THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

September 2019

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 Additional study support material 6-8
Correct Answer: D

1.2

Learning Outcome/s: 1.1.4 Identify the stakeholders involved in a business organisation and their respective information requirements.
Study text reference –Page 13-14
Correct Answer: C

1.3

Learning Outcome/s: 1.1.6 Identify the ethical requirements of financial reporting and the consequences of unethical behaviour.
Study text reference –Page 9-10
Correct Answer : B

1.4

Learning Outcome/s: 1.2.3 List the elements of financial statements.
Study text reference –Page 30
Correct Answer: C

1.5

Learning Outcome/s: 1.2.6 Explain qualitative characteristics of financial statements/financial information.
Study text reference –Page 45-47
Correct Answer : B

1.6

Learning Outcome/s: 4.6.4 Identify the instances where changes in accounting policies are acceptable.
Study text reference –Page 452
Correct Answer : B

1.7

Learning Outcome/s: 4.7.3 List the disclosure requirements of LKAS10.
Study text reference –Page 617-618
Correct Answer : D

1.8

Learning Outcome/s: 4.12.4 List the disclosure requirements of contingencies.
Study text reference –Page 615
Correct Answer : A

1.9

Learning Outcome/s: 4.10.3 Explain the difference between short-term employee benefits, post-employment benefits and other long-term employee benefits.
Study text reference -Page 575
Correct Answer : A

1.10

Learning Outcome/s: 4.12.2 Define provisions, liabilities, contingent liabilities and contingent assets. Define provisions, liabilities, contingent liabilities and contingent assets.
Study text reference -Page 610
Correct Answer: C

(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 18
Responsibilities of a company director - Preparation of financial statements of the company in accordance with the applicable financial reporting framework - The prevention and detection of fraud - The internal controls necessary to enable the preparation of financial statements that are free from material misstatement whether due to error or fraud - Act within their powers - Promote the best interest of the company - Exercise Independent judgement - Exercise reasonable skill, care and diligence - Avoid conflict of interest - Not accept benefits from 3rd parties

2.2

Learning Outcome/s: 1.1.5 State the differences between financial accounting and management accounting.
Study text reference -Page 12

Financial accounting	Management accounting
Provide historical information	Provide detailed information including budgets and forecasts
Satisfy the information needs of external users	Satisfy the information needs of internal users/management
Provide summarized information	Provide detailed information

2.3

Learning Outcome/s: 1.2.10 Explain the difference between a set of financial statements prepared using accrual basis versus cash basis.
Study text reference -Page 56-57
Cash basis & Accrual Basis Under the accrual basis of accounting the effects of transactions and other events are recognized when they occur and they are recorded in the accounting record and reported in the financial statements of the period to which they relate. However in the cash basis of accounting transactions and other events are recognized and recorded in the financial statements when cash or its equivalents are received or paid.

2.4

Learning Outcome/s: 2.6.1 State the purpose of control accounts.
Study text reference - Page 285
• An incorrect amount may be posted to the control account because of a miscasting in the total in the book of origin. [original entry]. • A transposition error may occur in posting an individual's balance from the book of prime entry to the memorandum ledger. • A transaction may be recorded in the control account and not in the memorandum ledger. • The sum of balances extracted from the memorandum ledger may be incorrectly extracted or calculated [Miscast].

2.5

Learning Outcome/s: 2.1.2 Explain the purpose of source documents used in accounting.
Study text reference -Page 64-65
Source documents and its purpose (i) Delivery note – to check whether goods are issued as per purchase order. Based on the delivery note, a goods received note is prepared at stores and the stores ledger is updated. (ii) Time recorder / attendance register – to update the employees payroll data (iii) Goods dispatch note/ copy of delivery note – As a proof of delivery as per the invoice raised. This is then used to record it in the bin card or stores ledger

2.6

Learning Outcome/s: 2.1.4 Explain the objective of primary books used in accounting.
Study text reference -Page 113-114
1. Depreciation 2. Correction of errors 3. Recognition of impairment of assets

2.7

Learning Outcome/s: 2.3.4 Identify the characteristics of computerised accounting packages. Identify the characteristics of computerised accounting packages.
Study text reference – page 121-122
Disadvantages of computerised accounting package - Initial time and cost involved in installing the system is very high - Need for security checks to ensure unauthorised personnel have no access to the data files - Necessity to develop a system of coding - Lack of an audit trail

2.8

Learning Outcome/s: 3.6.1 Identify different methods of financial statement analysis. Identify different methods of financial statement analysis.
Study text reference - Page 699-700
Problems in cross company comparison • Different degree of diversification • Different production and purchasing policies • Different financing policies • Different accounting policies • Different effects of government incentives

2.9

Learning Outcome/s: 4.2.2 Explain the treatment for initial and subsequent measurement of PPE.
Study text reference -Page 188-196
Non-current asset (a) Machinery= cost +delivery charge+ installation cost = Rs. 560,000+ Rs.15,000+ Rs.6,000 = Rs. 581,000 (b) Subsequent measurement= cost- accounting depreciation – accounting impairment = Rs. 581,000- (Rs. 581,000/15*5/12) = Rs. 581,000- Rs.16,139 = Rs. 564,861

2.10

Learning Outcome/s: 4.13.1 Identify the need to adopt SLFRS for SMEs.
Study text reference -Page 656-657
Small and medium sized entities might **not be subjected to strict regulations** which require detailed and comprehensive reporting to protect the rights of the shareholders. (**No public accountability**) Accordingly a one size fits all framework may not generate relevant and useful information for those companies as the **purpose and the use for which the financial statements are prepared will not be the same** as for listed companies. Similarly the **cost of the reporting may not be justified** for the limited needs of users of SME.

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s: 2.7, 2.5 2.7 Bank Reconciliation 2.5 Correction of Errors
Study text reference -Page 246-262, 286-311

(a)

Correction of the cash book

	Rs.
Balance as at 31 March 2019	(5,600)
Add: Under-cast receipt	1,200
Cancelled cheque	900
Corrected balance	(3,500)

Bank Reconciliation Statement as at 31 March 2019

		Rs.
Balance per bank statement		(8,200)
Add:		
Unrealised cheques		8,800
Less:		
Unpresented cheques	4,000	
Cancelled cheque included in unpresented cheques	(900)	
	3,100	
Erroneously credited cheques	1,000	
		4,100
Balance as per the corrected cash book		(3,500)

(b)

Suspense Account			
	Rs.		**Rs.**
Balance	480,000	Unaccounted depreciation	400,000
		Rent expense	20,000
		Pre-paid rent	60,000
	480,000		480,000

Revised Profit	
	Rs.
As per draft financial statements	925,100
Add	
Profit from disposal of motor vehicle **(W1)**	1,800,000
Inventory	2,400
	2,727,500
Less	
Incorrect sales	2,200,000
Depreciation	400,000
Rent	20,000
	2,620,000
Revised profit	107,500

W1

Disposal of Motor Vehicle		
		Rs.
Sales proceeds		2,200,000
Cost	2,000,000	
Accounting depreciation	1,600,000	
(2,000,000/5*4)		
Written down value as at 31 March 2019		400,000
Profit		1,800,000

(Total 10 marks)

Answer 04

Relevant Learning Outcome/s: 2.2, 4.4 2.2 Double entry concept 4.4 Cash Flow statement
Study text reference –Page 90-100, 635

(a)

	Non-current asset +	Current asset =	Equity +	Non-current Liab +	Current Liab
	Rs.	Rs.	Rs.	Rs.	Rs.
(i)	-	+ 180,000		+ 60,000	+ 120,000
			-1,800		+1,800
(ii)	-	- 100,000 + 120,000	+ 20,000	-	-
(iii)	+ 225,000	- 85,000			+ 140,000

Alternative answer part (i)

Interest expenses of 1,800 can be adjusted as current asset -1,800 and Equity -1,800

The loan full amount may be considered under non- current liabilities as the division of current and non- current is only for disclosure purposes.

(b) **Cash flows from operating activities - Direct method**

	Rs. '000
Cash received from sales (570 + 8,250 – 750)	8,070
Cash paid to suppliers of goods (320 + 5,210 – 470)	(5,060)
Cash paid to suppliers of services including employees:	
26 + (650 + 1,660) – (28 + 54)	(2,254)
Income tax paid (82 + 4.8 – 8.8)	(78)
Net Cash-flows from operating activities	**678**

Note: Purchases = Cost of sales + Closing stock – Opening stock

= Rs. 4,950,000 + Rs. 980,000 – Rs. 720,000 = Rs. 5,210,000

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 3.4 Non-Profit Entities
Study text reference –Page 394-416

(a)

Kurunegala Sports Club	
Income and Expenditure Account	
for the year ended 31 December 2018	
	Rs.
Income	
Subscriptions **(W1)**	843,000
General donations	230,000
	1,073,000
Less: Expenses	
Salaries and wages (167,000-4,000)	163,000
Maintenance	34,500
Rates paid	9,100
Depreciation (42,000+85,200)	127,200
	333,800
Excess	**739,200**

(b)

Kurunegala Sports Club	
Statement of Financial Position	
as at 31 December 2018	**Rs.**
Assets	
Non-current assets	
Land	1,000,000
Equipment	300,000
Furniture	340,800
	1,640,800
Current assets	
Subscriptions receivables	7,800
Pre-paid rates	5,200
Cash	931,500
	944,500
	2,585,300
Equity	
Accumulated fund account	2,139,300
Special fund account	396,000
	2,535,300
Current liabilities	
Subscriptions received in advance	50,000
	50,000
	2,585,300

Workings

Subscription account			
	Rs.		**Rs.**
Balance as at 1.1.2018	15,000		
Income & Exp. Account	843,000	Receipts and payment account	900,200
Balance as at 31.12.2018	50,000	Balance as at 31.12.2018	7,800
	908,000		908,000

Specific Donations	**Rs.**
Special fund account	1,400,000
Salaries	(4,000)
Transferred to accumulated fund	(1,000,000)
	396,000

Accumulated fund account

Opening balance	400,100
(+) surplus	739,200
Transferred from specific fund	1,000,000
	2,139,300

Answer 06

Relevant Learning Outcome/s: 3.3 Partnerships
Study text reference -Page Additional study material 30-55

(a)

Realisation Account

	Rs.		Rs.
Land	1,300,000	Partner - A (Land and building)	1,000,000
Building	425,000	Cash - debtors	7,000
Receivables	14,200	partner - C (debtors)	5,000
Loan - B	100,000	Partner B (loan)	100,000
Cash - expenses	6,300	Loss on realisation	
		A	366,750
		B	244,500
		C	122,250
	1,845,500		**1,845,500**

(b)

Partners' Capital Accounts

	A	B	C
	Rs.	**Rs.**	**Rs.**
Balance c/f	1,100,000	513,000	237,100
Realisation A/c	(1,000,000)	(100,000)	(5,000)
Partners current account	23,000	(11,500)	(51,200)
Realisation A/c – loss	(366,750)	(244,500)	(122,250)
Cash	243,750	(157,000)	(58,650)

Partners' Current Accounts

	A	B	C
	Rs.	**Rs.**	**Rs.**
Balance	23,000	(11,500)	(51,200)
Transferred to capital A/cs	(23,000)	11,500	51,200

(c)

Cash Book

	Rs.		Rs.
Balance	17,100	Payables	45,900
Realisation of debtors	7,000	Expenses	6,300
Partners A/ C -A	243,750	Partners A/ C	
		B	157,000
		C	58,650
	267,850		**267,850**

(Total: 10 marks)

SECTION 3

Answer 07

Relevant Learning Outcome/s: 3.2, 4.9.6 3.2 Financial statements of limited liability companies and group of companies 4.9.6 Compute deferred tax.
Study text reference -Page 427-465, 554-568

(a)

Zimega PLC		
Statement of Comprehensive Income		
For the Year Ended 31 March 2019		
		Rs.'000
Sales		1,458,444
Cost of sales	W 01	(871,500)
Gross profit		586,944
Other income	W 09	10,000
Administrative expenses	W 07	(299,625)
Distribution expenses	W 08	(163,950)
Other expenses		(12,000)
Finance expenses		(80,000)
Profit before Tax		**41,369**
Tax expense	W 06	(4,500)
Profit after tax		**36,869**
Other comprehensive income		
Revaluation deficit	W 3.4	(6,000)
Total comprehensive income		**30,869**

Zimega PLC		
Statement of Financial Position		
As at 31 March 2019		
Non-current assets		**Rs.'000**
Property, plant & equipment	W 03	775,150
Total non-current assets		**775,150**
Current assets		
Inventory	W 02	153,500
Financial assets at fair value through profit or loss	W 05	108,000
Trade receivables	W 10	274,669
Allowance for doubtful debt	W 04	(18,500)
Cash & cash equivalents		16,500
Total current assets		**534,169**
Total assets		**1,309,319**

Equity & liabilities		
Stated capital		200,000
Revaluation reserve		34,000
Retained earnings (802,200+36,869)		839,069
Total equity		**1,073,069**
Current liabilities		
Trade payable		229,500
Accrued expense		1,350
Tax payable	W 06	5,400
Total current liabilities		**236,250**
Total equity & liabilities		**1,309,319**

Presentation

Working 01: Cost of sales	**Rs'000**
Opening stock	175,000
Add: Purchases	850,000
	1,025,000
Less: Closing inventory (W2)	(153,500)
	871,500

Working 02: Closing inventory (Rs.'000)

Cost **=**154,000

Net realizable value = 153,500

According to LKAS 2: Inventory should be valued at lower of cost or NRV.

Accordingly closing inventory would be Rs. 153,500.

Working 03: PPE

Property, Plant & Equipment	**At Cost/valuation**	**Accumulated depreciation**	**Revaluation**	**NBV**
	Rs.'000	**Rs.'000**	**Rs.'000**	**Rs.'000**
Land	300,000	-	10,000	310,000
Building	450,000	(27,000)	(28,000)	395,000
Furniture & equipment	12,000	(5,600)	-	6,400
Motor vehicles	60,000	(3,750)	-	56,250
Office equipment	15,000	(7,500)	-	7,500
	837,000	**(43,850)**	**(18,000)**	**775,150**

3.2 Depreciation **(Rs.'000)**

Building	-	(450,000/50) =9,000
Office equipment	-	(15,000/10) =1,500
Furniture & fittings	-	(12,000/15) =800
Motor vehicles	-	(60,000-30,000)/6*9/12 = 3,750

3.3 Revaluation

	Land (Rs.'000)	Building (Rs.'000)
Cost	300,000	450,000
Accumulated depreciation	-	(27,000)
Carrying value as at 31. 03 2019	300,000	423,000
Revalued amounts	310,000	395,000
Revaluation surplus/ (deficit)	**10,000**	**(28,000)**
The revaluation surplus recognized in previous years (40,000*40%)		16,000
Therefore deficit recognized in P&L		**12,000**

3.4 Other comprehensive income	**(Rs.'000)**
Surplus on land	10,000
Reversal on building	(16,000)
Net impact on OCI	(6,000)

Working 04: Allowance for doubtful debt (Rs.'000)

Allowance as at 31 March 2019	18,500
Already provided for	(13,800)
Provision for the year	4,700

Working 05: Financial assets at fair value through profit & Loss

	(Rs.'000)
TB value	100,600
Less: transaction cost charge to P&L	(600)
Carrying value of the investment	100,000
Fair value of the investment	(108,000)
Fair Value gain	8,000

Working 06: Income tax payable (Rs.'000)

Current year provision:	5,400
Last year over provision	(900)
Tax expense for the year	4,500

Working 07: Administration expenses	**(Rs.'000)**
As per TB:	287,725
Depreciation (W3) (9,000+1,500+800)	11,300
Transaction cost (W 5) (Note 1)	600
Total expense	299,625

(Note 1): The same expense may be categorized as other expenses or may be charged separately to the income statement as an expense and the marks should be awarded to those classifications as well.

Working 8: Distribution expenses (Rs.'000)

As per TB:	154,000
Depreciation motor vehicle (W3)	3,750
Provision for doubtful debt (W4)	4,700
Bad debt	1,500
Total expense	163,950

Working 9: Other income	**(Rs.'000)**
As per TB:	2,000
Fair value gain on financial assets =	8,000
Total Income	10,000

Working 10: Trade debtor	**(Rs.'000)**
Trade debtors	276,169
Bad debt write off	(1,500)
	274,669

(b) **Deferred Tax Calculation** **(Rs.)**

Carrying value as at 31 March 2019	
Cost	15,750,000
Accumulated depreciation $\frac{15,750,000*2}{15}$=	(2,100,000)
	13,650,000
Tax base as at 31 March 2019	
Cost	15,750,000
Capital allowances claimed $\frac{15,750,000*2}{5}$=	(6,300,000)
	9,450,000
Temporary taxable difference	4,200,000
Tax rate	28%
Deferred tax liability	**1,176,000**

(Total 20 marks)

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