Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure

Accounting Standards Council

Saudi Organization for Chartered and Professional Accountants (SOCPA)

Revised Version

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Introduction

The Companies Law requires preparing financial statements at the end of each fiscal year of a company[1] during the liquidation period. The company shall, upon termination, enter into liquidation and shall retain its legal personality to the extent necessary for liquidation.[2]

The company's assemblies shall remain valid during the liquidation period, and the role thereof shall be limited to practicing its powers that are not in conflict with those of the liquidator.[3]

The liquidation is either:

- Voluntary: when partners or shareholders are unwilling to continue the business activity and intend to liquidate the company prematurely. A decision of the voluntary liquidation shall be issued by the partners or the general assembly. In this case, it shall be determined that an entity has assets enough to cover its debts by the end of the proposed liquidation period and it is not in distress according to the Bankruptcy Law; or
- Compulsory: for the following reasons:
    - A judicial order is issued by a competent judicial authority.[4] This kind of liquidation is usually caused by a dispute between partners or a lawsuit filed by some of them with the competent judicial authority to liquidate the company,
    - A company's legal term comes to its end and it is unlikely to extend it, or

1 Companies Law, Article 209, para. 3.

2 Companies Law, Article 203, para. 1.

3 Companies Law, Article 203, para. 3.

4 Companies Law, Article 205, para. 2.

- A company is distressed or bankrupt or is forced by its creditors or a competent authority to enter into a liquidation proceeding in accordance with the Bankruptcy Law.[5]

The need to establish principles and requirements for recognition, measurement, presentation and disclosure in the financial statements of entities that enter into liquidation

If an entity is a going concern, it shall prepare its financial statements according to the requirements of IFRS Standards as endorsed in the KSA, either the full IFRSs or the IFRS for SMEs, as applicable, as well as other local pronouncements supplemental to the international standards. When the going concern basis becomes invalid and an entity enters into liquidation, it shall not prepare its financial statements on such basis upon which all IFRS Standards have been developed. Hence, the entity shall apply another basis of accounting. The IFRS Standards as endorsed in the KSA do not provide an appropriate basis for an entity that enters into liquidation to prepare its financial statements. It is impractical to adapt such standards for use in preparing financial statements that provide users with useful information about the overall effect of the liquidation and the value to be returned from their investments or losses an entity would incur after finalization of the liquidation. Therefore, SOCPA has decided to bridge this gap by issuing a relevant standard that establishes recognition, measurement, presentation and disclosure principles and requirements for entities that enter into liquidation. This Standard is considered as a financial reporting framework separate from IFRS Standards as endorsed in the KSA and other supplemental local pronouncements.

[5] According to HE Minister of Commerce's letter no. 20326, dated 4-7-1442 A.H, and the Secretary General of the Bankruptcy Committee's letter no. 5/321, dated 15-6-1442 A.H corresponding to 28-1-2021 A.D, entities that enter into a liquidation proceeding according to the Bankruptcy Law are not required to prepare financial statements since they are not subject to the Companies Law.

Amendments to IFRS Standards to be included in the document of endorsement

Paragraph 25 of IAS 1 *Presentation of Financial Statements* (paragraph 9 of Section 3 *Presentation of Financial Statements* of the IFRS for SMEs), requires that when financial statements are not prepared on a going concern basis, the basis on which they are prepared shall be disclosed. After issuance of the Liquidation Basis Financial Reporting Standard, that paragraph shall be amended to read as follows, in the context of the preparation of financial statements in the KSA, "… When an entity does not prepare financial statements on a going concern basis, ~~it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.~~ the full IFRSs shall cease to be applicable and the entity shall prepare its financial statements on the liquidation basis in accordance with the *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure*, endorsed in the KSA."

Paragraph 3.9 of the IFRS for SMEs requires that when financial statements are not prepared on a going concern basis, the basis on which they are prepared shall be disclosed. After issuance of the Liquidation Basis Financial Reporting Standard, that paragraph shall be amended to read as follows, in the context of the preparation of financial statements in the KSA: "…When an entity does not prepare financial statements on a going concern basis, ~~it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.~~ the IFRS for SMEs shall cease to be applicable and the entity shall prepare its financial statements on the liquidation basis in accordance with the *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure*, endorsed in the KSA."

Principles of Liquidation Basis Financial Reporting

Objective of Liquidation Basis Financial Statements

The objective of financial statements prepared on a going concern basis is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. These going concern basis financial statements shall be prepared as required by IFRS Standards, either full IFRSs or the IFRS for SMEs, as applicable. When the going concern basis becomes invalid due to an entity entering into liquidation, the financial statements shall be designed to provide information about the reporting entity that is useful to users in knowing the overall effect of the liquidation and its impact on their rights in the entity. Such liquidation basis financial statements shall be prepared as required by this Standard.

Going Concern and Imminence of Liquidation

Liquidation basis financial statements are prepared on the assumption that the going concern basis is invalid and the entity will inevitably be liquidated. In principle, an entity is established assuming that its businesses will continue and it has no intention or need to enter into liquidation. To revoke such assumption, some conditions and events shall be met to conclusively prove the imminence of liquidation. For example, a decision to liquidate an entity is taken by its highest governing body.

Legal Unit and Accounting Unit

When an entity enters into liquidation, the legal unit considerations prevail over the accounting unit ones because the liquidation proceeding is applied to the legal unit. Therefore, financial information relevant to users is focused on assets and liabilities of the legal unit, including the monetary value expected from the disposal of that legal unit's investments. In addition, an entity often loses control and it is controlled by other parties (for example, a liquidator or court). The consolidation of financial statements is, therefore, inappropriate when applying a liquidation basis.

Liquidation Basis Financial Reporting Standard: Requirements for Recognition, Measurement, Presentation and Disclosure

Objective

1 Objective of this Standard is to assist preparers under liquidation in preparing financial statements that include financial information useful to users of such statements in knowing the overall effect of the liquidation and its impact on their rights in the entity.

2 To that end, this Standard provides guidance on when and how an entity can prepare its financial statements on the liquidation basis of accounting and explains related recognition, measurement, presentation and disclosure requirements.

Scope

3 When an entity enters into imminent liquidation and it is required or voluntarily decides to prepare general purpose financial statements, IFRS Standards as endorsed in the KSA and other supplemental local pronouncements are no longer applicable to that entity. Instead, this Standard applies to all entities that prepare general purpose financial statements, whatever their nature, legal form or ownership structure is, excluding government entities, when they enter into imminent liquidation.

4 Related party information is important to users of financial statements whether they are prepared by going concern entities or by entities under liquidation. Therefore, requirements of IAS 24 *Related Party Disclosures* (or Section 33 *Related Party Disclosures* of the IFRS for SMEs, as applicable) apply to an entity that prepares its financial statements on the liquidation basis, and are an integral part of this Standard.

5 This Standard establishes recognition, measurement, presentation and disclosure principles and requirements for general purpose financial statements during the liquidation period.

6 This Standard determines the complete set of financial statements for entities that enter into liquidation and prepare their financial statements according to this Standard.

7 This Standard is not applicable to accounting for the termination of a sub-activity, closure of a division, branch or component, or merger of an entity into another, as these events do not constitute departure from the going concern basis.

Imminent Liquidation

8 An entity shall prepare its financial statements as required by this Standard if the liquidation is imminent.

9 The liquidation is imminent when:

(a) A liquidation decision is approved by the person(s) authorized to make the decision effective and the likelihood of the following is remote:

1. Suspend the decision by other parties (for example, persons with shareholder rights), or
2. Reverse the liquidation decision.

(b) The liquidation decision is forced by an external authority (for example, in case of compulsory liquidation) and the likelihood to reverse the decision is remote.

(c) An entity's legal term comes to its end (termination of a company by the force of law) and the likelihood to extend it is remote.

10 Imminent liquidation means to cease activity, liquidate assets and pay liabilities to terminate the legal existence of an entity.

11 The cessation of activity without the termination of an entity by paying any remaining amounts back to owners and ending the legal existence of the entity is not an imminent liquidation. For example, an entity may suspend its business due to absence of a viable market for its products or for the purpose of restructuring

and changing its business line, while holding its legal existence to resume activity in case that a viable market exists or the business line is changed.

12 Likewise, an entity incurring great amount of losses does not mean in itself that the liquidation is imminent (for example, as when the Companies Law prescribes specific procedures to be implemented in case that accumulated losses reach a certain level, otherwise the company shall be deemed terminated by the force of law). However, if a company is terminated by the force of law because of its failure to implement the necessary procedures in case that the accumulated losses reach a certain level, the company may be deemed under imminent liquidation.

13 In addition, it shall not constitute an imminent liquidation if a plan is developed as part of the governance documents at the time of an entity's establishment to liquidate the entity. This applies whether the liquidation is implemented through staggered downsizing while maintaining normal activities (for example, sell and purchase assets, take loans, conduct manufacturing activities, sell goods and render services) or due to the entity's nature, for example, some investment funds and special-purpose vehicles.

Basis of Preparation

14 The liquidation basis depends on:

(a) Measurement of assets at the monetary amount or consideration expected from their disposal.

(b) Measurement of liabilities at the contractual amounts payable to settle them.

(c) Recognition of other assets (such as trademarks) that have not been previously recognised under the financial reporting framework that was applicable to the entity while it was a going concern if such assets can be reliably estimated and are expected to be sold or to be used to settle liabilities during the liquidation.

(d) Recognition and presentation of the estimated costs of the disposal of assets or other elements that are expected to be sold during the liquidation, in the statement of net assets in liquidation subtracted from the related assets or in total separately from assets when they can be reliably estimated and the assumptions underlying such estimation are verifiable.

(e) Recognition of costs and income items that are expected to be incurred or gained (for example, payroll costs or income from pre-existing claims that are expected to be fulfilled during the liquidation) until the end of the liquidation when they can be reliably estimated and the assumptions underlying such estimation are verifiable.

(f) Provision of sufficient disclosures about the information in the financial statements and the circumstances of liquidation.

15 The basis of preparation is expected to achieve a fair presentation of net assets as at the reporting date and changes in net assets during the reporting period.

16 In the extremely rare circumstances in which management concludes that compliance with a requirement in this Standard would be so misleading that it would conflict with the objective of this Standard, the entity shall depart from that requirement in the manner set out in paragraph 17 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

17 When an entity departs from a requirement of this Standard in accordance with paragraph 16, it shall disclose:

(a) that management has concluded that the financial statements present fairly the entity's net assets and changes in net assets;

(b) that it has complied with applicable requirements of this Standard, except that it has departed from a particular requirement to achieve a fair presentation;

(c) the requirement from which the entity has departed, the nature of the departure, including the treatment that this Standard requires, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of this Standard, and the treatment adopted; and

(d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

Complete Set of Financial Statements

18 A complete set of liquidation basis financial statements comprises:

(a) Statement of net assets, which shall present an entity's assets and liabilities;

(b) Statement of changes in net assets, which shall present items that led to changes in net assets during the period from the beginning to end of the financial period/year; and

(c) Notes, which shall provide detailed information about the amounts recognised in the financial statements.

Initial Recognition and Measurement

19 This Standard shall be applied prospectively from the beginning of the financial year during which liquidation became imminent or the financial year that precedes the financial year during which liquidation became imminent in case no financial statements have been issued for the former.

20 The information in the statement of financial position as at the beginning of the financial year (the end of the previous financial year) referred to in paragraph 19 shall be the starting point for the purpose of the implementation of this Standard.

21 In case the information referred to in paragraph 20 is not available or a preparer finds it difficult to obtain the information due to incomplete records of assets, the assets shall be measured at the beginning of the financial year for which financial statements according to this Standard are first prepared using the available documents containing reliable information about the asset value that should have

been recognized at the beginning of the financial year. In the absence of reliable information about the asset value that should have been recognized at the beginning of the financial year, assets shall be recognized and measured at a deemed cost as required by the financial reporting framework applicable to the entity prior to liquidation using instructions in paragraph 24 of this Standard.

22 An entity shall, at the end of the financial year during which liquidation became imminent or the financial year that precedes the financial year during which liquidation became imminent in case no financial statements have been issued for the former:

(a) Recognise other assets (such as trademarks) that have not been previously recognised under the financial reporting framework that was applicable to the entity while it was a going concern and measure them at the monetary amount or consideration expected from their disposal if such assets can be reliably estimated and are expected to be sold or to be used to settle liabilities during the liquidation.

(b) Derecognise assets that do not generate cash flows when they are realized, such as deferred expenses.

(c) Measure assets to reflect the monetary amount or consideration expected from their disposal when implementing the liquidation plan if such assets can be reliably estimated.

(d) Measure liabilities at the contractual amounts payable to settle them. An entity shall adjust its liabilities to reflect changes in assumptions resulting from the entity's decision to liquidate (for example, timing of payments). However, a liability shall not be reduced by any expected forgiveness unless such forgiveness is ordered by a court or offered by a creditor.

(e) Measure the expected costs of disposal described in paragraph 14(d) and expense and income items expected until the end of the liquidation described in paragraph 14(e) at the undiscounted value of such amounts (i.e., ignore the time value of money).

23 The application of requirements of subparagraphs 22(a)-(e) results in items in the statement of net assets at the end of the first financial period for which such statement is prepared after entering into the liquidation. Items of the statement of changes in net assets include changes in net assets arising, for example, from the recognition of assets that were not previously recognized, disposal of assets or settlement of liabilities, measurement or re-measurement of items affecting net assets at the end of the period as compared with the information in the statement of financial position as at the beginning of the period to which the liquidation basis is first applied, as well as any changes arising from distributions to owners during the period.

24 An entity shall make measurements mentioned in paragraph 22 in accordance with reasonable assumptions that take into account the entity's specific circumstances and the condition of each asset being measured. Examples of considerations that may be taken into account are:

(a) Whether an asset can be measured at fair value when an active market exists for the asset, or for new or used similar assets that can be a benchmark for measuring the asset, taking into account the characteristics of the asset being measured in the entity's specific circumstances.

(b) Whether it is possible to obtain a valuation from an independent valuer without undue cost or effort.

(c) Whether there is a quotation to buy the same or similar assets during the period but before the issue of the financial statements, taking into account the characteristics of the asset being measured in the entity's specific circumstances.

(d) Whether there is a transaction to sell a similar asset during the period but before the issue of the financial statements, taking into account the characteristics of the asset being measured in the entity's specific circumstances.

(e) If assets cannot be reliably measured to reflect the monetary amount or consideration expected from their disposal when implementing the liquidation plan, they shall be recognised at their carrying amounts in case they have been previously recognised prior to the liquidation. Disclosures required by subparagraphs 33 (f) and (g) shall be provided along with the disclosure that the previously recognised costs of assets do not reflect the monetary amount or consideration expected from their disposal when implementing the liquidation plan.

Subsequent Measurement

25 At each reporting date, an entity shall re-measure assets and other elements initially recognised in applying the liquidation basis according to paragraph 22 (for example, trademarks), liabilities, costs of disposal or other expected costs and expected income to reflect the actual or estimated changes in the value of the monetary amount or consideration expected from the disposal of assets, in the contractual amounts payable to settle liabilities or other costs or in income since the previous reporting date.

Presentation

26 An entity shall present asset items in the order of their liquidity and their priority to be liquidated according to the liquidation plan, if any.

27 An entity shall not offset assets and liabilities in the statement of net assets, nor positive and negative change items in the statement of changes in net assets, unless the entity has a legally enforceable right to set off recognized amounts or the offsetting reflects the substance of transactions or other events such as when an entity presents changes in net assets arising from the disposal of assets by deducting from the amount of consideration on disposal the carrying amount of the asset and related selling expenses.

28 An entity shall present information in the statement of changes in net assets in items that are relevant to understanding the sources of changes in net assets during the reporting period. It shall present separately each material class of similar items and present separately items of a dissimilar nature unless they are immaterial. For example, the statement of changes in net assets may include the following items:

(a) Changes arising from recognition of assets that were not recognised at the beginning of the reporting period, from sale, realization or disposal of existing assets or from settlement of liabilities at amounts different from those recognized at the beginning of the reporting period.

(b) Changes arising from estimating or re-estimating income expected until the end of the liquidation.

(c) Changes arising from estimating or re-estimating costs expected until the end of the liquidation.

(d) Changes arising from estimating or re-estimating the monetary amount or consideration expected from a future disposal of assets.

(e) Changes arising from estimating or re-estimating contractual amounts that will be required for a future settlement of liabilities (for example, forgiveness of a certain debt).

(f) Changes arising from distributions to owners out of net assets.

29 An entity shall present a complete set of financial statements (including comparative information) at least annually in case the liquidation lasts for more than a year, and present a complete set of financial statements at the end of liquidation. When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:

(a) the reason for using a longer or shorter period, and

(b) the fact that amounts presented in the financial statements are not entirely comparable.

Consolidated Financial Statements

30 Given that the preparation of financial statements on a liquidation basis requires presentation and measurement principles substantially different from those required for the financial statements on a going concern basis, that users of the financial statements of entities that enter into liquidation need information of a special nature and that the legal unit prevails over the accounting unit during the liquidation proceeding, the requirements to consolidate financial statements while an entity is a going concern do not provide useful financial information to users of liquidation basis financial statements. Therefore, an entity that prepares its financial statements on the liquidation basis shall prepare unconsolidated financial statements according to this Standard as its general purpose financial statements. It shall measure all its investments at the monetary amount or consideration expected from the disposal of such investments when implementing the liquidation plan as required by paragraph 22 of this Standard.

Disclosure

31 An entity shall sufficiently disclose all information that is relevant to understanding the statement of net assets in liquidation, the statement of changes in net assets in liquidation and circumstances of the liquidation. Disclosures shall include information about the monetary amounts or other compensation the entity expects to receive and the value of present or contingent liabilities (in case of payables described in paragraphs 14(d) and (e)) the entity expects to pay during the liquidation. Disclosures shall provide adequate information to understand circumstances of the liquidation.

32 The entity's title, whenever mentioned, shall be accompanied by "under liquidation".

33 An entity shall disclose, at a minimum, each of the following when it prepares its financial statements in accordance with this Standard:

(a) A statement that the financial statements are prepared on the liquidation basis in accordance with the *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure*, endorsed in the KSA;

(b) The reasons behind entering into the liquidation, such as the entity's decision to cease business, a court order or the expiration of the legal term; an adequate description of the facts and circumstances that led to entering into the liquidation; and any legal requirements applicable to the entity due to the liquidation;

(c) A explanation of the entity's liquidation plan, including:

1. The expected way to dispose assets and other elements that the entity expects to sell that have not been previously recognised as assets (for example, trademarks),
2. The expected way to settle liabilities, and
3. The expected completion date for the liquidation;

(d) A qualitative description of material assets of the entity, for example, usages of such assets and whether they are pledged as security for any of the entity's liabilities.

(e) The major methods and assumptions used in measuring each class of assets and liabilities, including any subsequent changes to them;

(f) In case that one or more of the assets recognised prior to entering into the liquidation cannot be reliably measured to reflect the monetary amount or consideration expected from the disposal of such assets when implementing the liquidation plan:

1. The fact that the carrying amount presented in the statement of net assets does not reflect the monetary amount or consideration expected from the disposal of such assets when implementing the liquidation plan, and

2. A range of the monetary amounts expected from the disposal of those assets, when it is possible to determine such a range reasonably;

(g) In case that one or more of the assets that had not been recognised prior to entering into the liquidation cannot be reliably measured to reflect the monetary amount or consideration expected from the disposal of such assets when implementing the liquidation plan, and such assets are expected to be sold:

1. An enumeration of such assets and an adequate description of their nature, and

2. A range of the monetary amounts expected from the disposal of those assets, when it is possible to determine such a range reasonably;

(h) Kind and value of the payable and receivable cost and income items in the statement of net assets in liquidation and the expected period for paying such costs or receiving such income;

(i) Sources and usages of cash during the reporting period, classified into:

1. Assets sold,

2. Liabilities paid,

3. Distributions made to owners, and

4. Other cash flows paid or received;

(j) Information about secured receivables, its amounts and kind of securities, disputed debts and reasons for dispute, and whether there are lawsuits brought against the entity's debtors and the expected outcome of such lawsuits;

(k) Information about any lawsuits brought against the entity and their expected outcomes;

(l) The liquidator's name and contact information; and

(m) Any other information relevant to the liquidation the management of the entity deems necessary for understanding the liquidation circumstances and information presented in the financial statements.

Comparative Information

34 Since the preparation of financial statements on a liquidation basis requires recognition, measurement and presentation principles substantially different from those required for the financial statements on a going concern basis, it is impractical to present comparative financial statements in the first financial statements prepared on a liquidation basis. However, an entity shall disclose the opening balances of its financial position according to the financial reporting framework that was applicable prior to the liquidation (closing balances of the previous financial year).

35 A comparative information for prior periods under liquidation shall be presented if the liquidation proceeding extends for more than one financial period/year.

Effective Date

36 This Standard shall apply to an entity that enters into liquidation after the issuance of the Standard. Application is permitted for an entity that has already entered into liquidation before the issuance of the Standard but has not issue financial statements yet.

(End of the Standard)

Appendix A
Defined Terms

This appendix is an integral part of this Standard

For purposes of this Standard, the following terms are used in this Standard with the meanings specified:

Fair value

It is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Liquidation

A process to transform an entity's assets into cash or other assets, settle its liabilities to creditors and terminate it by paying any remaining amounts back to owners. The liquidation may be either compulsory or voluntary. It shall not be deemed a liquidation proceeding for the purpose of preparing financial statements of an entity that is required to prepare general purpose financial statements if the entity is acquired by, or fully merged into, another entity.

Statement of changes in net assets in liquidation

A statement presents changes in net assets arising from changes in the entity's assets and liabilities or distributions made to owners during the reporting period.

Statement of net assets in liquidation

A statement presents an entity's net assets as at the end of the reporting period as required by this Standard.

Assets

For the purposes of this Standard, they represent the resources an entity controls as at the date of the statement of net assets, or expects to acquire in a later period until the end of the liquidation, if such resources can be reliably estimated and are expected to be sold or to be used to settle liabilities during the liquidation.

Liabilities

For the purposes of this Standard, they represent all the payables an entity shall fulfil whether they are existing as at the date of the statement of net assets or are expected to be incurred by the entity in a later period until the end of the liquidation, if such payables can be reliably estimated.

Deemed cost

An amount used as a surrogate for cost or depreciated cost of an asset at a given date in absence of adequate information to specify the asset's cost according to the financial reporting framework that was applicable at that date. This amount is used as a basis for any subsequent measurement of the asset. The deemed cost is estimated using the guidance provided in paragraph 24 of the Standard.

Legal unit

The natural or legal person that legally owns assets and assumes liabilities. For example, an entity that has an investment in a subsidiary legally owns its shares in that subsidiary, but does not hold a legal portion in the asset items of the subsidiary nor assume a legal portion in its liability items.

Appendix B
Basis for Conclusions

This appendix accompanies, but is not part of, this Standard.

Introduction

B1 Below is a summary of the considerations of SOCPA's Accounting Standards Council (the "Council") in reaching the conclusions related to this Standard. This appendix includes the reasons for accepting some approaches and refusing some others. The Council's members have given more weight to some factors than others.

Background information

B2 The Council has established this Standard to bridge the gap in local practices related to the preparation of financial statements of entities under liquidation and to meet the need for a standard that deals with this issue.

B3 Many interviews have been held with licensed practitioners in the KSA who have experience in the performance of liquidation proceedings and the preparation of financial statements for local entities under liquidation. A questionnaire has been developed and sent to many parties (certified public accountants, bankruptcy officeholders (lawyers), financial statement preparers, regulators, judicial and supervisory authorities, etc.). The outcomes revealed different practices in the preparation of financial statements on a liquidation basis and a need to set a standard that addresses specifically such statements. Respondents to the questionnaire had some observations and comments about the draft standard that have been summarized in a research study presented to the Accounting Standards Council.

B4 A draft standard has been presented in an international meeting attended by more than 25 international professional organizations, including the IASB, to seek their opinions on the draft. It has been found that no international nor local standards dealing with the liquidation accounting are adopted in their jurisdictions. The attendees looked forward to benefiting from SOCPA's experience and to receiving the Standard after its finalization.

Scope

B5 The initial draft included a section for protective settlement and financial restructuring procedures. However, the Council decided to separate that section from this Standard since it has a substantially different nature and an entity that enters into such procedures is considered as a going concern. Hence, principles for liquidation basis financial reporting have been developed and included in this Standard.

B6 The government entities and agencies have been excluded from the application of the Standard because they are subject to different control and supervision regulations that may include special financial reporting requirements. In addition, it is difficult to apply the liquidation basis recognition, measurement, presentation and disclosure principles and requirements to such entities.

B7 The Standard includes a number of disclosure requirements that meet the needs of the users of the financial statements of entities that enter into liquidation. Such requirements are an output of many discussions during the Council's meetings with stakeholders. Given the importance of the related party information to users of the financial statements, whether they are prepared by a going concern or an entity under liquidation, the Council discussed the appropriateness of requiring disclosures about related parties. Since SOCPA has previously endorsed standards that regulate such disclosures, namely IAS 24 *Related Party Disclosures* (or Section 33 *Related Party Disclosures* of the IFRS for SMEs), the Council has considered it appropriate to require the implementation of such standards instead of including the related party disclosure requirements in this Standard.

B8 The liquidation basis financial statements provide their users with specific information about the conversion from reporting an entity's economic performance and financial position to reporting the amount of cash and other consideration that creditors and owners expect to receive. The liquidation basis recognition, measurement, presentation and disclosure principles and requirements are different from the concepts of recognition and measurement in the financial reporting on a going concern basis. Some respondents inquired whether the liquidation basis financial statements should be considered as special purpose financial statements. The Council determined that if a standard is endorsed by the appropriate standard setter, the financial statements that would be prepared according to that endorsed standard shall be considered as general purpose financial statements.

Imminence of liquidation

B9 The defined terms annexed to the initial draft included a definition of the liquidation. However, during the discussion meetings, some of the stakeholders proposed to apply determinants for the imminent liquidation. The liquidation decision is undoubtedly a critical event and it shall be approved by authorized parties and its reversal by others or by the entity shall be highly unlikely. Therefore, the Council has added clear determinants for the imminent liquidation that nullifies the going concern basis. The Council considers that such addition is sufficient to enhance the objectivity and practicality of the Standard. It has annexed some application guidance and examples to improve understanding of the application requirements.

Liquidation cases

B10 The Companies Law contains a chapter on the liquidation of companies that contains the related legal articles. Some of the attendees in the round table meetings held by the Council to discuss the draft standard with stakeholders inquired whether the Standard would include the liquidation proceedings required by the Bankruptcy Law and its implementing regulations. After reviewing the requirements of such Law, it has been found that it contains no indication to the preparation of financial statements nor a reference to the Companies Law. In addition, the preparation of financial statements is not a duty of the bankruptcy officeholder, even though he is legally responsible for managing an entity that enters into liquidation. Instead, he is only required to prepare periodic reports (every three months at least) on the liquidation progress. Since owners no longer have control over the company after the appointment of an officeholder, the requirement of the Companies Law for a management or liquidator to prepare financial statements is no longer applicable. In addition, the bankruptcy officeholder is not required by the Bankruptcy Law to take on the duties required from a management or liquidator under the Companies Law. According to the aforementioned, a company that enters into a liquidation proceeding subject to the Bankruptcy Law is not required to prepare financial statements. To verify this understanding, the Council has sought the Bankruptcy Committee's opinion on the draft standard and the Bankruptcy Committee replied, "The legal basis for obligating companies under liquidation to prepare financial statements is established in article 209 of the Companies Law." They added, "However, when such a company is liquidated in accordance with the Bankruptcy Law by commencing a liquidation proceeding, it acquires a new legal position, namely the liquidation position. Such new position of the incorporated debtor is outside the scope of the Companies Law and, then, the debtor becomes subject to the provisions of the Bankruptcy Law that assign the business management duties to a bankruptcy officeholder. After reviewing the provisions of the Bankruptcy Law relating to liquidation proceedings and duties of the officeholder, we found that they do not require the preparation of financial statements and, instead, the officeholder is required to prepare a periodic report on the liquidation progress and submit the same to the court. Thus, a bankruptcy officeholder is not obligated to prepare financial statements but it may be appropriate to set bases and standards to regulate the financial information contained in the abovementioned periodic report to enhance its quality and realize its intended objectives." Therefore, this Standard is generally intended to entities that enter into liquidation other than the liquidation proceedings that are implemented in accordance with the Bankruptcy Law.

Non-publicly accountable entities (small and medium-sized entities)

B11 In light of the studies carried out by the Council and meetings with stakeholders, there is no need to set different requirements for publicly accountable entities (such as listed companies) and other entities (commonly called small and medium-sized entities). Therefore, the Council decided to prepare one standard for all entities that enter into liquidation.

Recognition and measurement - When to start implementing the liquidation basis

B12 The Council deliberated the time at which an entity shall start to implement the liquidation basis, and decided to raise this issue during the round table discussions. Views of the attendees were divided between the application of the Standard: (1) prospectively from the date at which a liquidation decision is taken; (2) from the beginning of the financial year during which such a decision is taken; or (3) retrospectively to cover all previous financial years for which financial statements have not been prepared prior to the liquidation decision. Given the nature of information needs of users of the financial statements of companies that enter into liquidation and the substantial difference between presentation and measurement principles of the liquidation basis and those of the going concern basis, and to facilitate the application of the Standard by removing the need to re-measure assets at the beginning of the application, the Council adopted the view that the Standard shall be applied from the beginning of the financial year during which a liquidation decision becomes imminent as detailed in the Standard. This direction is in line with the requirements of IAS 10 that precludes the preparation of financial statements on a going concern basis if a decision to liquidate an entity is taken after the end of the financial period and before the preparation of the financial statements for that year.

Cost and benefit

B13 In addition to B12, there was near-unanimous agreement among attendees in the round table discussions that evaluation of assets at the beginning of the liquidation basis financial reporting period would be difficult due to the undue cost and effort it would cost. Therefore, the Council decided that the statement of financial position that was prepared at the end of the last year on a going concern basis (historical information) or, in case that such statement had not been prepared for any reason, its account balances shall be the starting point and the opening statement of financial position for the purpose of the application of the liquidation basis of accounting. When an entity prepares its first financial statements after taking a decision to liquidate, it shall apply the requirements of the Standard, including carrying out the revaluations required to prepare the statement of net assets at the end of the financial year to which the liquidation basis is first applied and making a comparison between the information as at the beginning and end of the year to determine changes in net assets. Such comparison shall constitute the information to be shown in the statement of changes in net assets.

Recognition and measurement of expected expenses and income until the end of the liquidation

B14 Entering into liquidation is a major turning point in an entity's life. It changes an entity's objective from maximizing owners' equity through continuing operations to determining the amount that can be given to its owners through cessation of operations, disposal of assets and settlement of liabilities. Hence, the information needs cover any income an entity expects to earn and any expense an entity expects to incur until the expected completion date of the liquidation. This Standard, therefore, requires the recognition of expected costs and income until the end of the liquidation.

Appendix C
Application Guidance

This appendix provides guidance for the application, but is not part, of this Standard.

Guidance material

The following guidance material explains how an entity can identify when to apply this Standard. It is not intended to provide an exhaustive list of all cases in which this Standard shall be applied.

Expiration of an entity's term

AG1 Entity A operates in the contracting sector. It was established in accordance with the Companies Law and its establishment procedures were completed on 15 October 2X00. Its term is determined in its articles of association to be 20 (twenty) years. Until 15 October 2X20, the general assembly has not determined yet to extend the entity's term. According to the entity's articles of association, the financial year-end is 31 December every calendar year.

Analysis: Due to the expiration of the entity's term on 15 October 2X20 and the failure to extend it, the entity shall enter into liquidation upon the expiration of its legal term. The entity shall prepare its financial statements for the year 2X20 in accordance with the *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure.*

Voluntary Liquidation

AG2 Partners in Entity B that operates in the retail sector determined to liquidate the company voluntarily because of business infeasibility. A resolution of the general assembly to liquidate the entity was issued on 30 November 2X20. The entity's financial year-end is 31 December every calendar year.

Analysis: The *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure* shall be applied for the year that will end on 31 December 2X20.

AG3 Partners in Entity B that operates in the retail sector determined to liquidate the company voluntarily because of business infeasibility. On 30 November 2X20, a resolution of the general assembly was issued to liquidate the entity on 1 January 2X21. Due to the obstacles of lawsuits brought by and against the company, the liquidation took 3 years. The entity's financial year-end is 31 December every calendar year.

Analysis: The *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure* shall be applied for the years that will end on 31 December 2X20, 2X21, 2X22, 2X23.

Judicial Liquidation

AG4 An order of the competent judicial authority to liquidate an entity was issued on 1 March 2X20 due to a dispute between partners and a liquidator was appointed. The last financial statements of the entity were issued on 31 December 2X19. The liquidation took 5 years. The entity's financial year-end is 31 December every calendar year.

Analysis: The liquidator shall prepare the financial statements of the entity in accordance with the *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure* as from the financial year during which the liquidation order was issued (2X20) and for all subsequent years of liquidation.

Maintaining the license of a professional service company (entity)

AG5 Due to Covid-19 consequences, a company decided to temporarily suspend its activity and close its client portfolio during the coming six months. The partners decided to maintain the legal existence and professional licenses of the company to resume activity if market conditions get better.

Analysis: The *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure* shall not be applied because the liquidation is not imminent. Resuming of the activity is not unlikely because the partners decided to maintain the legal existence and professional licenses of the company.

An entity encounters financial difficulties and decides to terminate its activity

AG6 Entity A is a goods manufacturer. In 2X18, it began to encounter financial difficulties due to low demand for its goods in the market. On 13 November 2X18, the board of directors approved a plan to liquidate the entity and cease its existence. The board of directors has the authority to enforce the plan. No other parties can prevent the implementation of the plan and the likelihood to reverse the liquidation decision is remote.

Analysis: The entity shall apply the *Liquidation Basis Financial Reporting Standard: Principles and Requirements for Recognition, Measurement, Presentation and Disclosure* as from 2X18.

(End of Appendices)