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THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

08204 – Accounting Applications and Taxation

Certificate in Accounting and Business II Examination
March 2013

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

(a) Goodwill on Consolidation

	<u>(Rs.000's)</u>	
Investment	18,000	
Fair value of Non-controlling Interest	<u>6,000</u>	
	24,000	
Less: Fair Value of identifiable Net Assets taken-over	<u>(21,800)</u>	
Goodwill on Consolidation	<u>2,200</u>	(3 marks)

(b) Non-Controlling Interest

	<u>(Rs.000's)</u>	
Fair value on the day of acquisition	6,000	
Revaluation Reserve - (600 @ 20%)	120	
Post acquisition Profit – (2,200 @ 20%)	440	
Additional Depreciation (800 x 10% x 20%)	(16)	
Impairment of goodwill – (400 @ 20%)	<u>(80)</u>	
	<u>6,464</u>	(3 marks)

(c) Consolidated Retained Earnings

	<u>(Rs.000's)</u>	
Gamma PLC	18,400	
Delta PLC - (2,200 @ 80%)	1,760	
Dividend Delta PLC - (1,000 @ 80%)	800	
Less: Additional depreciation (800 @ 10% x 80%)	(64)	
Unrealised Profit on inventory (GIT 312,000 + Closing stock 120,000) * 20/120	(72)	
Impairment of Goodwill - (400 @ 80%)	<u>(320)</u>	
	<u>20,504</u>	(4 marks)

Note: Post acquisition profit of Delta PLC is;

Net Assets on 31/03/2012 (10,000 + 800 + 12,400)	= 23,200
Net assets on 01/04/2011	= <u>21,000</u>
	<u>2,200</u>

(d)

GAMMA PLC
Statement of Consolidated Financial Position as at 31 March 2012

<u>ASSETS</u>	Rs.000's
<u>Non-current Assets</u>	
Property, Plant and Equipment [25,300 + 20,500 + 800 (F value) – 80 (dep'n)]	46,520
Goodwill on Consolidation (2,200 – 400)	1,800
 <u>Current Assets</u>	
Inventory [4,200 + 2,400 + 312 (GIT) – 72 (URP)]	6,840
Trade and Other Receivables [3,200 + 1,800 – 312 (GIT) – 60 (Deb. Int)]	4,628
Cash & Cash Equivalents [2,400 + 1,450 + 60 (CIT)]	<u>3,910</u>
	<u>63,698</u>
 <u>EQUITY & LIABILITIES</u>	
<u>Share Capital & Reserves</u>	
Stated Capital	25,000
Revaluation Reserve [3,000 + 600 @ 80%]	3,480
Consolidated Retained Earnings	20,504
Non-Controlling Interest	6,464
<u>Non-Current Liabilities</u>	
12% Debentures (5,000 – 1,000)	4,000
<u>Current Liabilities</u>	
Trade & Other Payables [1,700 + 2,350]	4,050
Dividend payable (1,000 – 800)	<u>200</u>
	<u>63,698</u>

(10 marks)

Workings

Controlling Cost Account

Investment in Delta PLC	18,000	Fair value of NA acquired	21,800
Non controlling interest at fair value	<u>6,000</u>	Goodwill	<u>2,200</u>
	<u>24,000</u>		<u>24,000</u>

Non Controlling Interest

Additional depreciation	16	Fair value	6,000
Impairment of GW	80	Revaluation reserve (600 x 20%)	120
Balance c/f (NCI)	<u>6,464</u>	Post acquisition profit (2,200 x 20%)	<u>440</u>
	<u>6,560</u>		<u>6,560</u>

(3)

Consolidated Retained Earnings.

Additional Depreciation (800 x 10% x 80%)	64	Balance b/f	18,400
Unrealised profit on inventory (52 + 20)	72	Retained profit Delta PLC (2,200 x 80%)	1,760
Impairment of GW (400 x 80%)	320	Dividend Delta PLC (1,000 x 80%)	800
Balance c/f	<u>20,504</u>		<u> </u>
	20,960		20,960
	=====		=====

Answer No. 02

(a)

Epsilon PLC

Statement of Comprehensive Income for the year ended 31 March 2012

	<u>Rs.000's</u>
Sales (308,600 – 120)	308,480
Cost of Goods sold (262,000 – 35(abn. cost) – 280 (GIT) -120 Open. stock adj)	<u>261,565</u>
Gross Profit	46,915
Distribution Cost (18,460 + 3,250 (dep'n M.V) + 50 (bad-debt) + 69 (increase in doubtful debt prov'n)	(21,829)
Administration expenses (12,450 + 1,590 (dep'n) + 1,500 (amort'n of Patent))	(15,540)
Other expenses (+ 35 (Inventory logistical problem) +180 (impairment of machinery)	<u>215</u>
Profit before taxation	9,331
Taxation (2,600 + 150 (under-prov'n) + 40 (def. Tax)	<u>(2,790)</u>
Profit for the year	6,541
<u>Other Comprehensive Income</u> Reversal of impairment	<u>(400)</u>
Total Comprehensive Income for the year	<u>6,141</u>

(10 marks)

(b)

Epsilon PLC
Statement of Financial Position as at 31 March 2012

Rs.000's

ASSETS

Non-Current assets

Property, Plant and Equipment	27,510
Intangible Assets (Patent right) (2,500 – 1,500 amortisation)	1,000

Current Assets

Inventory (8,050 + 280 (GIT))	8,330
Trade Receivable (5,260 – 30 – 50 (bad debt) – 259 (prov'n))	4,921
Other Receivable	620
Cash and Cash Equivalents	<u>5,390</u>
	<u>47,771</u>

EQUITY & LIABILITIES

Stated Capital & Reserves

Stated Capital – 2 million Ord. Shares	21,000
12% Cum. Preference shares	5,000
Retained Earnings	16,821

Non-Current Liabilities

Deferred Tax Liability	40
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Current Liabilities

Trade Payable	2,540
Other Payables (1,200 + 450 (Income tax payable + 120 (advance on sales) + 600 pref. dividends)	<u>2,370</u>
	<u>47,771</u>

(9 marks)

(c) **Statement of changes in equity during the year ended 31 March 2012**

	Ordinary <u>Share Cap</u>	Revaluation <u>Reserve</u>	Retained <u>Earnings</u>
Balance on 01/04/2011	21,000	400	12,500
Over-statement of Opening Inventory	-	-	(120)
Balances re-stated on 01/04/2011	21,000	400	12,380
Revaluation	-	-	-
Total Comprehensive Income for the year	-	(400)	6,541
Interim Ordinary dividend	-	-	(1,500)
Prof. Dividend	-	-	(600)
Balances on 31/03/2012	21,000	-	16,821

(3 marks)

(d) **Statement showing movements in Property, Plant & Equipment**

	Land & <u>Buildings</u>	Motor <u>Vehicles</u>	Machinery	Furniture & <u>Equipment</u>
Cost / Revaluation				
Balance on 01/04/2011	23,400	14,200	4,150	2,500
Revaluation adjustment – Dep	-	-	(2,670)	-
Revaluation Reserve – Reversal	-	-	(400)	-
Impairment	-	-	(180)	-
balance on 31/03/2012	23,400	14,200	900	2,500
Depreciation				
Balance on 01/04/2011	860	7,800	1,840	820
Charge for the year	510	3,250	830	250
Revaluation adjustment	-	-	(2,670)	-
Balance on 31/03/2012	1,370	11,050	Nil	1,070
WD Value on 31/03/2012	22,030	3,150	900	1,430

Total Value

= 27,510

(3 marks)

Answer No. 03

(i) Statement of financial position

- * Assets controlled by the entity - useful in predicting the ability to generate cash flows (for investors)
- * Financial structure - useful in predicting borrowing needs, the distribution of future profit/cash and likely success in raising new finance (for Investors, lenders)
- * Liquidity and Solvency - useful in predicting whether financial commitments will be met as and when they fall due

Statement of comprehensive income

- * Profitability - useful in assessing the performance in light of resources controlled and thereby to predict profitability when resources are changed
- * Ratio - Useful in calculation of certain ratios such as Interest cover which will be useful to lenders in determining whether the return for their loan could be recovered
- * For employees - Assessing their performance based rewards, bonuses etc

Statement of cash flows

- * This information is used to assess the entity's investing, financing and operating activities. They show the entity's ability to produce cash and the needs which utilize those cash flows.
This will be useful to investors in assessing the entity's cash generating activities. Also prediction of future cash flows

(award marks for any suitable answers)

(3 marks)

- (ii) (a) Identify whether a single arrangement comprises separately identifiable components and recognize the revenue separately

Sale of machine	4,250,000	(On the delivery of machinery - 20 December 2012)
Installation	<u>250,000</u>	(Once the installation is completed)
	<u>4,500,000</u>	

For 31 December 2012

Revenue	4,250,000
Advance received	250,000

(3 marks)

- (b)
- | | |
|--------------------------------------|-----------|
| Price under normal terms of credit | 1,200,000 |
| Price under extended terms of credit | 1,280,000 |
| Financing element | 80,000 |

For 31 December 2012

Revenue	1,200,000
Finance Income	80,000

(1 mark)

- (c) Dispatch date 18-Dec-12
Received by 21-Jan-13
Customer
Shipment Terms FOB (Free On Board)

Revenue shall be recognized when the risk and rewards are passed to the buyer. In import/export sales transactions, one of the consideration in determining the risk and rewards transfer point is the Shipment terms.

Under FOB terms, seller is responsible up to the goods are loaded on to ship and sale shall be recognized at that point

For 31 December 2012

Revenue	3,800,000
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(1 ½ marks)

(iii)

				Rs. '000	
	Sales (Cash sales - Rs. 720,000)			7,800	
	Cost of Sales			(5,850)	
	Gross Profit			1,950	
	Expenses and taxation			(1,320)	
	Profit for the year			630	
	As at 31 December 2012				
	- Inventory			1,200	
	- Debtors			884	
(a)	Revenue for year 2013				
		<u>2012</u>	<u>Increase</u>	<u>2013</u>	
	Cash sales	720	Nil	720	
	Credit sales	7,080	10%	7,788	
		7,800		8,508	

(b)	Purchases for year 2013					
	GP Margin – 2012		25%			
	GP for year 2013	Expected sales*GP Margin	=	2,127		
	Cost of sales 2013	Sales - GP	=	6,381		
	b/f inventory			1,200		
Add	Purchases			6,591		
Less	c/d inventory			(1,410)		
	Cost of sales			6,381		
(c)	Profit for year 2013					
	Gross profit			2,127		
	Expenses & taxation (increased by 5%)			(1,386)		
				741		
(d)	Debtors balance as at 31 December 2013					
	Current debtors payment period	=	<u>Debtors</u>	* 360 days		
			Credit sales			
		=	884	* 360 days		
			7,080			
		=	45	days		
	New credit period		75	days		
	<i>(by applying same formula above)</i>					
	76 days	=	<u>Debtors</u>	* 360 days		
			7,788			
			1,623			
(e)	Creditors balance as at 31 December 2013					
	Creditors settlement period	=	<u>Creditors</u>	* 360 days		
			Credit purchases			
	30 days	=	<u>Creditors</u>	* 360 days		
			6,591			
		=	549			
						(6 ½ marks)

(Total 15 marks)

Answer No. 04

	Exempt/ Not Liable	Liable
Employment Income		
Salary – 63,000 x 8 = 504,000		504,000
64,050 x 4 = 256,200		256,200
Cost of Living allowance		70,200
Extra duty allowance - exempt	32,000	
Availability allowance 1,700 x12 - exempt	20,400	
Language allowance 800 x12		9,600
Worked on holidays - 63,000/20 *9		28,350
Vehicle allowances 18,000 x 12 = 216,000		
Less: exempt 50,000 per month	216,000	
Rental value of residence provided for government employees is exempt		
Accommodation expenses - (440 x 4 = 1,760 x 136 = 239,360)	239,360	
Air fare - 65,000	65,000	
Employment Income		868,350
Employment tax free allowance		100,000
Statutory Income from employment		768,350
Interest income		
Net Interest received on deposits made in commercial banks – Since the tax has been deducted, it does not form part of the assessable income	123,600	
Interest from savings account – no WHT has been deducted		48,000
Profits and income from the sales of a book - If the income is received within one year - 50% is exempt	27,000	27,000
Sale of a block of land is not taxed since it is not out of a source of income specified in the law		
Business Income		
Net profit as per accounts	683,850	
Less: other sources of income		
Rent income	(480,000)	
Profit on sale of the ECG machine computer	(34,000)	
Add/less – disallowable items/allowable items		
Stock adjustment opening stock 14,000		
Add purchases 742,000		
756,000		
Less closing stock 16,000		
Cost of sales 740,000		
Already charged 742,000		
To be adjusted 2,000	2,000	
Salaries paid to wife – allowed		
Overtime paid including to his wife – allowed		
Purchase of an ECG machine	90,000	
Purchase of a nebulizer machine	30,000	
Profit/loss from the disposal of the ECG machine		

Sale proceeds	=	34,000		
Less: cost of acquisition	=	80,000		
Less: capital allowance granted	=	<u>80,000</u>	<u>0</u>	
Tax profit			34,000	
Therefore, capital allowance is granted on the cost of acquisition less tax profit from the old machine				
90,000 - 34,000 =		56,000		
Capital allowance - 33 1/3%			(18,667)	
Profit/loss from the disposal of the nebulizer machine				
Sale proceeds	=	0		
Less: cost of acquisition	=	25,000		
Less: capital allowance granted	=	<u>25,000</u>	<u>0</u>	
Tax profit			<u>0</u>	
Therefore, capital allowance is granted on the cost of acquisition				
Capital allowance = 30,000 x 33 1/3%			(10,000)	
Renewal of surgical instruments – allowed				
Rates to building 40,000 x 1/2			20,000	
Repairs to building – allowed				
Adjusted profit			283,183	283,183
Rent Income				
Gross rent received		480,000		
Less: rates = (40,000 x 1/2)		<u>20,000</u>		
		460,000		
Less: 25% for repairs		<u>115,000</u>		
		345,000		
=====				
NAV = RA - repair allowance = 200,000 – 50,000				
= 150,000				
= 1/2 of 150,000 = 75,000				
Net rent is more than NAV				345,000
Income from spouse				
Salary - 450,000				
Over time - 166,000				616,000
Total statutory income				2,087,533
Less: deductions under section 32				
Interest paid to the bank on a loan, and sufficient other sources of income is available to deduct the interest expense				342,000
Assessable income				1,745,533
Less qualifying payments				
contribution to WROP –is not a qualifying payment				
Donation – to an approved charity – not claimable				
Capital payment of a loan is not a qualifying payment				
Personal allowance				500,000
Taxable income				1,245,533
First 500,000 @ 4%		20,000		

Next	500,000	@ 8%	40,000			
Balance	245,533	@ 10%	24,553			
Gross income tax payable				84,553		
Less: tax credit						
self-assessment				75,000		
PAYE				12,450		
Refund Due				(2,897)		

(25 marks)

Answer No. 05

Computation of Divisible profit, Share of profit and Partnership Tax payable by MNO Enterprises For the year of assessment 2011/12		
	Rs.	
Net loss as per account		(736,550)
Add: Partners' salaries		
Malaka 900,000		
Neelaka 500,000	1,400,000	
Yard rent - allowed		
Advertisement - donation to a charity	18,000	
1,876,000 -18,000 = 1,858,000		
25% disallowed	464,500	
Entertainment	619,000	
Interest paid to Ovinaka allowed		
Nation Building tax – 100% allowed		
Audit fees on an opinion not allowed	32,000	
All other expenses allowed		
Divisible profit/ Adjusted Profit		1,796,950
Partnership Tax (Divisible Profit + Other Income) - 600,000		
1,796,950 + 0 – 600,000 = 1,196,950 x 8% = 95,756		
		=====

	Total	Malaka	Neelaka	Ovinaka
Share of profit	396,950	132,317	132,317	132,316
Salaries paid to partners	1,400,000	900,000	500,000	
Divisible Profit	1,796,950			

(10 marks)

Answer No. 06

Turnover	Rs. 80,925,560
Deduct excluded turnover	Rs. 6,590,875

Liable turnover	Rs. 74,334,685
Less: 50% exemption	Rs. 37,167,343

	Rs. 37,167,343
	=====
NBT payable @ 2%	Rs. 743,346
	=====

(5 marks)

Answer No. 07

An assessor can make an assessment or an additional assessment at any time after the time bar in the following instances.

The subsequent receipt of any arrears relating to profits from employment for that year of assessment.

The subsequent receipt of interest income which was excluded in that year of assessment.

In the case of an executor by reason of an incorrect statement.

Where in the opinion of the assessor any fraud evasion or willful default has been committed by the tax payer in relation to any income tax payable for that year of assessment.

(5 marks)

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