SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

September 2016

SECTION 1

Answer 01

1.1

Learning outcomes/s: 1.2.5
Explain the underlying assumption (going concern) in accounting and accounting concepts (accrual, materiality, consistency, entity, matching, prudence, periodic, realisable, relevance, reliability and comparability).
Correct answer: D

1.2

Learning outcomes/s: 1.2.1
Explain the objectives of financial reporting.
Correct answer: A

1.3

Learning outcomes/s: 2.2.4
Discuss the concept of "dual aspect" in relation to the elements of financial statements.
Correct answer: C

1.4

Learning outcomes/s: 4.4.1
Identify the different types of cash flows associated with an organization.
Correct answer: C

1.5

Learning outcomes/s: 2.1.1
Identify source documents and other records used in accounting
Correct answer: B

1.6

Learning outcomes/s: 1.2.6
Explain qualitative characteristics of financial statements/financial information.
Correct answer: B

1.7

Learning outcomes/s: 3.2.4
Explain the concepts and principles surrounding consolidation of financial statements.
Correct answer: A

1.8

Learning outcomes/s: 3.2.5
State the regulatory requirement to prepare consolidated financial statements for a group of companies.
Correct answer: C

1.9

Learning outcomes/s: 3.6.2
Compute basic accounting ratios (profitability ratios, liquidity ratios, gearing ratios excluding investor ratios).
Correct answer: A

1.10

Learning outcomes/s: 3.2.1
Identify the sources of funds available for a limited liability company.
Correct answer: B

(Total: 20 marks)

Answer 02

2.1

Learning Outcome/s: 2.5.2		
Prepare journal entries for correction of errors.		
Sales	Dr	9,000
Suspense a/c	Cr	9,000
Office furniture	Dr	65,000
Suspense a/c	Cr	65,000
Discount allowed	Dr	2,860
Discount received	Cr	2,860

2.2

Learning Outcome/s: 2.6.2	
Prepare a reconciliation of control account balances with a total of individual accounts.	
Balance as per trade receivable control account before adjustment	1,586,000
Less: Over-statement of a credit sale (482,000 – 48,200)	(433,800)
Add: Written-off amount received	8,000
Correct trade receivable control account balance	1,160,200
Therefore, the correct total of individual trade receivable account balances should be Rs. 1,160,200.	

2.3

Learning Outcome/s: 4.3.1

Explain the criteria to be satisfied to recognise revenue from sale of goods and rendering services.

- The product or service has been provided to the buyer
- The buyer has recognised his liability to pay for the goods or services provided.
- The buyer has indicated his willingness to hand over cash or other assets in settlement of his liability.
- The monetary value of the goods or services has been established.

OR

- Revenue is recognised when it is probable that future economic benefits will flow to the entity and,
- The amount of revenue can be measured reliably.

OR

- The revenue is recognised when the entity has transferred to the buyer, the significant risks and rewards of the ownership.
- The revenue can be measured reliably.

2.4

Learning Outcome/s: 4.2.2
Explain the treatment for initial and subsequent measurement of PPE

(a) **Initial recognition**

	Rs.
Purchase price	10,000,000
Import duties	2,000,000
Trade discount received	(200,000)
Initial delivery and handling costs	150,000
	11,950,000

(b) Ken shall <u>choose either the cost model or the revaluation model</u> for subsequent measurement and the <u>selected accounting policy should be applied to the entire class of machinery</u>.

2.5

Learning Outcome/s: 4.6.7
Explain prior period errors.

(a) (i) Not measuring inventory at the lower of cost and NRV is <u>a prior period error</u> as it does not comply with LKAS 2.

(ii) Changing the useful life is <u>not a prior period error</u>. It is a change in estimate.

(b) Prior period errors should be <u>corrected retrospectively</u>.

2.6

Learning Outcome/s: 4.7.2
Explain adjusting events and non-adjusting events.

(a) Adjusting event – it gives evidence that the NRV at the end of the report period is significantly lower.

(b) Non-adjusting event – it is due to a condition that arose after the reporting period.

(c) Non-adjusting event– it is not due to conditions that existed at the end of the reporting period.

2.7

Learning Outcome/s: 4.9.6
Compute deferred tax.
(a) Taxable temporary difference (b) Deductible temporary difference (c) Taxable temporary difference

2.8

Learning Outcome/s: 4.8.4
Explain the accounting of a finance lease in the lessees' books

PV of minimum lease payments

	Rental	Discounting rate (10%)	PV
2016	130,000	1	130,000
2017	130,000	0.909	118,182
2018	130,000	0.826	107,438
			355,620

FV of the machinery is lower than the PV of minimum lease payments.
Therefore, the asset should be recognised at Rs. 305,000 (i.e. 300,000 + 5,000).

2.9

Learning Outcome/s: 4.12.4
List the disclosure requirements of contingencies.
(i) Brief description of the nature of the contingent liability (ii) An estimate of the financial effect (iii) An indication of the uncertainties relating to the amount or timing of any outflow (iv) The possibility of any reimbursement

2.10

Learning Outcome/s: 4.11.2
Explain initial and subsequent measurement of financial assets and financial liabilities.
(i) If quoted company shares held for short term: Financial asset at FVTPL (ii) If held for long term: Available-for-sale(AFS) financial asset

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s:
2.2.2 Relate the connection between "dual aspect" of accounting and the accounting equation
2.7.2 Prepare a reconciliation statement reconciling the cash book balance with the bank statement balance.

(a) Net assets as at 31 March 2016 adjusted for transactions:

	Rs.
Net assets as at 31 March 2016 before adjustments	6,800,000
Purchase of machine has no impact on the net asset value (cash reduced or creditors balance increased by that amount)	Nil
Add: Proprietor's drawings	240,000
	7,040,000
Less: Net assets as at 31 March 2015	4,280,000
Profit earned for the year	2,760,000

(b) **Adjusted bank balance on 31 July 2016**

	Rs.
Balance shown in the statement	3,014,250
Add: Direct deposits by customers	120,000
Dividend directly credited	38,500
Less: Bank charges	(250)
L/C charges	(42,500)
Balance as per cash book on 31 July 2016 should be	3,130,000

Correct bank balance as per cash book on 31 August 2016

	Rs.
Opening bank balance	3,130,000
Add: Total debits	8,250,000
Less: Total credits	(9,800,000)
Bank charges to be accounted for	(2,400)
Bank balance that should be shown in the statement of financial position as at 31 August 2016	1,577,600

Bank reconciliation statement as at 31 August 2016

	Rs.
Balance as per correct cash book	1,577,600
Add: Un-presented cheques	720,000
Less: Un-realised deposits	(480,000)
Balance as per bank statement	1,817,600

Therefore, the balance as per the bank statement on 31 August 2016 = Rs. 1,817,600

(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)

ARS Associates			
Computation of profit available for the appropriation account			**Rs.**
Profit as per trial balance given			1,400,000
Adjustment for stock withdrawal			40,000
Profit on disposal of vehicle [1,800 – (1,600 – 500 * 9/12)]			575,000
Depreciation overcharged (500 * 3/12)			125,000
Profit available for appropriation			2,140,000
Appropriations:			
Partners' salary:	Anil	360,000	
	Ranil	300,000	
	Sunil	240,000	(900,000)
Interest on capital:	Anil	180,000	
	Ranil	135,000	
	Sunil	135,000	(450,000)
Share of profit	Anil	395,000	
	Ranil	237,000	
	Sunil	158,000	(790,000)

(b)

ARS Associates			
Statement of financial position as at 31 March 2016			**Rs.**
ASSETS			
Non-current assets			
Property, plant and equipment (½ mark) (½ mark) (½ mark) (6,280 – (1,600 – 375) + 125 depreciation over-provision)			5,180,000
Current assets			
Inventories			1,780,000
Trade receivables			1,250,000
Cash at bank			2,495,000
Total assets			10,705,000
CAPITAL AND LIABILITIES			
Partners' capital account	- Anil	5,000,000	
	- Ranil	3,000,000	
	- Sunil	2,000,000	10,000,000
Partners' current account	- Anil	(1,365,000)	
	- Ranil	(303,000)	
	- Sunil	2,073,000	405,000
Current liabilities			
Trade payables			300,000
Total capital and liabilities			10,705,000

Working 01

Partners' Current Account

	Anil	**Ranil**	**Sunil**		**Anil**	**Ranil**	**Sunil**
Balance on 1 April 2015	-	650,000	-	**Balance on 1 April 2015**	500,000	-	800,000
Stock withdrawal			40,000	**Interest on capital**	180,000	135,000	135,000
Partners' salary	-	325,000	220,000	**Partners' salary**	360,000	300,000	240,000
Motor vehicle taken	1,800,000			**Share of profit**	395,000	237,000	158,000
Capital account	1,000,000	**-**	**-**	**Capital account**	-	-	1,000,000
Balance c/d			2,073,000	**Balance c/d**	1,365,000	303,000	
	2,800,000	975,000	2,333,000		2,800,000	975,000	2,333,000

Working 02

Partners' Capital Account

	Anil	**Ranil**	**Sunil**		**Anil**	**Ranil**	**Sunil**
				Balance on 1 April 2015	4,000,000	3,000,000	3,000,000
Current account	-	-	1,000,000	**Current account**	1,000,000	-	-
Balance c/d	5,000,000	3,000,000	2,000,000				
	5,000,000	3,000,000	3,000,000		5,000,000	3,000,000	3,000,000

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 3.4.2
Prepare financial statements for non-profit entities.

(a)

	Rs.		**Rs.**
Balance b/f on 1 January 2015	4,800	Balance b/f on 1 January 2015	1,700
Income and expenditure a/c	89,020	Receipts and payments a/c	89,720
Balance c/f on 31 December 2015	5,600	Balance c/f on 31 December 2015	8,000
	99,420		99,420
31.12.2015 Bal B/F	8,000	31.12.2015 Bal B/F	5,600

Biyagama Gramodaya Society	
Statement of income and expenses for the year ended 31 December 2015	
	Rs.
Income	
Donations	5,640
Sale of craft items	3,450
Hire income	4,000
Rent income	10,000
Sundry receipts	1,230
Subscriptions	89,020
	113,340
Expenses	
Donations	2,300
Electricity	3,100
Stationery	800
Insurance	4,500
Depreciation	23,950
Travelling expenses	2,900
Sundry expenses	1,720
	39,270
Excess of income over expenditure	74,070

(b)

- These donations are treated as capital receipts and thus are transferred to a special fund account (e.g. building construction fund) maintained for a specific purpose.
- This has to be shown in the balance sheet just below the accumulated fund account.
- After completion of the specific project or event, the excess or balance of the specific fund should be transferred to the accumulated fund account.
- Any income relating to the special fund account is added to the respective fund. Any revenue expenditure relating to the special fund account is deducted from the respective fund.
- However, any expenditure of a capital nature on account of this special fund (e.g. expenditure on the construction of a building out of the building fund) should be shown on the assets side of the balance sheet and an equal amount should be transferred from that special fund to the accumulated fund.

(Total: 10 marks)

Answer 06

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

(a)

Solomon Traders		
Statement of profit or loss for the year ended 31 March 2016		
	Rs.	**Rs.**
Sales		
Cash sales (940 – 320)		620,000
Credit sales		5,220,000
		5,840,000
Cost of sales		
Inventory on 1 January 2015	680,000	
Add: Purchases		
Cash purchases	860,000	
Credit purchases	3,450,000	
	4,310,000	
Less: Inventory on 31 December 2015	(840,000)	(4,150,000)
Gross profit		1,690,000
Expenses		
Depreciation [(420 + 250) @ 20%]	470,000	
Warehouse rent (20 * 12)	240,000	
Telephone (30 – 2.6 – 2.4)	25,000	
Electricity (38.4 – 3.4 + 2)	37,000	
Insurance	12,000	
Salaries	483,000	
Bad debts	120,000	
Other expenses	180,000	(1,567,000)
Net profit for the year		123,000

Workings:

Trade receivable control account			
Balance b/d	540,000	Error correction – cash	320,000
Sales for the year	5,220,000	Bank	4,640,000
		Bad debts	120,000
		Balance c/d	680,000
	5,760,000		**5,760,000**

Trade payable control account			
		Balance b/d	372,000
Bank	3,240,000	Purchases for the year	3,450,000
Balance c/d	582,000		
	3,822,000		**3,822,000**

(b)

Solomon Traders		
Statement of financial position as at 31 March 2016		
	Rs.	**Rs.**
Non-current assets		
Property, plant & equipment (3,100 - 420 + 250 – 50)		2,880,000
Current assets		
Inventory	840,000	
Trade receivables	680,000	
Prepayment – telephone	2,400	
Cash at bank	446,600	1,969,000
		4,849,000
Capital		
Proprietor's capital as at 1 April 2015		4,322,000
Profit for the year		123,000
Drawings during the year		(200,000)
		4,245,000
Current liabilities		
Trade payables		582,000
Accrued expenses [20 (warehouse rent) + 2 (electricity)]		22,000
		4,849,000

SECTION 3

Answer 07

Relevant Learning Outcome/s: 3.2.3
Prepare financial statements for the purpose of management and publication

Auto Mirage PLC	
Statement of comprehensive income for the year ended 31 March 2016	
	Rs.
Revenue	3,260,100
Cost of sales (1,956,060 + 12,630)	(1,968,690)
Gross profit	1,291,410
Other income	156,200
Administrative expenses **(W1)**	(1,223,536)
Distribution expenses **(W2)**	(149,138)
Finance cost	(12,300)
Profit before tax	62,636
Income tax	(71,800)
Profit/(loss) for the year	(9,164)
Other comprehensive income (available-for-sale financial asset)	19,000
Total comprehensive income	9,836

(W1) Administrative expenses

	Rs.
As per trial balance	500,520
Loss from machinery disposal	143,016
Lease rent (working)	180,000
Provision for guarantee	400,000
	1,223,536

(W2) Distribution expenses

	Rs.
As per trial balance	152,890
Allowance for doubtful debts	2,248
Available-for-sale transaction cost	(6,000)
	149,138

(b)

Auto Mirage PLC					
Statement of changes in equity for the year ended 31 March 2016					
	Stated capital (Rs.)	**Revaluation reserve (Rs.)**	**Retained earnings (Rs.)**	**AFS reserve (Rs.)**	**Total**
Balance as at 1 April 2015	1,000,000	120,000	2,249,062		3,369,062
Profit/(loss) for the year			(9,164)		(9,164)
Transfer of Revaluation reserve on disposal to retained earnings		(120,000)	120,000		
Other comprehensive income				19,000	19,000
Balance as at 31 March 2016	1,000,000	-	2,359,898	19,000	3,378,898

(c)

Auto Mirage PLC	
Statement of financial position as at 31 March 2016	
	Rs.
ASSETS	
Non-current assets	
Property, plant and equipment	2,570,404
Investment	525,000
	3,095,404
Current assets	
Inventories	185,000
Trade debtors	737,308
Other receivables	950,000
Cash and cash equivalents	69,870
	1,942,178
Total assets	**5,037,582**
EQUITY AND LIABILITIES	
Equity	
Stated capital	1,000,000
Retained earnings	2,359,898
AFS reserve	19,000
	3,378,898
Non-current liabilities	
Employee benefits	45,230
Current liabilities	
Trade payables	998,204
Provision for guarantee	400,000
Rent payable	80,000
Income tax payable	66,800
Accrued expenses	68,450
	1,613,454
Total equity and Liabilities	**5,037,582**

(Total 10 marks)

Property, plant and equipment

	Cost/revalued amount	Accumulated dep^n	Disposal	NBV
Land and building – at cost	2,500,000	200,560		2,299,440
Machinery – at revalued amount	1,250,000	156,984	1,093,016	-
Furniture and fittings – at cost	275,400	98,536		176,864
Equipment – at cost	126,850	32,750		94,100
	4,152,250	**488,830**		**2,570,404**

Workings

Inventory

	Rs.
As per trial balance	197,630
Cost of sales (income statement)	12,630
NRV	185,000

Machinery disposal

	Rs.
Sales proceeds receivable	950,000
NBV	1,093,016
Loss on disposal – P/L	143,016

Operating lease

		Rs.
Total lease rental payments	(100,000 * 9)	900,000
Annual lease expense	(900,000/5)	180,000
Amount paid on 31 March 2016		100,000
Accrual		80,000
Income statement	180,000	
Rent (trial balance)		100,000
Accrual		80,000

Guarantee given to Rio

Since it is probable that economic benefits will be required to settle the obligation, a provision should be recognised for the best estimate of the obligation (i.e. 80%)

Income statement	400,000	
Provision for guarantee given to Rio		400,000

Income tax payable

	Rs.
Income tax for the year (310,000 x 28%)	86,800
Tax payment –2015/16	(20,000)
Tax payable	66,800

Allowance for doubtful debts

	Rs.
Trade debtors as per trial balance	744,756
1% allowance	7,448
Provision as per trial balance	5,200
Under-provision P/L (W2)	2,248

Investment – available-for-sale

As per trial balance	500,000
Transaction cost	6,000
	506,000
Fair value (FV) as at 31 March 2106	525,000
FV gain – other comprehensive income	19,000

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