	
Credit	Bank Loan		900

Bank Loan (both Long Term and Short Term)

Cash (Bank loan paid)	**690**	Balance B/F	2,200
Balance C/D	2,410	**Cash (Bank loan obtained)**	**900**
	3,100		3,100

(10 marks)

Suggested Answers to Question Six:

(A)

(a)

Chapter 02 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

(02 marks)

(b)

Chapter 02 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

1) Trade payables
2) Bank Loans
3) Bank overdraft
4) Sales advance
5) Prepayments
6) Income tax payable
7) Compensation Receivables
8) Corporate bonds
9) Debentures
10) Investment of Redeemable Preference Shares (Debt nature)

(03 marks)

(B)

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

Borrowing Cost to be Capitalized	**=**	**Total Borrowing Cost**			**-**	**Investment Income**
	=	Project Loan	+	Term loan		
	=	40 Million x 10% x 9/12	+	10 Million x 9%x 9/12	-	0.5 Million
	=	3 Million	+	0.675 Million	-	0.5 Million
	=	3.675 Million			-	0.5 Million
	=	**Rs.3.175 Million**				

(05 marks)

(Total 10 marks)

Suggested Answers to Question Seven:

(a)

Chapter 02 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

Revenue Recognition

Sale of Laptop

The sale of Laptop shall be recognized at the point of customer accepting the laptop.

Debit	Receivable from the Customer	89,552	
Credit	Revenue from Laptop sale		89,552

Sale of Internet Facility

The income from internet facility shall be recognized monthly as and when the service is obtained.

Monthly revenue 6,265 (150,448/24)

Debit	Receivable from the Customer	6,269	
Credit	Revenue from Internet Facility		6,269

Cash Received from the Customer

Cash received from the customer shall be adjusted to the receivable from the customer.

Debit	Cash	10,000	
Credit	Receivable from the Customer		10,000

Workings

Sale of Laptop and Internet Facility

Calculating the Discount offered

Agreement Period		2 Years
Total Agreement Value	10,000 × 24	**240,000**
Standalone Prices		
Laptop		100,000
Internet Facility	7,000 × 24	168,000
Total of Standalone Prices		**268,000**
Discount Received if both Products obtained		28,000 (268,000 – 240,000)

Allocating the Discount among the two products

Product	Stand-alone Price	Transaction Price Allocation
Laptop	100,000	89,552 (100,000/268,000 × 240,000)
Internet Facility	168,000 (7,000 × 24)	150,448 (168,000/268,000 × 240,000)
Total	**268,000**	**240,000**

(06 marks)

(b)

Chapter 02 Part I – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(1) Not recognizing the impairment of the previous/already used machinery

As per LKAS 08 – Accounting policies, accounting estimates and errors, Accounting error is an omission of misstatement arising from failure to use or misuse of information that could reasonably be expected to be considered in preparing and presenting the financial statements.

Since the previous machine was underutilized with the installation of the new machine, a clear impairment indication can be identified as per LKAS 36 Impairment of Assets. The impairment has been quantified as Rs.7.5Million. Non-adjustment of the impairment is regarded an accounting error. Therefore profit of the company is reduced by Rs.7.5 Mn.

(2) Not accounting for the depreciation of Motor Vehicle

As per LKAS 16 Property Plant and Equipment, a property, plant or equipment shall commence the depreciation as and when the asset is available for use. Therefore, when the new machine is available for use, the depreciation should have been accounted. Not recognizing the depreciation is an accounting error.

As per LKAS 08, if the error is material to stakeholders, error shall be retrospectively adjusted, unless it shall be prospectively adjusted. Thereby, Rusiru Ltd. shall take corrective actions depending on the materiality of the errors. Rs. 750,000/- should be charged in the financial statements for the year ended 31st March 2022.

(04 marks)

(Total 10 marks)

End of Section B

Suggested Answers to Question Eight:

Chapter 03 part I – Financial Statements for a Limited Liability Company for Publication Purpose

(a)

Jackson PLC
The Statement of Profit or Loss and Other Comprehensive Income
For the Year ended 31.03.2022

	Notes		(Rs.'000)
Revenue			168,000
Cost of Sales			(104,400)
Gross Profit			**63,600**
Other Income	01		3,050
Less Expenses:			
Distribution Expenses		30,912	
Administration Expenses		24,260	
Other Expenses	02	375	
Finance Expenses	03	3,360	(58,907)
Profit Before Tax	04		**7,743**
Income Tax			(7,300)
Profit After Tax			**443**
Other Comprehensive Income			
Revaluation gain/ loss			5,000
Total Comprehensive Income			**5,443**

(09 marks)

(b)

Jackson PLC
Statement of Financial Position
As at 31.03.2022

(Rs.'000)

Assets :	**Notes**		
Non-Current Assets			
Property Plant & Equipment	05	36,840	
Right to use the assets		3,000	39,840
Current Assets			
Inventories	06	39,400	
Trade Receivables	07	30,800	
Prepayments		9,000	
Fixed Deposits		20,000	
Interest Receivable		250	
Cash & Cash Equivalent	08	7,200	106,650
Total Assets			**146,490**
Equity And Liabilities :			
Stated Capital & Reserves			
Stated Capital		100,000	
Retained Earnings		14,943	
Revaluation Reserve		5,000	119,943
Total Equity			
Non-Current Liabilities			
Lease Liability		1,669	1,669
Current Liabilities			
Trade Payables		17,900	
Tax Payable		5,500	
Compensation Payable		375	
Accrued Expenses		400	
Lease Liability		703	24,878
Total Equity and Liabilities			**146,490**

(09 marks)

(c)

Jackson PLC
Statement of Changes of Equity
For the Year ended 31.03.2022 **(Rs.'000)**

Description	Stated Capital	Retained Earnings	Revaluation Reserve	Total
Balance as at 01.04.2021	100,000	14,500	-	114,500
Profit	-	443	-	443
Revaluation Gain	-	-	5,000	5,000
Dividends	-	-	5,000	5,000
Balance As At 31.03.2022	**100,000**	**14,943**	**5,000**	**119,943**

(02 marks)

(d)
Jackson PLC
Notes and disclosures (Rs'000)

Note 1 - Other Income

Interest Income +250 (W8)	3,050
	3,050

Note 2 - Other Expenses

Compensation	375
	375

Note 3 - Finance Expenses

Lease Interest	360
Finance Expense	3,000
	3,360

Note 4 - Profit Before Tax

Depreciation	3,160
Audit Fee	400
Compensation	375
NVR Loss	1,600
Lease Interest	360
	5,895

Note 5 - Property Plant and Equipment

Jackson PLC
Statement of movements of Property, Plant & Equipment
For the year ended 31.03.2022 **(Rs'000)**

Description	Land	Building	Machinery	Motor Vehicle	Total
Cost					
As at 01.04.2021	20,000	18,000	14,000		52,000
Revaluation	5,000				5,000
Addition				4,000	4,000
Balance as at 31.03.2022	**25,000**	**18,000**	**14,000**	**4,000**	**61,000**
Depreciation					
Balance as at 01.04.2021	-	9,000	8,000		17,000
Depreciation		360	2,800	1,000	4,100
Balance as at 31.03.2021	**-**	**9,360**	**10,800**	**1,000**	**21,160**
Carrying Value 31.03.2022					**39,840**

Note 6 - Inventory

Inventory	41,000
(-) Inventory net realizable value loss	(1,600)
	39,400

Note 7 - Trade Receivables

Trade receivables	37,000
(-) Allowance for Trade Receivables	(6,200)
	30,800

Note 8 - Cash and cash equivalents

Cash in hand and cash at bank	7,200

Expense Schedule

	Distribution	Administration	Other
As per TB	29,912	17,700	
Depreciation Motor Vehicle	1,000		
Depreciation Building		360	
Depreciation Machinery		2,800	
Audit fee		400	
Insurance		3,000	
Compensation			375
	30,912	**24,260**	**375**

Workings

W1 - Inventory

Cost of inventory	41,000
Net realizable vale	39,400
Net realizable value loss	1,600

W2 - Land Revaluation

Revalued Amount	25,000
Cost of Land	20,000
Revaluation Gain	5,000

W3 - Leasing

3.1 Right of Use assets

Fair Value of the assets	4,000
(-) Accumulated Depreciation	(1,000)
Net book value	3,000

Depreciated on useful life as the ownership transferred at the end of useful life

3.2 Lease Liability

Fair value of assets		4,000
(-) Down Payment		(1,000)
Opening Lease Liability		3,000
+ Interest 3,000 × 12%		360
(-) Lease installment		(988)
Closing lease liability		2,372
Next year installment	988	
(-) Next year interest 2,372 × 12%	(285)	
Current portion of lease liability		703
Non-current portion of lease liability		1,669

W4 - Depreciation

	Building	Machinery
Cost	18,000	14,000
Useful life	50	5
Depreciation	360	2,800

W5 - Expenses

5.1 Accrued Audit Fee	400	
5.2 Insurance Expense		
Prepaid Insurance	12,000	
Period relevant for current year	3/12	
Insurance Expense	3,000	

W6 - Tax

6.1 Tax Expense

Current year tax expense		7,300
Period year tax under or over provision		
Prior year tax payment	4,300	
Prior year tax payable	(4,300)	-
		7,300

6.2 Tax Payable

Current year tax expense		7,300
Total tax paid	6,100	
(-) Tax paid for the prior year	(4,300)	
Current year tax paid		(1,800)
Current year tax payable		5,500

W7 - Compensation Payable

As per LKAS 10 Events after the Reporting period, the compensation claim paid after the year end of Rs. 375,000 is and adjusting event.

W8 - Interest Income Receivable

Rs. 250,000 interest on fixed deposit it shall be recognized as an other income and interest receivable

(05 marks)
(Total 25 marks)

Suggested Answers to Question Nine:

Chapter 04 – Interpretation of Financial and Non-financial Data and Information

(a)

(i) Gross Profit Ratio

$$= \frac{\textbf{Gross Profit}}{\textbf{Sales}} \times \textbf{100}$$

$$= \frac{26{,}600}{76{,}000} \times 100 = \underline{\underline{\textbf{35\%}}}$$

(ii) **Current Ratio** = **Current Assets : Current Liabilities**

= 75,200 : 52,200

= **1.44 : 1**

(iii) **Debtors Collection Period**

$$= \frac{\textbf{Average Debtors}}{\textbf{Credit Sales}} \times 365$$

$$= \frac{(27{,}000 + 22{,}000)/2}{76{,}000} \times 365$$

= **118 Days**

(iv) **Inventory Resident Period**

$$= \frac{\textbf{Average Inventory}}{\textbf{Cost of Sales}}$$

$$= \frac{(41{,}000 + 40{,}000)/2}{49{,}400} \times 365$$

$$= \frac{40{,}500}{49{,}400} \times 365$$

= **299 Days**

(v) **Creditors Settlement Period**

$$= \frac{\textbf{Average creditors}}{\textbf{Credit Purchases}} \times 365$$

$$= \frac{(35{,}700 + 27{,}000)/2}{50{,}400} \times 365$$

$$= \frac{31{,}350}{50{,}400} \times 365$$

= **227 Days**

(vi) **Gearing Ratio**

$$= \frac{\textbf{Debt Capital}}{\textbf{Equity Capital}} \times \textbf{100}$$

$$= \frac{18{,}000}{145{,}000} \times 100$$

= **12.4%**

(vi) **Interest Cover Ratio**

$$= \frac{\textbf{Profit before Interest and Tax}}{\textbf{Interest}}$$

$$= \frac{11{,}000}{2{,}600}$$

= **4.23 Times**

(vii) **Assets Turnover Ratio** $= \dfrac{\textbf{Total Turnover}}{\textbf{Total Assets}}$

$= \dfrac{76,000}{215,200}$

= **<u>0.35 Times</u>**

Workings

W1 – Calculating the credit purchases

Opening Inventory	40,000
Purchases (49,400 + 41,000 – 40,000)	50,400
	90,400
(-) Closing Inventory	(41,000)
Cost of Sales	49,400

(08 marks)

(b)

Two of the improvement suggestions below for each aspect shall be adequate.

i) Gross Profit Margin

- Increasing the revenue through promotions
- Increasing the revenue through sales incentives
- Increasing the revenue through branding
- Increasing the revenue through pricing adjustments
- Increasing the revenue through changing the product mix
- Reducing the cost of sales through cost controls
- Reducing cost of sales through systems and procedures
- Reducing cost of sales using the technology

ii) Stock Residence Period

- Increasing the sales volume through promotions, sales incentives
- Eliminating slow moving and non-moving inventory
- Improving warehouse management
- Use of demand forecasting and integration of supplier systems to overcome excessive inventory
- Considering techniques such as just in time

(04 marks)

(Total 12 marks)

Suggested Answers to Question Ten:

Chapter 05 part II –Consolidated Financial Statements

(a) Goodwill Calculation

Purchase Consideration	50,000
Fair Value of Non-Controlling Interest	6,000
Total Investment	56,000
(-) Fair Value of Net Assets of Subsidiary at Acquisition	
Stated Capital	(25,000)
Retained Earnings	(7,000)
Goodwill	**24,000**

(03 marks)

(b)

Astro Group
Consolidated Statement of Financial Position
As at ended 31st March 2022

(Rs.'000)

Assets:		
Non-Current Assets		
Property Plant & Equipment (34,600+11,250-5,000)		40,850
Goodwill (24,000-300)		23,700
		64,550
Current Assets		
Inventory (12,300+15,000-875) **(W3)**	26,425	
Trade Receivables (30,200 + 10,900)	41,100	
Cash & Cash Equivalent (2,750+1,550)	4,300	71,825
Total Assets		**136,375**
Equity and Liabilities :		
Equity:		
Stated Capital	60,000	
Retained Earnings **(W1)**	25,120	85,120
NCI **(W2)**		5,405
Non-Current Liabilities		
Bank loan		16,000
Current Liabilities		
Trade Payables (20,350 + 5,140)	25,490	
Bank overdraft (3,700 + 660)	4,360	29,850
Total Equity and Liabilities		**136,375**

W1 - Retained Earnings

Retained Earnings			
Unrealized Profit (875 × 80%)	700	Consolidate	27,800
Goodwill	300	BL(9,900 - 7,000 × 80%)	2,320
Profit on Disposal	4,000		
B/C/F	25,120		
	30,120		30,120

W2 - NCI

NCI			
Unrealized Profit (875 × 20%)	7175	Investment	6,000
Profit on Disposal	1,000	RIE (2,900 × 20%)	580
B/C/F	5,405		
	6,580		6,580

W3

Unrealized Profit = 3,500 × 25% = 875

(10 marks)

(Total 13 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.

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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