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**SCHOOL OF ACCOUNTING AND BUSINESS  
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE  
PROGRAMME**

**YEAR II SEMESTER I  
END SEMESTER EXAMINATION – NOVEMBER 2014**

**AFM 20630 Advanced Financial Accounting**

Date : 28th November 2014  
Time : 9.00 a.m. - 12.00 p.m.  
Duration : Three (03) Hours

**Instructions to Candidates:**

- Answer ALL questions
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly

**Question No. 01**

The statements of financial position of Big PLC and Medium PLC as of 31<sup>st</sup> March 2014 were as follows.

	<b>BIG PLC</b>	<b>MEDIUM PLC</b>
	<b>Rs.000</b>	<b>Rs.000</b>
<b><u>Non-current assets</u></b>		
Property, plant and equipment	350,000	200,000
Intangible Assets	50,000	20,000
Investments (Note 1)	250,000	-
	<u>650,000</u>	<u>220,000</u>
<b><u>Current Assets</u></b>		
Inventories	70,000	60,000
Trade and other receivables	80,000	40,000
Cash and cash equivalents	20,000	10,000
	<u>170,000</u>	<u>110,000</u>
<b>Total assets</b>	<b><u>820,000</u></b>	<b><u>330,000</u></b>
<b><u>Equity and Liabilities</u></b>		
<b><u>Equity</u></b>		
Stated Capital ( Rs.1 per share)	400,000	100,000
Retained earnings	200,000	120,000
	<u>600,000</u>	<u>220,000</u>
<b><u>Non-current Liabilities</u></b>		
Long term borrowings	100,000	40,000
Retirement benefit Obligations	50,000	10,000
	<u>150,000</u>	<u>50,000</u>
<b><u>Current Liabilities</u></b>		
Trade payables	70,000	60,000
<b>Total equity and liabilities</b>	<b><u>820,000</u></b>	<b><u>330,000</u></b>

The following information about the above two companies are also available for your consideration.

I. The composition of investments of Big Plc was as follows.

Investment in Medium Plc	Rs.230 Mn.
Other financial assets	<u>Rs. 20 Mn.</u>
Total	<u>Rs.250 Mn.</u>

II. Big PLC purchased 80Mn. shares of Medium PLC on 1<sup>st</sup> April 2013. The terms of the business combination were as follows.

- a. Immediate cash payment of Rs.230Mn
- b. Big PLC will make a further cash payment of Rs.70 Mn. to the former shareholders of Medium PLC on 1<sup>st</sup> April 2015. However Big PLC has not recorded the further cash payment payable in its financial statements. On 1<sup>st</sup> April 2013 Big PLC could have borrowed funds at an annual interest rate of 10%.

The following information pertaining to acquisition of Medium Plc is also available for you.

- a. It is the policy of Big PLC to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Medium PLC as at 1<sup>st</sup> April 2013 was Rs.3.
- b. On 1<sup>st</sup> April 2013, the individual financial statements of Medium PLC showed Retained earnings balance of Rs.100Mn.
- c. The directors of Big Plc carried out a fair value exercise to measure the identifiable assets and liabilities of Medium Plc as of 1<sup>st</sup> April 2013 and the following were identified.
  - i. Plant and machinery having a carrying a value of Rs.50 Mn had an estimated market value of Rs.80 Mn. The estimated future economic life of the plant and machinery as of 1<sup>st</sup> April 2013 was four years and this estimate remains valid even as of 31<sup>st</sup> March 2014. None of these plant and machinery were disposed during 2013/2014.

- ii. Intangible asset with an estimated market value of Rs.10 Mn had not been recognized in the individual financial statements of Medium Plc. As of 1<sup>st</sup> April 2013 the estimated future economic life of this intangible asset was twenty years.

The above fair value adjustments have not been reflected in the individual financial statements of Medium Plc.

- III. The inventories of Medium PLC as at 31<sup>st</sup> March 2014 includes goods purchased from BIG Plc. The selling price of the goods included in the inventories of Medium PLC was Rs.12 Mn. Big Plc applied a markup of one third of its production cost in arriving at the sales price of these goods.
- IV. The trade receivables of Big Plc included Rs.20 Mn receivable from Medium PLC in respect of the sale of goods. The trade payables of Medium PLC include equivalent amount payable to Big Plc.

**You are required to,**

- a. Compute the goodwill arising on acquisition of Medium Plc.

(5 Marks)

- b. Compile the consolidated statement of financial position for the Big Plc and the group as at 31<sup>st</sup> March 2014.

(25 Marks)

**(Total 30 Marks)**

**Question No. 02**

Saman has been in the business of import, local purchase and sale of motor vehicle spare parts. The trial balance of his business as at 31<sup>st</sup> March 2014 is given below.

	<b>Debit (Rs.000)</b>	<b>Credit (Rs.000)</b>
Capital Account – 01 <sup>st</sup> April 2013		200,000
Current Account – 01 <sup>st</sup> April 2013		70,000
Motor vehicles	20,000	
Buildings	80,000	
Computers and equipment	25,000	
Land	80,000	
Accumulated Depreciation – 1 <sup>st</sup> April 2013		-
Motor vehicles		12,000
Building		40,000
Computers and equipment		10,000
Inventories – 1 <sup>st</sup> April 2013	256,000	
Purchase – Spare parts	450,000	
Packing materials	30,000	
Sales		820,000
Purchase returns - Packing materials		15,000
Sales returns	12,000	
Trade receivables / Payables	85,000	50,000
Other income		8,000
Admin. Salaries	30,000	
Sales staff salaries	20,000	
Electricity	12,000	
Insurance	5,000	
Security	4,400	
Commission	9,000	

Discounts	6,000	
Telephone expenses	12,000	
VAT payable		5,000
Sale of vehicle		10,000
Long term loan		60,000
Loan interest	12,000	
Staff loan	5,000	
Building maintenance	7,800	
Other administration expenses	36,000	
Other selling expenses	15,600	
Advertising expenses	11,600	
Import duty & carriage inwards	7,800	
Investment in fixed deposit	45,000	
Cash at Bank	11,800	
Suspense account	11,000	
	<b>1,300,000</b>	<b>1,300,000</b>

The following additional information is also available for your consideration.

- a. Value of inventories as at 31<sup>st</sup> March 2014 was as follows.

Spare parts	Rs. 120 Mn
Packing materials	Rs. 8 Mn

A customer returned spare parts sold at a price of Rs.40 Mn on 30<sup>th</sup> March 2014. However this was not recorded in the books of account of the business until 31<sup>st</sup> March 2014. But the value of these goods has been included in the above finished goods at the above price. Saman maintains a gross profit of 25% on the cost of spare parts sold.

- b. Goods costing Rs.10 Mn was robbed while bringing from harbor to stores on 30<sup>th</sup> March 2014. Stocks in transit have been insured for Rs.2 Mn. The above event has not been recorded in the books of accounts of the business.

- c. Trial balance of Saman's business as at 31<sup>st</sup> March 2014 did not agree, and the difference was transferred to a suspense account. Subsequently the following errors were identified in reviewing the accuracy of accounting records.
- I. Telephone bill paid in the month of January 2014 amounting to Rs.5.2Mn had been recorded in the Telephone account as Rs.2.5 Mn. However this has been correctly recorded in the cash book.
  - II. Advertising expenses paid amounting to Rs. 5 Mn has not been recorded in the advertising expenditure account.
  - III. Credit purchases amounting to Rs. 8.5 Mn was recorded in creditors control account as Rs.5.8 Mn. However this transaction has been correctly recorded in the purchase account.
  - IV. Rs. 10 Mn received from a debtor of the company has been credited twice to debtors control account. However this has been correctly recorded in the cash book.
- d. Trade receivables amounting to Rs.5 Mn need to be written off as bad debts. Impairment Provision for bad debts should be kept at 5% of the trade receivables (net) outstanding as at 31<sup>st</sup> March 2014.
- e. A Motor vehicle which was acquired on 01<sup>st</sup> April 2009 for Rs.15 Mn was disposed for Rs. 10 Mn on 31<sup>st</sup> December 2013. Sale proceeds received have been debited to cash book and credited to sale of vehicles account. No other entries have been recorded in the books of accounts of the business in this regard.
- f. Property, Plant & Equipment need to be depreciated using straight line method at following rates.
- |                         |               |
|-------------------------|---------------|
| Building                | 5% per annum  |
| Motor Vehicles          | 20% per annum |
| Computers and Equipment | 25% per annum |
- g. The following needs to be accrued as at 31/03/2014.
- |             |            |
|-------------|------------|
| Electricity | - Rs. 5 Mn |
| Security    | - Rs. 3 Mn |
| Telephone   | - Rs. 1 Mn |

- h. Cash at bank balance was extracted to the trial balance prior to reconciling with the Bank statement. Upon reconciliation it was noted,
- I. Bank charges charged by the bank amounting to Rs.50,000 have not been recorded in the Cash book.
  - II. Cheques deposited valued at Rs. 50Mn have not been realized up to 31<sup>st</sup> March 2014.
- i. Investment in fixed deposit was made on 01<sup>st</sup> January 2014. Bank has offered interest at the rate of 12% per annum. However no interest income has been accrued in 2013/2014 books of accounts of the Company.

You are **required** to prepare the following for the use of Internal Management of the business.

- a. Statement of comprehensive income for the year ended 31<sup>st</sup> March 2014.
- b. Statement of Financial position as at 31<sup>st</sup> March 2014.

**(Total 30 Marks)**



### **Question No. 03**

- a. The following information about New Food Bakers (Pvt.) limited and the industry in which it operates is available for your review.

	2013	2014	Industry Average (2014)
Net Profit ratio	18%	12%	25%
Return on Equity	15%	12%	10%
Current ratio	1.5	1.3	1.8
Quick ratio	0.6	0.1	1
Debt collection period (days)	105	130	45
Inventory residence period (days)	40	20	50
Payables payment period (days)	90	125	60
Gearing ratio	75%	70%	25%
EPS (Rs.)	12	8	16
DPS (Rs.)	1	0	8

You are working as an accountant of BEST Holdings Plc. Your Managing director informed you that New food bakers (Pvt.) Limited is available for sale and he is interested in acquiring it. He requests you to review the above information and write a report to him evaluating the New Food Bakers financial performance, liquidity, efficiency of using resources and solvency.

(14 Marks)

- b. Current ratio of Good luck Plc was 15. Critically explain the impact it might have on the profitability of Good luck Plc?

(3 Marks)

- c. Gearing ratio of Good luck Plc is 80%. Critically explain the impact this might have on the profitability and the going concern of Good luck Plc?

(3 Marks)

d. Explain what effect the following action would have on business organizations' current ratio?

- i. Inventory is purchased on cash
- ii. A supplier is paid by a cheque
- iii. A long term debt is paid off early
- iv. Inventory is sold for a profit on cash
- v. A customer pays off a debt

(5 Marks)

e. During the last three years current ratio of, Big PLC has significantly increased. However at the same time quick ratio has significantly reduced. Briefly explain what has happened? Has the liquidity of the company improved?

(3 Marks)

f. Current ratio of BAD Plc is 0.5. Critically explain what do you understand by this?

(2 Marks)

**(Total 30 Marks)**

#### **Question No. 04**

a. Define what is an "Associate company" as per the Sri Lanka Accounting standards?

(2 Marks)

b. Briefly explain the following with respect to the cash flow statements?

- i. Operating activities
- ii. Financing activities

(4 Marks)

c. Explain two circumstances where consolidation financial statements need to be prepared even when the acquirer does not have voting rights more than 50%?

(4 Marks)

**(Total 10 Marks)**