THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

08204 – Accounting Applications and Taxation

Certificate in Accounting and Business II Examination

March 2014

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

a) Goodwill on consolidation (Rs. '000)

Investment at cost	20,200
Fair-value of Non-Controlling Interest	
500,000 shares * 20% * Rs.18.50	1,850
	22,050
Fair-value of identifiable net assets	21,200
Goodwill on consolidation	850

b) Non-Controlling Interest account (Rs. '000)

Fair-value as at 1 April 2012	1,850
Revaluation Reserve (600 @ 20%)	120
Impairment of goodwill (200 @ 20%)	(40)
Share of post-acquisition profit	
(5,100 * 20%)	1,020
Less: dividend paid	
(500,000 shares * 20% * Rs1/=)	(100)
	2,850

c) Megamart PLC

Consolidated Statement of Comprehensive Income for the year ended 31 March 2013

		Rs. ('000)
Revenue	56,800 + 24,800 – 5,500 *(Inter co Sales)*	76,100
Cost of sales	34,400 + 14,900 – 5,500 + 330 (URP) + 88 (URP)	(44,218)
Gross Profit		**31,882**
Other income	1,240 +1,300 – 150 (management fee) – 400 (dividend)	1,990
Distribution cost	3,800 + 1,800	(5,600)
Admin expenses	5,060 + 2,210 + 200 (impairment) – 150 (management fee) + 80 (depreciation)	(7,400)
Financial charges	480 + 260	(740)
Profit before tax		**20,132**
Income tax expense	4,860 + 1,830	(6,690)
Profit for the year		**13,442**
Attributable to:		
Shareholders of Megamart Plc		12,462
Non-Controlling Interest	[5,100 (Minimart profit) – 200 (goodwill impairment)] * 20%	980
		13,442

d)

Megamart PLC

Consolidated Statement of Financial Position as at 31 March 2013

	Rs. '000	**Rs. '000**
ASSETS		
Non-Current Assets		
Property, Plant & Equipment	20,400 + 18,300 + 800 (Note i) – 80 (depreciation)	39,420
Goodwill on consolidation	850 – 200 (impairment)	650
Current Assets		
Inventory	5,040 + 4,280 + (440 GIT – 88 URP) – 330 (URP)	9,342
Trade and other receivables	3,600 + 2,840 – 440 (inter company balance)	6,000
Cash and cash equivalents	1,960 + 1,980	3,940
		59,352
EQUITY & LIABILITIES		
Share Capital & Reserves		
Stated Capital	25,000 + 2,200	27,200
Retained Earnings	Note ii	22,322
Consolidated revaluation reserve	2,200 + (600 @ 80%)	2,680
Non-Controlling Interest		2,850
Current Liabilities		
Trade and other payables	2,500 + 1,800	4,300
		59,352

Notes:

i. Net assets of Minimart PLC on day of acquisition:

Share Capital	15,000
Revaluation Reserve	1,000
Retained Earnings	4,400
	20,400
Fair value of identifiable net assets taken over	21,200
Therefore, increase in fair value of plant & machinery	800

ii. Consolidate Retained Earnings

Megamart PLC	19,300
Profit for the year consolidated – Megamart	(9,440)
Profit for the year consolidated	12,462
	22,322

OR

Megamart PLC	19,300
Minimart PLC [(5100-500)*80/100]	3,680
Goodwill impairment [200*80/100]	(160)
URP on stocks [88+330]	(418)
Dep .on revaluation	(80)
	22,322

Answer No. 02

a) Marga Apparel PLC (MAP)

Statement of Comprehensive Income for the year ended 31 March 2013

	Rs. '000	**Rs. '000**
Revenue	88,800 – 390(consignment)	88,410
Cost of sales	50,600 – 300(consignment) + 120 + 1,320(dep^n) + 840(patent)[Note b]	(52,580)
Gross Profit		35,830
Other income	1,200 + 475(vehicle exchange)[Note a] + 500(government grant)[Note e]	2,175
Distribution cost	4,840 + 33(bad debts) + 900(motor vehicle dep^n) + 600(advertisement) [Note b] + 20(bad debts)	(6,393)
Administration expenses	4,660 + 430(dep^n) + 640(dep^n)	(5,730)
Profit before tax		25,882
Income tax expense	8,800 – 220(over provision) + 168(deferred tax)[Note c]	(8,748)
Profit for the year		**17,134**
Other comprehensive income:		
Revaluation of land		500
Total comprehensive income for the year		**17,634**

b) Marga Apparel PLC (MAP)

Statement of Financial Position as at 31 March 2013

	Rs. '000	**Rs. '000**
ASSETS		
Non Current Assets		
Property, Plant & Equipment		28,620
Intangible assets - Patent	4,200 - 840	3,360
		31,980
Current Assets		
Inventory	8,060 + 300	8,360
Trade receivables	4,280 – 390(consignment) – 20(bad debts) – 203 (prov^n: 193 +10)[Note f]	3,667
Other receivables		880
Cash and cash equivalents		2,565
		47,452

	Rs. '000	Rs. '000
EQUITY & LIABILITIES		
Share Capital & Reserves		
Stated capital		15,000
Revaluation reserve		720
Retained earnings		24,884
		40,604
Non Current Liabilities		
Diferred tax	[Note c]	168
Current Liabilities		
Trade payables		3,650
Other payables	660 + 370(tax payable) + 2,000 (diferred revenue)	3,030
		47,452

c) Marga Apparel PLC (MAP)

Statement of changes in equity for the year ended 31/03/2013

	Share Capital	Revaluation Reserve	Retained Earnings
Balance as at 1 April 2012	15,000	600	8,750
Comprehensive income for the year	-	-	17,134
Revaluation of land	-	500	-
Impairment of plant & machinery	-	(380)	-
Interim dividend paid	-	-	(1,000)
Balance as at 31 March 2013	**15,000**	**720**	**24,884**

d)

Marga Apparel PLC (MAP)
Statement showing movement in Property, plant & equipment

	Land & Buildings	**Plant & Machinery**	**Furniture & Equipment**	**Motor Vehicle**	**TOTAL**
Cost					
Balance as at 1 April 2012	23,600	6,600	3,200	4,800	38,200
Additions	-	1,200	-	3,200	4,400
Part exchange	-	-	-	(4,800)	(4,800)
Impairment	-	(4,220)	-	-	(4,220)
Revaluation/impairment	500	(380)	-	-	120
Balance as at 31 March 2013	24,100	3,200	3,200	3,200	33,700
Acc. Depreciation					
Balance as at 1 April 2012	2,080	2,900	1,210	1,625	7,815
Charge for the year	430	1,320 120	640	300 600	2,690 720
Impairment	-	(4,220)	-	-	(4,220)
Part exchange	-	-	-	(1,925)	(1,925)
Balance on 31 March 2013	2,510	120	1,850	600	5,080
Written Down Value as at 31 March 2013	21,590	3,080	1,350	2,600	28,620

Notes

(a) Gain or Loss on part-exchange

Fair-value of vehicles received under part-exchange		3,200
Add: payment received		150
		3,350
Book value of vehicle given under part-exchange:		
Cost	4,800	
Accumulated depreciation	(1,925)	
		(2,875)
Gain on part-exchange		475

(b) Patent right

Balance as per trial balance	4,800
Less: advertisement cost charged to income statement	(600)
	4,200
Amortisation @ 20%	(840)
Balance	3,360

(c) Deferred Tax

Carrying amount of plant & machinery [1,200 – 120]	1,080
Tax base [1,200 less 50%]	(600)
Taxable temporary difference	480
Tax thereon @ 35%	168

(d) Impairment of plant & machinery

Carrying amount of relevant plant & machinery [6,600 – (2900 + 1,320)]	2,380
Recoverable amount	(2,000)
Impairment Loss	380

(e) Government grant

Balance as per trial balance	2,500
Amount transferred to profit or loss 5,000 * 6/60	(500)
Deferred income	2,000

(f) Trade receivables

Balance as per trail balance		4,280
Less – Consignment sale	390	
Bad debts write off	20	(410)
		3,870
Less – specific provision		(10)
		3,860
General provision - 5%		(193)
		3,667

Answer No. 03

(i) (a) A provision relates to:

- uncertainty about timing; or
- uncertainty about the amount payable

As far as trade payables are concerned, the payment is for goods/services received and invoiced or for goods/services where the timing and amount of settlement has been formally agreed with the supplier.

Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier.

(b) Company A has filed a case claiming compensation. There is a probability of an inflow of economic benefits to Company A. This is dependent upon the order to be made in this case, and hence is uncertain. Therefore the claim expected to be received is a contingent asset

Contingent assets shall not be recognised, since this may result in the recognition of income that may never be realised.

However, when the realisation of income is <u>virtually certain</u>, then the related asset is not a contingent asset and its recognition is appropriate.

(ii) Recognition criteria for current asset:

- expected to realise the asset or intend to sell or consume in its normal operating cycle;
- the asset is held primarily for the purpose of trading;
- expected to realise as an asset within 12 months after the reporting period; or
- asset is cash or cash equivalent.

As these cars are held for the purpose of trading and expected to realise in the normal operating cycle, it is to be treated as a current asset (under inventory).

(iii) (a)

Average profit mark-up = Gross profit / Cost of sales = 3,240 / (12,840 - 3,240)
= 33.75 %

Return on capital employed = PBIT / Capital employed = (1,980 + 220) / 12,560
= 17.5 %

Average inventory resident period = (Average inventory / Cost of sales) * 365
= {[(4,420 + 5,060) /2] / 9,600} * 365
= 180 days

Average trade receivable collection period = (Average Debtors / Sales) * 365
= {[(2,160 + 2,320) / 2] / 12,840} * 365
= 64 days

Average trade payable settlement period = (Average Creditors / Purchases) * 365

Average Creditors = *(1,780 + 1,920) / 2*
= *1,850*
Purchases = *Cost of sales + Closing stock – Opening stock*
= *9,600 + 5,060 – 4,420*
= *10,240*

Therefore, average trade payable settlement period = (1,850 / 10,240) * 365
= 66 days

(b)
- For a trading entity, an average inventory resident period of 180 days (i.e. 6 months) is too high. Inventory should be checked for redundant and slow-moving items and the average inventory resident period should be reduced drastically.
- Average trade receivable collection period of 64 days (more than 2 months) is very high. Management should take necessary action to reduce this to less than a month or so.
- Average trade payable settlement period of 66 days is reasonable, particularly when compared with the average trade receivable collection period.

Working capital cycle = average inventory resident period + average trade receivable collection period - average trade payable settlement period

= 180 days + 64 days – 66 days
= 178 days

This implies that it takes 178 days (6 months) in average to convert an inventory item into cash. This is not a satisfactory level.

Answer No. 04

Computation of Income tax payable by Mr. Chaminda Kularatna for the year of assessment 2012/2013

	Exempt/ not liable	**Liable**
Employment income		
Salary – 150,000 x 12		1,800,000
Vehicle allowances: 65,000 x 12 = 780,000 Exempt 50,000 per month = 600,000	600,000	180,000
Bonus received – on cash basis		170,000
Reimbursement of telephone bills - 72,000 x 50%		36,000
Reimbursements of medical expenses		306,000
Reimbursement of house rent - 20,000 x 12 **Statutory limit not applicable as not provided a house**		240,000
Reimbursements of annual trip expenses		143,000
Employer's contribution to the provident fund - Note		
		2,875,000
Less: Employment Tax Free Allowance		(100,000)
		2,775,000
Interest income		
Interest on a deposit made in Australia **It is exempt since it has been remitted to Sri Lanka through a bank**	277,760	
Interest from NRFC is exempt from tax	83,200	
Interest from the savings account , does form part of the statutory income since no WHT has been deducted by the bank		**34,000**
Other income		
Dividend income does form part of the statutory income since no WHT has been deducted		**68,000**
Profit on sale of listed shares is exempt	14,000	

Rental income			
Gross rent received	720,000		
Less: rates	(60,000)		
	660,000		
Less: Repair Allowance (25%)	165,000		
Net rent	495,000		
Net Annual Value			
Rating assessment	200,000		
Less: Repair Allowance (25%)	(50,000)		
	150,000		
Net rent is more than Net Annual Value			
No exemption is available since the floor area is more than 500 Sq. ft			**495,000**
Business income			
Net Income as per accounts	2,222,000		
Add/(Less)			
Profit on sale of the computer	(35,000)		
Book depreciation on the new computer	50,000		
Profit/(Loss) from the disposal of the computer Sale proceeds 35,000 ***Less****:* Tax WDV Cost of acquisition 90,000 Capital allowance granted (90,000) - Tax profit 35,000	35,000		
Capital allowances on new computer-100,000 x 25% **New computer has been purchased prior to the sale. Therefore, it is* ***not a replacement******	(25,000)		
Rent - 240,000 ~ $3/4^{th}$ disallowed	180,000		
Entertainment expenses	67,000		
Adjusted profit	2,494,000		**2,494,000**
TOTAL STATUTORY INCOME			**5,866,000**
Less: Deductions under Section 32 – interest paid on a loan taken to purchase a motor car - Not allowed			-
ASSESSABLE INCOME			**5,866,000**
Less: Qualifying Payments			
EPF contribution – not a qualifying payment			-
Donation to *Api wenuwen Api* – government (100% is claimable)			(100,000)

Life policy premium Rs.86,000 **Limited to lower of Rs.75,000 and 1/3 of AI**			(75,000)
Capital repayment is not a qualifying payment			-
Personal allowance			(500,000)
TAXABLE INCOME			**5,191,000**
First 500,000 @ 4%	20,000		
Next 500,000 @ 8%	40,000		
Business Income 2,494,000 @ 10%	**249,400**		
Dividend income 68,000 @ 10%	**6,800**		
Next 500,000 @ 12%	60,000		
Next 500,000 @ 16%	80,000		
Balance 629,000 @ 20%	125,800		
GROSS INCOME TAX PAYABLE	582,000		
***Less:* Tax Credits**			
Self-assessment Payments PAYE	(350,000) (255,000)		
BALANCE TAX PAYABLE / (REFUND DUE)	**(23,000)**		

Note: Employer's contribution to the provident fund will be taxed as a terminal benefit in the Y/A in which it will be received.

Answer No. 05

Computation of Divisible Profits of Ruwan Designers for the year of assessment 2012/13

	Rs.	**Rs.**
Net income as per account		**14,809,000**
Add / (Less):		
Interest from fixed deposit - WHT has been deducted		(130,000)
Rent received		(960,000)
Partners' Salaries: Ruwan 1,600,000 Shantha 1, 600,000		3,200,000
Book Depreciation - buildings **Capital allowance on building:- not allowed since purchased**		450,000
Construction of new office room		789,000
Capital allowance: 10% of Rs.789,000 (since floor area is increased)		(78,900)
Rates attributable to rented area – disallowed 44,000 x 1/2		22,000
Interest paid to Ruwan on loan – allowed		-
Adjusted profit/Divisible profit		**18,101,100**
***Add:* Other Income**		
Rent Income		
Gross Rent	960,000	
Less: Rates	(22,000)	
	938,000	
Less: Repair Allowance (25%)	(234,500)	**703,500**
Total Divisible Profits & Other Income		**18,804,600**
Less: Partnership Tax Free Allowance		(600,000)
Taxable Income		**18,204,600**
Partnership Tax - 8% of Rs.18,204,600		**1,456,368**

Distribution of Divisible Profits and Other Income

	Total	**Ruwan**	**Shantha**
Share of profit	14,901,100	7,450,550	7,450,550
Salaries paid to partners	3,200,000	1,600,000	1,600,000
Divisible profit	18,101,100		
Rent income	703,500	351,750	351,750

Answer No. 06

Calculation of balance tax payable/refund due of Mr. Gunasekara for the Y/A 2012/13

	Rs.	Rs.
Assessable income		1,000,000
Less: Tax Free Allowance		(500,000)
Taxable income		500,000
Income tax payable @ 4%		20,000
Less: Instalments paid		(24,000)
Add: Discount for early payment of tax		
10% of Rs.24,000		
or		
10% of Rs.20,000	2,400	
*****whichever is lower*****	2,000	(2,000)
Refund due		**6,000**

Answer No. 07

Collettes Rubber Industries (Pvt) Ltd
VAT for March 2013

	Rs.		**Rs.**
OUTPUT VAT			
Supply of goods			
Exports – zero rated	20,000,000	**0%**	0
Local supplies	10,000,000	**12%**	1,200,000
	30,000,000		1,200,000
***LESS*: INPUT TAX**			
VAT on imports	1,200,000		
VAT on local purchases	300,000		
	1,500,000		
100% can be claimed on exports $\frac{20,000,000}{30,000,000} \times 1,500,000$	1,000,000		
Input VAT on standard supplies allowed up to 100% of the output tax	500,000		
Total input VAT claimable	1,500,000		(1,500,000)
VAT refund due			**300,000**

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