

**THE FINANCIAL REPORTING FRAMEWORK FOR
SMALL- AND MEDIUM-SIZED ENTITIES**
By Larry L. Perry, CPA

**CPA Firm Support Services, LLC
(CPA Practice Aids, LLC)
www.cpafirmssupport.com**

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. Practice aids, audit programs and audit correspondence are illustrative only. It is provided with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. The contents of these materials have not been subjected to peer review by the AICPA or any of its representatives. By incorporating the concepts, philosophies, suggestions and practice aids included with these materials into to a CPA firm's system of quality control, the user accepts full responsibility for their accuracy and completeness.

ENTRY-LEVEL ACCOUNTANT SKILL TRAINING

ABOUT THE AUTHOR: LARRY L. PERRY, CPA

With 40 years' experience as a CPA, Larry is a nationally known author of accounting and auditing manuals, a professional continuing education instructor and author, and a consultant to CPA firms. He is managing member of CPA Firm Support Services, LLC, (www.cpafirmssupport.com), an organization providing live webcasts and self-study courses to small- to medium-sized CPA firms. Larry writes a weekly article on AccountingWeb.com, *Today's World of Audits*, focusing on accounting and auditing subjects applicable to small- and medium-sized entities.

TABLE OF CONTENTS

PART 1—AN OVERVIEW	9
LEARNING OBJECTIVES	9
INTRODUCTION	9
BASIC FINANCIAL STATEMENT ISSUES	10
Financial Statements	10
Objective of Financial Statements.....	10
Materiality	10
Qualitative Characteristics of Financial Statements.....	10
Elements of Financial Statements	10
RECOGNITION CRITERIA	11
COMPARATIVE STATEMENTS	12
Disclosure of Accounting Policies	12
Fair Presentation Framework Concepts	12
Fair Presentation in Accordance With the FRF for SMEs.....	13
Going Concern Issues	13
FRF FOR SMEs DIFFERENCES FROM U.S. GAAP	14
Inventories.....	14
U.S. GAAP:	14
FRF for SMEs:.....	14
Goodwill.....	14
U.S. GAAP:	14
FRF for SMEs:.....	15
Intangible Assets.....	15
U.S. GAAP:	15
FRF for SMEs:.....	15
Investments	15
U.S. GAAP:	15
FRF for SMEs:.....	15
Fair Value Accounting.....	16
U.S. GAAP:	16
FRF for SMEs:.....	16
Derivatives	16
U.S. GAAP:	16
FRF for SMEs:.....	16
Lease Accounting.....	17
U.S. GAAP:	17
FRF for SMEs:.....	17
Income Tax Accounting	17
U.S. GAAP.....	17
FRF for SMEs:.....	18
Retirement and Postemployment Benefits.....	18
U.S. GAAP:	18
FRF for SMEs:.....	18
Comprehensive Income.....	19
U.S. GAAP:	19

FRF for SMEs:	19
<u>Revenue Recognition</u>	19
U.S. GAAP:	19
FRF for SMEs:	19
<u>Stock-Based Compensation Plans</u>	20
U.S. GAAP:	20
FRF for SMEs:	20
U.S. GAAP:	20
FRF for SMEs:	21
<u>Consolidation and Subsidiaries</u>	21
U.S. GAAP:	21
FRF for SMEs:	21
<u>Business Combinations</u>	21
U.S. GAAP:	21
FRF for SMEs:	22
<u>Push-Down (New Basis) Accounting</u>	22
U.S. GAAP:	22
FRF for SMEs:	22
<u>FINANCIAL STATEMENTS AND TRANSITION TO THE FRF FOR SMES</u>	22
Deciding to Use the FRF for SMEs	23
Summary of Opportunities for Increased Efficiency using the FRF for SMEs	24
<u>CONCLUSION</u>	25
<u>APPENDIX A—ILLUSTRATIVE FINANCIAL STATEMENTS FOR A SMALL REPORTING ENTITY</u> ...	26
<u>PART 2—STATEMENT OF FINANCIAL POSITION</u>	34
<u>LEARNING OBJECTIVES</u>	34
<u>PRESENTATION OF STATEMENT OF FINANCIAL POSITION</u>	34
<u>SPECIAL ACCOUNTING ISSUES FOR FINANCIAL ASSETS AND LIABILITIES</u>	35
Current Assets	35
Current Liabilities	35
Other Issues	36
Certain Disclosures	37
Financial assets:	37
Transfers of financial assets:	37
Financial Liabilities:	37
Derivatives:	37
Income:	38
<u>INVENTORIES</u>	38
Cost Measurement Techniques and Formulas	38
<u>INTANGIBLE ASSETS</u>	41
Identifiable Criterion	41
Control Criterion	41
Future Economic Benefits	41
Recognition and Measurement	41
<u>INTERNALLY-GENERATED GOODWILL</u>	42
<u>INTERNALLY-GENERATED INTANGIBLE ASSETS</u>	42
<u>PROPERTY, PLANT AND EQUIPMENT</u>	43
Asset Disposals	45
Discontinued Operations	45
<u>INVESTMENTS</u>	45

<u>Equity Method</u>	46
<u>Cost Method</u>	46
<u>Presentation and Disclosure</u>	46
<u>LONG-TERM OBLIGATIONS</u>	46
<u>COMMITMENTS</u>	47
<u>CONTINGENCIES</u>	47
<u>GUARANTEES</u>	48
<u>EQUITY</u>	48
<u>Accounting for Stock and Equity Compensation</u>	49
<u>Presentation and Disclosure</u>	49
<u>APPENDIX B--ILLUSTRATIVE STATEMENT OF ASSETS, LIABILITIES AND EQUITY (or Statement of Financial Position)</u>	51
<u>PART 3—STATEMENT OF OPERATIONS AND RELATED ACCOUNT CLASSIFICATIONS</u>	53
<u>LEARNING OBJECTIVES</u>	53
<u>PRESENTATION OF STATEMENTS OF OPERATIONS</u>	53
<u>STATEMENT OF OPERATIONS</u>	53
<u>Treatment of Major Classifications on the Statement of Operations</u>	54
<u>Recognizing Revenues</u>	54
<u>Multiple Deliverable Arrangements</u>	55
<u>Other Income</u>	56
<u>Principal vs. Agent</u>	56
<u>Improper Revenue Recognition</u>	56
<u>Improper Revenue Recognition in Smaller Entities</u>	57
<u>Disclosures</u>	58
<u>NONMONETARY TRANSACTIONS</u>	58
<u>Other matters</u>	59
<u>OPERATING EXPENSES</u>	59
<u>LEASE ACCOUNTING</u>	59
<u>Lessee's Accounting</u>	60
<u>Capital Leases:</u>	60
<u>Operating Leases:</u>	61
<u>Land and Building Leases:</u>	61
<u>Disclosure:</u>	61
<u>Lessor's Accounting</u>	62
<u>Direct Financing Lease:</u>	62
<u>Sales-Type Lease:</u>	62
<u>Operating Lease:</u>	63
<u>Presentation and Disclosure:</u>	63
<u>PENSION AND POST-RETIREMENT BENEFIT PLANS</u>	64
<u>Defined Contribution Plans</u>	64
<u>Multiemployer Plans</u>	64
<u>Individual Deferred Compensation Contracts</u>	65
<u>Defined Benefit Plans</u>	65
<u>INCOME TAXES</u>	65
<u>Taxes Payable Method</u>	65
<u>Deferred Income Taxes Method</u>	66

<u>Common Book/Tax Differences</u>	66
<u>Temporary Differences</u>	66
<u>Illustration of the Deferred Tax Method</u>	67
<u>Measurement, Presentation and Disclosure</u>	69
<u>ACCOUNTING CHANGES</u>	70
<u>Accounting Policies</u>	70
<u>Accounting Estimates</u>	70
<u>Errors</u>	71
<u>Disclosures</u>	71
<u>Initial Application of the FRF for SMEs Policies:</u>	71
<u>Voluntary Changes in Policies:</u>	71
<u>Changes in Estimates:</u>	71
<u>Errors:</u>	71
<u>RISKS AND UNCERTAINTIES</u>	71
APPENDIX C--ILLUSTRATIVE STATEMENT OF OPERATIONS.....	73
<u>PART 4—STATEMENT OF CASH FLOWS AND SPECIAL ISSUES</u>	75
<u>LEARNING OBJECTIVES</u>	75
<u>STATEMENT OF CASH FLOWS</u>	75
<u>Cash and Cash Equivalents</u>	75
<u>Classifications of Cash Flows</u>	76
<u>Operating Activities:</u>	76
<u>Investing Activities</u>	77
<u>Financing Activities</u>	77
<u>Non-cash Transactions</u>	77
<u>Disclosures</u>	77
<u>Preparation of the Statement of Cash Flows</u>	78
<u>RELATED PARTY TRANSACTIONS</u>	78
<u>Disclosures</u>	79
<u>SUBSEQUENT EVENTS</u>	79
<u>Disclosures</u>	80
<u>SUBSIDIARIES</u>	80
<u>Consolidation Principles</u>	81
<u>Accounting Principles for the Cost and Equity Methods</u>	81
<u>Non-controlling Interests</u>	82
<u>Principles of Consolidation Summarized</u>	83
<u>INTERESTS IN JOINT VENTURES</u>	83
<u>BUSINESS COMBINATIONS</u>	84
<u>Conditions for Recognition</u>	84
<u>Other Business Combination Issues</u>	85
<u>Disclosures</u>	86
<u>Combinations of Entities under Common Control</u>	86
<u>Summary of Accounting for Business Combinations</u>	87
<u>NEW BASIS (PUSH-DOWN) ACCOUNTING</u>	87
<u>Disclosures</u>	88
<u>FOREIGN CURRENCY TRANSLATION</u>	88

<u>CHOOSING THE FRF FOR SMES</u>	89
<u>SUMMARY OF REASONS FOR USING THE FRF FOR SMES</u>	89
<u>CONCLUSION</u>	90
<u>APPENDIX A--ILLUSTRATIVE STATEMENT OF CASH FLOWS</u>	91
<u>Glossary</u>	93