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SRI LANKA

Association of Accounting Technicians of Sri Lanka

Level III Examination - July 2023

Suggested Answers

(301) FINANCIAL REPORTING (FAR)

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

Level III Examination - July 2023

(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. Relevance

In order to financial information to be useful to the users they must be capable of making a difference in decisions made by the users. Relevance is ensured when both predictive value and confirmatory value of financial information are instated.

2. Faithful Representation

Faithful representation of financial statements would be ensured if the prepared financial statements are complete, neutral and free from error.

(03 marks)

(b)

Going Concern

The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future.

(02 marks)

(Total 05 marks)

Suggested Answers to Question Two:

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

(Explaining any two of the below elements would permit full marks)

Key Contents of an Integrated Report

An integrated report includes 8 content elements that are fundamentally linked to each other and are not mutually exclusive.

1. Business model

Key areas

- Mission and Vision of the organization
- Organizational structure, business activities, and processes
- Basic business inputs and outputs and outcomes thereon
- Strategic goals, main risks and opportunities
- All six types of capitals.

Since there is a significant difference among business models based on various business sectors, segment-wise presentation will be useful.

2. Organizational overview and external environment

Key areas

- Ownership and operating structure
- Main activities and markets
- Market positioning
- Key quantitative information (e.g.: Turnover, Number of employees)

External environment

- The legitimate needs and interests of key stakeholders
- Macro and micro economic conditions
- Market forces, such as the relative strengths and weaknesses of competitors and customer demand
- The effect of technological changes

- Environmental challenges
- The legislative and regulatory environment in which the organization operates
- The political environment in the country

3. Management of capital/ Performance

Key areas

- Quantitative indicators with respect to targets risks and opportunities
- The organization's effects (both positive and negative) on the capital and relationship between present performance and external outlook of the business
- Key performance indicators (KPI)
- Special instances where regulations have a significant effect on performance

4. Relationship with stakeholders

Key areas

- The way how does the organization recognize its stakeholders
- The process of interaction with stakeholders.
- Recognition of material issues of the stakeholders
- The way by which stakeholders contribute to assess the results, relationships, and external outlook of the organization.

5. Strategy and resource allocation

Key areas

- The organization's short, medium, and long-term strategic objectives
- Positioning by the organization in the mass market.
- Relevance of long-term strategies for the current business model
- Resource allocation plan
- How it will measure achievements and target outcomes for the short, medium and long term
- Performance against strategic goals.

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6. External Outlook

Key areas

- Organization's expectations regarding external environment
- How that will affect the organization
- How the organization is currently equipped to respond to the critical challenges and uncertainties that are likely to arise.

7. Governance

Key areas

- The leadership structure of the entity
- Compulsory and voluntary governance structure of the corporate good governance system followed by the entity.
- Code of ethics implemented by the organization.
- Specific processes used to make strategic decisions and to establish and monitor the governance structure.

8. Risk management and internal control

Key areas

- The specific source of risks and opportunities.
- Assessment by the organization regarding the likelihood of risk and opportunities which might arise.
- Specific steps that will take to mitigate and manage the key risks.
- Reporting on the responsibility of the board for effectiveness of internal controls, safeguarding the interest of stakeholders and internal controls.

(05 marks)

Suggested Answers to Question Three:

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

Service	Charges separately	Calculation	Price as per SLFRS 15
Soil sample testing	500,000	500,000/8,000,000*7,500,000	468,750
Structured Engineering Services	2,500,000	2,500,000/8,000,000*7,500,000	2,343,750
Initial BOQ Preparation Service	3,000,000	3,000,000/8,000,000*7,500,000	2,812,500
Mechanical electrical and plumbing services	2,000,000	2,000,000/8,000,000*7,500,000	1,875,000
	8,000,000		**7,500,000**

(05 marks)

Suggested Answers to Question Four:

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

(a) The components of other comprehensive income
(Stating any three of the below components would permit full marks)

1. Changes in revaluation surplus
2. Actuarial gain or losses on defined benefit plans
3. Remeasurement of defined benefit plans
4. Gains and losses arising from translating the financial statements of a foreign operation
5. Gains and losses on financial assets are measured at fair value through other comprehensive income
6. The effective portion of Gains and losses on a cash flow hedge
7. Liabilities designated at fair value through profit or loss. (the amount in change in fair value is attributable to changes in the liability's credit risk)

(03 marks)

(b) Short-term employee benefits

(Stating any two of the below components would permit full marks)

1 Salaries and Wages

2 Paid Annual Leave

3 Paid Sick Leave

4 Paid Maternity/Paternity Leave

5 Profit Sharing Bonuses

6 Non-monetary benefits (e.g.: medical care, cars, free/subsidized goods or services)

7 Free/ subsidized goods or services.

(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 II – Financial Statements for a Limited Liability Company for Publication Purpose

Lak (Pvt) Ltd.
Statement of Cash Flows
For the year ended 31st March 2023

Profit before tax (1,015 – 275)		740
+/- adjustments		
Profit on disposal **(W3)**		(1,050)
Loan interest expense		275
Provision for Gratuity		900
Depreciation **(W3)**		3,700
		4,565
(-) Gratuity Payments **(W5)**		(650)
(-) Tax Payments **(W1)**		(90)
		3,825
Changes in working capital		
Increase in inventory	(2,000)	
Decrease in trade and other receivables	2,030	
Increase in trade and other payables	3,000	3,030
Net cash flow generated from operating activities		**6,855**
Investment activities		
Disposal of equipment	2,750	
Purchase of land **(W3)**	(9,900)	
Net cash flow from investing activities		**(7,150)**
Financial activities		
Dividend Paid **(W2)**	(100)	
Repayment of Bank Loan **(W6)**	(130)	
Loan Interest paid **(W4)**	(75)	
Obtaining loan	1,500	
Net cash flow from financing activities		**1,195**
Net Cash Flow for the Year		**900**

Opening Cash and Cash Equivalents		1,900
Closing Cash and Cash Equivalents as at 31st March 2023		**2,800**

Working

W1 - Tax payments

Tax Payable

Cash	**90**	Balance B/F	1,100
Balance C/D	1,300	Tax Expense	290
	1,390		1,390

W2 - Dividend paid

Retained Earnings

Dividend	**100**	Balance B/F	1,800
Balance C/D	2,150	Profit After Tax	450
	2,250		2,250

W3 - Disposal of Property Plant and Equipment

Property Plant and Equipment

Balance B/F	1,3000	Disposal AC	2,900
Cash	9,900	Balance C/D	20,000
	22,900		22,900

Accumulated Depreciation

Disposal AC	1,200	Balance B/F	7,000
Balance C/D	9,500	Depreciation	3,700
	10,700		10,700

Disposal AC

Machinery	2,900	Accumulated Dep.	1,200
Profit or Loss	1,050	Cash	**2,750**
	3,950		3,950

W4 – Interest Expense

Interest Payable

Cash	**75**	Balance B/F	300
Balance C/D	500	Interest Expense	275
	575		575

W5 – Gratuity Expense

Debit	Gratuity Expense	900	
Credit	Gratuity Provision		900

Gratuity Provision

Cash	**650**	Balance B/F	4,400
Balance C/D	4,650	Gratuity Expense	900
	5,300		5,300

W6 - Bank loan

Bank loan

Cash	**100**	Balance B/F	12,100
Balance C/D	13,500	Interest Expense	1,500
	13,600		13,600

(Total 10 marks)

Suggested Answers to Question Six:

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

(a)

01. According to the Sri Lanka Accounting Standard for Small and Medium Enterprises, inventory **should be measured at the lower of cost or net realizable value.** Based on this standard, information received, that net realizable value is lower than cost after the reporting date is a adjusting event in the financial statements. Therefore, the lower of cost or net realizable value on reporting date should be reported and the difference between those values should be recognized as an expense in the respective financial year**.**

02. According to the Sri Lanka Accounting Standard for Small and Medium entities, **there is no provision for the capitalization of borrowing cost.** Therefore, the interest related to the loan obtained for the construction of the building should be expensed.

03. **Changing the deprecation method from reducing balance method to straight line method is a change in accounting estimates. This needs to be adjusted prospectively.** Therefore, the depreciable value on 01st April 2022 should be spread over the remaining useful life under the straight-line method.

(05 marks)

(b)

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

1. Annual depreciation amount for the year 2021/2022

= Cost - Scrap Value / Expected Useful Life

= 4,000,000 - 0 / 5

= 800,000

The amount of depreciation for the first year of the machine is Rs. 800,000

Amount of depreciation for the year 2022/2023

= 3,200,000 - 0 / 8

= 400,000

The effect of the accounting estimate change should be applied for the current year and future periods. **Therefore, amount of depreciation to be reported for the year 2022/2023 should be reduced to Rs.400,000.**

2. This is an accounting error; therefore it should be adjusted retrospectively. Error shaouls be corrected. The purchase of a computer is a capital expenditure and should be capitalized as a machine. Then the expenses charged for the year 31/03/2023 will be reduced by Rs.300,000. But related to the computer, depreciation should be recorded as expenditure in the month of March 2023.

Accordingly the depreciation for a month amounting to Rs.6,250/- (300,000/4 x ½ = 6,250) should be provided.

(05 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

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

(a)

This is a specific loan taken for construction purposes. Therefore, the interest on the total loan amount obtained can be capitalized. Capitalization should start once the expenditure on the asset starts. Therefore, borrowing cost for only for 11 months can be capitalized.

ABC Bank 40,000,000 * 16 % * 11/12	= 5,866,666.66
PQR Bank 15,000,000 * 18 % * 11/12	= 2,475,000.00
	= 8,341,666.66
(-) Investment Income 1,100,000 * 11/12	= (1,008,333.33)
Amount to be capitalized	= <u>7,333,333.33</u>

Alternative Answer

Loan Interest:

ABC Bank = $40{,}000 \times \frac{16}{100} \times \frac{11}{12}$ = 5,867

ABC Bank = $15{,}000 \times 18\% \times \frac{11}{12}$ = 5,867

8,312

Borrowing Cost Capitalization rate = $\frac{8{,}342}{55{,}000} \times 100$ = 15.17%

Borrowing Cost = 50,000 x 15.17% = **7,583,636**

Borrowing Cost to be Capitalized = 7,583,636 – 1,100,000 x $\frac{11}{12}$ = 6,575,303

(06 marks)

(b)

1.An obligating event

An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

2.A provision

Provision is a liability of uncertain timing or amount.

(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)

Richard PLC
Statement of Profit or Loss and other Comprehensive Income
For the Year Ended 31st March 2023

	(Rs.'000)
Revenue	295,000
Cost of Sales (134,000 + 800) **(W - 6)**	(134,800)
Gross Profit	**160,200**
Other Income **(W - 5)**	8,608
	168,100
Less Expenses:	
Distribution Expenses **(W - 3)**	(32,000)
Administration Expenses **(W - 2)**)	(48,200)
Finance Expenses **(W - 4)**	(10,500)
Profit Before Tax	**78,108**
Income Tax **(W - 8)**	(6,250)
Profit After Tax	**71,858**
Other Comprehensive Income	5,000
Total Comprehensive Income	**76,858**

(10 marks)

(b)

Richard PLC
Statement of Financial Position
As at 31st March 2023

<u>Assets</u>	**(Rs.'000)**	**(Rs.'000)**
Non-Current Assets		
Property Plant and Equipment		143,800
Current Assets		
Inventory (47,000 -800) **(W - 6)**	46,200	
Trade Receivables (16,500 + 800 - 692)	16,608	
Income tax Receivable **(W - 8)**	2,900	
Prepaid Rates	9,000	
Cash and Cash Equivalents	20,975	95,683
Total Assets		**<u>239,483</u>**

Equity		
Stated Capital	120,000	
Revaluation Reserve	5,000	
Retained Earnings	91,358	216,358
Non-Current Liabilities		
Leased Creditors **(W - 1)**	5,806	
Provision for Gratuity	9,100	14,906
Current Liabilities		
Trade payables	6,500	
Leased Creditors **(W - 1)**	1,219	
Audit fees payable	500	8,219
Total Equity and Liabilities		**239,483**

(08 marks)

(c)

Richard PLC
Statement of Changes in Equity
For the Year Ended 31st March 2023

(Rs '000)

	Stated Capital	**Revaluation Reserves**	**Retained earnings**	**Total**
Balance as at 1/4/2022	120,000	-	19,500	139,500
Revalution of land	-	5,000		5,000
Profit for the year	-		71,858	71,858
Balance as at 31/3/2023	120,000	5,000	91,358	216,358

(03 marks)

(d)

Note 04 - Statement of Movement of Property, Plant and Equipment

Cost/Revaluation	**Land**	**Buildings**	**Machinery**	**Motor Vehicles**	**Right of Use Asset**	**Total**
Cost/Revaluation Opening Balance	70,000	45,000	44,000	17,000		176,000
Additions					15,000	15,000
Disposals/ Transfers				(7000)		(7,000)
Revaluation	5,000					5,000
Balance as at 31.03.2023	***75,000***	***45,000***	***44,000***	***10,000***	***15,000***	***189,000***

Accumulated Depreciation						
Opening Balance		16,000	8,500	6,000		30,500
Depreciation for the Year		900	8,800	2,000	3000	14,700
Disposals						
Revaluations						
As at 31.03.2023	-	*16,900*	*17,300*	*8,000*	*3,000*	*45,200*
Carrying Value as @ 31.03.2023						**143,800**

(04 marks)

Working :

W-01

Year	**O/B**	**Interest**	**Installment**	**Capital**	**C/B**
1	8,000,000	2,000,000	2,975,000	975,000	7,025,000
2	7,025,000	1,756,250	2,975,000	1,218,750	5,806,250
3	5,806,250	1,451,562	2,975,000	1,523,438	4,282,812
4	4,282,812	1,070,703	2,975,000	1,904,297	2,378,515
5	2,378,515	594,629	2,975,000	2,380,371	-

W 02 – Profit before tax is obtained after deducting following expenses.

TB		35,000
Depreciation	- Building	900
	Machinery	8,800
Audit fee		500
Rates		3,000
		48,200

W 03 – Distribution Expenses

TB	=	27,000
Depreciation M/V	=	2,000
Right to Use Assets	=	3,000
	=	**32,000**

W 04 – Finance Expenses

TB	=	8,500
Lease Interest	=	2,000
	=	**10,500**

W 05 – Other Income

TB	=	7,100
Lease Interest	=	800
Over provision of bad debt	=	708
	=	**8,608**

W 06

Cost	=	3,800
NRV (6,000 x 1,000 x 50%)	=	3,000
Over Valued Amount	**=**	**800**

W 07 **Provision of Bad debtors**

Profit and loss ACC	708	Balance B/F	1,400
Balance C/D	692		
	1,400		1,400

W 08 - Income tax

Income tax

Cash	12,400	Balance B/F	3,250
		Profit and loss ACC	6,250
		Balance C/D	2,900
	12,400		12,400

(Total 25 marks)

Suggested Answers to Question Nine:

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

(A)

Ratio	Formula	2023
(i) Gross Profit Ratio	Gross profit / sales * 100	= 136,800/360,000 × 100 = **38%**
(ii) Current Ratio	Current Assets / Current Liabilities	= 82,200 : 49,200 = **1.67:1**

(iii) Quick Assets Ratio	Quick Assets / Current Liabilities	= (82,200 – 48000) : 49,200 = **0.69:1**
(iv) Debtors' Collection Period	Average debtors / sales on credit * 365	= <u>(27,000 +26,000) /2</u> x365 360,000 x 80% = <u>26,500 x 365</u> 288,000 = **34 Days**
(v) Stock Residence Period	Average inventory / cost of sales * 365	= <u>(48,000 +40,000) /2</u> x365 223,200 = <u>44,000 x 365</u> 232,200 = **69 Days**
(vi) Gearing Ratio	Debt Capital / Equity Capital	=16,000/148,880 = **10.75%**
(vii) Interest Cover	Profit before tax + interest / interest	=(23,500 + 12,500)/12,500 = <u>36,000</u> 12,500 = **2.88 Times**
(viii) Dividend Cover	Profit After Tax / Total Dividends	=18,095/3000 = **6.03 Times**

(08 marks)

(B)
Efficiency

Rate	Rajarata Co	Industry
Stock holding period	69 Days	55 Days
Debt collection period	34 Days	30 Days

Stock residence period.

Stock holding period in the industry is 55 days, but in the Rajarata Ltd it is 69 days. That is the reflection of insufficient sales effort during the period. Further the Rajarata Ltd is not worried about the customer requirement in purchasing stock items. As a result, there will be so many slow-moving items in the inventory. Based on this Rajarata Ltd is poor in inventory management compared to the industry averages.

Debtors' Collection Period.

In terms of Debtors' Collection Period Rajarata Ltd takes longer period to collect their debts compared to the other companies in the industry. When other companies in the industry takes 30 days to collect their debts Rajarata Ltd takes 34 days to collect their debts. That will reflect the poor debt collect effort and the inappropriate debt approval process of Rajarata Ltd. Based on this Rajarata Ltd is inefficient in debt collection.

Liquidity

Rate	Rajarata Co	Industry
Current Ratio	1.67	2
Quick Assets Ratio	0.6	0.9

Current Ratio

Current Ratio of the company is 1.67 and, in the industry, it is 2. Other companies in the industry maintains high level of current assets in order to fulfill the short-term obligation, compared to the Rajarata Ltd. Based on the current ration liquidity position of Rajarata Ltd is poor. Rajarata Ltd expose to high level of liquidity risk.

Quick Assets Ratio

Quick asset ratio is a reflection of availability of high liquid assets in order to meet the short-term obligations. Based on quick asset Ratio Rajarata Ltd has only 0.6 of high liquid assets in order to meet 1 current liability. But other companies in the industry has 0.9 of high liquid assets in order to meet 1 current liability. In terms of quick asset ratio also Rajarata Ltd is not in the satisfactory level of liquidity.

(04 marks)
(Total 12 marks)

Suggested Answers to Question Ten:

Chapter 05 part II - Consolidated Financial Statements

(a)

Goodwill on acquisition

	Rs.Million
Investment	500
+ Fair value of NCI	140
	640
Less	
Fair value of identifiable net assets	(600)
Goodwill	**40**

(03 marks)

(b)

Amitha PLC

Consolidated Statement of Comprehensive Income

For the Year Ended 31st March 2023

(Rs.'000)

Revenue (1,050,000+550,000-144,000)	1,456,000
Cost of Sales (651,000+330,000-144,000+7,500)	(844,500)
Gross Profit	**611,500**
Other Income	
Management Fee (24,000-24,000)	-
Interest Income (25,000 – 5,000)	20,000
Profits on Disposal of Motor Vehicles (42,000+14,500-2,000)	54,500
	686,000
Expense	
Distribution Expenses (109,000 + 79,000 – 400)	(187,600)
Administration Expenses (135,000+95,000-24,000)	(206,000)
Finance Expenses (45,000+6,000-5,000)	(46,000)
Profit Before Tax	246,400
Income Tax	(20,900)
Profit After Tax	225,500
Other Comprehensive Income	30,000
Total Comprehensive Income	**255,500**

Working

W1 – Unrealized Profit = 45,000/120*20

= 7,500

W2 - Unrealized Profit from sale of delivery vehicle

Selling Price	= 10 ,000
Carrying Value	=(8,000)
Profit	= 2,000

W3 - Over depreciation

Deprecation done by the Samitha PLC	= 2,000	(10 000/5)
Deprecation required for the Group	= (1,600)	(8,000/5)
Over depreciation	= 400	

W4 – Intercompany transactions

- Intercompany sales Rs.144,000
- Intercompany Management fee (2,000 * 12) Rs.24000
- Intercompany Interest Rs.5,000

(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.