



CHIRANJEEV JAIN
— CLASSES —

FOR CA - FINAL COURSE

QUESTION BANK
FOR
FINANCIAL REPORTING

As per the New syllabus of Final issued by
Board of Studies of ICAI

Volume I - 15th Edition

**"IT'S TIME TO BE BUSY BECAUSE TODAY WILL
BE YESTERDAY VERY SOON"**

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Thanks in advance for helping us!

REMEMBER

“IN ORDER TO SUCCEED, WE MUST FIRST BELIEVE THAT WE CAN”

*Dedicated to
My Father Sri Mool Chand Jain
and
My Mother Smt. Sarala Devi Jain*

Think Beyond 90+ IN CA FINAL - Financial Reporting

STOP Memorizing Without Understanding the CONCEPTS

It's Time to Learn Accounts Conceptually

PREFACE

Financial Reporting is Paper 1 in Chartered Accountancy – Final Course. It is rightly so because Accounting is the language of business and without understanding accounting terminology, it is not possible to understand business and commerce. It is, therefore, essential for all CA students to possess knowledge of Financial Reporting concepts and practices.

The approach of the book is examination-oriented problems from ICAI Study Resource and solutions have also been included in all chapters as per ICAI Suggested solution. Examples and Illustration (mostly selected from ICAI Study Modules) have been included in the book to understand the IND AS concepts.

Recent question from ICAI RTP, MTP and Exam papers with answers have been included to help the students. Practical Question from Other Sources are also included in some of the chapters for better understanding of the concepts. Solutions for some of these questions may not be provided for which students may refer our class notes.

Considering the importance of the question bank and its practical implications, care has been taken to solve almost all the problems for the benefit of the students.

We are sure the book will prove extremely useful to CA Final students.

We are Thankful to all my students to have faith on me.

Suggestions from all readers would be highly appreciated and acknowledged.

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All the questions are divided in three categories for REVISION Purpose:

	<i>This colour indicates - such questions are based on direct concept, which can be answered without reading the solution if student retain the concept. Student can ignore such question at the time of revision if they have insufficient time.</i>
	<i>This colour indicates - such questions should be solved at least one time and identify mistake (if any) committed while understanding or solving the questions and such mistakes should be considered while doing revision.</i>
	<i>This colour indicates - such questions are important and requires sufficient practice. Such questions must be revised before Exam. Such Question should be practiced by writing.</i>

Disclaimer: In Exam, Questions can be asked from any categories.

Note: Before Exam CJ Sir will provide a set of expected questions for every attempt in which questions may be from any category. That question should be revised in the last revision before exam along with all the questions which student have marked.

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**“CA IS NOT HARD” IF U
“WORK HARD”**

CHAPTER 1

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING UNDER IND AS

ILLUSTRATIONS FROM ICAI STUDY MATERIAL

Illustration 1: Derecognition vs. Faithful Representation

As at 31 March 20X2, Natasha Ltd. carried trade receivables of ₹ 280 crores in its balance sheet. At that date, Natasha Ltd. entered into a factoring agreement with Samantha Ltd., a financial institution, according to which it transferred the trade receivables in exchange for an immediate cash payment of ₹ 250 crores. As per the factoring agreement, any shortfall between the amount collected and ₹ 250 crores will be reimbursed by Natasha Ltd. to Samantha Ltd. Once the trade receivables have been collected, any amounts above ₹ 250 crores, less interest on this amount, will be repaid to Natasha Ltd. The directors of Natasha Ltd. are of the opinion that the trade receivables should be derecognized.

You are required to explain the appropriate accounting treatment of this transaction in the financial statements for the year ending 31 March 20X2, and also evaluate this transaction in the context of the Conceptual Framework. [MTP Nov 2024]

Solution: Accounting Treatment:

Trade Receivables fall within the ambit of financial assets under Ind AS 109, Financial Instruments. Thus, the issue in question is whether the factoring arrangement entered into with Samantha Ltd. requires Natasha Ltd. to derecognize the trade receivables from its financial statements.

As per Para 3.2.3, 3.2.4, 3.2.5 and 3.2.6 of Ind AS 109, Financial Instruments, an entity shall derecognise a financial asset when, and only when:

- a) the contractual rights to the cash flows from the financial asset expire, or
- b) it transfers the financial asset or substantially all the risks and rewards of ownership of the financial asset to another party.
- c) In the given case, since the trade receivables are appearing in the Balance Sheet of Natasha Ltd. as at 31 March 20X2 and are expected to be collected, the contractual rights to the cash flows have not expired.
- d) As far as the transfer of the risks and rewards of ownership is concerned, the factoring arrangement needs to be viewed in its substance, rather than its legal form. Natasha Ltd. has transferred the receivables to Samantha Ltd. for cash of ₹ 250 crores, and yet, it remains liable for making good any shortfall between ₹ 250 crores and the amount collected by Samantha Ltd. Thus, in substance, Natasha Ltd. is effectively liable for the entire ₹ 250 crores, although the

shortfall would not be such an amount. Accordingly, Natasha Ltd. retains the credit risk despite the factoring arrangement entered.

- e) It is also explicitly stated in the agreement that Samantha Ltd. would be liable to pay to Natasha Ltd. any amount collected more than ₹ 250 crores, after retaining an amount towards interest. Thus, Natasha Ltd. retains the potential rewards of full settlement.
- f) A perusal of the above clearly shows that substantially all the risks and rewards continue to remain with Natasha Ltd., and hence, the trade receivables should continue to appear in the Balance Sheet of Natasha Ltd. The immediate payment (i.e. consideration as per the factoring agreement) of ₹ 250 crores by Samantha Ltd. to Natasha Ltd. should be regarded as a financial liability, and be shown as such by Natasha Ltd. in its Balance Sheet.

Illustration 2:

The directors of Hind Ltd. are particular about the usefulness of the financial statements. They have opined that although Ind AS implement a fair value model, Ind AS are failing in reflecting the usefulness of the financial statements as they do not reflect the financial value of the entity.

Discuss the views of the directors as regards the use of fair value in Ind AS and the fact that the Ind AS do not reflect the financial value of an entity, making special reference to relevant Ind AS and the Conceptual Framework.

Solution:

Usage of Fair Value in Ind AS:

Treatment under Ind AS:

The statement of the directors regarding Ind AS implementing a fair value model is not entire accurate. Although Ind AS do use fair value (and present value), it is not a complete fair value system. Ind AS are often based on the business model of the entity and on the expectations of realizing the asset- and liability-related cash flows through operations and transfers.

It is notable that what is preferred is a mixed measurement system, with some items being measured at fair value while others measured at historical cost.

About Fair Value (Ind AS 113)

Ind AS 113 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This price is an exit price.

Ind AS 113 has given consistency to the definition and application of fair value, and this consistency is applied across other Ind AS, which are generally required to measure fair value in accordance with Ind AS 113. However, it cannot be implied that Ind AS requires all assets and

liabilities to be measured at fair value. Rather, many entities measure most items at depreciated historical costs, although the exception being in the case of business combinations, where assets and liabilities are recorded at fair value on the date of acquisition. In other cases, usage of fair value is restricted.

Examples of use of fair value in Ind AS:

- a) Ind AS 16 Property, Plant and Equipment permits revaluation through other comprehensive income, provided it is carried out regularly.
- b) Disclosure of fair value of Investment Property in Ind AS 40, while the companies account for the same under the cost model.
- c) Ind AS 38 Intangible Assets allows measurement of intangible assets at fair value with corresponding changes in equity, but only if the assets can be measured reliably by way of existence of an active market for them.
- d) Ind AS 109 Financial Instruments requires some financial assets and liabilities to be measured at amortized cost and others at fair value. The measurement basis is largely determined by the business model for that financial instrument. Where the financial instruments are carried at fair value, depending on the category and circumstances, the movement in the fair value (gain or loss) is either recognized in profit or loss or in other comprehensive income.

Financial value of an entity

Although Ind AS makes use of fair values in the measurement of assets and liabilities, the financial statements prepared under Ind AS are not intended to reflect the aggregate value of the entity, as could be the notion among people. As discussed in 2.2 above, the Conceptual Framework specifically states that general purpose financial statements are not intended to show the value of a reporting entity. Furthermore, such an attempt would not be fruitful as certain internally generated intangible assets cannot be recognized under Ind AS. Instead, the objective of general purpose financial reports is to provide financial information about the reporting entity which would be useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

It is only in the case of acquisition of an entity by another entity and subsequent consolidation in group accounts that an entity's net assets are reported at fair value.

Illustration 3:

Everest Ltd. is a listed company having investments in various subsidiaries. In its annual financial statements for the year ending 31 March 20X2 as well as 31 March 20X3, Everest Ltd. classified Kanchenjunga Ltd. a subsidiary as 'held-for-sale' and presented it as a discontinued operation. On 1 November 20X1, the shareholders had authorized the management to sell all of its holding in Kanchenjunga Ltd. within the year. In the year to 31 March 20X2, the management made a public announcement of its intention to sell the investment but did not actively try to sell the subsidiary as it was still operational within the Everest group.

Certain organizational changes were made by Everest Ltd. during the year to 31 March 20X3, thereby resulting in additional activities being transferred to Kanchenjunga Ltd. Additionally, during the year ending 31 March 20X3, there had been draft agreements and some correspondence with investment bankers, which showed in principle only that Kanchenjunga was still for sale.

Discuss whether the classification of Kanchenjunga Ltd. as held for sale and its presentation as a discontinued operation is appropriate, by referring to the principles of the relevant Ind AS and evaluating the treatment in the context of the Conceptual Framework for Financial Reporting.

Solution:

Kanchenjunga Ltd. is a disposal group in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. Disposal group can be defined as a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

Para 6 of Ind AS 105 provides that a disposal group shall be classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. Ind AS 105 is particularly strict as far as the application of held for sale criteria is concerned, and often the decision to sell an asset or a disposal group is made well before the criteria are met.

Thus, as per Ind AS 105, for the asset (or disposal group) to be classified as held for sale, it must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

For the sale to be highly probable:

- The appropriate level of management must be committed to a plan to sell the asset (or disposal group).
- An active programme to locate a buyer and complete the plan must have been initiated.
- The asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value.
- The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.
- It is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

In the given case, the draft agreements and correspondence with investment bankers are not specific enough to fit in the points above to prove that the criteria for held for sale was met at that date. Additional information would be needed to confirm that the subsidiary was available for immediate sale, and that it was being actively marketed at an appropriate price so as to satisfy the criteria in the year to 31 March 20X2.

Further, the organizational changes made by Everest Ltd. in the year 20X2-20X3 are a good indicator that Kanchenjunga Ltd. was not available for immediate sale in its present condition at the point of classification. The fact that additional activities have been given to Kanchenjunga Ltd. indicate that the change wasn't insignificant. The shareholders had authorized for a year from 1 November 20X1. There is no evidence that this authorization extended beyond 1 November 20X2.

Conclusion:

Based on the information provided in the given case, it appears that Kanchenjunga Ltd. should not be classified by Everest Ltd. as a subsidiary held for sale. Instead, the results of the subsidiary should be

reported as a continuing operation in the financial statements for the year ending 31 March 20X2 and 31 March 20X3.

Evaluation of treatment in context of the Conceptual Framework

The Conceptual Framework states that the users need information to allow them to assess the amount, timing and uncertainty of the prospects for future net cash inflows. Highlighting the results of discontinued operations separately equips users with the information that is relevant to this assessment as the discontinued operation will not contribute to cash flows in the future.

If a company has made a firm decision to sell the subsidiary, it could be argued that the subsidiary should be classified as discontinued operation, even if the criteria to classify it as 'held for sale' as per Ind AS 105 have not been met, because this information would be more useful to users. However, Ind AS 105 criteria was developed with high degree of strictness on classification. Accordingly, this decision could be argued to be in conflict with the Conceptual Framework.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: The directors of Jayant Ltd. have received the following email from its majority shareholder:

To: Directors of Jayant Ltd. Re: Measurement

I recently read an article published in the financial press about the 'mixed measurement approach' that is used by lots of companies. I hope Jayant Ltd. does not follow such an approach because 'mixed' seems to imply 'inconsistent'. I believe that consistency is of paramount importance, and hence feel it would be better to measure everything in a uniform manner. It would be appreciated if you could provide further information at the next annual general meeting on measurement bases, covering what approach is taken by Jayant Ltd. and why, and the potential effect such an approach has on the investors trying to analyse the financial statements.

Prepare notes for the directors of Jayant Ltd. to discuss the issue raised in the shareholders' email with reference to the Conceptual Framework wherever appropriate.

Ans: 'Mixed measurement' approach implies that a company selects different measurement bases (e.g. historical cost or fair value) for its various assets and liabilities, rather than using one single measurement basis for all items. The measurement basis so selected should reflect the type of entity and the sector in which it operates and the business model that the entity adopts.

There are criticisms of the mixed measurement approach, particularly under the IFRS regime, because investors think that if different measurement bases are used for assets and liabilities, the resulting figures could lack relevance or exhibit little meaning.

It is however important to note that figures of items in the financial statements cannot be derived by following a one-size-fits-all approach. Such an approach may not provide relevant information to users. A particular measurement basis may be easier to understand, more verifiable and less costly to implement. Therefore, to state that 'mixed measurement' approach is 'inconsistent' is a poor argument. In reality, a mixed approach may actually provide more relevant information to the stakeholders.

The Conceptual Framework confirms the allowance of the usage of a mixed measurement approach in developing standards. The measurement methods included in the standards are those which the standard-setters believe provide the most relevant information and which most faithfully represent the underlying transaction or event. Based on the reactions to the convergence to Ind AS, it feels that most investors feel this approach is consistent with their analysis of financial statements. Thus, the arguments against a mixed measurement are far outweighed by the greater relevance achieved by such measurement bases.

Jayant Ltd. prepares its financial statements under Ind AS, and therefore applies the measurement bases permitted in Ind AS. Ind AS adopt a mixed measurement basis, which includes current value (fair value, value in use, fulfilment value and current cost) and historical cost.

Where an Ind AS allows a choice of measurement basis, the directors of Jayant Ltd. must exercise judgment as to which basis will provide the most useful information for its primary users. Furthermore, when selecting a measurement basis, measurement uncertainty should also be considered. The Conceptual Framework states that for some estimates, a high level of measurement uncertainty may outweigh other factors to such an extent that the resulting information may be of little relevance.

QUESTIONS FROM OTHER SOURCE

Q2 Balance sheet of a trader on 31st March, 20X1 is given below:

Particulars	₹
Assets	
Non-current assets	
Property, Plant and Equipment	65,000
Current assets	
Inventories	30,000
Financial assets	
Trade receivables	20,000
Other asset	10,000
Cash and cash equivalents	5,000
	1,30,000
Equity and Liabilities	
Equity	
Share capital	60,000
Other Equity - Profit and Loss Account	25,000
Non-current liabilities	
10% Loan	35,000
Current liabilities	
Financial liabilities	
Trade payables	10,000
	1,30,000

Additional information

- a) The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.20X2 was ₹ 60,000.
- (b) The trader's purchases and sales in 20X1-20X2 amounted to ₹ 4 lakh and ₹ 4.5 lakh respectively.
- (c) The cost and net realisable value of inventories on 31.03.20X2 were ₹ 32,000 and ₹ 40,000 respectively.
- (d) Employee benefit expenses for the year amounted to ₹ 14,900.
- (e) Other asset is written off equally over 4 years.
- (f) Trade receivables on 31.03.20X2 is ₹ 25,000, of which ₹ 2,000 is doubtful. Collection of another ₹ 4,000 depends on successful re-installation of certain product supplied to the customer.
- (g) Cash balance on 31.03.20X2 is ₹ 37,100 before deduction of interest paid on loan.
- (h) There is an early repayment penalty for the loan ₹ 2,500.

The Profit and Loss Accounts and Balance Sheets of the trader are shown below in two cases (i) assuming going concern (ii) not assuming going concern.

Ans: Profit and Loss Account for the year ended 31st March, 20X2

	Case (i)	Case (ii)
	₹	₹
Revenue from operations – Sales (A)	4,50,000	4,50,000
Expenses		
Purchases	4,00,000	4,00,000
Changes in inventories	(2,000)	(10,000)
Employee benefit expenses	14,900	14,900
Finance cost	3,500	6,000
Depreciation and amortisation expenses	15,500	15,000
Other expenses - Provision for doubtful debts	2,000	6,000
Total Expenses (B)	4,33,900	4,31,900
Profit for the period (A-B)	16,100	18,100

Balance Sheet as at 31st March, 20X2

	Case (i)	Case (ii)
	₹	₹
Assets		
Non-current assets		
Property, Plant and Equipment	52,000	60,000

Current Asset		
Inventories	32,000	40,000
Financial assets		
Trade receivables (less provision)	23,000	19,000
Other asset	7,500	Nil
Cash and cash equivalents (after interest paid on loan)	33,600	33,600
	1,48,100	1,52,600
Equity and Liabilities		
Equity		
Share Capital	60,000	60,000
Other Equity - Profit & Loss A/c	41,100	43,100
Non-current liabilities		
10% Loan	35,000	37,500
Current liabilities		
Trade payables	12,000	12,000
	1,48,100	1,52,600

QUESTIONS FROM RTP/MTP/EXAMS

Q3. Mr. Unique commenced business on 1/04/17 with ₹ 20,000 represented by 5,000 units of the product @ ₹ 4 per unit. During the year 2017-18, he sold 5,000 units @ ₹ 5 per unit. During 2017-18, he withdraw ₹ 4,000.

- 31/03/18: Price of the product @ ₹ 4.60 per unit
- Average price indices: 1/4/17: 100 & 31/3/18: 120

Find out:

- a) Financial capital maintenance at Historical Cost
- b) Financial capital maintenance at Current Purchasing Power
- c) Physical Capital Maintenance

[Exam May 2019]

Ans: Financial Capital Maintenance at historical costs

	₹	₹
Closing capital (₹ 25,000 – ₹ 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At historical cost)	-	
Introduction (At historical cost)	<u>20,000</u>	<u>(20,000)</u>
Retained profit		<u>1,000</u>

Financial Capital Maintenance at current purchasing power

	₹	₹
Closing capital (₹ 25,000 – ₹ 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At closing price) (5,000 x ₹ 4.80)	24,000	
Introduction (At closing price)	<u>Nil</u>	<u>(24,000)</u>
Retained profit		<u>(3,000)</u>

Physical Capital Maintenance

	₹	₹
Closing capital (At current cost) [₹ (5,000 x 4.6) – ₹ 4,000]		19,000
Less: Capital to be maintained		
Opening capital (At current cost) (5,000 x ₹ 4.60)	23,000	
Introduction (At current cost)	<u>Nil</u>	<u>(23,000)</u>
Retained profit		<u>(4,000)</u>

Q4. What is Equity, Income and Expenses as per 'Framework for Financial Reporting under Ind AS'? How the information with respect to income and expenses helps the users in understanding of the financial statements? **[MTP Nov 2022; Exam Sep 2025 (4 Marks)]**

Ans: **Equity:** Equity claims are claims on the residual interest in the assets of the entity after deducting all its liabilities. In other words, they are claims against the entity that do not meet the definition of a liability.

Income and Expenses: Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Income and expenses are the elements of financial statements that relate to an entity's financial performance. Users of financial statements need information about both an entity's financial position and its financial performance. Hence, although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.

Different transactions and other events generate income and expenses with different characteristics. Providing information separately about income and expenses with different characteristics can help users of financial statements to understand the entity's financial performance.

Q5: Discuss the following in the context of 'Conceptual Framework for Financial Reporting under Indian Accounting Standards':

(i) The cost constraint on useful financial information

(ii) Executory contracts.

[Exam May 2022; Nov 2023 (6 Marks)]

Ans:

(i) The cost constraint on useful financial information;

Role of Cost: Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that these costs are justified by the benefits of reporting that information.

Basis of Assessment of Cost: Both the providers and users of financial information incur costs in reporting and analysing financial information. In applying the cost constraint, ICAI assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in formulating a proposed Ind AS, the ICAI seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that Ind AS. In most situations, assessments are based on a combination of quantitative and qualitative information.

Cost Perspective: Due to the inherent subjectivity, assessments of different individuals about the costs and benefits of reporting particular items of financial information will vary. Therefore, ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

(ii) Executory Contracts:

Definition: An executory contract is a contract, or a portion of a contract, that is equally unperformed — neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

Outcome of Executory Contract: An executory contract establishes a combined right and obligation to exchange economic resources. The rights and obligations are interdependent and cannot be separated. Hence, the combined rights and obligations constitute a single asset or liability.

The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable.

Basis of Disclosure: Whether such an asset or liability is included in the financial statements depends on both the recognition criteria and the measurement basis selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

Q6: Defense Innovators Limited is a public sector undertaking and is engaged in the construction of warships and submarines. XYZ Private Limited approached Defense Innovators Limited for construction of "specially designed" ships for it, which will be used by XYZ Private Limited for transportation of specific goods. The offer was accepted by the Defense Innovators Limited and both the companies entered into an agreement for the construction and delivery of 3 specially designed ships on 'Fixed Price' basis with variable component in respect to certain items.

Base and depot (B & D) spares for all three ships shall be procured by Defense Innovators Limited and will be paid on the cost of the item with certain percentage.

The contract states that "certain equipment" out of variable cost items, will be supplied by XYZ Private Limited at 'free of cost' for installation on board of ship. It is, therefore, to be noted as under:

- (i) Some equipment are procured by Defense Innovators Limited in the presence of the XYZ Private Limited's representative for technical scrutiny as well as negotiating the prices. The vendors of these equipment are paid by Defense Innovators Limited. The cost of the equipment along with the cost of installation and profit thereon is claimed and reimbursed by XYZ Private Limited to Defense Innovators Limited.
- (ii) There are certain other equipment for which orders are directly placed and also paid by the XYZ Private Limited. These equipment are known as 'Buyer Furnished Equipment (BFE)' and are delivered to the company 'free of cost' for installing in the ship. The labour cost of Installation of these are already included in the price component of the contract. BFEs are returned to the buyer after completion of the ship.

The period required for construction of one ship was approximately four years.

Whether the cost of Buyer Furnished Equipment's (BFE's) supplied by XYZ Private Limited to Defense Innovators Limited for-installing the same in the ships can be considered as 'inventory' by Defense Innovators Limited and then on delivery of ship will be recognised as revenue in its books of account? Elaborate.

[RTP May 2022; MTP May 2023]

Ans: Before any item can be recognised as an inventory, it should meet the definition of 'asset' as given in the Conceptual Framework for Financial Reporting under Ind AS, issued by the Institute of Chartered Accountants of India as follows:

"An asset is a present economic resource controlled by the entity as a result of past events and economic resource is a right that has the potential to produce economic benefits".

The orders in respect of Buyer Furnished Equipment's (BFEs) are directly placed by the buyer and payment in respect of them is made by the buyer. These are then supplied to the company for installing in the ship and the buyer pays installation charges which are included in the contract price. Thus, the company has neither incurred any cost on BFEs nor any amount is recoverable on account of such equipment except installation charges. Accordingly, such equipment are not 'assets' that may be considered as a part of its contract work-in progress.

In fact, after installation in the ship, BFEs are returned to the buyer after completion of the ship. Thus, these are only held by the company in the capacity of a bailee. Since, it cannot be considered as an 'asset', therefore, it can neither be considered as 'inventory' nor as 'work-in-progress'.

Further, it can also not be considered as a part of sale value or revenue of the company as no consideration would be receivable with respect to the cost of such equipment.

On the basis of the above, it can be concluded that:

- (i) The BFEs cannot be considered as inventories / Work-in-progress for Defense Innovators Limited.
- (ii) The BFE's cost cannot be considered as part of sales value / contract revenue to Defense Innovators Limited.

Q7: Explain the criteria in the Conceptual Framework for Financial Reporting for the recognition of an asset and discuss whether there are inconsistencies with the criteria in Ind AS 38.

[Exam Nov 22 (6 Marks)]

Ans: The Conceptual Framework defines an asset as a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits. Assets should be recognized if they meet the Conceptual Framework definition of an asset and such recognition provides users of financial statements with information that is useful i.e. it is relevant as well as results in faithful representation. However, the criteria of a cost-benefit analysis always exists i.e. the benefits of the information must be sufficient to justify the costs of providing such information. The recognition criteria outlined in the Conceptual Framework allows for flexibility in the application in amending or developing the standards.

Para 8 of Ind AS 38 'Intangible Assets', defines an intangible asset as an identifiable non-monetary asset without physical substance. Further, Ind AS 38 defines an asset as a resource:

- controlled by an entity as a result of past events; and
- from which future economic benefits are expected to flow to the entity.

Furthermore, Para 21 of Ind AS 38 states that an intangible asset shall be recognised if, and only if:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- the cost of the asset can be measured reliably.

This requirement is applicable both in case of an externally acquired intangible asset or an internally generated intangible asset. The probability of expected future economic benefits must be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset. Further, as per Para 33 of Ind AS 38, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations. If the recognition criteria are not satisfied, Ind AS 38 requires the expenditure to be expensed as and when it is incurred.

It is notable that the Conceptual Framework does not prescribe a 'probability criterion'. As long as there is a potential to produce economic benefits, even with a low probability, an item can be recognized as an asset according to the Conceptual Framework. However, in terms of intangible assets, it could be argued that recognizing an intangible asset having low probability of generating economic benefits would not be useful to the users of financial statements given that the asset has no physical substance.

The recognition criteria and definition of an asset under Ind AS 38 are different as compared to those outlined in the Conceptual Framework. To put in simple words, the criteria in Ind AS 38 are more specific, but definitely do provide information that is relevant and a faithful representation. When viewed from the prism of relevance and faithful representation, the requirements of Ind AS 38 in terms of recognition appear to be consistent with the Conceptual Framework.

Q8: Discuss with respect to 'Conceptual Framework for Financial Reporting under Indian Accounting Standards', 'faithful representation', one of the qualitative characteristics of financial information. **[Exam May 23 (6 Marks)]**

Ans: Faithful representation

To be useful, financial information must faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

To be a perfectly faithful representation, a depiction would have following three characteristics:

Complete: A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.

Neutral: A neutral depiction is without bias in the selection or presentation of financial information. Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated, and liabilities and expenses are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses.

Free from error: Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, being free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

Q9: Discuss the characteristics of good financial statements. **[Exam Nov 23 (6 Marks)]**

Ans: Characteristics of good financial information are:

1) Relevance

“Relevant financial information”

- Is financial information with (a) predictive value or (b) confirmatory value or both
- Makes it capable of making a difference in decisions made by users

- Makes it relevant financial information

Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.

Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

The characteristic of 'relevance' also includes the concept of materiality. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity.

2) Faithful Representation

To be useful, financial information must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

To be a perfectly faithful representation, a depiction would have following three characteristics:

Complete: A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.

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Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated.

Free from error: Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects.

Q10: How can one enhance the usefulness of financial information by applying four enhancing qualitative characteristics? **[MTP May 2024; Nov 24 Exams (4 Marks)]**

Ans: The usefulness of financial information can be enhanced by applying four enhancing qualitative characteristics as follows:

Comparability: Users' decisions involve choosing between alternatives. Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date. Comparability refers to the use of the same methods for the same items, and uniformity implies that like things must look alike and different things must look different.

Verifiability: Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Verification can be direct or indirect.

Timeliness: Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

Understandability: Classifying, characterising and presenting information clearly and concisely makes it understandable.

Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or does not provide a faithful representation of what it purports to represent.

Sometimes, one enhancing qualitative characteristic may have to be diminished to maximise another qualitative characteristic. For example, a temporary reduction in comparability as a result of prospectively applying a new Ind AS may be worthwhile to improve relevance or faithful representation in the longer term. Appropriate disclosures may partially compensate for non-comparability.

Q11: Explain the criteria in the Conceptual Framework for Financial Reporting for the recognition and de-recognition of an asset. **[Exam May 24 (4 Marks)]**

Ans: Recognition of assets

The Conceptual Framework for Financial Reporting defines an asset as a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits. Assets should be recognized if they meet the Conceptual Framework definition of an asset and such recognition provides users of financial statements with information that is useful i.e. with (a) relevant information; and (b) a faithful representation of the asset.

(i) Relevance

Information about assets is relevant to users of financial statements. However, recognition of a particular asset may not always provide relevant information like when:

- (a) it is uncertain whether an asset exists; or
- (b) an asset exists, but the probability of an inflow or outflow of economic benefits is low

It may be a combination of factors and not any single factor that determines whether recognition provides relevant information.

Whether or not the asset is recognised, explanatory information about the uncertainties associated with it, may need to be provided in the financial statements.

(ii) Faithful representation

Recognition of a particular asset is appropriate if it provides not only relevant information, but also a faithful representation of that asset and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or by other factors.

Faithful representation of a recognised asset involves not only recognition of that item, but also its measurement as well as presentation and disclosure of information about it.

Derecognition of assets

Derecognition is the removal of all or part of a recognised asset from an entity's balance sheet.

Derecognition normally occurs when that item no longer meets the definition of an asset i.e. when the entity loses control of all or part of the recognised asset.

In some cases, an entity might appear to transfer an asset but derecognition of that asset is not appropriate. For example, if an entity has apparently transferred an asset but retains exposure to significant positive or negative variations in the amount of economic benefits that may be produced by the asset, this sometimes indicates that the entity might continue to control that asset. If an entity has transferred an asset to another party that holds the asset as an agent for the entity¹ the transferor still controls the asset.

Q12: Discuss the limitations of general-purpose financial reporting [Exam May 2025 (4 Marks)]

Ans: Limitations of General-Purpose Financial Reporting

- ◆ General-purpose Financial Reporting does not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks;
- ◆ General-purpose Financial Reporting is not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity; and
- ◆ General-purpose Financial Reporting is not primarily directed to other parties, such as regulators and members of the public other than investors, lenders and other creditors