CA THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

NOT FOR SALE

SUGGESTED SOLUTIONS

KB1 – Business Financial Reporting

December 2019

SECTION 1

Answer 01

Relevant learning outcome/s: 1.1.1 and 1.3.1
Study text reference: Pages 13 –16 and 43

(a)

According to the Conceptual Framework, an asset is 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.

(i) Even though it is likely that that the introduction of new designs will contribute to future economic benefits, the designer may join BIT's competitor and therefore cannot be controlled by the company. Therefore the salary paid does not meet the definition of an asset.

(ii) As BIT has paid the taxes, it is a resource controlled by the company as a result of past events. Future economic benefits embodied in an asset may flow to the entity in a number of ways. One such way is using it to settle a liability. Since the amount paid can be used against a future tax liability taxes paid is an asset to the company.

(b)

- Ensuring the formulation and implementation of a sound business strategy.
- Appointing the chair and senior independent director if relevant.
- Ensuring the CEO and the management team possess the skills, experience and knowledge to implement the desired strategy.
- Approving budgets and major capital expenditure.
- Determining limits of authority and financial delegation.
- Ensuring integrity of information, internal controls, business continuity and risk management.
- Ensuring compliance with laws and regulations, and effective control of company activities.
- Ensuring all stakeholders' interests are taken into account in decision making.
- Recognising sustainable business developments in decision making and intergrated
- Ensuring reporting adoption of effective CEO and key management succession plan.
- Ensuring the company's values, standards, accounting policies and financial regulations are adopted/upheld.
- Establishing a process of monitoring and evaluation of plan implementations, budgets etc.
- Establishing a process for corporate reporting on an annual and quarterly basis.
- Fulfilling other vital board transactions based on the maturity/complexity of the company.

(Total: 10 marks)

NOT FOR SALE

Answer 02

Relevant learning outcome/s: 2.1
Study text reference: Page 93

Amortisation of grant received to represent the relevant amount of the asset's depreciation	
	Rs. '000
For 2016 (20,000/10 * 9/12)	1,500
For 2017	2,000
For 2018	2,000

Extract of the income statement		
For the year ended 31 December 2018		
		Restated
	2018	**2017**
	(Rs. '000)	**(Rs. '000)**
Revenue	340,100	301,420
Gross profit	68,020	60,284
Amortisation of grants	2,000	2,000
Expenses	(40,200)	(37,520)
Net profit	29,820	24,764

Extract of the statement of changes in equity	
As at 31 December 2018	
Retained earnings	**Rs. '000**
Balance as at 1 January 2017	1,516,716
Correction of prior period error	1,500
Profit for the year	24,764
Balance as at 31 December 2017	1,542,980
Profit for the year	29,820
Balance as at 31 December 2018	**1,572,800**

NOT FOR SALE

Extract of the statement of financial position		
As at 31 December 2018		
		Restated
	2018	**2017**
	(Rs. ‘000)	**(Rs. ‘000)**
Reserves		
Retained earnings	1,572,800	1,542,980
Non-current liabilities		
Deferred income	14,500	16,500

Disclosures

(1) The company has not amortised the government grants received of Rs. 20 million to purchase the depreciable asset worth Rs. 30 million. During the year, the said error was corrected by restating the opening balances for the earliest period presented per LKAS 8.

(2) Due to the correction of this error, the government grants of Rs. 20 million shown under equity previously were reflected as deferred income under non-current liabilities at the unamortised amount as at the reporting date.

(Total: 10 marks)

NOT FOR SALE

Answer 03

Relevant learning outcome/s: 2.2
Study text reference: Pages 341 – 355

	Provision matrix				
	Current	**1 – 30 days past due**	**31 – 60 days past due**	**61 – 90 days past due**	**Over 90 days past due**
Probability of default (PD)	8.53%	15.79%	26.32%	47.00%	100.00%
Loss given default (LGD)	5.00%	5.00%	5.00%	5.00%	5.00%
Default rate	0.43%	0.79%	1.32%	2.35%	5.00%

* Application of LGD rate across all the buckets

Debtor aging	**Gross carrying amount (Rs. million)**	**Collective impairment (Rs. million)**	**Individual impairment (Rs. million)**	**Total impairment (Rs. million)**
Current	160	0.688	-	0.688
1 – 30 days past due	90	0.711	-	0.711
31 – 60 days past due	45	0.594	-	0.594
61 – 90 days past due	35	0.823	-	0.823
Over 90 days past due	48	2.400	2.00	4.400
Provision before economic factor adjustment		**5.21**	**2.00**	**7.216**

(Total: 10 marks)

NOT FOR SALE

Answer 04

Relevant learning outcome/s: 4.1
Study text reference: Pages 632 – 666

(a)

		2018	2017
(i)	Gross profit ratio	20%	25%
(ii)	PBIT margin	2.598%	3.75%
(iii)	Current ratio	2:1	1.75:1
(iv)	Quick ratio	0.91:1	1.03:1

(b) When the gross profit amounts are considered, the highest gross profit was recorded in 2018. However, the GP ratio is only 20% in 2018 compared to 25% in 2017. Even though revenue significantly increased (by 55%), it appears that the company was not able to manage its cost of sales to maintain the previous year's GP margin. Further it is possible that the increase in revenue came from an increase in quantity. Since the GP margin had decreased, there could have been a reduction in the selling price.

Similarly, the PBIT margin also came down in 2018 to 3% from 4% in 2017, perhaps as a result of not implementing cost reduction measures.

In terms of liquidity, in 2018 the company recorded a healthy current ratio compared to other years. However, it is clear from the quick ratio that XYZ shows a better current assets position due to a high level of inventory held by the company. In 2018, possible inefficiencies in managing inventory, such as having slow moving inventory, is visible from the quick ratio. Therefore, in terms of short-term solvency, the company had more liquid assets to meet short-term liabilities in 2017. In 2018, the company has not maintained adequate liquid assets and not managed its working capital properly.

Accordingly, the statement made by the CEO is not accurate.

(Total: 10 marks)

NOT FOR SALE

Answer 05

Relevant learning outcome/s: 2.1 and 2.3
Study text reference: Pages 194 – 206 and 594 – 610

(a)

In the statement of cash flows:

(i) There is no cash movement. Therefore nothing should be reflected in the statement of cash flows from this share issue other than removing the non-cash element from the movement of the related party account balance under changes in working capital.

Either of answer

(ii) Dividends paid may be classified as a financing cash flow because it is the cost of obtaining financial resources. Alternatively, dividends paid may be classified as an operating cash flow in order to assist users to determine the ability of the company to pay dividends out of operating cash flows.

(iii) These investments with very short-term maturities are components of cash and cash equivalents as at the year end.

(b) The company should account for each lease component within the contract as a lease separately from the non-lease component of the contract. It should allocate the consideration in the contract to each lease component on the basis of the relative standalone price of the lease component and the standalone price of the non-lease component.

Combined contract		**Monthly charge (Rs.)**
Lease component	(27,000/30,000 * 28,000)	25,200
Non-lease component	(3,000/30,000 * 28,000)	2,800
		28,000

The non-lease component represents maintenance service charges (Rs. 2,800 per month) and it should be charged to profit in the period in which they are incurred.

SLFRS 16 *Leases* requires the lease component to recognise a right-of-use asset and an associated liability at the inception of the lease.

The right-of-use asset is measured at cost less any accumulated depreciation and impairment losses. The cost of the right-of-use asset includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date. The recognised right-of-use asset is depreciated on a straight line basis over the shorter of its estimated useful life and the lease term.

NOT FOR SALE

Initial recognition of right-of-use asset

	Rs.
Lease liability/present value of future lease payments	616,895
Legal and installation charges	31,905
Rent advance payment	151,200
	800,000

	April 2019
Right to use asset – gross carrying value	800,000
Depreciation (800,000/36)	(22,222)
Accumulated depreciation	
Right to use asset – net carrying value	777,778

At the commencement of the lease, the company should recognise the lease liability, measured at the present value of lease payments to be made over the lease term. In calculating the present value of lease payments, the company should use the interest rate implicit in the lease. After the commencement date, the amount of the lease liability should be increased to reflect the accretion of interest and also reduced for the lease payments made.

	April 2019	
PV of lease liability (opening)	616,895	
Interest expense (OP liability * 12%/12)	6,169	
Rent paid – net of advance	(12,600)	$\left\{(28,000 - 2,800) - \frac{151,200}{12}\right\}$
PV of lease liability (closing)	610,464	

(Total: 10 marks)

NOT FOR SALE

Answer 06

Relevant learning outcome/s: 2.1
Study text reference: Pages 509 – 576

Jay PLC and it subsidiary
Consolidated Statement of Fianncial Position
As at 31 December 2018

	JP Rs.000	KPL Rs.000	W 1 GW	W 1 Dep	Interest	W2 Asso.	W3 URP	W4 URP	Impairment	Inter co. Balances	post-acq profit allocation	Total Rs.000
Assets												
Non-current assets												
Property, plant and equipment	1,320,800	551,300	254,000	(10,542)								2,115,558
Investments	980,000		(680,000)			(300,000)						-
Investment in associate (**1/2**)						353,850		(3,450)	(4,000)			346,400
Brand name			10,000									10,000
Goodwill			286,081									286,081
	2,300,800	551,300	(129,919)	(10,542)		53,850		(3,450)	(4,000)			2,758,039
Current assets												
Inventory	67,540	245,200					(1,300)					311,440
Trade receivable	145,700	197,900										343,600
Amount due from KPL	72,000	-								(72,000)		-
Cash and cash equivalent	123,450	14,700								12,000		150,150
	408,690	457,800										805,190
Total assets	2,709,490	1,009,100	(259,838)	(10,542)		53,850	(1,300)	(3,450)	(4,000)	(60,000)		3,563,229
Equity and liabilities												
Equity												
Stated capital	1,200,600	400,000	(400,000)									1,200,600
Retained earnings	1,131,890	388,300	(120,000)	(6,325)	(1,515)	53,850	(1,300)	(3,450)	(4,000)		(107,320)	1,330,130
	2,332,490	788,300	(520,000)									2,530,730
Non-controlling interest			273,632	(4,217)							107,320	376,735
Non-current liabilities												
Retirement benefit obligation	145,600	-	40,000									185,600
Deferred consideration			16,529		1,515							18,044
Deferred tax liability	25,400	2,300	59,920									87,620
	171,000	2,300	116,449									291,264
Current liabilities												
Trade payables	200,400	150,700										351,100
Amounts due to JP	-	60,000								(60,000)		-
Accrued expenses	5,600	7,800										13,400
	206,000	218,500										364,500
Total equity and liabilities	2,709,490	1,009,100	(129,919)	(10,542)	-	53,850	(1,300)	(3,450)	(4,000)	(60,000)	-	3,563,229

NOT FOR SALE

W1: Goodwill	
Consideration paid	680,000
Deferred consideration	16,529
(20,000/1.1^2)	
NCI	273,632
	970,161
FV of net assets acquired	
Stated capital	400,000
Retained earnings	120,000
FV increase of land	24,000
FV increase of building	230,000
Deferred tax liability	(71,120)
(24,000 + 230,000) * 0.28	
Pension liability	(40,000)
Brand name	10,000
Deferred tax asset	11,200
	684,080
Goodwill	**286,081**
Excess depreciation	
230,000/20 * 11/12	10,542
Interest cost	1,515
(16,529 * 10% *11/12)	

W2: Investment in associate	
Cost	300,000
Share of post acqusition profit (389,500 – 210,000) * 0.3 (Dividends already deducted from RE)	53,850
URP (46,000/100) * 25 * 30%	(3,450)
Impairment	(4,000)
	346,400
Dr: Investment in associate	
Cr: Consolidated retained earnings	

NOT FOR SALE

W3: Sales by QPL to KPL	
URP (52,000 * 20/120) * 30% * 50%	1,300
Dr: Reatined earnings	
Cr: Group inventory	

W4: Sales by JP to QPL	
URP (46,000 * 25%)	11,500
Dr: Retained earnings	
Cr: Investment in associate	

W5: Allocation of post acq. profit	
Retained earnings	
KPL (268,300 * 60%)	160,980
NCI	107,320
	268,300

NOT FOR SALE

Answer 07

Relevant learning outcome/s: 2.2
Study text reference: Pages 618 – 626

(a)

(i)

If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity should allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life.

Component	Gross carrying value	Depreciable amount	Annual depreciation	Net carrying value	Annual maintenance cost
	Rs. million	Rs. million	Rs. million	Rs. million	Rs. million
Main body	3.75	3.38	0.34	3.41	0.36
Metal cover	1.50	1.50	0.19	1.31	0.18
Wooden base	2.25	2.14	0.43	1.82	0.12
	7.50	7.01	0.95	6.55	0.66

As computed above, the depreciation charge of the machine for the year is Rs. 0.95 million. Also, the annual maintenance cost of the machine is Rs. 0.66 million. Both of these amounts were initially included in the cost of inventory. Subsequently with sale of these inventory, both costs were charged to profit or loss as cost of sales.

The net carrying value of Rs. 6.55 million should be presented in the statement of financial position as at 31 March 2019.

(ii)

Banning the usage of the machine by the government with effect from 1 April 2023 shows an indication that the machine is impaired. NPA is therefore required to review the recoverable value, useful life and residual value in order to take account of the changed circumstances.

	Rs. million
Net carrying value as at 1 April 2019	6.55
Depreciation from April 2019 to June 2019 (0.95/4)	(0.24)
Net carrying value as at 30 June 2019	6.31

Value in use as at 30 June 2019			**Rs. million**
PV of cash inflows			5.93
Cash outflows	**CF**	**DCF @ 12%**	
30.06.2020	0.5	0.893	(0.45)
30.06.2021	0.75	0.797	(0.60)
30.06.2022	1.25	0.712	(0.89)
			4.00

NOT FOR SALE

Fair value less cost to sell as at 30 June 2019	Rs. million
Selling price	3.80
Less: Commission @ 5%	(0.19)
	3.61

The net carrying value of the machine as at 30 June 2019 was Rs. 6.31 million, whereas the recoverable value was only Rs. 4 million (which is the higher of the value in use (Rs. 4 million) and FV less cost to sell (Rs. 3.61 million). Hence the impairment loss of Rs. 2.31 million (6.31 – 4) should be recognised in profit or loss **.**

The revised useful life of the entire machine as at 30 June 2019 is 3 years and 9 months. Hence the depreciation expense for period July 2019 to March 2020 would be Rs. 0.8 million (4/3.75 * 0.75). The net carrying value of the machine, which will be shown in the statement of financial position as at 31 March 2020, would be Rs. 3.2 million (4 – 0.8).

(iii)

Events after the end of the reporting period are those events that occur between the end of the reporting period and the date when the financial statements are authorised for issue. There are two types of events.

1. Those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period); and
2. Those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events after the end of the reporting period)

In this case NPA's reporting period ends on 31 March 2019 and the financial statements were authorised for issue on 10 July 2019. The government issued banning rules for the use of the machine on 30 June 2019.

Since the imposition of the new law provides an indication of a condition that arose after the end of the reporting period, this has to be treated as a non-adjusting event.

An entity should not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.

However, NPV should disclose the non-adjusting event (the nature of the event, and an estimate of its financial effect as calculated in part (ii) above).

(b)

Allocation of discount to Tehan

The contract includes a discount of Rs. 5,000 on the overall transaction (Rs. 83,000 – Rs. 78,000), which is allocated proportionately to the three services in the contract when applying the relative standalone selling price method. However, because Venix regularly sells cleaning and maintenance services together as a bundle for Rs. 45,000 (at a Rs. 5,000 discount compared to its total selling price of Rs. 50,000 (Rs. 28,000 + Rs. 22,000)) and security services for Rs. 33,000, there is evidence that the entire discount should be allocated to the cleaning and maintenance services.

NOT FOR SALE

Performance obligation	Standalone selling price	Price allocation	Calculation	Discount allocation
Security	33,000	33,000		-
Cleaning	28,000	25,200	(45,000/50,000 * 28,000)	2,800
Maintenance	22,000	19,800	(45,000/50,000 * 22,000)	2,200
	83,000	78,000		5,000

Allocation of discount to NTP (Pvt) Ltd

As the discount attributable to each bundle is not the same and the analysis of the services in each bundle does not provide observable evidence that the discount relates to just one or two services, the discount of Rs. 10,000 should be allocated to all three services proportionately as shown below.

Performance obligation	Standalone selling price	Price allocation	Calculation	Discount allocation
Security	30,000	26,000	(65,000/75,000 * 30,000)	4,000
Cleaning	25,000	21,667	(65,000/75,000 * 25,000)	3,333
Maintenance	20,000	17,333	(65,000/75,000 * 20,000)	2,667
	75,000	65,000		10,000

(Total: 25 marks)

NOT FOR SALE

Notice of Disclaimer

The answers given are entirely by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and you accept the answers on an "as is" basis.

They are not intended as “Model answers’, but rather as suggested solutions.

The answers have two fundamental purposes, namely:

1. to provide a detailed example of a suggested solution to an examination question; and

2. to assist students with their research into the subject and to further their understanding and appreciation of the subject.

The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) makes no warranties with respect to the suggested solutions and as such there should be no reason for you to bring any grievance against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). However, if you do bring any action, claim, suit, threat or demand against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), and you do not substantially prevail, you shall pay the Institute of Chartered Accountants of Sri Lanka's (CA Sri Lanka’s) entire legal fees and costs attached to such action. In the same token, if the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is forced to take legal action to enforce this right or any of its rights described herein or under the laws of Sri Lanka, you will pay the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) legal fees and costs.

© 2013 by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).
All rights reserved. No part of this document may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior written permission of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

NOT FOR SALE