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White Paper

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Purpose of This Document

This document is intended to inform SAP Business One partners about the potential necessary steps that should be taken to provide the desired financial reporting of their customers. Each selected standard is summarized separately on the following IASB Web page:

http://www.iasb.org/IFRS+Summaries/IFRS+and+IAS+Summaries+-+English+(2009)/IFRS+and+IAS+Summaries+-+English+-+(2009).htm

The description of a particular standard appearing in this document shows its impact on SAP Business One from an SAP perspective. The scope of this document is to present some issues related to preparing financial statements according to IFRS. It is not intended as a complete description of the IFRS framework, nor of SAP Business One functionality.

This document provides general hints, tips, and recommendations concerning the use of SAP Business One. However, SAP Business One localizations differ from one to another so the usage of the described functionalities should be used in consideration of the particular localization features. It is highly recommended to consult a certified auditor, accounting advisor, or other authority, to confirm appropriateness and correctness of actions taking into account local and company specifics.

In the standard summary, we provide a section informing you about the availability of information needed to prepare financial statements. Accurate reporting in SAP Business One depends not only on functionality, but also on correct setup and usage.

The content of this document is subject to change since both SAP Business One capabilities and the IFRS may change in the future.

Overview

Small and medium-sized entities (SMEs) have been excluded for a long time from any discussion about unification and standardization of their financial reporting. This was mainly because of concerns about their size, revenues, and so on, in comparison to large companies. Recently, in line with the strengthening of the reporting rules for large companies, a similar process is taking place with respect to small and midsize companies. There is increasing overall awareness of the need for standardization, reliability, and comparability of financial reporting among all companies on the financial market.

The most important aspect of International Financial Reporting Standards (IFRS) for the SME sector is the competitive advantage gained from the presentation of the company results according to IFRS. This is seen as improving the perception of the company as multinational and more reliable.

The other aspect of the increased awareness of the need for internationally recognized financial reporting is the adoption of new technologies in the financial reporting is prepared and presented (for example, XBRL).

Both of these aspects affect the demands of SMEs of their software providers, including SAP. SAP Business One is reacting to new market trends and is able to help its customers fulfill their financial reporting needs.

Glossary

Term	Abbreviation	Description
SME	Small and medium-sized entities	Small and medium enterprises (also SMEs, small and medium businesses, SMBs) are companies whose headcount or turnover falls below certain limits.
IFRS	International Financial Reporting Standards	International Financial Reporting Standards (IFRS) are Standards, Interpretations and the Framework for the Preparation and Presentation of Financial Statements (in the absence of a Standard or an Interpretation) adopted by the International Accounting Standards Board (IASB).
IAS	International Accounting Standard	The old term used for IFRSs
IASB	International Accounting Standard Board	The International Accounting Standards Board (IASB) founded on April 1, 2001 is the successor of the International Accounting Standards Committee (IASC) founded in June 1973 in London. It is responsible for developing the International Financial Reporting Standards (new name for the International Accounting Standards issued after 2001), and promoting the use and application of these standards.

Term	Abbreviation	Description
FASB	Financial Accounting Standards Board	The Financial Accounting Standards Board (FASB) is a private, not-for-profit organization whose primary purpose is to develop generally accepted accounting principles (GAAP) within the United States in the public's interest.
GAAP	Generally Accepted Accounting Principles	Generally Accepted Accounting Principles (GAAP) is the term used to refer to the standard framework of guidelines for financial accounting used in any given jurisdiction.

What is IFRS?

Any meaningful discussion about comprehensive financial reporting would place IFRS at the top of the agenda.

First known as International Accounting Standards (IAS), IFRS was developed by the International Accounting Standards Committee beginning in 1973. In 2001, the standards were certified by the International Accounting Standards Board (IASB) and formally adopted by the European Union as its single financial reporting standard. Since then, in addition to taking effect throughout Europe, IFRS is the accepted reporting standard in over 100 countries.

One of the most important activities was the Norwalk Agreement (2002) between the IASB and the U.S. Financial Accounting Standards Board (FASB) which led to a commitment that FASB rules and IFRS standards would be made mutually compatible. Various countries have already adopted a timetable for convergence, and companies in many countries are required to comply in the next few years.

The objective of financial statements is to provide information about the financial position, performance, and changes in the financial position, of a business entity. This information is useful to a wide range of users in making economic decisions, and in providing the current financial status of the entity to its shareholders and public in general.

IFRSs are based on a clearly stated set of principles and can comprise a much smaller number of stated rules. However, this does not mean IFRS is any less stringent or clear on how business activity is to be treated.

IFRS assumes a going concern working on an accrual basis (never cash). To cope with the systemic demands IFRS imposes, and to avoid unpleasant surprises, companies must prepare their infrastructures for this change in advance. SAP can help by providing software that meets the new requirements.

Understanding that IFRS includes both accounting and reporting impacts on the way that the company operates from a financial reporting point of view. The use of IFRS to harmonize internal and external reporting may lead to organizational changes. The introduction of IFRS reporting should encourage companies to reevaluate their managerial and financial accounting functions. In many cases, the introduction of IFRS may give companies an opportunity to simplify their operations in this regard. It can also help them reduce costs by synchronizing the areas involved and providing a single set of numbers for both internal and external decision makers – including managers, shareholders and creditors.

Since the adoption of IFRS can mean significant changes in the philosophy and process of financial reporting, it is imperative that companies obtain adequate knowledge of what IFRS involves and what kind of changes they should expect.

The first step in any IFRS project is to determine how the accounting rules in current use differ from those under IFRS. This entails analyzing individual financial statement positions to identify where IFRS rules require different valuation procedures and then pinpointing the information and entries needed to make the new valuations. Also critical is the analysis of how those new entries and valuations impact financial statements. When options for compliance exist, a clear understanding of both the costs as well as the benefits of different approaches to compliance is critical in making the best, most profitable decisions in achieving IFRS compliance. The overall process can be summarized by the following general points:

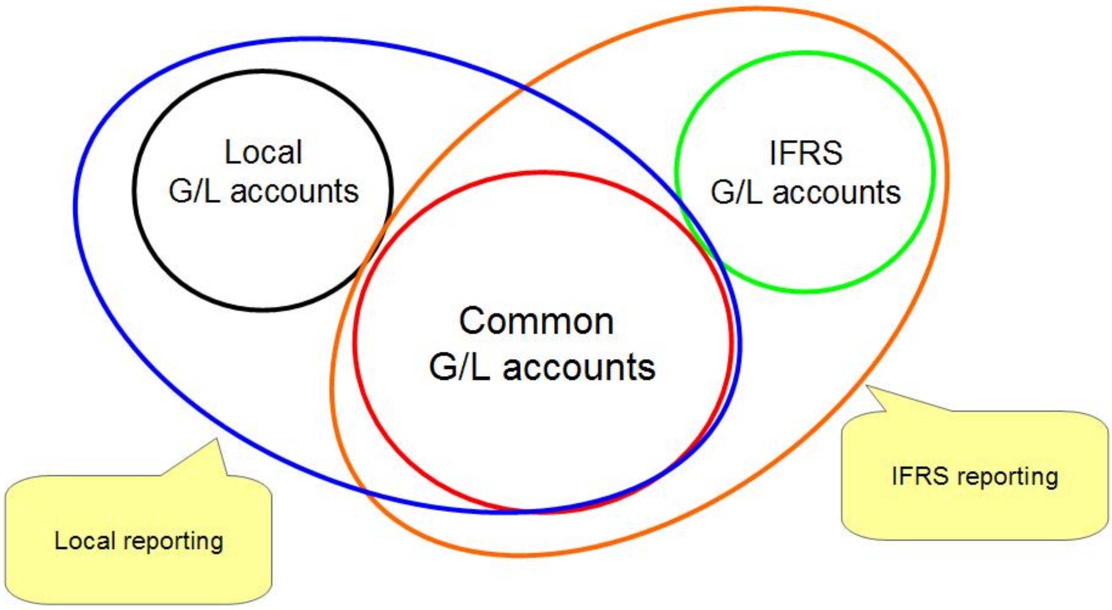
1. Analyze the differences between local legislation and IFRS. Usually, the main differences are in the following areas:
    - Valuation and depreciation of fixed assets
    - Foreign currency valuation
    - Provisions
    - Stock valuation
    - Revenue (and cost) recognition
2. Identify which differences are relevant for the company itself.
3. Minimize the number and extent of the differences (if possible).
4. Prepare the internal accounting policy to support the preparation of financial statements according to IFRS

Parallel Accounting Systems

The introduction of IFRS into the accounting system of the company means the introduction of parallel accounting systems into the G/L ledger. Some transactions have, by nature, different meanings for local legislation and for IFRS purposes. Therefore, it is a must for a company to create special G/L accounts to comply with local legislation and for IFRS-related postings. In fact, the G/L ledger should include 3 types of accounts:

- For local legislation,
- For IFRS, and
- For common purposes

The following diagram illustrates the setup:



Using this setup, we can cover all eventualities resulting from IFRS adoption in the accounting system. There are generally 3 scenarios:

- A transaction that has the same impact for the local legislation and for the IFRS rules. The transaction is posted to the common G/L accounts. For example, a purchasing invoice for services.
- A transaction that has different valuations for the local legislation and for IFRS. It is posted in parallel to local and IFRS G/L accounts. For example, depreciation of fixed assets.
- A transaction that is required only by local legislation or only by IFRS rules. It is then posted to only local or only to IFRS G/L accounts. For example, specific provision.

Companies should consider the introduction of this parallelism into the accounting as one of the main challenges when IFRS is being adopted as a parallel reporting ledger.

SAP Business One supports the need for parallel G/L accounts (for local and IFRS purposes). It provides the functionality to record and report the transactions and G/L accounts in parallel.

List of Currently Valid IFRSs

On 9th July, 2009, the IASB issued an IFRS designed for the use of SMEs. This standard is being considered as part of this document. Additionally, the following standards are relevant:

IFRSs

- IFRS 1 First-time Adoption of International Financial Reporting Standards
- IFRS 2 Share-based Payment
- IFRS 3 Business Combinations
- IFRS 4 Insurance Contracts
- IFRS 5 Noncurrent Assets Held for Sale and Discontinued Operations
- IFRS 6 Exploration for and evaluation of Mineral Resources
- IFRS 7 Financial Instruments: Disclosures
- IFRS 8 Operating Segments

IASs

- IAS 1 Presentation of Financial Statements
- IAS 2 Inventories
- IAS 7 Cash Flow Statements
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 Events After the Balance Sheet Date
- IAS 11 Construction Contracts
- IAS 12 Income Taxes
- IAS 16 Property, Plant, and Equipment
- IAS 17 Leases
- IAS 18 Revenue
- IAS 19 Employee Benefits
- 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 26 Accounting and Reporting by Retirement Benefit Plans
- IAS 27 Consolidated and Separate Financial Statements
- IAS 28 Investments in Associates
- IAS 29 Financial Reporting in Hyperinflationary Economies
- IAS 31 Interests in Joint Ventures
- IAS 32 Financial Instruments: Presentation
- IAS 33 Earnings per Share
- IAS 34 Interim Financial Reporting
- IAS 36 Impairment of Assets
- IAS 37 Provisions, Contingent Liabilities, and Contingent Assets
- IAS 38 Intangible Assets
- IAS 39 Financial Instruments: Recognition and Measurement
- IAS 40 Investment Property
- IAS 41 Agriculture

IFRICs

List of valid Interpretations (International Financial Reporting Interpretations Committee and Standing Interpretations Committee)

- IFRIC 1 Changes in Existing Decommissioning, Restoration, and Similar Liabilities
- IFRIC 2 Members' Shares in Co-operative Entities and Similar Instruments
- IFRIC 4 Determining whether an Arrangement contains a Lease
- IFRIC 5 Rights to Interests arising from Decommissioning, Restoration, and Environmental Rehabilitation Funds
- IFRIC 6 Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
- IFRIC 8 Scope of IFRS 2
- IFRIC 9 Reassessment of Embedded Derivatives
- IFRIC 10 Interim Financial Reporting and Impairment
- IFRIC 11 IFRS 2—Group and Treasury Share Transactions
- IFRIC 12 Service Concession Arrangements
- IFRIC 13 Customer Loyalty Programs
- IFRIC 14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements, and their Interaction
- IFRIC 15 Agreements for the Construction of Real Estate
- IFRIC 16 Hedges of a Net Investment in a Foreign Operation
- IFRIC 17 Distributions of Noncash Assets to Owners

SICs

- SIC 7 Introduction of the Euro
- SIC 10 Government Assistance—No Specific Relation to Operating Activities
- SIC 12 Consolidation—Special Purpose Entities
- SIC 13 Jointly Controlled Entities—Non-Monetary Contributions by Venturers
- SIC 15 Operating Leases—Incentives
- SIC 21 Income Taxes—Recovery of Revalued Non-Depreciable Assets
- SIC 25 Income Taxes—Changes in the Tax Status of an Entity or its Shareholders
- SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease
- SIC 29 Service Concession Arrangements: Disclosures
- SIC 31 Revenue—Barter Transactions Involving Advertising Services
- SIC 32 Intangible Assets—Web Site Costs

Standards Overview

IFRS 1 First-time Adoption of International Financial Reporting Standards

Standard Summary

The objective of this IFRS is to ensure that an entity's *first IFRS financial statements*, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

a. is transparent for users and comparable over all periods presented;
b. provides a suitable starting point for accounting under *International Financial Reporting Standards (IFRSs)*; and
c. can be generated at a cost that does not exceed the benefits to users.

An entity shall prepare and present an *opening IFRS statement of financial position* at the *date of transition to IFRSs*. This is the starting point for its accounting under IFRSs. The IFRS requires an entity to do the following in the opening IFRS statement of financial position that it prepares as a starting point for its accounting under IFRSs:

a. recognize all assets and liabilities whose recognition is required by IFRSs. The standard allows an exception and defines the transition from local legislation to IFRS. However the differences between the local legislation and IFRS are not explicitly described in the standard.
b. not recognize items as assets or liabilities if IFRSs do not permit such recognition;
c. reclassify items that it recognized under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under IFRSs; and
d. apply IFRSs in measuring all recognized assets and liabilities.

The IFRS requires disclosures that explain how the transition from previous GAAP to IFRSs affected the entity's reported financial position, financial performance, and cash flows.

Impact on SAP Business One Functionality

To present an opening IFRS statement of the financial position at the date of transition of IFRS, SAP Business One financial reports can be used to report at a certain date. To comply with the standard, manual adjustments may be inevitable. In particular, the SAP Business One balance sheet report should be used to generate an opening IFRS balance sheet on the date of the transition to IFRS. Prior to its generation, you need to ensure that specific adjustments are made to differentiate IFRSs from accounting principles used for operation accounting.

To explain how the transition from previous GAAP to IFRSs has affected the entity's reported financial position, financial performance and cash flows, you need to create two sets of financial reports by using SAP Business One financial reports, one including, and the other excluding, the specific IFRS adjustments.

You can use financial report templates in SAP Business One for setting up financial reports for IFRS purposes.

Standard for SMEs Implication

First-time adoption of the standard for SMEs is described in section 35. The process is similar to IFRS 1. The important point from the SAP Business One perspective is the preparation of the financial statements for the actual accounting period, as well as for the required comparative periods, based on the standard for SMEs. The financial report templates can be used for these purposes. The functionality lets you create customized forms according to the needs of the particular company.

IFRS 5 Noncurrent Assets Held for Sale and Discontinued Operations

Standard Summary

The objective of this standard is to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. In particular, the IFRS requires:

a. assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and
b. assets that meet the criteria to be classified as held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of comprehensive income.

An entity shall classify a noncurrent asset (or disposal group) as held for sale if its carrying amount is recovered principally through a sale transaction rather than through continuing use.

For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be *highly probable*. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active program to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan are made or that the plan is withdrawn.

A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and

a. represents a separate major line of business or geographical area of operations,
b. is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or
c. is a subsidiary acquired exclusively with a view to resale.

Impact on SAP Business One Functionality

SAP Business One provides 2 functions to help you comply with the standard.

One is the Fixed Assets add-on (available only for some localizations) which lets you record, monitor, and make the necessary accounting postings related to your company's fixed assets. For identification and monitoring of the assets valid for the standard, you can use standard product features such identifier or user-defined fields.

Your company should exclude these assets from depreciation runs by using standard add-on functionality.

In addition SAP Business One comprises a set of reporting capabilities to prepare financial reports (balance sheets and profit and loss reports) as the standard requires.

Standard for SMEs Implication

The implications of this section for SAP Business One are in line with the functionality description available for the full IFRS 5.

IAS 1 Presentation of Financial Statements

Standard Summary

The objective of this standard is to prescribe the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

<u>A complete set of financial statements comprises to be presented at least annually:</u>

(Note. In case of the preparation of Financial Statements more frequently the IAS 34 is applicable)

a. a statement of financial position as at the end of the period (in case of IFRS 1 the opening statement of financial position is prepared as well);
b. a statement of comprehensive income for the period;
c. a statement of changes in equity for the period;
d. a statement of cash flows for the period (the statement is prepared based on IAS 7);
e. notes, comprising a summary of significant accounting policies and other explanatory information; and
f. a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an IFRS.

Except when IFRSs permit or require otherwise, an entity shall disclose comparative information in respect of the previous period for all amounts and narrations reported in the current period's financial statements.

An entity shall recognize all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise.

An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies, and processes for managing capital.

Impact on SAP Business One Functionality

To help users produce IFRS financial statements, SAP Business One supports the creation of additional G/L accounts in the existing chart of accounts. The new accounts should be distinguished from the local G/L accounts by, for example, a special prefix in the account code (such as IFRS). This would allow the identification and filtration of the special accounts in standard SAP Business One reports.

SAP Business One comprises a set of financial reports that aggregate all business transactions with an impact on accounting. As well as IFRS-dedicated G/L accounts, each IFRS-specific transaction contains identifying characteristics (such as reference fields, identifiers, or transaction codes). These business transactions provide a basis for the creation and presentation of fair and accurate reports compliant with IFRS after manual adjustments are made to differentiate them from non-IFRS relevant transactions.

To disclose comparative information in respect of the previous period for all amounts reported in the current period's financial statements, users are recommended to use comparison financial statements.

The combination of various standard reports (such as G/L reports, trial balance reports, and so on), ad hoc queries, and specific tools (such as. XL Reporter) help the user to identify changes in equity and cash accounts.

SAP Business One also provides functionality such as item properties, item groups, and so on, to filter and track various material classes easily.

Standard for SMEs Implication

The relevant sections in the Standard for SMEs are sections 3 to 7. These sections define the fair presentation of financial statements, what compliance with the IFRS for Small and Medium-sized Entities requires, and what is a complete set of financial statements. The sections also describe each statement separately.

The implication for SAP Business One is the same as for the original IAS1 described above.

IAS 2 Inventories

Standard Summary

The objective of this standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized.

Inventories shall be measured at the lower of cost and net realizable value.

The cost of inventories shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified. However, the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labor, efficiency, and capacity utilization. They are regularly reviewed and, if necessary, revised in the light of current conditions

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

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

Impact on SAP Business One Functionality

SAP Business One supports both approaches for inventory valuation: perpetual and nonperpetual inventory systems.

A perpetual inventory system reflects the value of inventory postings by means of monetary transactions in the accounting system. These monetary transactions are carried out only when items defined as WH (warehousing) items are received or released from stock.

Inventories under a perpetual inventory system can be valuated using valuation methods (FIFO, weighted average) which are in line with IFRS requirements. For articles using the standard valuation method it is required to adjust value to lower of cost and net realizable value for IFRS reporting purposes (see description of the tools below).

In a nonperpetual inventory system, item cost updates are made on a periodic basis.

SAP Business One integrates inventory valuation and movements into all transactional operations in a perpetual inventory system. This includes receipts, delivery, and other stock movements that are part of daily company operations. For sales transactions, for example, A/R invoices, SAP Business One automatically evaluates the carrying amount, recognizing it as an expense together with related revenue without further necessary action from the user’s side.

The valuation of inventory available in SAP Business One represents the inventory cost. The company’s accountant has to investigate and analyze the net realizable value. The accountant’s analysis should be based on the market situation regarding the respective goods as well as the situation with the respective goods in the company warehouse. Decisions about the revaluation of goods or the creation of a provision for stock are left to accountants. The principle of materiality should be taken into consideration.

Net realizable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of business.

Reconsideration of the inventory valuation should take place on a regular basis (as required in par. 33).

SAP Business One supports the per article valuation method and thus the reporting entity should properly set valuation method for inventories having a similar nature.

For any adjustments in inventories value SAP Business One provides functionality of material revaluation (available for perpetual and nonperpetual Inventory systems). To comply with the standard requirements, users should use expense accounts for any inventory write-downs. In case of reversal transactions, such as value increases, users should also use the expense account. Such transactions are also reflected in SAP Business One inventory reports such the audit report or the inventory valuation simulation report.

SAP Business One lets you set calculation formulas for products and specify the value of the finished goods. However, the integration of the scrap value or its further use in the production is not part of the standard functionality. Therefore, any required adjustments should be made by the company's accountant using other functionalities (for example, material revaluation)

SAP Business One lets you simulate the valuation method for items and groups of items, using the inventory valuation simulation report. It gives the accountant the opportunity to look at and disclose the inventory valuated in the proper valuation method from the IFRS point of view.

SAP Business One allows you to classify the inventories also as fixed assets by selecting the *Fixed Assets* check box. However the related posting and disclosure should be done by your company accountant.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 13. The implications of this section to SAP Business One are in line with the functionality description available for the full IAS2.

IAS 7 Cash Flow Statements

Standard Summary

The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows that classifies cash flows during the period from operating, investing, and financing activities.

Cash flows are inflows and outflows of cash and cash equivalents. *Cash* comprises cash on hand and demand deposits. *Cash equivalents* are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The statement of cash flows shall report cash flows during the period classified by operating, investing, and financing activities.

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity.

An entity shall report cash flows from operating activities using either:

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

An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the statement of financial position.

Impact on SAP Business One Functionality

SAP Business One supports the preparation of cash flow statements by both direct and indirect methods, using a combination of the following functionalities:

- Marking G/L accounts as cash accounts,
- Marking specific cash-relevant transactions by specific transaction codes or identifiers. These identifiers are not available in the cash flow report so you can use the G/L report for identifying transactions. You can also use this approach for handling a transaction involving more than one payment mean.
- Analyzing cash-relevant transactions via a cash flow report and a cash report [1]

The summarized information serves as a basis for the preparation of the cash flow statement according to the standard.

[1] Available only for Czech Republic, Slovakia, Hungary, Poland and Russia.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 7. The most important implication for SAP Business One is the use of this method in the preparation of cash flow statements. Although this standard allows both the direct and indirect methods, the recommendation is to use the direct method mainly because of its value for readers of the financial statements. You can use it via a thorough system setup (for example, by the cash G/L accounts). This method provides an opportunity for better transaction identification as well as cross-checking.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Standard Summary

The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.

Accounting policies are the specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements (for example, change in the valuation method of inventory or change in the useful life of fixed assets). When an IFRS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the IFRS and considering any relevant Implementation Guidance issued by the IASB for the IFRS.

The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. A *change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset that, results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors. The effect of a change in an accounting estimate, shall be recognized prospectively by including it in profit or loss in:

a. the period of the change, if the change affects that period only; or
b. the period of the change and future periods, if the change affects both.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

a. was available when financial statements for those periods were authorized for issue; and
b. could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:

a. restating the comparative amounts for the prior periods presented in which the error occurred; or
b. if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities, and equity for the earliest prior period presented.

Impact on SAP Business One Functionality

To comply with requirements in this standard, users need to exercise their judgment independent of SAP Business One, since the factors involved are outside the control of SAP.

You need to consider manual adjustments.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 10. The same SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IAS 11 Construction Contracts

Standard Summary

The objective of this Standard is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Due to the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed.

This Standard shall be applied in accounting for construction contracts in the financial statements of contractors.

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

Contract revenue shall comprise:

a. the initial amount of revenue agreed in the contract; and
b. variations in contract work, claims, and incentive payments:
    i. to the extent that it is probable that they will result in revenue; and
    ii. they are capable of being reliably measured

Contract revenue is measured at the fair value of the consideration received or receivable.

Contract costs shall comprise:

a. costs that relate directly to the specific contract;
b. costs that are attributable to contract activity in general and can be allocated to the contract; and
c. such other costs as are specifically chargeable to the customer under the terms of the contract.

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract shall be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period.

When the outcome of a construction contract cannot be estimated reliably:

a. revenue shall be recognized only to the extent of contract costs incurred that it is probable will be recoverable; and
b. contract costs shall be recognized as an expense in the period in which they are incurred.

When it is probable that total contract costs exceed total contract revenue, the expected loss shall be recognized as an expense immediately.

Impact on SAP Business One Functionality

Companies can enter relevant documents (such as sales and purchasing invoices or down payment invoices) via standard functionality. The level of construction should be measured separately and subsequently the accounting treatment of revenue and costs associated with construction contracts should be covered by manual adjustments.

The possible options involve the utilization of the projects for the purpose of monitoring the relevant transactions. The summarized transactions should be subsequently analyzed and manual adjustments should be made if the percentage of the completion defers from the amounts in accounting.

The values which should be presented in the financial statements as revenues and expenses are independent from the invoiced amounts or received / issued payments.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 23 dedicated to various types of revenues. The SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IAS 16 Property, Plant, and Equipment

Standard Summary

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognized in relation to them.

Property, plant and equipment are tangible items that:

a. are held for use in the production or supply of goods or services, for rental to others (exception for real estate for rent, they are covered by IAS 40), or for administrative purposes; and
b. are expected to be used during more than one (accounting/annual) period.

The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

a. it is probable that future economic benefits associated with the item will flow to the entity; and
b. the cost of the item can be measured reliably.

Measurement at recognition: An item of property, plant, and equipment that qualifies for recognition as an asset shall be measured at its cost. The cost of an item of property, plant, and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit unless such interest is recognized in the carrying amount of the item in accordance with IAS 23.

The cost of an item of property, plant, and equipment comprises:

a. its purchase price, including import duties and nonrefundable purchase taxes, after deducting trade discounts and rebates.
b. any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
c. the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Measurement after recognition: An entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant, and equipment.

Cost model: After recognition as an asset, an item of property, plant, and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Revaluation model: After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

If an asset's carrying amount increases as a result of a revaluation, the increase shall be recognized in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognized in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss. If an asset's carrying amount decreases as a result of a revaluation, the decrease shall be recognized in profit or loss. However, the decrease shall be recognized in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. *Depreciable amount* is the cost of an asset, or other amount substituted for cost, less its residual value. Each part of an item of property, plant, and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. The depreciation charge for each period shall be recognized in profit or loss unless it is included in the carrying amount of another asset. The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

The *residual value* of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

To determine whether an item of property, plant and equipment is impaired, an entity applies IAS 36 *Impairment of Assets*.

Impact on SAP Business One Functionality

SAP Business One provides specific functionality in the Fixed Assets add-on (available only for some localizations) which supports this standard. You can specify the acquisition value, and select the method of depreciation (for accounting and tax purposes), such complete or partial retirement (impairment) which suits the company's accounting needs. For reporting purposes, there is the asset history sheet report with the following relevant information:

- Asset master data
- Acquisition and production costs / start of fiscal year (APC Start FY)
- Acquisition
- Retirement
- Transfer
- Write-up
- Accumulated depreciation (acc. depr.)
- Net book value / start of fiscal year (NBV Start Fy)
- Depreciation in current fiscal year (depr. in curr.)
- Acquisition and production costs/end of fiscal year (APC End FY)
- Net book value / end of fiscal year (NBV End FY)

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 17. The SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IAS 17 Leases

Standard Summary

The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to leases.

The classification of leases adopted in this Standard is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

Leases in the financial statements of lessees

Operating Leases

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

Finance Leases

At the commencement of the lease term, lessees shall recognize finance leases as assets and liabilities in their balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate shall be used. Any initial direct costs of the lessee are added to the amount recognized as an asset.

Minimum lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rents shall be charged as expenses in the periods in which they are incurred.

A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognized shall be calculated in accordance with IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. If there is no reasonable certainty that the lessee obtains ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

Leases in the financial statements of lessors

Operating Leases

Lessors shall present assets subject to operating leases in their statements of financial position according to the nature of the asset. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets, and depreciation shall be calculated in accordance with IAS 16 and IAS 38. Lease income from operating leases shall be recognized in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished

Finance Leases

Lessors shall recognize assets held under a finance lease in their statements of financial position and present them as a receivable at an amount equal to the net investment in the lease. The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.

Manufacturer or dealer lessors shall recognize selling profit or loss in the period, in accordance with the policy followed by the entity for outright sales. If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognized as an expense when the selling profit is recognized.

Sale and leaseback transactions

A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The result of the transaction is presented in the Financial Statements.

Impact on SAP Business One Functionality

You can specify separate control accounts for business partners to monitor lease receivables/payables to their presentations in the company's financial statements.

In addition, SAP Business One lets you mark transactions via a specific transaction code or identifier. Such transactions can then be filtered as IAS 17 relevant in the standard SAP Business One reports (for example, G/L Report).

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 20. The SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IAS 18 Revenue

Standard Summary

The primary issue in accounting for revenue is determining when to recognize revenue. Revenue is recognized when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably.

This Standard shall be applied in accounting for revenue arising from the following transactions and events:

a. the sale of goods;
b. the rendering of services; and
c. the use by others of entity assets yielding interest, royalties, and dividends.

Revenue shall be measured at the fair value of the consideration received or receivable. *Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Revenue from the sale of goods shall be recognized when all the conditions defined by standard have been satisfied.

When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognized by reference to the stage of completion of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when all the conditions defined by standard are satisfied.

The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method (similar approach is applicable for IAS11). Under this method, revenue is recognized in the accounting periods in which the services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period.

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

Revenues for interests, royalties and dividends shall only be recognized on the basis defined by the standard.

Impact on SAP Business One Functionality

SAP Business One by default posts to revenue accounts in all relevant transactions relating to sale of goods and services such as sales invoices (items and services), credit memos and goods issues. You can select the revenue accounts manually for each document.

For posting of revenues resulting from interests, royalties and dividends, it is recommended to use either manual journal entries with appropriate revenue accounts or proper setup to define postings made with bank statement processing.

It is up to the user to make sure other conditions defined by the standard are fulfilled since they cannot be assessed automatically by SAP Business One. This is relevant mainly, but not limited to, fair value, measure of risks and rewards, costs and ownership transfer, and so on. The statement is related to international commercial terms (Incoterms), although they are not mentioned in the standard directly. The important point is considering the legal as well as the economic side of the transaction. It is essential to take into account the irreversibility of the transaction.

Certain adjustments are inevitable when posting delivery before the period end, and posting the invoice relating to this delivery in the period after. To comply with the standard, revenue should be recognized in the period when delivery (transfer of property rights to the asset) was realized. The adjustments are relevant also when there is an expectation that risk varies for certain goods. When the risk is higher a company can create reserves (to the expenses) and if the risk is decreased, the reserves can be released (decrease of expenses).

SAP Business One's reserve invoice supports this standard. However, the following points should be considered:

- Right to obtain goods when required
- Goods must be separately identified from the seller's other stock, and should not be capable of being used to fill other orders received between the invoice document date and the shipment of the goods to the customer.
- Goods must be complete and ready for delivery

When goods are delivered without an invoice, the occurrence of the sale is taken into consideration and, if necessary, the revenues should be recognized even there is no paper invoice.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 23. The SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IAS 21 The Effects of Changes in Foreign Exchange Rates

Standard Summary

An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency. The principal issues are which exchange rates to use and how to report the effects of changes in exchange rates in the financial statements.

A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

At the end of each reporting period:

a. foreign currency monetary items shall be translated using the closing rate;
b. nonmonetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and
c. nonmonetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.

The Standard permits an entity to present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

Foreign operation is an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change. If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies.* The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the standard defined procedures.

Impact on SAP Business One Functionality

SAP Business One supports standard reporting in two different currencies: local and system. All automatic transactions are translated to local and system currency from foreign currency with the transaction date, that is, the posting date. To report financial statements in other than the local currency, manual adjustments are necessary using manual journal entries, exchange rate differences (foreign currency versus local currency) and / or conversion differences functionality (local currency versus system currency). Special attention should be given to inventory transactions in foreign currency (see IAS 2).

You can set the currency used for the reporting purposes as decided by the company's management. It is important to follow the recalculation rules from the functional currency to the presentation currency.

The standard takes into account that the key date for the determination of the exchange rate for the transaction is the transaction date, when the transaction took place. It is also recommended for SAP Business One users to consider the transaction date. SAP Business One allows users to set one of the following dates as the reference for purchasing documents: posting dates, document dates, or VAT dates (for CEE countries). You can also specify the exchange rate for a particular document.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 30. The same SAP Business One functionality as described above for supporting compliance with the Standard for SMEs. It is important for the company to consider and plan the use of the functional and reporting currency in line with SAP Business One options for local and system currency.

IAS 24 Related Party Disclosures

Standard Summary

The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

A party is related to an entity if:

a. directly, or indirectly through one or more intermediaries, the party:
   i. controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries, and fellow subsidiaries);
   ii. has an interest in the entity that gives it significant influence over the entity; or
   iii. has joint control over the entity;
b. the party is an associate (as defined in IAS 28 *Investments in Associates*) of the entity;
c. the party is a joint venture in which the entity is a venturer (see IAS 31 *Interests in Joint Ventures*);
d. the party is a member of the key management personnel of the entity or its parent;
e. the party is a close member of the family of any individual referred to in (a) or (d);
f. the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
g. the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

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

An entity shall disclose key management personnel compensation in total and for each of the defined categories.

The disclosures required by paragraph 17 shall be made separately for each of the following categories:

a. the parent;
b. entities with joint control or significant influence over the entity;
c. subsidiaries;
d. associates;
e. joint ventures in which the entity is a venturer;
f. key management personnel of the entity or its parent; and
g. other related parties.

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

Impact on SAP Business One Functionality

From the nature of the requirements of this paper, possibilities for automation are limited. You can identify transactions using identifiers or reference fields that are automatically transferred from marketing documents to journal entries. You can filter and report these transactions for consolidation or for the purpose of disclosure in the notes to financial statements using standard SAP Business One reports (for example, G/L reports).

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 33. The functionality of SAP Business One for specifying relevant transactions lets you act in compliance with the Standard for SMEs. Transaction identification is needed for individual as well as consolidated financial statement preparation.

IAS 27 Consolidated and Separate Financial Statements

Standard Summary

The objective of IAS 27 is to enhance the relevance, reliability, and comparability of the information that a parent entity provides in its separate financial statements and in its consolidated financial statements for a group of entities under its control. The Standard specifies:

a. the circumstances in which an entity must consolidate the financial statements of another entity (being a subsidiary);
b. the accounting for changes in the level of ownership interest in a subsidiary;
c. the accounting for the loss of control of a subsidiary; and
d. the information that an entity must disclose to enable users of the financial statements to evaluate the nature of the relationship between the entity and its subsidiaries.

Consolidated financial statements are the financial statements of a group presented as those of a single economic entity. A group is a parent and all its subsidiaries. A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent). Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

A parent must consolidate its investments in subsidiaries. There is a limited exception available to some nonpublic entities. However, that exception does not relieve venture capital organizations, mutual funds, unit trusts, and similar entities from consolidating their subsidiaries.

Noncontrolling interests must be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent. Total comprehensive income must be attributed to the owners of the parent and to the noncontrolling interests even if this results in the noncontrolling interests having a deficit balance.

Changes in a parent's ownership interest in a subsidiary that do not result in the loss of control are accounted for within equity.

When an entity loses control of a subsidiary it derecognizes the assets and liabilities and related equity components of the former subsidiary. Any gain or loss is recognized in profit or loss. Any investment retained in the former subsidiary is measured at its fair value at the date when control is lost.

A parent must **not** present consolidated financial statements if and only if:

a. the parent is itself a wholly owned subsidiary, or is a partially owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
b. the parent's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
c. the parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and
d. the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.

When an entity elects, or is required by local regulations, to present separate financial statements, investments in subsidiaries, jointly controlled entities, and associates must be accounted for at cost or in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

An entity must disclose information about the nature of the relationship between the parent entity and its subsidiaries.

Impact on SAP Business One Functionality

SAP Business One does not support automatic consolidation and separate financial statements. However, it does allow users to identify transactions related to intragroup transactions in the following areas:

- Inventories
- Receivables/payables
- Cash
- Expenses and revenues
- Dividends
- Rendered services

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 9. The basic prerequisite for the preparation of consolidated financial statements is the financial statement from the subsidiary prepared based on the same rules and accounting policies as for the parent company. This increases the importance of the preparation of individual financial statements for the company as well as the identification of the specific transactions with the parent company for later exclusion for consolidation purposes. Therefore sections 3 or 33 are related to this section as well.

IAS 29 Financial Reporting in Hyperinflationary Economies

Standard Summary

This Standard shall be applied to the financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.

This Standard does not establish an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgment when restatement of financial statements in accordance with this Standard becomes necessary. Hyperinflation is indicated by characteristics of the economic environment of a country that include, but are not limited to, the following:

a. the general population prefers to keep its wealth in nonmonetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;
b. the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;
c. sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;
d. interest rates, wages, and prices are linked to a price index; and
e. the cumulative inflation rate over three years is approaching, or exceeds, 100%.

The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy shall be stated in terms of the measuring unit current at the balance sheet date. The corresponding figures for the previous period required by IAS 1 Presentation of Financial Statements and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the balance sheet date.

The restatement of financial statements in accordance with this Standard requires the application of certain procedures as well as judgment. The consistent application of these procedures and judgments from period to period is more important than the precise accuracy of the resulting amounts included in the restated financial statements.

The restatement of financial statements in accordance with this Standard requires the use of a general price index that reflects changes in general purchasing power. It is preferable that all entities that report in the currency of the same economy use the same index.

When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this Standard, it shall treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.

Impact on SAP Business One Functionality

When initializing a new company database in a hyperinflationary economy, you can use the SAP Business One system currency functionality to stabilize financial values by using a nonnational and noninflated currency. However, this option is disabled after any transaction with impact on the general ledger is added.

The G/L accounts revaluation wizard (available for relevant localizations) should be used to run the G/L account revaluation process on balance sheet accounts according to user-defined parameters. This helps you update the actual values of balance sheet accounts.

To comply with the standard, manual adjustments may be inevitable.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 31. The SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IAS 31 Interests in Joint Ventures

Standard Summary

This Standard shall be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income, and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.

Jointly controlled assets

Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. The assets are used to obtain benefits for the venturers.

In respect of its interest in jointly controlled assets, a venturer shall recognize in its financial statements:

a. its share of the jointly controlled assets, classified according to the nature of the assets;
b. any liabilities that it has incurred;
c. its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;
d. any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and
e. any expenses that it has incurred in respect of its interest in the joint venture.

Jointly controlled entities

Proportionate consolidation is a method of accounting whereby a venturer's share of each of the assets, liabilities, income, and expenses of a jointly controlled entity is combined line by line with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.

The equity method is a method of accounting whereby an interest in a jointly controlled entity is initially recorded at cost and adjusted thereafter for the post-acquisition change in the venturer's share of net assets of the jointly controlled entity. The profit or loss of the venturer includes the venturer's share of the profit or loss of the jointly controlled entity. This information should be presented on the separate line in the Statement of Comprehensive Income (for IAS 28 and IAS 31 together).

Separate financial statements of a venturer

When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities, and associates that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for either:

a. at cost, or
b. in accordance with IAS 39.

Impact on SAP Business One Functionality

SAP Business One enables the creation of a property flag on inventory and fixed assets items to identify whether a particular object is part of joint venture. This can help the company to filter these items for disclosure in balance sheets.

You can perceive a joint venture as a business partner of the SAP Business One company. You can therefore identify this partner with a special flag (property) to distinguish them from other partners and to report on this partner specifically.

If your company uses proportionate consolidation as a method of accounting, you can create manual journal entry adjustment transactions to reflect a consolidated entity.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 31. The SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IAS 34 Interim Financial Reporting

Standard Summary

The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period.

Interim financial report means a financial report containing either a complete set of financial statements (as described in IAS 1 Presentation of Financial Statements (as revised in 2007)) or a set of condensed financial statements (as described in this Standard, there are specific rules for the presentation of comparable information from the beginning of the accounting period) for an interim period. Interim period is a financial reporting period shorter than a full financial year.

An interim financial report shall include, at a minimum, the following components:

a. condensed statement of financial position;
b. condensed statement of comprehensive income, presented as either;
   i. a condensed single statement; or
   ii. a condensed separate income statement and a condensed statement of comprehensive income;
c. condensed statement of changes in equity;
d. condensed statement of cash flows; and
e. selected explanatory notes.

If an entity publishes a set of condensed financial statements in its interim financial report, those condensed statements shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard. Additional line items or notes shall be included if their omission would make the condensed interim financial statements misleading.

In deciding how to recognize, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data. In making assessments of materiality, it shall be recognized that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.

An entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements (which covers the interim periods), except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis.

Impact on SAP Business One Functionality

SAP Business One comprises a set of financial reports that aggregate all business transactions with an impact on accounting. These provide a basis for the presentation of fair and accurate reports compliant with IFRS after making manual adjustments to differentiate IFRS relevant transactions from non-IFRS relevant transactions.

To disclose comparative information in respect of the previous period for all amounts reported in the current period's financial statements, we recommend that you use comparison financial statements.

Use a combination of various reports, ad hoc queries, and specific tools, to help you to identify changes on equity and cash accounts.

SAP Business One also provides item properties and item groups functionality for filtering and tracking various material classes easily.

Standard for SMEs Implication

The Standard for SMEs does not specifically address the presentation of the interim financial statements.

IAS 37 Provisions, Contingent Liabilities, and Contingent Assets

Standard Summary

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities, and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing, and amount.

Provisions

A provision is a liability of uncertain timing or amount. and it should be recognized when, and only when:

a. an entity has a present obligation (legal or constructive) as a result of a past event;
b. it is probable (that is, more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and
c. a reliable estimate can be made of the amount of the obligation. The Standard notes that it is only in extremely rare cases that a reliable estimate will not be possible.

Measurement

The amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.

Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes.

Impact on SAP Business One Functionality

Considering whether a certain asset is doubtful, or whether a receivable or a liability is contingent depends on company judgments and factors outside SAP Business One.

However, you can create a manual journal entry to post any provision for an asset in the holding of the company, or to classify a contingent liability or a contingent asset, and to revaluate them to their fair value.

Additionally, SAP Business One provides users with options to create manual journal entries with a 13^{th} period flag to distinguish various period-end closing transactions as well as IFRS relevant transactions.

You can use the doubtful debts functionality available under the customer receivables aging report to post allowances for receivables that are less likely to be collected at the end. You can report receivables from a standard receivable account to a provision specific general ledger account with offset posting to an expense account.

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 21. You can use the same SAP Business One functionality as described above for supporting compliance with the Standard for SMEs.

IAS 38 Intangible Assets

Standard Summary

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

An intangible asset is an identifiable nonmonetary asset without physical substance.

An intangible asset shall be measured initially at cost.

The cost of a separately acquired intangible asset comprises:

a. its purchase price, including import duties and nonrefundable purchase taxes, after deducting trade discounts and rebates; and
b. any directly attributable cost of preparing the asset for its intended use.

Expenditure on an intangible item shall be recognized as an expense when it is incurred unless:

a. it forms part of the cost of an intangible asset that meets the recognition criteria; or
b. the item is acquired in a business combination and cannot be recognized as an intangible asset. If this is the case, it forms part of the amount recognized as goodwill at the acquisition date (see IFRS 3).

An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

Measurement after recognition

An entity shall choose either the cost model or the revaluation model as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.

Cost model: After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortization and any accumulated impairment losses.

Revaluation model: After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market.

The residual value of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:

a. there is a commitment by a third party to purchase the asset at the end of its useful life; or
b. there is an active market for the asset and:
    i. residual value can be determined by reference to that market; and
    ii. it is probable that such a market will exist at the end of the asset's useful life.

An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:

a. the technical feasibility of completing the intangible asset so that it will be available for use or sale.
b. its intention to complete the intangible asset and use or sell it.
c. its ability to use or sell the intangible asset.
d. how the intangible asset will generate probable future economic benefits.

Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.

e. the availability of adequate technical, financial, and other resources to complete the development and to use or sell the intangible asset.
f. its ability to measure reliably the expenditure attributable to the intangible asset during its development.

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:

a. costs of materials and services used or consumed in generating the intangible asset;
b. costs of employee benefits (as defined in IAS 19) arising from the generation of the intangible asset;
c. fees to register a legal right; and
d. amortization of patents and licenses that are used to generate the intangible asset.

Impact on SAP Business One Functionality

Calculating the cost of separately acquired intangible asset requires company judgment independent from SAP Business One. Factors to consider are outside SAP Business One control.

You should handle intangible assets using the Fixed Assets add-on (for localizations where applicable). This add-on also handles depreciation (regular or special).

Standard for SMEs Implication

The relevant section in the Standard for SMEs is section 18. You can use the SAP Business One functionality as described above to act in compliance with the Standard for SMEs.

IAS 39 Financial Instruments: Recognition and Measurement

Standard Summary

Objective

The objective of this Standard is to establish principles for recognizing and measuring financial assets, financial liabilities, and some contracts to buy or sell nonfinancial items. Requirements for presenting information about financial instruments are in IAS 32 *Financial Instruments: Presentation*. Requirements for disclosing information about financial instruments are in IFRS 7 *Financial Instruments: Disclosures*.

For the purpose of measuring a financial asset after initial recognition, this Standard classifies financial assets into the following four categories defined in paragraph 9:

a. financial assets at fair value through profit or loss;
b. held-to-maturity investments;
c. loans and receivables; and
d. available-for-sale financial assets.

After initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following financial assets:

a. loans and receivables as defined in paragraph 9, which shall be measured at amortized cost using the effective interest method;
b. held-to-maturity investments as defined in paragraph 9, which shall be measured at amortized cost using the effective interest method; and
c. investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost (see Appendix A paragraphs AG80 and AG81).

Impairment and uncollectibility of financial assets

An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Subsequent measurement of financial liabilities

After initial recognition, an entity shall measure all financial liabilities at amortized cost using the effective interest method, except for:

a. financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which shall be measured at cost.
b. financial liabilities that arise when a transfer of a financial asset does not qualify for derecognizing or when the continuing involvement approach applies. Paragraphs 29 and 31 apply to the measurement of such financial liabilities.
c. financial guarantee contracts as defined in paragraph 9. After initial recognition, an issuer of such a contract shall (unless paragraph 47(a) or (b) applies) measure it at the higher of:
    i. the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
    ii. the amount initially recognized (see paragraph 43) less, when appropriate, cumulative amortization recognized in accordance with IAS 18 *Revenue*.

d. (d) commitments to provide a loan at a below-market interest rate. After initial recognition, an issuer of such a commitment shall (unless paragraph 47(a) applies) measure it at the higher of:
    i. the amount determined in accordance with IAS 37; and
    ii. the amount initially recognized (see paragraph 43) less, when appropriate, cumulative amortization recognized in accordance with IAS 18.

Derecognizing of a financial liability

An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—that is, when the obligation specified in the contract is discharged or canceled or expires.

Derecognizing of a financial asset

The special flow of the evaluation is necessary for the decision of whether and to what extent a financial asset is derecognized.

Impact on SAP Business One functionality

You use the effective interest method for the discounting of receivables. For SAP Business One purposes, note the following prerequisites:

- Original receivable is in the system
- If you need to discount the receivable, you can post the calculated value to the system as a manual journal entry, increasing, or decreasing the value of the original receivable for financial reporting purposes

An example of the type of embedded derivative mentioned in the standard is a financial lease contract including the possibility that at the end of the lease the lessee can buy the subject of lease for a specific price.

The amortized cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Standard for SMEs Implication

The relevant sections for this and the additional two standards below in the Standard for SMEs are sections 11 and 12. The SAP Business One functionality as described above lets you act in compliance with the Standard for SMEs.

IFRS 7 Financial Instruments: Disclosures

Standard Summary

The objective of this IFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate:

a. the significance of financial instruments for the entity's financial position and performance; and
b. the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

The qualitative disclosures describe management's objectives, policies, and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

The IFRS applies to all entities, including entities that have few financial instruments (for example, a manufacturer whose only financial instruments are accounts receivable and accounts payable) and those that have many financial instruments (for example, a financial institution most of whose assets and liabilities are financial instruments).

When this IFRS requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

The principles in this IFRS complement the principles for recognizing, measuring, and presenting financial assets and financial liabilities in IAS 32 Financial Instruments: Presentation and IAS 39 Financial Instruments: Recognition and Measurement

Impact on SAP Business One functionality

One of the important disclosures is the analysis of the due dates of the payables as part of the liquidity risk. The payment schedule of the payables represents the outflow of the cash and has a significant impact on the liquidity risk.

SAP Business One lets you prepare reports showing the aging of receivables and payables. This functionality supports the mentioned need for disclosure and enables the company to analyze its future cash flows.

Standard for SMEs Implication

The relevant sections for this and the additional two standards below in the Standard for SMEs are sections 11 and 12. You can use the SAP Business One functionality as described above to act in compliance with the Standard for SMEs.

IFRS 32 Financial Instruments: Presentation

Standard Summary

The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities, and equity instruments; the classification of related interest, dividends, losses, and gains; and the circumstances in which financial assets and financial liabilities should be offset.

The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in IAS 39 Financial Instruments: Recognition and Measurement, and for disclosing information about them in IFRS 7 Financial Instruments: Disclosures.

The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset, or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset, and an equity instrument.

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

<u>A financial asset is any asset that is:</u>

a. cash;
b. an equity instrument of another entity;
c. a contractual right:
    i. to receive cash or another financial asset from another entity; or
    ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or
d. a contract that will or may be settled in the entity's own equity instruments and is:
    i. a nonderivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
    ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

<u>A financial liability is any liability that is:</u>

a. a contractual obligation:
    i. to deliver cash or another financial asset to another entity; or
    ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or
b. a contract that will or may be settled in the entity's own equity instruments and is:
    i. a nonderivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
    ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

a. the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;
b. the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or
c. The instrument has all the features and meets the conditions in paragraphs 16A and 16B.

A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

a. currently has a legally enforceable right to set off the recognized amounts; and
b. intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously

Impact on SAP Business One Functionality

To prepare the presentation of the financial assets, liabilities and equity in a correct format, use the financial report templates in SAP Business One. These templates let you prepare various reports with the required structure by integrating the different financial assets, liabilities, and equity parts into the proper sections of the reports.

Standard for SMEs Implication

The relevant sections for this and the additional two standards below in the Standard for SMEs are sections 11 and 12. The SAP Business One functionality as described above enables you to act in compliance with the Standard for SMEs.

Standard for Small and Medium-sized Entities

Standard basic definitions and principles

Small and medium-sized entities are entities that:

a. do not have public accountability; and
b. publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

An entity has public accountability if:

a. its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
b. it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds, and investment banks.

The objective of financial statements of an SME is to provide information about the financial position, performance, and cash flows of the entity 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.

Qualitative characteristics of information in financial statements

Understandability

The information provided in financial statements should be presented in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, the need for understandability does not allow relevant information to be omitted on the grounds that it may be too difficult for some users to understand.

Relevance

The information provided in financial statements must be relevant to the decision making needs of users. Information has the quality of relevance when it capable of influencing the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

Materiality

Information is material—and therefore has relevance—if its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. However, it is inappropriate to make, or leave uncorrected, immaterial departures from the IFRS for Small and Medium-sized Entities to make a particular presentation of an entity's financial position, financial performance or cash flows.

Reliability

The information provided in financial statements must be reliable. Information is reliable when it is free from material error and bias and represents faithfully that which it either purports to represent or could reasonably be expected to represent. Financial statements are not free from bias (that is, not neutral) if, by the selection or presentation of information, they are intended to influence the making of a decision or judgment to achieve a predetermined result or outcome.

Substance over form

Transactions and other events and conditions should be accounted for and presented in accordance with their substance and not merely their legal form. This enhances the reliability of financial statements.

Prudence

The uncertainties that inevitably surround many events and circumstances are acknowledged by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias.

Completeness

To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability

Users must be able to compare the financial statements of an entity through time to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities to evaluate their relative financial position, performance, and cash flows. Hence, the measurement and display of the financial effect of like transactions and other events and conditions must be carried out in a consistent way throughout an entity and over time for that entity, and in a consistent way across entities. In addition, users must be informed of the accounting policies employed in the preparation of the financial statements, and of any changes in those policies and the effects of such changes.

Timeliness

To be relevant, financial information must be able to influence the economic decisions of users. Timeliness involves providing the information within the decision time frame. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the needs of users in making economic decisions.

Balance between benefit and cost

The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgmental process. Furthermore, the costs are not necessarily borne by those users who enjoy the benefits, and often the benefits of the information are enjoyed by a broad range of external users.

Financial reporting information helps capital providers make better decisions, which results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. Individual entities also enjoy benefits, including improved access to capital markets, favorable effect on public relations, and perhaps lower costs of capital. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes.

Accrual basis

An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting. On the accrual basis, items are recognized as assets, liabilities, equity, income, or expenses when they satisfy the definitions and recognition criteria for those items.

Financial position

The financial position of an entity is the relationship of its assets, liabilities, and equity as of a specific date as presented in the statement of financial position. These are defined as follows:

a. An **asset** is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
b. A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
c. **Equity** is the residual interest in the assets of the entity after deducting all its liabilities.

Assets

The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. Those cash flows may come from using the asset or from disposing of it.

Many assets, for example property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset. Some assets are intangible.

In determining the existence of an asset, the right of ownership is not essential. Thus, for example, property held on a lease is an asset if the entity controls the benefits that are expected to flow from the property.

Liabilities

An essential characteristic of a liability is that the entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a constructive obligation. A legal obligation is legally enforceable as a consequence of a binding contract or statutory requirement. A constructive obligation is an obligation that derives from an entity's actions when:

a. by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept particular responsibilities, and
b. as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

The settlement of a present obligation usually involves the payment of cash, transfer of other assets, provision of services, the replacement of that obligation with another obligation, or conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Equity

Equity is the residual of recognized assets minus recognized liabilities. It may be subclassified in the statement of financial position. For example, in a corporate entity, subclassifications may include funds contributed by shareholders, retained earnings and gains or losses recognized directly in equity.

Performance

Performance is the relationship of the income and expenses of an entity during a reporting period. This IFRS permits entities to present performance in a single financial statement (a statement of comprehensive income) or in two financial statements (an income statement and a statement of comprehensive income). Total comprehensive income and profit or loss are frequently used as measures of performance or as the basis for other measures, such as return on investment or earnings per share.

Income and expenses are defined as follows:

a. **Income** is increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors.
b. **Expenses** are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors.

Income

The definition of income encompasses both revenue and gains.

a. **Revenue** is income that arises in the course of the ordinary activities of an entity and is referred to by a variety of names including sales, fees, interest, dividends, royalties, and rent.
b. **Gains** are other items that meet the definition of income but are not revenue. When gains are recognized in the statement of comprehensive income, they are usually displayed separately because knowledge of them is useful for making economic decisions.

Expenses

The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity.

a. **Expenses** that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages, and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, or property, plant and equipment.
b. **Losses** are other items that meet the definition of expenses and may arise in the course of the ordinary activities of the entity. When losses are recognized in the statement of comprehensive income, they are usually presented separately because knowledge of them is useful for making economic decisions.

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