THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

20404 – Advanced Financial Reporting

CA Professional (Strategic Level II) Examination
December 2013

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

	Universal	Galaxy	Earth		Adjustments		Group
					Dr	Cr	
Assets							
Non-current assets							
Property plant and equipment	250,000	200,000	150,000		20,000	2,000	468,000
Goodwill					153,000		153,000
Intangible Asset					12,000		12,000
Investment in Associate					53,000		53,000
Investment	90,000	70,000	10,000		345,000	400,000	105,000
	340,000	270,000	160,000				791,000
Current assets							
Inventory	60,000	40,000	50,000			7,000	93,000
Trade receivable	120,000	30,000	20,000			10,000	140,000
Cash and cash equivalents	10,000	10,000	20,000				20,000
	190,000	80,000	90,000				253,000
Total assets	530,000	350,000	250,000				1,044,000
Equity and Liability							
Equity							
Stated capital	150,000	120,000	100,000		120,000	240,000	390,000
Retained earnings	70,000	50,000	70,000		52,000	3,500	71,500
Other components of equity	20,000	10,000	10,000		11,667	0	18,333
	240,000	180,000	180,000				479,833
NCI						82,167	82,167
							562,000
Non-current liabilities							
Provisions	80,000	50,000	30,000			27,500	157,500
Borrowings	100,000	50,000	10,000				150,000
Deferred Tax	10,000	20,000			500	5,000	34,500
Total non current liabilities	190,000	120,000	40,000				342,000
Current liabilities							
Trade and other payables	60,000	30,000	20,000		10,000		80,000
Short term borrowings	40,000	20,000	10,000				60,000
Total current liabilities	100,000	50,000	30,000				140,000
Total equity and liabilities	530,000	350,000	250,000				1,044,000
	-	-	-		777,167	777,167	-

Working 1				Balance sheet
Goodwill calculation				
Cost of investments				
Share exchange				
Total G shares	8,000,000	6,000,000	240,000,000	
Deferred payment	40,263,000	0.62092	25,000,000	
FV of NCI	4,000,000	20	80,000,000	
			345,000,000	
FV of net assets of G at the date of acquisition			192,000,000	
Goodwill			153,000,000	
			153,000,000	153,000,000

Working 2				
FV of net assets of G at the date of acquisition				
Share capital		12,000,000	120,000,000	
RE			40,000,000	
Other			5,000,000	
FV of PPE	CV	150,000,000		
	FV	170,000,000		
		20,000,000		
	DT @ 25%	5,000,000	15,000,000	
	Intangible Asset		12,000,000	
			192,000,000	192,000,000

Working 3			
Non Controlling Interest	$33\,{}^{1}/_{3}$ %		
FV of net assets of G at the date of acquisition		80,000,000	
Post acquisition Increase in net assets		500,000	
Other Reserves		1,666,667	
Other reserves		82,166,667	

Working 4			
Post-acquisition Increase in net assets			
Share capital		120,000,000	
Reserves		60,000,000	
FV of PPE (Net of DT)	15,000,000		
Extra Depreciation	(2,000,000)		
Reversal of DT	500,000		
Unrealised profit	(7,000,000)		
Intangible asset	12,000,000	18,500,000	
Net Assets 31/3/2013		198,500,000	6,500,000
$33\,^{1}/_{3}$ %			2,166,667

Alternative method			
R/E of G as at 31.3.2013		50,000,000	
Pre- acquisition R/E		(40,000,000)	
		10,000,000	
Unrealized profit	(7,000,000)		
Extra Depreciation	(2,000,000)		
Reversal of DT	500,000	(8,500,000)	
		1,500,000	
NCI 1,500,000*$33\,^{1}/_{3}$ %			500,000
Other component of equity $33\,^{1}/_{3}$ %	5,000,0000		<u>1,666,667</u>
			<u>2,166,667</u>

Working 5					
Investment in Associate					
Investment in E is considered as investment in associate due to existence of significant influence-					
Cost of investment (50mn-5mn)			50,000,000		
Share capital		100,000,000			
Retained earnings		50,000,000			
Other Equity components		15,000,000			
NA 1/4/2012		165,000,000			
Ownership Interest	20%		33,000,000		
NA 31/3/2013 (100+70+10)		180,000,000	36,000,000		
Increase in NA			3,000,000		
Investment in Associate 31/3/2013			53,000,000	53,000,000	-

Working 6					
Elimination of un-earned profits					
Inventory	1,000,000				
GP	7		7,000,000		

Working 7					
Consolidated Reserve Reconciliation					
Retained Earnings 31/3/2013		70,000,000			
Intangible					
Dep.	(2,000,000)				
DT	500,000	(1,500,000)			
Elimination of un-earned profits		(7,000,000)			
Interest on deferred payment (25mn*10%)		(2,500,000			
Associate		3,000,000			
Increase in Galaxy's R/E		10,000,000			
NCI		(500,000)	71,500,000	71,500,000	-

Working 8			
Other reserves	30,000,000		
NCI	(1,666,667)		
AFS reversal	(5,000,000)		
Pre Acquisition	(5,000,000)		
		18,333,333	18,333,333

Working 9			
Intercompany eliminations			
A's receivable from G	10,000,000		
G's payable to A		10,000,000	
Associate company balance are not eliminated			
		Compilation and presentation of balance sheet	

Answer No. 02

As per LKAS 39, the bond is a financial liability and it should be initially recorded at fair value less transaction cost. Subsequently the bond should be measured at amortised cost.

According to LKAS 21, foreign currency monetary items should be translated using the closing rate. Exchange difference arising from the said translation should be recognized in profit or loss.

(a) Initial measurement of loan = US$ 10,000,000 – US$160,000
= US$ 9,840,000
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Finance cost in US$ is = 9,840,000 x 8%
= US$ 787,200

Closing balance of the loan is = US$ 10,000,000 – 160,000 + 787,200 – 800,000

= US$ 9,827,200
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The loan would be initially recorded in LKR as = US$ 9,840,000 x 125
= Rs. 1,230,000,000
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The finance cost would be initially recorded in LKR as = 787,200 x 130
= Rs. 102,336,000
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The actual payment of interest would be
recorded at US$800,000 x 134 = Rs. 107,200,000
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The loan balance as at 31 March 2013 will be
Reflected at US$9,827,200 @134 = Rs. 1,316,844,800
==============

The exchange difference created by this transaction would be recognized in profit or loss.

Exchange loss is equal to = (1,230,000,000+102,336,000-107,200,000)
= 1,225,136,000
Closing Balance @ y/e rate = 1,316,844,800
Exchange loss (1,316,844,800 - 1,225,136,000) = 91,708,800
=========

(b) The loan to the supplier would be regarded as a financial asset. Accordingly cost of arranging the loan should be included in carrying amount of the loan. Therefore initial carrying value of the loan should be Rs. 5.1 million.

Under the effective interest method part of the finance income should be recognized in the current period. The income recognize in the current period shall be = Rs. 510,000 (Rs. 5.1 mn x 10%).

This financial asset would have been shown in the statement of financial position as at 31 March 2013 at Rs. 5,610,000. (5.1 + 0.51mn)

However, there is an indication about impairment of financial asset at the end of March 2013. Therefore this asset should be re-measured of the present value of the revised estimated future cash inflows, using the original effective interest rate.

Under the revised estimate the closing carrying amount of the asset should be Rs. 4,958,677

The reduction in carrying value of Rs. 651,323 (Rs. 5,610,000 – 4,958,677) should be charged to income statement as impairment loss.

$\left(6mn / (1.1)^2 \right)$

(c) This is an equity settled share based payment scheme as per SLFRS 2. Options to be measured at FV of the instrument at the grant date. That should be recognized as an expense and in equity.

Statement of financial position

	31 March 2012	**31 March 2013**
Equity	2,500,000	10,000,000

Statement or comprehensive income	**year ended 31 March 2012**	**year ended 31 March 2013**
Operating expenses	2,500,000	7,500,000

Total expected cost as at 31 March 2012 = 10,000,000 (100,000 x 5 x 20)

1/4 is recognized in equity as at 31 March 2012	=	2,500,000 ========
Total expected cost as at 31 March 2013	=	20,000,000 (250,000 x 4 x 20)
$2/4^{th}$ is recognized in equity as at 31 March 2013	=	10,000,000

(d)

Carrying value or PPE	=	260 mn
Tax base of PPE	=	(140) mn
Taxable temporary difference (DTL)		120 mn
Retirement Benefit		
Accounting base	=	26
Tax lease	=	0 mn
Deductible temporary difference (DTA)	=	(26)
Intangibles		
Accounting base (6-(6*1/4))	=	4.5 mn
Tax base	=	0 mn
Deductible temporary difference	=	4.5
Deferred tax liability 31.03.2013 = (120-4.5)		
89.5mn x 28%	=	25.06 mn
Opening balance 31.03.2012	=	32 mn
Provision for the year (deferred tax income)	=	6.94 mn ====

Answer No. 03

(a) (i) Stock residence period = $\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365$

Average inventory = (460+950/2) = $\frac{705}{2,730} \times 365$ days

= 94 days

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(ii) Trade receivable collection period = $\frac{\text{Average trade receivables}}{\text{Credit sales}} \times 365$

Average trade receivables = (740+718/2) = $\frac{729}{1,740} \times 365$ days

= 153 days

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(iii) Asset utilization ratio = $\frac{\text{Revenue}}{\text{Total assets}} \times 100$

= $\frac{3,830}{4,350} \times 100$

= 88%

= ===

(iv) Price earning ratio = mkt price/EPS

= $\frac{40}{21.85}$

EPS = PAT/no. of share = 1.83

= 437/20 = 21.85 ===

(v) Dividend yield ratio = DPS/MP x 100

= $\frac{5}{40} \times 100$

DPS = 100/20 = 5

= 12.5%

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(vi) Trade payables payment period = $\frac{\text{Average trade creditors}}{\text{Credit purchase}} \times 365$

= $\frac{345}{1,480} \times 365$

Average trade creditors = (270+420/2) = $\frac{270 + 420}{2}$

= 85 days

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(b)	**2012**	**2013**
Asset utilization		
Asset turnover ratio		
Turnover	52,000 x 100	87,400 x 100
Total assets	132,740	216,320
	39.55%	40.4%
	=====	=====
Working capital management		
Debtors collection period		
Trade receivables x 365	23,410 x 365	40,650 x 365
Credit sales	52,500	87,400
	162 days	169 days
	=======	=======
Creditors payment period		
Trade payables x 365	13,800 x 365	14,420 x 365
Cost of sales	52,500-25,750	87,400-39,228
	188 days	109 days
	=======	=======
Inventory period		
Inventory x 365	18,270 x 365	27,540 x 365
Cost of sales	52,500 – 25,750	87,400 – 39,228
	249 days	208 days
	=======	=======
Profitability		
ROCE = PBIT x 100	17,250 x 100	23,150 x 100
TA-CL	109,000	196,400
	15.83%	11.79%
	====	====
Profit margin	17,250-3,200-1,040 x 100	23,150-14,200-2,450 x 100
PAT x 100	52,500	87,400
Turnover	24%	7%
	===	===
GP margin	25,750 x 100	39,228 x 100
	52,500	87,400
	49%	44.8%
	===	====
Liquidity		
Current ratio	18,270+23,410+28,310	27,540+40,650+4230
	13,800+9,940	14,420+5,500
	69,990	72,420
	23,740	19,920
	2.9:1	3.6:1
	====	====
Quick ratio	69,990-18,270	72,420-27,540
	23,740	19,920
	2.1:1	2.2:1
	====	====

(9)

Asset utilization

There is no major change in asset utilization in 2013 compared to 2012. This is mainly due to increase in PPE as the plant was acquired in 2013 and due to significant increase (66%) in revenue in 2013. As the increases in both total assets and revenue in almost similar percentages, plan was not an asset in 2012 as it was under operating lease.

Working capital management

Debtors collection period has increased form 165 days in 2012 to 169 days in 2013. Increase in debtors could be as a result of increase in revenue. The co. needs to assess the risk of bad debts. Payments period has decreased in 2013. This may require to review contracts with new existing suppliers in order to get favourable payments periods. Even though the credit period granted by suppliers is 109 days, it takes average 169 day to recover dues from debtors. Inventory period has decreased significantly. This could be as a result of having good inventory mgt. system

Profitability

Profitability of the company has significantly decreased during 2013. Even though the revenue had increased by 66% in 2013, the company must be having increased expenses which resulted deterioration of profit. Cost structure of the company including direct costs should be reviewed as GP margin also had decreased in 2013

Liquidity

Liquidity position appears to be good as it has enough current assets to settle current liabilities. However, as creditors' payments to be made before debtors are realized, it may have a liquidity issue in the future unless the company review the position continuously and take necessary steps to overcome the issue.

Answer No. 04

(a) Whistle blowing policies are established by the business organisations to encourage and enable the employees to raise voluntarily their genuine concerns in relation to any wrongful, illegal or harmful activities to the interest of the company, to the audit committee/management rather than overlooking a problem or 'blowing the whistle" outside.

Employees are often the first to realize and have opportunity to detect frauds/ fraudulent activities by other employees A whistle blowing policy encourages the employees to raise their concerns on any breach of code of ethics, regulatory and legal requirements, financial malpractices, improper accounting, fraudulent or malicious activities involving company's assets etc. Therefore, this is an important communication channel introduced as an integral part of corporate fraud and risk management.

Therefore, when there is a whistle blowing policy management of the business organizations will be able to identify any of these harmful activities if any, and take timely actions to resolve them. This will result in reducing the losses, since all major issues are setting highlighted soon and taken care of. Further this will result in continuous improvements to the process and systems in the organisations.

(b) (i) CEO's suggestion is not acceptable. Because property under consideration was acquired for sale. Therefore it should be classified as inventories. Properties acquired for rental to others, capital appreciation etc. can only be considered as investment properties. If this property is classified as an investment property at fair value, there will be a credit to income amounting to Rs. 60 mn. This will result in reduction in loss of the company by Rs. 60 mn. Therefore it should be explained to CEO that this property cannot be classified as an investment property, since it does not meet the criteria stipulated in the LKAS. Therefore the adjustment proposed by the CEO should not be entertained.

(ii) CEO's suggestion is not acceptable. Based on the information given, this investment need to be classified under "available for sale" financial assets since it has been acquired as a strategic investment. According to para 9 of LKAS 39, financial asset can be classified as FVTPL only if that asset is held for trading or designated initially as FVTPL. Strategic investment does not meet the said criteria.

Therefore it should be informed to the CEO that this investment cannot be classified under "FA at FV through P&L as per the provisions of LKAS 39 we should continue to classify & present it under available for sale financial assets.

Answer No. 05

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions (IASB Framework).

There are wide range of users of financial statements such as; shareholders, managers, potential investors, employees, regulators, general public, bankers, inland revenue etc.

They have divers interests in the financial statements.

Therefore, it is a fact that over a period the disclosures made in the financial statements have become both voluminous and complex. Dilemma is how helpful is the growth in the volumes and complexities of disclosures to the stakeholders.

One may argue that the complexities and the volumes of disclosures are result of complex accounting standards. However, it also can be argued that complexities in modern business transactions, investments, financial instruments and relationships etc. could contribute to the complex and voluminous disclosures.

Some of the critical areas are; fair value accounting, hedge and derivative accounting. It is also challenging to provide minimum disclosures on these areas.

Examples of voluminous and complex disclosures;
IFRS 7 disclosures on financial instruments
IAS 24 related party transactions
IFRS 8 Operating segments
IFRS 12 Disclosure of investment in other entities

View of the preparers of financial statements is different from users of financial statements. Obtaining/collating information for disclosure purpose could be costly as much as they are useful for users. Information cost also include cost of revealing sensitive information to competitors.
Eg. Operating Segments

Even though, clutter of information in the financial statements reporting is a problem, there is still room for improvement in quality of disclosures.

Entities shall disclose material, relevant and timely information to users of the financial statements. Such information shall enable the users assess the performance and financial position of the entity and compare it with past performance as well as with the other entities that are similar and different.
Due to the current adverse economic conditions such as resent financial markets crisis, information request by regulators have increased remarkably.

However, what is required is to provide information efficiently in an integrated manner (management discussions and analysis) in order to support the users to make informed decisions. Financial statements should be customer focused.

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