THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

MOCK EXAMINATION – DECEMBER 2013

Financial Reporting Framework

Answer No. 01

a. Wrong- Inventories comprising agricultural produce that has harvested from its biological assets are measured on initial recognition at their fair value less estimated point of sale cost at the point of harvest.

b. Proportionate revenue can be recognized if it is probable that the customer will approve the variation and the amount of revenue arising from the variation and the amount of revenue can be reliably measured

c. Wrong – Rs.0 .5 Mn should charge to profit and loss as a lease rent

d. Both ways can argue – This LKAS 23 also says that interest earned from the temporary investment of specific loans should be deducted from the amount of finance costs that can be capitalized. However, in this case, the interest was earned during a period in which the finance costs were NOT being capitalized, thus the interest received of would be credited to the income statement and not to the capitalized finance costs.

e. To capitalize cost of the replaced polythene, few conditions need be satisfied such as increase quality of products, increase life time of the greenhouses. Further, able to reliably measure remaining value (WDV) of the existing polythene.

f. Selective revaluation is prohibited by LKAS 16

g. If an intangible assets which is internally generated, to be recognized as an intangible assets it first should meet criteria of an intangible assets such as it is probable that economic future economic benefits will flow the entity and the cost of the assets can be reliably measured

h. Trade and other receivables should value using fair value

i. This correct

j. The fire has taken place during the financial year 2012/13. Hence adjusting the financial statement in that year is correct. However if this even has taken place after the reporting period this become a non-adjusting event.

Answer No. 02

(a) **Surplus on revaluation**

Revalued amount	Rs.40Mn
NBV at 1/4/2012 (32mn -5.6mn)	(Rs. 26.4)Mn
Surplus	**Rs.13.6Mn**

Recognize the surplus as revaluation reserve and in the statement of comprehensive income

(b) In this situation, an obligation to restore the building to its original state arises at the time the alterations were made. If there is nothing the company can do to avoid the obligation, then the full provision for the estimated reinstatement costs of Rs.400,000 should be made by means of the prior year adjustment assuming that discounting the provision is unlikely to have any material impact.

The company should also set up a corresponding asset in accordance with LKAS 37. This is because an obligation to return the property to its original state is incurred as result of constructing the offices which represent access to future economic benefits that are to be enjoyed over more than one period. Therefore, an asset is recognized at the same as the provision. In practice, this would be added to the cost of the offices etc. and depreciated over the shorter of the lease term and their useful life.

The prior year adjustment made should take account of the effect of any backlog depreciation. Care should also be taken to ensure that capitalizing the provision does not result in stating the asset at above its recoverable amount. Therefore, it may be necessary to test the asset for impairment under LKAS 36.

(c) 1. Interest cost is based on the capitalization rate which is the weighted average of the borrowing costs

2. Interest income from Treasury bond should be deducted when arriving at the borrowing costs which should be capitalized.

Answer No. 03

Report format

To : Chief Financial Officer
From : Accountant
Subject : Impairment of Business
Date : 22nd November 2013

(a) External Indicators

- Market value of the company based on net assets, etc.
- Impact on the recession in US market and for how many periods will it be continuing?
- Carrying value of the assets compared with market prices or replacement costs
- Any other

Internal Indicators

- Evidences for obsolesces or physical damages
- Impact on the US market recession to the demand of garments
- Net losses made over the years
- Depression in other financial indicators of the group
- Any other

(b) (1) Fair value less costs to sell

A price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.

If there is a binding agreement or an active market, fair value less costs to sell is based on the information available to reflect the amount that an entity could obtain, at the end of the reporting period form the disposal of the asset in an arm's length transaction between knowledgeable willing parties, after adjusting the assets disposal.

(2) Value in use

Expected future cash flows after applying the relevant discount rate.

Answer No. 04

According to LKAS 23 (paragraph 8), borrowing cost should be capitalized. However, due to this policy change, Strong PLC deviates from LKAS 23.

Strong PLC
Extract from the Income Statement

	2012	(Restated) 2011
	Rs. million	Rs. million
Profit before interest & Income taxes	32,000	17,400
Interest expense	(1,750)	(1,400)
Profit before Income taxes	30,250	16,000
Income taxes	(9,075)	(4,800)
Profit	**21,175**	**11,200**

Statement of Change in Equity

	Retained Earnings (Restated) Rs. million
Balance as at 31 December 2010	24,000
Changes in accounting policy for capitalization of interest {(1200 x (1-30%)}	(840)
Balance as at 31 December 2011 (restated)	23,160
Profit for the year 31 December 2011 (restated)	11,200
Balance as at 31 December 2011 (restated)	34,360
Profit for the year 31 December 2012	21,175
Balance as at 31 December 2012	**55,535**

Answer No. 05

(i) Since the present value (Rs. 7.71 million) at the date of agreement is more than or "substantially" of the fair value (Rs. 7.7 million) this is a finance lease.

Calculation of present value is as follows;

Payment (Rs. million)	Year	DF@15%	PV (Rs. million)
2	0	1	2.00
2	1	0.876	1.74
2	2	0.756	1.51
2	3	0.658	1.32
2	4	0.572	1.14
10			**7.71**

(ii) Amount recognized in Income Statement

	Rs. million
Revenue (working 1)	16.28
Cost of Sales	(14.00)
Gross Profit	2.28
Finance Income	1.59

Amount recognized in the statement of financial position.

Finance lease receivable	
Current	6.20
Non-current	5.33

Working 1

	Cash flow	DF@15%	PV millions
2012	6.2	1	6.2
2013	6.2	0.870	5.39
2014	6.2	0.756	4.69
	18.6		16.28
1st installment			(6.2)
			9.94
Accrued interest Y/E 31 March 2013 (9.94 x 16%)			1.59
Finance receivable			11.53

Answer No. 06

(i) (a) LKAS – 37 Provisions, Contingent Liabilities and Contingent Assets applied.

- As there is uncertainty over the timing and outcome of the lawsuit, company may not have to make a provision.
- However, as there is a possibility that the company may incur costs, this will be considered as a Contingent liability as of 31 March 2013.

(i) (b)

- If the lawyers recommend that the company should settle the liability it is a present obligation.

- There is no uncertainty of timing and outcome of the lawsuit and expense needs to be recognized in the P&L immediately.

Damages/claims- expense	Dr.	500,000	
Other payables			500,000

(ii) Calculation of total warranty provision;

Defects	Expected cost	%	Rs. million
No	-	60%	-
Minor	6	30%	1.8
Major	12	10%	1.2
			3.0

Answer No. 07

(i) The board of directors should include at least two non-executive directors or one thirds of the total number of directors (3), whichever higher.

In this case the board should include at least 3 directors.

(ii) Mr. Rajaratne is not considered to be an independent director as he has been working as the CEO of a subsidiary within the last two years immediately before his appointment.

(iii) Remuneration Committee should exclusively consists of non-executive directors.
Mr. Perera being an executive director, he cannot be a member of the Remuneration Committee.

(iv) Audit Committee should have minimum of 2 independent non-Executive directors.
Mr. Perera is an executive director and Mr. Rajaratne is not an "independent" director.

(v) Mr. De Silva should declare his interest in buyer/customer of Good Govern PLC, to the shareholders. In addition to that if there is any material contract with buyers from which Mr. De Silva has interest in it need to be separately disclosed.

Answer No 08

- According to SLFPS 8 paragraph 13(a) and (c), Electronics and Infrastructure segments clearly satisfy the revenue and assets tests and same are separately reportable segments.
- Agriculture sector does not satisfy the revenue test. However, it satisfies the assets test and there is no need to consider the profit test.
- Therefore it is a reportable segment.
- Energy sector does not satisfy the revenue or the assets tests, but it does satisfy the profit test because its profit of Rs. 200,000 is 10% of the greater of the absolute amount of losses of those segments (Rs.750,000) and those that either breakeven or make a profit.
- Therefore Energy segment is a reportable segment.