

1.

FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

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Quote:

*“Failure will never overtake you
if your determination to succeed is strong enough”*



SECTION A – QUESTIONS

(Questions of Study Material, RTPs, MTPs and Past Exams to be Practiced in the Class)

Q.FRW.SM.01(A):

Carrying amount of a machine is 40,000 (Historical cost less depreciation). The machine is expected to generate Rs. 10,000 net cash inflow. The net realisable value (or net selling price) of the machine on current date is Rs. 35,000. The enterprise's required earning rate is 10% per year.



SOLUTION

The enterprise can either use the machine to earn Rs. 10,000 for 5 years. This is equivalent of receiving present value of Rs. 10,000 for 5 years at discounting rate 10% on current date. The value realised by use of the asset is called value in use. The value in use is the value of asset by present value convention.

Value in use = Rs. 10,000 (0.909 + 0.826 + 0.751 + 0.683 + 0.621) = Rs. 37,900

Net selling price = Rs. 35,000

The present value of the asset is Rs. 37,900, which is called its recoverable value. It is obviously not appropriate to carry any asset

at a value higher than its recoverable value. Thus, the asset is currently overstated by Rs. 2,100 (Rs. 40,000 – Rs. 37,900).

Q.FRW.SM.02(A): (Similar to MTP May'24)

Opening Balance Sheet of Mr. A is showing the aggregate value of assets, liabilities and equity Rs. 8 lakhs, Rs. 3 lakh and Rs. 5 lakhs respectively. During accounting period, Mr. A has the following transactions:



- 1) Earned 10% dividend on 2,000 equity shares held of Rs. 100 each
- 2) Paid Rs. 50,000 to creditors for settlement of Rs. 70,000
- 3) Rent of the premises is outstanding Rs. 10,000
- 4) Mr. A withdrew Rs. 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction.

SOLUTION

Effects of each transaction on Balance sheet of the trader is shown below:

	Transactions	Assets Rs. Lakhs (a)	Liabilities Rs. Lakhs (b)	Equity Rs. lakhs (c) + (a – b)
	Opening	8.00	3.00	5.00
1)	Dividend earned	8.20	3.00	5.20
2)	Settlement of Creditors	7.70	2.30	5.40
3)	Rent Outstanding	7.70	2.40	5.30
4)	Drawings	7.61	2.40	5.21

Q.FRW.RMP.03(A): (RTP May20, MTP Nov19, Nov20& May21)

A Ltd. has entered into a binding agreement with Gamma Ltd. To buy a custom-made machine Rs. 1,00,000. At the end of 20X1-X2, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered & it will be scrapped after delivery. The expected scrap value is nil.



You are required to advise the accounting treatment and give necessary journal entry in the year 20X1-X2.

SOLUTION

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated, and the value of outflow can be reliably measured. In the given case, A Ltd. Should recognize a liability of Rs. 1,00,000 to Gamma Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of machine should be recognised as an expense.

Journal entry

Loss on change in production method To Gamma Ltd. (Loss due to change in production method)	Dr.	1,00,000	1,00,000
Profit and loss A/c To Loss on change in production method (Loss transferred to profit and loss account)	Dr.	1,00,000	1,00,000

Q.FRW.RMP.04(A): (MTP Nov20)

Medha Ltd. took a loan from bank for Rs.10,00,000 to be settled within 5 years in 10 equal half yearly installments with interest. First installment is due on 30.09.2020 of Rs. 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Medha Ltd. for the year ended 31stMarch, 2020 according to Schedule III.

SOLUTION

As per Schedule III, a liability should be classified as current when it satisfies any of the following criteria:

- i.** It is expected to be settled in the company’s normal operating cycle;
- ii.** It is held primarily for the purpose of being traded;
- iii.** It is due to be settled within twelve months after the reporting date; or
- iv.** The company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

Q.FRW.RMP.05(A): (MTP May’18, Nov’18; RTP May’22; MTP May’24)

"One of the characteristics of the financial statement is neutrality." Do you agree with this statement? Explain in brief.

SOLUTION:

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 based on the business results. Information contained in the financial statements must be free from bias. It should reflect a balanced view of the financial position of the company without attempting to present them in biased manner. Financial statements cannot be prepared with the purpose to influence certain division, i.e., they must be neutral.

Q.FRW.RMP.06(A): (RTP Nov22; EXAM May19; EXAM Nov’20, EXAM JAN’25)

Summarised Balance Sheet of Cloth Trader as on 31.03.2017 is given below:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Proprietor’s Capital	3,00,000	Fixed Assets	3,60,000

Profit & Loss Account	1,25,000	Closing Stock	1,50,000
10% Loan Account	2,10,000	Sundry Debtors	1,00,000
Sundry Creditors	50,000	Deferred Expenses	50,000
		Cash & Bank	25,000
	6,85,000		6,85,000

Additional Information is as follows:

- (1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realisable value of fixed assets on 31.03.2018 was Rs.3,25,000.
- (2) Purchases and Sales in 2017-18 amounted to Rs.22,50,000 and Rs.27,50,000 respectively.
- (3) The cost and net realizable value of stock on 31.03.2018 were Rs.2,00,000 and Rs.2,50,000 respectively.
- (4) Expenses for the year amounted to Rs.78,000.
- (5) Deferred Expenses are amortized equally over 5 years.
- (6) Sundry Debtors on 31.03.2018 are Rs.1,50,000 of which Rs.5,000 is doubtful. Collection of another Rs.25,000 depends on successful re-installation of certain product supplied to the customer;
- (7) Closing Sundry Creditors are Rs.75,000, likely to be settled at 10% discount.
- (8) Cash balance as on 31.03.2018 is Rs.4,22,000.
- (9) There is an early repayment penalty for the loan of Rs.25,000.

You are required to prepare: (Not assuming going concern)

- (1) Profit & Loss Account for the year 2017-18.
- (2) Balance Sheet as on 31st March, 2018.

SOLUTION:

Profit and Loss Account for the year ended 2017-18(not assuming going concern)

Particulars	Amount	Particulars	Amount
To Opening Stock	1,50,000	By Sales	27,50,000
To Purchases	22,50,000	By Closing Stock	2,50,000
To Expenses*	78,000	By Trade payables	7,500
To Depreciation	35,000		
To Provision for doubtful debts	30,000		
To Deferred cost	50,000		
To Loan penalty	25,000		
To Net Profit (b.f.)	3,89,500		
	30,07,500		30,07,500

Balance Sheet as at 31st March, 2018 (not assuming going concern)

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital	3,00,000	Fixed Assets	3,25,000
Profit & Loss A/c	5,14,500	Stock	2,50,000
10% Loan	2,35,000	Trade receivables (less provision)	1,20,000
Trade payables	67,500	Deferred costs	Nil
		Bank	4,22,000
	11,17,000		11,17,000

*Assumed that Rs.78,000 includes interest on 10% loan amount for the year.

Q.FRW.RMP.07(A): (EXAM Nov'20 & MTP May'24)

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

SOLUTION

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The framework for Preparation and Presentation of Financial Statements suggests that the financial statements should maintain the following four qualitative characteristics to improve the usefulness of the information furnished therein.

- 1. Understandability:** The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities and accounting.
- 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 misstatement (i.e., omission or erroneous statement) can influence economic decisions of a user.
- 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 is not likely to be reliable unless transactions and events reported are faithfully represented. The reporting of transactions and events should be neutral, i.e., free from bias and be reported on the principle of 'substance over form'. The information in financial statements must be complete. Prudence should be exercised in reporting uncertain outcome of transactions or events.
- 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.



SECTION B- HOMEWORK QUESTIONS

(Questions of Study Material, RTPs, MTPs and Past Exams to be Practiced at Home)

Q.FRW.SM.01(B): (RTP Nov'18)

Mohan started a business on 1st April 20X1 with Rs. 12,00,000 represented by 60,000 units of Rs. 20 each. During the financial year ending on 31st March, 20X2, he sold the entire stock for Rs. 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 20X1-X2 if Financial Capital is maintained at historical cost.

SOLUTION

Particulars	Financial Capital Maintenance at Historical Cost (Rs.)
Closing equity (Rs. 30 x 60,000 units)	18,00,000 represented by cash
Opening equity	60,000 units x Rs. 20 = 12,00,000
Permissible drawings to keep Capital intact	6,00,000 (18,00,000 – 12,00,000)

Thus, in order to maintain the capital intact Mohan can withdraw Rs. 6,00,000 as the maximum amount

Q.FRW.SM.02(B):

Balance Sheet of Anurag Trading Co. on 31st March, 20X1 is given below:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
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 realisable value of fixed assets as on 31st March, 20X2 was 64,000.
- (ii) Firm's sales & purchases for the year 20X1-X2 amounted to 5 lacs & 4.50 lacs respectively.
- (iii) The cost and net realisable value of the stock were 34,000 and Rs. 38,000 respectively.
- (iv) General Expenses for the year 20X1-X2 were 16,500.
- (v) Deferred Expenditure is normally amortised equally over 4 years starting from F.Y. 20X0-X1 i.e., 5,000 per year.
- (vi) Out of debtors worth 10000, collection of 4000 depends on successful re design of certain product already supplied to the customer.
- (vii) Closing trade payable is 10000 which likely to be settled at 95%.
- (viii) There is pre-payment penalty of 2000 for bank loan outstanding.

Prepare profit & loss account for the year ended 31.3.20X2 by assuming it is not a Going concern.



SOLUTION

**Profit and loss Account of Anurag trading Co.
For the year ended 31.3.20X2
(Assuming business is not going concern)**

Particulars	Amount	Particulars	Amount
To opening stock	36000	By sales	500000
To purchase	450000	By trade payable	500
To general expenses	16500	By closing stock	38000
To depreciation (69000-65000)	5000		
To provision for doubtful debts	4000		
To deferred expenditure	15000		
To loan penalty	2000		
To net profit	10000		
	538500		538500

Q.FRW.RMP.3(B): (RTP - Nov18, Nov21; EXAM Dec21; MTP May19 & May21)

What is meant by ‘Measurement’? What are the bases of measurement of Elements of Financial Statements? Explain in brief.

SOLUTION

Measurement is the process of determining money value at which an element can be recognized in the balance sheet or statement of profit and loss. The framework recognizes four alternative measurement bases for the purpose. These bases can be explained as:

Historical cost	This is the Acquisition price. According to this, assets are recorded at an amount of cash and cash equivalent paid or the fair value of the assets at time of acquisition.
Current Cost	Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
Realisable (Settlement) Value	For assets, amount currently realizable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount expected to be paid on settlement of liability in the normal course of business.
Present Value	Assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

In preparation of financial statements, all or any of the measurement basis can be used in varying combinations to assign money values to financial items.

Q.FRW.RMP.4(B): (RTP May19, May21)

- (i) With regard to financial statements, name any five qualitative characteristics and elements.
- (ii) Aman started a business on 1st April 2020 with Rs. 24,00,000 represented by 1,20,000 units of Rs. 20 each. During the financial year ending on 31st March, 2021, he sold the entire stock for Rs. 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Aman in the year 2020-21 if Financial Capital is maintained at historical cost.

SOLUTION

(a) Qualitative Characteristics of Financial Statements:

Understandability, Relevance, Comparability, Reliability & Faithful Representation

Elements of Financial Statements:

Asset, Liability, Equity, Income/Gain and Expense/Loss

(b)

Particular	Financial Capital Maintenance at Historical Cost (Rs.)
Closing equity (Rs. 30 x 1,20,000 units)	36,00,000 represented by cash
Opening equity	1,20,000 units x Rs. 20 = 24,00,000
Permissible drawings to keep Capital intact	12,00,000 (36,00,000 – 24,00,000)

Q.FRW.RMP.5(B): (EXAM Jan21)

(a) Explain how financial capital is maintained at historical cost?

(b) Kishore started a business on 1st April 2019 with Rs. 15,00,000 represented by 75,000 units of Rs. 20 each. During the financial year ending on 31st March 2020, he sold the entire stock for Rs. 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Kishore in the year 2019-20 if Financial Capital is maintained at historical cost.

SOLUTION:

Financial capital maintenance at historical cost: Under this convention, opening and closing assets are stated at respective historical costs to ascertain opening and closing equity. If retained profit is greater than or equals to zero, the capital is said to be maintained at historical costs. This means the business will have enough funds to replace its assets at historical costs. This is quite right as long as prices do not rise

Maximum amount withdrawn by Kishore in year 2019-20 if financial capital is maintained at historical cost

Particular	Financial Capital Maintenance at Historical Cost (Rs.)
Closing equity (Rs.30 x 75,000 units)	22,50,000 represented by cash
Opening equity	75,000 units x Rs.20 = 15,00,000
Permissible drawings to keep Capital intact	7,50,000 (22,50,000 – 15,00,000)

Thus Rs. 7,50,000 is the maximum amount that can be withdrawn by Kishore in year 2019-20 if Financial capital is maintained at historical cost.

Q.FRW.RMP.6(B): (RTP May19, Nov20)

With regards to financial statements name any four.

- (1) Users
- (2) Qualitative characteristics
- (3) Elements

SOLUTION

1) users of financial statement:

Investors, Employees, Lenders, Supplies/Creditors, Customers, Government & Public.

2) qualitative Characteristic of Financial Statements:

Understandability, Revenue, Compatibility, Reliability & Faithful Representation

3) Elements of Financial Statements:

Assets, Liability, Equity, Income/Gain and Expenses/Losses

Q.FRW.RMP.7(B): (EXAM May18) (RTP May18)

Briefly explain the elements of financial statements.

SOLUTION

Elements of Financial Statements

Asset	Resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise
Liability	Present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits.
Equity	Residual interest in the assets of an enterprise after deducting all its liabilities
Income/gain	Increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equity participants
Expense/loss	Decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants

Q.FRW.RMP.8(B): (EXAM July21)

A trader commenced business on April 1, 2020 with Rs. 1,20,000 represented by 6,000 units of a certain product at Rs. 20 per unit. During the year 2020-21 he sold these units at Rs. 30/- per unit and had withdrawn Rs. 60,000. The price of the product at the end of financial year was Rs. 25/- per unit. Compute retained profit of the trader under the concept of physical capital maintenance at current cost. Also state, whether answer would be different if the trader had not withdrawn any amount.

SOLUTION:

Physical Capital Maintenance at Current Cost

In the given case, the specific price index applicable to the product is 125 (25/20X100).

Current cost of opening stock = (Rs. 1,20,000 / 100) x 125 Or 6,000 units x Rs. 25 = Rs. 1,50,000

Current cost of closing cash = Rs. 1,20,000 (Rs. 1,80,000 – Rs. 60,000)

Opening equity at closing current costs = Rs. 1,50,000

Closing equity at closing current costs = Rs. 1,20,000

Retained Profit = Rs. 1,20,000 – Rs. 1,50,000 = (-) Rs. 30,000

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of Rs. 1, 20,000 is not sufficient to buy 6,000 units again at increased price of Rs. 25 per unit. The drawings should have been restricted to Rs. 30,000 (Rs. 60,000 – Rs. 30,000).

If the trader had not withdrawn any amount, then the answer would have been as below:

Current cost of opening stock = Rs. 1,80,000

Opening equity at closing current costs = Rs. 1,50,000

Retained Profit = Rs. 1,80,000 – Rs. 1,50,000 = Rs. 30,000

If the trader had not withdrawn any amount, then the retained profit would have been Rs. 30,000.



Student Notes:-