



# Grade 13 Accounting

## Teacher's Guide

(To be Implemented from 2018)



**Department of Commerce**  
**Faculty of Science & Technology**  
**National Institute of Education**  
**Maharagama, Sri Lanka**  
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**Accounting**

**Grade 13**

**Teachers' Guide**

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## **Message from the Hon. Minister of Education**

## **Message from the Director General**

With the primary objective of realizing the National Educational Goals recommended by the National Education Commission, the prevalent content based curriculum was modernized, and the first phase of the new competency based curriculum was introduced to the eight year curriculum cycle of the primary and secondary education in Sri Lanka in the year 2007

The second phase of the curriculum cycle was introduced to the education system in the year 2015 as a result of a curriculum rationalization process based on research findings and various proposals made by stake holders.

Within this rationalization process the concepts of vertical and horizontal integration have been employed in order to build up competencies of students, from foundation level to higher levels, and to avoid repetition of subject content in various subjects respectively and furthermore, to develop a curriculum that is implementable and student friendly.

The new Teachers' Guides have been introduced with the aim of providing the teachers with necessary guidance for planning lessons, engaging students effectively in the learning teaching process, and to make Teachers' Guides will help teachers to be more effective within the classroom. Further, the present Teachers' Guides have given the necessary freedom for the teachers to select quality inputs and activities in order to improve student competencies. Since the Teachers' Guides do not place greater emphasis on the subject content prescribed for the relevant grades, it is very much necessary to use these guides along with the text books compiled by the Educational Publications Department if, Guides are to be made more effective.

The primary objective of this rationalized new curriculum, the new Teachers' Guides, and the new prescribed texts is to transform the student population into a human resource replete with the skills and competencies required for the world of work, through embarking upon a pattern of education which is more student centered and activity based.

I wish to make use of this opportunity to thank and express my appreciation to the members of the Council and the Academic Affairs Board of the NIE, the resource persons who contributed to the compiling of this Teachers' Guide and other parties for their dedication in this matter.

**Dr. (Mrs.) Jayanthi Gunasekara**  
Director General  
National Institute of Education

## **Foreword**

## **Message from the Director**

According to the present policy with regard to the curricula of Sri Lanka the entire curriculum has to be revised once every eight years. A new revision of this nature has become necessary because of the meaningful expectation that a generation of students capable of facing local as well as global challenges taking place, needs to be produced. Further the recent past has witnessed immense economic, political, social and trade related changes on a global scale. As a result the stage has arisen for all curricula to be revised in 2015. The revised G.C.E. (Advanced Level) Grade 13 curriculum has been revised and will come into effect from the year 2018

Taking the situation above in to consideration, I am extremely pleased that Grade 13 Accounting, Teacher's guide has been written and forwarded in such a short time.

I would like to extend my very sincere thanks, especially to the panel of writers, for functioning with such commitment, to the Director General for her instructions and guidance for the fulfillment of this task successfully, to the Deputy Director General and to all those who supported the conclusion of this responsible endeavor.

It is my firm belief that this Teacher's guide on Accounting for Grade 13 will prove of immense support to subject directors, In service advisors and teachers in the provision of learning experiences successfully, to students.

**P. H. Kusumawathie**

Director (Covering)

Department of Commerce



## **Curriculum Committee**

<b>Guidance and Approval</b>	:	<b>Dr. (Mrs.) Jayanthi Gunasekara</b> Director General National Institute of Education
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## **Instructions for the use of the Teachers' Guide**

This Teachers' Guide has been prepared for Grade 13 based on the syllabus for Accounting proposed to be implemented for G.C.E. (A/L) from 2018.

Model activities have been included here as guidance in the planning of teachers' learning-teaching process so as to ensure the development of the students' competencies.

This Teachers' Guide has been prepared in keeping with the order in which the learning – teaching process should be implemented in the classroom. Learning outcomes have been presented for every competency level in the syllabus. It is expected that the teacher will implement a student-centered learning-teaching procedure to ensure that all the students achieve these learning outcomes and the relevant competencies. For this purpose the learning-teaching process has been presented under each competency level in order to provide you with guidance. It is by no means compulsory that you conform to these instructions in that very form itself since, you as creative individuals, have complete freedom to conform to any other student-centered learning-teaching procedure you consider for students.

Similarly, included in this Teachers' Guide are the basic terms and concepts related to the subject area under each competency level. They will serve as guidance to the subject matter you should elicit through the activities in the classroom as well as for the notes you give the students.

**S.K. Prabakaran**

Senior Lecturer

Project Leader - Accounting

Department of Commerce

National Institute of Education

## **National Goals**

1. The achievement of a functioning sense of National Cohesion, National Integrity, and National Unity.
2. The establishment of a pervasive pattern of Social Justice and active elimination of inequities.
3. The evolution of a Sustainable Pattern of living – A sustainable Life Style.
4. Seeking a livelihood and work opportunities that are, at one and the same time, productive and give avenues of self-fulfilment.
5. Participation in human resource development that will support socio-economic growth of the country.
6. Involvement in nation building activities: learning to care.
7. Cultivation of an element of adaptability to change – learn to learn and adapt, developing competence to guide change.
8. Coping with the complex and the unforeseen; and achieve a sense of security and stability.
9. Securing an honourable place in the international community.

## Basic Competencies

The following competencies promoted through education will help to achieve the above mentioned National Goals.

### (i) Competencies in Communication

This first set of competencies is made up of four subsets - Literacy, Numeracy, Graphics and information communication skills :

Literacy	: Carefully listening, Speaking clearly, Reading for comprehension, writing clearly and accurately.
Numeracy	: Using numbers to count, calculate, code and to measure, matter, space and time.
Graphics	: Making sense of line and form, expressing and recording essential data, instructions and ideas with line, form, colour, two and three-dimensional configurations, graphic symbols and icons
ICT Competencies	: Knowledge on computers, and the ability to use the information technology skills at learning or work as well as in the private life

### (ii) Competencies relating to the Personality Development

- Generic skills such as creativity, divergent thinking, initiative, decision making, problem-solving, critical and analytical thinking, team work, inter-personal relationships, discovering and exploring
- Values such as integrity, tolerance and respect for human dignity.
- Cognition

### (iii) Competencies related to the Environment.

This is the second set of competencies related to the Social, Biological and Physical Environments.

<b>Social Environment</b>	: Awareness, sensitivity and skills linked to being a member of multi cultural plural society, social relationship, personal conduct, general and national heritage, legal conventions, rights, responsibilities, duties and obligations.
<b>Biological Environment</b>	: Awareness, sensitivity and skills linked to the living world, man and the ecosystem, trees, forests, seas, water, air and life - plant, animal and human life.
<b>Physical Environment</b>	: Awareness, sensitivity and skills related to space, energy, fuels, matter, materials and their links to human living, food, clothing, shelter, health, comfort, respiration, sleep, relaxation, rest, wastes and excretion, media of communication and transport. <i>Included here are the skills in the use of tools to shape and materials for living and learning.</i>

**(iv) Competencies related to Preparation for the world of work**

Employment related skills to maximize their potential and to enhance their capacity to contribute to economic development; to discover their vocational interests and aptitudes; to choose a job that suits their abilities and; to engage in a rewarding and sustainable livelihood

**(v) Competencies related to religion and ethics**

This fourth set of competencies are laden with values and attitudes. It is essential for individuals to assimilate values, so that they may function in a manner consistent with the ethical, moral and religious modes of conduct, rituals and practices in everyday living, selecting the most appropriate.

**(vi) Competencies in Play and Use of Leisure**

Competencies that link up with pleasure, joy, emotions and such human motivations. These find expression in play, sports, athletics and leisure pursuit of many types. These also link up with such values as cooperation, team work, healthy competition in life and work. Included here are such activities that are involved in aesthetics, arts, drama, literature, exploratory research and other creative modes in human living.

**(vii) Competencies related to 'Learning to learn**

These competencies flow directly from the nature of a rapidly changing, complex and interdependent world. Whatever one learns, that learning will need updating and review. This requires that one should be aware of, sensitive and skilful in sustained attention, and be willing to persevere and attend to details that matter in a given situation.

## **Objectives of the Subject**

- Obtain basic understanding of the theoretical basis of accounting.
- Obtain and apply basic knowledge of accounting techniques.
- Produce guidance on new educational opportunities opened through the subject area of accounting.
- Apply the knowledge acquired through the area of accounting, for various professional needs.
- Acquiring the knowledge for the effective use of resources in a gainful manner that is suitable for sustainable development within the existing social, economic and political environments.
- Acquire the ability of preparation, presentation, and analysis of financial statements of various business organizations.
- Acquire the experiences through the research study in the subject that can be used for future research study development.

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# **Learning Outcomes and Model Activities**

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**Competency 11.0 : Uses Sri Lanka Accounting Standards for the preparation and presentation of financial statements**

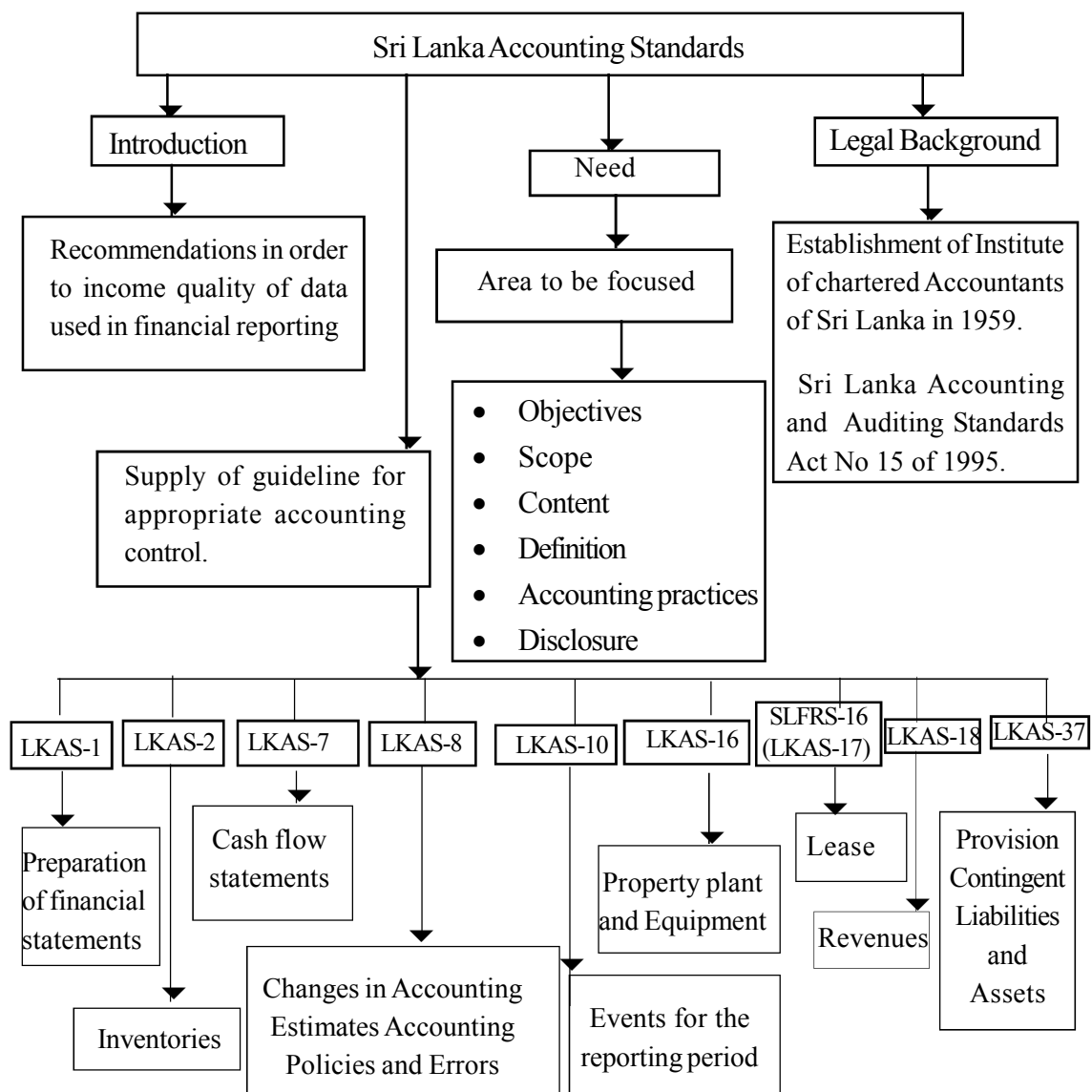
**Competency Level 11.1 : Uses legal background of Sri Lanka Accounting Standards**

**Learning outcomes :**

- Explains importance of Accounting and Auditing standards Act for Accounting.
- Name duties related to Sri Lanka Accounting Standards committee.
- Name duties related to Accounting and Auditing Standards Monitoring Board.
- Name duties related to Institute of Chartered Accountants of Sri Lanka.

**Basic Terms and Concepts**

**Concepts Maps**



## **Teaching Learning Process :**

### **Engagement**

- Why Sri Lanka Accounting Standards use for the preparation of financial statements.

Highlight following facts based on the answers given by students according to the above question.

- Explains the need of Accounting Standards in order to maintain quality and consistency of Financial Statements.

### **Proposed instructions to assist learning :**

- Pay attention for the following topics to be given to each group.
  - Accounting Standards Committee
  - Sri Lanka Accounting Standards Monitoring Board.
  - Institute of Chartered Accountants of Sri Lanka.
- Give guidelines in order to disclose details related to each topic after providing reading materials.
- Advise them to introduce Accounting and Auditing Standards Act No. 15 of 1995.
- Advise them to introduce topics given to each group.
- Guide them to write how each topic effect on accounting.
- Distribute questions to each group provided in Annexure 11.1.1
- Prepare them to present their findings in more creative manner.

### **Guideline to Subject Matter :**

- Disclose that in preparing and presenting financial statements of specified Business enterprise should follow Sri Lanka Accounting Standards recommended by Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995.
- Incorporation of Sri Lanka Accounting Standards Committee according to Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995.
- The Sri Lanka Accounting Standards Committee has been established as clearly stipulated in the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995.
- The Sri Lanka Accounting and Auditing Standards Monitoring Board has the power to examine whether the Sri Lanka Accounting Standards have been adhered to in preparation of accounting statements of a specified business enterprises, and to take necessary action if the standards have not been adhered to.

- Example For Functions of Institute of Chartered Accountants of Sri Lanka.
  - Organizing exams in order to provide related qualification and relevant educational courses.
  - Controlling and supervising of student education and training.
  - Maintaining and controlling of accounting standards and required methods and limitations in maintaining them.
  - Promote resources on Accounting and related subjects.
  - Development maintaining and revising the standards for the clearly specified Business enterprise using legal powers vested by the Sri Lanka Accounting and Auditing Standards Act. No. 15 of 1995.

#### **Annexure 11.1.1**

- Provide answers for the question given to each group.
  - Group 01.  
Explain in brief the importance of Accounting and Auditing Standards Act.
  - Group 02.  
Explain in brief the role of Sri Lanka Accounting and Auditing Standards Monitoring Board.
  - Group 03  
Explain 4 duties of Institute of Chartered Accountants of Sri Lanka.

#### **Assessments and Evaluation Criteria**

- Introduce in brief the accounting standards
- Naming role of Accounting Standard Committee
- Naming role of Accounting and Auditing Monitoring Board.
- Naming four functions of Institute of Chartered Accountants of Sri Lanka

**Competency 11.0 : Uses Sri Lanka Accounting Standards for the preparation and presentation of financial statements**

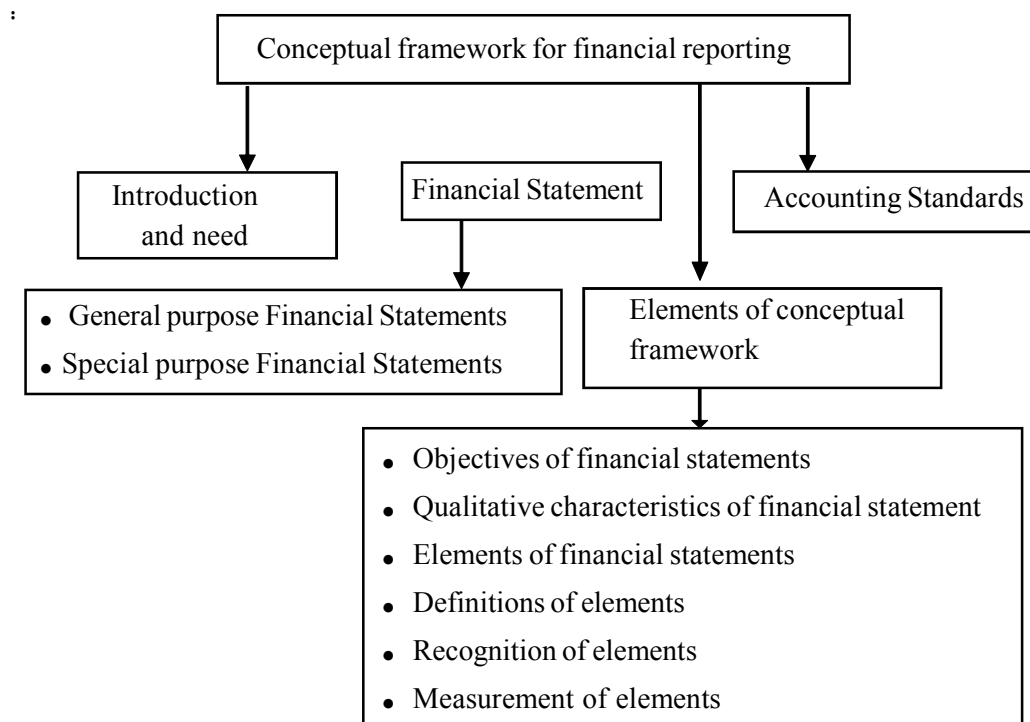
**Competency Level 11.2 : Analyze Conceptual Framework for Financial Reporting**

**Learning outcomes :**

- Name types of financial statements
- Explains conceptual framework for financial reporting.
- Explains elements of conceptual framework for financial reporting

**Basic terms and concepts**

**Concept Map**



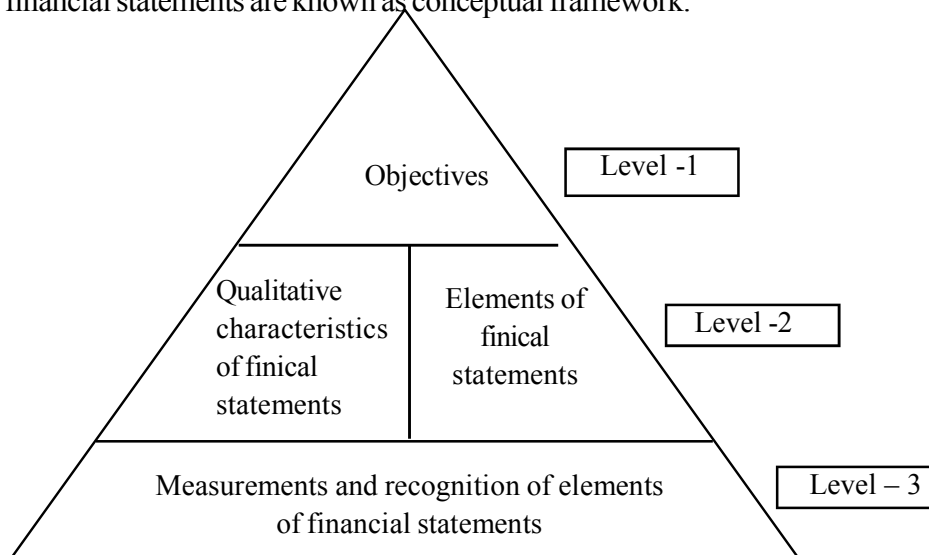
**Proposed instructions to Assist Learning**

- Commence a discussion incorporating the following points.
  - Objectives of Financial Reporting
  - Problems faced by organization if they do not compliance with standard methods.
  - Benefits gained by organizations in complain with the conceptual framework;
  - Financial statements prepared by organization
  - Elements of financial statements
  - Users of financial statements
  - What is meant by Accounting Standards

### **Guidelines on subject matter :**

- **Conceptual framework for financial reporting**

A set of rules which helps to make functions and limitations of financial accounting and financial statements are known as conceptual framework.

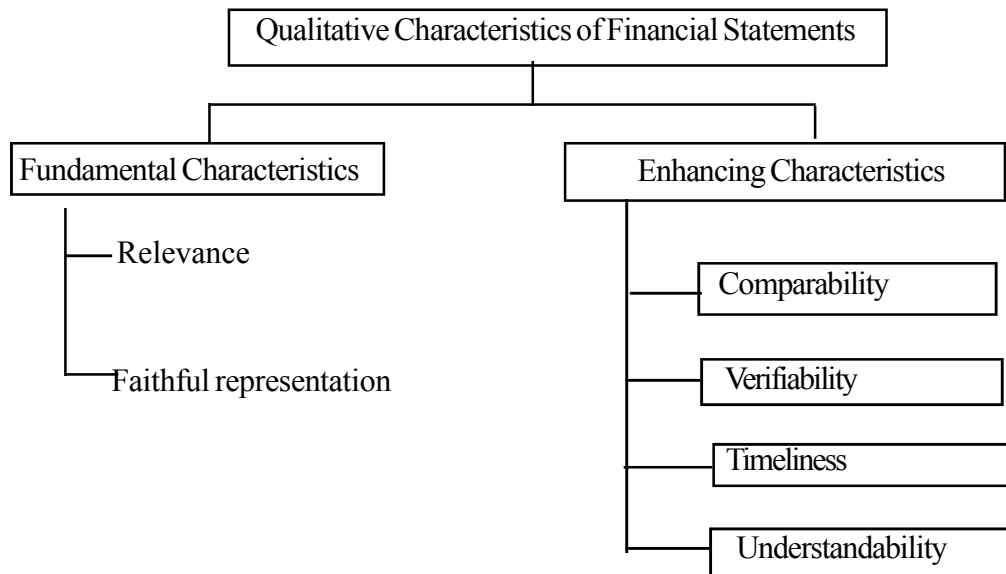


- **Objectives of financial Statements**

The objectives of general purpose financial reporting to provide financial statements reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources of the entity.

General purpose financial statements provide financial performance, financial position and changes in financial position of an entity. Underling assumption in preparing financial statement is going concern concept.

## Diagram



- **Relevance**

Relevant financial information is capable of making a difference in the decision made by users. If financial information is to be useful it must consist following sub characteristics.

- Predictive value
- Confirmatory value
- Materiality

- **Faithful representation**

Economic phenomena represented in financial reports should be faithfully presented. To be a perfectly faithful representation a depiction would have following characteristics.

- Completeness
- Neutral

- **Comparability**

If data of one entity can be compared with similar information about another entities and with similar information about the same entity for another period is known as comparability.

- **Verifiability**

Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent.

- **Timeliness**

Timeliness means having information available to decision making in time to be capable of influencing their decisions.

- **Understandability**

Presenting information clearly and concisely makes it understandable to the users.

- **Elements and Definitions**

Contents of financial statements represents the elements. Information provided by the elements helps to achieve objectives of financial reporting. There are five elements.

They are,

- Assets
- Liabilities
- Income
- Expenses
- Equity

- **Assets**

An asset is a resource controlled by the entity as a result of past transactions / events and from which future economic benefits are expected to flow to the entity.

Following main three characteristics should be possessed by an asset according to the above definition.

- Ability to generate economic benefits
- Can be controlled by the entity
- As a result of a past transaction or event

- **Liabilities**

A liability is a present obligation of the entity arising from past transactions / events. The settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Following main three characteristics should be possessed by liability according to the above definition.

- It is probable that an out flow of resources embodying economic benefit will result from the settlement of a present obligation.
- Present obligation
- There should be a present obligation
- As a result of a past transaction or an event.

- **Equity**

Equity is the residual interest in the assets the entity after deducting all its liabilities.

The above equity, assets and liabilities are directly related to the measurement of financial position of an entity.

- **Income**

Income is increased in economic benefits during the accounting period in the form of inflows or increases of assets or decreases of liabilities that result in increases in equity. Other than those relating to contributions from equity participants.

- **Expenses**

Expenses are decreases in economic benefits during the accounting period in the form of outflows of assets or incurrence of liabilities that result in decreases in equity. Other than those relating to distribution to equity participants.

- **Recognition of the Elements**

Following criteria to be recognized in order to identify elements on accordance with conceptual framework for financial reporting.

- Elements should be in accordance with the definition
- Economic benefit embodying should inflow to the organization.
- Can be measured reliably.

- **Measurements of the elements of Financial Statement**

Measurement of the process of determining the monetary amounts of which the elements of the financial statement. Following methods can be used in measuring elements of financial statements.

- Historical cost
- Current cost



- Reliable value
- Present value

### **Introduction to Accounting Standards**

Various professional Institutes provide rules to be followed by organizations in preparing financial statements are known by Accounting Standards or required rules to be followed in recognizing, measuring and presenting transactions. The Institute of Chartered Accountants of Sri Lanka is the authorized institute in Sri Lanka.

### **Assessment & Evaluation Criteria**

- Explains conceptual framework for financial reporting
- Names and explains elements of conceptual framework for financial reporting.
- Institution to Accounting Standards
- Answer following questions in brief
  1. State the underlying concept in preparing financial statements.
  2. Give three characteristics of assets and liabilities and equity.
  3. State a similarity and difference between liabilities and equity.
  4. Conditions to be satisfied in recognizing elements of financial statements.
  5. State the objectives of General purpose financial statements.
  6. State two techniques used in measuring elements of financial statements.
  7. State two enhancing characteristics and fundamental characteristics of financial information.

**Competency 11.0 : Uses Sri Lanka Accounting Standards for the preparation and presentation of financial statements**

**Competency Level 11.3 : Accounting and discloses changes in Accounting Estimates and Policies**

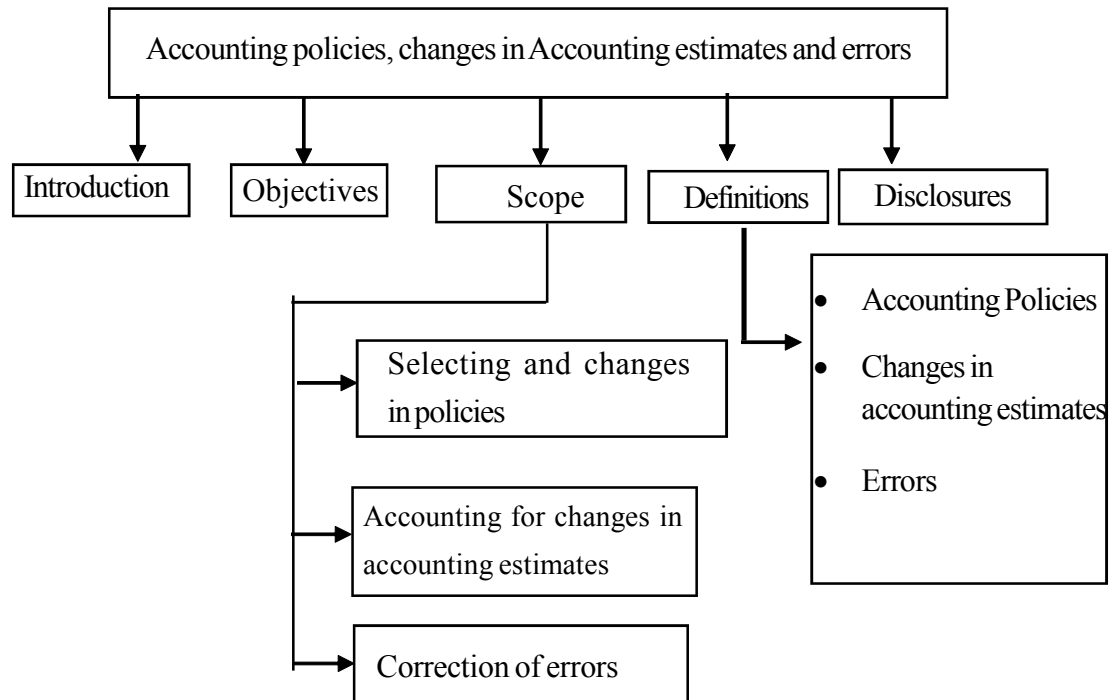
**No of Periods : 05**

**Learning Outcomes :**

- Defines “Accounting policies, changes in Accounting estimates and errors” according to the standard.
- Presents two main points to be considered in selecting Accounting Policies.
- States the situations where Accounting Policies could be changed.
- Explains the way of recoding changes in accounting estimates.
- States that it should recognize and correct current year errors before approving the financial statements.
- Disclosure requirements according to the standard.

**Basic terms and concepts**

### Concept Map



## **Learning - teaching Process**

- Conduct a discussion to highlight following
  - Accounting policies
  - Changes in accounting estimates
  - Errors
  - Changes in accounting policies
  - Disclosure requirement for changes in accounting estimates

## **Guidance on Subject Matter**

- Definitions
  - Accounting Policies  
Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.
  - Changes in accounting estimates  
Is an adjustment of the carrying amount of an asset or a liability or the amount of the periodic consumption of an asset. That result from the assessment of the present status of and expected future benefits and obligations associates with assets and liabilities.
  - Errors  
Are omissions from and misstatements in the entities periods arising from a failure to user or misuse of reliable information that was available when financial estimates for those periods were authorized for issue.  
Example : Mathematical errors, errors in use of accounting policies, oversight misinterpretation and frouds.
- **Selecting Accounting Policies :**  
There are two ways of selecting an accounting policies.
  - If an accounting standard clearly applies to a transaction or an event. The accounting policy should adhere to the standard.
  - If not management shall use to judgment in developing and applying an accounting policy.
- **Changes in Accounting Policies**  
An entity shall change an accounting policy only if the change
  - (a) Is required by a standard
  - (b) Required to changes in entity's financial position performance or cash flows to be presented in more reliable and more relevant manner.

**Accounting for changes in accounting estimates.**

- If the change affects only the period in which the change occurred. Then adjust the profit or loss of the period.

Examples : • Impairment loss on trade receivables.

- Allowance for expected losses on trade receivables

- If the change affects both the period in which the changes occurred and the future periods. Then adjust the profits / losses of each period affected.

Examples : Changes in depreciation values due to the changes in useful economic life of property plant and equipment.

- If the change affects assets, liabilities or equity. Then adjust the related period assets, liabilities, equity and their fair values.

**(Important : Accounting for Changes in accounting policies and errors are not discussed for Advanced Level)**

**Examples of disclosures.**

<b>Changes in Accounting Policies</b>	<b>Changes in Accounting Estimates</b>	<b>Prior period errors</b>
<ul style="list-style-type: none"><li>• Nature of the change accounting policy</li></ul>	Reasons for changing the estimates	Nature of the prior period errors.
<ul style="list-style-type: none"><li>• The effect on present and future periods</li></ul>	Effect on the financial statements due to the change in the estimate	The correction at the beginning of the earliest period presented.
		A description of how and in which period the error has been occurred.

**Assessment and Evaluation Criteria**

- Define accounting policies, changes in accounting estimates and errors according to the standard.
- Name two main points to be considered in selecting accounting policies.
- Name two situations where accounting policies could be changed.
- Explain the way of recording changes in accounting estimates.
- State that errors found in preparing financial statements should be corrected before authorizing for issue.
- Disclosure requirements according to the standard.

**Competency level 11.0 : Uses Sri Lanka Accounting Standards in preparing and presenting financial statements**

**Competency level 11.4 : Explaining the main concepts relating to inventory and accounting for inventory**

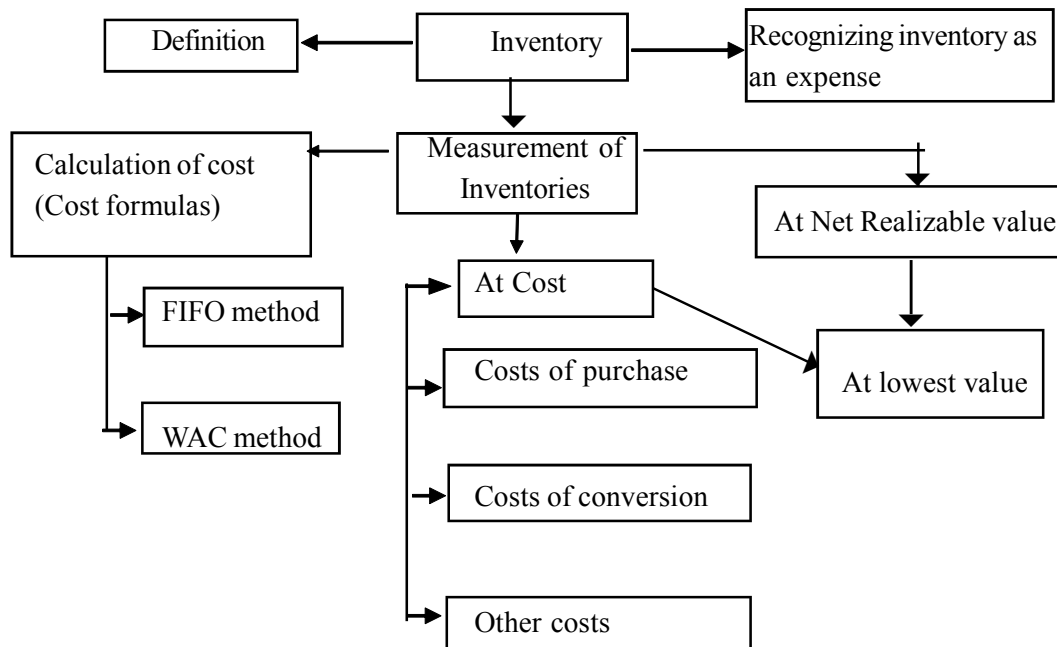
**No of periods : 05**

**Learning outcomes :**

- Defines “Inventory” as per Inventory Standard
- Explains the inventory cost
- Explains Net Realizable Value
- Calculates cost of closing stocks based on First In First Out method (FIFO) and Weighted Average Cost method (WAC).
- Records the value of inventory which is recognized as an expense in the financial statements.

**Basic Terms and Concepts**

### Concept Map



**Approach :**

- Discuss the following with students
  - Types of inventories
  - Definitions of inventories
- Inquiries from students about few stock items that could be seen in the following business at the year end.
  - At a grocery
  - At a furniture shop

**Proposed instruction for activity plan**

01. Name the closing inventories of each of the following businesses
  - At a grocery
  - At a garment factory
  - At a beauty salon
  - At a building construction business
02. Define following terms as per inventory standard
  - Inventory
  - Costs of inventories
  - Net Realizable value
03. Fashion Ltd company produces and exports readymade garments. Using the following information selects items that can be included under costs of inventories of this company.  
(This company is a registered company for VAT)
  - Purchase price of raw materials
  - Carriage inward charges of raw materials
  - Loading and unloading charges
  - Value Added Tax
  - Trade discounts (On purchase price)
  - Salaries of machine operators
  - Costs for fashion designing
  - Salaries of supervisors
  - Interest on bank loans
  - Expenses in preparing expert documents

04. Following are the details of inventories of a company as at the year end.

As per LKAS 01, calculate the value of inventories based on lower of cost and net realizable value using item by item method and group method separately. Show the journal entries and extracts of financial statements.

Group	Types of product	Number of units	Unit cost (Rs.)	Net Realizable value (Rs.)
Soap	A	300	50	40
	B	200	40	45
	C	100	30	40
Tooth paste	P	50	80	70
	Q	60	50	60

05. Following are the stocks receipts and issues details of Wansan's business for the year ended 31.03.2016

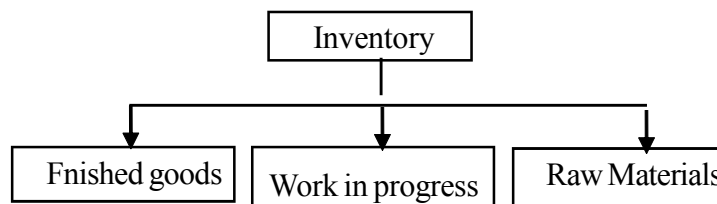
Date	Description	Quantity (units)	Unit price (Rs.)
01.03.2016	Opening inventory	100	45
02.03.2016	Purchases	300	45
05.03.2016	Issues	200	-
10.03.2016	Purchases	800	60
15.04.2016	Issues	400	-
21.03.2016	Issues	400	-
25.03.2016	Purchases	600	75
30.03.2016	Issues	400	-

Calculate the following based on First In First Out method (FIFO) and weighted Average Cost of method?

- (i) Inventory value as at 31.03.2016
  - (ii) Cost of sales
  - (iii) Gross profit if all the stocks mentioned above will be sold at Rs. 80
06. Mention the two situations where the inventories could be recognized as expenses.
07. Mention two disclosures regarding inventories in the financial statements?
- Provide each group with learning materials of standards.
  - Guide students to answer the questions using those materials.
  - State whether their answers are correct when they present answers to the class

**Guidelines for subject matters :**

- Definitions
  - Inventories are assets :
    - (a) held for sale in the ordinary course of business (Finished goods)
    - (b) In the process of production for such sale (work in progress)
    - (c) In the form of materials or supplies to be consumed in the production process or in the rendering of services (Raw materials)



- • Elements of cost of inventories
  - Costs of purchase
  - Costs of conversion
  - Other costs incurred in bringing the inventories to their present location and condition.

- **Net Realizable value**

Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale.

Net realisable value = Estimated selling price – (Estimated costs of completion + Estimated costs necessary to make the sale)

- As per LKAS 02, inventories shall be measured at the lower of cost and net realizable value.



- As per LKAS 02, inventories shall be measured at the lower of cost and net realizable value.
- Methods of deciding net realizable value.

There are the methods of deciding the lower of cost or net realizable value.

1. Item by item basis
2. Group method

- **Cost formulas**

Before calculating cost or net realizable value of inventories, it should be confirmed that the remaining inventory balance is consisted with which purchase / which product.

Cost formulas provide a basis to decide on which purchases or which products the remaining inventory is represented. There are few methods.

Following cost formulas are recommended by the standard.

- (i) First in First Out method (FIFO)
- (ii) Weighted Average Cost method (WAC)

**(i) First in First Out method (FIFO)**

The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. But in Practically, it is not needed to sell the items in first out first out basis only.

**Weighted average cost method (WAC)**

Under this method, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period.

It is calculated as follows.

$$\text{Weighted Average Price} = \frac{\text{Value of inventory at the issuing date}}{\text{Quantity of inventory at the issuing date}}$$

Recognition as an expense :

There are two situations here the inventories are recognized as an expense.

- (i) When inventories are sold, the carrying amount of those inventions shall be recognized as an expense in the period in which the related revenue is recognized. It is identified as cost of sales.
- (ii) The amount of any written – down of inventories to net realizable value and all losses of inventories shall be recognized as an expense in the period the written down or loss occurs.

**Evaluation and assignment criteria**

- Defining inventories as per the standard.
- Explaining costs of inventories
- Calculation of inventory cost using FIFO and WAC methods.
- Situations in which stocks are recognized as an expense.
- Disclosures regarding inventories in financial statements.

**Competency level 11.0 : Uses Sri Lanka Accounting Standards in preparing and presenting financial statements**

**Competency level 11.5 : Defining basic concepts and accounting for property plant and equipment**

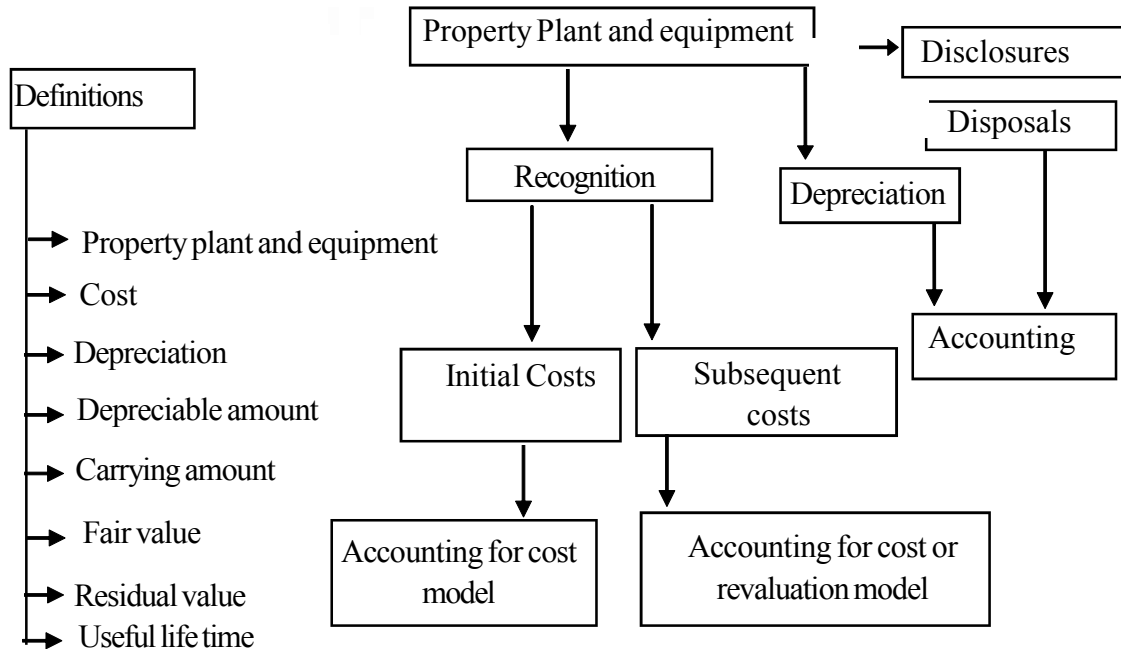
**Number of periods : 05**

**Learning outcomes :**

- Defining property plant and equipment as per Sri Lanka Accounting Standard.
- Defining the following terms as per Sri Lanka Accounting Standard
  - Cost
  - Depreciation
  - Depreciable amount
  - Carrying amount
  - Fair value
  - Residual value
  - Useful life time
- States the need of consideration towards initial costs and subsequent costs when recognizing
- Names elements of costs
- Explains that it should be necessary to measure at cost for the first time and then cost model or revaluation model could be used for measurement of property plant and equipment.
- Accounting at revaluation model
- Name depreciation methods and accounting for depreciation.
- Accounting for disposal of property plant and equipment
- Make necessary disclosures regarding property plant and equipment

## Basic terms and concepts

### Concept Map



### Teaching learning process :

- In order to approach to this competency level, guide students to answer the attachment number 11.5.1.
- Conduct a discussion on types of property plant and equipment used by various businesses.
- Property, plant and equipment are tangible items that : are held for use in the production or supply of goods or services, for rental to others or for administrative purposes and are expected to be used during more than one period.
- Following terms should be defined as pr LKAS 16 – Property, plant and equipment
  - Cost
  - Depreciation
  - Carrying amount
  - Fair value
  - Residual value / scrap value
  - Useful life time

## Guidance of subject matter

- **Cost**

Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements.

- **Depreciation**

Depreciable amount is the cost of an asset or other amount substituted for cost, less its residual value.

- **Carrying amount**

Carrying amount is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairments losses.

<b>Calculation of impairment losses are not expected here</b>
---

- **Fair value**

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

- **Residual value**

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, in the condition expected at the end of its useful life.

- **Useful life**

Useful life is the period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.

- **Recognition**

The cost an item of property, plant and equipment shall be recognized as an asset if,

1. It s probable that future economic benefits associated with the item will flow to the entity and,
2. The cost of the item can be measured reliably.

- An entity evaluates under the recognition principle all its property plant and equipment costs at the time they are incurred those. These costs can be of two types.

1. Initial costs
2. Subsequent costs

- **Initial costs**

Costs incurred initially to acquire or construct an item of property, plant and equipment. These costs should be capitalized.

- **Subsequent costs**

Costs incurred subsequently to add to, replace part of or service it. Could be identified in two types.

1. Capital expenditure
2. Revenue expenditure

- **Capital expenditure**

Expenditure incurred in an innovation or establishment of a new equipment to increase the useful life time of an asset or capacity of an asset or quality of the products or to decrease expenses related in production could be identified as capital nature expenses.

- **Revenue expenditure**

The costs incurred in maintaining the assets.

Examples : Machine repair expenses

Building painting expenses

Property, plant and equipment measurement at recognition.

An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost and it includes following.

- (a) Its purchase price, including import duties and non refundable purchase taxes, shipment charges, insurance charges after deducting trade discounts and rebates.
- (b) Any costs directly attributable to bringing the asset to the expected location and condition.

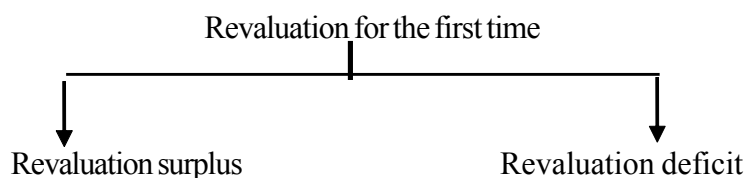
Example :

- Direct costs of construction or acquisition of assets
- Cost of site preparation
- Initial delivery and handling costs
- Installation and assembly costs
- Net costs of testing whether the asset is functioning properly
- Professional fees

- (c) The estimation of costs of dismantling and removing the assets at the end of the life time.

### Measurement after recognition :

- An entity shall choose either the cost model or revaluation model for measurement after recognition at cost.
- Property, plant and equipment are measured at revaluation model as follows.
- Methods of recording fair value of the asset. Here the carrying amount has been calculated by deducting accumulated depreciation against cost and compare it with the fair value.
- Revaluation of Property, Plant and equipment



(1) Accumulated depreciation until revaluation date

Relevant Accumulated depreciation account Dr. xx

Relevant asset account Cr/ xx

(1) Accumulated depreciation until revaluation date

Relevant Accumulated for depreciation account Dr. xx

Relevant asset account Cr/ xx

(2) Revaluation surplus

Relevant asset a/c Dr. xx

Revaluation surplus a/c Cr. xx

(Profit or Loss & Other Comprehensive)

income statement)

(2) Revaluation deficit

Other expenses Dr. xx

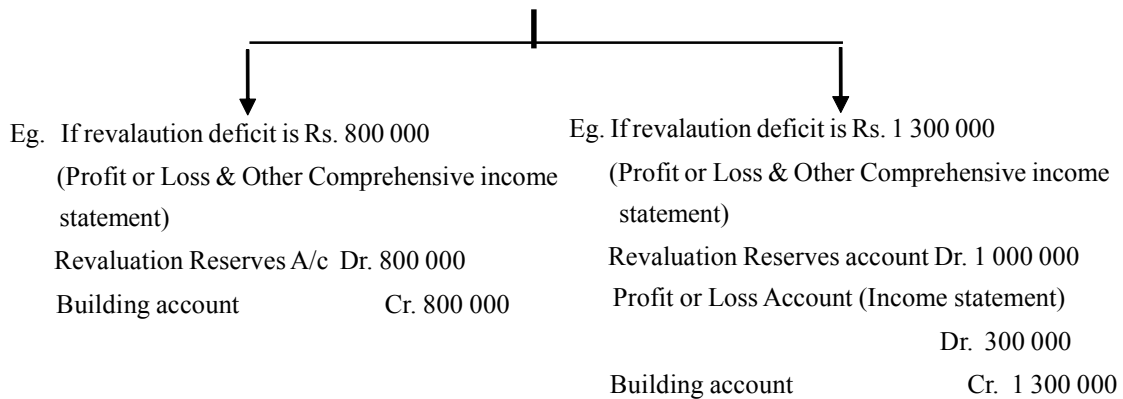
(Profit or Loss & Other Comprehensive)

Relevant asset account Cr. xx

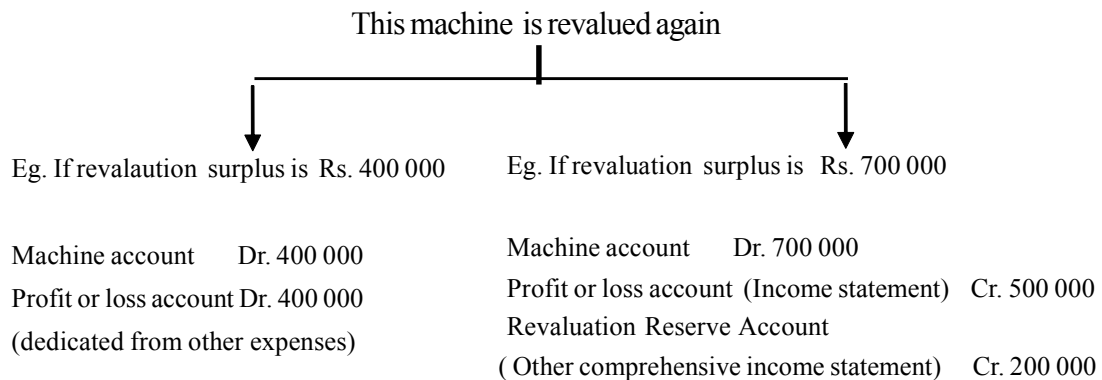
Revaluation of an item of property, plant and equipment when it was revalued in a previous year.

**Example :** A Profit of Rs. 1 000 000 was received by the first time revaluation of building.

This building is revalued again



Imagine that the deficit is Rs. 500 000 by the first time revaluation of a machine.



- When revaluing assets, accumulated depreciation should be debited to provision for depreciation account and credited to relevant asset account.
- Calculation of depreciation of property, plant and equipment using straight line method and reducing balance method.
- Calculation of depreciation as per straight line method.

$$\text{Annual depreciation} = \frac{\text{Cost} - \text{residual value}}{\text{Useful life time}}$$

Calculation of depreciation as per reducing balance method.

Annual depreciation = (Cost – Accumulated depreciation) X Rate of depreciation

Annual depreciation is recorded as follows.

Depreciation account Dr. xx  
Accumulated depreciation account Cr. xx



- According for disposals of property, plant and equipment

Journal entries relating to disposals of property, plant and equipment are as follows.

Cost of the disposed asset

Asset disposal account	Dr. xx	
Asset account		Cr. xx

- Accumulated depreciation of the disposed asset.

Accumulated for depreciation account	Dr. xx	
Asset disposal account		Cr. xx

- Sales price of the asset

Cash account	Dr. xx	
Asset disposal account		Cr xx

- Exchange value of asset

Asset account	Dr. xx	
Asset disposal account		Cr. xx

- Profit arising from disposal

Asset disposal account	Dr. xx	
Profit or loss account (Income statement)		Cr. xx

- Loss arising from disposal

Profit or loss account (Income statement)	Dr. xx	
Asset disposal account		Cr. xx

- Disclosures relating to property, plant and equipment

- The measurement bases used for determining the gross carrying amount
- The depreciation method used
- The useful lives or the depreciation rates used
- The gross carrying amount and the accumulated depreciation at the beginning and end of the period.

### Attachment 11.5.1

01. Mention whether the following assets in the business could be recognized as property, plant and equipment.  
Business organization

Type of business	Recognize/ not recognize as property, plant and depreciation.
<ol style="list-style-type: none"> <li>1. A motor vehicle which is for selling at “Isuru Motors” who is a motor vehicle selling company.</li> <li>2. Bus used by "Renuka Transport Services" which provide passenger Transport Services.</li> <li>3. Sewing machines at a garment factory</li> <li>4. The land of the garment factory</li> <li>5. Office building of <ul style="list-style-type: none"> <li>• Home land building construction company</li> </ul> </li> </ol>	

02. Following are the details of a machine which is important by a manufacturing company. The business is a VAT registered company.

	(Rs.000')
Listed of price of the machine	1000 (Trade discount 10%)
Import duties	200
Clearing fees	20
Carriage inwards	10
Unloading charges	05
Installation and assembly costs	35
Engineering and professional fees	10
Cost of first test round	08
Cash received from selling samples produced in the test round	03
VAT (Relevant for purchasing of the machine)	90
Reinstallation cost in another place	10
Machine repair expenses	12
Calculation the initial recognition cost of the machine?	

03. Mention the two conditions needed to recognize property, plant and equipment as an asset?

04. As at 01.04.2016, value of machineries at Vimukthi PLS is Rs. 1 200 000. As at that date, balance of the accumulated for depreciation account is Rs. 400 000.
- According to first time revaluation as at 01.04.2016, value of machineries is Rs. 950 000. Show the relevant journal entries?
  - If these machineries are revalued for Rs. 750 000 for the first time as at 01.04.2016. Write the relevant journal entries
  - If these machineries were revalued on 01.04.2015 and a deficit of Rs. 500 000 was received and again revalue on 01.04.2016 for a value of Rs. 950 000. Write the relevant journal entries.
  - If the revalued amount as at 01.04.2016 is Rs. 750 000 and by the revaluation done as at 01.04.2015 received a surplus of Rs. 50 000. Write the relevant journal entries.
05. As at 01.04.205, Ruwan PLC purchased a motor vehicle for a value of Rs. 2 700 000. Useful life time is 5 years (Depreciation rate s 20%) and residual value is Rs. 200 000.
- Calculation annual depreciation based in straight line method for the years ending 2015/2016 and 2016/2017
  - Prepare the relevant journal entries and ledger accounts for the two years.
  - As at 01.04.2016, Nethumi PLC purchased a machinery for a value of Rs. 1 500 000 and it is revalued annually at 20% on reducing balance method. Calculate depreciation for the following years.
- |           |      |      |
|-----------|------|------|
| Year 2016 | 2017 | 2018 |
|-----------|------|------|

### **Evaluation**

- Define property, plant and equipment as per LKAS 16.
- Define the following terms as per the standard
  - Cost
  - Depreciable amount
  - Carrying value
  - Residual value
  - Useful life time

**Competency level 11.0 : Uses Sri Lanka Accounting Standards in preparing and presenting financial statements**

**Competency level 11.6 :**

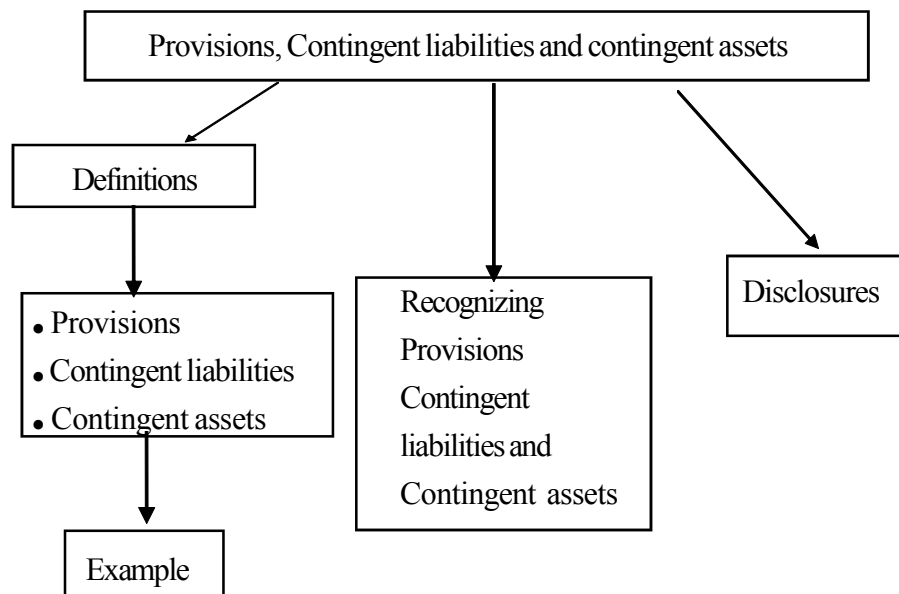
**No of periods : 05**

**Learning outcomes :**

- Defines provisions, contingent liabilities and contingent assets as per Sri Lanka Accounting Standard
- Compare provisions, contingent liabilities and contingent assets
- Recognition and disclosures according to Sri Lanka Accounting standard.

**Basic terms and concepts**

**Concept Map**



**Teaching – learning Process :**

- Conduct a discussion with student to highlight followings
- Provisions
- Contingent liabilities
- Contingent assets
- Recognition
- Disclosures

**Guidance and Subject matters :**

Definitions according to standard

- Provisions :  
“Is a liability of uncertain timing or amount”
- Contingent liability :  
“ A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non occurrence of one or more uncertain future events wholly within the control of the entity.

A present obligation that arise from past events but is not recognized because ,

- (i) It is not probable that an outflow of resources embodying economic benefits will require settling the obligation.
- (ii) The amount of the obligation cannot be measured with sufficient reliability.

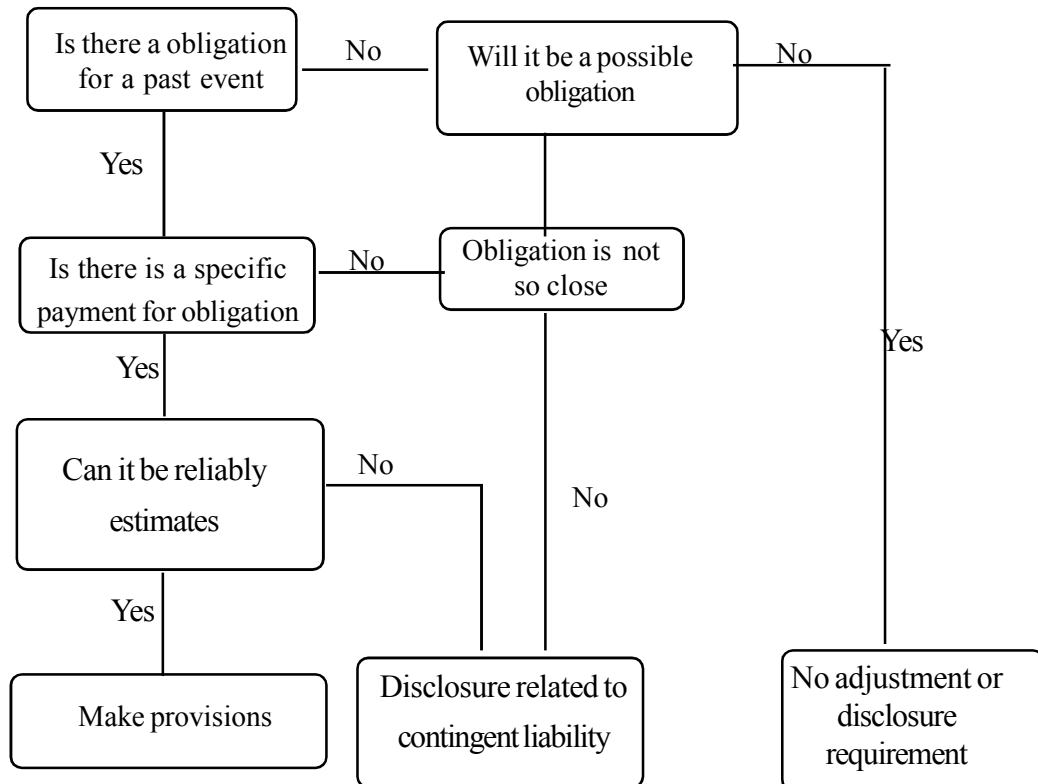
If above conditions satisfied it could be recognized as an expense in the Income Statement and should show under current liabilities.

**Contingent Liability**

Following conditions to be satisfied

- (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- (ii) The amount of the obligation cannot be measured with sufficient reliability.
  - Cannot be controlled by the organization
  - As a result of a past event / transaction
- (iii) Contingent liabilities are not recognized as a liability in financial statement. Only disclosure is required.

- By examining following diagram provisions and contingent liabilities could be understand.



### Contingent Assets

Could not be recognized as an asset on the statement of financial position. Disclose only if there is an inflow economic benefit.

- Example for provisions
- Provisions for warrantee
- The government or any organization files a case selecting compensation or environmental pollution.
- An employee files a case seeking compensation as he was terminated from the employment. Amount could be reliably estimated.
- Example for contingent liabilities
  - An employee files a case seeking compensation as he was terminated with the current year and the amount could not be reliably estimated.

- Compensation payable due to closure of a section of the business.
- Example for contingent assets
- The compensation claimed for a land which was taken over by the Road Development Authority.

#### Disclosures

Provisions	Contingent liabilities	Contingent Assets
1. Opening and closing balances of provisions.	1. A brief description of the nature of the liability	1. A brief description of the nature of the assets
2. Additional provisions made within the current period	2. An indication of the uncertainties relating to the amount or timing of any out flow.	2. An estimate for the financial effect
3. Provisions provided during the year		

#### Assessment and Evaluation Criteria

- Define following according to LKAS 37
  - Provisions
  - Contingent Assets
  - Contingent liabilities
- Differentiate between contingent assets and contingent liabilities.
- Disclosure requirement
- Explain in brief each of the following situations to be presented in financial statements. Journal entries if it is a provision.
  1. Sales income for the year ended 31/03/2017 was two million. They provide a warranty period. It is estimated that 2% provision could be provided as warranty.
  2. An employee files a case against the company seeking compensations of 5 000 000. Lawyer decided that it not required to be compensation. .
  3. Environmental authority files a case against company for a compensation of Rs. 200 000. It is reliably estimated that it should be paid in the future.
  4. An organization files a case against a businessman who breaches an agreement. Compensation value is Rs. 400 000. It is not decided that. This compensation is receivable or not.

**Competency level 11.0 : Uses Sri Lanka Accounting Standards in preparing and presenting financial statements**

**Competency level 11.7 : Understands Accounting for Leases**

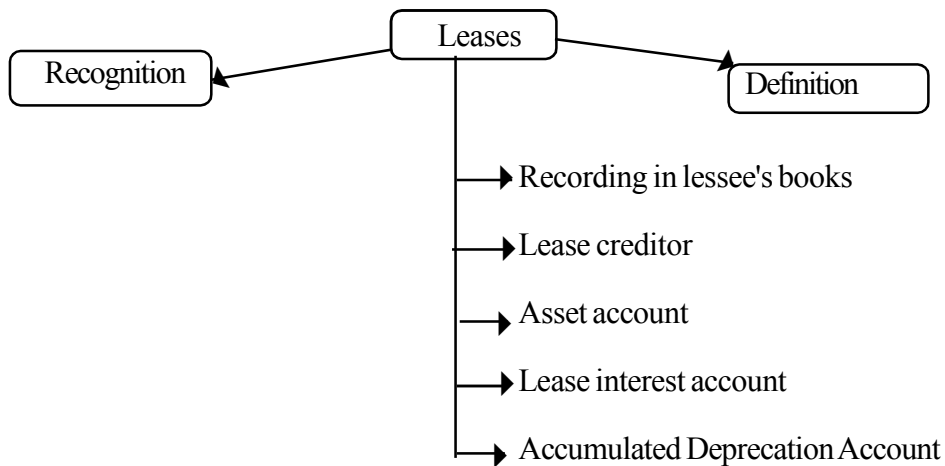
**No of periods : 05**

**Learning Outcomes :**

- Defines leases according to the Sri Lanka Accounting Standard.
- Records leases in books of purchaser.
- Accounting for interest on lease.
- Presents how to show lease creditors on statement of financial position.

**Basic terms and concepts**

**Concept Map**



**Proposed Instructions to Assist Learning :**

- Conduct a group discussion to highlight following points.

Explain this competency level by providing practical examples to the students as an approach.

- Give each student a copy of Annexure 11.7.1, 11.7.2.



### Proposed Instructions for Learning

- Parties related to lease – Lessee and Lessor
- Assets acquired to lease terms – and, building, machines, motor vehicles, equipments.
- Lease means – A lease is an agreement whereby the lessor conveys to the lessee. The right to use an asset for an agreed period of time in return for a payment or series of payments.
- Risks and rewards of right to use of lease property.

Risks	Rewards
<ul style="list-style-type: none"> <li>• Idle capacity</li> <li>• Technical obsolesces</li> <li>• Maintenance and repair</li> </ul>	<ul style="list-style-type: none"> <li>• Generating of economic benefits</li> <li>• Increases in asset value</li> <li>• Gain from appreciation in value</li> </ul>

- The accounting for the lease in the books of the lessee.

- Lower of fair value or present value of right of use of lease property.

Relevant asset account	Dr	xxx	
lease creditor account		Cr	xxx

- Initial deposit value / Down payment

Lease creditor account	Dr	xxx	
Cash account		Cr	xxx

- Interest on lease at the end of the period

Interest on lease account	Dr	xxx	
Lease creditor account		Cr	xxx

- If interest is not given

Interest at the end of 1 <sup>st</sup> year			
Fair value of the asset (or less amount)		xxx	
Initial deposit		(xx)	
		<u>xxx</u>	

(Interest should be calculated based on this value)

- Payment of installment

Lease creditor account	Dr	xx	
Cash account			Cr xx

- Calculation of depreciation = If title transferred at the end of the lease period  
=  $\frac{\text{fair value} - \text{Residual value}}{\text{useful economic life}}$

$$= \frac{\text{fair value} - \text{residual value}}{\text{Lease period}}$$

Presenting closing lease creditor value on statement of financial position.

Lease creditor	XX
----------------	----

- Give each student a copy of Annexure 11.7.2

Amanda Plc Ltd purchased a machine on 01.04.2017 for finance lease. Following transactions are provided.

Interest on lease - 15%

Title is transferred at the end of the lease period.

Following are the interest for each year.

Year	Interest on lease
2017/2018	171 289
2018/2019	136 994
2019/2020	97 542
2020/2021	52 174
Total interest	<u>457 999</u>

### Required

1. Relevant journal entries and account in for annual depreciation for the year ended 31.03.2018.
2. Relevant ledger account and accounting for annual depreciation for the year ended 31.03.2018
3. Discloser requirement in financial statement for the year ended 31.03.2018

### Assessment and evaluation criteria

- Define leases according to Sri Lanka accounting standard.
- Accounting for leases in lessee's books
- Recording of interest on lease
- Recording of lease creditor as current and non current liability in the statement of financial position.
- On 01.04.2016 Sahan Ltd acquired a motor vehicle on finance leased terms.

Following details are provided.

Fair value of the motor vehicle	- Rs. 230 000
Lease period	- 5 years
No initial deposit	- Rs. 606 800
(paid at the end of each year)	
Annual interest	- 10%
Useful life of the motor vehicle	- 5 years
Residual value	- Rs. 300 000

- Relevant journal entries and ledger accounts of Sahan Ltd for the year ended 31.03.2017 are as follows.

**Sahan Ltd**  
**General Journal**

<b>Date</b>	<b>Details</b>	<b>Debit</b>	<b>Credit</b>
01.04.2016	Motor vehicle account (Dr)	2300 000	
	Lease creditor account		2300 000
	(Purchase of a motor vehicle on lease)		
31.03.2017	Interest on lease account (Dr)	230 000	
	Lease creditor account		230 000
	(Recording of interest)		
31.03.2017	lease creditor account (Dr)	606 800	
	Cash account		606 800
	(Payment of annual installment)		
31.03.2017	Motor vehicle depreciation account	400 000	
	Accumulated depreciation on		400 000
	Motor vehicle account		
	(Recording of annual depreciation)		

**Workings :**

$$\begin{aligned}
 31.03.2017 \quad \text{Interest payment} &= 2300,000 \times \frac{10}{100} \\
 &= \underline{\underline{Rs.230,000}} \\
 \text{Annual deprecations at 31.03.2017} &= \frac{2300,000 - 300,000}{5} \\
 &= \underline{\underline{Rs .400 ,000}}
 \end{aligned}$$

#### Lease Creditor's account

	Rs.		Rs.
01.04.2016 Cash (Initial Capital)	xxx	01.04.2016 Motor vehecle A/c	2300 000
31.03.2017 Cash (Annual nstallment)	606 800	31.03.2017 Interest Account	2300 000
31.03.2017 Balance c/d	1923 200		
	<u>2530 000</u>		<u>2530 000</u>
		01.04.2017 Balance B/f	1923 200

#### Motor Vehicle account

	Rs.		Rs.
01.04.2016 Lease Creditor account	2300 000		
	<u>2300 000</u>	31.03.2017 Balance C/d	<u>2300 000</u>
31.03.2017 Balance B/f	<u>2300 000</u>		<u>2300 000</u>

#### Lease Interest account

	Rs.		Rs.
31.03.2017 Lease creditor account	23000	31.03.2017 Profit of loss account ( Income statement) (finance expenses)	230 000
	<u>230 000</u>		<u>230 000</u>

#### Depreciaton on motor vehicle account

	Rs.		Rs.
31.03.2017 Accumulated depreciation	400 000	31.03.2017 Profit of loss account (Income statement distribution expenses)	400 000
	<u>400 000</u>		<u>400 000</u>

#### Accumulated depreciaton on motor vehicle account

	Rs.		Rs.
31.03.2017 Balance c/d	400 000	31.03.2017 Depreciation account	400 000
	<u>400 000</u>		<u>400 000</u>
		31.03.2017 Balance B/f	<u>400 000</u>

**Sahan Ltd**

Extract of statement of financial position as at 01.03.2017

Statement of comprehensive income

Rs.

**Distribution expenses**

Motor vehicle depreciation	400 000
----------------------------	---------

**Finance expenses**

Interest on lease	230 000
-------------------	---------

**Statement of financial position**

<b>Non current liabilities</b>	1508 720
--------------------------------	----------

Lease creditor 414 480

(192320 - 414 480)

**Current liabilities**

Lease creditor	414 480
----------------	---------

(Installment – Next year interest)

**Workings**

Next year interest (31.03.2018)	$= \frac{1923,200}{100} \times \frac{10}{100} = 192,300$
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**Notes :**

Following items were considered when calculating profit before tax.

Lease interest	Rs. 230 000
----------------	-------------

Motor vehicle Depreciation	Rs. 400 000
----------------------------	-------------

**Student are not expected to calculate lease interests.**

**Competency level 11.0 : Uses Sri Lanka Accounting Standards in preparing and presenting financial statements**

**Competency level 11.8 : Disclose and Accounting for events after reporting period**

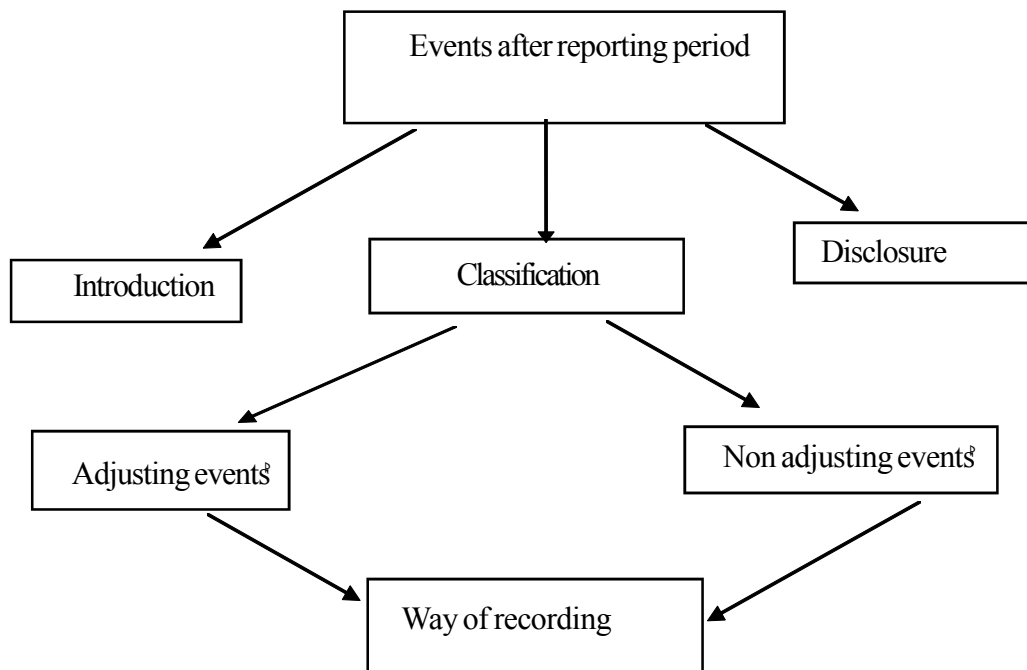
**No of periods : 05**

**Learning outcomes :**

- Defines events after reporting period according to the standard
- Classifies adjusting and not adjusting events according to the standard
- Discloses according to the standard

**Basic terms and concepts**

**Concept Map**



**Activity :**

- Presents following flash card to the students.

01. Presentation of Financial statements of Hansali PLC Ltd for the year ended 31.03.2016

02. Directors authorized financial statement on 10.08.2016. Financial statements were presented to share holder on 30.04.2016

03. Financial Statements were presented on 2016.09.30 to share holder

- Explain events after reporting period by allowing students to examine details in flash cards.
  - What is the accounting period?
  - What is the time after reporting period?
  - What are the events after reporting period?
- Divide students in to two groups provide them a list of transactions in Annexure 11.8.1 after explaining events after reporting period.

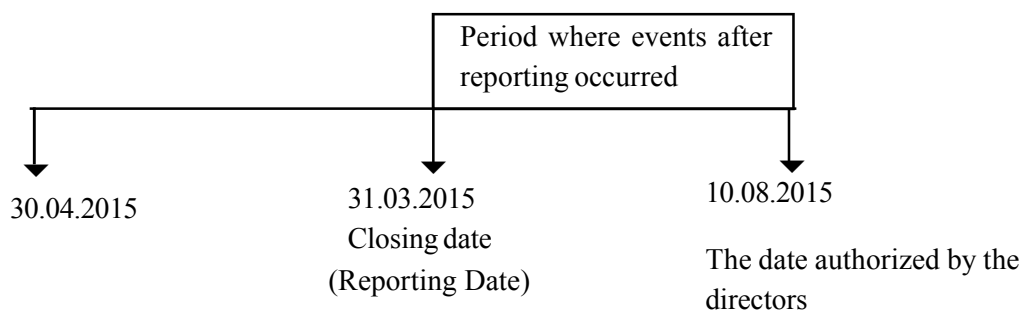
### Activity

- Provide following topics to two students groups
  1. Adjusting events
  2. Non adjusting events
- Direct each groups to list of transactions related to each topic.
- Direct them to present each of the above information in financial statements.
- Provide the groups to creativity present their findings to the whole class.
- Summarize the subject matter after their findings.

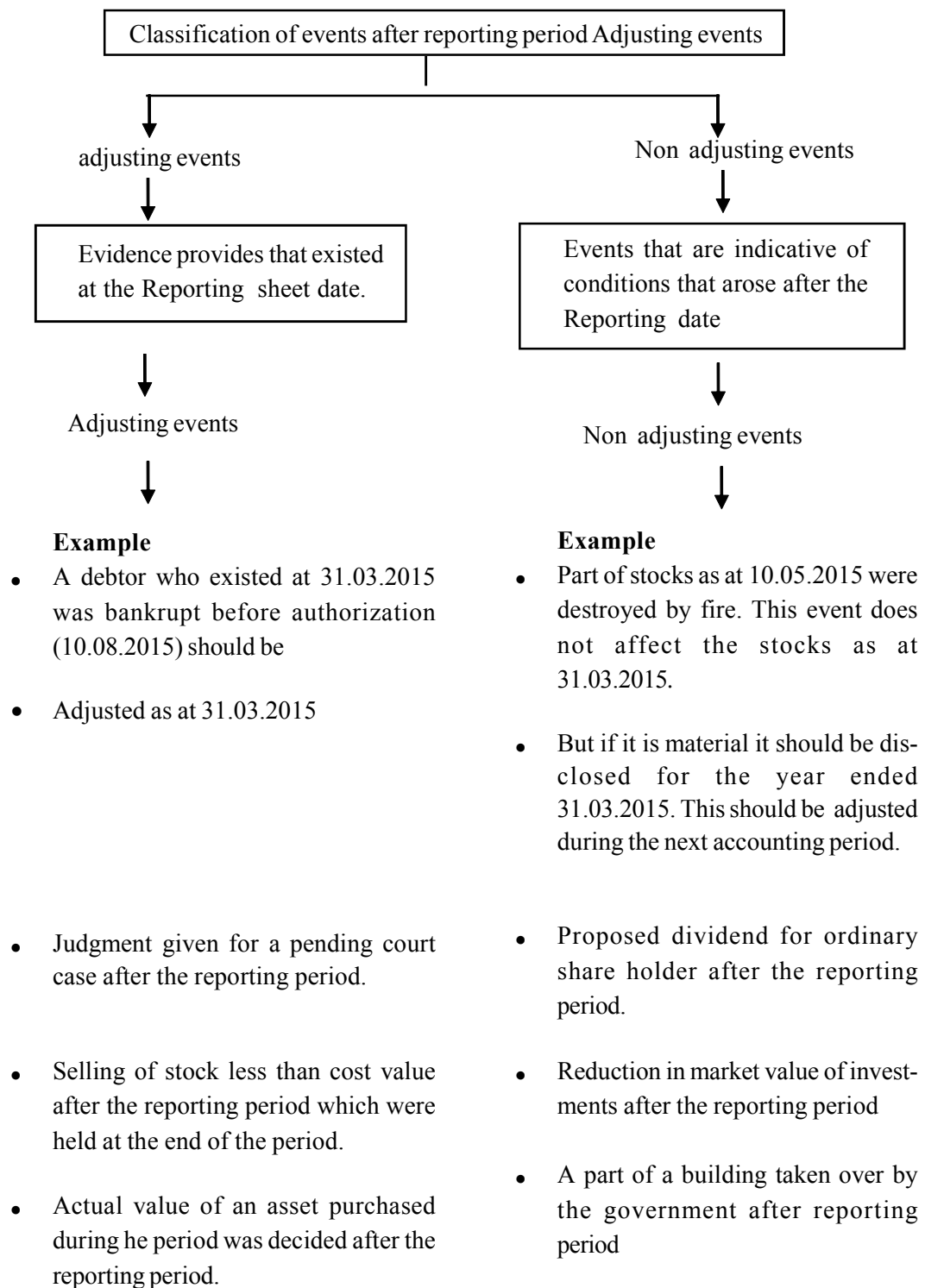
### Guidance on subject matter :

Events after reporting period

“Are those events, favourable and unfavourable that occur between the end of the reporting period and the date when the financial statements are authorized for issue.”







Dissimilarities between adjusting and non adjusting events.

<b>Adjusting events</b>	<b>Non adjusting events</b>
1. Provides at the end of the reporting period	1. Presents a situation existed after the reporting period
2. These would affect profit and loss, and statement of comprehensive income and statement of financial position.	2. Do not affect on profit and loss statement of comprehensive income and statement of financial position.
3. Adjusting event in financial statement.	3. Non adjusting events in financial statement.
4. Disclosure and adjusting needed.	4. Disclose by way of a note

### **Disclosure requirements**

- Date of authorization for issue
- The person who authorizes
- Discloses the situation as at the end of the period
- Nature of non adjusting events
- Elements in financial effect
- If it is not a financial estimate

### **Annexure 11.8.1**

#### **List of Transaction**

Accounting period : 01.04.2016 – 31.03.2017

Date of Authorization : 15.08.2017

1. On 10.05.2017 it is proposed to pay 10% dividends for ordinary share holders of Subodha PLC Company
2. Value of Investment on 31.03.2017 was Rs. 450 000. Directors decided that market value of investment on 15.08.2017 was Rs. 350 000.
3. Court decided to pay a compensation of Rs. 150 000 on 15.04.2017 to employee who has filed a case against the company.

4. Death of a debtor worth Rs. 50 000 informed on 20.04.2017 who was existed at 31.03.2017.
5. Closing stock value as at 31.03.1017 amounted to be Rs. 600 000. Stocks closing Rs. 100 000 was sold on 10.04.2017 for Rs. 75 000.
6. On 10.07.2017 a part of a build destroyed by fire and estimated loss is Rs. 500 000.
7. On 10.07.2017 an insurance company agrees to pay a insurance claim of Rs, 200 000 which were damaged at the end of the according year.
8. The government has taken a land which belongs to the company on 12.07.2017 estimated value is Rs. 1500 0000.

### **Assessment and Evaluation Criteria**

1. Defines following
  - Reporting period
  - After the reporting period
  - Events after the reporting period
2. Classification of events after the reporting period
3. Classifies adjusting and non adjusting events.
4. Provide examples for adjusting and non adjusting events
5. Select the adjusting events and make necessary adjustment
  - (i) An insurance company agrees to pay Rs. 10 000 for an insurance claim requested during the accounting period.
  - (ii) Proposed dividends for ordinary share holders were Rs. 5 000
6. Accounting year of Perera Ltd ends on 11.03.2017. On 30.05.2017 directors were authorizes their financial statements. Following events were reported after 31.03.2017.
  1. Goods costing Rs. 350 000 as at 31.03.2017 has an net realizable value of Rs. 290 000 on the same day. This stock was sold on 25.04.2017 for Rs. 250 000.
  2. Somapala an employee field a case against the company. On 15.04.2017. The court decided to pay Rs. 100 000 as compensation.
  3. A building costing Rs. 500 000 was destroyed by fire on 30.04.2017 loss is estimated as Rs. 150 000

4. Government has takenover a land valued Rs. 1 500 000 on 07.05.2017

**Required :**

1. Classfiy adjusting and non adjusting events.
2. Disclosure requirement and the way of adjusting in financial statements.

State whether true / false

- (i) Reporting period is the time period between starting and ending date. (.....)
- (ii) Proposed dividends for ordinary share holders should only be disclosed. (.....)
- (iii) Goods costing Rs. 100 000 at the end has been sold for Rs. 80 000 before authorization of financial statements. It increase the profit. (.....)

**Competency 11.0 : Uses Sri Lanka accounting Standards in preparing and Presenting of Financial Statements**

**Competency Level 11.9 : Keeps accounts and discloses Revenues**

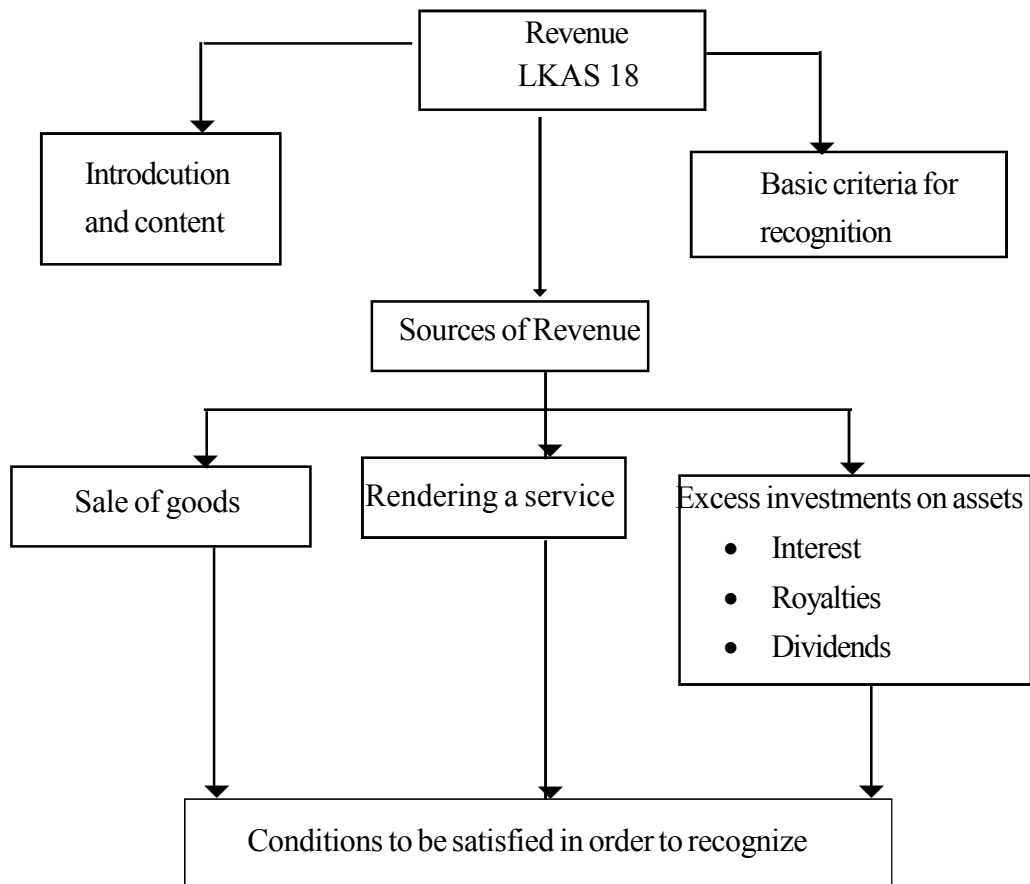
**Number of Priods : 02**

**Learning outcomes :**

- Creates revenue according to the standard
- Recognize variety of revenues

**Basic Terms and Concepts**

**Concept Maps**



- Lead a discussion with students to highlight following.
  - Importance of recognizing “Revenue”
  - Items to be included in “Revenue”
  - Criteria of recognizing “Revenue”
  - Provide a definition for ‘Revenue’
- Revenue arises in ordinary course of activities of an organization. Income can be divided in to two.
  - Revenue
  - Profit
- The objective of this standard is to prescribe the accounting treatment of revenue arising from certain types of transactions and events. According to LKAS 18
- It should satisfy followings in order to recognize revenue.

There are two conditions to be satisfied

1. It is probable the economic benefits associated with the transaction will flow to the entity.
2. The amount of the revenue can be measured reliably.

#### **Examples :**

- If Rs. 46 000 cash collected by selling goods with an inclusive of 15% VAT can be divided into two.
  1. Sales value of Rs. 40 000 exclusive of VAT. Profits earned from that sale is an economic benefit to the organization.
  2. Value added amount of Rs. 6 000 collected on behalf of the government is not gaining any benefit of the organization.

- Any revenue arising from the use by others of entity assets yielding or any source of investment is interest income. It could be recognized as an income and should account only is the economic benefit flows into the business and could be measured reliably. Any transaction could be measured reliably and economic benefit associated with the transaction will flow to the entity is known by “Revenue”

This standard applies to revenue from

1. The sale of goods
2. Rendering of service
3. The use by others of entity assets gives rise to revenue in the form of

- Interest
- Royalty
- Dividends

### **Sale of Goods**

- Goods produced by the entity for the purpose of sale and goods purchased for sale could be considered as revenue of an organization.

Revenue from the sale of goods shall be recognized when all the following conditions have been satisfied.

- (i) The entity has transferred of the buyer the significant risks and rewards of ownership
- (ii) The entity retains neither continuing management involvement to the degree usually associated with ownership nor effective control over the goods sold.
- (iii) Value could be measured reliably
- (iv) It is probable that the economic benefits associated with the transaction will flow to the entity.

### **Rendering of Services.**

- When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognized by reference to the stage of completion of the transaction at the end of the reporting period.
- The outcomes of a transaction can be estimated reliably when all the following conditions are satisfied.
  - (a) The amount of revenue can be measured reliably
  - (b) It is probable that the economic benefits associated with the transaction will flow to the entity.
  - (c) The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

### **Example :**

- Consultation period of two years given for a project and it will be paid at the end of the service period. Total consultation expense is Rs. 800 00 and at the end of the first year 40% s payable.

The first year 40% payable.

At the end of the first year service income is  $800,000 \times \frac{40}{100} = \text{Rs.}320,000$

### Interest Income

- Interest income is a source of revenue by providing excess resources to other parties.

Interest income relevant for the period to be recognized in respect to the time under accrual basis. Interest income to be recorded if the amount can be measured reliably and, created an inflow of economic benefits.

### Example :

- On 01.04.2018 an amount of Rs. 500 000 deposited in a fixed investment at an interest rate of 10%. Accounting year ends in on 31.12.2018. Company does not received any interest income during the period. But it can be calculated as follows.

$$500,000 \times \frac{10}{100} \times \frac{9}{12} = \text{Rs. } 37\,500$$

Interest income for the period is Rs. 37 500. It should be recorded under current asset since they could not be collected for the period.

### Royalties

- Royalty income should be calculated according to accrual basis. It could be recognized as an income only if
  - It is probable that the economic benefits associated with the transaction will flow to the entity.
  - The amount of the revenue can be measured reliably.

### Example :

An owner of a graphite mine has given authority to extract graphite to another party.

For each tonne of graphite a payment of Rs. 5 000 should be given.

10 tonnes were extracted during the first year and Rs. 40 000 paid each year.

Therefore

Royalty income according to the royalty agreement is Rs. 50 000 calculated based on accrual.

Receivable amount of 40 000 should be shown under current asset.

### Dividends

- The amount of dividends payable to each share holder depends on the ability of owner of the share holder.  
Also it could be measured reliably.



**Example**

- Purchased 40 000 shares at a price of Rs. 20 each. It is decided to pay a three dividends to their share holders and obtained approval from the board of directors.
- Divided income for the period is Rs. 40 000 shared X 3 each = Rs. 120 000

Revenue can be define as follows.

Revenue is the gross inflow of economic benefits during the period arising in the course of ordinary activities of an entity when those inflows result in increases in equity other than increases relating to contributions from quality participants.

**Assessment and Evaluation**

1. Name items included in revenue
2. Conditions to be satisfied to recognize revenue,
3. State the relevant revenue with the amount if its could e recognize as revenue, the related conditions to be satisfied it is not recognized as revenue.
  - (a) Senani Ltd sold yogurt to Manaodya Ltd. In order to settle the payment. Manodya gave 157000 costing two torches and balance amount of Rs. 18 600 paid by way of a cheque.
  - (b) Sold a 69 000 goods inclusive of 15% + VAT and received Rs. 20 000 as an advance for the next year.
  - (c) A fixed deposit opened on 01.01.2108 at an interest rate of 10%. Their accounting year ends on 31.03.2018.
  - (d) According to the rent agreement it is agreed to pay a Rs. 4 000 for every one cube of brick removed. During the first year they received 150 cubes of bricks. They paid Rs. 450 000 the rent institute.
  - (e) Purchased 20 000 shared at a price of Rs. 40 each and for the first year 8% of divides were agreed to pay.

**Competency 12.0 : Prepares Financial Statements for a Limited Company**  
**Competency Level 12.1: Analysis legal background relating to Limited Liability Company**

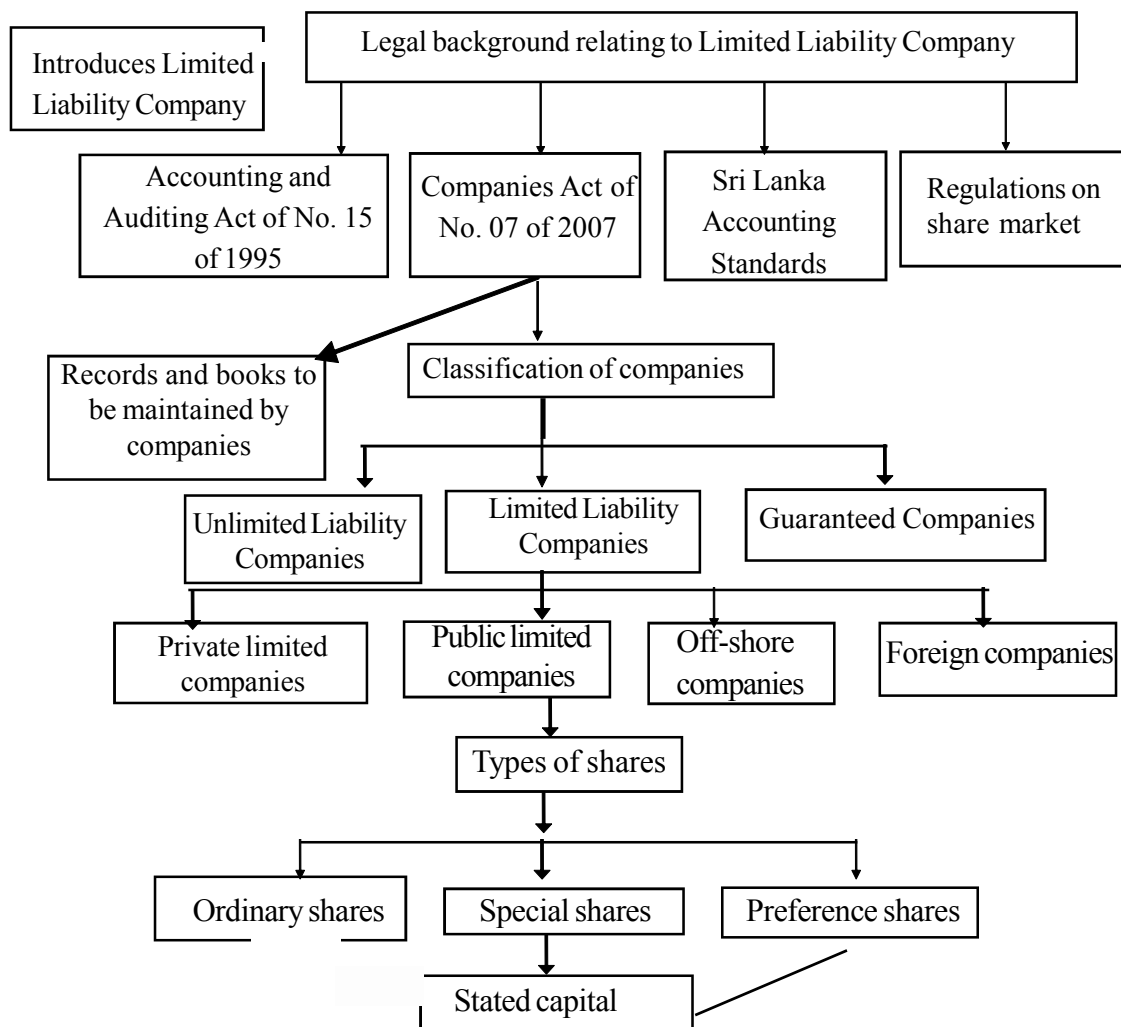
**No. of Periods : 06**

**Learning Outcomes :**

- Defines “Limited Liability Companies”.
- Classifies companies according to the companies Act of No 7 of 2007
- Explains about the existence of legal background relating to accounting for companies.
- Stated the records to be maintained by companies
- Explains types of shares that can be issued by a company and the term stated capital.

**Basic Terms and concepts :**

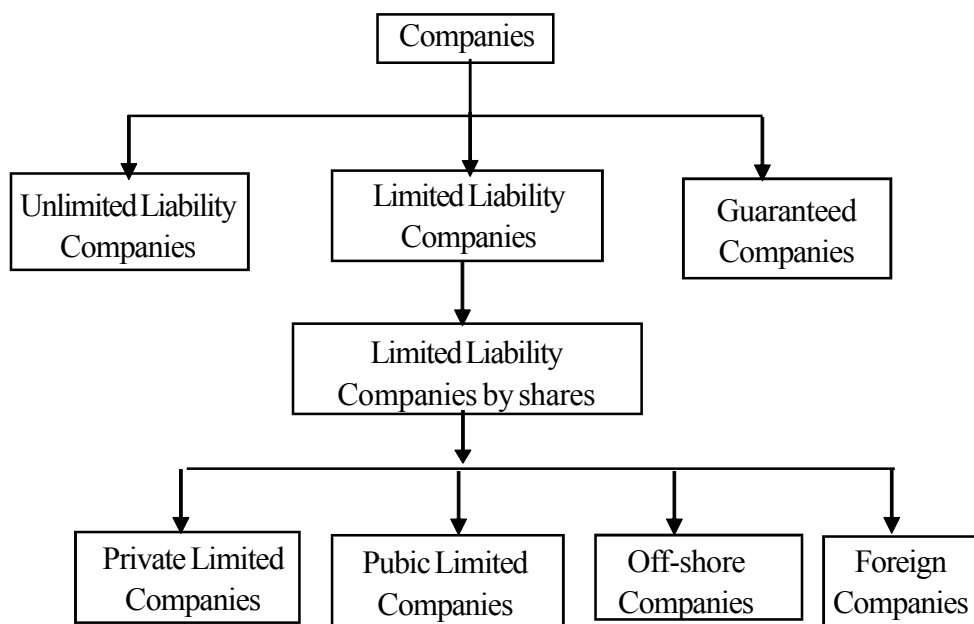
**Concept Map**



## Learning – Teaching Process

### Engagement :

- Distribute a copy of Annexure 12.1.1
- Conducting brainstorming inquiring about students opinions relating to limited liability companies as business organization.
- Lead the discussion emphasizing following facts
  - Introduction about Limited Liability Companies
  - Legal background relating to Incorporated Companies
  - Introduction of records and books to be maintained by a Limited liability companies.
  - Introduction about types of shares of a Limited Liability Company and raising of stated capital.
  - Classification of companies according to the Companies Act is as follows.



**Books and record that are maintained by Limited Liability Companies**

- (i) Records on cash receipts to the company and ways of spending using the collection.
- (ii) Records about assets and liabilities
- (iii) Records on trading of goods such as credit purchases and sales with details of customers and suppliers.
- (iv) Records on closing stock.
- (v) Service reports if it related to provide services.

**Types of shares of Limited Liability Company.**

According to the section 49 of companies Act, “share in a company shall be movable property.” Types of shares that can be issued by Limited Liability Companies are, as follows.

1. Ordinary shares / Equity shares
2. Preference shares
3. Special shares

**Only Introduction of Preference shares should be taught at  
G.C.E Advance Level**

**Stated Capital**

Companies issue its shares to general public in order to raise funds for company. The capital raised through such share issues is the stated capital.

According to the section 58 of companies Act, stated capital in relation to a company means the total of all amounts received by the company or due and payable to the company in respect of the issue of shares and in respect of calls on shares.”

Issue of shares in a company to be launched in accordance with the section 51 of

Companies and provisions in articles of association.

**Consideration for issue of shares**

As per the section 52 of companies Act, the Board of directors decides the consideration for which the shares will be issued.

**The consideration for a share issued may take in any, form including**

- cash
- Promissory notes
- Future services
- Assets and properties
- other securities

## Annexure 121.1

- Distribute a copy of Annexure 12.1.1 among students.

01. Categorize the names of business firms available in your town in the table given below.

Sole Proprietorship Business	Business with a few number of owners	Business with several number of owners
1.	1.	1.
2.	2.	2.
3.	3.	3.
4.	4.	4.

02. State three differences between Public Limited Liability Companies and Private Limited Companies

Public Limited Companies	Private Limited Companies
1.	1.
2.	2.
3.	3.

03. Write down three books and records to be maintained by a Limited Liability Company.

.....

.....

.....

04. State three types of shares that can be issued to general public to raise funds by a Public Limited Liability Company.

.....

.....

05. Differentiate two types of shares given below using the available criteria.

.....

.....

Criteria	Ordinary shares	Preference shares
1. Ownerships of company		
2. Right for dividends		
3. Right for voting		
4. Right for administration		

**Assessment and Evaluation Criteria :**

1. Classify the forms of business
2. Stating the differences between public limited and private limited companies
3. Name the books and records to be maintained by a public limited company.
4. State the types of shares which can be issued by a public limited Company and briefly explain the differences.

**Competency 12.0 : Prepares Financial Statements for a Limited Company**  
**Competency Level 12.2 : Accounting recorders for issuing shares by collecting consideration at once.**

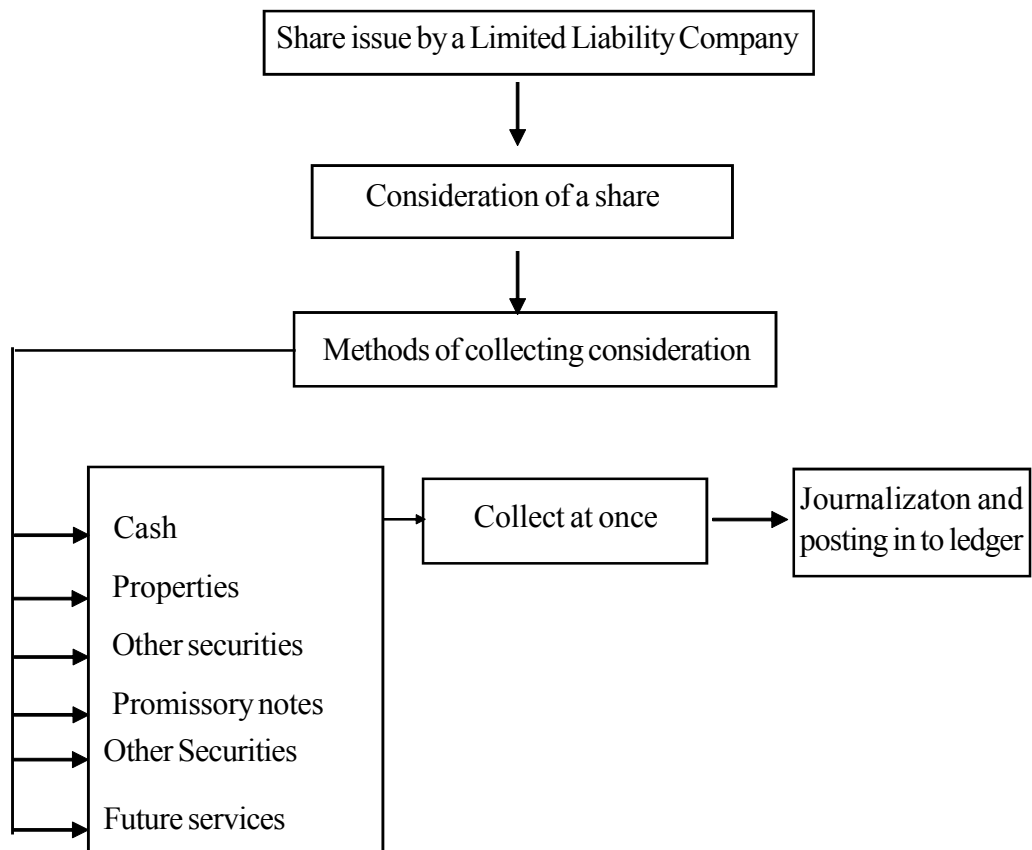
**No. of Periods : 08**

**Learning outcomes :**

- Explains “consideration of a share”
- States the methods of collecting consideration of a share.
- Prepares accounts of when collecting the consideration by cash at once.

**Basic Terms and Concepts :**

**Concepts Map**



### Learning – Teaching Process :

### Engagement :

- Distribute annexure 12.2.1, 12.2.2, 12.2.3 and 12.3.4
- Lead a discussion with students recalling the memory and the practical situation of share market using following questions.
  - What is meant by a share?
  - What is meant by a consideration of a share?
  - How to decide the consideration of a share and how to get approval for it.
  - How to collect the consideration of a share.

**Guidance to Clarify Subject Matter.**

Share issue and collect consideration.

Issue of share can be taken place in two occasions such as

- (i) Initial Public Offer
- (ii) Secondary Public share offer

Consideration per share can be collected at once or as installments (collection as installments is not under G.C.E (Advanced level Syllabus))

**Journal entries relating to collection of cash at once.**

- |                                      |         |
|--------------------------------------|---------|
| (i) Cash account                     | Dr. xxx |
| Share issue account                  | Cr. xxx |
| (Receipt of money with applications) |         |

2) Share issue account Dr

Stated capital Account Cr

(Allotment of shares)

- Cash to be returned back when a company received applications for shares exceeding the number of shares to be issued. Allotment of shares can be done by using a selected ratio using different losses. This is referred as pro - rata allocation method.
- Excess collection to be refunded to applicant under this method, there,

Share issue Account Dr.

Cash Account	Cr.
--------------	-----

- Distribute the annexure 12.2.1 among students.



### Annexure 12.2.1

Complete following table using the knowledge you acquired relating to consideration per share.

Brief definition on consideration of share	Parties who decides the consideration of a share	Things that are accepted for a consideration of a share	Way of collect consideration of a share

### Annexure 12.2.2

- Distribute Annexure 12.2.2 among students.
  - On 01.01.2018 Amanda PLC issued 100 000 share to general public at a consideration of Rs. 40 closing date for application collection was 31.01.2018. 120 000 Shares were applied by applicant on 31.01.2018
  - On 02.02.2018 excess money was refunded to applicant and remaining were capitalized.
  - Record the above situation in ledger accounts.

#### Amanda PLC

##### Cash Account

--	--

##### Share issue Account

--	--

##### Stated capital – Ordinary shares Account

--	--

### Annexure 12.2.3

- Distribute annexure 12.2.3 among students.

Arunalu PLC issued 100 000 shares at a consideration of Rs. 50 on 01.01.2018 to general public closing date for application collection was 31.01.2018 and 250 000 shares were requested on applications.

**Required :**

Answer following questions referring to above incidents.

(a) (i) Amount collected with applications,

(i) Amount rejected

(ii) Amount of capitalizations /amount of allocated shares?

(b) Write down journal entries if all the money was collected to cash account.

(i) ..... Dr  
..... Cr  
( )

(ii) ..... Dr  
..... Cr  
( )

(iii) ..... Dr  
..... Cr  
( )

- Distribute annexure 12.2.4 among students.

#### Annexure 12.2.4

Locahna PLC issued shares at a consideration of Rs. 60 and collected all considerations at once.

Share holders Discription	Existing share holders	Employees	Local Investors & other individuals	Foreigners	Total
Number of Shares applied for	50,000	200,000	300,000	50,000	-----
Number of shares allocated	-----	-----	100,000	----	-----
Rate of allocation ``	1 : 1	2 : 1	.....	5 : 1	.....

#### Required :

- Journal entry for cash collection with applications.  
..... Dr  
..... Cr
- Journal entry for cash returned / refund  
..... Dr  
..... Cr
- Journal entry for capitalization  
..... Dr  
..... Cr
- Did an employee receive 5000 shares. How much he paid with application.  
..... Dr  
..... Cr
- A local investor received 3000 shares. Amount refund to him was?

#### Criteria for Assessment and Evaluation

- Describing of consideration of a share
- Stating the ways of collecting consideration per share.
- Journal entry records for collection of consideration at once.
- Postings in ledger for cash collection of consideration at once.

**Competency 12.0 : Prepares Financial Statements for a Limited Company**

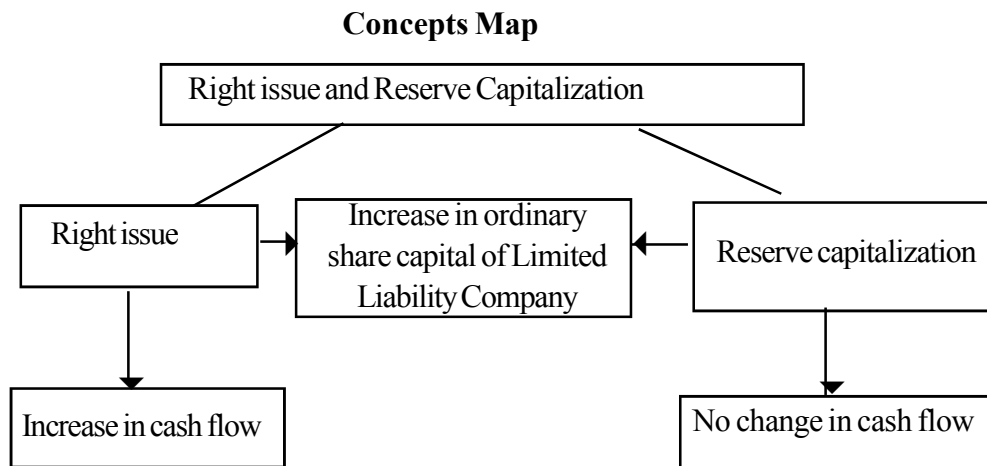
**Competency Level 12.3 : Accounting for Reserve Capitalization and right issue**

**No. of Periods : 04**

**Learning outcomes :**

- Explains the right issue
- Explains reserve capitalization
- State the differences between right issue and reserve capitalization
- Records right issue and reserve capitalization in account

**Basic Terms and Concepts :**



**Guidance on Subject Matters :**

**Engagement :**

- Lead a discussion with students relating to their ideas related to issue of shares by limited liability company.
- Brief introduction about right issue.
- Aims of exercising a right issue
- Reserves available in Limited Liability Company
- Brief description on revaluation reserves, General reserves and retained earnings.
- Aims of capitalization of reserves.

## Right Issue Means;

- Issuing shares to existing ordinary share holders of a Limited Liability Company based on a ratio by getting money.

**Reserve Capitalization means.**

- Issuing shares to existing ordinary share holders of a limited Liability Company based on a ratio using available reserves not by collecting money from them.

### Journal Entry for Right Issue

Cash Account	Dr	
Stated capital - Ordinary shares Account		Cr
(Right issue of ordinary shares at .....ratio)		

### Journal entry for Reserve Capitalization

Relevant Reserve Account	Dr	
Stated capital – Ordinary shares Account		Cr
(Capitalization of Reserves at ..... ratio)		

**Distribute Annexure 12.3.1 among students.**

### Annexure 12.3.1

Complete following table referring to the discussion mane.

(i) Difference between right issue and reserve capitalization

Criteria	Right Issue	Reserve capitalization
Cash flow		
Total equity		
Use of reserves		
Number of shareholders		

## (2) Similarities between right issue and reserve capitalization

1.
2.

Atugapura PLC  
Statement of Financial Position 1s at 01.01.2017  
(Extracts)

Rs' 000

Stated Capital		
Ordinary Shares (100 000)		4 000
Reserves		
Revaluation Reserves	1 000	
General Reserves	500	
Retained Earnings	2 000	3 500

Board of directors made following decisions.

1. Capitalization of reserves by issuing ordinary shares for existing ordinary share holders at 4 : 1 ratio for a consideration of Rs. 40 /-
2. Right issue for a consideration of Rs. 50 for the ordinary shares available before the reserve capitalization at a ratio of 5 : 1

**Required :**

- (i) Journal entries to record above transactions.
- (ii) General ledger accounts relating to above transactions.
- (iii) Extracts of statement of financial position after recording above transactions.

**Instructions :**

$$\text{Existing consideration per share} = \frac{4000,000}{100,000}$$

$$= \text{Rs. 40}$$

$$\text{Amount of reserve capitalization} = \frac{100000}{4} \times 40 = \text{Rs. 1000000}$$

$$\text{Amount of Right Issue} = \frac{100000}{5} \times 50 = \text{Rs. 1000000}$$

Distribute Annexure 12.3.3 among students.

**Annexure 12.3.3**

**Thilakshana PLC**  
**Statement of financial position as at 01.01.2018**  
**(Extracts)**

	(Rs.' 000)
Stated capital	
Ordinary share capital at Rs. 50/-	5 000
Reserves	
Retained earnings	3 000

Above equity details are appeared to the following decisions made by board of directors.

- Right issue of ordinary shares at a ratio of 4 : 1 for a consideration of Rs. 50/-
- Reserve capitalization after the right issue considering all available shares at a ratio 5 : 1 at a consideration at Rs. 50/-

**Required :**

1. Journal entries to record above transactions
2. General ledger accounts to record above transactions

**Assessment & Evaluation**

- Differentiating right issue and reserve capitalization
- Stating similarities between right issue and reserve capitalization
- Preparing a Journal Entries for right issue and reserve capitalization using an example.
- Preparing accounts relating to right issue and reserve capitalization
- Preparing statement of financial position after the right issue and reserve capitalization

**Competency 12.0 : Prepares Financial Statements for a Limited Company**

**Competency Level 12.4.1 : Preparing of financial statement of Limited Liability Company by applying Sri Lanka Accounting**

**Standards**

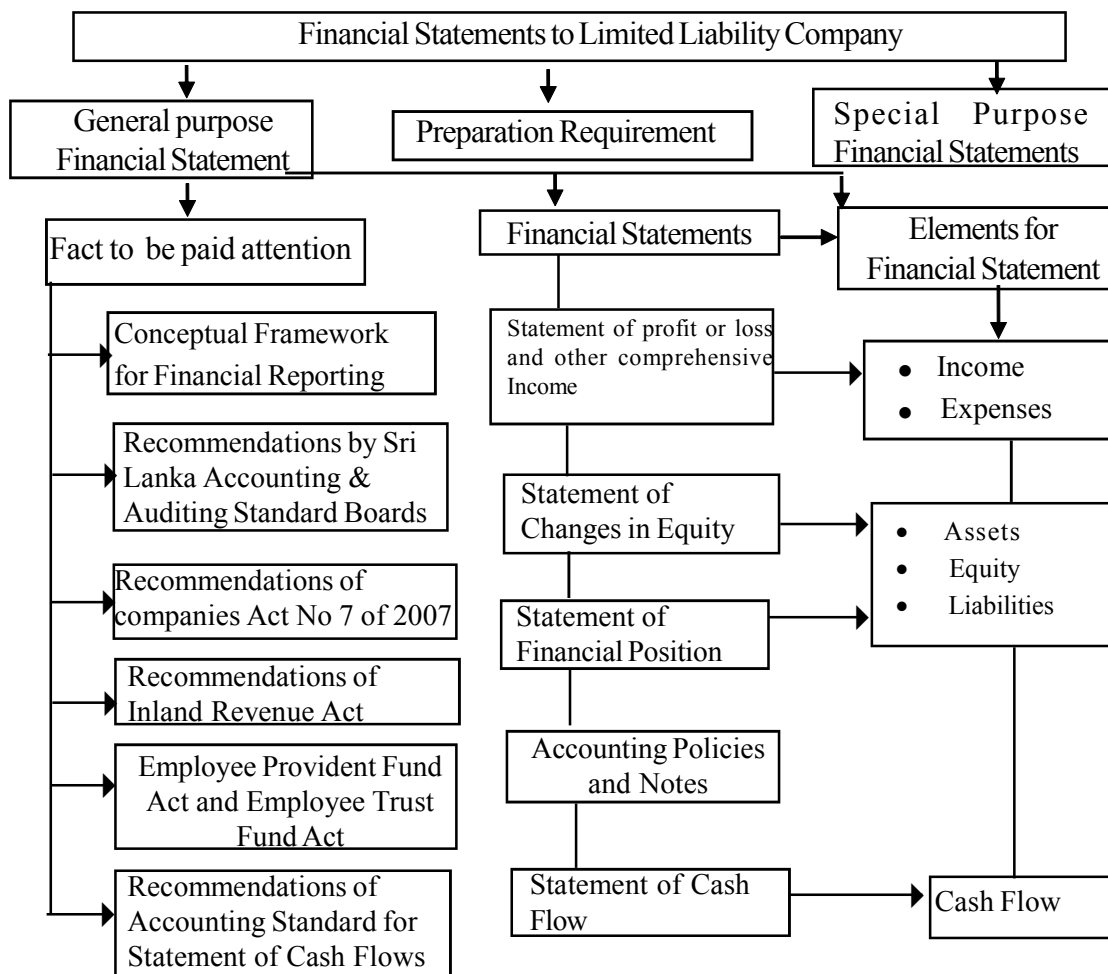
**No. of Periods : 60**

**Learning outcomes :**

- Prepares statement of profit or loss and other comprehensive income according to the recommendations under the Accounting Standard for Presentation of financial statements.
- Prepares statement of financial position
- Prepares statement of changes in Equity
- Prepares Notes to the accounts

**Basic Terms and Concepts :**

**Concepts map**





### **Learning Teaching Process :**

- Financial Statements of a Limited Liability Company are prepared on two requirements bases as
  1. Special purpose
  2. General purpose
- Financial Statements which included all information (for management requirements) are called as special purpose financial Statements. These are also referred as descriptive Financial Statements.
- Financial Statements prepared to provide accounting information for the common of external parties are general purpose financial statements.
- When preparing general purpose financial statements, it is required to consider about,
  - Recommendations, formats and guidelines mentioned in Sri Lanka Accounting Standard No. 01
  - Recommendations in conceptual framework for financial reporting
  - Requirements in Companies Act No 07 of 2007
  - Guidelines from Sri Lanka Accounting and Auditing Standards Committee.
- Following are the items / Components of financial Statements,
  1. Statements of profit or loss and after comprehensive income
  2. Statement of financial position
  3. Statement of changes in equity
  4. Statement of cash flows
  5. Accounting policies and notes
- Recommended format and guidelines in Sri Lanka Accounting Standard 01 to be applied when preparing financial statements.

.....PLC  
**Statement of Profit or Loss and other comprehensive Income**  
**for the year ended .....** (Rs.000)

	Notes	Rs.	Rs.
Sales			xxx
Cost of Sales			(xxx)
Gross profit			xxx
Other Income	01		xxx
Distribution Cost		xx	xxx
Administration cost		xx	
Other Expenses		xx	
Finance cost		xx	(xxx)
Profit Before Tax	02		xxx
Income Tax Expenses	03		(xxx)
Profit /Loss for the period			xxx
<b>Other Comprehensive Income</b>			
Change in revaluation reserve of Property Plant & Equipment			xxx/(xx)
Total Comprehensive Income			xxx

-----PLC  
**Statement of Changes in Equity**  
**for the year ended .....** (Rs.000)

Description	Ordinary Shares	Revaluation Reserve	General Reserve	Retained Earnings	Total
Balance B/F	xx	xx	xx	xx	xx
Share Issue	xx	--	--	--	xx
Total Comprehensive Income	--	xx	--	xx	xx
Right Issue	xx	--	--	--	xx
Reserve Capitalization	xx	--	(xx)	(xx)	--
Transfer to General reserves	--	--	xx	(xx)	--
Interim Dividends paid					
- Ordinary Shares	--	--	--	(xx)	(xx)
Closing Balance	xxx	xx	xx	xx	xxx

..... PLC  
**Statement of Financial Position as at**  
**31. ....**

(Rs.000)

	Notes	Rs.	Rs.
Non-current assets			
Property, plant and equipment	04		xxx
Right of use of lease property	05		xxx
Investment (Long term)			xxx
			xxx
Current Assets			
Inventory		xxx	
Trade Receivable	06	xxx	
Other current Assets		xxx	
Cash and cash equipments	07	xxx	xxx
Total Assets			xxx
Equity & Liability			
Stated Capital			
Ordinary Shares			xxx
Reserves			
Revaluation reserves			xxx
General Reserve		xxx	
Retained Earnings		xxx	xxx
			xxx
Non Current Liabilities			
Bank Loan		xxx	
Lease Creditors (Non - Current)		xxx	xxx
Current Liabilities			
Lease creditors (current)		xxx	
Trade Payables		xxx	
Current portion of Long term debts		xxx	
Short term Provisions		xxx	
Other Current Liabilities		xxx	
Short-term loans / Bank OD		xxx	
Total Equity and Liabilities			xxx

Accounting policies and notes to the accounts disclosed together with financial statements of Limited Liability Company.

Followings to be disclosed using notes.

(i) Other Income	Rs
Profit on disposal of PPE	xx
Dividend Income	xx
Interest Income	xx
Rent Income	xx
Discount Received	xx
Commission Income	xx
	<u>xx</u>
	<u>xx</u>

(2) Following expenses are considered in calculating Profit before tax

	Rs.
Depreciation	xx
Loss on disposal of PPE	xx
Deficit / Loss on revaluation	xx
Loan interest	xx
Lease Interest	xx
Warranty expense	xx
Stock written off	xx
Employee Compensation	xx
Director fee/Allowance/Remittances	xx
Audit fees	xx
EPF expenses	xx
ETF expenses	xx
Donations	xx

(3) Income Tax

Income Tax on profit for the year	xxx
Under / over Provision (Last Year)	x/(x)
	<u>xx</u>
	<u>xx</u>

## (4) Property, Plant and Equipment

(Rs.000)

	Land	Buildings	Motor vehicles	Machines	Office Equipment	Computers	Total
Opening Balance	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Purchases	--	xxx	--	--	--	xxx	xxx
Revaluations	xxx	xxx	--	--	--	--	xxx
Disposals	--	--	(xx)	--	--	--	(xx)
Depreciation Adjustment for Revaluation	--	(xxx)	--	--	--	--	(xxx)
Closing Balance	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Accumulated Depreciation							
Opening Balance	--	xxx	xxx	xxx	xxx	xxx	xxx
Depreciation for the year	--	xxx	xxx	xxx	xxx	xxx	xxx
Disposals	--	(xx)	--	--	--	(xx)	(xx)
Depreciation Adjustment for revaluation	--	(xxx)	--	--	--	--	(xxx)
Closing Balance	--	xxx	xxx	xxx	xxx	xxx	xxx
Carrying Amount	xxx	xxx	xxx	xxx	xxx	xxx	xxx

## (5) Right of use of lease Property

## (6) Trade receivables

xx

Motor Van	xxx
Less Accumulated	(xx)
Depreciation	<u>xxx</u>

Allowance for expected	
losses on trade receivables	(xx)
	<u>xxx</u>

(7) Cash and Cash equivalents	Rs.
Petty cash Balance	xx
Cash	xx
Treasury Bills (3 months)	<u>xxx</u>
	<u>xxx</u>

Accounting policies applied in preparing & presentation of finance statements to be closed with the financial statements. Such as,

- (i) Cost formula used for inventory valuation (FIFO/WAC)
- (ii) Base for asset recognition either cost or revalued amount

(iii) Various agreements assigned by the business

**Instructions for Planning Exercise :**

Students can be assigned to bring financial reports of limited liability companies available in news papers, magazine or internet as a pre requirement for engaging to this competency level. Discuss with students relating to the information available in those reports.

- Discuss the students ideas by getting information of financial statements separately.
  - Explain about the information provided through each type of financial statements.
  - Statement of profit or loss & other comprehensive income – financial performance  
Statement of changes in equity and statements of financial position – financial status
  - Discuss about the information which are important for interested parties for decision making but not disclose in the face of financial statements.
  - Emphasis the necessity of preparing accounting notes which disclose the important information for interested parties relating to preparation and preparation of financial statements.
- 
- Distribute Annexure 12.4.1.1, 12.4.1.2, 12.4.1.3, 12.4.1.4, and 12.4.1.5 among students.
    - Following annexure to be distribute among students in the order of 124.1.1, 12.4.1.2, 12.4.1.3, 12,4.1.4 and 12.4.1.5.
    - Facilitate students to engage in activities by following the instructions on them.
    - Give opportunity for students to present the class.

**Annexure 12.4.1.1**

Balance of income and expenses for the financial year of 2017/2018 of Milano PLC given below.

	<b>(Rs.000)</b>
Sales	40600
Purchases	25000
Inventory 01/04/2017	4000
Carriage inward charges	1000
Return Inwards	600
Return Outwards	500
Profit on disposal of motor vehicle	100
Rent income	600
Interest Income	300
Salaries an wages	4000
Book keeping expenses	200
Doubtful debts	t70
Impairment loss of trade receivables	30
Loan interest	100
Stock Donations	50
Director remittances	600
Audit fee	160
Sales warantee	140
Depreciation for Buildings	80
Depreciation for moteo vehicle	120
Eco emisson and vehicle license fee	40
Telephone and Electricity expenses	200
Advertising expences	100
Lease interest	60
EPF Expense	600
ETF Expense	120
Other Administration Expense	1230
Other distribution expense	150
Other Financial expense	50
Surplus on Land revaluation for first time	2000

#### **Additional Information**

1. Inventory as at 31/3/2018 was Rs. 3500,000. Net Realizable value of it was estimated as Rs. 3200,000

2. Income Tax is  $\frac{1}{3}$  of profit before tax of the accounting year.

**Required :**

1. Prepare statement of profit or loss and other comprehensive Income for the year ended 31/3/2018 of Milano PLC referring above details.
2. Prepare notes to the account for the year ended 31/3 of Milano PLC

**Annexure 12.4.1.2**

- (1) Balance of equity items as at 01.04.2017 of Wariyapola LC given below.

	Rs.'000
Rs. 50/- ordinary shares (2000 000)	100 000
Revaluation reserves (Land)	4 000
General Reserve	22 500
Retained earnings	3 500

- (2) Extract from the statement of profit or loss and other comprehensive income for the year ended 31.03.2018 of Wariyapola PLC.

Profit for the period	Rs. 6500 000
Surplus on land revaluation during the year	Rs. 2000 000
Total comprehensive Income	Rs. 8500 000

- (3) Transactions caused to change the equity during the year ended 31.03/2018 of Wariyapola PLC are as follows.

- (i) On 01/04/2017, 5000 ordinary shares were issued and 60 000 applications were collected for that share were proportionately distributed and excess money was returned,
- (ii) On 01/07/2017 board of directors decided to capitalize its reserves considering the ordinary shared available at 01/4/2017 before the new share issue by offering 1 share for every 5 ordinary shares held at a consideration of Rs. 50. General reserves are used for that.
- (iii) On 01/10/2017. 20 000 ordinary shared were issued for ordinary share holders at 4 : 1 ratio at a consideration of Rs. 50. All shareholders exercised the right.
- (iv) On 31/03/2018, board of directors decided to transfer Rs. 1000 000 dividend of Rs. 3000 000 for ordinary shares. However for ordinary share holders during the year.



**Required :**

1. Statement of changes in Equity for the year ended 31/03/2018 of Wariyapola PLC.
2. Notes to the account referring above transactions for the year ended 31/03/2018 of Wariyapola plc
3. Journal entries, ledger accounts to record above transaction.

**Annexure 12.4.1.3**

Balances available as at 31/3/2018 in Raththota PLC after preparing statement of profit or loss and other comprehensive income and statement of changes in equity given below.

Inventory as at 31/3/2018	7800
Investment in ordinary shares	6000
Fixed deposit (3 years)	2500
Trade receivables	6425
Trade payable	9165
12% Bank Loan	3600
Prepaid Insurance (31/03/2018)	60
Income tax payable 31/3/2018	480
Property, plant and equipment (carrying amount)	19840
Bank loan payable as at 31/03/2018	65
Allowance for Expected losses on trade receivables	25
Accrued electricity as at 31/3/2018	40
Cash and cash equivalents	8750
Revaluation reserves	8200
Stated capital – Ordinary shares	16800
Lease creditors	5700
Lease creditor – current portion	300
General reserve	2300
Retained earnings	4700

- Prepare statement of financial position as at 31/03/2018 of Raththota PLC

#### Annexure 12.4.1.4

Following account balances are extracted from the accounting records prepared by Singithi PLC as at 31/03/2017

Balances of property, plant and equipment and accumulated depreciation as at 01/04/2016

	Cost	Accumulated Depreciation
Land and Building (Land Cost Rs. 4000)	7500	850
Distribution vehicles	10000	3200
Machines	6000	2500
Furniture and fittings	2700	700
Computer s	4000	1500

#### Additional Information.

1. During the year 2016/2017 Land were revalued for Rs. 6000 000
  2. A motor vehicle cost Rs. 3000 000 was exchanged on 31/03/2017 with a new motor vehicle of Rs. 5000 000. Rs 2800 000 was paid by cash on exchange. Accumulated depreciation for exchanged vehicle was Rs. 1500 000.
  3. Annual deprecation expenses for buildings distribution vehicles, machines, furniture and fittings and computers were Rs. 4000 000, Rs. 800 000, Rs. 500 000, Rs. 300 000 and Rs. 1000 000 respectively.
- Prepare note on property, plant and equipment referring Singiti PLC

**Annexure 12.4.1.5**

Trial Balance as at 31/3/2017 of Ruwanjalee PLC given below.

(Rs. 000)

Description	Dr	Cr
Property Plant and Equipment – (cost)		
Land and Buildngs (land - Rs. 17 500)	22 500	
Motor vehicles	6 600	
Machines	8 400	--
Computer & Equipment	4 200	--
Accumulated depreciation for property, plant & equipment as at		
Buildings	--	1 000
Motor vehicles	--	300
Machines	--	400
10% Fixed Deposit	4500	
Cost of sales and sales	20 600	64 500
Income tax payment	400	
Adminstrtaion Expenses	6 520	--
Distribution expenses	8 000	--
Finance Expenses	1 800	--
Trade receivables	2 480	
Trade payable		1 800
Allowance for Expected losses on trade receivables	--	200
Stated capital - ordinary shares (2016.01.01)		10 000
Revaluation reserves (2016.04.01)	--	3000
General Reserve (2016.04.01)	--	2 000
Retained Earnings (2016/2017)	--	3 000
Interm dividends (2016.04.01)	400	--
15% Bank Loan	--	2 000
Lease Creditors	--	3 000
Stock as at 31.03/2017	3 600	--
Cash	2000	
	92 000	92 000

Following adjustment to be completed before preparation of financial statements of Rewnajalee PLC for the year ends 31.03.2017

- (01) Adjustment related to property plant and equipment (All depreciable assets to be depreciated on straight line method)
  - (i) Useful life time of building is 40 years of salvage value is estimated.
  - (ii) Balance of Revaluation reserves represents the surplus generated through land revaluation before 2 years. This land was revalued for Rs. 20000000 during the year and it was not adjusted yet.
  - (iii) Motor vehicle account balance represent the motor vehicle acquired on finance lease at 01.04.2016 with a fair value if Rs. 3000 000. Down payment was not made when purchasing the motor vehicle. Annual lease installment of Rs. 600 000 to be paid at the end of each year. Installment payment made this year was recorded under finance expenses. Annual interest is 10% of the opening balance, Motor vehicles to be depreciated by 10% per annum.
  - (iv) Salvage value of machines of the end of useful life time of 10 years was estimated as Rs. 40 000.
  - (v) Remaining useful life time of computer and equipment were estimated as another 2 years form 01/04/2017.
- (02) Inventory items cost Rs. 200 000 including stock of 31.03.2017 were sold for Rs. 150 000 on 10.04.2016
- (03) Stock cost Rs. 1000 000 was sent to Padeniya PLC on 31/01/2017 on sale or return basis. There were not sold till 31.03.2017. Invoice value of the there were Rs.1500 000. Period of return is not yet over. This stock was not included for closing stock.
- (04) Maspotha PLC, a debtor with a due of Rs. 80 000 was declared as bankrupt by the court on 12.04.2017. this balance was already recognized as an expected losses on trade receivables as at 31.03.2017. Rs. 300 000 Allowance to be maintained for an expected losses on trade receivables on remaining debtor balance.
- (05) Fixed deposit was started on 01.04.2016 and, the interest received was included in banks statement. No adjustment was done on that.

- (06) 6 months interest payment for 15% bank loan was included in finance expenses. Interest for remaining 6 months were not yet paid. Rs. 400 000 out of the bank loan to be paid within 2017/2018.
- (07) Ruwanjalee PLC sold goods under warranty certificates. It was estimated that a provision of Rs. 200 000 to be made for sales warrantys.
- (08) Income tax for the year was  $\frac{1}{4}$  of profit before tax.
- (09) Rs. 500 000 was paid for advertising expenses during the year. Rs. 300 000 out of that is applied for next year.
- (10) Financial statement were approved by board of directors on 30.06.2017

**Required :**

- (i) Statement of profit or loss and other comprehensive income for the year ended 31.03.2017
- (ii) Statement of changes in equity for the year ended 31.03.2017
- (iii) Statement of financial position as at 31.03.2017
- (iv) Notes to the account for the year ended 31.03.2017

**Criteria for Assessment and evaluation**

- Explaining other comprehensive income
- Stating the content of total comprehensive income
- Recording the transactions affected for equity.
- Preparing financial statements using given facts

**Exercise :** Trial balance extracted from Saranga PLC as at 31.03.2017 given below

(Rs.'000)

Discription	Dr	Cr
Trade receivable / Trade payable	2 600	2 200
Accrued expenses as at 31.03.2017	--	200
Prepaid distribution expenses as at 31.03.2017	100	--
Property, plant and equipment (cost and Accumulated depreciation)		
Land	10 000	--
Buildings	4 000	1 000
Motor vehicles	12 000	2 000
Machines	1 400	400
Depreciation for property, plant and equipment	1 000	--
Cost of sales and sales	12 000	26 000
Administration Expenses	3 300	--
Distribution cost	1 800	--
Finance Expense	1 200	--
Other Expense	800	--
10% Bank Loan	--	2 000
Lease Creditor (01.04.2016)	--	4 560
Allowance for expected losses on trade receivables (31.03.2017)	--	800
Income tax payment	1 300	--
Stated capital - Ordinary shares (200 000 shares)	--	5 000
Income tax payment	400	--
Retained earnings (01.04.2016)	--	6 090
Revaluation Reserves	--	1 500
Salaries and wages	2 000	-
Cost of inventory as at 31.03.2017	1 000	--
EPF Payable	--	150
Repair expense for sales warranty	100	--
General reserve	--	8 100
Cash and cash equivalents	5 000	-
	60 000	60 000

## Additional Information

Following facts to be considered in preparing financial statements of Saranga PLC for the year ended 31/03/2017.

- (i) A motor vehicle acquired under a lease on 01/04/2016 by Saranga PLC was correctly recorded. Followings are related to motor vehicles.

Fair value of motor vehicle was Rs. 6000 000. Lease period 4 years. Rs. 1440 000 was paid as down payment. Annual installment of Rs. 1440 000 to be paid at the end of each year. Expected useful life time of the motor vehicle is 5 years. Lease interest included in current and next year lease installments are as follows.

Year	Interest (Rs'000)
2016/2017	456
2017/2018	357

- (2) Bank loan to be paid by 4 installments. First installment to be paid on 30.09.2017. Loan interest was not paid for whole year.
- (3) Property plant and equipment other than lease motor vehicle are used for administration activities. Annual depreciation for property, plant and equipment items given below.
- (i) Expected useful lifetime of buildings is 40 years.
- (ii) Motor vehicles other than lease motor vehicles to be depreciated by 10% per annum.
- (iii) Salvage value of machines at the end of useful time of 10 years was estimated as Rs. 400 000.
- (iv) Lease motor vehicle was not depreciated for current year.
- (4) Allowance was made as expected losses on trade receivables for a due of Rs. 600 000 from samduni PLC which was a balance under trade receivables. This amount was declared as bankrupt by the court.
- (5) Management of the company decided to start a provision for sales warranty. 2% of sales to be provided for sales warranty. Amount spent to repair warranted items are included in trial balance.
- (6) 10% contribution from employees from salary was adjusted and, Rs. 50 000 was paid. 15% of employee contribution for EPF and 3% contribution for ETF were not yet adjusted.
- (7) A professional valuer revalued land and buildings on 31.03.2017 as follows.

Land	Rs. 2500 000
Buildings	Rs. 12 000 000

Revaluation surplus and deficits were recognized in previous revaluations' and valuation reserve consisted with

Surplus on building revaluation	- Rs. 300 000
Surplus in land revaluation	- Rs. 1200 000
-	<u>Rs. 1500 000</u>

- (8) Inventory items cost Rs. 300 000 which include under closing stock is expiring on 10.04.2017 those items were sold for Rs. 320 000 after reducing its prices and Rs. 45 000 was spent for that.
- (9) Income tax for the year is  $\frac{1}{4}$  of the profit before tax.
- (10) Company made a right issue on 01/10/2016 offering ordinary share at 4 :1 ratio, it was correctly entered in ledger. Consideration per share was Rs. 25. All share holders exercised their right.
- (11) following decisions were taken by board of directions on 31. 03. 2017
- (i) Reserve capitalization using retained earnings at a ratio of 5:1
  - (ii) Transfer Rs. 500 000 to general reserves.
  - (iii) Pay Rs. 2/- dividend for ordinary share holders (only for shares available & before reserve capitalizations)

### **Required**

- (i) Statement of Profit or loss and other comprehensive income for the year ended 31.03.2017
  - (ii) Statement of charges in equity for the year ended 31.03.2017
  - (iii) Statement of financial position as at 31.03.2017
- Exercise for explaining subject matters.



- **Exercise for explaining subject matters.**

Trial balance extracted from chandi PLC as at 31.03.2017;

(Rs.'000)

Description	Dr	Cr
Sales	--	80 600
Cost of sales	52 000	--
Electricity, Rates and Insurance	150	--
Advertising and sales promotion expense	400	--
Carriage outward charges	100	--
Director remuneration	2 000	--
Salaries and wages	1 820	--
Interest payments	800	--
Trade receivable	3 050	--
Trade payable		1 700
Income dividend	2000	--
Property, plant and equipment cost and accumulated depreciation as at 01.04.2016		
Land and buildings	30 000	2 500
Motor vehicle	44 000	7 800
Treasury bills (3 months)	3000	700
Cash Balance	3 270	--
Petty cash balance	600	--
Office equipment	400	--
Impairment losses on trade receivables	100	--
Allowance for expected losses on trade receivables 01.14.2016	--	200
Audit fee		
General reserve	--	1 200
Lease creditor	--	4 000
Provision for Income tax as at 01.04.2016	--	150
Income tax payment	380	--
Stock as at 31.03.2017 at cost	3 500	--
Retained earnings as at 01.4.2016	--	3 000
Revaluation reserves	---	1 800
Stated capital - Ordinary shares (200 000 shares)	--	40 000
Other income	--	350
Eco emission and licence fee of motor vehicle	30	--
12% fixed deposit	2 000	--
15% Long term Bank Loan	--	6 000
	150 000	150 000

01. (i) Cost of buildings were Rs. 10 000. Revaluation reserve balance represent the surplus created thorough the land revaluation on 1.04.2014. A professional valuation institute revalued lands on 1.4.2016 again and recognized a deficit / loss of Rs. 2000. The deficit / loss was not yet recorded.

- (iii) All depreciable assets to be depreciated on straight line method by using rates given below.

Salvage value estimation for office equipment at the end of useful life time of 3 years is Rs. 900.

- (3) Board of directors approves financial statements on 05.02.2017. On 10.04.2017 the court informed about the bankruptcy of debtor with above of Rs. 50. Bad debts are adjusted using the provision for doubtful debt account. Allowance for expect loss of trade receivable should increase by Rs. 100.

- (5) Payable amount of income tax for previous year was settled with in current year 1/10 of profit before tax was assessed as income tax for current year.

- (7) Fixed deposit was stated on 01.10.2016 and bank informed interest for the period ended 31.03.2017 was added to the fixed deposit. But it was not yet adjusted.

(8) Interest payment balance represent the loan interest paid within the year. Loan was obtained prior to 01.04.2016 .

(9) A computer purchase on 01.10.2016 of Rs. 2000 was wrongly recorded as purchases. Useful life time of computers is 4 years. Computers to be listed as office equipment.

(10) Board of directors made following decisions On 31.03.2017.

- Reserve capitalization using retained earnings at a ratio of 20 : 1.
- Transfer Rs. 500 to general reserves.
- Rs. 1 to be paid as dividend for ordinary shareholders.

#### Chandi PLC

#### Statement of profit or loss and other comprehensive income for the year ended 31.03.2017

	Notes	Rs.'000	Rs.000
Sales	--		80 000
Cost of sales			(50 000)
Gross profit			30 000
Other income	01	--	470
			30 470
Distribution cost		9 280	
Adminstration Expenses		5 920	
Other expenses		850	
Finance Expenses		1 100	(17 150)
Profit Before Tax	02		13 320
Income tax expense	03		(1 332)
Profit for the year			11 988
<b>Other comprehensive Income</b>			
Revaluation deficit			(1 800)
Total compresensive income			10 188

Chandi PLC  
**Statement of changes in Equity**  
**for the year ended 31.03.2017** (Rs.'000)

Description	Stated capital ordinary shares	Revaluation Reserves	General Reserve	Retained Earnings	Total
Balance B.F as at 1'4.2014	40 000	1 800	1200	3 000	46 000
Reserve capitalization	2 000	--	--	(2000)	--
Total comprehensive Income	--	(1 800)	--	11 988	10 188
Ttransfer to general reserve	--	--	500	(500)	--
Dividend payment	--	--	--	(2 000)	(2 000)
Balance as at 31.3.2017	42 000		1 700	10 488	54 188

Chandi PLC  
**Statement of Financial Position**  
**for the year ended 31.03.2017**

	Notes	Rs. 000	Rs. 000
<b>Assets</b>			
Non-current Assets			
Property, plant & Equipment	04		52 050
Right of use of lease property	05		3200
12% fixed deposit			2 120
			57 370
<b>Current Asset</b>			
Inventory		3 450	
Trade receivable (3000-300)		2 700	
Prepaid expenses		150	
Cash and cash equivalents	06	4 270	10 570
<b>Total Assets</b>			67 940
Equity & liabilities			
Stated capital - Ordinary shares			42 000
General reserves		1 700	
Retained earnings		10 488	12 188
			54 188
<b>Non-current liabilities</b>			
Lease crditors		2 000	
15% Bank Loan		6 000	8 000
<b>Current Liabilities</b>			
Lease creditor (Current portion)		1 000	
Trade and other payables		2 900	
Accrued expenses		250	
Provision for compensation of Employees		500	
Income tax payable		1 102	5752
<b>Total Equity and liabilities</b>			67 940

Notes to the financial statements (Rs.'000)

**01. Other Income**

Interest for deposits	120
Other Income	350
	<u>470</u>

**02. Following items were considered in calculating Profit Before Tax**

	(Rs.'000)
Deficit on land revaluation	200
Loss on disposal of motor vehicle	100
Stock written off	100 50
Employee compensation	500
Director remuneration	2000
Bank Loan Interest	900
Audit fee	500
Lease Interest	200

**03. Income Tax**

$$\left(13320 \times \frac{10}{100}\right)$$

Tax on Profit of the period 1332

**04. Property Plant and Equipment**

Cost	Land	Buildings	Motor Vehicles	Office Equipment	Total
Balances as at 1.4.2016	20 000	10 000	40 000	3 000	73 000
Purchases	--	--	--	2 000	2 000
Revaluation	(2 000)	--	--	--	(2 000)
Disposal	--	-	(1 000)	--	(1 000)
Balance 31.3.2017	18 000	10 000	39 000	5 000	72 000
Accumulated depreciation					
Balances at 1.4.2016	--	2 500	7 800	700	11 000
Depreciation expenses	--	5 00	7800	950	9250
Disposal	--	--	(300)		(300)
Balance 31.3.2017	--	(3 000)	15300	(1 650)	19950
Company Amount	18 000	7 000	23700	3 350	52050

**Note 5 : Right of use of Lease Property**

Motor Vehicle	4000
less : Accunulated	
Depreciation	<u>(800)</u>
	<u>3200</u>

**Note 6: Cash and cash equipment**

Treasury Bills	400
Petty cash balance	600
Cash balance	<u>3270</u>
	<u>4270</u>

**Note 7:** Board of director proposed to pay a find dividend of Rs. 200 for ordinary shareholders.

**Workings****Distribution cost**

Motor vehicle depreciation	8 600
Under allowance expected losses on trade receivables	250
Adveristing and promotion	300
Carriage outward charges	100
Eco emission and licence fee	30
	<u>9280</u>

**Administration Expenses**

Depreciation for Building	500
Depreciation for Machines	950
Electricity, Rates & Insurence	200
Director remuneration	200
Salaries an Wages	1 820
Audit fee	<u>500</u>
	<u>5920</u>

**Finance Expenses**

	(Rs.)
Loan Interest	950
Lease Interest	200
	<u>1100</u>

**Other Expenses**

	(Rs.)
Deficit/loss on land revaluation	200
Loss on disposal of motor vehicle	100
Stock Written Off	50
Employee compensation	<u>500</u>
	<u>850</u>

**Motor vehicle disposal A/C**

			(Rs.)
MV	1000	MV Acc. Dep.	300
		.Purchases	600
		P/L	100
	<u>1000</u>		<u>1000</u>

Lease Creditor A/C

		(Rs.'000)	
Trade payables	1 200	Balance B/f	4 000
		Laase Interest	200
B/c/d	<u>3 000</u>		
	<u>4 200</u>		<u>4 200</u>

Current Liabilities	1200 - 200	= 1000
Non-current Liabilities	3000 - 1000	= 2000

Allowance for expected losses on trade receivables

		Rs. '000	
Debtor	50	Balance B/f	200
Impairment loss	100	P/L (under provision)	250
B/c/d	<u>300</u>		
	<u>450</u>		<u>450</u>

$$\text{Fixed deposit interest} = 2000 \times \frac{12}{100} \times \frac{1}{2} = \underline{\underline{120}}$$

expected

$$\text{Loan interest} = 6000 \times \frac{15}{100} = 900$$

$$\text{Interest Paid} = (800)$$

$$\text{Accrued Loan interest} = \underline{\underline{100}}$$

**Accumulated depreciation for Disposed Motor Vehicle**

$$\begin{aligned} 01.10.2014 - 01.04.2016 &= \frac{1}{2} \text{ years} \\ &= \left( 1000 \times \frac{10}{100} \times 1.5 \right) = \underline{\underline{300}} \end{aligned}$$

**Depreciation for the year**

$$\text{Motor vehicle} = \left( \frac{4000}{5} \right) = 800$$

$$\begin{aligned} \text{Other vehicle} &= \left( 39000 \times \frac{20}{100} \right) = 7800 \\ &= \underline{\underline{8600}} \end{aligned}$$

$$\text{Buildings} = \left( 1000 \times \frac{5}{100} \right) = 500$$

$$\text{Office Equipment} = \left( \frac{3000 - 300}{3} \right) = 700$$

$$\text{Computer} = \left( \frac{2000}{4} \times \frac{1}{2} \right) = 250$$

$$\underline{\underline{= 950}}$$

Debtors' Control /Trade receivabe a/c		(Rs.'000)
Balance B/F	3050	Impairment losses on trade receivables 50
	<u>3050</u>	Balance C/d <u>3000</u>
Balance B/d	3000	<u><u>3050</u></u>

Income Tax a/c		(Rs.'000)
Cash	380	Balance B/F 150
		P/L A/C 1332
Balance C/d	<u>1102</u>	(Income Statement) <u>1482</u>
	<u><u>1482</u></u>	Balance B/d <u>1102</u>



**Competency            12.0 : Prepares Financial Statements for a Limited Company**

**Competency Level 12.4.2 : Prepare Statement of Cash flows of a limited liability company accordance with the Sri Lanka Accounting Standard**

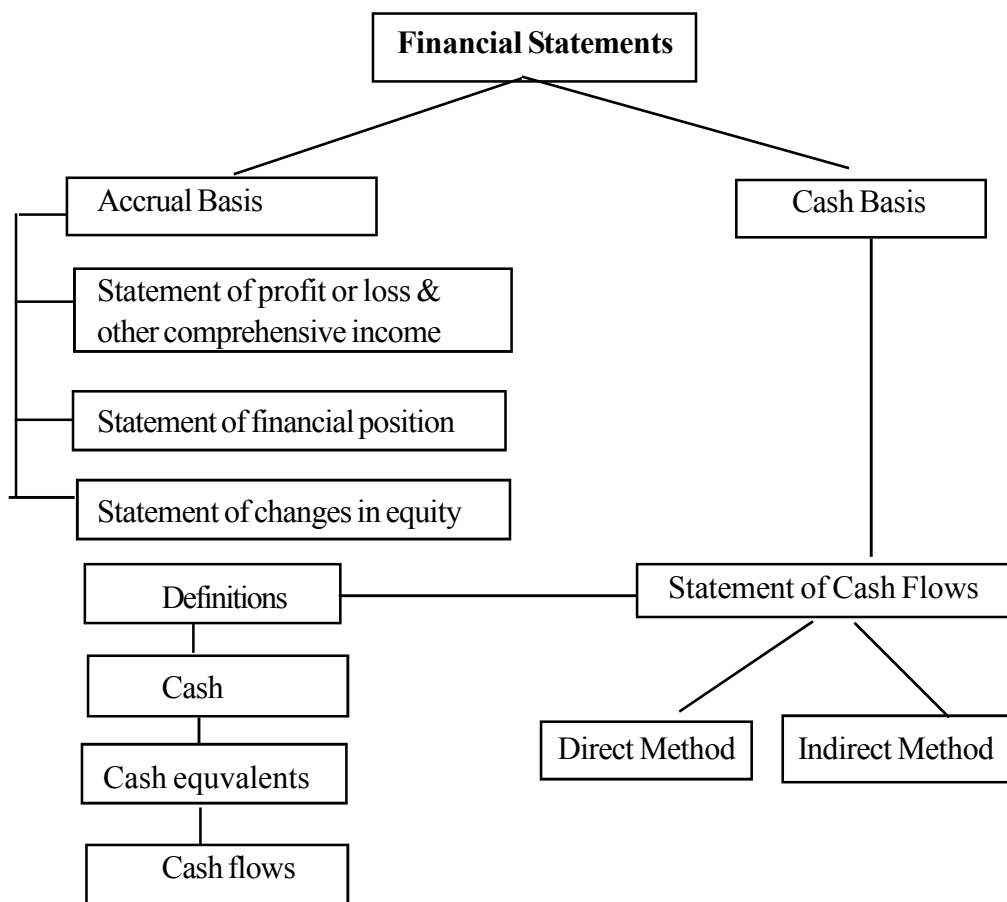
**No. of Periods            : 12**

**Learning Outcomes :**

- Explains statement of Cash flows as per the applied accounting standard.
- Explains operating Activities
- Explains investing activities
- Explains financing activities
- Prepares statement of cash flows by applying accounting standard

**Basic Terms and concepts :**

**Concept Map**



## **Proposed instruments for Learning – teaching process**

Proper and clear explanation is required relating to the subject content and related subject matters of this competency level of the syllabus.

### **Introduction / Objectives**

- Provision of information about the changes in cash and cash equivalents of an entity for a concerned period by means of a statement of cash flows which classifies cash flows during the period generated from or used in operating, investing and financing activities..
- Statement of cash flow presents the sources of cash generated and sources of cash used by a business with in a period concerned.
- Important facts about the definitions given in accounting standard.

- **Cash**

Cash comprises cash in hand and demand deposits.

Ex. Cash balance, petty cash balance.

- **Cash equivalents**

Short term, highly liquid investments that are readily convertible to known amounts of cash which are subject to a significant risk of changes in value.

Example : 3 months Treasury bills

- **Cash Flows**

Receipts are known as cash inflows and payments are known as cash outflows

- **Operating Activities**

Cash flows from the principal revenue producing activities of the entity and other activities that are not investing or financing activities.

Examples :

- Receipts from selling goods or services
- payments to suppliers for providing goods or services
- Payment of salaries and others for employees.
- Receipts from insurance compensation and payments for insurance premium.
- Any other cash flow which can not be identified as investing or financing activities

**Investing Activities :**

Investing activities means expenditures have been made for resources intended to generate future income and cash flows. It included acquisition and disposal of long term assets for future business developments.

Example :

- Cash payments to acquire, construct or capitalized development cost relating to property, plant and equipment, intangibles and other long term assets.
- Cash receipts from sale of property, plant and equipment, intangibles and other long term assets.
- Cash payments to acquire equity or debt instruments of other entities, investments in joint ventures and cash receipts from sale of those investments.
- Cash advances and loans made to other parties and cash receipts from the repayments.
- Interest received, dividend received, rent received.

**Financing Activities:**

Financing activities means the cash flows which make changes in composition of equity capital and debt capital of a business. There are connected with the ways of capital raising of a business.

Example:

- Proceeds from issuing shares or other equity instruments.
- Payments to owners to acquire or redeem shares.
- Proceeds from issuing debentures and long term loans or repayment of amount borrowed.
- Payment of finance lease installments. (Except interest)
- Payment of dividends for share holders (Distribution among owners).

**Reporting of cash flows**

Two methods are available to report cash flows for concerned period as

1. Direct method
2. Indirect method

- Both methods can be applied to calculate cash flows from operating activities. Cash flows from investing and financing activities can be calculated only by using direct method. Reporting method of statement of cash flow is decided depending on the method applied for operating cash flows.

All gross cash receipts and gross cash payments are disclosed through the direct method.; where by profit or loss is adjusted for the effect of transactions of non-cash nature, changes in working capital to calculate operating cash flows under indirect method.

Cash flows relating to income and expenses which used to calculate net profit are considered when reporting operating cash flows under direct method.

- Under indirect method, the net cash flow from operating activities is determined by removing the effect of non-cash items form profit before tax. Further items that to be categorized under other activities and changes in working capital to be adjusted. The amount.
- This calculation can be explained further using following table.

<b>Direct Method</b>	<b>Indirect Method</b>
<ul style="list-style-type: none"> <li>Record the cash receipts and cash payments for operating activities.</li> </ul> <p>Example</p> <ul style="list-style-type: none"> <li>Cash purchases / Cash sales</li> <li>Creditor payments/ debtor receipts.</li> <li>Commission received / Interest and other receipts</li> <li>Cash payments for operating expenses</li> <li>Tax payments</li> <li>Interest payment</li> </ul>	<p>Following to be adjusted by taking the profit / loss before tax for the period as the base.</p> <ul style="list-style-type: none"> <li>Non – monetary transactions / items)</li> </ul> <p>Example :</p> <ul style="list-style-type: none"> <li>Depreciation, Loss on disposal of PPE</li> <li>interest expenses to be added back</li> <li>Income which to be considered under other activities to be deducted.</li> </ul> <p>Example : Interest income Dividend income</p> <ul style="list-style-type: none"> <li>Adjustment for working capital changes including Accruals and Pre payments.</li> <li>Tax payment</li> <li>Interest payment</li> </ul>

**Format**

**Direct Method**

.....**Business**

**Statement of cash flows for the year ended .....**

**(Rs.)**

<b>Operating Activities</b>		
Cash sales	xxx	
Debtor receipts	xxx	
Cash purchase	(xx)	
Payments to suppliers	(xx)	
Cash payment for administration expenses	(xx)	
Cash payment for distribution expenses	(xxx)	
Cash payment for other operating expenses	(xx)	
Cash generated from / used in operating activities	xx	
Interest paid	(xx)	
Tax paid	(xx)	
Net cash flows generated from / used in operating Activities		xx
<b>Investing Activities</b>		
Received cash from disposal of property, plant and Equipment	xxx	
Received cash from selling other Non-current Assets	xx	
Loan provided to employees	(xx)	
Dividend received	xx	
Interest received	xx	
Rent received	xx	
Purchase of property, plant and equipment	(xx)	
purchase of other non-current assets	(xx)	
Net cash flows generated from/used in investing activities		xx
<b>Financing Activities</b>		
Share issue	xx	
Loan obtaining	xx	
Other Long term loan obtaining	xx	
Dividend paid	(xx)	
Distribution among share holders	(xx)	
Repayment of loan	(xx)	
Loan installment paid	(xx)	
Lease instalment paid (Except interest)	(xx)	
Net cash flow generated from / used in financial activities		xxx
Net increase / decrease in cash and cash equivalents		xxx
Opening cash and cash equivalents		xxx
Closing cash and cash equivalents		xxx

## Operating cash flow (Generated from / used in) Using Indirect Method

.....Business

Statement of cash flows for the year ended .....

(Rs.'000)

<b>Operating Activities</b>		
Profit Before Tax		
<b>Adjustments</b>	xx	
Depreciation of property plant and equipment	xxx	
Loss on disposal of property plant and equipment	xxx	
Profit on disposal of property plant and equipment	(xxx)	
Interest expense	xx	
Interest income, rent income, Dividend income	(xxx)	
Operating profit before working capital changes.	xx	
Changes in inventories(Difference between opening and closing balance)		
Changes in Trade receivables (Difference between opening and closing balance)	x/(x)	
Changes in prepaid expenses (Difference between opening and closing balance)	x/(x)	
Changes in Trade payables (Difference between opening and closing balance)	x/(x)	
Changes in accrued expenses (Difference between opening and closing balance)	x/(x)	
Cash generated from / used in operating activities	x	
Interest paid	(x)	
Tax paid	(x)	
Net cash flow generated from / used in operating activities		xx

### Distribute annexure 12.4.2.1 among student.

Recognize following items referring LKAS 7. State whether the items are cash and cash equivalent in the space provided.

Petty cash balance	.....
Cash balance (favourable)	.....
Investment (2 years)	.....
Treasury Bills (3 months)	.....
Fixed Deposit (1 year)	.....

2. Put a (✓) in the suitable column to categorize following items according to the cash flow categorization in LKAS – 7 using direct method.

Items	Operating	Investing	Financing
Cash and cheque received from trade debtors			
Salaries and wages paid for employees.			
Income tax payment			
Dividend payment			
Rent received for business place			
Lease installment payment (except interest)			
Capitalization of reserves			
Purchase of machine for business use			
Cheque payments for trade creditors			
Proceeds from selling used office equipment			
Loan interest paid			
Cash collection from right issue			
Obtaining a bank loan			
Payment of audit fee			
Receipt of fixed deposit interest			
Repayment of Bank loan			
Purchase of property, plant and equipment			
Electricity and insurance payment			
Purchase of Long-term investments			
Cash sales			
Cash purchases			

**Distribute annexure 12.4.2.2 among students.**

Following cash control account was prepared by Newway PLC for the year ended 31/03/2017

Newway PLC			
Cash Control for the year ended 31/03/2017			
			(Rs.'000)
Balance B/F at 01.04.2016	1500	Cash purchases	2 000
Cash sales	4 000	Creditor payments	3 500
Debtor receipt	7500	Expenses	
		Adminstration expenses paid	2 000
Income		Distribution expense paid	1 200
Dividend for invetsment	400	Loan interest paid	1 000
Rent Income	200	Other payments	
Other receipts		Income tax paid	2 000
Disposing a land	5 500	Purchase of motor vehicle	4 500
Ordinary Share Issue	3 000	Purchase of furnuture & office	1 500
Bank loan obtained	2 000	equipment	
Collection from right issue	1 000	Lease repayment	1 000
		Loan installment and payment	2800
		Dividend paid	2 400
		Balance C/d 31.3.2017	1200
	25 100		25 100
01.04.2017 Balance B/F	1200		

**Note :** Lease interest of Rs. 500 was included in paid lease installment

**Required :**

Prepare statement of cash flow for the year ended 31.3.2017 of Newway PLC by applying direct approach according to LKAS - 7



**Distribute Annexure 12.4.2.3 among students.**

(1) Calculate profit before tax using the fact extracted from Dinidu PLC

Retained earnings Balance as at 01.04.2016	4 000
Transections occurred during 31.03.2017	
Dividend payment for ordinary share holdres	500
Proposed dividend for ordinary share holdres	400
Collection from right issue	2 000
Capitalization of reserves	1 000
Transfers to general reserves	1 500
Income tax payments	1 200
Income tax expense for the year	1 600
Retained earnings as at 31.3.2017	5 400

(2) State the correct adjustment relating to items given below when calculating operating cash flows using indirect method according to LKAS-07.

Item	Adjustment to be done		
	add	Less	Not to be adjusted
Deprecation of PPE			
Dividend income			
Proceeds from disposal of motor vehicle used for administration activities			
Interest expense			
Receipts from debtors			
Income tax paid			
Income tax expense			
Interest paid			

((3) Current assets and current liabilities available in Sankapala PLC as at 31.03.2017 given below. State the way of recording the effect as add (+) or less (-) when calculating operating cash flow using indirect method.

Item	31.03.2016	31.03.2017	Adjustment
Closing stocks	2 000	3 000	
Prepaid expenses	500	300	
Treade debtors	3 500	3 000	
Trade creditors	1 200	1 700	
Accrued operating expenses	700	300	

**Distribute Annexure 12.4.2.4 among students.**

- (1) Mudalindu PLC started its operations on 01.04.2016. Financial statements of first year given below.

**Mudalindu PLC**  
**Statement of Profit or loss**  
**for the year ended 31.03.2017**

(Rs.'000)		
Sales		9 500
Cost of sales		(4 500)
Gross profit		5 000
Other Income		500
		5500
Dsitribution expenses	1 400	
Adminstration expenses	1 600	
Finance expenses	400	(3 400)
Profit Before Tax		2 100
Income Tax		(600)
Profit for the period		1 500

**Mudalindu PLC**  
**Statement of Finance Position**  
**as at 31.03.2017**

(Rs.000)

Property plant and equipment	7 000
Investments (Shanthi PLC)	2 000
Inventories	1 500
Trade and other receivables	4 000
Bank balance	1 000
<b>Total Assets</b>	<b>15 500</b>
<b>Equity and Liabilities</b>	
Stated capital - ordinary shares (Rs.90-100)	9 000
Retained earnings	1 000
10% Bank loan (2016.04.01)	3 000
Trade and other payables	2250
Accured Interest	150
Tax Payables	100
<b>Total Equity and Liabilities</b>	<b>15 500</b>

**Other Informtion :**

- (i) Mudalindu PLC engages purchase and sales on credit terms. Trade & other receivable balance represent trade debtors and trade & other payable balance represent trade creditors.
- (ii) Rs. 100 000 out of finance expenses in statement of profit or loss was bank changes, remaining were interest for bank loan.
- (iii) Composition of property plant and equipment given below.

Asset	Cost	Accumulated Depreciation	Carrying Amount
Machines	2 400	400	2 000
Motor vehicles	3 000	600	2 400
Land	2 600	-	2 600
	8 000	1 000	7 000
	8 000	1 000	7 000

- All property plant and equipment items were purchased on cash.
- (iv) Other income consist of dividend collected for investments.
- (v) Dividends were not paid by the company with in the year.

**Required :**

1. Statement of cash flows (as per LKAS 7)
  - Prepare statement of cash flows using direct method to calculate the cash flows from operating activities.
  - Prepare statement of cash flows using indirect method to calculate cash flows from operating activities.
2. State two items which cannot be considered as cash flow.

**Guidance for clarifying subject matters.**

**Santh PLC**  
**Statement of profit or loss for the year ended 31.03.2017**  
**(Rs.'000)**

	Note	Amount	Amount
Sales			20 000
Cost of sales			(8 000)
Gross profit			12 000
Other income			400
			12 400
Distribution cost		2 300	
Administration expenses		2 700	
Finance expenses		1 000	
Other expenses		400	(6 400)
Profit Before Tax			6 000
Income Tax			(1 500)
Profit for the year			4 500
Surplus on land Revaluation			2 500
Total Comprehensive			7 000

**Santh PLC**  
**Statement of changes in Equity for the year ended 31.03.2017**

(Rs.'000)

Description	Ordinary shares	Revaluation Reserves	General Reserve	Refained earnings	Total
Balance at 01.04.2016	8 000	1 500	2 000	4 200	15 700
Share issue	1 000	-	-	-	1 000
Right issue	2 000	-	-	-	2 000
Reserve capitalization	2 000	-	-	(2 000)	-
Total comprehensive Income	-	2 500	-	4 500	7 000
Dividend paid	-	-	-	(1 000)	(1 000)
Tranfer to General reserves	-	-	500	(500)	-
Balance at 31.03.2017	13 000	4 000	2 500	5 200	24 700

**Santh PLC**  
**Statement of changes in Equity for the year ended 31.03.2017**

(Rs.'000)

Asset	Note	Amount 2017.03.31	Amount 2016.03.31
Non current asset			
Property, plant and equipment		18 000	15 300
Investment		2 000	1 000
Current assets			
Closing Inventory		2 200	1 000
Trade Reveivables		2 500	1 500
Treasury bills (03 months)		500	-
Cash		1 700	200
Total Assets		26 900	19 000
Equity & Liabilities			
Stated capital			
Ordinary shares		13 000	8 000
Reserves			
Revaluation reserves		4 000	1 500
General reserves		2 500	2 000
Retained earnings		5 200	4 200
Non-current liabilities			
Bank loan		1 700	2 600
Current liabilities			
Trade Payables		500	700
Total Equity and Liabilities		26 900	19 000

**Additional Information :**

1. Interest for bank loan was included under finance expenses.
2. All purchases and sales were on credit term.
3. During the year, equipment cost, Rs, 1000 000 was sold with a profit of Rs. 00 000.
4. Stock as at 31.03.2017 at cost was Rs. 2600 000. Net reliable value of it was estimated as Rs. 2200 000. Stock written of Rs. 400 000 was included under other expenses.

**Santh PLC**  
**Property, Plant and Equipment**

(Rs.'000)

Description	Land	Buildings	Motor vehicles	Equipments	Total
Balance at 01.04.2016	4 500	5 800	1 200	5 700	17 200
Additions	-	-	2 000	-	2 000
Disposal	-	-		(1 000)	(1 000)
Revaluations	2 500	-	-	-	2 500
Balance as at 31.03.2017	7 000	5 800	3 200	4 700	20 700
Accumulated Depreciation					
Balance as at 01.04.2016	-	800	300	800	1 900
Deprecation expense	-	400	500	300	1 200
Disposal	-	-	-	(400)	(400)
Balance as at 31.03.2017	-	(1 200)	(800)	(700)	(2 700)
Carrying Amount	7 000	4 600	2 400	4 000	18 000

**Required :**

Prepare

1. Statement of cash flows using direct method as LKAS 7
2. Operating cash flows using indirect method as LKAS
3. By referring the financial statements of Sanath PLC

(1)

**Sanath PLC**  
**Statement of Cashflows**  
**for the year ended 31.03.2017**

(Rs.'000)

Operating Activities		
Debtor receipts	19 000	
Creditor payments	(9 800)	
Expense payment	(3 800)	
Cash flow generated from operating activities	5 400	
Interest paid	(1 000)	
Tax paid	(1 500)	
Net cash flows generated from operating Activities		2 900
Investing Activities		
Disposal of equipment	1 000	
Purchase of Motor vehicle	(2 000)	
Purchase of investment	(1 000)	
Net cash flows used in investing activities		(2 000)
Financing Activities		
Issue of shares	1000	
Right Issue	2 000	
Payment of bank loan	(900)	
Dividend paid	(1000)	
Net cash flows generated from fiancail activities		1100
Net increase in cash and cash equivalents		2000
Cash and cash equivalents as at 01/04/2016		200
Cash and cash equivalents as at 31.03.2017		2200

## Workings

### Debtor Control Account - Trade Rceivable (Rs.000)

B/F	1 500		
Sales	20 000	Cash	19 000
	<u>21 500</u>	B/C/d	<u>2 500</u>
			<u>21 500</u>
B/F	2 500		

### Creditor Control Account / Trade payables (Rs.000)

Cash	9800	B/F	700
C/d	<u>500</u>	Pruchases	9600
	<u>10300</u>		<u>10300</u>
		B/F	500

### Disposal of Equipment Accont

Equipment	1000	Acc. Dep. Equipment	400
P/L	<u>400</u>	Cash	<u>1000</u>
	<u>1400</u>		<u>1400</u>

### Purchase Calculation

	(Rs.000)
Opeining Stock	1000
+ Pruchases	9600
Stock to be sold	10600
Closing stock	(2600)
	<u>8000</u>

### Distribution Expenses (Rs.000)

Dep. MV	500	P/L Account	2300
Cash	<u>1800</u>		<u>2300</u>
	<u>2300</u>		

### Administration Expenses (Rs.000)

Dep. Building	400	P/L	2 700
Dep. Equipment	300		
Cash	<u>2 000</u>		<u>2 700</u>
	<u>2 700</u>		



**Sanath PLC**  
**Statement of Cashflows**  
**for the year ended 31.03.2017** **(Rs.'000)**

Operating Activities		
Debtor receipts	6 000	
Depreciation	1 200	
Profit on disposal of equipment	(400)	
Interest expense	1 000	
	7 800	
Working capital changes		
Increase in inventory	(1 200)	
Increase in trade receivables	(1 000)	
Decrease in trade payable	(200)	
	5 400	
Cashflows from operating activities		
Interest paid	(1 000)	
Tax paid	(1 500)	
Net cash flows generated from operating Activities		2 900
Investing Activities		
Disposal of equipment	1 000	
Purchase of Motor vehicle	(2 000)	
Purchase of investmen	(1 000)	
Net cash flows used in investing activities		(2 000)
Financing Activities		
Issue of shares	1000	
Right Issue	2 000	
Payment of bank loan	(900)	
Dividend paid	(1000)	
Net cash flows generated from fiancail activities		1100
Net increase in cash and cash equivalents		2000
Cash and cash equivalents as at 01/04/2016		200
Cash and cash equivalents as at 31.03.2017		2200

**Competency 13.0 : Presents information required for management to decision making by analyzing and interpreting financial statements using ratios.**

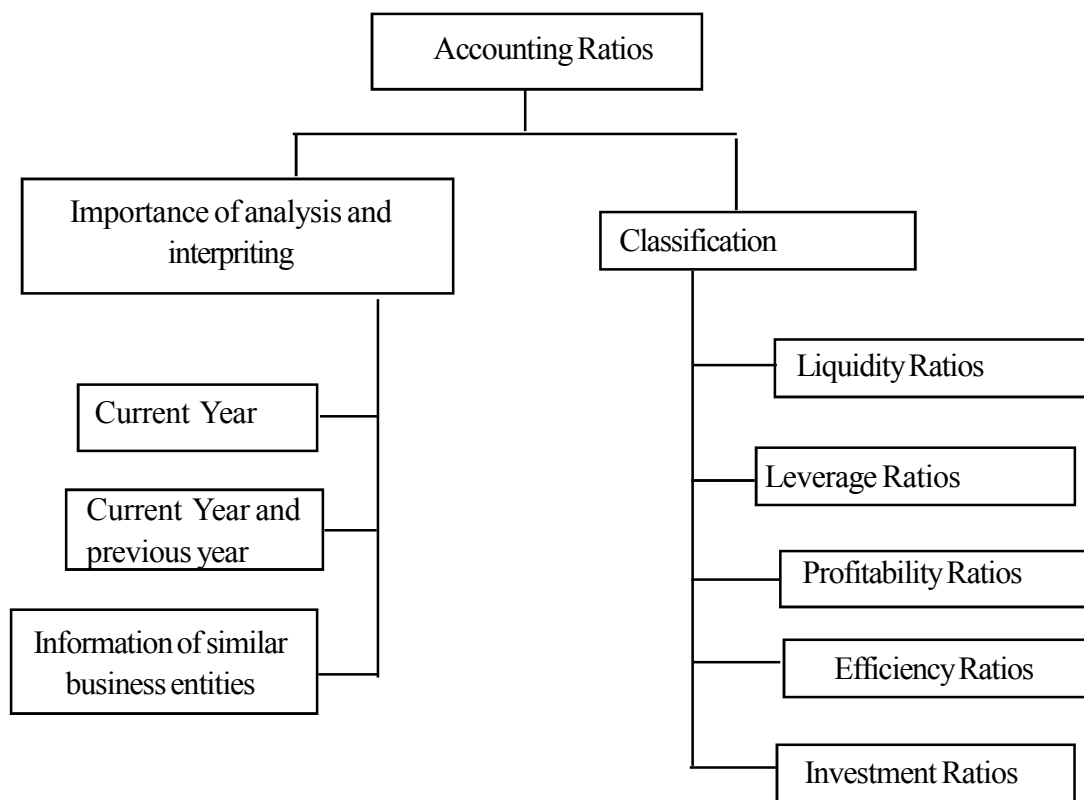
**Competency level 13.1 : Emphasis the requirement and importance of interpreting financial statements**

**No. of Periods : 10**

**Learning Outcomes :**

- Explains the meaning of analyzing and interpreting financial statements.
- Presents the requirements of analyzing and interpreting financial statements.
- Explains the ability of using various ratios as a technique to analyze and interpret financial statements.

**Basic terms and concepts**



- Real status of business cannot be understood just by referring the information available in the financial statements. Information can be presented in more meaningful manner by using accounting ratios. This process is simply defined as “analyzing and interpreting financial statements.”
- Following requirements can be attained by analyzing and interpreting financial statements.
  - Can recognize the status of a business analytically than the available information in financial statements.
  - Estimation of future financial status, profitability and liquidity.
  - Can assess present status of the business.
  - Can compare current year data with previous years or with other similar business entities.
  - Guide to make suitable decisions.
- Accounting ratios are classified as follows for the need of decision making.
  - Liquidity ratios
  - Leverage ratios
  - Profitability ratios
  - Efficiency ratios
  - Investment ratios

### **Criteria for Assessment and evaluation**

- Notify the importance of accounting ratios for decisions making
- Classify accounting ratios as requirements
- Notify the areas subject to compare using accounting ratios

**Competency 13.0 : Presents information required for management to decision making by analyzing and interpreting financial statements using ratios.**

**Competency level 13.2 : Calculates and Interprets liquidity ratios**

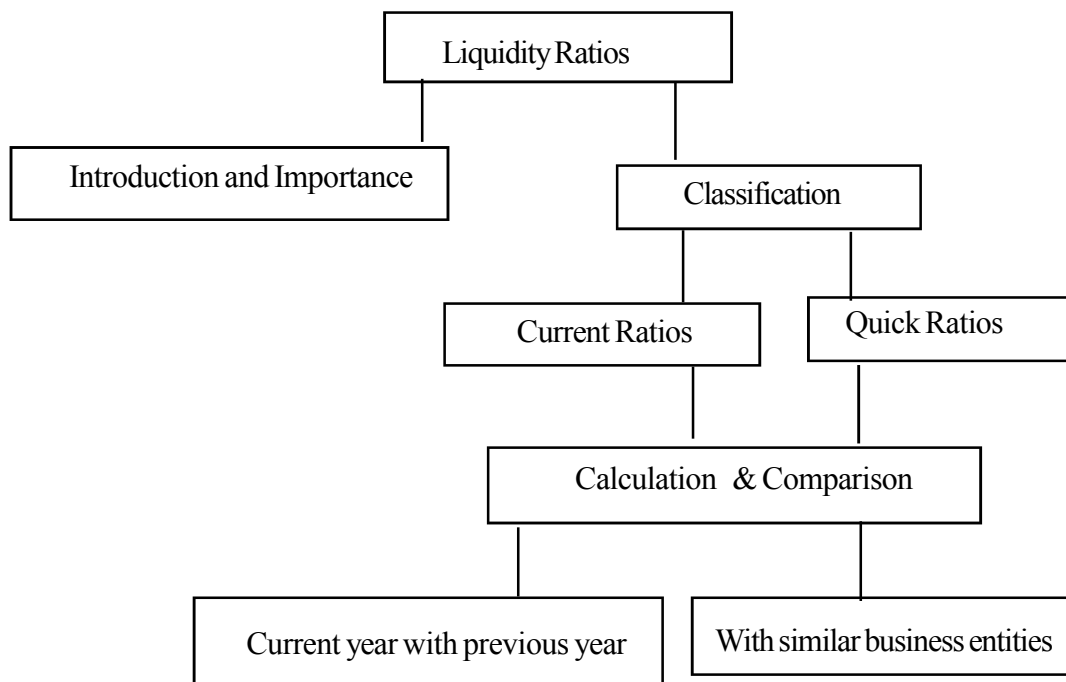
**No. of Periods : 06**

**Learning Outcomes :**

- Explains “Liquidity ratios.”
- Names and describes types of the liquidity
- Calculate current ratio
- Calculate quick ratio
- Makes decisions comparing ratios..

**Basic terms and concepts**

**Concept Map**



### Instructions for Activities :

Present following instructions to student.

#### Extract of financial statement.

31.03.2016 (Rs.'000)		31.03.2015 (Rs.'000)
450	Inventory	500
300	Trade debtors	200
150	Cash and Cash equivalents	300
250	Trade creditors	350
50	Accured Expenses	50

- Get the answers for following questions referring above information?
- Ask them to calculate current assets, and current liabilities for each year.
- Let them to obtain current ratio by comparing current assets and current liabilities for each year.
- Notify them the ratio between current assets after removing inventories with current liabilities as quick ratio.
- current ratio used to measure the short term liquidity.
- It shows the ability of repaying current liabilities. Standard ratio for current ratio is 2 : 1 (current assets : current liabilities). Current ratio can be calculated as

$$\text{Current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$$

- Quick ratio is obtained by comparing the amount remained after deducting inventory and prepaid expenses from current assets with current liabilities.
- Liquidity ratios are important to assess the short term solvency.
- Liquidity ratios can be used to make decisions relating to short term financang of a business by comparing them with previous year or similar business entity.

### Criteria Assessment and evaluation

- Notify the importance of calculating liquidity ratios.
- Following details are relating to Hansini's business and a competitive business of it, Shinsa's business as at 31.03.2018

	Hansini (Rs.'000)	Ahinsa (Rs.'000)
Inventories	6 000	7 000
Trade reveivables	4 000	6 000
Prepaid expenses	2 000	3 000
Trade Payables	8 000	9 600
Accrued expenses	4 000	2 400
Cash and cash equivalants	6 000	8 000

1. Calculating following ratios from each business
  - current ratio
  - quick ratio
2. Which business in more efficient considering liquidity. Explain with reasons.

**Competency 13.0 : Presents information required for management to decision making by analyzing and interpreting financial statements using ratios.**

**Competency level 13.3 : Calculating and interprets Leverage Ratios**

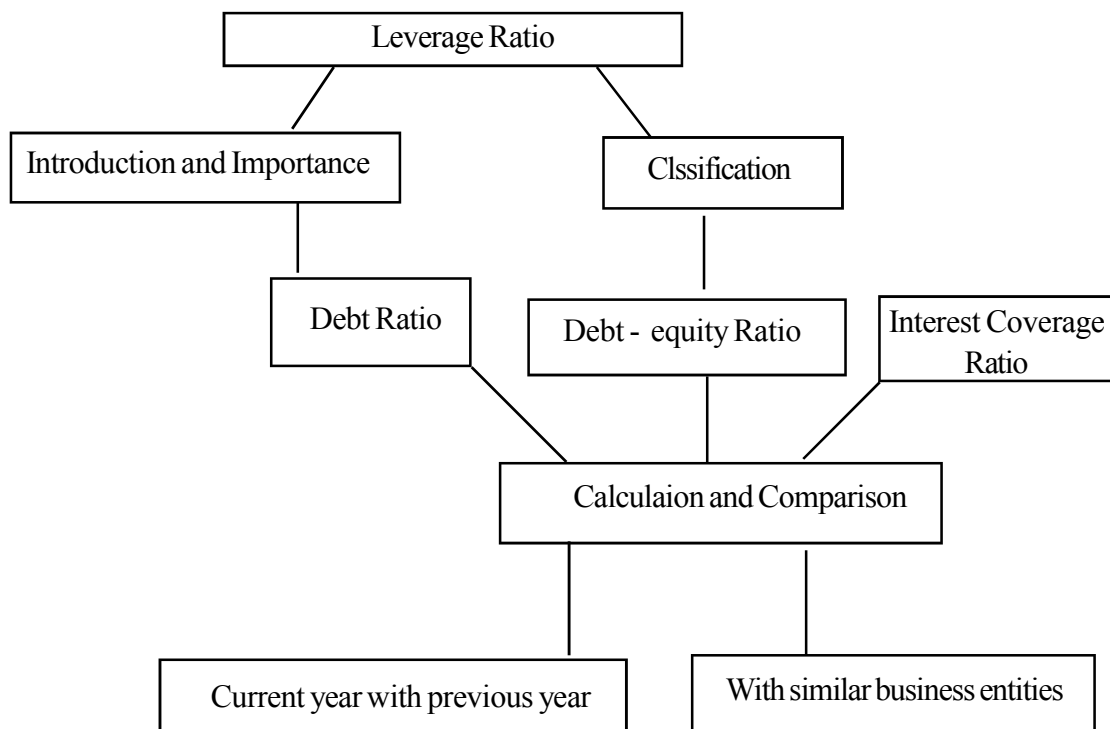
**No. of Periods : 06**

**Learning Outcomes :**

- Explains “Leverage ratios.”
- Calculates Debt-Equity Ratio
- Calculates Debt Ratio
- Calculates interest coverage ratio
- Make decisions comparing ratio.

**Basic terms and concepts**

**Concept Map**



### Instructions for Activities :

- Present following information to students.

#### Extracts of statement of financial position

2016.03.31 (Rs.'000)		2017.03.31 (Rs.'000)
8 000	Stated capital (Rs. 20)	12 000
2 000	Reserves	3 000
5 000	12% Bank Loan	4 000
6 000	Current liabilities	9 000

Profit before tax of each year was 10% from equity.

Obtain answers for following questions referring above information.

- Calculate equity capital for each year
- Calculate Total capital for each year
- Calculate the presentation of debt capital from total capital for each year
- Present the debt capital as a ratio of equity capital  
(Debt capital : equity capital)
- Calculate the value by adding profit before tax and interest expense for each year.
- Present the answer obtained by dividing value obtained by adding profit before tax and interest from interest expense as number of times.
- Long term financial stability of a business is measured by using the leverage ratios
- Long term solvency can be studied by comparing equity capital and debt capital
- It is necessary to evaluate the ability of paying interest for long term loans.

Ratios to be studied under Leverage ratios.

- Debt ratio
- Debt – equity ratio
- Interest coverage ratio

#### Debt ratio

Debt ratio is used to measure the percentage of debt capital from total capital. Long term loans with fixed interest rate are considered under debt capital.

$$\frac{\text{Debt capital}}{\text{Total capital}} \times 100$$



Debt capital = Long term loans

Total capital = Ordinary share capital + Reserves + Long term loans

- **Debt – Equity Ratio**

Relationship between debt capital and equity capital is presented as Debt-equity ratio.

If debt capital is greater than equity capital it is recognized as **high leverage** where, debt capital is lower than equity capital, it is referred as **low – leverage**.

Debt capital : Equity capital or

$$\frac{\text{Debt capital}}{\text{Equity capital}} \times 100$$

$$\text{Equity Capital} = \text{Ordinary Share Capital} + \text{Reserves}$$

### **Interest Coverage Ratio**

This ratio is considered whether business earned enough profit to cover the interest for long term loans. High value for interest coverage ratio is exhibited the safety of loan provided.

$$\frac{\text{Profit Before Tax Interest}}{\text{Interest}}$$

### **Criteria for Assessment and Evaluation**

- Explains the objectives of calculating leverage ratio.
- Following extracts of statement of financial position is of Rohin's business

	<b>03.31.2016</b>	<b>03.31.2017</b>
	(Rs.'000)	(Rs.'000)
Stated Capital Ordinary Shares ar Rs. 25/-	20 000	24 000
General Reserves	4 000	6 000
Revaluation Reserves for PPE	5 000	9 000
Retained Earnings	11 000	6 000
12% Bank Loan	20 000	20 000
10% Morgage loan (4 years)	5 000	2 000
Current liabilities	12 000	15 000

Profit before tax is 10% from equity

Calculate following ratios

- Debt equity ratio
- Debt ratio
- Interest Coverage ratio
- Present your opening on long term financial stability of this business.

**Competency 13.0 : Presents information required for management to decision making by analyzing and interpreting financial statements using ratios.**

**Competency level 13.4 : Calculating interprets Profitability Ratios**

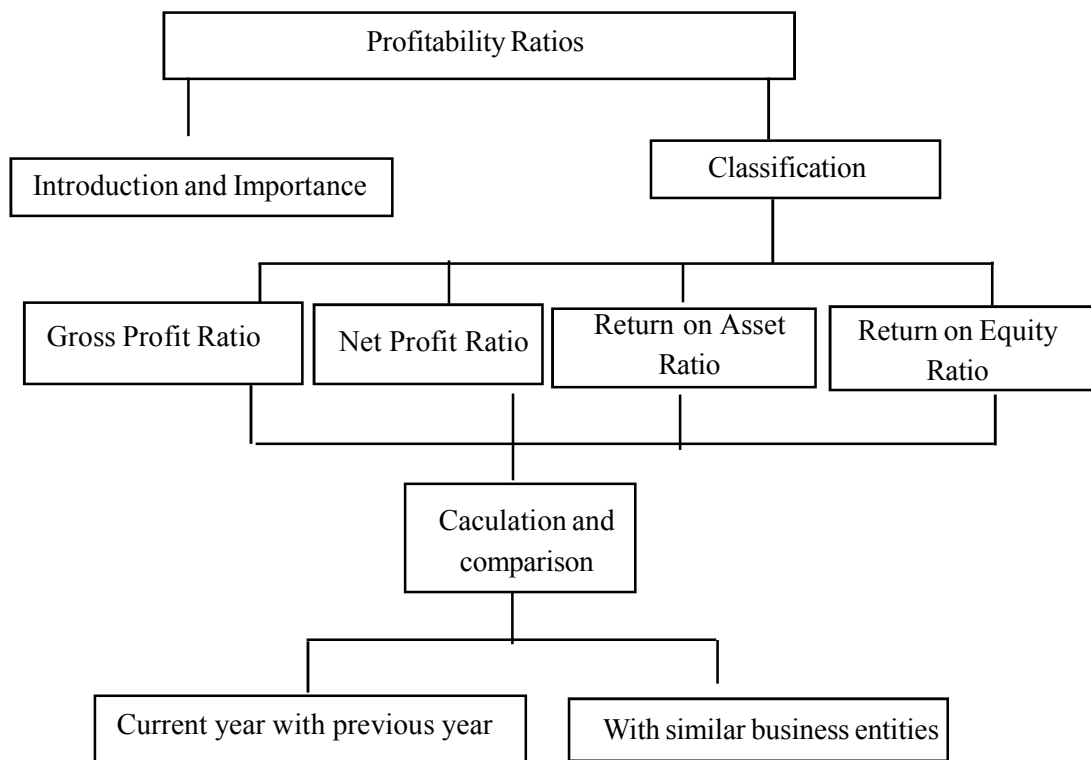
**No. of Periods : 06**

**Learning Outcomes :**

- Explains profitability ratios
- Names and explains types of profitability ratios
- Calculates Gross profit ratio
- Calculates Net profit ratio
- Calculates Return on Assets ratio
- Calculates Return on Equity ratio
- Makes decisions by comparing ratios

**Basic terms and concepts**

### Concept Map



### Instruction for Activities

Distribute following financial statements among students.

**Randika PLC**  
**Statement of Profit or Loss**

2017.03. 31 (Rs.'000)		2017.03. 31 (Rs.'000)
10 000	Sales	8 000
<u>(6 000)</u>	Cost of Sales	<u>(5 600)</u>
4 000	Gross Profit	2 400
<u>(1 500)</u>	Operating Expenses	<u>(1 000)</u>
2 500	Profit before tax	1 400
<u>(750)</u>	Income Tax	<u>(420)</u>
<u>1 750</u>	Profit for the Period	<u>980</u>

**Randika PLC**  
**Statement of Financial Postiion**

2017.03. 31 (Rs.'000)		2017.03. 31 (Rs.'000)
15 000	Non-current Assets	12 000
10 000	Current Assets	8 000
12 000	Ordinary Share Capital	10 000
3 000	Reserves	4 000
2 000	10% Long term Loans	2 000

- Get the answers for following questions for year 2016
  - Gross profit as a percentage of sales
  - Profit for the year as a percentage of sales
  - Profit for the year as a percentage of Total assets
  - Profit for the year as a percentage of Equity
  - Notify that percentage between Gross profit and sales is the Gross profit ratio and percentage of profit for the year from sales is Net profit ratio.
  - Percentage of profit for the year from equity is referred as return on equity.

- **Profit after deducting income tax** is referred as profit for the period.
- Calculate ratio for year 2017 as they calculated for the year 2016.
- Better year can be selected by comparing ratio for two years.
- Profitability ratios are calculated as follows.

$$\text{Gross Profit Ratio} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

$$\text{Net Profit Ratio} = \frac{\text{Profit before tax / Profit for the year}}{\text{Sales}} \times 100$$

$$\text{Return on assets} = \frac{\text{Profit for the year} + \text{Interest}}{\text{Total Assets}} \times 100$$

$$\text{Return on Equity} = \frac{\text{Profit for the year}}{\text{Equity capital}} \times 100$$

#### **Criteria for Assessment and Evaluation :**

- Briefly explains the advantages of calculating profitability ratios
- Financial year of Capital PLC was ended as at 31.03.217. Annual sales were Rs. 500 000. Gross profit was 40% of sales. Operating expenses except interest were Rs. 65 000 and interest expenses were Rs. 15 000. Income tax for the year was Rs. 30 000.
- Total Assets were Rs. 60 000 and quantity were 75% of assets.
- Calculate following ratios.
  - Net Profit Ratio
  - Return on assets ratio
  - Return on equity ratio
  - Proposed the actions to be taken in order to reach gross profit ratio up to 30%

**Competency 13.0 : Presents information required for management to decision making by analyzing and interpreting financial statements using ratios.**

**Competency level 13.5 : Calculates and interprets efficiency ratios**

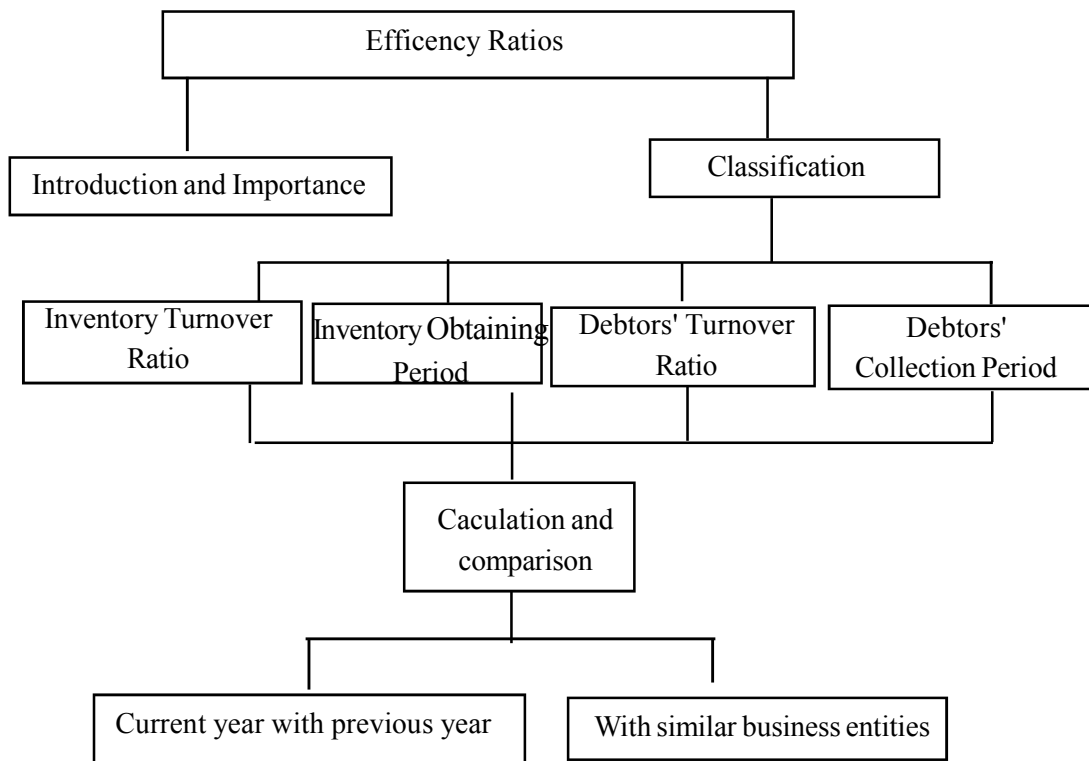
**No. of Periods : 06**

**Learning Outcomes :**

- Explains efficiency ratios
- Names and explains types of efficiency ratios
- Calculates inventory turnover ratio
- Calculates inventory obtaining period
- Calculates debtors' turnover ratio
- Calculates debtors' collection period
- Makes decisions by comparing ratios

**Basic terms and concepts**

**Concept Map**



### Instructions for Activities

- Present following details to students
- Following information were obtained from financial statements of Kalpani PLC, in which financial year was ended at 31.03.2018

	Rs.'000
Credit sales	90 000
Credit purchases	60 000
Inventory as at 01.04.2017	8 000
Trade debtors as at 01.04.2017	16 000
Inventory as at 31.03.2018	12 000
Trade debtors as at 31.03.2018	14 000
Operating expenses	9 000

- Obtain the answers for questions below referring above details
- Calculate cost of sales
- Calculate average inventories
- Obtain the answer by dividing cost of sales from average inventors, and present it as number of times.
- Obtain the answer by dividing cost of sales from average inventory and multiply it by 365 days.
  - Express the answer in number of days
  - Calculate average trade debtors.
  - Obtain the answer by dividing cost of sales from average trade debtors and present it as number of times
  - Obtain the answer by dividing cost of sales from average trade debtors and then multiply it by 365 days; express the answer in number of days.

### Criteria for Assessment and Evaluation

- States the benefits of efficiency ratios
- Ratios calculated by Hasini PLC for 2 years given below.

	2017	2018
Inventory Turn Over Ratio (No. of times)	18	15
Inventory holding period (days)	20	24
Debtors' Turn over Ratio (No of times)	10	12
Debtors' collection period (days)	36	30

Answer for followings referring above

- Year in which sales were more efficient.
- Year in which debtor collection was more efficient.
- Year in which the operations were more efficient

**Competency 13.0 : Presents information required for management to decision making by analyzing and interpreting financial statements using ratios.**

**Competency level 13.6: Calculates and interprets investors' ratios**

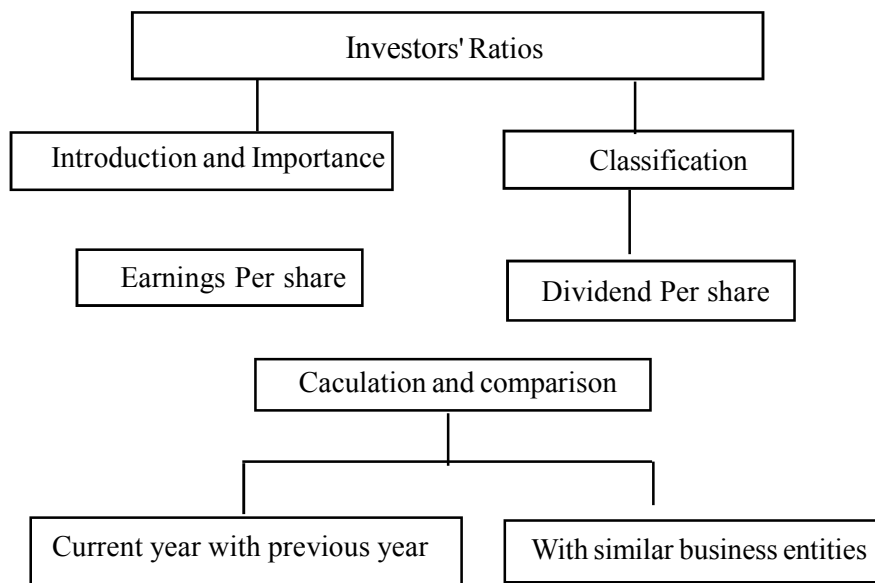
**No. of Periods : 06**

**Learning Outcomes :**

- Explains investors' ratios
- Names and explains types of investors' ratios
- Calculates earnings per share.
- Calculates dividend per share.
- Makes decisions by comparing ratios

**Basic terms and concepts**

**Concept Map**



**Instructions for Activities**

Extracts of statement of changes in equity for the year ended 31.03.2018 at Dewmini PLC given below.



	Ordinary Share Capital	General Reserves	(Rs.'000) Retained Earnings
Balance as at 01.04.2017	10 000	2 000	1 000
Profit for the year	-	-	4 000
Transfer	-	-	(500)
Dividend paid	-	-	(1 000)
Balance as at 31.03.2018	<u>10 000</u>	<u>2 000</u>	<u>3 500</u>

- Consideration of an ordinary share as at 31.03.2018 was Rs. 20/-
  - Inquire about the possibility of distributing profits for ordinary share holders for the year 2018
  - Inquire about the amount paid as interim dividends getting the year.
  - Inquire about the number of shares issued by the company.
  - Notify that earnings per share is calculated by dividing profit for the year form the number of ordinary shares.
  - Notify that dividend per share is calculated by dividing dividends for the ordinary share holders from the number of ordinary shares.
  - Investor's ratios can be calculated as follows.

$\text{Earnings per share} = \frac{\text{Profit for the year}}{\text{Number of Ordinary Shares}}$
---

$\text{Dividend per share} = \frac{\text{Dividends for ordinary shares}}{\text{Number of Ordinary Shares}}$
---

#### Criteria for Assessment and Evaluation:

- State the uses of investors' ratios for an entrepreneur
- Way of calculating earnings per share
- Way of calculating dividend per share
- Following details were obtained from similar type of companies.

	A Ltd	B Ltd
Earning per share (Rs.)	24.75	18.25
Dividend per share (Rs.)	10.50	10.50

- State the most suitable company for investment.

## Competency 14.0 : Evaluation Basic Concepts of Management Accounting

### Competency level 14.1 : Make use of Management Accounting for Decision Making

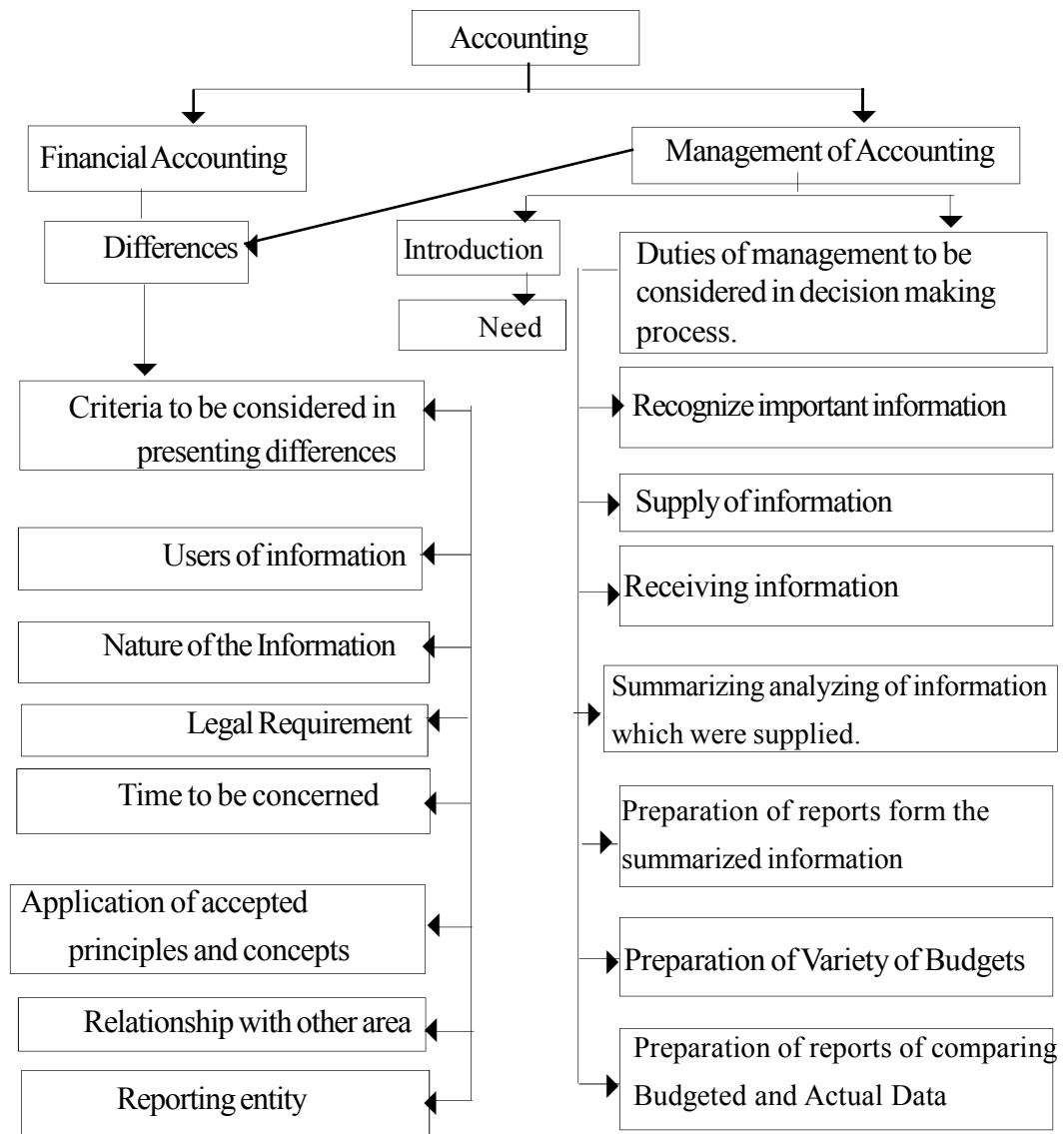
No. of Periods : 06

#### Learning Outcomes :

- Explains management accounting.
- Names duties of management to be considered in making management decision making.
- Tabulate the differences between management accounting and financial accounting.

#### Basic terms and concepts

##### Concept Map



### **Proposed instructions for Teaching – learning process**

- Explain subject matter and content of the subject related to this competency level.
- Accounting can be divided into two types. They are,
  1. Financial Accounting
  2. Management Accounting
- Cost accounting is discussed as a sub section of Management Accounting.
- Management Accounting means provision of relevant information what will assist management to make decisions by collecting and arranging relevant data.
- Association of Chartered Certified Accountants defines management as follows.
- “Providing management accounting techniques to help you support business to plan, control and monitor performance.”
- Management accounting means providing financial and non financial information for all the managerial levels.
- Need of management accounting can be summarized as follows.
  - provide information for management decisions.
  - Identify differences and make necessary corrections by comparing estimated situations and Actual situations.
  - Provide appropriate solutions in order to solve problems arises in operational activities.
  - Preparation of reports and evaluation of efficiency of different sections of the business.
  - provide past and future situations in order to make future plans.

Management duties to be considered in making management decisions.

- Provide financial accounting and cost accounting information to managers
- Classifying and analyzing of information collected.
- Arrange financial, cost data and data collected from other areas according to the requirement of the managers.
- Preparation of reports from the summarized data.
- Preparation of budgets for management activities.
- Preparation of reports by comparing Budgeted and Actual Circumstances.
- Different bases, criteria identifying dissimilarities between management and financial accounting.

Basis/ Criteria	Management Accounting	Financial Accounting
• Parties who uses information	Managers/internal parties	Both external and internal parties
• Nature of information	Monitory and non monitory information which helps management to make decisions.	Information which can be measured in monitory terms
• Legal Requirement.	No legal requirement	Legal requirement
• Time to be considered	Present and future information	Past activities
• Duration covered by the report	No specified time period for report. Reports prepared based on different departments.	Reports prepared for an accounting period.
• Application of accepted principles and concepts	Based on management requirement.	Should prepare accounting to Sri Lanka Accounting Standards.
• Reporting entity	The whole organization is not considered at once. Each area of department considered separately.	Reports prepared as one entity.
• Relationship between other areas	Information provided to economics financial and information statistics beyond accounting	Limited only accountint

#### **Assessment and Evaluation criteria :**

- (i) What are the main types of accounting?
- (ii) Explain the meaning of management accounting
- (iii) What are the management duties to be considered in making decisions?
- (iv) Differentiate management and financial accounting based in criteria.

**Competency 14.0 : Evaluation Basic Concepts of Management Accounting**

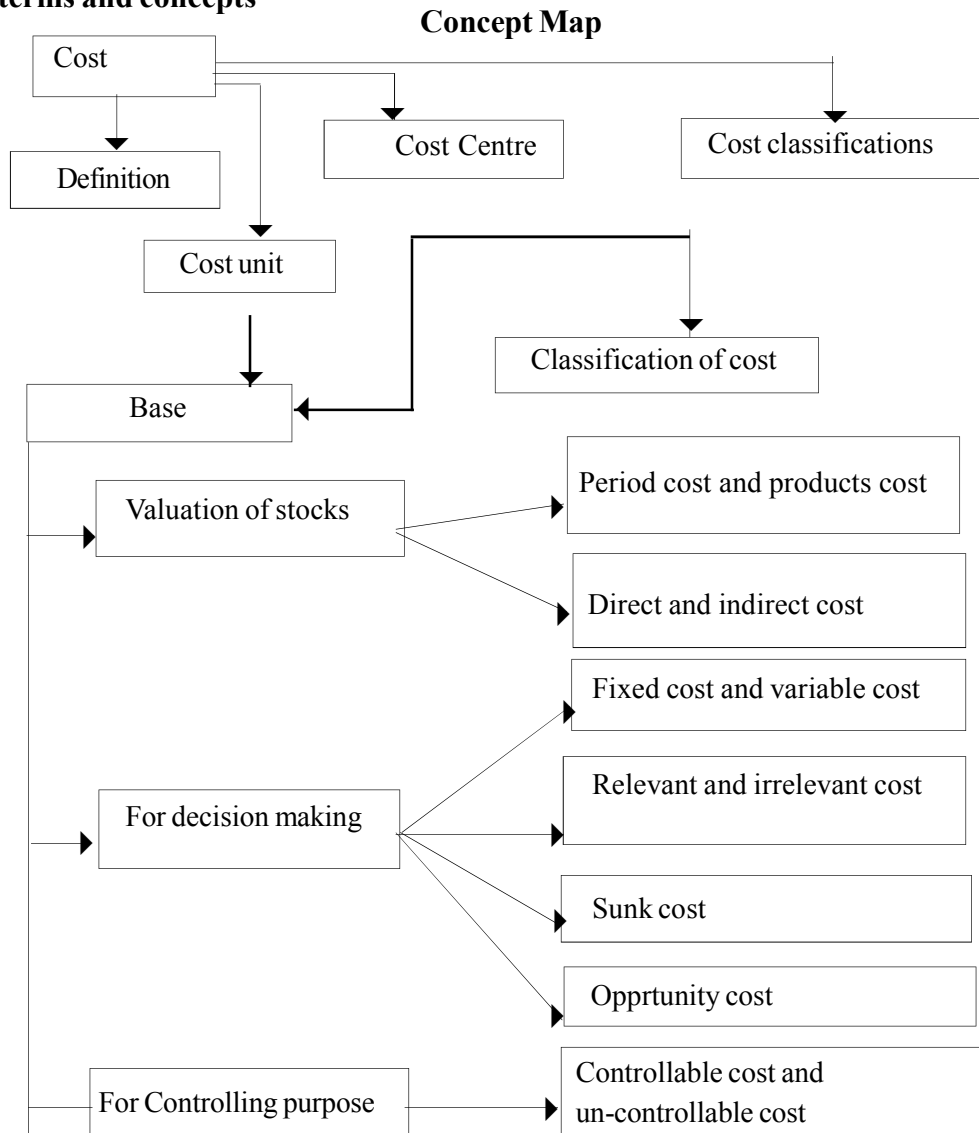
**Competency level 14.2 : Analyses basic concepts of Management Accounting**

**No. of Periods : 14**

**Learning Outcomes :**

- Explains cost, cost unit cost centre.
- Classifies cost based on different objectives of management
- Explains and names classification of costs for valuation of stocks.
- Classifies costs for decision making
- Classifies costs for controlling purpose

**Basic terms and concepts**



### Proposed instructions for Teaching-learning Process

- Explains subject matter and subject content of related to this competency level.
  - Sahan Abeynayake who runs a business near express way with three departments of consumer selling, sweets outlet and stores. Following expenses estimated to be incurred for 1 Kg of rice.

	(Rs.)
Rice (1kg)	80.00
Three vegetables 250g each	120.00
Fish	100.00
Caradomom	30.00
Coconut	50.00
Gas / Fire wood	30.00
Other expenses	40.00

- He decided to prepare 6 packets of lunch 1 kg of rice and also he makes his own decisions.
- Inquire student ideas highlighting following :
- Manager requires related cost in order to make decisions of the business.
- There are different departments in an organization and it is required to collect costs of each department.
- Makes decisions like, calculation of cost per unit from total cost, calculation of selling price, valuation of stocks.

### Cost concepts

- **Cost**

Value of economic resources sacrificed in order to purchase or to provide service.

- **Cost Unit**

A quantitative measurement used to calculate cost of a product or service.

- **Cost Centres**

It is a place, activity, equipment or a person in relation to a cost unit to identify and management of cost.

## **Classification of cost**

It can be classify according to the need of management.

- Cost classification for stock valuation

Cost accounting provides information in order to value inventories.

Cost can be classify as follows.

- Product cost
- Period Cost
- Period cost means total cost incurred to produce goods or services. A cost which can be identifiable with a product, changes with the volume of production are known as direct cost (prime cost), cost incurred in common, do not change with the volume of production. Known by the name of indirect production cost (Production overheads)
- Cost which are debited to profit and loss account (Income statement) against income of a particular period known by the name of period cost.

### **Cost classification for decision making**

- Behavior of a cost should be identified in order to prepare budgets, profit planning, preparation and operating of plans for financial control. Cost can be classified as follows.
  - Variables and fixed cost
  - Relevant and irrelevant cost
  - Sunk cost
  - Opportunity cost
- Any cost that changes directly in proportion to the volume of production, activity level or sales volume known by the name variable costs, variable cost per unit is a fixed value. Whereas total variable cost varies with the level of production or sales volume.
- Any costs which do not changes with the activity level or volume of sales known by the name fixed costs, Total fixed costs do not change but unit fixed cost changes with the activity level or volume of sales.
- If any cost directly relevant to a decision is known by the name relevant costs, and other cost which are not discussed under relevant costs known by the name irrelevant costs.
- Irrelevant costs already incurred as a result of a past decision made by the management known by the sunk cost.
- Next best return forgone when selecting best alternative from several alternatives known by the name opportunity costs.

- Cost classification for controlling purpose.

Classification of cost based on responsibilities of managers to minimize or to control the cost. And thereby cost can be clarify as follows.

- Controllable costs
- Un- Controllable costs

Any costs behaves within the responsibility of manager of an organization is known by controllable cost. Whereas any costs which do not behaves with the responsibility of manages of an organization is known by uncontrollable costs.

### **Assessment and Evaluation Criteria**

1. What is the cost unit used in following cost centres :
  - A Bakery
  - Hospital
  - An electricity supply organization
  - A Cinema
2. Piyal started a furniture shop on 01.01.2018 by withdrawing Rs. 400 000 from a 12% fixed deposit. He registered his business by the name “Dewa Shakhty” by incurring registered fee of Rs. 2500.

For furniture they incurred.

- Purchase of machinery for Rs. 80 000
- Obtain a building for a monthly rent of Rs. 8 000
- Payment of Rs. 3 000 per finished table allocated for each carpenter.
- Purchased 400sq.ft of timber at a price of Rs. 400 per sq.ft and for each table it is required 18sq.ft of timber.
- Rs. 18 000 incurred for factory insurance and electricity
- Incurred Rs. 4 000 for sand papers and polish
- Should include equipment depreciation of Rs. 3000 (for 3 months)
- Included other factory expenses of Rs. 19 000.
- During the quarter ended 31.03.2018. They manufactured 20 tables out of which 15 were sold.



**Based on the above answer following questions.**

- (i) Calculate period cost and product cost
- (ii) What is the value of remaining stock as at 31.03/2018 (Raw material and finished stock)
- (iii) Calculate variable and fixed costs separately.

3. Explain following in brief by giving examples

- (iv) Irrelevant cost
- (v) Sunk cost
- (vi) Opportunity cost

**Competency 14.0 : Evaluation Basic Concepts of Management Accounting**

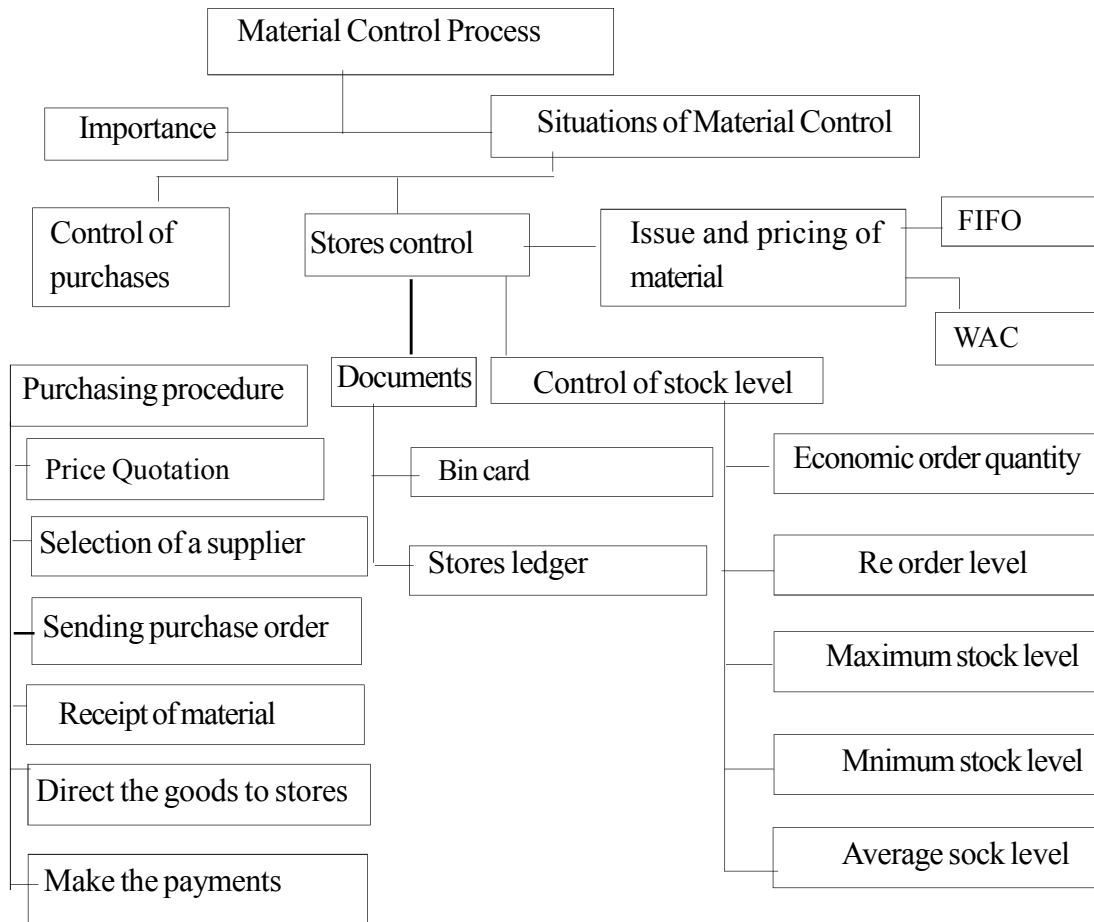
**Competency level 14.3 : Uses Process of Material Control**

**No. of Periods : 10**

**Learning Outcomes :**

- Explain importance of material control
- Names situations of material control
- Presents purchasing procedure
- Presents techniques of material control
- Calculates Economic order quantity
- Names documents related to material control
- Calculate re order level
- Calculate maximum stock level
- Calculate minimum stock level
- Calculate average stock level
- Apply FIFO method and WAC for pricing and issue of stocks.

**Basic terms and Concepts Concept Map**



## **Teaching learning process**

Explain subject matters and content of the subject related to this competency level.

Discuss with students importance of controlling daily consumable goods like rice, sugar, milk, tea, which were purchased in bulk for a once a month, store then appropriately in bins and also store in small containers for daily requirement.

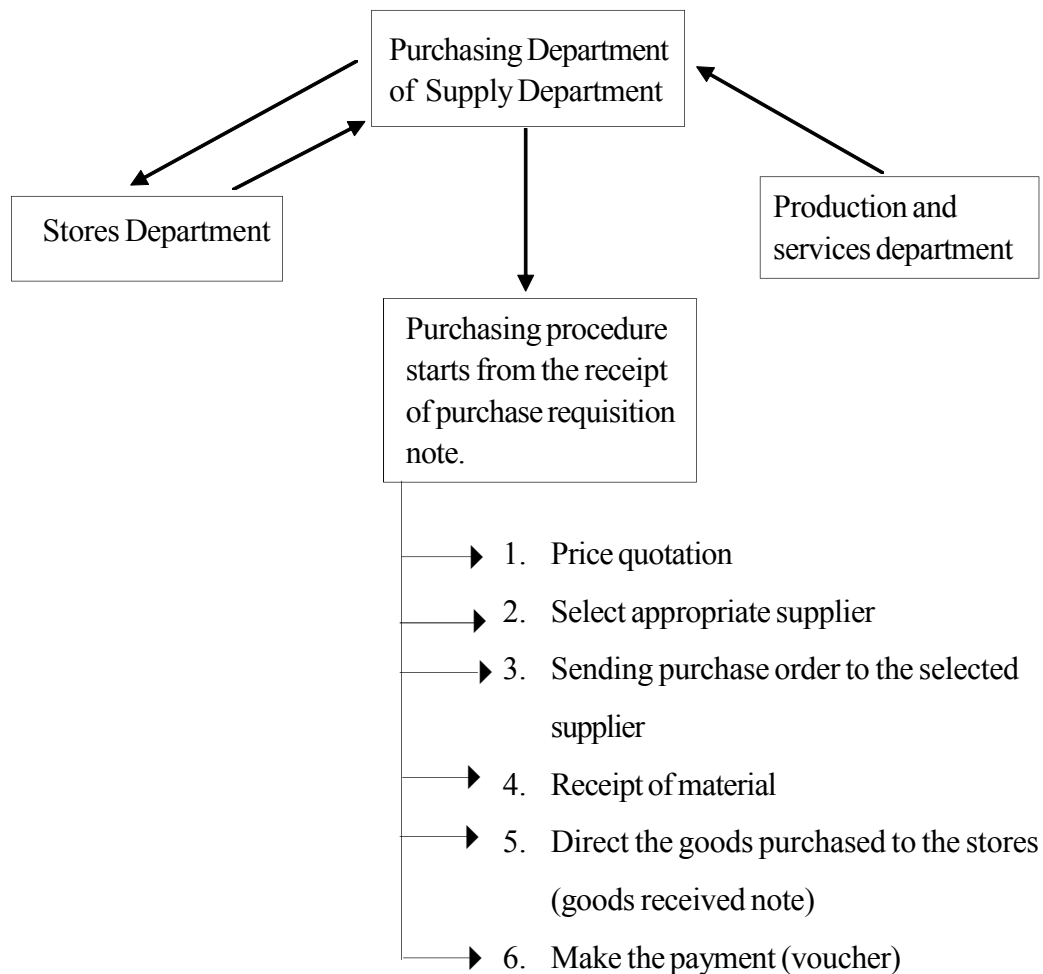
Discuss the way of stock control techniques.

- Inquire students ideas of stock control techniques.
- Controlling of material purchases
- Controlling of store of materials
- Controlling of issue of stocks

Direct and indirect materials used and product on or supplying if service is known by materials, Importance of controlling rich costs are as follows.

- Working capital will not unnecessarily tied up with stocks.
- Minimize cost of purchase and cost of maintaining stocks.
- Carry out production activities without any obstruction
- Minimizing of stock wastage
- Can avoid urgent purchases
- Report stock detail to the management

It is required to maintain stock control according to a procedure. Following diagram shows purchasing procedure, documents used.



1. Production or service department request raw materials from stores by issuing material requisition note.
2. Inquire whether the stores have enough materials.
3. Following answers are provided by the stores to supply department.
  - Note enough material in store.  
Direct purchase requisition note to supply department indicating required quantity.
  - Enough materials are available in store. No need of purchase.
  - Recording of materials received. Store them accordingly, pricing of material, issues from stores are maintained by the stores. Also maintain different techniques for stock control.

- Source documents used in material control.
  - Bin card
  - Stores ledger
- Bin card includes details of receipt and issues of material and balance stock for a day.
- Stores ledger is a statement which shows receipt of material and issues of material and balance stock **with values**. LKAS 02 recommends methods to be used in pricing of material issues.
  1. First In First Out (FIFO)
  2. Weight Average Cost (WAC)
- According to FIFO method materials in the stores are issued by using price of the firstly purchased materials after finishing first quantity batch prices of next purchased batch showed be used (Discuss under competency level 11.4).
- Weight Average cost method uses the prices calculate by dividing total value of material from quantity of material issues (Discuss under competency level 11.4).
- Economic order quantity means the quantity to be purchased at a time to minimize total cost development from ordering and holding expenses.
- Assumptions used in EOQ model.
  1. Annual demand is known and fixed
  2. Ordering cost is known and fixed
  3. Holding cost is fixed
  4. quantity ordered received at once
  5. Price per unit is fixed
  6. Minimum stock level is at the zero level

Economic order quantity can be calculated as follows.

$$EOQ = \sqrt{\frac{2DCo}{ch}}$$

EOQ means Economic Order Quantity

D – Annual consumption / Demand

Co – Cost of ordering

Ch – Annual holding cost per unit

- Following stock levels are used in stock control.
  1. Re-order level
  2. Minimum stock level
  3. Maximum stock level
  4. Average stock level
- Re-order level means the level at which material should be purchased.

$$\text{Re-order level} = \text{maximum consumption} \times \text{maximum lead time.}$$

Maximum waiting time is known as maximum lead time and maximum usage is known as maximum consumption.

- Maximum stock level means the minimum stock level to be maintained in order to carry out production without any interruption.

$$\text{Minimum stock level} = \text{Re order level} - (\text{Average consumption} \times \text{average lead time})$$

- Maximum stock level is the stock level to be maintained at any given time which should not exceed. Excess stock is not good for the organization.
- Average quantity of material storage known as average stock level. There are two usage of calculating average stock level.

$$\text{Maximum stock level} = \text{Reorder level} - (\text{Minimum consumption} \times \text{Minimum lead time}) + \text{Reorder Quantity}$$

$$\text{Average stock level} = \text{Minimum stock level} + \frac{\text{Economic order Quantity}}{2}$$

Or

$$\text{Average stock level} = \frac{\text{Minimum stock level} + \text{Maximum stock level}}{2}$$

### Assessment and Evaluation :

1. State the purpose, department who issues or receive for each of the following source documents.

Source document	Issued by	Received by	Purpose
<ul style="list-style-type: none"><li>• Stores requisition note</li><li>• Goods requisition note</li><li>• Tenders / Quotations</li><li>• Purchase order</li><li>• Delivery note</li><li>• Goods received note</li></ul>			

2. Recommended methods used in issuing prices of materials.

- (i) .....
- (ii) .....

3. Following details are related to material

- Monthly stock consumption 500 units
- Price per unit Rs. 80
- Cost per order Rs. 60
- Holding cost is 10% of material cost per unit.

1. Calculate Economic order quantity

2. Number of orders per year

Maximum consumption	– 300 units per day
Average consumption	– 200 units per day
Re order period	– average of 10 days
Re order quantity	– 3 000 units

Calculate

1. Re order level
2. Maximum stock level
3. Minimum stock level
4. Average stock level

**Competency 14.0 : Evaluation Basic Concepts of Management Accounting**

**Competency level 14.4 : Records the labour cost**

**No. of Periods : 05**

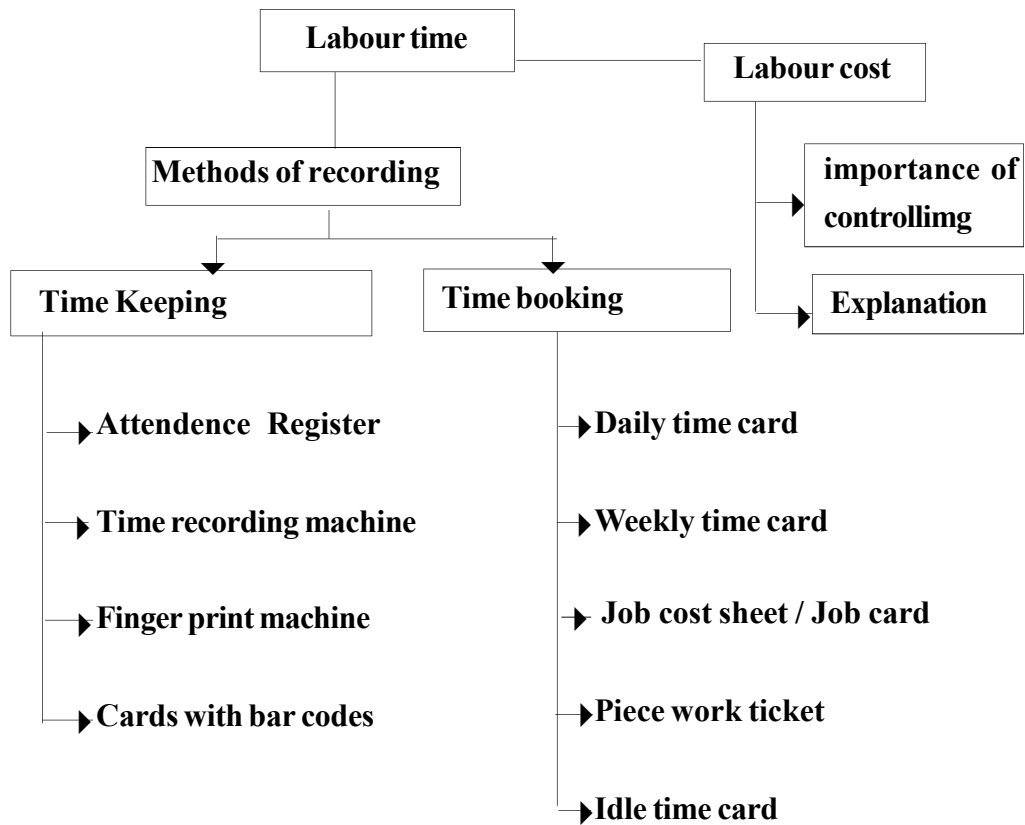
**Learning Outcomes :**

- Explains labour cost
- Presents importance of labour cost control
- Keeps records of Labour cost

**Basic terms and concepts :**

:

**Concept Map**





## **Proposed Instruction for Teaching Learning Process**

Explains subject matter and Subject content related to this competency level.

Explains directly or indirectly incurred to pay wages of workers who sacrifice their labour to produce goods or service is meant by labour cost. It includes following.

- Basic salary
- Overtime payment
- Other extra allowances
- Medical or other special allowances
- Employee Provident Fund contribution
- Employee Trust Fund
  
- Importance of labour cost control :
  - More attention is needed for labour cost than other resources reason being labour is a human resources,
  - A control of labour cost is important because large proportion of cost unit comprises of labour cost.
  - Can minimize cost time per unit by increasing production capacity through an improvement of labour productivity.
  - Recording of labour time can be two types
    - Time keeping
    - Time booking
- Methods of time keeping  
Attended time is the time duration between arrival and departure time of workers in an organization. There are several methods;  
**Examples**
  - Attendance register
  - Time recording machine
  - Finger print machine
  - Cards with bar codes

### **Methods of time booking**

Records time spent by workers in different jobs or process for determining labour cost is time booking. These are variety of records depending on the nature of the organization. Following are some of the methods of time booking.

- Time cards
  - Daily time card
  - Weekly time card
- Job ticket
- Job cost sheet / Job card
- Piece work ticket
- Idle time card
- **Time card**

A sheet completed by each worker by including the time spent of each job.

A sheet/card which is used to record the time spent on each job during the day is known as daily time card. A sheet/card records weekly time details known as weekly time card.

- **Job Ticket**

A card which contains duties, instructions to be given and required time for each job of worker is called job ticket.

- **Job cost sheet / Job card**

This is a document which will be completed by several workers who perform a particular job and transfer to the other works after finishing each worker's Job.

- **Piece work ticket**

This is a document which is used to record the time taken by each worker to produce goods in a situation where their wages are based on output level.

- **Idle Time Card**

This is the time if any worker not engaged in any other work due to machine breakdowns; lack of raw materials or electricity power cuts. Idle time is also taken for the calculation of wages.

### **Assessment and evaluation**

Following information is relevant for the calculation of wages of Nisha book shop".

- Maximum working number of days for a month are 20 days. 8 hours per day. Starts from 8.00 am to 4.00 pm.
- 1.5 times per hourly rate is paid for any worker who works on Saturday and Sundays.

- Cost of living per month for a worker is Rs. 2000.
- EPF contributions
  - Employee contribution towards EPF is 10% on basic salary.
  - Employer contribution towards EPF is 15% on basic salary.

Employee Name			
Kubudu	16 000	20	Sumudu
Sumudu	19 200	20	10
Pubudu	20 000	18	15

- Calculate labour cost according to following headings.
  - Basic salary
  - Overtime payments
  - Cost of living benefit
  - EPF contribution
  - Total Labour cost
- (i) State the source documents used in recording labour time
- (iii) What are the benefits of labour cost control.

**Competency 14.0 : Evaluation Basic Concepts of Management Accounting**

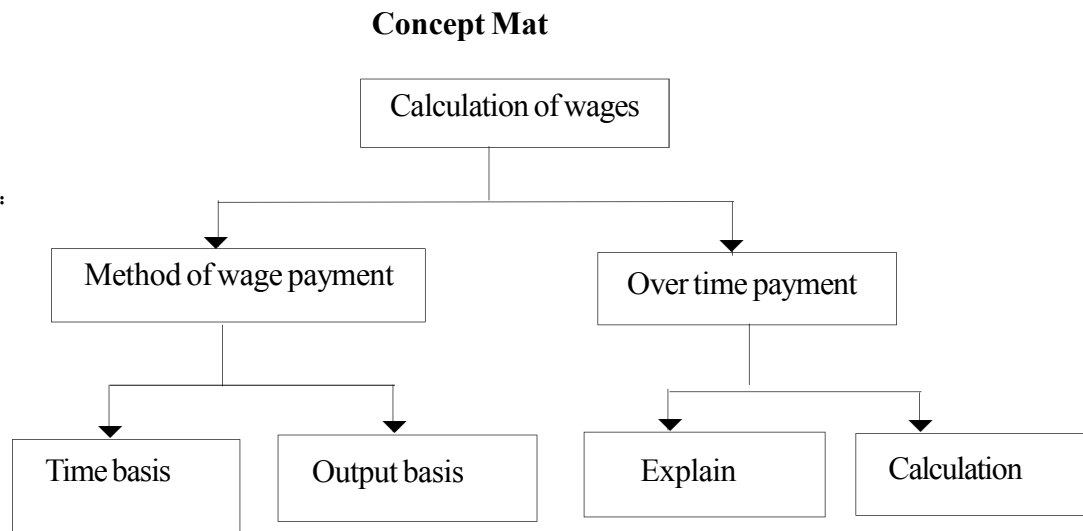
**Competency level 14.5 : Calculate labour cost based on time and output**

**No. of Periods : 05**

**Learning Outcomes :**

- Names methods of Salary payment
- Explains time and output basis
- Explains overtime payments
- Calculates overtime payments

**Basic terms and concepts :**



**Proposed Instructions and Teaching Learning Process :**

Explain subject matter and content of the subject related to this competency level.

- There are two basis for labour cost calculation
  - Time basis
  - Output basis
- If workers are paid according to the time for which they work is known as time basis wage payment.
- It can be calculated as follows.

$$\text{No of hours worked} \times \text{Rate per hour} = \text{Wage}$$

If workers are paid according to the quantity of work done is known as output basis wage payment. This is also known as “Piece rate” payment.

It can be calculated as follows.

$$\text{No of units produced} \times \text{rate per unit} = \text{Wage}$$

Comparison between time basis and output basis

Time basis	Output basis
<ul style="list-style-type: none"> <li>Wages paid based on time worked by an employee.</li> <li>Appropriate where output cannot be measured in quantitative terms</li> <li>Workers are not motivated</li> <li>Favorable for the apprentices.</li> <li>Extra supervision needed</li> </ul>	<ul style="list-style-type: none"> <li>Wages paid based on output level.</li> <li>Can used in a situation where work can be measured.</li> <li>Workers are motivated.</li> <li>Unfavorable for the apprentices.</li> <li>Extra supervision not needed.</li> </ul>

- Payment made for the extra hours worked is known as overtime payment. **Overtime wage rate is higher than the normal wage.** It can be calculated as follows.

$$\text{Overtime hours} \times \text{overtime rate per hour} = \text{overtime payment}$$

#### Assessment and Evaluation Criteria :

- (a) Number of units produced by three employees during a day are as follows. Rate per unit of output is Rs. 20.

Employee	Units produced
Sunny	60
Winne	55
Jonie	65

(b) Numbers of hours worked during the first week are as follows.

	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
Amal	8	8	8	8	8	5	4
lakmal	8	8	8	8	10	6	4
Kalpani	8	8	8	8	10	-	5
Gotham	10	6	7	8	8	5	3

- They should work eight hours during week days except Saturday and Sunday. Normal hour rate is Rs. 80.
- Overtime payments are as follows.
- 1.5 times per hour during weekday rate of wage
- Two times week day rate of wage for Saturday and Sunday.

**Calculate following**

- (i) Total salary of each worker for a week
- (ii) Overtime payment of each workers for a week
- (iii) Total cost of labour

**Competency 14.0 : Evaluation Basic Concepts of Management Accounting**

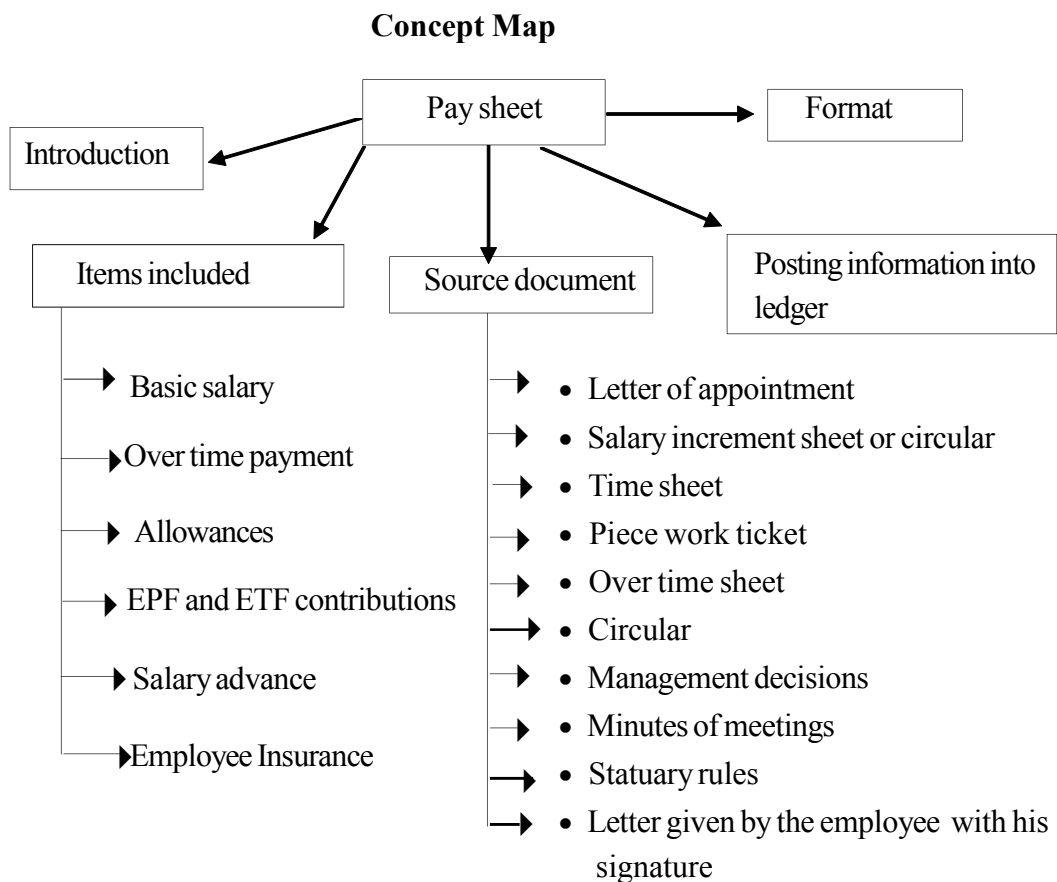
**Competency level 14.6 : Prepare pay sheet**

**No. of Periods : 20**

**Learning Outcomes :**

- Lists source documents appropriate for the preparation of salary pay sheet.
- States items included in a pay sheet.
  - Basic salary
  - Allowances
  - Gross Salary
  - Deductions
  - Net Salary
- Presents format of a pay sheet
- Prepares pay sheet
- Posts information in pay sheet to ledger

**Basic Terms and Concepts :**



**Proposed Instructions for learning – teaching process :**

Explain subject matter and content of subject related to this competency level.

- Pay sheet is a statement which includes total salaries. Deductions, Gross salary and EPF an ETF contribution of each employee for a particular period.

Item	Source
1. Basic salary / Total salary	<ul style="list-style-type: none"> <li>• Letter of appointment</li> <li>• Salary increment sheet/circular</li> <li>• Time card</li> <li>• Piece work ticket</li> </ul>
2. Overtime	<ul style="list-style-type: none"> <li>• Overtime payment sheet,</li> <li>Overtime payment ticket.</li> </ul>
3. Allowances	<ul style="list-style-type: none"> <li>• Circulars</li> </ul>
4. EPF contributions	<ul style="list-style-type: none"> <li>• Management decisions</li> </ul>
ETF contributions	<ul style="list-style-type: none"> <li>• Minutes of meetings</li> </ul>
5. Salary Advance	<ul style="list-style-type: none"> <li>• Statuary rules</li> </ul>
6. Employee insurance installment	<ul style="list-style-type: none"> <li>• EPF Act. ETF Act</li> <li>• Letter given by the employee with his signature</li> </ul>

**Format of a pay sheet**

.....Ltd

**Paysheet for the month ..... year .....**

			Earnings				Deductions					Rs.		
Serial number	Employee number	Name	Basic salary	Allowances	Overtime payments	Gross salary	EPF contribution	Salary Advance	Employee loan	Total Deduction	Net salary	ETF contribution	ETF contribution	Signature of Employee



- Following journal entries are related to the data included in pay sheet by using salary and wages control account.

1. Total Gross Salary

Salaries and wages account	Dr	xxx	
Salaries and wages control account			xxx

2. Total deductions from the salary

Salaries and wages control account	Dr	xxx	
Relevant deduction account			xxx

3. EPF contribution of employer

EPF expense account	Dr	xxx	
EPF payable account			xxx

4. ETF contribution

ETF expense account	Dr	xxx	
EPF payable account			xxx

5. Payment of net salary

Salaries and wages account	Dr	xxx	
Cash account			xxx

7. Net salary not paid in cash

Salaries and wages control account	Dr	xxx	
Salaries and wages payable account			xxx

At the end of the period balance in salaries wages account. Employee Provident Fund expense account. Employee trust fund expense account are transfered to the profit and loss (Income statement) account.

**Assessment and Evaluation criteria :**

Following salary details are related to Naotunna (PLC) Ltd for the month of march 2018.

- Standard number of labour hours per month 160
- Rate per hour is Rs. 200
- Overtime payment is 150% form the total salary
- EPF contribution from basic salary
  - Employee 10%
  - Employer 15%
- ETF contribution is 3% from basic salary.

**Required :**

- Pay sheet for the month of March 2018
- General journal entries
- Ledger accounts

**Competency 14.0 : Evaluation Basic Concepts of Management Accounting**

**Competency level 14.6 : Absorbs Overhead Cost to a Product**

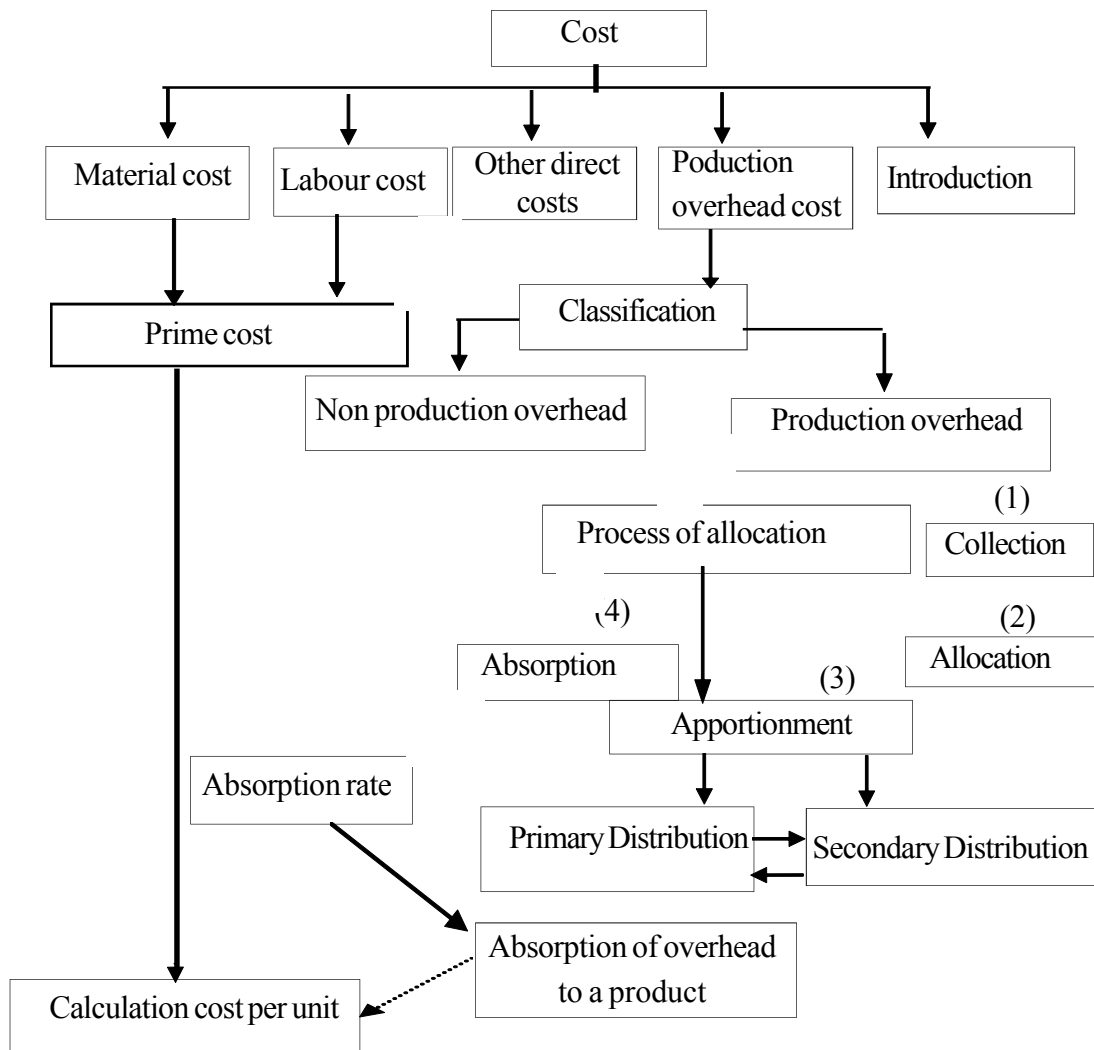
**No. of Periods : 30**

**Learning Outcomes :**

- Explains production overheads.
- Classifies production over head cost as manufacturing and non manufacturing.
- Explains and lists process of allocation of production over heads.
- Prepares production over head analysis sheet.
- Absorbs production over head to a unit of product.

**Basic Terms and concepts**

**Concepts Map**



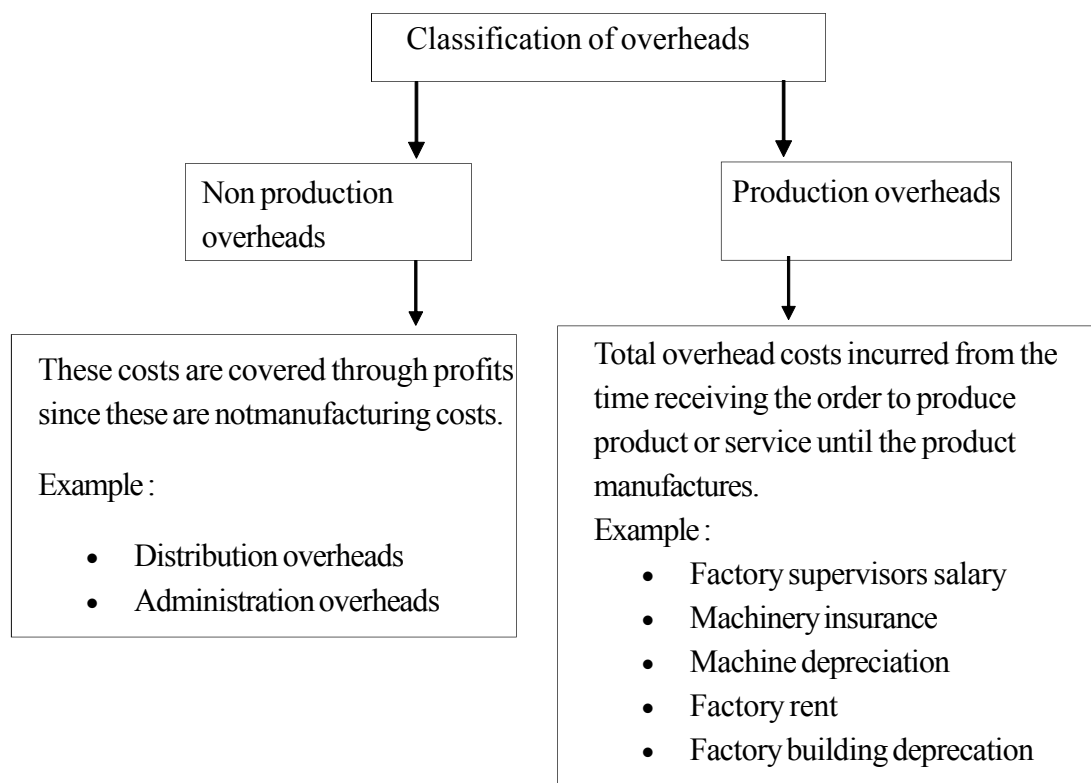
## Subject matter :

### Production overhead Cost

Total common expenses incurred for large quantity of production which cannot be identified with a single product can be turned as overhead cost is known as production overhead cost or in other words total of indirect materials, labour and other expenses.

**Example :** Glue, polish, varnish, security Guard salary, supervisor's salary, rent, rates, electricity

These costs cannot be identified for a cost unit. Therefore, it can be identified for a production.



### Process of distribution overheads

Distribution overhead costs among cost centres which can't be identified easily for each cost centres. This is known as distribution of overheads and following are the relevant steps.

1. Collection of overhead costs
2. Allocation of overhead costs
3. Apportionment of overhead costs
4. Absorption of overhead costs

## Collection of overhead costs

Cost could be recognized by following source documents relevant for each expenses.

Example :	Overhead cost item	Source document
	<ul style="list-style-type: none"><li>• Indirect wages</li><li>• Electricity expenses</li><li>• Depreciation of used for production</li></ul>	<ul style="list-style-type: none"><li>• Salary pay sheet</li><li>• Electricity bill / voucher</li><li>• General journal voucher</li></ul>

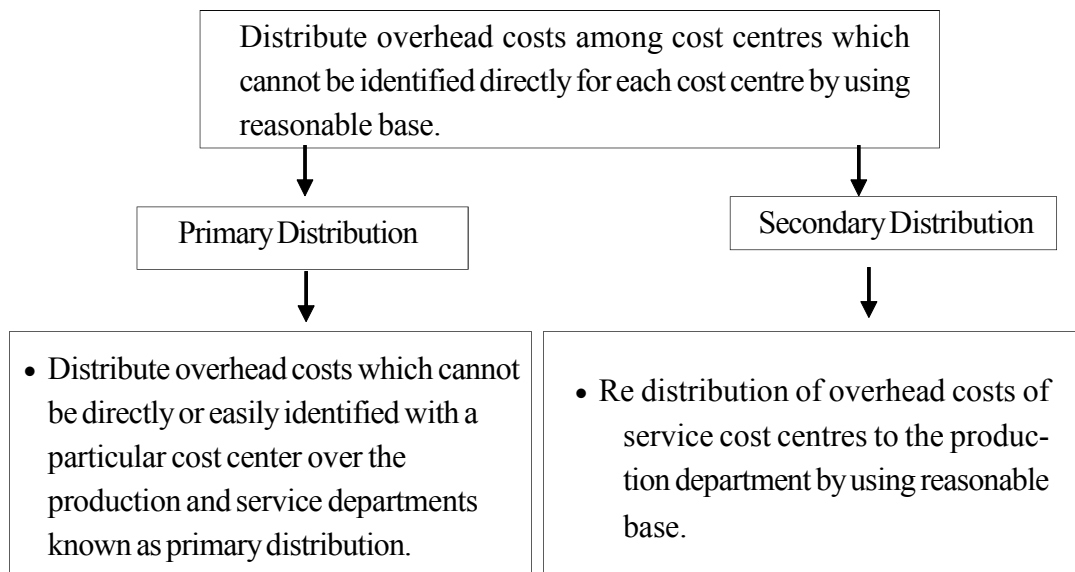
## Allocation of overhead costs

- Distribute overhead costs among cost centres which can be identified easily for each cost centre.

**Example :**

- Receipt of electricity bill for each cost centre
- Preparation of salary pay sheet for each cost centre

## Appointment of overhead head costs



### Examples for bases of Apportionment

Cost item	Base of portionment
Electricity Rent Rates Repair of building Lighting	Floor area / square feet
Water bills Electricity bills Telephone expenses	Units consumed
Medical expenses Restaurant Keeping expenses Indirect wages Expenses of welfare Employee insurance Supervision expenses	Number of employees
Machine depreciation Machine insurance	Value of machinery / carrying value
Expenses of service department	Number of stores requisitions / consumption rate
Maintenance expenses	Number of hours spent for maintainance
Expenses of air conditoning	Volume

### Absorption of overhead costs

Charging or absorbing total over head cost pertaining to production department to a cost unit can be termed as absorption of overheads.

Overhead absorption rates can be calculated by dividing budgeted overhead cost from a number of units or using an appropriate base.

**Example :**

Overhead Absorption Rate	Method of Calculation
1. Output Basis	$\frac{\text{Total estimated overhead costs}}{\text{Estimated number of units product}}$
2. Direct material cost basis	$\frac{\text{Total estimated overhead costs}}{\text{Estimated direct material cost}} \times 100$
3. Direct labour cost basis	$\frac{\text{Total estimated overhead costs}}{\text{Estimated direct labour cost}} \times 100$
4. Prime cost basis	$\frac{\text{Total estimated overhead costs}}{\text{Estimated prime cost}} \times 100$
5. Direct labour hour basis	$\frac{\text{Total estimated overhead costs}}{\text{Estimated direct labour hours}}$
6. Machine hour basis	$\frac{\text{Total estimated overhead costs}}{\text{Estimated machine hours}}$

Preparation of overhead analysis sheet. Example is as follows.

- (i) There are two production departments and a service department in a garment factory. Expenses of producing 1000 garments are as follows.

Item	Cutting section	Sewing section	Stores
Machine (Rs.)	700 000	1 400 000	-
Building (Rs.)	400 000	200 000	1 000 000
Area (sq ft)	10 000	50 000	10 000
No of workers	1 000	2 000	500
No of stores	50	30	-
Requisitions notes			
Indirect materials (Rs.)	20 000	40 000	-
Indirect wages (Rs.)	50 000	100 000	-

	(Rs.)
Building rent	70 000
Electricity	14 000
Employee insurance	8 400
Machine insurance	3 000
Machine depreciation	30 000
Prepare production overhead analysis sheet.	

Cost item	Basis of apportionment	Total value	Production Department		(Rs.)
			Cutting	Sewing	Stores
Indirect machine	Direct /Allocation	60 000	20 000	40 000	-
Indirect wages	Direct /Allocation	150 000	50 000	100 000	-
Building rent	Area (1:5:1)	70 000	10 000	50 000	10 000
Electricity	Area (1:5:1)	14 000	2 000	10 000	2 000
Machine insurance	Value of machine (1:2)	3 000	1 000	2 000	-
Employee insurance	No. of Workers (2:4:1)	8 400	2 400	4 800	1 200
Machine depreciation	Value of machine (1:2)	30 000	10 000	20 000	-
Total overhead cost	Cost	335 400	95 400	226 800	13 200
Service department overhead cost	Stores requisitions (5:3)	---	8 250	4 950	(13 200)
Total overhead cost		335 400	103 650	231 750	-

(2) Following estimated costs are related to Cooray furniture shop for the next year.

Item	Production department		Service department
	A	B	S
Direct wages (Rs.)	360 000	120 000	20 000
Indirect materials (Rs.)	30 000	20 000	10 000
Direct materials (Rs.)	480 000	180 000	30 000

Other production overhead costs	(Rs.)
Machine Depreciation	400 000
Employee expenses	200 000
Rent	300 000

	A	B	C
Cost of machine (Rs.)	125 000	70 000	5 000
Area (sq.ft.)	3 000	1 500	500
No of employees	60	30	10
Direct labour hours	3 700	3 350	-

Service department cost should be distributed among production department by using 1 : 1 basis.

**Required :**

1. Overhead analysis sheet
2. Secondary distribution
3. Calculate overhead absorption rates for A and B departments by using direct labour hours.

**Answer :**

(Rs.'000)				
(01) Item	Basis if apportionment	Production Dept.		Service (Rs)
		A (Rs.)	B (Rs.)	S (Rs.)
Indirect wages	Direct /Allocation	360	120	20
Indirect expenses	Direct /Allocation	30	20	10
Indirect material	Direct /Allocation	480	180	30
Machine depreciation	cost of machine 25:14:1	250	140	10
Employee expenses	Number of employees 6:3:1	120	60	20
Rent	square feet (6 : 3 : 1)	180	90	30
		1 420	610	120
02. Cost of service department	1 : 1	60	60	(120)
Total overhead		1 480	670	-



(03) Overhead absorption rates

Department A	Department B
$\frac{\text{Total estimated overhead costs}}{\text{Estimated direct labour cost}}$	$\frac{\text{Total estimated overhead costs}}{\text{Estimated direct labour cost}}$
$\frac{1480000}{3700} = \text{Rs. } 400$	$\frac{670000}{3350} = \text{Rs. } 200$

03. Cooray furniture shop received an order to produce 1000 chairs. Estimated costs are as follows.

Direct material cost per chair   Rs. 700

Direct labour cost per chair     Rs. 1000

Direct other expenses             Rs. 100

Overhead costs are absorbed based on direct labour cost.

A – 08 Direct labour hours

A – 06 Direct labour hours

(i) Calculate cost per chair

	(Rs.)
Direct material cost	700
Direct labour cost	1000
Direct other costs	<u>100</u>
Prime cost	1800
<b>Overhead cost :</b>	
Dep. A Rs. 400 x 08	3200
Dep. B Rs. 200 x 06	<u>1200</u>
Production cost per chair	<u><u>6200</u></u>

**Instructions to assist learning**

- Present students expenses listed in Annexure 14.7.1
- Instruct them to classify according to the following.
  - Production overhead costs
  - Administration overhead costs
  - Distribution overhead cost
  - Selling overhead costs

- Ask them to suggest the type of cost related in calculating production cost of a unit
- Discuss with the student how to apply above cost on order to calculate unit cost.
- Presents the students clearly process of distributing over head cost. Basis of apportionment.
- Give each student a copy of annexure 14.7.2 related to Naween's business. (3/6 groups)
- Allow them to distribute following by using over head analysis sheet.
  - Primary distribution
  - Secondary distribution
- Provide following overhead absorption rates to each group
  - Direct material basis
  - Direct labour cost basis
  - Machine hour basis
  - Direct labour hour basis
  - Prime cost basis
  - Production unit basis
- Direct hem to calculate overhead cost absorption rate of each department.
- Direct them to search overhead of a flower pot in order to calculate overhead absorption rate give to each group.
- Direct material cost of a flower pot Rs. 1100
- Direct labour cost Rs. 650
- Provide exercise to students in order to calculate cost related to different situations.

#### **Annexure 14.7.1**

##### **List of expenses of overhead costs.**

- Sales representatives salary
- Packing expenses
- Sales commission
- Audit fees
- Office expenses
- Administration salaries and wages
- Machine maintenance expenses
- Factory rent
- Factory supervisors salary
- Motor vehicle insurance
- Advertising expenses

- Factory electricity
- Factory insurance
- Office rent
- Indirect material
- Distribution vehicle maintenance cost
- Production department maintenance cost
- Office equipment depreciation
- Factory rate

#### Annexure 14.7.2

- Following expenses are related to production cost of 1000 plastic follower vases.

	(Rs.)
Building rent	4200
Indirect wages	44 000
Machine maintenance	4400
Machine operation power	21 000
Factory workers expenses	8800

#### Other Information

Item	Procution Department		Stores
	Assesment	Finisting	
Number of employees	05	05	01
Cost of machine (Rs.)	700 000	400 000	-
Machine hours	2 000	1 500	-
Direct labour hours	2 500	2 250	-
Direct Material cost	500 000	600 000	-
Area (sq.mt)	10	10	01
Direct labour cost (Rs.)	250 000	400 000	-
Material requisition notes	10	05	-

## Assessment and Evaluation Criteria

- (i) State whether following statement is true / false
- Total overhead cost means the addition of indirect material, indirect labour and indirect other expenses which cannot be directly identifiable for a cost unit.
- (2) Classify following overhead cost as production or non production.
- Advertising, factory rent, machine depreciation, Electricity, factory insurance, sales commission, fuel, factory wages, office salaries
- (3) Selection of correct sequence of distribution of general overhead cost.
- Collection of cost, allocation, apportionment
  - Collection of cost, allocation, apportionment and absorption.
  - Source document, apportionment and absorption
  - Collection of cost, allocation, apportionment and absorbs to cost unit
  - Collection of cost, primary distribution, secondary distribution and absorption.
- (4) Explain in brief
- Primary distribution
  - Secondary distribution of overhead
- (5) Prepare a overhead analysis sheet, according to accrual basis (all values are in Rupees)

Machine depreciation 40 000

Indirect materials division A - 50 000 B - 40 000

Indirect wages division B - 100 000 B - 60 000

Insurance 10 000

Factory rent 20 000

Supervisory Salary 30 000

Electricity 5 000

Basis of Apportionment	A	B	Service
Machine cost (Rs.)	200 000	100 000	50 000
Area (sq.mt)	300	100	100
No; of employees	50	40	10
Electricity consumed (units)	30	20	10
Value of insurance policy	300 000	100 000	100 000

Service department overhead costs are equally distributed among production departments.  
 Service department overhead costs are equally distributed among production departments.

(6) Following cost are related to one unit of torch.

Direct material               Rs. 900  
 Direct labour               Rs. 400

	(Rs.'000)		
	Finishing	Assable	Stores
Total overhead cost	875 500	414 500	210 000
Material requisition notes	700	500	-
Expected machine hours	25 000	30 000	-
Expected labour hours	10 000	20 000	-

- Overhead costs of finishing and assamble departments are absorbed according to machine hours and labour hours respectively
- Calculate unit cost of a torch

**Competency 15.0 : Supports the management decision making through cost behaviour and cost, volume profit analysis**

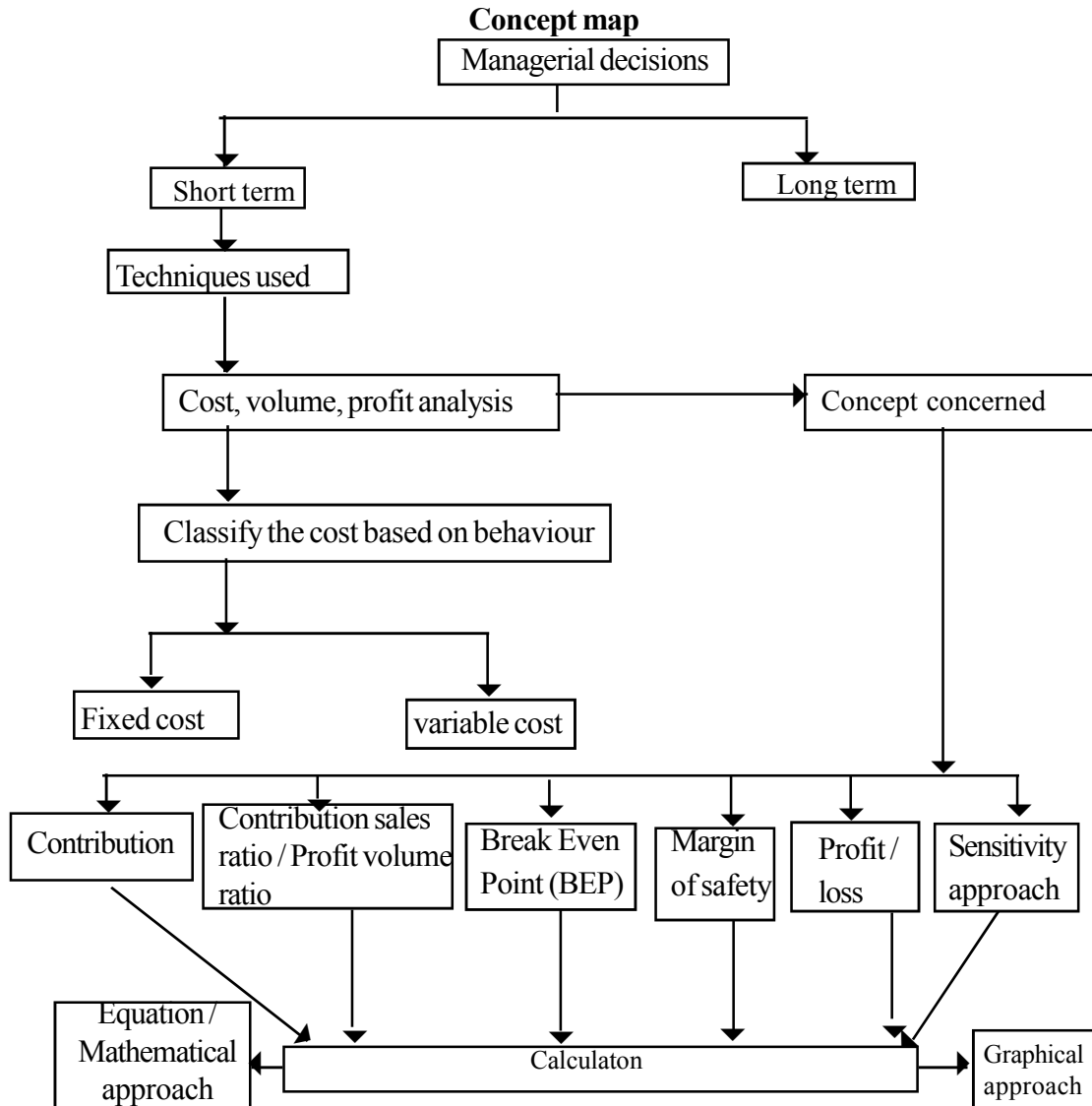
**Competency level 15.1 : Analyses the behaviour of cost**

**No. of Periods : 02**

**Learning Outcomes :**

- Classifies the cost based on behaviour
- Explains the variable cost
- Explains the fixed cost
- Reviews the behaviour of cost through a graph

**Basic terms and concepts**



## Teaching-Learning process

Give the following details to the students

In order to celebrate the commerce day of the college, the school main hall will be used and the maximum capacity of the main hall is 500 sets. Treasure estimates following expenses for this event.

- Stationery for one student – R. 15.00
- Refreshment for one student – Rs. 50.00
- For lighting - Rs. 30 000.00
- For sound systems - Rs. 20 000.00

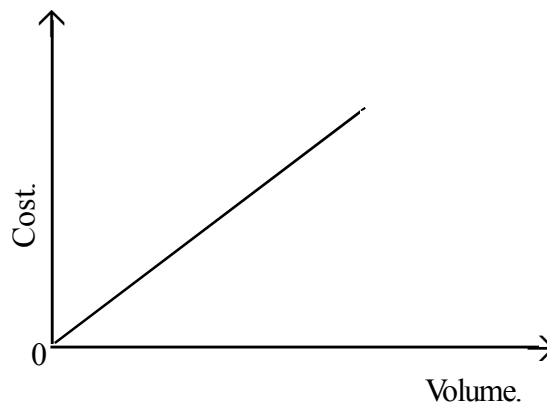
Find out the following information from the above details.

- Identify the costs which are changed with number of students.
- Identify the costs which are not been changed with number of students.
- Explain that the cost which are changed with number of participants is identified as variable cost and the cost which are not changed with number of participants is identified as fixed cost.
- In cost, volume profit analysis, cost is classified only into two categories such as fixed cost and variable cost.
- Show that cost / Income behaves as a straight line with volume.

## Variable cost

The cost which tends to vary in proportion with volume of output is identified as variable cost. This is named as variable cost.

- Eg:
- Commission on sale
  - Direct materials
  - Direct labour

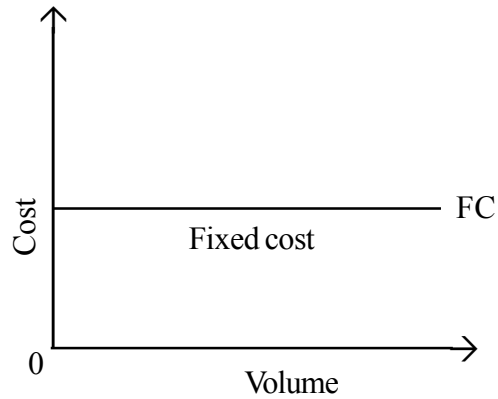


## Fixed cost

The cost which tends to be unaffected by variation of output is identified as fixed cost.

Example : • Rent expense

- Insurance



- For short term decision making purposes, cost classified as fixed and variable.

## Assessment and Evaluation Criteria

- Compare between fixed and variable cost
- Categorize the following cost items as fixed and variable.
  - Annual rent – Rs, 120 000
  - Raw material cost of 10 000 units – Rs. 200 000
  - Sales commission per unit – Rs. 10
  - Salaries of office staff – Rs. 60 000
  - Fuel expense for bus – Rs. 20 000

Create separately

- Total variable cost curve and
- Total fixed cost curve

When volume of output changes from 2000 units to 10 000 units.



**Competency 15.0 : Supports the managerial decision making by analysing the cost behaviour and cost volume profit analysis**

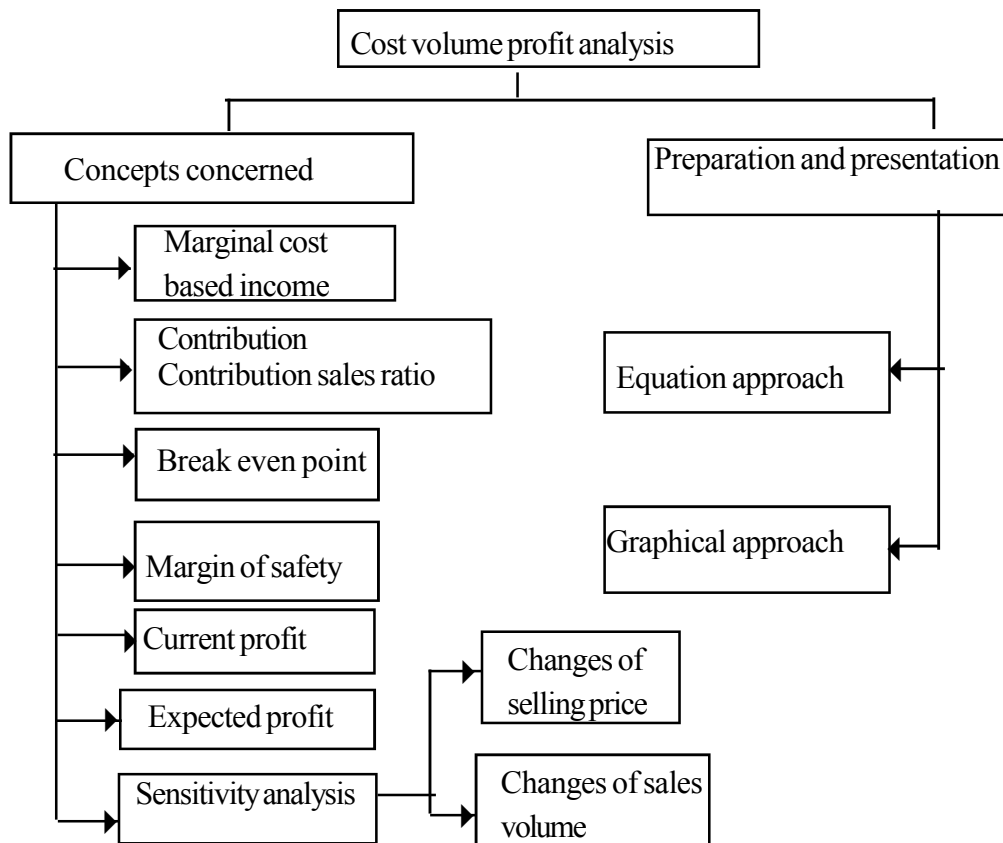
**Competency level 15.2 : Supports the decision making using cost volume profit analysis**

**No. of Periods : 18**

**Learning Outcomes :**

- Calculates contribution per unit
- Calculates total contribution
- Makes decisions by calculating contribution sales ratio
- Calculates Break Even Point in units and in value
- Calculates margin of safety
- Presents cost volume profit analysis in equation form and graphical form.
- Decision making based on cost volume profit analysis
- Show the sensitive items in relation to changes of sales price and sales volume

**Concept Map**



**Guideline for subject matters :**

- Marginal costing means the technique in which variable costs are charged to cost units and fixed costs of the period are written off against the total contribution.
- Marginal cost based income statement
- Income statement is prepared by considering only one product or service and calculate the total profit.

Marginal cost based income statement is as follows.

Income	x
• Variable cost	(x)
• Contribution	x
• Fixed cost	(x)
• Profit	x

- Difference between the income and variable cost is identified as contribution. This could be calculated as unit contribution and total contribution.

**Unit contribution**

Unit selling price	x
Unit variable cost	(x)
Contribution	<u><u>x</u></u>

**Total contribution**

Total income	xx
Total variable cost	(xx)
Total contribution	<u><u>xx</u></u>

- Contribution sales ratio reflects the value of contribution in sales price. This is named as profit volume ratio and sales contribution ratio.

$$\text{Contribution sales ratio} = \frac{\text{Contribution}}{\text{Sales}} \times 100$$

**Example :**

- Current sales units are 10 000 of a product which has a sales price of Rs. 200. When producing 2000 units, total cost is Rs. 400 000. At 3 000 units, total cost is Rs. 550 000

- | Quantity (units) | Total cost (Rs.) |
|------------------|------------------|
| 2 000            | 400 000          |
| 3 000            | 550 000          |

$$\text{Unit variable cost} = \frac{\text{Change of total cost}}{\text{Change of quantity}}$$

$$= \frac{150,000}{1,000} = \underline{\underline{150}}$$

- $$\begin{aligned} \text{Unit contribution} &= \text{Unit selling price} - \text{unit variable cost} \\ &= (200 - 150) \\ &= \underline{\underline{50}} \end{aligned}$$

- $$\begin{aligned} \text{Contribution sales ratio} &= \frac{\text{Unit contribution}}{\text{Unit selling price}} \times 100 \\ &= \frac{50}{200} \times 100 \\ &= \underline{\underline{25\%}} \end{aligned}$$

- Break even points means the level in which a company survives in the market without making any profit or loss.
- Break even units can be calculated by dividing fixed cost from contribution.
- Break even point can be presented as a value and as in units.
- The gap between the present capacity and Break even point is margin of safety and it is the sales which exceeds break even point.
- The margin of safety can be calculated by dividing profit by contribution sales ratio
- Profit is calculated by deducting fixed cost by total contribution
- Total contribution could be obtained by adding profit to fixed cost.

**Example :**

- Present capacity / sales units = 5 000
- Selling price per unit = Rs. 200
- Contribution sales ratio = 40%
- Fixed cost = Rs. 240 000

- Calculate contribution per unit?
- Break even point in value and in units?
- Calculate profit?

$$\text{Contribution} = 200 \times \frac{40}{100} = \underline{\underline{80}}$$

- Break even point (units) =  $\frac{\text{Fixed cost}}{\text{Unit contribution}}$

$$= \frac{240,000}{80}$$

$$= \underline{\underline{3000 \text{ units}}}$$

- Break even point (Rs.) = (3000 x 200/-)
- = Rs.600,000

or

$$= \frac{240,000}{40} \times 100$$

$$= \text{Rs.}600,000 / -$$

- Margins of safety (units) = Present capacity units - Break even units
- = 5 000 - 3 000
- = 2 000 units

- Margins of safety (Rs.) = Margin of safety (units) x Unit selling price
- = 2 000 x 200
- = Rs. 400 000

- Profit calculation = Total contribution - Fixed cost  
 = 400 000 - 240 000  
 = 160 000

- Total contribution =  $\frac{\text{Profit}}{\text{Contribution sales ratio}}$   
 =  $\frac{160000}{40} \times 100$   
 = Rs.400000

- Margin of Safety (Rs.) x contribution sales ratio

$$= \left( 400,000 \times \frac{40}{100} \right)$$

$$\text{Profit} = \underline{\underline{\text{Rs.160,000}}}$$

- Number of units to be produced to achieve an expected profit can be calculated using the following equation.
- Number of units to be produced =  $\frac{\text{Fixed cost} + \text{Expected profit}}{\text{Unit contribution}}$
- According to above examples, if the company expects a profit of Rs. 200 000, calculate the number of units to be produced?

$$= \frac{240000 + 200000}{80}$$

$$= \frac{440000}{80}$$

$$= \underline{\underline{5500}} \text{ Units}$$

### Sensitivity Analysis

- Analysis the changes of different variables which affect over the profit in sensitivity analysis.
- Only the changes of sales value and sales price are considered here.**
- The difference of a single variable is considered into account and therefore the other pretend to be constant.

- Sensitivity analysis could be further explained in following table

	Toal Contribution	Breadk even Point	Margin of Safety	Price
Selling price deduction	Decreases	Increases	Decreases	Decreases
Selling price increased	Increases	Decreases	Increases	Increases
Sales volume deduction	Decreases	no change	Decreases	Decreases
Sales volume increment	Increases	no change	Increases	Increases

Assumption used in cost volume profit analysis

- Cost is classified only as fixed and variable
- Fixed cost is not changed in the short term
- Total revenue and total cost curves are straight lines
- The firm produces only one product
- Technology, production methods and efficiency are not changed.
- Example  
 “Nadeera PLC” producers and sells only one product. Following details are given in relation to that product.
 

Production capacity (units)	8 000.00
Current profit	Rs. 180 000.00
Contribution sales ratio	40%
Fixed cost	300 000.00

Calculate the following

- Margin of safety (Rs.)
- Total contribution
- Break Even point (Rs.)
- Contribution per unit
- Break even point (units)
- Selling price per unit
- Variable cost

**Proposed Answer :**

$$\begin{aligned} 2. \text{ Value of Margin of safety} &= \frac{\text{Profit}}{\text{Profit volume ratio}} \\ &= \frac{180000}{40} \times 100 \\ &= \underline{\underline{Rs.450000}} \end{aligned}$$

$$\begin{aligned} 3. \text{ Total contribution} &= \text{Profit} + \text{Fixed cost} \\ &= 180\,000 + 300\,000 \\ &= \underline{\underline{Rs. 480\,000/-}} \end{aligned}$$

$$\begin{aligned} 4. \text{ Break even point (value)} &= \frac{\text{Fixed cost}}{\text{Profit volume ratio}} \\ &= \frac{300,000}{40\%} \\ &= \underline{\underline{750,000}} \end{aligned}$$

$$\begin{aligned} 5. \text{ Contribution per units (Rs.)} &= \frac{\text{Total contribution}}{\text{Number of units}} \\ &= \frac{480000}{8000} \times 100 \\ &= \underline{\underline{Rs.60}} \end{aligned}$$

$$\begin{aligned} 6. \text{ Break even point units} &= \frac{\text{Fixed cost}}{\text{Contribution per unit}} \\ &= \frac{300,000}{60} \\ &= \underline{\underline{5,000 \text{ unit}}} \end{aligned}$$

$$\begin{aligned}
 7. \text{ Selling price per unit} &= \frac{\text{Break even sales}}{\text{Number of units}} \\
 &= \frac{750,000}{5000} \\
 &= \underline{\underline{Rs. 150}}
 \end{aligned}$$

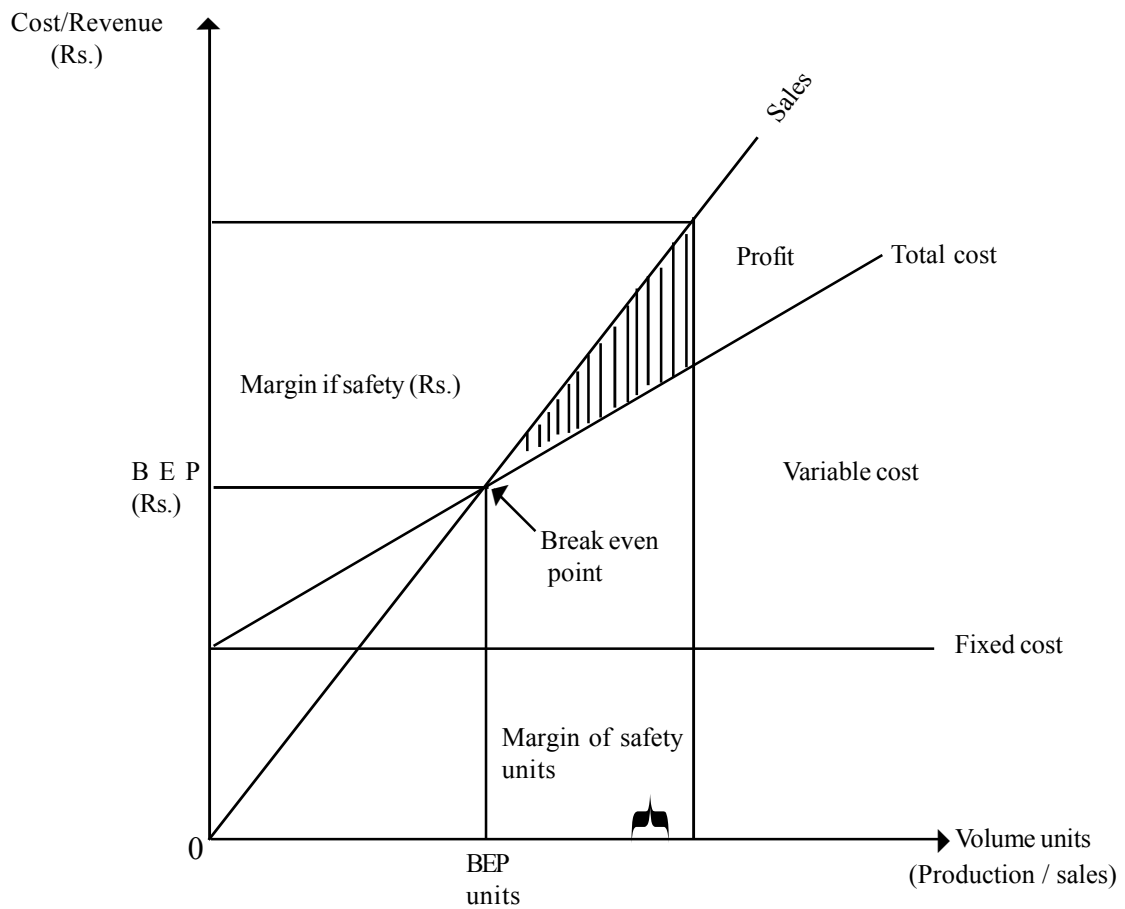
$$\begin{aligned}
 8. \text{ Variable cost per unit} &= \text{Selling price per unit} - \text{contribution per unit} \\
 &= \text{Rs. 150} - \text{Rs. 50} \\
 &= \underline{\underline{Rs. 90}}
 \end{aligned}$$

- Cost volume profit analysis could be presented through equation form as above as well as graphical form.
- In the graphical approach, vertical axes represents cost and revenue and the horizontal axes represents volume.
- Cost volume profit analysis could be illustrated using following graphs.
- Traditional break even point graph
- Contribution break even point graph
- profit volume chart

### **Traditional Break Even point graph**

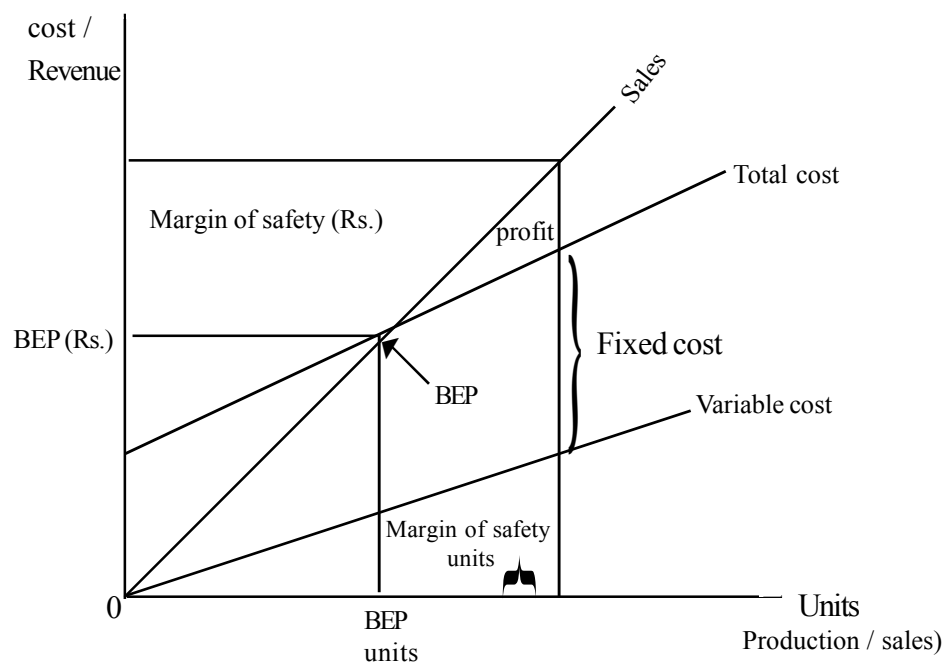
Total revenue line, total cost line and fixed cost line are necessary in the graph.





### Contribution Break Even point graph

Only the revenue line, variable cost line and total cost line are essential in the graph.

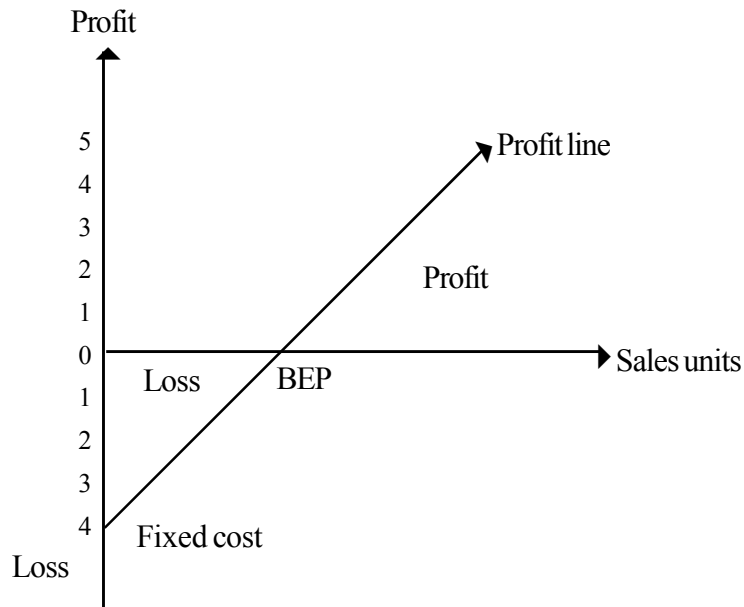


### Profit volume chart

Profit volume chart is drawn to show the profit at each sales level.

The graph represents Break even point in units and fixed costs.

In the vertical axes, fixed cost and profit & loss are represented.



- Following are the direct material costs of a bottle of mixed fruits prepared by “anoja” manufacturing company.

	(Rs.)
Pineapple	150.00
Apple	100.00
Grapes	200.00
Sugar	150,00

- Direct labour cost per bottle is Rs. 200.
- Following expenses are needed to be incurred in the production and distribution process.

Production overhead cost	180 000
Administration overhead cost	120 000
Distribution overhead cost	100 000

- It is estimated to price 4000 bottles. Selling price of a bottle is Rs. 1000.
- Calculate the following using above information
  - Total variable cost
  - Total fixed cost
  - Total cost
  - Cost per unit
  - Contribution per unit
  - Total profit
  - Break even number of bottles
  - Number of bottles at margin of safety
  - Value of margin of safety
- The management of this company was received an order of 200 bottles for an event organized by a youth club. If this order is supplied, an additional overhead cost of Rs. 20 000 needed to be incurred. A bottle is demanded for Rs. 600. Mention whether this order is accepted or not with reasons.
- It is expected to increase the production and sales by 20% in the following month. although the variable cost remains unchanged fixed cost will be increases by Rs. 5000. If the company expected a profit of Rs. 630 000, mention the price at which a bottle should be sold?

**Evaluation and assignment criteria.**

- Calculation of break even point.
- calculate contribution sales ratio
- Create traditional break even point chart
- At the production level of 1000 units, loss of a company is Rs. 30 000. At the production level of 4000 units, profit is Rs. 30 000. calculate profit volume ratio?
- Break even point of a company is 12000 units.  
Fixed cost is Rs. 150,000.  
Create profit volume chart.

**Competency 16.0 : Supports the capital investment decision making**

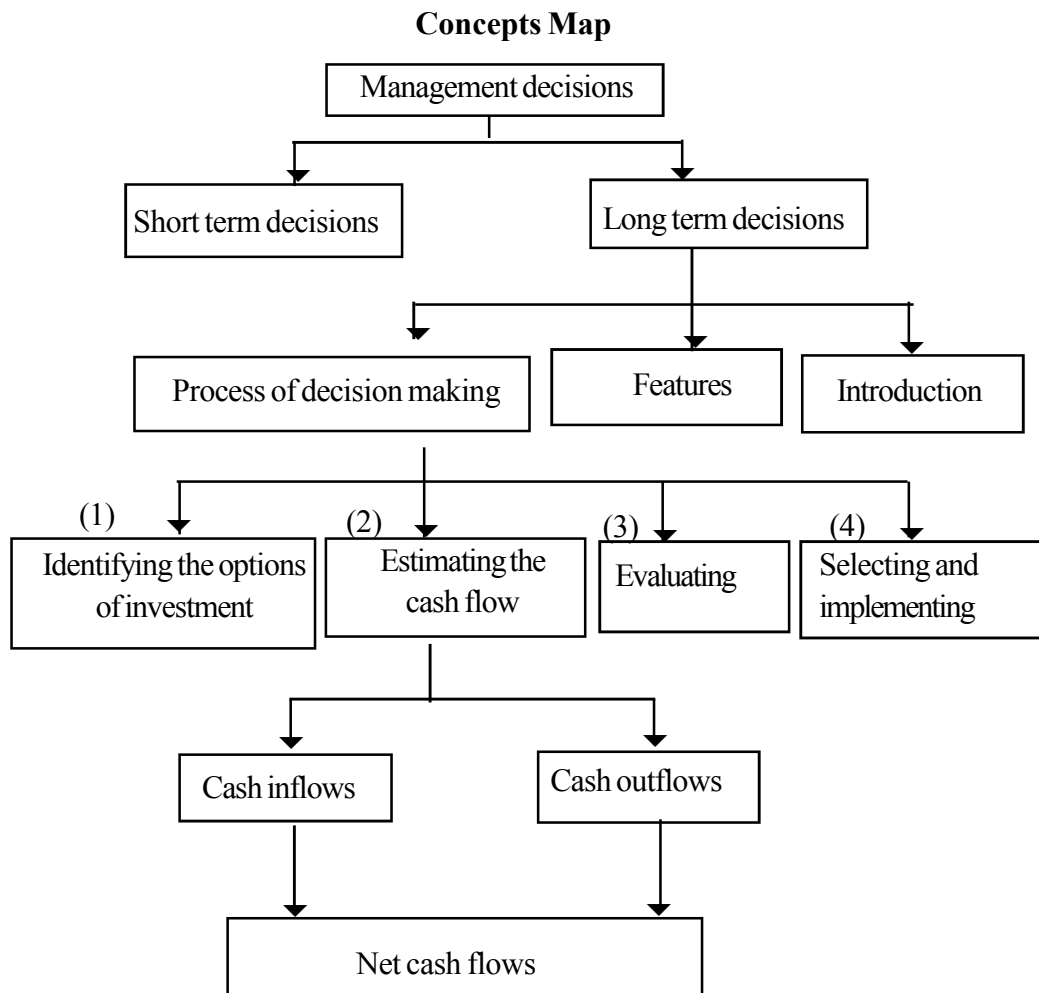
**Competency 16.1 : Plans the process of long term decision making**

**Number of Periods : 04**

**Learning outcomes :**

- Defines long term decisions
- Process of long term decisions making
- Identifying cash flow estimations relates to long term decisions and calculates net cash flow

**Main terms and concepts :**



**Guidance for subject matter :**

- Present 16.1.1. attachment for students to approach for this competency level.
- categorize the decisions as short term and long term
- Give each group a long term decision after recognizing the long term decisions.
- Guide students to present examples of cash inflows and cash outflows if each of the decisions are implemented.

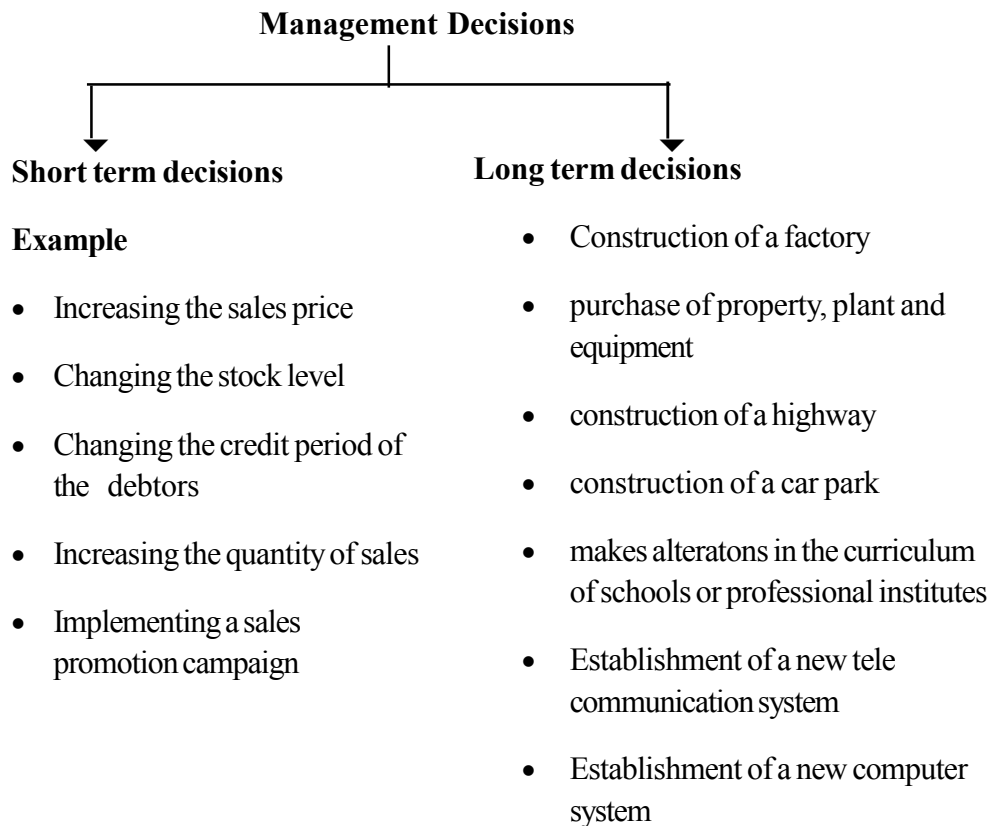
A table like below can be used for that

Decision	Cash flow	
	Cash inflows (Rs.)	Cash outflows (Rs.)

- Guide students to categorize the cash flows under following situations.
  1. Initial investment cash flows
  2. Operating cash flows
  3. Terminal cash flows
- Calculate net cash flows received by each group
- Give the opportunity to present the answers of each group
- Revise on subject matters after their presentations
- Defining long term decisions
- Categorize the long term decisions
- Mentioning the steps of long term decision making process.
- Estimating the cash flows by implementing long term decisions.
- Calculating net cash flows.

## Subject Matters

Decision of a business can be considered as follows :



### 01). Long Term Decisions

- The decision of a company in long term agreement is called investment decision. Company expects economical results within subsequent years through such a decision.

By constructing a factory.

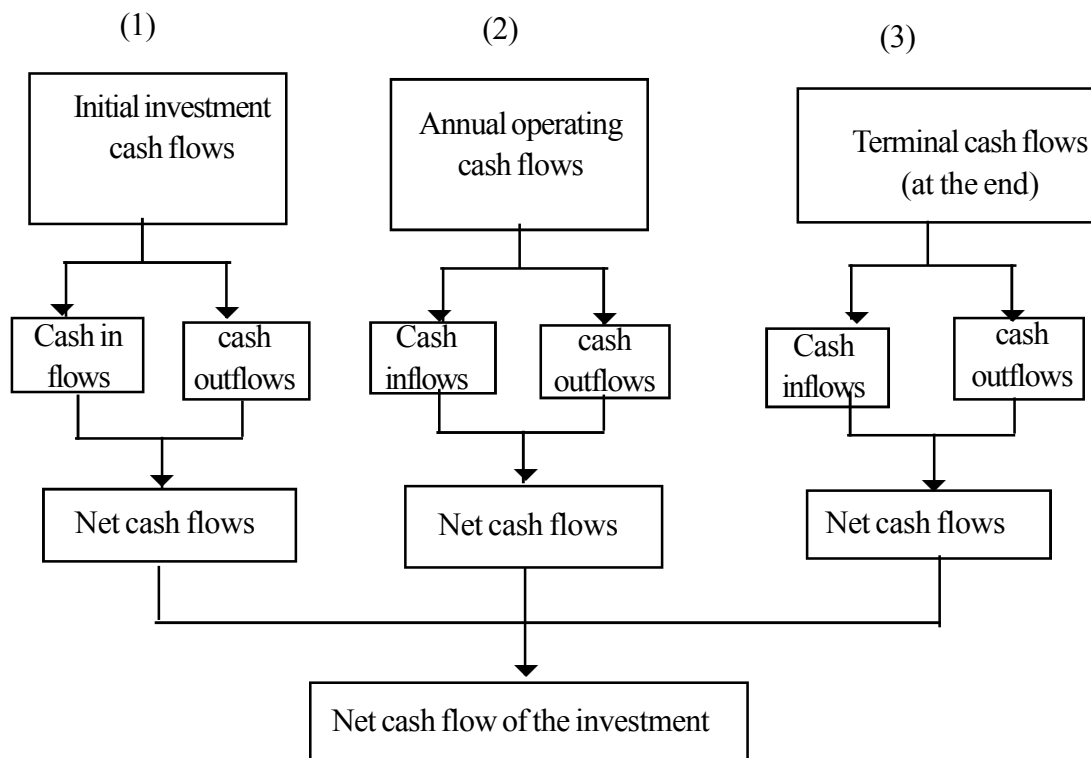
- Can engage in manufacturing
- Uses long term
- Earns income by selling products

### 02) Characteristics of long term decisions

- Expected scale of investment is large
- Risk due to long term
- Decisions are unchangeable /unalterable (a wrong decision couldn't be able change)
- Funds are necessary throughout the long term

## Long term decision making process

- A high consideration should be given on the decision since it affects a long term. Therefore the following steps should be followed in making long term decisions.
  1. Identifying the alternatives of investment
  2. Establishing the cash flows of alternatives
  3. Evaluating the alternatives
  4. Selecting and Implementing the suitable project
- Estimation of cash flows and evaluation of investments are considered as the most important steps to be made.
- Important sectors with cash flows estimation



Important factors when considering cash flows.

1. Consider after tax cash flows
2. Only the incremental cash flows are considered. It means, not the existing cash flows, the cash flows which are increased due to investment considered here.
3. Includes all the cash flows happened due to indirect effects to the investment.
4. Sunk cost (The cost which already incurred) is not considered as a cash flow.
5. Interest is not included in cash flows
6. Deprecation and non cash expenses are not considered as cash flows.

### Initial investment cash flows

		(Rs.)
• Investment (new asset) purchasing price		xxx
• Transportation and installation costs		xx
• Initial working capital requirements		xxx
		<hr/>
		xxx
• (-) cash received from selling the existing asset	xx	
• Tax payable when selling the existing asset	(x)	(xx)
• Initial next cash flow		xxx
		<hr/>
		<hr/>

### Example :

	(Rs.)
Cost of existing machine	250 000
Purchasing price of new machine	500 000
Expected sales price of existing machine	100 000
Payable tax on the selling price of the existing machine	200 000
New working capital requirements	75 000
Installment cost of the new machine	50 000

### Requirements :

1. Calculate the cash inflows and cash outflows of initial investment
2. Calculate the net cash flow of initial investment



### Solution

1. Cash inflows	(Rs.)	Cash outflows	(Rs.)
Sales price of old machine	100 000	Cost of new machine	500 000
(-) Tax Payable	(20 000)	Cost of establishment	50 000
	<u>80 000</u>	New working capital requirement	75 000
			<u>625 000</u>

$$\begin{aligned} 2. \text{ New cash flow of initial investment} &= \text{cash out flows} - \text{Rs. 545 000} \\ &(\text{Rs. 625 000} - \text{Rs. 80 000}) \end{aligned}$$

### Annual operating cash flows

There are the cash inflows and cash outflows during the useful life time of the investment by using it in the production process.

### Examples :

- Cash sales
- Cash receipt from debtors
- Cash purchases
- Cash payments to creditors
- Cash payments for operations
- Fixed assets maintenance expenses except depreciation
- Taxation

### Other payments related to operations

The difference between cash inflows and cash outflows are identified as operating net cash flow.

### Example 02

following are the cash flows of an asset of its useful lifetime of 5 years.

(1) increments of sales income

Year	(1)	(2)	(3)	(4)	(5)
(Rs.)	500 000	500 000	600 000	700 000	800 000

(2) Estimation of annual purchasing expenses

	(1)	(2)	(3)	(4)	(5)
(Rs.)	180 000	180 000	190 000	200 000	240 000

(3) during the first year, electricity expenses increased by 3000 and in the subsequent years increased by Rs. 1000 each period.

(4) During the first year, operating expenses increased by Rs. 4000 and in the subsequent years by Rs. 1000 each period.

(5) Annual depreciation Rs. 5000

(6) It is expected to incur a repair expense of Rs. 15 000 in the third year.

(7) 10% tax payable on profit.

Calculate annual net cash flow of operations.

**Solution :** First, profit before tax should be calculated.

Cash flow item \ Years	01	02	03	04	05
Sales Income Statement	500	550	600	700	800
Total Income	500	550	600	700	800
Purchase (Rs.)	(180)	(180)	(190)	(200)	(240)
Electricity Expenses (Rs.)	(3)	(4)	(5)	(6)	(7)
Operating Expenses (Rs.)	(4)	(5)	(6)	(7)	(8)
Depreciation	(5)	(5)	(5)	(5)	(5)
Repair Expenses	-	-	(15)	-	-
Total Expenses (Rs.)	(192)	(194)	(226)	(218)	(260)
Profit before Tax	308	356	379	482	540
Tax (10%)	(30.8)	(35.6)	(37.9)	(48.2)	(54)
Profit for the period	277.2	320.4	341.1	433.8	486
(+) Depreciation	5	5	5	5	5
Net cash flow of operations	282.2	325.4	346.1	438.8	591

### Terminal cash flows

Cash inflows and cash outflows at the end of the investment is identified as terminal cash flows.

#### Example :

- Residual value of the investment
- Recovery of working capital

Profit	Cash outflows
1. Total income and total expenses are considered	Cash inflows and cash outflows are considered
2. Accrual basis is used	Cash basis is used
3. Calculates net profit / loss	Calculate net cash flow
4. Items which are not inflows and outflows are included.	Non cash items are removed
5. capital nature items are not included.	<b>Example :</b> Bad debts, depreciation, discount allowed. Capital nature items are included

#### Evaluation and assignment criteria :

- Defining long term decisions
- Categorize long term decisions
- Steps of long term decisions making process
- Estimating the cash flows derived by implementing long term decisions.
- Calculating net cash flows.
- Give examples for cash flows
- Give with examples on how to calculate cash flows when net profit is given.
- Name the situations in which cash flows occur in a business
- What are the factors to be considered in calculating cash flows?
- Given below are the details of a machine which a company expects to purchase.
  - Purchasing price Rs. 750 000
  - Installation cost Rs. 50 000
  - Initial working capital requirement Rs. 50 000

This could be recovered at the end of the period

- It is estimated that the existing machine could be sold for Rs. 20 000
- Information regarding the machine are as follows.
- First year is Rs. 150 000 and it will be increased by 10% each year. Increasing of expenses in the first year is Rs. 50 000, In the second and third years it is increased by 10% each and fourth and fifth years it is decreased by 10%
- Annual machine depreciation Rs. 140 000
- Taxation on profit 40%
- Useful life time of the asset is 5 years and residual value is Rs. 50 000

**Requirements :**

1. Calculate the value of initial investment?
2. Calculate annual operating net cash flow?
3. Calculate terminal cash flow?
4. Show the table of calculating cash flows in 5 years.

**Competency 16.0 : Support the capital investment decision making**

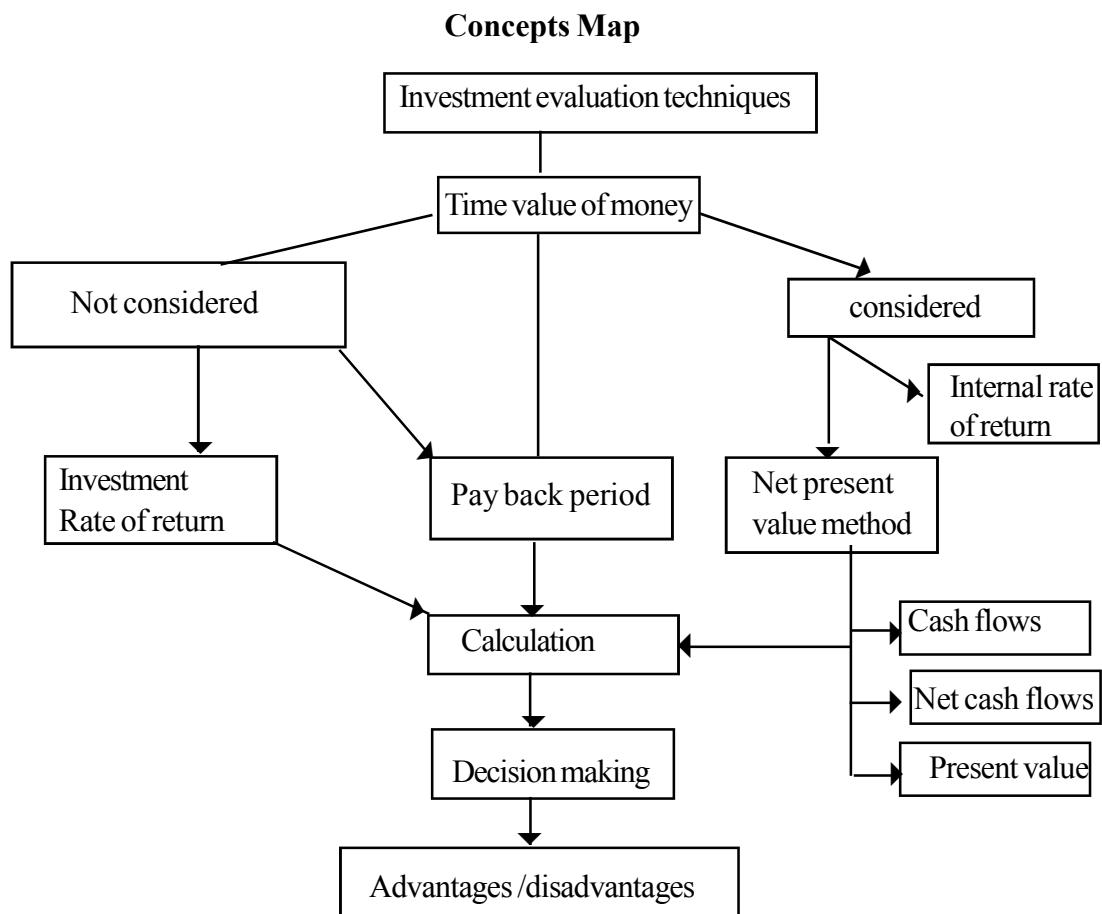
**Competency 16.2 : Supports to make investments decisions by using different capital evaluation methods.**

**Number of Periods : 16**

**Learning outcomes :**

- Names the various capital evaluation techniques.
- Makes decisions on Accounting rates of Return.
- Makes decisions on Pay back period.
- Defines relevant and irrelevant costs.
- Defines time value of money.
- Explains net present value method.
- Makes decisions on net present value.
- Mentions the advantages and disadvantages of capital evaluation techniques.

**Main terms and concepts :**



- **Subject matters :**

Before selecting investments those should be evaluated using various techniques. The evaluation techniques are categorized using time value of money.

**Time value of money**

The value of money which received today is higher than the value of money which will be received in the future is identified as time value of money. The time value changes due to interest or investment costs.

- There are two techniques which do not consider the time value of money
  1. Investment rate of return method.
  2. Pay back period method

**Investment rate of return method (Accounting rate of return)**

This method means the rate of return for the investment.

When calculating this method, cash flows and time value of money are not considered.

only the profit for the period (profit after tax) has been considered.

$$\text{Accounting Rate of Return} = \frac{\text{Average net profit after tax}}{\text{Average investment}} \times 100$$

$$\text{Average net profit after tax} = \frac{\text{Total of the profit after tax during the life time of investment}}{\text{Number of years.}}$$

$$\text{Average investment} = \frac{\text{Value of initial investment} + \text{value of investment of the end}}{2}$$

2

**Example :**

- Initial investment is Rs. 200 000. It is estimated that at the end of the three periods the value of the investment will be Rs. 80 000.

- Profit for the three periods.

		Rs.
1	-	100 000
2	-	120 000
3	-	80 000

$$\text{Calculate investment rate of return} = \frac{100 + 120 + 80}{3} = \frac{300}{3}$$

$$\text{Average net profit after tax} = \frac{300}{3} = 100$$

$$= \frac{200,000 + 80,000}{2}$$

$$\begin{aligned} \text{Average Investment} &= \frac{280,000}{2} \\ &= 140,000 \end{aligned}$$

$$\begin{aligned} \text{Investment rate of return} &= \frac{\text{Average net profit after tax}}{\text{Average investment}} \times 100 \\ &= \frac{100,000}{140,000} \times 100 \\ &= 71.4\% \end{aligned}$$

If the value of this investment at the end is 0.

$$\begin{aligned} \text{Investment rate of return} &= \frac{100,000}{\frac{200,000 + 0}{2}} \times 100 \\ &= \frac{100,000}{100,000} \times 100 \\ &= 100\% \end{aligned}$$

How to make decisions based on investment rate of return?

- If there is a pre determined accounting rate of return, the investments which have a higher rate of return that value should be selected. (should invest money)
- If there are two or more investment opportunities, investments which have high returns should be selected.

### **Advantages and disadvantages of Investment Rate of Return**

#### **Advantages**

1. It is easy and simple in calculating
2. Can be implemented with low cost.
3. No need of calculating the cash flows since this is based on profits)
4. Easy to select investments which gives high returns.

#### **Disadvantages**

1. Time value of moneys not taken into account.
2. Cash flows are not considered.
3. Errors in calculating the profit are directing after since this method is based on profit.

#### **2. Pay back period method.**

- The period which takes to payback the cash of cost which is affiliated with the project is identified as pay back period.
- Pay back period is calculated based on annual net cash flows of the investment.
- this method does not consider the time value of money.

There are two ways in receiving annual cash flows.

1. Receiving equal cash flows every year.
2. Receiving changing cash flows every year.

How to calculates the pay back period.

1. if future net cash flows are equal every period.

$$\text{Pay back period} = \frac{\text{Initial investment}}{\text{Annual net cash flow}}$$



Calculation of pay back period during an abnormal privilege of net cash flows.

$$\text{Pay back period} = \frac{\text{Net cash flow of the next period}}{12 \text{ month}}$$

**Example :**

1. A company expects to invest in an investment which has a value of Rs. 250 000 and expected annual cash flows are Rs. 50 000 every year. Calculate pay back period

$$\begin{aligned} \text{Pay back period} &= \frac{\text{Initial investment}}{\text{Annual net cash flows}} \\ &= \frac{250000}{50000} \\ &= \underline{\underline{5 \text{ Years}}} \end{aligned}$$

2. A company expects to purchase two machines. The net cash flows related to these two machines are as follows. Purchasing price of both the machines is Rs. 50 000.

Years	Net cash flows (Rs.)	
	Machinery A (Rs.)	Machinery B (Rs.)
1	80 000	80 000
2	80 000	70 000
3	70 000	90 000
4	90 000	50 000
5	60 000	40 000

Decide on which machine to be purchased on pay back period?

**Solutions :**

Years	Net cash flows Machine A (Rs.)	Accumulated net cash flows Machine A (Rs.)	Net cash flows machine B (Rs.)	Accumulates net cash flows Machines B (Rs.)
0		(300 000)		(300 000)
1	80 000	(220 000)	80 000	(220 000)
2	80 000	(140 000)	70 000	(150 000)
3	70 000	(70 000)	900 00	(60 000)
4	900 00	20 000	50 000	(10 000)
5	600 00	80 000	40 000	30 000

:

Machine A

Machine B

$$3 \text{ years} + \frac{70000}{90000} \times 12$$

$$4 \text{ years} + \frac{10000}{40000} \times 12$$

$$3 \text{ years} + \frac{28}{3} \text{ Months}$$

$$4 \text{ years} + 3 \text{ Months}$$

$$\text{Pay back period} = \underline{\underline{3 \text{ years and 9 months}}}$$

$$= \underline{\underline{4 \text{ years and 3 months}}}$$

Machinery is suitable to be purchased due to less pay back period.

- Decision under pay back period**

Should select the investment which has a less pay back period.

- Advantages and disadvantages of pay back period**

Advantages	Disadvantages
<ol style="list-style-type: none"> <li>1. consideration of cash flows</li> <li>2. invested amount could be received quality</li> <li>3. Implementation cost is less</li> <li>4. Easy to calculate</li> <li>5. Awareness is low</li> </ol>	<ol style="list-style-type: none"> <li>1. Not considering the time value of money</li> <li>2. Not considering all cash flows</li> <li>3. Cash flows gained after the pay back period is avoided from the account.</li> </ol>

- **Net Present Value Method (NPV)**

This could be identified as the best method for evaluating investments.

There are few steps to be followed to calculate Net Present Value such as,

1. Calculate cash flows
2. Calculate net cash flows
3. Find out present value
4. Find out Net present value

### **Present value**

This is identified as the today's value of future cash flows.

from time value of money we have understood that the present value of future cash flows are present value is calculated by discounting and it means the process of decreasing the value. Discounting value table will help you.

#### **Example :**

Year	10% discounting factor	Net cash flows
0	1.000	(50 000)
1	0.909	40 000
2	0.826	30 000
3	0.751	30 000

- Year “0” means the present moment. Therefore present value of (Rs. 50 000) is (Rs. 50 000).
- At the end of the first year cash flow is Rs. 40 000 and its present value is  $0.909 \times 40\,000$  Rs. 36 360.
- At the end of the second year cash flow is Rs. 30 000 and its present value is  $0.826 \times 30\,000 =$  Rs. 24 780.
- At the end of the third year cash flow is Rs. 30 000 and its present value is  $0.751 \times 30\,000 =$  Rs. 22 530.
- By adding the period values, Net present value is calculated.

### Decision based on Net Present value

If the Net Present Value is positive it is suitable to accept the project (Invest in the project).

- if there is only one investment and it has a positive NPV, it is advisable to accept the project.
- If there are few more investments it is advisable to accept the project which has the highest NPV.

### Advantages and disadvantages of Net present value.

#### Advantages :

1. This method considers all the cash flows.
2. Can select the time value discounting factors.

#### Disadvantages :

1. Need to calculate cash flows
2. It is difficult to select the correct discounting factor.

How to make decisions by calculating present value and Net Present Value.

- (i) Calculate the present values of following cash flows based on 10% discounting factors.

Year	Net Cash Flow (Rs.)
1	10 000
2	25000
3	15000
4	10000

10% discounting factor

Year	0	01	02	03	04
Discounting factor	1.000	0.909	0.826	0.751	0.683

**Solution :**

Years	10% Discounting factor	Net cash flows	Present value
01	0.909	10 000	9 090
02	0.826	25 000	20 650
03	0.751	15 000	11 265
04	0.683	10 000	6 830
<b>Total present value</b>			<b>47 837</b>

- (ii) In the above example, if it is expect to purchase a machinery for a value of Rs. 60 000. write the decision by calculating Net Present Value?

**Solution**

Years	10% Discounting factor	Net cash flows	Present value	
00	(60 000)	1,000	(60 000)	(60 000)
01	10 000	0.909	9 090	
01	25 000	0.826	20 650	
03	5 000	0.726	11 625	
04	10 000	0.683	6 830	47 580
<b>Total present value</b>				<b>-12 165</b>

It is not suitable to purchase the machinery since Net Present value is negative.

Net Present value is defined as the difference between totals of present values and present value of initial investment.

Net Present value = Total present values of net cash flows - Present value of initial investment

**Relevant cost and Irrelevant cost**

Relevant cost are the costs which are changed from option to option. When comparing investments.

In order words, these cost are not stable with options.

### Example

- Labour costs and electricity expenses are changed from option to option. These are called relevant costs.

Rent, insurance premiums are not changed from option to option. These are called irrelevant cost.

Costs which have been already incurred are called as **sunk cost**.

### Guidance on activity plan :

- Present the following question to students. Do you need Rs. 5 000 now? or next week? Explain the students that it is better to get Rs. 5 000 now and the reasons, which they provide write on board.
- Conduct a discussion with students to highlight following factors.
- It is most suitable to reserve an amount today than in future
- By investing that an amount could generate an interest.
- The value of cash received today is higher than received that amount in a future date and it could be identified as the time value of money. value of Rs. 5 000 received today is higher, than the value of Rs. 5 000 which will be received in the future.
- **The main reason for this time value of money interest or cost of capital.**
- Present value of future cash flows should be found by discounting it from a discounting factor.

A company expects to purchase two machineries and the details as follows.

#### Cash flows

	Machine X	Machine Y	10% discounting Factor
New purchasing price	300 000	300 000	1.000
First year	90 000	80 000	0.909
Second year	100 000	90 000	0.826
Third year	150 000	100 000	0.751
Fourth year	150 000	90 000	0.683

- Guide students to calculate present value of initial investment.
- Guide them to calculate present values of years 1, 2, 3 and 4
- Advise them to deduct present value of initial investment by present values of future cash flows.
- The difference is Net Present Value
- Advise them to make the purchasing decision based on net present value.
- Discuss the reasons for that decision.
- Calculate NPV of the other group and confirm whether their answers are correct.
- After confirming, present the subject matters to the class.
- Discuss with students few more examples.

#### **Evaluation and Assignment criteria**

- Name investment evaluation techniques
- Calculate accounting rate of return
- Make the decisions on payback period
- Explain time value of money
- Make the decisions on present value and net present value
- Mention the advantages and disadvantages of investment evaluation techniques
- Make the decisions based on various evaluation techniques.

#### **Exercises :**

01. Pay back periods of two expected investments are given below.

Investment 1 – 4 years and 3 month

Investment 2 – 4 years and 1 month

Mention the investment to be accepted and write the reasons.

**Exercise :**

1. There are two options for a business to invest their money. Details are as follows.

	First investment (Rs.)	Second investment (Rs.)
Investment cost	500 000	500 000
Profit year1	90 000	80 000
year 2	100 000	100 000
year 3	150 000	150 000
year 4	120 000	170 000

The values of each investment at the end are Rs.100 000 and Rs. 200 000 respectively.

**Requirements**

1. Calculate accounting rate of return of each investment?
  2. Mention with reasons the investment to be selected.
02. Given below are the net cash flows of a firm which expects to purchase two machines with values of Rs. 300 000 each.

**Net cash flow (Rs.)**

Year	Machine X	Machine Y
1	60 000	100 000
2	80 000	175 000
3	100 000	100 000
4	150 000	80 000

1. Calculate pay back period of each machine?
  2. mention the machine to be purchased with reasons.
- (03) (i) Discount the net cash flows of above x and y machines using 10% discounting factor and calculate net present value?
- (ii) Mention the machine to be purchased on Net Present Value?



10% discounting factor

Years	0	1	2	3	4
	1.000	0.909	0.826	0.751	0.683

(04) “Saroma garment factory” expects to purchase a new machine future and it costs Rs. 150 000. Expected future cash inflows and outflows of this machine as follows.

Years	1	2	3	4
Cash inflows	160 000	180 000	150 000	160 000
Cash outflows	100 000	150 000	100 000	90 000

12% discounting factor

	0	1	2	3	4
	1.000	0.893	0.797	0.712	0.636

#### Requirements :

1. Calculate pay back period.
2. Calculate Net present value
3. Purchasing decision based on Net Present value
4. Mention the maximum price which the company wishes to pay for the machine.

(05) Write **true or false** of following statements.

1. Time value means the value of cash received in future are lower than the value of cash received today (.....)
2. Initial investment of a project is rs 500 000. Cash flow of the first year is rS. 30 000. Discount factor is 10%. Net present value of this investment is a negative value.

- (06) Details regarding two machines which could be used in a specific task have been given below

	Machines 1	Machines 2
Initial investment	600 000	600 000
Annual rent	100 000	100 000
Profit in the first year	250 000	400 000
Profit in the second year	560 000	600 000
Profit in the third year	600 000	800 000

**Requirements :**

1. Calculate annual cash flows?