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Practice Section

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Financial Reporting Framework for Small- and Medium-Sized Entities

Illustrations of the Application of Certain Principles and Criteria of the FRF for SMEs ™ Accounting Framework

Illustrations of the Application of Certain Principles and Criteria of the FRF for SMEs™ Accounting Framework

Introduction

The FRF for SMEs™ accounting framework is a simplified and intuitive non-GAAP accounting framework. Management and accounting professionals should use its judgment and apply the general principles, concepts, and criteria contained in the framework when developing accounting policies and accounting for transactions and events. As such, extensive examples and illustrations have not been included in the FRF for SMEs accounting framework. However, AICPA staff believes that the illustrations on the following pages may provide helpful guidance to those implementing the framework. These illustrations of the application of certain principles and criteria in the framework are not part of the framework. Management and others should follow the requirements of the FRF for SMEs accounting framework and use their judgment in applying those requirements to particular transactions and events.

Illustrative Example of Transition—Initial Application of the FRF for SMEs™ Accounting Framework

(This material is illustrative only.)

This example illustrates how the accounting treatment specified in chapter 3, "Transition," of *Financial Reporting Framework for Small- and Medium-Sized Entities*, might be applied in a particular situation. Matters of principle relating to particular situations should be decided in the context of the framework.

Background

ABC Company has a calendar year end. ABC Company's first reporting period using the FRF for SMEs™ accounting framework is December 31, 20X2, and it intends to issue comparative financial statements. Therefore, its date of transition to the framework is the beginning of business on January 1, 20X1 (or, equivalently, close of business on December 31, 20X0). ABC Company presented financial statements under U.S. GAAP annually to December 31st each year up to, and including, December 31, 20X1.

Application of Requirements

ABC Company would apply the FRF for SMEs™ accounting framework effective for periods ending on December 31, 20X2 in:

a. preparing its opening statement of financial position at January 1, 20X1; and

b. preparing and presenting its statement of financial position for December 31, 20X2 (including comparative amounts for 20X1), statement of operations, statement of retained earnings, and statement of cash flows for the year ending December 31, 20X2 (including comparative amounts for 20X1), and disclosures (including comparative information for 20X1). The disclosures would include the amount of each charge or credit to equity at the date of transition to the FRF for SMEs accounting framework resulting from the adoption of the principles in the framework and the reasons therefor.

Illustrative Example of a Summary of Significant Accounting Policies

(This material is illustrative only.)

This example illustrates how an entity might present its summary of significant accounting policies in the notes to the financial statements.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accompanying financial statements have been prepared in accordance with the *Financial Reporting Framework for Small- and Medium-Sized Entities* issued by the American Institute of Certified Public Accountants. This special purpose framework, unlike generally accepted accounting principles (GAAP) in the United States of America, does not require the recognition of deferred taxes. We have chosen the option to recognize only current income tax assets and liabilities. *[Other primary differences would be described as necessary.]*

Nature of Business

ABC, Inc. (the Company) is primarily involved in the steel service center and reinforcing bar (rebar) fabrication business. Through the Company's steel service centers located in Virginia, West Virginia, and North Carolina, the Company distributes a full line of hot-rolled and cold-rolled carbon steel and structural steel to industrial accounts.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of ABC, Inc. and its wholly- owned subsidiary, SubCo, Inc. All significant intercompany transactions have been eliminated.

or

Investments in subsidiaries that the Company controls are accounted for under the equity method. Under the equity method, original investments are recorded at cost and adjusted by the Company's share of undistributed earnings or losses of these entities.

Inventory

Inventory consists of new steel, scrap steel, and hardware supplies and is stated at the lower of cost (determined on a weighted-average basis) or net realizable value.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with original maturities of three months or less to be cash equivalents.

Accounts Receivable

The Company reports trade receivables at net realizable value. Management determines the allowance for doubtful accounts based on historical losses and current economic conditions. On a continuing basis, management analyzes delinquent receivables and, once these receivables are determined to be uncollectible, they are written off through a charge against the allowance.

Investments

Investments in marketable equity and debt securities held for sale are included in other assets and measured at market value. Accordingly, changes in market value are included in net income in the period incurred. Investments in nonmarketable securities are carried at cost and included in other assets.

Intangible Assets

Intangible assets subject to amortization consist of loan costs. These costs are amortized on a straight-line basis.

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Assets are depreciated over their estimated remaining useful lives using the straight-line method. Maintenance, repairs, and minor renewals are charged against income, when incurred. Additions and significant renewals are capitalized. The cost and accumulated depreciation of assets sold or retired are removed from the respective accounts. Any gain or loss from the sale or retirement of property is reflected in income.

Amortization of assets acquired under a capital lease is computed using the straight-line method over the lesser of the lease term or the useful life of the leased asset.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with *Financial Reporting Framework for Small and Medium-Sized Entities* requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

Shipping and Handling

Costs incurred for shipping and handling are included in cost of sales in the statements of income.

Income Taxes

The Company elected under the Internal Revenue Code to be taxed as an S corporation. In lieu of corporation income taxes, the stockholders of an S corporation are generally taxed on their proportionate share of the Company's taxable income. However, certain states require the Company to report income taxes at the corporate level. The provision for income taxes includes taxes on income to those states for which the Company has been required to pay the tax at the corporate level. The Company uses the taxes payable method in accounting for income taxes. Under the taxes payable method, only current income tax assets and liabilities are recognized.

or

The Company elected under the Internal Revenue Code to be taxed as an S corporation. In lieu of corporation income taxes, the stockholders of an S corporation are generally taxed on their proportionate share of the Company's taxable income. However, certain states require the Company to report income taxes at the corporate level. The provision for income taxes includes taxes on income to those states for which the Company has been required to pay the tax at the corporate level. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards and

Income Taxes (*Continued*)

liabilities, are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non- current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Subsequent Events

Management has evaluated subsequent events through May 12, 20X3, which is the date the financial statements were available to be issued.

Start-Up Costs

Start-up costs, consisting of establishment costs, expenditures to open a new facility, and expenditures for starting new operations, are expensed in the year incurred. For 20X2, these costs were $2,050,000, and for 20X1, they were $1,100,000.

or

Start-up costs, consisting of establishment costs, expenditures to open a new facility, and expenditures for starting new operations, are capitalized and amortized over 15 years. For 20X2, these costs were $2,050,000, and for 20X1, they were $1,100,000.

Joint Ventures

From time to time, the Company enters into collaborative arrangements for the research and development (R&D), manufacture or commercialization (or both) of products, and product candidates. These collaborations generally provide for nonrefundable, upfront license fees, R&D, and commercial performance milestone payments, cost sharing, royalty payments, or profit sharing. These collaborative arrangements are accounted for under the equity method. Under the equity method, original investments are recorded at cost and adjusted by the Company’s share of undistributed earnings or losses of these entities.

or

From time to time, the Company enters into collaborative arrangements for the research and development (R&D), manufacture or commercialization (or both) of products, and product candidates. These collaborations generally provide for nonrefundable, upfront license fees, R&D, and commercial performance milestone payments, cost sharing, royalty payments, or profit sharing. These collaborative arrangements are accounted for using the proportionate consolidation method. The proportionate consolidation method results in the Company recognizing in its statement of financial position, its share of the assets and liabilities of the jointly controlled joint venture, and in its statement of operations, its share of the revenue and expenses of the joint venture.

Defined Benefit Plans

The Company has two defined benefit retirement plans that cover substantially all of its employees. Defined benefit plans for salaried employees provide benefits based on employees' years of service and five-year final overall base compensation. Defined benefit plans for hourly paid employees, including those covered by multiemployer pension plans under collective bargaining agreements, generally provide benefits of stated amounts for specified periods of service. The Company's policy is to fund, at a minimum, amounts as are necessary on an actuarial basis to provide assets sufficient to meet the benefits to be paid to plan members in accordance with the requirements of the Employee Retirement Income Security Act of 1974. Assets of the plans are administered by an independent trustee and are invested principally in fixed income securities, equity securities, and real estate. The Company accounts for all defined benefit plans using the accrued benefit obligation method. Under this method, the accrued benefit obligation is based on an actuarial valuation report prepared for funding purposes.

or

The Company has two defined benefit retirement plans that cover substantially all of its employees. Defined benefit plans for salaried employees provide benefits based on employees' years of service and five-year final overall base compensation. Defined benefit plans for hourly paid employees, including those covered by multiemployer pension plans under collective bargaining agreements, generally provide benefits of stated amounts for specified periods of service. The Company's policy is to fund, at a minimum, amounts as are necessary on an actuarial basis to provide assets sufficient to meet the benefits to be paid to plan members in accordance with the requirements of the Employee Retirement Income Security Act of 1974. Assets of the plans are administered by an independent trustee and are invested principally in fixed income securities, equity securities, and real estate. The Company accounts for all defined benefit plans using the current contribution payable method. Under this method, only the contribution attributable to the current year is expensed.

Intangibles Acquired in a Business Combination

In connection with its acquisition of XYZ Co., the Company has recognized, separately as identifiable assets, those intangible assets where acquisition-date market value could be measured reliably. These intangible assets are amortized on a straight line basis over their useful lives. Other intangible assets acquired have been subsumed into goodwill.

or

In connection with its acquisition of XYZ Co., the Company has subsumed into goodwill all intangible assets acquired in the transaction.

Illustrative Example—Going Concern

(This material is illustrative only.)

This example provides suggestions on applying the going concern requirements of chapter 2, "General Principles of Financial Statement Presentation and Accounting Policies," of *Financial Reporting Framework for Small- and Medium-Sized Entities*. Matters of principle relating to particular situations should be decided in the context of the framework.

Background

The going concern assumption is a fundamental principle in the preparation of financial statements. When preparing financial statements, management should make an assessment of whether the going concern basis of accounting is appropriate. This assessment involves making a judgment, at a particular point in time (the date of the statement of financial position), about the future outcome of events or conditions that are inherently uncertain.

Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading, or seeking protection from creditors pursuant to laws or regulations. Accordingly, unless the going concern assumption is inappropriate in the circumstances of the entity, assets and liabilities are recorded on the basis that the entity will be able to realize its assets, meet its obligations, and obtain refinancing (if necessary) in the normal course of business.

Management Considerations Related to Going Concern

Management may want to consider the following questions when making an assessment of whether the going concern basis of accounting is appropriate. The questions are not intended to be all-inclusive and neither will all questions be appropriate for every entity.

- Borrowing requirements
  - Are the covenants on current borrowings satisfied as of the date of the statement of financial position?
  - Is interest in arrears on any current borrowings as of the date of the statement of financial position?
  - Have monthly cash flow forecasts been compared to credit facilities available to establish whether or not there are any projected deficits? If so, are there plans in place to cover them; for example, to renegotiate facilities with lenders?
  - Have forecasts been tested against existing covenants to assess whether any violations are expected? If so, are there plans in place to prevent the violations from occurring?

- Contingent liabilities
  - Is the entity exposed to any contingent liabilities; for example, those arising through
    - legal proceedings?
    - guarantees or warranties or both?
    - product liability not covered by insurance?
    - environmental clean-up costs?
- Products and services
  - For each of the main products or services, are any economic, political, or other factors that may cause the market, or the strength of the entity's products within the market, to change?
  - If there is a high risk of losing existing customers, has management considered the likelihood of finding alternative sales markets?
  - Has management considered the robustness of the entity's supply chain and whether there are weak links that could adversely affect the entity's ability to deliver its products and services or increase costs, or both, through the need to seek and use alternative supply sources?
- Financial and operational risk
  - Is there any risk to the entity of
    - adverse movements in interest rates?
    - adverse movements in currency exchange rates?
    - exposure to risk through major fixed-price or fixed-rate contracts?
- Financial adaptability
  - Is there an adequate plan to enable the company to take effective action to alter the amounts and timing of its cash flows so that it can respond to unexpected needs or opportunities?
  - Does the company have the ability to
    - dispose of assets or to postpone the replacement of assets without significantly affecting other cash flows?
    - lease assets rather than to purchase outright?
    - obtain new sources of financing?
    - renew or extend loans?
    - restructure debts?
    - raise additional equity capital?
    - continue business by making limited reductions in the level of operations or by making use of alternative resources?

Illustration

Management may become aware of material uncertainties relating to events or conditions and conclude that a known event or condition is probable of having a severe impact on the entity's ability to realize its assets and discharge its liabilities in the ordinary course of business. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with other conditions or events. The following are examples of those conditions and events:

- Negative trends. For example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and adverse key financial ratios.
- Other indications of possible financial difficulties. For example, default on loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets.
- Internal matters. For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations.
- External matters that have occurred. For example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a drought, earthquake, or flood.

Management should consider its plans for dealing with the adverse effects of those conditions and events and whether those plans will mitigate the adverse effects and be effectively implemented. Management's considerations relating to its plans may include the following:

- Plans to dispose of assets
    - Are there restrictions on the disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets?
    - What is the marketability of assets that the entity plans to sell?
    - What are the possible direct or indirect effects of disposal of assets?
- Plans to borrow money or restructure debt
    - Is debt financing available, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets?
    - Are there existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity?
    - What are the possible effects on the entity's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral?
- Plans to reduce or delay expenditures
    - Is it feasible to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets?
    - What are the possible direct or indirect effects of reduced or delayed expenditures?

- Plans to increase ownership equity
  - Is it feasible to increase ownership equity, including existing or committed arrangements to raise additional capital?
  - Are there existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors?

Management should disclose the material uncertainties relating to the events or conditions along with its plans for dealing with the adverse effects of the conditions and events. Management may conclude that the going concern basis is not appropriate. In that situation, the FRF for SMEs accounting framework should not be used. An entity that is not a going concern should prepare its financial statements on the liquidation basis of accounting.

Illustrative Example—Push-Down Accounting

(This material is illustrative only.)

This example illustrates how the accounting treatment specified in chapter 29, "New Basis (Push-Down) Accounting," of *Financial Reporting Framework for Small- and Medium-Sized Entities* might be applied in particular situations. Matters of principle relating to particular situations should be decided in the context of the framework.

Illustration 1

Push-down accounting is a technique that attributes revised values to the assets and liabilities reported in the entity's financial statements based on a purchase transaction or transactions of its equity interests. Application of the technique results in the acquirer's cost being assigned to the assets and liabilities of the acquired entity. For example, assume ABC Company acquires 100 percent of the equity of XYZ Company for $150 million. ABC Company applies the acquisition method specified in chapter 11, "Business Combinations," of the FRF for SMEs accounting framework to account for this business combination in its consolidated financial statements. Further, assume XYZ Company's net assets equaled $60 million prior to the acquisition. If push- down accounting is applied, XYZ Company would establish a new basis for its net assets equal to $150 million in its separate stand-alone financial statements.

Illustration 2

When an individual or entity already owns an equity interest in an entity, the revaluation or market value is proportionate to that owner's increase in ownership. For example, assume ABC, Inc. is owned by two individuals, A and B. A owns 80 percent of the outstanding equity and B owns 20 percent of the outstanding equity in ABC, Inc. On July 1, 20X2, B purchased the 80 percent interest from A for $10 million, after which B owned 100 percent of the outstanding equity in ABC, Inc. For simplicity, assume that the book values of ABC, Inc.'s assets and liabilities equal their market values, with the exception of property, plant, and equipment. The market value of the property, plant, and equipment was determined to be $12 million. Also, for simplicity, the tax effects of the acquisition have been ignored.

Application of Requirements

The following illustrates the application of push-down accounting in illustration 2 and the amounts that would be reflected in ABC, Inc.'s financial statements after push-down accounting is applied.

In millions of dollars

	Book Value	Push-Down Entries	Push-Down Basis
Current assets	\$6	--	\$6
Property, plant, and equipment	10	Dr.\$1.6	11.6
Goodwill	--	Dr. 3.6	3.6
Total assets	\$16	Dr. \$5.2	\$21.2
Current liabilities	\$6	--	\$6
Long-term debt	4	--	4
Common stock	1	Dr. \$0.8 Cr. 10.0	10.2
Retained earnings	5	Dr. 4	1
Total liabilities and equity	\$16	Cr. \$5.2	\$21.2

Proportionate step-up:

Step-up in property, plant, and equipment: \$2 × 80 percent purchased = \$1.6. Premium paid is \$5.2, Goodwill = \$5.2 − 1.6 = \$3.6

Illustrative Example—Disclosure of Plain-Vanilla Interest Rate Swap

(This material is illustrative only.)

This example illustrates a "plain-vanilla" interest rate swap and the disclosures required by the FRF for SMEs™ accounting framework. Matters of principle relating to particular situations should be decided in the context of the framework.

Background

In a *plain-vanilla interest rate swap*, a reporting entity agrees to pay cash flows equal to interest at a predetermined fixed rate on a stated notional principal for a stated period and, in return, the reporting entity receives interest at a floating rate on the same notional principal for the same period of time. Importantly, the reporting entity can be the fixed-rate payer and the floating-rate receiver or vice versa. The FRF for SMEs accounting framework requires, for derivatives such as an interest rate swap, disclosure of the face or contract amount (or notional principal amount if there is no face or contract amount), the nature and terms, including a discussion of the credit and market risk of those instruments, and the cash requirements of those instruments. In addition, an entity should provide a description of the entity's objectives for holding the derivatives and the net settlement amount of the derivatives at the statement of financial position date.

Illustration

Assume ABC Company has $1,000,000 of nonamortizing variable-rate debt outstanding with interest payments due on a quarterly basis. The note accrues interest at the 3-month London Interbank Offered Rate (LIBOR) plus 2 percent and matures via a balloon payment in 7 years. In order to hedge the Company's interest rate risk, the Company would enter into a 7-year interest rate swap for a notional amount of $1,000,000 at a current swap rate (fixed rate) of 2.85 percent. The Company would pay the fixed rate of 2.85 percent on the $1,000,000 notional amount on a quarterly basis and would receive the 3-month LIBOR rate on a quarterly basis. The LIBOR to be received is determined one quarter prior to payment so the payment is made 3 months in arrears. Accordingly, the Company knows 3 months in advance what the payment will be. Payments are settled on a net basis; so, if the 3-month LIBOR is greater than 2.85 percent, then the Company will receive a payment. Therefore, the Company has effectively converted its variable-rate debt into fixed-rate debt with an effective interest rate of 4.85 percent (2.85 percent fixed + 2 percent spread).

Example Disclosure

The Company sometimes borrows at variable rates and uses interest rate swaps as cash flow hedges of future interest payments, which have the economic effect of converting borrowings from floating rates to fixed rates. The interest rate swaps allow the Company to raise long-term borrowings at floating rates and swap them into fixed rates that are lower than those available if it borrowed at fixed rates directly. Under the interest rate swaps, the Company agrees with other parties to exchange, at specified intervals (mainly quarterly), the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts.

At December 31, 20X2, the Company has $1,000,000 of nonamortizing variable-rate debt outstanding with interest payments due on a quarterly basis. The note accrues interest at the 3-month LIBOR plus 2 percent. In order to hedge interest rate risk, the Company entered into an interest rate swap for a notional amount of $1,000,000 at fixed rate of 2.85 percent. Under this swap agreement, the Company pays the fixed rate of 2.85 percent on the $1,000,000 notional amount on a quarterly basis, and receives the 3- month LIBOR rate on a quarterly basis. Payments are settled on a net basis, and the Company has effectively converted its variable-rate debt into fixed-rate debt with an effective interest rate of 4.85 percent (2.85 percent fixed + 2 percent spread). As of December 31, 20X2, the net settlement amount of the interest rate swap contact was $6,360.

Illustrative Example—Presentation of Equity-Method Investment on the Statement of Cash Flows

(This material is illustrative only.)

This example illustrates how the accounting treatment specified in chapter 8, "Statement of Cash Flows," of the FRF for SMEs framework might be applied in particular situations. Matters of principle relating to particular situations should be decided in the context of the framework.

Example

The following table presents condensed financial data of ABC Corp. for 20X2 and 20X1.

ABC Corp.
Statement of Financial Position as of December 31

	20X2	20X1
Cash and cash equivalents	$2,200	$ 600
Receivables	2,250	2,100
Inventory	1,000	600
Plant assets (net)	700	645
Investment in marketable securities	–0–	200
Investment in XYZ Company	800	700
	$6,950	$4,845
Accounts payable	$ 750	$1,200
Accrued liabilities	330	520
Long-term debt	800	1,000
Capital stock	1,400	1,400
Retained earnings	3,670	725
	$6,950	$4,845

ABC Corp.
Statement of Operations
For the Year Ended December 31, 20X2

Sales	$15,200
Cost of goods sold	(10,400)
Gross profit	4,800
Selling and administrative expense	(1,455)
Income from operations	3,345
Other revenues and gains	
Loss on sale of marketable securities	(50)
Investment income from XYZ Company	250
Net income	$ 3,545

Additional information

- Depreciation expense of $145 is included in the selling and administrative expense in 20X2.

- ABC Corp. owns 100 percent of XYZ Company and uses the equity method to account for its investment in XYZ Company.
- During 20X2, XYZ Company reported net income of $250 and distributed $150 to ABC Corp.
- ABC Corp. paid cash dividends during 20X2 of $600.

Illustration of Indirect Method Statement of Cash Flows

ABC Corp.
Statement of Cash Flows
For the Year Ended December 31, 20X2

Cash flows from operating activities:		
Net income		$3,545
Adjustments to reconcile by operating activities:		
Depreciation expense	$145	
Loss on sale of marketable securities	50	
Undistributed earnings of XYZ Company	(100)	
Increase in receivables	(150)	
Increase in inventory	(400)	
Decrease in accounts payable	(450)	
Decrease in accrued liabilities	(190)	(1095)
Net cash provided by operating activities		2,450
Cash flows from investing activities:		
Sale of marketable securities		150
Purchase of plant assets		(200)
Net cash used by investing activities		(50)
Cash flows from financing activities:		
Retirement of long-term debt		(200)
Payment of cash dividends		(600)
Net cash used by financing activities		(800)
Net increase in cash and cash equivalents		1,600
Cash and cash equivalents, December 31, 20X1		600
Cash and cash equivalents, December 31, 20X2		$2,200

Illustration of Direct Method Statement of Cash Flows

ABC Corp.
Statement of Cash Flows
For the Year Ended December 31, 20X2

Cash flows from operating activities:	
Cash collected from customers	$15,050
Cash paid for inventory	(11,250)
Cash paid for operating expenses	(1,500)

Distribution from XYZ Company	150
Net cash provided by operating activities	2,450
Cash flows from investing activities:	
Sale of marketable securities	150
Purchase of plant assets	(200)
Net cash used by investing activities	(50)
Cash flows from financing activities:	
Retirement of long-term debt	(200)
Payment of cash dividends	(600)
Net cash used by financing activities	(800)
Net increase in cash and cash equivalents	1,600
Cash and cash equivalents, December 31, 20X1	600
Cash and cash equivalents, December 31, 20X2	$2,200

Illustrative Example—Amortization of Goodwill

(This material is illustrative only.)

This example illustrates how the accounting treatment specified in chapter 13, "Intangible Assets," of *Financial Reporting Framework for Small- and Medium-Sized Entities* might be applied in particular situations. Matters of principle relating to particular situations should be decided in the context of the framework.

Background

Under the FRF for SMEs accounting framework, goodwill should be amortized generally over the same period as that used for federal income tax purposes or, if not amortized for federal income tax purposes, then a period of 15 years.

Illustration

Assume that ABC Company acquires 100 percent of XYZ Company on March 1, 20X2, and the acquisition is accounted for using the guidance in chapter 28 of the FRF for SMEs™ accounting framework. As a result of this acquisition, goodwill in the amount of $750,000 is recognized.

If ABC Company amortizes the goodwill for federal income tax purposes under IRC Section 197 (180 months), the amortization expense reported on ABC Company's statement of operations for the year ending December 31, would be as follows:

20X2 (March–December)	$ 41,667
20X3–2X16	50,000
2X17	8,333
Total amortization	$750,000

Illustrative Example—Consolidation When There Is a Material Difference in the Basis of Accounting Between a Parent and a Subsidiary

(This material is illustrative only.)

This example illustrates how the accounting treatment specified in chapter 23, "Consolidated Financial Interests and Noncontrolling Interests," of *Financial Reporting Framework for Small- and Medium-Sized Entities* might be applied in particular situations. Matters of principle relating to particular situations should be decided in the context of the framework.

Background

The FRF for SMEs accounting framework states that "a material difference in the basis of accounting between a parent and a subsidiary precludes the preparation of consolidated financial statements." As such, when the financial statements of a subsidiary (*a*) are not prepared in accordance with the framework (those prepared on a cash or tax basis or using unacceptable accounting principles), or (*b*) otherwise contain errors, they should be revised, or correcting entries should be made in consolidation.

In addition, when the policy choice set out in chapter 22, "Subsidiaries," of *Financial Reporting Framework for Small- and Medium-Sized Entities*, is made to account for its subsidiaries using the equity method, the same revisions or corrections would be required (unless impractical) to properly present the investment in a nonconsolidated subsidiary.

Example

Assume that Parent Corp. owns 100 percent of Subsidiary Company, which prepares its financial statements using U.S. GAAP. The only material difference between the FRF for SMEs accounting framework and U.S. GAAP in Subsidiary Company's financial statements is the treatment of Subsidiary Company's investments in marketable securities. In the U.S. GAAP financial statements, Subsidiary Company's investments in marketable securities are classified as available for sale. Accordingly, unrealized gains and losses are excluded from Subsidiary Company's statements of income and are reported as a separate component in the statements of comprehensive income.

In accordance with chapter 11, "Equity, Debt, and Other Investments," of Financial Reporting Framework for Small- and Medium-Sized Entities, an entity should measure investments in equity instruments held for sale at market value with changes in market value being recognized in net income in the period incurred. Therefore, in order to present consolidated financial statements (or to present Subsidiary Company as an investment in a nonconsolidated subsidiary, using the equity method), Parent Corp. would need to adjust Subsidiary Company's U.S. GAAP financial statements so that changes in market value of Subsidiary Company's investments in marketable securities held for sale are included in net income in the period incurred.

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