THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KC1 – Corporate Financial Reporting

June 2015

SECTION 1

Answer 1

(a)

Relevant Learning Outcome/s: 1.1.1 – 1.1.7	
1.1.1.	Advise on the application of Sri Lanka Accounting Standards in solving complicated matters.
1.1.2.	Recommend the appropriate accounting treatment to be used in complicated circumstances in accordance with Sri Lanka Accounting Standards.
1.1.3.	Evaluate the outcomes of the application of different accounting treatments.
1.1.4.	Propose appropriate accounting policies to be selected in different circumstances.
1.1.5.	Evaluate the impact of the use of different expert inputs to financial reporting.
1.1.6.	Advise appropriate application and selection of accounting/reporting options given under standards.
1.1.7.	Design the appropriate disclosures to be made in the financial statements.

(a)	FVTPL	if the instrument is purchased for trading purposes or the instrument can be designated as FVTPL
	HTM	if the instrument is purchased to hold to maturity and the entity has the ability to hold till maturity can also be designated as AFS or if any of the above
	AFS	classification is not applicable
	L&R	cannot be so classified if the instrument is in an active quoted mkt.

(4 marks)

(b)

		2013			2014		
Instrument 1	12%	10%			9%		
		Interest	FV	Adjustment	Interest	FV	Adjustment
1/1/2013	-100						
31/12/2013	12	12	103.47	(15.47)			
31/12/2014	12				12	102.75	11.28
31/12/2015	112						

	AFS		FVTPL		LR/HTM	
Statement of comprehensive income	2013	2014	2013	2014	2013	2014
Interest income	12	12	12.00	12.00	12	12
FV gain/(loss)			3.47	(0.72)		
Statement of other comprehensive income						
FV gain/(loss)	3.47	(0.72)				
Total comprehensive income	15.47	11.28	15.4711	11.28122	12	12

	AFS		FVTPL		LR/HTM	
Balance sheet	2013	2014	2013	2014	2013	2014
Investment in corporate bond	103.47	102.75	103.47	102.75	100	100

* assumed that the interest is settled on 31st December

(6 marks)

(c) Instrument classified as AFS cannot be classified as FVTPL, whether or not the market improves subsequently. It is permitted to re-classify the instrument as L&R only if it meets the definition of the L&R category. That is the instrument shall not be in an active market at the time of reclassification Re-classification shall be at FV at the date of re-classification. Reclassification to HTM is permitted only if the intention or the ability has changed from the initial recognition. Or the tenting period has lapsed. The re-classification shall not be done because the market has changed.

(5 marks)

(d) **Active market is described as;**

A market in which transactions for the assets or liabilities take place with sufficient frequency and volume for pricing information to be available on an ongoing basis. For some instruments the debt market may not be active as there are only insufficiently frequent transactions with sizable volumes.

(3 marks)

(3 marks)

Instrument 2

(e) This is a derivative as it has following features of a derivative. Its value changes in response to the change in SLIBOR. There is no initial net investment settlement occurring at a future date.

(4 marks)

(f) FV of the instrument as at 31/12/2013 11.7

Derivative	Dr.	11.7	
PL	Cr.		11.7

FV of the instrument as at 31/12/2014 10.3

PL	Dr.	1.4	
Derivative	Cr.		1.4

Calculation of interest income

		Interest paid	Interest received	Net income
		6%	0.06	
		400	400	
1/7/2012	31/12/2013	12	12	0
31/12/2013	30/06/2014	12	14	2
30/06/2014	31/12/2014	12	15	3

Balance sheet	**2014**	**2013**
Financial asset - interest rate swap	10.3	11.7
P/L and OCI		
(Increase)/decrease in FV	1.4	11.7
Interest income	-5	

(3 marks)

Answer 02

Relevant Learning Outcome/s: 1.1.1 – 1.1.7., 5.1.1.	
1.1.1.	Advise on the application of Sri Lanka Accounting Standards in solving complicated matters.
1.1.2.	Recommend the appropriate accounting treatment to be used in complicated circumstances in accordance with Sri Lanka Accounting Standards.
1.1.3.	Evaluate the outcomes of the application of different accounting treatments.
1.1.4.	Propose appropriate accounting policies to be selected in different circumstances.
1.1.5.	Evaluate the impact of the use of different expert inputs to financial reporting.
1.1.6.	Advise appropriate application and selection of accounting/reporting options given under standards.
1.1.7.	Design the appropriate disclosures to be made in the financial statements.
5.1.1.	Advise on accurate presentation of financial statements for a given set of circumstances with reference to global examples.

(a)
- Income approach
- Market approach
- Cost approach

(2 marks)

(b)

					2014									2015								
Property	Cost	Acc. Dep.	Fair value	Fair value	Category	Land CV	Building NBV	FV/dep adjustment	DT	Net Impact	PL	OCI		Category	Land CV	Building NBV	Depreciation	FV adjustment/Dep	DT	Net Impact	PL	OCI
	Rs. million	Rs. million	Rs. million	Rs. million					25%													
	31/3/2014	31/3/2014	31/3/2014	1/4/2015																		
A	700	200	700	850	PPE	420	80	200	-50	150		150		PPE	420	252	-28	178	-22	128	-28	156
B	450	-	350	400	PPE	450	0	-100		-100	-100			PPE	350	0	0	50		50	50	
C	800	300	900	1200	IP	400	100	-5		-5	-5			IP	400	95	-5	0	0	-5	-5	
D	550	-	600	600	PPE	550	0	50	0	50	0	50		IP	0	0	0	0	0	0		0
E	600	-	700	800	Operating lease					0												
F	800	-	900	700	PPE	800	0	100	0	100		100		PPE	900	0	0	-200		-200	-100	-100
								245	**-50**	**195**	**-105**	**300**					**-33**	**28**	**-22**	**-27**	**-83**	**56**

Statement of comprehensive income	2013	2014
Investment property /PPE depreciation	-5	-33
Fair Value Loss on PPE	-100	-50
Deferred tax	0	0
Profit after tax	-105	-83
Statement of other comprehensive income		
Fair Value gain on PPE	350	78
Deferred tax	-50	-22
	300	56
Total Comprehensive income	195	-27

(18 marks)

(c) (i) According to ICASL fair valuation guidelines, the properties shall be fair valued by a qualified values

PPE shall be revalued at regular intervals where the fair value does not differ materially from the FV at the reporting date.

Hence the FV cannot be increased or decreased at discretion.

(ii) Actions

Discuss the accounting standard requirements with the managing director and advise.

At a discussion bring the issue to the notice of the Board of Directors and the regulators.

Refrain from incorporating values under instruction or pressure.

(5 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s 2.1.1. 2.1.2, 3.2.1, 4.1.3.	
2.1.1.	Compile consolidated financial statements for a group with more than two subsidiaries, sub-subsidiaries or foreign subsidiaries.
2.1.2.	Recompile a consolidated set of financial statements, post-acquisition, merger or divestment.
3.2.1.	Evaluate external financial statements
4.1.3.	Evaluate integrated/sustainability reports in accordance with the "triple bottom line principle" and GRI guidelines.

(a) Control assessment.
Majority of the directors are appointed by LFPL.
LFPL is the largest shareholder with 45%. Application of defector control.
Charles right to approve dividends above 70% is only a protective right.

(b)

Statement of Financial Position				
As at 31st December (in Rs.'000)	**2014**	Consolidation Adjustments	Other	Consolidated
Non-Current Assets				
Goodwill		371.53		371.53
Brand		100.00		100.00
Property, plant and equipment	1,000	950.00	(10.00)	1,940.00
Long term investment	566		46.41	612.41
Total Non-Current Assets	**1,566**	**1,422**	**36**	**3,024**
Current Assets				
Inventories	337	22.00		359.00
Trade and other receivables	967	75.00	(217.77)	824.23
Other investments	91			91.00
Cash and cash equivalents	20			20.00
Total Current Assets	**1,415**	**97**	**(218)**	**1,294**
Total Assets	**2,981**	**1,519**	**(181)**	**4,318**
Equity and Liabilities				
Stated Capital and Reserves				
Stated capital	1,250	472.50		1,722.50
Retained earnings	480		(181.36)	298.64
Total Equity	**1,730**	**472.50**	**(181.36)**	**2,021.14**
NCI		550.00		550.00
		1,022.50	(181.36)	2,571.14
Non-Current Liabilities				
Interest bearing Loans	430			430.00
Deferred consideration		75.13		75.13
Deferred tax liabilities	20	66.90		86.90
Retirement benefit liabilities	14			14.00
Total Non-Current Liabilities	**464**	**142**	**-**	**606**
Current Liabilities				
Bank overdraft	3			3.00
Trade and other payables	647	354.00		1,001.00
Dividends payable				-
Income tax liabilities	65			65.00
Interest bearing Loans	72			72.00
Total Current Liabilities	**787**	**354**	**-**	**1,141**
Total Equity and Liabilities	**2,981**	**1,519**	**(181)**	**4,318**

Workings

1	Goodwill calculation			
	Consideration transferred		472.50	
	Deferred consideration	Note 1.1	75.13	
	NCI @FV		550.00	
			1,097.63	
	FV of NA acquired			
	Land		320.00	
	Building		480.00	
	Plant		150.00	
	Brand		100.00	
	Trade receivable		75.00	
	Inventory		22.00	
	Vat		(159.00)	
	Liabilities		(195.00)	
	Deferred tax	Note 1.2	(66.90)	
			726.10	
	Goodwill		**371.53**	
1.1	Deferred consideration		100.00	
	Discount rate	10%		
		0.751315	75.13	
1.2	Deferred tax			
	BV	FV	DT	
	Land 329 131.6			
	Building 197.4	480.00	70.65	
	Plant 115			
	-50	150.00	21.25	
			(91.90)	
	Tax losses	100	25	
			(66.90)	
2	Carrying value of the plant		75	
	Recoverable value		65	
Higher of VIU and FV				
	Impairment		10	
3	Investment		-300	
	Coupon	1	36	336
		2	36	
		3	336	
	EIR		12.00%	
	FV	10%	310.41	
	Interest receivable		36	346.41
	FV gain			10.41

4	Trade receivable			
		CV	350	
		Y1	100	
		Y2	50	
		Discount factor	10%	
		Expected NCF	132.2314	
		Impairment loss		217.7686

(c) Sustainability.

Sustainability is about corporate citizenship, or corporate responsibility. In essence it is about environmental awareness, involvement in local community issues and measuring and reporting. More importantly modifying company business processes to reduce operational use of natural resources and energy is also a part of sustainability.

Why important?

- Better reputation
- Improved access to capital
- Manage stakeholder demands
- Improve business performance
- Manage cost and manage efficiency

(d)		Healthy Foods	LFPL
	Return on capital employed	18.00%	16.62%
	Return on equity	20.00%	13.99%
	Net profit margin	16.00%	8.07%
	gross profit margin	32.00%	31.00%
	Accounts receivable collection period	60 days	92.74 days
	Inventory turnover period	45 days	46.84 days
	Accounts payable period	90 days	89.93 days
	Current ratio	1:2	1:1.8
	Gearing ratio	0.30	24.80
	Interest cover	10 times	6.90 times

Analysis

The net profit margin of HF is almost double that of the LFPL, even though the GP margins are almost the same for both companies.

It appears that the fixed cost/ overhead management of HF is much better than LFPL.

Since the NP of HF is double that of LFPL, it has contributed to better return on capital of HF.

Good working capital management is observed for HF as the AR collection period and inventory turnover periods are better than those of LFPL.

HF has a more favourable current ratio than LFPL.

Even though the HF gearing ratio is higher than that of LFPL, HF has a healthy interest cover.

HF is highly attractive to the investors due to good ROCE, ROC and interest cover compared to LFPL.

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