Chartered Accountancy – BL 01

Financial Accounting

Sandeepa Jayasekera

MBA (PIM-SJP), 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.

1

1

Introduction to Company Accounts

Companies Act Requirements on Financial Reporting

3

Need to keep records on Financial Position

Records shall be maintained on

- Cash Receipts and Payments
- Assets and Liabilities
- Inventory
- Sales and Purchases

The Financial Statements shall represent the Financial Position and Profits in a True and Fair manner.

4

Capital

5

Ordinary Share Capital

Companies are raising their equity capital through an ordinary share issue.

The ordinary shareholders are the owners of the company.

6

Ordinary Share Capital

There's no nominal value for the shares. Shares are measured at their issue price. The issue price can be received at once or with different stages.

Different stages of obtaining the issue price of a share

- At Application (Once you apply to buy shares)
- At Allocation (Once shares are allocated among the applicants)
- At Invitation (Once shareholders are invited to pay the balance)

Question 01

Praveen Ltd. has issued 1,000,000 shares at Rs.20/- each. The issue price of Rs.20/- is received as Rs.10/- at application, Rs.5/- at allocation and Rs.5/- at invitation.

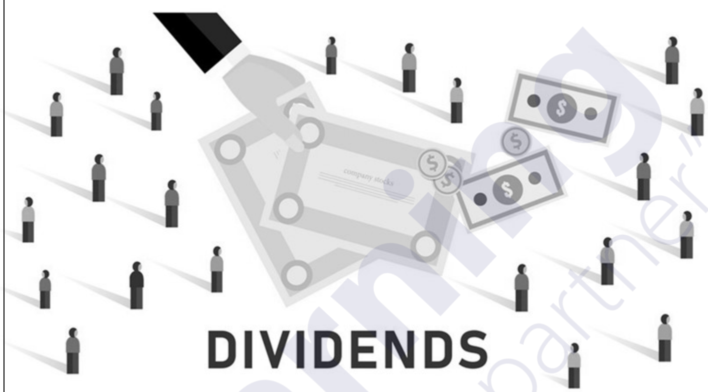
- 1,500,000 share applications were received by 01 January 20X9
- On 01st February 20X9 the excess share applications were rejected.
- On 15th February 20X9, shares were allocated.
- 15th of March 20X9, the cash on invitation was received.

Ordinary Share Dividends

Dividends are a distribution of profits among the shareholders. It can be decided either as a per share value or as a percentage of the share value.

Example

- Per share dividend is Rs.2/-
- 5% dividend per share



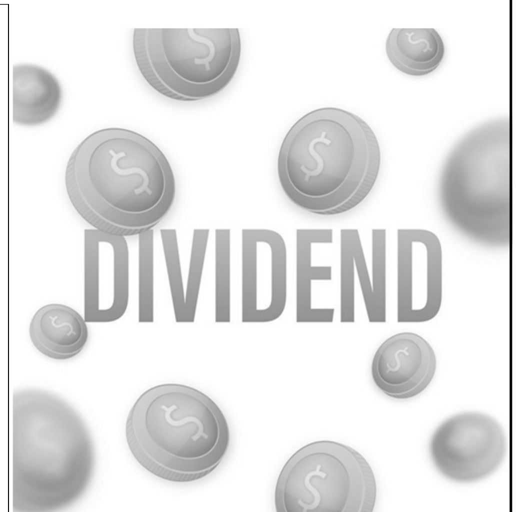
9

Ordinary Share Dividends

The ordinary shareholders are the owners of the company. They are bearing the risk of the business.

Depending on the profits made by the company the dividend amount is decided. Thereby the dividend payment can be higher or lower or may be no dividend as well.

The entire profit may not be shared as dividends, a part can be retained within the business.

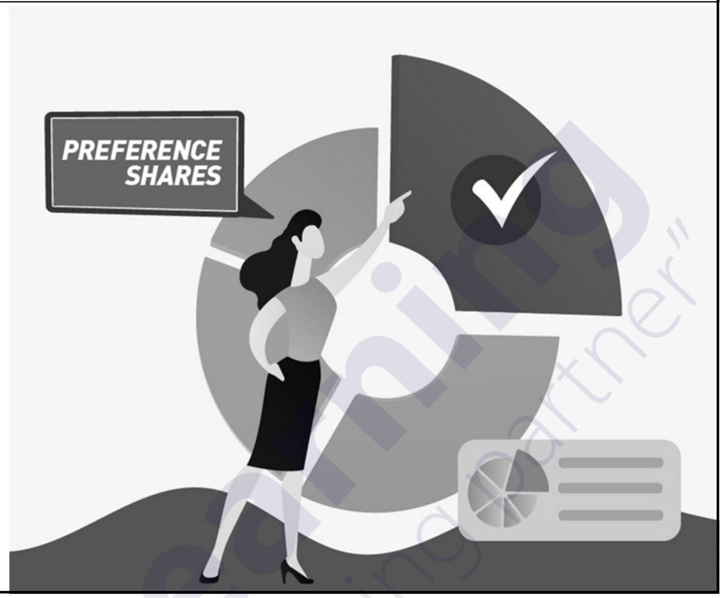


10

Preference Share Capital

Preference shares is another type of shares. The preference shareholders receive special preferential rights.

Preference shareholders are not the owners of the company. They don't have a voting power.



11

Question 02

What are the differences between preference shares and ordinary shares?

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12

Question 03

Kalani Ltd. has issued 100,000, Rs.2/- ordinary shares. They have issued 50,000 Rs.1/- preference shares (Equity nature) as well. During the year ended 31 March 20X1, company has earned a profit after tax of Rs.100,000. Company has decided to pay a 50% of the profit attributable to ordinary shareholders as a dividend.

Required

- Total dividend
- Retained profit
- Extract of the Profit or Loss

Question 04

The stated capital of Neetha PLC is Rs.2,000,000/-. Of that the issued capital is Rs.1,500,000/-. Company has decided to pay an ordinary share dividend of 5%.

Calculate the amount of ordinary share dividend.

Market Price per Share

Once the shares are issued, if the company is a publicly listed company, the shares can be traded among the shareholders in a share exchange at different prices depending on demand and supply. Such trading prices are the market price of a share.

The issue price of a share and market price of a share may be different. However, such differences need not to be accounted, as those are not making any impact to the company.

15

Debentures and Corporate Bonds

Companies can issue Debentures and Corporate bonds to raise long term debt capital.

16

Comparison of Debt Capital and Share Capital

Description	Share Capital	Debt Capital
Capital provided by	Shareholders, the owners	Debt providers (Public)
Return	Profit (Realized as Dividends)	Interest (Mostly Fixed)
IF return is not paid	Shareholders need to bear	Can take legal actions
Guarantees	No	Can have Assets as a Pledge
Risk	High	Low
Priority at Liquidation	Last	Before the Shareholders

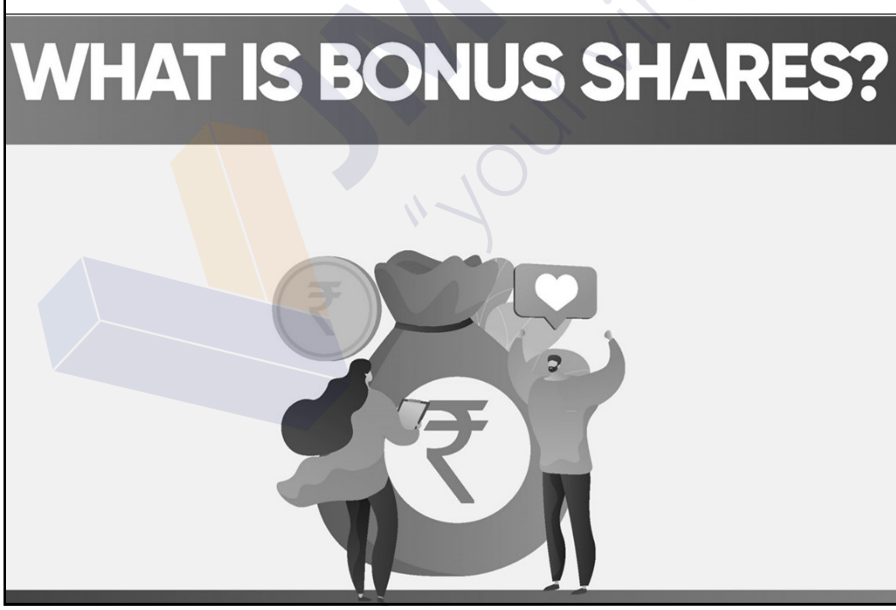
Question 05

Thilini Ltd. has issued Rs.1,000,000, debentures at 15% interest rate. Interest are paid in 30th June and 31 of December every year. If the financial year ends on 31 March, how much is the interest expense and accrued interest?

Equity

- **Capital** – Ord. share capital and pref. shares of equity nature.
- **Reserves** – Undistributed profit kept within the business for different purposes.
  - Revaluation Reserves – As explained in LKAS 16, these are the gains which cannot be shared as dividends
  - Retained Profit – The retained profit after paying the dividends.
  - Other Reserves – For these reserves amounts are transferred from profit
    - Statutory Reserves – Reserves maintained on regulatory purposes. Dividends cannot be paid.
    - Common Reserves – Reserves maintained for other purposes. IF required can be used for dividend payments,

Bonus Issue



A company can issue bonus shares to increase the stated capital.

New shares will be issued to existing shareholders free of charge.

Bonus Issue

Shareholders can sell the freely received shares in share market and realize a gain. Therefore, mostly companies are issuing bonus shares instead of paying dividends.

The accounting for bonus shares will capitalize the reserves. The value of bonus issue will be transferred from reserves to stated capital.

Reduction of reserves will reduce future dividends as well. However, bonus issue will not bring additional cashflow to the company.

Double Entry

Dr Reserves

Cr Stated Capital

21

Question 06

Financial position of Highland Ltd. is as follows.

Stated Capital (Rs.1/-)	20,000
Revaluation Reserve	14,000
Retained Profit	16,000

A bonus issue was made of 1 share for every 4 shares.

Required

Value of bonus issue, the double entry and financial position after the bonus issue.

22

Rights Issue

New shares will be issued to the existing shareholders at a price lower than the existing market value. Shareholders can subscribe the rights as per their wish and either sell them in market or keep them.

23

Rights Issue

As a result of a Rights issue the stated capital and cash will increase in a company.

Double Entry
Dr Cash/Bank
Cr Stated Capital

24

Question 07

The financial position of Roja Ltd. on 31 March 20X9 was as follows.

Stated Capital (Rs.1/-)	16,000
Revaluation Reserve	14,000
Retained Profit	20,000

A Rights Issue was made of 1 share for every 4 shares at Rs.1.20

Required

Determine the double entry and provide the financial position after the rights issue.

Question 08

The financial position of Hilma Ltd. on 31 March 20X9 was as follows.

Ordinary Share Capital Rs.2/-	200,000
Revaluation Reserve	70,000
Retained Profit	230,000

Provide the financial position after each of scenarios

1. A Bonus issue of 1 share for every 2 shares
2. After the bonus issue, an issue of rights of 1 share for every 3 shares at Rs.2.5

Financial Statements of a Limited Company for Publishing

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27

Structure of Statement of Profit or Loss and Other Comprehensive Income

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28

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XXX PLC

Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31st March 20X0

	Notes	Rs.
Sales		XXX
Cost of Sales		(XX)
Gross Profit		**XX**
Other Income	01	X
Administration Expenses		(XX)
Distribution Costs		(XX)
Other Expenses	02	(XX)
Finance Expenses	03	(XX)
Profit Before Tax	04	**XX**
Taxes		(X)
Profit After Tax		**XX**

29

29

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	Notes	Rs.
Other Comprehensive Income		
Revaluation Gain on Property, Plant and Equipment		X
Gains/Losses on remeasuring Fair Value of Available for Sale Financial Assets		X/(X)
Remeasurement Gains/Losses on Defined Retirement Benefit Plans		X/(X)
Gains/Losses arising from translating financial statements of foreign operations to local currency		X/(X)
Total Comprehensive Income		**XX**

30

30

Structure of Statement of Financial Position

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31

XXX PLC
Statement of Financial Position
As at 31st March 20X0

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	Notes	Rs.	Rs.
Assets			
Non-current Assets			
Property, Plant and Equipment	05	XX	
Intangible Assets		XX	
Investments in Associates		XX	
Other Financial Assets		XX	XX
Current Assets			
Inventory	06	XX	
Trade Receivable	07	XX	
Other Current Assets		XX	
Cash and Cash Equivalents	08	XX	XX
Total Assets			XXX

32

32

	Notes	Rs.	Rs.
Equity			
Stated Capital		XX	
Retained Earnings		XX	
Revaluation Reserves		XX	XX
Non-current Liabilities			
Other Financial Liabilities		XX	
Interest bearing Borrowings		XX	
Preference Shares		XX	XX
Current Liabilities			
Trade Payable		XX	
Accrued Expenses		XX	
Current portion of Interest bearing Borrowings		XX	XX
Total Equity and Liabilities			XXX

Structure of Statement of Changes in Equity

XXX PLC
Statement of Changes in Equity
For the year ended 31st March 20X0

	Stated Capital	Retained Earnings	Revaluation Reserve	Total
Balance as at 01.04.20X9	XX	XX	XX	XX
Share Issue	XX			XX
Net Profit for the Year		XX		XX
Revaluation Gains			XX	XX
Dividends		(X)		(X)
Balance as at 31.03.20X0	XX	XX	XX	XX

35

Accounting Notes

36

01. Other Income

	Rs.
Profit on Sale of Property, Plant & Equipment	XX
Fixed Deposit Interest	XX
Dividend Income	XX
	XX

02. Other Expenses

	Rs.
Loss on Sale of Property, Plant & Equipment	XX
Loss on Impairment of Assets	XX
Inventory Provision	XX
	XX

03. Finance Expenses

	Rs.
Dividend on Preference Shares	XX
Interest on Bank Loans	XX
Bank Overdraft Interest	XX
	XX

04. Following expenses have been deducted from Profit Before Tax

	Rs.
Director Remuneration	XX
Audit Fees	XX
Employee Salaries	XX
Depreciation	XX
Impairment Losses	XX

Property, Plant & Equipment

	Land	Building	Machinery	Motor Vehicles	Furniture	Total
Cost/ Revalued Amount						
Balance as at 01.04.20X9	XX	XX	XX	XX	XX	XXX
Additions		XX	XX			XXX
Revaluation	XX					XXX
Disposals				(X)		(X)
Balance as at 31.03.20X0	XX	XX	XX	XX	XX	XXX
Depreciations						
Balance as at 01.04.20X9	XX	XX	XX	XX	XX	XXX
Depreciation charge for the year		XX	XX	XX	XX	XXX
Revaluation						
Disposals				(X)		(X)
Balance as at 31.03.20X0	XX	XX	XX	XX	XX	XXX
Carrying Amount	XX	XX	XX	XX	XX	XXX

06. Inventories

	Rs.
Raw Material	XX
Work-in-progress	XX
Finished Goods	XX
	XX

07. Trade Receivable

	Rs.
Trade Debtors	XX
(-) Provision for Debtor Impairment	XX
	XX

08. Cash and Cash Equivalents

	Rs.
Short-term Investments	XX
Bank balance	XX
Cash in hand	XX
	XX

Question 01

The following trial balance was extracted from the books of **Diana Ltd.** as at 31st March 2020.

(Rs. '000)	Dr.	Cr.
Stated Capital (5,000,000 ordinary shares)		50,000
Retained Earnings as at 01st April 2019		17,000
Property, Plant and Equipment as Cost:		
Land & Buildings (cost of land is Rs. 20 million)	32,000	
Motor Vehicles	7,300	
Computer Software	12,000	
Capital Work-in-Progress	8,200	
Accumulated Depreciation as at 01st April 2019:		
Buildings		4,800
Motor Vehicles		3,200
Computer Software		3,000
Inventory as at 31st March 2020	39,400	

(Rs. '000)	Dr.	Cr.
Trade Receivables / Trade Payables	28,100	29,100
Cash in Hand and Cash at Bank	10,700	
Allowance for Trade Receivables as at 01st April 2019		3,400
Income Tax Paid	1,300	
Interim Dividend Paid – Ordinary Shares	5,000	
Cost of Sales / Sales	198,500	281,900
Other Income		3,000
12% Bank Loan		4,000
Income Tax Payable as at 01st April 2019		750
Administration Expenses	30,350	
Distribution Expenses	23,400	
Finance Expenses	8,400	
Employee Benefits (Provision for gratuity)		4,500
	404,650	404,650

The following additional information is also provided:

(1) Part of the inventory costing Rs. 800,000/- held as at 31st March 2020, was found to be obsolete and this was sold on 30th April 2020 for Rs. 400,000/- by increasing an additional transport cost of Rs. 100,000/-.

(2) On 01st October 2019, the company acquired a new computer software for Rs. 7,000,000/- and this was recorded under computer software account. On the same day, the company had to incur a further cost of Rs. 2,000,000/- to develop it to make it suitable for their business. This development cost of the computer software has been charged to administration expenses.

(3) On 31st March 2020, the land was revalued to Rs. 23,700,000/- and this has not been recorded in the books of accounts.

(4) Depreciation is calculated on the straight line basis at cost. The useful life of Property, Plant and Equipment is as follows:

Buildings	: 50 years
Motor Vehicles	: 04 years
Computer Software	: 05 years

(5) During the year, the company has recovered Rs. 1,500,000/- from a debtor who had been written-off as a bad debt in the previous years and this amount was credited to trade receivables account. Further, a general provision of 10% has to be made from the trade receivables balance as at 31st March 2020.

(6) Insurance payment of Rs. 1,200,000/- which was paid for the entire calendar year of 2020, was recorded under administration expenses.

(7) The following expenses are required to be accrued as at 31st March 2020:

	Rs.
Electricity	300,000
Water	150,000

(8) The Income Tax Liability of the company for the year of assessment 2019/20 is estimated to be Rs. 2,300,000/-.

(9) The financial statements were authorized for issue by the Board of Directors on 05th June 2020.

Considering the above information,

You are required to:

Prepare the following, for **Diana Ltd.** in a form suitable for publication.

(a) Statement of Profit or Loss and Other Comprehensive Income (Comprehensive Income Statement) for the year ended 31st March 2020. (10 marks)

(b) Statement of Financial Position as at 31st March 2020. (08 marks)

(c) Statement of Changes in Equity for the year ended 31st March 2020. (03 marks)

(d) Statement showing movement of Property, Plant and Equipment for the year ended 31st March 2020. (04 marks)

(Total 25 marks)

Question 02

The following trial balance was extracted from the books of **Diamond PLC** as at 31st March 2020:

(Rs. '000)	Dr.	Cr.
Stated Capital (6,000,000 ordinary shares)		60,000
Retained Earnings as at 01st April 2019		19,300
Property, Plant and Equipment at Cost:		
Land & Buildings (Cost of land is Rs. 38 million)	45,000	
Plant and Machinery	10,250	
Office Equipment	6,300	
Accumulated Depreciation as at 01st April 2019:		
Buildings		4,500
Plant & Machinery		3,700
Office Equipment		2,100
Inventory as at 31st March 2020	35,300	
Trade Receivables / Trade Payables	18,100	17,100

(Rs. '000)	Dr.	Cr.
Cash in Hand and Cash at Bank	8,350	
Allowance for Trade Receivables as at 01st April 2019		3,000
Pre-payments	6,000	
Income Tax Paid	4,200	
Interim Dividend Paid – Ordinary Shares	6,500	
Cost of Sales / Sales	205,000	281,000
Other Income		6,000
Income Tax Payable as at 01st April 2019		2,750
Administration Expenses	34,550	
Distribution Expenses	24,400	
Finance Expenses	2,400	
Bank Loan		2,500
Employee Benefits (Provision for Retirement)		4,400
	406,350	406,350

The following additional information is also provided:

(1) The net realizable value of the inventory as at 31st March 2020 was Rs. 34,875,000/-.

(2) One of its customers who owed Rs. 500,000/- to the business was declared bankrupt on 20th May 2020, thus the amount in due became irrecoverable. No provision has been made in the books of accounts in this regard. Further, it was decided to maintain the allowance for receivables at 10% of the remaining balance as at 31st March 2020.

(3) Audit fee of Rs. 400,000/- related to the financial year 2019/20 has not been accounted and pre-payment account represents insurance payment made for entire calendar year 2020.

(4) On 31st March 2020, the company disposed a machinery for Rs. 350,000/- which was purchased on 01st April 2018 at Rs. 500,000/-. Cash received on disposal has been debited to cash book and credited to machinery account. Other than that no entries were made in respect of the disposal of machinery.

(5) Property, Plant and Equipment are to be depreciated on the straight-line basis at cost. The useful life of the assets is as follows:

Buildings	: 50 years
Plant and Machinery	: 04 years
Office Equipments	: 05 years

(6) The company carried out an impairment test on 31st March 2020 and it was revealed that fair value less cost of disposal of office equipment was Rs. 2,540,000/-. Value in use of the office equipment was Rs. 2,800,000/-. There were no adjustments made in the books of account regarding the impairment.

(7) As at 31st March 2020, the company revalued its land for Rs. 40,000,000/- and it is not recorded in the books of accounts.

(8) ½ of the bank loan balance as at 31st March 2020 should be settled in the year 2020/21.

(9) The total income tax liability for the year 2018/19 was Rs. 2,750,000/- which was paid during the year ended 31st March 2020 and the amount paid has been charged to the income tax paid account. The total income tax liability for the year 2019/20 is estimated as Rs. 3,300,000/-.

(10) The directors of the company approved the financial statements for issue on 30th June 2020.

You are required to:

Prepare the following, for **Diamond PLC** in a form suitable for publication:

(a) Statement of Profit or Loss and Other Comprehensive Income (Comprehensive Income Statement) for the year ended 31st March 2020. (10 marks)

(b) Statement of Financial Position as at 31st March 2020. (08 marks)

(c) Statement of Changes in Equity for the year ended 31st March 2020. (03 marks)

(d) Statement showing movement of Property, Plant and Equipment for the year ended 31st March 2020. (04 marks)

(Total 25 marks)

Question 03

The following trial balance was extracted from the books of Nazeen Ltd. as at 31st March 2021

(Rs. '000)	Dr.	Cr.
Property, Plant and Equipment at Cost:		
Land & Buildings (Cost of land is Rs. 25 million)	37,500	
Plant and Machinery	6,250	
Motor Vehicle	9,600	
Accumulated Depreciation as at 01st April 2020:		
Buildings		7,500
Plant & Machinery		3,750
Motor Vehicle		5,000
Inventory as at 31st March 2021	8,920	
Trade Receivables	14,180	
Advance Account	2,806	
Pre-payments	1,200	

(Rs. '000)	Dr.	Cr.
Cash in Hand and at Bank	805	
Bank Loan		3,600
Provision for Gratuity		1,250
Trade Payables		6,800
Income Tax Payables as at 01st April 2020		720
Allowance for Trade Receivables		3,000
Cash Received on Disposal of Motor Vehicles		4,500
Cost of Sales/Sales	67,760	100,400
Director's Fees	1,200	
Audit Fees	270	
Other Administration Expenses	10,240	
Distribution Expenses	7,210	
Interest Expenses	718	
Income Tax Paid	2,000	

(Rs. ‘000)	Dr.	Cr.
Interim Dividend Paid	1,000	
Stated Capital (700,000 Ordinary Shares)		7,000
Retained Earnings as at 01st of April 2020		28,139
	171,659	171,659

The following additional information is also provided:

(1) Property, Plant and Equipment are to be depreciated on the straight-line basis at cost. The
useful life of the assets is as follows:

Buildings : 50 years
Plant and Machinery : 05 years
Motor vehicles : 05 years

(2) Motor vehicle recorded in the ledger for Rs.9.6 million at cost had been disposed for Rs.4.5 million on 31st December 2020, but it is not updated in the ledger accounts yet except the entry on cash received on disposal. The sale proceeds of this vehicle is recorded in the cash received on disposal of motor vehicle account.

(3) A new motor vehicle was purchased during the year under a finance lease on 01st April 2020. Fair value of the leased motor vehicle was Rs. 5 million and the lease term is 5 years. Annual lease Installment of Rs.806,000/- should be settled on 31st March each year. Implicit interest rate is 11% per annum. The ownership of the Motor vehicle is transferred to Nazeen Ltd. at the end of lease term. Down payment made on the motor vehicle of Rs.2 million and 01st installment of Rs.806,000/- have been recorded in the advance account. Other than that no entries were made in the books of account in this regard.

(4) Pre-payment account consists of the rent paid in advance for the calendar year 2021. Monthly rent is Rs.100,000/-.

(5) The following expenses have not been accrued / provided as at 31st March 2021 in the books of accounts:

- Internet and telephone bills for the month of March 2021 - Rs.55,000/-
- Gratuity Provision for the year of Rs.500,000/-

(6) ½ of the loan balance as at 31st March 2021 should be settled in the year 21/22.

(7) As at 31st March 2021, there was a customer who had an outstanding balance of Rs.2.5 million was overdue for more than 360 days. This amount was already provided in the accounts. However, an amount of Rs.2.2 million was settled by the customer in April 2021 and the balance was decided to write-off as bad debts during the year ended 31st March 2021.

(8) Tax liability for the year of assessment 2020/21 was estimated as Rs.1.5 million.

(9) The board of directors of the company approved the financial statements for issue on 30th May 2021.

You are required to:

Prepare the following, for Nazeen Ltd. in a form suitable for publication:

(a) Statement of Profit or Loss and Other Comprehensive Income (Comprehensive Income Statement) for the year ended 31st March 2021. (10 marks)

(b) Statement of Financial Position as at 31st March 2021. (09 marks)

(c) Statement of Changes in Equity for the year ended 31st March 2021. (02 marks)

(d) Statement showing movement of Property, Plant and Equipment for the year ended 31st March 2021. (04 marks)

(Total 25 marks)

Ratio Analysis

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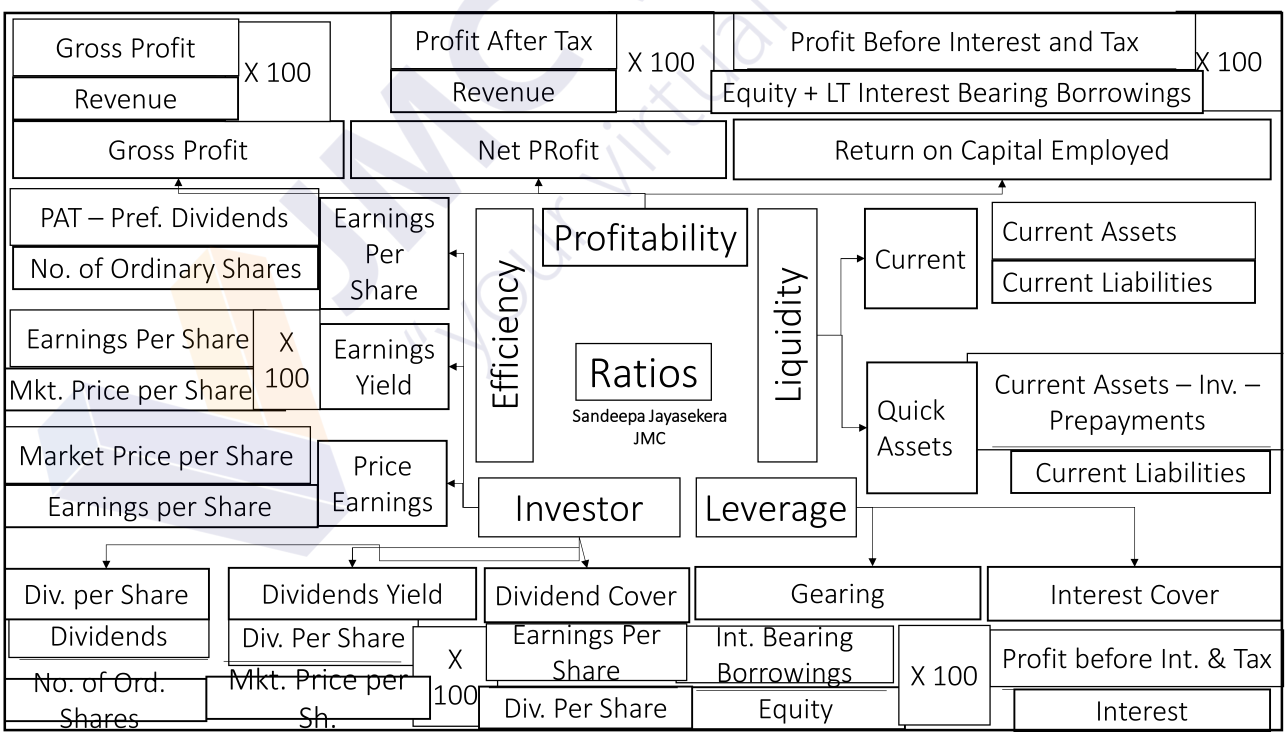
57

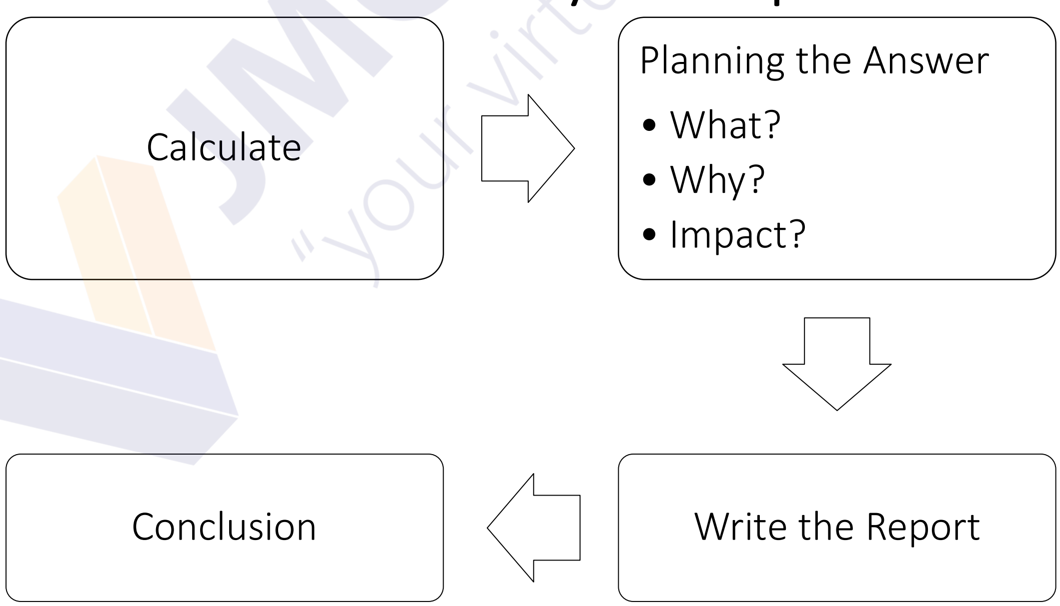


58

Ratios provide the **Relationship** of **Two Financial Statement Figures** as a

- Percentage
- Times
- Days

Ratio Analysis Steps



Profitability

- Gross Profit Margin
- Net Profit Margin
- Return on Capital Employed

61

61

Gross Profit Margin	Gross Profit/Sales X 100
Net Profit Margin	Profit After Tax/Sales X 100
Return on Capital Employed (ROCE)	$\dfrac{\text{Interest + Profit Before Tax}}{\text{Long Term Interest Bearing Borrowings + Equity}} \times 100$

62

NP Margin

Point	Explanation
Definition	Per rupee sales how much of Net profits were generated
Reflects	Overall efficiency and effectiveness in management
Higher the ratio	Higher the efficiency and management Higher savings for company growth Higher ability to declare dividends

63

Investor Ratios

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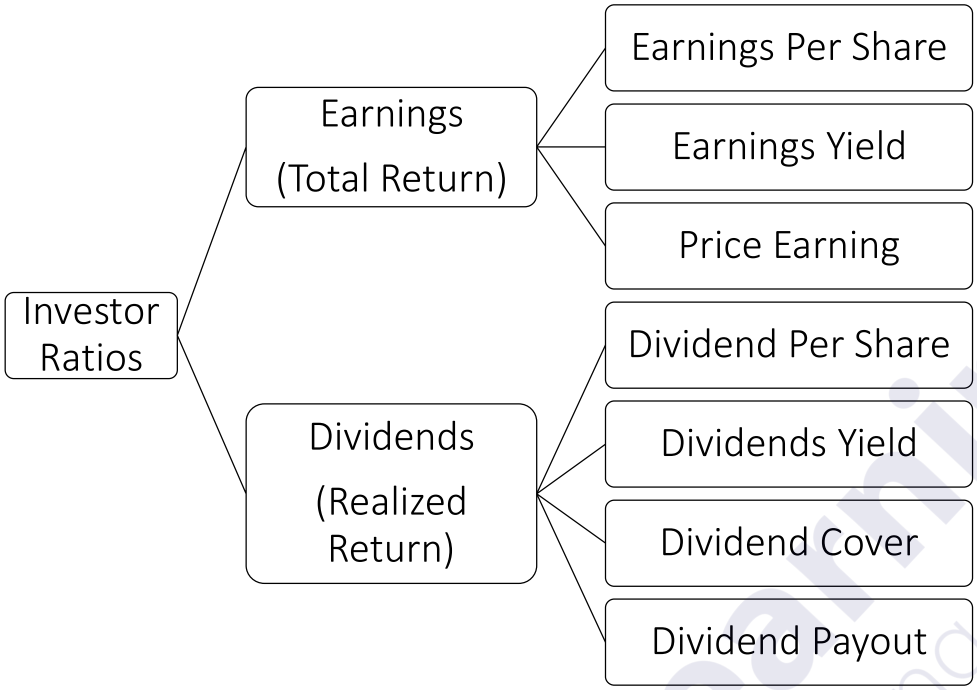
64



65

65

EPS

Point	Explanation
Definition	Per ordinary share, how much of earnings has been generated
Reflects	Distribution of Earnings among the Ordinary Shareholders
Higher the ratio	• Higher earnings generated for ordinary shareholders • Higher ability to pay dividends

66

66

Price Earning

Point	Explanation
Definition	Number of times of Earnings required to recover the investment (Investment Recovery Period)
Reflects	• Investors faith over growth potential • Investor's Risk Appetite
Higher the ratio	• Investors are having growth prospects about the company • Mature Company
Lower the ratio	• Either ○ Company is doing exceptionally well in return ○ Company may be undervalued

Dividends Based Ratios

Dividend Per Share (DPS): $\frac{\text{Ordinary Share Dividends}}{\text{Weighted Average Number of Ord Shares}}$

Dividend Yield: $\frac{\text{Dividend Per Share}}{\text{Market Price Share}} \times 100$

Dividend Cover: $\frac{\text{Earnings Per Share}}{\text{Dividend Per Share}}$

Dividend Payout: $\frac{\text{Dividend Per Share}}{\text{Earnings Per Share}} \times 100$

Dividends Yield

Point	Explanation
Definition	Per rupee investment (Cost) how much of dividends (Realized Return) being paid
Reflects	• Dividend payout per market price
Higher the ratio	• Investors gets encouraged • Affect the growth, as dividend is a cash outflow

Dividend Cover

Point	Explanation
Definition	How many times dividends can be paid out of the earnings
Reflects	• Dividend coverage over earnings • Dividend policy
Higher the ratio	• Investors are discouraged as low dividend paid • Beneficial for the growth

Liquidity Ratios

Different Types of Current Assets

Inventory	• Less Liquid
Prepayments	• Less Liquid
Trade Receivables	• High Liquid
Short Term Investments	• High Liquid
Cash & Cash Equivalents	• High Liquid

Current Ratio

Quick Asset Ratio

Liquidity Ratios (Times)

Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Quick Asset Ratio	$\frac{\text{(Current Assets – Inventory – Prepayments)}}{\text{Current Liabilities}}$

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73

Quick Asset (Acid Test) Ratio

Point	Explanation
Quick Assets	Current Assets – Inventory - Prepayments
Definition	How much of Quick Assets available for per rupee of Current Liability
Reflects	Adequacy of quick assets to settle current liabilities
Higher the ratio	Strong ability to settle current liabilities Stronger Liquidity position

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74

Leverage Ratios

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75

Gearing Ratio

$$\frac{\text{Interest Bearing Borrowings}}{\text{Equity}} \times 100$$

Interest Cover

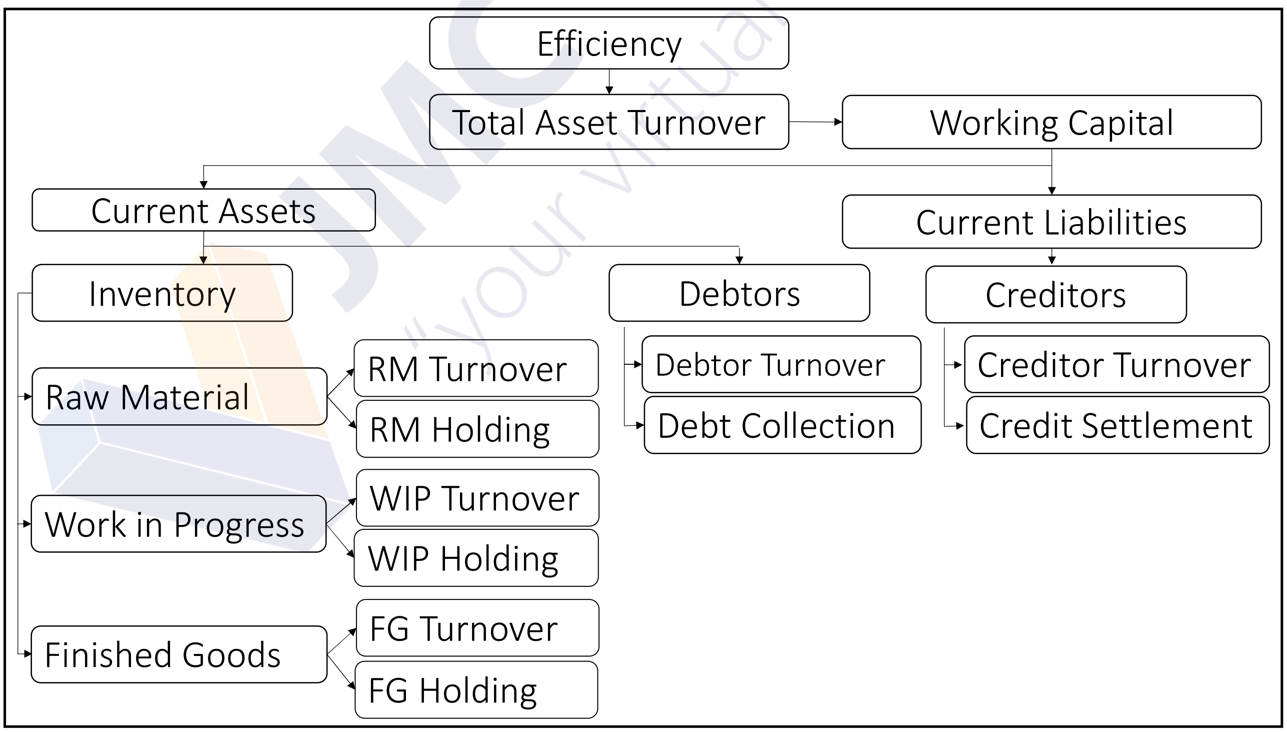
$$\frac{\text{Operating Profit}}{\text{Interest Expense}}$$

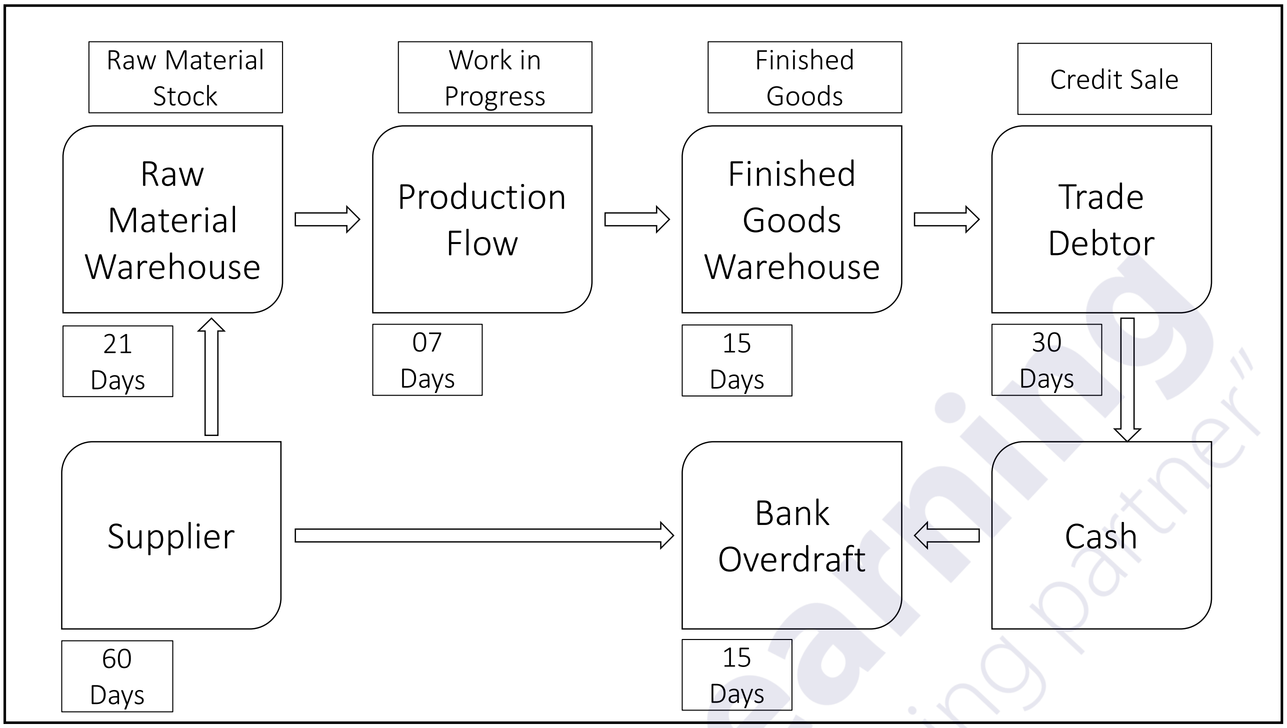
JMC 76

76

Interest Cover

Point	Explanation
Definition	How many times Interest can be paid out of Operating Profit
Reflects	Adequacy of earnings to settle interest payments
Higher the ratio	• Higher ability to pay interest • Higher ability to obtain further loans • Lower risk of defaulting interest payments • Lower solvency risks





79

How many days does raw materials remained in raw material warehouse?	21 Days	Raw Material Holding Period
In a year, on average how many times raw materials are issued to production flow?	365/21 17 Times	Raw Material Turnover
How many days it took to convert raw materials to finished goods (Production lead time)?	07 Days	Work in Progress Holding Period
In a year, on average, What is the number of production batches?	365/07 52 Times	Work in Progress Turnover

80

How many days does finished goods remained in warehouse before becoming a sale?	15 Days	Finished Goods Holding Period
In a year, on average how many times does finished goods were sold?	365/15 24 Times	Finished Goods Turnover
How many days offered to trade debtors as credit period?	30 Days	Debt Collection Period
In a year, on average, how many times does a trade debtor has settled the due amounts?	365/3 12 Times	Debtor Turnover

81

How many days offered by suppliers as credit period?	60 Days	Credit Settlement Period
In a year, on average, how many times does entity has settled the trade payables?	365/60 06 Times	Creditor's Turnover

82

Asset Turnover Ratios (Times)

Total Asset Turnover	• Sales/Total Assets

83

Total Asset Turnover - Explanation

Point	Explanation
Definition	Per rupee asset how many **times** sales were generated in a given period of time
Reflects	Asset utilization in terms of generating sales
Higher the ratio	Higher the asset utilization Lower overstatements in assets Lower idle and unnecessary assets

84

Inventory Turnover Ratios (Times)

Raw Material Turnover	$\frac{\text{Raw Material Consumption}}{\text{Average Raw Materials}}$
Work in Progress Turnover	$\frac{\text{Cost of Production}}{\text{Average Work in Progress}}$
Finished Goods Turnover	$\frac{\text{Cost of Sales}}{\text{Average Finished Goods}}$

85

Inventory Turnover Requisites

Raw Material Consumption	Opening Raw Material Stock + Raw Material Purchases (-) Closing Raw Material Stock
Cost of Production	Cost of Sales + Closing Finished Goods Stock (-) Opening Finished Goods Stock

86

Inventory Holding Ratios (Days)

Raw Material Holding Period = $\frac{365}{\text{Raw Material Turnover}}$

Raw Material Holding Period = $\frac{365}{\text{RM Consumption}}$ X Average Raw Material Stock

Work in Progress Holding Period = $\frac{365}{\text{Work in Progress Turnover}}$

Work in Progress Holding Period = $\frac{365}{\text{Cost of Production}}$ X Average Work in Progress Stock

Inventory Holding Ratios (Days)

Finished Goods Holding Period = $\frac{365}{\text{Finished Goods Turnover}}$

Finished Goods Holding Period = $\frac{365}{\text{Cost of Sales}}$ X Average Finished Goods Stock

Raw Material Turnover - Explanation

Point	Explanation
Definition	How many times raw materials have been issued to the production during a given period of time
Reflects	Movability of raw materials from Raw materials warehouse to production
Higher the ratio	Highly moving raw materials Lower slow-moving inventories Lower risk of impairment, obsolescence Lower risk of cash tied up in raw materials

89

Raw Material Holding Period - Explanation

Point	Explanation
Definition	How many days raw materials were within the Raw Material warehouse prior to be issued to production
Reflects	Movability of raw materials
Lower the ratio	Highly moving raw materials Lower slow-moving inventories Lower risk of impairment, obsolescence Lower risk of cash tied up in raw materials

90

Work in Progress Turnover - Explanation

Point	Explanation
Definition	How many times work in progress have become finished goods during a given period of time (No. of Production Batches)
Reflects	Manufacturing efficiency
Higher the ratio	Highly moving work in progress Lower slow-moving work in progress Lower risk of impairment, obsolescence Lower risk of cash tied up in work in progress

91

Work in Progress Holding Period - Explanation

Point	Explanation
Definition	How many days work in progress were within the Production prior becoming a finished good (Manufacturing Time)
Reflects	Manufacturing efficiency
Lower the ratio	Highly moving work in progress Lower slow-moving work in progress Lower risk of impairment, obsolescence Lower risk of cash tied up in work in progress

92

Finished Goods Turnover - Explanation

Point	Explanation
Definition	How many times finished goods have become sales during a given period of time
Reflects	Movability and income generation frequency of finished goods
Higher the ratio	Highly moving finished goods Lower slow-moving finished goods Lower risk of impairment, obsolescence Lower risk of cash tied up in finished goods

93

Finished Goods Holding Period - Explanation

Point	Explanation
Definition	How many days Finished Goods were within the Finished Goods warehouse prior becoming a sale
Reflects	Movability and income generation frequency of finished goods
Lower the ratio	Highly moving finished goods Lower slow-moving finished goods Lower risk of impairment, obsolescence Lower risk of cash tied up in finished goods

94

Debtor Turnover (Times)

Debtor Turnover

$$\frac{\text{Credit Sales}}{\text{Average Debtors}}$$

95

Debt Collection Period (Days)

Debt Collection Period

$$\frac{365}{\text{Debtor Turnover}}$$

Debt Collection Period

$$\frac{365}{\text{Credit Sales}} \text{ X } \text{Average Debtors}$$

96

Debtor Turnover - Explanation

Point	Explanation
Definition	How many times a debtor has settled the debt in a given period of time
Reflects	Frequency of debt recoveries
Higher the ratio	Higher recoveries Aggressive recovering strategy Lower risk of debtor impairment Negative impacts over relationships with the customers

97

Debtor Collection Period - Explanation

Point	Explanation
Definition	How many days an average debtor takes to settle the debt.
Reflects	Credit period given to debtors
Lower the ratio	Higher recoveries Aggressive recovering strategy Conservative credit policy Lower risk of debtor impairment Negative impacts over relationships with customers

98

Creditor Turnover (Times)

$$\text{Creditor Turnover} = \frac{\text{Credit Purchases}}{\text{Average Creditors}}$$

Credit Settlement Period (Days)

$$\text{Credit Settlement Period} = \frac{365}{\text{Creditor Turnover}}$$

$$\text{Credit Settlement Period} = \frac{365}{\text{Credit Purchases}} \times \text{Average Creditors}$$

Limitations of FSA

- Historical
- Subjectivity
- Only Monetary
- Negativity Effect
- Inflation Ignored
- Absence of Standard
- Differences in Acc. Policies
- Financial Position is a Snap Shot
- Manipulations (Window Dressing, Changes in Ac. Estimates etc.)

Question 01

The following information has been extracted from the Financial Statements of **Eco Protect Lanka (Pvt) Ltd.** as at / for the year ended 31st March 2018 and 31st March 2017:

(Rs. '000)

For the year ended	31st March 2018	31st March 2017
Turnover	220,650	199,500
Cost of Sales	147,835	137,655
Gross Profit	72,815	61,845
Profit before interest and income tax	17,750	18,220
Profit for the year	15,620	15,820
As at	**31st March 2018**	**31st March 2017**
Inventories	12,200	10,550
Trade Receivables	28,200	22,500
Shareholders' Equity	121,030	105,410
Bank Loans	9,950	10,350
Stated Capital (1,000,000 ordinary shares)	100,000	100,000

The following industry averages have also been identified:

Gross profit ratio	40%
Net profit ratio	12%
Return on Capital Employed (ROCE)	8%
Stock turnover ratio	10 times
Debtors' turnover ratio	9 times
Debtors' collection period	40 days

Assume that all sales were made on credit terms and there was no other comprehensive income for the year.

You are required to:

Analyse the performance of **Eco Protect Lanka (Pvt) Ltd.** for the year ended / as at 31st March 2018, considering the industry averages identified above. (10 marks)

Answer 01

Ratio	Formula	2018	Industry Average
Gross Profit Margin	Gross Profit/Sales X 100	72,815/220,650X100 =33%	40%
Net Profit Margin	Profit After Tax/Sales X 100	15,620/220,650X100 =7%	12%
Return on Capital Employed	Profit before Interest and Tax/(Equity + Interest bearing Long-Term Debt) X 100	17,750/(121,030+9950)X100 =13.55%	8%
Stock Turnover	Cost of Sales/Inventory	147,835/(12,200+10,550)/2 =13 times	10 times

Answer 01

Ratio	Formula	2018	Industry Average
Debtor Turnover	Sales/Receivables	220,650/(28,200+22,500)/2 =8.7 times	9 times
Debt Collection Period	365/Sales X Receivables	365/8.7 =42 Days	40 Days

To : Eco Protect Lanka (Pvt) Ltd
From : Financial Consultant
Date : 31/7/2021

I'm pleased to submit this report analyzing the profitability and efficiency of Eco Lanka (Pvt) Ltd for the year ended 31 March 2018 with the industry averages.

Despite the improvement in revenue by 10% compared to previous year and the increase in gross profit margin, yet the company has a lower gross profit margin than the industry. This may be either due to lower sales prices than the market rates or due to higher cost of sales caused by inefficiencies.
The net profit margin is even lower by 41% than the industry average. This may be partly due to lower gross profits and comparatively higher operating expenses in Eco Private Ltd. The cost controls, systems and waste may be causing comparatively lower profitability.

The return on capital employed shows a 69% higher ratio than the industry. This may be due to lower debt capital in the company than the industry. We can observe that the company's gearing position is only 8% resulting in a low geared situation. Therefore, other companies in industry may be using debt funding than Eco Lanka.
The inventory turnover of the company is 30% higher in company. Therefore, the sales volume may be higher than the industry. This may be due to company's application of lower prices and high-volume strategy.
The debtor turnover and the debt collection period is compatible to industry with minor variance.

Conclusion
Overall the recommendations would be to revisit the pricing strategy and increase marketing awareness of the company. There's a possibility to expand the company with debt funding as company is less geared.

107

Question 02

The following additional information is also extracted for the year ended 31st March 2018 from Indochem PLC (ICL) and Takasago (Pvt) Ltd. (TL):

	ICL (Rs.'000)	TL (Rs.'000)
Current Assets	66,850	35,600
Current Liabilities	26,900	17,900
Sales	175,000	89,000
Purchases	64,000	36,000
Equity	97,750	26,700
Long-Term Interest Bearing Debt Non-Current Portion	10,200	0
Long-Term Interest Bearing Debt Current Portion	5,200	5,500
Trade Payables	13,100	8,000

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108

Question 02

(1) Credit purchases is 80% from the total purchase.
(2) Trade payables as at 31st March 2017 of ICL and TL were Rs.12 million and Rs.6 million respectively.

You are required to:
Compute the following ratios for both companies:
(a) Current Assets Ratio.
(b) Gearing Ratio.
(c) Creditors' Turnover Ratio. (06 marks)

Answer 02

Ratio	Formula	Indochem	Takasago
Current Ratio	Current Assets : Current Liabilities	66,850:26,900 2.48:1	35,600:17,900 1.98:1
Gearing	Long-term Interest Bearing Debt/Equity X 100	(10,200+5,200)/97,750 X 100 15.75%	5,500/26,700X100 =20.6%
Creditor's Turnover	Credit Purchases/Trade Payables	(64,000X80%)/(12,000+13,100)/2 4.08 Times	(36,000X80%)/(6,000+8,000)/2 4.11 Times

Question 03

The following information has been extracted from the Financial Statements of **Sabco Ltd.** as at / for the year ended 31st March 2019 and 31st March 2018:

Extract of Statement of Comprehensive Income *(Rs. '000)*

For the year ended	31st March 2019
Turnover	220,700
Cost of Sales	143,780
Gross Profit	76,920
Profit before Interest and Tax	34,760
Profit After Tax	16,177

Extract of Statement of Financial Position *(Rs. '000)*

As at	31st March 2019	31st March 2018
Inventories	25,250	16,400
Trade Receivables	27,580	19,850
Equity	125,600	118,000
Long-term Loan	12,000	15,600

Assume that all sales are on credit basis.

You are required to:

(a) **Compute** the following ratios based on the above information for the financial year ended 31st March 2019:
(i) Gross Profit Ratio.
(ii) Debtors' Collection Period.
(iii) Stock Residence Period.
(iv) Return on Capital Employed (ROCE). (06 marks)

(b) **List** two (02) possible actions each for further improvements of below ratios:
(i) Gross Profit Ratio.
(ii) Debtors' Collection Period. (04 marks)
(Total 10 marks)

Answer 03

Ratio	Formula	2019
Gross Profit Margin	Gross Profit/Sales X 100	76,920/220,700X100 =34.5%
Debtor's Collection Period	365/Credit Sales X Average Debtor	365/220,700X(27,580 +19,850)/2 39 Days
Stock Residence Period	365/Cost of Sales X Average Stock	365/143,780X(25,250 +16,400)/2 53 Days
Return on Capital Employed	Profit before Interest and Tax/(Equity + Long-term Interest bearing Debt) X 100	34,760/(125,600+12,000)X100 =25.3%

Answer 03

Improve Gross Profit

- Increase Sales
  - Better pricing
  - Increased marketing
  - Increased branding and promotions
  - Sales targets
  - Change the product mix
  - Increased geographical coverage

Answer 03

Improve Gross Profit

- Reduce Cost of Sales
  - Cost controls
  - Increase quality
  - Reduce waste
  - Use of technology
  - Management techniques to reduce cost

Improve Debtor's Collection

- Strengthen recovery controls
- Debtor's factoring
- Discounts

Question 04

Explain three (03) limitations of ratio analysis. (06 marks)

Answer 04

Absence of proper standards

The ratios are not governed by a regulatory body. Therefore, standard definitions are not available for ratios. For an example the net profit margin may use profit before tax as well as profit after tax as the numerator. Further, gearing is calculated as debt divided by equity and debt divided by debt plus equity. This creates confusions in reaching conclusions.

117

Answer 04

Window dressing

The ratios are prepared based on financial statements. The financials can be manipulated using accounting estimates, leading and lagging, fake transactions etc. Thus, the ratios may even show a manipulated picture.

Only quantitative

Ratios are only numerical figures and it covers the quantitative aspects of the entity. However, the qualitative aspects such as humanitarian aspects, nature protections, employee welfare, social responsibilities etc. are not being covered.

118

Question 05

The following information has been extracted from the Financial Statements of **Medi Tec (Pvt) Ltd.** as at / for the years ended 31st March 2019, 31st March 2018 and 31st March 2017:

Extract from Statements of Comprehensive Income *(Rs.'000)*

For the year ended	31st March 2019	31st March 2018	31st March 2017
Turnover	300,000	275,000	260,000
Cost of sales	179,960	178,425	169,450
Gross profit	120,040	96,575	90,550
Profit before interest and Tax	43,000	38,000	41,250
Profit after Tax	27,500	28,300	27,800

Extract from Statements of Financial Position *(Rs. '000)*

As at	31st March 2019	31st March 2018	31st March 2017
Current Assets:			
Inventories	19,000	15,000	14,000
Trade Receivables	40,500	27,000	21,500
Cash and cash equivalents	8,500	6,200	7,400
	68,000	**48,200**	**42,900**
Equity:			
Stated capital	110,000	110,000	110,000
Retained earnings	60,000	32,500	4,200
	170,000	**142,000**	**114,200**
Long-term Loan	42,000	56,000	38,000
Current Liabilities:			
Trade Payables	19,500	16,200	15,300
Income Tax Payables	9,500	9,100	7,600
Accrued Expenses	8,500	6,100	6,800
	37,500	**31,400**	**29,700**

You may assume that all sales are made on credit basis.

Using the above information,

You are required to:

Analyze the performance of **Medi Tec (Pvt) Ltd.** for the years ended / as at 31st March 2018 and 31st March 2019 calculating the following ratios:

(a) Gross Profit Ratio

(b) Net Profit Ratio

(c) Stock Turnover Ratio

(d) Debtors' Collection Period

(e) Return on Capital Employed (ROCE)

(10 marks)

Answer 05

Ratio	Formula	2019	2018
Gross Profit Margin	Gross Profit/Sales X 100	120,040/300,000X100 =40%	96,575/275,000X100 =35%
Net Profit Margin	Profit after Tax/Sales X 100	27,500/300,000X100 =9.1%	28,300/275,000X100 =10.3%
Stock Turnover	Cost of Sales/Average Stock	179,960/(19,000+15,000)/2 =10.6 Times	178,425/(15,000+14,000)/2 =12.3 Times

Answer 05

Ratio	Formula	2019	2018
Debtor's Collection Period	365/Credit Sales X Average Debtor	365/300,000X(40,500 +27,000)/2 =41 Days	365/275,000X(27,000 +21,500)/2 =32 Days
Return on Capital Employed	Profit before Interest and Tax/(Equity + Long-term Interest bearing Debt) X 100	43,400/(170,000+42,000)X100 =20.48%	38,300/(142,000+56,000)X100 =19.29%

To : Chief Executive Officer
From : Financial Consultant
Date : 31/7/2021

I'm pleased to submit this report analyzing the profitability and efficiency of Medi Tec (Pvt) Ltd for the year ended 31 March 2018 and 2019.

The gross profit margin has increased from 35% to 40%. Given the cost of sales remain the same amount, the increase in gross profits is mainly driven by a selling price increase. The sustainability of a price increase shall be assessed based on nature of product, elasticity of demand, market structure and competition.
However, the net profit margin shows a decline, this may be due to higher operational expenses and finance cost may be. Overall the return on capital employed has slightly increased as a result of increase in operating profits created through increase in gross profits.

The stock turnover has been reduced from 12.3 times to 10.6 times. This shows that the volume of inventory moving has been reduced. The inventory has increased creating a risk of impairment, obsolescence and cash tied up in inventory.

The debt collection period has increased from 32 days to 41 days. This can be observed from the increase in trade receivables as well. This cause a risk of debtor impairment and cash tied up in debtors.

Despite, the revenue increased by increase in selling prices, the inventory is getting piled up and debtors are getting aged. These shall be considered.

125

Question 06

The following ratios have been calculated by Wakkumbura Holdings PLC for the financial years ending 31st March 2019 and 31st March 2018.

	2018/19	2017/18
Current ratio	1.75	1.5
Return on Capital Employed (ROCE)	11%	13%
Stock residence period	50 days	38 days

You are required to:

State two (02) possible reasons for the variations in each of the above computed ratios during the 2018/19 in compared with 2017/18. (05 marks)

Answer 06

Current Ratio

- Increase in current assets
  - Sales promotions
  - Debtor recoveries
- Reduction in current liabilities
  - Settling the loans obtained
  - Renting out than outright purchase

Answer 06

Return on Capital Employed

- Operating profit
  - Reduction in sales
  - Increase in operational expenses
- Debt capital
  - Increase in borrowings

Answer 06

Stock Residence Period

- Drop in sales
- Slow moving inventory
- Obsolete inventory
- Inefficiencies in warehousing

Question 07

The following information has extracted from the Financial Statements of **Delta Ltd.** as at / for the year ended 31st March 2020 and 31st March 2019:

Extract from Statement of Comprehensive Income *(Rs. '000)*

For the year ended	31st March 2020
Sales	92,500
Cost of Sales	62,900
Gross Profit	29,600
Profit Before Interest and Tax	10,700
Interest Expenses	2,200
Profit After Tax	5,500

Extract of Statements of Financial Position (Rs.'000)

As at	31st March 2019	31st March 2018
Inventories	15,000	16,500
Trade Receivables	11,700	12,700
Current Assets	31,300	34,000
Current Liabilities	19,000	17,500
Equity	16,500	11,000
Long-term loan	4,500	6,000

The following ratios have been computed for **Delta Ltd.** for the year ended 31st March 2019.

Gross Profit Ratio	30%
Net Profit Ratio	10%
Debtors' Collection Period	45 days
Inventory Residence Period	85 days
Current Ratio	1.94 : 1
Interest Cover	4 times

You may assume that all sales are made on credit basis.

You are required to:

(a) **Calculate** the following ratios based on the above information for the year ended / as at 31st March 2020.

(i) Gross Profit Ratio

(ii) Net Profit Ratio

(iii) Debtors' Collection Period

(iv) Inventory Residence Period

(v) Current Ratio

(vi) Interest Cover

(06 marks)

(b) **Analyze** the performance of **Delta Ltd.** for the year ended / as at 31st March 2020 considering the computed ratios for the previous year. (06 marks)

(Total 12 marks)

Answer 07

Ratio	Formula	2020	Industry Average
Gross Profit Margin	Gross Profit/Sales X 100	29,600/92,500X100 =32%	30%
Net Profit Margin	Profit After Tax/Sales X 100	5,500/92,500X100 =6%	10%
Debt Collection Period	365/Sales X Average Receivables	365/92,500X(11,700+ 12,700)/2 =48 Days	45 Days
Stock Residence Period	365/Cost of Sales X Average Inventory	365/62,900X(15,000+ 16,500)/2 =91 Days	85 Days

Answer 07

Ratio	Formula	2018	Industry Average
Current Ratio	Current Assets : Current Liabilities	31,300 : 19,000 1.65 : 1	1.94 : 1
Interest Cover	Operating Profit/Interest Expense	10,700/2,200 4.9 Times	4 Times

To : Delta Ltd
From : Financial Consultant
Date : 31/7/2021

I'm pleased to submit this report analyzing the profitability and efficiency of Delta Ltd for the year ended 31 March 2020 with the industry averages.

The gross profit margin of the company is 32% compared to industry average of 30%. This shows a slight increase in gross profits may be caused due to increase in selling prices or cost efficiencies generated in the entity.
However, at the net profit levels, industry net profit remains at 10% while, company rates is at a lower level of 6%. This indicates inefficiencies in managing the operational expenses including the finance costs.
The debt collection period is 3 days in arrears than the industry average and the stock residence period is 6 days in arrears than the industry average. This may indicate the risk of impairment and cash getting tied up in debtors and inventory.

135

Industry is having a better liquidity position of 1.94 times compared to 1.65 times in company. Despite the liquidity position in both are comparatively above the general averages, having a higher liquidity position in industry will give better assurance to short term fund providers.
The interest cover of the company is better than the industry as it has 4.9 times compared to 4 times. This suggests that company has lower borrowings than the industry causing lower interest cost.

136

Question 08

The following information have been extracted from the comprehensive Income Statements for the year ended 31st March 2020 & 31st March 2019 and the Statements of Financial Position as at 31st March 2020 & 31st March 2019 of Shakthi PLC.

Extract from Statements of Comprehensive Income *(Rs.'000)*

For the Year Ended	31st March 2020	31st March 2019
Sales	300,100	275,000
Cost of Sales	180,000	152,500
Gross Profit	120,040	122,500
Profit Before Interest and Tax	44,500	32,000
Profit Before Tax	38,000	27,800
Profit After Tax	27,500	23,500

Statements of Financial Position *(Rs. '000)*

As at 31st March	2020	2019
Assets:		
Non-Current Assets:		
Property, Plant and Equipment at Carrying Value	125,000	120,000
Current Assets:		
Inventories	32,000	30,000
Trade Receivables	30,500	27,000
Cash and Cash Equivalents	8,500	6,200
	71,000	63,200
Total Assets:	196,000	183,200

Equity and Liabilities:		
Equity:		
Stated Capital (9,000,000 ordinary shares)	90,000	90,000
Retained Earnings	15,300	5,800
	105,300	95,800
Non-Current Liabilities:		
Long Term Loan	45,000	56,000
Current Liabilities:		
Trade and Other Payables	24,200	16,200
Income Tax Payables	9,500	9,100
Accrued Expenses	12,000	6,100
	45,700	31,400
Total Equity and Liabilities	196,000	183,200

You are required to:

(a) **Calculate** the following ratios of **Shakthi PLC** based on the above information for the year ended/as at 31st March 2020 and 31st March 2019:

(i) Gross Profit Ratio

(ii) Net Profit Ratio

(iii) Quick Assets Ratio

(iv) Return on Capital Employed (ROCE)

(v) Gearing Ratio

(vi) Earnings per Share (06 marks)

(b) **Analyze** the performance of **Shakthi PLC** based on the above computed ratios.

(06 marks)

(Total 12 marks)

LKAS 07 Statement of Cash Flows

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141

141

Cash Flow Statement Mind Map

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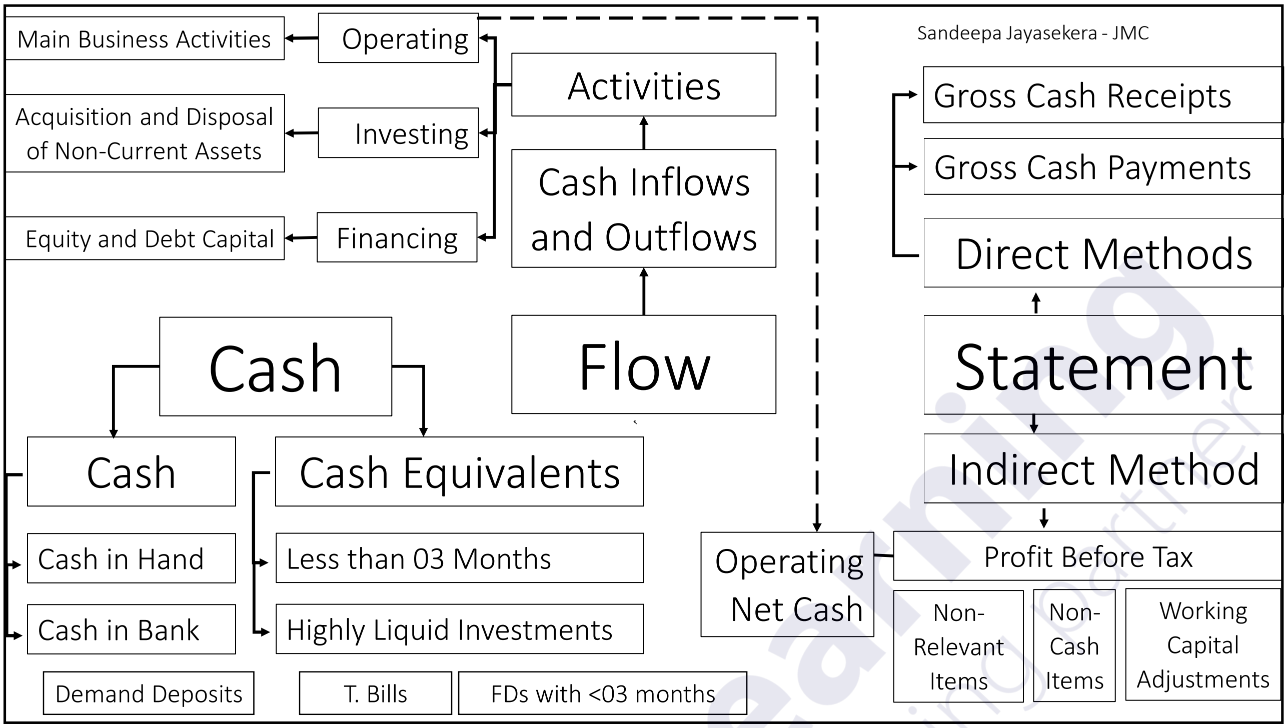
142

142



143

Cash

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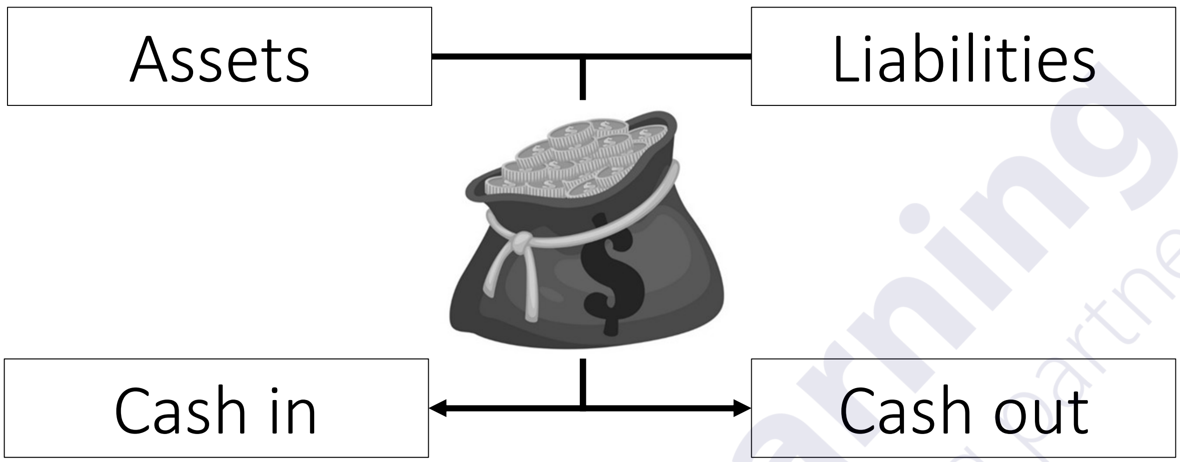
144

A business actually exists due to Cash



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145

A Statement of Cash Flows is prepared

for Decision Makers

to know about the ways Cash was brought in and taken out!

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146

Statement of Cash Flows

Statement that presents	Cash Flows generated from activities categorized into	Operating Investing Financing	during the period under consideration

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147

Cash

- Cash in Hand
- Cash at Bank (Current Accounts)

Cash Equivalents

- Short term (3 months or less than 3)
- Highly Liquid
- Investments

Treasury Bills with a maturity period of up to 03 months

Fixed Deposits with a maturity period of up to 03 months

Savings Accounts

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148

Operating Activities

Cash Flows related to the principal revenue generating activities of the entity

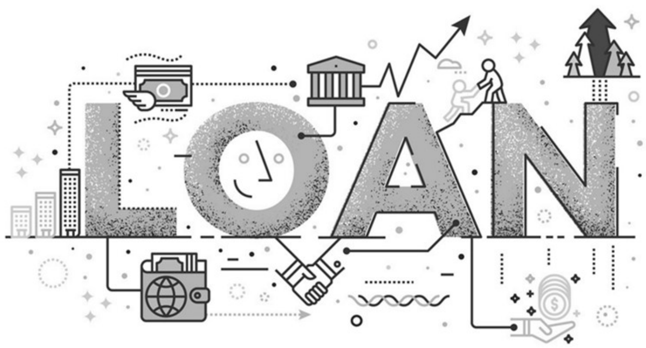
- Cash Sales
- Cash Purchases
- Receipts from Debtors
- Payments to Creditors
- Payments to Employees
- Utility Bill Payments
- Tax Payments

Investing Activities

- Disposal proceeds from sale of Property, Plant and Equipment
- Purchase of Property, Plant and Equipment
- Sale of Investments
- Investments in Shares
- Dividend Income
- Purchase of Intangible Assets

Cash Flows related to acquisition and disposal of non-current assets

Financing Activities



Cash Flows related to financing of Equity and Debt Capital

- Ordinary Share Issue
- Dividend Payments
- Preference Share Issue
- Loans Repaid
- Loans Obtained
- Rights Issue

Question 01

Match the following items in the Statement of Financial Position to the Activities in the Statement of Cash Flows

Non-current Assets
Property, Plant and Equipment
Intangible Assets
Investment in Subsidiaries
Other Financial Assets
Current Assets
Inventory
Trade Receivables
Cash and Cash Equivalents

Operating

Investing

Financing

Equity
Stated Capital
Retained Earnings
Non-current Liabilities
Interest bearing Borrowings
Preference Shares
Current Liabilities
Trade Payables
Accrued Expenses
Current portion of Interest bearing Borrowings

To which activity do you classify Interest Paid?

Usually Financing Activities

If a loan is obtained for main business activities

↓

Operating Activities

To which activity do you classify Tax Payments?

If on the profit of main business activities	If on Investing Activities
↓ Operating	↓ Investing

Foreign Currency Cash Flows

Changes arising from applying the exchange rate as at the reporting date to foreign assets and liabilities are not cash flows.

Changes that arise by settling a transaction using foreign currency are cash flows.

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155

Methods of Preparing Statement of Cash Flows

Direct Method

- Gross Cash Receipts
- Gross Cash Payments separately disclosed
- The practical use of this is less
- Can be used if there are less transactions.

Indirect Method

- If there are large volume of transactions, using direct method for operating activities is difficult
- Therefore, we convert the profit before tax into cash from operations by doing few adjustments

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156

Direct Method and Indirect Method

Direct Method

Indirect Method

Operating Activities

Operating Activities

Investing Activities

Financing Activities

Importance of Statement of Cash Flows

- To determine the survival, growth, and direction of the entity
- To manage operations
- To understand the business growth
- To evaluate the ability to generate cash flows
- Can use for Business Valuation
- To remove accounting adjustments such as depreciation, impairment

Direct Method

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159

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XXX PLC
Statement of Cash Flows (Direct Method)
For the year ended 31st March 20X0

	Rs.	Rs.
Cash Flows from Operating Activities		
Cash Sales	XX	
Cash Purchases	(XX)	
Receipts from Debtors	XX	
Salary Payments	(XX)	
Payments to Creditors	(XX)	
Utility Payments	(XX)	
Taxes Paid	(XX)	
Net Cash Flows from Operating Activities		XX

160

160

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XXX PLC
Statement of Cash Flows (Direct Method)
For the year ended 31st March 20X0

	Rs.	Rs.
Cash Flows from Investing Activities		
Purchase of Property, Plant and Equipment	(XX)	
Proceeds from Disposal of Property, Plant and Equipment	XX	
New Investments	(XX)	
Interest Received	XX	
Dividend Received	XX	
Net Cash Flows from Investing Activities		XX

161

161

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XXX PLC
Statement of Cash Flows (Direct Method)
For the year ended 31st March 2021

	Rs.	Rs.
Cash Flows from Financing Activities		
Proceeds from Issue of Shares	XX	
Proceeds from Long-term Loans	XX	
Loans Repaid	(XX)	
Dividends Paid	(XX)	
Interest Paid	(XX)	
Net Cash Flows from Financing Activities		XX

162

162

Question 02

Extract of Statement of Comprehensive Income of **Tokyo Trading Ltd.** for the year ended 31st March 2018 is as follows:

	Rs.
Sales	760,000
Cost of Sales	(643,000)
Gross Profit	**117,000**
Other Income - Investment Income	850
Distribution Expenses	(30,000)
Administration Expenses	(32,000)
Finance Expenses	(6,500)
Profit Before Tax	**49,350**

163

Balances extracted from the statements of Financial Position of **Tokyo Trading Ltd.** as at 31st March 2018 and 31st March 2017 are as follows:

	As at 31st March 2018 (Rs.)	As at 31st March 2017 (Rs.)
Inventory	132,000	125,000
Trade Receivables	205,000	218,000
Trade Payables	142,000	135,000
Income Tax Payable	3,500	2,000

164

The following additional information is also provided:

(1) Depreciation charges for the year ended 31st March 2018 was Rs.12,500/-.

(2) Finance expenses represent the interest paid to Debenture holders.

(3) Income tax expenses for the year ended 31st March 2018 was Rs.8,000/-.

(4) All the purchases and sales were made on credit basis.

Using the above information,

You are required to:

Prepare Cash Flows from operating activities of **Tokyo Trading Ltd.** for the year ended 31st March 2018 using the Direct Method. (05 marks)

165

Question 03

The following balances were extracted from the Statement of Comprehensive Income for the year ended 31st March 2017 and the Statements of Financial Position as at 31st March 2017 of **Lison Auto (Pvt) Ltd.**:

For the year ended	31st March 2017 (Rs.'000)
Profit on disposal of machinery	500
Depreciation for the year on machinery	1,250

	As at 31st March 2017 (Rs. '000)	As at 31st March 2016 (Rs. '000)
Cost of machinery	3,000	2,500
Accumulated depreciation of machinery	(2,000)	(1,500)

166

Cost of disposed machinery during the year ended 31st March 2017 was Rs.1,000,000/-. Depreciation for the current year includes the depreciation of disposed machinery up to date of disposal. New machinery has been purchased on 31st March 2017 and no depreciation has been provided on that machinery for the year ended 31st March 2017.

You are required to:

Prepare the Net Cash Flows generated from investing activities for the year ended 31st March 2017 showing separately cash received from the disposal of old machinery and cash paid to purchase of new machinery. (05 marks)

167

Question 04

The following information was extracted from the books of Jaz Ltd.:

(1) On 01st February 2018, Jaz Ltd. issued 100,000 ordinary shares at an issue price of Rs.10/- each. Of this total consideration, Rs.6/- per share is payable on application before 20th March 2018 and the balance of Rs.4/- per share is payable on allotment on 10th April 2018. The company has received applications for 120,000 shares and rejected the excess applications with money received by 30th March 2018.

(1) The company has obtained a bank loan of Rs.5 million on 01st January 2018 from ABC Bank. As per the loan agreement, re-payments have been started from 31st January 2018 and the breakup of the installments paid was as follows:

168

	Total Installment paid (Rs.)	Interest portion (Rs.)
31.01.2018	77,955	68,700
28.02.2018	77,955	64,200
31.03.2018	77,955	61,380
Total	**233,865**	**194,280**

(3) The company has obtained a bank overdraft facility of Rs.750,000/- on 31st March 2018.

(4) The company has given a long term loan of Rs.1,000,000/- on 31st March 2018 to a founder employee of the company.

You are required to:

Prepare the Net Cash Flows generated from financing activities for the year ended 31st March 2018. (05 marks)

169

169

Question 05

The Statements of Financial Position of Monica Ltd. are given below:

Rs.'000	31/3/X8	31/3/X7
<u>Non-current Assets</u>		
Property, Plant and Equipment	2900	2200
(-) Accumulated Depreciation	(575)	(400)
	2325	**1800**
<u>Current Assets</u>		
Inventory	420	385
Debtors	375	320
Prepaid Expenses	48	30
Cash	230	150
	1073	**885**
Total Assets	**3398**	**2685**

170

170

Rs.'000	31/3/X8	31/3/X7
Equity		
Capital	2418	1435
Retained Earnings	285	220
	2703	1655
Non-current Liabilities		
Bank Loan	250	300
Current Liabilities		
Creditors	185	315
Current Portion of Bank Loan	50	100
Accrued Expenses	35	15
Tax Provision	100	120
Dividend Payable	75	180
	445	730
Total Equity and Liabilities	3398	2685

171

171

Profit or Loss Account for the year ended 31/03/2018 (Rs.'000)

Sales	4250
Cost of Sales	(2850)
Gross Profit	1400
Administration Expenses	(175)
Distribution Expenses	(480)
Other Expenses	(270)
Finance Expenses (Interest)	(200)
Profit Before Tax	275
Taxes	(110)
Profit After Tax	165
Dividends	(100)
Retained Profit of the Year	65

Prepare the Statement of Cash Flows using the Direct Method considering that all purchases and sales were made on credit

172

172

Indirect Method

173

Indirect Method

Profit Before Tax	XX
Adjustments	
Non-cash transactions	X/(X)
Non-operating Income/Expenses	X/(X)
Changes in Working Capital	X/(X)
Cash generated from Operating Activities	XX
Tax Paid	(X)
Net Cash Flow from Operating Activities	XX

174

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XXX PLC
Statement of Cash Flows (Indirect Method)
For the year ended 31st March 20X0

	Rs.	Rs.
Cash Flows from Operating Activities		
Profit Before Tax	XX	
Adjustments		
Depreciation	XX	
Unrealised Gain/Loss on Foreign Exchange	X/(X)	
Profit/Loss on Disposal of Assets	X/(X)	
Investment Income	(XX)	
Impairment Losses	XX	
Interest Expense		XX

175

175

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Cash from Operations prior to Changes in Working Capital		
Changes in Working Capital		
(Increase)/Decrease in Debtors	(X)/X	
(Increase)/Decrease in Inventory	(X)/X	
Increase/(Decrease) in Creditors	X/(X)	
Increase/(Decrease) in Accrued Expenses	X/(X)	
Cash generated from Operating Activities	XX	
Interest Paid	(X)	
Income Tax Paid	(X)	
Gratuity Paid	(X)	
Net Cash Flows from Operating Activities		XX

176

176

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XXX PLC
Statement of Cash Flows (Indirect Method)
For the year ended 31st March 20X0

	Rs.	Rs.
Cash Flows from Investing Activities		
Purchase of Property, Plant and Equipment	(XX)	
Disposal Proceeds of Property, Plant and Equipment	XX	
New Investments	(XX)	
Interest Received	XX	
Dividends Received	XX	
Net Cash Flows from Investing Activities		XX

177

177

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XXX PLC
Statement of Cash Flows (Indirect Method)
For the year ended 31st March 20X0

	Rs.	Rs.
Cash Flows from Financing Activities		
Proceeds from Issue of Shares	XX	
Long term Loans Obtained	XX	
Loans Repaid	(XX)	
Dividends Paid	(XX)	
Interest Paid	(XX)	
Net Cash Flows from Financing Activities		XX

178

178

Question 07

1. The profit of ABC Ltd. is Rs. 1,000/-. Depreciation is Rs. 200/-. All other income and expenses are made in cash. Calculate the Profit received in Cash.
2. Total Profit of Sita Ltd. Was Rs. 5,000/-. The profit from the sale of land during the year is Rs. 1,000/-. Except this, all income and expenses are made in cash. Calculate the Profit received in Cash.
3. The Opening Debtor Balance of Rollo Ltd. is Rs. 500/- and the Closing Debtor Balance is Rs. 1,000/-. Profit for the year is Rs. 1,000/-. Sales is Rs. 5,000/-. If all income and expenses, other than sales, were made in cash, what is the Profit received in Cash?
4. The Opening Creditor Balance of Rita Ltd. is Rs. 4,000/-. Credit purchases during the year is Rs. 10,000/-. The Closing Creditor Balance is Rs. 2,000/-. Profit for the year is Rs. 7,000/-. If all income and expenses, other than credit purchases, were made in cash, what is the Profit received in Cash?

179

Question 08

The Statements of Financial Position as at 31st March 2017 and 31st March 2016 of ABC Company Ltd. are given below:

Rs.'000	As at 31st March 2017		As at 31st March 2016	
Assets				
Non-current Assets:				
Property, Plant and Equipment (at cost)	10,000		10,000	
Accumulated Depreciation	(4,500)		(4,000)	
Carrying Value		5,500		6,000
Current Assets:				
Inventories	5,500		6,000	
Trade and Other Receivables	8,100		5,160	
Cash and Cash Equivalents	250	13,850	300	11,460
Total Assets		19,350		17,460

180

Rs.'000	As at 31st March 2017		As at 31st March 2016	
<u>Equity and Liabilities</u>				
Equity:				
Ordinary Share Capital		10,000		10,000
Irredeemable Preference Share Capital		4,000		2,500
Retained Earnings		2,300		400
Total Equity		16,300		12,900
Non-current Liabilities:				
Bank Loan		350		1,250
Current Liabilities:				
Bank Loan	750		750	
Trade and Other Payable	1,660		2"300	
Loan Interest Payable	40		60	
Income Tax Payable	250	2,700	200	3,310
Total Equity and Liabilities		19,350		17,460

181

The following additional information is also provided:

(1) Income tax expense for the year ended 31st March 2017 was Rs.600,000/-.

(2) Interest expense on bank loan for the year ended 31st March 2017 was Rs.380,000/-.

(3) There were no disposals or purchases of Property, Plant and Equipment during the year.

(4) No dividends are paid or declared during the year.

You are required to:

Prepare the statement of Cash Flows of **ABC Company Ltd.** for the year ended 31st March 2017 using <u>indirect method</u>.

182

Question 09

The Statements of Financial Position of **Seven Roses Ltd.** as at 31st March 2017 and 31st March 2018 are given below:

Rs.'000	As at 31st March 2018		As at 31st March 2017	
<u>Assets:</u>				
Non-current Assets:				
Property, Plant and Equipment (at cost)	46,000		56,000	
Accumulated Depreciation	(24,000)		(20,000)	
Carrying value		22,000		36,000
Current Assets:				
Inventories	16,000		5,800	
Trade Receivables	33,500		29,400	
Cash and Cash Equivalents	3,500	53,000	5,000	40,200
Total Assets		75,000		76,200

183

Rs.'000	As at 31st March 2018		As at 31st March 2017	
<u>Equity and Liabilities</u>				
Equity:				
Ordinary Share Capital		50,000		50,000
Retained Earnings		7,200		6,000
		57,200		56,000
Current Liabilities:				
Trade and Other Payables	17,700		19,800	
Income Tax Payable	100	17,800	400	20,200
Total Equity and Liabilities		75,000		76,200

184

The following additional information is also provided:

(1) During the year, the company paid interim dividend of Rs.2,000,000/- to its ordinary shareholders.

(2) On 31st March 2018, the company sold a machinery for Rs.4 million which was purchased on 01st April 2015 at a cost of Rs.10 million. The useful life time of the machinery is 5 years.

(3) There were no purchases of Property, Plant and Equipment during the year.

(4) The income tax expense of the company for the year of assessment 2017/18 was estimated to be Rs.450,000/-.

Using the above information,

You are required to:

Prepare the Cash Flow Statement of **Seven Roses Ltd.** for the year ended 31st March 2018 using indirect method. (10 marks)

185

Question 10

The statements of Financial Position as at 31st March 2017 and 31st March 2018 of **Siyasto Creations (Pvt) Ltd.** are as follows:

As at 31st March Rs.'000	2018	2017
Assets:		
Non-current Assets:		
Property, Plant and Equipment at cost	4,740	4,300
Accumulated Depreciation	(2,060)	(1,410)
Carrying Value	2,680	2,890
Current Assets:		
Inventories	2,370	1,415
Trade Receivables	4,450	2,536
Cash and Cash Equivalents	2,280	1,320
	9,100	5,271
Total Assets	11,780	8,161

As at 31st March Rs.'000	2018	2017
Equity:		
Stated Capital - Ordinary shares	2,000	2,000
Retained Earnings	3,660	1,460
	5,660	3,460
Non-current Liabilities:		
Long Term Loans	1,000	-
Employee benefits (Provision for gratuity)	590	500
Deferred Tax Liabilities	720	500
	2,310	1,000
Current Liabilities:		
Trade Payables	2,760	2,851
Income Tax Payables	1,050	850
	3,810	3,701
Total Equity and Liabilities	11,780	8,161

Extract of the Statement of Comprehensive Income for the year ended 31st March 2018

	Rs.'000
Profit before interest and income tax	2,900
Interest expenses	(250)
Profit Before Income Tax	**2,650**
Income tax	(450)
Profit for the year	**2,200**

The following additional information is also provided:

(1) Income tax for the year includes the deferred tax expense for the year ended 31st March 2018.

(2) An equipment costing Rs.550,000/- has been disposed during the year ended 31st March 2018 for Rs.400,000/-. The carrying value of the equipment as at the date of disposal was Rs.200,000/-.

(3) There was no other comprehensive income for the year ended 31st March 2018. Further, there were no accrued interest expenses as at the year end.

(4) No payments for gratuity was made during the year ended 31st March 2018.

You are required to:

Prepare the Statement of Cash Flows of **Siyasto Creations (Pvt) Ltd.** for the year ended 31st March 2018 under the indirect method. (10 marks)

Question 11

The statements of financial position of **Royal (Pvt) Ltd.** are given below:

As at 31st March Rs.'000	2020	2019
Non-Current Assets:		
Property, Plant and Equipment	4,205	3,838
Accumulated Depreciation	(2,090)	(1,810)
Carrying value	2,115	2,028
Current Assets:		
Inventories	1,320	920
Trade Receivables	1,723	1,905
Cash and Cash Equivalents	397	457
	3,440	3,282
Total Assets:	5,555	5,310

As at 31st March Rs.'000	2020	2019
Equity:		
Stated Capital	1,000	1,000
Retained Earnings	960	820
	1,960	1,820
Non-Current Liabilities:		
Long Term Loans	1,300	1,200
	1,300	1,200
Current Liabilities:		
Short Term Loans	200	150
Trade Payables	1,695	1,590
Interest Payable on loans	180	100
Income Tax Payable	220	450
	2,295	2,290
Total Equity and Liabilities	5,555	5,310

The following additional information is also provided:

(1) Income tax expense for the year ended 31st March 2020 was Rs. 205,000/-.
(2) A more vehicle has been disposed on 31st March 2020 for Rs. 1,800,000/- by the company. The cost of the motor vehicle and accumulated depreciation as at 31st March 2020 were Rs. 2,500,000/- and Rs. 1,250,000/- respectively. Further, on the same day, the company has purchased a motor lorry.
(3) Interest expense on loans for the year ended 31st March 2020 was Rs. 295,000/-.
(4) An interim dividend of Rs. 100,000/- had been paid during the year to its ordinary shareholders.
(5) The company has obtained a bank loan of Rs. 800,000/- during the year.

You are required to:

Prepare the Statement of Cash Flows of **Royal (Pvt) Ltd.** for the year ended 31st March 2020 using <u>indirect method</u>. (10 marks)