

CA FINAL

40th Edition

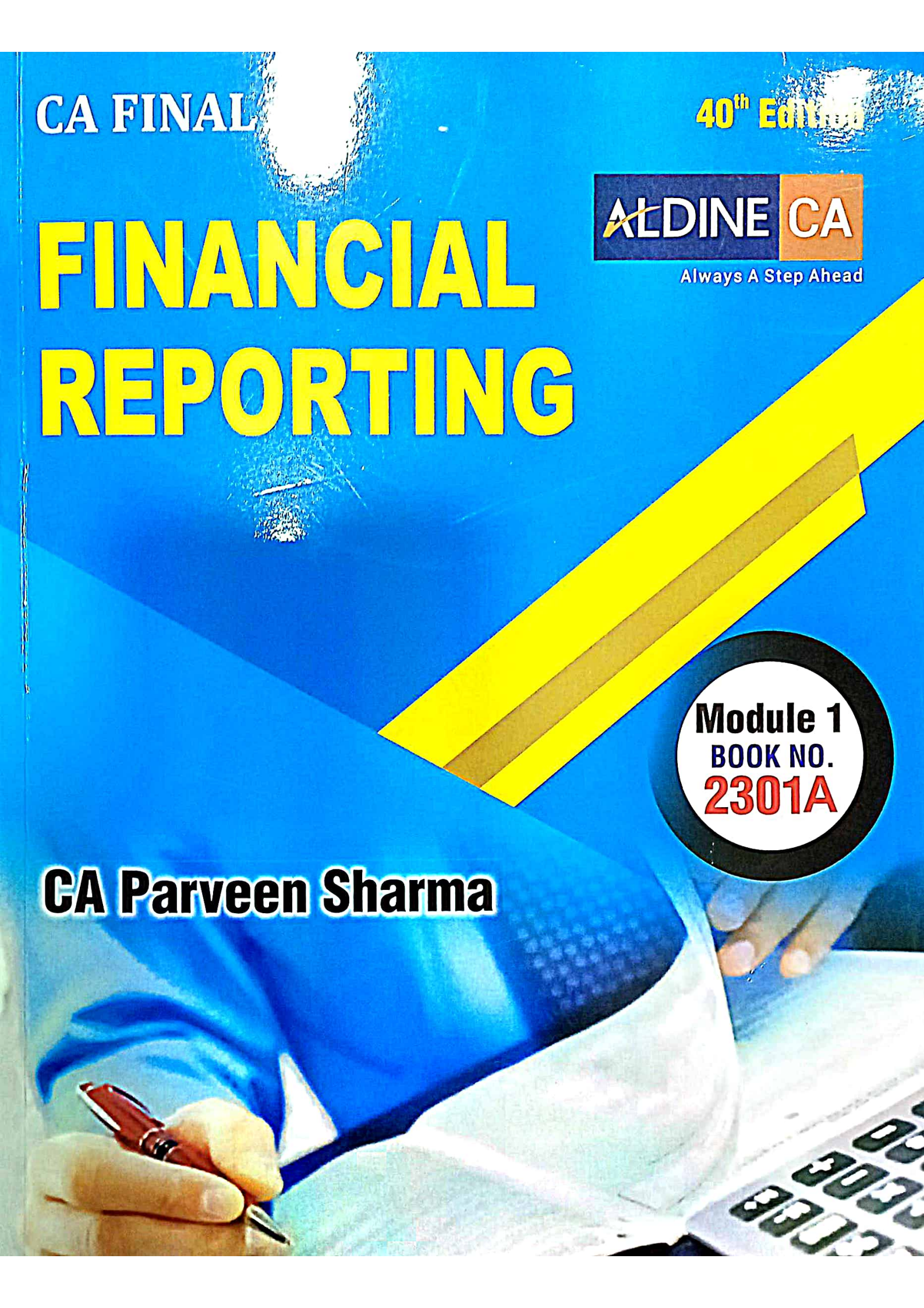
FINANCIAL REPORTING

ALDINE CA

Always A Step Ahead

Module 1
BOOK NO.
2301A

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FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)

CONTENTS

Status and Purpose of the Conceptual Framework under Indian Accounting Standards	1.2
Chapter 1 The Objective of General Purpose Financial Reporting	1.3
Chapter 2 Qualitative characteristics of Useful Financial Information	1.7
Chapter 3 Financial Statements and the Reporting Entity	1.12
Chapter 4 The Elements of Financial Statements Introduction	1.15
Chapter 5 Recognition and Derecognition the Recognition Process	1.24
Chapter 6 Measurement Introduction	1.30
Chapter 7 Presentation and Disclosure	1.44
Chapter 8 Concepts of Capital and Capital Maintenance Concepts of Capital	1.47
Appendix Defined terms	1.49

STATUS AND PURPOSE OF THE *CONCEPTUAL FRAMEWORK*

- SP1.1 The *Conceptual Framework for Financial Reporting under Indian Accounting Standards (Conceptual Framework)* describes the objective of, and the concepts for, general purpose financial reporting. The purpose of the *Conceptual Framework* is to:
- assist the Institute of Chartered Accountants of India (ICAI) in formulation of Indian Accounting Standards (Ind ASs) that are based on consistent concepts;
 - assist preparers to develop consistent accounting policies when no Ind AS applies to a particular transaction or other event, or when an Ind AS allows a choice of accounting policy; and
 - assist all parties to understand and interpret the Ind ASs.
- SP1.2 The *Conceptual Framework* is not an Ind AS. Nothing in the *Conceptual Framework* overrides any Ind AS or any requirement in an Ind AS.
- SP1.3 To meet the objective of general purpose financial reporting, the ICAI may sometimes specify requirements that depart from aspects of the *Conceptual Framework*. If the ICAI does so, it will explain the departure in the Appendix to the relevant Ind AS.
- SP1.4 The *Conceptual Framework* may be revised from time to time on the basis of the ICAI's experience of working with it and international developments in this regard.
- Revisions of the *Conceptual Framework* will not automatically lead to changes to the Ind ASs. Any decision to amend an Ind AS would require the ICAI to go through its due process for formulating an amendment to that Ind AS.
- SP1.5 The *Conceptual Framework* contributes to the mission of the ICAI to formulate Ind ASs that bring transparency, accountability and efficiency to financial markets. The ICAI's accounting standards formulation related work serves the public interest by fostering trust, growth and long-term financial stability in the global economy. The *Conceptual Framework* provides the foundation for Ind ASs that:
- contribute to transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.
 - strengthen accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Ind ASs based on the *Conceptual Framework* provide information needed to hold management to account. As a source of globally comparable information, those Ind ASs are also of vital importance to regulators.
 - contribute to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language derived from Ind ASs based on the *Conceptual Framework* lowers the cost of capital and reduces international reporting costs.

Chapter 1

The Objective of General Purpose Financial Reporting

CONTENTS	<i>from paragraph</i>
INTRODUCTION	1.1
OBJECTIVE, USEFULNESS AND LIMITATIONS OF GENERAL PURPOSE FINANCIAL REPORTING	1.2
INFORMATION ABOUT A REPORTING ENTITY'S ECONOMIC RESOURCES, CLAIMS AGAINST THE ENTITY AND CHANGES IN RESOURCES AND CLAIMS	1.12
Economic resources and claims	1.13
Changes in economic resources and claims	1.15
Financial performance reflected by accrual accounting	1.17
Financial performance reflected by past cash flows	1.20
Changes in economic resources and claims not resulting from financial performance	1.21
INFORMATION ABOUT USE OF THE ENTITY'S ECONOMIC RESOURCES	1.22

Introduction

- 1.1 The objective of general purpose financial reporting forms the foundation of the *Conceptual Framework*. Other aspects of the *Conceptual Framework*—the qualitative characteristics of, and the cost constraint on, useful financial information, a reporting entity concept, elements of financial statements, recognition and derecognition, measurement, presentation and disclosure—flow logically from the objective.

Objective, usefulness and limitations of general purpose financial reporting

- 1.2 The objective of general purpose financial reporting¹ is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.² Those decisions involve decisions about:
- (a) buying, selling or holding equity and debt instruments;
 - (b) providing or settling loans and other forms of credit; or
 - (c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.
- 1.3 The decisions described in paragraph 1.2 depend on the returns that existing and potential investors, lenders and other creditors expect, for example, dividends, principal and interest payments or market price increases. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and on their assessment of management's stewardship of the entity's economic resources. Existing and potential investors, lenders and other creditors need information to help them make those assessments.
- 1.4 To make the assessments described in paragraph 1.3, existing and potential investors, lenders and other creditors need information about:
- (a) the economic resources of the entity, claims against the entity and changes in those resources and claims (see paragraphs 1.12–1.21); and

1 Throughout the *Conceptual Framework*, the terms 'financial reports' and 'financial reporting' refer to general purpose financial reports and general purpose financial reporting unless specifically indicated otherwise.

2 Throughout the *Conceptual Framework*, the term 'entity' refers to the reporting entity unless specifically indicated otherwise.

Chap. 1 • Framework for Preparation and Presentation of Financial Statements

- (b) how efficiently and effectively the entity's management and governing board¹ have discharged their responsibilities to use the entity's economic resources (see paragraphs 1.22–1.23).
- 1.5 Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.²
- 1.6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.
- 1.7 General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.
- 1.8 Individual primary users have different, and possibly conflicting, information needs and desires. The ICAI, in formulating Ind ASs, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.
- 1.9 The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.
- 1.10 Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.
- 1.11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The *Conceptual Framework* establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the ICAI and preparers of financial reports strive. As with most goals, the *Conceptual Framework's* vision of ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because it takes time to understand, accept and implement new ways of analysing transactions and other events. Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness.

Information about a reporting entity's economic resources, claims against the entity and changes in resources and claims

- 1.12 General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity. Financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions relating to providing resources to an entity.
- Economic resources and claims**
- 1.13 Information about the nature and amounts of a reporting entity's economic resources and claims can help users to identify the reporting entity's financial strengths and weaknesses. That information can help users to assess the reporting entity's liquidity and solvency, its needs for additional financing and how successful it is likely to be in obtaining that financing. That information can also help users to assess management's stewardship of the entity's economic resources. Information about priorities and payment requirements of existing claims helps users to predict how future cash flows will be distributed among those with a claim against the reporting entity.
- 1.14 Different types of economic resources affect a user's assessment of the reporting entity's prospects for future cash flows differently. Some future cash flows result directly from existing economic resources, such as accounts receivable. Other cash flows result from using several resources in

1 Throughout the *Conceptual Framework*, the term 'management' refers to management and the governing board of an entity unless specifically indicated otherwise.

2 Throughout the *Conceptual Framework*, the terms 'primary users' and 'users' refer to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

combination to produce and market goods or services to customers. Although those cash flows cannot be identified with individual economic resources (or claims), users of financial reports need to know the nature and amount of the resources available for use in a reporting entity's operations.

Changes in economic resources and claims

1.15 Changes in a reporting entity's economic resources and claims result from that entity's financial performance (see paragraphs 1.17–1.20) and from other events or transactions such as issuing debt or equity instruments (see paragraph 1.21). To properly assess both the prospects for future net cash inflows to the reporting entity and management's stewardship of the entity's economic resources, users need to be able to identify those two types of changes.

1.16 Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources. Information about the return the entity has produced can help users to assess management's stewardship of the entity's economic resources. Information about the variability and components of that return is also important, especially in assessing the uncertainty of future cash flows. Information about a reporting entity's past financial performance and how its management discharged its stewardship responsibilities is usually helpful in predicting the entity's future returns on its economic resources.

Financial performance reflected by accrual accounting

1.17 Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period. This is important because information about a reporting entity's economic resources and claims and changes in its economic resources and claims during a period provides a better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period.

1.18 Information about a reporting entity's financial performance during a period, reflected by changes in its economic resources and claims other than by obtaining additional resources directly from investors and creditors (see paragraph 1.21), is useful in assessing the entity's past and future ability to generate net cash inflows. That information indicates the extent to which the reporting entity has increased its available economic resources, and thus its capacity for generating net cash inflows through its operations rather than by obtaining additional resources directly from investors and creditors. Information about a reporting entity's financial performance during a period can also help users to assess management's stewardship of the entity's economic resources.

1.19 Information about a reporting entity's financial performance during a period may also indicate the extent to which events such as changes in market prices or interest rates have increased or decreased the entity's economic resources and claims, thereby affecting the entity's ability to generate net cash inflows.

Financial performance reflected by past cash flows

1.20 Information about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash inflows and to assess management's stewardship of the entity's economic resources. That information indicates how the reporting entity obtains and spends cash, including information about its borrowing and repayment of debt, cash dividends or other cash distributions to investors, and other factors that may affect the entity's liquidity or solvency. Information about cash flows helps users understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance.

Changes in economic resources and claims not resulting from financial performance

1.21 A reporting entity's economic resources and claims may also change for reasons other than financial performance, such as issuing debt or equity instruments. Information about this type of change is necessary to give users a complete understanding of why the reporting entity's economic resources and claims changed and the implications of those changes for its future financial performance.

Information about use of the entity's economic resources

1.22 Information about how efficiently and effectively the reporting entity's management has discharged its responsibilities to use the entity's economic resources helps users to assess management's stewardship of those resources. Such information is also useful for predicting how efficiently and effectively management will use the entity's economic resources in future periods. Hence, it can be useful for assessing the entity's prospects for future net cash inflows.

Chap. 1 • Framework for Preparation and Presentation of Financial Statements

- 1.23 Examples of management's responsibilities to use the entity's economic resources include protecting those resources from unfavourable effects of economic factors, such as price and technological changes, and ensuring that the entity complies with applicable laws, regulations and contractual provisions.

Chapter 2

Qualitative Characteristics of Useful Financial Information

CONTENTS	<i>from paragraph</i>
INTRODUCTION	2.1
QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION	2.4
Fundamental qualitative characteristics	2.5
Relevance	2.6
Materiality	2.11
Faithful representation	2.12
Applying the fundamental qualitative characteristics	2.20
Enhancing qualitative characteristics	2.23
Comparability	2.24
Verifiability	2.30
Timeliness	2.33
Understandability	2.34
Applying the enhancing qualitative characteristics	2.37
THE COST CONSTRAINT ON USEFUL FINANCIAL REPORTING	2.39

Introduction

- 2.1 The qualitative characteristics of useful financial information discussed in this chapter identify the types of information that are likely to be most useful to the existing and potential investors, lenders and other creditors for making decisions about the reporting entity on the basis of information in its financial report (financial information).
- 2.2 Financial reports provide information about the reporting entity's economic resources, claims against the reporting entity and the effects of transactions and other events and conditions that change those resources and claims. (This information is referred to in the *Conceptual Framework* as information about the economic phenomena.) Some financial reports also include explanatory material about management's expectations and strategies for the reporting entity, and other types of forward-looking information.
- 2.3 The qualitative characteristics of useful financial information¹ apply to financial information provided in financial statements, as well as to financial information provided in other ways. Cost, which is a pervasive constraint on the reporting entity's ability to provide useful financial information, applies similarly. However, the considerations in applying the qualitative characteristics and the cost constraint may be different for different types of information. For example, applying them to forward-looking information may be different from applying them to information about existing economic resources and claims and to changes in those resources and claims.

Qualitative characteristics of useful financial information

- 2.4 If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

¹ Throughout the *Conceptual Framework*, the terms 'qualitative characteristics' and 'cost constraint' refer to the qualitative characteristics of, and the cost constraint on, useful financial information.