THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

March 2016

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).
Correct Answer C

1.2

Learning Outcome/s: 1.1.6. Identify the ethical requirements of financial reporting and the consequences of unethical behaviour.
Correct Answer B

1.3

Learning Outcome/s: 1.2.4. Explain the elements of financial statements; assets, liabilities, equity, income, expenses and cash flows.
Correct Answer D

1.4

Learning Outcome/s: 1.2.5. Explain the underlying assumption (going concern) in accounting and accounting concepts (accrual, materiality, consistency, entity, matching, prudence, periodic)
Correct Answer B

1.5

Learning Outcome/s: 1.2.6. Explain qualitative characteristics of financial statements/financial information.
Correct Answer C

1.6

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).
Correct Answer A

1.7

Learning Outcome/s: 4.8.2 Explain the difference between a finance lease and an operating lease.
Correct Answer C

1.8

Learning Outcome/s: 4.10.1 Define employee benefits.
Correct Answer D

1.9

Learning Outcome/s: 4.11.1 Identify basic financial assets and financial liabilities.
Correct Answer B

1.10

Learning Outcome/s: 4.13.2 Identify entities that can follow SLFRs for SMEs.
Correct Answer C

(2 x 10 = total 20 marks)

Answer 02

2.1

Learning Outcome/s: 2.1.2. Explain the purpose of source documents used in accounting.
Credit Note – A credit note is issued by a supplier to a customer in respect of goods returned or overpayment made by the customer. Remittance Advice – A remittance advice is issued to a supplier with a payment, detailing which invoices are being paid and which credit notes have been setoff if any. It also confirms the amount being paid, so that any discrepancies can be easily identified and investigated. GRN- A GRN is used to list the goods that a business has received from a supplier.

2.2

Learning Outcome/s: 2.3.4 Identify the characteristics of computerised accounting packages.
Advantages - The packages can be used by non- specialists - A large amount of data can be processed very quickly - More accurate than manual systems - Can analyse data readily.

2.3

Learning Outcome/s:
2.5.3. Solve omissions and errors embedded in accounting records and financial statements, using suspense accounts.

(i)	Suspense account		Dr. 3,000	
		Debtors account		Cr.3,000
(ii)	Depreciation		Dr. 6,350	
		Suspense account		Cr.6,350
(iii)	Sales		Dr. 1,125	
	Purchase		Dr. 1,125	
		Suspense account		Cr.2,250

2.4

Learning Outcome/s: 3.2.4 Explain the concepts and principles surrounding consolidation of financial statements.
Parent – An entity that controls one or more entities.   Subsidiary – An entity that is controlled by another entity (known as the parent)

2.5

Learning Outcome/s: 4.2.1. List the criteria which must be satisfied in order to recognise an asset under Property, Plant and equipment (PPE).
- It is probable that future economic benefits associated with the item will flow to the entity and   - The cost of the item can be reliably measured.

2.6

Learning Outcome/s: 4.3.2. Explain the accounting treatment with regard to recognition of revenue arising from interest, dividend and royalties.
Interest – accrual basis considering the <u>effective interest method</u>   Dividend – when right to receive is established   Royalties – accrual basis

2.7

Learning Outcome/s: 4.6.2. Explain accounting policies.   4.6.5. Explain accounting estimates.
- A change in accounting policy – must be applied retrospectively.   - A change in accounting estimates – must be applied prospectively

2.8

Learning Outcome/s: 4.8.4 Explain the accounting of a finance lease in lessees' books.
(i) Depreciation Dr. 40, 000   Provision for depreciation Cr. 40, 000   (Being recording depreciation)   (ii) Because the lessee has the option to purchase the asset at the end of the lease term. It is reasonably certain that the lessee will exercise this option.

2.9

Learning Outcome/s: 4.9.6. Compute deferred tax.			
	Acc. Base	Tax Base	TD
PPE	410,000	350,000	60,000
Warranty provision	50,000	-	(50,000)
Net TD			10,000
DT liability at 25%			2,500

2.10

Learning Outcome/s:

4.11.2. Explain initial and subsequent measurement of financial assets and financial liabilities.

i) Initial measurement of held to maturity investment is at FV plus transaction cost. i.e. at 51,000. Subsequently the instrument should be measured at amortised cost using EIR, and the gains and losses are recognised in P/L.

ii) Initial measurement is at FV (Rs. 2 mn) and the transaction cost of Rs. 15,000 is not added to the FV. It should be recognised in P/L. Subsequently the instrument should be measured at FV while gains and losses are recognised in P/L.

iii) AFS should be initially recognised at FV plus transaction cost (Rs. 50 mn). Subsequently at FV with gains and losses are recognised in OCI.

(3 x 10 = total 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s:
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.

(A)

(i) **Trade Receivable control account**

	Rs.
Balance as given	595,600
Add: Overstatement of discount allowed (5,400-4,500)	900
Less: Overstatement of sales (42,400 – 24,400)	(18,000)
Correct control account balance	578,500

(ii)

Correct total of sub-ledger balances	578,500
Less: Omitted balance	(46,000)
Correction of discount allowed (15,000 – 10,500)	(4,500)
Individual account balances total at the beginning	528,000

(B) **Bank reconciliation as on 30.11.2015**

Bank balance as per bank statement	275,500
Less: Un-presented cheques (84,500 + 5,000)	(89,500)
Add: Unrealised deposits	124,200
Balance as per cash book (should be)	310,200

Therefore, opening bank balance as per cash book = Rs. 310,200

Bank reconciliation as on 31.12.2015

Balance as per bank statement	420,000
Less: Un-presented cheques (18,000 + 5,000)	(23,000)
Add: Unrealised deposits	92,500
Balance as per cash book	489,500

∴ Closing bank balance as per cash book is Rs. 489,500

(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).

(a)

LMN Associates
Trading, Profit or Loss and Appropriation account
For the year ended 31 December 2015

			Rs.
Sales			3,300,000
Less: Cost of sales (1,860 – 120 (drawings))			1,740,000
Gross profit			1,560,000
Profit on office equipment disposed			50,000
Less: Expenses			
Depreciation		150,000	
Operational expenses		640,000	
Interest on loan		20,000	
			810,000
Profit available for appropriation			800,000
APPROPRIATIONS:			
Partners' salary:	Leo	240,000	
	Maxi	180,000	420,000
Interest on capital:	Leo	50,000	
	Maxi	30,000	
	Neil	30,000	110,000
Share of profit	Leo	108,000	
	Maxi	81,000	
	Neil	81,000	270,000
			800,000

Workings

Partners' current account

	Leo	Maxi	Neil		Leo	Maxi	Neil
Balance 31/12/2015	-	**50,000**	**40,000**	**Balance 31/12/2015**	**275,000**	-	-
M. Vehicle taken	100,000	-	-	Loan interest	-	-	20,000
Stock withdrawal	120,000	-	-	Partners' salary	240,000	180,000	-
Drawings	250,000	150,000		Interest on capital	50,000	30,000	30,000
				Share of profit	108,000	81,000	81,000
Balance c/d	**203,000**	**91,000**	**91,000**				
	673,000	291,000	131,000		673,000	291,000	131,000

(b) **LMN Associates**

Statement of financial position as at 31st December 2015

<u>Assets</u>

Non-current Assets:			**Rs.**
Property, plant and equipment (850 – 150 – 50)		650,000	
Current assets:			
Inventories		480,000	
Trade receivable		260,000	
Cash at Bank		495,000	
Total Assets		1,885,000	
<u>Capital and Liabilities</u>			
Partners' Capital Account - Leo	500,000		
- Maxi	300,000		
- Neil	300,000	1,100,000	
Partners' Current Account - Leo	203,000		
- Maxi	91,000		
- Neil	91,000	385,000	
Non-current liabilities:			
Partners' Loan Account - Neil		200,000	
Current Liabilities:			
Trade payables		200,000	
		1,885,000	

(Total 10 marks)

Answer 05

Relevant Learning Outcome/s: 3.5.2. Prepare financial statements from incomplete records.

Rajah Traders
Statement of Profit or Loss for the year ended 31st December 2015

		Rs.
Sales: Cash sales		1,846,000
Credit sales		2,880,000
		4,726,000
Less: Cost of sales (working below)		(3,129,000)
Gross Profit		1,597,000
Profit on sale of motor vehicle (648,000 – 350,000)		298,000
		1,895,000
LESS: EXPENSES		
Depreciation (4,284 + 248 – 3,780)	752,000	
Rent (188 + 20 + 44)	252,000	
Telephone (32 – 4.3 + 6.3)	34,000	
Electricity (98.4 + 1.6)	100,000	
Insurance (140.1 – 4.1)	136,000	
Salaries	232,000	
Selling and Distribution	260,000	
		1,766,000
Net profit for the year		129,000

Workings: Cost of sales

1.

Inventory on 01.01.2015	840,000	
Add: Purchases		
Cash purchases	139,000	
Credit purchases (W3)	3,130,000	
	4,109,000	
Less: inventory on 31.12.2015	980,000	
		3,129,000

2. Trade Receivable control account

Balance b/d	440,000		
		Bank	2,480,000
Sales for the year	2,880,000	Balance c/d	840,000
	3,320,000		**3,320,000**

3. Trade payable control account

		Balance b/d	550,000
Bank	3,040,000	Purchases for the year	3,130,000
Balance c/d	640,000		
	3,680,000		**3,680,000**

(Total 10 marks)

Answer 06

Relevant Learning Outcome/s: Learning Outcome 3.5 Incomplete Records 3.4 Non-Profit Entities 3.4.2. Prepare financial statements for non-profit entities

Sun Shine Sports Club

Statement of Income and Expenses for the year ended 31 December 2015

Income			
Subscriptions			90,000
Life membership			
Revenue			1,500
Interest income			5,600
Rent income			6,420
Gross receipt from sport meet			20,132
			123,652
Expenses			
Salaries		7,620	
Insurance		20,000	
Sports meet expenses	(10,130+8,000)	18,130	
Audit fees		12,000	
Travelling		752	
Depreciation (2,436+7,500)		9,936	68,438
Excess income over expenditure			55,214

Subscription Account

Income for the year	90,000	Receipt and payment a/c	93,000
Amount received for 2016	6,000	Outstanding for 2015	3,000
	96,000		96,000

Sunshine Sports Club
Statement of Financial Position as at 31.12.2015

Non-Current Assets				
	Cost	Accu. Dep	NBV	
Land	240,000		240,000	
Building	52,400	5,680	46,720	
Sports Equipment	75,000	7,500	67,500	354,220
Current Assets				
Subscription receivable (1,500 x 2)				3,000
Cash in hand & Bank balance				7,350
				10,350
Total Assets				364,570
Equity				
Accumulated Fund			174,356	
Add: Excess income over expenditure			55,214	229,570
Building Fund				110,500
				340,070
Non-Current Liabilities				
Deferred Life Membership fees (12,000 – 1,500)				10,500
Current Liabilities				
Subscription received in advance (1,500 x 4)				6,000
Sports meet expenses payable				8,000
				14,000
				364,570

(Total 10 marks)

SECTION 3

Answer 07

Learning Outcome

3.2.3 Prepare financial statements for the purpose of management and publication

2.4.2. Prepare the year-end financial statements for accruals, pre-payments, depreciation, bad debts and closing stocks.

4.7.2. Explain adjusting events and non-adjusting events.

4.12.3. Explain the criteria to be satisfied when recognising provisions in financial statements.

(a)

Asiamart (Pvt.) Ltd.

Statement of Comprehensive Income

For the year ended 31 March 2015

(In Rs. 000's)

Sales (20,780 – 160)	20,620
Less: Cost of sales	
(11,400 + 200)	11,600
Gross Profit	9,020
Profit on sale of vehicle (880-850)	30
	9,050
Administration expenses:	
1,840 + 608 (depreciation)	(2,448)
Selling & Distribution expenses:	
1,080 + 23 (debt prov'n)	
+ 40 (bad debt) + 900 (dep'n)	(2,043)
Financial exp: (120 Deb int + 80 Pref div)	(200)
Profit before taxation	4,359
Income tax expenses 1,020 + 28 (under prov)	(1,048)
Net Profit for the year	3,311
Other Comprehensive income:	
Revaluation of Land	250
Total Comprehensive income	3,561

(b) **Asiamart (Pvt) Ltd.**

Statement of Changes in Equity for the year ended 31.03.2015

	Stated Capital	**Revaluation Surplus**	**Retained Profit**	**Total**
Balance on 01.04.2014	4,800	-	1,600	6,400
Revaluation of land	-	250	-	250
Net Profit for the year	-	-	3,311	3,311
Interim dividend paid	-	-	(400)	(400)
Balance on 31.03.2015	4,800	250	4,511	9,561

(c) **Asiamart (Pvt.)Ltd.**
Statement of Financial Position as at 31 March 2015 (½ m)

(In Rs. 000's)

Non-current Assets		
Property, plant and equipment**:**		7,922
Current Assets:		
Inventory (2,500 - 200)	2,300	
Trade Receivable		
1680 - 160 – 20 – 40 - 73 (Prov)	1,387	
Other receivable Vehicle sales	880	
Cash and cash equivalent	460	5,027
Total Assets		**12,949**
Equity and Liabilities:		
Stated Capital (Ord. Capital)		4,800
Revaluation surplus		250
Retained Profit		4,511
		9,561
Non-current Liabilities:		
Redeemable preference shares	1,000	
12% Debentures	1,000	2,000
Current Liabilities:		
Trade payables	900	
Income tax payable (1,048 – 700)	348	
Accrued debenture interest	60	
Pref. dividend payable	80	1,388
		12,949

(d) **Note to Property, Plant and Equipment**

(Rs. 000's)

	Land	Buildings	M. Vehicle	Furniture	Equip	Total
Cost:						
Balance on 01/04/14	3,400	3,000	4,400	980	1,800	13,580
Additions	-	-	-	-	-	-
Disposal	-	-	(1,600)	-	-	(1,600)
Revaluation	250)	-	-	-	-	250
Balance on 31/03/15	3,650	3,000	2,800	980	1,800	12,230
Accumulated Depreciation:						
Balance on 01/04/14	-	940	1,640	320	650	3,550
Charge for the year	-	150	900	98	360	1,508
Disposal	-	-	(750)	-	-	(750)
Balance on 31/03/15	-	1,090	1,790	418	1,010	4,308
Net Book Value on 31/03/15:	3,650	1,910	1,010	562	790	7,922

Total Net Book Value = Rs. 7,922,000

(Total 20 marks)

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