THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

September 2017

SECTION 1

Answer 01

1.1

Learning Outcome/s: 1.2.4
Explain the elements of financial statements: assets, liabilities, equity, income, expenses and cash flow.
Study text reference: Page 29
Correct answer: B

1.2

Learning Outcome/s: 1.2.5
Explain the underlying assumptions in accounting and accounting concepts.
Study text reference: Page 42
Correct answer: D

1.3

Learning Outcome/s: 1.2.9
Discuss the fundamentals of both accrual basis and cash basis of accounting.
Study text reference: Page 41
Correct answer: C

1.4

Learning Outcome/s: 2.1.4
Explain the objective of primary books used in accounting.
Study text reference: Page 70
Correct answer: B

1.5

Learning Outcome/s: 2.3.2
Record transactions based on source document.
Study text reference: Page 68
Correct answer: C

1.6

Learning Outcome/s: 4.5.3
Explain the methods of inventory measurement.
Study text reference: Page 487
Correct answer: D

1.7

Learning Outcome/s: 4.7.2
Explain adjusting events and non-adjusting events.
Study text reference: Page 617
Correct answer: A

1.8

Learning Outcome/s: 4.9.3
Define temporary differences.
Study text reference: Page 559
Correct answer: D

1.9

Learning Outcome/s: 4.11.2
Explain initial and subsequent measurement of financial assets and financial liabilities.
Study text reference: Page 593
Correct answer: D

1.10

Learning Outcome/s: 4.12.3
Explain the criteria to be satisfied when recognizing provisions in financial statement.
Study text reference: Page 606
Correct answer: C

(2 x 10 = 20 marks)

Answer 02

2.1

Learning Outcome/s: 1.1.4
Stakeholders involved in a business organisation and their respective information requirement.
Study text reference: Page 14
i. Shareholders want to know how well the management is performing. They want to know how profitable the business is and how much profit they can afford to withdraw from the business for their own use. OR Shareholders want to know whether to retain the existing investment, to re-invest or divest the shareholding. ii. Providers of finance to the business want financial information to ensure that the business is able to keep up interest payments and finally repay the amounts advanced. They would also want financial information to decide whether to provide further finance. iii. Taxation authorities want to know about business profits in order to assess the tax payable by the company, including sales taxes. They would also want financial information for the purposes of tax planning.

2.2

Learning Outcome/s: 4.13
SLFRS for SMEs
Study text reference: Page 658
1. Earnings per share 2. Interim financial reporting 3. Segment reporting 4. Classification of non-current assets (or disposal group) as held-for-sale.

2.3

Learning Outcome/s: 1.2.6
Explain qualitative characteristics of financial statement/financial information.
Study text reference: Page 44
To be presented faithfully, information must be: • Complete • Neutral • Free from errors

2.4

Learning Outcome/s: 2.1.2
Explain the purpose of source documents used in accounting.
Study text reference: Pages 64 – 65
i. Goods received note ii. Debit note iii. Receipts

2.5

Learning Outcome/s: 2.2.3
Define the term "double entry system" and explain its role in accounting.
Study text reference: Page 104
i. Electricity payable account Dr. Rs. 4,500 Cash/bank Cr. Rs. 4,500 ii. Photocopy machine/PPE/Office equipment account Dr. Rs. 35,000 Payable account (Z (Pvt) Ltd) Cr. Rs. 35,000 iii. Cash Dr. Rs. 5,000 Trade receivables Cr. Rs. 5,000

2.6

Learning Outcome/s: 2.3.4
Identify the characteristics of computerised accounting packages.
Study text reference: Page 121

Advantages

- Can be used by non-specialists.
- A large amount of data can be processed very quickly.
- More accurate than manually recording transactions and preparing financial statements.
- Able to handle and process a large volume of data.
- Once the data has been input, a computerised system can analyse data rapidly to present useful control information for managers.
- Easier to deliver year-end financial statements.
- Facilitate quick delivery of processed financial information at a given time.
- Facilitate back up of information.
- Possibility of operating from remote locations.

Disadvantages

- Initial time and costs involved in installing the system, training personnel etc.
- Require security checks.
- Necessary to develop a system of coding and checking.
- Lack of audit trail.
- Possible resistance from staff to the introduction of the system.
- Possibility of losing data due to a computer virus/hacking.

2.7

Learning Outcome/s: 3.3.1
Explain the nature of partnerships and special accounts relating to partnerships.
Study text reference: Page 355

(i) <u>Loan given by Kamal to the partnership</u>

Dr: Bank/Cash Rs. 250,000
Cr. Loan account (Kamal) Rs. 250,000
(Being recorded to the loan given by Kamal to the partnership)

<u>Interest payable for the month of March on Kamal's loan</u>

Dr: Interest expense Rs. 2,917
Cr: Current account (Kamal) Rs. 2,917
(Being recorded the interest payable for the month of March on Kamal's loan)

(ii) <u>Monthly salaries payable to the partners for the month of March</u>

Dr: Partners' salaries (appropriation account)	Rs. 40,000
Cr: Current account (Kamal)	Rs. 20,000
Cr. Current account (Sunil)	Rs. 20,000

(Being recorded the monthly salaries payable to the partners for the month of March)

2.8

Learning Outcome/s: 3.6.2
Compute basic accounting ratios
Study text reference: Page 677

ROCE = (PBIT/Capital employed) * 100
= (6,000 + 500)/(12,500 + 2,500) * 100
= 43.33%

Assets turnover = Sales/Capital employed
24,000/15,000
1.6 times

Interest cover = PBIT/Interest
(6,000 + 500)/500
13 times

2.9

Learning Outcome/s: 4.1.3
Explain the criteria to be used in the classification of assets and liabilities as current and non-current.
Study text reference: Page 432

- Expected to be settled in the normal operating cycle of the entity.
- Due to be settled within 12 months of the reporting date.
- Held primarily for the purpose of being traded.
- Does not have a right at the reporting date to defer settlement of the liability by the transfer of cash or other assets for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instrument, do not affect its classification.

2.10

Learning Outcome/s: 4.6.7
Explain prior period errors.
Study text reference: Page 450
(a) Prior period errors are omissions from and misstatements in the financial statements for one or more prior periods, arising from a failure to use or a misuse of reliable information that: • Was available when the financial statements for those periods were authorised for issue, and • Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. (b) According to LKAS 8, prior period errors should be corrected by retrospective restatement.

(Total: 30 marks)

SECTION 2

Answer 03

Learning Outcome/s: 2.6
State the purpose of control account
Study text reference: Page 265

(a) (i)

Corrected receivable control account (Rs.)

Balance as given	23,880	Incorrectly recorded discount	3,800
Undercast sales	1,000	Returns inwards	2,700
Returned cheque	2,000	Settlement discount	1,200
		Setoff against payables	600
		Cash received not recorded	4,300
		Balance c/d	14,280
	26,880		26,880
Balance b/f	14,280		

(ii)

	Rs.
Balance per the list of debtors account	3,980
Add	
Omitted sales	2,500
Debit balance included as credit balance (2 * 900)	1,800
Omitted balance	7,000
Less	
Discount given	(1,000)
Balance per the corrected debtor control account	14,280

(b) A trade discount is a reduction in the list price of an article, given by a wholesaler or manufacturer to a retailer. It is often given in return for bulk purchase orders. There is no accounting entry made for trade discounts.

A cash discount is a reduction in the amount payable in return for payment in cash, or within an agreed period.

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 2.5 and 2.7
2.5 Correction of errors 2.7 Bank reconciliations
Study text reference: Pages 299 – 311, 249 – 259

(a)

	Total assets Rs.	Profit Rs.
Per question	565,000	45,200
Capitalised maintenance cost	(10,000)	(10,000)
Depreciation on main. cost	2,000	2,000
Undercast sales	3,000	3,000
Inventory received after the year-end	(15,000)	(15,000)
Adjusted amounts	545,000	25,200

(b) (i)

Cash at bank account (Rs.)

Direct deposit	1,500	Balance (O/D)	75,900
Error in supplier cheque	900	Bank charges	3,500
Dividends received	5,000	Undercast amount	8,000
Correct balance c/d	80,000		
	87,400		87,400
		Correct balance b/d	80,000

(ii) **Bank reconciliation**

		Rs.
Balance per bank statement	(Fav)	30,000
<u>Add</u>		
Unrealised cheques		64,000
<u>Less</u>		
Un-presented cheques		(174,000)
Balance per cash at bank account	(O/D)	(80,000)

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 3.4
Non-profit entities
Study text reference: Pages 399 – 416

(a) **Subscription account for the year ended 31 March 2017**

	Rs.		Rs.
Balance b/d (subs in arrears)	30,000	Balance b/d (subs in adv)	50,000
		Subs received: 2015/16	20,000
		2016/17	980,000
Income & expenditure a/c	1,070,000	2017/18	60,000
		Overdue subs written off	10,000
Balance c/d (subs in adv)	60,000	Balance c/d (subs in arrears)	40,000
	1,160,000		**1,160,000**

(b) **Income and expenditure of the club for the year ended 31 March 2017**

	Rs.		Rs.
Administrative expenses (480,000 + 2,000)	482,000	Subscription income	1,070,000
Depreciation on buildings	50,000	Bar profit (note below)	11,400
Sports equipment (200,000 + 45,000)	245,000	Sports competition profit (362,000 – 280,000)	82,000
Overdue subs written off	10,000	Hiring of sports equipment	125,000
Income over expenditure	501,400		
	1,288,400		**1,288,400**

Bar trading account

	Rs.	Rs.
Sales		1,620,000
Cost of sales		
Opening bar stock	79,000	
Purchases	980,000	
	1,059,000	
Closing stock	(42,000)	(1,017,000)
Gross profit		603,000
Expenses		
Bar wages	(365,000)	
Depreciation (580,000 @ 20%)	(116,000)	
Bar expenses (110,000 – 3,000 + 3,600 (accrued electricity))	(110,600)	(591,600)
Profit for the year		11,400

(Total: 10 marks)

Answer 06

Relevant Learning Outcome/s: 4.4
Cash flow statement
Study text reference: Pages 637 – 648

Nirasha Traders (Pvt) Limited	
Statement of cash flows	
For the year ended 31 March 2017	
	Rs. '000
Cash flows from operating activities	
Net profit before taxation	648,667
Adjustments:	
Depreciation (645,967 – 185,000 – 491,800)	30,833
Interest expense	4,500
Profit on sale of investments	(31,000)
Operating profit before working capital changes	653,000
Decrease in trade and other receivables	5,000
Increase in inventories	(215,000)
Decrease in trade payables	(100,000)
Cash generated from operations	343,000
Interest paid	(3,000)
Income taxes paid	(35,200)
Net cash flow from/(used in) operating activities	*304,800*
Cash flow from investing activities	
Purchase of property, plant and equipment	(491,800)
Proceeds from sale of investment	56,000
Net cash flow from/(used in) investing activities	*(435,800)*
Cash flow from financing activities	
Proceeds from issue of share capital	50,000
Proceeds from long-term borrowings	150,000
Net cash flow from/(used in) financing activities	*200,000*
Net increase/(decrease) in cash and cash equivalents	**69,000**
Cash and cash equivalents as at 1 April 2016	35,000
Cash and cash equivalents as at 31 March 2017	104,000

(Total: 10 marks)

Answer 07

Relevant Learning Outcome/s: 3.2
Financial statements of limited liability companies and group of companies
Study text reference: Pages 366 – 388

(i)

Delta PLC
Statement of comprehensive income for the year ended 31 March 2017

	Rs. '000
Sales	274,500
Cost of sales	(202,600)
Gross profit	**71,900**
Other income: Fair value gain	250
Administrative expenses (21,600 – 360 (gratuity pay) + 670 (grat. prov) + 1,018 (depreciation))	(22,928)
Selling and distribution expenses (19,780 + 79 (debt provision) + 3,720 (depreciation) + 320 (bad debts)	(23,899)
Other expenses	(200)
Profit before taxation	**25,123**
Income tax expenses (6,200 + 200)	(6,400)
Net profit for the year	**18,723**
Other comprehensive income:	
Revaluation gain	600
Total comprehensive income	**19,323**

(ii)

Delta PLC
Statement of changes in equity for the year ended 31 March 2017

	Stated capital	**Revaluation reserve**	**Retained profit**	**Total**
	(Rs. '000)	**(Rs. '000)**	**(Rs. '000)**	**(Rs. '000)**
Balance on 31 March 2016	21,000	5,000	4,850	30,850
Net profit			18,723	18,723
Other comprehensive income				
Revaluation gain	-	600	-	600
Dividends paid	-	-	(2,000)	(2,000)
Balance on 31 March 2017	**21,000**	**5,600**	**21,573**	**48,173**

(iii)

Delta PLC

Statement of financial position as at 31 March 2017

	Rs. '000
ASSETS	
Non-current assets	
Property, plant and equipment	24,322
Total non-current assets	24,322
Current assets	
Inventory (20,800 – 200)	20,600
Trade receivables (9,500 – 320(bad debts) – 459(provision))	8,721
Financial asset fair value through profit or loss	2,750
Cash and cash equivalents	3,220
Total current assets	35,291
Total assets	59,613
EQUITY AND LIABILITIES	
Equity	
Stated capital	21,000
Revaluation reserve	5,600
Retained profit	21,573
Total equity	48,173
Non-current liabilities	
Retirement benefit obligation	3,540
Current liabilities	
Trade payables	6,500
Income tax payable	1,400
Total current liabilities	7,900
Total equity and liabilities	59,613

(iv)

Notes
Property, plant and equipment

					Rs. '000
	Land	**Buildings**	**Motor vehicle**	**Furniture and office equipment**	**Total**
Cost/valuation					
Balance on 1 April 2016	10,000	9,000	14,600	5,640	39,240
Revaluation	-	-	600	-	600
Additions	-	-	-	160	160
Transfer of revaluation on depreciation	-	-	(5,660)	-	(5,660)
Balance on 31 March 2017	**10,000**	**9,000**	**9,540**	**5,800**	**34,340**
Accumulated depreciation					
Balance on 1 April 2016	-	4,700	4,200	2,040	10,940
Revaluation	-		(5,660)	-	(5,660)
Depreciation charge for the year	-	450	3,720 *	568	4,738
Balance on 31 March 2017		5,150	2,260	2,608	10,018
Net book value	**10,000**	**3,850**	**7,280**	**3,192**	**24,322**

*** Motor vehicle depreciation (Rs. '000)**			
Up to 1 October 2016	14,600	20%	1,460
From 1 October 2016 to 31 March 2017			
Nissan car	1,000	25%	125
Other motor vehicles (Note 1)	8,540	50%	2,135
Total			3, 720

Note 1

Total depreciation of motor vehicle up to 1 October 2016 (Rs. '000)
4,200 + 1,460 = 5,660

As at 1 October 2016, other motor vehicle value (Rs. '000)

Value (14,600 – 2,400)	12,200
Depreciation (5,660 – 2,000)	3,660
Value for depreciation (12,200 – 3,660)	8,540

Building depreciation (Rs. '000)			
Up to 31 March 2017	9,000	5%	450

Furniture and office equipment depreciation (Rs. '000)			
Up to 31 March 2017	5,640	10%	564
Additions	160	10%	4
Total			568

Revaluation gain Nissan car	**Rs. '000**
Revalued amount	1,000
Net carrying value (2,400 – 2,000)	400
Revaluation gain (1,000 – 400)	600

(Total: 20 marks)

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