24 September 2004

Comments by UNCTAD – ISAR Secretariat on IASB Discussion Paper "Preliminary Views on Accounting Standards for Small and Medium-sized Entities".

Question 1a. Do you agree that full IFRSs should be considered suitable for all entities? If not, why not?

We are of the view that though full IFRSs could conceptually be considered suitable for all entities, over the years the IASs have been getting more complex and voluminous, to a point where they have become too burdensome, particularly for smaller entities to implement. It is important to keep in mind that the availability of the necessary infrastructure and expertise for implementing IFRSs varies significantly among entities and countries. Therefore, we are of the view that a less burdensome version of IFRSs should be made available for small and medium sized entities. Furthermore, the smallest entities that are often owner-managed and have few employees need to use a simple accruals-based accounting system.

Question 1b. Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs? If not, why not?

As stated in our response to question 1a, we agree that the Board should develop a separate, simplified set of financial reporting standards suitable for SMEs.

Question 1c. Do you agree that IASB Standards for SMEs should not be used by publicly listed entities (or any other entities not specifically intended by the Board), even if national law or regulation were to permit this? Do you also agree that if the IASB Standard for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs? If not, why not?

We agree that IASB Standards for SMEs should not be used by publicly listed entities. Furthermore, we are of the view that if the IASB Standards for SMEs are used by publicly listed entities their financial statements cannot be described as being in compliance with IFRSs for SMEs.

Question 2. Are the objectives of the IASB standards for SMEs as set out in preliminary view 2 appropriate and, if not, how should they be modified?

We think that the objectives as set out in preliminary view 2 are appropriate. It is possible that views may differ on the relative emphasis placed among the objectives.

Question 3a. Do you agree that the Board should describe the characteristics of the entities for which it intends the standards but that those characteristics should not prescribe quantitative "size tests"? If not, why not, and how would an appropriate size test be developed?

We agree that the Board should describe the characteristics of the entities for which it intends the SME standards. However, given the differences among different countries and economies around the world, it would be impractical to provide a universal definition of SMEs in quantitative terms. Detailed definitions should be left for national authorities to decide who are better positioned to determine the appropriate requirements in the specific circumstances of their respective economies.

Question 3b. Do you agree that the Board should develop standards that would be suitable for all entities that do not have public accountability and should not focus only on some entities that do not have public accountability, such as only the relatively larger ones or only the relatively smaller ones? If not, why not?

We are of the view that one SME standards may not be suitable for all entities that do not have public accountability. The fact that there is a big range between relatively large and relatively smaller SMEs needs to be recognized. Furthermore, accounting and reporting needs may differ significantly between relatively larger SMEs and relatively smaller SMEs. In our opinion, as stated in response to question 1a, the smallest entities that are often owner-managed and have few employees should use a simple accruals-based accounting.

Question 3c. Do the two principles in preliminary view 3.2, combined with the presumptive indicators of "public accountability" in preliminary view 3.3, provide a workable definition and appropriate guidance for applying the concept of "public accountability"? If not, how would you change them?

We agree that the principles in preliminary view 3.2 combined with the presumptive indicators as set out in preliminary view 3.3, may provide a workable definition. However, we are of the opinion that the term "significant public interest" may better describe the public accountability principle. We are also of the view that the final determination of "public accountability" or "significant public interest" should rest with national authorities.

Question 3d. Do you agree that an entity should be required to use full IFRSs if one or more of the owners of its shares objects to the entity's preparing its financial statements on the basis of IASB standards for SMEs? If not, why not?

Such details should be left for national authorities to decide.

Question 3e. Do you agree that if a subsidiary, joint venture, or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of the parent, venturer, or investor, the entity should comply with full IFRSs, and not IASB standards for SMEs, in its separate financial statements? If not, Why not?

We think that if an entity is required to prepare financial information in accordance with full IFRSs, then it would be more costly for it to prepare another set of financial statements in accordance with the standard for SMEs. However, such issues should be left for national authorities to decide.

Question 4. Do you agree that if IASB standards for SMEs do not address a particular accounting recognition or measurement issue, the entity should be required to look to the appropriate IFRS to resolve that particular issue? If not, why not, and what alternative would you propose?

In this case the presumption should be that the standards for SMEs address the necessary accounting recognition and measurement issues. We agree that in the event that an SME encounters an issue that is not addressed in the SME standards it should be required to look to the appropriate IFRS to resolve that particular issue.

Question 5a. Should an SME be permitted to revert to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS, or should an SME be required to choose only either the complete set of IFRSs or the complete set of SME standard with no optional reversion to individual IFRSs? Why?

We are of the view that if an SME decides to prepare its financial statements in accordance with the SME standards, then it should stick to that decision consistently. As stated in response to question 4 above, it should be only in exceptional circumstances that it would be required to look to the appropriate IFRS to resolve certain issues that might not be addressed in the SME standard.

Question 5b. If an SME is permitted to revert to an IFRS, should it be:

(a) required to revert to the IFRS in its entirety (a standard-by-standard approach);

(b) permitted to revert to individual principles on the IFRS without restriction while continuing to follow the remainder of the SME version of the IFRS (a principle-by-principle approach); or

(c) required to revert to all the principles in the IFRS that are related to the treatment in the SME version of the IFRS while continuing to follow the remainder of the SME version of the IFRS (a middle ground between a standard-by-standard and principle-by-principle approach)?

Please explain your reasoning and, if you favour (c), what criteria do you propose for defining 'related' principles?

As stated in response to question 5a, once an SME decides to apply the SME standard then it should do so consistently.

Question 6. Do you agree that development of IASB standards for SMEs should start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs (including Interpretations), and then making modifications deemed appropriate? If not, what approach would you follow?

We agree with this approach towards developing the IASB standard for SMEs. Furthermore, consistency with the Framework and the principles and related mandatory guidance from IFRSs would allow smooth transition from one level to another as SMEs develop.

Question 7a. Do you agree that any modifications for SMEs to the concepts or principles in full IFRSs must be on the basis of the identified needs of users of SME financial statements or cost-benefit analysis? If not, what alternative bases for modifications would you propose, and why? And if so, do you have suggestions about how the Board might analyse the costs and benefits of IFRSs in an SME context?

We agree that cost-benefit analysis and user needs should be primary considerations in determining modifications for SMEs to the concepts or principles in full IFRSs. It would be important to keep in mind that cost-benefit analysis considerations need to be taken with the circumstances of all potential users of the SME standard. The special circumstances of some SMEs in developing economies and countries with economies in transition need to be kept in mind.

Question 7b. Do you agree that it is likely that disclosure and presentation modifications will be justified based on user needs and cost-benefit analysis and that the disclosure modifications could increase or decrease the current level of disclosure for SMEs? If not, why not?

We agree that it is likely that disclosure and presentation modifications based on user needs and cost-benefit analysis are justified. However, it is difficult to state whether the disclosure modifications could increase or decrease the current level of disclosures for SMEs without considering a "specific current level". In general, however, the disclosure modifications would be expected to decrease "the current level of disclosure" for SMEs.

Question 7c. Do you agree that, in developing standards for SMEs, the Board should presume that no modification would be made to the recognition or measurement principles in IFRSs, though that presumption could be overcome on the basis of user needs and a cost-benefit analysis? If not, why not?

We are of the view that possible modifications to recognition or measurement principles in IFRSs should be considered with an open mind. The nature and magnitude of the types of transactions most SMEs encounter should be taken into consideration.

Question 8a. Do you agree that IASB standards for SMEs should be published in a separate printed volume? If you favour including them in separate sections of each individual IFRS (including interpretations) or some other approach, please explain why.

We agree with the view that the IASB standards for SMEs should be published in a stand-alone printed volume. Simplification considerations also extend to the manner in which the SME standards are made available to preparers and users.

Question 8b. Do you agree that IASB standards for SMEs should be organised by IAS/IFRS number rather than in topical sequence? If you favour topic sequence or some other approach, please explain why.

We are of the view that organizing the IASB standards for SMEs by IAS/IFRS numbers would be useful, particularly for users who may have to refer to the full IASs/IFRSs to resolve issues that are not addressed by the standards for SMEs.

Question 8c. Do you agree that each IASB standard for SMEs should include a statement of objective, an executive summary, and a glossary of key terms?

We are of the view that the stand-alone IASB standard for SMEs should be as concise as possible. Glossary of key terms would be useful to the extent that their inclusion does not make the individual standard and ultimately the whole volume unnecessarily long.

Question 9. Are there any other matters related to how the Board should approach its project to develop standards for SMEs that you would like to bring to the Board's attention?

We would like to once again highlight that in the process of developing the standards for SMEs through this project, prevailing legal and social circumstances and the differences in the economic situation of SMEs in different countries as well as their capacity to implement the standards for SMEs need to be borne in mind. The relative cost of implementation may be higher in some economies than others. Therefore, we are of the view that in order to meet financial reporting needs of different levels of SMEs, a three-tiered structure and approach proposed by ISAR be followed by the IASB in its project on accounting standards for SMEs.

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

ACCOUNTING AND FINANCIAL REPORTING GUIDELINES FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SMEGA)

LEVEL 2 GUIDANCE

UNITED NATIONS
New York and Geneva, 2004

Note

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Preface

At its 17th session in July 2000, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) identified a number of obstacles that small and medium-sized enterprises (SMEs) were facing in applying accounting standards that had been issued by various standard-setting bodies, both national and international. It was agreed that a project should be undertaken to identify possible approaches that would meet the accounting and financial reporting needs of such enterprises.

ISAR has supported the International Accounting Standards Board (IASB) as the international standard setter of reference for accounting and reporting standards. The International Accounting Standards (IAS) issued by the IASB, however, have been created largely with the financial reporting needs of listed companies in mind. Consequently, it has often been difficult to apply them to SMEs, particularly those in developing countries and countries with economies in transition. For many businesses in these countries, professional help may also be disproportionately expensive.

To meet the financial reporting needs of SMEs, ISAR is proposing that a three-tiered structure be adopted, as follows:

Level 1. This level would apply to listed enterprises whose securities are publicly traded and those in which there is significant public interest. These enterprises should be required to apply the accounting and financial reporting standards (IAS and International Financial Reporting Standards, or IFRS) issued by the IASB.

Level 2. This level would apply to significant business enterprises that do not issue public securities and in which there is no significant public interest. ISAR has developed a single set of requirements derived from the IAS issued by the IASB, but embodying only requirements for the most regularly encountered transactions. This level would still have the option to follow the full set of IAS and IFRS issued by the IASB.

Level 3. This level would apply to the smallest entities, which are often owner-managed and have few employees. The approach proposed is a simple accruals-based accounting, based on that set out in IAS, but closely linked to cash transactions. A derogation would, however, be permitted within this level for businesses to use cash accounting for a limited time when first establishing their accounting systems.

Exactly how the boundaries between the three levels should be specified is a matter that cannot be dealt with adequately without knowledge of the specific economy in which an enterprise operates. ISAR recommends that there be a system with at least three levels, but how these levels are defined must be determined by each member State that chooses to apply this approach, taking into account the prevailing economic, legal and social circumstances, particularly the member State’s enterprise structure.

However, for some member States an indication of ISAR's thinking with regard to some of the terminology used in defining the three levels may be useful. One example is the concept of significant public interest. While enterprises in which there is significant public interest exist in all member States, the criteria and thresholds for identifying them vary. In general, ISAR considers that the impact of an entity on employment or the generation of significant economic activity in the country implies a public interest. One possible criterion for assessing public interest could therefore be the number of employees that an enterprise has. Some member States might, for example, wish to designate the top 10 per cent of enterprises (ranked by number of employees) that employ the largest number of workers in their economies as enterprises in which there is significant public interest.

The proposed guidance (SMEGA) that ISAR has developed for Level 2 enterprises is set out in the material that follows.

The Level 2 guidance is intended to be available to member States to use in its present form, but they can also adapt it to suit their specific national circumstances. For example, Guideline 3 contains a benchmark treatment for property, plant and equipment (depreciated historical cost) and an allowed alternative (revalued amount). Member States can choose to eliminate one of these options in using the SMEGA.

The guidance for Level 2 is intended, on the one hand, to be user friendly, understandable and focused only on the most frequently encountered transactions, but, on the other hand, to be derived from IAS/IFRS and facilitate the development of enterprises from Level 2 to Level 1. It is based on the view that, to be useful and cost effective, the SMEGA should be as short as possible and concentrate on measurement approaches that are feasible within the available infrastructure but enable users to make informed decisions. In developing the guidance, judgements are needed to balance the need for brevity and usability with the need to be comprehensive and to provide sufficient explanation.

ISAR realizes that there are no objective criteria for determining which standards should fall within the SMEGA and which do not, and that, consequently, it is largely a matter of judgement which standards are included and which excluded. For instance, IAS 11, Construction Contracts, has been excluded. While it might be considered an industry-specific standard, and therefore of limited general application, it includes a fundamental revenue recognition principle that applies to all entities having unfinished contracts at the accounting date. However, as is discussed above, the main criterion applied in identifying the standards to be included in the SMEGA was whether most small enterprises would be likely to have the particular kind of operation or transaction addressed by an individual standard. Accordingly, IAS 11 was excluded from the SMEGA. However, compliance with IAS 11 would be required if an enterprise had to record revenue earned on partially completed construction contracts.

In accordance with Guideline 12 of the SMEGA, an enterprise that complied with the SMEGA would indicate in its accounting policy note that its accounts had been drawn up in accordance with the SMEGA (and not the full IAS/IFRS). If the enterprise also had to refer to an element of full IAS/IFRS, it would still retain the reference to the SMEGA in its policy note.

ISAR is aware that the IASB has an “active research project” on the application of IAS to SMEs and in emerging economies. At this stage, it is not clear what the outcome of this project will be and if and when any definitive guidance will be produced. ISAR supports the IASB’s work in this area and has requested that it be given priority. ISAR will keep the SMEGA under review in light of developments in the IASB’s project.

The SMEGA’s guidance for Level 2 is based on the IAS applicable in 2002. ISAR recognizes that the IASB’s work to improve its existing standards and develop new ones may mean that in the future changes are needed to the SMEGA. For this reason, as well as to take into account any feedback from practical application, the SMEGA will need to be reviewed from time to time.

CONTENTS

Note: Certain terms in the SMEGA have been italicized, and definitions of these terms can be found in Annex 1. When the same term appears with and without italics, the un-italicized term may have a different meaning from that given in the definition.

Introduction

Scope

1. These accounting and reporting guidelines for small and medium-sized enterprises (SMEGA) are intended for the preparation of general-purpose financial statements for SMEs in developed and developing countries as well as in economies in transition. Such statements would be prepared at least annually and are intended to meet the information needs of a wide range of users.

Users

2. Users of financial statements generally include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and, in some jurisdictions, the public. For SMEs, the most significant users are likely to be investors/owners and creditors, who may have the power to obtain information additional to that contained in the financial statements. Management is also interested in the information contained in the financial statements, even though it has access to additional management and financial information.

Objectives

3. The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to users of such information in making economic decisions. Financial statements show the results of management's stewardship of and accountability for the resources entrusted to it.

Underlying assumptions

4. Financial statements are prepared on the accrual basis of accounting. They are normally prepared on the assumption that an enterprise is a going concern that will continue to operate for at least the foreseeable future.

Qualitative characteristics

5. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal characteristics are:

(a) Understandability: It is essential that information provided in financial statements be readily understandable by users.

(b) Relevance: To be useful, information must be relevant to the decision-making needs of users. The relevance of information is affected by its nature and materiality.

(c) Reliability: Information is reliable when it is free from material error and bias and can be depended on by users to represent faithfully that which it is said to represent. In assessing reliability, substance over form, prudence, neutrality and completeness are also considered.

(d) Comparability: Users must be able to compare the financial statements of an entity over time in order to identify trends in the entity's financial position and performance.

6. Constraints: The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgemental process. Standard setters as well as the preparers and users of financial statements should be aware of this constraint.

7. In practice, trade-offs between qualitative characteristics are often necessary. Determining the relative importance of the characteristics in different cases is a matter of professional judgement.

Elements

8. An "*asset*" is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

9. A **"***liability***"** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

10. "Equity" is the residual interest in the *assets* of the enterprise after all its *liabilities* have been deducted.

11. "Income" encompasses both *revenue* and gains. It includes increases in economic benefits during the accounting period in the form of inflows or enhancements of *assets* as well as decreases of *liabilities* that result in increases in equity, other than those relating to contributions from equity participants.

12. "Expenses" encompass losses as well as those expenses that arise in the course of the *ordinary activities* of the entity. Expenses are decreases in economic benefits.

Recognition

13. An item that meets the definition of an element should be recognized if (a) it is probable that any future economic benefit associated with the item will flow to or from the enterprise, and (b) the item has a cost or value that can be measured with reliability.

Measurement

14. The measurement base most commonly adopted by enterprises in preparing their financial statements is *historical cost*. This is usually combined with other measurement bases for certain specific items, as referred to in the SMEGA.

Transactions not covered by the SMEGA

15. Where an entity has a transaction that falls outside the SMEGA, it is suggested that the preparer look for guidance within the hierarchy referred to in Guideline 12.

Guideline 1. Presentation of Financial Statements*

Components of financial statements

1.1. A complete set of financial statements includes the following components:

(a) a balance sheet;
(b) an income statement;
(c) a statement showing either:
   (i) all changes in equity; or
   (ii) changes in equity other than those arising from capital transactions with owners and distributions to owners;
(d) a cash flow statement; and
(e) accounting policies and explanatory notes.

Overall considerations

1.2. Financial statements should present fairly the financial position, financial performance and *cash flows* of an enterprise. The appropriate application of the SMEGA, with additional disclosure when necessary, results, in virtually all circumstances, in financial statements that achieve a fair presentation as appropriate for SMEs. In the event that the SMEGA do not cover a transaction undertaken by an enterprise, the enterprise should look to the full set of International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) for authoritative guidance, as set out in paragraph 12.1 of Guideline 12.

1.3. An enterprise whose financial statements are drawn up in compliance with the SMEGA should specify in its accounting policy note that the SMEGA are the requirement followed. There should be no reference to an IAS or an IFRS, nor should the entity hold itself out as complying with an IAS or IFRS in any form.

1.4. Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material.

1.5. In the extremely rare circumstances when management concludes that compliance with a requirement in the SMEGA would be misleading, and that therefore departure from a requirement is necessary in order to achieve a fair presentation, an enterprise should disclose:

(a) that management has concluded that the financial statements fairly present the enterprise's financial position, financial performance and *cash flows*;
(b) that it has complied in all material respects with applicable Guidelines, except for departing from them in order to achieve a fair presentation; and
(c) the nature of the departure, including the treatment that the SMEGA would require, the reason why that treatment would be misleading in the circumstances, and the treatment adopted.

1.6. When preparing financial statements, management should make an assessment of an enterprise's ability to continue as a going concern. Financial statements should be prepared on a going-concern basis unless management either intends to liquidate the enterprise or cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt on the enterprise's ability to continue as a going concern, those uncertainties should be disclosed. When the financial statements are not prepared on a going-concern basis, that fact

* This Guideline is based on IAS 1. See derivation table in Annex 3 for further details.

should be disclosed, together with the basis on which the financial statements are prepared and the reason why the enterprise is not considered to be a going concern.

1.7. An enterprise should prepare its financial statements, except for cash flow information, under the accrual basis of accounting.

1.8. The presentation and classification of items in the financial statements should be retained from one period to the next unless

(a) a significant change in the nature of the operations of the enterprise or a review of its financial statement presentation demonstrates that the change will result in a more appropriate presentation of events or transactions; or

(b) a change in presentation is required by the SMEGA.

1.9. Each material item should be presented separately in the financial statements. Immaterial amounts should be aggregated with amounts of a similar nature or function and need not be presented separately. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item judged in the particular circumstances where its presentation comes into question.

1.10. *Assets* and *liabilities* should not normally be offset in the financial statements. However, some offsetting is required or permitted in exceptional circumstances, as mandated by the Guidelines (e.g. paragraph 2.6). Offsetting may also take place where gains, losses and related expenses arising from the same or similar transactions are not material.

1.11. Unless the SMEGA permit or require otherwise, comparative information with respect to the previous period should be disclosed for all numerical information in the financial statements. Comparative information should be included in narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Structure and content

1.12. Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed, and repeated when it is necessary for a proper understanding of the information presented:

(a) the name of the reporting enterprise or other means of identification;

(b) the balance sheet date or the period covered by the other financial statements, whichever is appropriate to the related component of the financial statements; and

(c) the *reporting currency*.

1.13. Financial statements should be presented at least annually. When, in exceptional circumstances, an enterprise's balance sheet date changes and annual financial statements are presented for a period longer or shorter than one year, an enterprise should disclose, in addition to the period covered by the financial statements:

(a) the reason why a period other than one year is being used; and

(b) the fact that comparative amounts for the income statement, changes in equity, cash flows and related notes are not comparable.

Balance sheet

1.14. Each enterprise should determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet. Paragraphs 1.16 to 1.20 of this Guideline apply when this distinction is made. When an enterprise chooses not to make this classification, *assets* and *liabilities* should be presented broadly in order of their liquidity.

1.15. Whichever method of presentation is adopted, an enterprise should disclose, for each *asset* and *liability* item that combines amounts expected to be recovered or settled both before and after 12 months from the balance sheet date, the amount expected to be recovered or settled after more than 12 months.

1.16. An *asset* should be classified as a current asset when it:

(a) is expected to be realized in, or is held for sale or consumption in, the normal course of the enterprise's operating cycle; or
(b) is held primarily for trading purposes or for the short term and is expected to be realized within 12 months of the balance sheet date; or
(c) is *cash* or a *cash-equivalent* asset that is not restricted in its use.

All other *assets* should be classified as non-current assets.

1.17. A *liability* should be classified as a current liability when it:

(a) is expected to be settled in the normal course of the enterprise's operating cycle; or
(b) is due to be settled within 12 months of the balance sheet date.

All other *liabilities* should be classified as non-current liabilities.

1.18. An enterprise should continue to classify its long-term interest-bearing liabilities as non-current, even when they are due to be settled within 12 months of the balance sheet date, if:

(a) the original term was for a period of more than 12 months;
(b) the enterprise intends to refinance the obligation on a long-term basis; and
(c) that intention is supported by an agreement to refinance, or to reschedule payments, that is completed before the financial statements are authorized for issue.

The amount of any *liability* that has been excluded from current liabilities in accordance with this paragraph, together with information in support of this presentation, should be disclosed in the notes to the balance sheet.

1.19. At a minimum, the face of the balance sheet should include line items presenting the following amounts:

(a) *property, plant and equipment;*
(b) *intangible assets;*
(c) financial *assets* (excluding amounts shown under (e) and (f));
(d) *inventories;*
(e) trade and other receivables;
(f) *cash* and *cash equivalents;*
(g) trade and other payables;
(h) tax liabilities and assets;
(i) *provisions;*
(j) non-current interest-bearing liabilities; and
(k) issued capital and reserves.

1.20. Additional line items, headings and subtotals should be presented on the face of the balance sheet when such presentation is necessary to present fairly the enterprise's financial position.

1.21. An enterprise should disclose the following, either on the face of the balance sheet or in the notes:

(a) for each class of share capital:
  (i) the number of shares authorized;
  (ii) the number of shares issued and fully paid, and issued but not fully paid;
  (iii) par value per share, or that the shares have no par value;
  (iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the year;
  (v) the rights, preferences and restrictions attaching to that class, including restrictions on the distribution of dividends and the repayment of capital;
  (vi) shares in the enterprise held by the enterprise itself; and
  (vii) shares reserved for issuance under options and sales contracts, including the terms and amounts;

(b) a description of the nature and purpose of each reserve within owners' equity;

(c) the amount of dividends that were proposed or declared after the balance sheet date but before the financial statements were authorized for issue; and

(d) the amount of any cumulative preference dividends not recognized.

An enterprise without share capital, such as a partnership, should disclose information equivalent to that required above, showing movements during the period in each category of equity interest and the rights, preferences and restrictions attaching to each category of equity interest.

Income statement

1.22. At a minimum, the face of the income statement should include line items that present the following amounts:

(a) *revenue;*

(b) the results of *operating activities;*

(c) finance costs;

(d) *tax expense;*

(e) net profit or loss for the period.

Additional line items, headings and subtotals should be presented on the face of the income statement when such presentation is necessary to present fairly the enterprise's financial performance.

1.23. All items of income and expense recognized in a period should be included in the determination of the net profit or loss for the period unless the SMEGA require or permit otherwise.

1.24. When items of income and expense within profit or loss from *ordinary activities* are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

1.25. Circumstances that may give rise to the separate disclosure of items of income and expense in accordance with paragraph 1.24 include the following:

(a) the write-down of *inventories* to *net realizable value* or *property, plant and equipment* to recoverable amount, as well as the reversal of such write-downs;

(b) a restructuring of the activities of an enterprise and the reversal of any *provisions* for the costs of restructuring;

(c) disposals of items of *property, plant and equipment*;

(d) disposals of long-term investments;

(e) discontinuing operations;

(f) litigation settlements; and

(g) other reversals of *provisions*.

1.26. An enterprise should present, either on the face of the income statement or in the notes to the income statement, an analysis of expenses using a classification based on either the nature of expenses or their function within the enterprise.

1.27. Enterprises classifying expenses by function should disclose additional information on the nature of expenses, including *depreciation* and amortization expense and staff costs.

1.28. An enterprise should disclose, either on the face of the income statement or in the notes, the amount of dividends per share, declared or proposed, for the period covered by the financial statements.

Changes in equity

1.29. An enterprise should present, as a separate component of its financial statements, a statement showing the following:

(a) the net profit or loss for the period;

(b) each item of income and expense, gain or loss that, as required by the Guidelines, is recognized directly in equity, and the total of these items; and

(c) the cumulative effect of changes in accounting policy and the correction of *fundamental errors*.

In addition, an enterprise should present, either within this statement or in the notes, the following:

(d) capital transactions with owners and distributions to owners;

(e) the balance of accumulated profit or loss at the beginning of the period and at the balance sheet date, and the movements for the period; and

(f) a reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and the end of the period, separately disclosing each movement.

Notes to the financial statements

1.30. The notes to the financial statements of an enterprise should:

(a) present information about the basis of preparation of the financial statements and the specific *accounting policies* selected and applied for significant transactions and events;

(b) disclose the information required by the SMEGA that is not presented elsewhere in the financial statements; and

(c) provide additional information that is not presented on the face of the financial statements but that is necessary for a fair presentation.

1.31. Notes to the financial statements should be presented in a systematic manner. Each item on the face of the balance sheet, the income statement and the cash flow statement should be cross-referenced to any related information in the notes.

1.32. The *accounting policies* section of the notes to the financial statements should describe the following:

(a) the measurement basis (or bases) used in preparing the financial statements; and

(b) each specific accounting policy that is necessary for a proper understanding of the financial statements.

1.33. An enterprise should disclose the following, if the information is not disclosed elsewhere in information published with the financial statements:

(a) the domicile and legal form of the enterprise, its place of incorporation and the address of the registered office (or principal place of business, if different from the registered office); and

(b) a description of the nature of the enterprise's operations and its principal activities.

Guideline 2. Cash Flow Statements[*]

Presentation of a cash flow statement

2.1. The cash flow statement should report *cash flows* during the period classified by operating, investing and *financing activities*.

2.2. *Cash flows* from *operating activities* are primarily derived from the principal *revenue*-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. *Cash flows* arising from income taxes should be separately disclosed within the *operating activities* section unless they can be specifically identified with financing and *investing activities*. Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in the determination of net profit or loss. However, the *cash flows* relating to such transactions are *cash flows* from *investing activities*.

Investing activities

2.3. The separate disclosure of *cash flows* arising from *investing activities* is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and *cash flows*.

Financing activities

2.4. The separate disclosure of *cash flows* arising from financing activities is important because it is useful in predicting claims on future *cash flows* by providers of capital to the enterprise.

2.5. An enterprise should report *cash flows* from *operating activities* using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing *cash flows*.

2.6. An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from financing and *investing activities*, except to the extent that *cash flows* described in paragraph 2.7 are reported on a net basis.

2.7. *Cash flows* arising from the following operating, investing or *financing activities* may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the *cash flows* reflect the activities of the customer rather than those of the enterprise; and
(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

2.8. Investing and financing transactions that do not require the use of *cash* or *cash equivalents* should be excluded from a cash flow statement. Such transactions should be disclosed

[*] This Guideline is based on IAS 7. See derivation table in Annex 3 for further details.

elsewhere in the financial statements in a way that provides all the relevant information about these investing and *financing activities*.

2.9. An enterprise should disclose the components of *cash* and *cash equivalents* and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

Cash and cash equivalents

2.10. *Cash equivalents* are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. To qualify as a *cash equivalent*, an investment must be readily convertible to a known amount of *cash* and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a *cash equivalent* only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from *cash equivalents* unless they are, in substance, *cash equivalents* – for example, in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

2.11. Bank borrowings are generally considered to be *financing activities*. However, in some countries, bank overdrafts that are repayable on demand form an integral part of an enterprise's cash management. In these circumstances, bank overdrafts are included as a component of *cash* and *cash equivalents*. A characteristic of such banking arrangements is that the bank balance often fluctuates between being positive and being overdrawn.

Other disclosures

2.12. An enterprise should disclose, together with a commentary by management, the amount of significant *cash* and *cash equivalent* balances held by the enterprise that are not available for use by the enterprise.

Guideline 3. Property, Plant and Equipment*

3.1. An item of *property, plant and equipment* should be recognized as an *asset* when:

(a) it is probable that future economic benefits associated with the *asset* will flow to the enterprise; and

(b) the *cost* of the *asset* to the enterprise can be measured reliably.

3.2. An item of *property, plant and equipment* that qualifies for recognition as an asset should initially be measured at its *cost*.

3.3. The *cost* of an item of *property, plant and equipment* comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable *costs* of bringing the *asset* to working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable *costs* include the following:

(a) the *cost* of site preparation;

(b) initial delivery and handling costs;

(c) installation costs;

(d) professional fees such as for architects and engineers; and

(e) the estimated cost of dismantling and removing the *asset* and restoring the site, to the extent that it is recognized as a *provision* under Guideline 8.

3.4. Administration and other general overhead costs are not a component of the *cost* of *property, plant and equipment* unless they can be directly attributed to the acquisition of the *asset* or bringing the *asset* to its working condition. Similarly, start-up and similar preproduction *costs* do not form part of the *cost* of an *asset* unless they are necessary to bring the *asset* to its working condition. Initial operating losses incurred prior to an *asset's* achieving planned performance are recognized as an expense.

3.5. The *cost* of a self-constructed *asset* is determined using the same principles as for an acquired asset.

3.6. An item of *property, plant and equipment* may be acquired in exchange or part exchange for a dissimilar item of *property, plant and equipment* or other *asset*. The *cost* of such an item is measured at the *fair value* of the *asset* received, which is equivalent to the *fair value* of the *asset* given up adjusted by the amount of any *cash* or *cash equivalents* transferred.

3.7. Subsequent expenditure relating to an item of *property, plant and equipment* that has already been recognized should be added to the *carrying amount* of the *asset* when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing *asset*, will flow to the enterprise. All other subsequent expenditure should be recognized as an expense in the period in which it is incurred.

3.8. Expenditure on repairs or maintenance of *property, plant and equipment* is made to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of the *asset*. As such, it is usually recognized as an expense when incurred. For example, the *cost* of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the originally assessed standard of performance.

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* This Guideline is based on IAS 16. See derivation table in Appendix 3 for further details.

3.9. Major components of some items of *property, plant and equipment* may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage. The components are accounted for as separate *assets* because they have useful lives different from those of the items of *property, plant and equipment* to which they relate. Therefore, provided the recognition criteria in paragraph 3.1 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate *asset*, and the replaced *asset* is written off.

Measurement subsequent to initial recognition

Benchmark treatment

3.10. Subsequent to initial recognition as an *asset*, an item of *property, plant and equipment* should be carried at its *cost* less any accumulated depreciation (3.19) and any accumulated *impairment losses* (3.25).

Allowed alternative treatment

3.11. Subsequent to initial recognition as an *asset*, an item of *property, plant and equipment* should be carried at a revalued amount (its *fair value* at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses). Revaluations should be made with sufficient regularity so that the *carrying amount* does not differ materially from that which would be determined using *fair value* at the balance sheet date.

3.12. The *fair value* of land and buildings is usually the market value. This value is determined by appraisal, which is normally undertaken by professionally qualified valuers.

3.13. The *fair value* of items of plant and equipment is usually the market value determined by appraisal. When there is no evidence of market value because of the specialized nature of the plant and equipment and because these items are rarely sold, except as part of a continuing business, they are valued at their depreciated replacement cost.

3.14. When an item of *property, plant and equipment* is revalued, any accumulated depreciation at the date of the revaluation is either:

(a) Restated proportionately with the change in the gross carrying amount of the *asset* so that the *carrying amount* of the *asset* after revaluation equals its revalued amount (this method is often used when an *asset* is revalued by means of an index to its depreciated replacement cost); or

(b) Eliminated against the gross carrying amount of the *asset* and the net amount restated to the revalued amount of the *asset*. For example, this method is used for buildings that are revalued to their market value. The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in *carrying amount*, in accordance with paragraph 3.16.

3.15. When an item of *property, plant and equipment* is revalued, the entire class of *property, plant and equipment* to which that *asset* belongs should be revalued.

3.16. When an *asset's carrying amount* is increased as a result of a revaluation, the increase should be credited directly to equity under the heading of revaluation surplus. However, a revaluation increase should be recognized as income to the extent that it reverses a revaluation decrease of the same *asset* previously recognized as an expense.

3.17. When an *asset's carrying amount* is decreased as a result of a revaluation, the decrease should be recognized as an expense. However, a revaluation decrease should be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same *asset*.

3.18. The revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realized. The whole surplus may be realized on the retirement or disposal of the *asset*. However, some of the surplus may be realized as the *asset* is used by the enterprise; in such a case, the amount of the surplus realized is the difference between *depreciation* based on the revalued *carrying amount* of the *asset* and *depreciation* based on the *asset's* original cost. The transfer from revaluation surplus to retained earnings is not made through the income statement.

Depreciation

3.19. The *depreciable amount* of an item of *property, plant and equipment* should be allocated on a systematic basis over its *useful life*. The depreciation method used should reflect the pattern according to which the *asset's* economic benefits are consumed by the enterprise. The depreciation charge for each period should be recognized as an expense unless it is included in the *carrying amount* of another *asset*.

3.20. The economic benefits embodied in an item of *property, plant and equipment* are consumed by the enterprise principally through the use of the *asset*. However, other factors such as technical obsolescence and wear and tear while an *asset* remains idle often result in the diminution of the economic benefits that might have been expected to be available from the *asset*. Consequently, all the following factors need to be considered in determining the *useful life* of an *asset*:

(a) the expected usage of the *asset* by the enterprise (usage is assessed by reference to the *asset's* expected capacity or physical output);

(b) the expected physical wear and tear, which depends on operational factors such as the number of shifts for which the *asset* is to be used, the repair and maintenance programme of the enterprise, and the care and maintenance of the *asset* while idle;

(c) technical obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or the service output of the *asset*; and

(d) legal or similar limits on the use of the *asset*, such as the expiry dates of related *lease*s.

3.21. Land and buildings are separable *assets* and are dealt with separately for accounting purposes, even when they are acquired together. Land normally has an unlimited life and, therefore, is not depreciated. Buildings have a limited life and, therefore, are depreciable *assets*. An increase in the value of the land on which a building stands does not affect the determination of the *useful life* of the building.

3.22. A variety of depreciation methods can be used to allocate the *depreciable amount* of an *asset* on a systematic basis over its *useful life*. These methods include the straight-line method, the diminishing balance method and the sum-of-the-units method. Straight-line depreciation results in a constant charge over the *useful life* of the *asset*. The diminishing balance method results in a decreasing charge over the *useful life* of the *asset*. The sum-of-the-units method results in a charge based on the expected use or output of the *asset*. The method used for an *asset* is selected based on the expected pattern of economic benefits and is consistently applied from period to period unless there is a change in the expected pattern of economic benefits from that *asset*.

3.23. The *useful life* of an item of *property, plant and equipment* should be reviewed periodically and, if expectations are significantly different from previous estimates, the *depreciation* charge for the current and future periods should be adjusted.

3.24. The depreciation method applied to *property, plant and equipment* should be reviewed periodically and, if there has been a significant change in the expected pattern of economic benefits from those *assets*, the method should be changed to reflect the changed pattern. When such a change in depreciation method is necessary, the change should be accounted for as a change in accounting estimate, and the depreciation charge for the current and future periods should be adjusted.

Impairment

3.25. At each balance sheet date, the entity should assess whether there is any indication that an *asset* may be impaired. If there is any such indication, the entity should consider whether the continued use of the *asset*, or group of *assets* forming a *cash generating unit*, is likely to generate *cash flows* sufficient to absorb the *amortization* of the *cost* of the *asset*. In the event that the undiscounted future *cash flows* are expected to be insufficient, the carrying value should be reduced.

Retirements and disposals

3.26. An item of *property, plant and equipment* should be eliminated from the balance sheet on disposal or when the *asset* is permanently withdrawn from use and no future economic benefits are expected from its disposal.

3.27. Gains or losses arising from the retirement or disposal of an item of *property, plant and equipment* should be determined as the difference between the estimated net disposal proceeds and the *carrying amount* of the *asset* and should be recognized as income or expense in the income statement.

Disclosure

3.28. The financial statements should disclose, for each class of *property, plant and equipment*:

(a) the measurement bases used for determining the gross carrying amount (when more than one basis has been used, the gross carrying amount for that basis in each category should be disclosed);

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the *carrying amount* at the beginning and end of the period showing:

   (i) additions;
   (ii) disposals;
   (iii) increases or decreases during the period resulting from revaluations;
   (iv) *impairment losses* recognized in the income statement during the period (if any);
   (v) *impairment losses* reversed in the income statement during the period (if any);
   (vi) *depreciation*; and
   (vii) other movements.

Comparative information is not required for the reconciliation in (e) above.

3.29. The financial statements should also disclose the existence and amounts of restrictions on title, as well as *property, plant and equipment* pledged as security for *liabilities*.

3.30. When items of *property, plant and equipment* are stated at revalued amounts, the following should be disclosed:

(a) the basis used to revalue the *assets*;

(b) the effective date of the revaluation; and

(c) whether an independent valuer was involved.

Guideline 4. Leases*

Classification of leases

4.1. The classification of *leases* is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibility of losses from idle capacity or technological obsolescence and of variations in return caused by changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's *economic life* and of gain from appreciation in value or realization of a *residual value*.

4.2. Whether a *lease* is a *finance lease* or an *operating lease* depends on the substance of the transaction rather than the form of the contract. Following are examples of situations that would normally lead to a lease's being classified as a finance lease:

(a) the *lease* transfers ownership of the *asset* to the lessee by the end of the *lease term*.
(b) the lessee has the option to purchase the *asset* at a price that is expected to be sufficiently lower than the *fair value* at the date the option becomes exercisable such that, at the *inception* of the *lease*, it is reasonably certain that the option will be exercised.
(c) the *lease term* is for the major part of the *economic life* of the *asset*, even if title is not transferred.
(d) at the *inception* of the *lease*, the present value of the *minimum lease payments* amounts to at least substantially all of the *fair value* of the leased asset.
(e) the leased assets are of a specialized nature such that only the lessee can use them without major modifications.

4.3. Following are indicators of situations that, individually or in combination, could also lead to a *lease's* being classified as a finance lease:

(a) If the lessee can cancel the *lease*, the lessor's losses associated with the cancellation are borne by the lessee.
(b) Gains or losses from the fluctuation in the *fair value* of the residual fall to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the *lease*).
(c) The lessee has the ability to continue the *lease* for a secondary period at a rent substantially lower than market rent.

Finance leases

4.4. Lessees should recognize finance leases as *assets* and *liabilities* in their balance sheets at amounts equal at the *inception* of the *lease* to the *fair value* of the leased property or, if lower, at the present value of the *minimum lease payments*. In calculating the present value of the *minimum lease payments,* the discount factor is the *interest rate implicit in the lease,* if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

4.5. Lease payments should be apportioned between the finance charge and the reduction of the outstanding *liability*. The finance charge should be allocated to periods during the *lease term* so as to produce a constant periodic rate of interest on the remaining balance of the *liability* for each period.

* This Guideline is based on IAS 17. See derivation table in Annex 3 for further details.

4.6. A *finance lease* gives rise to a depreciation expense for the *asset* as well as a finance expense for each accounting period. The depreciation policy for leased *assets* should be consistent with that for depreciable *assets* that are owned.

4.7. If there is no reasonable certainty that the lessee will obtain ownership by the end of the *lease term*, the *asset* should be fully depreciated over the *lease term* or its *useful life*, whichever is shorter.

4.8. Lessees should disclose for finance leases, for each class of *asset*, the net *carrying amount* at the balance sheet date and the basis on which *contingent rent*s have been recognized in the income statement.

Operating leases

4.9. Lease payments under an *operating lease* should be recognized as an expense in the income statement on a straight-line basis over the *lease term* unless another systematic basis is representative of the time pattern of the user's benefit.

4.10. All incentives for the agreement of a new or renewed *operating lease* should be recognized as an integral part of the net consideration agreed for the use of the leased asset. The lessee should recognize the aggregate benefit of incentives as a reduction of rental expense over the *lease term*.

4.11. Lessees should disclose the total of future *minimum lease payments* under *non-cancellable operating leases* for each of the following periods:

(i) not later than one year;
(ii) later than one year and not later than five years; and
(iii) later than five years.

Sale and leaseback

4.12. A sale-and-leaseback transaction involves the sale of an *asset* by the vendor and the leasing of the same *asset* back to the vendor. The lease payment and the sale price are usually interdependent since they are negotiated as a package. The accounting treatment of a sale-and-leaseback transaction depends on the type of *lease* involved.

4.13. If a sale-and-leaseback transaction results in a finance lease, any excess of sales proceeds over the *carrying amount* should not be immediately recognized as income in the financial statements of a seller-lessee. Instead, it should be deferred and amortized over the *lease term*.

4.14. If a sale-and-leaseback transaction results in an *operating lease* and it is clear that the transaction is established at *fair value*, any profit or loss should be recognized immediately. If the sale price is below *fair value*, any profit or loss should be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the *asset* is expected to be used. If the sale price is above *fair value*, the excess over *fair value* should be deferred and amortized over the period for which the *asset* is expected to be used.

4.15. For *operating leases*, if the *fair value* at the time of a sale-and-leaseback transaction is less than the *carrying amount* of the *asset*, a loss equal to the amount of the difference between the *carrying amount* and *fair value* should be recognized immediately.

Guideline 5. Intangible Assets[*]

Recognition and initial measurement of an intangible asset

5.1. **An *intangible asset* should be recognized if, and only if, it meets the definition of an *asset*, and:**

(a) **it is probable that the future economic benefits that are attributable to the *asset* will flow to the enterprise; and**

(b) **the *cost* of the *asset* can be measured reliably.**

An enterprise controls an *asset* if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an *intangible asset* would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control, since an enterprise may be able to control the future economic benefits in some other way.

5.2. **An enterprise should assess the probability of future economic benefits using 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*.**

5.3. **An *intangible asset* should be measured initially at cost.**

5.4. **Internally generated goodwill should not be recognized as an *asset*.**

Internally generated intangible assets

Research phase

5.5. **No *intangible asset* arising from *research* (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.**

Development phase

5.6. **An *intangible asset* arising from *development* (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the following:**

(a) **the technical feasibility of completing the *intangible asset* so that it will be available for use or sale;**

(b) **the enterprise's intention to complete the *intangible asset* and use or sell it;**

(c) **its ability to use or sell the *intangible asset*;**

(d) **how the *intangible asset* will generate probable future economic benefits (among other things, the enterprise should demonstrate the existence of a market for the output of the *intangible asset* or the *intangible asset* itself or, if it is to be used internally, the usefulness of the *intangible asset*);**

[*] This Guideline is based on IAS 38. See derivation table in Annex 3 for further details.

(e) the availability of adequate technical, financial and other resources to complete the *development* and to use or sell the *intangible asset*; and

(f) its ability to measure reliably the expenditure attributable to the *intangible asset* during its *development*.

5.7. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognized as *intangible assets*.

Recognition of an expense

5.8. Expenditure on an intangible item should be recognized as an expense when it is incurred, unless it forms part of the *cost* of an *intangible asset* that meets the recognition criteria (see paragraphs 5.1 to 5.7).

5.9. Expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognized as part of the *cost* of an *intangible asset* at a later date.

5.10. Subsequent expenditure on an *intangible asset* after its purchase or its completion should be recognized as an expense when it is incurred unless:

(a) it is probable that this expenditure will enable the *asset* to generate future economic benefits in excess of its originally assessed standard of performance; and

(b) this expenditure can be reliably measured and attributed to the *asset*.

If these conditions are met, the subsequent expenditure should be added to the *cost* of the *intangible asset*.

5.11. After initial recognition, an *intangible asset* should be carried at its *cost* less any accumulated *amortization* and any accumulated *impairment losses*. If *fair value* can be determined by reference to an *active market*, revaluation is an allowed alternative treatment.

Amortization

Amortization period

5.12. The *depreciable amount* of an *intangible asset* should be allocated on a systematic basis over the best estimate of its *useful life*. There is a rebuttable presumption that the *useful life* of an *intangible asset* will not exceed 20 years from the date when the asset is available for use. *Amortization* should commence when the *asset* is available for use.

5.13. If control over the future economic benefits from an *intangible asset* is achieved through legal rights that have been granted for a finite period, the *useful life* of the *intangible asset* should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and

(b) renewal is virtually certain.

Amortization method

5.14. The amortization method used should reflect the pattern according to which the *asset's* economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortization charge for each period should be recognized as an expense unless another Guideline permits or requires it to be included in the *carrying amount* of another *asset*.

Residual value

5.15. The *residual value* of an *intangible asset* should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the *asset* at the end of its *useful life*; or

(b) there is an *active market* for the *asset* and:

(i) *residual value* can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's *useful life*.

Review of amortization period and amortization method

5.16. The amortization period and the amortization method should be reviewed at least at the end of each financial year. If the expected *useful life* of the *asset* is significantly different from previous estimates, the amortization period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the *asset*, the amortization method should be changed to reflect the changed pattern. Such changes should be accounted for as changes in accounting estimates by adjusting the amortization charge for the current and future periods.

Recoverability of the carrying amount: Impairment losses

5.17. At each balance sheet date, the entity should assess whether there is any indication that an asset may be impaired. If there is any such indication, the entity should consider whether the continued use of the asset, or group of assets forming a cash-generating unit, is likely to generate cash flows sufficient to absorb the amortization of the cost of the asset. In the event that the undiscounted future cash flows are expected to be insufficient, the carrying value should be reduced.

Retirements and disposals

5.18. An *intangible asset* should be de-recognized (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

5.19. Gains or losses arising from the retirement or disposal of an *intangible asset* should be determined as the difference between the net disposal proceeds and the *carrying amount* of the *asset* and should be recognized as income or expense in the income statement.

Disclosure

5.20. The financial statements should disclose the following for each class of *intangible assets*, distinguishing between internally generated *intangible assets* and other *intangible assets:*

(a) the useful lives or the amortization rates used;

(b) the amortization methods used;

(c) the gross carrying amount and the accumulated *amortization* (aggregated with accumulated impairment losses) at the beginning and end of the period;

(d) the line item(s) of the income statement in which the *amortization* of *intangible assets* is included; and

(e) a reconciliation of the *carrying amount* at the beginning and end of the period showing:

(i) retirements and disposals;

(ii) *impairment losses* recognized;

(iii) *impairment losses* reversed;

(iv) *amortization* recognized during the period; and

(v) additions and other changes in the *carrying amount* during the period.

Comparative information is not required.

5.21. The financial statements should also disclose:

(a) if an *intangible asset* is amortized over more than 20 years, the reasons why the presumption that the *useful life* of an *intangible asset* will not exceed 20 years from the date when the *asset* is available for use is rebutted;

(b) a description, the *carrying amount* and the remaining amortization period of any individual *intangible asset* that is material to the financial statements of the enterprise as a whole; and

(c) the existence and *carrying amounts* of *intangible asset*s whose title is restricted and the *carrying amounts* of *intangible assets* pledged as security for *liabilities*.

Guideline 6. Inventories[*]

6.1. *Inventories* should be measured at the lower of cost and *net realizable value*.

6.2. The cost of *inventories* should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the *inventories* to their present location and condition.

6.3. The cost of *inventories* of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by using specific identification of their individual costs.

6.4. The cost of *inventories*, other than those dealt with in paragraph 6.3, should be assigned by using the first-in, first-out (FIFO) or weighted average cost formulas.

Recognition as an expense

6.5. When *inventories* are sold, the carrying amount of those *inventories* should be recognized as an expense in the period in which the related *revenue* is recognized. The amount of any write-down of *inventories* to *net realizable value* and all losses of *inventories* should be recognized as an expense in the period in which the write-down or loss occurs. The amount of any reversal of any write-down of *inventories* arising from an increase in *net realizable value* should be recognized as a reduction in the amount of *inventories* recognized as an expense in the period in which the reversal occurs.

Disclosure

6.6. The financial statements should disclose:

(a) the *accounting policies* adopted in measuring *inventories*, including the cost formula used;
(b) the total carrying amount of *inventories* and the carrying amount in classifications appropriate to the enterprise; and
(c) the carrying amount of *inventories* pledged as security for *liabilities*.

6.7. The financial statements should disclose either:

(a) the cost of *inventories* recognized as an expense during the period; or
(b) the operating costs, applicable to *revenues*, recognized as an expense during the period, classified by their nature.

[*] This Guideline is based on IAS 2. See derivation table in Annex 3 for further details.

Guideline 7. Government Grants and Other Government Assistance*

7.1. *Government grants* are assistance by *government* in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the *operating activities* of the enterprise.

7.2. *Government grants*, including non-monetary grants at *fair value*, should not be recognized until there is reasonable assurance that:

(a) the enterprise will comply with the conditions attaching to them; and

(b) the grants will be received.

7.3. *Government grants* should be recognized as income over the periods necessary to match them with the related *costs* they are intended to compensate, on a systematic basis. They should not be credited directly to shareholders' interests.

7.4. In most cases, the periods over which an enterprise recognizes the costs or expenses related to a government grant are readily ascertainable, and thus grants in recognition of specific expenses are recognized as income in the same period as the relevant expense. Similarly, grants related to depreciable *assets* are usually recognized as income over the periods and in the proportions in which *depreciation* on those *assets* is charged.

7.5. A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the enterprise, with no future related costs, should be recognized as income of the period in which it becomes receivable, as an extraordinary item if appropriate.

7.6. Government *grants related to assets*, including non-monetary grants at *fair value*, should be presented on the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the *carrying amount* of the *asset*.

7.7. *Grants related to income* are sometimes presented as a credit in the income statement, either separately or under a general heading such as "Other income"; alternatively, they are deducted in reporting the related expense.

7.8. A government grant that becomes repayable should be accounted for as a revision to an accounting estimate. Repayment of a grant related to income should be applied first against any unamortized deferred credit set up in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or where no deferred credit exists, the repayment should be recognized immediately as an expense. Repayment of a grant related to an *asset* should be recorded by increasing the *carrying amount* of the *asset* or reducing the deferred income balance by the amount repayable. The cumulative additional *depreciation* that would have been recognized to date as an expense in the absence of the grant should be recognized immediately as an expense.

Government assistance

7.9. Excluded from the definition of *government grants* in paragraph 7.1 are certain forms of *government assistance* that cannot reasonably have a value placed on them and transactions that cannot be distinguished from the normal trading transactions of the enterprise.

7.10. Examples of assistance that cannot reasonably have a value placed on them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be

* This Guideline is based on IAS 20. See derivation table in Appendix 3 for further details.

distinguished from the normal trading transactions of the enterprise is a government procurement policy that is responsible for a portion of the enterprise's sales. The existence of the benefit might be unquestioned, but any attempt to segregate the trading activities from *government assistance* could well be arbitrary.

7.11. The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary so that the financial statements will not be misleading.

7.12. Loans at nil or low interest rates are a form of *government assistance*, but the benefit is not quantified by the imputation of interest.

7.13. *Government assistance* to enterprises meets the definition of *government grants* even if there are no conditions specifically relating to the *operating activities* of the enterprise other than the requirement to operate in certain regions or industry sectors. Such grants should therefore not be credited to equity.

Disclosure

7.14. The following matters should be disclosed:

(a) the accounting policy adopted for *government grants*, including the methods of presentation adopted in the financial statements;

(b) the nature and extent of *government grants* recognized in the financial statements and an indication of other forms of *government assistance* from which the enterprise has directly benefited; and

(c) unfulfilled conditions and other contingencies attaching to *government assistance* that has been recognized.

Guideline 8. Provisions*

8.1. A *provision* should be recognized when:

(a) an enterprise has a present obligation (legal or constructive) as a result of a past event, excluding those arising from executory contracts, except where these are onerous;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

Probable outflow of resources embodying economic benefits

8.2. For a *liability* to qualify for recognition, there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Guideline, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur (i.e. the probability that the event will occur is greater than the probability that it will not). Where it is not probable that a present obligation exists, an enterprise discloses a *contingent liability,* unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 8.19).

Reliable estimate of the obligation

8.3. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of *provisions*, which by their nature are more uncertain than most other balance sheet items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a *provision*.

Contingent liabilities

8.4. An enterprise should not recognize a *contingent liability.*

8.5. A *contingent liability* is disclosed, as required by paragraph 8.19, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets

8.6. An enterprise should not recognize a *contingent asset.*

8.7. *Contingent assets* are not recognized in financial statements, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a *contingent asset* and its recognition is appropriate.

8.8. A *contingent asset* is disclosed, as required by paragraph 8.20, where an inflow of economic benefits is probable.

Measurement

8.9. The amount recognized as a *provision* should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The entity should disclose whether the amount has been discounted or not.

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* This Guideline is based on IAS 37. See derivation table in Annex 3 for further details.

Risks and uncertainties

8.10. Risk describes variability of outcome. A risk adjustment may increase the amount at which a *liability* is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or *liabilities* are not understated. However, uncertainty does not justify the creation of excessive *provisions* or a deliberate overstatement of *liabilities*. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a *provision.*

8.11. The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a *provision*.

8.12. Where some or all of the expenditure required to settle a *provision* is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate *asset*. The amount recognized for the reimbursement should not exceed the amount of the *provision*. Gains from the expected disposal of *assets* should not be taken into account when measuring a *provision*.

8.13. In the income statement, the expense relating to a *provision* may be presented net of the amount recognized for a reimbursement.

8.14. *Provisions* should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the *provision* should be reversed.

8.15. A *provision* should be used only for expenditures for which the *provision* was originally recognized.

8.16. *Provisions* should not be recognized for future operating losses.

8.17. If an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a *provision*.

Disclosure

8.18. For each class of *provision*, an enterprise should disclose:

(a) the *carrying amount* at the beginning and end of the period; and

(b) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.

8.19. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of *contingent liability* at the balance sheet date a brief description of the nature of the *contingent liability* and, where practicable, an estimate of its financial effect, measured under paragraphs 8.9 and 8.10.

8.20. Where an inflow of economic benefits is probable, an enterprise should disclose a brief description of the nature of the *contingent assets* at the balance sheet date and, where practicable, an estimate of their financial effect, measured using the principles set out for *provisions* in paragraphs 8.9 and 8.10.

8.21. Where any of the information required by paragraphs 8.19 and 8.20 is not disclosed because it is not practicable to do so, that fact should be stated.

8.22. In extremely rare cases, disclosure of some or all of the information required by paragraphs 8.18 to 8.20 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the *provision*, *contingent liability* or *contingent asset*. In such cases, an enterprise need not disclose the information but should disclose the general nature of the dispute, together with the fact that, and the reason why, the information has not been disclosed.

8.23. Examples of accounting for *provisions* are given in Annex 2, part A.

Guideline 9. Revenue*

Measurement of revenue

9.1. *Revenue* should be measured at the *fair value* of the consideration received or receivable.

Sale of goods

9.2. *Revenue* from the sale of goods should be recognized when all the following conditions have been satisfied:

(a) the enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the enterprise retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(c) the amount of *revenue* can be measured reliably;

(d) it is probable that the economic benefits associated with the transaction will flow to the enterprise; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Rendering of services

9.3. When the outcome of a transaction involving the rendering of services can be estimated reliably, *revenue* associated with the transaction should be recognized by reference to the stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

(a) the amount of *revenue* can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the enterprise;

(c) the stage of completion of the transaction at the balance sheet date can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

9.4. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, *revenue* should be recognized only to the extent of the expenses recognized that are recoverable.

9.5. "Goods" include goods produced by the enterprise for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.

9.6. The rendering of services typically involves the performance by the enterprise of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Some contracts for the rendering of services are directly related to *construction contract*s – for example, those for the services of project managers and architects.

9.7. *Revenue* includes only the gross inflows of economic benefits received and receivable by the enterprise on its own account. Amounts collected on behalf of third parties, such as sales taxes, goods and services taxes and value-added taxes, are not economic benefits flowing to

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* This Guideline is based on IAS 18. See derivation table in Annex 3 for further details.

the enterprise and hence do not result in increases in equity. Therefore, they are excluded from *revenue*. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the enterprise. The amounts collected on behalf of the principal are not *revenue*. Instead, *revenue* is the amount of commission.

Interest, royalties and dividends

9.8. *Revenue* arising from the use by others of enterprise *assets* yielding interest, royalties and dividends should be recognized on the bases set out in paragraph 9.9 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the enterprise; and

(b) the amount of the *revenue* can be measured reliably.

9.9. *Revenue* should be recognized on the following bases:

(a) interest should be recognized on a time proportion basis;

(b) royalties should be recognized on an accrual basis in accordance with the substance of the relevant agreement; and

(c) dividends should be recognized when the shareholder's right to receive payment is established.

9.10. *Revenue* is recognized only when it is probable that the economic benefits associated with the transaction will flow to the enterprise. However, when uncertainty arises about the collectability of an amount already included in *revenue,* the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense rather than as an adjustment of the amount of *revenue* originally recognized. Some examples of *revenue* recognition issues are given in Annex 2, part B.

Disclosure

9.11. An enterprise should disclose:

(a) the *accounting policies* adopted for the recognition of *revenue*, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

(b) the amount of each significant category of *revenue* recognized during the period, including *revenue* arising from:

- (i) the sale of goods;
- (ii) the rendering of services;
- (iii) interest;
- (iv) royalties; and
- (v) dividends; and

(c) the amount of *revenue* arising from exchanges of goods or services included in each significant category of *revenue*.

Guideline 10. Borrowing Costs*

10.1. *Borrowing costs* may include:

(a) interest on bank overdrafts and short-term and long-term borrowings;

(b) amortization of ancillary costs incurred in connection with the arrangement of borrowings;

(c) finance charges in respect of finance leases; and

(d) *exchange differences* arising from *foreign currency* borrowings to the extent that they are regarded as an adjustment to interest costs.

Recognition

Borrowing costs: benchmark treatment

10.2. *Borrowing costs* should be recognized as an expense in the period in which they are incurred.

Borrowing costs: allowed alternative treatment

10.3. *Borrowing costs* should be recognized as an expense in the period in which they are incurred, except to the extent that they are capitalized in accordance with paragraph 10.4.

10.4. *Borrowing costs* that are directly attributable to the acquisition, construction or production of a *qualifying asset* should be capitalized as part of the cost of that *asset*. The amount of *borrowing costs* eligible for capitalization should be determined in accordance with this Guideline.

10.5. Examples of *qualifying assets* are *inventories* that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and investment properties. Other investments, and those *inventories* that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not *qualifying assets*. *Assets* that are ready for their intended use or sale when acquired also are not *qualifying assets*.

Borrowing costs eligible for capitalization

10.6. To the extent that funds are borrowed specifically for the purpose of obtaining a *qualifying asset*, the amount of *borrowing costs* eligible for capitalization on that asset should be determined as the actual *borrowing costs* incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

10.7. To the extent that funds are borrowed generally and used for the purpose of obtaining a *qualifying asset*, the amount of *borrowing costs* eligible for capitalization should be determined by applying a capitalization rate to the expenditures on that *asset*. The capitalization rate should be the weighted average of the *borrowing costs* applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a *qualifying asset*. The amount of *borrowing costs* capitalized during a period should not exceed the amount of *borrowing costs* incurred during that period.

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* This Guideline is based on IAS 23. See derivation table in Annex 3 for further details.

10.8. The capitalization of *borrowing costs* as part of the *cost* of a *qualifying asset* should commence when:

(a) expenditures for the *asset* are being incurred;

(b) *borrowing costs* are being incurred; and

(c) activities that are necessary to prepare the *asset* for its intended use or sale are in progress.

10.9. Capitalization of *borrowing costs* should be suspended during extended periods in which active development is interrupted.

10.10. Capitalization of *borrowing costs* should cease when substantially all the activities necessary to prepare the *qualifying asset* for its intended use or sale are complete.

10.11. When the construction of a *qualifying asset* is completed in parts and each part is capable of being used while construction continues on other parts, capitalization of *borrowing costs* should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

Disclosure

10.12. The financial statements should disclose:

(a) the accounting policy adopted for *borrowing costs*;

(b) the amount of *borrowing costs* capitalized during the period; and

(c) the capitalization rate used to determine the amount of *borrowing costs* eligible for capitalization.

Guideline 11. Income Taxes*

Current tax

11.1 *Current tax* for current and prior periods should, to the extent unpaid, be recognized as a *liability*. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess should be recognized as an *asset*.

11.2 The benefit relating to a *tax loss* that can be carried back to recover *current tax* of a previous period should be recognized as an *asset*.

11.3 *Current tax* liabilities (asset*s*) for the current and prior periods should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

11.4 *Deferred tax assets* and *liabilities* may be recognized if the enterprise wishes to do so.

Income statement

11.5 *Current tax* should be recognized as income or an expense and included in the net profit or loss for the period, except to the extent that the tax arises from a transaction or event that is recognized other than in the income statement.

11.6 *Current tax* should be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

Presentation

11.7 Tax assets and tax liabilities should be presented separately from other *assets* and *liabilities* in the balance sheet. *Deferred tax assets and liabilities*, if recognized, should be distinguished from *current tax* assets and liabilities.

11.8 When an enterprise makes a distinction between current and non-current assets and liabilities in its financial statements, and has decided to account for deferred taxes, it should not classify *deferred tax assets (liabilities)* as current assets (liabilities).

11.9 An enterprise should offset *current tax* assets and *current tax* liabilities if, and only if, the enterprise:

(a) has a legally enforceable right to set off the recognized amounts; and

(b) intends either to settle on a net basis or to realize the *asset* and settle the *liability* simultaneously.

11.10 The major components of *tax expense* (income) should be disclosed separately.

* This Guideline is based on IAS 12. See derivation table in Annex 3 for further details.

Guideline 12. Accounting Policies*

12.1. Management should select and apply an enterprise's *accounting policies* so that the financial statements comply with all the requirements of the SMEGA. Where there is no specific requirement, management should look in turn to the following for guidance:

(a) full IAS/IFRS;
(b) interpretations;
(c) appendices to standards;
(d) implementation guidance;
(e) the definitions, recognition criteria and measurement concepts set out in the conceptual framework; and
(f) pronouncements of other standard setters that use a similar conceptual framework to develop accounting standards; other accounting literature; and accepted industry practice, to the extent that these are consistent with items (a) to (e) above.

Management should use its judgement in developing an accounting policy resulting in information that is relevant to the needs of investors and creditors and is reliable in nature.

Where management bases its accounting policy on IAS/IFRS, it should be guided by user needs in making disclosures. In such a case the entity is not then obliged to comply with the full IAS/IFRS, and should continue to describe itself in its accounting policy note as complying with the SMEGA.

12.2. An entity should select and apply its *accounting policies* for a period consistently for similar transactions, other events and circumstances, unless the Guideline elsewhere specifically requires or permits categorization of items for which different policies may be appropriate.

12.3. A change in accounting policy should be made only if it is required by the Guideline or if it results in a more relevant and reliable presentation in the financial statements of the effects of transactions or other events on the entity's financial position, financial performance or *cash flows*.

12.4. The following are not changes in accounting policies:

(a) the adoption of an accounting policy for transactions or other events that differ in substance from those previously occurring; and
(b) the adoption of a new accounting policy for transactions or other events that did not occur previously or were immaterial.

12.5. A change in an accounting policy that is made following an amendment to the Guideline should be accounted for in accordance with the transitional provisions, if any, issued with the Guideline.

12.6. Where application of a change in the Guideline has a material effect on the current period or any prior period presented, an entity should disclose the following:

(a) the fact that the change in accounting policy is made in accordance with the change in the Guideline, with a description of those provisions;
(b) the amount of the adjustment for the current period and for each prior period presented;

* This Guideline is based on IAS 8. See derivation table in Annex 3 for further details.

(c) the amount of the adjustment relating to periods prior to those included in the comparative information; and

(d) the fact that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost and effort.

12.7. A change in an accounting policy other than one mandated under paragraph 12.5 should be applied retrospectively. The opening balance of retained earnings for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented should be adjusted, where applicable, as if the new accounting policy had always been in use.

12.8. Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When comparative information for a particular prior period is not restated, the new accounting policy should be applied to the balances of *assets* and *liabilities* as at the beginning of the next period, and a corresponding adjustment should be made to the opening balance of retained earnings for the next period.

12.9. When a change in an accounting policy has an effect on the current period or any prior period presented, or may have an affect in subsequent periods, an entity should disclose the following:

(a) the reasons for the change;

(b) the amount of the adjustment for the current period and for each prior period presented;

(c) the amount of the adjustment relating to periods prior to those presented; and

(d) that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.

Changes in accounting estimates

12.10. The effect of a change in an accounting estimate should be recognized prospectively by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

12.11. The nature and amount of a change in an accounting estimate that has an affect on the current period or is expected to have an effect in subsequent periods should be disclosed. If it is impractical to quantify that amount, this fact should be disclosed.

Errors

12.12. The amount of the correction of a fundamental error should be accounted for retrospectively. An error should be corrected by:

(a) either restating the comparative amounts for the prior periods in which the error occurred; or

(b) when the error occurred before the earliest prior period presented, restating the opening balance of retained earnings for that period, so that the financial statements are presented as if the error had never occurred.

12.13. Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When no restatement of comparative figures takes place, the opening balance of retained earnings for the next period should be restated for the cumulative effect of the error before the beginning of that period.

Disclosure

12.14. An entity should disclose:

(a) the nature of the error; and

(b) the amount of the correction for each prior period presented.

Guideline 13. Foreign Exchange Rates*

Foreign currency transactions

13.1. A foreign currency transaction should be recorded, on initial recognition in the *reporting currency*, by applying to the *foreign currency* amount the *exchange rate* between the *reporting currency* and the *foreign currency* at the date of the transaction.

13.2. At each balance sheet date:

(a) foreign currency *monetary items* should be reported using the *closing rate;*

(b) non-monetary items that are carried in terms of *historical cost* denominated in a *foreign currency* should be reported using the *exchange rate* at the date of the transaction; and

(c) non-monetary items that are carried at *fair value* denominated in a *foreign currency* should be reported using the *exchange rate* that existed when the values were determined.

13.3. *Exchange differences* arising on the settlement of *monetary items* or on reporting an enterprise's *monetary items* at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Disclosure

13.4. An enterprise should disclose the amount of *exchange differences* included in the net profit or loss for the period.

13.5. When the *reporting currency* is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the *reporting currency* should also be disclosed.

* This Guideline is based on IAS 21. See derivation table in Annex 3 for further details.

Guideline 14. Events after Balance Sheet Date*

14.1. An enterprise should adjust the amounts recognized in its financial statements to reflect adjusting *events after the balance sheet date*.

14.2. The following are examples of adjusting *events after the balance sheet date* that require an enterprise to adjust the amounts recognized in its financial statements, or to recognize items that were not previously recognized:

(a) the resolution after the balance sheet date of a court case which, because it confirms that an enterprise already had a present obligation at the balance sheet date, requires the enterprise to adjust a *provision* already recognized, or to recognize a *provision* instead of merely disclosing a *contingent liability*;

(b) the receipt of information after the balance sheet date indicating that an *asset* was impaired at the balance sheet date, or that the amount of a previously recognized *impairment loss* for that *asset* needs to be adjusted. For example:

(i) when the bankruptcy of a customer occurs after the balance sheet date, it usually confirms that a loss already existed at the balance sheet date on a trade receivable account and that the enterprise needs to adjust the carrying amount of the trade receivable account; and

(ii) the sale of *inventories* after the balance sheet date may give evidence about their *net realizable value* at the balance sheet date;

(c) the determination after the balance sheet date of the *cost* of *assets* purchased, or the proceeds from *assets* sold, before the balance sheet date;

(d) the determination after the balance sheet date of the amount of profit-sharing or bonus payments, if the enterprise had a present legal or *constructive obligation* at the balance sheet date to make such payments as a result of events before that date; and

(e) the discovery of fraud or errors indicating that the financial statements were incorrect.

14.3. An enterprise should not prepare its financial statements on a going concern basis if management determines, after the balance sheet date, either that it intends to liquidate the enterprise or to cease trading, or that it has no realistic alternative but to do so.

14.4. An enterprise should not adjust the amounts recognized in its financial statements to reflect non-adjusting *events after the balance sheet date.*

14.5. An example of a non-adjusting event after the balance sheet date is a decline in market value of investments between the balance sheet date and the date when the financial statements are authorized for issue. The fall in market value does not normally relate to the condition of the investments at the balance sheet date, but reflects circumstances that arise in the following period. Therefore, an enterprise does not adjust the amounts recognized in its financial statements for the investments. Similarly, the enterprise does not update the amounts disclosed for the investments as at the balance sheet date, although it may need to give additional disclosure under paragraph 14.7.

14.6. If an enterprise receives information after the balance sheet date about conditions that existed at the balance sheet date, the enterprise should, in light of the new information, update disclosures that relate to these conditions.

14.7. Where non-adjusting *events after the balance sheet date* are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions, an enterprise should disclose the following information for each significant category of non-adjusting event after the balance sheet date:

* This Guideline is based on IAS 10. See derivation table in Annex 3 for further details.

(a) the nature of the event; and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

14.8. The following are examples of non-adjusting *events after the balance sheet date* that may be of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions:

(a) announcing a plan to discontinue an operation, disposing of *assets* or settling *liabilities* attributable to a discontinuing operation, or entering into binding agreements to sell such *assets* or settle such *liabilities*;

(b) major purchases and disposals of *assets*, or expropriation of major *assets* by *government;*

(c) the destruction of a major production plant by a fire after the balance sheet date;

(d) abnormally large changes after the balance sheet date in asset prices or foreign *exchange rates*; and

(e) changes in tax rates or tax laws enacted or announced after the balance sheet date that have a significant effect on current and *deferred tax assets and liabilities*.

14.9. If dividends to holders of equity instruments (for example, common shares, certain preferred shares, warrants or options to purchase common shares) are proposed or declared after the balance sheet date, an enterprise should not recognize those dividends as a *liability* at the balance sheet date.

14.10. An enterprise should disclose the date when the financial statements were authorized for issue and who gave that authorization. If the enterprise's owners or others have the power to amend the financial statements after issuance, the enterprise should disclose that fact.

Guideline 15. Related-Party Disclosures*

15.1. This section deals only with those *related-party* relationships described in (a) to (d) below:

(a) enterprises that, either directly or indirectly through one or more intermediaries, are under common control with the reporting enterprise;

(b) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them *significant influence* over the enterprise, and close members of the family of any such individual;

(c) key management personnel (i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the reporting enterprise, including directors and officers of companies and close members of the families of such individuals); and

(d) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (b) or (c) or over which such a person is able to exercise *significant influence*. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

In considering each possible *related-party* relationship, attention is directed to the substance of the relationship, and not merely the legal form.

15.2. In the context of this Guideline, the following are deemed not to be related parties:

(a) two companies simply because they have a director in common, notwithstanding paragraph 15.1 above (but it is necessary to consider the possibility, and to assess the likelihood, that the director would be able to affect the policies of both companies in their mutual dealings);

(b) (i) providers of finance;

(ii) trade unions;

(iii) public utilities; and

(iv) government departments and agencies, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of an enterprise or participate in its decision-making process); and

(c) a single customer, supplier, franchisor, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence.

Disclosure

15.3. The following are examples of situations where *related-party transaction*s may lead to disclosures by a reporting enterprise in the period they affect:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of property and other *assets*;

(c) rendering or receiving of services;

(d) agency arrangements;

(e) leasing arrangements;

(f) transfer of *research* and *development;*

* This Guideline is based on IAS 24. See derivation table in Annex 3 for further details.

(g) licence agreements;

(h) finance (including loans and equity contributions in *cash* or in kind);

(i) guarantees and collaterals; and

(j) management contracts.

15.4. *Related-party* relationships where *control* exists should be disclosed irrespective of whether there have been transactions between the related parties.

15.5. If there have been transactions between related parties, the reporting enterprise should disclose the nature of the *related-party* relationships as well as the types of transactions and the elements of the transactions necessary for an understanding of the financial statements.

15.6. The elements of transactions necessary for an understanding of the financial statements would normally include:

(a) an indication of the volume of the transactions, either as an amount or as an appropriate proportion;

(b) amounts or appropriate proportions of outstanding items; and

(c) pricing policies.

15.7. Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of *related-party transactions* on the financial statements of the reporting enterprise.

Annex 1

Definitions

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.

An ***active market*** is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

An ***asset*** is a resource

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise.

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

The ***carrying amount*** is the amount at which an asset is recognized in the balance sheet after deduction of any accumulated depreciation and accumulated impairment losses thereon.

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

A ***cash-generating unit*** is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash flows from other assets or groups of assets.

The ***closing rate*** is the spot exchange rate at the balance sheet date.

A ***construction contract*** is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

A ***constructive obligation*** is an obligation that derives from an enterprise's actions where,

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A ***contingent asset*** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

A ***contingent liability*** is

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognized because

  (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

  (ii) the amount of the obligation cannot be measured with sufficient reliability.

Contingent rent is that portion of the lease payments which is not fixed in amount but is based on a factor other than the passage of time (e.g. percentage of sales, amount of usage, price indices, market rates of interest).

Control is ownership, either directly or indirectly through subsidiaries, of more than one half of the voting power of an enterprise, or a substantial interest in voting power and the power to direct, by statute or agreement, the financial and operating policies of the management of the enterprise.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition, production or construction.

Current tax is the amount of income taxes payable (recoverable) in respect of the *taxable profit (tax loss)* for a period.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of

(a) deductible temporary differences;

(b) the carry forward of unused tax losses; and

(c) the carry forward of unused tax credits.

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its ***residual value***.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Development is the application of ***research*** findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Economic life is either
- (a) the period over which an asset is expected to be economically usable by one or more users; or
- (b) the number of production or similar units expected to be obtained from the asset by one or more users.

Events after the balance sheet date are events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorized for issue. Two types of events can be identified:
- (a) those providing evidence of conditions that existed at the balance sheet date (adjusting events after the balance sheet date); and
- (b) those indicative of conditions that arose after the balance sheet date (non-adjusting events after the balance sheet date).

The ***exchange difference*** is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

The ***exchange rate*** is the ratio for exchange of two currencies.

The ***fair value*** of an asset is the amount for which an asset could be exchanged, or a liability settled, between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's-length transaction.

A ***finance lease*** is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

Foreign currency is a currency other than the reporting currency of an enterprise.

Fundamental errors are errors discovered in the current period that are of such significance that the financial statements of one or more prior periods can no longer be considered to have been reliable at the date of their issue.

Government refers to government, government agencies and similar bodies, whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an enterprise or range of enterprises qualifying under certain criteria. Government assistance for the purpose of this Guideline does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise. They exclude those forms of government assistance which cannot reasonably have a value placed on them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

Grants related to assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.

Historical cost assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or, in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

An ***impairment loss*** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

The ***inception*** of the lease is the earlier of the date of the lease agreement or the date of a commitment by the parties to the principal provisions of the lease.

An ***intangible asset*** is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

The ***interest rate implicit in the lease*** is the discount rate that, at the inception of the lease, causes the aggregate present value of

(a) the minimum lease payments; and
(b) the unguaranteed residual value to be equal to the fair value of the leased asset.

Inventories are assets

(a) held for sale in the ordinary course of business;
(b) in the process of production for such sale; or
(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

A ***lease*** is an agreement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time.

The ***lease term*** is the non-cancellable period for which the lessee has contracted to lease the asset, together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

A ***legal obligation*** is an obligation that derives from

(a) a contract (through its explicit or implicit terms);
(b) legislation; or

(c) other operation of law.

A ***liability*** is a present obligation of an enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make, excluding *contingent rent*, costs for services and taxes to be paid by and reimbursed to the lessor, together with, in the case of the lessee, any amounts guaranteed by the lessee or by a party related to the lessee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, and if, at the inception of the lease, it is reasonably certain that the option will be exercised, then the minimum lease payments comprise the minimum payments payable over the lease term and the payment required to exercise this purchase option.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

A ***non-cancellable lease*** is a lease that is cancellable only

(a) upon the occurrence of some remote contingency;

(b) with the permission of the lessor;

(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

An ***obligating event*** is an event that creates a legal or constructive obligation that results in an enterprise's having no realistic alternative to settling that obligation.

Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

An ***operating lease*** is a lease other than a finance lease.

Ordinary activities are any activities undertaken by an enterprise as part of its business and related activities in which the enterprise engages in furtherance of, incidental to, or arising from these activities.

Property, plant and equipment are tangible assets that:

(a) are held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

A ***provision*** is a liability of uncertain timing or amount.

A ***qualifying asset*** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Related party: Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

A ***related-party transaction*** is a transfer of resources or obligations between related parties, regardless of whether a price is charged.

Reporting currency is the currency used in presenting the financial statements.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Residual value is the net amount an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Significant influence is (for the purpose of SMEGA) participation in the financial and operating policy decisions of an enterprise without having control of those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors but also by, for example, participation in the policy-making process, material intercompany transactions, interchange of managerial personnel or dependence on technical information.

Tax expense (tax income) is the aggregate amount included in the determination of net profit or loss for the period in respect of current tax and deferred tax.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, on which income taxes are payable (recoverable).

Useful life is either

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.

Annex 2

Examples

These examples illustrate the application of the related Guidelines and are provided to assist in clarifying their meaning.

A. Recognition of provisions

Example 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. Based on past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event: The *obligating event* is the sale of the product with a warranty, which gives rise to a *legal obligation*.

An outflow of resources embodying economic benefits in settlement: Probable for the warranties as a whole.

Conclusion: A *provision* is recognized for the best estimate of the costs of making good under the warranty products sold before the balance sheet date.

Example 2: Legal Requirement to Fit Smoke Filters

Under new legislation, an enterprise is required to install smoke filters in its factories by 30 June 2000. The enterprise has not fitted the smoke filters.

(a) At the balance sheet date of 31 December 1999:

Present obligation as a result of a past obligating event: There is no obligation because there is no *obligating event* either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion: No *provision* is recognized for the cost of fitting the smoke filters.

(b) At the balance sheet date of 31 December 2000:

Present obligation as a result of a past obligating event: There is still no obligation for the costs of fitting smoke filters because no *obligating event* has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the *obligating event* has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement: The likelihood of incurring fines and penalties for non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion: No *provision* is recognized for the costs of fitting smoke filters. However, a *provision* is recognized for the best estimate of any fines and penalties that are more likely than not to be imposed.

Example 3: A Court Case

After a wedding in 2000, 10 people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are underway seeking damages from the enterprise, but it disputes its *liability*. Up to the date of authorization of the financial statements for the year to 31 December 2000 for issue, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year ending 31 December 2001, its lawyers advise that, because of new developments in the case, it is probable that the enterprise will be found liable.

(a) At the balance sheet date of 31 December 2000:

Present obligation as a result of a past obligating event: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion: No *provision* is recognized. The matter is disclosed as a *contingent liability* unless the probability of any outflow is regarded as remote.

(b) At the balance sheet date of 31 December 2001:

Present obligation as a result of a past obligating event: On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A *provision* is recognized for the best estimate of the amount required to settle the obligation.

Example 4: Refurbishment Costs – No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event: There is no present obligation.

Conclusion: No *provision* is recognized.

The cost of replacing the lining is not recognized because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions; even the intention to incur the expenditure depends on the company's deciding to continue operating the furnace or to replace the lining. Instead of a *provision* being recognized, the depreciation of the lining takes into account its consumption (i.e. it is depreciated over five years). The relining costs then incurred are capitalized, with the consumption of each new lining shown by depreciation over the subsequent five years.

B. Revenue recognition

The following examples illustrate the application of the SMEGA in a number of commercial situations in order to clarifying their meaning. The examples focus on particular aspects of a transaction and do not constitute comprehensive discussions of all the relevant factors that might influence the recognition of *revenue*. The examples generally assume that the amount of *revenue* can be measured reliably; that it is probable that the economic benefits will flow to the enterprise; and that the costs incurred or to be incurred can be measured reliably. The examples do not modify or override the standard.

Sale of goods

Since laws vary from country to country, the recognition criteria in this standard will be met at different times. In particular, the law may determine the point in time at which the enterprise transfers the significant risks and rewards of ownership. Therefore, the examples in this section of the appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

1. *"Bill and hold" sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing.*

   Revenue is recognized when the buyer takes title, provided:

   (a) it is probable that delivery will be made;
   (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognized;
   (c) the buyer specifically acknowledges the deferred delivery instructions; and
   (d) the usual payment terms apply.

   Revenue is not recognized when there is simply an intention to acquire or manufacture the goods in time for delivery.

2. *Goods shipped subject to conditions, including the following situations:*

   (a) *Installation and inspection.*

   Revenue is normally recognized when the buyer accepts delivery and installation and inspection are complete. However, *revenue* is recognized immediately upon the buyer's acceptance of delivery when:

   (i) the installation process is simple in nature (e.g. the installation of a factory-tested television receiver that only requires unpacking and connection of power and antennae); or

   (ii) the inspection is performed only for purposes of final determination of contract prices (e.g. for shipments of iron ore, sugar or soya beans).

   (b) *On approval when the buyer has negotiated a limited right of return.*

   If there is uncertainty about the possibility of return, *revenue* is recognized when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

   (c) *Consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller).*

   Revenue is recognized by the shipper when the goods are sold by the recipient to a third party.

   (d) *Cash on delivery sales.*

   Revenue is recognized when delivery is made and cash is received by the seller or its agent.

3. *Layaway sales, in which the goods are delivered only when the buyer makes the final payment in a series of instalments.*

   Revenue from such sales is recognized when the goods are delivered. However, when experience indicates that most such sales are consummated, *revenue* may be recognized when a significant deposit is received, provided the goods are on hand, identified and ready for delivery to the buyer.

4. *Orders in which payment (or partial payment) is received in advance of delivery for goods not presently held in inventory (e.g. the goods are still to be manufactured or will be delivered directly to the customer from a third party).*

   Revenue is recognized when the goods are delivered to the buyer.

5. *Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase by the seller of the goods.*

   The terms of the agreement need to be analyzed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence *revenue* is recognized. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to *revenue*.

6. *Sales to intermediate parties, such as distributors, dealers or others, for resale.*
   Revenue from such sales is generally recognized when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

7. *Subscriptions to publications and similar items.*
   When the items involved are of similar value in each time period, *revenue* is recognized on a straight-line basis over the period in which the items are despatched. When the items vary in value from period to period, *revenue* is recognized on the basis of the sales value of the item despatched in relation to the total estimated sales value of all items covered by the subscription.

8. *Instalment sales, under which the consideration is receivable in instalments.*
   Revenue attributable to the sales price, exclusive of interest, is recognized at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognized as *revenue* as it is earned, on a time proportion basis that takes into account the imputed rate of interest.

9. *Real estate sales.*
   Revenue is normally recognized when legal title passes to the buyer. However, in some jurisdictions the equitable interest in a property may vest in the buyer before legal title passes and, therefore, the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognize *revenue*. In either case, if the seller is obliged to perform any significant acts after the transfer of the equitable and/or legal title, *revenue* is recognized as the acts are performed. An example is a building or other facility on which construction has not been completed.

In some cases, real estate may be sold with a degree of continuing involvement by the seller such that the risks and rewards of ownership have not been transferred. Examples are sale and repurchase agreements that include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determine how the transaction is accounted for. It may be accounted for as a sale, or as a financing, a leasing or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of *revenue*.

A seller must also consider the means of payment and evidence of the buyer's commitment to complete payment. For example, when the aggregate of the payments received, including the buyer's initial down payment or continuing payments by the buyer, provide insufficient evidence of the buyer's commitment to complete payment, *revenue* is recognized only to the extent that cash is received.

Rendering of services

10. *Installation fees.*
Installation fees are recognized as *revenue* by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognized when the goods are sold.

11. *Servicing fees included in the price of the product.*
When the selling price of a product includes an identifiable amount for subsequent servicing (e.g. after sales support and product enhancement on the sale of software), that amount is deferred and recognized as *revenue* over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

12. *Advertising commissions.*
Media commissions are recognized when the related advertisement or commercial appears before the public. Production commissions are recognized by reference to the stage of completion of the project.

13. *Insurance agency commissions.*
Insurance agency commissions received or receivable that do not require the agent to render further service are recognized as *revenue* by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognized as *revenue* over the period during which the policy is in force.

14. *Admission fees.*
Revenue from artistic performances, banquets and other special events is recognized when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.

15. *Tuition fees.*
Revenue is recognized over the period of instruction.

16. *Initiation, entrance and membership fees.*
Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate

annual subscription, the fee is recognized as *revenue* when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to the purchase of goods or services at prices lower than those charged to non-members, it is recognized on a basis that reflects the timing, nature and value of the benefits provided.

17. *Franchise fees.*
Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognized as *revenue* on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate:

(a) *Supplies of equipment and other tangible assets.*
The amount, based on the *fair value* of the *assets* sold, is recognized as *revenue* when the items are delivered or title passes.

(b) *Supplies of initial and subsequent services.*
Fees for the *provision* of continuing services, whether part of the initial fee or a separate fee, are recognized as *revenue* as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognized as *revenue* as the services are rendered.

The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognized over the period during which the goods are likely to be sold to the franchisee. The balance of an initial fee is recognized as *revenue* when performance of all the initial services and other obligations required of the franchisor (e.g. assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognized as *revenue* in proportion to the number of outlets for which the initial services have been substantially completed.

If the initial fee is collectable over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognized as cash instalments are received.

(c) *Continuing franchise fees.*
Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognized as *revenue* as the services are provided or the rights used.

(d) *Agency transactions.*
Transactions may take place between the franchisor and the franchisee which, in substance, involve the franchisor's acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to *revenue*.

18. *Fees from the development of customized software.*
Fees from the development of customized software are recognized as *revenue* by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Interest, royalties and dividends

19. *Licence fees and royalties.*

Fees and royalties paid for the use of an enterprise's assets (e.g. trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognized in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement – for example, when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely such that the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further *revenues* from the box office receipts. In such cases, *revenue* is recognized at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognized only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

Annex 3

Source Material

The SMEGA for Level 2 SMEs are drawn from *International Accounting Standards and Interpretations.* The standards that have been included are (see derivation table on page 111 for more details):

SMEGA	IAS	Comments
1	1	
2	7	
3	16, 36	The SMEGA for Level 2 include impairment guidance but do not follow IAS 36 measurement rules. SIC 10 is also included.
4	17	SIC 15 is included.
5	38	
6	2	
7	20	
8	37	Discounting of provisions is not required.
9	18	
10	23	
11	12	
12	8	This version takes into account modifications proposed in the IASB exposure draft of May 2002.
13	21	
14	10	
15	24	

The SMEGA for Level 2 SMEs do not include the following standards:

11	Construction contracts
14	Segment reporting
19	Employee benefits
22	Business combinations
26	Accounting and reporting by retirement benefit plans
27	Consolidated financial statements
28	Accounting for investments in associates
29	Financial reporting in hyperinflationary economies
30	Disclosures in the financial statements of banks
31	Financial reporting of interests in joint ventures
32	Financial instruments: disclosure and presentation
33	Earnings per share
34	Interim financial reporting
35	Discontinuing operations
39	Financial instruments: recognition and measurement
40	Investment property
41	Agriculture

Derivation table

SMEGA	IAS	Remarks
1.1	1.7	
1.2	1.10	
1.3	1.11	
1.4	1.12	
1.5	1.13	Adapted and (d) excluded
1.6	1.23	
1.7	1.25	
1.8	1.27	
1.9	1.29, 1.31	
1.10	1.33	
1.11	1.38	
1.12	1.46	(b) excluded
1.13	1.49	
1.14	1.53	
1.15	1.54	
1.16	1.57	
1.17	1.60	
1.18	1.63	
1.19	1.66	
1.20	1.67	
1.21	1.74	
1.22	1.75	(d) and (f) excluded
1.23	1.88	
1.24	1.80	Exposure draft, improvements project
1.25	1.82	Same as above
1.26	1.77	
1.27	1.83	
1.28	1.85	
1.29	1.86	
1.30	1.91	
1.31	1.92	
1.32	1.97	
1.33	1.102	(c) and (d) excluded
2.1	7.10	
2.2	7.14, 7.35	Examples in 7.14 excluded
2.3	7.16	
2.4	7.17	
2.5	7.18	
2.6	7.21	
2.7	7.22	
2.8	7.43	
2.9	7.47	
2.10	7.7	
2.11	7.8	
2.12	7.48	
3.1	16.7	
3.2	16.14	
3.3	16.15	
3.4	16.17	
3.5	16.18	
3.6	16.21	
3.7	16.23	

SMEGA	IAS	Remarks
3.8	16.25	
3.9	16.27	
3.10	16.28	
3.11	16.29	
3.12	16.30	
3.13	16.31	
3.14	16.33	
3.15	16.34	
3.16	16.37	
3.17	16.38	
3.18	16.39	
3.19	16.41	
3.20	16.43	
3.21	16.45	
3.22	16.47	
3.23	16.49	
3.24	16.52	
3.25	36	Drafted by Consultative Group – based on IAS 36
3.26	16.55	
3.27	16.56	
3.28	16.60	
3.29	16.61	(a) only
3.30	16.64	(d)–(f) excluded
4.1	17.5	
4.2	17.8	
4.3	17.9	
4.4	17.12	
4.5	17.17	
4.6	17.19	
4.7	17.19	
4.8	17.23	
4.9	17.25	
4.10	SIC 15.3 and 5	Only parts of paragraphs 3 and 5 included
4.11	17.27	Only (a) included
4.12	17.49	
4.13	17.50	
4.14	17.52	
4.15	17.54	
5.1	38.19	
5.2	38.13	
5.3	38.20	
5.4	38.36	
5.5	38.42	
5.6	38.45	
5.7	38.51	
5.8	38.56	In (a) and (b) reference to other paragraphs adapted
5.9	38.59	
5.10	38.60	Last sentence excluded
5.11	38.63, 38.64	Only part of paragraph 64 included
5.12	38.79	
5.13	38.85	
5.14	38.88	
5.15	38.91	
5.16	38.94	

SMEGA	IAS	Remarks
5.17	36	Drafted by Consultative Group – based on IAS 36
5.18	38.103	
5.19	38.104	
5.20	38.107	(e) vi–viii excluded
5.21	38.111	(c) and (e) excluded
6.1	2.6	
6.2	2.7	
6.3	2.19	
6.4	2.21	
6.5	2.31	
6.6	2.34	(d)–(f) excluded
6.7	2.37	
7.1	20	Definition included (no paragraph number)
7.2	20.7	
7.3	20.12	
7.4	20.17	
7.5	20.20	
7.6	20.24	
7.7	20.29	
7.8	20.32	
7.9	20.34	
7.10	20.35	
7.11	20.36	
7.12	20.37	
7.13	SIC 10.3	Adapted reference to other paragraphs
7.14	20.39	
8.1	37.14	
8.2	37.23	
8.3	37.25	
8.4	37.27	
8.5	37.31	
8.6	37.33	
8.7	37.34	
8.8	37.36	
8.9	37.43	
8.10	37.42	
8.11	37.53	
8.12	37.54	
8.13	37.59	
8.14	37.61	
8.15	37.63	
8.16	37.66	
8.17	37.84	
8.18	37.85	
8.19	37.86	(b) and (c) excluded
8.20	37.89	
8.21	37.91	
8.22	37.92	
8.23		Reference note to examples in Annex
9.1	18.9	
9.2	18.14	
9.3	18.20	

SMEGA	IAS	Remarks
9.4	18.26	
9.5	18.3	
9.6	18.4	
9.7	18.8	
9.8	18.29	
9.9	18.30	
9.10	18.34	
9.11	18.35	
10.1	23.5	
10.2	23.7	
10.3	23.10	
10.4	23.11	
10.5	23.6	
10.6	23.15	
10.7	23.17	
10.8	23.20	
10.9	23.23	
10.10	23.25	
10.11	23.27	
10.12	23.29	
11.1	12.12	
11.2	12.13	
11.3	12.46	
11.4	12.47	Adapted
11.5	12.58	Adapted – reference to deferred tax and (b) are excluded
11.6	12.61	Adapted – reference to deferred tax excluded
11.7	12.69	
11.8	12.70	
11.9	12.71	
11.10	12.79	
12.1	8.4 and 8.6	From exposure draft – improvements project of May 2002, 8.4 adapted, 8.6, (a) excluded
12.2	8.7	Part of paragraph excluded
12.3	8.9	
12.4	8.11	Part of (b) excluded
12.5	8.12	Reference to Standard adapted
12.6	8.15	
12.7	8.20	
12.8	8.21	
12.9	8.23	
12.10	8.27	
12.11	8.29	Reference to paragraph 30 excluded
12.13	8.33	
12.14	8.35	(c) and (d) excluded
13.1	21.9	
13.2	21.11	
13.3	21.15	
13.4	21.42	(b) and (c) excluded
13.5	21.43	
14.1	10.7	
14.2	10.8	

SMEGA	IAS	Remarks
14.3	10.13	
14.4	10.9	
14.5	10.10	
14.6	10.18	
14.7	10.20	
14.8	10.21	(a), (e) and (f) excluded. In (b) reference to IAS 35 excluded.
14.9	10.11	
14.10	10.16	
15.1	24.3	
15.2	24.6	
15.3	24.19	
15.4	24.20	
15.5	24.22	
15.6	24.23	
15.7	24.24	
Annex 1	Glossary of terms	Selected terms only
Annex 2	IAS 37, Appendix C, Examples 1, 6, 11 A; IAS 18, Appendix	
Annex 3	Source material	

ACCOUNTING AND FINANCIAL REPORTING GUIDELINES FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SMEGA)

LEVEL 3 GUIDANCE

UNITED NATIONS
New York and Geneva, 2003

NOTE

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Preface

At its 17th session in July 2000, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) identified a number of obstacles that small and medium-sized enterprises (SMEs) were facing in applying accounting standards that had been issued by various standard-setting bodies, both national and international. It was agreed that a project should be undertaken to identify possible approaches that would meet the accounting and financial reporting needs of such enterprises.

ISAR has supported the International Accounting Standards Board (IASB) as the international standard setter of reference for accounting and reporting standards. The standards (IAS) issued by the IASB, however, have been created largely with the financial reporting needs of listed companies in mind. Consequently, it has often been difficult to apply them to SMEs, particularly those in developing countries and countries with economies in transition. For many businesses in these countries professional help may also be disproportionately expensive.

In order to meet the financial reporting needs of SMEs, ISAR is proposing that a three-tiered structure be adopted, as follows:

Level 1. This level would apply to listed enterprises whose securities are publicly traded and those in which there is significant public interest. These enterprises should be required to apply the accounting and financial reporting standards (IAS and IFRS) issued by the IASB.

Level 2. This level would apply to significant business enterprises that do not issue public securities and in which there is no significant public interest. ISAR has developed a single set of requirements that have been derived from the IAS issued by the IASB, but embodying only requirements for the most regularly encountered transactions. This level would still have the option to follow the full set IAS and IFRS issued by the IASB.

Level 3. This level would apply to the smallest entities that are often owner-managed and have few employees. The approach proposed is a simple accruals-based accounting, based on that set out in international accounting standards, but closely linked to cash transactions. National regulators may permit a derogation for newly formed businesses or new entrants to the formal economy to use cash accounting for a limited time.

How exactly the boundaries between the three levels should be specified is a matter that cannot be dealt with adequately without knowledge of the specific economy in which the enterprises operate. The recommendation of ISAR is that there should be a system with at least three levels, but how these levels are defined must be determined by each member State that chooses to apply this approach, taking into account the prevailing economic, legal and social circumstances, particularly the member State's enterprise structure.

The SMEGA – Level 3 that ISAR has developed are set out in the material that follows.

Introduction

1. The SMEGA for Level 3 are designed for financial statements of small enterprises that are owner-managed and have few employees. Such enterprises should generally follow a simple accruals-based accounting system that is closely linked to cash transactions.[1]

Scope

2. Level 3 enterprises typically have significant difficulties in accessing bank and trade credit. They are likely to be one-person enterprises or businesses with few employees. The SMEGA for Level 3 are intended to meet the needs of users and preparers of financial statements for these enterprises.

Components of financial statements

3. A set of financial statements for Level 3 enterprises includes the following components:

(a) an income statement;
(b) a balance sheet; and
(c) explanatory notes.

Level 3 accounting framework

4. The two financial statements – the income statement and the balance sheet – are based on a simple accruals accounting approach broadly consistent with IAS 1. The guidance requirements do not involve compliance with specific IAS but are based on the historical cost and accruals measurement approach, which is the basis of IAS. To ensure that the Level 3 financial statements are part of a coherent framework within the three levels, Level 3 guidance rules are linked with those for Level 2 and IAS.

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[1] National regulators may permit a derogation for newly formed businesses or new entrants to the formal economy to use cash accounting for a limited time.

5. Level 3 statements will normally be prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future (see paragraph 24).

The objectives of Level 3 financial statements

6. The objective of Level 3 financial statements is to provide information about the reporting enterprise's financial performance and financial position that will be useful to users in assessing the performance of the enterprise and the stewardship of the enterprise's management.

Users and their needs

7. The objective of financial statements is to help develop the business by providing useful information to users. Therefore, the statements are designed to reflect user needs. Evidence suggests that the principal users of financial statements of Level 3 enterprises are likely to be:

(a) management;
(b) lenders and other creditors;
(c) government;
(d) taxation authorities; and
(e) SME agencies.

8. The following is a summary of the likely needs of these users:

Management:

- to confirm how well or badly the enterprise has performed during the year (including the levels of income, costs and revenues);
- for applying for external financing;
- for financial management purposes (e.g. deciding what portion of profits to retain); and/or
- as a tool for succession planning and management of wealth.

Lenders and other creditors:

- to assess risk in the credit decision; and
- to monitor the performance of enterprises that have been given credit.

Government: For macro- and microeconomic planning purposes

Tax authorities: For tax assessment purposes

SME agencies*:* To assess support requests from enterprises (e.g. grant applications, training requests, subsidized business services)

Qualitative characteristics

9. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal characteristics are:

(a) *Understandability:* It is essential that information provided in financial statements be readily understandable by users.

(b) *Relevance:* To be useful, information must be relevant to the decision-making needs of users.

(c) *Reliability:* Information is considered to be reliable when it is free from material error and bias and can be depended on by users to represent faithfully that which it purports to represent.

(d) *Comparability:* Users must be able to compare the financial statements of an enterprise over time in order to identify trends in the enterprise's financial position and performance.

10. The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgemental process.

Standard setters as well as the preparers and users of financial statements should be aware of this constraint.

11. In practice, trade-offs between qualitative characteristics are often necessary. Determining the relative importance of the characteristics in different cases is a matter of professional judgement.

Elements

12. *Asset*: An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

13. *Liability*: A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

14. *Equity*: Equity is the residual interest in the assets of the enterprise after all its liabilities have been deducted.

15. *Income* encompasses both revenue and gains. It includes increases in economic benefits during the accounting period in the form of inflows or enhancements of assets as well as decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

16. *Expenses* encompass losses as well as those expenses that arise in the course of the ordinary activities of the enterprise. Expenses are decreases in economic benefits.

Recognition

17. An item that meets the definition of an element should be recognized if (a) it is probable that any future economic benefit associated with the item will flow to or from the enterprise, and (b) the item has a cost or value that can be measured with reliability.

Measurement

18. The measurement base most commonly adopted by enterprises in preparing their financial statements is historical cost.

19. In many cases, it is unlikely that Level 3 enterprises will have the resources to prepare these statements, and therefore the assumption is that the statements will be prepared by an external agency.

Level 3 enterprises and financial management

20. For day-to-day management of the enterprise, owner-managers will tend to rely heavily on cash flow information. It is widely recognized that the managing of cash is critical to the survival of a business and to managing relationships with banks and other providers of finance. It is recommended that owner-managers keep cash records that will be a source of prime entry for the financial statements. These records, whether produced manually or using a software package, will be an important component in the financial management of Level 3 enterprises.

I. Basic requirements

21. The following details the basic guidance for Level 3 enterprises. For material transactions or events not covered by this guidance, reference should be made to the appropriate requirements in the guidance for Level 2 enterprises.

22. The minimum set of primary financial statements includes the following components:

(a) A balance sheet;
(b) An income statement; and
(c) Explanatory notes.

23. Enterprises may wish to include other statements that are likely to enhance the overall transparency and quality of the enterprise's provision of information to users, for example a cash flow statement.

24. Financial statements should be prepared on a going-concern basis unless management either intends to liquidate the enterprise or cease trading, or has no realistic alternative but to do so.

25. An enterprise should prepare its financial statements using a simplified accruals basis of accounting.

26. The following information should be prominently displayed:

(a) the name of the reporting enterprise; and
(b) the balance sheet date and the period covered by the income statement.

27. Financial statements should be presented at least annually.

28. The enterprise should present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet.

29. An asset should be classified as a current asset when it:

(a) is expected to be realized in, or is held for sale or consumption in, the normal course of the enterprise's operating cycle; or
(b) is held primarily for trading purposes or for the short term and is expected to be realized within 12 months of the balance sheet date; or
(c) is cash on hand.

All other assets should be classified as non-current assets.

30. A liability should be classified as a current liability when it:

(a) is expected to be settled in the normal course of the enterprise's operating cycle; or
(b) is due to be settled within 12 months of the balance sheet date.

All other liabilities should be classified as non-current liabilities.

31. As a minimum, the face of the balance sheet should include line items that present the amounts in the formats in Annex 3.

32. Additional line items, headings and subtotals should, if relevant to the enterprise, be presented on the face of the balance sheet.

33. An enterprise should disclose the movement of owner's equity during the financial year.

34. The income statement should follow the structure and, as a minimum, use the headings shown in Annex 1.

35. An item of property, plant or equipment should initially be measured at its cost. The cost of an item of property, plant or equipment comprises its purchase price, including import duties and

non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price.

36. The depreciable amount (cost less expected proceeds from disposal) of an item of property, plant or equipment should be allocated on a systematic basis over its useful life. Straight-line depreciation is the simplest method.

37. If an item of property, plant or equipment becomes impaired, in that it is unlikely to generate cash flows to absorb the depreciable amount of the item over its useful life, its carrying value should be reduced.

38. Land normally has an unlimited life and, therefore, is not depreciated. Buildings have a limited life and, therefore, are depreciable assets.

39. The financial statements should disclose for each class of property, plant and equipment a reconciliation of the carrying amount at the beginning and end of the period showing:

- additions;
- disposals;
- depreciation; and
- other movements.

40. Lease payments, whether deriving from an operating or finance lease, and payments under hire purchase (HP) contracts should be recognized as an expense (on a cash basis, not on an accruals basis). If the payments are material, the expense should be shown under a specific lease payment heading in the formatted income statement.

41. The value of the lease should not be shown either as an asset or as a liability on the balance sheet. The same approach should be adopted for assets acquired under HP contracts.

42. Inventories should be measured at the lower of cost and net realizable value (the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale).

43. The cost of inventories should comprise all costs of purchase and other costs incurred in bringing the inventories to their present location and condition.

44. The cost of inventories should be assigned by using specific identification of the individual costs of items whenever possible. The cost of other inventories should be assigned by using the first-in, first-out (FIFO) or weighted average cost formulas.

45. Revenue should exclude taxes on goods and services but should include commissions receivable.

46. Revenue from the sale of goods should be recognized when the enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods.

47. Revenue from the rendering of services should be recognized to the extent that the service has been provided.

48. Where there is uncertainty as to the receipt of payment for a trade debt, a reasonable provision should be made against trade receivables.

49. Any significant gains or losses should be separately disclosed.

II. Model financial statements

The financial statements

50. The two statements – the income statement and the balance sheet – are based on a simple accruals accounting approach broadly consistent with IAS 1. To ensure that the Level 3 financial statements are a part of a coherent framework within the three levels, Level 3 guidance rules are linked with IAS.

The costs and benefits of the financial statements

51. The formats take into consideration the cost/benefit issues of Level 3 enterprises. In order to ensure that the statements are useful to owner-managers of typical Level 3 enterprises, the costs of preparing the statements need to be weighed against the benefits to other users and particularly the enterprise itself. For example, potential providers of external financing are likely to require the two financial statements in order to assess the risks involved in the proposed transaction.

Users and their needs

52. The objective of the proposed financial statements is to help users extract information that can be helpful in developing the business. Therefore, the design of the statements is intended to reflect users' needs.

Income statement: Annexes 1 and 2

Rationale

53. The structure of the income statement has been designed primarily to meet the needs of owner-managers. It is recognized that the income statement is used by owner-managers to see whether in their pricing they have correctly anticipated the level of costs and profit margins.

54. It is assumed that most enterprises at this level will price goods and services on a cost-plus basis. Thus, the "contribution" reflects

the difference between the sales and those costs which the mark-up is calculated on, which are described in the statement as "direct costs".

55. Direct costs will vary from enterprise to enterprise. For example, Annex 2 illustrates an income statement for a typical retail business where the mark-up is likely to be made just on purchases. Other types of enterprises may have different definitions of direct costs.

56. The cost structures of enterprises at this level are likely to be very different from those of large businesses. The reason for this is that the majority of these enterprises' costs are likely to be direct. In contrast, the majority of the costs of large businesses are indirect (i.e. related to overheads).

57. The "tax" shown in the income statement relates to the estimated tax due for the year, which relates to the profit or loss for the same year. It therefore follows that the profit after tax and owners' drawings/dividends corresponds to the amount shown under the heading "increase/decrease in owners' capital" in the balance sheet in Annex 3.

58. The headings under "indirect costs" will reflect the materiality of the costs in relation to the total indirect costs and their importance with regard to disclosure for users in general. Therefore, there is likely to be some variation among different types of enterprises.

Balance sheet – Annex 3

59. The relevance of the headings will to a certain extent depend on the nature of the enterprise, but the main structure and headings should be applicable for most enterprises at this level.

Cash flow statements

60. Historical cash flow statements have been excluded from the minimum set of financial statements at this level because there is little evidence suggesting that users at this level find such statements useful. It is, however, recognized that cash management on a daily

basis is critical to the health and survival of enterprises at this level. No prescribed format has been suggested for the keeping of cash records because of variations that may be utilized by different enterprises. For example, some record-keeping systems are paper-based and individualized, whereas others use software packages that prescribe a standard format.

Annex 1

Model income statement format (example)

XYZ Ltd.
Income statement
for the year ended 31 December 20xx

Sales Direct operating costs	
Total direct operating costs	
Contribution	
Indirect costs	
Total indirect costs	
Profit before interest and other financing costs	
Less: Interest Other financing costs	
Profit after interest and other financing costs	
Less: Tax	
Profit after tax	
Owners' drawings	
Increase/decrease in owners' capital	

Annex 2

Model income statement (example)

XYZ Ltd.
Income Statement
for the year ended 31 December 20xx
(in US$)

Sales	325 000
Direct operating costs	
Opening inventories	30 100
Purchases	195 000
	225 100
Less:	
Closing inventories	32 500
Total direct operating costs	192 600
Contribution	132 400
Indirect costs	
Salaries	34 350
Depreciation	6 500
Lease rent	15 600
Motor vehicle expenses	6 500
Insurance	1 300
Telephone	1 700
Light and heat	1 150
Total indirect costs	67 100
Profit before interest and other financing costs	65 300
Less:	
Interest and other financing costs	1 300
Profit after interest and other financing costs	64 000
Less:	
Tax	8 400
Profit after tax	55 600
Owners' drawings	45 000
Increase (decrease) in owners' capital	10 600

Annex 3

Model balance sheet (example)

XYZ Ltd
Balance Sheet
as of 31 December 20X1
(in US$)

Assets			
Non-current assets			
Property	170 000		
Less: Accumulated depreciation	40 000	130 000	
Equipment	85 000		
Less: Accumulated depreciation	25 000	60 000	
Total non-current assets			190 000
Current assets			
Materials		18 200	
Stock		34 000	
Trade receivables	28 500		
Less: Provisions	2 500	26 000	
Bank accounts		5 600	
Cash		1 200	
Total current assets			85 000
Total assets			275 000 ======
Owners' equity and liabilities			
Owners' capital		132 900	
Earnings for the year	55 600		
Less: Drawings this year	45 000		
Increase in owners capital		10 600	
Owners' capital 31 December 20X1			143 500
Non-current liabilities			
Loans		105 500	
Current liabilities			
Bank	2 500		
Taxes payable	4 600		
Trade payables	18 900		
Total current liabilities		26 000	
Total liabilities			131 500
Total owners' equity and liabilities			275 000 ======