THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

March 2018

SECTION 01

Answer 01

1.1

Learning Outcome/s: 1.1.3
Identify external environmental factors which affect the process of accounting (including economical, technological and regulatory requirements).
Study text reference – Page 21
Correct Answer: D

1.2

Learning Outcome/s: 4.2.1
List the criteria which must be satisfied in order to recognise an asset under Property, Plant and Equipment.
Study text reference – Page 502 - 503
Correct Answer: C

1.3

Learning Outcome/s: 1.2.5
Explain the underlying assumption (going concern) in accounting and the accounting concepts (accrual, materiality, consistency, entity, matching, prudence, periodic, realisable, relevance, reliability and comparability).
Study text reference – Page 38 – 41
Correct Answer : A

1.4

Learning Outcome/s: 1.2.6
Explain the qualitative characteristics of financial statements/financial information.
Study text reference – Page 42 - 43
Correct Answer: C

1.5

Learning Outcome/s: 2.1.1
Identify source documents and other records used in accounting.
Study text reference – Page 64 - 65
Correct Answer : B

1.6

Learning Outcome/s: 2.5.1
Identify omissions and errors in accounting.
Study text reference – Page 296 – 298
Correct Answer : B

1.7

Learning Outcome/s: 2.6.1
State the purpose of control accounts.
Study text reference – Page 284
Correct Answer : D

1.8

Learning Outcome/s: 4.5.2
Explain different methods used in inventory valuation.
Study text reference – Page 486 - 489
Correct Answer : B

1.9

Learning Outcome/s: 4.1.2
Discuss the items to be presented on the face of the Statement of Comprehensive Income (soCI), Statement of Financial Position (sofP), Statement of Cash Flows (soCF) and Statement of Changes in Equity (soCie).
Study text reference - Page 438 - 439
Correct Answer : C

1.10

Learning Outcome/s: 4.13.2
Identify the entities that can follow SLFRS for SMEs.
Study text reference - Page 658
Correct Answer: D

(2 x 10 = Total: 20 marks)

Answer 02

2.1

Learning Outcome/s: 1.1.1
Identify the governance structure of business organisations.
Study text reference - Page 7
• Investment is less risky than sole proprietor and partnership • No limitations on the number of shareholders • Raising finance is easy • Separate legal identity for the business • Transfer of shares from investors to others is easy • Tax advantages

2.2

Learning Outcome/s: 1.1.1
Identify the governance structure of business organisations.
Study text reference - Page 18 – 19 Additional study support material
• Reviewing the internal controls and recommending improvements to the internal control system. • Review and approve the internal audit plan • Provide directions to the internal audit team. • Ensure that the financial statements are prepared in compliance with an applicable financial reporting framework.

2.3

Learning Outcome/s: 1.2.4
Explain the elements of financial statements; assets, liabilities, equity, income, expenses and cash flows.
Study text reference - Page 28
(i) Not an asset of the company – building held under operating lease is not a resource controlled by the company (ii) Asset – amounts receivable from a customer is a resource controlled by the company as a result of sales made and the economic benefits will flow to the company when the amounts are received. (iii) Not an asset of the agent - these inventories held by the agent cannot be controlled by the agent as he has to return whatever unsold goods to the principal.

2.4

Learning Outcome/s 2.1.4
Explain the objective of primary books used in accounting.
Study text reference - Page 70 - 76

Sales Return day book - This is maintained to record and summarise the credit notes raised by the business when customers return goods <back to the company> for some reasons.

Purchase Return day Book - This is maintained to record and summarise the credit notes received from the suppliers in respect of the goods which the business send back to its suppliers.

Cash Book - This is a book of prime entry to record and summarise cash receipts & cash payments.

2.5

Learning Outcome/s : 2.3.2
Record transactions based on source documents.
Study text reference - Page 101 – 109

i.	Trade receivable /A	Dr. Rs. 5,000	
	Sales		Cr. Rs. 5,000
ii.	Trade payables/supplier K	Dr. Rs. 4,500	
	Purchase returns		Cr. Rs. 4,500
iii.	Cash in hand/ Cash at bank	Dr. Rs. 2,000	
	Trade receivables		Cr. Rs. 2,000

2.6

Learning Outcome/s: 2.6.2
Prepare a reconciliation of control account balances with a total of individual accounts.
Study text reference - Page 264-270

Correct trade receivable balance:

Total of individual trade receivable balances	Rs. 2,100,000
Discount allowed not entered in the sub-ledger	(Rs. 12,000)
Correct trade receivable control account balance	Rs. 2,088,000

2.7

Learning Outcome/s: 2.7.1
State the purpose and need for preparation of bank reconciliation statements.
Study text reference – page 246
An **error** made in recording the amount of the cheque received from a customer in the cash book. Accordingly the above error has led to a difference between the cash book balance and bank statement balance. The bank charges which were not recorded in the cash book. The company would get to know about the bank charges after checking the bank statement. Therefore, till then a a difference between the cash book balance and bank statement balance will appear due to the **omission/missing** of that transaction from the cash book. An unrealised cheque which was issued to a supplier by crediting the cash book. Accordingly the timing difference of the above mentioned transaction has caused a difference between the cash book balance and bank statement balance.

2.8

Learning Outcome/s: 4.7.2
Explain adjusting events and non-adjusting events.
Study text reference - Page 616 -618
Adjusting Events - Events that occur between the end of the reporting period and the date when the financial statements are authorized for issue and provide evidence of conditions that existed at the end of the reporting period. **Non Adjusting Events -** Events that occur between the end of the reporting period and the date when the financial statements are authorized for issue and are indicative of conditions that arose after the reporting period.

2.9

Learning Outcome/s: 4.6.5
Explain accounting estimates.
Study text reference -Page 606
• There should be a present obligation as a result of a past event. • It should be probable that a transfer of economic benefits will be required to settle the obligation. • Should be able to make a reliable estimate of the obligation.

2.10

Learning Outcome/s: 3.6.2
Compute basic accounting ratios (profitability ratios, liquidity ratios, gearing ratios excluding investor ratios).
Study text reference – Page 675-686
Ratio Computation • ROCE = $\frac{\text{PBIT} \quad *100}{\text{(Equity + Long Term Debt)}} = \frac{125{,}000*100}{625{,}000+75{,}000} = 17.86\%$ • Return on Equity= $\frac{\text{Net profit} \quad *100}{\text{Equity}} = \frac{77{,}250}{625{,}000}*100 = 12.36\%$ • Quick Ratio= $\frac{\text{Current Assets- Inventory}}{\text{Current Liabilities}} = \frac{375{,}000-125{,}000}{175{,}000} = 1.43$

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s: 2.2.2 and 2.5.2
2.2.2 Relate the connection between "dual aspect" of accounting and the accounting equation. 2.5.2 Prepare journal entries for correction of errors.
Study text reference – Page 90-101, 296-311

(a) **Impacts on accounting equation:**

	Non-current assets +	Current assets =	Equity +	Non-current Liabilities +	Current Liabilities
(i)	+ 800,000	- 200,000 =		+ 400,000	+ 200,000
(ii)	+ 1,400,000	=	+ 300,000	+ 1,100,000	
(iii)		+ 600,000 =	+ 60,000		+ 540,000

(1,100,000 can be recorded under current or non-current liabilities)

(b) **Journal entries to rectify the errors:**

		Dr	Cr
(i)	Trade receivables control account Dr.	Rs. 18,000	
	Sales account		Rs. 18,000
	(Being omitted sales now brought into account)		
(ii)	Cash at bank account Dr	Rs. 80,000	
	Trade receivable		Rs. 80,000
	(Being recording of direct receipt from a customer)		
	Showroom rent a/c Dr	Rs. 30,000	
	Cash at bank a/c		Rs. 30,000
	(Being recording of standing order payment of showroom rent)		
(iii)	Supplier - SP account Dr.	Rs. 80,000	
	Discount allowed account	Rs. 40,000	
	Discount received account	Rs. 40,000	
	(Being rectification of error in respect of discount received)		

Alternate answer for b (ii)

	Dr	Cr
Cash at bank a/c Dr.	Rs. 50,000	
Showroom rent a/c Dr.	Rs. 30,000	
Trade receivable a/c/Sakura		Rs. 80,000
(Being items omitted in bank/cash book now brought into accounts)		

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 3.3.2
Prepare the financial statements for a partnership including the appropriation accounts (simple financial statements for a partnership without change in the ownership during the period).
Study text reference – Page 352-360

(a)

Appropriation Account

		Amount (Rs.)
Amended Net Profit **(W1)**		980,000
Partners' salaries- - Sunil- 25,000*12 - Anil- 30,000*12	660,000	
Interest on Capital -Sunil-35,000 -Anil-21,000 -Vipul-14,000	70,000	(730,000)
Share of Profit		250,000
Sunil	125,000	
Anil	75,000	
Vipul	50,000	

W1: Amended Net Profit Calculation

	Rs.
Net Profit	972,500
Less: Interest Expense (250,000*12%)	(30,000)
Add; Insurance claim Receivables (50,000*75%)	37,500
Amended Net Profit	980,000

(b)

Partners' Current account

	Sunil (Rs.)	**Anil (Rs.)**	**Vipul (Rs.)**		**Sunil (Rs.)**	**Anil (Rs.)**	**Vipul (Rs.)**
Balance 01.01.2017	-	75,000	37,500	Balance 01.01.2017	125,000	-	-
Drawings	100,000	170,000	60,000	Loan interest	30,000	-	-
Profit guarantee	-	36,000	-	Salaries	300,000	360,000	
				Interest on capital	35,000	21,000	14,000
				Share of profit	125,000	75,000	50,000
Bal C/d	515,000	175,000	2,500	Profit guarantee			36,000
	615,000	**456,000**	**100,000**		**615,000**	**456,000**	**100,000**

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 3.5.2
Prepare financial statements from incomplete records.
Study text reference -Page 316-344

(i) **Income statement of Sarath's business for the quarter ended 31.12.2017**

	Rs	Rs
Sales (3,800 + 420)		4,220,000
Less: Cost of sales		
Opening inventory	nil	
Add: purchases **(W2)**	3,400,000	
Less: Closing inventory	(465,000)	2,935,000
Gross Profit		**1,285,000**
Less: Expenses		
Salaries 30,000 + 15,000 (proprietor)	(45,000)	
Rent 8,000 + 4,000 (accrued) + 12,000 (rent deposit)	(24,000)	
Depreciation 600,000 @ 20% * 3/12	(30,000)	
Bank charges	(2,000)	
Bad debt written off	(10,000)	
Other expenses 584,000 + 12,000 (proprietor)	(596,000)	(707,000)
Net Profit for the quarter		**578,000**

(ii) **Statement of financial position as at 31.12.2017**

	Rs.	Rs.
Non-current assets		
Office equipment 600,000 - 30,000 (depn)		570,000
Current assets		
Inventory	465,000	
Trade receivable **(W1)**	422,000	
Rent advance 48,000 – 12,000	36,000	
Advance paid for furniture	15,000	
Cash at bank 411,000 – 320,000	91,000	1,029,000
Total assets		**1,599,000**
Equity		
Proprietor's account:		
Initial Capital		900,000
Cash withdrawal	(290,000)	
Business expenses met 15,000 + 12,000	(27,000)	(263,000)
Net Profit for the quarter		578,000
		1,215,000
Current Liabilities		
Trade Payable		380,000
Accrued expenses - Rent		4,000
Total equity and liabilities		**1,599,000**

Workings:

(W1) Trade receivables control account

	Amount (Rs.)
Balance b/d	nil
Sales during the quarter	4,220,000
Cheque return	12,000
Receipts from customers	(3,800,000)
Bad debts written off	(10,000)
Balance c/d	**422,000**

(W2) Trade payable control account

	Amount (Rs.)
Balance b/d	nil
Purchases for the quarter	3,400,000
Amount paid to suppliers	(2,700,000)
Un-presented cheque	(320,000)
Balance c/d	**380,000**

(Total 10 marks)

Answer 06

Relevant Learning Outcome/s: 4.4.2
Prepare a cash flow statement under both direct method and indirect method.
Study text reference - Page 626-647

Sisil (Pvt) Ltd
Statement of cash flows for the year ended 31 December 2017

	Amount (Rs.)
Profit before tax	770,320
Depreciation	228,820
Interest received	(52,000)
Interest paid	29,850
(Increase)/ decrease in inventories	(451,000)
(Increase)/ decrease in trade receivables	173,280
Increase/ (decrease) in trade payables	(512,373)
Increase/ (decrease) in accrued expenses	(9,050)
Cash generated from operating activities	177,847
Interest received	52,000
Interest paid	(29,850)
Tax paid **(W1)**	(65,350)
Net cash generated from operating activities	134,647
Cash flows from investing activities	
Payment to acquire PPE	(138,850)
Investment made	(1,000,000)
Net cash flows from investing activities	(1,138,850)
Cash flows from financing activities	
Issue of shares	1,500,000
Loan repayment	(450,867)
Net cash flows from financing activities	1,049,133
Increase in cash and cash equivalents	44,930
Cash and cash equivalents at 1 January 2017	420,300
Cash and cash equivalents at 31 December 2017	465,230

W1	**Income Tax Payable Account**	**Amount (Rs.)**
	B/f	17,800
	Income tax provision	74,000
	Less: Income tax paid	(65,350)
	C/f	26,450

Note: can be classified under investing/financing activities as well

(Total: 10 marks)

Answer 07

Relevant Learning Outcome/s 3.2.3
Prepare financial statements for the purpose of management and publication.
Study text reference - Page 443-449, 462-465

(a) (i)

Enet PLC
Statement of comprehensive income for the year ended 31 December 2017

	Rs.'000	
Revenue	780,970	
Cost of sales	(591,436)	W1
Gross profit	**189,534**	
Other income	3,485	W2
Administration expenses(45,300+12,00+2,450)	(48,950)	
Distribution expenses	(10,970)	
Finance cost (4,302+514)	(4,816)	
Profit before tax	**128,283**	
Taxation (3,700+357 + 6,730)	(10,787)	
Profit after tax	**117,496**	

(ii)

Enet PLC
Statement of financial position as at 31 December 2017

	Rs. '000	
Non-current assets		
Property, plant and equipment	533,675	W6
Leased assets (2,400-2,400+4,626-1,156)	3,470	W4
	537,145	
Current assets		
Inventory	4,750	
Trade receivables	14,560	
Cash at bank	39,800	
	59,110	
Total assets	**596,255**	

	Rs. '000	
Equity and liabilities		
Equity		
Stated capital	200,000	
Retained earnings (191,132+4000+117,496)	312,628	
Revaluation reserve	33,500	
	546,128	
Non-current liabilities		
Deferred tax liability (24,300+357)	24,657	
Lease Creditor	1,951	
	26,608	
Current liabilities		
Trade payables	12,350	
Accrued expenses	3,650	
Income tax payable	6,730	
Lease Creditor	789	
	23,519	
Total equity and liabilities	**596,255**	

Working 1 - Cost of sales	
	Rs. '000
Opening inventory	5,600
Purchases	589,430
Less: Closing inventory	4,750
	590,280
Machinery Depreciation	1,156
	591,436

Working 2 - Disposal of property	
	Rs. '000
Sale proceeds received	65,000
Less: Carrying amount	
Revalued amount 31.12.2015	70,000
Accu. dep up to disposal	(8,485)
(70,000/16.5*2)	
Carrying value at 31.12.17	61,515
Profit from disposal	3,485

Working 3 - Deferred tax	
	Rs. '000
Accounting base	20,400
Tax base	19,125
(25,500/8*6)	
Temporary Difference	1,275
DT liability (1,275*28%)	357

Working 4 - Finance lease	Rs. '000
Total to be paid	6,000
Down payment	1,200
Balance to be paid	4,800
FV of the machinery	5,000
Lower	4,626
(Dr. Leased assets, Cr. Lease creditor)	
Down payment & 1st instalment payment	
(Dr. Lease creditor, Cr. Leased assets)	
Lease Creditor Closing Bal.	2,740
(4,626 - 2,400+514)	
Current (2,739.9-1,950.885)	789
Non-current	1,951
Depreciation	1,156
(4,626/4)	
(Dr. Cost of sales, Cr. Leased assets)	
Finance cost for the year	514

Working 5 - Interest Calculation				
Year	Opening Balance (Rs.)	15% Interest (Rs.)	Instalment Payment (Rs.)	Closing Balance (Rs.)
2017	3,426,000	513,900	(1,200,000)	2,739,900
2018	2,739,900	410,985	(1,200,000)	1,950,885

Working 6 - Property, Plant and Equipment				
	Cost as at 31 December 2017 Rs. '000	Accumulated Depreciation as at 31 December 2017 Rs. '000	Disposal (W2) Rs. '000	Written Down Value as at 31 December 2017 Rs. '000
Land	340,000	-		340,000
Building	102,560	34,260	(61,515)	6,785
Plant and machinery	144,330	25,780	-	118,550
Motor vehicle	120,680	52,340	-	68,340
				533,675

(Total 20 marks)

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