THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

March 2015

SECTION 1

1(a)

1.1.

Learning Outcome: (1.1.1) Identify the governance structure of business organisations.
Correct answer: D

1.2

Learning Outcome: (1.2.6) Explain qualitative characteristics of financial statements/financial information
Correct answer: D

1.3

Learning Outcome: (1.2.6) Explain qualitative characteristics of financial statements/financial information.
Correct answer: D

1.4

Learning Outcome: (1.2.3) List the elements of financial statements.
Correct answer: B

1.5

Learning Outcome: (1.2.9) Discuss the fundamentals of both accrual basis and cash basis of accounting.
Correct answer: C

1.6

Learning Outcome: (2.7.1) State the purpose and need for preparation of bank reconciliation statements
Correct answer: C

1.7

Learning Outcome: (2.2.2) Relate the connection between "dual aspect" of accounting and the accounting equation.
Correct answer: C

1.8

Learning Outcome: (3.6.2) Compute basic accounting ratios (profitability ratios, liquidity ratios, gearing ratios excluding investor ratios)
Correct answer: B

1.9

1. Learning Outcome: (2.1.3) Identify the primary books used in accounting.
Correct answer: D

1.10

Learning Outcome: (2.5.2) Prepare journal entries for correction of errors.
Correct answer: C

[Total marks for 1(a) (MCQs) 2x10= 20 marks]

1(b)

1.11

Learning Outcome: (1.1.4) - Identifying the stakeholders involved in a business organization and their respective information requirements
Any appropriate answer Shareholders- wealth maximisation, Bankers - Repayment ability of loans Customers – Existence of the product or service in the market Suppliers – Repayment ability and continuing supply

1.12

Learning Outcome: (1.1.5) – State the differences between financial accounting and management accounting.
A- True B- True 1. Three external users- shareholders, bankers, regulatory authorities, tax authorities 2. Managers

1.13

Learning Outcome: (4.1.3) – Explain the criteria to be used in the classification of assets and liabilities as current and non-current
Instances where a liability is classified as a current liability: - When it is expected to be settled in the normal operating cycle of the entity. - When it is due to be settled within 12 months from the reporting date. - When it is held primarily for the purpose of being traded.

1.14

Learning Outcome: (4.6.4) – Identify the instances where changes in accounting policies are acceptable.
Change in accounting policies are acceptable only when: 1. The change is require by a LKAS/SLFRS. 2. The change will result in more appropriate presentation of events or transactions in the financial statements of the entity, providing more reliable and relevant information

1.15

Learning Outcome: (2.3.3) – Prepare ledger accounts

Electricity Expense Account

	Dr.		Cr
Balance B/F	150,000	Accrued Expense	12,000
Accrued expense	23,000	Water Bills	5,000
		Suspense Account	16,000
		Balance C/D	140,000
	173,000		173,000
Balance B/F	140,000		

1.16

Learning Outcome: (4.7.2) – Explain adjusting events and non-adjusting events.
The destruction occurred on 15 April 2014, **do not affect the situation at the reporting date** and hence, not an adjusting event, **but** should be disclosed **in** the financial statements.

1.17

Learning Outcome: (4.3.1) – Explain criteria to be satisfied to recognise revenue from sale of goods and rendering of services.

i. **Yes-** revenue earned as the cash has been paid irrespective of the fact that whether goods were collected later at the request and risks of the buyer

ii. **Yes-** Buyer has recognized his liability as at 31.3.2014 by accepting the goods on the same day.

iii. **No.** Since the goods have not been dispatched to the buyer all the risks and rewards are still with the entity. Therefore the revenue is not earned. It is only a liability to the entity as it accepted an advance**.**

1.18

Learning Outcome: (4.8.3) - Explain the conditions to be satisfied to recognise a lease as a finance lease.

(a) The lease transfers ownership of the asset to the lessee by the end of the lease term.

(b) The lessee has the option to purchase the asset at a price that is expected to sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain at the inception of the lease that the option will be exercised.

(c) The lease term is for the major part of the economic life of the asset even if title is not transferred.

(d) At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

(e) The leased assets of such a specialized action that only the lessee can use them without major modifications.

1.19

Learning Outcome: (4.5.3) – Explain the methods of inventory measurement.

Value of physical quantity	180,000
Written off for net realizable value	(12,000)
Uncounted Inventory (60 + 2)	62,000
	230,000

1.20

Learning Outcome: (4.4.1) – Identify the different types of cash flows associated with an organization.

(i) Cash out flow = 2,100,000–[2,270,000–420,000+(320,000–240,000)] = 170,000

(ii) Under <u>cash flow from investment activities</u>, Rs. 170,000 will be shown as acquisition of PPE.

[Total marks for 1(b) 3 x10= 30 marks]

SECTION 2

Learning Outcome: (3.3.1) Explain the nature of partnerships and special accounts relating to partnership. (3.3.2) Prepare the financial statements for a partnership including appropriation accounts (simple financial statements for a partnership without change in the ownership during the period)

Answer 02

I. **Appropriation account**

Net Profit available for appropriation (640 – 30 loan interest) 610,000

Interest on Capital	- Elmo 800 @ 8%	64,000	
	- Niles 600 @ 8%	48,000	
Partners' salary	- Niles	108,000	
Share of profit	- Elmo	260,000	
	- Niles	130,000	
		610,000	(4 marks)

2. **Partners Current account**

	Elmo	**Niles**		**Elmo**	**Niles**
Balance b/d	220,000		Balance b/d		260,000
Partners' drawing	120,000	240,000	Interest on loan	30,000	
			Interest on capital	64,000	48,000
			Partners salary		108,000
Balance c/d	14,000	306,000	Share of profit	260,000	130,000
	354,000	**546,000**		**354,000**	**546,000**

(4 marks)

3. These are not business expenses and hence not charged in Profit or Loss account. Owners of a business are entitled to the profit on their investment (i.e. the capital invested). Appropriation account is a profit sharing mechanism for the different contribution made by each partners.

(2 marks)

(Total: 10 marks)

Learning Outcome: (2.6.2) Prepare a reconciliation of control account balances with a total of individual accounts. (2.7.2) Prepare a reconciliation statement reconciling the cash book balance with the bank statement balance.

Answer 03

(a) (1) **Cash Account No. 2**

	Dr. (Rs)	Cr(Rs)	Balance (Rs)
Balance BF	255,000		255,000
Cash AC No. 1 Correction		175,000	80,000
Cash AC No. 1 Correction		45,000	35,000
Cash AC No. 1 Correction	650,000		685,000
Balance at 31.3.2014			**685,000**

(3 marks)

(2) **Bank Reconciliation statement** -Account NO.1

	Rs.
Balance as per cash book	**50,000**
Less Cheques unrealised	(475,000)
Add Cheques Unpresented	215,000
Balance as per Bank Statement	(210,000)

(4 marks)

(3) **Debtors Control Account**

	Dr(Rs)	Cr(Rs)	Balance(Rs)
Balance	500,000		500,000
Sales Returns		45,000	455,000
Sales	60,000		515,000
Balance			515,000

(2 marks)

(4)

	Rs.
Corrected Total	515,000
Unrecorded discount allowed	15,000
Total of the trade receivable sub-ledger before Correction	530,000

(1 mark)

(Total: 10 marks)

Learning Outcome:
(2.5.1) Identify omission and errors in accounting.
(2.5.2) Prepare journal entries for correction of errors.
(2.5.3) Solve omissions and errors embedded in accounting records and financial statements, using suspense accounts.

Answer 04

(1) Journal entries:

(a)	Trade receivable control account	Dr	78,000	
	Sales account	Cr		78,000
(b)	Rent account	Dr	25,000	
	Suspense account	Cr		25,000
(c)	Suspense account	Dr	24,000	
	Discount allowed account	Cr		12,000
	Discount received account	Cr		12,000
(d)	Suspense account	Dr	18,000	
	Salary account	Cr		18,000
(e)	Sales account	Dr	28,000	
	Trade receivable control account	Cr		28,000
(f)	Trade payable account	Dr	52,000	
	Goods returned	Cr		52,000

(6 marks)

(2)

Suspense account

		Balance	17,000
Discount allowed	12,000	Rent	25,000
Discount received	12,000		
Salary account	18,000		
	42,000		**42,000**

(2 marks)

(3)

Net profit before adjustments	520,000
Sales	78,000
Rent	(25,000)
Discount allowed	12,000
Discount received	12,000
Salary	18,000
Sales	(28,000)
Purchases	52,000
Adjusted profit	639,000

(2 marks)

(Total: 10 marks)

Answer 05

Learning Outcome: (3.5.2) Prepare financial statements from incomplete records.

Workings

Trade receivable control account

	Rs.000s		Rs.000's
Opening balance	-	Cash	1,660
Credit sales during the year (balancing amount)	2,140		
		Closing balance	480
	2,140		**2,140**

Trade payable control account

	Rs.000s		Rs.000s
Cash	1,140	Opening balance	-
Discount received	110	Credit Purchases during the year (balancing amount)	1,890
Closing balance	640		
	1,890		**1,890**

(1) **Trading account** **(Rs.000's)**

Credit sales		2,140
Cash sales		440
		2,580
Less: Cost of Sales		
Opening stock	-	
Cash purchases	120	
Credit purchases	1,890	
	2,010	
Closing stock	(410)	
Drawings	(52)	1,548
Gross profit		1,032

Drawing is the above balancing figure : Rs 52,000 (4 marks)

(2) **Statement of Profit or Loss for the year ended 31.12.2014**

		(Rs.000's)
Gross Profit		1,032
Discount received		110
		1,142
Less Expenses;		
Salaries	115	
Rent	60	
Depreciation charges	130	
Other expenses	180	485
Net Profit for the year		**657**

(3 marks)

(3) **Statement of financial position as at 31.12.2014**

			(Rs.000's)
Non-current assets	Cost	Accumulated Depreciation	Written down value
Equipment	650	130	520
Current Assets:			
Inventory		410	
Trade Receivable		480	
Bank balance		268	1,158
Total assets			**1,678**
Proprietor's Capital:			
Balance on 01.01.2014 (Capital introduction)			500
Profit for the year			657
Drawings (Cash 72000 + Goods 52,000)			(124)
			1,033
Current Liabilities:			
Trade payable			640
Accrued rent			5
			1,678

(3 marks)

(Total: 10 marks)

SECTION 3

Learning Outcome: (3.2.3) Prepare financial statements for the purpose of management and publication.

Answer 06

(1) **Statement of Comprehensive Income for the year ended 31.12.2014**

(In Rs 000's)

Sales	11,750 – 180 (Return) - 160 (Advances)		11,410
Less: Cost of sales			
Inventory on 01.01.2014		880	
Purchases net of returns		7,200	
Carriage inwards		220	
		8,300	
Inventory on 31.12.2014		(1,070)	
Samples		(120)	
Stock loss		(300)	
			6,810
Gross Profit			4,600
Discount received			280
Reduction in provision for doubtful debt			80
			4,960
Administration expenses (W 1)			(1,894)
Selling & Distribution expenses(W 2)			(1,158)
Profit before taxation			1,908
Income tax expenses 520 + 30 (under provision)			550
Net Profit for the year			1,358
Other Comprehensive income:			
Revaluation of Land			200
Total Comprehensive income			1,558

(7 marks)

Administration expenses (W 1)

as per the trial balance	1,440
stock loss	60
accrued rent	12
Prepayments	(10)
depreciation	392
	1, 894

Selling & Distribution expenses(W 2)

as per the trial balance	860
bad debt	40
discount	120
accrued advert	18
Samples	120
	1,158

(2) **Statement of changes in equity for the year ended 31.12.2014**

	Stated Capital	**Revaluation Surplus**	**Retained Profit**
Balance on 01.01.2014	3,500	-	2,350
Revaluation of land	-	200	-
Net Profit for the year	-	-	1,358
Interim dividend paid	-	-	(300)
Balance on 31.12.2014	3,500	200	3,408

(3 marks)

(3) **Statement of Financial Position as at 31.12.2014**

(In Rs 000's)

Non-current Assets

Property, plant and equipment:

Item	Cost	Acc.Dep'n	Carrying value
Land	2,800	-	3,000
Building	2,500	480 + 125	1,895
Furniture & Fitt	820	320 + 82	418
Office Equipment	950	400 + 185	365
	7,070	**1,592**	**5,678**

Current Assets:		
Inventory	1,070	
Trade Receivable		
1,240 – 40 (b.debt)– 60 (Provision)	1,140	
Insurance receivable	240	
Prepayment	10	
Cash and cash equivalent	530	2,990
Total Assets		**8,668**

Equity and Liabilities:	
Stated Capital	3,500
Revaluation surplus	200
Retained Profit	3,408
	7,108

Current Liabilities:

Trade payables	1,180	
Income tax payable 520 – (360-30)	190	
Advance received on sales	160	
Accrued expenses (18 +12)	30	1,560
		8,668

(10 marks)

(Total: 20 marks)

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