THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KE1 – Financial Accounting & Reporting Fundamentals

September 2018

SECTION 1

Answer 01

1.1

Learning Outcome/s: 1.1.1 Identify the governance structure of business organisations.
Study text reference: Page 19
Correct answer: D

1.2

Learning Outcome/s: 1.1.5 State the differences between financial accounting and management accounting.
Study text reference: Pages 12 and 13
Correct answer: D

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 (Additional Study Support)
Correct answer: B

1.4

Learning Outcome/s: 1.2.9 Discuss the fundamentals of both accrual basis and cash basis of accounting.
Study text reference: Pages 40 and 41
Correct answer: D

1.5

Learning Outcome/s: 4.4.1 Identify the different types of cash flows associated with an organisation.
Study text reference: Pages 629 – 631
Correct answer: D

1.6

Learning Outcome/s: 4.5.4 List the disclosure requirement with regard to inventories per LKAS 2.
Study text reference: Page 501 & 502
Correct answer: C

1.7

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

1.8

Learning Outcome/s: 4.10.1 Define employee benefits.
Study text reference: Page 574 and 575
Correct answer: A

1.9

Learning Outcome/s: 4.11.1 Identify basic financial assets and financial liabilities.
Study text reference: Pages 587 and 588
Correct answer: A

1.10

Learning Outcome/s: 4.12.2 Define provisions, liabilities, contingent liabilities and contingent assets.
Study text reference: Page 606
Correct answer: B

(2 x 10 = 20 marks)

Answer 02

2.1

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 21, additional study support material 6 - 8
- Economic factors (e.g. trend in foreign exchange rates) - Political factors (e.g. government policy on export trade, incentives available etc.) - Technological factors (e.g. technology used and development in technology) - Social factors (e.g. environmental pollution)

2.2

Learning Outcome/s: 1.1.4 Identify the stakeholders involved in a business organisation and their respective information requirements.
Study text reference: Page 16 - 17
Government – being the owner, needs to know whether the income is sufficient to run the sector and the level of satisfaction of the commuters. General public – being customers, need to know whether they receive satisfactory facilities for the fare they pay, a timely service etc. Employees – need to know adequacy of the remuneration paid, facilities provided etc. Suppliers – ability to pay their dues. Bankers – ability to repay loans

2.3

Learning Outcome/s: 1.2.1

Explain the objectives of financial reporting.

Study text reference: Additional Study Support Page 16

(i) Information about the entity's economic resources and the claims against them (i.e. financial position) to help users assess the entity's liquidity and solvency and its likely need for additional financing.

(ii) Information about a reporting entity's financial performance helps users understand the return that the entity has produced on its economic resources. This is an indicator of how efficiently and effectively management has used the resources of the entity and is helpful in predicting future returns.

(iii) Information about a reporting entity's cash flows during a period helps users to assess the entity's ability to generate future net cash inflows and gives users a better understanding of its operations.

2.4

Learning Outcome/s: 2.1.1 and 2.1.4

2.1.1 Identify source documents and other records used in accounting.

2.1.4 Explain the objective of primary books used in accounting.

Study text reference: Page 64 – 65,71

	Source document (½ mark each)	**Book of prime entry**
(i)	Deposit slip	Cash book/bank book
(ii)	Sales invoice	Sales day book
(iii)	Finance lease agreement	General journal

2.5

Learning Outcome/s: 2.2.3

Define the term "double entry system" and explain its role in accounting.

Study text reference: Pages 101 and 102

Double entry system and its role in accounting

The double entry system is based on the idea that each transaction has an **equal but opposite effect (dual effect)**. Accordingly in accounting, every financial transaction must be **entered in ledger accounts as a debit and as an equal but opposite credit**. Thus every transaction is recorded twice so that every debit balance is balanced by a credit.

2.6

Learning Outcome/s: 2.5.2
Prepare journal entries for correction of errors.

Study text reference: Pages 299 – 310

i.	Insurance expense	Dr. Rs. 52,000
	Suspense account	Cr. Rs. 52,000
	(Being recording of omitted insurance expense)	
ii.	Marketing expense	Dr. Rs. 30,000
	Sales	Cr. Rs. 30,000
	(Being correction of incorrectly recorded marketing expenses)	
iii.	Sales	Dr. Rs. 90,000
	Trade debtors/Trade receivable Control a/c	Cr. Rs. 90,000
	(Being correction of incorrectly recorded sales)	

2.7

Learning Outcome/s: 4.8.2
Explain the difference between finance lease and operating lease.

Study text reference: Pages 532 – 543

- The lease term of 7 years is for the majority of the useful lifetime of the machinery.
- The present value of Rs. 14.6 million is approximately equal to the fair value of Rs. 14.55 million at inception.
- The leased asset is stated as specialised, thus only the lessee may be able to use it without major modifications.

Therefore the lease can be classified as a finance lease under LKAS 17.

2.8

Learning Outcome/s: 2.3.4
Identify the characteristics of computerised accounting packages.

Study text reference: Page 122

- Sales ledger
- Receivable ledger
- Inventory module
- General ledger
- Job costing module
- Report generator

2.9

Learning Outcome/s: 4.9.4 Explain the difference between taxable temporary differences and deductible temporary differences.
Study text reference: Pages 558 – 561
i. **Taxable temporary difference** Since these costs were already deducted for tax purposes, depreciation of the carrying amount will be taxed in future periods. ii. **Deductible temporary difference** Alpha can deduct retirement benefit costs in determining taxable profits/loss in future periods when the benefits are paid

2.10

Learning Outcome/s: 3.5
Incomplete records

Study text reference: Pages 326-331

	Rs.
Sales	44,000
Gross profit (20%)	(8,800)
Cost of sales	35,200
Opening inventory	6,000
Add: Purchases	40,000
Closing inventory	-
Cost of goods sold and destroyed	46,000
Cost of goods lost (46,000 – 35,200)	10,800

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s: 2.6 Control accounts
Study text reference: Pages 264 – 293

(a)

Statement showing the correction of total amount in payable ledger

		Rs.
Total amount before adjustment		1,235,340
Add:		
Unrecorded purchases	156,000	
Dishonored cheque	87,660	
Error in recording the discount	5,000	248,660
		1,484,000

(b)

Corrected payable control account

		Rs.
Balance before adjustments		1,540,000
Add:		
Unrecorded purchases	156,000	
Interest expense on delayed payments	46,500	
		202,500
Less:		
Free sample	77,000	
Discounts on early settlements	56,500	
Purchase return	35,000	
Error in recording payable	90,000	(258,500)
		1,484,000

(c) **Reasons for maintaining control accounts**

- To ensure accuracy
- To simplify and facilitate easy extraction of figures
- Provide internal checks
- Facilitate location of errors where posting to control accounts are made daily/weekly/monthly.

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 3.6 and 2.7
3.6 Analysis of business performance through financial statements
2.7 Bank reconciliation
Study text reference: Pages 685 – 693, 246 – 262

(a)

	Rs. '000
Current assets	
Cash	2,000
Trade receivables	25,000
Inventory	46,000
Short-term investments	10,000
	83,000
Current liabilities	
Trade payables	19,000
Accrued expenses	3,000
	22,000
(i) **Current ratio**	
Current assets	3.77
Current liabilities	
(ii) **Quick ratio**	
Current assets – Inventory	1.68
Current liabilities	
(iii) **Receivables collection period**	
Trade receivables x 365	41 days
Credit sales	
(iv) **Payables payment period**	
Trade payables x 365	55 days
Credit purchases	

(b)

Adjustments in cash book	
	Rs. '000
Bank balance before adjustments	80,000
Add:	
Incorrectly debited to the cash column	5,000
Unrecorded deposits/direct deposit	1,000
	86,000
Less:	
incorrectly recorded cheque payment	900
Corrected cash book balance	85,100

Bank reconciliation statement	
	Rs. '000
Balance per corrected cash book	85,100
Add:	
Cheques issued but not presented	10,000
Less:	
Cheques deposited but not realised	1,700
Balance per bank statement	93,400

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 4.13 and 4.2
4.13 SLFRS for SMEs
4.2 Property, plant and equipment
Study text reference: Pages 188 – 207 and 654 – 662

(a) The scope of SLFRS for SMEs specifically states that this standard is not applicable for finance companies or that finance companies are of public interest and hence SLFRS for SMEs is not applicable and full SLFRS will be applicable.

(b) (i) Two options in full SLFRS not included in SLFRS for SMEs
- Revaluation model for intangible assets
- Choice between cost and fair value models for investment property
- Options for government grants

(ii) Simplifications adopted under SLFRS for SMEs
Accounting for research and development → treated as an expense.

(c)

	Rs. million	
Revaluation amount on 31 March 2017	3.6	
Less: carrying value	(3.0)	
Revaluation surplus	0.6	Credited to revaluation reserve account on 31 March 2017
Year ended 31 March 2018		
Valuation on 1 April 2017	3.6	
Depreciation for the Y/E 31 March 2018	(1.2)	
Carrying value on 31 March 2018	2.4	
Sale value	2.6	
Profit on disposal	0.2	

Impact on the elements of the financial statements for the year ended 31 March 2018.

Income statement

1. Depreciation charges Rs. 1.2 million
2. Profit on disposal of vehicle Rs. 0.2 million

Other comprehensive income and changes in equity

3. Rs. 0.6 million is deducted from the revaluation reserve and added to retained earnings (in the statement of changes in equity)

(Total: 10 marks)

Answer 06

Relevant Learning Outcome/s: 3.3
Partnerships
Study text reference: Pages 31 – 55 (Additional Study Support)

(a)

Tharanga, Vipul and Kasun Partnership
Realisation Account

	Rs. '000		**Rs. '000**
Land and buildings	105,400	Motor vehicle to Kasun – capital account	38,000
Motor vehicle	28,000	Receipt of cash – land and buildings	102,000
Inventory	4,560	Receipt of cash – inventory	4,000
Trade receivables	13,600	Receipt of cash – trade debtor	13,100
Realisation expenses	125	Debtor guarantee – Tharanga	500
Early settlement expense	435		
Profit on realisation – Tharanga	2,192		
– Vipul	1,644		
– Kasun	1,644		
	157,600		**157,600**

(b) **Partners' Capital Accounts**

	Tharanga	**Vipul**	**Kasun**		**Tharanga**	**Vipul**	**Kasun**
	Rs. '000	**Rs. '000**	**Rs. '000**		**Rs. '000**	**Rs. '000**	**Rs. '000**
Transferred from current account	-	-	3,140	Balance 31 March 2018	40,000	30,000	30,000
Acquisition of motor vehicle	-	-	38,000	Transferred from current account	16,000	17,000	-
Debtor guarantee – Tharanga	500	-	-	Profit on realisation	2,192	1,644	1,644
Cash	57,692	48,644	-	Cash	-	-	9,496
	58,192	**48,644**	**41,140**		**58,192**	**48,644**	**41,140**

(Total: 10 marks)

SECTION 3

Answer 07

Relevant Learning Outcome/s: 3.2.3 and 3.2.5
3.2.3 Prepare financial statements for the purpose of management and publication. 3.2.5 State the regulatory requirement to prepare consolidated financial statements for a group of companies.
Study text reference: Pages 365 – 385, 471

(a) (i)

Ceytag PLC
Statement of profit or loss for the year ended 31 March 2018

	Rs. '000	
Sales	175,690	
Cost of sales	(110,805)	**W1, W2**
Gross profit	64,885	
Add: Other income	28	
Administrative expenses (32,400 + 4,200 + 1,825 + 2,912 + 3,012)	(44,349)	**W3, W5**
Distribution expenses (3,100 + 2,700)	(5,800)	**W5**
Financial expenses	(1,230)	
Profit before tax	**13,534**	
Taxation	(6,660)	**W7**
Profit for the year	**6,874**	

(ii)

Ceytag PLC
Statement of financial position as at 31 March 2018

	Rs. '000	
Non-current assets		
Property, plant and equipment	56,726	
Current assets		
Inventory	16,895	**W1**
Trade receivables (4,700 – 1,200)	3,500	
Prepayment (7,300 – 1,825)	5,475	**W5**
Cash at bank	25,300	
	51,170	
Total assets	**107,896**	
Equity and liabilities		
Equity		
Stated capital	50,000	
Retained earnings (11,190 + 6,874)	18,064	
	68,064	
Non-current liabilities		
Redeemable preference shares	20,000	
Deferred income (1,400 – 28)	1,372	
	21,372	
Current liabilities		
Trade payables	6,400	
Income tax payable	6,160	
Accrued expenses (1,700 + 4,200)	5,900	
	18,460	
Total equity and liabilities	**107,896**	

Working 1	**Rs. '000**
Value of inventory as at 31 March 2018	17,400
Cost of slow-moving items above NRV (800 – 295)	(505)
	16,895

Working 2	**Rs. '000**
Cost of sales	
Opening inventory	12,300
Add: Purchases (112,400 + 3,000)	115,400
Less: Closing inventory	(16,895)
	110,805

Working 3 – Depreciation	Rs. '000
Building (60,250 * 5%)	3,012
Equipment (14,560 * 20%)	2,912
Motor vehicle (10,800 * 25%)	2,700
	8,624

Working 4
Sales order placed cannot be recognised as revenue even though it is for a specific quantity and at a specific price.

Working 5 – Lease rent paid		
	Rs. '000	
Amount paid	7,300	
Amount relevant for the future period	(5,475)	
(7,300/12*9)		
Amount relevant for the year	1,825	*Administrative expenses*

(Alternatively 7,300/10 x 3)

Cash back of Rs. 1,400,000 should be split equally between the lease period and charged to profit or loss. Amount relating to future periods should be reflected as deferred income.

Accordingly,

W6 – Amounts relevant	
	Rs. '000
For the current year (1,400/50)	28
For the future years (1,400 – 28)	1,372
	1,400

	Rs. '000
Dr: Other income	1,372
Cr. Deferred income	1,372
Working 7 – Income tax	
Income tax for the current year (22,000*28%)	6,160
Under provision for previous year	500
Tax charge	6,660

(b)

- Power over more than 50% of the voting rights by virtue of agreement with other investors.
- The parent has the power to govern the financial and operating policies of the entity by statute or an agreement.
- The parent has the power to appoint or remove a majority of members of the board of directors.
- The parent has the power to cast a majority of votes at meetings of the board of directors.

(Total: 20 marks)

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