



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JULY 2015

(AA31) FINANCIAL ACCOUNTING AND REPORTING

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

(1) **Time:** 03 hours.

(2) **Structure of Question Paper and the Marks Allocation:**

Section	Requirement	Marks
A	All questions are compulsory.	20
B	All questions are compulsory.	30
C	Only two out of three questions should be answered.	50
Total Marks		100

01-08-2015
Morning
[9.00 – 12.00]

No. of Pages : 12
No. of Questions : 07

- (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.**

SECTION A

Four (04) compulsory questions

(Total 20 marks)

Question 01

1.1 The conceptual framework for the preparation and presentation of financial statements deals with certain matters.

(a) **State** three(03) such matters it deals with. (03 marks)

(b) **Identify** the meaning of “General Purpose Financial Statements”. (02 marks)

(Total 05 marks)

- 1.2 ABC Ltd.**, a newly formed manufacturing business commenced its operations on 01st April 2014. Following information have been extracted from the company's books of accounts for the year ended 31st March 2015:

	Rs.
Cost of raw materials consumed	500,000
Total direct labour cost	550,000
Other variable production cost	380,000
Fixed production overhead for the year	260,000
Idle labour cost included in total direct labour cost (due to unexpected work stoppage)	20,000
Administration overheads	240,000

	Units
Normal capacity of production facilities	40,000
Actual production during the year	32,000
Number of units sold during the year	28,000

Assume that the company is involved in the manufacturing of a single product.

Assess the value of finished goods held as at 31st March 2015. (05 marks)

- 1.3** Following information is relevant to **Sigma Company**:

- (a) The trade receivable balance of **Sigma Company** as at 31st March 2015 included an amount of Rs.28,000/- due from **Omega**. On 10th April 2015, **Omega** was declared as bankrupt.
- (b) On 20th March 2015, an employee of **Sigma Company** filed a case against the company claiming Rs.100,000/- as compensation for the damages caused to his head during working hours due to non-availability of safety hats. On 31st May 2015, court ordered to pay Rs.100,000/- as compensation to this employee.

(Assume that the financial statements of Sigma Company were authorized for issue on 20th June 2015)

State with reasons as to how you are going to account for the above two situations, in accordance with LKAS 10 Events after the Reporting Period. (05 marks)

- 1.4 Explain** the obligation of a company to prepare financial statements as per the Companies Act No. 07 of 2007. (05 marks)

End of Section A

SECTION B

Three (03) compulsory questions

(Total 30 marks)

Question 02

Statements of Financial Position as at 31st March 2013, 31st March 2014 and 31st March 2015 and the Statements of Comprehensive Income for the years ended 31st March 2014 and 31st March 2015 of **Martin PLC** are given below:

Martin PLC Statements of Financial Position

(Rs.'000)

	As at 31st March 2015	As at 31st March 2014	As at 31st March 2013
Assets:			
Non-Current Assets:			
Property, Plant and Equipment	45,000	35,000	40,000
Current Assets:			
Inventories	14,000	12,000	11,600
Trade and Other Receivables	12,750	13,750	10,558
Cash and Cash Equivalents	100	250	500
Total Assets	71,850	61,000	62,658
Equity and Liabilities:			
Equity:			
Stated Capital - Ordinary Shares	30,000	30,000	30,000
Retained Earnings	19,249	9,771	5,000
Total Equity	49,249	39,771	35,000
Liabilities:			
Non-Current Liabilities:			
Long Term Borrowings	10,716	8,329	16,700
Current Liabilities:			
Trade and Other Payables	11,885	12,900	10,958
Total Liabilities	22,601	21,229	27,658
Total Equity and Liabilities	71,850	61,000	62,658

Martin PLC
Statements of Comprehensive Income

(Rs.'000)

for the year ended	31 st March 2015	31 st March 2014
Sales	148,000	110,000
Cost of Sales	(99,600)	(76,500)
Gross Profit	48,400	33,500
Operating Expenses	(33,936)	(25,750)
Operating Profit	14,464	7,750
Finance Expenses	(2,133)	(1,582)
Profit Before Tax	12,331	6,168
Income Tax Expenses	(2,853)	(1,397)
Profit For The Year	9,478	4,771
Other Comprehensive Income	-	-
Total Comprehensive Income For The Year	9,478	4,771

The following additional information is also provided:

- (1) No dividend payment is made during the years considered.
- (2) All sales are made on credit basis.
- (3) Assume 365 days a year.

You are required to:

Compute the following ratios for the years ended 31st March 2014 and 31st March 2015:

- (a) Gross Profit Ratio.
- (b) Return on Capital Employed (ROCE).
- (c) Assets Turnover Ratio.
- (d) Average Inventory Residence Period.
- (e) Average Debtors Collection Period. (10 marks)

Question 03

- (a) **Dudly & Sons (Pvt) Ltd.** purchased a lorry under a finance lease from **Gogo Finance PLC** on 01st April 2014. The details relevant to the lease are given below:

Fair Value of the Lorry	Rs.1,000,000/-
Lease Term	5 years
Lease rental	Annual lease rental of Rs.280,854/- payable at the end of each year.
Implicit interest rate	12.5%
Salvage value after 5 years	Nil.
Estimated useful life of the Lorry	5 years

You are required to:

- (i) **Prepare** the relevant ledger accounts in the books of **Dudly & Sons (Pvt) Ltd.** to record the above lease transactions.
- (ii) **Prepare** the extracts of the Statement of Financial Position as at 31st March 2015 and the Statement of Comprehensive Income for the year ended 31st March 2015. (06 marks)
- (b) **Explain** “Constructive Obligation” with an example according to LKAS 37 Provisions, Contingent Liabilities and Contingent Assets. (04 marks)
- (Total 10 marks)

Question 04

- (a) Following balances have been extracted from the Statement of Financial Position as at 31st March 2015 of **Seya Co. Ltd.:**

	Rs.
Office Equipment (at cost)	461,000
Accumulated Depreciation	(175,000)
Net Book Value as at 31st March 2015	286,000

A revaluation carried out on 30th June 2015 revealed that an item of Office Equipment at a cost of Rs.90,000/- and having a net book value of Rs.67,500/- as at 31st March 2015 had a revalued amount of Rs.40,000/-. Company’s policy is to depreciate its office equipment at the rate of 20% per annum on straight-line basis at cost.

Assume the fair values of all the other items of office equipment were equivalent to their net book values on that date.

You are required to:

- (i) **Record** all necessary entries required to account for the above revaluation as at 30th June 2015 in the General Journal.
- (ii) **Compute** the net book value of office equipment after incorporating revaluation as at 30th June 2015. (06 marks)
- (b) **Differentiate** the terms, “Prospective Application” and “Retrospective Application” with reference to LKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. (04 marks)
- (Total 10 marks)

End of Section B

SECTION C

Answer any two (02) questions only.

(Total 50 marks)

Question 05

Micro Company Ltd. is a company listed in the Colombo Stock Exchange. The Trial Balance of the company as at 31st March 2015 is as follows:

Micro Company Ltd.
Trial Balance as at 31st March 2015 (Rs.'000)

	Dr.	Cr.
Stated Capital - Ordinary Share Capital (2 million shares)		23,100
Preference Share Capital (100,000 shares)		9,000
16% Debentures		3,500
Retained Earnings as at 01 st April 2014		725
<u>Property, Plant and Equipment - at cost</u>		
Land	16,800	
Building	11,300	
Building Work-In-Progress (WIP)	1,300	
Motor Vehicles	9,250	
Office Equipment	2,640	
Furniture & Fittings	2,200	
<u>Provision for Depreciation as at 01st April 2014</u>		
Building		8,475
Motor Vehicles		4,550
Office Equipment		1,584
Furniture & Fittings		1,100
Inventories as at 31 st March 2015 - at cost	7,550	
Trade Receivables / Trade Payables	22,450	17,571
Tax Liability for the Year of Assessment 2013/14		400
Accrued Expenses		434
Bank Loan		2,367
Cash in Hand and at Bank	1,081	
Cost of Sales / Sales	70,015	105,500
Preference Dividend Paid	50	
Administration Expenses	15,950	
Selling & Distribution Expenses	13,350	
Other Operational Expenses	3,375	
Finance Charges	220	
Income Tax Paid	775	
	178,306	178,306

The following additional information is also provided:

- (1) Company redeemed all the Debentures on 31st March 2015 at a premium of 5%. On the same date, the company paid accrued interest for the year. All payments made on account of this redemption have erroneously been recorded to trade payables account.
- (2) On 30th September 2014, the company exchanged one of its old lorries for a new lorry. The cost of the old lorry was Rs.950,000/-. It was purchased on 01st April 2012. The company paid Rs.800,000/- being balance settlement of the exchange transaction and debited this amount to Motor Vehicles account. The value of the new lorry was Rs.1,250,000/-. No other entries have been made in the books of accounts in this respect.
- (3) During the year, the company has purchased the following assets:

Date	Asset	Value (Rs.)
01.05.2014	Scanning Machine	900,000
01.01.2015	Book Racks	160,000

- (4) Depreciation is calculated on the straight-line basis at cost or revalued amount. The useful life of Property, Plant and Equipment is as follows:

Building	:	20 years
Motor Vehicles	:	5 years
Office Equipment	:	5 years
Furniture & Fittings	:	10 years

Policy of the company is not to provide depreciation on building WIP until the building construction is completed.

- (5) At the end of the year, it was confirmed that a trade receivable balance of Rs.117,000/- was not recoverable. A general provision of Rs.345,000/- is to be made for doubtful debts.
- (6) Accrued expenses as at 31st March 2015 are to be provided as follows:

	Rs.
Audit Fees and Other Professional Fees	255,000
Telephone, Water & Electricity	17,000

- (7) Rs.800,000/- of the bank loan outstanding balance is to be settled during the next year.
- (8) The net realizable value of the stock as at 31st March 2015 was estimated as Rs.7,300,000/-.

- (9) It was agreed that the Income Tax Liability of the year of assessment 2013/14 as Rs.350,000/- and it was paid during the year of assessment 2014/15. The Company's tax liability for the year of assessment 2014/15 is estimated as Rs.510,000/-.
- (10) The Board of Directors of the company has decided to pay a final dividend of cents 50 per share for the ordinary shares held on 31st March 2015 at the board meeting held on 15th May 2015:
- (11) The financial statements were authorized for issue by the Board of Directors on 20th June 2015.

You are required to:

Prepare the following, in a form suitable for publication for **Micro Company Ltd.:**

- (a) Statement of Comprehensive Income for the year ended 31st March 2015. (09 marks)
- (b) Statement of Financial Position as at 31st March 2015. (09 marks)
- (c) Statement of Changes in Equity for the year ended 31st March 2015. (04 marks)
- (d) Notes to Property, Plant and Equipment. (03 marks)
- (Total 25 marks)

Question 06

- (a) **Define** the following terms as per LKAS 27 - Consolidated and Separate Financial Statements:
- (i) Consolidated Financial Statements.
 - (ii) Non-controlling Interest.
 - (iii) Control. (06 marks)
- (b) **Alpha PLC** acquired 75% ordinary share capital of **Beeta PLC** on 01st April 2013 when the retained earnings balance of **Beeta PLC** was stated at Rs.1,400,000/-. The fair value of identifiable net assets of **Beeta PLC** on the date of acquisition was Rs.6,100,000/-.
- Assume any variation in the fair value of these net assets from its book value was due to increase in the value of the Motor Vehicle which is depreciated at 20% per annum on the straight line basis.

The Statements of Financial Position as at 31st March 2015 of the two companies are given below:

Statements of Financial Position
as at 31st March 2015:

(Rs.'000)

	Alpha PLC	Beeta PLC
Assets:		
Non Current Assets:		
Property, Plant and Equipment	14,500	2,845
Investment in Beeta PLC	5,000	-
Current Assets:		
Inventories	6,300	3,950
Trade & Other Receivables	3,540	1,590
Cash & Cash Equivalents	450	260
	29,790	8,645
Equity & Liabilities:		
Share Capital & Reserves:		
Stated Capital (Ordinary Share Capital)	20,000	4,000
Retained Earnings	2,375	1,700
Non-Current Liabilities:		
Bank Loan	1,500	950
Current Liabilities:		
Trade Payables	5,640	1,635
Accrued Expenses	275	360
	29,790	8,645

The following additional information is also provided:

- (1) **Beeta PLC** has 400,000 issued and fully paid shares and there were no new issues after 01st April 2013. The market value of these shares as at 01st April 2013 was Rs.15/- per share. **Alpha PLC** adopts full goodwill method in consolidating subsidiaries.
- (2) **Alpha PLC** sells goods to **Beeta PLC** at a profit of 25% on cost. On 31st March 2015 inventories of **Beeta PLC** included Rs.440,000/- worth of goods purchased from **Alpha PLC**.
- (3) On 30th March 2015, **Beeta PLC** remitted Rs.350,000/- to **Alpha PLC** being part settlement of outstanding bills for the purchase of goods. This amount was received by **Alpha PLC** only on 04th April 2015 and accounted for it then.
- (4) Impairment test carried out on 31st March 2015 revealed that the goodwill on consolidation had been impaired by Rs.150,000/-.

You are required to:

- (i) **Compute** the Goodwill on Consolidation.
- (ii) **Prepare** Consolidated Retained Earnings Account.
- (iii) **Prepare** Non-Controlling Interest Account.
- (iv) **Prepare** the Statement of Consolidated Financial Position as at 31st March 2015.

(19 marks)

(Total 25 marks)

Question 07

The Statements of Financial Position as at 31st March 2014 and 31st March 2015 and the Statement of Comprehensive Income for the year ended 31st March 2015 of **Brand House Co. Ltd.** are given below:

Brand House Co. Ltd.
Statements of Financial Position (Rs.'000)

	as at 31 st March 2015		as at 31 st March 2014	
Assets				
Non Current Assets:				
Property, Plant and Equipment:				
Land		6,500		6,500
Buildings	2,215		2,215	
Less: Accumulated Depreciation	(1,550)	665	(1,440)	775
Motor Vehicles	2,750		1,500	
Less: Accumulated Depreciation	(1,812)	938	(1,125)	375
Office Equipment	695		855	
Less: Accumulated Depreciation	(560)	135	(513)	342
		8,238		7,992
Investments		1,600		1,600
Less: Provision for impairment		(100)		-
		9,738		9,592
Current Assets:				
Inventories		510		455
Trade Receivables		2,750		2,890
Investment Income Receivable		18		25
Cash & Cash Equivalents		67		55
		3,345		3,425
Total Assets		13,083		13,017
Equity and Liabilities				
Equity:				
Stated Capital - Ordinary Share Capital		7,000		7,000
Retained Earnings		1,792		635
		8,792		7,635
Non Current Liabilities:				
15% Debentures	-		2,500	
Bank Loan	1,120		1,620	
Retirement Benefit Obligation	600	1,720	550	4,670
		10,512		12,305
Current Liabilities:				
Trade Payables		2,442		594
Accrued Expenses		55		45
Income Tax Payable		48		35
Bank Loan Interest Payable		26		38
		2,571		712
Total Equity and Liabilities		13,083		13,017

Brand House Co. Ltd.
Statement of Comprehensive Income
for the year ended 31st March 2015 (Rs.'000)

Sales		18,600
Cost of sales		(8,800)
Gross Profit		9,800
Other Income:		
Investment income	175	
Profit on Sale of Office Equipment	60	235
		10,035
Less: Expenses		
Distribution expenses	4,670	
Administration expenses	3,210	
Finance expenses	488	(8,368)
Profit Before Tax		1,667
Income Tax Expenses		(510)
Profit After Tax		1,157
Other Comprehensive Income		-
Total Comprehensive Income for the year		1,157

The following additional information is also provided:

- (1) On 31st March 2015, the company has redeemed all its debentures.
- (2) Finance expenses represent the interest on bank loan and the interest paid on debentures.
- (3) An office equipment purchased on 01st April 2011 for Rs.160,000/- was disposed on 30th September 2014. The company's policy is to depreciate Office Equipments within 5 years.
- (4) During the year, the company has purchased a new Lorry.
- (5) Depreciation charge for the current year is Rs.956,000/-.
- (6) During the year, the company identified that the Market value of the Investments has been reduced by 100,000/- and had adjusted the impairment in the financial statements.
- (7) The company has provided Rs.200,000/- as gratuity provision for the year.

You are required to:

Prepare the Statement of Cash Flows of **Brand House Company Ltd.** for the year ended 31st March 2015 using indirect method. (25 marks)

ACTION VERB CHECK LIST

Knowledge Process	Verb List	Verb Definitions
Level 01 Comprehension Recall & explain important information	Define	Describe exactly the nature, scope, or meaning.
	Draw	Produce (a picture or diagram).
	Identify	Recognize, establish or select after consideration.
	List	Write the connected items one below the other.
	Relate	To establish logical or causal connections.
	State	Express something definitely or clearly.
	Calculate/Compute	Make a mathematical computation
	Discuss	Examine in detail by argument showing different aspects, for the purpose of arriving at a conclusion.
	Explain	Make a clear description in detail revealing relevant facts.
	Interpret	Present in an understandable terms.
	Recognize	To show validity or otherwise, using knowledge or contextual experience.
	Record	Enter relevant entries in detail.
Summarize	Give a brief statement of the main points (in facts or figures).	

Knowledge Process	Verb List	Verb Definitions
Level 02 Application Use knowledge in a setting other than the one in which it was learned / Solve closed-ended problems	Apply	Put to practical use.
	Assess	Determine the value, nature, ability, or quality.
	Demonstrate	Prove, especially with examples.
	Graph	Represent by means of a graph.
	Prepare	Make ready for a particular purpose.
	Prioritize	Arrange or do in order of importance.
	Reconcile	Make consistent with another.
	Solve	To find a solution through calculations and/or explanation.

Knowledge Process	Verb List	Verb Definitions
Level 03 Analysis Draw relations among ideas and compare and contrast / Solve open-ended problems.	Analyze	Examine in detail in order to determine the solution or outcome.
	Compare	Examine for the purpose of discovering similarities.
	Contrast	Examine in order to show unlikeness or differences.
	Differentiate	Constitute a difference that distinguishes something.
	Outline	Make a summary of significant features.