



JMC JAYASEKERA  
MANAGEMENT CENTRE  
"Pioneers in Professional Education"

# Chartered Accountancy – BL 01

## Financial Accounting

Sandeepa Jayasekera

B.Sc. (Acct.) Hons. Gold Medal Winner, ACA, SAT, ACMA (UK), CGMA (UK), CA Prize Winner for AFR subject in Strategic Level II, CA First in Order of Merit Prize Winner in CAB II Level, CIMA Strategic Level Aggregate Prize Winner, Reading for MBA (PIM-SJP).

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# Financial Accounting Syllabus



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## Financial Accounting Syllabus

	Topic	Weight
1	Accounting and Business Environment	10%
2	Conceptual Framework for Financial Reporting	10%
3	Accounting Systems and Functions	20%
4	Financial Reporting	30%
5	Financial Statements Analysis	10%
6	Financial Reporting Standards	20%

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## Financial Accounting Detail Syllabus

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Financial Accounting Detail Syllabus	
Main Topic	Subtopics
1. Accounting and Business Environment	1.1 Accounting and Business Environment 1.2 Financial Statements 1.3 Objectives of Financial Information
2. The Conceptual Framework for Financial Reporting	2.1 Conceptual Framework
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Financial Accounting Detail Syllabus	
Main Topic	Subtopics
3. Accounting Systems and Functions	3.1 Source Documents and Financial Records 3.2 Double Entry Bookkeeping and Ledger Accounting 3.3 From Trial Balance to Financial Statements 3.4 Inventory 3.5 Tangible Non-Current Assets 3.6 Accruals and Pre-payments 3.7 Impairment Losses and Allowances 3.8 Provisions and Events after the Reporting Period 3.9 Bank Reconciliations

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Financial Accounting Detail Syllabus	
Main Topic	Subtopics
3. Accounting Systems and Functions	3.10 Control Accounts 3.11 Correction of Errors
4. Financial Reporting	4.1 Preparation of Financial Statements for Sole Proprietors 4.2 Incomplete Records 4.3 Partnerships 4.4 Introduction to Company Accounts 4.5 Preparation of Financial Statements for Companies 4.6 Statements of Cash Flows

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Financial Accounting Detail Syllabus	
Main Topic	Subtopics
4. Financial Reporting	4.7 Not for Profit Organizations
5. Financial Statements Analysis	5.1 Analysis of Financial Information
6. Financial Reporting Standards	6.1 LKAS 01 Presentation of Financial Statements 6.2 LKAS 02 Inventories 6.3 LKAS 10 Events after the Reporting Period 6.4 LKAS 16 Property Plant and Equipment
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## Financial Accounting Detail Syllabus

Main Topic	Subtopics
6. Financial Reporting Standards	6.5 LKAS 37 Provisions, Contingent Liabilities and Contingent Assets 6.6 LKAS 08 Accounting Policies, Accounting Estimates and Errors 6.7 Income Taxes 6.8 Employee Benefits 6.9 SLFRS 16 Leases

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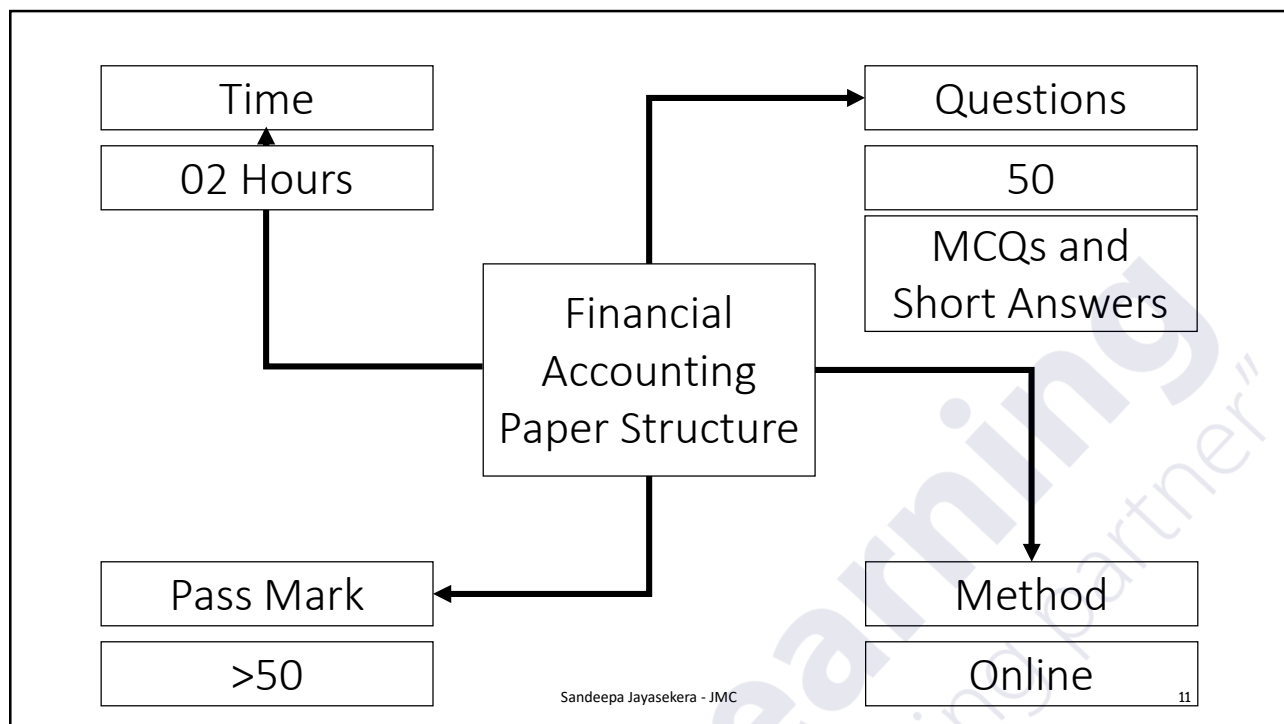
## Financial Accounting and Reporting Paper Structure

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## Financial Accounting Paper Structure

**Time**

- 02 Hours

**Questions**

- 50 Questions
- MCQs and Short Answers
- All are Compulsory

**Pass Mark**

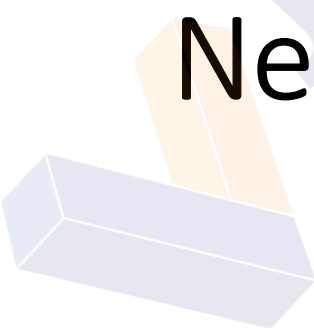
- More than 50 Marks

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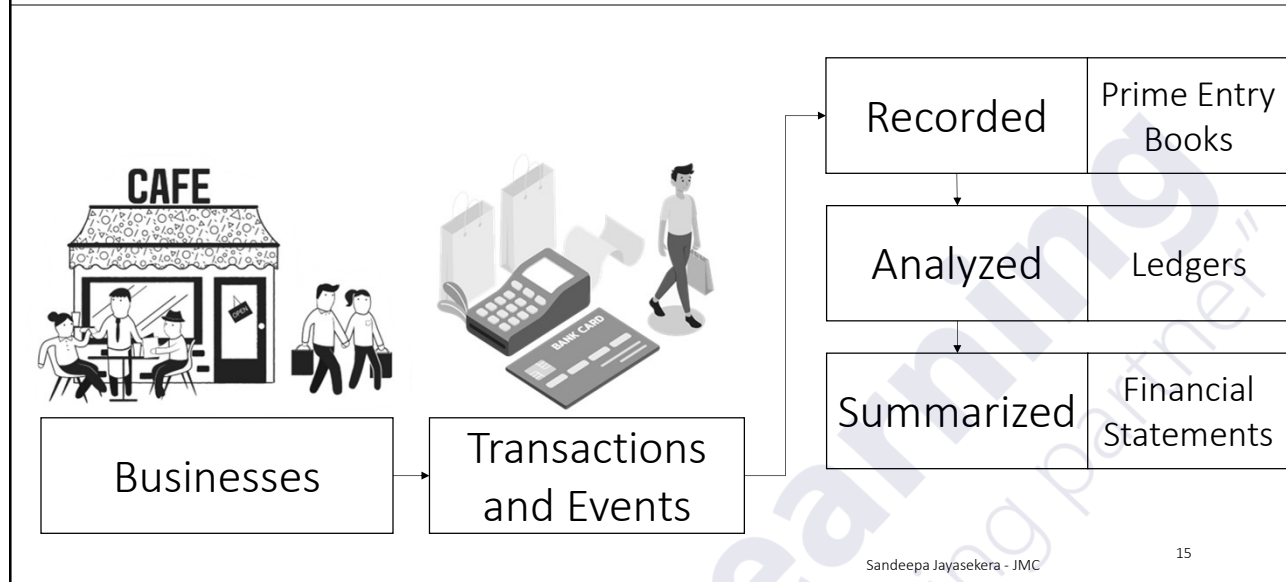
# Need of Financial Accounting

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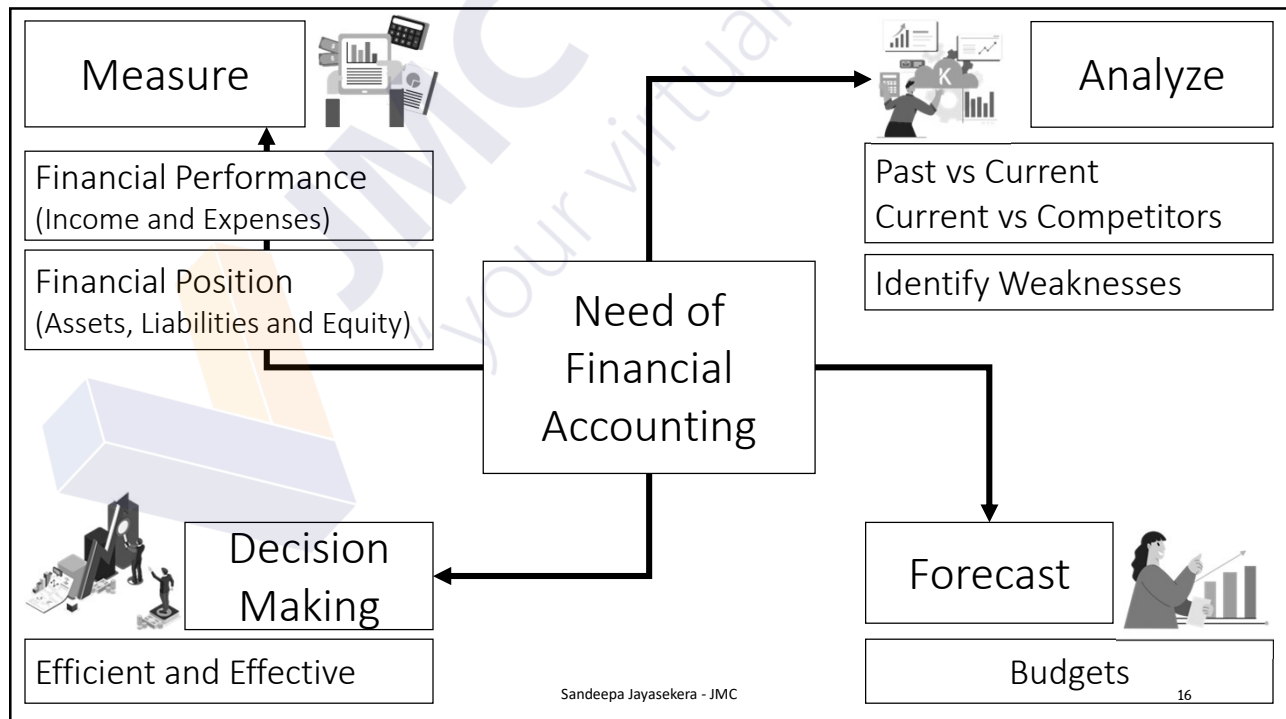
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# What is Financial Accounting?



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# Nature of Business Organizations

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## What is a Business?



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## Business Entity Concept



Business

Two  
Independent  
Parties



Owners

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## Types of Businesses

Description	Sole Proprietorship	Partnerships	Companies
Ownership			
Control			
Liability			

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## Types of Businesses

Description	Sole Proprietorship	Partnerships	Companies
Accounting and Auditing			
Profit Sharing			
Business Continuity			

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## Business Growth and Globalization Impacts on Financial Reporting

	<p>2012 Sri Lanka Adopted International Financial Reporting Standards</p>	
<p>Business Growth comes with Increased Regulations</p>		<p>Multinational Companies exist around the globe</p>
<p>Sourcing Finance requires Better Financial Reporting</p>		<p>Require a Global Financial Reporting</p>

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# External Environment Factors

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## What is Environment?

Environment is  
Everything  
around a  
Business both  
Physical and  
Social

Macro

### Indirect Influences

Political and  
Legal

Economical

Social

Technological

Micro

### Direct Influences

Rivals

Customers

Suppliers

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# Governance

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## What is Corporate Governance?

System

By which Companies  
and Entities

Directed and  
Controlled

Those Charged with Governance  
Board of Directors



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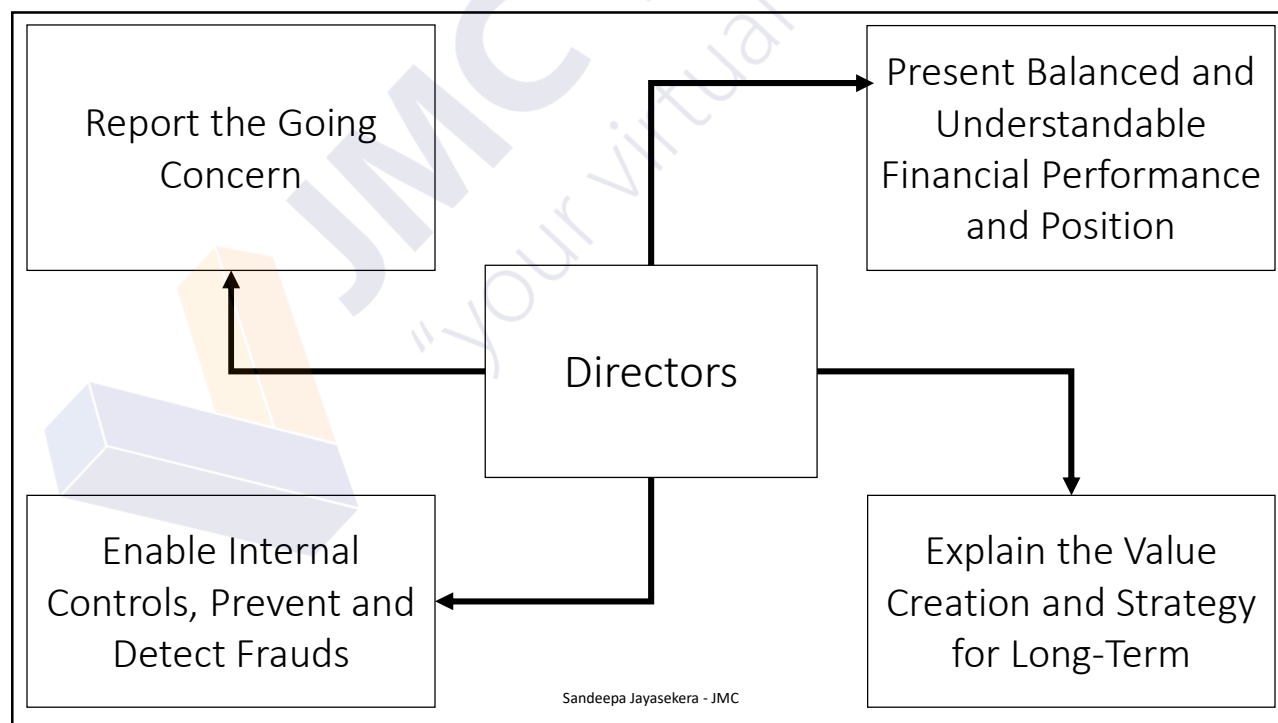
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## Directors are Responsible for PREPARATION of FINANCIAL STATEMENTS

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# Regulatory Requirements

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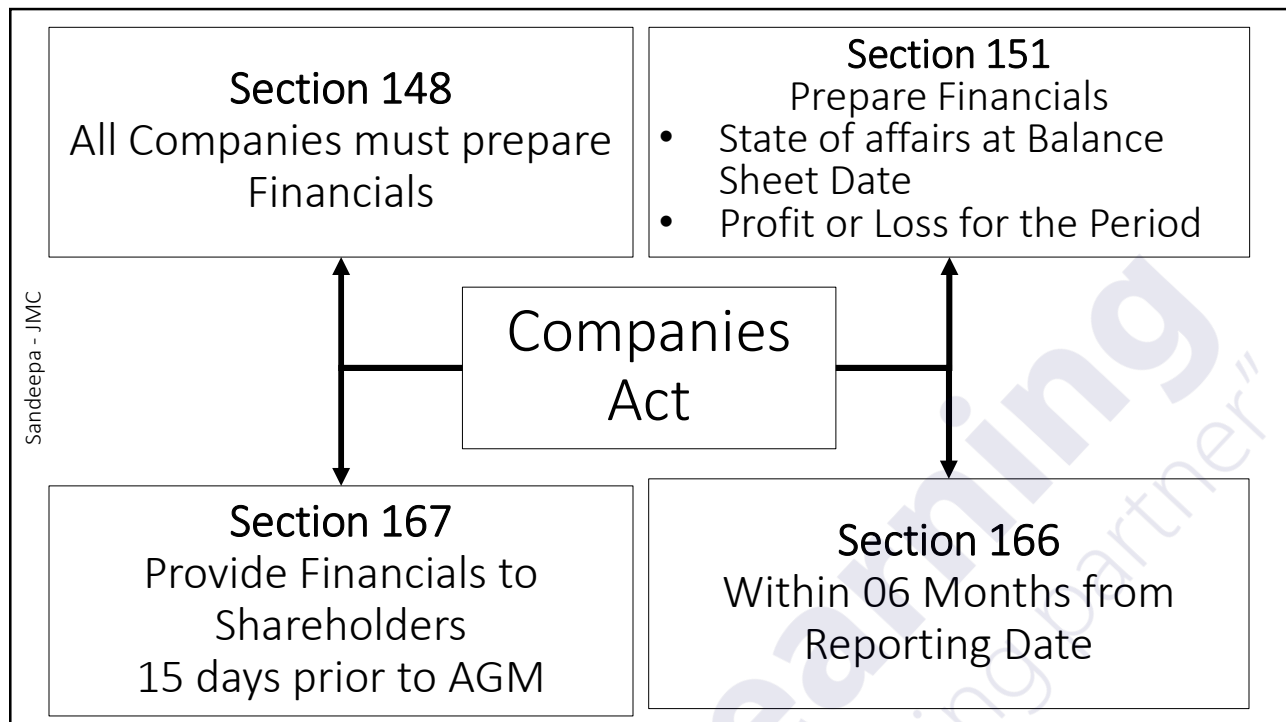
## Companies Act No. 07 of 2007 Requirements

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# Accounting Standards and Role of CA Sri Lanka

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Responsible to Prepare  
Accounting Standards



We Adopt International Financial  
Reporting Standards

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## Reasons to form Standards

↑ Comparability

↑ Meaningfulness of Disclosures

To assist Users of Financial Statements

To assist Preparers of Financial Statements

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# Legal vs Commercial View of Accounting

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## Substance Over Form

Transactions accounted shall reflect Commercial Substance than Legal Form



Leased Car recognized as an Asset, Despite Legal Title is in Absence

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# Ethics in Accounting

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Objectivity

Being **unbiased** and **free** from **pre-judgements**

Integrity

Providing **accurate** and **complete** information, while agreeing with one's **conscience**

Confidentiality

**Not** disclosing **sensitive** information to third parties

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Professional Competence  
and Dure Care

Maintaining professional knowledge  
and skill at the level required to  
perform the accounting service

Professionalism

Behaving in compliance with relevant  
professional regulations

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# Developments in Accounting Profession

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## Globalization and Multinationals

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## Impact of Technology on Accounting Profession

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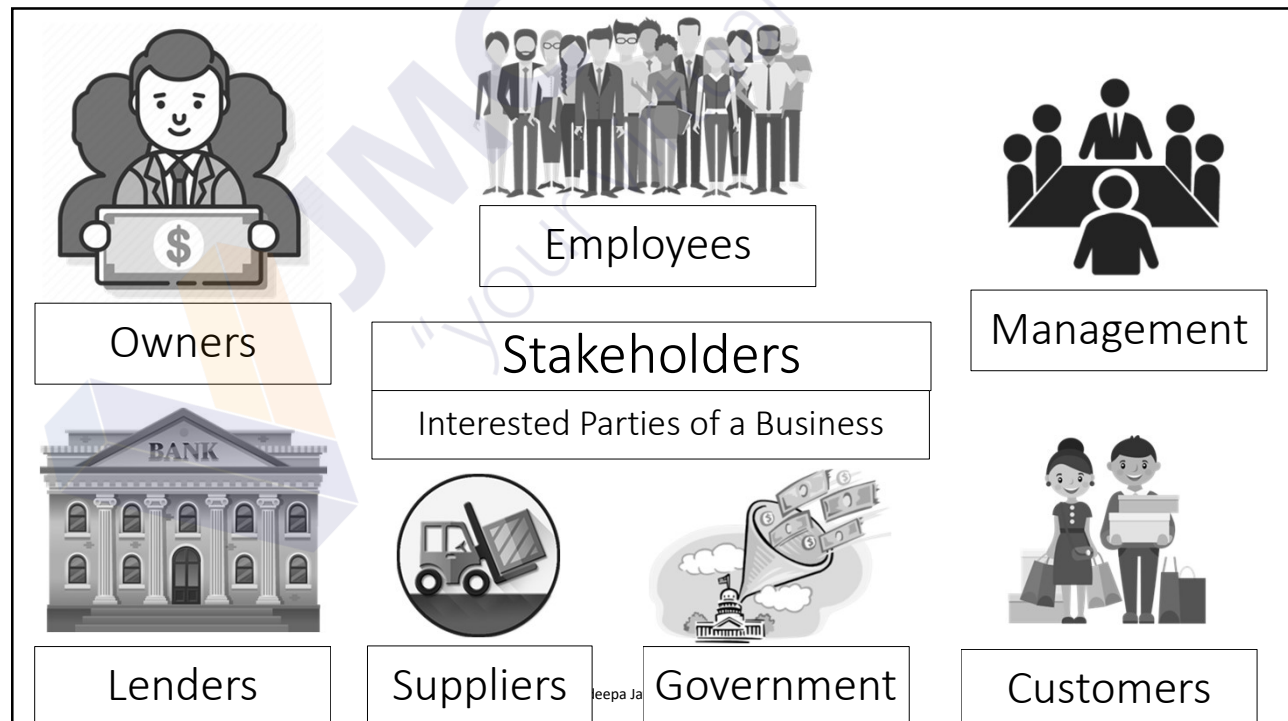
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# Stakeholders of a Business

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Stakeholders of an Entity		
Stakeholder	Decisions	Type of Info
Board of Directors		
Shareholders		
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Stakeholders of an Entity		
Stakeholder	Decisions	Type of Info
Suppliers		
Customers		
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Stakeholders of an Entity		
Stakeholder	Decisions	Type of Info
Bankers		
Employees		
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Stakeholders of an Entity		
Stakeholder	Decisions	Type of Info
Government		
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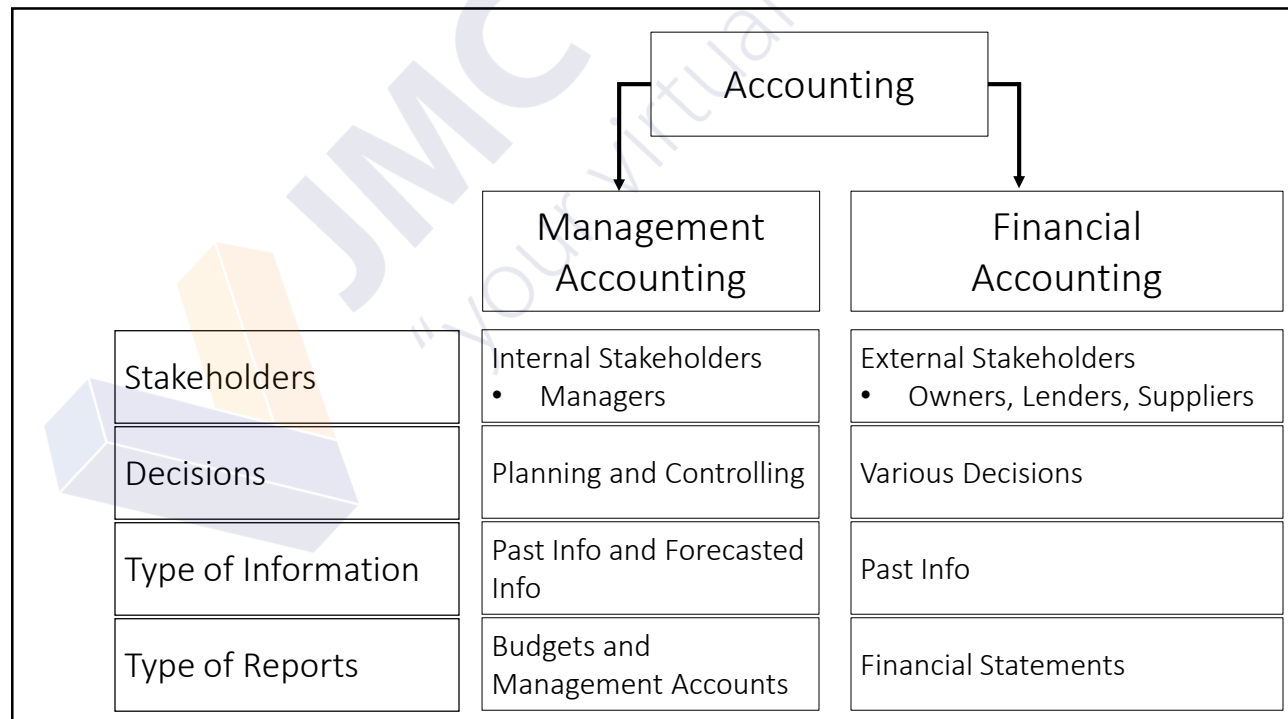
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# Accounting

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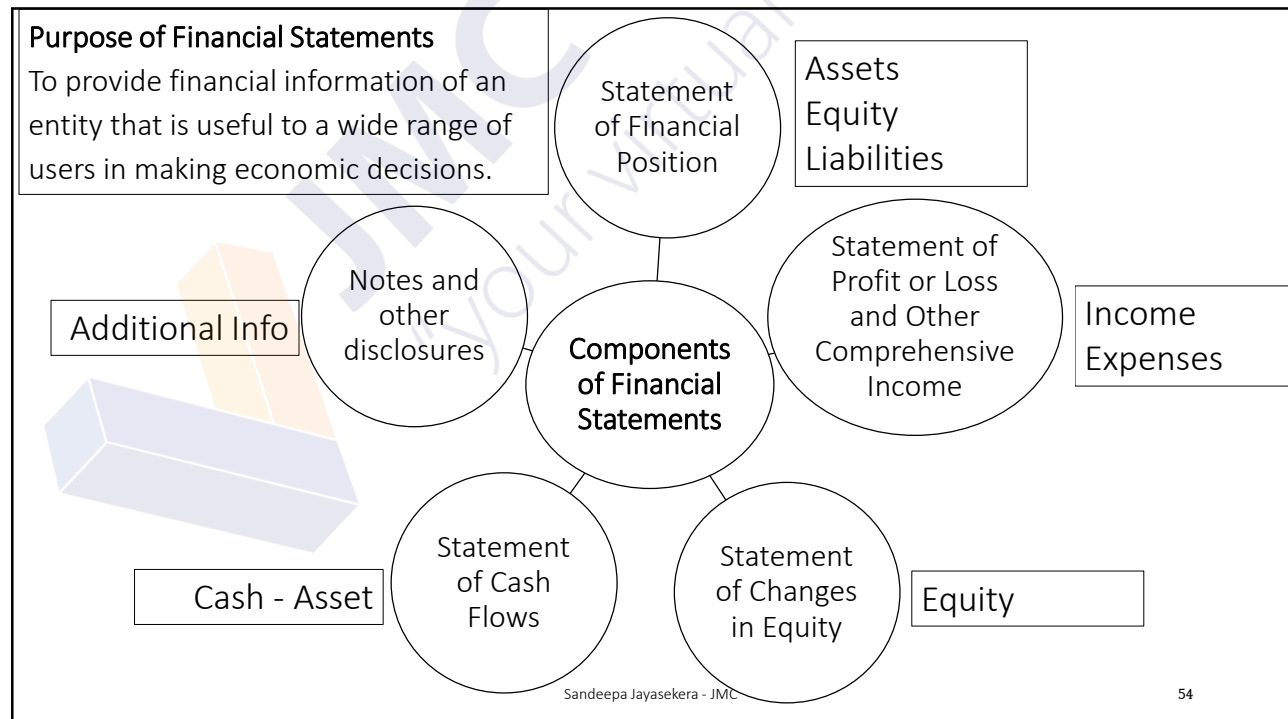
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# Financial Statements

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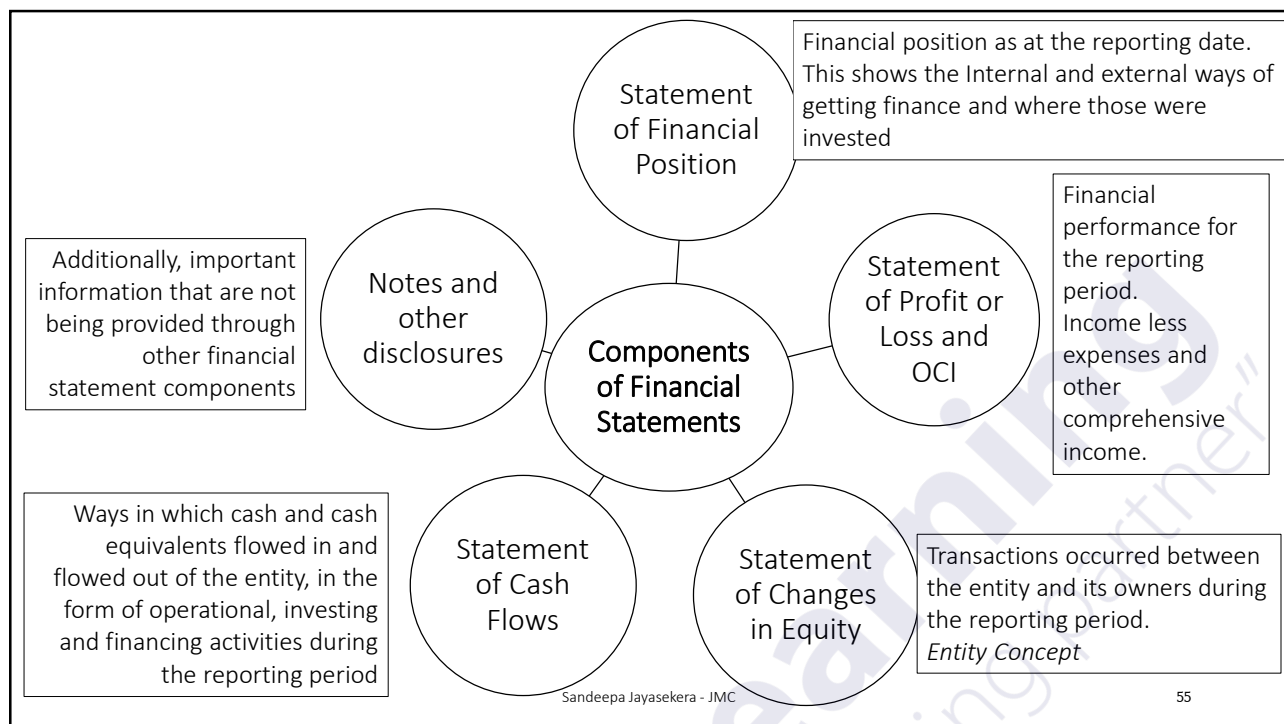
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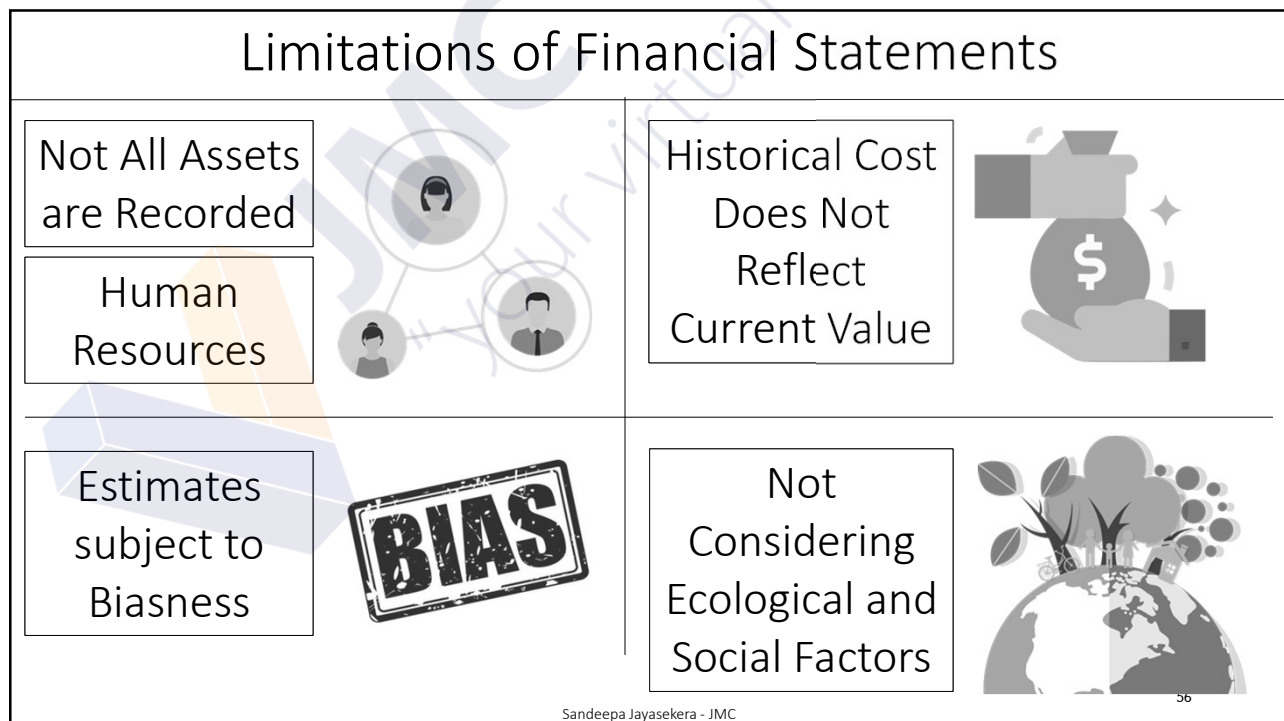
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# Conceptual Framework for the Financial Reporting (From 01.01.2020)

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# What is the Conceptual Framework?



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Statement that describes

Objectives

Concepts

for General Purpose  
Financial Reporting

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## 2 Types of Financial Reporting

General Purpose

Used by a wide range of users

Special Purpose

Used by limited group of users

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## Objective of General Purpose Financial Reporting

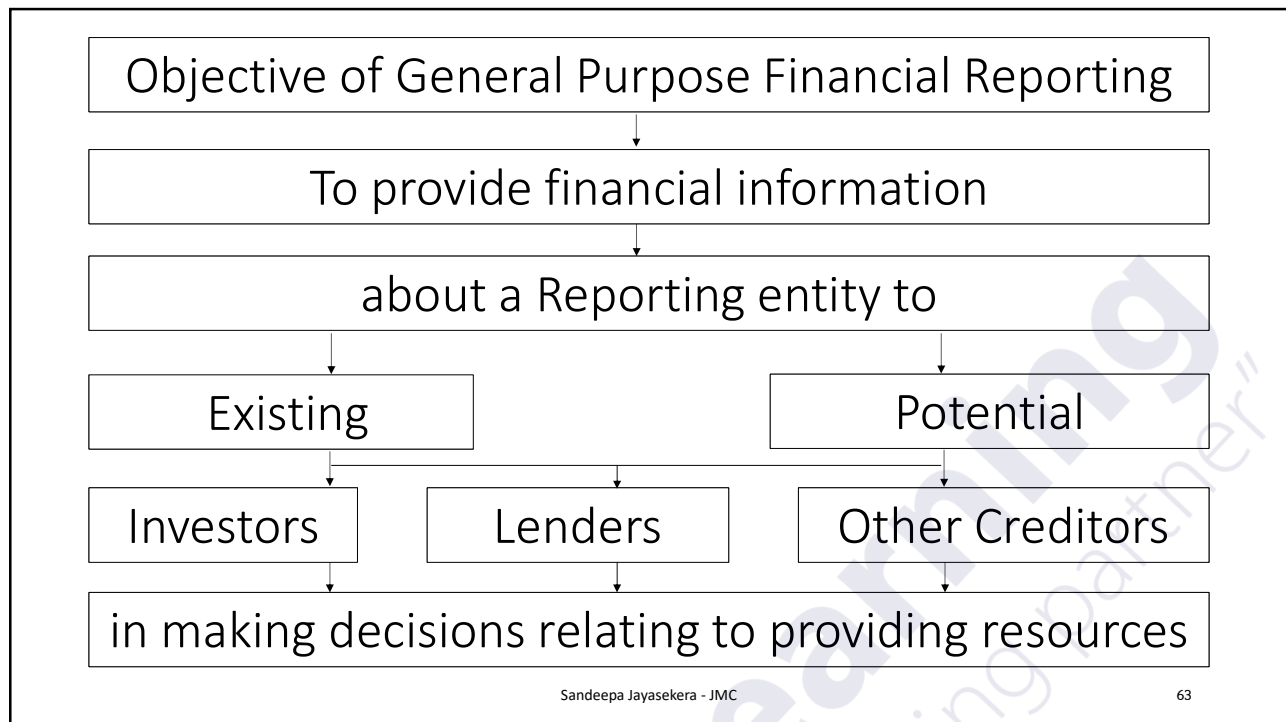


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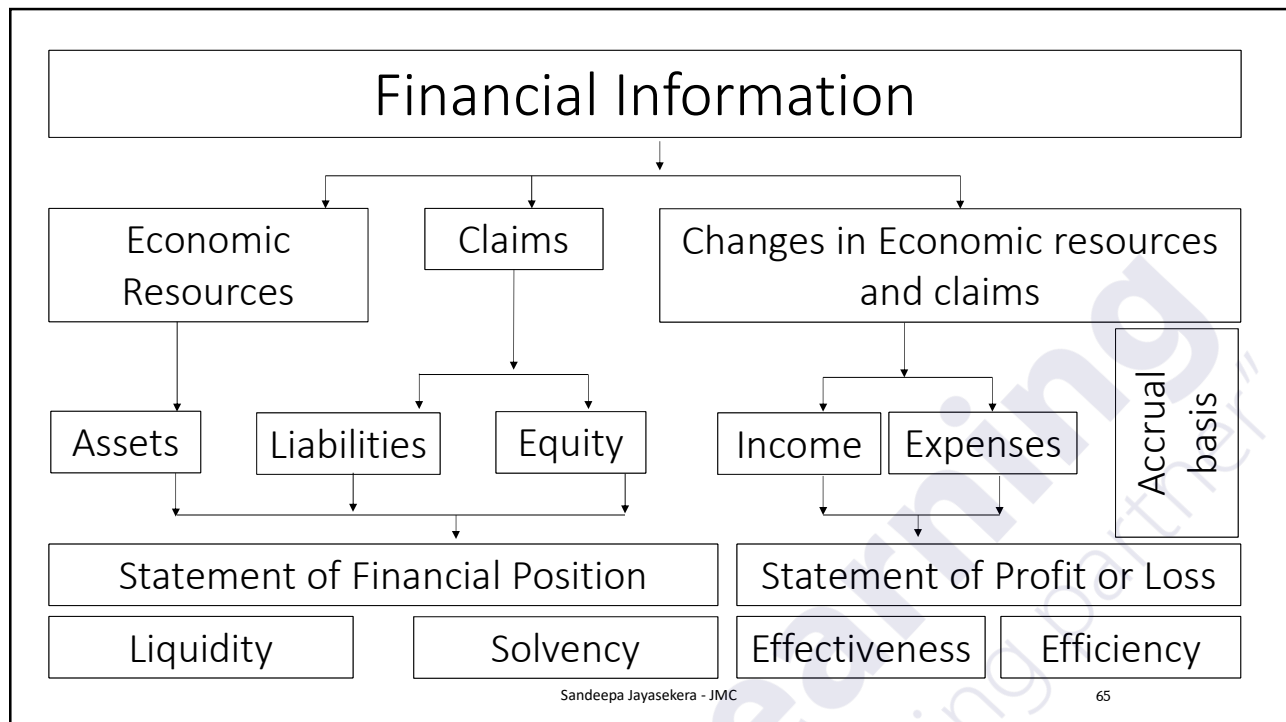
# What is a Financial Information?



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## Question 01

What is the relevant concept to identify Debtors and Creditors in Financial Statements?



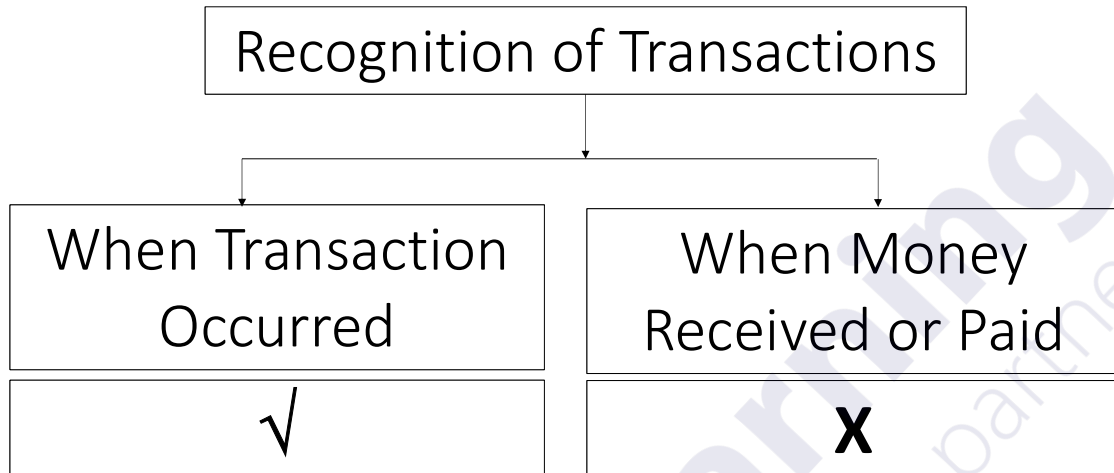
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# Accrual basis



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## Why do we need a Conceptual Framework? (Purpose)



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To develop future standards

To review existing standards

To promote harmonization by reducing number of alternative accounting treatments

To account for matters that has yet to form the subject of a standard

To interpret information contained in financial statements


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## Question 02

What is the Institution that is empowered to set accounting standards?



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# Concepts in the Conceptual Framework that are relevant to Financial Reporting



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Qualitative  
Characteristics  
of Financial  
Information

Elements of  
Financial  
Statements

Recognition of  
Elements

Measurement  
of Elements

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# Qualitative Characteristics of useful Financial Information

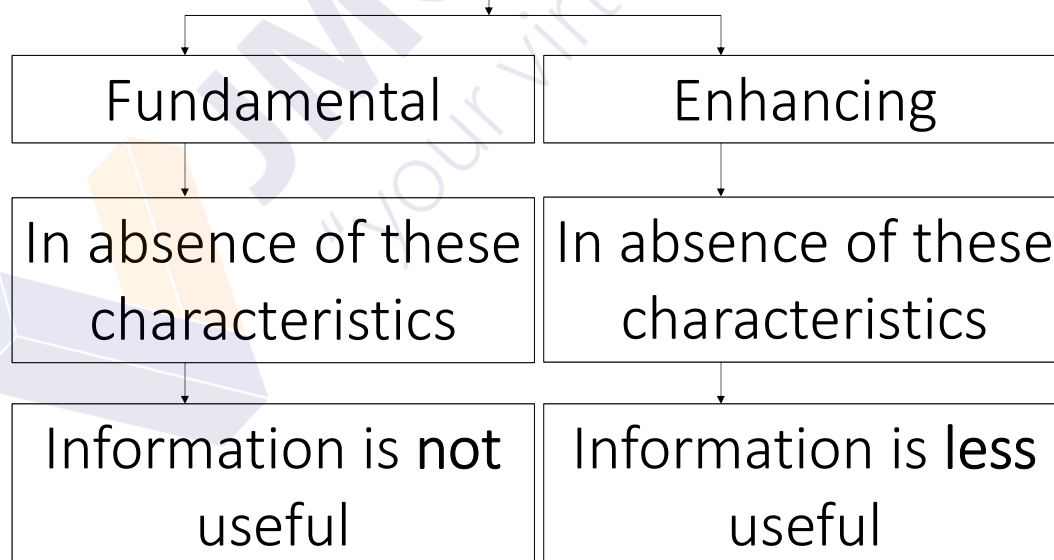


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## Qualitative Characteristics



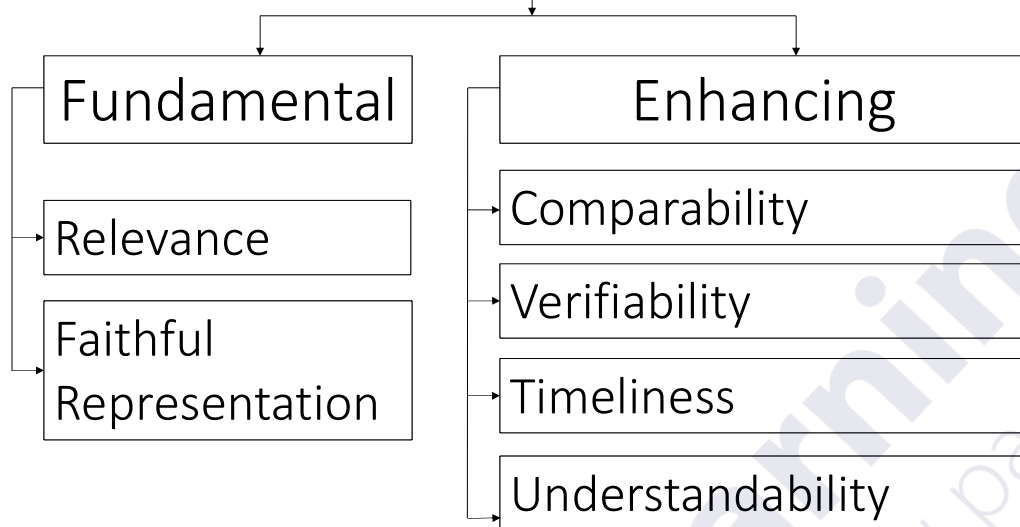
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# Qualitative Characteristics



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## Fundamental Qualitative Characteristics



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# Relevance

If an information is  
capable of making a difference  
in decisions

## Example

A company's total debt is 80% of total assets.  
Therefore, the bank decided not to grant a new loan  
to the company.

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## Sub Components of Relevance

Predictive value

Ability to forecast  
future outcomes

E.g.

Making investment decisions  
based on forecasted profits  
for the next two years

Confirmatory value

Ability to verify  
previous predictions

E.g.

Comparing previous year's  
forecast against actual  
information

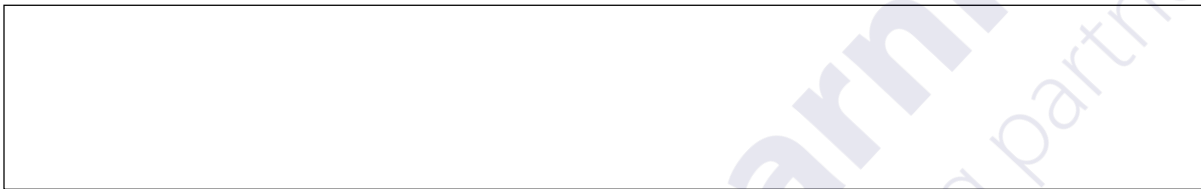
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## Question 03

Explain using concepts, the reason to charge the value of small equipment and tools that can be used for more than one year to the Statement of Profit or Loss

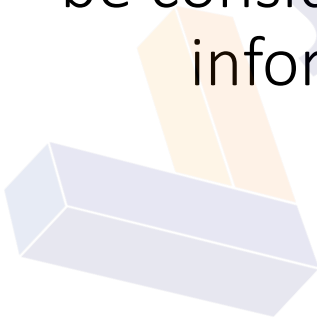


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The materiality of information needs to be considered, in deciding whether an information is relevant or not



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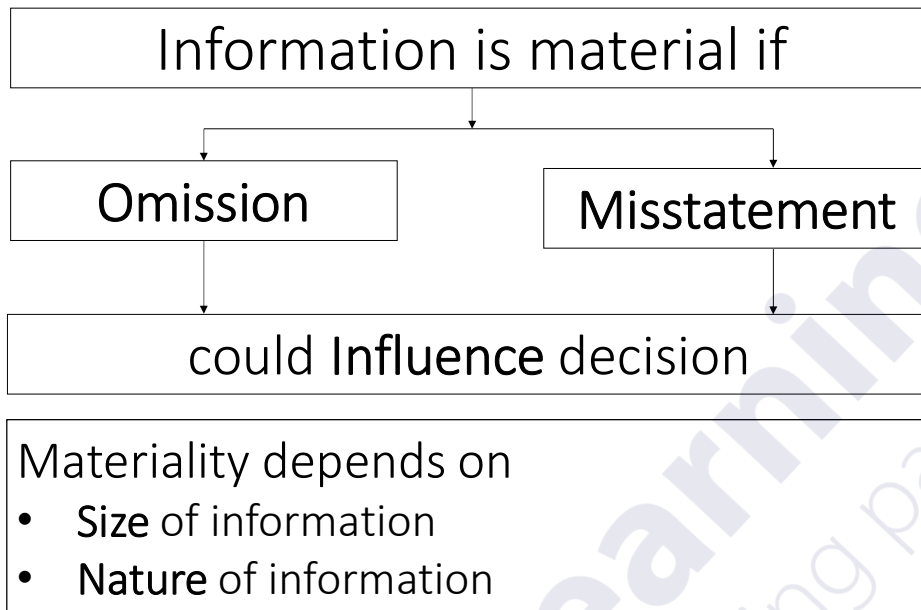
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# Materiality



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## Materiality Example

- Omission of Rs. 10 Mn income of a company with a total income of Rs. 100 Mn, could be material
- Omission of Rs. 100,000/- income of the same company, could be not material based on Size. However, same can be material based on Nature, such as Rs.100,000/- fraud done by a Director.

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## Faithful Representation

Financial Reports must

represent Economic phenomena

in Words and Numbers

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To be a Faithful Representation,  
information must be

Complete

Neutral (Unbias)

Free from Errors

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# Completeness

Depiction of all necessary information

- Figures
- Process used to determine figures
- Explanation of significant facts
- Quality
- Nature

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# Free from Errors

Does not mean 100% accurate

There can't be errors or omissions in the

- Description of the phenomenon
- Process used to produce reported information

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## Free from Errors

Ex.

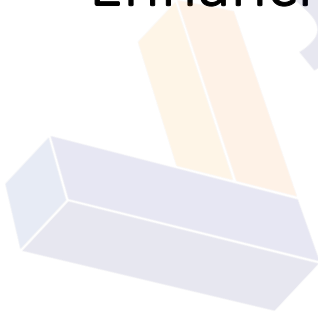
An accounting estimate is not 100% accurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained

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## Enhancing Qualitative Characteristics



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# Comparability

Ability to identify and understand

Similarities

Differences

in an entity's information

with another similar information

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## Comparisons can be made

With a  
different  
period of  
the same  
entity

With the  
same  
period of a  
different  
entity

With  
industry  
average of  
the same  
period

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# Verifiability

Knowledgeable

Independent

observers

ability to reach consensus

of a financial information

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# Timeliness

Information available

in time

Older the information is, the less useful it is.

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# Understandability

Making the financial information

Understandable to

Users with reasonable knowledge

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Information is made understandable  
when it is

Clearly

Concisely

Presented

Classified

Characterized

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# Underlying Assumption in Preparation of Financial Statements



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## Going Concern

An entity

continuing

its operations

for a foreseeable future

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# Going Concern

It is assumed that the entity has neither the intention nor the necessity of **liquidation** or of **curtailing materially** the scale of its operations

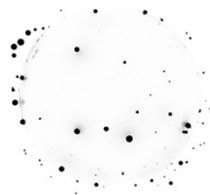
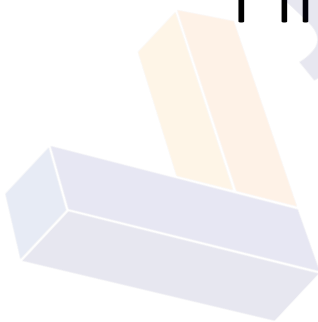
If, the entity has the intention to liquidate or curtail major operations, then the financial statements would be prepared on a basis other than going concern basis (Liquidity Basis/Breakup Basis)

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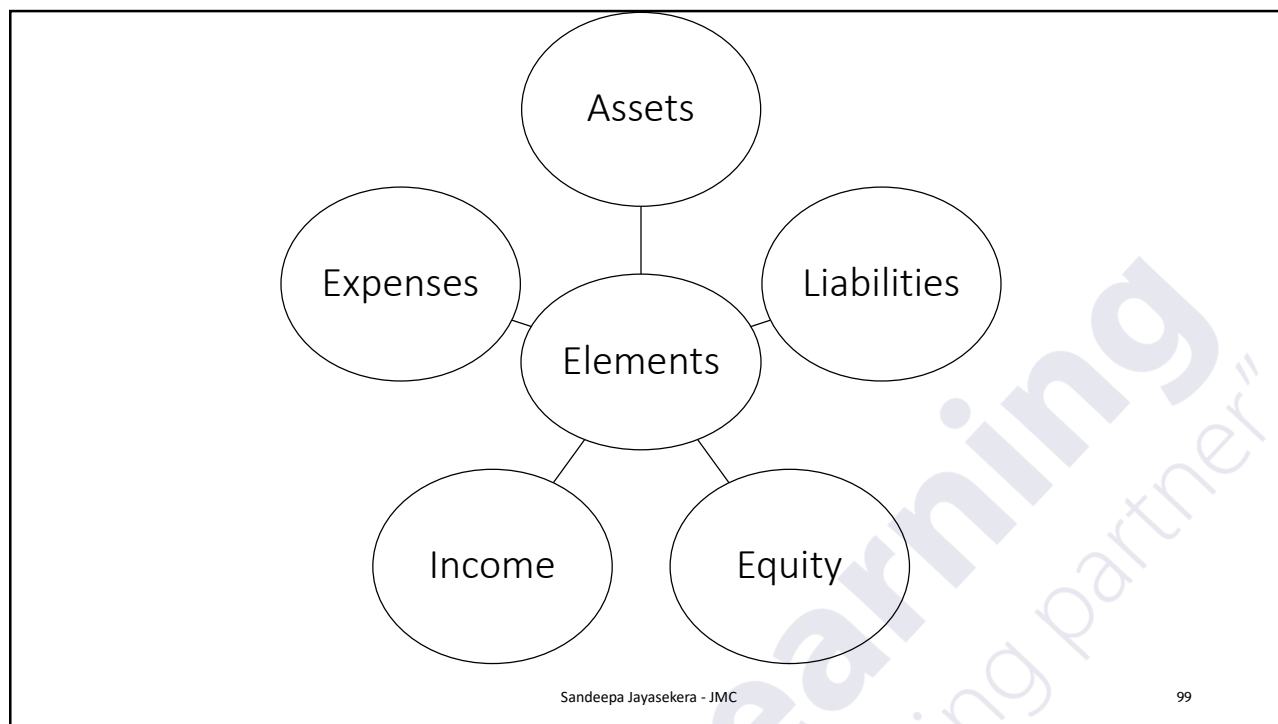
# Elements of Financial Statements



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# Defining the Elements of Financial Statements

A cartoon illustration of a boy with short grey hair, wearing a grey shirt and shorts, holding a notepad and a pen. To his left is a large 3D bar chart with two bars: a purple one in the foreground and an orange one behind it.

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# Asset is

A present economic resource

controlled by the entity

as a result of past events

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## Past Events

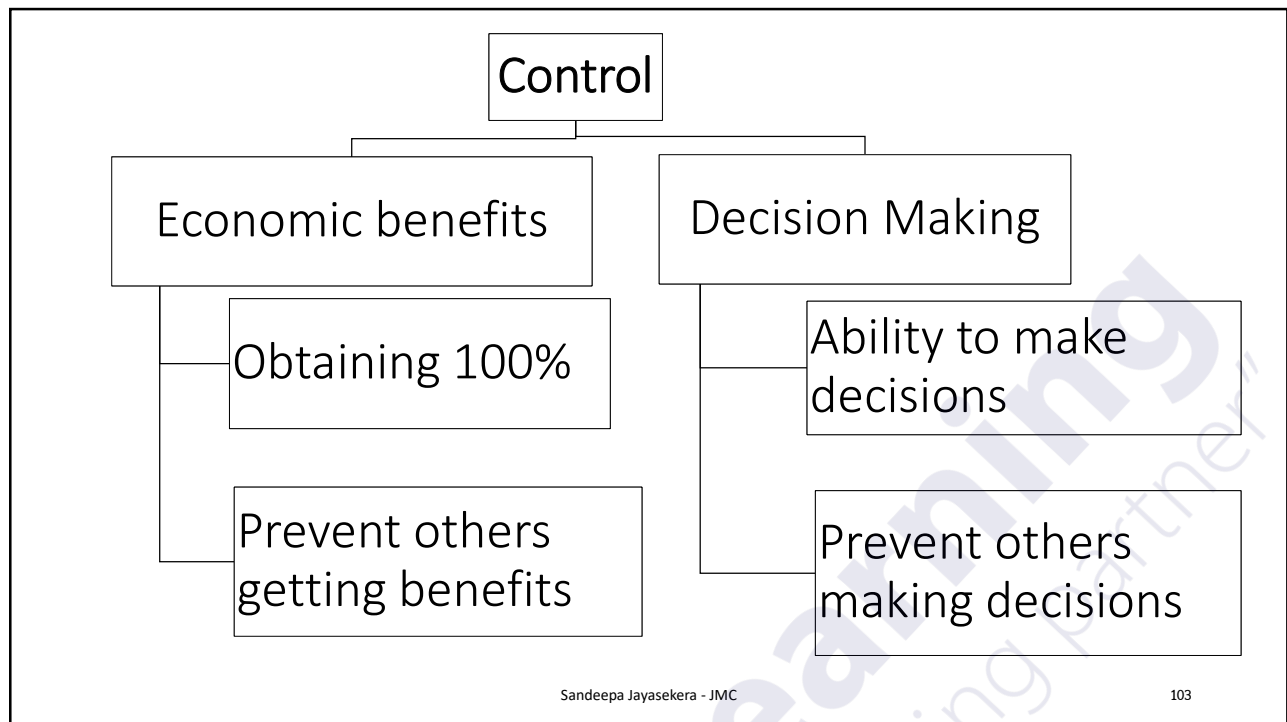
Nature	Nature	Asset
Transaction	Credit sales	Debtor
Activity	Production	Inventory
Agreement	Loan agreement	Property

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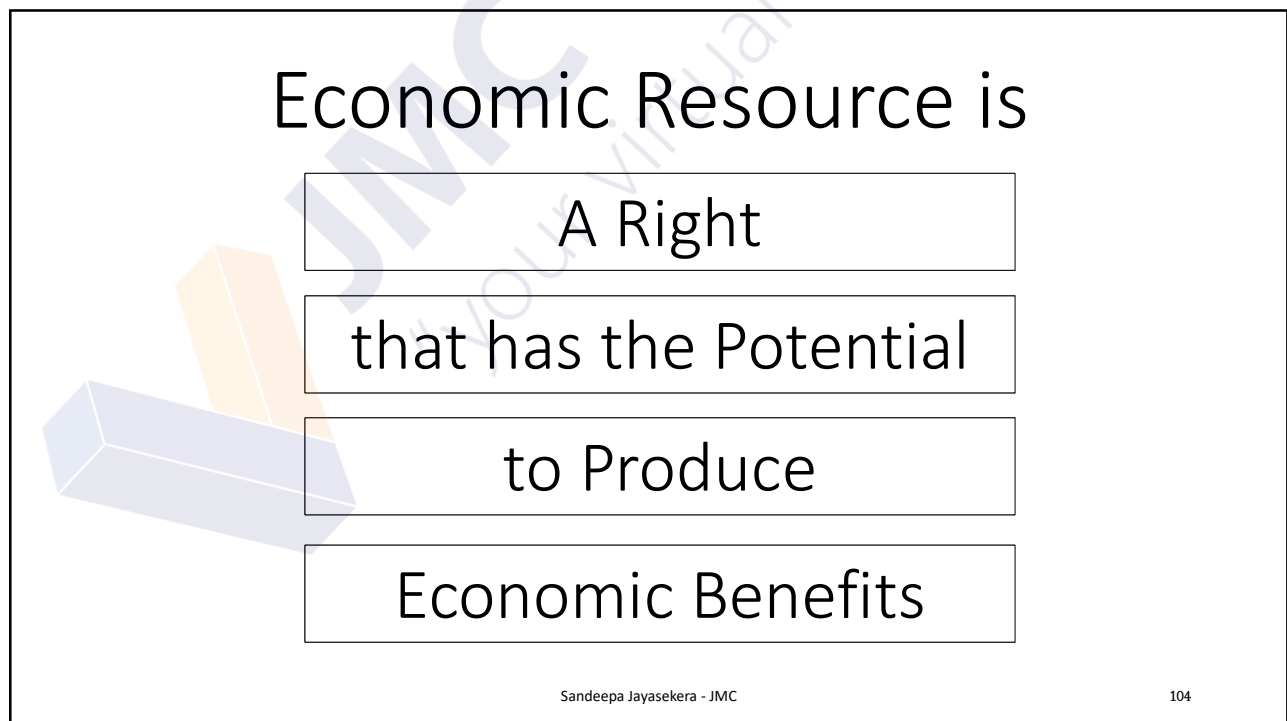
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# Economic Benefits are

Producing cash inflows

Reducing cash outflows

Receiving goods or services

Exchanging economic resources on  
favourable terms

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# Liability is

A Present Obligation of the Entity

to Transfer Economic Resources

as a Result of Past Events

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## Past Events

Nature	Nature	Liability
Transaction	Credit purchases	Creditor
Activity	Production	Salaries payable to employees
Agreement	Loan agreement	Bank Loan

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## A Liability could arise

Legally

Constructively

Legislation

Policies

Statute

Statements

Contract

Practices

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## Examples for Liabilities

A loan obtained by a company, under a loan agreement, Employee Provident Fund (EPF) payable under the EPF act are legally enforceable obligations.

Incentives being paid by a company, warranties issued for during sale of goods are constructive obligations.

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## Equity is

Assets

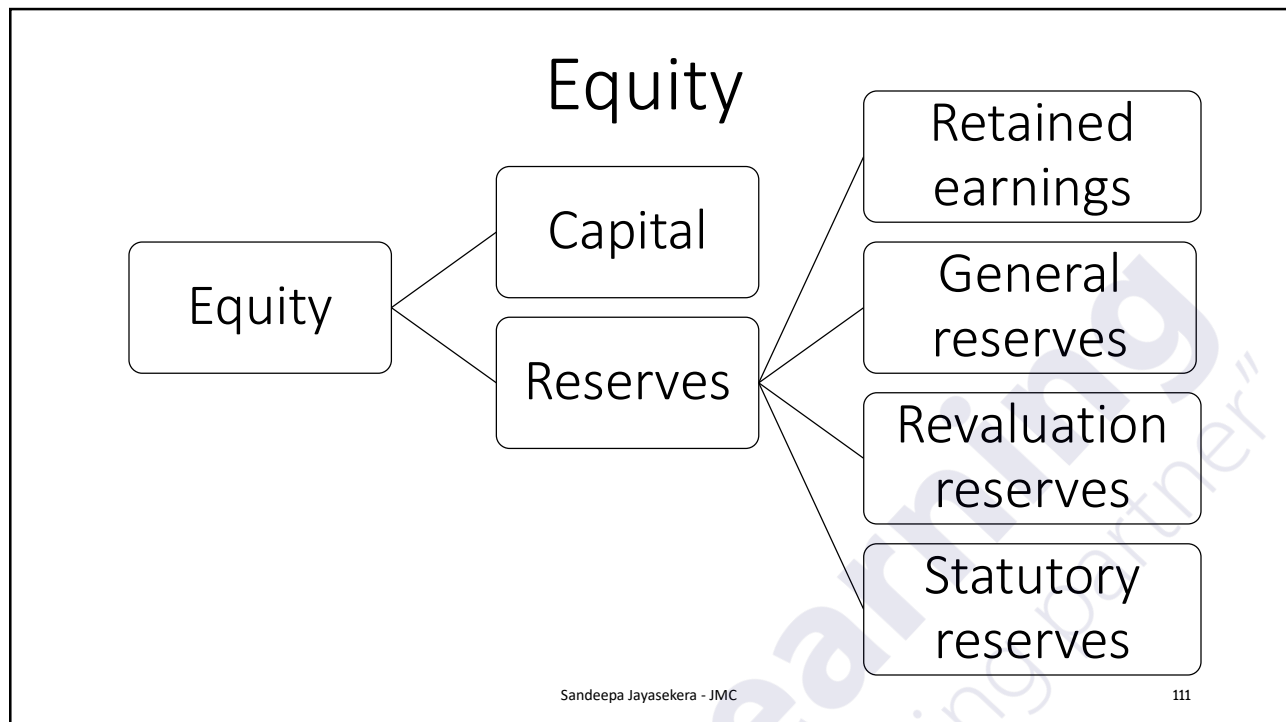
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Liabilities

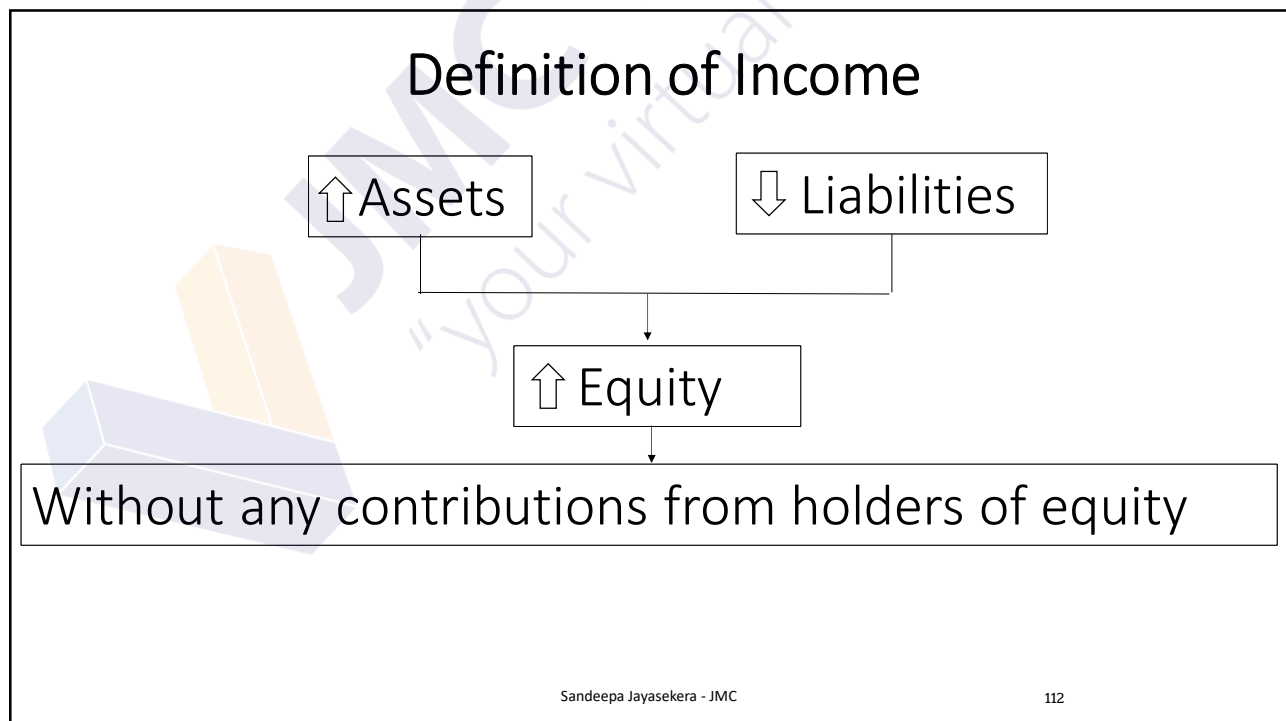
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## Example for Income

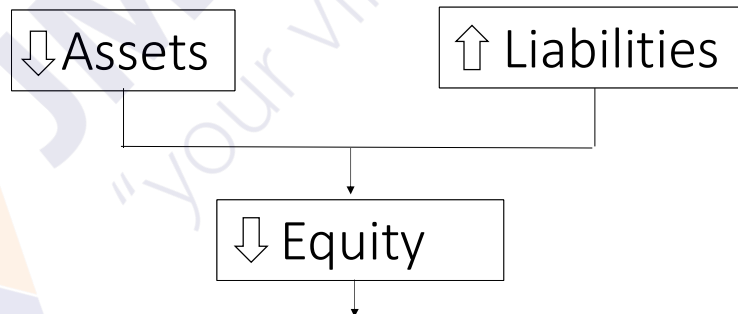
A sale result in increase in assets in terms of cash or debtor. Sale result in an increase in profit. Therefore, the equity will increase without any contribution from the owners. Therefore, sales is an income.

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## Definition of Expense



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## Example for Expenses

Purchase result in reduction of assets in terms of cash or increase in creditor liability.  
Purchase result in decrease in profitability.  
Thereby, the equity will be reduced without any distribution to owners.

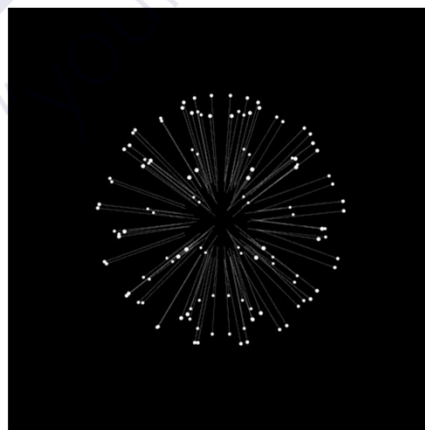
Therefore, purchases is an expense.

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## Recognition of the Elements of Financial Statements



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# Steps to Recognize Financial Statement Elements

Meet the Definition

Being a Useful Information

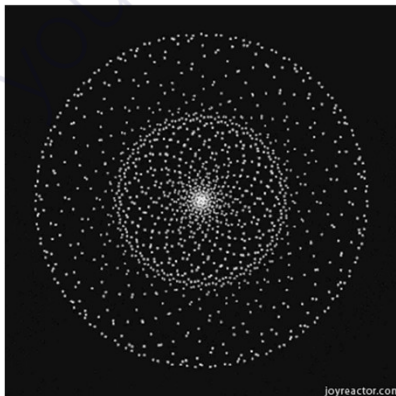
- Relevance
- Faithful Representation

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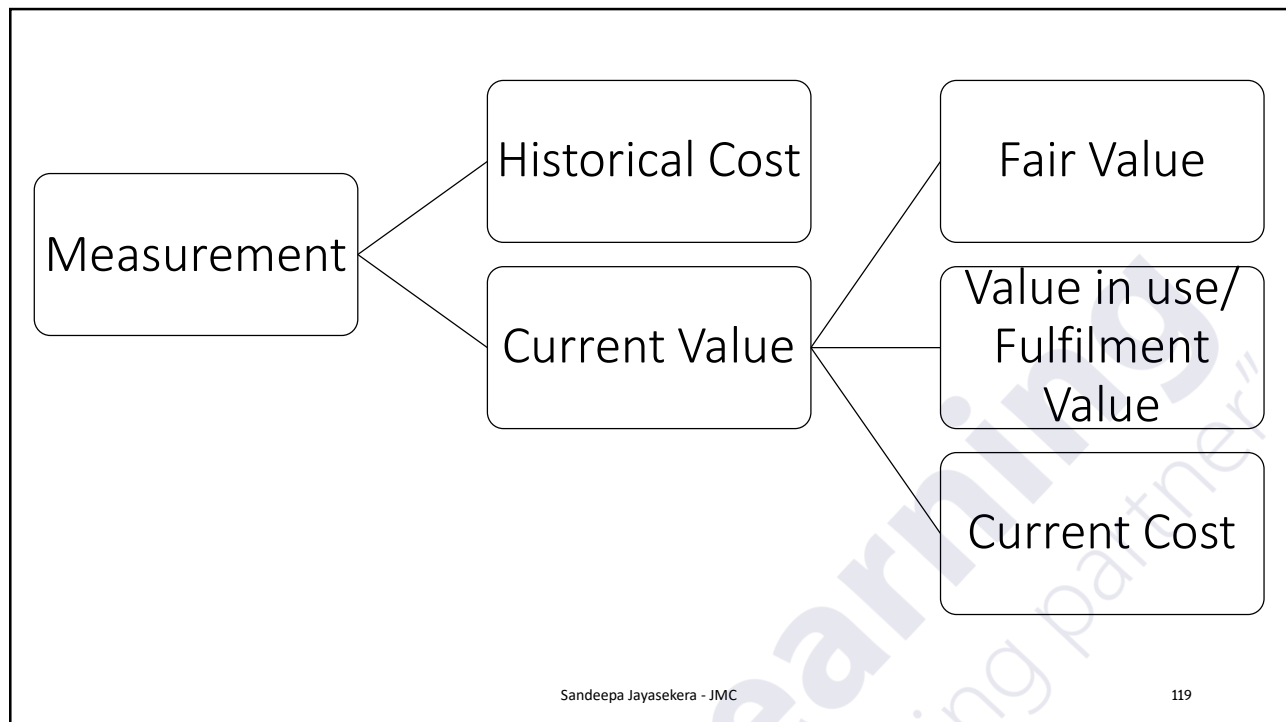
# Measurement of the Elements of Financial Statements



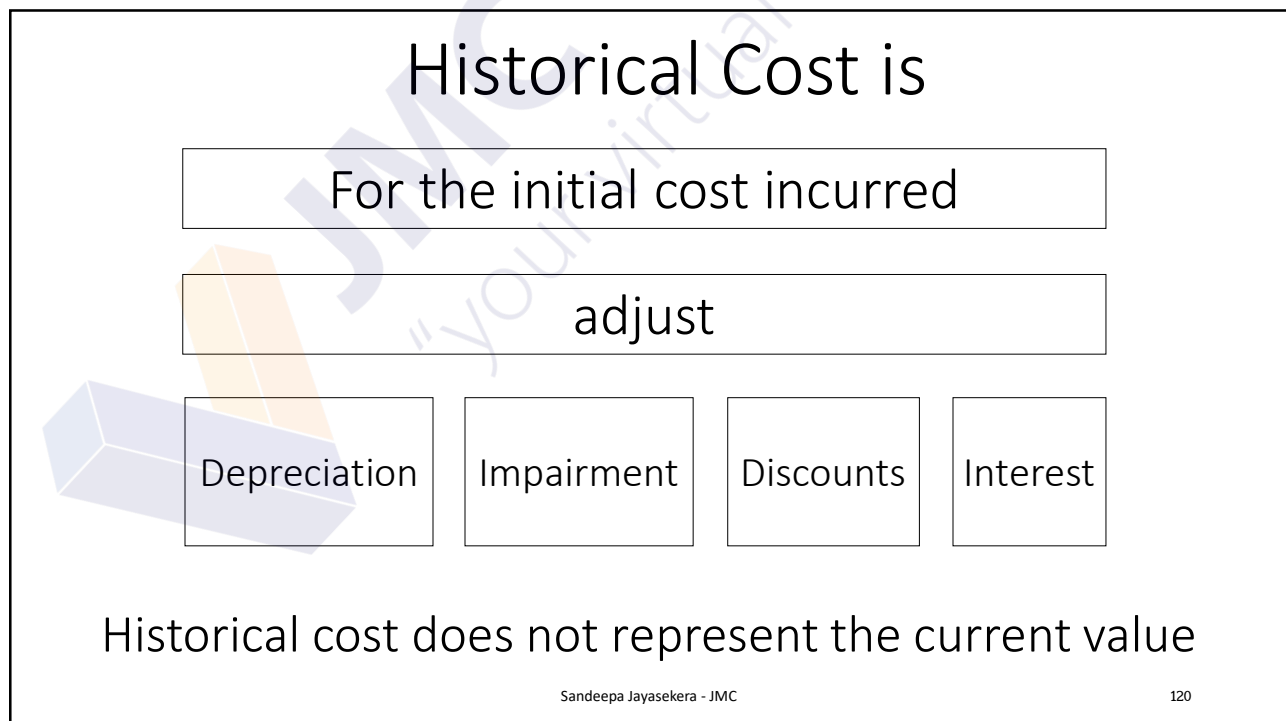
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## Question 06

What is the accounting concept that leads not to adjust inflation in financial statements?



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## Fair Value is

The price

received to sell an asset

paid to settle a liability

in an orderly transaction

between market participants

at the measurement date

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# Value in use is

Present value of

Cash flows expect to derive from the  
use of an asset

Time value of money will be adjusted

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# Current Cost is

Cost or consideration received

to acquire or create an equivalent asset

or to incur an equivalent liability

at the measurement date

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## Question 07

Sathish Ltd. purchased a machine for Rs. 10 Mn on 01<sup>st</sup> January 2019. Its useful life is 4 years. On 31<sup>st</sup> December 2020, the management estimates that this machine could be sold at a market value of Rs. 7.5 Mn. The price of a similar new machine on that date is Rs. 12 Mn. The net cash flows over the remaining useful life is Rs. 4 Mn and the discount rate is 10% (1 - 0.91, 2 - 0.83, 3 - 0.75). The scrap value is zero. Calculate the historical cost, fair value, current cost and value in use of this machine.

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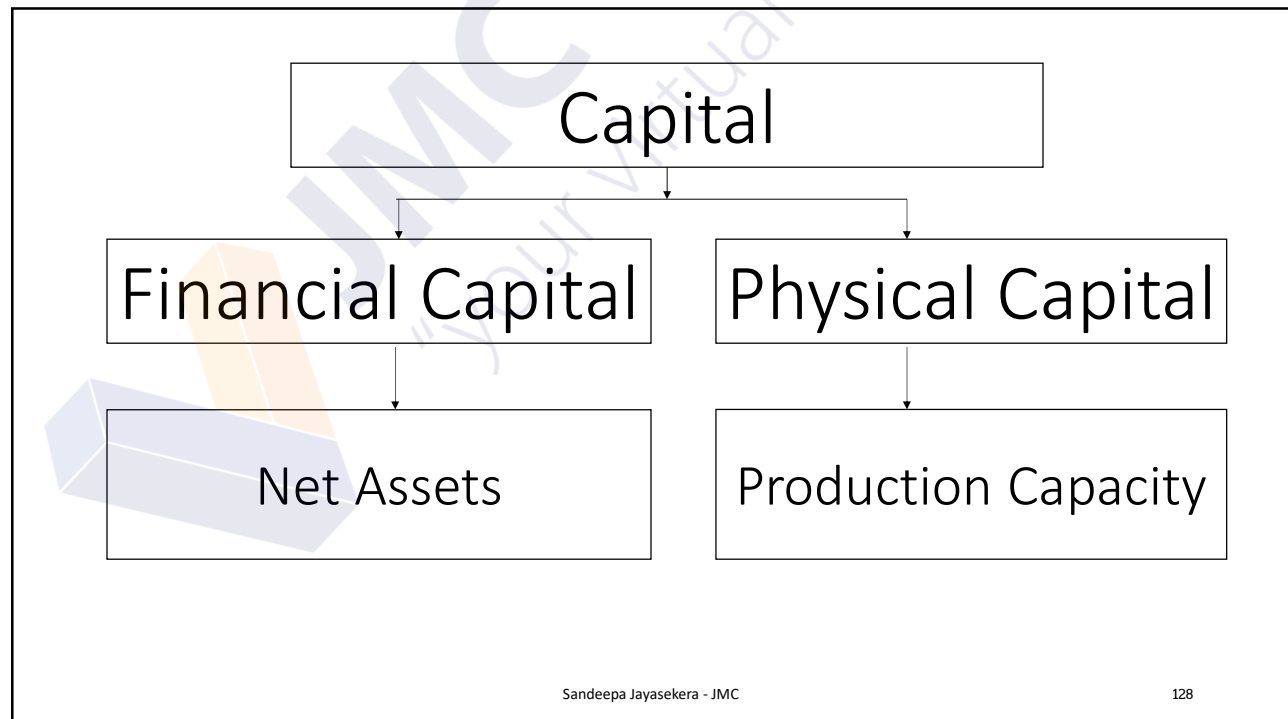
# Capital and Capital Maintenance



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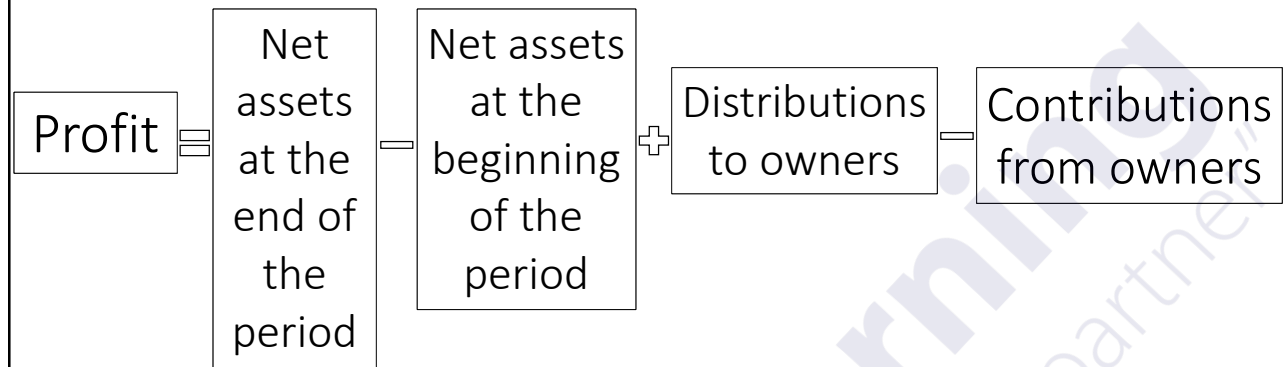
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# Financial Capital Maintenance

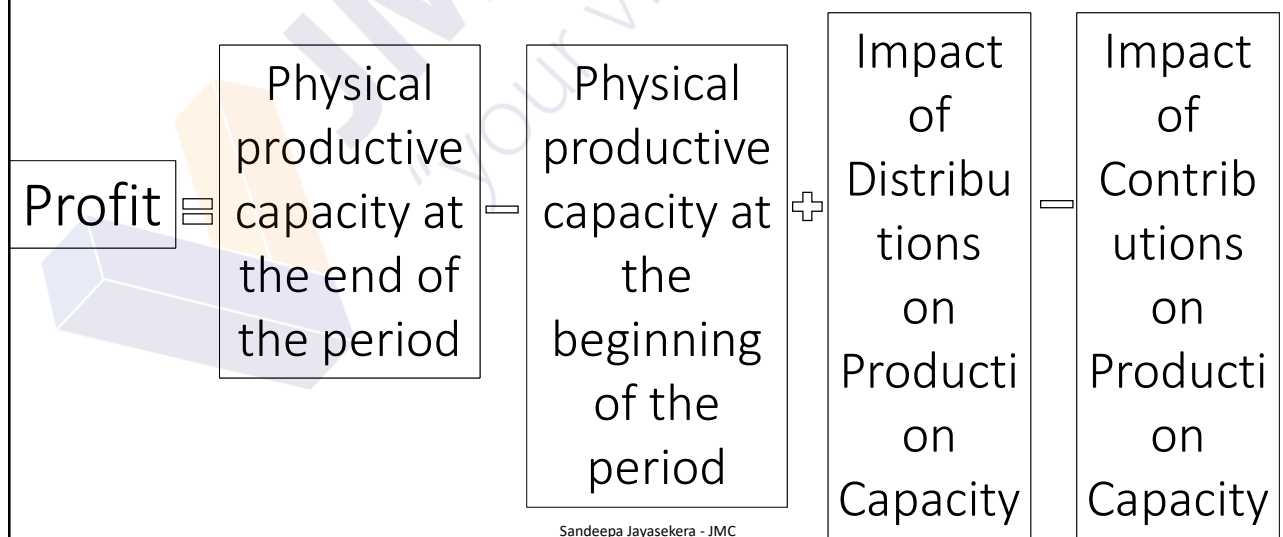


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# Physical Capital Maintenance



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## Question

**Siriwardane**, a sole proprietor commenced his wholesale business in 2016. The net assets of his business as at 01<sup>st</sup> April 2017 was Rs. 3.2 million and as at 31<sup>st</sup> March 2018 it was Rs. 4.5 million. During the financial year ending 31<sup>st</sup> March 2018, he made drawings of Rs. 0.5 million. Further, during the year under review, he introduced an additional capital totaling to Rs. 1 million from time to time.

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## Question

**You are required to:**

- (a) Differentiate financial capital maintenance concept from physical capital maintenance concept in arriving at profit. (03 marks)
  - (b) Calculate the earned profit of Siriwardane's business based on the financial capital maintenance concept. (02 marks)
- (Total 05 marks)

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