



**Association of Accounting Technicians of Sri Lanka**

**AA3 Examination - January 2018**

**Questions and Suggested Answers  
(AA 31)**

**FINANCIAL ACCOUNTING AND REPORTING  
(FAR)**

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA  
EDUCATION AND TRAINING DIVISION

**AA3 Examination - January 2018**  
**(AA 31) Financial Accounting and Reporting**

**SUGGESTED ANSWERS**

**SECTION A**

Four (04) compulsory questions.

(Total 20 marks)

*Suggested Answers to Question One*

**Relevance.** Financial Information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

It is assumed that users of financial statements have a fair knowledge of business, economic activities and a willingness to study the information with reasonable diligence.

**Faithful Representation**

Financial reports represents economic phenomena in words and numbers. To be useful, Financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a depiction would have three characteristics. It would be;

- Complete

- Neutral

- Free from error

(05 marks)

*Suggested Answers to Question Two*

Tax base	=	5,000,000 - 3,000,000	=	<b>2,000,000</b>
Carrying value	-	2,500,000		
(a) Temporary difference	=	2,500,000 - 2,000,000	=	<u><b>500,000</b></u>
				(02 marks)
(b) Differed Tax Liability	=	500,000 x 28%	=	<u><b>140,000</b></u>

(03 marks)

(Total 05 marks)

### ***Suggested Answers to Question Three***

- (a) - To improve quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.
- Provide a more cohesive and efficient approach to corporate reporting that draws on different reporting standards and communicates the full range of factors that materiality affect the ability of an organization to create value.
- Enhance accountability and stewardship for the broad base of capitals (financial, manufactured, natural, human, etc.) and promote understanding of their interdependencies.
- Support integrated thinking decision making and actions that focus on the creation of value in the short-term, medium-term and long-term.

**(02 marks)**

- (b) 1. Organizational overview and external environment
2. Business model
3. Capital Management
4. Stakeholder relationship
5. Strategy and resource allocation
6. Outlook
7. Risk management and internal control

**(03 marks)**

**(Total 05 marks)**

### ***Suggested Answers to Question Four***

<b>Extract of cash flow statement</b>		<b>(Rs. '000)</b>
Cash flow from investing activities:		
Sale proceeds on Disposal (W 01)		750
Purchase of Assets [3,000 - (2,500 - 1,000)]		(1,500)
<b>W 01 Disposal of Machinery</b>		<b>(Rs. '000)</b>
Cost	1,000	Depreciation (W 02) <span style="float: right;">750</span>
P & L	500	Sales proceeds <span style="float: right;">750</span>
	<u>1,500</u>	<u>1,500</u>
<b>W 02</b>		<b>(Rs. '000)</b>
Total depreciation charged		1,250
Depreciation on existing machinery (2,000 - 1,500)		(500)
Depreciation on disposal machinery		750

**(05 marks)**

***End of Section A***

Three (03) compulsory questions  
(Total 30 marks)

### *Suggested Answers to Question Five*

(a) - The amount charged as expenditure

Research expenses	=	3,000,000
Staff training cost	=	300,000
Sales promotion cost	=	50,000
	=	<u><u>3,350,000</u></u>

- The amount capitalized as Intangible assets

Patent right *	=	25,000
Professional fee	=	250,000
Intangible asset	=	<u><u>275,000</u></u>

\* Patent right is assumed to be material.

(06 marks)

(b) Interest (20,000 x 15% x 11/12)	=	2,750,000
Investment Income	=	(300,000)
<b>Amount to be capitalized</b>	=	<u><u>2,450,000</u></u>

(04 marks)  
(Total 10 marks)

### *Suggested Answers to Question No. 06*

		DM	MM
Gross Profit Ratio	=	(8,350 / 28,750) x 100	
	=	<b>29%</b>	<b>30%</b>

There is a slight increase in gross profit ratio comparing with DM. Reasons for the increase may be increase in sales and decrease in cost of sales.

		<b>DM</b>	<b>MM</b>
<b>Net Profit Ratio</b>	=	$(5,220 / 28,750) \times 100$	
	=	<u><b>18.16%</b></u>	<u><b>25%</b></u>

Though there is a slight increase in gross profit of **DM** compared to **MM**, net profit ratio was increased by 7% comparing with **DM**. There may be a reduction in expenses related to administration, selling and distribution and finance of **MM** than **DM**.

		<b>DM</b>	<b>MM</b>
<b>ROCE</b>	=	$(5,220 / 22,030) \times 100$	
	=	<u><b>24%</b></u>	<u><b>32.64%</b></u>

As a result of higher net profit ratio of **MM** compared to **DM**, ROCE of **MM** also represents a higher value compared to **DM**. Higher net profit may be the main reason for the higher ROCE in **MM**. As a whole higher profitability shows at **MM** than **DM**.

		<b>DM</b>	<b>MM</b>
<b>Quick Assets Ratio</b>	=	$(10,470 - 5,240) / 3,200$	
	=	<u><b>1.63 : 1</b></u>	<u><b>2.08 : 1</b></u>

Quick asset ratio of **MM** is higher than **DM**. More cash may be held with Debtors of **MM**. The accepted benchmark for quick asset ratio is 1 : 1. Therefore, both companies should improved on quick asset. 1

		<b>DM</b>	<b>MM</b>
<b>Debtors Collection Period</b>	=	$(2,840 / 20,125) \times 365$	
	=	<u><b>52 days</b></u>	<u><b>60 days</b></u>

Debt collection period at is high **MM**. Increase in debt collection period may be allowed to increase the sales and thereby achieve higher profits.

*(10 marks)*

## ***Suggested Answers to Question Seven***

**ABC Company Limited**

**Statement of Cash Flows**

**For the year ended 31.03.2017**

		<b>(Rs. '000)</b>
<b>Net Cash flows from Operating Activities</b>		
Net Profit before Tax (1,900 + 600)		2,500
Depreciation		500
Interest exp.		380
		3,380
Income tax paid (W 01)		(550)
		2,830
<b>Changes in working Capital</b>		
Decrease in Inventories	500	
(Increase) in Trade and Other receivables	(2,940)	
(Decrease) in Trade and Other payables	(640)	(3,080)
Net Cash flows from operating activities		(250)
<b>Finance Activities</b>		
Repayment of loan	(900)	
Interest paid (W 02)	(400)	
Issuing Irredeemable preference share capital	1,500	
Net cash flows from Financial Activities		(200)
<b>Investing Activities</b>		
Net changes in cash and cash equivalent during the period		(50)
Cash and Cash Equivalents as at 01st April 2016		300
<b>Cash and Cash equivalents as at 31st March 2017</b>		<b>250</b>

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**Workings:****W 01**

<b>Income Tax</b>			
Cash	550	B/B/F	200
B/C/F	250	P & L	600
	<u>800</u>		<u>800</u>

**W 02**

<b>Interest</b>			
Cash	400	B/B/F	60
B/C/F	40	P & L	380
	<u>440</u>		<u>440</u>

*(Total 10 marks)*

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*End of Section B*

Two (02) compulsory questions.  
(Total 50 marks)

*Suggested Answers to Question Eight*

(a)

**Gajaba PLC**  
**Statement of Comprehensive Income**  
**For the year ended 31.03.2017**

		(Rs. '000)
Sales (160,000 - 1,200)		158,800
Cost of sales (107,000 + 125)		(107,125)
Gross Profit		51,675
<b>Other Income:</b>		
Profit on disposal of PPE (W 01)	768.75	
Reversal of bad debt over provision (W 06)	855	1,623.75
		53,298.75
<b>Expenses:</b>		
Distribution (W 04)	20,546.25	
Administration (W 03)	12,220	32,766.25
		20,532.50
Finance expenses (W 05)		(6,100)
		14,432.50
<b>Profit before tax:</b>		
Taxation (W 07)		(3,500)
Profit after tax		10,932.25
<b>Other comprehensive Income</b>		
Revaluation on building		2,000
<b>Total Comprehensive Income</b>		<b>12,932.50</b>

(10 marks)

(b)

**Gajaba PLC**  
**Statement of Financial Position**  
**As at 31.03.2017**

(Rs. '000)

		(Rs. '000)	
<b><u>Assets:</u></b>			
<b><u>Non-Current Assets</u></b>			
Property, Plant and Equipment			30,662.50
<b><u>Current Assets</u></b>			
Inventory		9,375	
Trade Receivable (11,000 - 100)	10,900		
Less: Allowance for Receivables	(545)	10,355	
Cash at Bank		3,000	
Cash in hand		200	22,930
<b>Total Assets</b>			<b>53,592.50</b>
<b><u>Equity and Liabilities</u></b>			
Stated Capital		20,000	
Retained Earnings		15,432.50	
Revaluation reserve		2,000	37,432.50
<b><u>Non-Current Liabilities</u></b>			
Redeemable preference shares capital		5,000	
Bank loan		1,500	6,500
<b><u>Current Liabilities</u></b>			
Bank loan		1,500	
Trade payables		6,000	
Income tax payable		1,900	
Accrued expenses		260	9,660
			<b>53,592.50</b>

(07 marks)

(c)

**Gajaba PLC**  
**Statement of Changes in Equity**  
**For the year ended 31.03.2017**

	<b>Ordinary Shares</b>	<b>Revaluation Reserve</b>	<b>Retained Earnings</b>	<b>Total</b>
Balance B/F - 01.04.16	20,000	-	6,500	26,500
Revaluation of buildings	-	2,000	-	2,000
Profit for the year	-	-	10,932.50	10,932.50
Interim dividends	-	-	(2,000)	(2,000)
	<b>20,000</b>	<b>2,000</b>	<b>15,432.50</b>	<b>37,432.50</b>

**Notes to the financial statements**

The company has decided to pay a final dividend Rs. 01/- per share for the ordinary shares held on 31st March 2017.

*(03 marks)*

(d)

<b>Description</b>	<b>Land</b>	<b>Buildings</b>	<b>M/V</b>	<b>Office /E</b>	<b>Total</b>
<b>Cost:</b>					
Balance B/F - 01.04.16	20,000	5,000	15,000	4,000	44,000
Disposal	-	-	(2,300)	-	(2,300)
Revaluation	-	2,000	-	-	2,000
<b>Balance as at 31.03.2017</b>	<b>20,000</b>	<b>7,000</b>	<b>12,700</b>	<b>4,000</b>	<b>43,700</b>
<b><u>Depreciation</u></b>					
Balance as at 01.04.16	-	2,000	6,000	2,600	10,600
Depreciation for the year (W02)	-	200	3,606.25	500	4,306.25
Disposal	-	-	(1,868.75)	-	(1,868.75)
Balance as at 31.03.17	-	2,200	7,737.50	3,100	13,037.50
<b>Carrying value as at 31.03.17</b>	<b>20,000</b>	<b>4,800</b>	<b>4,962.50</b>	<b>900</b>	<b>30,662.50</b>

*(05 marks)*

*(Total 25 marks)*

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**Workings****W 01 Disposal Account**

Cost	2,300	Cash	1,200
P & L	768.75	Depreciation	1,868.75
	<u>3,068.75</u>		<u>3,068.75</u>

**W 02 Depreciation for the year**

Motor vehicle disposal	431.25
Balance	3,175
	<b>3,606.25</b>

**Depreciation - on disposed vehicle**

$$(2,300 / 4) \times 3 \frac{3}{12} = 1,868.75$$

**W 03 Administration Expenses**

TB	11,460
Depreciation - Building	200
Office equipment	500
Accrued Telephone & Electricity	60
	<u>12,220</u>

**W 04 Distribution Expenses**

TB	16,740
Depreciation - Motor vehicle	3,606.25
Accrued Advertising	200
	<u>20,546.25</u>

**W 05 Finance Expenses**

TB	5,600
Dividend on Redemable Preference Shares	500
	<u>6,100</u>

**W 06 Allowance for Trade Receivables**

Bad debt	100	B/B/F	1,500
P & L	855		
B/C/F	545		
	<u>1,500</u>		<u>1,500</u>

**W 07 Income Tax Account**

Cash	2,000	B/B/F	400
B/C/F	1,900	P & L	3,500
	<u>3,900</u>		<u>3,900</u>

## Suggested Answers to Question Nine

(A)

(a) Goodwill Calculation

Investment made by parent	=	12,000	
Non-Controlling Interest	=	<u>3,000</u>	
	=		15,000

Less: Fair Value of Net Assets

Stated Capital	=	7,000	
General Reserve	=	1,800	
Retained Earning	=	<u>2,000</u>	(10,800)
Goodwill	=		<u><u>4,200</u></u>

(05 marks)

(b)

**Gamunu PLC**  
**Consolidated Statements of Comprehensive Income**  
**For the year ended 31st March 2017**

(Rs. '000)

Sales (250,000 + 110,000 - 2,000)		358,000
Cost of Sales (140,000 + 72,000 - 2,000 + 100)		(210,100)
<b>Gross Profit</b>		<b>147,900</b>
<b>Other Income:</b>		
Interest Income (800 + 250 - 600)	450	
Dividend Income (1,600 + 45 - 500)	1,145	
Other Income (1,550 - 600 - 400)	550	2,145
		150,045
<b>Expenses:</b>		
Distribution (40,000 + 13,500)	(53,500)	
Administration (10,000 + 3,000 - 600)	(12,400)	
Finance (8,000 + 2,000 - 600)	(9,400)	(75,300)
Profit before tax		74,745
Income tax (14,500 + 2,000)		(16,500)
<b>Profit for the year</b>		<b><u><u>58,245</u></u></b>

(14 marks)

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(B) **Possible Reasons:**

1. **Current Ratio:**

- Reduction in credit period offered to trade receivables
- Reduced stock holding
- Increased credit period offered by creditors

2. **Debtors' collection period:**

- A drop in credit sales
- Extended credit facilities to trade receivables to increase sales.

3. **Stock residence period:**

- Existence of non-moving items
- Increase in inventory held due to expected increase of sales

*(06 marks)*

*(Total 25 marks)*



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*End of Section C*

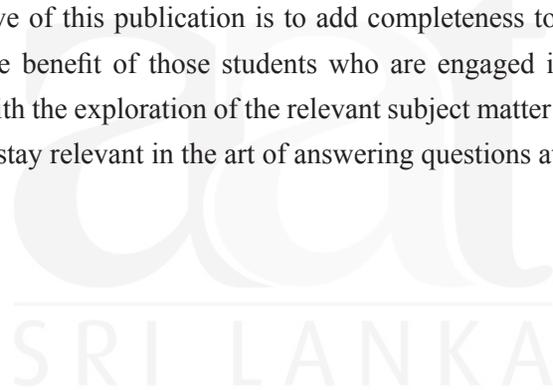
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***Notice :***

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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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