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Serial No.....

**Institute of Certified Management Accountants of Sri Lanka**  
**Operational Level**  
**November 2016 Examination**

**Examination Date :** 12<sup>th</sup> November 2016      **Number of Pages :** 11  
**Examination Time:** 9.30 a.m. – 12.30 p.m.      **Number of Questions:** 07

**Instructions to Candidates**

1. Time allowed is **three (3) hours.**
2. Total: **100** Marks
3. Part I : Answer **all** questions  
Part II: Answer **all** questions in **Question No.2** & any **one (1)** question from **Section A** and select any **two (2)** questions from **Section B.**
4. The answers should be in **English Language.**

<b><u>Subject</u></b>	<b><u>Subject Code</u></b>
<b>Financial Accounting and Reporting</b>	<b>(FAR / OL 2 – 202)</b>

**PART I**

**Question No. 01 (20 Marks)**

Answer all parts of Question No.1. Select the most suitable answer to each part of the question. Write the number of the part of the question and the selected answer by stating the relevant English letter, in your answer booklet. **E.g. (1) (relevant English letter), (2) (relevant English letter) etc...**

- (1) The issue of a new IFRS means that:
  - (i) Issues that are not in the scope of an existing standard are covered.
  - (ii) Issues raised by users of existing standards are explained and clarified.
  - (iii) An existing standard may be partially or completely withdrawn.
  - (iv) Current financial reporting practice is modified.
  - (a) (i),(ii) & (iii) only.
  - (b) (ii),(iii) & (iv) only.
  - (c) (i), (iii) & (iv) only.
  - (d) (i), (ii) & (iv) only
- (2) Which of the following statements about “accounting concepts” are **correct**?
  - (i) The application of prudent concept means that assets must be understated and liabilities must be overstated in preparing financial statements.
  - (ii) The money measurement concept requires all assets and liabilities to be accounted for at original (historical) costs
  - (iii) The substance over form convention means that the economic substance of a transaction should be reflected in the financial statements, not necessarily its legal form
  - (iv) The realization concept means that profits or gains cannot normally be recognized in profit or loss until realized

- (a) (i) & (iii) only
- (b) (ii) & (iii) only
- (c) (ii) & (iv) only
- (d) (iii) & (iv) only

(3) During the accounting year 2016, Alfa made the following changes.

**Which ONE of these changes would be classified as “a change in accounting policy” as determined by LKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*?**

- (i) Changed the valuation method of inventory from FIFO to weighted average.
- (ii) Changes the useful economic life of its office equipment’s from six years to four years
- (iii) Changed the depreciation of plant and equipment’s from straight line depreciation method to reducing balance depreciation method
- (iv) Increased the allowance for irrecoverable trade receivables for the year 2015 from 5% to 10 % of outstanding balances.

- (a) (i)
- (b) (ii)
- (c) (iii)
- (d) (iv)

(4) PQR Company signed a contract to provide office cleaning services for an entity for a period of one year from 1<sup>st</sup> October 2015 for a fee of Rs.800/- per month.

The contract required the entity to make a one payment to PQR covering all twelve months’ service in advance. The contract cost to PQR was estimated at Rs.600/- per month for wages, materials and administration costs.

**What profit or loss on the contract should PQR recognize in its statement of profit or loss for the year ended 31<sup>st</sup> March 2016?**

- (a) Rs.2,400/- loss
- (b) Rs. 1,200/- profit
- (c) Rs. 2,400/- profit
- (d) Rs. 6,000/- profit

(5) The net realizable value of inventory is defined as the actual or estimated selling price less all costs to be incurred in making, selling and distributing.

**Which of all the following additional items should be deducted in calculating the net realizable value of inventory?**

	Trade Discounts	Settlement Discounts	Costs to completion
(a)	No	Yes	Yes
(b)	Yes	No	Yes
(c)	Yes	Yes	No
(d)	Yes	Yes	Yes

(6) PQ in incurring expenditure on project 500 which meets the definition of a qualifying asset, in accordance with the *Borrowing Costs*. The company has the following debt components:

- (i) 7% Rs.200,000/- debt used specifically to finance project 500.
- (ii) 8% Rs.750,000/- preference share capital.
- (iii) 12% Rs.100,000/- short term loan.
- (iv) 6% Rs.300,000/- convertible debt.

**What Capitalization rate would PQ apply to expenditure incurred on project 500?**

- (a) 7.00%
- (b) 7.33%
- (c) 7.70%
- (d) 7.83%

**(7) According to the LKAS 40 *Investment Property*, which of the following is correct?**

- (a) Investment property is property held for administration purposes.
- (b) Investment property is property held for use in the supply of services.
- (c) Investment property is property held for use in the production of goods.
- (d) Investment property is property held by owner to earn rental income or for capital appreciation.

**(8) On 1<sup>st</sup> April 2012 Beta purchased an asset for Rs.750,000/-, the asset had useful life of six years and nil residual value.**

On 1<sup>st</sup> October 2015 the asset was classified as held for sale in accordance with SLFRS 5 *Non-current assets held for sale and discontinuing Activities*. On that date the fair value less cost of disposing of the assets were assessed as Rs.275,000/-.

**What is the total expense that should be recognized in respect of this asset in the statement of profit or loss for the year ended 2016?**

- (a) Rs. 62,500/-
- (b) Rs.100,000/-
- (c) Rs.125,000/-
- (d) Rs.162,500/-

**(9) Which of the following may be included in a company's statement of financial position as an intangible asset under LKAS 38 - *Intangible Assets*?**

- (a) Start-up cost
- (b) Expenditure on completed research
- (c) Payment on account of patents
- (d) Internally-generated good will

**(10) In the current year, Texco Company has raised a loan for Rs.5,000,000/-. The loan is payable in 10 equally half-yearly installments. The first installment is due six months after the loan was raised.**

**How should the loan be reported in Texco's next financial statements?**

- (a) As a current liability
- (b) As a non-current liability
- (c) As an equity
- (d) As both a current and a non-current liability.

**(10 × 2 Marks = Total 20 Marks)**

End of Part I

## PART II

### Section A

Answer all questions in Question No.2 and any one (1) question from Section A

#### Question No. 02 (20 Marks)

The following Trial Balance relates to Cinderella PLC as at 31<sup>st</sup> March 2016:

	(Rs.'000)	(Rs.'000)
Leasehold property – at valuation 1 <sup>st</sup> April 2015	70,000	
Plant & Machinery – at cost	96,600	
Plant & Machinery – Accumulated depreciation at 1 <sup>st</sup> April 2015		29,600
Capitalized development expenditure – at 1 <sup>st</sup> April 2015	30,000	
Development expenditure – accumulated amortization at 1 <sup>st</sup> April 2016		11,000
Closing Inventory – at 31 <sup>st</sup> March 2016	32,100	
Trade Receivables	46,300	
Bank Balance		3,500
Trade Payables & Provisions		27,000
Revenue		450,000
Cost of sales	314,000	
Distribution cost	19,500	
Administration expenses	30,200	
Preference dividend paid	1,000	
Interest on bank borrowing	3,000	
Equity dividend paid	8,000	
Research and development costs	10,800	
Equity shares of Rs.10/- each		60,000
8% redeemable preference shares of Rs.1/- each		25,000
Retained earnings as at 1 <sup>st</sup> April 2015		29,500
Deferred tax		5,900
Property revaluation surplus		20,000
	661,500	661,500

**Following additional information is also available:**

(1) Non-current assets – tangible:

The property had a remaining life of 20 years as at 1<sup>st</sup> April 2015. The company's policy is to revalue its property at each year end and as at 31<sup>st</sup> March 2016 it was valued at Rs.52 million. Ignore deferred tax on the revaluation.

On 1<sup>st</sup> April 2015 an item of plant was disposed of for Rs.3 million cash. The proceeds have been treated as sales revenue by Cinderella PLC. The plant is still included in the above trial balance figures at its cost of Rs.12 million and accumulated depreciation of Rs.7 million (to the date of disposal).

All plant is depreciated at 20% per annum using the reducing balance method. Depreciation and amortization of all non-current assets is charged to cost of sales.

(2) Non-current assets – intangible:

In addition to the capitalized development expenditure (of Rs.30 million), further research and development costs were incurred on a new project which commenced on 1<sup>st</sup> April 2015. The research stage of the new project lasted until 30<sup>th</sup> June 2015 and incurred Rs.2.7 million of costs. From that date the project incurred development costs of Rs.900,000/- per month. On 1<sup>st</sup> October 2015 the directors became confident that the project would be successful and yield a profit well in excess of its costs. The project is still in development at 31<sup>st</sup> March 2016.

Capitalized development expenditure is amortized at 10% per annum using the straight – line method. All expensed research and development is charged to cost of sales.

- (3) Cinderella PLC is being sued by a customer for Rs.4 million for breach of contract over a cancelled order. Cinderella PLC has obtained legal opinion that there is a 15% chance that Cinderella PLC will lose the case. Accordingly Cinderella PLC has provided Rs.600,000/- (Rs.4 million × 15%) included in administrative expenses in respect of the claim. The unrecoverable legal costs of defending the action are estimated at Rs.150,000/-. These have not been provided for as the legal action will not go to court until next year.
- (4) The preference shares were issued on 1<sup>st</sup> October 2015 at par. They are redeemable at a premium which gives them an effective finance cost of 10% per annum.
- (5) The directors have estimated the provision for income tax for the year ended 31<sup>st</sup> March 2016 at Rs.10.5 million. The required deferred tax provision as at 31<sup>st</sup> March 2016 is Rs.6.2 million.

**You are required to prepare the following for Cinderella PLC:**

- (a) Statement of Profit and Loss and Other Comprehensive Income for the year ended 31<sup>st</sup> March 2016. **(06 Marks)**
- (b) Statement of Financial Position as at 31<sup>st</sup> March 2016. **(08 Marks)**
- (c) Statement of Changes in Equity For the year ended 31<sup>st</sup> March 2016. **(03 Marks)**
- (d) A note to the Financial Statement, showing movement of Property, Plant and Equipment for the year ended 31<sup>st</sup> March 2016. **(03 Marks)**
- (Total 20 Marks)**

**Question No. 03 (20 Marks)**

The following information relates to the draft financial statements Anderson & Co.

	<b>2016 Rs.'000</b>	<b>2015 Rs.'000</b>
<b><u>Assets</u></b>		
<b><u>Non-Current Assets</u></b>		
Property Plant & Equipment (Note 1)	36,600	26,100
Financial Assets: Equity Investments (Note2)	<u>5,250</u>	<u>7,700</u>
	<u>41,850</u>	<u>33,800</u>
<b><u>Current Assets</u></b>		
Inventory	11,850	9,050
Trade Debtors	7,400	6,200
Bank	<u>-</u>	<u>2,000</u>
	<u>19,250</u>	<u>17,250</u>
<b>Total Assets</b>	<b><u>61,100</u></b>	<b><u>51,050</u></b>
<b><u>Equity &amp; Liabilities</u></b>		
<b><u>Equity</u></b>		
Equity Shares of Rs.1/- each (Note 3)	17,000	10,000
Share Premium (Note 3)	-	2,500
Revaluation reserve (Note 3)	2,500	4,100
Retained Earnings	<u>15,150</u>	<u>10,450</u>
	34,650	27,050
<b><u>Non- Current Liabilities</u></b>		
Financial Lease Payables	7,500	7,200
Differed Tax	<u>1,550</u>	<u>1,250</u>
	9,050	8,450
<b><u>Current Liabilities</u></b>		
Tax	3,300	2,350
Bank Overdraft	1,800	-
Provision for Product Warranties (Note 5)	1,800	2,800
Finance Lease Payable	5,300	2,600
Trade Creditors	<u>5,200</u>	<u>7,800</u>
	<u>17,400</u>	<u>15,550</u>
<b>Total Equity &amp; Liabilities</b>	<b><u>61,100</u></b>	<b><u>51,050</u></b>

**Summarized Statement of Profit and Loss for the years ended 31<sup>st</sup> March**

	<b>2016 Rs.'000</b>	<b>2015 Rs.'000</b>
Sales	63,000	44,400
Cost of Sales	<u>(46,000)</u>	<u>(32,000)</u>
Gross Profit	17,000	12,400
Investment Income (Note 3)	1,700	950
Operating Expenses	(9,650)	(7,300)
Finance Expenses	<u>(1,050)</u>	<u>(550)</u>
Profit Before Tax	8,000	5,500
Income Tax	<u>(3,300)</u>	<u>(2,600)</u>
Profit for the year	<u>4,700</u>	<u>2,900</u>

The following additional information is available:

**Note 1: Property, Plant & Equipment**

	<b>Cost</b>	<b>Accumulated Depreciation</b>	<b>Written Down Value</b>
	<b>Rs.'000</b>	<b>Rs.'000</b>	<b>Rs.'000</b>
<b>As at 1<sup>st</sup> April 2015</b>	35,600	(9,500)	26,100
<b>Finance Lease – additions</b>	8,200	-	8,200
<b>Purchase of New Plant</b>	9,300	-	9,300
<b>Disposal of Property</b>	(6,500)	2,500	(4,000)
<b>Depreciation for the year</b>	-	(3,000)	(3,000)
<b>As at 31<sup>st</sup> March 2016</b>	46,600	(10,000)	36,600

The Property disposed of was sold for Rs.7.5 million.

**Note 2: Investments**

During the year an investment that had a carrying amount of Rs.3.5 million was sold for Rs.3.8 million. No Investments were purchased during the year

**Note 3: Investment Income**

Investment Income consisted of:

Year Ended 31<sup>st</sup> March

	<b>2016 (Rs.'000)</b>	<b>2015 (Rs.'000)</b>
Dividend received	350	400
Profit on sale of investment	300	-
Increase in fair value	<u>1,050</u>	<u>550</u>
	<u><u>1,700</u></u>	<u><u>950</u></u>

**Note 4: Equity, Share Premium & Revaluation**

On 1<sup>st</sup> October 2015 there was a bonus issue of shares that was funded from the share premium and some of the revaluation reserve. This was followed on 30<sup>th</sup> October 2015 by an issue of shares for each at par.

**Note 5: Product Warranty**

The movement in the Product warranty provision has been included in cost of sales.

**You are required to prepare a “Statement of Cash Flows” for Anderson & Co for the year Ended 31<sup>st</sup> March 2016, in accordance with LKAS 7, using the indirect method. (Total 20 Marks)**

**Question No. 04 (20 Marks)**

(a) Define the following terms as per **LKAS 24 “Related Party Disclosures”**:

- (i) Related party **(02 Marks)**
- (ii) What conditions should be satisfied, if a person or a close member of that person’s family is considered to be related to a reporting entity? **(03 Marks)**
- (iii) Related party transaction **(02 Marks)**
- (iv) Close members of the family of a person **(03 Marks)**

- (b) **Rotech's** current year end is 31st March 2016. Its financial statements were authorized for issue by its directors on 10<sup>th</sup> May 2016 and AGM (Annual General Meeting) will be held on 10<sup>th</sup> June 2016. The following matters have been brought to your attention:
- (i) On 20<sup>th</sup> April 2016 a fire completely destroyed the company's largest warehouse and the inventory it contained. Carrying amounts of the warehouse and the inventory were Rs.8 million and 5 million respectively. The company did not update the value of its insurance cover due to oversight and due to this the company will be able recover maximum of Rs.9 million from its insurers. Rotech's trading operations have been severely disrupted due to the fire and it expects large trading losses for some time to come. **(04 Marks)**
- (ii) A one category of inventory held at another warehouse was valued at its cost of Rs.250,000/- at 31<sup>st</sup> March 2016. In April 2016, 80% of this inventory was sold for 140,000 on which Rotech's marketing staff earned a commission of 10% of the selling price. **(03 Marks)**
- (iii) Government announced tax changes on 25<sup>th</sup> May 2016 which have the effect of increasing Rotech's deferred tax liability by Rs.350,000/- as at 31<sup>st</sup> March 2016. **(03 Marks)**
- (Total 20 Marks)**  
End of Section A

## Section B

Answer any two (2) questions

### Question No. 05 (20 Marks)

- (a) **Define the following terms as per SLFRS 10 "Consolidated Financial Statements"**
- (i) Consolidated financial statements
- (ii) Control of an investee **(05 Marks)**
- (b) On 31<sup>st</sup> March 2012 Hope acquired 60% of the ordinary share capital and 20% of the Debentures of Soap for Rs.950,000/- and Rs.80,000/- respectively. At that date Soap had a retained earnings balance of Rs.500,000/- and a share premium balance of Rs.75,000/-.

The following statements of financial positions have been prepared as at 31<sup>st</sup> March 2016.

	Hope Rs.	Soap Rs.
<b><u>Assets</u></b>		
<b><u>Non-Current Assets</u></b>		
Tangible assets	3,500,000	1,750,000
Investments : Shares in Group undertakings	<u>1,040,000</u>	<u>-</u>
	4,540,000	1,750,000
<b><u>Current Assets</u></b>	<u>2,760,000</u>	<u>1,900,000</u>
	<b><u>7,300,000</u></b>	<b><u>3,650,000</u></b>
<b><u>Equity &amp; Liabilities</u></b>		
<b><u>Capital &amp; Reserves</u></b>		
Ordinary Shares of Rs.1/- each	2,500,000	850,000
Share Premium Account	450,000	75,000
Retained Earnings	<u>1,750,000</u>	<u>750,000</u>
	4,700,000	1,675,000
<b><u>Non- Current Liabilities</u></b>		
Debentures	-	300,000
<b><u>Current Liabilities</u></b>	<u>2,600,000</u>	<u>1,675,000</u>
<b><u>Total Equity &amp; Liabilities</u></b>	<b><u>7,300,000</u></b>	<b><u>3,650,000</u></b>



**Additional information is as follows:**

- (1) During the year to 31<sup>st</sup> March 2016, Hope transferred a tangible asset to Soap for Rs.350, 000/-. The asset was purchased three years ago, 31<sup>st</sup> March 2013 for Rs.750, 000/- and had a useful economic life of five years.
- (2) Soap's depreciation policy is 25% per year based on cost. Both Companies charge a full year's depreciation in the year of acquisition and none in the year of disposal.
- (3) Non-controlling interest is valued at fair value on acquisition. For this purpose, a share price for Soap of Rs.1.75 each is representative of the fair value of the shares held by the non-controlling interest. The value of goodwill as at 31<sup>st</sup> March 2016 is Rs.75,000/-

**You are required to prepare the consolidated statement of financial position of Hope and its subsidiary Soap as at 31<sup>st</sup> March 2016.**

**(15 Marks)**

**(Total 20 Marks)**

**Question No. 06 (20 Marks)**

- (a) Define the following terms as per **LKAS-17 "Leases"**.
  - (i) A lease
  - (ii) A finance lease
  - (iii) Gross investment in the lease
  - (iv) Net investment in the lease
  - (v) Unearned finance income

**(5 × 2 Marks = 10 Marks)**
- (b) Danston PLC has purchased a Plant and Machinery on 01<sup>st</sup> April 2015 under the terms of lease for Rs. 4 Million for the period of 5 years at the rate of 11%. First payment due at the end of the first year. The lease agreement specifies that Danston PLC decided to keep the Plant and Machinery at the end of the lease.

**You are required to:**

- (i) Present the amortization schedule **and** **(05 Marks)**
- (ii) Calculate the appropriate amounts to be included in the financial statements of the lessee for the year ended 31<sup>st</sup> March 2016. **(05 Marks)**

**(Total 20 Marks)**

$$\text{Annuity PV Factor} = \frac{1 - (1 + r)^{-n}}{r}$$

$r$  = rate per period

$n$  = number of periods

**Question No. 07 (20 Marks)**

(a) **Define the following terms as per LKAS -36 “Impairment of Assets”:**

- (i) A cash generating unit (02 Marks)
- (ii) Fair value (02 Marks)
- (iii) An impairment loss (01 Mark)

(b) The objective of **LKAS 36 “Impairment of Assets”** is to prescribe the procedures that an entity applies to ensure that its assets are not impaired

**You are required to explain what is meant by impairment review. Your answer should include reference to assets that may form a cash generating unit.**

You are **not** required to describe the indicators of impairment or how impairment losses are allocated against assets. (04 Marks)

(c) (i) Texaco acquired an item of plant at a cost of Rs.500,000/- on 1<sup>st</sup> April 2014 to produce and package Tess bags for one of their major customers. The plant had an estimated residual value of Rs.25,000/- and an estimated life of five years, neither of which has changed. Texaco uses straight line method of depreciation. On 31<sup>st</sup> March 2016, Texaco was informed by the major customer (who buys the products produced by the plant) that it would no longer be placing orders with Texaco. Further even before this information was known Texaco, had been having difficulty of finding extra work for this plant. It has estimates that net cash inflows earned from the plant for the next three years will be:

	Rs.’000
Year ended: 31 <sup>st</sup> March 2017	170
31 <sup>st</sup> March 2018	130
31 <sup>st</sup> March 2019	110

On 31<sup>st</sup> March 2016, the plant is still expected to be sold for its estimated residual value.

Texaco has confirmed that there is no market in which to sell the plant at 31<sup>st</sup> March 2016.

Texaco’s cost of capital is 10% and the following values should be used:

Value of Rs.1 at:	Rs.
End of Year 1	0.91
End of Year 2	0.83
End of Year 3	0.75

**You are required to calculate the carrying amount of the assets as at 31<sup>st</sup> March 2016 after applying any impairment losses.** (04 Marks)

(ii) Texaco owned a 100% subsidiary, Delta and is treated as cash generating a unit. On 31<sup>st</sup> March 2016, there was a fire that caused damaged to some of Delta’s plant. The assets of Delta immediately before the fire were:

	Rs.’000
Goodwill	1,400
Patent	900
Factory Building	3,000
Plant	2,500
Receivables and cash	<u>1,200</u>
	<u>9,000</u>

As a result of the fire, the recoverable amount of Delta is Rs.4 million.

The fire destroyed an item of plant completely that had carrying amount of Rs.500,000/-.

Delta has an open offer from a competitor of Rs.750,000/- for its patient. The receivables and cash are already stated at their net receivable values.

**You are required to calculate the carrying amount of the assets as at 31<sup>st</sup> March 2016 after applying any impairment losses.**

**(07 Marks)**

**(Total 20 Marks)**

End of Section B

End of Part II

End of Question Paper

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