THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

No of pages: 21

Executive Level

Financial Accounting & Reporting Fundamentals

(Pilot Paper)

<u>Instructions to candidates</u>

(1) Time allowed: Reading and planning – 20 minutes
Writing – 3 hours

(2) Section 1(a): 10 multiple choice questions (MCQs) – **all questions are compulsory**

Section 1(b): 10 sub-questions – **all questions are compulsory**

Section 2: 4 questions – **answer any 3 questions**

Section 3: 1 question - **compulsory**

(3) Answers to Section 1(a) should be in the special paper given to you. The most suitable answer (A, B, C or D) should be entered in the paper against the relevant question number.

Answers to questions in all other sections should be in the answer booklet given to you.

(4) Begin each answer in Section 2 and Section 3 on a separate page in the answer booklet.

(5) All answers should be in **one language** and in the **medium applied for**.

K E 1

SECTION 1

All questions are compulsory. *Total marks for Section 1 is 50 marks.* *Recommended time for the section is 90 minutes.*

Question 01

1(a): You are required to choose the most appropriate answer. **(Total 20 marks)**

1.1. With reference to the Conceptual Framework for Financial Reporting, which of the following qualitative characteristics of financial information falls into the category of "Fundamental" and "Enhancing"?

i. Materiality
ii. Verifiability
iii. Understandability
iv. Faithful Representation

	Fundamental	Enhancing
A.	i, ii	iii , iv
B.	i	ii, iii, iv
C.	i , iv	ii, iii
D.	i, ii, iii	iv

(2 marks)

1.2. Which of the following can be regarded as a governance principle of a business?

A. The majority of the board of directors should be non-executive
B. CEO should not hold any shares of the company thereby he/she can use his/her expertise effectively to run the business
C. Chairman of the board should be a major shareholder of the company to protect the interest of the shareholders
D. Both offices of CEO and the chairman should be held by one person as it allows fast and efficient decision making

(2 marks)

1.3. Which of the following entities falls into Small and Medium Sized entities (SMEs)?

A. An entity that does not have public accountability
B. An entity listed on a stock exchange listed under the Securities and Exchange Commission Act No. 36 of 1987
C. An entity in which the equity instruments are traded in the public market
D. A fund management company

(2 marks)

1.4. Which of the following items **cannot** be considered as a short term employees benefit?

A. Wages, salaries, EPF and ETF
B. Payment of annual and sick leave
C. Payment of gratuity
D. Profit sharing and bonuses

(2 marks)

1.5. Which of the following items is **not** considered a financial asset of a company?

A. Cash
B. Treasury bills
C. Shares issued by the company
D. Equity instruments of another company

(2 marks)

1.6. Which of the following transactions would be presented in a statement of cash flows according to LKAS 07: Statement of Cash Flows?

i. Conversion of debt into equity
ii. Loan interest received
iii. Issue of bonus shares
iv. Proceeds of loan issue

A. i & ii
B. i & iii
C. ii & iv
D. i & iv

(2 marks)

1.7. According to LKAS 08: Accounting Policies, Changes in Accounting Estimates and Errors, which of the following statements best describe “prospective application"?

i. Recognising a change in accounting estimate in the current and future periods affected by the change
ii. Correcting the financial statements as if a prior period error had never occurred
iii. Appling a new accounting policy to transactions occurring after the date at which the policy changed
iv. Applying a new accounting policy to transactions as if that policy had always been applied

A. i & ii
B. i & iii
C. ii & iv
D. i & iv

(2 marks)

1.8. The bank statement of an entity as at 31st March 2014 shows a debit balance (overdraft) of Rs. 25,000. The following information was revealed after checking the bank statement and books of accounts.

- Un-realized cheques as at 28th February 2014 was Rs. 19,000 and of which only Rs. 15,000 had been realized during March 2014
- Un-presented cheques for payment as at 28th February 2014 was Rs. 35,000 and of which only Rs. 25,000 had been paid for during March 2014
- Cheques issued during the month of March amounting to Rs. 11,000 were not presented to the bank
- Bank charges which appeared in the bank statement for the month of March was Rs. 2,000

What is the carrying amount of the Bank Balance to be shown in the statement of financial position as at 31st March 2014?

A. An overdraft of Rs. 12,000
B. An overdraft of Rs. 42,000
C. A credit balance of Rs. 2,000
D. A credit balance of Rs. 25,000

(2 marks)

1.9. What is the Return on Equity (ROE) of an entity based on the following information?

- Gross Profit Margin – 30%
- All expenses (except cost of sales and income tax) to Revenue - 12%
- Income Tax to Revenue – 9%
- Asset Turnover ratio - 3 times

A. 3%
B. 10%
C. 18%
D. 27%

(2 marks)

1.10. Which of the following is **true** with respect to the concept of Going Concern?

A. A public company has a longer foreseeable future life compared to a partnership business
B. Financial statements are prepared on the assumption that the entity will last for a foreseeable future period
C. Going concern of an entity is determined on the basis of assets which are intended to be used for a longer period of time
D. Financial statements should be prepared based on the fact that the entity has been conducting its business continuously.

(2 marks)

1(b): You are required to write short answers to all the questions with attention given to action verbs.

(Total 30 marks)

1.11. The opening balances of Property, Plant & Equipment (PPE) and provision for depreciation were Rs. 4,690,000 and Rs. 2,480,000 respectively. The closing balances were Rs. 8,569,000 and Rs. 3,123,000 respectively. Depreciation expense for year was Rs. 988,400 and Rs. 543,000 has been recognized as profit on sale of PPE during the year. It was further reported that an item of PPE with a book value of Rs. 432,000 at the time of sale has been disposed during the year.

Required:

Compute three (03) cash flow items to be shown in the Statement of Cash Flows for the year.

(3 marks)

1.12. Mint Limited has imported a new moulding machine from China. The estimated useful life of the machine is 15 years. The first reporting period of the company is 2013/2014. The following cost were incurred during the year 2013/2014.

Cost items	**Rs.**
Amount paid through the bank represents Cost of machine, Freight and Insurance	9,453,500
Taxes and clearing charges (including refundable VAT Rs. 300,600)	2,476,800
Transportation cost to proposed factory	345,000
Installation, including site preparation	245,000
Cost incurred on the test run prior to use	117,600
Sale proceeds of output of test production	19,000
Estimated cost of dismantling	154,000
Expenses incurred for opening ceremony	96,000
Estimated cost of the first order	342,000
Estimated residual value	172,300
The date which new machine ready for the usage	15/08/2013
The date which commercial production commenced	01/10/2013

Required:

Compute the depreciation charge for the year 2013/2014.

(3 marks)

1.13. As per the standard LKAS 10: Events after the Reporting Period. There are two kinds of events; Adjusting and Non Adjusting Events.

Required:

Explain Adjusting and Non Adjusting Events described in LKAS 10, using an example for each category.

(3 marks)

1.14. There are various kinds of accounting packages used in financial accounting, where the General Ledger Module is a common module in accounting software packages.

Required:

List three (03) other modules that can be operated on standalone basis or integrated basis in accounting packages.

(3 marks)

1.15. Debtors sub ledger total of an entity as at 31st March 2014 was Rs. 200,000 which was not agreed with a balance of debtors control accounts. A further investigation of the information revealed the following.

- Discount allowed amounting to Rs. 5,000 had been omitted from the discount received journal when recording where as the correct amount was recorded in the sub ledger.
- Goods returned by debtors amounting to Rs. 14,000 were not recorded in the sub ledger whereas it was properly posted to the general ledger.
- A sales invoice of Rs. 25,000 had been recorded twice in the Sales Journal while recording correctly in the sub ledger.

Required:

Prepare the relevant general journal entries with reference to the above information

(3 marks)

1.16. Every parent company should prepare consolidated financial statements incorporating all of its subsidiaries as per the provisions made by the Companies Act No. 07 of 2007.

Required:

State three (03) circumstances under which the parent company will deemed to have the control over other entities to prepare consolidated financial statements as stated in the Companies Act No. 07 of 2007.

(3 marks)

1.17. According to LKAS 18: Revenue, certain criteria need to be satisfied in order to recognise revenue in the financial statements for a particular period. Given below are some revenue items:

- Money received from a client on the promise that goods will be delivered in May 2014
- Rs. 2,000 the relevant amount of dividend declared by a company in which the entity has invested on 15 April 2014
- Interest receivable of Rs. 12,000 on a fixed deposit made at a bank for 12 months ending 30 June 2014

Required:

Explain with reason whether the above revenue items should be recognised by the entity for year ended 31st March 2014 using the following format.

Item	**Recognised? (Yes) / (No)**	**Reason**
Money received from a client		
Dividend		
Interest		

(3 marks)

1.18. The following information is available with respect to a furniture manufacturing company

Item	**Cost (Rs.)**	**Selling price (Rs.)**	**Costs to sell (Rs.)**
Timber	1,500,000	2,000,000	250,000
Partly completed Furniture	450,000	550,000	120,000
Completed Furniture	1,500,000	3,000,000	500,000

Identify the above inventory items according to the three categories of inventory as per the requirements of LKAS 02: Inventories with respective carrying amounts using the following format.

Inventory Type	Carrying Amount (Rs.)

(3 marks)

1.19. Chartered Accountants have an obligation to maintain the highest standards of conduct and integrity. Ethics play a vital role in today's business context especially in financial statement preparation and presentation.

(i) After reviewing the draft accounts you were asked by your superior to enhance the closing stock value by Rs. 2 million to improve the bottom line of the company.

(ii) Marketing Manager has given instructions to the accounting staff not to incorporate provision for bad debts as such provisions will affect the computation of their incentives.

(iii) You were instructed by the Managing Director to transfer his personal expenses (paid by the company) to company's sundry expenses.

Required:

State whether the above mentioned suggestions are ethically correct or wrong.

(3 marks)

1.20. A company made a taxable profit of Rs. 8,250,000 for the year ended 31st March 2014. The company's tax rate is 28%. The carrying value of Property, Plant and Equipment was Rs. 3,500,000 and the tax base of Property, Plant and Equipment was Rs. 2,100,000 as at the date of the reporting period. The Deferred Tax Liability balance as at 01st April 2013 was Rs. 265,000.

Required:

Compute the tax expense for the year ending 31st March 2014.

(3 marks)

SECTION 2

Three out of the four questions should be answered. *Total marks for Section 2 is 30 marks.* *Recommended time for the section is 54 minutes.*

Question 02

2.1. Kamal, Lalith and Maali carryout a partnership business by sharing profits in the ratio of 2:2:1 respectively. Draft financial statements which are not in accordance with the provisions in the partnership agreement are given below together with some additional information.

Income Statement for the year ended 31st March 2014	
	Rs.
Revenue	2,000,000
Cost of Sales	(1,200,000)
Gross Profit	800,000
Administrative Expenses	(250,000)
Selling and Distribution Costs	(190,000)
Finance cost	(30,000)
Profit for the year	330,000
Distribution of profit	
Kamal	110,000
Lalith	110,000
Maali	110,000

Statement of Financial Position as at 31st March 2014	
Non Current Assets	**Rs.**
Property, Plant and Equipment	470,000
Current Assets	
Inventory	125,000

Accounts Receivable	80,000
Cash	25,000
Total Current Asset	230,000
Total Assets	**700,000**
Equity	
Partners Capital Accounts	
Kamal	80,000
Lalith	60,000
Maali	60,000
Partners Current Accounts	
Kamal	120,000
Lalith	80,000
Maali	(20,000)
Loan	300,000
Current Liabilities	
Accounts Payables	12,000
Accruals	8,000
Total Equity and Liabilities	**700,000**

Partnership agreement includes the following:

- Profits / losses should be shared among Kamal, Lalith and Maali in the ratio of 2:2:1 respectively
- 25% annual interest should be paid to partners on capital balances
- Annual salary of Rs. 100,000 should be paid to Maali
- Partners are entitled to take goods for their personal use from the partnership at cost

Additional information:

- The interest / finance cost shown was the amount paid for the period from 01st April 2013 to 30th September 2013.
- Kamal had taken inventories worth of Rs. 30,000 from the business
- Rs. 55,000 should be provided for utility charges up to 31st March 2014

- Depreciation of Rs. 15,000 on Motor Vehicles which are used for distribution activities to be provided.
- Rent advance of Rs. 40,000 paid on the building rented out for the office had been recognized as an expense for the period.

Required:

1. **Prepare** Partners Current Accounts starting with the balances as given in the draft Statement of Financial Position.

   (4 marks)
2. **Prepare** the Statement of financial position as at 31st March 2014.

   (4 marks)

2.2. "Comparability" is an important characteristic of financial statements.

Required:

State two (02) methods adopted in the preparation of financial statements to facilitate comparability.

(2 marks)

(Total 10 marks)

Question 03

The following information of "PQR Manufacturers" for the year ended 31st March 2014 is given.

Item	**Rs. '000**
Machinery at cost	1500
Buildings at cost	2000
Raw material stock as at 01/04/2013	500
Work in Process as at 01/04/2013	200
Finished goods as at 01/04/2013 (at transfer price)	330
Prepaid insurance	25
Accrued electricity as at 01/04/2013	40
Sales	7950
Insurance premium paid	70
Electricity expense paid	90
Purchases of raw materials	2100
Raw materials returns outward	60
Finished goods returns inward	20
Water expense	80
Telephone charges	150
Salaries - factory	900
Direct labour	590
Production accessories	374

Additional information

- Depreciation is provided on straight line method as follows.

	Useful life (years)	**Residual value (Rs.)**	**Date of acquisition**
Machinery	5	200,000	01.04.2011
Buildings	20	400,000	01.04.2010

- 3/4 of the building is used for the factory.

- The following proportions of expenses are applicable for the factory.

Electricity	90%
Water	90%
Insurance	60%
Telephone	10%

- Accrued and prepaid expenses as at 31st March 2014 were as follows.

Expense	**Accrued (Rs.)**	**Prepaid (Rs.)**
Electricity	80,000	
Insurance		25,000

- Factory salaries is the net amount after deducting 10% for EPF.

- Unused production accessories at the year-end amounted to Rs. 130,000

- A raw material stock with a cost of Rs. 40,000 was completely damaged during the year. The insurer had approved Rs. 30,000 on this claim.

- The cost of raw materials, work in progress and finished goods (at transfer price) as at 31st March 2014 were Rs. 200,000, Rs. 160,000 and Rs. 440,000 respectively.

- A minimum royalty fee of Rs. 100,000 should be paid for the license obtained to enhance product features. An extra payment of Rs.10 each per unit is paid on the excess production over 5,000 units. During the year, the company manufactured 6000 units.

- Finished goods are transferred to stores with a profit margin of 10 % on cost.

Required:

1. **Prepare** the manufacturing account for the year ended 31 March 2014.
(5 marks)
2. **Calculate** the gross profit for the year ended 31 March 2014.
(3 marks)
3. **Explain** why finance lease should be recognized as an asset in the books of lessee even though the lessee does not have any legal ownership of the asset.
(2 marks)

(Total 10 marks)

Question 04

4.1. The draft profit for the year ended 31st March 2014 was Rs. 400,000, but when the financial statements were prepared even the trial balance did not tally. The difference was then transferred to a suspense account. Subsequently, the following information was revealed:

- A sales invoice for Rs. 50,000 was not posted to the debtors control account while the sales account was correctly credited
- Cash collection from debtors amounting to Rs. 150,000 was debited to the creditors account
- Discount received amounting to Rs. 20,000 had been recognized as discount allowed
- The opening balance of creditors control account amounting to Rs. 540,000 was recorded as Rs. 450,000
- Bad Debts written off amounting to Rs. 25,000 had been posted to staff loan account while itwas correctly posted to the debtors control account.
- A credit note issued by the entity for Rs. 16,500 has been omitted from the books of account.

Required:

1. **Prepare** the suspense account **(4 marks)**

2. **Compute** correct profit for the year. **(2 marks)**

4.2. The following information relates to a trade union which consists of 6,000 employees as at 31st March 2014. Annual subscription of a member is Rs. 100. The trade union recognizes the subscription on accrual basis. However, the entity ceases to recognize subscription of a member in to revenue whose subscription are arrears for more than 2 years.

- Total membership fees collected during the year ended 31st March 2014 was Rs. 520,000.
- The arrears of subscription as at 31.03. 2013 were as follows.

No of members	Years
1000	For 2 years
50	For 1 year

- 15 members whose subscriptions were in arrears for 2 years as 31.03.2013 did not pay the subscription during the year ended 31.03.2014. The rest paid the arrears for the two years but the subscription for the current year is in arrears.

- During the current year new 50 members took the membership and they paid the subscription for one year in advance as well
- 400 members had paid the subscription in advance as at 31.03. 2013 and of them 200 paid the subscription in advance as at 31.03.2014 as well.
- 10 members whose subscriptions were in arrears at 01.04.2013 left the union without paying the arrears.

Required:

Prepare the subscription account of the trade union for the year ended 31st March 2014.

(4 marks)
(Total 10 marks)

Question 05

SQ Brothers commenced its business on 01/04/2012 as a sole proprietorship by investing Rs. 400,000. SQ Brothers did not maintained proper books of accounts based on the double entry system. However, the following information for the year ended 31st March 2014 was made available.

- All the cash sales are entered in a day book and it totaled to Rs.500,000 for the year.
- The total of credit sales invoices amounted to Rs. 800,000.
- Debtors, creditors, cash balances, inventory, unrealized cheques and un-presented cheques and bank charges were as follows.

	As at 01/04/2013 (Rs.)	**As at 31/03/2014 (Rs.)**
Cash in hand	20,000	37,000
Balance as per bank statement	50,000	35,000
Un-realized cheques	0	15,000
Un-presented cheques	0	35,000
Debtors	110,000	?
Creditors	0	?
Inventory	45,000	100,000

- Cash discount received and allowed amounted to Rs. 5,000 and Rs. 14,000 respectively.
- The cost of equipment which had been acquired at the commencement of the business was Rs. 300,000. This type of equipment is depreciated by similar businesses at 20% per annum on cost. Subsequently another equipment was acquired on 30 March 2014 for Rs. 125,000.
- SQ brothers maintains a steady gross profit margin of 40% on sales.
- Cash purchases amounted to Rs. 500,000.
- Payments made to creditors was Rs. 285,000.
- Cash collected from debtors was Rs. 745,000.
- The owner had taken Rs. 70,000 from the collections for his personal use.
- Utility bills to be paid as of 31 March 2014 amounted to Rs. 38,000.
- Assume that the entity did not have any other assets or liabilities other than those arising from the given information.

Required:

1. **Prepare** the Income Statement of SQ Brothers for the year ended 31st March 2014

(5 marks)

2. **Prepare the** Statement of Financial Position of SQ brothers as at 31st March 2014

(5 marks)

(Total 10 marks)

SECTION 3

Compulsory question.
Total marks for Section 3 is 20 marks.
Recommended time for the section is 36 minutes.

Question 06

The trial balance of ABC Ltd as at 31 March 2014 was prepared by the book keeper of the company is given below.

Trial Balance as at 31st March 2014		
	Rs. '000	**Rs. '000**
Land and Buildings	4,200	
Motor vehicles	1,800	
Accumulated Depreciation - Buildings		244
Accumulated Depreciation - Motor Vehicles		720
Income Tax Paid	260	
Accounts Receivable	428	
Provision for Doubtful debts		12
Prepaid Insurance as at 01.04.2013	56	
Cash at bank	60	
Treasury Bills	96	
Accounts Payable		150
Dividends Paid	200	
Profit for the year		1,775
Income tax payable as at 01.04.2013		160
EPF Payable as at 01.04.2013		75
EFT Payable as at 01.04.2013		9
Other Accruals as at 01.04.2013		360
12 % Debentures		300
Capital		2,000
Retained Earnings as at 01.04.2013		1,295
	7,100	7,100

Additional information:

- Land and Buildings were revalued on 1 April 2013 at the following amounts Land: Rs. 4 million and Buildings: Rs. 1.4 million.

  The carrying amounts of land and buildings as at 01/04/2013 comprised of as follows.

	Cost (Rs.)	**Accumulated depreciation (Rs.)**	**Carrying amount (Rs.)**
Land	2,000,000	-	2,000,000
Buildings	2,200,000	200,000	2,000,000

  The remaining life time of the Building as determined by the valuer was only 40 years from 1 April 2013. The adjustments arising from the revaluation had not been taken into account and the depreciation on buildings for the year was provided for on cost.

- Depreciation for motor vehicles was provided for at 20% on cost for the year. However the remaining useful life of motor vehicles was estimated to be 1 year from 31.3.2014 with a residual value of Rs. 200,000.

- Accruals as at 31.3.2014 were as follows

	(Rs. '000)
EPF	100
ETF	12
Other Expenses	300

- Debenture interest is payable bi-annually on 30^{th} September and 31^{st} March. Interest for the 2^{nd} six months period has not been paid or provided for.

- The cost and the net realisable value of inventory as at 31^{st} March 2014 were Rs. 400,000 and Rs. 350,000 respectively.

- It was decided to write off of Rs. 28,000 from debtors. The company provides 2% for bad and doubtful debts on the debtors' balance at the end of each year.

- Prepaid insurance as at 31^{st} March 2014 was Rs. 60,000.

- Sales revenue includes an advance received from a customer amounting to Rs. 100,000 to sell goods in May 2014.

- Income tax for the year has been estimated as Rs. 384,000. Tax paid during the reporting period included Rs. 126,000 as the final tax payment for the year of assessment 2012/2013.

- In order to calculate the Net Profit shown in the trial balance the following amounts have been considered.

  Sales Rs. 16,250,000, cost of sales Rs. 7,432,000, other income Rs. 130,000, distribution cost Rs. 3,696,000, administration cost Rs. 2,451,000, finance charges Rs. 672,000 and other costs Rs. 354,000. These all items are subject to any required adjustments given above.

Required:

1. **Prepare** the Statement of Comprehensive Income for the year ended 31st March 2014.

   (8 marks)

2. **Prepare** the Statement of Changes in Equity as at 31st March 2014.

   (2 marks)

3. **Prepare** the Statement of Financial Position as at 31st March 2014.

   (10 marks)

(Total 20 marks)