1 Framework for Preparation and Presentation of Financial Statements

BASIC CONCEPTS	
	The International Accounting Standards Committee (IASC) issued a Conceptual Framework to serve as a basis for the accounting standards. The Accounting Standards Board of the ICAI has issued a similar framework for the same purpose in July 2000. This framework provides the fundamental basis for development of new standards as also for review of existing standards. The framework sets out the concepts underlying the preparation and presentation of general-purpose financial statements prepared by enterprises for external users. This framework explains components, users, qualitative characteristics and elements of financial statements The framework also explains concepts of capital, capital maintenance and determination of profit.

Question 1

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?

Answer

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. Since financial statements are prepared within the framework of accounting concepts their general format and representation is uniform. However, in spite of such uniformity, the financial statements should observe and maintain the following qualitative characteristics as far as possible within limits of reasonable cost/ benefit.

1. *Understandability*: The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business activities and basic accounting terms. It is not right to think that more disclosures are always better. A mass of irrelevant information creates confusion and can be even more harmful than non-disclosure. No relevant information can be however withheld on the grounds of complexity.

2. *Relevance*: The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its omission or misstatement can influence economic decisions of a user. An example of materiality may be the non availability of balance confirmation from a major debtor or the fact that old unsettled insurance claims are shown as recoverable instead being written off.
3. *Reliability*: To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless:
   (a) Transactions and events reported are faithfully represented.
   (b) Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of 'substance over form'.
   (c) The reporting of transactions and events are neutral, i.e. free from bias.
   (d) Prudence is exercised in reporting uncertain outcome of transactions or events.

   Reliability increases with increasing objectivity and diminishing subjectivity in comments.
4. *Comparability*: Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies. The criterion of comparability lies in uniformity of format and uniformity in accounting policies so that apples are compared always with apples.
5. *True and Fair View*: Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The framework does not deal directly with this concept of true and fair view, yet the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of all relevant financial information about an enterprise.

Question 2

"One of the characteristics of financial statements is neutrality"- Do you agree with this statement?

Answer

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different

conclusion on the business results. For example if the assets of a company primarily consist of debtors and insurance claims and the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key debtors have not given balance confirmation certificates, an erroneous conclusion may be drawn on the liquidity of the company. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.

Question 3

Balance Sheet of Anurag Trading Co. on 31st March, 2014 is given below:

Liabilities	*Amount (₹)*	*Assets*	*Amount (₹)*
Capital	*50,000*	*Fixed Assets*	*69,000*
Profit and Loss A/c	*22,000*	*Stock in Trade*	*36,000*
10% Loan	*43,000*	*Trade Receivables*	*10,000*
Trade Payables	*18,000*	*Deferred Expenditure*	*15,000*
	-	*Bank*	*3,000*
	1,33,000		*1,33,000*

Additional Information:

(i) Remaining life of fixed assets is 5 years with even use. The net realizable value of fixed assets as on 31st March, 2015 was ₹64,000.

(ii) Firm's sales and purchases for the year 2014-15 amounted to ₹5 lacs and ₹4.50 lacs respectively.

(iii) The cost and net realizable value of the stock were ₹34,000 and ₹38,000 respectively.

(iv) General Expenses for the year 2014-15 were ₹16,500.

(v) Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 2013-14 i.e. ₹5,000 per year.

(vi) Out of debtors worth ₹10,000, collection of ₹4,000 depends on successful re-design of certain product already supplied to the customer.

(vii) Closing trade payable is ₹10,000, which is likely to be settled at 95%.

(viii) There is pre-payment penalty of ₹2,000 for Bank loan outstanding.

Prepare Profit & loss Account for the year ended 31st March, 2015 by assuming it is not a Going Concern.

Answer

Profit and Loss Account of Anurag Trading Co. for the year ended 31st March, 2015

(Assuming business is not a going concern)

	₹		₹
To Opening Stock	36,000	By Sales	5,00,000
To Purchases	4,50,000	By Trade payables	500
To Expenses	16,500	By Closing Stock	38,000
To Depreciation (69,000-64,000)	5,000		
To Provision for doubtful debts	4,000		
To Deferred expenditure	15,000		
To Loan penalty	2,000		
To Net Profit	10,000		
	5,38,500		5,38,500