

XYZ Group: Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 1 – illustrating the classification of expenses by function)

Notes	20X2		20X1	
	CU		CU	
Revenue	5	6,863,545		5,808,653
Cost of sales		(5,178,530)		(4,422,575)
Gross profit		1,685,015		1,386,078
Other income	6	88,850		25,000
Distribution costs		(175,550)		(156,800)
Administrative expenses		(810,230)		(660,389)
Other expenses		(106,763)		(100,030)
Finance costs	7	(26,366)		(36,712)
Profit before tax	8	654,956		457,147
Income tax expense	9	(270,250)		(189,559)
Profit for the year		384,706		267,588
Retained earnings at start of year		2,171,353		2,003,765
Dividends		(150,000)		(100,000)
Retained earnings at end of year		2,406,059		2,171,353

XYZ Group: Consolidated statement of financial position at 31 December 20X2

	Notes	20X2	20X1	20X0
		CU	CU	CU
ASSETS				
Current assets				
Cash		28,700	22,075	18,478
Trade and other receivables	10	585,548	573,862	521,234
Inventories	11	57,381	47,920	45,050
		671,629	643,857	584,762
Non-current assets				
Investment in associate	12	107,500	107,500	107,500
Property, plant and equipment	13	2,549,945	2,401,455	2,186,002
Intangible assets	14	850	2,550	4,250
Deferred tax asset	15	4,309	2,912	2,155
		2,662,604	2,514,417	2,299,907
Total assets		3,334,233	3,158,274	2,884,669
LIABILITIES AND EQUITY				
Current liabilities				
Bank overdraft	16	83,600	115,507	20,435
Trade payables	17	431,480	420,520	412,690

Interest payable	7	2,000	1,200	-
Current tax liability		271,647	190,316	173,211
Provision for warranty obligations	18	4,200	5,040	2,000
Current portion of employee benefit obligations	19	4,944	4,754	4,571

XYZ Group: Consolidated statement of financial position at 31 December 20X2				
Current portion of obligations under finance leases	20	21,461	19,884	18,423
		819,332	757,221	631,330
Non-current liabilities				
Bank loan	16	50,000	150,000	150,000
Long-term employee benefit obligations	19	5,679	5,076	5,066
Obligations under finance leases	20	23,163	44,624	64,508
		78,842	199,700	219,574
Total liabilities		898,174	956,921	850,904
Equity				
Share capital	22	30,000	30,000	30,000
Retained earnings	4	2,406,059	2,171,353	2,003,765
		2,436,059	2,201,353	2,033,765
Total liabilities and equity		3,334,233	3,158,274	2,884,669

XYZ Group: Consolidated statement of cash flows for the year ended 31 December 20X2

	Notes	20X2	20X1
		CU	CU
Cash flows from operating activities			
Profit for the year		384,706	267,588
Adjustments for non-cash income and expenses:			
Non-cash finance costs (a)		800	1,200
Non-cash income tax expense (b)		79,934	16,348
Depreciation of property, plant and equipment		270,360	219,547
Impairment loss		30,000	-
Amortisation of intangibles		1,700	1,700
Cash flow included in investing activities:			
Gain on sale of equipment		(63,850)	-
Changes in operating assets and liabilities			
Decrease (increase) in trade and other receivables		(11,686)	(52,628)
Decrease (increase) in inventories		(9,461)	(2,870)
Increase (decrease) in trade payables (c)		10,120	10,870
Increase in current and long-term employee benefit payable		793	193

<i>Net cash from operating activities</i>	693,416	461,948
Cash flows from investing activities		
Proceeds from sale of equipment	100,000	-
Purchases of equipment	(485,000)	(435,000)
<i>Net cash used in investing activities</i>	(385,000)	(435,000)
Cash flows from financing activities		
Payment of finance lease liabilities	(19,884)	(18,423)
Repayment of borrowings	(100,000)	-
Dividends paid	(150,000)	(100,000)
<i>Net cash used in financing activities</i>	(269,884)	(118,423)
Net increase (decrease) in cash and cash equivalents	38,532	(91,475)
Cash and cash equivalents at beginning of year	(93,432)	(1,957)
Cash and cash equivalents at end of year	23 (54,900)	(93,432)
(a) Finance costs paid in cash	25,566	35,512
(b) Income taxes paid in cash	190,316	173,211
(c) Includes unrealised foreign exchange loss	1,000	-

XYZ Group: Accounting policies and explanatory notes to the financial statements for the year ended 31 December 20X2

1. General information

XYZ (Holdings) Limited (the Company) is a limited company incorporated in A Land. The address of its registered office and principal place of business is _____. XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited . Their principal activities are the manufacture and sale of candles.

2. Basis of preparation and accounting policies

These consolidated financial statements have been prepared in accordance with the *International Financial Reporting Standard for Small and Medium-sized Entities* issued by the International Accounting Standards Board. They are presented in the currency units (CU) of A Land.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiary. All intragroup transactions, balances, income and expenses are eliminated .

Investments in associates

Investments in associates are accounted for at cost less any accumulated impairment losses.

Dividend income from investments in associates is recognised when the Group's right to receive payment has been established. It is included in other income.

Revenue recognition

Revenue from sales of goods is recognised when the goods are delivered and title has passed. Royalty revenue from licensing candle-making patents for use by others is recognised in accordance with the relevant licence agreements. Revenue is measured at the fair value of the consideration received or receivable, net of discounts and sales-related taxes collected on behalf of the government of A Land.

Borrowing costs

All borrowing costs are recognised in profit or loss in the period in which they are incurred.

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases (known as temporary differences). Deferred tax liabilities are generally recognised for all 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 (taxable temporary differences). Deferred tax assets are generally recognised for all 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 (deductible temporary differences)—but only to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and is adjusted to reflect the current assessment of future taxable profits. Any adjustments are recognised in profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the taxable profit (tax loss) of the periods in which it expects the deferred tax asset to be realised or the deferred tax liability to be settled, on the basis of tax rates that have been enacted or substantively enacted by the end of the reporting period.

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less their residual values over their estimated useful lives, using the straight-line method. The following annual rates are used for the depreciation of property, plant and equipment:

Buildings	2 per cent
Fixtures and equipment	10–30 per cent

If there is an indication that there has been a significant change in depreciation rate, useful life or residual value of an asset, the depreciation of that asset is revised prospectively to reflect the new expectations.

Intangible assets

Intangible assets are purchased computer software that is stated at cost less accumulated depreciation and any accumulated impairment losses. It is amortised over its estimated life of five years using the straight-line method. If there is an indication that there has been a significant change in amortisation rate, useful life or residual value of an intangible asset, the amortisation is revised prospectively to reflect the new expectations.

Impairment of assets

At each reporting date, property, plant and equipment, intangible assets and investments in associates are reviewed to determine whether there is any indication that those assets have suffered an impairment loss. If there is an indication of possible impairment, the recoverable amount of any affected asset (or group of related assets) is estimated and compared with its carrying amount. If estimated recoverable amount is lower, the carrying amount is reduced to its estimated recoverable amount and an impairment loss is recognised immediately in profit or loss.

Similarly, at each reporting date, inventories are assessed for impairment by comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, its carrying amount is reduced to selling price less costs to complete and sell, and an impairment loss is recognised immediately in profit or loss.

If an impairment loss subsequently reverses, the carrying amount of the asset (or group of related assets) is increased to the revised estimate of its recoverable amount (selling price less costs to complete and sell, in the case of inventories), but not in excess of the amount that would have been determined had no impairment loss been recognised for the asset (group of related assets) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership of the leased asset to the Group. All other leases are classified as operating leases.

Rights to assets held under finance leases are recognised as assets of the Group at the fair value of the leased property (or, if lower, the present value of minimum lease payments) at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are deducted in measuring profit or

loss. Assets held under finance leases are included in property, plant and equipment, and depreciated and assessed for impairment losses in the same way as owned assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Inventories

Inventories are stated at the lower of cost and selling price less costs to complete and sell. Cost is calculated using the first-in, first-out (FIFO) method.

Trade and other receivables

Most sales are made on the basis of normal credit terms and the receivables do not bear interest. Where credit is extended beyond normal credit terms, receivables are measured at amortised cost using the effective interest method. At the end of each reporting period, the carrying amounts of trade and other receivables are reviewed to determine whether there is any objective evidence that the amounts are not recoverable. If so, an impairment loss is recognised immediately in profit or loss.

Trade payables

Trade payables are obligations on the basis of normal credit terms and do not bear interest. Trade payables denominated in a foreign currency are translated into CU using the exchange rate at the reporting date. Foreign exchange gains or losses are included in other income or other expenses.

Bank loans and overdrafts

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Employee benefits—long-service payment

The liability for employee benefit obligations relates to government-mandated long-service payments. All full-time staff, excluding directors, are covered by the programme. A payment is made of 5 per cent of salary (as determined for the twelve months before the payment) at the end of each of five years of employment. The payment is made as part of the December payroll in the fifth year. The Group does not fund this obligation in advance.

The Group's cost and obligation to make long-service payments to employees are recognised during the employees' periods of service. The cost and obligation are measured using the projected unit credit method, assuming a 4 per cent average annual salary increase, with

employee turnover based on the Group's recent experience, discounted using the current market yield for high quality corporate bonds.

Provision for warranty obligations

All goods sold by the Group are warranted to be free of manufacturing defects for a period of one year. Goods are repaired or replaced at the Group's option. When revenue is recognised, a provision is made for the estimated cost of the warranty obligation.

3. Key sources of estimation uncertainty

Long-service payments

In determining the liability for long-service payments (explained in note 19), management must make an estimate of salary increases over the following five years, the discount rate for the next five years to use in the present value calculation, and the number of employees expected to leave before they receive the benefits.

4. Restriction on payment of dividend

Under the terms of the bank loan and bank overdraft agreements, dividends cannot be paid to the extent that they would reduce the balance of retained earnings below the sum of the outstanding balance of the bank loan and the bank overdraft.

5. Revenue

	20X2	20X1
	CU	CU
Sale of goods	6,743,545	5,688,653
Royalties – licensing of candle-making patents	120,000	120,000
	6,863,545	5,808,653

6. Other income

Other income includes dividends received from an associate of CU 25,000 in both 20X1 and 20X2 and gain on disposal of property, plant and equipment of CU 63,850 in 20X2.

7. Finance costs

	20X2	20X1
	CU	CU
Interest on bank loan and overdraft	(21,250)	(30,135)
Interest on finance leases	(5,116)	(6,577)
	(26,366)	(36,712)

8. Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2	20X1
	CU	CU
Cost of inventories recognised as expense	5,178,530	4,422,575
Research and development cost (included in other expenses)	31,620	22,778
Foreign exchange loss on trade payables (included in other expenses)	1,000	—
Warranty expense (included in cost of sales*)	5,260	7,340
*If the entity classifies its expenses by nature in its income statement, this would say 'included in raw materials and consumables used'.		

9. Income tax expense

	20X2	20X1
	CU	CU
Current tax	271,647	190,316

Deferred tax (note 15)	(1,397)	(757)
	270,250	189,559

Income tax is calculated at 40 per cent (20X1: 40 per cent) of the estimated assessable profit for the year.

Income tax expense for the year CU 270,250 in 20X2 (CU 189,559 in 20X1) differs from the amount that would result from applying the tax rate of 40 per cent (both 20X2 and 20X1) to profit before tax because, under the tax laws of A Land, some employee compensation expenses (CU 20,670 in 20X2 and CU 16,750 in 20X1) that are recognised in measuring profit before tax are not tax-deductible..

10. Trade and other receivables

	20X2	20X1
	CU	CU
Trade debtors	528,788	528,384
Prepayments	56,760	45,478
	585,548	573,862

11. Inventories

	20X2	20X1
	CU	CU
Raw materials	42,601	36,450
Work in progress	1,140	900
Finished goods	13,640	10,570
	57,381	47,920

12. Investment in associate

The Group owns 35 per cent of an associate whose shares are not publicly traded.

	20X2	20X1
	CU	CU
Cost of investment in associate	107,500	107,500
Dividend received from associate (included in other income)	25,000	25,000

13. Property, plant and equipment

	Land and buildings	Fixtures and equipment	Total
	CU	CU	CU
Cost			
1 January 20X2	1,960,000	1,102,045	3,062,045
Additions	-	485,000	485,000
Disposals	-	(241,000)	(241,000)
31 December 20X2	1,960,000	1,346,045	3,306,045
Accumulated depreciation and impairment			
1 January 20X2	390,000	270,590	660,590
Annual depreciation	30,000	240,360	270,360
Impairment	-	30,000	30,000
Less accumulated depreciation on assets disposed of	-	(204,850)	(204,850)

31 December 20X2	420,000	336,100	756,100
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Carrying amount

31 December 20X2	1,540,000	1,009,945	2,549,945
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During 20X2 the Group noticed a significant decline in the efficiency of a major piece of equipment and so carried out a review of its recoverable amount. The review led to the recognition of an impairment loss of CU 30,000.

The carrying amount of the Group's fixtures and equipment includes an amount of CU 40,000 (20X1: CU 60,000) in respect of assets held under finance leases.

On 10 December 20X2 the directors resolved to dispose of a machine. The machine's carrying amount of CU 1,472 is included in fixtures and equipment at 31 December 20X2, and trade payables includes the Group's remaining obligation of CU 1,550 on the acquisition of this machine. Because the proceeds on disposal are expected to exceed the net carrying amount of the asset and related liability, no impairment loss has been recognised.

14. Intangible assets

Software:

Cost	CU
1 January 20X2	8,500
Additions	-
Disposals	-
31 December 20X2	8,500
Accumulated depreciation and impairment	
1 January 20X2	5,950
Annual amortisation (included in administrative expenses*)	1,700

31 December 20X2	7,650
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Carrying amount

31 December 20X2	850
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*If the entity classifies its expenses by nature in its income statement, this would say 'included in depreciation and amortisation expense'.

15. Deferred tax

Differences between amounts recognised in the income statement and amounts reported to tax authorities in connection with investments in the subsidiary and associate are insignificant.

The deferred tax assets are the tax effects of expected future income tax benefits relating to:

- (a) the long-service benefit (note 19), which will not be tax-deductible until the benefit is actually paid but has already been recognised as an expense in measuring the Group's profit for the year.
- (b) the foreign exchange loss on trade payables, which will not be tax-deductible until the payables are settled but has already been recognised as an expense in measuring the Group's profit for the year.

Management considers it probable that taxable profits will be available against which the future income tax deductions can be utilised.

The following are the deferred tax liabilities (assets) recognised by the Group:

	Software	Foreign exchange	Long-service	Total
	loss		benefit	
	CU	CU	CU	CU
1 January 20X1	1,700	-	(3,855)	(2,155)
Charge (credit) to profit or loss for the year	(680)	-	(77)	(757)

1 January 20X2	1,020	-	(3,932)	(2,912)
Charge (credit) to profit or loss for the year	(680)	(400)	(317)	(1,397)
31 December 20X2	340	(400)	(4,249)	(4,309)

The deferred tax assets for the foreign exchange loss and the long-service benefits and the deferred tax liability for software relate to income tax in the same jurisdiction, and the law allows net settlement. Therefore, they have been offset in the statement of financial position as follows:

	20X2	20X1
	CU	CU
Deferred tax liability	340	1,020
Deferred tax asset	(4,649)	(3,932)
	(4,309)	(2,912)

16. Bank overdraft and loan

	20X2	20X1
	CU	CU
Bank overdraft	83,600	115,507
Bank loan—fully repayable in 20X4, prepayable without penalty	50,000	150,000
	133,600	265,507

The bank overdraft and loan are secured by a floating lien over land and buildings owned by the Group with a carrying amount of CU 266,000 at 31 December 20X2 (CU 412,000 at 31 December 20X1).

Interest is payable on the bank overdraft at 200 points above the London Interbank Borrowing Rate (LIBOR). Interest is payable on the seven-year bank loan at a fixed rate of 5 per cent of the principal amount.

17. Trade payables

Trade payables at 31 December 20X2 include CU 42,600 denominated in foreign currencies (nil at 31 December 20X1).

18. Provision for warranty obligations

Changes in the provision for warranty obligations during 20X2 were:	20X2
	CU
1 January 20X2	5,040
Additional accrual during the year	5,260
Cost of warranty repairs and replacement during the year	(6,100)
31 December 20X2	4,200

The obligation is classified as a current liability because the warranty is limited to twelve months.

19. Employee benefit obligation—long-service payments

The Group's employee benefit obligation for long-service payments under a government-mandated plan is based on a comprehensive actuarial valuation as of 31 December 20X2 and is as follows:

	20X2
	CU
Obligation at 1 January 20X2	9,830
Additional accrual during the year	7,033
Benefit payments made in year	(6,240)

Obligation at 31 December 20X2	10,623
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The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	4,944	4,754
Non-current liability	5,679	5,076
Total	10,623	9,830

20. Obligations under finance leases

The Group holds one piece of specialised machinery with an estimated useful life of five years under a five-year finance lease. The future minimum lease payments are as follows:

	20X2	20X1
	CU	CU
Within one year	25,000	25,000
Later than one year but within five years	25,000	50,000
Later than five years	-	-
	50,000	75,000

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	21,461	19,884

Non-current liability	23,163	44,624
	44,624	64,508

21. Commitments under operating leases

The Group rents several sales offices under operating leases. The leases are for an average period of three years, with fixed rentals over the same period.

	20X2	20X1
	CU	CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100
At year-end, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:		
	20X2	20X1
	CU	CU
Within one year	13,050	26,100
Later than one year but within five years	-	13,050
Later than five years	-	-
	13,050	39,150

22. Share capital

Balances as at 31 December 20X2 and 20X1 of CU 30,000 comprise 30,000 ordinary shares with par value CU 1.00 fully paid, issued and outstanding. An additional 70,000 shares are legally authorised but unissued.

23. Cash and cash equivalents

20X2	20X1
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	CU	CU
Cash on hand	28,700	22,075
Overdrafts	(83,600)	(115,507)
	(54,900)	(93,432)

24. Contingent liabilities

During 20X2 a customer initiated proceedings against XYZ (Trading) Limited for a fire caused by a faulty candle. The customer asserts that its total losses are CU 50,000 and has initiated litigation claiming this amount.

The Group's legal counsel do not consider that the claim has merit, and the Company intends to contest it. No provision has been recognised in these financial statements as the Group's management does not consider it probable that a loss will arise.

25. Events after the end of the reporting period

On 25 January 20X3 there was a flood in one of the candle storage rooms. The cost of refurbishment is expected to be CU 36,000. The reimbursements from insurance are estimated to be CU 16,000.

On 14 February 20X3 the directors voted to declare a dividend of CU 1.00 per share (CU 30,000 total) payable on 15 April 20X3 to registered shareholders on 31 March 20X3. Because the obligation arose in 20X3, a liability is not shown in the statement of financial position at 31 December 20X2.

26. Related party transactions

Transactions between the Company and its subsidiary, which is a related party, have been eliminated in consolidation.

The Group sells goods to its associate (see note 12), which is a related party, as follows:

Sales of goods		Amounts owed to the Group by the related party and included in trade receivables at year-end	
20X2	20X1	20X2	20X1
CU	CU	CU	CU

Associate	10,000	8,000	800	400
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The payments under the finance lease (see note 20) are personally guaranteed by a principal shareholder of the Company. No charge has been requested for this guarantee.

The total remuneration of directors and other members of key management in 20X2 (including salaries and benefits) was CU 249,918 (20X1: CU 208,260).

27. Approval of financial statements

These financial statements were approved by the board of directors and authorised for issue on 10 March 2013