THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

March 2017

SECTION 01

Answer 01

1.1

Learning Outcome/s: 1.1.1 Identify the governance structure of business organisations.
Study text reference (Page 9/10)
Correct Answer: B

1.2

Learning Outcome/s: 1.1.2 Identify the role of accounting.
Study text reference (Page 04)
Correct Answer: D

1.3

Learning Outcome/s: 1.2.3 List the elements of financial statements.
Study text reference (Page 28)
Correct Answer : B

1.4

Learning Outcome/s: 1.2.8 Identify the role of CA Sri Lanka in financial reporting.
Study text reference (Page 52/53)
Correct Answer: C

1.5

Learning Outcome/s: 1.2.9 Discuss the fundamentals of both accrual basis and cash basis of accounting.
Study text reference (Page 56/57)
Correct Answer : B

1.6

Learning Outcome/s: 2.1.3 Identify the primary books used in accounting
Study text reference (Page 73)
Correct Answer : C

1.7

Learning Outcome/s: 2.2.2 Relate the connection between "dual aspect" of accounting and the accounting equation.
Study text reference (Page 90)
Correct Answer : A

1.8

Learning Outcome/s: 4.1.2 Discuss 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 : A

1.9

Learning Outcome/s: 4.5.1 Identify different types of inventory.
Study text reference (Page 494)
Correct Answer : D

1.10

Learning Outcome/s: 4.12.2 Define provisions, liabilities, contingent liabilities and contingent assets.
Study text reference (Page 606)
Correct Answer: D

(Total: 20 marks)

Answer 02

2.1

Learning Outcome/s: 2.3.2 Record transactions based on source documents.
Study text reference (Page 110)
Possible causes for a Credit note is: (Any one point) - Being value of goods returned - Being a special discount allowed - Being the cost of goods damaged on transit Creditor AA account Dr 12,500 Appropriate account Cr 12,500 (Appropriate account will be based on the answer for possible cause for credit note, the candidate writes)

2.2

Learning Outcome/s: 2.4.1 Identify the need for year-end adjustments on financial statements, such as accruals, closing stock, pre-payments, depreciation and bad debts.
Study text reference (Page 128)
(a) Profit for the year should be calculated by charging the expenses relating to that period. Accrued expenses should be charged against the profit for a particular period even though they have not yet been paid for. (b) Prepayments are made in one accounting period, but should not be charged against the profit unlit later period, because they relate to that later period. (c) Sales and the cost of goods sold in a particular period should be matched. Therefore, the purchase cost of goods unsold at the end of an accounting period should not be included in the cost of sales in that period.

2.3

Learning Outcome/s: 2.5.3 Solve omissions and errors embedded in accounting records and financial statements, using suspense accounts.
Study text reference (Page 299-306)

Opening Inventory adjustment	180,000	Trial balance difference		260,000
Discount allowed	40,000			
Discount received	40,000			
	260,000			260,000

2.4

Learning Outcome/s: 3.2.2

Prepare ledger accounts for the issue and redemption of shares and debentures.

Study text reference (Page 366)

(a) Total amount payable on redemption:

Debenture value	1,000,000
Premium on redemption @ 5%	50,000
Accrued Interest for 3 months	30,000
Total amount payable	1,080,000

(b) Journal entry:

Debenture account	Dr	1,000,000	
Premium on redemption	Dr	50,000	
Interest account	Dr	30,000	
Cash account	Cr		1,080,000

(Entries for redemption of debentures)

2.5

Learning Outcome/s 3.2.4

Explain the concepts and principles surrounding consolidation of financial statements.

Study text reference (Page 466/473)

(a)

- Consolidated financial statements are important because the users of the parent's financial statement need to know about the financial position, results of operations and changes in financial position of the group as a whole.
- As required by SLFRS 10
- As a legal requirement

(b)

- There may be some difficulties in defining the group or 'entity' of companies.
- Where a group consists of widely diverse companies in different lines of business, a set of consolidated financial statements may obscure important details unless supplementary information about every segment of the group business is provided.
- Consolidated financial statements may be misleading
  - (i) The solvency (liquidity) of one company may hide the insolvency of another.
  - (ii) The profit of one company may conceal the losses of another.
  - *(iii)* They imply that group companies will meet each other's debts (this is certainly not true: a parent company may watch creditors of an insolvent subsidiary go unpaid without having to step in).

2.6

Learning Outcome/s: 4.8.3 Explain the conditions to be satisfied to recognise a lease as a finance lease.
Study text reference (Page 533)
1. By the end of the lease term, the terms of the lease agreement mean that the lessee will legally own the asset. 2. The lessee can purchase the asset at a less-than-market price during or at the end of the lease term. 3. The lease term is for the majority of the useful life of the asset 4. At the inception of the lease, the present value of the minimum lease payments is approximately equal to the fair value of the leased asset. 5. The leased asset is so specialised that only the lessee can use it without major modification.

2.7

Learning Outcome/s: 4.9.5 Define tax base.
Study text reference (554-556)
a. Tax base is Rs. 25,000. No temporary difference. b. Tax base is Rs. 500,000. No temporary difference. **c.** The tax base is nil. The temporary difference is Rs. 7,000.

2.8

Learning Outcome/s: 4.10.2 Explain the difference between defined contribution plan and defined benefit plans.
Study text reference (Page 579-580)
In a defined contribution plan, the employer pays a regular defined amount as contributions into the plan each year. The contributions are invested and the size of the post-employment benefit paid to the employees depends on how the investments perform. Under defined benefit plan, the size of the post-employment benefit is determined in advance. If the employer’s contribution is not adequate to earn expected return to pay the defined post-employment benefits, the employer will be required to pay additional contributions to meet the shortfall. Accordingly the main difference is the nature of the promise.

2.9

Learning Outcome/s: 4.11.2 Explain initial and subsequent measurement of financial assets and liabilities.
Study text reference (Page 593/595)
a. Amortised cost b. Fair value through OCI c. Amortised cost

2.10

Learning Outcome/s:. 4.13.2 Identify entities that can follow SLFRS for SMEs.
Study text reference (Page 657)
Cost effectiveness in respect of financial reporting Relief from complex adjustments Simplified disclosure requirement

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s: 2.5.1 Identify omissions and errors in accounting. 2.7.2 Prepare a reconciliation statement reconciling the cash book balance with the bank statement balance.
Study text reference (page 246, 296)

Suggested detailed answer

(a)

Bank reconciliation statement for the month of December 2016:

Balance as per bank statement	911,000
Add: Un-realised deposits	485,000
Less: Un-presented cheques	(425,000)
Balance as per cash book	971,000

(b) **Adjusted cash book:**

Balance b/d	580, 000		
Direct deposit by Cyril	25,500	Bank charges	2,500
		Dishonored cheque	120,000
Bank Deposit	500,000	Standing order payment	12,000
		Balance c/d	971,000
	1,105,500		1,105,500

(c)

Bank account	Dr	500,000	
Capital account	Cr		500,000

(Deposit made to open a bank account)

Rent account	Dr	12,000	
Bank account	Cr		12,000

(payment for rent)

Bank account	Dr	25,500	
Customer – Cyril account	Cr		25,500

(cash received from a customer)

Customer – Rony account	Dr	120,000	
Bank account	Cr		120,000

(cheque received and deposited in a bank account dishonored)

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 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).
Study text reference (Page 352)

Suggested detail answer

Computation of the net profit available for appropriation	
	Rs.
Draft Profit	900,000
Less: Loan interest (200,000*13%*6/12)	13,000
Allowance for doubtful debts	75,000
	812,000

Appropriation account for the year ended 31 December 2016		**Rs.**
Net profit available for appropriation		**812,000**
Less: Partners' salaries		
Amal (30,000*12)	360,000	
Kamal (20,000*12}	240,000	(600,000)
Less: Interest on capital		
(100,000*10%) Amal	10,000	
(80,000*10%) Kamal	8,000	
(50,000*10%) Ranil	5,000	(23,000)
		189,000
Share of profit (balance)		
Amal		94,500
Kamal		63,000
Ranil		31,500
		189,000

Current account

	Amal	Kamal	Ranil		Amal	Kamal	Ranil
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
Balance B/F		7,500		Balance B/F	10,000		11,000
Drawings		10,000	25,000	Loan interest	13,000		
Computer			120,000	Partners' salaries	360,000	240,000	
				Interest on capital	10,000	8,000	5,000
				Share of profit	94,500	63,000	31,500
Balance c/d	487,500	293,500		Balance c/d			97,500
	487,500	311,000	145,000		487,500	311,000	145,000
Balance c/f			97,500	Balance c/f	487,500	293,500	

(Total: 10 marks)

Answer 05

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

(a)

Harsha Traders				
Statement of profit or loss				
For the year ended 31 December 2016				
			Rs.	
Revenue	W1		1,175,440	***Ref W1***
Opening Inventory		42,500		***1***
Purchases	W2	629,100		***Ref W2***
		671,600		
Less: Closing Inventory		33,100		
			(638,500)	
Gross Profit			536,940	
Rent	W3	42,600		
Depreciation (150,000/4)		37,500		
Electricity	W4	1,750		
Wages		5,400		
Insurance		50,500		
Stationery		12,000	(149,750)	
Profit for the year			387,190	

(b)

Harsha Traders			
Statement of Financial Position as at 31 December 2016			
		Rs.	
Assets			
Non-Current Assets			
Motor Bike (150,000-37,500)		112,500	
Current Assets			
Inventory		33,100	
Trade receivables		625,800	
Pre-paid rent		4,200	
Cash at Bank		196,600	
		859,700	
Total Assets		972,200	
Capital and Liabilities			
Capital account 1.1.2016	W5	459,310	***Ref W5***
Profit for the year		387,190	
Drawings		(2,000)	
		844,500	
Current Liabilities			
Trade payables		125,400	
Electricity payables		2,300	
		127,700	
Total capital & liabilities		972,200	

(Total: 10 marks)

Working 1 - Sales	**Rs.**
Cash received from customers	950,000
Add: Trade receivable as at 31.12.2016	625,800
	1,575,800
Less: Trade receivable as at 31.12.2015	500,360
Credit Sales for the year	1,075,440
Cash sales	100,000
	1,175,440

Working 2 – Purchases

	Rs.
Payment to suppliers	600,000
Add: Trade payable as at 31.12.2016	125,400
	725,400
Less: Trade payable as at 31.12.2015	96,300
Purchases for the year	629,100

Working 3 - Rent

	Rs.
Rent paid	42,000
Pre-paid rent as at 31.12.2015	4,800
	46,800
Pre-paid rent as at 31.12.2016	(4,200)
	42,600

Working 3 - Electricity

	Rs.
Electricity paid	1,300
Payable as at 31.12.2016	2,300
	3,600
Payable as at 31.12.2015	(1,850)
	1,750

Working 5- Opening Capital

	Rs.
Assets	
Inventory (44 500 - 2,000)	42,500
Bank Balance	9,800
Trade receivables	500,360
pre-paid rent	4,800
	557,460
Liabilities	
Trade payables	(96,300)
Electricity payable	(1,850)
	98,150
	459,310

Answer 06

Relevant Learning Outcome/s
3.6.2 Compute basic accounting ratios (profitability ratios, liquidity ratios, gearing ratios excluding investor ratios). 4.4.2 Prepare a cash flow statement under both direct method and indirect method.
Study text reference (Page 675/677)

Suggested detailed answer

Super-moon (Pvt) Ltd

(a) <u>**Ratios**</u>

(i) GP ratio = (Gross Profit / Sales) * 100
= (2,500,000/6,500,000) * 100 = 38.46 %

(ii) Inventory turnover period = (Ave. Inventory / Cost of sales) * 365
= (670,000/4,000,000) * 365 = 61 days

(iii) Average trade collection period = (Ave trade receivable / credit sales) * 365
= (350,000/4,200,000) * 365 = 30.4 days

(iv) Interest cover =profit before interest and tax / interest charge
= [(1,020,000 + 280,000) / 280,000 = 4.6 times

(v) ROCE = (PBIT / Ave capital employed) * 100
= [(1,020,000 + 280,000) / 2,500,000] * 100 = 52 %

(b) **Cash-flow from operating activities:**

Net profit before tax	1,020,000
Add: Financial charges	280,000
Depreciation charges	380,000
change *in working capital:*	
Increase in inventory	(260,000)
Increase in trade receivables	(60,000)
Increase in trade payables	40,000
Less: Income tax paid	<u>(203,000)</u>
Cash-flow from operating activities	<u>**1,197,000**</u>

(Total: 10 marks)

SECTION 3

Answer 07

Relevant Learning Outcome/s 3.2.3 Prepare financial statements for the purpose of management and publication.
Study text reference (Page 427 -475)

Suggested detail answer

(a)

Nectar PLC Statement of Comprehensive Income for the year ended 31 December 2016			
		Rs. '000	
Revenue	**W1**	1,556,750	
Cost of Sales	**W2**	(1,109,415)	**Ref W2**
Gross profit		447,335	
Administrative expenses	**W5**	(150,798)	**Ref W5**
Distribution expenses	**W6**	(96,148)	
Finance expenses	**W7**	(7,900)	
Profit before tax		192,489	
Income tax	**W10**	(152)	**Ref W10**
Profit for the year		**192,337**	
Total Comprehensive Income		**192,337**	

(b)

Nectar PLC **Statement of Changes in Equity for the year ended 31 December 2016**			
	Stated Capital **Rs. '000**	Retained Earnings **Rs. '000**	Total **Rs. '000**
As at 1.1.2016	50,000	435,432	485,432
Profit for the year		192,337	192,337
As at 31.12.2016	50,000	627,769	677,769

(c)

Nectar PLC			
Statement of Financial Position			
as at 31 December 2016			
		Rs. '000	
Non-Current Assets			
Property, plant and equipment	PPE note	644,120	
Current Assets			
Inventories		65,532	
Trade receivables	W4	96,102	**Ref W4**
Prepayments		6,500	
Cash and cash equivalent		16,300	
		184,434	
Total Assets		**828,554**	
Equity and liabilities			
Equity			
Stated Capital		50,000	
Retained earnings		627,769	
		677,769	
Non-current liabilities			
Interest bearing loans and borrowings	W8	50,000	
		50,000	
Current liabilities			
Trade payables		82,400	
Interest bearing loans and borrowings	W8	10,000	
Income tax payable	W10	150	
Loan interest payable		600	
Accrued expenses	W9	7,635	**Ref W9**
		100,785	
Total equity and liabilities		**828,554**	

(d)

Note: Property, plant and equipment					
	Rs. '000				
	Land	Building	Machinery	Furniture and fittings	**Total**
Cost					
as at 1.1.2016	300,000	213,500	152,585	9,275	**675,360**
Additions			29,181		**29,181**
as at 31.12.2016	300,000	213,500	**(W3)** 181,766	9,275	**704,541**
Accumulated Depreciation					
as at 1.1.2016	-	14,110	21,320	2,115	**37,545**
Depreciation for the year	-	4,270	**(W3)** 17,447	1,159	**22,876**
as at 31.12.2016	-	18,380	38,767	3,274	**60,421**
Net Book Value	**300,000**	**195,120**	**142,999**	**6,001**	**644,120**

(Total: 10 marks)

Working 1 – Revenue

A sale should never be recognised when the customer places an order even if it is virtually certain that goods will be sold.
Therefore;

Sales Dr 750,000
Trade receivables Cr 750,000

Working 2 -Cost of sales

	Rs. '000
Opening inventory	45,000
Purchases	1,112,500
Closing inventory	(65,532)
	1,091,968
Machinery Depreciation	17,447
	1,109,415

Working 3 -Depreciation

Staff training cost cannot be capitalised. Therefore;

Expenses	Dr.	34,000
Machinery	Cr	34,000

Machinery depreciation	Rs. '000				
As per TB	181,800				
JE	(34)				
	181,766				
Addition during the year	(29,181)	10%	2,918	for 9 months	2,189
opening balance	152,585	10%	15,259		15,259
					17,447

Working 4- Allowance for doubtful debts

	Rs.'000
Trade receivables as per TB	102,000
JE	(750)
Written off	(90)
	101,160
Allowance 5%	5,058
allowance as per TB	(1,000)
for the year	4,058
Net Trade receivables (101,160-5,058)	96,102

Working 5

	Rs.'000
Administrative expenses	
As per TB	145,200
Staff training	34
Depreciation	5,429
Electricity and water	135
	150,798

Working 6

Distribution expenses	Rs.'000
As per TB	92,000
Bad and doubtful debts (90+4,058)	4,148
	96,148

Working 7

Finance expenses	Rs.'000
As per TB	7,300
Loan interest (60,000*12%*1/12)	600
	7,900

Working 8

Bank loan	Rs.'000
Payable within one year	10,000
Payable after one year	50,000

Working 9

Accrued expenses	Rs.'000
As per TB	7500
Electricity	120
Water	15
	7,635

Working 10 –Income Tax

Income tax liability account (Rs.'000)

Cash	27,000	Balance b/d	25,000
Bal c/d	150,000	P/L	152,000
	177,000		177,000

Under provision for prior year (27,000-25,000)	2,000
Provision for current year	150,000
	152,000

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