Chapter 01 -

Elements & Components of Financial Statements and adjustments for financial statements

Elements of Financial Statements

01. Assets	Present economic resources controlled by the entity as a result of past event
02. Liabilities	Present obligations of the entity to transfer economic resources as a result of past events
03. Equity	The residual interest in the assets of the entity after deducting all its liabilities
04. Income	Increase in assets or decrease in liabilities, that result in increase equity, other than those relating to contributions from holders of equity claims
05. Expenses	Decrease in assets or increase in liabilities that result in decrease in equity other than those distribution to the owners

Components of Financial Statements

01. Statement of financial position
02. Statement of comprehensive income
03. statement of changes in equity
04. statement of cash flow
05. Notes & disclosures

Different measurement methods

01. Historical cost	Cost of buying in ordinary business
02. Current cost	Cost that is currently payable, if you buy an asset or similar.
03. Realizable / settlement value	The value after subtracting the further estimated costs in the normal course of operations and the estimated cost of sale from the estimated sale price.
04. Present value	The current discounted amount of net cash inflows, including estimated sales that can be sold in the normal course of business.

Financial Statements of a sole proprietorship business

.... Business
Statement of profit or loss
For the year ended 31.03.2026

Sales Income (Sales – Returns Inward)			XXX
(-) Cost of Sales			
Opening Inventory		XXX	
Purchases of Finished Goods / Total Production Cost	XXX		
(-) Return Outwards	(XX)	XXX	
Carriage Inwards		XXX	
Other direct expenses relating to purchases		XXX	
Cost of the goods to be sold		XXX	
(-) Costs of the goods unable to be sold			
Unrecorded Goods Drawings	(XXX)		
Closing Inventory	(XXX)	(XXX)	(XXX)
Gross Profit/ (loss)			XXX
+ Other Income			
Discounts Received		XXX	
Profit from disposal of assets			
Investment Income (Interest/ Dividend/ Rent)		XXX	XXX
			XXX
Distribution Expenses			
Advertising Expenses	XXX		
Bad and Doubtful debt	XXX		
Discounts Allowed	XXX		
Depreciation of distribution vehicles	XXX		
Sales Commission	XXX		
Carriage Outwards	XXX	XXX	
Administrative Expenses			
Salaries & Wages – Admin Staff	XXX		
Building rent & rates	XXX		
Electricity expense	XXX		
Insurance expense	XXX		
Bank Charges	XXX		

Furniture Depreciation	XXX		
Depreciation of Buildings	XXX		
EPF & ETF of Admin staff	XXX	XXX	
Other Expenses			
Inventory Write off	XXX		
Loss on damages of inventory	XXX		
Donations	XXX	XXX	
Finance Expenses/Cost			
Bank Loan Interest	XXX		
Bank Overdraft Interest	XXX	XXX	(XXX)
Net profit / (loss) for the year / period			XXX

.... Company
Statement of Financial Position
As at 2026/03/31

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Assets **Non-Current Assets**	**Cost**	**Accumulated Depreciation**	**Carrying Value**
Lands	XXX	-	XXX
Building	XXX	XXX	XXX
Motor Vehicles	XXX	XXX	XXX
Machinery	XXX	XXX	XXX
Furniture and Fittings	XXX	XXX	XXX
	XXX	XXX	XXX
Long term investments			XXX
Current Assets			
Inventory		XXX	
Trade Receivables	XXX		
(-) Provision for doubtful debts/Provision for impairment	(XXX)	XXX	
Prepaid expenses		XXX	
Accrued Income/ Income receivables		XXX	
Cash and Cash equivalents		XXX	XXX
Total Assets			XXX
Equity & Liabilities			
Capital		XXX	

(+) Net profit / (loss)	XXX	
(-) Drawings	XXX	XXX
Non-Current Liabilities		
Long term loans	XXX	XXX
Current Liabilities		
Trade Payables	XXX	
Accrued Expenses	XXX	
Advances Received	XXX	
Bank Overdraft	XXX	XXX
Total Equity & Liabilities		XXX

Adjustment Entries

01. Closing stock
02. Accrued Expenses & prepaid expenses
03. Income receivable & deferred income (advanced income)
04. Bad debt & recovery of bad debt written off
05. Doubtful debt provision
06. Non-current asset disposal & depreciation
07. EPF & ETF, APIT
08. Drawings made by owner (Cash / Goods)
09. Damaged goods and insurance proceeds
10. VAT, WHT

Closing Stock

01.

Closing Stock Acc Dr
Trade Account Cr

Extracts from final accounts are as follows,

Trade Account	
Opening Stock	xxx
Add: - Purchases	xxx
Add: - Carriage inwards	xxx
Stocks presented for sale	xxx
Less: - Closing Stock	(xxx)
Cost of Sales	xxx
Statement of Financial Position	
Current Assets	
Closing Stock	xxx

2. When Cost of the Closing Stock and its Net Realizable Value is given

Net Realizable value is the value of the closing stock after deducting all expected completion and sale costs from expected future sale proceeds of the closing stock.

Net Realizable Value = Expected Future Price of the stock - Expected completion and sale costs of the stock

This may result in cost being less than net realizable value or net realizable value being less than cost.

3. Double-entry when both cost and net realizable value of the closing stock is given and net realizable value is higher than cost,

In such instances net realizable value should be ignored and recorded only on cost. Accordingly,

Closing stock Account	Debit	
TradeAccount		Credit

4. When both cost and net realizable value of the closing stock is givenand net realizable value is less than cost,

Closing stock Account	Debit (On net realizable value)	
Profit and Loss Account	Debit (Difference between cost and net realizable value)	
Trade Account		Credit (On cost)

Question 01

In the business of Mr. Lal for the period ended from 31st March 2019 closing stock has been valued and its net realizable value is ascertained as Rs. 450,000. If according to the books, the cost of this closing stock is Rs. 540,000, relevant double entry is,

Accrued Expenses

Relevant expense Acc Dr

Relevant expense payable Account Cr (Current Liability)

Prepaid Expenses

Relevant prepaid expense Acc Dr (Current Assets)

Relevant expense Account Cr

Income Receivable

Relevant income receivable Acc	Dr (Current Assets)
Relevant income Account	Cr

Deferred Income / Received in advance

Relevant income Acc	Dr
Relevant deferred income Acc	Cr (Current liabilities)

Question 02

The following information was extracted from books of Trade of Mr. Naleen for the year ended 31st March 2019.

Cash receipts and payments extracted from the trial balance are as follows.

Advertising expenses	230,000	Interest income	280,000
Electricity	65,000	Rent income	330,000

Additional Information;

As of 1st April 2018, followings were identified,

1. Additional Rs. 50,000 was paid for advertising expenditure by the date 31st March 2018.
2. The unpaid electricity bill for the month by the date 31st March 2018was Rs. 5000.
3. Interest income receivable Rs. 20,000 by the date 31st March 2018.
4. Rs. 30,000 has been received in advance by the date 31st March 2018 form renting additional space belonging to the business.

In addition to these followings were observed by 31st March 2019,

1. Payable advertising expenditure is Rs. 70,000 as of 31st March 2019.
2. Additional Rs. 8000 has been paid for electricity by 31st March 2019.
3. Interest income receivable amount is Rs. 40,000 as of 31st March 2019.
4. Rs 10,000 has been received in advance as rent as at 31st March 2019.

Using the above information, make adjustments to accrued/pre-paid expenses and income and prepare ledger accounts indicating amounts to be included in financial statements also show extracts of the final accounts

Bad debts

Bad debt expense Acc Dr Trade receivable Account Cr

Recovery of bad debts

1. Recovery of bad debts written off during this year.

Here, the first step is bringing the debtor back to the account or reverse adjusting the bad debt written off.

Trade receivables		Debit	
	Bad debt Account		Credit

Recording the amount recovered

Cash		Debit	
	Trade receivables		Credit

2. Keep in mind that the recovery of bad debt in this year that was written off in the previous year should be accounted for as an income in this year. Thus, double entry is,

Cash		Debit	
	Recovered bad debts Account		Credit

Doubtful debt provision

Initial Recognition

Doubtful debt expense Acc Dr Provision for doubtful debt expense Cr

Subsequent Periods

If there is an **Under provision**,

Doubtful debt expense Acc Dr Provision for doubtful debt expense Cr

If there is an **Over provision**,

Provision for doubtful debt expense Dr Doubtful debt expense Acc Cr

Question 03

Following information of Lal Traders for the year ended 31st March 2019 are given to you.

Debtors as at 31st March 2019	960,000
Balance of provision for doubtful debts account as at 1st April 2018	6,000

The following adjustments were made during the year.

Rs. 10,000 from debtors has been written off as bad debts.

The provision of 2% for doubtful debts on the remaining debtors should be maintained. Accordingly, the calculation of doubtful debts,

Non-current asset disposal & depreciation

Depreciation of Property Plant & Equipment

Depreciable value	Cost of the asset – Residual value
Residual Value	Selling price after effective lifetime – cost of disposal
Effective Life time	Maximum lifetime that can be utilized for providing expected benefits.
Net Carrying amount	Cost of the asset – Accumulated depreciation
Depreciation formula	**(Cost of the asset – Residual value) / Useful Life**

Question 04

On 01st January, Quintus traders purchased an equipment incurring a cost of Rs. 700,000 and effective lifetime of this equipment is four years with utilizing it forproviding expected benefits and without incurring any capital expenditure on it. After that time, ithas been estimated that the equipment can be sold in the market for Rs. 130,000 by incurring a disposal cost of Rs. 30,000.

Accordingly, Calculate,

1. Depreciable value of this equipment.
2. Annual depreciation of this equipment.

Depreciation Methods

01. Straight line method
02. Reducing balance method
03. Using a pre-determined unit basis (Units of output produced / working hours)

Question 05 (Straight Line method)

In the business of Mr. Renuka, a machine was purchased at the cost of Rs. 780,000 on 1st January 2018 and the effective lifetime of this machine is 5 years. The residualvalue of this machine is estimated at Rs. 30,000. Calculate the depreciation for the year ended 31st December 2018.

Question 06 (Reducing balance method)

Senaka Traders purchased a motor vehicle for Rs. 800,000 on 01st January 2018 and the effective lifetime of this motor vehicle was estimated as 5 years. Thus, the annual depreciation rate is 20%. The depreciation method of the business is the reducing balance method. Accordingly, calculate depreciation for the years 2018, 2019, 2020 and 2021 on reducing balance method.

Using a pre-determined unit basis (Units of output produced / working hours)

$$\text{Depreciation amount of the asset} = \frac{\text{Depreciable value of the asset}}{\text{Expected units of the output of the asset.}} \times \text{Units of output Produced During the period}$$

$$\text{Depreciation amount of the asset} = \frac{\text{Depreciable value of the asset}}{\text{Total effective working hours of the asset}} \times \text{the number of hours used during the period}$$

$$\text{Depreciation amount of the asset} = \frac{\text{Depreciable value of the asset}}{\text{The total milage the asset can be run effectively}} \times \text{Total mileage run during the period}$$

Accounting for depreciation

01. Direct	Depreciation expense account Dr Relevant Asset account Cr
02. Indirect	Depreciation expense account Dr Provision for depreciation account Cr

Disposal of PPE

Scenarios

01. Sell an asset
02. Exchange an asset for another asset
03. Donation of an asset
04. Owner taking an asset for personal use.

01 Step	Remove the cost of the asset	Asset disposal Acc Dr Relevant Asset Acc Cr
02 Step	Remove the total accumulated depreciation as at disposal date	Accumulated Depreciation acc Dr Asset disposal Acc Cr
03 Step	Consideration received	Cash Dr Asset disposal Acc Cr
03 Step	If an asset exchange	Relevant exchanged asset acc Dr Asset disposal Acc Cr
04 Step	Find out the profit / loss **(Loss scenario)**	Profit /loss account Dr Asset disposal Acc Cr
04 Step	**(Profit scenario)**	Asset disposal Acc Dr Profit /loss account Cr

Question 07

A lorry purchased on 01st January 2017 for Rs. 1,000,000 was sold on 01st January 2019 for Rs. 800,000. The business treats the effective lifetime of motor vehicles as5 years and the annual rate is 20%.

Salary related adjustments - EPF & ETF

Employee name	Basic Salary	Allowances		Total Gross Salary	Deductions				Total Deductions	Net Salary	EPF 15%	ETF 5%
		Vehicle	Food		EPF 10%	Insur	Emp. fund	Sport club				
Nimal	1000	100	50	1150	(100)	-	(50)	(50)	(200)	950	150	50

Item	Double Entry
Total Gross Salary	Salary / wages expense Acc Dr 1,150 Salary control Acc Cr 1,150
Total Deduction	Salary control Acc Dr 100 Employee fund Acc Cr 50 Sports club Acc Cr 50
EPF contribution (Employee)	Salary control acc Dr 100 EPF payable Acc Cr 100
EPF contribution (Employer)	EPF expense acc Dr 150 EPF payable Acc Cr 150
ETF contribution	ETF expense acc Dr 50 ETF payable Acc Cr 50
Net Salary payment	Salary control Acc Dr 950 Cash Acc Cr 950
If Net salary is not paid	Salary control Acc Dr 950 Salary payable Acc Cr 950

APIT (Advanced Personal Income Tax)

APIT (Advance Personal Income Tax) is the system used in Sri Lanka to deduct income tax directly from an employee's monthly salary before it is paid. It replaced the earlier PAYE system and ensured taxes are collected regularly throughout the year.

How it works

- **Employers** are responsible for deducting APIT from employee salaries each month and **remitting it to the Inland Revenue Department (IRD).**
- APIT applies to employees whose income exceeds the **monthly tax-free threshold** (e.g., LKR 150,000 as per 2025 rules).
- It covers **all employment income**, including salary, bonuses, overtime, allowances, and benefits.

Salary Control Acc Dr APIT payable Acc Cr

Question 08

The salary related information of the ABC company as follows,

01. Gross salary (Basic salary + Allowances) – 200,000/=
02. Amount deduct for welfare fund from the employees – 50,000/=
03. APIT tax payable – 30,000/=

EPF Employer – 15%, EPF employee – 10% , ETF employer – 3%.

Net salary is fully paid by the end of the month by the company.

Prepare the salary control account & Show the Financial Statements extracts.

VAT (Value Added Tax)

Credit Sales including VAT	Trade debtors Dr 236,000 Sales Cr 200,000 VAT control acc Cr 36,000
Credit Purchase including VAT	Purchase Acc Dr 100,000 VAT Control acc Dr 18,000 Trade Creditors Cr 118,000
Paid VAT in cash	VAT control acc Dr 50,000 Cash Cr 50,000

Drawings made by owner (Cash / Goods)

Cash Drawings	Drawings Acc DR Cash Acc Cr
Goods Drawings	Drawings Acc Dr Purchase Acc / trade acc Cr