CA BUSINESS SCHOOL

POSTGRADUATE DIPLOMA IN BUSINESS FINANCE AND STRATEGY

SEMESTER 1: Financial Statements Analysis

Preparation of Financial Statements

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Contents

Code of Ethics and Corporate Governance

Introduction

Corporate Governance & Code of Ethics has become a vital element/concept within the overall business environment and profession of accounting as a whole.

Corporate Governance basically discusses how to govern/manage the entity's overall activities with best practices while code of ethics essentially guide professional accountants to work in an ethical manner.

Ultimately, CE & CG leads to the phenomena of Corporate Social Responsibility (CSR) which in turn has become the area that most of the entities are concentrating much and being awarded/recognized in recent past.

Discussion:

Business Sustainability | 3BL | Theories in Business Sustainability

Professional Code of Ethics

Institute of Chartered Accountants of Sri Lanka introduced following fundamental principles for its members.

The Public Interest

- Safeguard the interests of your clients(public practice) and employers
- Accept your responsibility to the public at large

Independence

- Be, and be seen to be, free of any interest that might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity (who are in public practice)

Integrity

- Be straightforward, honest and sincere in your approach to professional work

Objectivity

- Be fair and do not allow prejudice, conflict of interest or bias to override your objectivity
- Maintain an impartial attitude and protect the integrity of your professional services

Confidentiality

- Respect the confidentiality of information acquired in the course of your work and do not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose it

Technical and Professional Standards

- Carry out your professional work in accordance with the technical and professional standards relevant to that work

Professional Competence and Due Care

- Perform professional service with due care, competence and diligence
- Maintain professional knowledge and skills at required level
- Refrain from performing any services that you are not competent-to carry out unless assistance is obtained

Ethical Behaviour

- Conduct yourself in a manner consistent with the good reputation of the profession and refrain from any conduct that might bring discredit to the entire profession

Carryout Business in an Ethical Manner

In recent past, numerous business ethical issues have arisen in both profession of accounting & business world which were discussed through public media. Most of these includes insider dealing, price skimming, sale of harmful products and pollute the environment.

Following are some of the emergent topics due to unethical business practices.

- Whistle blowing

Whistle blowing is the term used to describe the act of an employee exposing an entity's unethical practices.

- Insider dealing/Trading

Simply, Insider dealing is the buying and/or selling of entity's stock (shares) based on inside knowledge. This occurs a responsible officer within the organization disclose the confidential information which are not yet published by the entity.

Some argue that insider dealing is not an unethical act since information suppose to disclose to the public. But some argue it is an unethical due to the fact that information not yet officially published.

❑ Ethical Investment

Ethical investment means investors buying only the selected entities' shares which have value systems similar to their own.

❑ Bribery

Bribery is a payment for a favor which results in someone acting in a way that is contrary to that demanded by the situation. Bribery basically different from receiving gifts, tipping or facilitation payments. But under certain circumstances, those also tend to define as a Bribe.

❑ Fraud

Fraud is an acting deceptively and dishonestly usually with the financial motive in mind.

❑ Forensic Accounting

Forensic Accounting is a new dimension of accounting profession in which investigation of money trails for the purpose of reporting to the law courts will be a main task/duty.

Corporate Governance

Corporate Governance is all about good governance. This means directions/control and management of the entity with good motive by the members of the Director Board.

Generally, Directors owe the following duties/tasks (legal) to their company.

- To act in good faith, in the best interest of the company.
- To act with care and diligence.
- To avoid improper use of information or position.
- To avoid complex between their role as a director and any of their personal interests. (agency theory)

The chief executive officer and the chief financial officer should state in writing to the board that the company's financial reports present a true and fair view in all material respects of the company's financial condition/position and operational results and are in accordance with relevant accounting standards.

Corporate Governance (contd.)

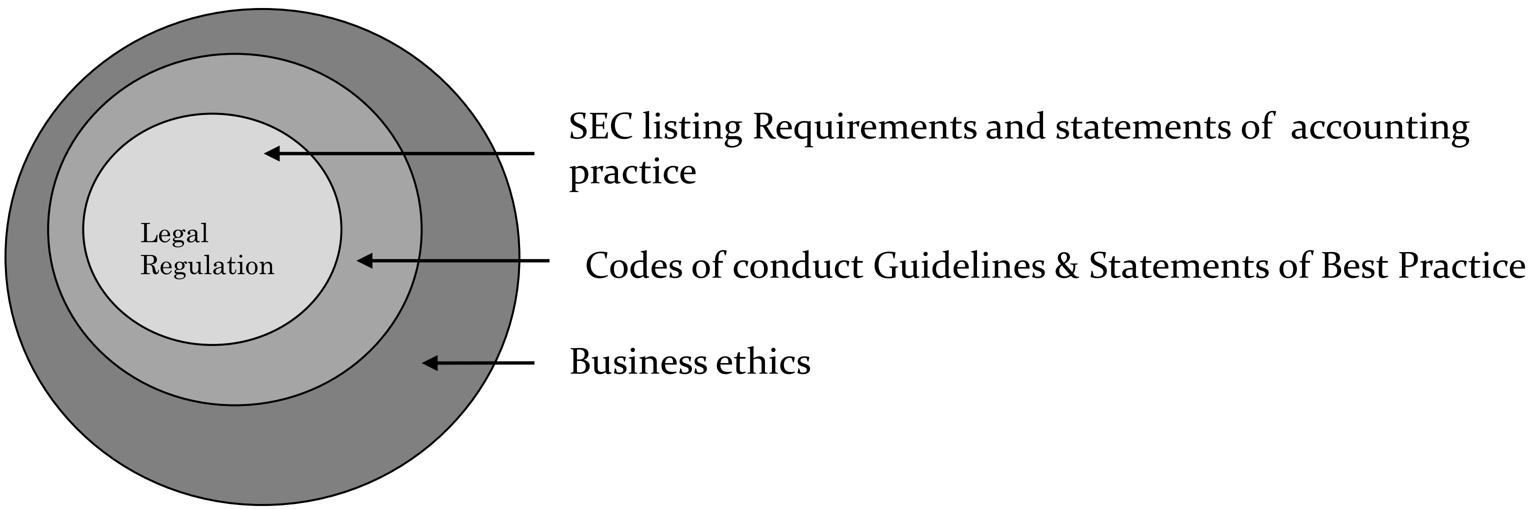
- The board should establish an audit committee and such audit committee should consist of:

1. only non-executive directors
2. a majority of independent directors
3. an independent chairperson, who is not chairperson of the board
4. at least three members

- The audit committee should have a formal charter.

- An entity should provide the following information: details of those on the audit committee, the number of meetings and attendees of the audit committee, and explanations of any departures from the recommendations as stated above should be included in the corporate governance section of the annual report. It is also recommended that the committee charter and the procedures for selection and appointment of external auditors are made publicly available.

- Though the corporate governance basically deals with the rights and obligations of companies' key management (Directors), It also considers the duties & rights of shareholders and other various stakeholders.
- The practice of corporate governance is vary from one country to another. Commonly, following structure could be seen in corporate governance.



Note: Every entity must establish suitable policies/procedures and applications of corporate social responsibility along with the corporate governance.

Corporate Social Responsibility & Stakeholder Theory

- A corporation usually has a large number of "**stakeholders"** who are individuals or groups that have an interest in the entity's affairs. They include share holders (the owners), employees, creditors, suppliers, governments and other interested parties (such as unions and environmental groups).

- It is the shareholders who vote at the annual general meeting, and the shareholders who choose the directors. In fact, it is commonly accepted that a central part of corporate governance is to ensure the maximization of shareholders' wealth.

- Stakeholder theory holds that the purpose of the entity is to work for the good of all stakeholder groups, not just to maximize shareholders' wealth. Employees, governments, customers and communities all have an interest in the affairs of the entity.

- Corporate Social Responsibility (CSR) refers the responsibility of an entity towards all stakeholders, including society in general and the physical environment within which it operates.

Role of Accountant

Accountants – with their information systems, performance appraisal expertise, and qualities such as integrity, objectivity and independence can help entities discharge their social and environmental obligations through the following types of activities:

- Modifying the existing systems to incorporate environmental and social revenues and expenditures.
- Rethinking the use of some accounting techniques (such as investment and performance appraisal) because they ignore the environmental and social elements.
- Having a greater awareness of the future by bringing to account potential contingent liabilities, changing payback periods, and determining the cost of environmental and social initiatives as well as the cost of not undertaking such initiatives.

- Expanding and developing new information systems to incorporate environmental and social information (for example, by including information on incorporation on the whole lifecycle of a product and not just the production cost).
- Including environmental and social information in external reporting. The accountant’s role goes beyond providing financial information to satisfy statutory requirements. It includes the provision of information – relevant, reliable, accurate and timely – on a number of issues for various stakeholders.
- Developing systems that not only capture the environmental and social activities but also evaluate the extent to which the activities meet the objectives.
- Attempting to measure both the cost of environmental and social activities as well as the benefits.

Identifying and Recording ;

Business Transactions & Events

Business Transaction

Business Transaction is the main source through which an entity compile its financial statements for the given period.

Regardless whether a sole proprietorship or a company, every entity should identify & record business transactions as and when they occurred.

Business Transactions are occurrence of incidents which results external exchanges of resources between the entity and another entity or individual through which entity’s assets, liabilities and/or equity get affected.

Every business transaction must measure in monetary terms & treated to be occur at arm’s length.

Every entity should record their transactions subject to the entity concept. (involved and get affected by the entity/ there should be a clear cause and effect relationship between entity and the business transaction)

Each & every business transactions should be recorded with suitable/proper documentary evidences/trails. These commonly called as “Source documents”

- Sales Invoice
- Purchase Order
- Land Deed
- Electricity/ Telephone Bill

Basically, business transactions could be divided in to cash and credit transactions.

Examples for common Business Transactions;

- Cash Sales
- Cash Purchases
- Purchase on credit
- Credit Sales (sale of goods to ABC & Co.)
- Payment of Salary
- Purchase of Motor Vehicle (NCA)
- Sale of Machinery
- Income Tax payable

How to distinguish business transactions from owners' personal transactions (This is crucial due to entity concept).

Example: Mr Perera, Owner of the Perera & Co. (Sole Proprietorship) bought a refrigerator,

a) using his own/personal money - do not record in the business.

b) using company's money - record in the business as withdrawals.

It is quite difficult to distinguish in sole proprietorship but need to do so.

Distinguish Between Business Transactions and Events

Business Events are occurrences/incidents that have a potential to be a business transactions but could not be yet recorded within the company. Only disclosure is required in the financial statements.

Example: Formal negotiation to combine the business with another, Negotiation to obtain a bank loan.

Accounting Equation

Accounting equation is one of the basic/fundamental phenomena in financial accounting which basically depicts the relationship between total assets, total liabilities and total equity of the particular entity at a given particular time.

At a given particular time, total assets of an entity must equal to the aggregation of total liabilities and total equity.

Assets = Equity + Liabilities (different versions to be discussed)

Assets are the resources held by an entity to run the business. Equity & Liabilities represents how an entity owned/acquired such assets.

- Equity - own capital/finance.
- Liabilities - Other than own capital, all the other third party capital.

Concept of Duality

Duality means every business transaction will have a dual effect.

some practical examples;

- ❑ Introduction of capital
- ❑ Purchase of assets
- ❑ Sale of Goods
- ❑ Obtain a Bank loan

Accounting Worksheet

Accounting worksheet is a summary of the total business transactions for a given period. Based on the worksheet, entity would clearly identify the dual effect of each transactions. First, record all the transactions in a table form and then record them in to the accounting equation.

Errors in Recording Business Transactions

Sometimes, it finds that assets side of the worksheet may not tally/agree with the liabilities & equity side due to various reasons. These reasons are commonly called as errors. Errors shall depict that concept of duality not followed/applied properly.

- Single - entry error
- Transposition error
- Incorrect entry
- Double accounting
- Misapplication of principles
- Unrecorded entry (different to others)

Some of the mistakes/errors (missing figures) could easily be able to find through accounting equation.

Capturing/Recording Accounting Information

As we have identified, every entity should record their transactions in a manner that helps generate financial statements quickly and accurately thereafter.

- **Journal**

is a book that records each transactions based on the source documents. This includes date of the transaction, nature, places (accounts) get affected.

Most of the companies keep a distinctive journal to record the transactions which are having similarities.

- **Ledger**

is a formal statement used by the organization to record all identified transactions for a given period. A particular ledger account shows the movements/changes of balances/amounts throughout the period.

Left Side - Debit (Dr)

Right Side - Credit (Cr)

It is ideal to have a separate individual ledger accounts for different categories of transactions.

Format

Dr. ………………….Account Cr.

Date	Particulars	L/F	Amount	Date	Particulars	L/F	Amount
(A)	(B)	(C)	(D)				

Note. - When Practically record the transactions, instead of above format, it commonly used the following "T" Account format which derived from the above format.

………………….Account

(A) (B) (D)

Rules of Debit and Credit

It is crucial / important to understand and remember the rules of debit and credit since it provides the basis for the recording of transactions and preparation of financial statements thereafter.

Step 1

Understand the Five (05) categories of Ledger Accounts available in any types of entity to which all transactions could be categorized.

	<u>Generally</u>
- Assets	Dr
- Liabilities	Cr
- Equity	Cr
- Expenses	Dr
- Income	Cr

Step 2

Apply the rule (increase will take the same position and vice versa)

When,

Assets & Expenses <u>Increase</u> → Debit

Assets & Expenses <u>Decrease</u> → Credit

When,

Equity, Liabilities & Income <u>Increase</u> → Credit

Equity, Liabilities & Income <u>Decrease</u> → Debit

Trial Balance (TB)

Trial Balance is the summary of entire ledger accounts balances for the particular date is concern. Trial Balance is treated as source (ultimate) to prepare financial statements. Trial Balance provides assurance that concept of duality applied properly, but not give comprehensive assurance on accuracy of recording transactions. (what does it mean and how to prepare TB?)

Statement of Financial Position

Introduction

Balance Sheet is a key element which represents overall sets of financial statements. Balance sheet essentially assess the financial position of an entity for a given particular date/time. As name indicates, it shows how Assets, Liabilities & Equity are being balanced for a particular date/time.

Assets - The Resources owned by the entity.
Liabilities - External Claims / Borrowings.
Equity - Internal Claims / Capital.

Balance Sheet represents investment & financing decisions of a particular entity for a given time.

Investment Decision - The Acquisition (or sale) of assets.
Financing Decision - The decision of how to finance the cost of the assets. (How to acquire the resources)

Use of Balance Sheet

Balance Sheet provides an assurance of accurate use/practice of duality concept and accounting equation by the company. (but still can contain some errors; recall the memories of previous session)

Being analyzing the balance sheet, users will make preliminary assessment of the entity's economic condition. They would evaluate;

- The types of assets in which the entity **invest**. (NCA Vs. CA)
- How the entity **finance** its assets? (own Vs. 3^{rd} party)
- **Gearing position** of the company. (TE Vs. TL)
- **Liquidity position** of the company. (CA Vs. CL)

Assets Vs Liabilities & Equity

Assets

Assets are the resources controlled by an entity and as a result, future economic benefits will flow in to the entity.

Three (03) key criteria to be satisfied;

- ❑ Future economic benefits must flow in to the entity.
- ❑ Controlled by the entity.
- ❑ As a result of the past events.

How to recognize/record the asset?

- ❑ Future economic benefits must be probable/certain.
- ❑ Cost & Value (fair) should able to be measure reliably.

Why an employee(s) not being treated as an asset of an organization?

Liabilities

A present obligation of an entity arising from past events and settlement will essentially result outflow of resources embodying economic benefits.

Three (03) key criteria to be satisfied;

- A present obligation.
- As a result of the past events.
- Outflow of resources embodying economic benefits.

How to recognize/record the Liability?

- Outflow of resources embodying economic benefits must be probable/certain
- Value should able to be measure reliably

Equity

Equity represents the owners’ claims on the assets/owners’ interest of the entity.

Equity = Total Assets - Total Liabilities

Equity comprised capital introduced by the owners and retained earnings.

Retained Earnings is treated as most powerful source of finance for most of the organization they quite struggling to seek finance from any other internal or external sources.

Format and Presentation of the Balance Sheet

Format → " T " Format. (Horizontal) (Traditional)

Format → Narrative/Vertical Format.

Note:
It's compulsory to indicate previous year similar line items (Comparatives) when presenting current year balance sheets' line items.

When presenting the consolidated/group balance sheet, figures/amounts of both parent company and consolidation (Group) should indicate with previous year figures/amounts separately.

Broader Categories of Assets and Liabilities

We, initially identified the nature and recognition mode of both assets & liabilities. Now we could analyze both assets & liabilities in broader manner as follows;

Assets → Non-Current Assets (NCA)
→ Current Assets (CA)

Liabilities → Non-Current Liabilities (NCL)
→ Current Liabilities (CL)

Note:
Regardless of the type of Entity, Current & Non-Current Assets/Liabilities should shown separately in the statement of financial position.

Types of Commonly Applicable Assets

- Property, Plant & Equipment
- Agricultural assets/biological assets
- Intangibles

NCA

- Inventories
- Trade Debtors
- Cash & cash equivalents

CA

Goodwill (Intangibles) → Internal (not recorded)
→ External (recorded in group)

- Determination: how to identify and measure?

Types of Commonly Applicable Liabilities

- Debentures
- Bank Loan
- Leasing

NCL

- Provisions
- Trade Creditors
- Bank Overdraft.

CL

Types of Commonly Applicable Equity

- Share Capital (UITF announcement on redeemable P/Sc.)
- Reserves
- Retained Earnings

Typical Assets & Liabilities : Measurement Techniques

- ❑ Historical Cost. (Original purchase cost)
- ❑ Current Cost. (Cost of replacement)
- ❑ Market Value. (Expected in the market)
- ❑ Present Value. (Discounted Value of future cash flows)
- ❑ Fair Value. (Determined in an arms length transactions)

Valuation of Stocks/Inventories

Stock

Cost NRV

Whichever is lower [why?]

Inventory Valuation Techniques.

- FIFO
- LIFO (no more applicable)
- HIFO
- WAC

Valuation of Trade Debtors

Value appear in the balance sheet should be a Net Debtors.

I) Bad Debtors. II) Doubtful Debtors.

Valuation of Property, Plant & Equipment

Value appear in the balance sheet should be a Written Down Value. (WDV)

Concept of

I) Depreciation & method of Depreciation. (UITF announcement.)

II) Amortization. (only in Intangibles)

III) Impairment.

IV) Revaluation.

Potential Limitations of the Balance Sheet

- Some items might be missing. (immaterial, non identifiable)
- Different techniques used to value the assets.
- Using historical cost.
- Using some assumptions & estimates. (no proof)

Income Statement |

Changes in Equity Statement

Overview

Income statement is a key element which represents overall sets of financial statements and tend to prepare at the end of the particular financial period (year).

Income statement reflects the overall financial performance of the particular entity for the given period of time and depicts profit/loss earned/incurred for such period.

The end result (bottom line) of the income statement called either “profit or loss” which basically derived through the adjustment of income and expenses for the given period.

Income comprised from revenue earned from major operational activities and other sources such as dividends/interests/profit from sale of NCA. All expenses & revenue are recurring nature including some provisions for the depreciation and bad/doubtful debtors.

Keys in Preparing Income Statement

- The reporting period
- Concept of accrual accounting
  - accrual income (Income & asset)
  - income received in advance (Liability)
  - accrued expenses (Expense & Liability)
  - expenses paid in advance (Asset)
- Accounting policies
- Depreciations/ Amortization/ Impairment

(Note: methods of calculation & application will be discussed in chapter 8)

Measuring Financial Performance Through Income Statement

- Recognition of income. How? When?
- Types of income recognized. Revenue & Gain.
- Classifications.

- Recognition of expenses. How? When?
- Types of expenses recognized. Cost & Loss.
- Classifications.

Income

Defined as increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increase in equity, other than those relating to contributions from equity participants.

Should identify when satisfy the following;

- Does an agreement for the provision of goods and services exist between the entity and a party external to the entity?
- Has cash been received; or does the entity have a claim against an external party that is for a specified consideration and is unavoidable without penalty?
- Have all acts of performance necessary to establish a valid claim against the external party been completed?
- Is it possible to reliably estimate the collectability of debts?

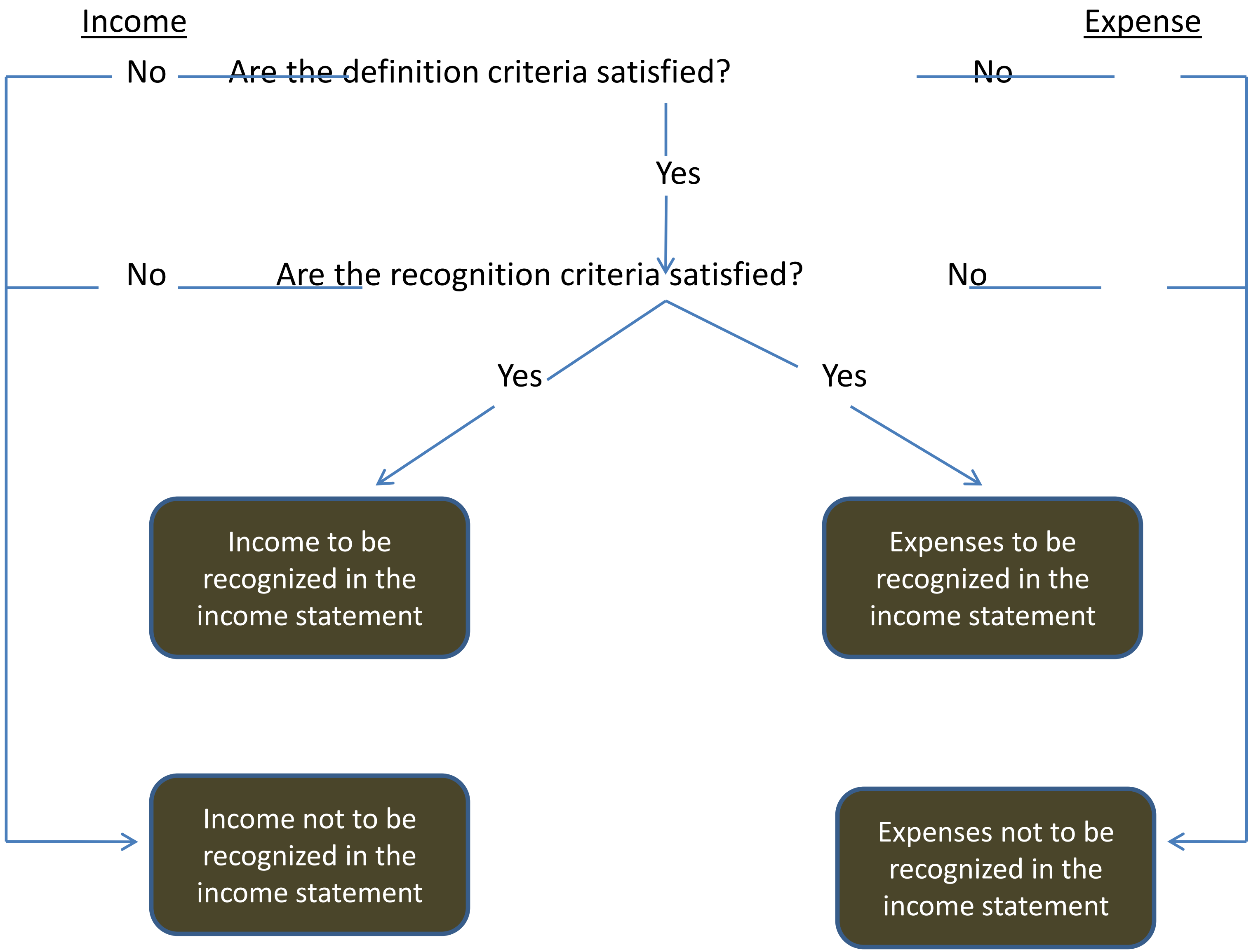
Expenses

Defined as decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants. (dividends & buy back)

Should identify when satisfy the following;

- Decrease in economic benefit is certain.
- Such outflow could measure reliably.

Summary to Remember



Preparation & Presentation

Appearance/format → External perspective

Appearance/format → Internal perspective

Entities which are govern by companies act, must comply with the SLFRSs and LKASs when preparing and presenting their financial statements.

Further, on the face of the income statement, following elements should disclose separately.

- Revenue
- Finance cost
- Share of profit/loss from associates/joint ventures
- Tax expenses
- Profit or Loss

Note: *It is a mandatory requirement to segregate/separate profit/loss from continuing & discontinuing operation.*

Treatment in relation to the following elements is also key in income statement;

- Material income & expenses
- Extraordinary items

Entities which are not govern by the companies act (non-reporting entities), may prepare & present income statement as their own wish. No predetermined format or presentation requirement for such category of entities.

Measuring Financial Performance

- Gross profit – GP

  GP purely measures operational & production efficiency of the entity.

  GP = (Total sales – Cost of sales)

- Net profit – NP

  NP reflects end result of the operational activities for the given period of time.

  NP = [GP – (all administration & other operational expenditures)]

- Pre – tax and Post – tax profit

  Conceptually, users may not change their decisions considerably based on the effect of corporate income tax of the entity.

  PBT = (GP – operational expenditures)

  PAT = (PBT – income tax)

- **Pre – interest and Post – interest profit**

  Users may change their decision by analyzing the fact that how entity manage their finance and costs of funding.

  PBI = (GP – operational expenditures)

  PAI = (PBI – interest/finance cost)

- **Pre and Post depreciation & amortization profit**

  Both depreciation and amortization are not actual expenditures. SLFRSs/LKASs require identifying these as an expenditures and adjusting accordingly.

- **EBITDA**

  Real Profit

- **Pre and Post material items profit**

  Usually entities tend to prepare & present with this format/classification where no mandatory requirement.

- **Pro forma earnings**

  This depicts only actual income & expenditures for the given period of time and end result accordingly.

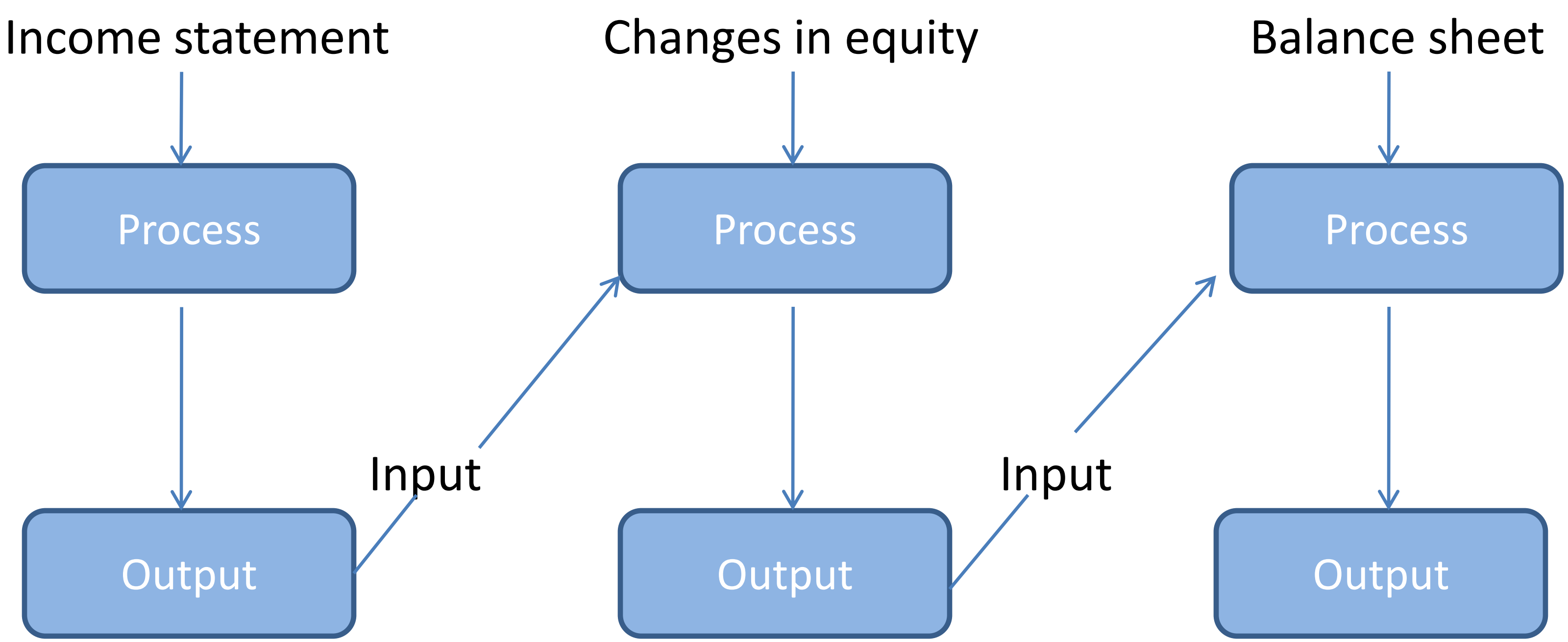
Statement of Changes in Equity

The SLFRSs /LKASs require entities to prepare & present statement of changes in equity as part of the financial statements. This statement denotes the changes in equity from the beginning to the end of the reporting period.

Hence, the statement of changes in equity shows;

- Income & expenses recognized in the income statement and its results.
- Income & expenses directly recognized to the equity.
- Transactions are carried out with equity holders and end result of them.

Relationship Between Three Elements



Statement of Cash Flows

Introduction

Statement of cash flows clearly denotes **cash inflows** and **outflows** of the entity and end result of **net cash position** for the given particular period of time.

Cash is the **most liquid current asset** of the entity which carries significant level of importance (as well as risk) in operational activities. (Cash refers cash in hand & cash equivalents)

An entity could take following actions to enhance/improve cash position.

- Enhance cash revenue (expansion/diversifications)
- Expedite/enhance collection from trade debtors
- Reduce unnecessary cash investment in stocks and other STCA
- Sale of (**idle**) assets
- Seek low cost sources of finance (both ST & LT)
- Control Operational & maintenance expenditures (not cut or minimize)
- Defer capital expenditures (has to manage; tradeoff)
- Maximum utilization of creditors' support (ethically)

Management of cash is pivotal for the success of an entity. Users will basically assist/analyze following by perusing cash flow statement.

- Ability to generate cash. (now and future)
- Ability to meet financial commitments/obligations including settlement of borrowings & dividends.
- Sources of cash generation and their nature.
- Ability to obtain external finance.

Statement of Cash Flows : Format

Cash flow statement is a key element which represents overall sets of financial statement. Hence, format of the cash flow statement is also governed by the accounting standards.

Cash flow statement can prepare & present either in Direct or Indirect method.

Generally, cash flows will be presented by categorizing in to following 03 areas.

1. Operating Activities

Cash inflows/outflows from major/key operational activities.

Receipts from customers (trade debtors)	xxxx
Payments to suppliers (trade creditors)	(xx)
Payments of other expenditures (utility)	(xx)
Inflows/(Outflows)	xx/(xx)

2. Investing Activities

Presenting cash inflows & outflows from investing activities which mainly comprised with movement (addition/disposal) of NCA.

Cash inflows from NCA	xxxx
Cash outflows from NCA	(xx)
Net cash inflow/(outflow)	xx/(xx)

3. Financing Activities

Depicts cash inflows & outflows with the affect of changing the composition of NCL. (including equity)

Cash inflows from NCL	xxxx
Cash outflows from NCL	(xx)
Net cash inflow/(outflow)	xx/(xx)

Summary

Area	Cash inflows	Cash outflows	Link to other statements
Operating activities	• Receipts from customers • Interest received • Dividends received	• Payments to suppliers and employees • Interest paid • Taxes paid	Revenue and expenses items in the income statement
Investing activities	• Sale of property, plant and equipment • Receipt of loan payments • Sale of equity in other entities	• Purchase of property, plant and equipment • Purchase of equity in other entities	Assets in the balance sheet
Financing activities	• Borrowing cash • Proceeds from issuing shares	• Repaying borrowed cash • Payments to acquire or redeem the entity's shares • Payment of dividends	Liabilities in the balance sheet

Presentation of Cash Flow Statement

In conclusion, cash flow statement denotes following in the given order.

- Net cash flow from operating activities.
- Net cash flow from investing activities.
- Net cash flow from financing activities.
- Total cash flow at the period end.
- Cash balance at the beginning of the period.
- Cash balance at the end of the period.

Profitability Vs Cash flows

Reconciliation of cash flows from operational activities with the operating profit of an entity for a particular period shall basically be considered in this task.

Operating profit differs from operational cash flows due to following reasons.

- Accrual Vs Cash concept.
- Non - cash items available.
- Working capital increase/decrease.

Hence, under indirect method, this need to be adjusts at the beginning of cash flow statement within the operational activities category.

Points to Note

Generally, perusal of cash flow statement communicates following alarming / warning signals to users/management/decision makers.

- Cash received < Cash paid.
- Operating cash outflow.
- Cash receipts from customers < Cash payments to Suppliers.
- Cash from operating activities < Operating Profit. (not same as others)
- Inflows from investing activities are inconsistent.
- Proceeds from borrowings > Repayment of borrowings.

Ratio Analysis : Cash Flow Statement

Commonly applicable ratios;

Ratio	Calculation
Cash adequacy ratio	$\frac{\text{Cash from operating Activities}}{\text{Capital expenditure + Dividends paid}}$
Cash flow ratio (liquidity)	$\frac{\text{Cash from operating activities}}{\text{Current liabilities}}$
Debt coverage ratio (solvency)	$\frac{\text{Non-current liabilities}}{\text{Cash from operating activities}}$
Cash flow to sales ratio (profitability)	$\frac{\text{Cash from operating activities}}{\text{Net sales}}$

Exercises

Exercise 01

Cost of purchase 01 unit of “X” is LKR 5.00 and brokerage will be total of LKR 50,000.00. Company will procure 100,000 units and further LKR 80,000.00 will incur as cost of conversion. Company plans to sell 01 unit at LKR 7.50 and sales commission of LKR 60,000.00 will be incurred in the event of sales.

Compute the value of inventory based on LKASs and show the entries appeared in relevant places.

Exercise 02

Some of the particulars belongs to PQR Ltd is given below;

1. Telephone bill for march/2012 is LKR 50,000.00
2. Electricity bill for march/2012 is LKR 20,000.00
3. Investment made in FD value of LKR 500,000.00 @ 10% rate on 1/10/2011

Compute the value of accruals. Show the ledger entries and places where they should shown in F/S ending 31st March 2012.

Exercise 03

Details of transactions pertaining to XYZ Ltd are given below;

1. LKR 600,000.00 insurance paid for 12 months starting from 1/10/2011
2. Company received LKR 1.2 million of building rent for 24 months which was rented on 1/4/2011

Compute the value of Pre-incurred expenditures and income received in advance and show necessary ledger entries along with the places to be appeared in F/S ending 31st March 2012.

Exercise 04

Total value of the debtor balance of ABC Ltd as at 31st March 2012 is LKR 5 million. Company is certain that the following debtors balances couldn't be recoverable.

	LKR/Mn
P	0.2
Q	0.35
R	0.65

Company also decided to provide for doubtful debtors as follows;

	LKR/Mn	%
X	0.8	10
Y	0.4	10
Z	0.2	20

Company is also decided to provide for doubtful debtors by using a flat rate of 8% of closing balance.

Compute bad debtors/specific & general provision of doubtful debtors and show necessary ledger entries along with the balances appeared in F/S.

<u>Exercise 05</u>

PQR Ltd procured a motor vehicle for the value of LKR 2.5 million and expected to generate revenue over next 5 years. After fifth year it could be sold for LKR 0.5 million.

1. Calculate the depreciable amount under both straight line and reducing balance methods

2. Calculate depreciation for next 3 years under both straight line and reducing balance methods

3. Show the necessary ledger entries and places to be appeared in F/S for next 3 years

4. Assume that motor vehicle sold for LKR 1.5 million after 3 years. Calculate profit/loss under both straight line and reducing balance methods