SRI LANKA

Association of Accounting Technicians of Sri Lanka

AA3 Examination - January 2020

Suggested Answers
(AA 31)

FINANCIAL ACCOUNTING AND REPORTING (FAR)

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A publication of the Education and Training Division

THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

EDUCATION AND TRAINING DIVISION

AA3 Examination - January 2020
(AA 31) Financial Accounting and Reporting

SUGGESTED ANSWERS

SECTION A

Four (04) compulsory questions.
(Total Marks 20)

Suggested Answers to Question No. 01

Chapter 01 - Conceptual Framework for Financial Reporting

(1) **Comparability**

Comparability is the qualitative characteristic that enables users to identify and understand similarities and difference among items.

(2) **Variability**

Variability means that different knowledgeable and independent observes could reach consensus although not necessarily complete agreement that a particular depiction is a faithful representation.

(3) **Timeliness**

Timeliness means having information available to decision makers on time to be capable of influencing their decisions.

(4) **Understandability**

Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyze the information technology.

(05 marks)

Suggested Answers to Question No. 02

Supplementary – Integrated Reporting

(a) 1. To improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital

2. Provide a more cohesive and efficient approach to corporate reporting that draws on

different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time.

3. Enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human and natural) and promote understanding of their interdependencies.
4. Support integrated thinking, decision making and actions that focus on the creation of value over short, medium and long term

(02 marks)

(b) **Organizational overview**

- Ownership and operating structure
- Principal activities and markets
- Market positioning
- Key quantitative information (eg- Revenue, Number of employees)

External Environment

- The legitimate needs and interests of key stakeholders
- Macro and micro economic conditions
- Market forces (Strength and weaknesses of competitors and customers demand)
- Effects of Technology change
- Environmental challenges
- The legislative and regulatory environment in which the organization operates
- Political environment in country

(03 marks)

(Total 05 marks)

Suggested Answers to Question No. 03

Chapter 03 -II - Supplementary -SLFRS 15 "Revenue from Contract with Customers"

1. Step 1 : Identify contract(s) with customer.
2. Step 2 : Identify separate performance obligations in the contract(s)
3. Step 3 : Determine the transaction price
4. Step 4 : Allocate the transaction price to the performance obligation in the contract.
5. Step 5 : Recognize revenue when the performance obligation is satisfied by the entity.

(05 marks)

Suggested Answers to Question No. 04

Chapter 05 – Statement of Cash Flow– LKAS 07

Ameen PLC

Cash Flows from Investing Activities

For the year ended 31.03.2019

	Rs. '000
Disposal of motor vehicle (W-1)	1,225
Purchase of Motor Vehicle	(3,000)
Acquisition of furniture	(2,500)
Net Cash Flows from investing activities	**(4,275)**

Workings: (W-01)

Disposal Account

Cost	4,500	Depreciation	2,800
		Loss	475
		Cash	1,225
	4,500		**4,500**

(05 marks)

(Total 20 marks)

End of Section A

SECTION B

Three (03) compulsory questions
(Total 30 marks)

Suggested Answers to Question No. 05

(a)

Chapter 06 - Financial Statement Analysis

a. **Gross Profit Ratio = (Gross Profit / Sales) *100**

	2019	**2018**
	120,040 * 100	96,575 * 100
	300,000	275,000
	= 40%	= 35%

Compared with 2018, Gross Profit Ratio of the company has increased. It may be due to increase in sales.

b. Net Profit Ratio = Net Profit Before Tax / Sales

	2019	**2018**
	27,500 * 100	28,300 * 100
	300,000	275,000
	9.2%	**10.29%**

Though Gross Profit Ratio has increased net profit ratio has decreased. It may be increased in expenses of the company.

c. Stock Turnover Ratio = Cost of Sales / Average Inventories

	2019	**2018**
	179,960	178,425
	17,000	(15,000+14,000)/2
	179,960	178,425
	(19,000+15,000)/2	(15,000+14,000)/2
	10.6 times	**12.3 times**

This shows the efficiency of the business to convert stocks into Turnover. Compared to 2018, stock turnover ratio has come down due to non-moving/ slow moving items are in the inventory.

d. Debtors Collection Period = (Average Debtors / Credit Sales) * 365

	2019	2018
	(40,500 + 27,000) / 2 * 365	(27,000 + 21,500) / 2 * 365
	300,000	275,000
	41 Days	**32 Days**

More days are required to collect the debts from debtors compared with 2018. This leads to increase in impairment provision on debtors.

e. Return on Capital Employed /ROCE = (PBIT / Debt & Equity Capital) * 100

	2019	2018
	43,400 * 100	38,300 * 100
	(170,000 + 42,000)	(142,500+56,000)
	20.48%	**19.29%**

Alternative Answer

		2019	2018
ROCE	=	27,500 * 100	28,300 * 100
		170,000	142,500
		16.18%	**19.86%**

This is the profit as a percentage of capital employed. It is a slight increase compared with 2018.

(10 marks)

Suggested Answers to Question No. 06

Chapter 05 – Statement of Cash Flow – LKAS 07

Wess (Pvt) Ltd
Statement of Cash Flows
For the year ended 31st March 2019

		Rs "000"
Cash flow from Operating Activities		
Profit Before Tax (600+175+300)		1,075
Adjustments for		
Interest Expenses	325	
Depreciation	1,970	
Profit on disposal **(W-1)**	(950)	1,345
Operating profit before working capital changes		**2,420**
Less: Income tax paid		(355)
Working Capital Changes		
Decrease in Inventories	150	
(Increase) in Trade and other receivables	(432)	
Increase in Trade Payable	930	648
Cash flows generated from operating activities		**2,713**
Cash flow from investing activities		
Acquisition of Property Plant and Equipment	(3,300)	
Proceed from Disposal of PPE	2,000	
Net cash flow from investing activities		**(1,300)**
Cash flow from financing activities		
Repayment of Loans	(550)	
Dividends Paid	(300)	
Loan interest paid (50+325)	(375)	
Net cash flow from financing activities		**(1,225)**
Net Cash increased during the period		**188**
Cash and cash equivalent at the beginning of the year		**210**
Cash and cash equivalent at the end of the year		**398**

Profit on disposal (W-1)

Workings:

(W-01)

Disposal Account

Cost	1,900	Accumulated Depreciation	850
Profit	950	Cash	2000
	2,850		**2,850**

(W-2) Income Tax

Income Tax

Cash	355	B/B/F	300
B/C/F	120	P&L	175
	475		**475**

(10 marks)

Suggested Answers to Question No. 07

(A)

Chapter 03 - Part I-Accounting Standards

(a) **Changes in Accounting Policies**

- In accordance with LKAS 08, this is a policy change.
- Accordingly, this should be adjusted through a retrospective restatement, by adjusting the comparative figure of (2017/18) and the earliest period reported (Retained earnings)
- Therefore, Githmi Ltd should adjust the 31.03.2018 Financial Statements by reducing its closing inventory and retained earnings by 6.7Mn and this will affect the (2018/19) financial statement's opening inventories and as a result current year profit will be increased by 6.7 million.

(b) **Accounting Error**

- In accordance with LKAS 08, this is an error.
- Retrospective Application would be as follows.
  (500,000/5)*(3/12)=25,000
- Accordingly, this should be adjusted through a retrospective restatement, by adjusting Retained Earnings of the year in which the error occurred or to the earliest period hence the net assets value is reduced by Rs.25,000 and retained earnings balance will be reduced by Rs. 25,000

(05 marks)

(B)

Chapter 03 - Part II - Accounting Standards

(a)

- In accordance with LKAS 37, this is a provision.
- It can be observed from Githmi Ltd,
  - o There is a present obligation, that is the finalized assessment
  - o This arise due to a past event and
  - o Reliable estimate can be made to assess the expected outflows
- At the beginning, company claimed Rs. 1.5 Mn as input tax and paid VAT accordingly. But the IRD has disallowed now Rs. 1Mn.This adjustment is pertaining to year ended 31st March 2019 and it is to be made in the same year. A VAT liability of Rs. 1 Mn should be provided for 2018/19.

(b)

- In accordance with LKAS 37, this is only a contingent liability
- Even though the legal case was filled, the lawyers had confirmed that the company will not require to pay such penalty of Rs.50Mn.
- Accordingly the likelihood of this payment is very remote as per the lawyer's comment. Therefore the company should clearly disclose the fact in the financial statement with necessary financial values.

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(05 marks)

(Total 10 marks)

End of Section B

SECTION C

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

Suggested Answers to Question No. 08

Chapter 04 – Financial Accounts of Limited Liability Companies

(a)

Medito PLC
Statement of Profit or Loss and Other Comprehensive Income
for the Year Ended 31st March 2019

Rs"000"

	Working	Amount	Amount
Sales			378,500
Less: Cost of Sales (269,400+700-230)-3,500			(266,370)
Gross Profit			**112,130**
Less Expenses:			
Distribution Expenses	**(W-1)**	(33,780)	
Administration Expenses	**(W-1)**	(52,720)	
Finance Expenses (500-360)	**(W-3)**	(140)	(86,640)
Profit Before Tax			25,490
Income Tax			(2,950)
Profit After Tax			22,540
Other Comprehensive Income			5,000
Comprehensive Income			**27,540**
Revaluation of Land			5,000
Total Comprehensive Income			**32,540**

(10 marks)

(b)

Medito PLC
Statement of Financial Position
As at 31st March 2019

	Working		Amount	Amount
Assets				
Non-Current Assets				
Property, Plant & Equipment	**(W-5)**		91,180	
Capital Work in Progress (16,000+360)			16,360	107,540
Current Assets				
Inventories (32,500-700+230)			32,030	
Trade Receivables		39,000		
Less: Provision for debt	**(W-6)**	(780)	38,220	
Pre-payments			1,500	
Cash and cash equivalent			16,500	88,250
Total Assets				**195,790**
Equity & Liabilities				
Equity				
Stated Capital	**(W-7)**		90,000	
Revaluation Reserve			5,000	
Retained Earning			30,540	
Total Equity				125,540
Non-Current Liabilities				
12% Bank Loan			6,000	
Gratuity Provision			20,500	26,500
Current Liabilities				
Current Portion of Bank Loan			6,000	
Income Tax Payable			200	
Accrued Expenses			700	
Trade Payables			36,850	43,750
Total Equity & Liabilities				**195,790**

(7 marks)

(c) (W-7)

Medito PLC

Statement of Changes in Equity

For the year ended 31st March 2019

	Stated Capital	Retained Earning	Revaluation	Total
B/B/F	90,000	17,000	-	107,000
Revaluation	-	-	5,000	5,000
Dividends paid	-	(9,000)		(9,000)
Profit for the year	-	22,540		22,540
B/C/D	**90,000**	**30,540**	**5,000**	**125,540**

(04 marks)

Note : It was proposed to pay final dividend of Rs.5/- for ordinary shares.

(d) W-5

Medito PLC

Statement of movements of PPE for the year ended 31st March 2019

	Land	Buildings	Plant & Machinery	Motor Vehicles	Office Equipment	Total
Cost:						
Balance 01.04.2018	**55,000**	**32,000**	**14,000**	**10,000**	**7,200**	**118,200**
Revaluation	5,000	-	-	-	-	5,000
Addition	-	-	4,000	-	-	4,000
Balance as at 31.03.2019	**60,000**	**32,000**	**18,000**	**10,000**	**7,200**	**127,200**
Depreciation						
Balance 01.04.2018		**15,000**	**6,000**	**5,500**	**3,500**	**30,000**
Charges for the year **(Working -2)**		1,600	1,700	2,000	720	6,020
Balance as at 31.03.2019		**16,600**	**7,700**	**7,500**	**4,220**	**36,020**
Carrying Value as at 31.03.2019	**60,000**	**15,400**	**10,300**	**2,500**	**2,980**	**91,180**

(04 marks)

(W-1) Expenses Analysis

Description	Workings	Selling and Expenses Distribution	Administration Expenses
From TB		29,500	46,000
Machinery Installation cost			(500)
Research Expenses			2,500
Depreciation	**W-2**	2,000	4,020
Bad Debts		2,000	
Allowance for trade receivables	**W-4**	280	
Electricity			700
Total		**33,780**	**52,720**

(W-2) Depreciation

1. Machinery	=	(14,000/10) + (4000/10*9/12)	=	1,700	
2. Buildings	=	32,000 / 20	=	1,600	
3. Office Equipment	=	7,200 / 10	=	720	4,020
4. Motor Vehicles	=	10,000 / 5	=		**2,000**

(W-3) Finance Expenses

From TB	=	500
Less Borrowing Cost (12,000,000 * 12% * 3/12)	=	(360)
Total	**=**	**140**

(W-4) Allowance for Debtors

Net Debtors			=	39,000
2% Provision	=	39,000 * 2%	=	**780**
Under Provision	=	780 - 500	=	**280**

(Total 25 marks)

Suggested Answers to Question No. 09

Chapter 07 - Group Financial Statements

(A)

(W-1) – Calculation of Goodwill

		(Rs.000)
Investment by Parent	=	40,000
Fair Value of NCI	=	7,720
Total	**=**	**47,720**
Less - Net Assets in Subsidiary		
Stated Capital	=	(35,000)
Retained Earnings	=	(6,000)
Goodwill	**=**	**6,720**

(5 marks)

(b)

Gajasakthi PLC
Consolidated Statement of Financial Position
As at 31st March 2019

			"000"
Assets			
Non-Current Assets			
Property plant & Equipment	(52,000 + 23,500)		75,500
Acc. Depreciation	(12,500 + 7,500)		(20,000)
Carrying Value			**55,500**
Goodwill on consolidation	**(W-1)**		6,720
Current Assets			
Inventories	(13,100 + 27,900 - 750) **(W-2)**	40,250	
Trade and other receivables	(40,250 + 10,500 - 2,500 - 4,000)	44,250	
Cash and cash equivalents	(2,300 + 1,100)	3,400	87,900
Total Assets			**150,120**
Equity and Liabilities			
Equity			
Stated Capital		80,000	
Consolidated Retained Earnings	**(W-2)**	14,270	94,270
Non-Controlling Interest	**(W-3)**		8,150
			102,420

Non-Current Liabilities			
Long Term Loan			16,200
Current Liabilities			
Trade & Other Payable	(20,250 + 11,400 - 2500)	29,150	
Short Term Loan	(5,400 + 950 - 4,000)	2,350	31,500
Total Equity & Liabilities			**150,120**

(W-2) Consolidated Retained Earnings

Parent Profits	=	13,300
Less : Unrealized Profits of stocks(4,500/120*20)	=	(750)
Share of Subsidiary Post Profit(W-4)	=	1,720
Total	**=**	**14,270**

(W-3) Non-Controlling Interest

Fair Value of NCI	=	7,720
Share of Subsidiaries Profit (20%*2,150) (W-4)	=	430
Total	**=**	**8,150**

(W-4) Post Profit in Subsidiary

Post Profit	=	2,150
80% Share to Parent = (2,150*80%)	=	1,720
20% Share to NCI = (2,150*20%)	=	430

(14 marks)

(B)

a. **Increase in Current Ratio**

1. Increase in the amount of the Stock with an expectation of increase in sales.(Excess Stock Build up)
2. Increase in the debtor's credit period with an expectation of increase in sales.

b. **Return on Capital Employed**

1. Increase in selling price and discount with an expectation of increase in sales, which was adversely affected profits.
2. Under-utilization of assets.
3. Reduction of profit margins.

c. **Increase in Stock Residency Period**

1. Excessive stock to facilitate the future high demand for the products.
2. Stock comprising slow moving or redundant items.

(06 marks)

(Total 25 marks)

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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