2009

IFRS Foundation: Training Material for the *IFRS® for SMEs*

Module 8 – Notes to the Financial Statements

IFRS™

IFRS Foundation: Training Material for the *IFRS® for SMEs*

including the full text of
Section 8 *Notes to the Financial Statements*
of the International Financial Reporting Standard (IFRS)
for Small and Medium-sized Entities (SMEs)
issued by the International Accounting Standards Board on 9 July 2009

with extensive explanations, self-assessment questions and case studies

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This training material has been prepared by IFRS Foundation education staff and has not been approved by the International Accounting Standards Board (IASB).
The accounting requirements applicable to small and medium-sized entities (SMEs) are set out in the *International Financial Reporting Standard (IFRS) for SMEs*, which was issued by the IASB in July 2009.

INTRODUCTION

This module focuses on the presentation of the notes to financial statements in accordance with Section 8 *Notes to the Financial Statements* of the *IFRS for SMEs*.

Section 3 *Financial Statement Presentation* sets out general presentation requirements and Sections 4–7 specify requirements for the presentation of the financial statements. Almost all sections of the *IFRS for SMEs* specify disclosures, most of which are presented in the notes rather than in the financial statements that are the subject of Sections 4–7.

Section 10 *Accounting Policies, Estimates and Errors* specifies how to select and apply accounting policies and how to report changes in accounting policies, changes in accounting estimates and the correction of prior period errors. This section requires disclosure of the accounting policies selected and of the most sensitive estimates and other judgements made in applying the accounting policies selected.

In particular, this module introduces the learner to the notes to financial statements, guides the learner through the official text, develops the learner's understanding of the requirements through the use of examples and indicates significant judgements that are required in presenting information in the notes to the financial statements. Furthermore, the module includes questions designed to test the learner's knowledge of the requirements and a case study to develop the learner's ability to present information in the notes of the financial statements in accordance with the *IFRS for SMEs*.

Learning objectives

Upon successful completion of this module you should know the financial reporting requirements for the notes to financial statements in accordance with the *IFRS for SMEs*. Furthermore, through the completion of the case study that simulate aspects of the real world application of that knowledge, you should have enhanced your competence to present information in the notes to the financial statements in accordance with the *IFRS for SMEs*. In particular you should, in the context of the *IFRS for SMEs*:

- know the structure of the notes and the order in which they are presented
- know the requirements to present accounting policies
- understand the requirement to present information about significant judgements in applying accounting policies
- understand how to present information about key sources of estimation uncertainty.

Module 8 – Notes to the Financial Statements

IFRS for SMEs

The *IFRS for SMEs* is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* includes mandatory requirements and other material (non-mandatory) that is published with it.

The material that is not mandatory includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* and explains its purpose, structure and authority.
- implementation guidance, which includes illustrative financial statements and a disclosure checklist.
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching its conclusions in the *IFRS for SMEs*.
- the dissenting opinion of an IASB member who did not agree with the publication of the *IFRS for SMEs*.

In the *IFRS for SMEs* the Glossary is part of the mandatory requirements.

In the *IFRS for SMEs* there are appendices in Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* Those appendices are non-mandatory guidance.

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Almost all sections of the *IFRS for SMEs* specify disclosures, most of which are presented in the notes to the financial statements. Moreover, additional disclosures are required when compliance with the specific requirements in the *IFRS for SMEs* is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position, financial performance and cash flows (see paragraphs 3.2 and 8.2(c)).

Section 8 *Notes to the Financial Statements* sets out the principles underlying information that is to be presented in the notes to the financial statements and how to present it. It specifies the structure of the notes and requires disclosure of significant accounting policies selected and of the most sensitive estimates and other judgements made in applying those accounting policies.

Disclosure of the most important of these judgements enables users of financial statements to understand better how the accounting policies are applied and to make comparisons between entities regarding the basis on which managements make these judgements.

Module 8 – Notes to the Financial Statements

REQUIREMENTS AND EXAMPLES

The contents of Section 8 *Notes to the Financial Statements* of the *IFRS for SMEs* are set out below and shaded grey. Terms defined in the Glossary of the *IFRS for SMEs* are also part of the requirements. Those terms are in **bold type** the first time they appear in the text of Section 8. The notes and examples inserted by the IFRS Foundation education staff are not shaded. Other annotations inserted by the IFRS Foundation staff are presented within square brackets in ***bold italics***. The insertions made by the staff do not form part of the *IFRS for SMEs* and have not been approved by the IASB.

Scope of this section

8.1 This section sets out the principles underlying information that is to be presented in the **notes** to the financial statements and how to present it. Notes contain information in addition to that presented in the **statement of financial position**, *[Refer: Section 4]* **statement of comprehensive income** *[Refer: Section 5]*, **income statement** (if presented) *[Refer: Section 5]*, combined **statement of income and retained earnings** (if presented) *[Refer: Section 6]*, **statement of changes in equity** *[Refer: Section 6]*, and **statement of cash flows** *[Refer: Section 7]*. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for **recognition** in those statements. In addition to the requirements of this section, nearly every other section of this IFRS requires disclosures that are normally presented in the notes.

Structure of the notes

8.2 The notes shall:

(a) present information about the basis of preparation of the financial statements and the specific **accounting policies** used, in accordance with paragraphs 8.5–8.7;

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

(c) provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.

Notes

The application of the *IFRS for SMEs*, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation of the financial position, financial performance and cash flows of SMEs. Additional disclosures are necessary when compliance with the specific requirements in the *IFRS for SMEs* is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position, financial performance and cash flows (see paragraph 3.2).

Module 8 – Notes to the Financial Statements

8.3 An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item in the financial statements to any related information in the notes.

8.4 An entity normally presents the notes in the following order:

(a) a statement that the financial statements have been prepared in compliance with the *IFRS for SMEs* (see paragraph 3.3);

(b) a summary of significant accounting policies applied (see paragraph 8.5);

(c) supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and

(d) any other disclosures.

Notes

Often the first note to the financial statements (ie positioned before the statement of compliance) presents general information about the reporting entity. This note commonly includes:

(i) information about the domicile and legal form of the entity, its country of incorporation and the address of its registered office (see paragraph 3.24(a));

(ii) a description of the nature of the entity's operations and its principal activities (see paragraph 3.24(b)); and

(iii) the date when the financial statements were authorised for issue and who gave that authorisation (see paragraph 32.9).

Example – notes to the financial statements

The illustrative note disclosures presented in examples 1 and 2 are not intended to illustrate all aspects of the note disclosures required by the *IFRS for SMEs*. Most sections of the *IFRS for SMEs* establish presentation and disclosure requirements. Those requirements have been summarised in the disclosure checklist that is included in the implementation guidance that accompanies but does not form part of the *IFRS for SMEs*.

The disclosure requirements in the *IFRS for SMEs* should be regarded as minimum requirements. Additional disclosures are necessary when compliance with the specific requirements in the *IFRS for SMEs* is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance. Accordingly, an entity must include in the notes to financial statements information that is not presented elsewhere in the financial statements but is relevant to an understanding of them.

Disclosure requirements apply only to material items. If an item is immaterial no disclosure is prescribed. Materiality is discussed in paragraph 2.6.

The notes set out in this example illustrate how note disclosures might be displayed by a small entity that manufactures and sells candles. Each entity will need to consider each disclosure requirement necessary to achieve a fair presentation in that entity's particular circumstances. These illustrative note disclosures should not be regarded as a template appropriate for all entities.

Ex 1 **A group that manufactures candles prepared the notes to its financial statements as follows:**

XYZ Group
Accounting policies and explanatory notes to the financial statements
for the year ended 31 December 20X2

1. General information

XYZ (Holdings) Limited (the Company) is a limited company incorporated in A Land. The address of its registered office and principal place of business is __________. XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited. Their principal activities are the manufacture and sale of candles.

2. Basis of preparation

These consolidated financial statements have been prepared in compliance with the *International Financial Reporting Standard (IFRS®) for Small and Medium-sized Entities (SMEs)* issued by the International Accounting Standards Board. They are presented in the currency units (CU) of A Land which is the presentation currency of the group and the functional currency of the company and its subsidiary.

The presentation of financial statements in accordance with the *IFRS for SMEs* requires the determination and consistent application of accounting policies to transactions and events. The principal accounting policies of the group are set out in note 3.

In some cases applying the group's accounting policies requires the use of estimates and other judgements. The judgements that management has made in the process of applying the group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements are set out in note 4.

3. Accounting policies (see example 2)

4. Key sources of estimation uncertainty

Long-service payments

In determining the liability for long-service payments (explained in note 20), management must make an estimate of salary increases over the following five years, the discount rate for the next five years to use in the present value calculation, and the number of employees expected to leave before they receive the benefits.

5. Restriction on payment of dividend

Under the terms of the bank loan and bank overdraft agreements, dividends cannot be paid to the extent that they would reduce the balance of retained earnings below the sum of the outstanding balance of the bank loan and the bank overdraft.

6. Revenue

	20X2	*20X1*
	CU	*CU*
Sale of goods	6,743,545	5,688,653
Royalties – licensing of candle-making patents	120,000	120,000
	6,863,545	5,808,653

7. Other income

Other income includes dividends received from an associate of CU25,000 in both 20X1 and 20X2 and gain on disposal of property, plant and equipment of CU63,850 in 20X2.

8. Finance costs

	20X2	*20X1*
	CU	*CU*
Interest on bank loan and overdraft	(21,250)	(30,135)
Interest on finance leases	(5,116)	(6,577)
	(26,366)	(36,712)

9. Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2	*20X1*
	CU	*CU*
Cost of inventories recognised as expense	5,178,530	4,422,575
Research and development cost (included in other expenses)	31,620	22,778
Foreign exchange loss on trade payables (included in other expenses)	1,000	–
Warranty expense (included in cost of sales)	5,260	7,340

10. Income tax expense

	20X2	*20X1*
	CU	*CU*
Current tax	271,647	190,316
Deferred tax (note 16)	(1,397)	(757)
	270,250	189,559

Income tax is calculated at 40 per cent (20X1: 40 per cent) of the estimated assessable profit for the year.

Income tax expense for the year CU270,250 in 20X2 (CU189,559 in 20X1) differs from the amount that would result from applying the tax rate of 40 per cent (both 20X2 and 20X1) to profit before tax because, under the tax laws of A Land, some employee remuneration expenses (CU20,670 in 20X2 and CU16,750 in 20X1) that are recognised in measuring profit before tax are not tax-deductible.

11. Trade and other receivables

	20X2	20X1
	CU	CU
Trade debtors	528,788	528,384
Prepayments	56,760	45,478
	585,548	573,862

12. Inventories

	20X2	20X1
	CU	CU
Raw materials	42,601	36,450
Work in progress	1,140	900
Finished goods	13,640	10,570
	57,381	47,920

13. Investment in associate

The Group owns 35 per cent of an associate whose shares are not publicly traded.

	20X2	20X1
	CU	CU
Cost of investment in associate	107,500	107,500
Dividend received from associate (included in other income)	25,000	25,000

14. Property, plant and equipment

	Land and buildings	Fixtures and equipment	Total
	CU	CU	CU
Cost			
1 January 20X2	1,960,000	1,102,045	3,062,045
Additions	–	485,000	485,000
Disposals	–	(241,000)	(241,000)
31 December 20X2	1,960,000	1,346,045	3,306,045

Accumulated depreciation and impairment			
1 January 20X2	390,000	270,590	660,590
Annual depreciation	30,000	240,360	270,360
Impairment	–	30,000	30,000
Less accumulated depreciation on assets disposed of	–	(204,850)	(204,850)
31 December 20X2	420,000	336,100	756,100
Carrying amount			
31 December 20X2	1,540,000	1,009,945	2,549,945

During 20X2 the Group noticed a significant decline in the efficiency of a major piece of equipment and so carried out a review of its recoverable amount. The review led to the recognition of an impairment loss of CU30,000.

The carrying amount of the Group's fixtures and equipment includes an amount of CU40,000 (20X1: CU60,000) in respect of assets held under finance leases.

On 10 December 20X2 the directors resolved to dispose of a machine. The machine's carrying amount of CU1,472 is included in fixtures and equipment at 31 December 20X2, and trade payables include the Group's remaining obligation of CU1,550 on the acquisition of this machine. Because the proceeds on disposal are expected to exceed the net carrying amount of the asset and related liability, no impairment loss has been recognised.

15. Intangible assets

Software:

Cost	*CU*
1 January 20X2	8,500
Additions	–
Disposals	–
31 December 20X2	8,500
Accumulated depreciation and impairment	
1 January 20X2	5,950
Annual amortisation (included in administrative expenses)	1,700
31 December 20X2	7,650
Carrying amount	
31 December 20X2	850

16. Deferred tax

Differences between amounts recognised in the income statement and amounts reported to tax authorities in connection with investments in the subsidiary and associate are insignificant.

The deferred tax assets are the tax effects of expected future income tax benefits relating to:

(a) the long-service benefit (note 20), which will not be tax-deductible until the benefit is actually paid but has already been recognised as an expense in measuring the Group's profit for the year.

(b) the foreign exchange loss on trade payables, which will not be tax-deductible until the payables are settled but has already been recognised as an expense in measuring the Group's profit for the year.

The Group has not recognised a valuation allowance against the deferred tax assets because, on the basis of past years and future expectations, management considers it probable that taxable profits will be available against which the future income tax deductions can be utilised.

The following are the deferred tax liabilities (assets) recognised by the Group:

	Software	*Foreign exchange loss*	*Long-service benefit*	*Total*
	CU	CU	CU	CU
1 January 20X1	1,700	–	(3,855)	(2,155)
Charge (credit) to profit or loss for the year	(680)	–	(77)	(757)
1 January 20X2	1,020	–	(3,932)	(2,912)
Charge (credit) to profit or loss for the year	(680)	(400)	(317)	(1,397)
31 December 20X2	340	(400)	(4,249)	(4,309)

The deferred tax assets for the foreign exchange loss and the long-service benefits and the deferred tax liability for software relate to income tax in the same jurisdiction, and the law allows net settlement. Therefore, they have been offset in the statement of financial position as follows:

	20X2	*20X1*
	CU	*CU*
Deferred tax liability	340	1,020
Deferred tax asset	(4,649)	(3,932)
	(4,309)	(2,912)

17. Bank overdraft and loan

	20X2	20X1
	CU	CU
Bank overdraft	83,600	115,507
Bank loan—fully repayable in 20X4, prepayable without penalty	50,000	150,000
	133,600	265,507

The bank overdraft and loan are secured by a floating lien over land and buildings owned by the Group with a carrying amount of CU266,000 at 31 December 20X2 (CU412,000 at 31 December 20X1).

Interest is payable on the bank overdraft at 200 points above the London Interbank Borrowing Rate (LIBOR). Interest is payable on the seven-year bank loan at a fixed rate of 5 per cent of the principal amount.

18. Trade payables

Trade payables at 31 December 20X2 include CU42,600 denominated in foreign currencies (nil at 31 December 20X1).

19. Provision for warranty obligations

Changes in the provision for warranty obligations during 20X2 were:

	20X2
	CU
1 January 20X2	5,040
Additional accrual during the year	5,260
Cost of warranty repairs and replacement during the year	(6,100)
31 December 20X2	4,200

The obligation is classified as a current liability because the warranty is limited to twelve months after the date of sale of the relevant goods.

20. Employee benefit obligation—long-service payments

The Group's employee benefit obligation for long-service payments under a government-mandated plan is based on a comprehensive actuarial valuation as of 31 December 20X2 and is as follows:

	20X2
	CU
Obligation at 1 January 20X2	9,830
Additional accrual during the year	7,033
Benefit payments made in year	(6,240)
Obligation at 31 December 20X2	10,623

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	4,944	4,754
Non-current liability	5,679	5,076
Total	10,623	9,830

21. Obligations under finance leases

The Group holds one piece of specialised machinery with an estimated useful life of five years under a five-year finance lease. The future minimum lease payments are as follows:

	20X2	20X1
	CU	CU
Within one year	25,000	25,000
Later than one year but within five years	25,000	50,000
Later than five years	–	–
	50,000	75,000

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	21,461	19,884
Non-current liability	23,163	44,624
	44,624	64,508

22. Commitments under operating leases

The Group rents several sales offices under operating leases. The leases are for an average period of three years, with fixed rentals over the same period.

	20X2	20X1
	CU	CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100

At year-end, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:

	20X2	20X1
	CU	CU
Within one year	13,050	26,100
Later than one year but within five years	–	13,050
Later than five years	–	–
	13,050	39,150

23. Share capital

Balances as at 31 December 20X2 and 20X1 of CU30,000 comprise 30,000 ordinary shares with par value CU1.00 fully paid, issued and outstanding. An additional 70,000 shares are legally authorised but unissued.

24. Cash and cash equivalents

	20X2	20X1
	CU	CU
Cash on hand	28,700	22,075
Overdrafts	(83,600)	(115,507)
	(54,900)	(93,432)

25. Contingent liabilities

In 20X2 a customer initiated proceedings against XYZ (Trading) Limited for a fire caused by a faulty candle. The customer asserts that its total losses are CU50,000 and has initiated litigation claiming this amount.

The Group's legal counsel do not consider that the claim has merit, and the Company intends to contest it. No provision has been recognised in these financial statements as the Group's management does not consider it probable that a loss will arise.

26. Events after the end of the reporting period

On 25 January 20X3 there was a flood in one of the candle storage rooms. The cost of refurbishment is expected to be CU36,000. The reimbursements from insurance are estimated to be CU16,000.

On 14 February 20X3 the directors voted to declare a dividend of CU1.00 per share (CU30,000 total) payable on 15 April 20X3 to registered shareholders on 31 March 20X3. Because the obligation arose in 20X3, a liability is not shown in the statement of financial position at 31 December 20X2.

27. Related party transactions

Transactions between the Company and its subsidiary, which is a related party, have been eliminated in consolidation.

The Group sells goods to its associate (see note 12), which is a related party, as follows:

	Sales of goods		*Amounts owed to the Group by the related party and included in trade receivables at year-end*	
	20X2	*20X1*	*20X2*	*20X1*
	CU	CU	CU	CU
Associate	10,000	8,000	800	400

The payments under the finance lease (see note 21) are personally guaranteed by a principal shareholder of the Company. No charge has been requested for this guarantee.

The total remuneration of directors and other members of key management in 20X2 (including salaries and benefits) was CU249,918 (20X1: CU208,260).

28. Approval of financial statements

These financial statements were approved by the board of directors and authorised for issue on 10 March 20X3.

Disclosure of accounting policies

8.5 An entity shall disclose the following in the summary of significant accounting policies:

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

(b) the other accounting policies used that are relevant to an understanding of the financial statements.

Example – disclosure of accounting policies

Ex 2 **A group that manufactures candles disclosed its accounting policies as follows:**

XYZ Group
Accounting policies and explanatory notes to the financial statements
for the year ended 31 December 20X2

3. Accounting policies

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiary. All intragroup transactions, balances, income and expenses are eliminated.

Investments in associates

Investments in associates are accounted for at cost less any accumulated impairment losses.

Dividend income from investments in associates is recognised when the Group's right to receive payment has been established. It is included in other income.

Revenue recognition

Revenue from sales of goods is recognised when the goods are delivered and title has passed. Royalty revenue from licensing candle-making patents for use by others is recognised on a straight-line basis over the licence period. Revenue is measured at the fair value of the consideration received or receivable, net of discounts and sales-related taxes collected on behalf of the government of A Land.

Borrowing costs

All borrowing costs are recognised in profit or loss in the period in which they are incurred.

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases (known as temporary differences). Deferred tax liabilities are recognised for all temporary differences that are expected to increase taxable profit in the future. Deferred tax assets are recognised for all temporary differences that are expected to reduce taxable profit in the future, and any unused tax losses or unused tax credits. Deferred tax assets are measured at the highest amount that, on the basis of current or estimated future taxable profit, is more likely than not to be recovered.

The net carrying amount of deferred tax assets is reviewed at each reporting date and is adjusted to reflect the current assessment of future taxable profits. Any adjustments are recognised in profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the taxable profit (tax loss) of the periods in which management expects the deferred tax asset to be realised or the deferred tax liability to be settled, on the basis of tax rates that have been enacted or substantively enacted by the end of the reporting period.

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less their residual values over their estimated useful lives, using the straight-line method. The following annual rates are used for the depreciation of property, plant and equipment:

Buildings	2 per cent
Fixtures and equipment	10–30 per cent

If there is an indication that there has been a significant change in depreciation rate, useful life or residual value of an asset, the depreciation of that asset is revised prospectively to reflect the new expectations.

Intangible assets

Intangible assets are purchased computer software that is stated at cost less accumulated depreciation and any accumulated impairment losses. It is amortised over its estimated life of five years using the straight-line method. If there is an indication that there has been a significant change in amortisation rate, useful life or residual value of an intangible asset, the amortisation is revised prospectively to reflect the new expectations.

Impairment of assets

At each reporting date, property, plant and equipment, intangible assets, and investments in associates are reviewed to determine whether there is any indication that those assets have suffered an impairment loss. If there is an indication of possible impairment, the recoverable amount of any affected asset (or group of related assets) is estimated and compared with its carrying amount. If estimated recoverable amount is lower, the carrying amount is reduced to its estimated recoverable amount, and an impairment loss is recognised immediately in profit or loss.

Similarly, at each reporting date, inventories are assessed for impairment by comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, its carrying amount is reduced to selling price less costs to complete and sell, and an impairment loss is recognised immediately in profit or loss.

If an impairment loss subsequently reverses, the carrying amount of the asset (or group of related assets) is increased to the revised estimate of its recoverable amount (selling price less costs to complete and sell, in the case of inventories), but not in excess of the amount that would have been determined had no impairment loss been recognised for the asset (group of related assets) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership of the leased asset to the Group. All other leases are classified as operating leases.

Rights to assets held under finance leases are recognised as assets of the Group at the fair value of the leased property (or, if lower, the present value of minimum lease payments) at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are deducted in measuring profit or loss. Assets held under finance leases are included in property, plant and equipment, and depreciated and assessed for impairment losses in the same way as owned assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Inventories

Inventories are stated at the lower of cost and selling price less costs to complete and sell. Cost is calculated using the first-in, first-out (FIFO) method.

Trade and other receivables

Most sales are made on the basis of normal credit terms, and the receivables do not bear interest. Where credit is extended beyond normal credit terms, receivables are measured at amortised cost using the effective interest method. At the end of each reporting period, the carrying amounts of trade and other receivables are reviewed to determine whether there is any objective evidence that the amounts are not recoverable. If such evidence is identified, an impairment loss is recognised immediately in profit or loss.

Trade payables

Trade payables are obligations on the basis of normal credit terms and do not bear interest. Trade payables denominated in a foreign currency are translated into CU using the exchange rate at the reporting date. Foreign exchange gains or losses are included in other income or other expenses.

Bank loans and overdrafts

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Employee benefits long-service payment

The liability for employee benefit obligations relates to government-mandated long-service payments. All full-time staff, excluding directors, are covered by the programme. A payment is made of 5 per cent of salary (as determined for the twelve months before the payment) at the end of each of five years of employment. The payment is made as part of the December payroll in the fifth year. The Group does not fund this obligation in advance.

The Group’s cost and obligation to make long-service payments to employees are recognised during the employees’ periods of service. The cost and obligation are measured using the projected unit credit method, assuming a 4 per cent average annual salary increase, with employee turnover based on the Group’s recent experience, discounted using the current market yield for high quality corporate bonds.

Provision for warranty obligations

All goods sold by the Group are warranted to be free of manufacturing defects for a period of one year. Goods are repaired or replaced at the Group's option. When revenue is recognised, a provision is made for the estimated cost of the warranty obligation.

Information about judgements

8.6 An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 8.7), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Notes

In some cases applying the group's accounting policies requires the use of judgements. The disclosure explicitly excludes judgements involving estimations because these are the subject of the disclosure in paragraph 8.7.

In the process of applying the entity's accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts it recognises in the financial statements. For example, management makes judgements in determining:

- whether is more likely than not that an outflow of resources embodying economic benefits will result from a present obligation that arises from past events (this judgement determines whether a liability is recognised);
- whether a lease transfers substantially all the risks and rewards incidental to the ownership of an asset (this judgement determines whether the lease is classified as a finance lease or an operating lease, ie from the lessee's perspective it determines whether at the start of the lease the entity recognises a leased asset and a corresponding lease obligation (finance lease) or it accounts for the lease as an executory contract (operating lease, ie there is no accounting for the lease at the start of the lease);
- when an entity transfers to the buyer the significant risks and rewards of ownership of the goods sold (this judgement together with other factors determines when to recognise revenue from the sale of goods);
- whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue from the sale of goods (this judgement determines whether the entity accounts for the transaction as a sale of goods (ie derecognise the asset sold and recognise revenue from the sale of the good) or a financing transaction (ie recognise the liability to repay the lender);
- whether the substance of the relationship between the entity and a special purpose entity (SPE) indicates that the entity controls the SPE (this judgement determines whether the SPE is consolidated in the entity's consolidated financial statements); and
- whether the substance of the relationship between the entity and an investee indicates that the entity has significant influence over the investee (this judgement

determines whether the investment is accounted for as an investment in an associate).

Disclosure of the most important judgements enables users of financial statements to understand better how the accounting policies are applied and to make comparisons between entities regarding the basis on which managements make these judgements.

Significantly different accounting can result from these judgements. Consider, for example, the effects of judgements around the binary initial recognition trigger for some items. To illustrate, consider the divide between provisions and contingent liabilities in respect of a present obligation. If management judges that settlement of the obligation is as likely to result in the outflow of cash as it is likely not to result in the outflow of cash (ie the two possible outcomes are equally likely), then the entity does not recognise the liability in its statement of financial position. However, if the likelihood of the outflow increased by the smallest amount (eg the likelihood of an outflow in settlement is judged to be 50.1 per cent), a liability (provision) would be recognised at the best estimate of the amount required to settle the obligation.

Because the *IFRS for SMEs* specifies different measurements for different classifications of items, the classification of an item can have a significant effect on the accounting for that item. Consider, for example, the measurement after initial recognition of a building (whose fair value can be determined reliably on an ongoing basis) that management found difficult to classify:

- If the building is an investment property it would be measured at its fair value.
- If the building is inventory it would be measured at the lower of its cost and its estimated selling price less costs to complete and sell.
- If the building is property, plant and equipment it would be measured at its cost less accumulated depreciation (if it is not impaired) and at its cost less accumulated depreciation and accumulated impairment (if it is impaired). Consider too that the carrying amount of impaired property, plant and equipment is the greater of its value in use (an entity-specific measure determined by discounting expected future cash flows) and its fair value less costs to sell.

When the financial effects of a difficult classification judgement are significant, it is easy to understand why information about such judgements is useful.

The Significant Estimates and Other Judgements section of each module of the IFRS Foundation training material for the *IFRS for SMEs* sets out information about significant judgements that sometimes needs to be made in the process of applying an entity's accounting policies to the transactions and events that are the subject of that module.

Example – information about significant judgements

Ex 3 **The notes to the financial statements of an entity for the year ended 31 December 20X3 contain the following information about the most significant judgements made in the process of applying the entity's accounting policies:**

Note 4 Judgements and estimates that have the most significant effects

4.1 Judgements in applying accounting policies

Special purpose entities

In 20X3 the entity sponsored the formation of a special purpose entity (SPE). The SPE allows three (and only those three) independent third parties, through ownership of the SPE's shares, to invest in a diversified range of listed financial assets purchased by the SPE in the open market. The entity receives service and commission fees for creating the SPE and for its investment manager services.

The SPE is consolidated if the entity has the power to govern the financial and operating policies of the SPE. It is difficult to determine whether the entity exerts control over the SPE. Judgements about risks and rewards as well as the entity's ability to make operational decisions for the SPE were therefore made. Those judgements include assessing whether

(a) in substance, the activities of the SPE are being conducted on behalf of the company according to its specific business needs so that the entity obtains benefits from the SPE's operation;

(b) in substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or whether, by setting up an 'autopilot' mechanism, the entity has delegated these decision-making powers;

(c) in substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; or

(d) in substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

On the basis of its assessment of the facts and circumstances (including the four indicators above) management decided that the risks and rewards of the assets held by the SPE reside directly with the three investors. Accordingly the entity did not consolidate the SPE in these consolidated financial statements.

Deconsolidation

The entity owns all of the equity of an entity (entity Y). From early January 20X3 the government of the jurisdiction in which the entity operates intervened in the operating and financial policies of entity Y to the extent that management is unable to conclude that the entity controlled entity Y during 20X3. The political environment in the jurisdiction is volatile and developments could affect the accounting treatment and carrying amount of the investment in entity Y. On the basis of its assessment of the facts and circumstances management decided not to consolidate entity Y in the entity's consolidated financial statements for the year ended 31 December 20X3.

Lawsuit

The entity is defending a lawsuit brought against it by a group of people who are collectively seeking compensation for damages to their health as a result of contamination to the nearby land that they believe to be caused by waste from the entity's production process. It is doubtful whether the entity is the source of the contamination since many entities operate in the same area producing similar waste and the source of the leak is unclear. Management denies any wrongdoing and is vigorously defending the case because the entity has taken precautions to avoid such leaks. However, at this time management cannot be certain that the entity's factory has not caused the leak and the true offender will become known only after extensive testing. The entity's legal counsel expect a court ruling in about two years. On the basis of its assessment of the available evidence management decided that it is probable that the entity will successfully defend the court case and accordingly it did not recognise a liability in the entity's consolidated statement of financial position at 31 December 20X3. Information about the existence of the possible obligation is disclosed in note 25.

Lease classification

A finance lease transfers substantially all the risks and rewards incidental to ownership. All other leases are operating leases. On 1 July 20X3 the entity entered into an agreement (as lessee) with an independent third party for the use of an executive jet. After considering all the facts and circumstances it is not clear whether the lease transfers substantially all the risks and rewards incidental to ownership. However, after considering all of the fact and circumstances management judges the lease to be an operating lease and therefore the entity accounts for the lease as an executory contract. Had the lease been judged to be a finance lease, the entity would have recognised the leased asset and a corresponding lease liability in its statement of financial position and it would have apportioned lease payments between finance costs and the repayment of the liability. It would also have depreciated the leased asset over its useful life. The entity's commitment to make future non-cancellable lease payments for the use of the jet is set out in note 40.

Information about key sources of estimation uncertainty

8.7 An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature.

(b) their carrying amount as at the end of the reporting period.

Notes

Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. For example, in the absence of recently observed market prices used to measure the following assets and liabilities, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the effect of technological obsolescence of inventories, provisions subject to the future outcome of litigation in progress, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about items such as the risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. No matter how diligently an entity estimates the carrying amounts of assets and liabilities subject to significant estimation uncertainty at the end of the reporting period, the reporting of point estimates in the statement of financial position cannot provide information about the estimation uncertainties involved in measuring those assets and liabilities and the implications of those uncertainties for the period's profit or loss.

Disclosure of information about assumptions and other major sources of estimation uncertainty at the end of the reporting period enhances the relevance, reliability and understandability of the information reported in financial statements.
These assumptions and other sources of estimation uncertainty relate to estimates that

require management's most difficult, subjective or complex judgements. Therefore, disclosure in accordance with paragraph 8.7 would be made in respect of relatively few assets or liabilities (or classes of them).

The disclosure does not apply to assets and liabilities measured at fair value based on recently observed market prices. When assets and liabilities are measured at fair value on the basis of recently observed market prices, future changes in carrying amounts would not result from using estimates to measure the assets and liabilities at the end of the reporting period. Using observed market prices to measure assets or liabilities obviates the need for estimates at the end of the reporting period. The market prices properly reflect the fair values at the end of the reporting period, even though future market prices could be different. In other words, such fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period. The objective of fair value measurement is to reflect fair value at the measurement date, not to predict a future value.

Beyond specifying that, in respect of those assets and liabilities, the notes shall include details of their nature and their carrying amount as at the end of the reporting period, the *IFRS for SMEs* does not prescribe the particular form or detail of the disclosures. Circumstances differ from entity to entity, and the nature of estimation uncertainty at the end of the reporting period has many facets. Paragraph 8.7 limits the scope of the disclosures to items that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The longer the future period to which the disclosures relate, the greater the range of items that would qualify for disclosure, and the less specific are the disclosures that could be made about particular assets or liabilities. A period longer than the next financial year might obscure the most relevant information with other disclosures.

The Significant Estimates and Other Judgements section of each module of the IFRS Foundation training material for the *IFRS for SMEs* sets out information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that may have a significant risk of causing a material adjustment within the next financial year to the carrying amounts of the assets and liabilities that are the subject of that module.

Example – information about key sources of estimation uncertainty

Ex 4 **Information about the key sources of estimation uncertainty could be disclosed as follows:**

Note 4 Judgements and estimates that have the most significant effects

...

4.2 Key sources of estimation uncertainty

Management believe that the assumptions made in the preparation of the financial statements are appropriate, and that the financial statements therefore present fairly in accordance with the *IFRS for SMEs*, in all material respects, the entity's financial position and performance. However, the application of assumptions and estimates means that any selection of different assumptions would cause our reported results to differ. The information that follows under this heading, is presented solely to assist users in understanding the financial statements, and is not intended to suggest that other assumptions would be less appropriate.

Fair value of financial instruments

Financial assets and financial liabilities that are not basic financial instruments (see note 12) are carried at their fair value, with changes in fair value recorded in profit or loss. When no active market exists, or when quoted prices are not otherwise available, judgement is required in determining fair value.

In these circumstances, fair value is determined using a variety of valuation techniques including present value methods, models based on observable input parameters, and models where some of the input parameters are unobservable. Valuation models are used primarily to value derivatives transacted in the over-the-counter market, including credit derivatives and unlisted securities with embedded derivatives. All valuation models are validated before they are used, and periodically reviewed thereafter, by independent qualified financial instrument valuation experts. Wherever possible, valuations derived from models are compared with quoted prices of similar financial instruments, and with actual values when realised, in order to further validate and calibrate our models.

Our models incorporate information about the actual or estimated market prices and rates, time value, volatility, market depth and liquidity among others. When available, we use market observable prices and rates derived from market verifiable data. When such factors are not market observable, changes in assumptions could affect the reported fair value of financial instruments. The models are applied from one period to the next. However, estimating fair value inherently involves a significant degree of judgement. Management therefore establishes valuation adjustments to cover the risks associated with the estimation of unobservable input parameters and the assumptions within the models themselves. Valuation adjustments are also made to reflect such elements as aged positions, deteriorating creditworthiness (including country-specific risks), concentrations in specific types of instruments and market risk factors (interest rates, currencies etc), and market depth and liquidity. Although a significant degree of judgement is, in some cases, required in establishing fair values, management believes the fair values recorded in the statement of financial position and the changes in fair values recorded in the statement of comprehensive income are reflective of the underlying economics, based on the controls and procedural safeguards employed. Nevertheless, management have estimated the effect that a change in assumptions to reasonably possible alternatives could have on fair values where model inputs are not market observable. For all financial instruments carried at fair value which rely on assumptions for their valuation, we estimate that fair value could lie in a range from CU500,000 lower to CU500,000 higher than the fair values of CU2,000,000 (see note 12) recognised in the financial statements.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* to transactions and events often requires judgement. Information about significant judgements and key sources of estimation uncertainty is useful in assessing the entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Disclosure of the most important of these judgements enables users of financial statements to understand better how the accounting policies are applied and to make comparisons between entities regarding the basis on which managements make these judgements.

Furthermore, in accordance with paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Disclosure of information about assumptions and other major sources of estimation uncertainty at the end of the reporting period enhances the relevance, reliability and understandability of the information reported in financial statements. These assumptions and other sources of estimation uncertainty relate to estimates that require management's most difficult, subjective or complex judgements. Therefore, disclosure in accordance with paragraph 8.7 would be made in respect of relatively few assets or liabilities (or classes of them).

Other sections of the *IFRS for SMEs* require disclosure of information about particular judgements and estimation uncertainties.

Each module of the IFRS Foundation training material for the *IFRS for SMEs* includes a separate part dedicated to the significant estimates and other judgements relating to the transactions, events and account balances that are the subject of that module.

Module 8 – Notes to the Financial Statements

COMPARISON WITH FULL IFRSs

A high level overview of differences between the requirements as issued at 9 July 2009 of presenting information in the notes to the financial statements in accordance with full IFRSs (see IAS 1 *Presentation of Financial Statements*) and the *IFRS for SMEs* (see Section 8 *Notes to the Financial Statements*) includes:

- The *IFRS for SMEs* is drafted in plain language and includes significantly less guidance on how to apply the principles.
- The disclosure requirements in the *IFRS for SMEs* are substantially reduced when compared with the disclosure requirements in full IFRSs. The reasons for the reductions are of four principal types:
  - (a) Some disclosures are not included because they relate to topics covered in full IFRSs that are omitted from the *IFRS for SMEs*.
  - (b) Some disclosures are not included because they relate to recognition and measurement principles in full IFRSs that have been replaced by simplifications in the *IFRS for SMEs*.
  - (c) Some disclosures are not included because they relate to options in full IFRSs that are not included in the *IFRS for SMEs*.
  - (d) Some disclosures are not included on the basis of users' needs or cost-benefit considerations.

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for the presentation of information on the notes to the financial statements in accordance with the *IFRS for SMEs* by answering the questions below.

Once you have completed the test check your answers against those set out below this test.

Assume all amounts are material.

Mark the box next to the most correct statement.

Question 1

Notes to the financial statements:

☐ (a) contain only information required to be disclosed by the *IFRS for SMEs* that was not presented in the statement of financial position, statement of comprehensive income, statement of changes in equity or cash flow statement.

☐ (b) contain information required by Section 8 *Notes to the Financial Statements* without reference to the other sections of the *IFRS for SMEs*.

☐ (c) contain the information required to be disclosed by the *IFRS for SMEs* that was not presented in the statement of financial position, statement of comprehensive income, statement of changes in equity or statement of cash flows and additional information relevant to an understanding of the financial statements.

Question 2

The cross-reference between each line item in the financial statements and any related information disclosed in the notes to the financial statements:

☐ (a) is voluntary.

☐ (b) is mandatory.

☐ (c) depends on the industry.

Question 3

The presentation of the notes to the financial statements in a systematic manner:

☐ (a) is voluntary.

☐ (b) is mandatory.

☐ (c) is mandatory, as far as is practicable.

Question 4

An entity normally presents the notes in the following order:

☐ (a) First, a statement that the financial statements have been prepared in compliance with the *IFRS for SMEs*.

Second, a summary of significant accounting policies applied.

Third, supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented.

Last, any other disclosures.

☐ (b) First, supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented.

Second, a statement that the financial statements have been prepared in compliance with the *IFRS for SMEs*.

Third, a summary of significant accounting policies applied.

Last, any other disclosures.

☐ (c) First, supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented.

Second, a summary of significant accounting policies applied.

Third, a statement that the financial statements have been prepared in compliance with the *IFRS for SMEs*.

Last, any other disclosures.

Question 5

An entity shall disclose in the summary of significant accounting policies:

☐ (a) the measurement basis (or bases) used in preparing the financial statements.

☐ (b) all the measurement bases specified in the *IFRS for SMEs* irrespective of whether they were used by the entity in preparing its financial statements.

☐ (c) the measurement basis (or bases) used in preparing the financial statements and the accounting policies used that are relevant to an understanding of the financial statements.

☐ (d) all of the measurement bases and the accounting policy choices available to the entity (ie specified in the *IFRS for SMEs*) irrespective of whether they were used by the entity in preparing its financial statements.

Question 6

Disclosure of information about key sources of estimation uncertainty:

☐ (a) is voluntary.

☐ (b) is mandatory.

Question 7

Disclosure of information about judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements:

☐ (a) is voluntary.

☐ (b) is mandatory.

Module 8 – Notes to the Financial Statements

Answers

Q1	(c) see paragraph 8.2
Q2	(b) see paragraph 8.3
Q3	(c) see paragraph 8.3
Q4	(a) see paragraph 8.4
Q5	(c) see paragraph 8.5
Q6	(b) see paragraph 8.6
Q7	(b) see paragraph 8.7

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for the presentation of information in the notes to the financial statements in accordance with the *IFRS for SMEs* by solving the case study below.

Once you have completed the case study check your answers against those set out below this test.

Case study

XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited. Their principal activities are the manufacture and sale of candles. The consolidated annual financial statements of the XYZ Group for the year ended 31 December 20X2 have been prepared in accordance with the *IFRS for SMEs* issued by the International Accounting Standards Board.

You are required to answer each question that has been annotated to the consolidated annual financial statements of the XYZ Group for the year ended 31 December 20X2.

Note: To answer this case study you need an overall understanding of the presentation of financial statements in accordance with the *IFRS for SMEs*.

XYZ Group consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2[(a)]

	Notes	20X2	20X1
(b), (c)		CU	CU
Revenue	5	6,863,545	5,808,653
Other income	6	88,850	25,000
Changes in inventories of finished goods and work in progress[(d)]		3,310	(1,360)

(a) Could the group present two statements (ie a consolidated statement of comprehensive income and a consolidated statement of changes in equity) instead of presenting a consolidated statement of income and retained earnings?

(b) How would the presentation of the consolidated statement of income and retained earnings change if the group had a discontinued operation in the year ended 31 December 20X2?

(c) How would the presentation of the consolidated statement of income and retained earnings change if the group had a partly-owned subsidiary?

Raw material and consumables used		(4,786,699)	(4,092,185)
Employee salaries and benefits		(936,142)	(879,900)
Depreciation and amortisation expense		(272,060)	(221,247)
Impairment of property, plant and equipment		(30,000)	–
Other expenses		(249,482)	(145,102)
Finance costs	7	(26,366)	(36,712)
Profit before tax[(e)]	8	654,956	457,147
Income tax expense	9	(270,250)	(189,559)
Profit for the year		384,706	267,588
Retained earnings at start of year		2,171,353	2,003,765
Dividends		(150,000)	(100,000)
Retained earnings at end of year		2,406,059	2,171,353

XYZ Group

Consolidated statement of financial position[(f)] at 31 December 20X2[(g)]

	Notes	20X2	20X1	20X0[(h)]
ASSETS		**CU**	**CU**	**CU**
Current assets[(i, j)]				

(d) Could the group choose to present an analysis of expenses by function instead of an analysis of expenses by nature?

(e) Is the group required to disclose this line item 'Profit before tax'?

(f) Does the *IFRS for SMEs* prohibit use of the words 'balance sheet' instead of the words 'statement of financial position'?

(g) Does the *IFRS for SMEs* prohibit presentation of the statement of financial position before the statement of income and retained earnings?

(h) Does the *IFRS for SMEs* require a statement of financial position at the beginning of the earliest comparative period?

(i) Instead of presenting its current assets separately from its non-current assets, could the group choose to present its assets in order of their liquidity?

(j) When an entity presents its assets and liabilities in order of their liquidity, is that order ascending or descending?

Cash		28,700	22,075	18,478
Trade and other receivables	10	585,548	573,862	521,234
Inventories	11	57,381	47,920	45,050
		671,629	643,857	584,762
Non-current assets				
Investment in associate	12	107,500	107,500	107,500
Property, plant and equipment	13	2,549,945	2,401,455	2,186,002
Intangible assets	14	850	2,550	4,250
Deferred tax asset	15	4,309	2,912	2,155
		2,662,604	2,514,417	2,299,907
Total assets		3,334,233	3,158,274	2,884,669

XYZ Group

Consolidated statement of financial position at 31 December 20X2 continued

	Notes	20X2	20X1	20X0
LIABILITIES AND EQUITY		CU	CU	CU
Current liabilities[(k)]				
Bank overdraft	16	83,600	115,507	20,435
Trade payables	17	431,480	420,520	412,690
Interest payable	7	2,000	1,200	-
Current tax liability		271,647	190,316	173,211
Provision for warranty obligations	18	4,200	5,040	2,000
Current portion of employee benefit obligations	19	4,944	4,754	4,571
Current portion of obligations under finance leases	20	21,461	19,884	18,423
		819,332	757,221	631,330
Non-current liabilities				
Bank loan	16	50,000	150,000	150,000
Long-term employee benefit obligations	19	5,679	5,076	5,066
Obligations under finance leases	20	23,163	44,624	64,508
		78,842	199,700	219,574
Total liabilities		898,174	956,921	850,904

(k) Instead of presenting its current liabilities separately from its non-current liabilities, could the group choose to present its liabilities in order of their liquidity?

XYZ Group

Consolidated statement of financial position at 31 December 20X2 continued

	Notes	20X2	20X1	20X0
Equity		**CU**	**CU**	**CU**
Share capital	22	30,000	30,000	30,000
Retained earnings	4	2,406,059	2,171,353	2,003,765
		2,436,059	2,201,353	2,033,765
Total liabilities and equity		3,334,233	3,158,274	2,884,669

XYZ Group

Consolidated statement of cash flows for the year ended 31 December 20X2

	Notes	**20X2**	**20X1**
		CU	**CU**
Cash flows from operating activities			
Profit for the year		384,706	267,588
Adjustments for non-cash income and expenses:			
Non-cash finance costs (i)		800	1,200
Non-cash income tax expense (ii)		79,934	16,348
Depreciation of property, plant and equipment		270,360	219,547
Impairment loss		30,000	–
Amortisation of intangibles		1,700	1,700
Cash flow included in investing activities:(l)			
Gain on sale of equipment		(63,850)	–
Changes in operating assets and liabilities:			
Decrease (increase) in trade and other receivables		(11,686)	(52,628)
Decrease (increase) in inventories		(9,461)	(2,870)
Increase (decrease) in trade payables (iii)		10,120	10,870
Increase in current and long-term employee benefit payable		793	193
Net cash from operating activities		693,416	461,948

(l) Does the *IFRS for SMEs* require the group to present this sub-heading?

XYZ Group

Consolidated statement of cash flows for the year ended 31 December 20X2 continued

	Notes	20X2	20X1
		CU	CU
Cash flows from investing activities			
Proceeds from sale of equipment		100,000	–
Purchases of equipment		(485,000)	(435,000)
Net cash used in investing activities		(385,000)	(435,000)
Cash flows from financing activities			
Payment of finance lease liabilities		(19,884)	(18,423)
Repayment of borrowings		(100,000)	–
Dividends paid		(150,000)	(100,000)
Net cash used in financing activities		(269,884)	(118,423)
Net increase (decrease) in cash and cash equivalents		38,532	(91,475)
Cash and cash equivalents at beginning of year		(93,432)	(1,957)
Cash and cash equivalents at end of year	23	(54,900)	(93,432)

(i) Finance costs paid in cash[(m)]	25,566	35,512
(ii) Income taxes paid in cash[(n)]	190,316	173,211
(iii) Includes unrealised foreign exchange loss	1,000	–

(m) Does the *IFRS for SMEs* require the group to separately disclose the amount of finance costs paid in cash?

(n) Does the *IFRS for SMEs* require the group to separately disclose the amount of income taxes paid in cash?

XYZ Group
Accounting policies and explanatory notes to the financial statements for the year ended 31 December 20X2

1. General information

XYZ (Holdings) Limited (the Company) is a limited company incorporated in A Land. The address of its registered office and principal place of business is _________. XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited. Their principal activities are the manufacture and sale of candles.

2. Basis of preparation and accounting policies

These consolidated financial statements have been prepared in accordance with the *International Financial Reporting Standard for Small and Medium-sized Entities* issued by the International Accounting Standards Board. They are presented in the currency units (CU) of A Land.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiary. All intragroup transactions, balances, income and expenses are eliminated.

Investments in associates[(o)]

Investments in associates are accounted for at cost less any accumulated impairment losses.

Dividend income from investments in associates is recognised when the Group's right to receive payment has been established. It is included in other income.

Revenue recognition

Revenue from sales of goods is recognised when the goods are delivered and title has passed. Royalty revenue from licensing candle-making patents for use by others is recognised on a straight-line basis over the licence period. Revenue is measured at the fair value of the consideration received or receivable, net of discounts and sales-related taxes collected on behalf of the government of A Land.

Borrowing costs[(p)]

All borrowing costs are recognised in profit or loss in the period in which they are incurred.

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases (known as temporary differences). Deferred tax liabilities are recognised for all temporary differences that are expected to increase taxable profit in the future. Deferred tax assets are

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[(o)] What other measurement bases, if any, could the group adopt as its accounting policy for investments in associates?

[(p)] Could the group change its accounting policy for borrowing costs so that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset (ie can the group account for borrowing costs in accordance with IAS 23 *Borrowing Costs* of full IFRSs).

recognised for all temporary differences that are expected to reduce taxable profit in the future, and any unused tax losses or unused tax credits. Deferred tax assets are measured at the highest amount that, on the basis of current or estimated future taxable profit, is more likely than not to be recovered.

The net carrying amount of deferred tax assets is reviewed at each reporting date and is adjusted to reflect the current assessment of future taxable profits. Any adjustments are recognised in profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the taxable profit (tax loss) of the periods in which it expects the deferred tax asset to be realised or the deferred tax liability to be settled, on the basis of tax rates that have been enacted or substantively enacted by the end of the reporting period.

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less their residual values over their estimated useful lives, using the straight-line method. The following annual rates are used for the depreciation of property, plant and equipment:

Buildings	2 per cent
Fixtures and equipment	10–30 per cent

If there is an indication that there has been a significant change in depreciation rate, useful life or residual value of an asset, the depreciation of that asset is revised prospectively to reflect the new expectations.

Intangible assets[q]

Intangible assets are purchased computer software that is stated at cost less accumulated depreciation and any accumulated impairment losses. It is amortised over its estimated life of five years using the straight-line method. If there is an indication that there has been a significant change in amortisation rate, useful life or residual value of an intangible asset, the amortisation is revised prospectively to reflect the new expectations.

Impairment of assets

At each reporting date, property, plant and equipment, intangible assets, and investments in associates are reviewed to determine whether there is any indication that those assets have suffered an impairment loss. If there is an indication of possible impairment, the recoverable amount of any affected asset (or group of related assets) is estimated and compared with its carrying amount. If estimated recoverable amount is lower, the carrying amount is reduced to its estimated recoverable amount, and an impairment loss is recognised immediately in profit or loss.

Similarly, at each reporting date, inventories are assessed for impairment by comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, its carrying amount is reduced to selling price less costs to complete and sell, and an impairment loss is recognised immediately in profit or loss.

If an impairment loss subsequently reverses, the carrying amount of the asset (or group of related assets) is increased to the revised estimate of its recoverable amount (selling price less costs to complete and sell, in the case of inventories), but not in excess of the amount that would have been determined had no impairment loss been recognised for the asset (group of related assets) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

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[q] If the group had purchased a trade mark the useful life of which management considers to be indefinite, would the group account for the trade mark at cost less accumulated depreciation and any accumulated impairment losses?

Leases[r]

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership of the leased asset to the Group. All other leases are classified as operating leases.

Rights to assets held under finance leases are recognised as assets of the Group at the fair value of the leased property (or, if lower, the present value of minimum lease payments) at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are deducted in measuring profit or loss. Assets held under finance leases are included in property, plant and equipment, and depreciated and assessed for impairment losses in the same way as owned assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Inventories

Inventories are stated at the lower of cost and selling price less costs to complete and sell. Cost is calculated using the first-in, first-out (FIFO) method.

Trade and other receivables

Most sales are made on the basis of normal credit terms, and the receivables do not bear interest. Where credit is extended beyond normal credit terms, receivables are measured at amortised cost using the effective interest method. At the end of each reporting period, the carrying amounts of trade and other receivables are reviewed to determine whether there is any objective evidence that the amounts are not recoverable. If so, an impairment loss is recognised immediately in profit or loss.

Trade payables

Trade payables are obligations on the basis of normal credit terms and do not bear interest. Trade payables denominated in a foreign currency are translated into CU using the exchange rate at the reporting date. Foreign exchange gains or losses are included in other income or other expenses.

Bank loans and overdrafts

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Employee benefits—long-service payment

The liability for employee benefit obligations relates to government-mandated long-service payments. All full-time staff, excluding directors, are covered by the programme. A payment of 5 per cent of salary (as determined for the twelve months before the payment) is made at the end of each of five years of employment. The payment is made as part of the December payroll in the fifth year. The Group does not fund this obligation in advance.

The Group's cost and obligation to make long-service payments to employees are recognised during the employees' periods of service. The cost and obligation are measured using the projected unit credit method[s], assuming a 4 per cent average annual salary increase, with employee turnover based on the Group's recent experience, discounted using the current market yield for high quality corporate bonds.

(r) What additional information, if any, would the group disclose in its 20X2 financial statements if management had found it difficult to classify (ie as an operating lease or a finance lease) a significant non-cancellable lease that the group entered into (as a lessee) in 20X2?

(s) In what circumstances could the group not use the projected unit credit method to measure its defined benefit obligation?

Provision for warranty obligations

All goods sold by the Group are warranted to be free of manufacturing defects for a period of one year. Goods are repaired or replaced at the Group's option. When revenue is recognised, a provision is made for the estimated cost of the warranty obligation.

3. Key sources of estimation uncertainty

Long-service payments

In determining the liability for long-service payments (explained in notes 2 and 19), management must make an estimate of salary increases over the following five years, the discount rate for the next five years to use in the present value calculation, and the number of employees expected to leave before they receive the benefits.

4. Restriction on payment of dividend

Under the terms of the bank loan and bank overdraft agreements, dividends cannot be paid to the extent that they would reduce the balance of retained earnings below the sum of the outstanding balance of the bank loan and the bank overdraft.

5. Revenue

	20X2	20X1
	CU	CU
Sale of goods	6,743,545	5,688,653
Royalties – licensing of candle-making patents	120,000	120,000
	6,863,545	5,808,653

6. Other income

Other income includes dividends received from an associate of CU25,000 in both 20X1 and 20X2 and a gain on disposal of property, plant and equipment[t] of CU63,850 in 20X2.

[t] Could the group present this amount as a separate line item in the consolidated statement of income and retained earnings described as 'Extraordinary item'?

7. Finance costs

	20X2	20X1
	CU	CU
Interest on bank loan and overdraft	(21,250)	(30,135)
Interest on finance leases	(5,116)	(6,577)
	(26,366)	(36,712)

8. Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2	20X1
	CU	CU
Cost of inventories recognised as expense	5,178,530	4,422,575
Research and development cost (included in other expenses)	31,620	22,778
Foreign exchange loss on trade payables (included in other expenses)	1,000	–
Warranty expense (included in raw materials and consumables used)	5,260	7,340

9. Income tax expense

	20X2	20X1
	CU	CU
Current tax	271,647	190,316
Deferred tax (note 15)	(1,397)	(757)
	270,250	189,559

Income tax is calculated at 40 per cent (20X1: 40 per cent) of the estimated assessable profit for the year.

Income tax expense for the year CU270,250 in 20X2 (CU189,559 in 20X1) differs from the amount that would result from applying the tax rate of 40 per cent (both 20X2 and 20X1) to profit before tax because, under the tax laws of A Land, some employee remuneration expenses (CU20,670 in 20X2 and CU16,750 in 20X1) that are recognised in measuring profit before tax are not tax-deductible.

10. Trade and other receivables[u]

	20X2	20X1
	CU	CU
Trade debtors	528,788	528,384
Prepayments	56,760	45,478
	585,548	573,862

11. Inventories[v]

	20X2	20X1
	CU	CU
Raw materials	42,601	36,450
Work in progress	1,140	900
Finished goods	13,640	10,570
	57,381	47,920

12. Investment in associate

The Group owns 35 per cent of an associate whose shares are not publicly traded.

	20X2	20X1
	CU	CU
Cost of investment in associate	107,500	107,500
Dividend received from associate (included in other income)	25,000	25,000

(u) Instead of presenting trade debtors and prepayments in the notes could the group have presented them as separate line items in the statement of financial position?

(v) Instead of presenting raw materials, work in progress and finished goods in the notes could the group have presented them as separate line items in the statement of financial position?

13. Property, plant and equipment[w]

	Land and buildings	Fixtures and equipment	Total
	CU	CU	CU
Cost			
1 January 20X2	1,960,000	1,102,045	3,062,045
Additions	–	485,000	485,000
Disposals	–	(241,000)	(241,000)
31 December 20X2	1,960,000	1,346,045	3,306,045
Accumulated depreciation and impairment			
1 January 20X2	390,000	270,590	660,590
Annual depreciation	30,000	240,360	270,360
Impairment	–	30,000	30,000
Less accumulated depreciation on assets disposed of	–	(204,850)	(204,850)
31 December 20X2	420,000	336,100	756,100
Carrying amount			
31 December 20X2	1,540,000	1,009,945	2,549,945

During 20X2 the Group noticed a significant decline in the efficiency of a major piece of equipment and so carried out a review of its recoverable amount. The review led to the recognition of an impairment loss of CU30,000.

The carrying amount of the Group's fixtures and equipment includes an amount of CU40,000 (20X1: CU60,000) in respect of assets held under finance leases.

On 10 December 20X2 the directors resolved to dispose of a machine. The machine's carrying amount of CU1,472 is included in fixtures and equipment at 31 December 20X2, and trade payables includes the Group's remaining obligation of CU1,550 on the acquisition of this machine. Because the proceeds on disposal are expected to exceed the net carrying amount of the asset and related liability, no impairment loss has been recognised.

[w] Is it acceptable that the group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?

14. Intangible assets[x]

Software:

Cost	**CU**
1 January 20X2	8,500
Additions	–
Disposals	–
31 December 20X2	8,500
Accumulated depreciation and impairment	
1 January 20X2	5,950
Annual amortisation (included in included in depreciation and amortisation expense')	1,700
31 December 20X2	7,650
Carrying amount	
31 December 20X2	850

15. Deferred tax

Differences between amounts recognised in the income statement and amounts reported to tax authorities in connection with investments in the subsidiary and associate are insignificant.

The deferred tax assets are the tax effects of expected future income tax benefits relating to:

(a) the long-service benefit (note 19), which will not be tax-deductible until the benefit is actually paid but has already been recognised as an expense in measuring the Group's profit for the year.

(b) the foreign exchange loss on trade payables, which will not be tax-deductible until the payables are settled but has already been recognised as an expense in measuring the Group's profit for the year.

The Group has not recognised a valuation allowance against the deferred tax assets because, on the basis of past years and future expectations, management considers it probable that taxable profits will be available against which the future income tax deductions can be utilised.

The following are the deferred tax liabilities (assets) recognised by the Group:

[x] Is it acceptable that the group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?

	Software	Foreign exchange loss	Long-service benefit	Total
	CU	CU	CU	CU
1 January 20X1	1,700	–	(3,855)	(2,155)
Charge (credit) to profit or loss for the year	(680)	–	(77)	(757)
1 January 20X2	1,020	–	(3,932)	(2,912)
Charge (credit) to profit or loss for the year	(680)	(400)	(317)	(1,397)
31 December 20X2	340	(400)	(4,249)	(4,309)

The deferred tax assets for the foreign exchange loss and the long-service benefits and the deferred tax liability for software relate to income tax in the same jurisdiction, and the law allows net settlement. Therefore, they have been offset in the statement of financial position as follows:

	20X2	20X1
	CU	CU
Deferred tax liability[(y)]	340	1,020
Deferred tax asset	(4,649)	(3,932)
	(4,309)[(z)]	(2,912)

(y) Is it permissible to offset deferred tax liabilities and deferred tax assets and to present the net deferred tax asset in the statement of financial position?

(z) If a material amount of the deferred tax asset is expected to be received in cash in 20X3, can the group present the amount to be received in 20X3 as a current asset in its statement of financial position at 31 December 20X2?

16. Bank overdraft and loan

	20X2	20X1
	CU	CU
Bank overdraft	83,600	115,507
Bank loan—fully repayable in 20X4, prepayable without penalty	50,000	150,000
	133,600[(aa)]	265,507

The bank overdraft and loan are secured by a floating lien over land and buildings owned by the Group with a carrying amount of CU266,000 at 31 December 20X2 (CU412,000 at 31 December 20X1).

Interest is payable on the bank overdraft at 200 points above the London Interbank Borrowing Rate (LIBOR). Interest is payable on the seven-year bank loan at a fixed rate of 5 per cent of the principal amount.

17. Trade payables

Trade payables at 31 December 20X2 include CU42,600 denominated in foreign currencies (nil at 31 December 20X1).

18. Provision for warranty obligations[(bb)]

Changes in the provision for warranty obligations during 20X2 were:[(cc)]

	20X2
	CU
1 January 20X2	5,040
Additional accrual during the year	5,260
Cost of warranty repairs and replacement during the year	(6,100)
31 December 20X2	4,200

The obligation is classified as a current liability because the warranty is limited to twelve months.

(aa) Instead of presenting its cash (current asset) separately from its bank overdraft (current liability), could the group choose to present the net amount (eg 20X2: CU54,900) as a current liability 'cash and cash equivalents' in its statement of financial position (as presented in the statement of cash flows)?

(bb) Is it acceptable that the group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?

(cc) If the warranty was for a longer period (eg three years) what additional line item, if any, would you expect to see in the disclosure about the changes in the provision for the period?

19. Employee benefit obligation—long-service payments[dd]

The Group's employee benefit obligation for long-service payments under a government-mandated plan is based on a comprehensive actuarial valuation as of 31 December 20X2 and is as follows:

	20X2
	CU
Obligation at 1 January 20X2	9,830
Additional accrual during the year	7,033
Benefit payments made in year	(6,240)
Obligation at 31 December 20X2	10,623

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	4,944	4,754
Non-current liability	5,679	5,076
Total	10,623	9,830

20. Obligations under finance leases

The Group holds one piece of specialised machinery with an estimated useful life of five years under a five-year finance lease. The future minimum lease payments are as follows:

	20X2	20X1
	CU	CU
Within one year	25,000	25,000
Later than one year but within five years	25,000	50,000
Later than five years	–	–
	50,000	75,000

(dd) Is it acceptable that the group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	21,461	19,884
Non-current liability	23,163	44,624
	44,624	64,508

21. Commitments under operating leases

The Group rents several sales offices under operating leases. The leases are for an average period of three years, with fixed rentals over the same period.

	20X2	20X1
	CU	CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100

At year-end, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:

	20X2	20X1
	CU	CU
Within one year	13,050	26,100
Later than one year but within five years	–	13,050
Later than five years	–	–
	13,050	39,150

22. Share capital

Balances as at 31 December 20X2 and 20X1 of CU30,000 comprise 30,000 ordinary shares with par value CU1.00 fully paid, issued and outstanding. An additional 70,000 shares are legally authorised but unissued.

23. Cash and cash equivalents

	20X2	20X1
	CU	CU
Cash on hand	28,700	22,075
Overdrafts	(83,600)	(115,507)
	(54,900)	(93,432)

24. Contingent liabilities

During 20X2 a customer initiated proceedings against XYZ (Trading) Limited for a fire caused by a faulty candle. The customer asserts that its total losses are CU50,000 and has initiated litigation claiming this amount.

The Group's legal counsel do not consider that the claim has merit, and the Company intends to contest it. No provision has been recognised in these financial statements as the Group's management does not consider it probable that a loss will arise.

25. Events after the end of the reporting period

On 25 January 20X3 there was a flood in one of the candle storage rooms. The cost of refurbishment is expected to be CU36,000. The reimbursements from insurance are estimated to be CU16,000.

On 14 February 20X3 the directors voted to declare a dividend of CU1.00 per share (CU30,000 total) payable on 15 April 20X3 to registered shareholders on 31 March 20X3. Because the obligation arose in 20X3, a liability is not shown in the statement of financial position at 31 December 20X2.

26. Related party transactions

Transactions between the Company and its subsidiary, which is a related party, have been eliminated in consolidation.

The Group sells goods to its associate (see note 12), which is a related party, as follows:

	Sales of goods		Amounts owed to the Group by the related party and included in trade receivables at year-end	
	20X2	20X1	20X2	20X1
	CU	CU	CU	CU
Associate	10,000	8,000	800	400

The payments under the finance lease (see note 20) are personally guaranteed by a principal shareholder of the Company. No charge has been requested for this guarantee.

The total remuneration of directors and other members of key management in 20X2 (including salaries and benefits) was CU249,918 (20X1: CU208,260).

27. Approval of financial statements

These financial statements were approved by the board of directors and authorised for issue on 10 March 20X3.

Answer to case study

(a) **Could the XYZ Group present two statements (ie a consolidated statement of comprehensive income and a consolidated statement of changes in equity) instead of presenting a consolidated statement of income and retained earnings?**

Yes, the group could present two statements (ie a consolidated statement of comprehensive income and a consolidated statement of changes in equity) instead of presenting a consolidated statement of income and retained earnings (see paragraphs 3.17 and 3.18).

(b) **How would the presentation of the consolidated statement of income and retained earnings change if the XYZ Group had a discontinued operation in the year ended 31 December 20X2?**

The group would present a separate line item in its statement of income and retained earnings disclosing a single amount comprising the total of (i) the post-tax profit or loss of a discontinued operation and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the net assets constituting the discontinued operation (see paragraph 5.5(e)). The line item would be presented above the profit for the year and separate from profit for the year from continuing operations.

(c) **How would the presentation of the consolidated statement of income and retained earnings change if the XYZ Group had a partly-owned subsidiary?**

In accordance with paragraph 5.6 the group would disclose separately in the statement of income and retained earnings allocations for the period of profit or loss for the period attributable to:

(i) non-controlling interest.

(ii) owners of the parent.

(d) **Could the XYZ Group choose to present an analysis of expenses by function instead of an analysis of expenses by nature?**

The group is required to present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses within the group, whichever provides information that is reliable and more relevant (see paragraph 5.11).

In accordance with paragraph 3.11(a) the group cannot voluntarily change the presentation and classification of items in the financial statements from one period to the next unless it is apparent, following a significant change in the nature of the group's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Section 10 *Accounting Policies, Estimates and Errors*.

Therefore, only if it is apparent, following a significant change in the nature of the group's operations or a review of its financial statements, that the presentation of an analysis of expenses by function would provide information that is reliable and more relevant than the analysis by nature could the group change its presentation policy.

(e) Is the group required to disclose this line item 'Profit before tax'?

Paragraph 5.5 does not require presentation of a separate line item 'Profit before tax'. However, in accordance with paragraph 5.9 an entity shall present additional line items, headings and subtotals in the statement of comprehensive income (and in the income statement, if presented), when such presentation is relevant to an understanding of the entity's financial performance. That requirement applies equally to the group's consolidated statement of income and retained earnings (see paragraph 6.5). Accordingly management must apply its judgement to determine whether or not to present a separate line item 'Profit before tax'.

(f) Does the *IFRS for SMEs* prohibit use of the words 'balance sheet' instead of the words 'statement of financial position'?

No, the *IFRS for SMEs* does not prohibit use of the title 'balance sheet' for the statement of financial position. Paragraph 3.22 explicitly permits use of titles for the financial statements other than those used in the *IFRS for SMEs* provided that they are not misleading. Because 'balance sheet' is widely used in some jurisdictions to describe the statement of financial position use of that title is unlikely to be misleading.

(g) Does the *IFRS for SMEs* prohibit presentation of the statement of financial position before the statement of income and retained earnings?

No, the *IFRS for SMEs* does not prohibit presentation of the statement of financial position before the statement of income and retained earnings. Paragraph 3.21 requires that the entity present each financial statement with equal prominence.

(h) Does the *IFRS for SMEs* require a statement of financial position at the beginning of the earliest comparative period?

No, the *IFRS for SMEs* does not require a statement of financial position at the beginning of the earliest comparative period. Paragraph 3.14 requires comparative information only in respect of the previous comparable period.

(i) Instead of presenting its current assets separately from its non-current assets, could the XYZ Group choose to present its assets in order of their liquidity?

Except when a presentation based on liquidity provides information that is reliable and more relevant, an entity is required to present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position (see paragraph 4.4). When that exception applies, all assets and liabilities shall be presented in order of approximate liquidity (ascending or descending).

In accordance with paragraph 3.11(a) an entity cannot voluntarily change the presentation and classification of items in the financial statements from one period to the next unless it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Section 10 *Accounting Policies, Estimates and Errors*.

Therefore, only if it is apparent, following a significant change in the nature of the group's operations or a review of its financial statements, that a presentation based on liquidity provides information that is reliable and more relevant than a presentation of current and non-current assets could the group change its presentation policy.

(j) **When an entity presents its assets and liabilities in order of their liquidity, is that order ascending or descending?**

In accordance with paragraph 4.4, when an entity presents its assets and liabilities in order of their liquidity, all assets and liabilities shall be presented in order of approximate liquidity (ascending or descending), ie the entity can choose either an ascending or a descending order.

(k) **Instead of presenting its current liabilities separately from its non-current liabilities, could the XYZ Group choose to present its liabilities in order of their liquidity?**

Except when a presentation based on liquidity provides information that is reliable and more relevant, an entity is required to present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position (see paragraph 4.4). When that exception applies, all assets and liabilities shall be presented in order of approximate liquidity (ascending or descending).

In accordance with paragraph 3.11(a) an entity cannot voluntarily change the presentation and classification of items in the financial statements from one period to the next unless it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Section 10 *Accounting Policies, Estimates and Errors*.

Therefore, only if it is apparent, following a significant change in the nature of the group's operations or a review of its financial statements, that a presentation based on liquidity provides information that is reliable and more relevant than a presentation of current and non-current assets could the group change its presentation policy.

(l) **Does the *IFRS for SMEs* require the XYZ Group to present this sub-heading?**

The *IFRS for SMEs* neither requires nor prohibits the presentation of this sub-heading in the statement of cash flows. Accordingly management must apply its judgement to determine whether or not to present a sub-heading 'cash flow included in investing activities' in its cash flow statement presented on the indirect method. The sub-heading increases the understandability of the statement of cash flows as it provides the reason for excluding the gain on sale of equipment from the entity's cash flows from operating activities.

(m) **Does the *IFRS for SMEs* require the XYZ Group to separately disclose the amount of finance costs paid in cash?**

Yes, paragraph 7.14 requires separate presentation of cash flows from interest and dividends received and paid.

(n) **Does the *IFRS for SMEs* require the group to separately disclose the amount of income taxes paid in cash?**

Yes, paragraph 7.17 requires separate presentation of cash flows from arising from income taxes.

(o) **What other measurement bases, if any, could the XYZ Group adopt as its accounting policy for investments in associates?**

In accordance with paragraph 14.4 an entity accounts for its investments in associates using (an accounting policy choice):

(i) the cost model in paragraph 14.5;

(ii) the equity method in paragraph 14.8; or

(iii) the fair value model in paragraph 14.9.

In accordance with paragraph 10.8(b) an entity cannot voluntarily change an accounting policy unless the change results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

The XYZ Group appears to have adopted the cost model as its accounting policy for investments in associates. Management could justify a change to the fair value model (or the equity method) on the basis that it would provide reliable and more relevant information about the entity's financial position, financial performance or cash flows.

Notes

An entity using the cost model is required to measure its investments in associates for which there is a published price quotation using the fair value model (see paragraph 14.7).

An entity using the fair value model is required to use the cost model for any investment in an associate for which it is impracticable to measure fair value reliably without undue cost or effort (see paragraph 14.10).

(p) **Could the XYZ Group change its accounting policy for borrowing costs so that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset (ie can the group account for borrowing costs in accordance with IAS 23 *Borrowing Costs* of full IFRSs).**

No, the group cannot change its accounting policy for borrowing costs. The *IFRS for SMEs* requires all borrowing costs to be recognised as an expense in profit or loss in the period in which they are incurred (see paragraph 25.2).

(q) **If the XYZ Group had purchased a trade mark the useful life of which management considers to be indefinite, would the group account for the trade mark at cost less accumulated depreciation and any accumulated impairment losses?**

Yes, all purchased intangible assets are accounted for at cost less any accumulated amortisation and any accumulated impairment losses (see paragraph 18.18). For the purposes of the *IFRS for SMEs* all intangible assets are considered to have a finite useful life (see paragraph 18.19). If the group is unable to make a reliable estimate of the useful life of an intangible asset, the life is presumed to be ten years (see paragraph 18.20).

(r) **What additional information, if any, would the XYZ Group disclose in its 20X2 financial statements if management had found it difficult to classify (ie as an operating lease or a finance lease) a significant non-cancellable lease which the group entered into (as a lessee) in 20X2?**

If the classification judgement has a most significant effect on the amounts recognised in the financial statements, in accordance with paragraph 8.6 the group would disclose information about the judgement that management made in classifying the lease. The disclosure would be made in the summary of significant accounting policies or other notes.

(s) **In what circumstances could the XYZ Group not use the projected unit credit method to measure its defined benefit obligation?**

If the group was not able, without undue cost or effort, to use the projected unit credit method to measure its obligation and cost under defined benefit plans, the group would be permitted to make the specified simplifications in measuring its defined benefit obligation with respect to current employees (see paragraph 28.19).

(t) **Could the XYZ Group present this amount as a separate line item in the consolidated statement of income and retained earnings described as 'Extraordinary item'?**

The *IFRS for SMEs* explicitly prohibits use of the term 'extraordinary items' in the statement of comprehensive income and the income statement (see paragraph 5.10). However, in accordance with paragraph 5.9 an entity should present additional line items, headings and subtotals in the statement of comprehensive income (and in the income statement, if presented), when such presentation is relevant to an understanding of the entity's financial performance. That requirement applies equally to an entity that presents a statement of income and retained earnings (see paragraph 6.5). Accordingly, the group cannot describe the gain as an extraordinary item in its consolidated statement of income and retained earnings. However, the group may highlight the gain by separately presenting it as a distinct line item in the consolidated statement of income and retained earnings.

(u) **Instead of presenting trade debtors and prepayments in the notes could the group present them as separate line items in the consolidated statement of financial position?**

Yes, the group could have presented trade debtors and prepayments as separate line items in its consolidated statement of financial position at 31 December 20X2 (see paragraph 4.11(b)).

The *IFRS for SMEs* does not prescribe the sequence or format in which items are to be presented in the statement of financial position. Paragraph 4.2 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

(a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position, and

(b) the descriptions used and the sequencing of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position (see paragraph 4.9).

The judgement on whether additional items are presented separately in the statement of financial position is based on an assessment of all of the following:

(a) the amounts, nature and liquidity of assets.

(b) the function of assets within the entity.

(c) the amounts, nature and timing of liabilities (see paragraph 4.10).

(v) Instead of presenting raw materials, work in progress and finished goods in the notes could the XYZ Group present them as separate line items in its consolidated statement of financial position?

Yes, the group could have presented raw materials, work in progress and finished goods as separate line items in its consolidated statement of financial position at 31 December 20X2 (see paragraph 4.11(c)).

The *IFRS for SMEs* does not prescribe the sequence or format in which items are to be presented in the statement of financial position. Paragraph 4.2 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

(a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position, and

(b) the descriptions used and the sequencing of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position (see paragraph 4.9).

The judgement on whether additional items are presented separately in the statement of financial position is based on an assessment of all of the following:

(a) the amounts, nature and liquidity of assets.

(b) the function of assets within the entity.

(c) the amounts, nature and timing of liabilities (see paragraph 4.10).

(w) Is it acceptable that the XYZ Group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?

Yes, paragraph 17.31(e) provides that this reconciliation need not be presented for prior periods (ie it provides an exception to the requirement in paragraph 3.14 to provide comparative information in respect of the previous comparative period).

(x) Is it acceptable that the XYZ Group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?

Yes, paragraph 18.27(e) provides that this reconciliation need not be presented for prior periods (ie it provides an exception to the requirement in paragraph 3.14 to provide comparative information in respect of the previous comparative period).

(y) **Is it permissible to offset deferred tax liabilities and deferred tax assets and to present the net deferred tax asset in the statement of financial position?**

Paragraph 2.52 prohibits offsetting assets and liabilities, or income and expenses, unless such offset is explicitly required or permitted by the *IFRS for SMEs*.

In accordance with paragraph 29.29 the group is required to offset its deferred tax assets and deferred tax liabilities, because it has a legally enforceable right to set off the amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. In all other circumstances the group would not be permitted to offset these balances.

(z) **If a material amount of the deferred tax asset is expected to be realised in 20X3, would the XYZ Group present the amount to be received in 20X3 as a current asset in its consolidated statement of financial position at 31 December 20X2?**

In accordance with paragraph 4.5(c) a deferred tax asset that is expected to be realised in 20X3 is a current asset. However, paragraph 29.28 prohibits the group from classifying any deferred tax as a current asset. Accordingly the group cannot present any part of its deferred tax asset as a current asset.

(aa) **Instead of presenting its cash (current asset) separately from its bank overdraft (current liability) could the group choose to present the net amount (eg 20X2: CU54,900) as a current liability ‘cash and cash equivalents’ in its consolidated statement of financial position (ie in the same way that it is presented in the consolidated statement of cash flows)?**

Paragraph 2.52 prohibits offsetting assets and liabilities, or income and expenses, unless such offset is explicitly required or permitted by the *IFRS for SMEs*. In the absence of a specific exemption from this requirement (ie the *IFRS for SMEs* does not provide an exemption) the group cannot present these items net in its consolidated statement of financial position.

(bb) **Is it acceptable that the XYZ Group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?**

Yes, paragraph 21.14 provides that this reconciliation need not be presented for prior periods (ie it provides an exception to the requirement in paragraph 3.14 to provide comparative information in respect of the previous comparative period).

(cc) **If the warranty was for a longer period (eg three years) what additional line item, if any, would you expect to see in the disclosure about the changes in the provision for the period?**

In the reconciliation of the provision the amount that relates to the unwinding of the discount in the present value calculation would be separately disclosed (see paragraph 21.14(ii)).

(dd) Is it acceptable that the XYZ Group has not provided comparative amounts for the reconciliation of the carrying amount at the beginning and end of the reporting period?

Yes, paragraph 28.41 provides that this reconciliation need not be presented for prior periods (ie it provides an exception to the requirement in paragraph 3.14 to provide comparative information in respect of the previous comparative period).