

ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

LEVEL III EXAMINATION - JANUARY 2021

(301) FINANCIAL REPORTING

20-03-2021
Morning
[08.45 – 12.00]

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

(1) **Time Allowed:** Reading : 15 minutes

Writing : 03 hours

No. of Pages : 10

No. of Questions : 10

(2) **All questions should be answered.**

(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.**

(7) **100 Marks.**

SECTION A

(Total 20 marks)

Question 01

Ethics and ethical behavior are extremely important in accounting for a variety of reasons. In global environment, ethical accounting has become more important and accountants need to act in a fair and transparent manner.

You are required to:

Explain three(03) reasons why ethics are important in accounting.

(05 marks)

Question 02

The qualitative characteristics of useful financial information apply to financial information provided in financial statements. There are two fundamental qualitative characteristics and the usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

You are required to:

Explain the two(02) fundamental qualitative characteristics as per the Conceptual Framework of Financial Reporting.

(05 marks)

Question 03

XYZ Ltd. has started construction of a new factory building on 01st June 2019 and it will be completed on 30th September 2021. An amount of Rs.30 million was utilized during the year ended 31st March 2020 for the construction of this new building. The loan obtained from **PQR Bank** was fully utilized for this construction. The balance amount spent on construction was used from the debenture issue and the loan obtained from **ABC Bank**.

You have given the following additional information relating to loans and debenture issue:

	Date of Obtained	Rate of Interest per Annum	Amount (Rs.)
PQR Bank	01.04.2019	14%	15 million
ABC Bank	01.04.2019	12%	10 million
Debentures (Rs.100/- per debenture)	01.04.2019	16%	10 million

Though the interest was paid on loans obtained from **PQR Bank** and **ABC Bank**, no capital repayments were made during the year ended 31st March 2020.

You are required to:

Calculate the borrowing cost to be capitalized on the building for the year ended 31st March 2020 as per LKAS 23 - Borrowing Cost. (05 marks)

Question 04

The followings information was extracted from the books of **Das Ltd.** for the year ended 31st March 2020:

- (1) A cost of Rs. 2 million was incurred by the company during the year on a program to train employees. It is expected that the performance of the employees will be improved as a result of the training program.
- (2) **Das Ltd.** developed a new product during the year and started its commercial operation on 01st June 2019. Before developing the new product, a research was conducted by the company incurring a cost of Rs. 3 million on 30th April 2019.

You are required to:

- (a) **Explain** whether each of the above costs could be recognized as intangible asset as per LKAS 38 - Intangible assets. (03 marks)
- (b) **State** two(02) criteria to be met to recognize a development cost as an intangible asset. (02 marks)

(Total 05 marks)

End of Section A

SECTION B

(Total 30 marks)

Question 05

- (a) The following information is related to **Best Tech Ltd.** a consumer electrical company for the year ended 31st March 2020:
- (1) During the financial year, a customer of the company has filed a case against the company to claim Rs.10 million as a compensation due to the poor quality of the company's products. The company's lawyers believe that there is a high probability that the company needs to pay the compensation to the said customer, however, they are uncertain of the amount of the compensation.
 - (2) The company sells its products with a warranty of 6 months for any manufacturing defects after purchase. As per the past experience, the company indicates that 70% of the goods sold will have no defects, 25% of the goods sold will have minor repairs and 5% of the goods sold will have major repairs. If minor repairs are detected in all products, repair cost would be Rs.1,200,000/- and if major repairs are detected in all products the repair cost would be Rs.4,800,000/-.

You are required to:

Explain how each of the above instances could be recognized in the Financial Statements of **Best Tech Ltd.** for the year ended 31st March 2020 as per LKAS 37-Provisions, Contingent Liabilities and Contingent Assets. (05 marks)

- (b) Financial Instrument is considered as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

You are required to:

List three(03) items included under financial assets and two(02) items included under financial liabilities. (05 marks)

(Total 10 marks)

Question 06

- (a) **Shine Tiles Ltd.** is in the business of manufacturing of wall tiles. The company imported a tile manufacturing machinery from China on 30th September 2020. FOB price of the machinery was Rs. 3 million. Freight charges and marine insurance cost of machinery were Rs.250,000/- and Rs.50,000/- respectively.

In addition, the following costs were incurred:

- (1) The company paid Rs.300,000/- as import duties and Rs.30,000/- as non-refundable taxes at the time of importing the machinery.
- (2) Engineering services cost of Rs.80,000/- has been incurred to install the machinery. Further, cost of Rs.75,000/- was incurred to site preparation and dismantle the old machinery.
- (3) After installing the machinery, test run was carried out and production cost of Rs.55,000/- was incurred on that.

- (4) Insurance policy was obtained to cover the future losses / damages to the machinery and annual premium was Rs.50,000/-.

You are required to:

Calculate the cost of the machinery at the initial recognition as per LKAS 16 - Property, Plant and Equipment. (06 marks)

- (b) The Securities and Exchange Commission was established for the purpose of regulating the securities market in Sri Lanka.

You are required to:

List four(04) duties of the Securities and Exchange Commission. (04 marks)
(Total 10 marks)

Question 07

The Statements of Financial Position of **Gamage (Pvt) Ltd.** as at 31st March 2020 and 31st March 2019 are given below:

Gamage (Pvt) Ltd.		
Statements of Financial Position		
<i>(Rs.'000)</i>		
As at 31st March	2020	2019
Assets:		
Non-Current Assets:		
Property, Plant and Equipment	3,205	2,838
Accumulated Depreciation	(1,090)	(810)
Carrying Value	2,115	2,028
Current Assets:		
Inventories	1,520	1,920
Trade Receivables	1,320	905
Cash and Cash Equivalents	600	457
	3,440	3,282
Total Assets:	5,555	5,310
Equity and Liabilities:		
Equity:		
Stated Capital	1,000	1,000
Retained Earnings	1,560	820
	2,560	1,820
Non-Current Liabilities:		
Long Term Loans	750	1,200
	750	1,200
Current Liabilities:		
Trade Payables	1,675	1,590
Short Term Loans	150	150
Interest Payable on loans	200	100
Income Tax Payable	220	450
	2,245	2,290
Total Equity and Liabilities	5,555	5,310

The following additional information is also provided:

- (1) Income tax expenses for the year ended 31st March 2020 was Rs.110,000/-.
- (2) A Motor vehicle was disposed on 01st April 2019. The cost of motor vehicle disposed was Rs.1,200,000/- and accumulated depreciation as at 01st April 2019 was Rs.650,000/-. Profit on disposal of the motor vehicle was Rs.600,000/-.
- (3) Interest expense on loans for the year was Rs.120,000/-.
- (4) An interim dividend of Rs.200,000/- has been paid for ordinary shareholders during the year.

You are required to:

Prepare the Statement of Cash Flows for **Gamage (Pvt) Ltd.** for the year ended 31st March 2020 using indirect method. (10 marks)

End of Section B

SECTION C

(Total 50 marks)

Question 08

The following information have been extracted from the comprehensive Income Statements for the year ended 31st March 2020 & 31st March 2019 and the Statements of Financial Position as at 31st March 2020 & 31st March 2019 of **Shakthi PLC**:

Extract from the Statements of Comprehensive Income

(Rs.'000)

For the Year Ended	31st March 2020	31st March 2019
Sales	300,100	275,000
Cost of Sales	180,060	152,500
Gross Profit	120,040	122,500
Profit Before Interest and Tax	44,500	32,000
Profit Before Tax	38,000	27,800
Profit After Tax	27,500	23,500

Statements of Financial Position (Rs. '000)

As at 31 st March	2020	2019
Assets:		
Non-Current Assets:		
Property, Plant and Equipment at Carrying Value	125,000	120,000
Current Assets:		
Inventories	32,000	30,000
Trade Receivables	30,500	27,000
Cash and Cash Equivalents	8,500	6,200
	71,000	63,200
Total Assets:	196,000	183,200
Equity and Liabilities:		
Equity:		
Stated Capital (9,000,000 ordinary shares)	90,000	90,000
Retained Earnings	15,300	5,800
	105,300	95,800
Non-Current Liabilities:		
Long Term Loan	45,000	56,000
Current Liabilities:		
Trade and Other Payables	24,200	16,200
Income Tax Payables	9,500	9,100
Accrued Expenses	12,000	6,100
	45,700	31,400
Total Equity and Liabilities	196,000	183,200

You are required to:

(a) **Calculate** the following ratios of **Shakthi PLC** based on the above information for the year ended / as at 31st March 2020 and 31st March 2019:

- (i) Gross Profit Ratio.
- (ii) Net Profit Ratio
- (iii) Quick Assets Ratio.
- (iv) Return on Capital Employed (ROCE).
- (v) Gearing Ratio.
- (vi) Earnings per Share.

(06 marks)

(b) **Analyze** the performance of **Shakthi PLC** based on the above computed ratios. (06 marks)

(Total 12 marks)

Question 09

Alpha PLC acquired 80% of the ordinary share capital of **Beeta PLC** on 01st January 2020 for Rs.85 million. On that day, the fair value of identifiable net assets of **Beeta PLC** was Rs.95 million and fair value of the non-controlling interest was Rs.25 million.

The Statements of Comprehensive income of **Alpha PLC** and **Beeta PLC** for the year ended 31st December 2020 were as follows:

Statements of Comprehensive Income
for the year ended 31st December 2020 (Rs.'000)

	Alpha PLC	Beeta PLC
Sales	325,000	140,000
Cost of Sales	(180,000)	(60,000)
Gross Profit	145,000	80,000
Other Income:		
Rent Income	600	-
Other Income	500	500
Expenses:		
Distribution Expenses	(26,000)	(12,800)
Administration Expenses	(48,000)	(24,000)
Finance Expenses	(2,500)	(1,800)
Profit Before Tax	69,600	41,900
Income Tax	(8,500)	(6,000)
Profit for the Year	61,100	35,900
Other Comprehensive Income	-	-
Total Comprehensive Income	61,100	35,900

The following additional information is also provided:

- (1) **Alpha PLC** has sold goods for Rs.6,000,000/- to **Beeta PLC** during the year with a profit margin of 25% on cost. As at 31st December 2020, $\frac{1}{3}$ of goods remained unsold at the premises of **Beeta PLC**.
- (2) On 31st October 2020, **Beeta PLC** sold a land costing of Rs.5,000,000/- to **Alpha PLC** for Rs.5,500,000/-.
- (3) **Beeta PLC** has paid monthly rent of Rs.50,000/- to **Alpha PLC** for usage of stores.

You are required to:

- (a) **Calculate** the goodwill arising from the consolidation. (04 marks)
 - (b) **Prepare** the Consolidated Comprehensive Income Statement for the year ended 31st December 2020. (09 marks)
- (Total 13 marks)

Question 10

The following trial balance was extracted from the books of **Diamond PLC** as at 31st March 2020:

Diamond PLC		<i>(Rs.'000)</i>
Trial Balance as at 31st March 2020		
	Dr.	Cr.
Stated Capital (6,000,000 ordinary shares)		60,000
Retained Earnings as at 01 st April 2019		19,300
Property, Plant and Equipment at Cost:		
Land & Buildings (Cost of land is Rs.38 million)	45,000	
Plant and Machinery	10,250	
Office Equipment	6,300	
Accumulated Depreciation as at 01st April 2019:		
Buildings		4,500
Plant & Machinery		3,700
Office Equipment		2,100
Inventory as at 31 st March 2020	35,300	
Trade Receivables / Trade Payables	18,100	17,100
Cash in Hand and Cash at Bank	8,350	
Allowance for Trade Receivables as at 01 st April 2019		3,000
Pre-payments	6,000	
Income Tax Paid	4,200	
Interim Dividend Paid - Ordinary Shares	6,500	
Cost of Sales / Sales	205,000	281,000
Other Income		6,000
Income Tax Payable as at 01 st April 2019		2,750
Administration Expenses	34,550	
Distribution Expenses	24,400	
Finance Expenses	2,400	
Bank Loan		2,500
Employee Benefits (Provision for Retirement)		4,400
	406,350	406,350

The following additional information is also provided:

- (1) The net realizable value of the inventory as at 31st March 2020 was Rs.34,875,000/-.
- (2) One of its customers who owed Rs.500,000/- to the business was declared bankrupt on 20th May 2020, thus the amount in due became irrecoverable. No provision has been made in the books of accounts in this regard. Further, it was decided to maintain the allowance for receivables at 10% of the remaining balance as at 31st March 2020.

- (3) Audit fee of Rs.400,000/- related to the financial year 2019/20 has not been accounted and pre-payment account represents insurance payment made for entire calendar year 2020.
- (4) On 31st March 2020, the company disposed a machinery for Rs.350,000/- which was purchased on 01st April 2018 at Rs.500,000/-. Cash received on disposal has been debited to cash book and credited to machinery account. Other than that no entries were made in respect of the disposal of machinery.
- (5) Property, Plant and Equipment are to be depreciated on the straight-line basis at cost. The useful life of the assets is as follows:
- | | | |
|---------------------|---|----------|
| Buildings | : | 50 years |
| Plant and Machinery | : | 04 years |
| Office Equipments | : | 05 years |
- (6) The company carried out an impairment test on 31st March 2020 and it was revealed that fair value less cost of disposal of office equipment was Rs.2,540,000/-. Value in use of the office equipment was Rs.2,800,000/-. There were no adjustments made in the books of account regarding the impairment.
- (7) As at 31st March 2020, the company revalued its land for Rs.40,000,000/- and it is not recorded in the books of accounts.
- (8) ½ of the bank loan balance as at 31st March 2020 should be settled in the year 2020/21.
- (9) The total income tax liability for the year 2018/19 was Rs.2,750,000/- which was paid during the year ended 31st March 2020 and the amount paid has been charged to the income tax paid account. The total income tax liability for the year 2019/20 is estimated as Rs.3,300,000/-.
- (10) The directors of the company approved the financial statements for issue on 30th June 2020.

You are required to:

Prepare the following, for **Diamand PLC** in a form suitable for publication:

- (a) Statement of Profit or Loss and Other Comprehensive Income (Comprehensive Income Statement) for the year ended 31st March 2020. (10 marks)
- (b) Statement of Financial Position as at 31st March 2020. (08 marks)
- (c) Statement of Changes in Equity for the year ended 31st March 2020. (03 marks)
- (d) Statement showing movement of Property, Plant and Equipment for the year ended 31st March 2020. (04 marks)
- (Total 25 marks)

End of Section C

ACTION VERBS CHECK LIST

Level of Competency	Description	Action Verbs	Verb Definitions
Knowledge (1)	Recall Facts and Basic Concepts.	Draw	Produce a picture or diagram.
		Relate	Establish logical or causal connections.
		State	Express details definitely or clearly.
		Identify	Recognize, establish or select after consideration.
		List	Write the connected items.

Level of Competency	Description	Action Verbs	Verb Definitions
Comprehension (2)	Explain & Elucidates Ideas and Information.	Recognize	Show validity or otherwise, using knowledge or contextual experience.
		Interpret	Translate into understandable or familiar terms.
		Describe	Write and communicate the key features.
		Explain	Make a clear description in detail using relevant facts.
		Define	Give the exact nature, scope or meaning.

Level of Competency	Description	Action Verbs	Verb Definitions
Application (3)	Use and Adapt Knowledge in New Situations.	Reconcile	Make consistent / compatible with another.
		Graph	Represent by graphs.
		Assess	Determine the value, nature, ability or quality.
		Solve	Find solutions through calculations and/or explanation.
		Prepare	Make or get ready for a particular purpose.
		Demonstrate	Prove or exhibit with examples.
		Calculate	Ascertain or reckon with mathematical computation.
		Apply	Put to practical use.

Level of Competency	Description	Action Verbs	Verb Definitions
Analysis (4)	Draw Connections Among Ideas and Solve Problems.	Communicate	Share or exchange information.
		Outline	Make a summary of significant features.
		Contrast	Examine to show differences.
		Compare	Examine to discover similarities.
		Discuss	Examine in detail by arguments.
		Differentiate	Constitute a difference that distinguishes something.
		Analyze	Examine in details to find the solution or outcome.