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ACCOUNTING BY SMALL AND MEDIUM-SIZED ENTERPRISES *

Report by the Ad Hoc Consultative Group of Experts on Accounting by Small and Medium-Sized Enterprises

* Submission of this document was delayed as a result of the need for further consultations with members of the ad hoc consultative groups.

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Appendix 1. Definitions

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.

Accounting profit is net profit or loss for a period before deduction of tax expenses.

An ***asset*** is a resource

(a) controlled by an enterprise as a result of past events; and
(b) from which future economic benefits are expected to flow to the enterprise.

An ***active market*** is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;
(b) willing buyers and sellers can normally be found at any time; and
(c) prices are available to the public.

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

Carrying amount is the amount at which an asset is recognized in the balance sheet after deduction of any accumulated depreciation and accumulated impairment losses thereon.

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 are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

The ***closing rate*** is the spot exchange rate at the balance sheet date.

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.

A ***constructive obligation*** is an obligation that derives from an enterprise's actions where,

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

A ***contingent asset*** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

A ***contingent liability*** is
(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
(b) a present obligation that arises from past events but is not recognized because
  (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
  (ii) the amount of the obligation cannot be measured with sufficient reliability.

Control is ownership, either directly or indirectly through subsidiaries, of more than one half of the voting power of an enterprise, or a substantial interest in voting power and the power to direct, by statute or agreement, the financial and operating policies of the management of the enterprise.

Contingent rent is that portion of the lease payments which is not fixed in amount but is based on a factor other than the passage of time (e.g. percentage of sales, amount of usage, price indices, market rates of interest).

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition, production or construction.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of
(a) deductible temporary differences;
(b) the carry forward of unused tax losses; and
(c) the carry forward of unused tax credits.

Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Economic life is either

(a) the period over which an asset is expected to be economically usable by one or more users; or
(b) the number of production or similar units expected to be obtained from the asset by one or more users.

Events after the balance sheet date are events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue. Two types of events can be identified:

(a) those providing evidence of conditions that existed at the balance sheet date (adjusting events after the balance sheet date); and
(b) those indicative of conditions that arose after the balance sheet date (non-adjusting events after the balance sheet date).

The ***exchange difference*** is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

The ***exchange rate*** is the ratio for exchange of two currencies.

Extraordinary items are income or expenses arising from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.

The ***fair value*** of an asset is the amount for which an asset could be exchanged, or a liability settled, between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's-length transaction.

A ***finance lease*** is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

Foreign currency is a currency other than the reporting currency of an enterprise.

Forgivable loans are loans that the lender undertakes to waive repayment of under certain prescribed conditions.

Fundamental errors are errors discovered in the current period that are of such significance that the financial statements of one or more prior periods can no longer be considered to have been reliable at the date of their issue.

Government refers to government, government agencies and similar bodies, whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an enterprise or range of enterprises qualifying under certain criteria. Government assistance for the purpose of this Guideline does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise. They exclude those forms of government assistance which cannot reasonably have a value placed on them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

Grants related to assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.

Guaranteed residual value is,

(a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and
(b) in the case of the lessor, that part of the residual value which is guaranteed by the lessee or by a third party unrelated to the lessor who is financially capable of discharging the obligations under the guarantee.

Historical Cost assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

An ***impairment loss*** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

The ***inception*** of the lease is the earlier of the date of the lease agreement or the date of a commitment by the parties to the principal provisions of the lease.

The lessee's ***incremental borrowing rate of interest*** is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

An ***intangible asset*** is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

The ***interest rate implicit in the lease*** is the discount rate that, at the inception of the lease, causes the aggregate present value of

- (a) the minimum lease payments; and
- (b) the unguaranteed residual value to be equal to the fair value of the leased asset.

Inventories are assets

- (a) held for sale in the ordinary course of business;
- (b) in the process of production for such sale; or
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

A ***lease*** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The ***lease term*** is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

A ***legal obligation*** is an obligation that derives from

(a) a contract (through its explicit or implicit terms);
(b) legislation; or
(c) other operation of law.

A ***liability*** is a present obligation of an enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with,
in the case of the lessee, any amounts guaranteed by the lessee or by a party related to the lessee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, and if, at the inception of the lease, it is reasonably certain that the option will be exercised, then the minimum lease payments comprise the minimum payments payable over the lease term and the payment required to exercise this purchase option.

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

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.

A ***non-cancellable lease*** is a lease that is cancellable only

(a) upon the occurrence of some remote contingency;
(b) with the permission of the lessor;
(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

An ***obligating event*** is an event that creates a legal or constructive obligation that results in an enterprise's having no realistic alternative to settling that obligation.

An ***onerous contract*** is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

An ***operating lease*** is a lease other than a finance lease.

Ordinary activities are any activities undertaken by an enterprise as part of its business and related activities in which the enterprise engages in furtherance of, incidental to, or arising from these activities.

Property, plant and equipment are tangible assets that
- (a) are held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

A ***provision*** is a liability of uncertain timing or amount.

A ***qualifying asset*** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Related party: Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

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

Reporting currency is the currency used in presenting the financial statements.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Residual value is the net amount an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Significant influence is (for the purpose of SMEGA) participation in the financial and operating policy decisions of an enterprise without having control of those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors but also by, for example, participation in the policy-making process, material intercompany transactions, interchange of managerial personnel or dependence on technical information.

The ***tax base*** of an asset or liability is the amount attributed to that asset or liability for tax purposes.

Tax expense (tax income) is the aggregate amount included in the determination of net profit or loss for the period in respect of current tax and deferred tax.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, on which income taxes are payable (recoverable).

Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either

(a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

(b) *deductible temporary differences*, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

Useful life is either

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.

Appendix 2. Examples

A. Recognition of provisions

Example 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. Based on past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event: The obligating event is the sale of the product with a warranty, which gives rise to a *legal obligation*.

An outflow of resources embodying economic benefits in settlement: Probable for the warranties as a whole.

Conclusion: A provision is recognized for the best estimate of the costs of making good under the warranty products sold before the balance sheet date.

Example 2: Legal Requirement to Fit Smoke Filters

Under new legislation, an enterprise is required to install smoke filters in its factories by 30 June 2000. The enterprise has not fitted the smoke filters

.

(a) At the balance sheet date of 31 December 1999:

Present obligation as a result of a past obligating event: There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion: No provision is recognized for the cost of fitting the smoke filters.

(b) At the balance sheet date of 31 December 2000:

Present obligation as a result of a past obligating event: There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement: The likelihood of incurring fines and penalties for non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion: No provision is recognized for the costs of fitting smoke filters. However, a provision is recognized for the best estimate of any fines and penalties that are more likely than not to be imposed.

Example 3: A Court Case

After a wedding in 2000, 10 people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are underway seeking damages from the enterprise, but it disputes its liability. Up to the date of approval of the financial statements for the year to 31 December 2000 for issue, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year ending 31 December 2001, its lawyers advise that, because of new developments in the case, it is probable that the enterprise will be found liable.

(a) At the balance sheet date of 31 December 2000:

Present obligation as a result of a past obligating event: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion: No provision is recognized. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At the balance sheet date of 31 December 2001:

Present obligation as a result of a past obligating event: On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A provision is recognized for the best estimate of the amount required to settle the obligation.

Example 4: Refurbishment Costs – No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event: There is no present obligation.

Conclusion: No provision is recognized.

The cost of replacing the lining is not recognized because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions; even the intention to incur the expenditure depends on the company's deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognized, the depreciation of the lining takes into account its consumption (i.e. it is depreciated over five years). The relining costs then incurred are capitalized, with the consumption of each new lining shown by depreciation over the subsequent five years.

B. Revenue recognition

The following examples illustrate the application of the SMEGA in a number of commercial situations in order to clarifying their meaning. The examples focus on particular aspects of a transaction and do not constitute comprehensive discussions of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably; that it is probable that the economic benefits will flow to the enterprise; and that the costs incurred or to be incurred can be measured reliably. The examples do not modify or override the standard.

Sale of goods

Since laws vary from country to country, the recognition criteria in this standard will be met at different times. In particular, the law may determine the point in time at which the enterprise transfers the significant risks and rewards of ownership. Therefore, the examples in this section of the appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

1. *"Bill and hold2 sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing.*

   Revenue is recognized when the buyer takes title, provided:
   (a) it is probable that delivery will be made;
   (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognized;
   (c) the buyer specifically acknowledges the deferred delivery instructions; and
   (d) the usual payment terms apply.

   Revenue is not recognized when there is simply an intention to acquire or manufacture the goods in time for delivery.

2. *Goods shipped subject to conditions, including the following situations:*
   (a) *Installation and inspection.*
   Revenue is normally recognized when the buyer accepts delivery and installation and inspection are complete. However, revenue is recognized immediately upon the buyer's acceptance of delivery when:
   (i) the installation process is simple in nature (e.g. the installation of a factory-tested television receiver which only requires unpacking and connection of power and antennae); or

(ii) the inspection is performed only for purposes of final determination of contract prices (e.g. for shipments of iron ore, sugar or soya beans).

(b) *On approval when the buyer has negotiated a limited right of return.*
If there is uncertainty about the possibility of return, revenue is recognized when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

(c) *Consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller).*
Revenue is recognized by the shipper when the goods are sold by the recipient to a third party.

(d) *Cash on delivery sales.*

Revenue is recognized when delivery is made and cash is received by the seller or its agent.

3. *Layaway sales, in which the goods are delivered only when the buyer makes the final payment in a series of instalments.*
Revenue from such sales is recognized when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognized when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.

4. *Orders in which payment (or partial payment) is received in advance of delivery for goods not presently held in inventory (e.g. the goods are still to be manufactured or will be delivered directly to the customer from a third party).*
Revenue is recognized when the goods are delivered to the buyer.

5. *Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase by the seller of the goods.*
The terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognized. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

6. *Sales to intermediate parties, such as distributors, dealers or others, for resale.*
Revenue from such sales is generally recognized when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

7. *Subscriptions to publications and similar items.*

When the items involved are of similar value in each time period, revenue is recognized on a straight line basis over the period in which the items are despatched. When the items vary in value from period to period, revenue is recognized on the basis of the sales value of the item despatched in relation to the total estimated sales value of all items covered by the subscription.

8. *Instalment sales, under which the consideration is receivable in instalments.*
Revenue attributable to the sales price, exclusive of interest, is recognized at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognized as revenue as it is earned, on a time proportion basis that takes into account the imputed rate of interest.

9. *Real estate sales.*
Revenue is normally recognized when legal title passes to the buyer. However, in some jurisdictions the equitable interest in a property may vest in the buyer before legal title passes and, therefore, the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognize revenue. In either case, if the seller is obliged to perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognized as the acts are performed. An example is a building or other facility on which construction has not been completed.
In some cases, real estate may be sold with a degree of continuing involvement by the seller such that the risks and rewards of ownership have not been transferred. Examples are sale and repurchase agreements that include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determine how the transaction is accounted for. It may be accounted for as a sale, or as a financing, a leasing or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.

A seller must also consider the means of payment and evidence of the buyer's commitment to complete payment. For example, when the aggregate of the payments received, including the buyer's initial down payment or continuing payments by the buyer, provide insufficient evidence of the buyer's commitment to complete payment, revenue is recognized only to the extent that cash is received.

Rendering of services

10. *Installation fees.*
Installation fees are recognized as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognized when the goods are sold.

11. *Servicing fees included in the price of the product.*
When the selling price of a product includes an identifiable amount for subsequent servicing (e.g. after sales support and product enhancement on the sale of software), that amount is deferred and recognized as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

12. *Advertising commissions.*
Media commissions are recognized when the related advertisement or commercial appears before the public. Production commissions are recognized by reference to the stage of completion of the project.

13. *Insurance agency commissions.*
Insurance agency commissions received or receivable that do not require the agent to render further service are recognized as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognized as revenue over the period during which the policy is in force.

14. *Admission fees.*
Revenue from artistic performances, banquets and other special events is recognized when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.

15. *Tuition fees.*
Revenue is recognized over the period of instruction.

16. *Initiation, entrance and membership fees.*
Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognized as revenue when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to the purchase of goods or services at prices lower than those charged to nonmembers, it is recognized on a basis that reflects the timing, nature and value of the benefits provided.

17. *Franchise fees.*
Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognized as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate:

(a) Supplies of equipment and other tangible assets.
The amount, based on the fair value of the assets sold, is recognized as revenue when the items are delivered or title passes.

(b) Supplies of initial and subsequent services.
Fees for the provision of continuing services, whether part of the initial fee or a separate fee are recognized as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognized as revenue as the services are rendered.

The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognized over the period during which the goods are likely to be sold to the franchisee. The balance of an initial fee is recognized as revenue when performance of all the initial services and other obligations required of the franchisor (e.g. assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognized as revenue in proportion to the number of outlets for which the initial services have been substantially completed.

If the initial fee is collectable over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognized as cash instalments are received.

(c) *Continuing franchise fees.*
Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognized as revenue as the services are provided or the rights used.

(d) *Agency transactions.*
Transactions may take place between the franchisor and the franchisee which, in substance, involve the franchisor's acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

19. *Fees from the development of customized software.*
Fees from the development of customized software are recognized as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Interest, royalties and dividends

20. *Licence fees and royalties.*
Fees and royalties paid for the use of an enterprise's assets (e.g. trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognized in accordance with the substance of the agreement. As a practical matter, this may be on a straight line basis over the life of the agreement – for example, when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or nonrefundable guarantee under a noncancellable contract that permits the licensee to exploit those rights freely such that the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognized at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognized only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

Appendix 3. Source Material

The SMEGA for Level 2 SMEs are drawn from *International Accounting Standards and Interpretations*. The standards that have been included are:

SMEGA	IAS	Comments
1	1	
2	7	
3	16, 36	The SMEGA for Level 2 include impairment guidance but do not follow IAS 36 measurement rules. SIC 10 is also included.
4	17	SIC 15 is included.
5	38	
6	2	
7	20	
8	37	Discounting of provisions is not required.
9	18	
10	23	
11	12	
12	8	This version takes into account modifications proposed in the IASB exposure draft of May 2002.
13	21	
14	10	
15	24	

The SMEGA for Level 2 do not include the following standards:

11	Construction contracts
14	Segment reporting
19	Employee benefits
22	Business combinations
26	Accounting and reporting by retirement benefit plans
27	Consolidated financial statements
28	Accounting for investments in associates
29	Financial reporting in hyperinflationary economies
30	Disclosures in the financial statements of banks
31	Financial reporting of interests in joint ventures
32	Financial instruments: disclosure and presentation
33	Earnings per share
34	Interim financial reporting

35	Discontinuing operations
39	Financial instruments: recognition and measurement
40	Investment property
41	Agriculture

Appendix 4. Members of the Ad Hoc Consultative Group on Accounting by SMEs[1]

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[1] Opinions expressed by the experts do not necessarily reflect those of the organizations they are affiliated with.

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