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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- Conceptual Framework for Financial Reporting

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Conceptual Framework for Financial Reporting

A conceptual framework is a statement of generally accepted theoretical principles that form the frame of reference for financial reporting.

Advantages and Disadvantages of a Conceptual Framework

Advantages

A. The situation is avoided whereby standards are developed on a patchwork basis, where a **particular accounting problem** is recognized as having **emerged**, and resources were then channeled into standardizing accounting practice in that area, without regard to whether that particular issue was necessarily the most important issue remaining at that time without standardization.

B. As stated above, the development of certain standards (particularly national standards) has been subject to considerable political interference from interested parties. Where there is a conflict of interest between user groups on which policies to choose, **policies deriving from a conceptual framework will be less open to criticism** that the standard-setter buckled to external pressure.

C. Some standards may concentrate on profit or loss, whereas some may concentrate on the valuation of net assets (statement of financial position).

Disadvantages

A. Financial statements are intended for a variety of users, and it is not certain that a single conceptual framework can be devised that will suit all users.

B. Given the diversity of user requirements, there may be a need for a variety of accounting standards, each produced for a different purpose (and with different concepts as a basis).

C. It is not clear that a conceptual framework makes the task of preparing and then implementing standards any easier than without a framework.

Content of the conceptual framework for financial reporting (2018)

- Chapter 01 - Objective of general-purpose financial reporting
- Chapter 02 - Qualitative characteristics of useful financial information
- Chapter 03 - Financial statements and the reporting entity
- Chapter 04 - The elements of financial statements
- Chapter 05 - Recognition and derecognition
- Chapter 06 - Measurement

- Chapter 07 - Presentation and disclosure
- Chapter 08 - Concepts of capital and capital maintenance

The introduction to the Conceptual Framework for Financial Reporting (the Conceptual Framework) points out the fundamental reason why financial statements are produced worldwide; that is, to satisfy the requirements of external users.

The preface emphasizes the way financial statements are used to make economic decisions, and thus financial statements should be prepared to this end. The types of economic decisions for which financial statements are likely to be used include the following.

- Decisions to buy, hold or sell equity investments.
- Assessment of management stewardship and accountability.
- Assessment of the entity's ability to pay employees.
- Assessment of the security of amounts lent to the entity.
- Determination of taxation policies.
- Determination of distributable profits and dividends.
- Inclusion in national income statistics.
- Regulations of the activities of entities.

Any additional requirements imposed by national governments for their own purposes should not affect financial statements produced for the benefit of other users.

Purposes of the Conceptual Framework

A) Assist the International Accounting Standards Board (Board) to develop IFRS Standards (Standards) that are based on consistent concepts.

B) Assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy.

C) Assist all parties to understand and interpret the Standards.

Scope of the Conceptual Framework

The Conceptual Framework is concerned with '**general purpose**' financial statements (ie a normal set of annual financial statements), but it can be applied to other types of financial statements.

The Conceptual Framework is not a Standard. Nothing in the Conceptual Framework overrides any Standard or any requirement in a Standard.

Chapter 01 - The objective of general-purpose financial reporting (paragraph 1.2)

The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

Those decisions involve decisions about:

A) buying, selling or holding equity and debt instruments.
B) providing or settling loans and other forms of credit.
C) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

The decisions described above depend on the returns that existing and potential investors, lenders and other creditors expect, for example, dividends, principal and interest payments or market price increases. Investors', lenders and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and on their assessment of management's stewardship of the entity's economic resources. Existing and potential investors, lenders and other creditors need information to help them make those assessments.

To make the assessments described above, existing and potential investors, lenders and other creditors need information about:

(a) the **economic resources** of the entity, **claims** against the entity and **changes in those resources and claims**.

(b) how **efficiently and effectively** the entity's management and governing board.

Information about the entity's economic resources and the claims against it helps users **to assess the entity's liquidity and solvency** and its likely need for additional financing.

Information about a reporting entity's financial performance (the changes in its economic resources and claims) helps users to **understand the return** that the entity has produced on its economic resources. This is an indicator of how efficiently and effectively management has used the resources of the entity and is helpful in predicting future returns.

Users and their information needs

User	Need of information
Investors	A) To help make a decision about buying or selling shares, taking up a rights issue and voting. B) Investors must have information about the level of dividend, past, present and future, and any changes in share price. C) Investors will also need to know whether the management has been running the company efficiently. D) As well as the position indicated by the statement of profit or loss and other comprehensive income, statement of financial position and earnings per share (EPS), investors will want to know about the liquidity position of the company, the company's future prospects, and how the company's shares compare with those of its competitors
Employees	Need information about the security of employment and future prospects for jobs in the company, and to help with collective pay bargaining.
Lenders	To help them decide whether to lend to a company. They will also need to check that the value of any security remains adequate, that the interest repayments are secure, that the cash is available for redemption at the appropriate time and that any financial restrictions (such as maximum debt/equity ratios) have not been breached.
Suppliers	To know whether the company will be a good customer and pay its debts.
Customers	To know whether the company will be able to continue producing and supplying goods.
Government	Specifically concerned with compliance with tax and company law, ability to pay tax and the general contribution of the company to the economy.
Public	The public at large would wish to have information for all the reasons mentioned above, but it could be suggested that it would be impossible to provide general purpose accounting information that was specifically designed for the needs of the public.

Information about a reporting entity's economic resources, claims against the entity and changes in resources and claims.

Economic resources and claims	Changes in resources and claims
Provided via **Statement of Financial Position**	Result from that entity's **financial performance** and from **other events or**

	transactions such as issuing debt or equity instruments.
• Help users to assess the reporting entity's liquidity and solvency. • Help users to assess management's stewardship of the entity's economic resources.	Two types of financial performances can be identified. A) Financial performance reflected by accrual accounting. – **Statement of profit or loss & Other Comprehensive Income** B) Financial performance reflected by past cash flows. – **Statement of Cash Flows**
	Other events and transactions: A) issuing debt or equity instruments

Chapter 02 - Qualitative characteristics of useful financial information

Fundamental qualitative characteristics	Enhancing qualitative characteristics
• Relevance • Faithful Representation	• Comparability • Verifiability • Timeliness • Understandability

Relevance (Para 2.6 onwards)

Relevant financial information is capable of **making a difference in the decisions** made by users. Financial information is capable of making a difference in decisions if it has **predictive value**, **confirmatory value** or both.

Predictive Value	• Financial information has predictive value **if it can be used as an input to processes** employed by users **to predict future outcomes.** • Financial information with predictive value is employed by users in making their own predictions.
Confirmatory Value	• Financial information has confirmatory value **if it provides feedback about (confirms or changes)** previous evaluations.

The predictive value and confirmatory value are interrelated. Information that has predictive value often also has confirmatory value.

- For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions.

The relevance of information is affected by its **nature** and its **materiality**.

Materiality	• Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. • Materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report

Faithful Representation (Para 2.12 onwards)

Financial reports represent **economic phenomena** in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it 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 below 3 characteristics need to be present.

A) Complete
B) Neutral
C) Free from error

Completeness	• A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. • *Ex: a complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all the assets in the group, and a description of what the numerical depiction represents (for example, historical cost or fair value)*
Neutrality	• Not being bias in the selection or presentation of financial information. • A neutral depiction is not slanted, weighted, emphasized, de emphasized or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably by users.

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. • Free from error does not mean perfectly accurate in all respects.

Substance over form (ie representing the economic substance of a transaction rather than its legal form in the financial statements) is **not a separate qualitative characteristic** under the Conceptual Framework. The IASB says that the application of substance over form is required in order to achieve a faithful representation. Faithful representation of a transaction is only possible if it is accounted for according to its substance and economic reality.

Enhancing Qualitative Characteristics (Para 2.12 onwards)

Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that both is relevant and provides a faithful representation of what it purports to represent.

Comparability	• Comparability is enables users to identify and understand similarities in, and differences among, items. • This does not relate to a single item because for a comparison it requires at least two items. • **Consistency** is related to comparability but not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. • **Comparability** is the **goal**; **consistency helps** to achieve that goal. • Comparability is **not uniformity.** Comparability is enhanced when things look different. • A single economic phenomenon can be faithfully represented in multiple ways but permitting alternative accounting methods for the same economic phenomenon diminishes comparability.
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. ○ Direct verification means verifying an amount or other representation through **direct observation**. Ex- counting cash ○ Indirect verification means **checking the inputs** to a model, formula or other technique and recalculating the outputs using the same methodology. Ex- Recalculating inventory cost using FIFO.
Timeliness	• Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. • Older the information is the less useful it is.
Understandability	• Classifying, characterizing and presenting information clearly and concisely makes it understandable. • Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena

The cost constraint on useful financial reporting (Para 2.39 onwards)

Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

Chapter 03 - Financial statements and the reporting entity

The objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources.

That information is provided:

a. in the statement of financial position, by recognizing assets, liabilities and equity:
b. in the statement(s) of financial performance by recognizing income and expenses; and
c. in other statements and notes, by presenting and disclosing information about:

i. recognized assets, liabilities, equity, income and expenses (including information about their nature and about the risks arising from those recognized assets and liabilities;
ii. assets and liabilities that have not been recognized (see paragraph 5.6), including information about their nature and about the risks arising from them;
iii. cash flows;
iv. contributions from holders of equity claims and distributions to them; and
v. the methods, assumptions and judgements used in estimating the amounts presented or disclosed, and changes in those methods, assumptions, and judgements.

Reporting period

Financial statements are prepared for a specified period of time (reporting period) and provide information about:

(a) assets and liabilities—including unrecognized assets and liabilities—and equity that existed **at the end of the reporting period**, or during the reporting period; and
(b) income and expenses **for the reporting period.**

To help users of financial statements to identify and assess changes and trends, financial statements also provide comparative information for at least one preceding reporting period.

Going concern assumption (The underlying assumption)

Financial statements are normally prepared on the assumption that the reporting entity is a going concern and **will continue in operation for the foreseeable future**. Hence, it is assumed that the entity has neither the intention nor the need to enter liquidation or to cease trading. If such an intention or need exists, the financial statements may have to be prepared on a different basis. If so, the financial statements describe the basis used.

The reporting entity

A reporting entity is an entity that is required, or chooses, to prepare financial statements. A reporting entity can be:

- a single entity or;
- a portion of an entity or
- can comprise more than one entity.

A reporting entity **is not necessarily a legal entity**.

Scenario	Reporting entity's financial statements are referred to as
If a reporting entity comprises both the parent and its subsidiaries	Consolidated financial statements
If a reporting entity is the parent alone	Unconsolidated financial statements
If a reporting entity comprises two or more entities that are not all linked by a parent-subsidiary relationship	Combined financial statements

Chapter 04 - The elements of financial statements

The elements of financial statements defined in the Conceptual Framework are:

(a) **assets**, **liabilities** and **equity**, which relate to a reporting entity's financial position; and
(b) **income** and **expenses**, which relate to a reporting entity's financial performance.

Item discussed in Chapter 1	Element	Definition or description
Economic resource	Asset	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.
Claim	Liability	A present obligation of the entity to transfer an economic resource as a result of past events.
	Equity	The residual interest in the assets of the entity after deducting all its liabilities.
Changes in economic resources and claims, reflecting financial performance	Income	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	Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.
Other changes in economic resources and claims	–	Contributions from holders of equity claims, and distributions to them.
	–	Exchanges of assets or liabilities that do not result in increases or decreases in equity.

Asset

An asset is 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.

<u>**Rights**</u> that have the potential to produce economic benefits take many forms, including:

A. rights that correspond to an obligation of another party, for example:
    i. rights to receive cash.
    ii. rights to receive goods or services.
    iii. rights to exchange economic resources with another party on favourable terms. Such rights include, for example, a forward contract to buy an economic resource on terms that are currently favourable or an option to buy an economic resource.
    iv. rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs.

B. rights that do not correspond to an obligation of another party, for example:
    i. rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are a right to use a physical object or a right to benefit from the residual value of a leased object.
    ii. rights to use intellectual property.

For the <u>**potential to produce economic benefits**</u> to exist, they do not need to be certain or even likely (ie there may be a low probability). This low probability will, however, affect whether the asset is recognised and how it is measured.

An economic resource could produce economic benefits for an entity by entitling or enabling it to do, for example, one or more of the following:

(a) receive contractual cash flows or another economic resource;
(b) exchange economic resources with another party on favourable terms;
(c) produce cash inflows or avoid cash outflows by, for example:
(d) using the economic resource either individually or in combination with other economic resources to produce goods or provide services;
(e) using the economic resource to enhance the value of other economic resources; or
(f) leasing the economic resource to another party;
(g) receive cash or other economic resources by selling the economic resource; or
(h) extinguish liabilities by transferring the economic resource.

An entity **<u>controls</u>** an economic resource if it has the present **ability to direct the use** of the economic resource and **obtain the economic benefits** that may flow from it. Control includes the present **ability to prevent other parties from directing the use** of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.

Liability

A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

For a liability to exist, three criteria must all be satisfied:

A) the entity has an obligation
B) the obligation is to transfer an economic resource
C) the obligation is a present obligation that exists as a result of past events

Obligation	• An obligation is a duty or responsibility that an entity has no practical ability to avoid. • Obligations are two types. A. **Legal obligations** - established by contract, legislation or similar means and are legally enforceable. B. **Constructive obligation** - from an entity's customary practices, published policies or specific statements.

Transfer of an economic resource	• The obligation must have the potential to require the entity to transfer an economic resource to another party. • Obligations to transfer an economic resource include, for example: (a) obligations to pay cash. (b) obligations to deliver goods or provide services. (c) obligations to exchange economic resources with another party on unfavourable terms. Such obligations include, for example, a forward contract to sell an economic resource on terms that are currently unfavourable or an option that entitles another party to buy an economic resource from the entity. (d) obligations to transfer an economic resource if a specified uncertain future event occurs. (e) (e) obligations to issue a financial instrument if that financial instrument will oblige the entity to transfer an economic resource.
Present obligation as a result of past events	• A present obligation exists as a result of past events only if: (a) the entity has already obtained economic benefits or taken an action; and (b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

Equity

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

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. Such claims may be established by contract, legislation or similar means, and include, to the extent that they do not meet the definition of a liability:

(a) shares of various types, issued by the entity; and
(b) some obligations of the entity to issue another equity claim.

Different classes of equity claims, such as ordinary shares and preference shares, may confer on their holders different rights, for example, rights to receive some or all of the following from the entity:

(a) dividends, if the entity decides to pay dividends to eligible holders;

(b) the proceeds from satisfying the equity claims, either in full on liquidation, or in part at other times; or
(c) other equity claims

Income

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

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.

It follows from these definitions of income and expenses that contributions from holders of equity claims are not income, and distributions to holders of equity claims are not expenses.

Question no 1

Wealth Management (Pvt) Ltd ("Wealth") enters into a legal arrangement to act as a trustee for Prudent (Pvt) Ltd ("Prudent") by holding listed shares on Prudent's behalf. Prudent will make all investment decisions, and Wealth will act according to Prudent's instructions. Wealth will earn a trustee fee for holding the shares.

The following statement was made by the accounts executive of Wealth:

"Since the investments in shares held by Wealth, those investments shall be recorded in the books of Wealth".

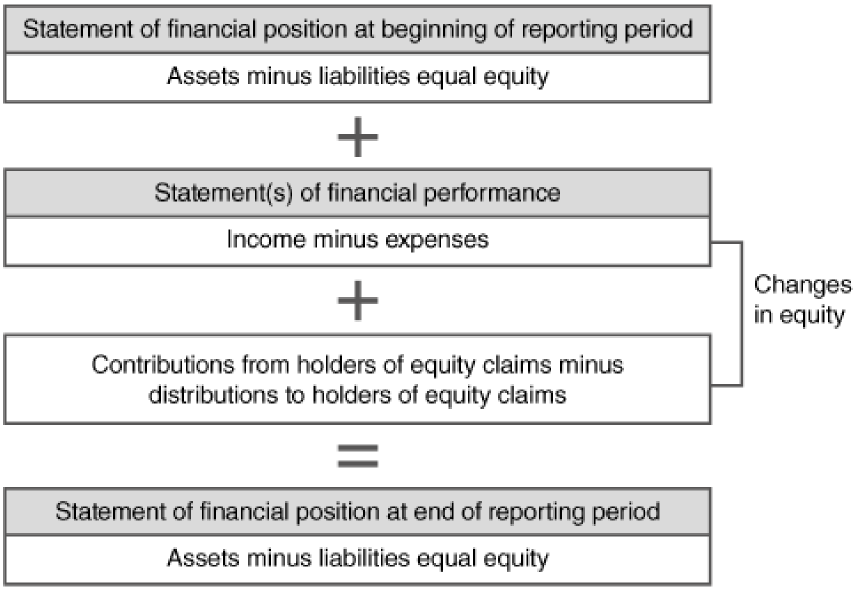
Required:

Assess the above statement with reference to Conceptual Framework for Financial Reporting.

Chapter 05 - Recognition and derecognition

Recognition is the process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition. Recognition involves depicting the item in one of those statements—either alone or in aggregation with other items—in words and by a monetary amount and including that amount in one or more totals in that statement.

The amount at which an asset, a liability or equity is recognized in the statement of financial position is referred to as its '**carrying amount**'.



How recognition links the elements of financial statements

The initial recognition of assets or liabilities arising from transactions or other events may result in the simultaneous recognition of both income and related expenses. For example, the sale of goods for cash results in the recognition of both income (from the recognition of one asset—the cash) and an expense (from the derecognition of another asset—the goods sold).

Recognition criteria

1. Meets the **definition** of the element.
2. Provides **relevant information** about the asset or liability and about any resulting income, expenses or changes in equity.
3. Provides a **faithful representation** of the asset or liability and of any resulting income, expenses or changes in equity.
4. **Benefit** of recognizing the element exceeds the cost of recognition of that element.

Relevance	Recognition of an element **may not provide** relevant information when: 1. it is uncertain whether an asset or liability exists **(existence uncertainty)** 2. an asset or liability exists, but the **probability** of an inflow or outflow of economic benefits is **low**.
Faithful representation	Faithful representation can is affected by the level of **measurement uncertainty** associated with element.

Question no 2

iSecurity PLC is a consultancy firm which provides consultancy services in relation to information technology (IT) security to corporates. Recently the management of the company has taken following decisions:

i. Three employees of the company were sent to Singapore for IT security training in order to develop their job-related skills. The total expenses incurred for this training were Rs. 1.2 million. The management has decided to capitalize these expenses as they will give rise to future economic benefits to the company.

ii. The company has raised a purchase order (PO) for procuring three modern laptops. The laptops will be available to the company only after the financial year end. The management has decided to recognise a liability at the year-end for the purchase of these laptops. Recently a new member was appointed to the company's board of directors. He has complained at a board meeting regarding the non-availability of timely information from the management.

Required:

Discuss the decisions taken by the management in (i) and (ii) above with reference to the 'Conceptual framework for Financial Reporting'.

Question no 3

Dress (Pvt) Ltd ("DPL") is engaged in designing dresses for ladies. You have been provided with the following information relating to the financial year ended 31 March 2025.

i. DPL has an employee who is extraordinarily creative in designing dresses. The company pays a very high salary and other benefits to retain him. The annual cost incurred by DPL for this employee is Rs. 20 million.

ii. DPL sued a supplier claiming the damages caused by the low-quality materials provided by this supplier. DPL expects to receive Rs. 10 million for the damages. The company's lawyer has advised that it is virtually certain that DPL will receive the damages claimed.

Required:

Per the Conceptual Framework for Financial Reporting assess whether each of the above should be recognized as an asset in the financial statements of DPL.

Derecognition

Derecognition is the removal of all or part of a recognized asset or liability from an entity's statement of financial position. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability:

(a) for an asset, derecognition normally occurs when the entity **loses control** of all or part of the recognized asset; and
(b) for a liability, derecognition normally occurs when the **entity no longer has a present obligation** for all or part of the recognized liability.

Chapter 06 – Measurement

Elements recognized in financial statements are quantified in monetary terms. This requires the selection of a measurement basis. Consideration of the qualitative characteristics of useful financial information and of the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses.

<table>
<tr><td>Historical cost</td><td colspan="2">Historical cost measures provide monetary information about assets, liabilities and related income and expenses, from the price of the transaction or other event that gave rise to them.
Historical cost does not reflect changes in values.
Comprising the consideration paid to acquire or create the asset plus transaction costs.
In some cases, a current value of the asset or liability is used as a deemed cost on initial recognition.</td></tr>
<tr><td rowspan="2">Current Value</td><td colspan="2">Current value measures provide monetary information about assets, liabilities and related income and expenses, using information updated to reflect conditions at the measurement date.
There are three current value measurement bases.
A. Fair Value
B. Value in use for assets and fulfilment value for liabilities
C. Current cost</td></tr>
<tr><td>Fair Value</td><td>Fair value is 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.
Fair value can be determined directly by observing prices in an active market. In other cases, it is determined indirectly using measurement techniques</td></tr>
</table>

	Value in use and fulfilment value	• Value in use is the present value of the cash flows, or other economic benefits, that an entity expects to derive from the use of an asset and from its ultimate disposal. • Fulfilment value is the present value of the cash, or other economic resources, that an entity expects to be obliged to transfer as it fulfils a liability.
	Current cost	• The current cost of an asset is the cost of an equivalent asset at the measurement date, comprising the consideration that would be paid at the measurement date plus the transaction costs that would be incurred at that date. • The current cost of a liability is the consideration that would be received for an equivalent liability at the measurement date minus the transaction costs that would be incurred at that date.

Question no 4

A machine was purchased on 1 March 2022 at a cost of Rs. 3m. It has a useful life of ten years and there had been not any impairment implication relation to this asset. This machine is not too specialized, and the current market price of the machine is Rs. 2m.

Further, the machine has a scrap value of Rs. 100,000 and is expected to generate Rs. 500,000 per annum for the remaining 8 years of its life and if the company's cost of capital is 10%.

Required:

Identify and explain the measurement methods as per conceptual framework in relation to the above asset.

Chapter 08 – Concepts of capital and capital maintenance

There are two capital concepts are identified.

Financial concept of capital	• 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 entity. • Is adopted by most entities in preparing their financial statements
Physical concept of capital	• Operating capability, capital is regarded as the productive capacity of the entity based on.

Accordingly, two capital maintenance concepts are also identified.

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
Physical Capital Maintenance	Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) 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.

Question no 5

P (Pvt) Ltd has a property that is used partly for administrative purposes. The other part, which can be sold separately, has been given on rent. This property has been reflected in the financial statements as property, plant and equipment and all the disclosures required by LKAS 16, Property, Plant and Equipment have been made.

Required:

Discuss whether the above property has been faithfully represented in the financial statements as required by the Conceptual Framework for Financial Reporting.