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ACCOUNTING BY SMALL AND MEDIUM-SIZED ENTERPRISES

Report by the ad hoc consultative group of experts on accounting by small and medium-sized enterprises

Executive summary

The seventeenth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), which was held in Geneva from 3 to 5 July 2000, deliberated on the accounting needs of small and medium-sized enterprises (SMEs). It identified a number of obstacles that SMEs face in maintaining accounting records and generating meaningful financial information. It recognized that in most member States, SMEs were required to conduct their accounting and reporting on the basis of standards that were originally intended for larger companies that were often listed on stock markets. Therefore, the session called for ad hoc expert consultations to be conducted with a view to formulating recommendations on a financial accounting and reporting framework, appropriate for SMEs. Accordingly, an ad hoc group consisting of 23 experts was formed. During the inter-session period, the group conducted a series of consultations. It deliberated on definitions and categorization of SMEs, elements of accounting and reporting that would be appropriate for SMEs at different levels, possible implementation difficulties and how the education needs of SME owners, managers, accounting personnel and others could be best met. Furthermore, preliminary discussions were held on the task of compiling guidance for SMEs. This report contains the deliberations of the ad hoc consultative group of experts and is being presented for consideration by the eighteenth session of ISAR.

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REPORT BY THE AD HOC CONSULTATIVE GROUP OF EXPERTS ON ACCOUNTING BY SMALL AND MEDIUM-SIZED ENTERPRISES

I. Introduction

1. At its seventeenth session, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) recommended that ad hoc expert consultations be held with a view to formulating recommendations for a financial accounting and reporting framework appropriate for small and medium-sized enterprises (SMEs). To that end, an ad hoc consultative group consisting of 23 experts from a wide cross-section of countries and of organizations such as the International Accounting Standards Board, the International Federation of Accountants, the World Bank, the Asian Development Bank and the European Commission, as well as various professional accounting associations, government standard-setters, academia, practitioners and others, was formed. It had the following issues for its consideration;

   - The categorization of the target group to which the SME accounting and reporting framework to be suggested would apply;
   - The identification of an accounting and reporting framework consistent with the characteristics set out in paragraph 3 of this report and suitable for the different types of SMEs;
   - The identification of possible difficulties in implementation;
   - How the education needs of SMEs (owners, managers, accounting personnel etc.) could be most appropriately met.

2. The ad hoc consultative group held consultations through electronic means and at a meeting in Geneva (10-11 May 2001). This report contains the outcome of those consultations.

3. The seventeenth session of ISAR specified that the financial accounting and reporting framework should:
   - Be simple, understandable and user-friendly;
   - Produce useful management information;
   - Be as standardized as possible;
   - Be flexible enough to accommodate the growth of business and increase the potential of some SMEs as they expand to use International Accounting Standards;
   - Be easily reconcilable for tax purposes;
   - Recognize the environment in which SMEs operate.

4. The session also agreed that it was up to each country to define different categories of SMEs in a manner appropriate to its needs and that any model accounting framework put forth would be voluntary.[1]

[1] The possible future ISAR guideline on accounting by SMEs is intended to be a non-mandatory technical aid for regulators in developing countries and countries with economies in transition, as well as other countries that may choose to use it.

5. In the light of these requirements, and of the background paper (TD/B/COM.2/ISAR/9) presented to the seventeenth session, the ad hoc consultative group decided that it was necessary to specify a framework which covered all entities likely to prepare annual financial reports. Furthermore, the aim was to place the SMEs within a coherent framework that would allow them to proceed logically from one level to another as they developed. Such a framework would inevitably have, at its most sophisticated level, a tier of entities that need to comply with all International Accounting Standards (IAS).[2]

II. Definitions and categories of SMEs

6. The ad hoc consultative group decided that the approach which best recognized the widely different nature of SMEs and their access to accounting expertise would involve a three-tier accounting framework, including two tiers dedicated to SMEs. At the most complex level (Level I), the top tier would include listed companies and companies in respect of which there is significant public interest. These are normally expected to fully meet IAS requirements. Below this level the second tier (Level II) would be larger SMEs, for which many aspects of the full IAS may be beyond their needs, since they are unlikely to have transactions or situations foreseen in the more complex standards. It is preferable that these companies use a modified set of standards, based on IAS recognition and measurement criteria, but with limited disclosure requirements.

7. The final level (Level III) would be for smaller entities. Here, it would be assumed that these enterprises have limited availability and access to accounting expertise and that they would be required to provide simplified accounts that comply broadly with the essential accruals accounting principles of IAS. The group recommended that the model include a chart of accounts for such entities and model financial statement formats. Also, it acknowledged that where a very small business is entering the formal economy for the first time, even these simple requirements might pose difficulties. It recommended, therefore, that the model allow further simplification for entrant businesses to use cash accounting in the initial phase, instead of accrual accounting, the rationale being that almost all their transactions are likely to be conducted on a cash basis.

8. The group recognized that the actual definitions of each of the three tiers proposed must rest with the national regulators who might choose to adopt the proposed system. In particular, monetary and other thresholds may not be applicable across different jurisdictions; and are influenced by the structure and level of economic activity. In general, as mentioned above, the agreed conclusions of the seventeenth session of ISAR recognized that “it is up to each country to define different categories of SMEs in a manner appropriate to its needs”. The group has therefore sought to provide generic definitions, intended above all to serve as a guide and to indicate its thinking. These should therefore be understood as broad indicators which are not by themselves intended to be operational. Member States that may wish to adopt the proposed system would have to introduce more specific thresholds, such as turnover, number of employees and total assets, that are appropriate to their local economic environment. The three tiers proposed by the group are presented below:

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[2] The future standards issued by the International Accounting Standards Board (IASB) will be known as "international financial reporting standards" (IFRS). It is understood that the IASB expects that in future companies and auditors will not distinguish between IAS and IFRS in accounting policy notes, but refer to the full set as international financial reporting standards. For the purpose of this report the term IAS is used.

Level I (full IAS compliance) covers all entities which issue public securities or in respect of which there is significant public interest, as well as banks and financial institutions. Significant public interest would include having sufficient employees to be in the top 10 percent of employers in the country. The group has therefore tried to encapsulate at least part of these entities by including an employment threshold as part of the Level I definition. The definition suggests that where an entity appeared in the top 10 percent of a list of employers ranked by number of employees, it would be required to comply with full IAS. However, there may be other ways of arriving at a definition that includes large employers in a country as a criterion.

Level II (abridged IAS) comprises significant commercial entities which issue neither public securities nor financial reports to the general public. Such entities might have shareholders who are external to the management and would normally have in-house accounting expertise sufficient to track transactions and monitor credit, and have more than a few employees.

Level III (simple accruals) consists of small commercial entities that are owner-managed and have few employees. Newly formed businesses or new entrants to the formal economy might be allowed, exceptionally, to provide accounts on a cash basis.

III. Level I SMEs — Accounting and reporting framework

9. While Level I is primarily oriented towards commercial entities which issue securities on public markets, the ad hoc consultative group recognized that there may well be entities in some countries which are either State or privately owned and which play a significant role in the national economy. For the purpose of consistency with the objective of having an inclusive framework which covers all commercially active entities, the consultative group felt that it would be preferable for parastatals with commercial attributes to use private sector accounting and reporting requirements (commercial accounting rules). It also felt that full IAS reporting should be required not only where an entity used the public capital market, but also where it was of such a size as to have a significant role in the national economy, particularly in terms of employing many people. In fact, although the framework of the International Accounting Standards Committee (IASC) focuses on capital markets, it also recognizes the needs of other users, including employees, suppliers and customers.

IV. Level II SMEs — Accounting and reporting framework

10. The ad hoc consultative group did not seek to define further the accounting framework for Level I financial reporting. This was assumed to be full IAS compliance, where this was applicable in the national accounting environment or the equivalent accounting requirements in force.

11. However, in defining rules for Level II, the group sought to define what elements of IAS were likely to be most relevant to larger SMEs. During the consultations, the model to which the working party frequently referred was the approach adopted in the United Kingdom, where a Financial Reporting Standard for Smaller Entities (FRSSE) was produced as a subset of the standards which comprise United Kingdom Generally Accepted Accounting Principles. The FRSSE is considered to provide a single standard

that covers all elements of the main standards that are likely to be encountered by smaller businesses. Although in the United Kingdom it has the status of a separate accounting standard, it is essentially a compilation of elements from the full set of standards. The entities that use it indicate in their accounting policy note that it is the FRSSE which they are adopting, not full UK GAAP. Notwithstanding, where a smaller entity has a transaction or a situation which falls outside the FRSSE, it is required to comply with the relevant rules of the wider standards.

12. The ad hoc consultative group took the view that the collection of abridged IAS (which during the consultations of the group was frequently referred to as the International Accounting Standards for Small and Medium-sized Enterprises (IASSME) would have a relationship to full IAS similar to that which the FRSSE has with the UK GAAP. It would be expected that in the vast majority of cases, SMEs that fall into the Level II category would find the accounting and reporting requirements for almost all of their activities covered by the abridged IAS. However, were the SME to find that it had a situation or a transaction which was covered by the abridged IAS, it would be required to refer to full IAS for the appropriate guidance.

13. An enterprise which complied with the abridged IAS would indicate in its accounting policy note that its accounts had been drawn up in accordance with the abridged IAS (and not in accordance with full IAS). If the enterprise had also had to refer to an element of full IAS, it would still retain the reference to abridged IAS.

14. Notwithstanding, the group felt that Level II enterprises within this system would always have the choice of complying with full IAS if they so wished. In such cases, it would be appropriate for the enterprises to refer to full IAS in their policy note.

15. The group felt that an abridged set of rules for smaller businesses could be particularly useful in a developing country framework. First, it could serve as a stepping stone on the way to full IAS compliance. Second, it could form the starting point for the development of a “technician” level of accounting expertise, specifically for SMEs. The services of such an expert would be cheaper and better adapted to the needs of small enterprises. The report to the seventeenth session of ISAR pointed out that in many countries expert accounting services were too expensive for SMEs. This problem was more acute in developing countries. Thus, the existence of an abridged set of IAS would create a situation where technicians could be specifically trained to apply those standards.

16. The ad hoc consultative group took the view that the abridged IAS should preserve the recognition and measurement base of the full IAS, and so the selection process would involve first identifying those standards thought unlikely to concern SMEs, and second identifying disclosure requirements that would not be applicable to SMEs or could be simplified. While taking the decision to retain the IAS recognition and measurement base, the group took into consideration the views expressed by the outgoing Board of the International Accounting Standards Committee (IASC) in its annual report for 2000 (*Annual Review 2000*, p. 12) that “the Board inclines to the view that a case can be made rarely, if at all, for differences in standards of recognition and measurement as between large and small businesses”. A similar view was expressed at the inaugural meeting of the IASB in April 2001 (*World Accounting Report*, May 2001, p. 12).

17. The abridged IAS that the ad hoc consultative group has envisaged could eventually be a single document that would bring together the relevant elements of the “core SME standards" identified by the consultative group. During its deliberations, the group identified "core standards" that were likely to affect most SMEs, bearing in mind that exceptions will always exist. Possible exceptions would also normally be caught by the requirement to refer to full IAS where the abridged IAS did not address a particular point. The group also had in mind that the core elements could well form the basis of training programmes, textbooks and software development. The more complex the "core set of standards", the more costly their application would be, possibly outweighing the potential benefits. The education needed to implement such a system would also be, as cost-effective as possible, more expensive. The aim was therefore to provide a set of "basic standards" that was as cost-effective as possible.

18. The ad hoc consultative group recommended that the following standards should form the abridged IAS:

IAS 1	*Presentation of Financial Statements*
IAS 2	*Inventories*
IAS 7	*Cash Flow Statements*
IAS 8	*Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*
IAS 10	*Events after Balance Sheet Date*
IAS 12	*Income Taxes*
IAS 16	*Property, Plant & Equipment*
IAS 17	*Leases*
IAS 18	*Revenue*
IAS 20	*Accounting for Government Grants and Disclosure of Government Assistance*
IAS 21	*The Effects of Changes in Foreign Exchange Rates*
IAS 23	*Borrowing Costs*
IAS 24	*Related Party Disclosures*
IAS 37	*Provisions, Contingent Liabilities and Contingent Assets*
IAS 38	*Intangible Assets*

Analysis and discussion of the abridged IAS

19. The ad hoc consultative group was of the view that the proposed abridged IAS ("IASSME") should focus on as small a core set as possible, so that it would be effective and useful and enable efficiencies to be achieved. The basic criterion applied was whether most small businesses were likely to have the particular kind of operation or kind of transaction addressed by an individual standard. It was recognized that small entities in developed economies were more likely to have some of the more complex transactions than those in developing countries or economies in transition. It should be remembered that the proposed use of the abridged IAS would be within a context where there remains a requirement to comply with full IAS if an SME at Level II were to encounter a transaction that the "core standards" do not address.

20. The ad hoc consultative group debated each standard extensively and reached agreement on the core set above. Nevertheless, in the case of certain IAS, for example in the case of leasing and employee benefits, it was not easy to decide whether these should be a part of the abridged IAS or not. Although IAS 17, *Leases,* has been included in the abridged IAS and IAS 19, *Employee Benefits* has not, they may both apply to some SMEs.

21. In the process of identifying the "core standards", the group retained IAS the recognition and measurement base. As a result, certain IAS that could be too burdensome for some SMEs have been included in the abridged IAS.

22. IAS 11, *Construction Contracts,* has been excluded from the abridged IAS but gave rise to much debate because while it might be considered to be an industry-specific standard, it includes a fundamental revenue recognition principle which applies to all entities which have unfinished contracts at the accounting date. The group decided to recommend that it be left outside the "core standards"; but, of course, compliance with it would be required if an enterprise had to record revenues earned on partially completed construction contracts.

23. The ad hoc consultative group took the view that enterprises with a group structure should not necessarily be excluded from the Level II definition. However, it believed that a group structure in SMEs was found relatively infrequently. Therefore, it was decided that IAS 27, *Consolidated Financial Statements and Accounting for Investments in Subsidiaries,* and IAS 28 *Accounting for Investments in Associates,* should not to be included in the core list. For the purpose of consistency, the elements of IAS 21, *The Effects Of Changes In Foreign Exchange Rates,* could be modified (for purposes of the abridged IAS) to exclude those parts that deal with the translation of the accounts of foreign subsidiaries. Similarly, a simplified form of IAS 8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies,* would be desirable.

24. It was felt that IAS 29, *Financial Reporting In Hyperinflationary Economies,* might well apply in some countries to SMEs. However, it should be left open to national regulators to decide whether, in the interests of cost-effectiveness, to incorporate it in their minimum list.

Potential complexity of some IAS in an SME environment

25. While the ad hoc consultative group took the view that accounting requirements for Level II should maintain the IAS recognition and measurement base, it felt that it was necessary to draw attention to the fact that some IAS could be rather burdensome in an SME environment. Some examples are as follows:

26. <u>IAS 12, *Income Taxes.*</u> The calculation of deferred taxes is relatively complicated and the information content as regards SMEs may not be particularly useful. The group felt that the cost of meeting the requirements of this standard might outweigh the potential benefits. Also, it noted that the United Kingdom FRSSE was currently being modified and a simplified treatment of deferred tax was being proposed.

27. <u>IAS 17, *Leases.*</u> Leasing is often a popular form of financing for SMEs, and the debt information is useful. The IAS provides for rental payments to be split between writing

off the lease obligation and a charge for interest. The apportionment between loan repayment and interest charges should be done by treating the rental payment as an annuity. However, this could be simplified, as in the case of the United Kingdom FRSSE, to make application easier.

28. IAS 19 *Employee Benefits.* This was not included in the minimum list, but the ad hoc consultative group noted that it could well apply in a number of developing countries where employer-related pension schemes are being encouraged. The group felt that the cost of applying the standard could be high, given the need for actuarial estimates, and the lack of a sufficient number of actuaries in many developing countries. It recognized the need for an alternative approach for SMEs.

29. IAS 36, *Impairment of Assets.* Although this standard was not included in the minimum list, the group noted that it could be applicable to SMEs in certain circumstances. It felt that the valuation process and its elements could be too complex to be applied confidently by SMEs.

30. IAS 39, *Financial Instruments: Recognition and Measurement.* It was considered that few SMEs have financial instruments other than trade receivables and payables and bank finance. Some form of simplification could make the standard easier to apply and more useful for SMEs.

Preliminary discussion on the compilation of the simplified disclosure

31. While the ad hoc consultative group decided to retain the IAS recognition and measurement base, it considered the extent to which disclosure and other requirements might be reduced in the abridged version of IAS. After some discussion, it took the view that a number of disclosure requirements could be simplified in the "core standards", as in the case of the United Kingdom FRSSE, for example. The choice of disclosure items is necessarily subjective. Essentially the rationale is that, generally, there is not a sufficient public interest requirement for disclosure by SMEs, and in addition their activities are usually simple enough not to require further analysis. Therefore, additional disclosures seem to be unnecessary for a proper understanding of their financial position. Also, it seemed that the costs associated with providing extensive disclosure could probably outweigh the potential benefits. The main external users of SMEs' financial statements are, to a large extent, banks and tax authorities, which can obtain the required information directly from the company. It is probably unnecessarily costly to require the SMEs at Level II to meet all disclosure requirements without regard to the "real needs" of their users. Therefore, the ad hoc consultative group worked towards simplifying this burden as much as possible by identifying disclosure requirements that were typically of importance for present and potential users.

32. The group felt that, as a starting point, the consultative group felt that the reduced requirements should be based on the black-letter paragraphs of selected IAS, without significant changes to the text. It noted that there would be cases where elements of the explanatory grey-letter paragraphs might need to be added to make the abridged IAS a workable document. There could also be cases where material in the appendices to an IAS might be needed in whole or in part for the abridged IAS. In this connection, the group noted that the practical examples in IAS 18 on revenue recognition and those in IAS 37 on provisions might be instances of this.

33. The group felt that there might also be cases where certain key recognition and measurement paragraphs of an IAS were onerous for SMEs and might create difficulties in the same way as certain complete standards. Falling into this category, for instance, were paragraphs 45-47 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, requiring measurement of provisions at the present discounted value of their future cash flows. In some cases there may be a need to provide more explanatory detail. Finally, the group was of the opinion that there might be a need to include some parts of the IASC framework and or some parts of ISAR's Objectives and Concepts Underlying Financial Statements in the abridged IAS and, in particular, some of the definitions of elements of financial statements.

V. Level III SMEs — Accounting and reporting framework

34. Level III comprises the smallest SMEs, those with the most difficulty in accessing bank and trade credit. They also have difficulties in obtaining affordable accounting services of the kind they need. While a Level II SME might well have 50 or 100 employees, the typical Level III SME might be a one-person enterprise or a business with two or three people. Consequently, the accounting requirements need **to take into consideration** the simplicity of the business transaction, the lack of resources and the limited in-house accounting expertise and infrastructure.

35. The ad hoc consultative group recommends that Level III SMEs follow a simple accruals accounting approach, broadly consistent with IAS 1, although not necessarily aimed at users other than management, tax officials, creditors and investors. The rules proposed by the ad hoc consultative group would not involve compliance with IAS, but would be based on the historical cost/accruals measurement approach, which is the basis of IAS. The reporting package recommended includes model financial statements and a model chart of accounts (see Appendix).

36. The basic measurement approach would consist of:

- Historical cost;
- Transactions accounted for when an economic event takes place (accruals);
- Allocation of expenses to the accounting periods in which related income is recognized (matching);
- No offsetting of related items.

37. This would imply a system capable of recognizing trade receivables and payables as they occur, as well as capitalization of fixed assets, use of depreciation and recognition of inventories.

Model financial statements and chart of accounts

38. Model financial statements are set out in the Appendix. It should be noted that these are, to a certain degree, detailed. Privileged users (management, tax and finance) generally require a detailed analysis of the business. Assuming that there is no obligatory public disclosure, no purpose is served by proposing more aggregated statements (and typically the preparation of summaries takes place as a supplementary step after preparation of detailed statements).

39. The sample financial statements are intended to encourage managers to think analytically about their business. Their objective is therefore not simply regulatory in the traditional sense, but to help develop the business by providing useful information. In particular, the enterprise is encouraged to identify different product streams, if relevant, and analyze both income and expenses against these streams, to help gauge profitability. Furthermore, there is a category for non-allocable expenses. Such a breakdown and analysis would provide useful information about the cost structure of the enterprise for internal decision-making.

40. The financial statements are necessarily linked to the maintenance of a general ledger. The system includes a chart of accounts for this ledger, which will facilitate the preparation of financial statements in line with the model. The chart is also set out in the Appendix.

Suggested simplifications for new entrants

41. Although the ad hoc consultative group decided on three levels of SMEs only, it recognized that for a micro-enterprise which was either a start-up or was moving from the informal to the formal economy, adoption of even the simplified accruals approach might pose too great an obstacle. In such a case, national regulators might consider allowing new entrants to use cash accounting during a transitional phase, or if their total revenue remains below a specified level. This cash accounting would involve only tracking cash transactions and striking simple periodic balances, with no allocation of revenue and expenses to different accounting periods, or recognition of fixed assets. This would perhaps be appropriate only for the smallest and simplest businesses. In this particular case, most transactions are cash-based and small in amount, with an insignificant amount of fixed assets. This alternative would facilitate the removal of a high cost-barrier to legitimacy for micro-enterprises wishing to enter the formal sector. It would also improve the availability of accounting data**,** which could have positive impacts on the growth of the enterprise and the fiscal balance of the country in which it operates.

VI. Conclusions

42. The ad hoc consultative group considered that the variety of types of entities that may be found in an economy covers an enormous range — from the subsistence-level, one-person business with virtually no records, to transnational corporations. The task of suggesting a voluntary framework can be carried out only if the range of types of entities is recognized and a differential reporting approach, which allows for progressively simplified reporting by the less sophisticated entities, is used. At the same time, it is necessary that a differential reporting system be internally consistent, permitting a logical progression through different stages as the business grows.

43. The most sophisticated level within the system should be the standards prepared by the IASB for use in international capital markets. However, the ad hoc consultative group recommends that national regulators use an abridged version of the IAS dealing with the routine needs of most large SMEs, which technician-level preparers could apply.

44. For smaller SMEs at Level III, the group recommends that regulators supplement the simple accruals system with a simple chart of accounts and standard financial statement formats. The uniform nature of this approach at a national level would help in the education of preparers and in reducing the cost of accounting. It should lead to greater

efficiency by providing management information for internal decision-making. National regulators may wish to allow micro-enterprises that are just entering the formal economy or are in a transitional phase to use cash accounting, since it is very likely that most of their transactions would be conducted on a cash basis.

45. The framework that the ad hoc consultative group recommended is intended to provide a coherent system covering all commercial entities in an economy and enabling small businesses to advance to full IAS compliance as they grow. The system is therefore aligned on accruals accounting, which starts with a simple approach in Level III, moving on to IAS-based recognition and measurement at Level II and then full IAS at Level I.

46. The ad hoc consultative group has considered on a preliminary basis the issue of possible reduced disclosure requirements for Level II. This preliminary analysis is available in a draft form and the ISAR may wish to comment on it immediately and/or assign it to the ad hoc group for further elaboration. Alternatively, national-standard setters may wish to undertake the task of further elaboration so that the basic guidance would be implementable within the context of their national economic environment.

47. The central task of the 18th session is to evaluate the report for each enterprise category. If it finds these approaches acceptable, it should discuss the ways and measures of producing a guideline for national-standard setters for accounting by SMEs.

Appendix I

Sample Level III financial statements

(previous year comparative figures omitted for simplicity)

LEVEL III MANAGEMENT REPORT (INCOME STATEMENT)

XYZ Ltd

Income statement

For the year ended 31 December 20X1

	Total	Product A	Product B	Unallocated
Sales	**325,000**	**140,000**	**160,000**	**25,000**
Materials	74,500	32,600	41,900	-
Changes in inventories	1,200	2,100	(900)	-
Depreciation	12,300	3,400	2,800	6,100
Salaries	137,700	43,200	43,200	51,300

Telephone	1,800	-	-	1,800
Power, light and heat	10,800	5,400	5,400	-
Insurance	2,600	-	-	2,600
Rent/rates	28,600	-	-	28,600
Lease rentals	6,500	-	5,300	1,200
Provisions	1,000			1,000
Motor vehicle expenses	1,900		-	1,900
Total operating expenses	**278,900**	**86,700**	**97,700**	**94,500**
Profit before interest and tax	**46,100**	**53,300**	**62,300**	**(69,500)**
Interest	(6,200)			
Profit before tax	**39,900**			
Disallowed for tax :				
Provisions	1,000			
Taxable profit	**40,900**			
Taxation	(10,275)			
Net profit for the year	**30,625**			

Movements on equity	
Balance at beginning of year	9,375
Profit for the year	30,625
Balance at end of year	40,000

LEVEL III BALANCE SHEET

XYZ Ltd

Balance sheet

As of 31 December 20X1

Assets			
Non-current assets			
Property	170,000		
Less: accumulated depreciation	40,000	130,000	
Equipment	85,000		
Less: accumulated depreciation	25,000	60,000	
Total non-current assets			190,000
Current assets			
Materials		18,200	
Inventory		34,000	
Trade receivables	28,500		
Less: provisions	2,500	26,000	
Bank accounts		5,600	
Cash		1,200	
Total current assets			85,000
Total assets			**275,000**
			========

Equity and liabilities			
Capital and reserves			
Capital		100,000	
Retained earnings		40,000	
Reserves		3,500	
Total capital and reserves			143,500
Non-current liabilities			
Notes payable	37,500		
Mortgage payable	68,000		
Total non -current liabilities		105,500	
Current liabilities			
Note payable (due in 6 months)	5,500		
Trade payables	20,500		
Total current liabilities		26,000	
Total liabilities			131,500
Total equity and liabilities			**275,000**
			========

LEVEL III CASH FLOW STATEMENT

XYZ Ltd Cash flow statement For the year ended 31 December 20X1			
Cash flows from operating activities:			
Cash receipts from customers	310,175		
Cash paid to suppliers and employees	(264,400)		
Cash generated from operations		45,775	
Interest paid	(6,200)		
Income taxes paid	(10,275)	(16,475)	
Net cash from operating activities:			29,300
Cash flows from investing activities:			
Purchase of equipment		(12,500)	
Proceeds from disposal of equipment		500	
Net cash used in investing activities			(12,000)
Cash flows from financing activities:			
Payment of notes payable		(5,500)	
Payment of mortgage (principal)		(10,000)	

Net cash used in financing activities			(15,500)
Net increase in cash and cash equivalents			1,800
Cash and cash equivalents on 1-1-20X1			5,000
Cash and cash equivalents on 31-12-20X1			**6,800**

LEVEL III CHART OF ACCOUNTS

(ledger accounts relating to model statements)

Income statement items

Sales

- Product A

- Product B

- Sundry

Materials

- Product A

- Product B

- Sundry

Changes in inventory

Depreciation

Salaries

- Product A

- Product B

- General

Telephone

Power, light and heat

- Product A

- Product B

- General

Insurance

Rent

Lease rentals

Provisions

Motor vehicle expenses

Interest

Taxation

Balance sheet items

Property at cost

Property: accumulated depreciation

Equipment

Equipment: accumulated depreciation

Inventory: raw materials

Inventory: finished goods

Trade receivables

Provisions against receivables

Bank account

Cash

Capital

Reserves

Retained earnings

Proprietor’s personal drawings

Notes payable

Bank loan

Trade payables

Sundry payables