



Association of Accounting Technicians of Sri Lanka

Level III Examination - July 2021

Suggested Answers

(301) FINANCIAL REPORTING (FAR)

Association of Accounting Technicians of Sri Lanka

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A publication of the Education and Training Division

THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

Level III Examination - July 2021

(301) FINANCIAL REPORTING

SUGGESTED ANSWERS

**Four (04) Compulsory Questions
(Total 20 Marks)**

SECTION - A

Suggested Answers to Question One:

Chapter 1- Governance Structure, the Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

(a) Non-financial information included in Annual Report

1. Corporate governance
2. Sustainability reporting
3. Environmental Reports / Environmental Impact Assessment Reports
4. Anti-bribery policies
5. Economic factors affecting the business
6. Corporate social responsibility
7. Risk reports
8. Employees' matters

(03 marks)

(b) Objectives of integrated reporting

1. Improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.
2. Promote a more cohesive and efficient approach to corporate reporting that draws on different reporting standards and communicated 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 such as (financial, manufactured, intellectual, human, social relationship and natural) and promote understanding of their interdependencies.
4. Support integrated thinking, decision making and actions that focus on the creation of value over the short, medium and long term.

(02 marks)

(Total 05 marks)

Suggested Answers to Question Two:

Chapter 2 Part I – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a) Objectives of Securities and Exchange Commission (SEC) of Sri Lanka

1. The creation and maintenance of a market in which securities can be issued and traded in an orderly and fair manner.
2. The protection of the interest of investors.
3. The operation of a Compensation Fund to protect investors from financial loss arising as a result of any licensed stock dealer being found incapable of meeting his contractual obligations.
4. The regulation of the security market and to ensure that professional standards are maintained in such market.

(02 marks)

(b) Duties and Functions of Securities and Exchange Commission (SEC) of Sri Lanka

1. To grant a licence to a body corporate as a stock exchange and ensure the proper conduct of its business.
2. To grant a licence to a managing company to operate a unit trust and to ensure the proper conduct of the business of such unit trust.
3. To grant compensation to any investor who suffers pecuniary loss arising as a result of any licenced stock broker or licenced stock dealer being found incapable of meeting his contractual obligations.
4. To advise the government on the development of the securities market.
5. To cancel or suspend the listing of any securities or the trading of any listed securities or to suspend the trading of all listed securities for not more than three days at a time, for the protection of investors.
6. To request the Registrar of Companies, in the exercise of the powers conferred on it by section 227 of the Companies Act, to call upon a private limited liability company to become a public limited company.
7. To inquire and conduct investigations into any activity of a licensed stock exchange or a licensed managing company.
8. To inquire and conduct investigations into any activity of a licensed stock broker or licensed stock dealer or a trustee of a unit trust.

(03 marks)

(Total 05 marks)

Suggested Answers to Question Three:

Chapter 1- Governance Structure, the Importance of Ethics in Accounting and Conceptual Framework of Financial Reporting

(a)

Financial capital maintenance. Under this concept a profit is earned only if the financial (or monetary) amount of the net assets at the end of the period exceeds the financial (or monetary) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

Physical capital maintenance. Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

(03 marks)

(b)

Going concern assumption - Financial statements are generally prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to enter liquidation or to cease operations.

(02 marks)

(Total 05 marks)

Suggested Answers to Question Four:

Chapter 2 Part II - Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

- As per SLFRS for SMEs, the borrowing cost should be charged to profit or loss as and when it is incurred, no exception to capitalize the borrowing cost for qualifying asset.
- As per SLFRS for SMEs, the inventories should be valued at lower of cost or NRV.
- As per SLFRS for SMEs, the reassessment of useful life of equipment should be considered as estimate change and adjusted prospectively from the current to future period.

(Total 05 marks)

End of Section A

Suggested Answers to Question Five:

Chapter 3 part II – Financial Statements for a Limited Liability Company for Publication Purpose

Enrich foods (Pvt) Ltd Statement of Cash flows For the Year Ended 31.03.2021		(Rs.'000)
Cash Flows from Operating Activities		
Profit Before Tax (W1)		1,890
Adjustment For		
Depreciation (3,250 – 2,200)	1,050	
Interest Expenses	300	
Provision for Gratuity (2,400 – 2,100)	300	
Income tax paid (W3)	200	1,850
Operating profit before working capital changes		3,340
Changes in working capital		
Decrease in inventories	700	
Increase in trade receivables	(460)	
Increase in trade payables	380	620
Cash flows generated from operations		3,960
Cash flows from investment activities		
Acquisition of Land (18,500-14,000)	(4,500)	
Net cash flows from investing activities		(4,500)
Cash flows from finance activities		
Dividends Paid	(200)	
Repayment of Loan	(400)	
Interest paid (W2)	(460)	(1,060)
Net cash decrease during the period		(1,600)
Cash & Cash Equivalent at the Beginning		2,100
Cash & Cash Equivalent at the End		500

W1 - Net profit before tax

Net profit (4,200 – 2,700)	1,500
Tax paid	190
Dividend paid	200
	<u>1,890</u>

W2

Interest A/C			
Cash	460	B/B/F	380
B/C/F	220	P & L	300
	<u>680</u>		<u>680</u>

W3

Income Tax Payable A/C			
Cash	200	B/B/F	420
B/C/F	410	P & L	190
	<u>610</u>		<u>610</u>

(Total 10 marks)**Suggested Answers to Question Six:**

Chapter 2 Part II - Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

	Stand- alone Price		Allocated Price
Software	300,000	55.56%	333,333
Maintenance	<u>240,000</u>	44.44%	<u>266,667</u>
	<u>540,000</u>		<u>600,000</u>

For the year ended 31st March 2021

Software	333,333
Maintenance (266,667/2)	<u>133,333</u>
	<u>466,666</u>

For the year ended 31st March 2022

Maintenance	<u>133,333</u>
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OR

Dr. Cash	600,000	
Cr. Sales Advance		600,000

(Being the entry for the receipt of 600,000 sales advance)

Dr. Sales Advance	466,666	
Cr. Sales - Software		333,333
Cr. Sales - Maintenance		133,333

(Being the entry for the revenue recognized in 2021)

Dr. Sales Advance	133,333	
Cr. Sales - Maintenance		133,333

(Being the entry for the revenue recognized in 2022)

(06 marks)

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(b)

	(Rs.'000)
Cost	10,000
Accumulated Depreciation as at 01.04.2020	<u>(4,000)</u>
WDV as at 01.04.2020	6,000
Reassessed useful life	8 years
so prospective depreciation from 01.04.2020 onwards	6,000/8
Depreciation charge for the year	<u>750</u>

(04 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(a)

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Eg-

- Constructed Building
- Manufacturing plants,
- Power generating facilities
- Inventories
- Intangible assets
- Infrastructure assets such as bridges and railways

(04 marks)

Chapter 2 Part II – Regulatory Requirements and Application & Disclosure Requirements of Sri Lanka Accounting Standards in preparing Financial Statements

(b)

Debentures	(100*100)	10,000	10%	1,000
Bank Loan		5,000	12%	<u>600</u>
Total Interest				1,600
Therefore Capitalization Rate		1,600/15,000	=	10.67%
Interest		12,000 * 10.67% * 9/12	=	960.30
Interest Cost to be Capitalized		960.30 - 160	=	<u>800.3</u>

(06 marks)
(Total 10 marks)

End of Section B

Suggested Answers to Question Eight:

Chapter 3 part I – Financial Statements for a Limited Liability Company for Publication Purpose

(a)

Nazeen PLC
The Statement of Profit or Loss and Other Comprehensive Income
for the Year ended 31.03.2021

			(Rs.'000)
Revenue	Notes		100,400
Cost of Sales			<u>(67,760)</u>
Gross Profit			32,640
Other Income	01		<u>3,540</u>
			36,180
<u>Less Expenses:</u>			
Distribution Expenses (W7)		(9,650)	
Administration Expenses (W7)		(14,065)	
Other Expenses		-	
Finance Expenses	02	<u>(1,048)</u>	(24,763)
Profit Before Tax			11,417
Income Tax (W6)			(1,500)
Profit After Tax			9,917
Other Comprehensive Income			-
Total Comprehensive Income			9,917

(10 marks)

(b)

Nazeen PLC
Statement of Financial Position
as at 31.03.2021

			(Rs.'000)
<u>Non Current Assets</u>			
Property Plant & Equipment			35,000
<u>Current Assets</u>			
Inventories		8,920	
Trade Receivables	03	13,380	
Prepayments		900	
Cash & Cash Equivalent		805	24,005
Total Assets			59,005

Equity And Liabilities :			
<u>Stated Capital & Reserves</u>			
Stated Capital		7,000	
Retained Earnings		37,056	
Total Equity			44,056
<u>Non Current Liabilities</u>			
Lease Liability (2,524 -528) (W4)		1,996	
Bank Loan (3600/2)		1,800	
Employee Benefit	04	1,750	5,546
<u>Current Liabilities</u>			
Trade Payables		6,800	
Accrued Expenses		55	
Lease Liability - Current Portion (W4)		528	
Bank Loan		1,800	
Income Tax Payable (W6)		220	9,403
Total Equity and Liabilities			59,005

(09 marks)

(c)

Nazeen PLC
Statement of Changes of Equity
For the Year ended 31.03.2021

Description	Stated Capital	Retained Earnings	Total
Balance as at 01.04.2020	7,000	28,139	35,139
Profit		9,917	9,917
Interim Dividends		(1,000)	(1,000)
Balance As At 31.03.2021	7,000	37,056	44,056

(02 marks)

(d)

Nazeen PLC
Statement of movements of PPE as at 31st March 2021

(Rs.'000)

Description	Land	Building	Plant	Motor Vehicles	Right to use Assets	Total
<u>Cost</u>						
Balance as at 01.04.2020	25,000	12,500	6,250	9,600	-	53,350
Additions	-	-	-	-	5,000	5,000
Disposal	-	-	-	(9,600)	-	(9,600)
Balance As At 31.03.2021	<u>25,000</u>	<u>12,500</u>	<u>6,250</u>	<u>-</u>	<u>5,000</u>	<u>48,750</u>

Acc. Depreciation						
Balance as at 01.04.2020	-	7,500	3,750	5,000	-	16,250
Charged for the year	-	250	1,250	1,440	1,000	3,940
Disposal	-	-	-	(6,440)	-	(6,440)
Balance as at 31.03.2021	-	7,750	5,000	-	1,000	13,750
Carrying Value 31.03.2021						<u>35,000</u>

(04 marks)

Notes:

Note 01 - Other Income

Profit on motor vehicle disposal (W1)	1,340
Reversal of bad debts (W5)	<u>2,200</u>
Total	<u>3,540</u>

Note 02 - Finance Expenses

Lease Interest (W3)	330
Interest	<u>718</u>
Total	<u>1,048</u>

Note 03 - Trade Debtors

Trade Debtors (14,180-300)	13,880
Allowance for debtors (W5)	<u>(500)</u>
Total	<u>13,380</u>

Note 04 - Gratuity

Balance as at 01.04.2020	1,250
Charge for the year	<u>500</u>
Balance as at 31.03.2021	<u>1,750</u>

Workings:

W1

MV Disposal A/C

Cost	9,600	Cash	4,500
P/L	<u>1,340</u>	Acc. Depreciation	<u>6,440</u>
	10,940		10,940

W2 – Depreciation

	Cost	Useful Life	Charge for the year	Dep. 1.4.2021	Acc. Dep.
Buildings	12,500	50	250	7,500	7,750
P & M	6,250	5	1,250	3,750	5,000
M/V	9,600	5	1,440*	5000	-
Right to use the assets	5,000	5	1,000	-	1,000
			<u>3,940</u>		

$$* \quad \frac{9,600}{5} \times \frac{9}{12} = \underline{1,440}$$

W3 - Lease Interest

	Capital at the beginning	Int. @11%	Installment	Capital Repaid	Capital outstanding
Y1	3,000	330	806	476	2,524
Y2	2,524	277.64	806	528	1,995.64
Y3	1,995.64	219.52	806	586.47	1,409.16
Y4	1,409.16	155.00	806	650	758
Y5	758	83	806	723	

W4**Lease Liability**

Advance	2,000	MV	5,000
Installment	806	Interest (W3)	330
B/C/F	2,524		
	<u>5,330</u>		<u>5,330</u>

W5**Allowance for Trade Receivables**

Debtors	300	B/B/F	3,000
P/L	2,200		
B/C/F	500		
	<u>3,000</u>		<u>3,000</u>

W6**Income Tax Payable**

Cash	2,000	B/B/F	720
B/C/F	220	P/L	1,500
	<u>2,220</u>		<u>2,220</u>

W7 Expense Schedule

	Distribution	Administration
As per TB	7,210	10,240
Depreciation Building		250
Depreciation P&M		1,250
Depreciation MV	1,440	
Depreciation right to use the asset	1,000	
Rent		300
Internet & Telephone		55
Gratuity		500
Director fee		1,200
Audit fee		270
	9,650	14,065

(Total 25 marks)

Suggested Answers to Question Nine:

Chapter 5 part II – Consolidated Financial Statements

(a)

Goodwill Calculation

	(Rs.'000)
Investment by Parent	42,000
NCI 20% @ Fair Value	6,000
	48,000
Less - Fair Value of Net Assets	(45,000)
Goodwill	3,000

(04 marks)

(b)

Sindu Ltd.
Consolidated Comprehensive Income Statement
for the year ended 31.03.2021

		(Rs.'000)
Sales (57,400 + 13,602 - 10,000)		61,002
Cost of sales (36,200 + 7,248 - 10,000 + 800)		(34,248)
Gross Profit		26,754
Other Income:		
Consultancy Service Income (300-300)	-	
Other Income (1,200 + 1,000 - 1,000)	1,200	1,200
		27,954
Expenses		
Distribution Expenses (7,200 + 1,170)	(8,370)	
Administration Expenses (4,680 + 2,580 - 300-200)	(6,760)	
Finance Expenses (690 + 210)	(900)	(16,030)
Profit Before Tax		11,924
Taxation (180 + 30)		(210)
Profit After Tax		11,714
Attributed To		
Parent		11,401
NCI (3,364 – 800 – 1,000**) × 20%		313
Total		11,714

Inter Company Revenue

$$\frac{8,000}{100} \times 125 = \underline{10,000}$$

Unrealized profit

$$\frac{4,000}{120} \times 25 = \underline{800}$$

** Depreciation on transferred machinery

$$\frac{4,000 - 3,000}{5} = \underline{200}$$

(09 marks)
(Total 13 marks)

Suggested Answers to Question Ten:

Chapter 4 - Interpretation of Financial and Non-financial Data and Information

(a)

$$\begin{aligned} \text{(i) Gross Profit Ratio} &= \frac{\text{Gross Profit}}{\text{Sales}} \times 100 \\ &= \frac{112,600}{378,500} \times 100 = \underline{29.75\%} \end{aligned}$$

$$\begin{aligned} \text{(ii) Net Profit Ratio} &= \frac{\text{Profit After tax}}{\text{Sales}} \times 100 \\ &= \frac{43,780}{378,500} \times 100 = \underline{11.57\%} \end{aligned}$$

$$\begin{aligned} \text{(iii) Current Ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\ &= \frac{74,700}{42,000} \\ &= \underline{1.78} \end{aligned}$$

$$\begin{aligned} \text{(iv) Debtors Collection Period} &= \frac{\text{Average Debtors}}{\text{Credit Sales}} \times 365 \\ &= \frac{(39,000+38,200)/2}{378,500} \times 365 \\ &= \underline{37 \text{ Days}} \end{aligned}$$

$$\begin{aligned}
\text{(v) Inventory Resident Period} &= \frac{\text{Average Inventory}}{\text{Cost of Sales}} \\
&= \frac{(29,000+32,500)/2}{265,900} \times 365 \\
&= \underline{\underline{42 \text{ Days}}}
\end{aligned}$$

$$\begin{aligned}
\text{(vi) Interest Cover Ratio} &= \frac{\text{Profit before Interest and Tax}}{\text{Interest}} \\
&= \frac{44,730 + 8,200}{8,200} \\
&= \frac{59,930}{8,200} \\
&\equiv \underline{\underline{6.45}}
\end{aligned}$$

(06 marks)

(b)
Profitability

GP Ratio

The gross profit ratio stood at 29.75% of the Company but the industry average was approximately higher by 5%, this might indicate that the Company might be selling the goods at discounted price or the manufacturing cost per unit is higher than that of its peers. An increase in cost of sales or decrease in sales might have led to drop of the GP ratio. It is very much important to investigate the composition of cost and should assess the possibility of selling the goods at a higher price. This could be done through a proper production advertising and awareness program.

Net Profit Ratio

The net profit ratio of the company was similar to that of the industry of the company; this could be due to other higher income. It is very much important to note that such nature of items was not generally recurring and the company should evaluate the possibility of maintaining sources to improve the profitability.

Liquidity

Current Ratio

The current ratio shows a marginal negative deviation from the industry (2.5:1) but this is not an issue to focus materially. The accepted ratio is 2:1. Further the debtors' collections ratios were really impressive but maintaining such stringent credit policy may affect the credit sales, this might be the reason for drop in margins. Current assets of the company are low. This indicates that company has problems in managing its working capital.

Efficiency

Debtors Collection Period

Debtors' collection period is low when compared with industry average. It is 37 days. Debtor's collection of the company is good. This shows that company is efficient in collecting dues from customers when compared to industry.

Inventory Resident Period

The Inventory residency period was almost same as the industry average level. Therefore, the company's performance is almost similar to the industry's performance in terms of inventory turnover.

Interest Cover Ratio

Interest cover ratio is high compared with industrial average. This shows security of loans. If this is high the company should manage the loans. They have to pay more as interest on loans.

Overall the company's position is maintained at the levels similar to the industry.

(06 marks)

(Total 12 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.



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