THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

08204 – Accounting Applications and Taxation

Certificate in Accounting and Business II Examination
September 2012

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

			Rs.'000
a) **Investment**			10,000
Market value of non-controlling interest			
	MV per share (Rs.)	25	
	Non-controlling shares	100,000	2,500
			12,500
Net Assets			
	Stated Capital	4,000	
	Increase in fair value	1,200	
	Retained earnings	4,500	9,700
			2,800 **(3 marks)**

b) Consolidated Statement of Comprehensive Income

Diamond Plc Group

Consolidated Statement of Comprehensive Income Statement for the year ended 31 March 2012

Rs. '000

	Diamond PLC	**Gem PLC**	**Adjustments**	**Consolidated**
Revenue	32,400	18,900	- Sales Return 400 - Intercompany sales 550	50,350
Cost of Sales	23,640	14,680	- Cost of Sales Return 320 - Intercompany sales 550 + URP on unsold 25	(37,475)
Gross Profit				**12,875**
Other Income	1,580	300	- MV disposal profit 120 - Inter co interest 60 - Dividend 900	800
Distribution Expenses	1,220	590	- Over depreciation on MV 15	(1,795)
Admin Expenses	1,800	1,250	+ Add Depreciation on building 10 + Directors remuneration 135	(3,195)
Finance Expenses	420	135	- Interco. interest 60	(495)
Goodwill impairment				(250)
Profit Before Tax				7,940
Income Tax Expense	1,600	750		(2,350)
Profit for the year				**5,590**
Profit attributable to equity holders of parent company				5,266
Profit attributable to Non-controlling interest			(Refer W-1)	324
				5,590

(11 marks)

c) Consolidated Statement of Financial Position

Diamond Plc Group
Consolidated Statement of Financial Position as at 31 March 2012

Rs.'000

	Diamond	**Gem**	**Adjustments**	**Consolidated**
Assets				
Property, plant and equipment	8,900	5,850	+ Inc in FV 1200 - Dep above 10 **[*(1200*1/3)/40 years]*** - MV disposal profit 120 + Over dep above -15[120*25%*6 mts)	15,835
Goodwill	2,800		Impairment 250	2,550
Inventories	4,275	4,000	+ cost of sales return 320 - URP on unsold 25	8,570
Cash and bank	1,250	185		1,435
Total Assets				**28,390**
Equity & Liabilities				
Stated capital				6,000
Revaluation reserve				4,000
Consolidated revenue reserve (**Refer W-1)**				14,704
Non-controlling interest (**Refer W-2)**				2,586
Trade and other payable				1,100
Total Equity & Liabilities				**28,390**

(6 marks)

(W – 1) **Rs.'000**

		Diamond	Gem	Consolidated
Profit after tax - Stated		5,300	1,795	
Additional dep on building due to FV inc (400/40 years = 10)			(10)	
Sales return		-	(400)	
Cost of sales return		-	320	
URP on unsold inventory	(250*50%*25/125)		(25)	
Disposal profit net of additional dep	120 - (120*25%*6 months)	(105)		
Director remuneration	(405*1/3)		(135)	
Intercompany dividend		(900)		
Goodwill impairment		(250)		
		4,045	**1,545**	**5,590**
NCI @ 25%			(386)	**(386)**
Profit				**5,204**
Retained profit b/f				**12,500**
Dividend				**(3,000)**
Console reserve as at 31 March 2012				**14,704**

(W – 2)

Non-controlling interest as at 31 March 2012

Rs.'000

Market value as at 1/4/2011		2,500
Profit for the year attributable to NCI		386
Dividend	(1200 * 25%)	(300)
		2,586

(Total - 20 marks)

Answer No. 02

(a)

Rainbow PLC
Statement of Comprehensive income for the year ended 31 March 2012

	Adjustments	Rs. '000
Sales		32,480
Cost of Sales	(+ Omitted invoice 140)	(19,460)
Gross Profit		**13,020**
Other Income	(- remove cash proceeds 2,975 +Profit on disposal of building 55)	85
Administration Expenses	(+Buil Dep: 61 + Plant & Machinery Dep 300 + Com equipment Dep 476 + Disposal value of MV 90 - rent deposit 10)	(3,352)
Distribution Expenses	(+loss on disposal 150 + MV dep: 990 + website cost 425 - bad debt reversal of 325 +provision for bad debt 80)	(2,672)
Finance Expense	(+ lease interest 25)	(130)
Profit before tax		6,951
Income tax expense	(current year 1940 + under provision 40)	(1,980)
Profit for the year		**4,971**
Other Comprehensive Income		
Gain on revaluation		2,891
Total comprehensive income for the year		**7,862**
		(12 marks)

(b)

Rainbow PLC
Statement of Financial Position as at 31 March 2012

Assets		**Rs. '000**
Non Current Assets		
Property, Plant and Equipment		12,614
Intangible assets		-
Current Assets		
Inventory		5,230
Trade Receivables		6,275
Provision for doubtful debts	(-write back 325 + Add provision 80)	(575)
Advances & prepayments	(-Computer adv 240)	135
Rent Deposit		10
Total Assets		**23,689**
Equity & Liabilities		
Capital & Reserves		
Stated Capital		4,000
Revaluation reserve	(Year surplus 2,891 - transfer to R/E on disposal 723)	2,168
Retained Earnings	(5,207 + current year's profit + transfer from R/R 723)	10,901
Non-Current Liabilities		
Lease		111
Current Liabilities		
Trade Payable	(+Omitted invoice 140)	4,720
Current portion of lease	(15.75*12 – IIS 20)	169
Income tax payable		1,480
Bank overdraft		140
Total Equity & Liabilities		**23,689**

(9 marks)

(c) Statement of movement in Property, Plant & Equipment

Rs. '000

	Land & Building	**FH - P & M**	**LH - P & M**	**Computer Equip**	**Motor Vehicle**
<u>Cost / Valuation</u>					
Balance b/f	9,700	1,900	500	1,050	5,250
Additions	-	-		1,140	
Transfer of Acc dep on Account of revaluation	(891)				
Adjustment on revaluation	2,891				
Disposals	(2,925)	-		-	(1,200)
Transfer from WIP					
Balance C/d	8,775	1,900	500	2,190	4,050
<u>Accumulated Depreciation</u>					
Balance B/f	850	925	125	480	2,450
Charge for the year	41				
	20	238	62	476	990
On disposal	(5)				(960)
Transfer of Acc dep on account of revaluation	(891)			-	
Balance C/d	15	1,163	187	956	2,480
Net book value	8,760	737	313	1,234	1,570

12,614

Working

3 marks

<u>Disposal</u>	<u>Building</u>		<u>MV</u>	
Sales proceeds		2,975		90
Cost	2,925		1,200	
Accumulated depreciation	(5)	(2920)	(960)	(240)
Profit		55		(150)

(Total 25 marks)

Answer No. 03

(a) **Measured bases for assets**

Historical cost: Assets are recorded at the amount of cash or cash equivalents exchanged. E.g. A fixed asset is measure at the price paid/payable at the time of acquisition.

Current cost: Assets are carried at the amount of cash or cash equivalents that would have to be paid, if the same or equivalent asset is acquired currently, e.g. when an asset's price is vulnerable due to high inflation, current cost could be used for example insurance purpose.

Realisable value: Where assets are carried at the amount of cash or cash equivalents that could be obtained by selling the asset in an orderly disposal, e.g. inventories are generally measured at the lower of cost and net realizable value.

Present value: Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business, e.g. fixed assets acquired on a finance lease is initially measured at this value. **(4 marks)**

(b)

<u>Statement of cash flow</u>	
<u>Operating activities</u>	
Adjustments	
Profit on disposal of motor vehicle	400,000
<u>Investment activities</u>	
Acquisition of motor vehicles	(4,000,000)
Sale proceeds of motor vehicle	3,400,000
<u>Financing activities</u>	
Bank loan proceeds	4,000,000
Repayment on loan	(1,200,000)
Interest payment on loan	(510,000)

(6 marks)

(c)

	<u>Rs. '000</u>	Capitalisation	Reason
Invoice value of the Plant	2,500	Yes	This is the purchase price
Freight and other transport charges	30	Yes	Direct cost
Custom duties and VAT	375	Only 125	Only irrecoverable direct taxed shall be capitalized
Fee paid to the agent in finalizing the deal	25	Yes	Since it is directly relating the purchase of the plant
Installation charges	135	Yes	The installation is required for the plant to be used for intended use
Engineer's salary		Yes - 45	Even though, he is an existing employee, the employee benefit for the period shall be capitalised. In case no internal engineer, the company will have to hire an external person and may have to incur the cost
Staff training cost	15	No	Not a direct cost

(5 marks)

Answer No. 04

Computation of Income tax payable by Mr. Sarath Manawadu for the year of assessment 2011/2012			
		Exempt/ not liable	**Liable**
Employment income Salary – 150,000 x 12			1,800,000
Vehicle allowances 60,000 x 12 = 720,000 Less: exempt 50,000 per month = 600,000		600,000	120,000
Bonus received – on cash basis			180,000
Reimbursement of telephone bills 52,000 x 50%			26,000
Accommodation expenses - (425 x 5 = 2,125 x 128 = 272,000) and air fare are exempt from tax - 74,000		272,000 74,000	
Reimbursements of medical expenses			94,000
Rental value Rating assessment + rates = 300,000 + 90,000 = 390,000 } higher Rent paid by the employer = 30,000 x 12 = 360,000 Employment income under section 4 (1) (a) is more than 1,800,000 Higher value of above is = 390,000 } lower Statutory restriction is = 180,000 Residential benefit = the above lower value – rent paid by the employee (180,000 – 9,000 x12) Liable to tax = 72,000			72,000
Employment Income			**2,292,000**
100,000 is exempt			**(100,000)**
Statutory income from employment			**2,192,000**
Interest income - Interest on a deposit made in Australia – It **is exempt** since it has been **remitted to Sri Lanka** through a bank -Interest from NRFC is exempt from tax			
Business Income			
Net profit as per accounts	**1,590,000**		
Less: other sources of income			
Rent income	(1,060,000)		
Profit on sale of the computer	(25,000)		
Add/less – disallowable items			
Rates to building 120,000 x 2/3	80,000		
Repairs to building – rented 450,000 x 2/3	300,000		
Royalty	825,000		
Book depreciation on the new computer	200,000		
Profit/loss from the disposal of the graphic computer Sale proceeds = 25,000 **Less**: cost of acquisition = 356,000 Less: capital allowance granted = 267,000 89,000 Tax Loss 64,000	(64,000)		
Therefore, capital allowance is granted on the cost of acquisition – 400,000 Capital allowance x 25%	(100,000)		
Advertisement expenses = 416,000 Disallowed @ 25%	104,000		
Adjusted profit	1,850,000		1,850,000

Rent Income Gross rent received 1,060,000 Less: rates = (120,000 x 2/3) 80,000 980,000 Less: 25% for repairs 245,000 Net Rent 735,000 ========= NAV = RA - repair allowance = 400,000 – 100,000 = 300,000 = 2/3 of 300,000 = 200,000 Net rent is more than NAV			735,000
Occupier's income = NAV – rent paid by the occupier **Net Annual Value** = Rating assessment – 25% for repairs 180,000 – 45,000 = 135,000 Gross rent paid = 60,000 **Occupier's income** = 135,000 - 60,000 = 75,000 **Owner's income** = NAV – occupier's income = 135,000 – 75,000 = 60,000			60,000
Total statutory income			4,837,000
Less: deductions under section 32 Interest paid on a loan to a person recognized by the CGIR, and sufficient other sources of income is available to deduct the interest expense			58,000
Royalty paid			650,000
Assessable income			4,129,000
Less qualifying payments -EPF contribution – not a qualifying payment -Donation – government (100% is claimable) -No qualifying payment – loan capital repayment was not taken from a bank (hence not entitle for qualifying payment -Personal allowance			46,000 500,000
Taxable income			3,583,000
First 500,000 @ 4% 20,000 Next 500,000 @ 8% 40,000 **Business income 1,850,000** **(maximum)** **@ 10% 185,000** Next 500,000 @ 12% 60,000 Balance 233,000 @ 16% 37,280			
Gross income tax payable	342,280		
Less: tax credit			
self-assessment payment PAYE	250,000 132,800		
Income tax overpaid – refund due	**40,520**		

Alternate answer for disposal of graphic computer (under business income)

(1) When computing the tax profit on the disposal of the graphic computer, capital allowance for the year in which the computer was sold will be as follows. In that case, there will not be a tax loss and it will effect to the capital allowance for the new asset since the new computer is a replacement. Accordingly, alternative answer is given below.

Profit/loss from the disposal of the graphic computer

Sale proceeds	=		25,000
Less: cost of acquisition	=	356,000	
Less: capital allowance granted	=	356,000	0
Tax profit			25,000

C/A is granted on the cost of acquisition –tax profit from the disposal of old computer

Capital allowances to be claimed;
New graphic computer (replacement basis)

= 400,000 - 25,000 = 375,000 x 25% = 93,750

Old graphic computer (depreciation for Y/A 2011/2012)
= 356,000 x 25% = 89,000

As per the alternative answer , the profit from the business is 1,831,250

Profit has gone down by	=	Rs. 18,750
Now payable tax is 18,750 x 10%	=	Rs. 1,875
Gross income tax liability will be	=	**Rs. 340,405**

Answer No. 05

Computation of Divisible profits and Partnership Tax payable by Sun Pack Enterprises For the year of assessment 2011/12		
	+	-
Net profit as per account	**3,083,000**	
Less: Interest from fixed deposit- WHT has been deducted		540,000
Add: Partners' salaries Wasantha 600,000 Sarath 500,000 Hemantha 400,000	1,500,000	
Expenses on training 142,000 – 48,000 = 94,000 – allowed Air passage = 2% of the profit and income of the previous year of assessment or actual expenditure whichever is **less** - 3,546,000 x 2% =70,920 Therefore, 48,000 is also allowed		
Entertainment – disallowed	214,000	
Book depreciation – building	450,000	
Capital allowance – building 4,500,000 x 6 2/3% The building which is used for an industrial undertaking has been purchased from a partnership		300,000
Bad debts written off		
Loans given to a partner	250,000	
Loans given to suppliers	150,000	
Trade debt – allowed		
Interest paid to a partner – allowed		
Divisible profit /Adjusted profit	**4,807,000**	
Partnership tax (Divisible Profit + Other Income) - Tax Free Allowance (4,807,000 + 0) – 600,000 = 4,207,000 **Partnership Tax =** 4,207,000 @ **8% = 336,560**		

Answer No. 06

a) The income of the child is aggregated with the income of the father where;

- the father is a resident individual and
- the marriage of the parents subsists during the year of assessment OR
- the marriage of the parents does not subsists during the year of assessment and the child is maintained and living with the father.
- In the year of assessment the marriage of the parents is ceased.

(3 marks)

b) The marriage of the parents is deemed not to subsist in the following circumstances.

- where the parents live in separation from each other under the decree of a competent court.
- where the parents live in separation from each other under a duly executed deed of separation.
- where the parents live in separation from each other in such circumstances in which the separation is likely to be permanent.

(2 marks)

Answer No. 07

(a) Goods mean all kinds of movable or immovable property other than;
money, and
computer software made to customers' special requirements etc. **(2 marks)**

(b) Once the registration of any person has been cancelled by the Commissioner General of Inland Revenue

- such person shall not display the certificate of registration effective from the date of cancellation.
- such person shall return the certificate of registration within the prescribed time period.
- such person shall not issue any tax invoice, tax debit note or tax credit note.
- any goods or services forming part of the assets of the taxable activity shall be deemed to have been supplied prior to the date of cancellation.
- but if the taxable activity including such assets are taken over by another VAT registered person there is no liability to pay VAT by the person referred to in paragraph (iv) above.

(3 marks)

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