

[EXPOSURE DRAFT FOR DISCUSSION PURPOSES ONLY]

# EXPOSURE DRAFT:

## FINANCIAL REPORTING FRAMEWORK FOR NON-PUBLIC ENTITIES

### REQUEST FOR COMMENT

March 2009

This Financial Reporting Framework for Non-Public Entities (hereafter referred to as 'the Framework' or 'this Framework'), is issued by the Working Group and released for public comment.

Comments received on the exposure draft will be considered in issuing a Framework for Non-Public Entities. Upon finalisation of the Framework by the working group, a model set of Financial Statements will be drafted and the Framework will be translated into Afrikaans. Appendix B to this Framework deals with Business Combinations, Consolidation and Equity Accounting, and will be completed once the Framework has been finalised.

This SAIPA ED 001 reflects the information as compiled by the Working Group and presents this information to SAIPA members in the form of ED 001.

Comments should be submitted using the following web address:

<http://sites.google.com/a/saipa.co.za/frf-npe/Home>

The website provide background information to the Framework and also a comment form.

Your comments should be dispatched so as to be received no later than **30 April 2009**. All comment letters will be regarded as being on public record unless confidentiality is requested.

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## INTRODUCTION TO THE FRAMEWORK

For some time now there has been debate around the level, complexity and cost implications of Financial Reporting Standards for organisations and legal entities with a limited audience. The Corporate Laws Amendment Act (2006) went some way towards differentiating between Financial Reporting Standards for 'Limited Interest' and 'Widely Held' companies. Against the backdrop of specific research commissioned by the South African Institute of Chartered Accountants (SAICA) and the continuing concern raised by members of various professional associations, practitioners and business owners and managers, a decision was taken to form a working group to evaluate the development of a separate set of Financial Reporting Standards for entities that do not require general purpose financial statements, including but not limited or restricted to owner managed entities.

### Objective

There is sound justification for this initiative. Some of the proposed benefits include:

- instituting a cost-effective process to create reliable, meaningful financial reports for these businesses;
- assisting government in its objectives to facilitate employment creation and an entrepreneurial spirit, without overburdening new entrepreneurs;
- creating an appropriate standard for reporting with consistency in terms of accounting application and interpretation;
- supporting financial institutions and others in their process of assessing the risk profile of the reporting entity; and
- increasing the reliance that SARS can place on reported information.

### Scope

The scope of the Working Group was to develop a high quality framework for entities that are not required by law to apply any other framework (such as IFRS, SA GAAP or Statement of GAAP for SMEs), or that are required by law to apply this Framework. The primary users of these financial statements were identified as the owners of the entities, financial institutions and SARS.

The Working Group agreed that the outcome would be measured against the following criteria:

- The costs of applying the Framework should not exceed the benefits to be derived.
- The Framework must enable the primary users (identified above) to evaluate the reporting entity's liquidity, solvency and profitability.
- It must be a stand-alone document which is succinct, easy to use and understand.
- It should address the majority of transactions and events that a reporting entity may encounter, and omit transactions that are either uncommon or relate to a few entities.
- It must ensure minimal deviation from management accounts, with as few adjustments as possible required, and must reflect the economic reality of the business activities by reflecting the intention of management.
- It must ensure that transactions are recognised with integrity to enable the primary users to place reliance thereon.

## Composition

The Working Group was constituted of representatives from the following institutions and associations:

- SAICA (South African Institute of Chartered Accountants)
- SAIPA (South African Institute of Professional Accountants)
- ACCA (Association of Chartered Certified Accountants)
- University of Johannesburg
- IRBA (The Independent Regulatory Board for Auditors – South Africa)
- SARS (South African Revenue Service)
- Banking Industry representation from ABSA and Nedbank
- Members of business and audit practices engaged in preparing and auditing financial reports

## Request for comment

An important part of developing the Framework is to solicit comment from preparers, auditors, users, government and other parties with an interest in a financial reporting Framework for Non-Public Entities. Accordingly the Framework is released for interested parties to submit comments. The Framework has a comment period of two months. Upon closure of the comment period, the Working Group will consider the submissions made, and modify, where appropriate, the Framework in the light of comments received, before proceeding to issue a finalised Framework.

Comment is invited on any aspects of the Framework by **30 April 2009**. Respondents are requested to express a clear overall opinion on whether the Framework in general is supported and that this opinion be supplemented by detailed comment, whether supportive or not, on the specific issues in the exposure draft. Comments must indicate the specific paragraph number or groups of paragraphs to which the comment relates. Comments should clearly explain the issue and propose suggested alternative wording with supporting reasoning.

## Acknowledgements

Sections of the Malaysian Accounting Standards Board Exposure Draft 52 – *Private Entity Reporting Standards* have been included in the Framework. The Framework also incorporates certain parts of the International Financial Reporting Standards and IFRS (IFRS) for Private Entities as issued by the International Accounting Standards Board. In addition to the aforementioned, and taking cognisance of the research results that indicated a preference for using IFRS as the basis for development of another framework, this Framework commenced with a document prepared from IFRS and incorporating previous endeavours in developing a simplified reporting framework.

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## SPECIFIC MATTERS FOR COMMENT

The Working Group invites comments on any aspect of this Exposure Draft, particularly on the questions set out below.

Comments are most helpful if they:

- a) comment on the questions as stated;
- b) indicate the specific paragraph or group of paragraphs to which they relate;
- c) contain a clear rationale; and
- d) describe any alternative the Working Group should consider, if applicable.

Respondents need not comment on all of the questions and are encouraged to comment on any additional issues that, in their view, warrant consideration.

The Working Group will consider all comments that it receives in writing by **30 April 2009**. Comments should be submitted using the following web address:

<http://sites.google.com/a/saipa.co.za/frf-npe/Home>

### Question 1 – Name of the Framework

This Framework has been named a Framework for Non-Public Entities. Do you agree with this name? If not, please provide an alternative name and justification for this.

### Question 2 – Purpose, objectives and scope

*Question 2 (a)*

Chapter 1 of this Framework provides the purpose, objectives and scope of this Framework. Do you agree with the current purposes, objectives and scope? If not, please provide details on how this Chapter may be improved.

*Question 2 (b)*

This Framework has opted for the alignment of the tax and accounting treatment, as a result of the scope as stated. This might result in the financial statements not achieving fair presentation. Do you believe that alternative treatments should be allowed whereby temporary differences can arise between book- and tax values? If so, which balance sheet items should an alternative be provided for.

### Question 3 – Transitional provisions

*Question 3 (a)*

Chapter 2 provides the transitional provisions for an entity to comply with the transition to this Framework.

- Do you agree with the current provision to restate comparatives if the entity's previous accounting framework was not IFRS, SA GAAP or the Statement of GAAP for SMEs (such as most Close Corporations) [Chapter 2, paragraph .03]? If not:

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- Would you propose no restatement or only the restatement of the Balance Sheet and related notes? or
- Should an option be given for restatement?

*Question 3 (b)*

Should an undue time, cost or effort exemption be included?

**Question 4 – Principles, recognition and measurement***Question 4 (a)*

Chapter 3 provides the principles, recognition and measurement criteria of this Framework. Do you agree with these? If not, please provide details on how this Chapter may be improved.

*Question 4 (b)*

Do you agree with the matching principle?

- Are there sections of this Framework that need to be re-assessed in light of your answer, for example dividends declared [Chapter 9, paragraphs .18 and .19]?

**Question 5 – Accounting treatment not covered in the Framework**

When developing an appropriate accounting policy for a transaction, event or balance not covered by this Framework, reference should be made to the recognition and measurement section, Chapter 3, [Chapter 4, paragraph .05]. Do you agree with the requirement where this Framework does not address a particular accounting recognition or measurement issue? If not, please provide details on how this Section may be improved.

**Question 6 – Changes in accounting policies and corrections of prior period errors**

This Framework proposes that any change in accounting policy or correction of a material prior period error shall be applied retrospectively with the resulting adjustment to be included in the opening balance of retained earnings for the period. Comparative information shall accordingly be presented as reported in the financial statements (AFS) of the prior period and is therefore not restated for the retrospective application [Chapter 4, paragraphs .08 and .12].

An entity is encouraged to present additional comparative information to show the profit or loss and the financial position of the current period and any prior periods presented as if the new accounting policy had always been applied [Chapter 4, paragraphs .09 and .13].

Do you agree with these proposals?

- If yes, do you agree that an entity shall be encouraged, rather than be mandated, to present the additional pro-forma comparative information?
- If not, would you propose no restatement or only the restatement of the Balance Sheet?

**Question 7 – Presentation of financial statements***Question 7 (a)*

Chapter 5 of this Framework does not require a Statement of Changes in Equity, but incorporates a Statement of Income and Retained Earnings. Disclosure of changes in equity, including reserves, is required on the face of the Balance Sheet or in the notes [Chapter 6, paragraphs .218, .219 and .222]. Do you agree with this proposal and the other requirements? If not, why and what alternative(s) would you propose?

*Question 7 (b)*

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In your experience list the types of reserves that Non Governmental Organisations (NGOs) have and how would you suggest these be accounted for in the financial statements?

**Question 8 – Balance Sheet (general)***Question 8 (a)*

The general measurement basis for all assets and liabilities is cost less accumulated impairment and accumulated depreciation (amortisation) [Chapter 6, paragraphs .02 and .03]. An entity may elect to disclose an attributed value of any asset or liability [Chapter 6, paragraph .04]. Do you agree with these proposals? If not, why and what alternative would you propose?

*Question 8 (b)*

Do you agree with the term ‘attributed value’, or would you prefer any other terms, for example ‘directors’ valuation’, ‘market value’, ‘insured value’, ‘deemed value’, ‘replacement value’, ‘depreciated replacement value’ or any other term [Chapter 6, paragraph .04]?

**Question 9 – Real estate**

This Framework requires that real estate is carried at cost less any accumulated impairment losses (if applicable) [Chapter 6, paragraphs .17 to .21] and no depreciation of real estate is required [Chapter 6, paragraph .22]. Subsequent expenditure on real estate shall also be accounted for in a manner consistent with its tax treatment [Chapter 6, paragraphs .25 and .26]. Land and buildings are not required to be separated, but they may be if an entity chooses to do so [Chapter 6, paragraph .35].

Do you agree with these proposals and the other requirements relating to real estate? If not, please provide details on how this Section may be improved.

**Question 10 – Plant and equipment**

This Framework requires that for tax-deductible assets the cost of an asset shall be allocated on a basis consistent with its tax treatment [Chapter 6, paragraph .45]. The cost of a tax-deductible asset shall be allocated on a straight-line basis over its useful life [Chapter 6, paragraph .46]. Subsequent expenditure on plant and equipment shall also be accounted for in a manner consistent with its tax treatment [Chapter 6, paragraphs .51 and .52].

Residual values for plant and equipment do not need to be estimated and all plant and equipment will be depreciated to zero. Furthermore, there is no option to depreciate tax-deductible plant and equipment over the estimated useful life, thereby differing from the tax treatment.

Do you agree with these proposals and the other requirements relating to plant and equipment? If not, do you believe there should be two allowed alternatives, one requiring the accounting treatment to be in line with the tax treatment, with a second option to allow for estimated useful lives and residual values (benchmark and alternative treatment)? If the latter is your preference, do you believe deferred tax should be a requirement in this Framework?

**Question 11 – Intangible assets and goodwill***Question 11 (a)*

This Framework proposes that all goodwill and internally generated intangible assets shall be expensed as incurred [Chapter 6, paragraph .62]. It also requires that tax-deductible intangible assets are accounted for in a manner consistent with their tax treatment [Chapter 6, paragraph 75]. Non-tax-deductible intangible assets are to be amortised over their useful lives on a straight-line basis, with a rebuttable presumption that the maximum useful life is 10 years [Chapter 6, paragraph 76].

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Residual values for intangible assets and goodwill need not be estimated and all intangible assets and goodwill will be depreciated to zero over a period not exceeding 10 years. There is no option to depreciate tax-deductible intangible assets over the estimated useful life.

Do you agree with these proposals and the other requirements relating to intangible assets and goodwill? If not, do you believe there should be two allowed alternatives, one requiring the accounting treatment to be in line with the tax treatment, with a second option to allow for estimated useful lives and residual values (benchmark and alternative treatment)? If the latter is your preference, do you believe deferred tax should be required or not?

*Question 11 (b)*

The definition, recognition and measurement principles of goodwill are contained in this Section, and require the same subsequent measurement and disclosure requirements as other intangible assets [Chapter 6, paragraphs .86 and .87].

Do you agree with the initial measurement principles and definition of goodwill? If you disagree with the definition or measurement requirements, why and what alternative would you propose? Would you suggest different guidance for goodwill?

**Question 12 – Leases**

This Framework proposes that all leases should be classified as operating leases [Chapter 6, paragraph .88]. It distinguishes between instalment sales and leases. Lease payments are to be recognised as income or expense by the lessor and lessee respectively, in a manner consistent with the tax treatment [Chapter 6, paragraphs .90 and .93].

Do you agree with the definitions, proposals and the other requirements in this Section? If not, why and what alternative would you propose? In particular, are there any additional disclosures you believe are required?

**Question 13 – Instalment sales**

This Framework requires that, for **instalment sales**, the purchaser shall recognise an asset an instalment sale payable (the seller recognises an instalment sale receivable) in its Balance Sheet at amounts equal to the cost of the asset to be purchased (sales price), excluding interest charges, i.e. principal debt plus any deposits paid [Chapter 6, paragraph .100 and .105]. The purchaser and seller will recognise interest expense and income in the same manner that interest is deductible or included for tax purposes, while the purchaser will recognise depreciation charges in the same manner that wear and tear is deductible for tax purposes [Chapter 6, paragraphs .102, .103 and .107].

Do you agree with the definitions, proposals and the other requirements in this Section? If not, why and what alternative would you propose? In particular, are there any additional disclosures you believe are required?

**Question 14 – Inventories***Question 14 (a)*

This Framework proposes that rebates and trade discounts indicated on the invoice be deducted in determining the cost of inventory [Chapter 6, paragraph .113]. This excludes early settlement discounts and other discounts and rebates received by the entity subsequent to the original invoice. Do you agree with this proposal? If not, why and what alternative(s) would you propose?

*Question 14 (b)*

This Framework proposes that the method to measure the cost of inventories shall be first-in, first-out (FIFO) or weighted average cost formula [Chapter 6, paragraph .115]. Owing to the nature of inventory, the value of inventory consumed may not always be easy to determine, e.g. scrap dealer,

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baker and butcher. Do you have any specific proposal(s) to provide more flexibility in quantifying the inventory values?

### **Question 15 – Impairment of assets**

#### *Question 15 (a)*

This Framework requires that an entity tests goodwill and other assets for impairment only if there is an indication of impairment [Chapter 6, paragraph .120]. It also proposes that entities may decide not to impair assets, even if an indicator exists and the fair value less costs to sell is less than the carrying amount, in which case the entity should disclose the carrying amount of such assets and the reason for not impairing [Chapter 6, paragraphs .133 and .135]. Do you agree with these proposals? If not, why and what alternative would you propose?

#### *Question 15 (b)*

This Framework only allows the fair value less costs to sell as the basis for impairment, thereby disallowing the value-in-use basis [Chapter 6, paragraphs .126 to .129]. Do you agree with this proposal? If not, why and what alternative would you propose?

#### *Question 15 (c)*

This Framework does not allow impairment losses to be reversed [Chapter 6, paragraph .132]. Do you agree with this proposal? If not, why and what alternative would you propose?

### **Question 16 – Provisions, contingent liabilities and contingent assets**

#### *Question 16 (a)*

Do you agree with the requirements of this Section [Chapter 6, paragraphs .136 to .159]? If not, why and what alternative(s) would you propose?

#### *Question 16 (b)*

Do you agree with the disclosure requirements for derivative instruments [Chapter 6, paragraph .159]? If not, why and what alternative(s) would you propose?

### **Question 17 – Deferred tax**

In principle, do you believe that “Non-Public Entities” entities should provide for deferred tax?

- i. If yes, which of the following methods would you prefer?
  - Timing differences – timing differences are differences between taxable profit or loss and accounting profit or loss that originate in one period and reverse in one or more subsequent periods. This method focuses on the Statement of Income and Retained Earnings of an entity.
  - Temporary differences – temporary differences are differences between the tax base of an asset or liability and its carrying amount in the Balance Sheet. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. This method focuses on the Balance Sheet of an entity.
- ii. Also, if yes, would you propose making the recognition of deferred tax compulsory or at the discretion of the entity?

### **Question 18 – Agriculture**

This Framework requires that livestock and growing crops acquired be accounted for at cost [Chapter 6, paragraph .182]. It prohibits the capitalisation of costs related to biological transformation as well as the capitalisation of the costs of additional biological assets generated internally [Chapter 6,

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paragraphs .182 and .184]. Do you agree with these proposals and the other requirements relating to Agriculture?

If not, would you prefer to measure livestock and growing crops at their tax values?

- i. If you prefer tax values, how would you suggest adjustments should be accounted for?
- ii. Would you propose making the use of tax values compulsory or at the discretion of the entity?

### **Question 19 – Investments**

#### *Question 19 (a)*

This Framework does not include a separate chapter on financial instruments. The chapter has been replaced with a section on investments [Chapter 6, paragraphs .195 to .208], equity [Chapter 6, paragraphs .216 to .219], loans payable [Chapter 6, paragraphs .224 to .233], cash and cash equivalents [Chapter 6, paragraphs .234 to .238], amounts receivable [Chapter 6, paragraphs .239 to .248] and amounts payable [Chapter 6, paragraphs .249 to .258].

The initial measurement basis for **all** investments is at cost [Chapter 6, paragraph .197] and subsequent measurement also at cost (loans at amortised cost) [Chapter 6, paragraphs .198 and .199]. For investments with control, joint control or significant influence, the alternative allowed method is to prepare consolidated financial statements [Chapter 6, paragraph .207]. This election for an alternative treatment may be undertaken on an investment-by-investment basis.

The Framework does not allow for any investments to be carried at fair value. The attributed value may, however, be disclosed [Chapter 6, paragraphs .206 and .208].

Do you agree with these proposals and the other requirements relating to investments? If not, why and what alternative would you propose?

#### *Question 19 (b)*

The Framework requires additional disclosures in respect of controlled entities and entities with significant influence (e.g. subsidiaries, special purpose entities, associates and jointly controlled entities), where the reporting entity does not prepare consolidated financial statements or does not apply the equity method of accounting [Chapter 6, paragraphs .209 to .212]. Do you agree with these proposals and disclosures? If not, why and what alternative would you propose?

#### *Question 19 (c)*

Derivative instruments held for speculative purposes are included in the scope of the investment section and accounted for accordingly [Chapter 6, paragraph .195]. Do you agree with this proposal, accounting treatment and resultant disclosures? If not, why and what alternative would you propose?

### **Question 20 – Equity, reserves and loans payable**

Do you agree with the requirements of these Sections [Chapter 6, paragraphs .216 to .233]? If not, why and what alternative(s) would you propose?

### **Question 21 – Cash and cash equivalents, amounts receivable and amounts payable**

Do you agree with the requirements of these Sections [Chapter 6, paragraphs .234 to .257]? If not, why and what alternative(s) would you propose?

### **Question 22 – Abnormal items**

This Framework incorporates the concept of abnormal items. These items shall be presented / disclosed separately [Chapter 7, paragraph .04]. Do you agree with this proposal and the other

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requirements relating to the Statement of Income and Retained Earnings? If not, why and what alternative would you propose?

**Question 23 – Construction contracts**

This Framework deals with -construction contracts [Chapter 7, paragraph .07]. Do you agree with this proposal? If not, why and what alternative would you propose?

**Question 24 – Revenue***Question 24 (a)*

This Framework requires revenue to be measured at the net invoiced value. Only rebates and discounts included on the invoice will be taken into account [Chapter 7, paragraph .11]. Pre-invoiced amounts are specifically not allowed to be recognised as revenue [Chapter 7, paragraph .12]. Do you agree with these proposals? If not, why and what alternative(s) would you propose?

*Question 24 (b)*

Are there any additional revenue transactions which require specific guidance? If so, please provide details on how this Section may be improved.

**Question 25 – Government grants**

This Framework requires government grants to be recognised as revenue when received or receivable.

The amounts are not required to be spread over the period during which the entity is required to comply with certain conditions [Chapter 7, paragraphs .17 and .18]. Do you agree with the requirements of this Section? If not, why and what alternative(s) would you propose?

**Question 26 – Discounts**

An entity shall disclose discounts allowed and received, which are not indicated on sales' invoices issued and invoices for goods and services received, respectively, separately on the face of the Statement of Income and Retained Earnings [Chapter 7, paragraphs .20 and .21]. Do you agree with these proposals? If not, why and what alternatives would you propose?

**Question 27 – Effects of changes in foreign exchange rates**

This Framework requires transactions denominated in a foreign currency to be recorded at spot rate on the date of the transaction, or the cover rate, if applicable [Chapter 7, paragraph .27]. Do you agree with this proposal and the other requirements relating to the Effects of Changes in Foreign Exchange Rates? If not, why and what alternative would you propose?

**Question 28 – Borrowing costs**

This Framework has no specific section on borrowing costs. Do you agree with this proposal? If you disagree with the proposal, why and what alternative would you propose?

**Question 29 – Employee benefits**

This Framework has no specific section on employee benefits. Do you agree with this proposal? If not, why and what alternative would you propose?

**Question 30 – Share-based payment**

This Framework has no specific section on share-based payments. Do you agree with this proposal? If not, why and what alternative would you propose?

**Question 31 – Taxation**

This Framework requires Secondary Tax on Company (STC) (this will be replaced by the new withholding tax on dividends) to be recognised in the period in which the dividends are declared [Chapter 7, paragraph .33], while Capital Gains Tax (CGT) needs to be recognised in the period in which the sale is made [Chapter 7, paragraph .34]. Do you agree with these proposals and the other requirements relating to STC and CGT? If not, why and what alternative would you propose?

**Question 32 – Cash flow statements**

Do you agree with the proposals and the other requirements in Chapter 8? If not, why and what alternative(s) would you propose?

**Question 33 – Related party disclosures***Question 33 (a)*

This Framework requires the disclosure of the total compensation of the Board of Directors or equivalent management body [Chapter 9, paragraph .07]. Do you agree with this proposal? If not, why and what alternative would you propose?

*Question 33 (b)*

This Framework requires detailed disclosure if there have been transactions between related parties on terms not equivalent to those that prevail in arm's length transactions, as well as any encumbrances [Chapter 9, paragraphs .08 and .09]. Do you agree with this proposal? If not, why and what alternative would you propose?

**Question 34 – Events after the Balance Sheet date***Question 34 (a)*

This Framework requires that dividends should be recognised when the dividends are declared [Chapter 9, paragraph .18]. It requires that dividends declared after Balance Sheet date, but before the AFS are finalised, should only be disclosed and **not** recognised as a liability [Chapter 9, paragraph .19]. Do you agree with these proposals? If not, why and what alternative would you propose?

*Question 34 (b)*

Would you support an overall principle that any event, between the Balance Sheet date and the authorisation date of the AFS, which is within management's control (i.e. not market related), (i) may or (ii) should be considered when recognising and measuring items in the AFS; or

Should the entity have a choice of fully disclosing the event after the Balance Sheet date (but not recognising / measure the event), or changing the measurement / recognition based on the event?

**Question 35 – Notes to the AFS**

This Framework requires that anticipated cash flows for capital commitments, provisional tax payments, lease payments, instalments and dividends proposed be disclosed [Chapter 9, paragraphs .26 to .29]. Do you agree with these proposals and the other requirements relating to anticipated cash flows? If not, please provide details on how this Section may be improved.

**Question 36 – Definitions (Appendix A – Glossary of Terms)**

Do you agree with the definitions in Appendix A? If you disagree with the definitions in Appendix A, what alternative(s) would you propose? Do you believe there are any definitions that have been omitted? Do you believe there are any definitions that are not required?

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**Question 37 – General**

The Working Group would appreciate any other comments relating to this Framework. Please do not hesitate to raise concerns, identify problems and make suggestions, even if not explicitly requested in the preceding questions.

Refer to document 2

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