

# Conceptual Framework of Financial Reporting

## AAT Level III FAR - Financial Reporting

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ACA, B.Sc. (Accounting) Sp. Hons., ACMA (SL), SAT, CIMA Passed Finalist,  
Reading for MBA (PIM), CA and CIMA Prize Winner



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# AAT Level 03 Financial Reporting



**Sandeepa Jayasekera**

B.Sc. (Acct.) Hons. Gold Medal Winner, ACA, SAT, ACMA (UK), CGMA (UK), CA Prize Winner for AFR subject in Strategic Level II, CA First in Order of Merit Prize Winner in CAB II Level, CIMA Strategic Level Aggregate Prize Winner, Reading for MBA (PIM-SJP).

## Syllabus

	Topic	Weight
1	Governance Structure, Ethics and Conceptual Framework	10
2	Sri Lanka Accounting Standards (LKAS 01, LKAS 08, LKAS 10, LKAS 12, LKAS 16, SLFRS 15, SLFRS 16, LKAS 19, LKAS 23, LKAS 36, LKAS 37, LKAS 38, LKAS 32, Accounting Standards for Small and Medium Scale Enterprises)	30
3	Preparation of Company Accounts for Publishing	30
4	Financial Statement Analysis	15
5	Consolidated Financial Statements	15

## Paper Structure

### Part A – 20 Marks

- 04 Short Answer Questions 05 Marks Each
- Questions from Standards and Conceptual Framework

### Part B – 30 Marks

- 03 Medium Scale Questions with 10 Marks each
- Accounting Standards and Cash Flow Statement

### Part C – 50 Marks

- Ratio Question for 12 Marks
- Consolidation Question for 13 Marks
- Company Accounts Preparation for 25 Marks

Total time duration 3 hours and 15 minutes of reading time

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## Conceptual Framework for the Financial Reporting

(From 01.01.2020)

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# What is the Conceptual Framework?



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Statement that describes

Objectives

Concepts

for General Purpose  
Financial Reporting

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## 2 Types of Financial Reporting

General Purpose

Used by a wide range of users

Special Purpose

Used by limited group of users

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## Objective of General Purpose Financial Reporting

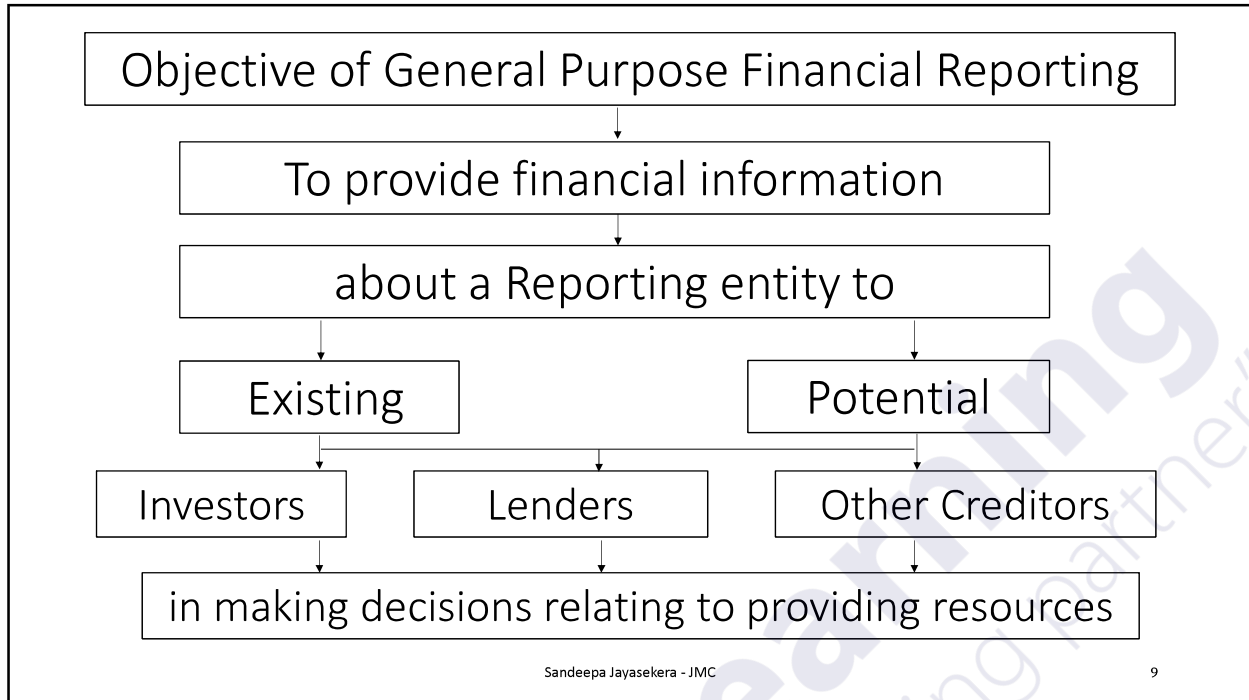


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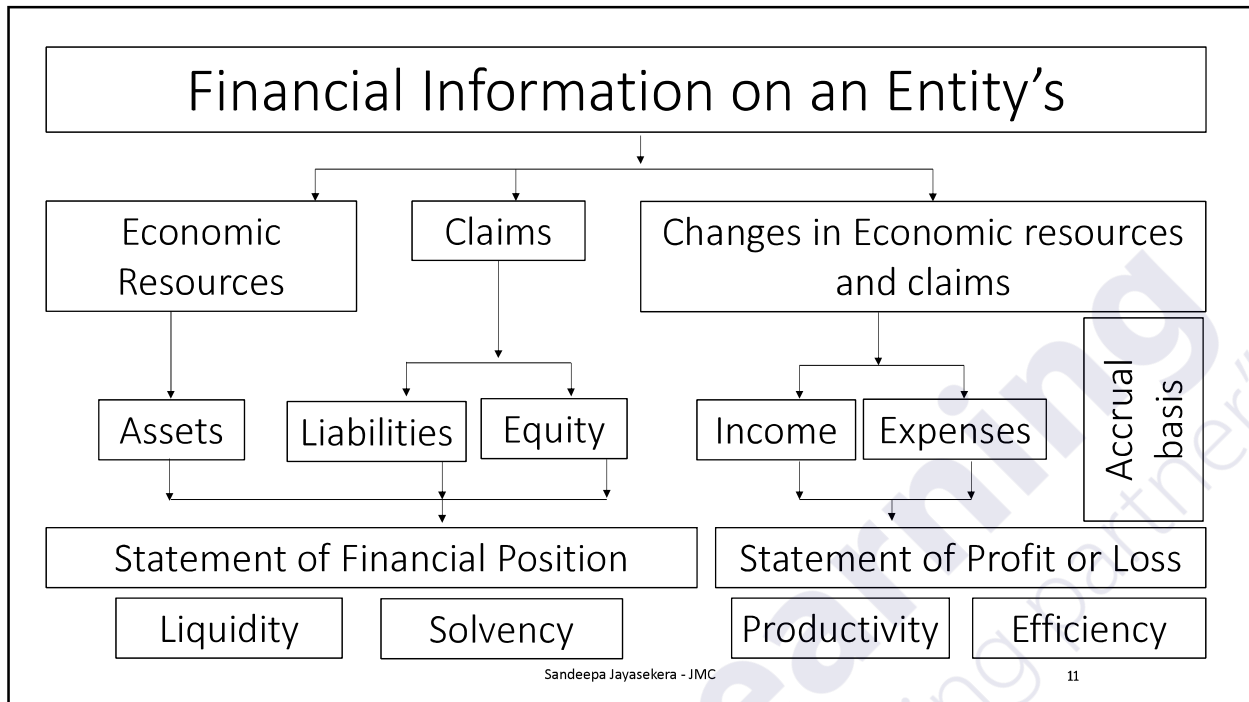
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# What is a Financial Information?

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## Question 01

What is the relevant concept to identify Debtors and Creditors in Financial Statements?

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# Accrual basis

Recognition of Transactions

When Transaction  
Occurred

✓

When Money  
Received or Paid

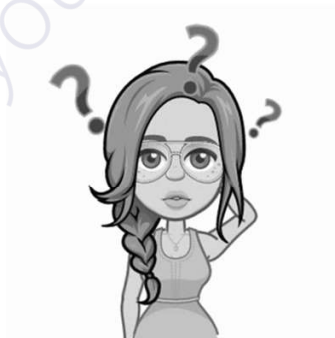
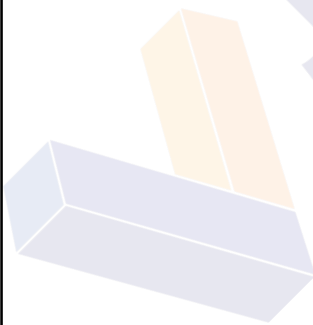
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## Why do we need a Conceptual Framework? (Purpose)



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To develop future standards

To review existing standards

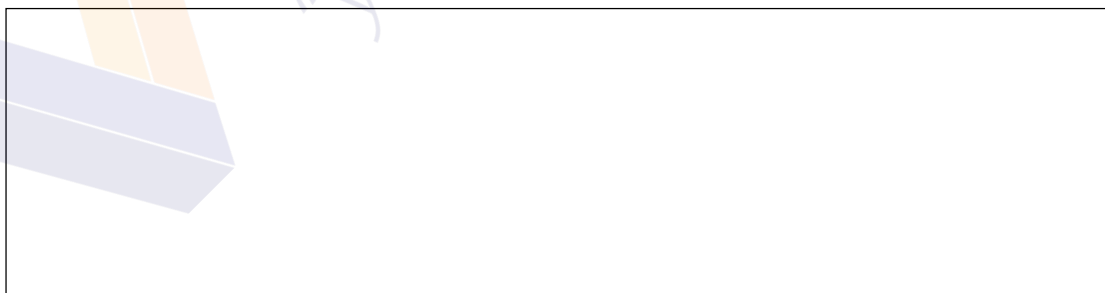
To promote harmonization by reducing number of alternative accounting treatments

To account for matters that has yet to form the subject of a standard

To interpret information contained in financial statements

## Question 02

What is the Institution that is empowered to set accounting standards?



# Concepts in the Conceptual Framework that are relevant to Financial Reporting



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Qualitative  
Characteristics  
of Financial  
Information

Elements of  
Financial  
Statements

Recognition of  
Elements

Measurement  
of Elements

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# Qualitative Characteristics of useful Financial Information

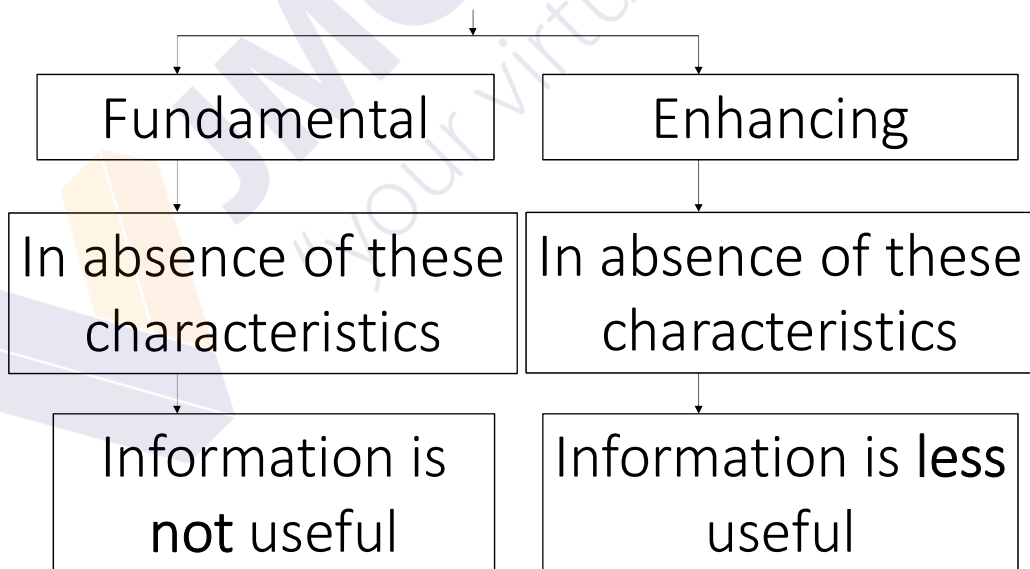


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## Qualitative Characteristics



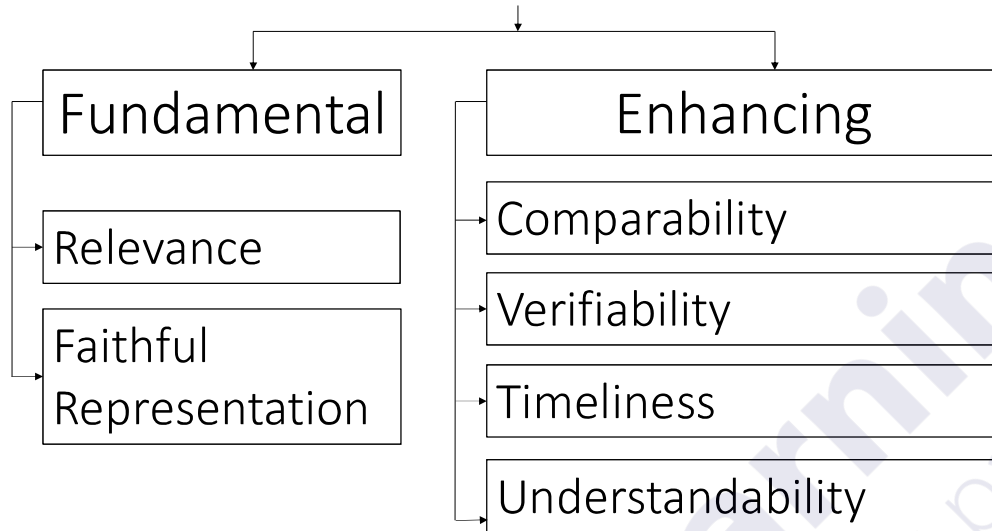
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# Qualitative Characteristics

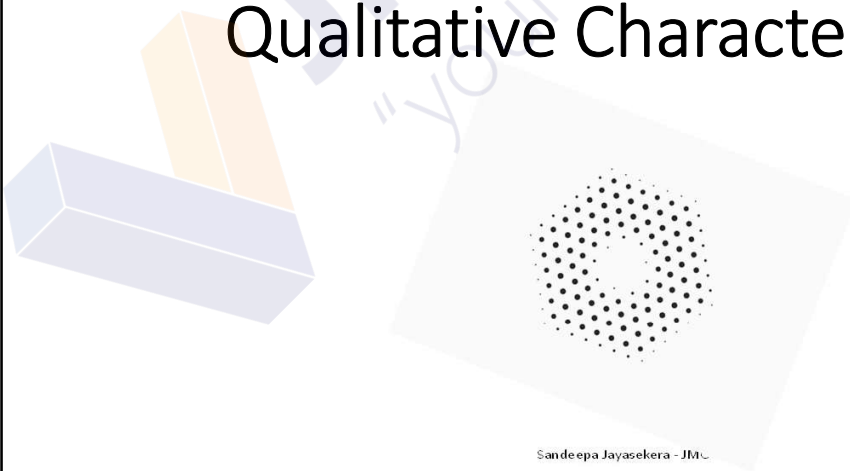


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## Fundamental Qualitative Characteristics



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# Relevance

If an information is

capable of making a **difference**

in **decisions**

## Example

A company's total debt is 80% of total assets.  
Therefore, the bank decided not to grant a new loan to the company.

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# Relevance

Predictive value

Ability to forecast future outcomes

Making investment decisions based on forecasted profits of the next two years

Confirmatory value

Ability to verify previous predictions

Comparing a previous year's forecast against actual information

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## Question 03

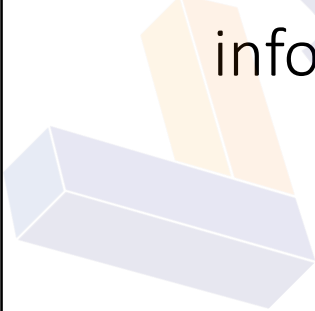
Explain using concepts, the reason to charge the value of small equipment and tools that can be used for more than one year to the Statement of Profit or Loss

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The materiality of information needs to be considered, in deciding whether an information is relevant or not



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# Materiality

Information is material if

Omission

Misstatement

could **Influence** decision

Materiality depends on

- **Size** of information
- **Nature** of information

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# Materiality

- Omission of Rs. 10 Mn income of a company with a total income of Rs. 100 Mn, could be material
- Omission of Rs. 100,000/- income of the same company, could be not material

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# Faithful Representation

Financial Reports must

represent Economic phenomena

in words and numbers

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To be a Faithful Representation,  
information must be

Complete

Neutral

Free from error

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## Completeness

Depiction of all necessary information

- Numerical depiction
- Process used to determine numerical depiction
- Explanation of significant facts
- Quality
- Nature

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## Free from Errors

Does not mean 100% accurate

No errors or omissions in the description of the phenomenon

No errors in the process used to produce reported information

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## Free from Error

Ex.

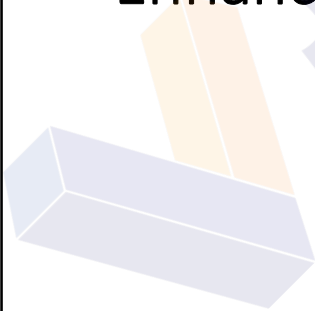
An accounting estimate is not 100% accurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained

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## Enhancing Qualitative Characteristics



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# Comparability

Ability to identify and understand

Similarities

Differences

in an entity's information

with another similar information

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# Comparisons can be made

With a  
different  
period of  
the same  
entity

With the  
same  
period of a  
different  
entity

With  
industry  
average of  
the same  
period

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# Verifiability

Knowledgeable

Independent

observers

ability to reach consensus

of a financial information

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# Timeliness

Information available

in time

Older the information is, the less useful it is.

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# Understandability

Making financial information

Understandable to

Users with reasonable knowledge

Information is made understandable when

Clearly

Concisely

Presented

Classified

Characterized

## Question 04

A company revalued a land purchased 10 years ago to represent it at fair value.  
Explain this using the fundamental qualitative characteristics of useful financial information.

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## Question 05

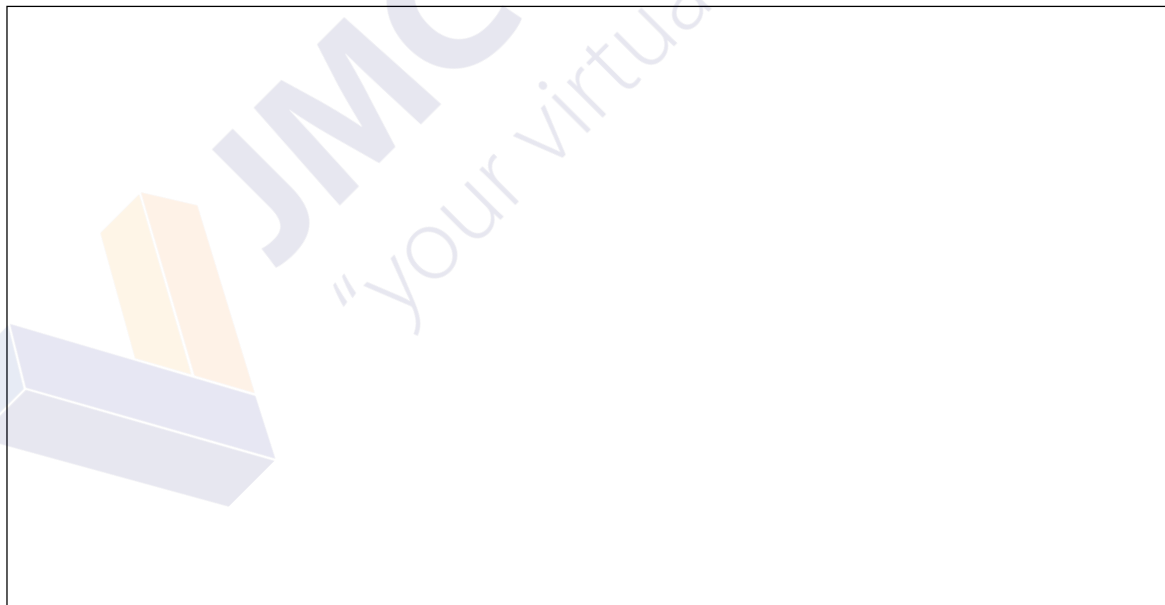
Explain the Enhancing Qualitative Characteristics of useful Financial Information



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# Underlying Assumption in Preparation of Financial Statements



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## Going Concern

An entity

continuing

its operations

for a foreseeable future

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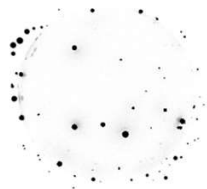
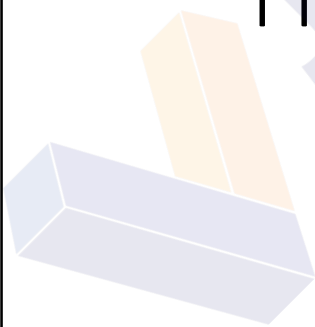


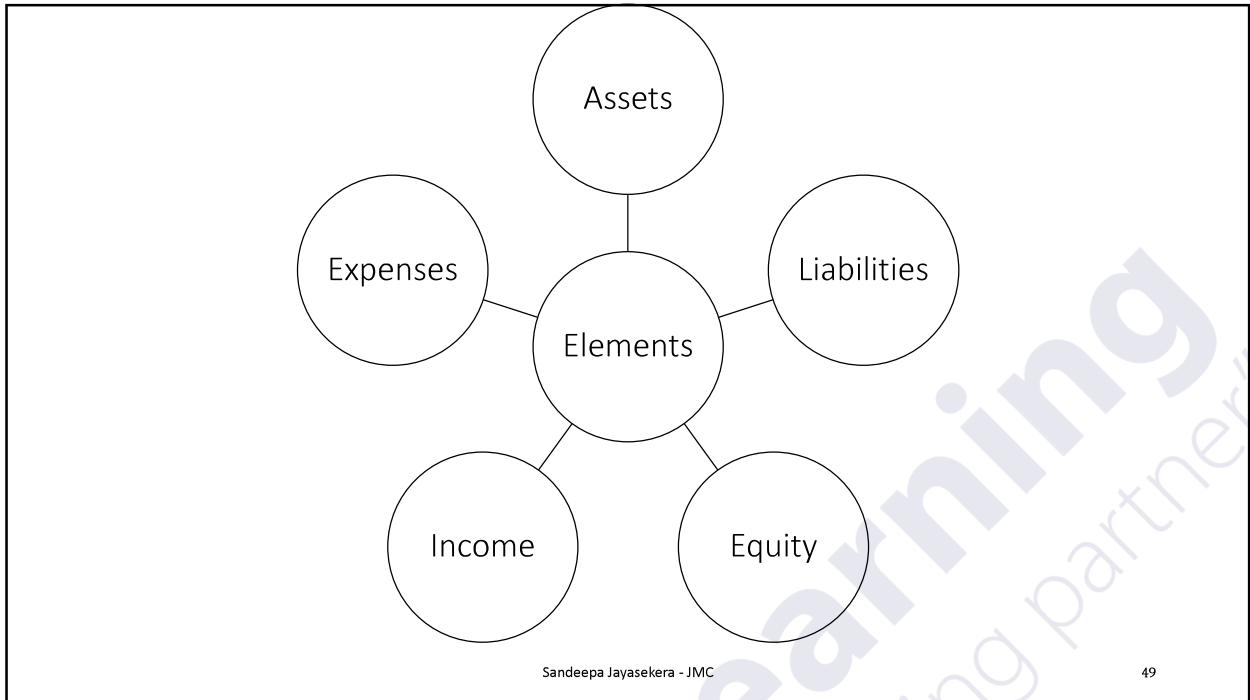
## Going Concern

It is assumed that the entity has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations

If, the entity has the intention to liquidate or curtail major operations, then the financial statements would be prepared on a basis other than going concern basis

## Elements of Financial Statements





# Defining the Elements of Financial Statements

A cartoon illustration of a boy with a notepad and a pen. To the left is a large, stylized number '50' composed of 3D blocks. A watermark "JMC 'Your virtual learning partner'" is visible across the slide.

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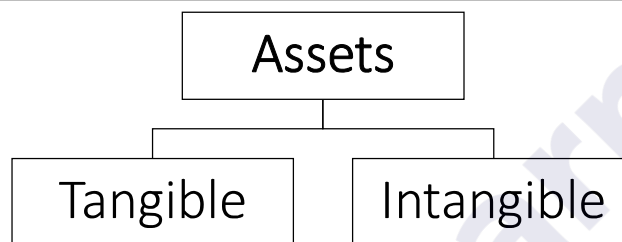
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# Asset is

A present economic resource

controlled by the entity

as a result of past events



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# Past Events

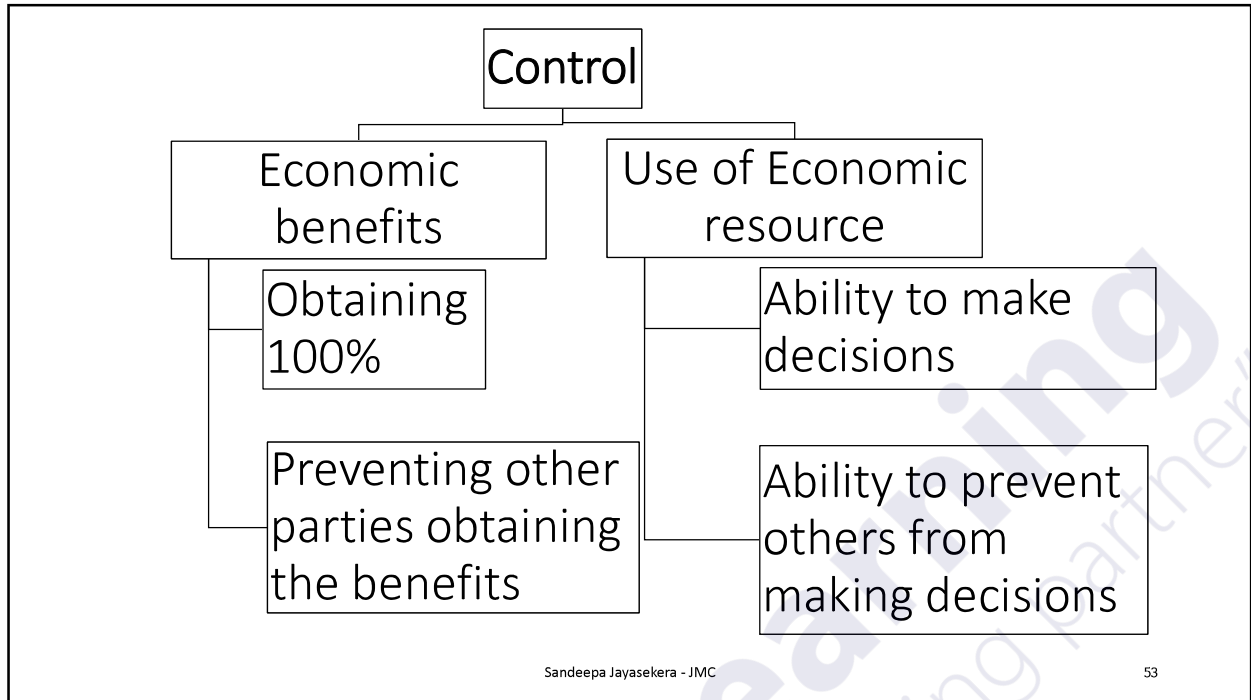
Nature	Nature	Asset
Transaction	Credit sales	Debtor
Activity	Production	Inventory
Agreement	Loan agreement	Property

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## Economic Benefits are

Producing cash inflows

Reducing cash outflows

Receiving goods or services

Exchanging economic resources  
on favourable terms

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## Liability is

A present obligation of the entity

to transfer an economic resource

as a result of past events

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## Past Events

Nature	Nature	Liability
Transaction	Credit purchases	Creditor
Activity	Production	Salaries payable to employees
Agreement	Loan agreement	Bank Loan

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## A Liability could arise

Legally

Constructively

Legislation

Policies

Statute

Statements

Contract

Practices

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## Examples for Liabilities

A loan obtained by a company, under a loan agreement, EPF payable under the Employee Provident Fund (EPF) Act are legally enforceable obligations.

Incentives being paid by a company, warranties issued for during sale of goods are constructive obligations.

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## Equity is

Assets

(-)

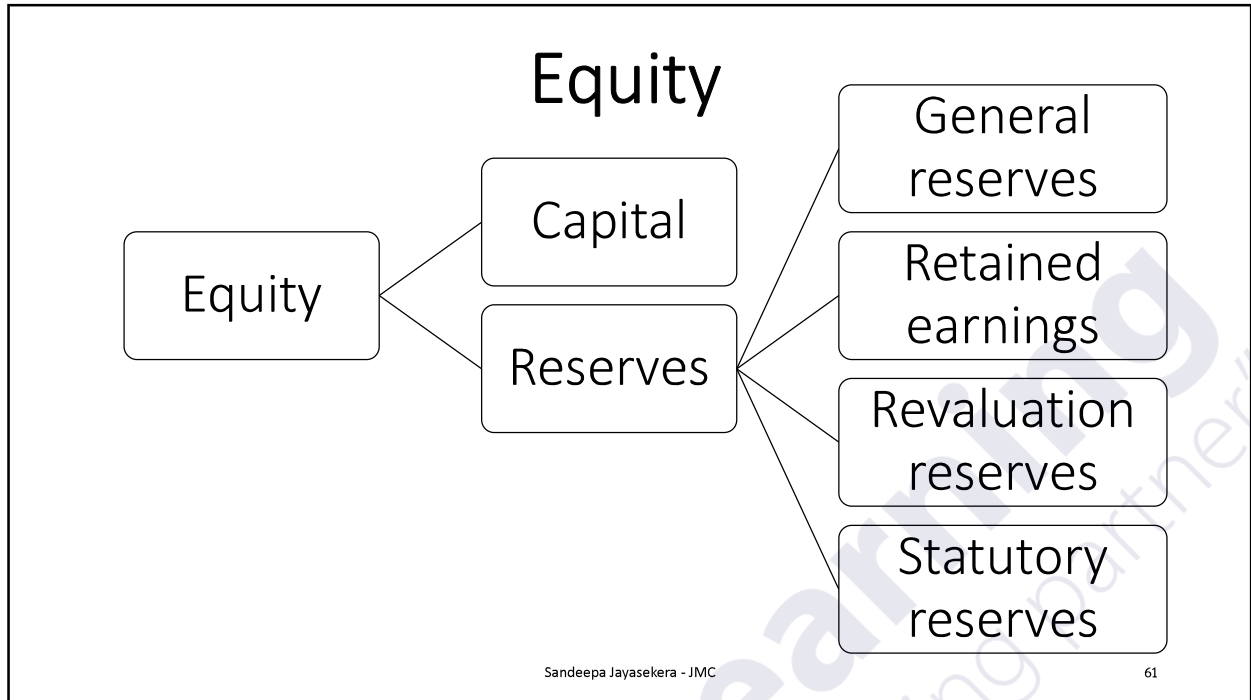
Liabilities

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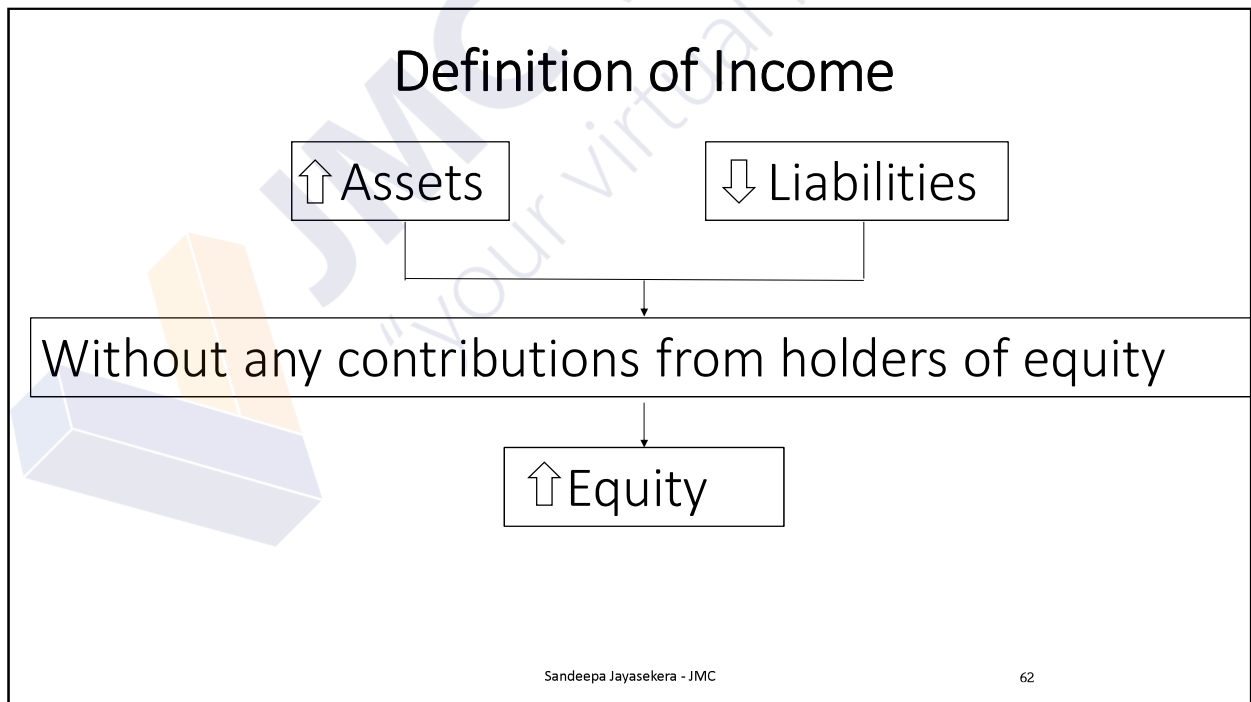
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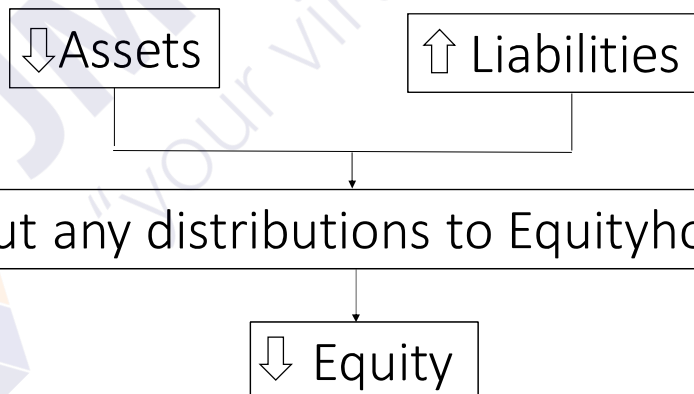
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## Example for Income

A sale result in increase in assets in terms of cash or debtor. Sale result in an increase in profit. Therefore, the equity will increase without any contribution from the owners. Therefore, sales is an income.

## Definition of Expenses



## Example for Expenses

Purchase result in reduction of assets in terms of cash or increase in creditor liability.  
Purchase result in decrease in profitability.  
Thereby, the equity will be reduced without any distribution to owners.

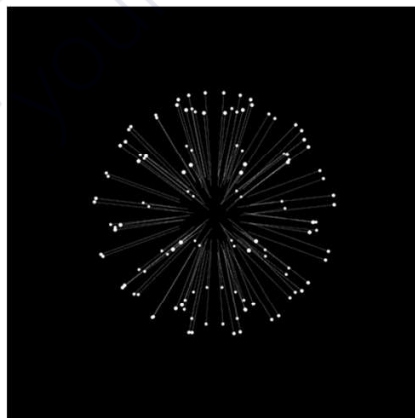
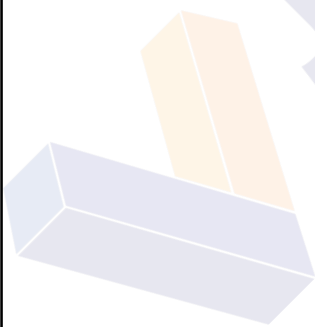
Therefore, purchases is an expense.

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## Recognition of the Elements of Financial Statements



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## Steps to Recognize Financial Statement Elements

Meet the Definition

Being an Useful Information

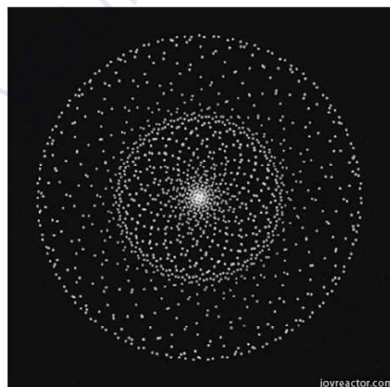
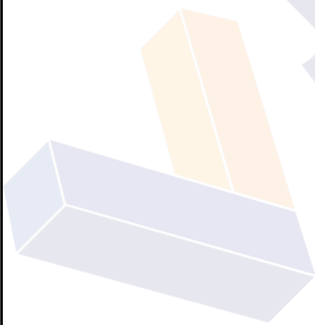
- Relevance
- Faithful Representation

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## Measurement of the Elements of Financial Statements



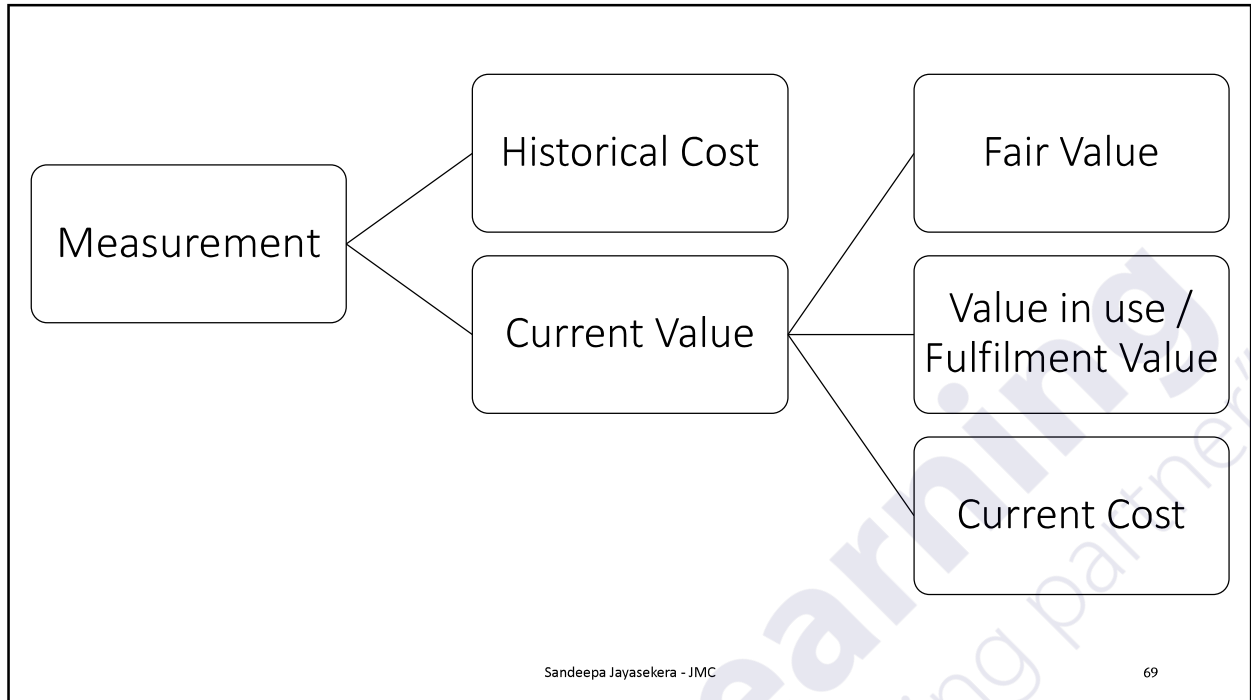
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## Historical Cost is

For the initial cost incurred

Adjust

Depreciation

Impairment

Discounts

Interest

Historical cost does not represent the current value

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## Question 06

What is the accounting concept that leads not to adjust inflation in financial statements?

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## Fair Value is

The price

received to sell an asset

paid to transfer a liability

in an orderly transaction

between market participants

at the measurement date

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# Value in use is

Present value

Cash flows expect to derive from the  
use of an asset

Time value of money will be adjusted

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# Current Cost is

Cost or consideration received

To acquire or create an equivalent asset

Or to incur an equivalent liability

At the measurement date

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## Question 07

Sathish Ltd. purchased a machine for Rs. 10 Mn on 01<sup>st</sup> January 2019. Its useful lifetime is 4 years. On 31<sup>st</sup> December 2020, the management estimates that this machine could be sold at a market value of Rs. 7.5 Mn. The price of a similar new machine on that date is Rs. 12 Mn. The net cash flows over the remaining useful life is Rs. 4 Mn and the discount rate is 10% (1 - 0.91, 2 - 0.86, 3 - 0.75). The scrap value is zero. Calculate the historical cost, fair value, current cost and value in use of this machine.

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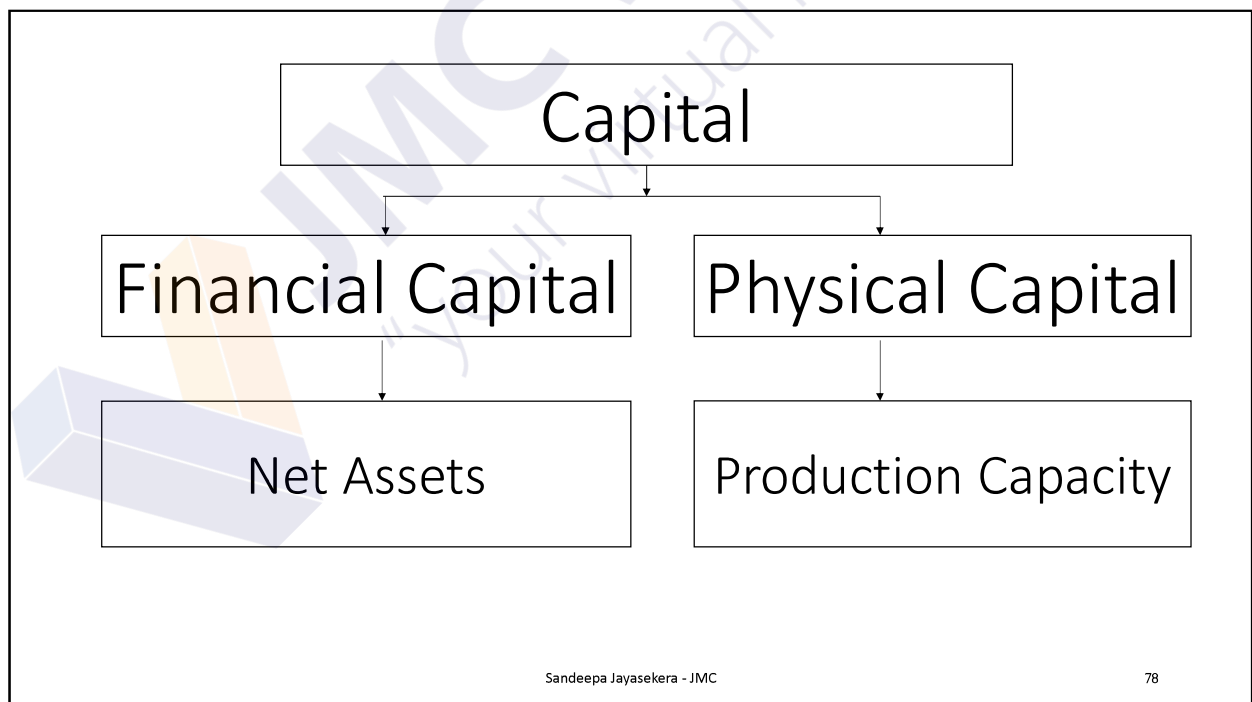
# Capital and Capital Maintenance



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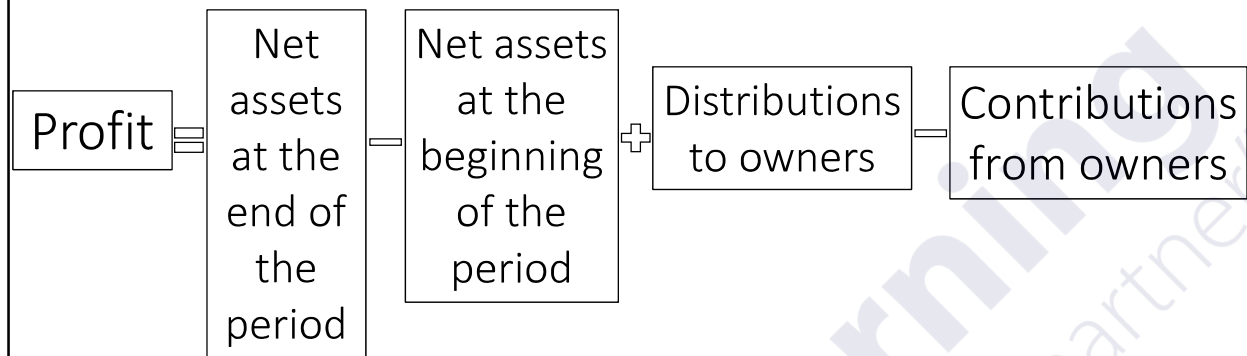
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# Financial Capital Maintenance



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## Question 08

The opening net assets of ABC Ltd were Rs.500,000. The owners invested Rs.100,000 during the year. A dividend of Rs.50,000 was paid. The closing net assets were Rs.700,000. How much was the profit generated?

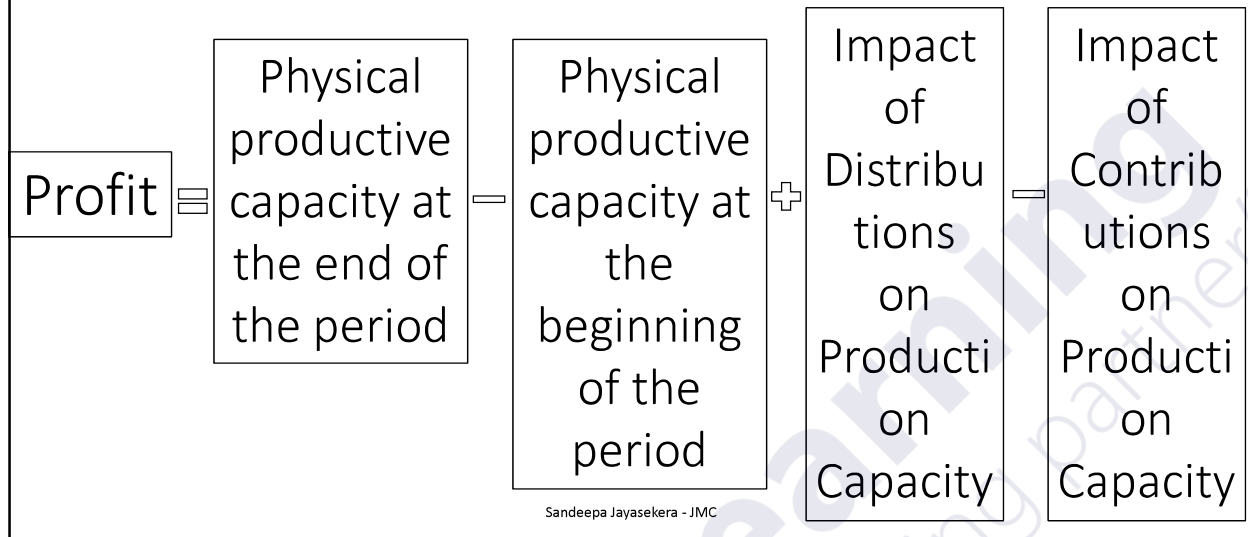
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# Physical Capital Maintenance



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