CA

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KB1 – Business Financial Reporting

December 2018

SECTION 1

Answer 01

Relevant Learning Outcome/s: 1.1 and 1.3 1.1 Conceptual framework of SLFRS. 1.3 Regulatory framework.
Study text reference: Pages 7, 35 – 41

(a)

(i) Per the Conceptual Framework for Financial Reporting, existing and potential investors, lenders and other creditors have been identified as the users of general purpose financial statements.

However, it recognises that employees, suppliers, customers, the government and its agencies might find general purpose financial reports useful, although the general purpose financial statements are not primarily directed to these parties.

Accordingly, the intended users of general purpose financial statements of Blizz (Pvt) Ltd are not government agencies, customers and suppliers. Nevertheless these financial statements may be useful for their purposes.

(ii) Per the Conceptual framework for Financial Reporting, in order for financial information to be useful, it must be relevant and faithfully represent what it purports to represent to the users of the financial statements. An asset is defined in the Conceptual Framework as a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity. The accounts receivable was an asset of this entity. However, when it was sold without recourse, Blizz (Pvt) Ltd lost control and no further economic benefits could be expected from it. Therefore, derecognising the asset in the statement of financial position of the entity gives a faithful representation of the transaction.

(b) Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 requires "specified business entities" to prepare and present their financial statements in compliance with Sri Lanka Accounting Standards. Criteria to be considered in identifying a specified business entity are defined by this Act. Spring (Pvt) Ltd's revenue is in excess of Rs. 500 million, which is one defined criteria in identifying a specified business entity. Therefore Spring (Pvt) Ltd (although it is not a listed entity) is required to prepare its financial statements in accordance with Sri Lanka Accounting Standards. On the other hand given that Spring (Pvt) Ltd is a private entity, which does not have public accountability, or if its financial statements are not published for external users, it has the option to apply SLFRS for SMEs in preparing its financial statements.

(Total: 10 marks)

Answer 02

Relevant Learning Outcome/s: 2.2 (Level B) Good knowledge and comprehension of the standard to identify moderately complicated issues and any potential implications to the financial statements, and to exercise professional judgment in the analysis and application of standards in resolving a moderately complicated matter related to financial reporting.
Study text reference: Pages 299 – 330

Item	Rs.	Rs.
<u>Property, plant and equipment</u>		**DTL/(DTA)**
Net book value as at 31 December 2017 [15 million – ((15 million/5)*2)]	9,000,000	
Tax WDV (15 million – (15 million*25%*2 years))	7,500,000	
Temporary difference	1,500,000	
Tax rate	28%	
Deferred tax liability		420,000
<u>Revaluation reserve</u> (12 million – 9 million)	3,000,000	
Tax rate	28%	
Deferred tax liability		840,000
<u>Inventory</u>		
Write off – inventory → Temporary difference (2 million – 1.5 million)	500,000	
Tax rate	28%	
Deferred tax asset		(140,000)
<u>Trade receivables</u>		
No temporary difference		
<u>Accrued expenses</u>		
Temporary difference	1,000,000	
Tax rate	28%	(280,000)
<u>Defined benefit obligation</u>		
Temporary difference	20,000,000	
Tax rate	28%	(5,600,000)
<u>Research and development</u>		
Net book value 275,0000 – (275,0000/5)*3)	1,100,000	
Tax WDV	-	
Temporary difference	1,100,000	
Tax rate	28%	308,000
		4,452,000

(Total: 10 marks)

Note (alternate answer for PPE)

PPE

Revalued amount	12,000,000
Tax WDV	(7,500,000)
Temporary difference	4,500,000
Tax rate	28%
Deferred tax liability	1,260,000

Answer 03

Relevant Learning Outcome/s: 2.2 (Level B) Good knowledge and comprehension of the standard to identify moderately complicated issues and any potential implications to the financial statements, and to exercise professional judgment in the analysis and application of standards in resolving a moderately complicated matter related to financial reporting.
Study text reference: Pages 350 – 355

(a) Total finance costs associated with the bond

	Rs. million
Coupon interest (10% * Rs. 100 million * 4 years)	40
Discount on issue (Rs. 100 million – Rs. 97 million)	3
Issue costs	2
Premium on redemption (Rs. 100 million * 5%)	5
Total finance costs	**50**

(b) Under the effective interest rate method, the calculation would be as follows.

		(12.706% p.a.)		
Year	**Opening balance**	**Finance cost**	**Payment**	**Closing balance**
	Rs. million	**Rs. million**	**Rs. million**	**Rs. million**
1	95.00	12.07	(10.00)	97.07
2	97.07	12.33	(10.00)	99.40
3	99.40	12.63	(10.00)	102.03
4	102.03	12.96	(10.00)	105.00
		50.00		

(c) The effective interest rate method is superior to the others as it takes full account of any cash flows arising during the life of the financial instrument.

These may be irregular, frontloaded or even. The method allocates the total finance cost in direct proportion to the amount outstanding and the length of time outstanding.

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 2.2 (Level B) Good knowledge and comprehension of the standard to identify moderately complicated issues and any potential implications to the financial statements, and to exercise professional judgment in the analysis and application of standards in resolving a moderately complicated matter related to financial reporting.
Study text reference: Page 400 – 404, 171 – 188

(a) The market-based condition (i.e. the increase in share price) will be ignored for the purpose of the calculation.

However the employment condition must be taken into account. The options will be treated as follows.

2,000 options x 2 directors x Rs. 100 x 1 year / 3 years = Rs. 133,333. Equity will be increased by this amount and an expense shown in profit or loss for the year ended 31 March 2018.

(b) Ashoka (Pvt) Ltd would recognise the impairment loss in the following way.

When the impairment loss is identified, it should be recognised as an expense immediately in the income statement. Where the impairment loss relates to a group of assets, usually the impairment loss is allocated in priority to those assets that have the most subjective valuations. The impairment identified in this way should usually be allocated to goodwill first, thereafter to intangible assets to which there is no active market, thirdly to assets for which their recoverable value is less than their carrying amount, and finally to any tangible assets in the unit.

As at 1 February 2018

	01/01/2018 Rs. million	**Impairment/loss Rs. million**	**01/02/2018 Rs. million**
Goodwill	40	(15)	25
Intangible assets (taxi license)	30	-	30
Vehicles	120	(30)	90
Sundry net assets	40	-	40
	230	(45)	185

The disposal loss of Rs. 30 million is recognised first for the stolen vehicles per LKAS 16 and the balance (Rs. 15 million) is attributed to goodwill.

As at 1 March 2018

	01/02/2018 Rs. million	**Impairment/loss Rs. million**	**01/03/2018 Rs. million**
Goodwill	25	(25)	-
Intangible assets	30	(5)	25
Vehicles	90	(0)	90
Sundry net assets	40	-	40
	185	(30)	155

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 4.1 Financial statement analysis.
Study text reference: Pages 632 – 655

(a)

	2018	2017
Net profit margin	7%	5%
Current ratio	2.14	2.15
ROCE	9.8%	6.7%
Debt	57%	64%

(b) **Explanations**

- Net profit margin has increased from 5% (when net profit was Rs. 66,200) to 7% (when net profit was Rs. 117,800). This can be mainly attributed to the increase in revenue by 23% compared to 2017 and a reduction in costs (interest and income tax) (from Rs. 66,000 to Rs. 42,000). The increase in profits from the previous year to this year is 78%, which is a significant increase.

- The current ratio remains almost constant. Whilst the current assets have increased by 22% (Rs. 890,900 to Rs. 1,087,200), Current liabilities have also increased by 23% (Rs. 414,500 to Rs. 509,000).

- ROCE has increased from 6.7% to 9.8%. Equity has increased from Rs. 863,400 to Rs. 915,000, and simultaneously borrowing costs have come down from Rs. 1,100,000 to Rs. 699,000. Overall total capital employed has come down.

- Interest bearing liabilities have decreased from Rs. 1,100,000 to Rs. 699, 600. This represents a 37% decrease.

- The debt ratio has come down from 64% to 57% as a result of the above. The profit to equity ratio has increased from 7.66% to 12.87% due to decreasing debts.

(Total: 10 marks)

SECTION 2

Answer 06

Relevant Learning Outcome/s: 3.1 Consolidated financial statements.
Study text reference: Pages 507 – 587

(b) With the disposal of 80% of Red, Green loses control over Red (Pvt) Ltd.

The gain/(loss) from the disposal is as follows.

	Rs. million
Sales proceeds	280
FV of remaining 15%	40
Carrying value of NCI	15
	335
Carrying value of net assets	(450)
Carrying value of goodwill	(12)
Loss	(127)

Fair value of the remaining investment of 15% should be recognised as a financial asset.

Rey (Pvt) Ltd and Its subsidiaries
Consolidtated statement of financial position
as at 31 March 2018

	Rey (Pvt) Lt	Key (pvt)Ltd	G/W	Dep	realised inventory	URP (Key to Re	Inv in JV	Impairment	Post acq. Profit	Group
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Assets										
Non-current assets										
Property, plant and equipment	560,600	172,700	36,000	(300)						769,000
Invesment	378,000		(300,000)				5,335	(10,000)		73,335
Goodwill			92,920							92,920
	938,600	172,700	(171,080)							935,255
Current assets										
Inventory	63,400	16,300	3,000		(3,000)	(217)				79,483
Receivables	84,500	97,200								181,700
Cash and cash equivalent	31,900	14,100								46,000
	179,800	127,600	3,000							307,183
Total assets	1,118,400	300,300	(168,080)							1,242,438
Equity and liabilitites										
Equity										
Stated capital	600,000	120,000	(120,000)							600,000
Retained earnings	404,500	94,500	(76,000)	(240)	(2,400)	(173)	5,335	(10,000)	14,800	411,822
Revaluation surplus	23,000	16,000	(16,000)							23,000
	1,027,500	230,500	(212,000)							1,034,822
Non controlling interest			33,000	(60)	(600)	(43)			3,700	35,997
Non-current liability										
Deferred Tax Liability	4,000	3,200	10,920							18,120
Current liabilties										
Trade payables	74,600	43,600								118,200
Accrued expenses	12,300	23,000								35,300
	86,900	66,600								153,500
Total equity and liabilities	1,118,400	300,300	(168,080)							1,242,438

Working 1	
Computation of goodwill	
	Rs.'000
Consideration transferred	300,000
Fair value of NCI	33,000
	333,000
Fair value of net assets	
Stated capital	120,000
Retained earnings	76,000
Revaluation surplus	16,000
FV increase in land	24,000
DT liability @ 28%	(6,720)
FV increase in building	12,000
DT liability @ 28%	(3,360)
FV increase in inventory	3,000
DT liability @ 28%	(840)
	240,080
Goodwill	92,920
Depreciation for FV increase in builc	**Rs.'000**
FV increase	12,000
Depreciation (12,000/30*9/12)	300
Dr. Retained earnings	240
Dr. NCI	60
Cr. PPE	300
Subsequent realisation of inventory	**Rs.'000**
Dr Retained earnings (3,000*80%)	2,400
Dr. NCI (3000*20%)	600
Cr. Inventory	3,000

Working 2			
Unrealised profit from inventory			**Rs.'000**
URP	(1,300/120*20)		217
Dr. Retained earnings			173
Dr. NCI			43
Cr. Inventory			217

Working 3		
Investment in Jey (Pvt) Ltd - Joint v	**Rs.'000**	
Cost of investment	78,000	
Share of post acq. Profit		
(23,670 - 13,000)*.50	5,335	

Working 4			
Post acquisition profit allocation		**Rs.'000**	
RE	(94,500-76,000)*80%	14,800	
NCI	(94,500-76,000)*20%	3,700	

Answer 07

Relevant Learning Outcome/s: 2.1 (Level A) and 2.2 (Level B)
2.1 Thorough knowledge and comprehension of the standard to identify significant complicated issues and any potential implications to the financial statements, and to exercise professional judgment in the evaluation and application of standards in resolving a complicated matter related to financial reporting. 2.2 Good knowledge and comprehension of the standard to identify moderately complicated issues and any potential implications to the financial statements, and to exercise professional judgment in the analysis and application of standards in resolving a moderately complicated matter related to financial reporting.
Study text reference: Pages 109 – 132, 133 – 146, 257 – 272, 348 – 350

(a) Under the recognition principle of LKAS 16 *Property, Plant and Equipment*, day-to-day servicing items are not capitalised but rather expensed (if the costs are incurred to bring the asset to its original conditions, such costs are expensed). Costs that result in the flowing of future economic benefits to the entity should be capitalised.

- Removal of the roof to add an additional floor and the cost to build the additional floor together with the roof – these costs will result in having another floor to the building, which will bring in additional cash flows to the company. Therefore these costs (Rs. 48 million) should be capitalised. The carrying amount of the existing roof should be derecognised.
- Repair of the car park to restore it to the original condition – this cost is incurred to bring the car park back to its original condition. Hence this is a repair and should be expensed to profit or loss.
- Improvements to hotel rooms – these costs should be capitalised, as they will result in improved economic benefits by allowing a higher room rate to be charged from guests.
- Wall painting costs appear to be a day-to-day servicing item and therefore should be expensed.
- Cost for promotional activities are n<u>ot recognised as part of the cost of the building</u> per LKAS 16 and should be expensed.

(b) Per LKAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* as at 31 March 2018, <u>there is a present constructive obligation</u> as a restructuring plan identifying the business (location) affected, number of employees that will be compensated and when the plan will be implemented, were all announced. This raised a <u>valid expectation in those who were affected, before the end of the financial year</u>

Restructuring has been announced and therefore an outflow of economic benefits is probable and the board has estimated the cost of the restructuring.

Therefore a provision should be recognised as at 31 March 2018. The provision amount is as follows.

	Rs. million
Direct cost	30
Compensation to employees	7
Non-cancellable lease payment (onerous contract) (1*3 years)	3
	40

(c) Classification of financial assets should be based on the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.

- Portfolio of investments in treasury bonds – the business model is collecting contractual cash flows (interest and the principal amount) and selling them. It assesses the bonds on an ongoing basis to maximise the return until a capital expenditure need arises. Therefore these bonds should be classified as financial assets, subsequently measured at fair value through other comprehensive income.
- Investments in listed equity shares of difference entities – these investments do not have the contractual cash flow characteristic. The business model is to maximise the overall return by holding and selling them. Therefore they will not be classified as financial assets, subsequently measured at amortised cost or at fair value through other comprehensive income. Accordingly these investments are classified as financial assets subsequently measured at fair value through profit or loss.
- Receivables portfolio – the business model is to hold these receivables to collect the contractual cash flows and thus should be classified as financial assets, subsequently measured at amortised cost.

(d) Changes in accounting policy should be applied retrospectively. That is the company should adjust the opening balance of each affected component of equity for the earliest prior period presented, and other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Per LKAS 1, when a retrospective restatement is done, three statements of financial positions should be presented.

In this case, the opening balance of retained earnings of the 2016 financial year needs to be adjusted by Rs. 8 million (Rs. 14 million – Rs. 6 million). Investment property should be shown as Rs. 14 million. Then in the 2017 financial year, the fair value increase of Rs. 0.8 million should be recognised in profit or loss and the value of the investment property should be shown as Rs. 14.8 million.

In the 2018 financial year, the fair value increase of Rs. 0.7 million should be recognised in profit or loss and the value of the investment property should be shown as Rs. 15.5 million.

(Total: 25 marks)

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