BLOCK II:
THE CONCEPTUAL FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Unit-1

Meaning and Significance of Conceptual Framework for Preparation and Presentation of Financial Statements

Unit Structure:

1.1 Introduction

Conceptual framework is a constitution which provides guidance for the preparation and presentation of financial statements. It works as the basis for the preparation and presentation of financial statements for external users. In the words of Financial Accounting Standard Board (FASB), USA, Conceptual Framework is a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and financial statements. The objectives identify the goals and the purposes of accounting. The fundamentals are the underlying concepts of accounting that guide the selection of transactions, events and circumstances to be accounted for, their recognition and measurement, and the means of summarising and communicating them to interested parties. Concepts of that type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting and applying accounting and reporting standards. The conceptual framework is intended to act as a constitution for the standard setting process. Conceptual framework projects are not intended to develop solutions to specific issues in financial reporting. They develop criteria to guide the Board's subsequent decisions on specific technical issues.

The International Accounting Standards Board (IASB) issued its 'Framework for the Preparation and Presentation of Financial Statements' in 1989. This is referred to as its conceptual framework. The IASB's conceptual framework is described in the document, "Framework for Preparation and Presentation of Financial Statements." Both the IASB and the FASB have a conceptual framework. The IASB and the FASB are now working on a joint project to develop an improved common conceptual framework that provides a sound foundation for developing future accounting standards. In India, the Institute of Chartered Accountants of India (ICAI) has issued its conceptual framework for the preparation and presentation of financial statements.

A conceptual framework is, therefore, a statement of theoretical principles for financial accounting and reporting. The framework seeks to identify the purpose, qualitative characteristics and broad content of general purpose financial reporting. It describes the objective of, and the concepts for, general purpose financial reporting. The Conceptual Framework is, thus, the foundation as the criteria or the basic ideas of this framework assist in financial accounting and reporting.

1.2 Objectives

After going through this unit, you will be able to

- Understand the concept of conceptual framework.
- Explain the meaning and purpose of conceptual framework.
- Explain the objectives of the financial statement
- Determine the users of the financial statement

1.3 Conceptual framework for preparation and presentation of financial statements

1.3.1 Meaning of Conceptual Framework

Conceptual framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. It is not an accounting standard. The conceptual framework does not override any specific accounting standard. It is stated that if there is a conflict between the framework and an accounting standard, the requirements of the Accounting standard prevail over those of the framework. Conceptual framework is a constitution which provides guidance for the preparation and presentation of financial statements. It works as the basis for the preparation and presentation of financial statements for external users

1.3.2 Significance of Conceptual framework:

The following functions reflects the significance of this framework:

(a) assist preparers of financial statements in applying Accounting Standards and in dealing with topics that have yet to form the subject of an Accounting Standard;

(b) assist the Accounting Standards Board in the development of future Accounting Standards and in its review of existing Accounting Standards;

(c) assist the Accounting Standards Board in promoting harmonisation of regulations, accounting standards and procedures relating to the preparation and presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by Accounting Standards;

(d) assist auditors in forming an opinion as to whether financial statements conform with Accounting Standards;

(e) assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with Accounting Standards; and

(f) provide those who are interested in the work of the Accounting Standards Board with information about its approach to the formulation of Accounting Standards.

Check Your Progress

1) ICAI stands for……………….

2) The International Accounting Standards Board (IASB) issued its 'Framework for the Preparation and Presentation of Financial Statements' in…………..

3) FASB stands for……………….

1.4 Objectives and Users of financial statements

1.4.1 Objectives of financial statements

Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, a statement of profit and loss (also known as 'income statement'), a cash flow statement and notes and other statements and explanatory material that are an integral part of the financial statements. Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events, and do not necessarily provide non-financial information. The objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions.

1.4.2 Users of financial statements

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their information needs. The users and their varied needs are summarised as follows:

(a) ***Investors.*** The providers of risk capital are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. They are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

(b) ***Employees***. Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

(c) ***Lenders***. Lenders are interested in information which enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

(d) ***Suppliers*** and other trade creditors. Suppliers and other creditors are interested in information which enables them to determine whether amounts owing to them will be paid when due.

(e) ***Customers***. Customers have an interest in information about the continuance of an enterprise, especially when they have a long term involvement with, or are dependent on, the enterprise.

(f) ***Governments and their agencies***. Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises and determine taxation policies, and to serve as the basis for determination of national income and similar statistics.

(g) ***Public***. Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

While all of the information needs of these users cannot be met by financial statements, there are needs which are common to all users. As providers of risk capital to the enterprise, investors need more comprehensive information than other users. The provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy.

Check Your Progress

1) What are the objectives of Financial Statement?

2) Who are the users of Financial Statement?

1.5 Elements of financial statement

Three elements relating to the statement of financial position (balance sheet) are asset, liability and equity and two elements related to statement of comprehensive income are income and expense. Therefore, the elements of financial statements are asset, liability, equity, income and expense.

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

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

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

Income: Income is the increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decrease of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Expenses : Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Stop to Consider

Compare and contrast the conceptual framwork set out by ICAI and IASB for the preparation and presentation of financial system.

1.6 Summing Up

1) Conceptual framework is a constitution which provides guidance for the preparation and presentation of financial statements. A conceptual framework is a statement of theoretical principles for financial accounting and reporting. The framework seeks to identify the purpose, qualitative characteristics and broad content of general purpose financial reporting

2) The International Accounting Standards Board (IASB) issued its 'Framework for the Preparation and Presentation of Financial Statements' in 1989

3) In India, the Institute of Chartered Accountants of India (ICAI) has issued its conceptual framework for the preparation and presentation of financial statements.

4) The following are the purposes of this framework.

   (a) assist preparers of financial statements in applying Accounting Standards and in dealing with topics that have yet to form the subject of an Accounting Standard;

   (b) assist the Accounting Standards Board in the development of future Accounting Standards and in its review of existing Accounting Standards;

   (c) assist the Accounting Standards Board in promoting harmonization of regulations, accounting standards and procedures relating to the preparation and presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by Accounting Standards;

   (d) assist auditors in forming an opinion as to whether financial statements conform with Accounting Standards;

   (e) assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with Accounting Standards; and

   (f) provide those who are interested in the work of the Accounting Standards Board with information about its approach to the formulation of Accounting Standards.

5) The objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions.

6) There are various users of accounting information such as investors, employees, lenders, customers, Governments and their agencies and Public. Enterprises

1.7 Model Questions

1. Discuss the conceptual framework of financial statement issued by the ICAI.
2. Discuss the purpose of conceptual framework.
3. Discuss the objectives of Financial Statement.
4. Who are the users of the Financial Statement? Elaborate.

1.8 References and Suggested Readings

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- www.icai.org.
- www.ifrs.org

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Unit-2
Conceptual Framework Issued by ICAI

Unit Structure:

2.1 Introduction

Conceptual framework means a constitution which guides the preparation and presentation of financial statements. It acts as a guide to the establishment, interpretation and application of accounting and reporting standards.The Framework is concerned with general purpose financial statements (hereafter referred to as 'financial statements'). Such financial statements are prepared and presented at least annually and are directed towards the common information needs of a wide range of users. The users have to rely on the financial statements as their major source of financial information and such financial statements should, therefore, be prepared and presented with their needs in view.

Conceptual framework does not help in solving specific issues or problems in financial recording and reporting. It sets out the concepts that underlie the preparation and presentation of financial statements for external users.

The framework is not an accounting standard and hence does not define standards for any particular measurement or disclosure issue. Framework does not override any specific accounting standard.

2.2 Objectives

After going through this unit you will be able to-

- Understand the meaning and purpose of conceptual framework of financial statements issued by the ICAI
- Focus on the objectives and users of financial statements
- Identify the qualitative characteristics that determine the usefulness of information in financial statements
- Define the elements of financial statements
- Recognize the elements from which financial statements are constructed
- Understand the measurement of assets and liabilities reported in financial statements
- Highlight the concepts of capital and capital maintenance

2.3 Meaning and purpose

Conceptual framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. It is not an accounting standard. The conceptual framework does not override any specific accounting standard. It is stated that if there is a conflict between the framework and an accounting standard, the requirements of the Accounting standard prevail over those of the framework.

The following are the purposes of this framework :

(a) assist preparers of financial statements in applying Accounting Standards and in dealing with topics that have yet to form the subject of an Accounting Standard;

(b) assist the Accounting Standards Board in the development of future Accounting Standards and in its review of existing Accounting Standards;

(c) assist the Accounting Standards Board in promoting harmonisation of regulations, accounting standards and procedures relating to the preparation and presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by Accounting Standards;

(d) assist auditors in forming an opinion as to whether financial statements conform with Accounting Standards;

(e) assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with Accounting Standards; and

(f) provide those who are interested in the work of the Accounting Standards Board with information about its approach to the formulation of Accounting Standards.

Check Your Progress

1. What are the purpose of conceptual framwork of financial statements issued by the ICAI?

2. Who are the users of financial statement as per ICAI?

2.4 Objectives and Users of financial statements

2.4.1 Objectives of financial statements

Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, a statement of profit and loss (also known as 'income statement'), a cash flow statement and notes and other statements and explanatory material thatare an integral part of the financial statements. Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events, and do not necessarily provide non-financial information. The objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions.

2.4.2 Users of financial statements

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their information needs. The users and their varied needs are summarised as follows:

(**a) Investors**. The providers of risk capital are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. They are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

(b) Employees. Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enablesthem to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

(**c) Lenders**. Lenders are interested in information which enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

(**d) Suppliers** and other trade creditors. Suppliers and other creditors are interested in information which enables them to determine whether amounts owing to them will be paid when due.

(**e) Customers**. Customers have an interest in information about the continuance of an enterprise, especially when they have a longterm involvement with, or are dependent on, the enterprise.

(f)**Governments** and their agencies. Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises and determine taxation policies, and to serve as the basis for determination of national income and similar statistics.

(g) **Public**. Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including thenumber of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

While all of the information needs of these users cannot be met by financial statements, there are needs which are common to all users. As providers of risk capital to the enterprise, investors need more comprehensive information than other users. The provision of financial statements thatmeet their needs will also meet most of the needs of other users that financial statements can satisfy.

2.5 The qualitative characteristics that determine the usefulness of information in financial statements

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Understandability

An essential quality of the information provided in financial statements is that it must be readily understandable by users. For this purpose, it is assumed that users have a reasonable knowledge of business, economic activities and accounting and study the information with reasonable diligence.

Relevance

To be useful, information must be relevant to the decision-making needsof users. Information has the quality of relevance when it influences theeconomic decisions of users by helping them evaluate past, present or futureevents or confirming, or correcting, their past evaluations. The relevance of information is affected by its materiality.

Reliability

To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be relied upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

Comparability

Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position, performance and cash flows. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and cash flows.

Apart from these four principal qualitative characteristics, there are certain other characteristics which make the financial information useful to the users. These are as follows:

Materiality

The relevance of information is affected by its materiality. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item or error, judged in the particular circumstances of its misstatement. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

Faithful Representation

To be reliable, information must represent faithfully the transactionsand other events it either purports to represent or could reasonably be expectedto represent. Thus, for example, a balance sheet should represent faithfullythe transactions and other events that result in assets, liabilities and equity ofthe enterprise at the reporting date which meet the recognition criteria.

Substance over Form

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

Neutrality

To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. The preparers of financial statements have to contend with the uncertainties that inevitably surround many events and circumstances. The uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements.

Completeness

To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Timeliness

If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability.

Balance between Benefit and Cost

The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Furthermore, the costs do not necessarily fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared. For these reasons, it is difficult to apply a cost-benefit test in any particular case.

True and Fair View

Financial statements are frequently described as showing a true and fair view of the financial position, performance and cash flows of an enterprise. Although this Framework does not deal directly with such concepts, the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of such information.

2.6 The Definition of the Elements of Financial Statements

Financial statement forms a part of the process of financial reporting. A complete set of financial statements include a balance sheet, a statement of profit and loss and a statement of cash flows. Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to the measurement of financialposition in the balance sheet are assets, liabilities and equity. The elements directly related to the measurement of performance in the statement of profit and loss are income and expenses.

The cash flow statement usually reflects elements of statement of profit and loss and changes in balance sheetelements.Three elements relating to the statement of financial position (balance sheet) are asset, liability and equity and two elements related to statement of comprehensive income are income and expense. Therefore, the elements of financial statements are asset, liability, equity, income and expense.

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

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

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

Income: Income is the increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decrease of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Expenses : Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

2.7 Recognition of the Elements from which financial statements are constructed

Recognition is the process of incorporating in the balance sheet or statement of profit and loss an item that meets the definition of an element and satisfies the criteria for recognition. It involves

the depiction of the item in words and by a monetary amount and the inclusion of that amount in the totals of balance sheet or statement of profit and loss. Items that satisfy the recognition criteria should be recognised in the balance sheet or statement of profit and loss. An item that meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and

(b) the item has a cost or value that can be measured with reliability.

Recognition of Assets

An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably. An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the enterprise beyond the current accounting period.

Recognition of Liabilities

A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts

that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements.

Recognition of Income

Income is recognised in the statement of profit and loss when increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of

increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

Recognition of Expenses

Expenses are recognised in the statement of profit and loss when decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase of liabilities or a decrease in assets (for example, the accrual of employees' salaries or the depreciation of plant and machinery). Many expenses are recognised in the statement of profit and loss on the basis of a direct association between the costs incurred and the earning of specific items of income. This process is commonly referred to as the matching of costs with revenues.

2.8 Measurement of assets and liabilities reported in financial statements

Measurement is the process of determining the monetary amounts at which the elements of financial statements are to be recognised and carried in the balance sheet and statement of profit and loss. This involves the selection of the particular basis of measurement. A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:

(a) Historical cost: Historical cost is the money figure at which an asset or liability is initially recorded and is the basis for all subsequent accounting, for those assets and liabilities. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) Current cost:Current cost of an asset is the amount of cash or other consideration that would be required today to obtain the same asset or its equivalent. Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset were acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) Realisable: (settlement) value:Realisable value is the amount of cash or its equivalent that would be received currently if an asset were sold in the normal course of business. Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at

their settlement values, that is, the undiscounted amounts of cash or cash equivalents expected to be required to settle the liabilities in the normal course of business.

(d) Present value :Present value is the cash flows associated with the expected sale or conversion of an asset at some future date discounted at an appropriate rate of interest. Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Stop to Consider

Do you think that conceptual framwork for preparing and reporting the financial statement of Blue chip companies are similar to other companies in India?

2.9 Concepts of Capital and Capital Maintenance

Maintenance of capital by an entity is very essential in order to survive. Capital maintenance is a principle of accounting which states that a profit is the residual revenue of a reporting period after the initial value of the capital of the business has been restored. Broadly, there are two concepts of capital maintenance- financial capital maintenance and physical capital maintenance. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the enterprise. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the enterprise based on, for example, units of output per day. The selection of the appropriate concept of capital by an enterprise should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the enterprise, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

The concepts of capital give rise to the following concepts of capital maintenance:

(a) *Financial capital maintenance*. Under this concept, a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount

of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) *Physical capital maintenance*. Under this concept, a profit is earned only if the physical productive capacity (or operating capability) of the enterprise at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

The concept of capital maintenance is concerned with how an enterprise defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for

distinguishing between an enterprise's return *on* capital and its return *of* capital; only inflows of assets in excess of amounts needed to maintain capitalcan be regarded as profit and therefore as a return on capital. Hence, profitis the residual amount that remains after expenses (including capitalmaintenance adjustments, where appropriate) have been deducted fromincome. If expenses exceed income, the residual amount is a net loss.

The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the enterprise is seeking to maintain. The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the enterprise. In general terms, an enterprise has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.

Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the enterprise are viewed as changes in the measurement of the physical productive capacity of the enterprise; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. This Framework is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements under the chosen

model.

Check You Progress

1. What are the qualitative characteristics of financial statement issued by ICAI?
2. What are the different element of financial statement?
3. What is capital maintenance?
4. Write notes on :

(a) Financial capital maintenance (b) Physical capital maintenance

2.10 Summing Up

Conceptual framework acts as a guide to the establishment, interpretation and application of accounting and reporting standards. Financial statements form a part of the process of financial reporting both to the internal and external users. Qualitative characteristics like relevance, understandability, reliability, materiality and the like are the attributes that make the information provided in financial statements useful to users.Items that satisfy the recognition criteria should be recognised in the balance sheet or statement of profit and loss. The elements of financial statements are to be recognised and carried in the balance sheet and statement of profit and loss by assigning monetary values. Maintenance of capital by an entity is very essential in order to survive. Capital maintenance is a principle of accounting which states that a profit is the residual revenue of a reporting period after the initial value of the capital of the business has been restored. The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statementsThe Conceptual framework will be applicable to the accounting models used in the preparation and presentation of financial statements

2.11 Model Questions

1. Mention the objectives and users of financial statements.
2. What are the qualitative characteristics that determine the usefulness of information in financial statements ?
3. Define the elements of financial statements.
4. Mention the criteria for recognition of the elements from which financial statements are constructed.
5. What are the different basis of measurement of assets and liabilities reported in financial statements?
6. Write a note on the concept of capital and capital maintenance.

2.12 References and Suggested Readings

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Unit-3
Conceptual Framework of Financial Statements Issued by the International Accounting Standards Board under IFRS-I

Unit Structure:

3.1 Introduction

The International Accounting Standards Board (IASB) issued its 'Framework for the Preparation and Presentation of Financial Statements' in 1989. This is referred to as its conceptual framework**.**The framework sets out the concepts that shape the preparation and presentation of financial statements for external users. The framework does not have the status of an accounting standard. The purpose of the framework is to assist the IASB in developing and revising IFRS that are based on consistent concepts,to help preparers develop consistent accounting policies when no IFRS Standard applies to a particular transaction or event, or when a Standard allows a choice of accounting policy;and to assist all parties to understand and interpret IFRS.

3.2 Objectives

After going through this unit you shall be able

- Understand the meaning and purpose of Conceptual framework issued by IASB

- Identify the objectives and the users of framework issued by IASB
- Understand the concept of reporting entity.

3.3 Conceptual framework of financial statements issued by the International Accounting Standards Board (IASB)

The IASB's conceptual framework is described in the document, "Framework for Preparation and Presentation of Financial Statements." Both the IASB and the FASB have a conceptual framework. The IASB and the FASB are now working on a joint project to develop an improved common conceptual framework that provides a sound foundation for developing future accounting standards. Such a framework is essential to fulfilling the Boards' goal of developing standards that are principles-based, internally consistent, and internationally converged, and that lead to financial reporting that provides the information investors need to make sound and effective decisions. The new framework will be built on the existing IASB and FASB frameworks, and consider developments subsequent to the issuance of these frameworks.It is a practical tool that:

a. assists the Board to develop IFRS Standards that are based on consistent concepts;
b. assists preparers to develop consistent accounting policies when no IFRS Standard applies to a particular transaction or event, or when a Standard allows a choice of accounting policy; and
c. assists others to understand and interpret the Standards.

3.4 Objectives and users of financial statements

The objective of the Conceptual Framework is to improve financial reporting by providing a more complete, clear and updated set of concepts. To achieve this, the Board is building on the existing Conceptual Framework—updating it, improving it and filling in the gaps instead of fundamentally reconsidering all aspects of the Conceptual Framework.

3.4.1: Objectives of financial statements

A financial statement is a formal record of the financial activities and position of a business. Its purpose is to convey an understanding of some financial aspects of a business firm .The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. This would guide in deciding statements, their contents and disclosures. A set of general purpose statements focus on financial position, performance and cash flows of an entity which could be used by any user group to assess investment decision, employment stability or growth, debt servicing, business continuity and ability to make societal contribution. General purpose financial statements are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

3.4.2 Users of financial statements

The different user groups of financial statements include the following:

1. Investors: Information need of the group primarily relates to decision making of buy, hold or sale entity's share. Also dividend paying ability of the entity is a matter of interest.
2. Employees: Employees need to know about the stability and continued profit ability of the employer which would ensure payment of remuneration, employee opportunities and retirement benefits.
3. Lenders: Lenders are interested in debt servicing capability.
4. Suppliers and other trade creditors: This group is interested in information about the entity's ability in the short run to pay their dues. Of course, they are interested in the long run viability of the entity, if it is their major customer.
5. Customers: Customers seek information about the continuation of the entity in particular if the entity is their major supplier.
6. Government and their agencies: They have manifold interests like taxation, contribution of the entity in employment generation and economic activities of the nation and also the infrastructural facilities to be provided to sub serve the need of the entity commensurate with is contribution to the society.
7. Public : Mostly interested in employment generation and societal contribution.

3.5 Reporting entity

A reporting entity is an entity that chooses, or is required, to present general purpose financial statements. When one entity (the parent) has control over another entity (the subsidiary), the boundary of the reporting entity can be determined by either direct control only (leading to unconsolidated financial statements) or by direct and indirect control (leading to consolidated financial statements). It does not have to be a legal entity and can comprise only a portion of an entity or two or more entities. Consolidated financial statements are generally more likely to provide useful information to users than unconsolidated financial statements. In consolidated financial statements, an entity reports on both its own (directly controlled) assets and liabilities; and its indirect assets and liabilities (those of its subsidiaries: the entities that it controls). In unconsolidated financial statements, an entity reports only on its own (directly controlled) assets and liabilities. The IASB is of the view that, in general, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements. Unconsolidated financial statements may also provide useful information. The IASB asserts that if an entity chooses, or is required, to prepare unconsolidated financial statements, it would need to disclose how users may obtain the consolidated financial statements. A reporting entity does not have to be a legal entity. If a reporting entity is not a legal entity, the boundary of the reporting entity needs to be set in such a way that the financial statements: (a) provide the relevant financial information needed by those existing and potential investors, lenders and other creditors who rely on the financial statements; and (b) faithfully represent the economic activities of the entity.

Check You Progress

1. What are the objectives of the conceptual framwork issued by IASB?
2. Who are the users of financial statement prepared as per the conceptual framwork issued by ICAI?
3. What is a reporting entity?

Stop to Consider

One of the primary reason behind the launch of IFRS was to create a common accounting language so that business and their financial statements can be consistent and relaible from company to company and country to country.

3.6 Summing Up

The framework sets out the concepts that shape the preparation and presentation of financial statements for external users.The objective of the Conceptual Framework is to improve financial reporting by providing a more complete, clear and updated set of concepts through a set of complete financial statements.The general purpose financial statements are required to be presented by a reporting entity.A reporting entity does not have to be a legal entity and can comprise only a portion of an entity or two or more entities.

3.7 Model Questions

1. Mention the objectives of financial statements
2. Mention the different user groups of financial statements
3. What is meant by reporting entity?

3.8 References and Suggested Readings

Lal, Jawahar.2003. Accounting Theory- An Introduction. Himalaya Publishing House. Mumbai.

Mukherjee Amitabha.2011 Illustrated Guide to Indian accounting Standards (IND Ass) and IFRSs. TaxmannPublications(P.) Ltd.New Delhi.

Porwal,LS .2007. Accounting Theory- An Introduction. Tata Mcgraw-Hill Publishing Company Limited.New Delhi

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Unit-4
Conceptual Framework Issued by the International Accounting Standards Board- under IFRS-II

Unit Structure:

4.1 Introduction

Financial statement of a business organization comprises of trading account, profit and loss account, balance sheet, cashflow and fund flow statement. The financial statement provides necessary information and data to its users (investors, management, employees, creditors, suppliers) for various decision making purposes. Financial statement are made to be presented, interpreted, analysed and compared to draw conclusions. The financial statement posses certain qualitative characteristics that make the information provided in financial statements useful to its users. The qualitative characteristics of financial statements includes: Easy Understanding, Reliability, Relevance Comparability and Faithful Presentation.

The information provided in the financial statement must be easily understandable by the user for decision making purpose who have reasonable knowledge in business and accounting. The information must be free of error and bias, and should not mislead. It should be presented faithfully which it either purports to represent or could reasonably be expected to represent. The information must be relevant to the requirements of the users i.e., it should satisfy the information need of whosoever uses it, because it becomes the criteria for various economic decisions of users. The information facilitates comparison of financial statements of an entity in order to identify the trends in financial position and performance. The statement must represents all the business transactions and other material events faithfully, in order to be reliable. The other qualitative characteristics in financial statement are materiality, faithful presentation, substance over form, neutrality, prudence, completeness, timeliness, true and fair view.

4.2 Objectives

After going through this unit you will be able to:

- Understand the qualitative characteristic of the financial information
- Define the various elements of financial statement.

4.3 The qualitative characteristics that determine the usefulness of information in financial statements

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. Four principal qualitative characteristic of financial information are understandability, relevance, reliability and comparability. Apart from these four characteristics, there are certain other characteristics which on an overall count reflect fair presentation.

1. ***Undertstandability***: Information provided in financial statements should be readily understandable by the users having reasonable knowledge of business, economic activities and accounting as well as a willingness to study the information with reasonable diligence.
2. ***Relevance***: Information must be relevant to the decision making needs of the users. If the information can influence the economic decisions of users by helping them to evaluate past, present or future payments or conforming or correcting, their past evaluations is considered as relevant.
3. ***Reliability***: An information is reliable if it is free from material error and bias. It should be presented faithfully which it either purports to represent or could reasonably be expected to represent.
4. ***Comparability***: It facilitates comparison of financial statements of an entity in order to identify the trends in financial position and performance.
5. ***Materiality***: Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of financial statements.

6. ***Faithful presentation***: To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria

7. ***Substance over form***: Transaction and other events should be presented based on substance and not in accordance with legal form.

8. ***Neutrality***: Financial information should be free from bias.

9. ***Prudence*** : Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

10. ***Completeness***: The information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of relevance.

11. ***Timeliness***: A piece of information loses relevance if there is delay in the reporting of information .So, financial information should be presented timely.

12. ***True and fair view***: Financial statements are frequently described as showing a true and fair view, or as presenting fairly, the financial position, performance and changes in financial position of an entity. Fair presentation requires the faithful presentation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, incomes and expenses set out in the framework.

4.4 The definition of the elements of financial statements

Three elements relating to the statement of financial position (balance sheet) are asset, liability and equity and two elements related to statement of comprehensive income are income and expense. Therefore, the elements of financial statements are asset, liability, equity, income and expense.

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

***Liability*:** A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

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

Income: Income is the increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decrease of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Expenses : Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Check Your Progress

1. Write the meaning of : Asset, Income, Expenses?
2. What is Prudence?
3. What are the different elements of financial statement issued by IFRS?
4. What are the different characteristic of finacial statements issued by IFRS?

Stop to Consider

Chinese Companies do not use IFRS or GAAP. They use Chinese Accounting Standards for Business Enterprise (ASBEs).

4.5 Summing Up

The financial statement of a business organization provides necessary information to its users for various decision making purposes.

The financial statement posses certain qualitative characteristics that make the information provided in the financial statements useful to its users. The qualitative characteristics of financial statement are (a) Understandibility (b) Reliability (c) Relevance (d) Comparability (e) Faithful Presentation (f) materiality (g) faithful presentation (h) substance over form (i) neutrality (j) prudence (k) completeness (l) timeliness and (m) true and fair view.

There are five elements of financial statements (a) Asset (b) liability (c) equity (d) Income (e) expenses. Out of five, three elements are related to the statement of financial position (balance sheet) which are asset, liability and equity and two elements related to comprehensive income are income and expenses.

4.6 Model Questions

1. What are the qualitative characteristics that determine the usefulness of information in financial statements?
2. What are the elements of financial statements? Define each elements of financial statements.

4.7 References and Suggested Readings

Lal, Jawahar. 2003. Accounting Theory- An Introduction. Himalaya Publishing House. Mumbai.

Mukherjee Amitabha. 2011 Illustrated Guide to Indian accounting Standards (IND Ass) and IFRSs. Taxmann Publications(P.) Ltd. New Delhi.

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Unit-5
Conceptual Framework issued by the International Accounting Standards Board- under IFRS-III

Unit Structure:

5.1 Introduction

Recognition is the process of incorporating in the balance sheet or statement of profit and loss an item that meets the definition of an element and satisfies the criteria for recognition. An item that meets the definition of an element should be recognised if it is probable that any future economic benefit associated with the item will flow to or from the enterprise and if the item has a cost or value that can be measured with reliability. Measurement is the process of determining the monetary amounts at which the elements of financial statements are to be recognised and carried in the balance sheet and statement of profit and loss. Capital maintenance is a principle of accounting which states that a profit is the residual revenue of a reporting period after the initial value of the capital of the business has been restored.

5.2 Objectives

After going through this unit you will be able to

- Understand how elements of financial statement are recognised.
- Understand how the elements of financial statement are measured.
- Discuss the concept of capital and capital maintenance.

5.3 The recognition of the elements from which financial statements are constructed

Recognition is the process of incorporating in the balance sheet or statement of profit and loss an item that meets the definition of an element and satisfies the criteria for recognition. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the totals of balance sheet or statement of profit and loss. Items that satisfy the recognition criteria should be recognised in the balance sheet or statement of profit and loss. An item that meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and

(b) the item has a cost or value that can be measured with reliability.

Recognition of Assets: An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably. An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the enterprise beyond the current accounting period.

Recognition of Liabilities: A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts

that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements.

Recognition of Income: Income is recognised in the statement of profit and loss when increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

Recognition of Expenses: Expenses are recognised in the statement of profit and loss when decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase of liabilities or a decrease in assets (for example, the accrual of employees' salaries or the depreciation of plant and machinery). Many expenses are recognised in the statement of profit and loss on the basis of a direct association between the costs incurred and the earning of specific items of income. This process is commonly referred to as the matching of costs with revenues.

5.4 Measurement of assets and liabilities reported in financial statements

Measurement is the process of determining the monetary amounts at which the elements of financial statements are to be recognised and carried in the balance sheet and statement of profit and loss. This involves the selection of the particular basis of measurement. A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:

*(a)**Historical cost.*** Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) Current cost. Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset were acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) Realisable (settlement) value. Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values, that is, the undiscounted amounts of cash or cash equivalents expected to be required to settle the liabilities in the normal course of business.

(d) Present value. Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Check Your Progress

1. What is measurement of assets and liabilities reported in financial statements?
2. Define the following

   a) Historical cost b) Current cost

   c) Realisable value d) Present Value

5.5 Concepts of Capital and capital maintenance

Maintenance of capital by an entity is very essential in order to survive. Capital maintenance is a principle of accounting which states that a profit is the residual revenue of a reporting period after the initial value of the capital of the business has been restored. Broadly there are two concepts of capital maintenance- financial capital maintenance and physical capital maintenance. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the enterprise. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the enterprise based on, for example, units of output per day. The selection of the appropriate concept of capital by an enterprise should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the enterprise, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

The concepts of capital give rise to the following concepts of capital maintenance:

(a) Financial capital maintenance: Under this concept, a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(***b) Physical capital maintenance*** : Under this concept, a profit is earned only if the physical productive capacity (or operating capability) of the enterprise at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

The concept of capital maintenance is concerned with how an enterprise defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an enterprise's return *on* capital and its return *of* capital; only inflows of assets in excess of amounts needed to maintain capital can be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income, the residual amount is a net loss.

The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the enterprise is seeking to maintain. The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the enterprise. In general terms, an enterprise has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.

Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the enterprise are viewed as changes in the measurement of the physical productive capacity of the enterprise; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. This Framework is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements under the chosen model.

Check Your Progress

1. Explain the concept of capital and capital maintenance.
2. What are financial Capital maintenance and physical capital maintenance.

Stop to Consider

Any company which is registered under the companies Act 1956 will have to comply with IFRS from 2012 onwards. Similarly, companies that are preparing financial statements which are required to be filed in India under companies Act 2013 will need to follow IFRS.

5.6 Summing Up

Recognition is the process of incorporating in the balance sheet or statement of profit and loss an item that meets the definition of an element and satisfies the criteria for recognition.

Measurement is the process of determining the monetary amounts at which the elements of financial statements are to be recognized and carried in the balance sheet and statement of profit and loss. Capital maintenance is a principle of accounting which states that a profit is a residual revenue of a reporting period after the initial value of the capital of the business has been restored. Broadly there are two concepts of capital maintenance- financial capital maintenance and physical capital assets. Financial Capital maintenance state that a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Physical capital maintenance state that a profit is earned only if the physical productive capacity (or operating capability) of the enterprise at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

5.7 Model Questions

1. What is recognition of the elements from which financial statements are constructed?
2. Define
   a) Recognition of Assets b) Recognition of liabilities
   c) Recognition of Income d) Recognition of Expenses
3. What is measurement of assets and liabilities reported in financial statements?
4. What are historical cost and current cost?
5. Distinguish between Realisable (settlement) value and present value.
6. State the concept of capital maintenance. What are the two concepts of capital maintenance?
7. What is financial capital maintenance and physical capital maintenance?

5.8 References and Suggested Readings

Lal, Jawahar. 2003. Accounting Theory- An Introduction. Himalaya Publishing House. Mumbai.

Mukherjee Amitabha. 2011 Illustrated Guide to Indian accounting Standards (IND Ass) and IFRSs. Taxmann Publications(P.) Ltd. New Delhi.

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