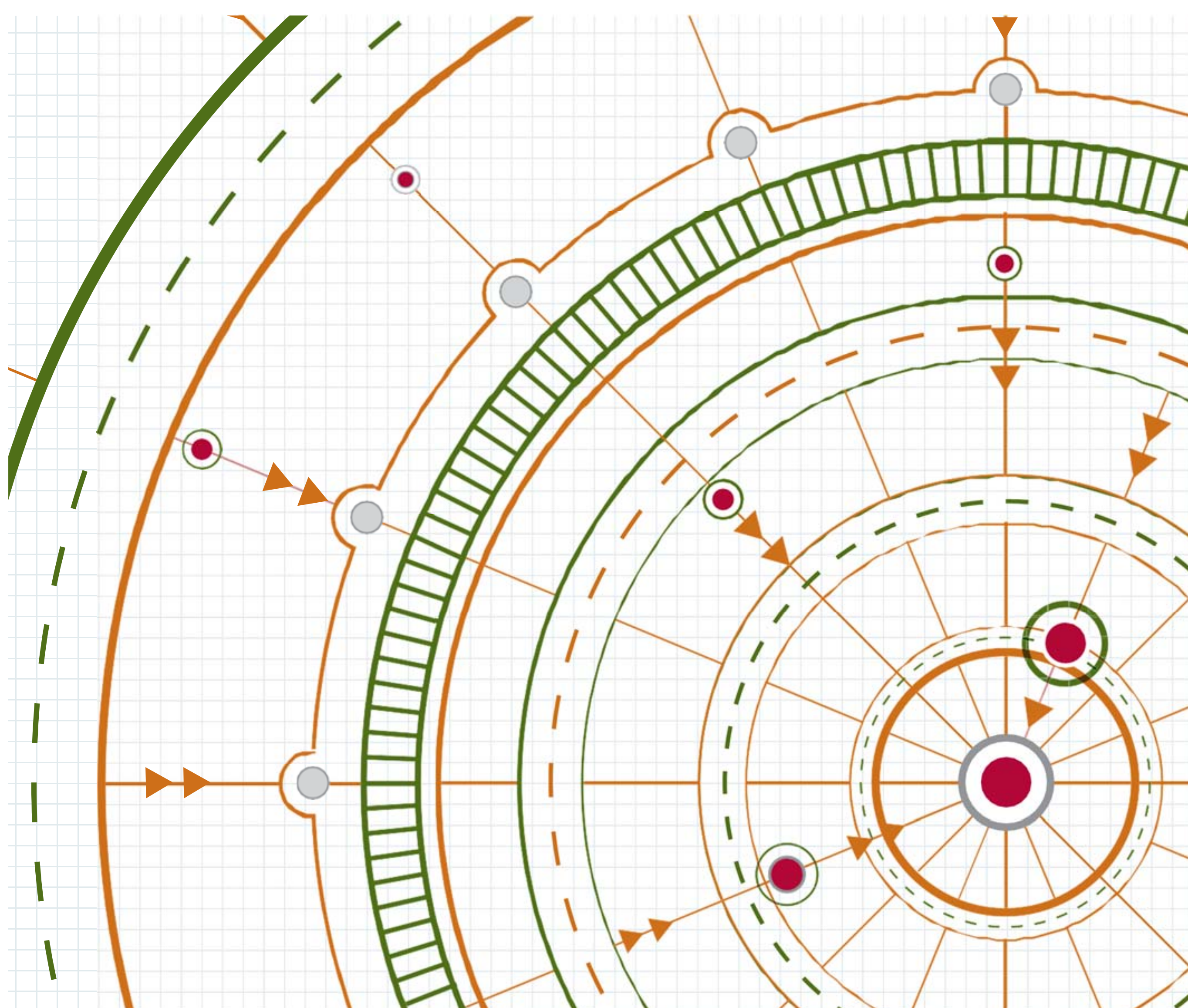
Module 35—Transition to the IFRS for SMEs



IFRS®

IFRS® Foundation
Supporting Material
for the *IFRS for SMEs*® Standard

including the full text of
Section 35 *Transition to the IFRS for SMEs*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

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Module 35—Transition to the *IFRS for SMEs*

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.
This module has been prepared by IFRS Foundation education staff.
The contents of Section 35 *Transition to the IFRS for SMEs* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 35. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the IFRS for SMEs* Standard.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This module focuses on the general requirements that a first-time adopter of the *IFRS for SMEs* Standard follows as specified in Section 35 *Transition to the IFRS for SMEs*. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in accounting for the transition to the *IFRS for SMEs* Standard. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provide a practical opportunity to apply the requirements for the first-time adoption of the *IFRS for SMEs* Standard and to make the disclosures required in an entity's first financial statements in applying the *IFRS for SMEs* Standard.

Module 35 – Transition to the *IFRS for SMEs*

Upon successful completion of this module, you should, within the context of the *IFRS for SMEs* Standard, be able to:

- determine when an entity is a first-time adopter of the *IFRS for SMEs* Standard;
- explain when an entity that has applied the *IFRS for SMEs* Standard in a previous period can apply Section 35;
- identify the date of transition to the *IFRS for SMEs* Standard;
- understand what is required, what is permitted, and what is prohibited when selecting an entity's initial accounting policies in accordance with the *IFRS for SMEs* Standard;
- determine the appropriate adjustments to assets, liabilities and equity at the date of transition;
- demonstrate an understanding of the mandatory exceptions and optional exemptions to retrospective application of the *IFRS for SMEs* Standard on first-time adoption provided within Section 35;
- provide the disclosures required for an entity applying Section 35; and
- demonstrate an understanding of significant judgements that are required in accounting for the transition to the *IFRS for SMEs* Standard.

IFRS for SMEs Standard

The *IFRS for SMEs* Standard is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the *IFRS for SMEs* Standard, Appendix A: Effective date and transition, and Appendix B: Glossary of terms, are part of the mandatory requirements.

In the *IFRS for SMEs* Standard, there are appendices to Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* These appendices provide non-mandatory guidance.

Module 35 – Transition to the *IFRS for SMEs*

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (March 2019) the SMEIG has not issued any Q&As relevant to this module.

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

Section 35 prescribes the accounting treatment and disclosure requirements for a first-time adopter of the *IFRS for SMEs* Standard. The objective of Section 35 is to provide a suitable starting point for accounting in accordance with the *IFRS for SMEs* Standard, that balances the need for financial statements to contain high quality information that is transparent for users, comparable over all periods presented, and that can be generated at a cost that does not exceed the benefits to users. An entity's first financial statements that comply with the *IFRS for SMEs* Standard are prepared using the requirements in the version of the *IFRS for SMEs* Standard that is effective for that reporting period, as modified by any specified exemptions (see paragraphs 35.9–35.11).[1]

An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Standard must include an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard, comparative information for at least one prior period and an explanation of how the transition from the previously applied accounting framework to the *IFRS for SMEs* Standard affected its reported financial position, financial performance and cash flows.

Section 35 specifies requirements for making adjustments to an entity's assets, liabilities and equity at its date of transition to the *IFRS for SMEs* Standard as a starting point for its accounting under the *IFRS for SMEs* Standard. The date of transition to the *IFRS for SMEs* Standard is the beginning of the earliest period for which full comparative information in accordance with the *IFRS for SMEs* Standard is presented. For example, if an entity's first annual financial statements that comply with the *IFRS for SMEs* Standard are for the year ended 31 December 20X4 and it presents comparative information for only one year, its date of transition is 1 January 20X3 (equivalent to close of business on 31 December 20X2).

The same accounting policies are used throughout all periods presented (ie including comparative information) in the first set of financial statements that conforms to the

[1] The 2015 version of the *IFRS for SMEs* Standard is effective for annual periods beginning on or after 1 January 2017. However, earlier application of these amendments is permitted, for example, in 2015 or 2016 reporting periods. Before the 2015 version of the Standard, the 2009 version of the Standard was the current version to be applied.

IFRS for SMEs Standard. Those accounting policies must be applied retrospectively, except as specified in paragraph 35.9 and when the entity chooses to use one or more of the exemptions from paragraph 35.10. There is also a general exemption from retrospective application when this would be impracticable (see paragraph 35.11). The accounting policies may differ from those used under the entity's previous financial reporting framework. Changes in accounting policies on first-time adoption of the *IFRS for SMEs* Standard may result in adjustments to the previously reported figures for the comparative period(s). All adjustments relating to reporting periods before the date of transition (ie before 1 January 20X3 in the above example) are recognised directly in retained earnings (or, if appropriate, in another category of equity) at the date of transition to the *IFRS for SMEs* Standard (see paragraph 35.8).

What has changed since the 2009 IFRS for SMEs Standard

The main changes made to Section 35 of the *IFRS for SMEs* Standard are the:

- addition of an option to permit Section 35 to be used more than once, together with disclosure requirements (see paragraph 35.2 and paragraph 35.12A);
- addition of an exception to the retrospective application of the *IFRS for SMEs* Standard for government loans at a below-market rate of interest that exist at the date of transition to the *IFRS for SMEs* Standard (see paragraph 35.9(f));
- addition of an option to permit first-time adopters to use an event-driven fair value measurement as 'deemed cost' (see paragraph 35.10(da));
- addition of an option permitting first-time adopters to apply Section 29 *Income Tax* prospectively from the date of transition, in line with the transitional provisions introduced for the revised Section 29, (see paragraph 35.10(h));
- addition of an option to permit an entity to use the previous generally accepted accounting principles (GAAP) carrying amounts of items of property, plant and equipment or intangible assets used in operations subject to rate regulation (see paragraph 35.10(m));
- addition of guidance for entities emerging from severe hyperinflation (see paragraph 35.10(n)); and
- simplification of the wording used in the exemption from the restatement of financial information on first-time adoption if it is impracticable (see paragraph 35.11).

A consequential change relating to Section 9 *Consolidated and Separate Financial Statements* (see paragraph 35.10(f)) and editorial changes have also been made. All the changes are covered in this module.

Module 35 – Transition to the *IFRS for SMEs*

REQUIREMENTS AND EXAMPLES

Scope of this section

35.1 This section applies to a **first-time adopter of the *IFRS for SMEs***, regardless of whether its previous accounting framework was **full IFRS** or another set of generally accepted accounting principles (GAAP) such as its national accounting standards or another framework such as the local income tax basis.

Notes—scope

A first-time adopter of the *IFRS for SMEs* Standard is an entity that presents its first annual financial statements that conform to the *IFRS for SMEs* Standard, regardless of whether its previous accounting framework was full IFRS Standards or another set of accounting standards or whether it ever prepared general purpose financial statements at all in the past. Full IFRS Standards are the International Financial Reporting Standards (IFRS) other than the *IFRS for SMEs* Standard.

35.2 An entity that has applied the *IFRS for SMEs* in a previous **reporting period**, but whose most recent previous annual **financial statements** did not contain an explicit and unreserved statement of compliance with the *IFRS for SMEs*, must either apply this section or apply the *IFRS for SMEs* retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors* as if the entity had never stopped applying the *IFRS for SMEs*. When such an entity does not elect to apply this section, it is still required to apply the disclosure requirements in paragraph 35.12A in addition to the disclosure requirements in Section 10.

Notes—an entity may apply Section 35 more than once

Application of Section 35 is mandatory the first time that an entity applies the *IFRS for SMEs* Standard in its annual financial statements. Compliance with the *IFRS for SMEs* Standard requires the financial statements to include an explicit and unreserved statement of compliance (paragraph 3.3). The purpose of Section 35 is to provide practical relief when an entity adopts the *IFRS for SMEs* Standard for the first time.

An entity that has previously applied the *IFRS for SMEs* Standard might subsequently stop applying that Standard. If that entity then later resumes using the *IFRS for SMEs* Standard, the entity can choose whether to apply Section 35 or whether to comply with all the requirements of the *IFRS for SMEs* Standard as if it had never stopped using that Standard. If the latter option is chosen, the entity retrospectively applies the *IFRS for SMEs* Standard as if it had never stopped applying the Standard, and the entity restates its comparative information accordingly. When an entity adopts the *IFRS for SMEs* Standard for the second time it may not need some or all of the reliefs provided in Section 35 and/or it might determine that the benefits of applying the *IFRS for SMEs* Standard as if it had continued to do so without interruption would exceed the costs of preparing such information, which is why a choice is given on the re-adoption of the *IFRS for SMEs* Standard, rather than requiring Section 35 to be applied.

Example—an entity may apply Section 35 more than once

Ex 1 **SME A meets the conditions to be a first-time adopter in 20X0 and applies Section 35 when preparing its financial statements for 20X0. In each of 20X0 and 20X1 SME A issues a complete set of financial statements applying the *IFRS for SMEs* Standard. On the first day of 20X2 SME A's parent sells its investment in SME A to another group, which is based in the same jurisdiction as SME A and which applies local GAAP. Consequently, in 20X2 and 20X3 SME A issues financial statements in accordance with local GAAP. In 20X4 the jurisdiction in which SME A (and the group of which it is a part) operates, requires all entities meeting specified criteria to prepare financial statements in accordance with the *IFRS for SMEs* Standard. In 20X4 SME A prepares its financial statements in accordance with the *IFRS for SMEs* Standard.**

SME A was a first-time adopter of the *IFRS for SMEs* Standard in 20X0. Section 35 was applied in the entity's 20X0 financial statements.

In 20X4, SME A may choose to apply Section 35 once again when preparing its 20X4 financial statements or it may choose to apply the *IFRS for SMEs* Standard retrospectively and therefore restate the 20X3 amounts as they would have been had SME A never ceased using the *IFRS for SMEs* Standard.

First-time adoption

35.3 A first-time adopter of the *IFRS for SMEs* shall apply this section in its first financial statements that conform to this Standard.

Notes—first-time adoption

The purpose of Section 35 is to provide requirements that ease the reporting burden for an entity's first financial statements prepared in accordance with *IFRS for SMEs* Standard. Without Section 35 an entity would be required to apply all the requirements in the *IFRS for SMEs* Standard retrospectively.

35.4 An entity's first financial statements that conform to this Standard are the first annual financial statements in which the entity makes an explicit and unreserved statement in those financial statements of compliance with the *IFRS for SMEs*. Financial statements prepared in accordance with this Standard are an entity's first such financial statements if, for example, the entity:

(a) did not present financial statements for previous periods;

(b) presented its most recent previous financial statements under national requirements that are not consistent with this Standard in all respects; or

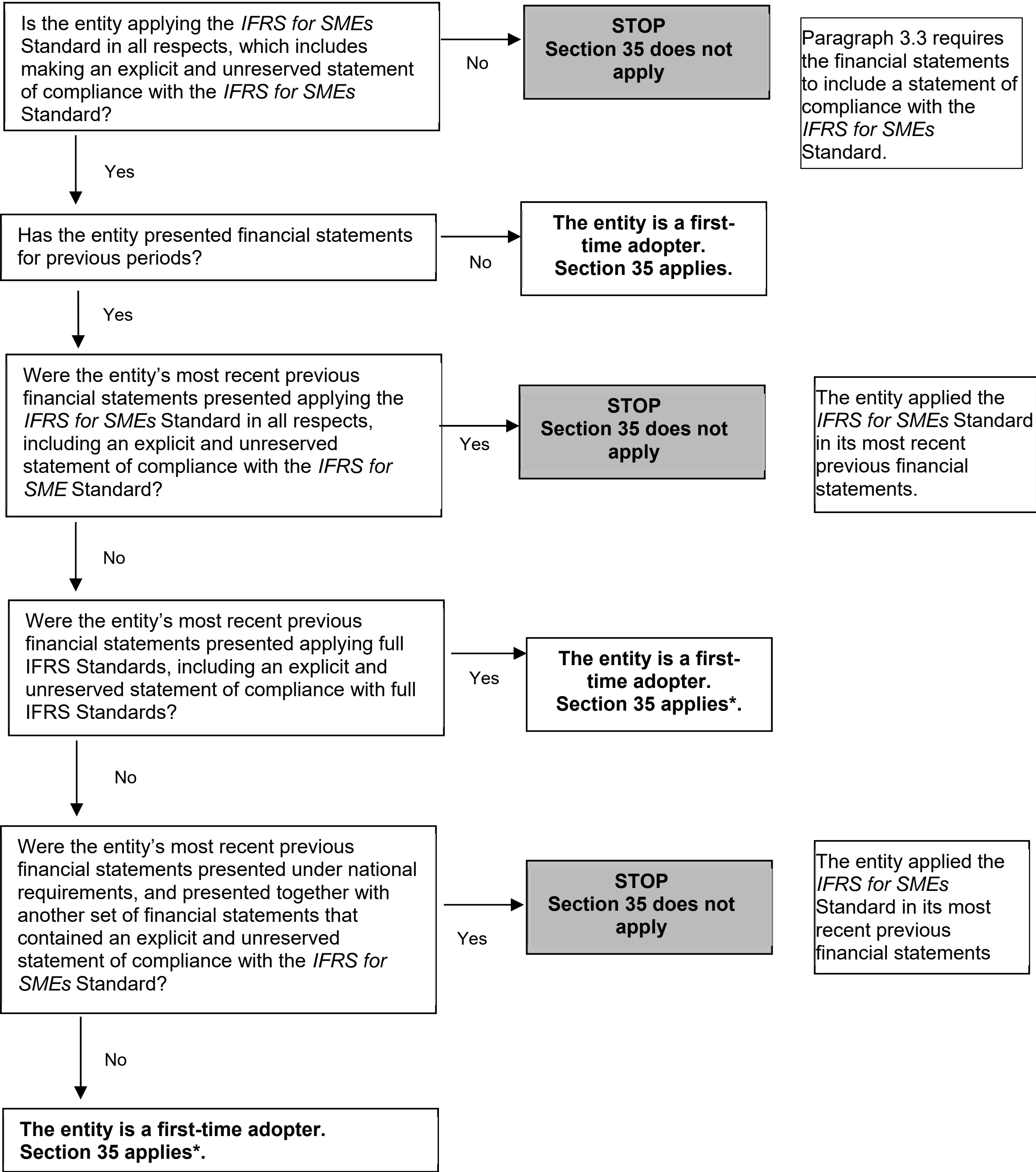
(c) presented its most recent previous financial statements in conformity with **full IFRS**.

Notes—determining whether the entity is a first-time adopter

An entity cannot assert compliance with the *IFRS for SMEs* Standard unless it complies with all the requirements of the *IFRS for SMEs* Standard. For example, an entity cannot pick and choose among the requirements of the *IFRS for SMEs* Standard and those of full IFRS Standards.

Determining whether an entity is a first-time adopter of the *IFRS for SMEs* Standard is the first step in applying Section 35. In most cases the determination is straightforward. In some cases, the determination will require judgement. Figure 1 illustrates the decision process to make such a judgement.

Figure 1 Decision tree—determining whether the entity is a first-time adopter of the *IFRS for SMEs* Standard



* If the entity is a first-time adopter for the second time, Section 35 is optional.

Examples—first financial statements that conform to the *IFRS for SMEs* Standard

Ex 2 **Ever since it was incorporated an entity has presented its financial statements in accordance with local GAAP. For the year ended 31 December 20X3 it also prepared proforma financial statements in accordance with the requirements of the *IFRS for SMEs* Standard except that those proforma financial statements included neither comparative figures nor a statement of compliance with the *IFRS for SMEs* Standard.**

The entity's financial statements for the year ended 31 December 20X4 comply with the *IFRS for SMEs* Standard. Consequently, those financial statements include comparative figures for 20X3 and an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard.

The complete set of financial statements prepared for the year ended 31 December 20X4 is the entity's first financial statements that conform to the *IFRS for SMEs* Standard. In 20X4 the entity is a first-time adopter of the *IFRS for SMEs* Standard. Section 35 applies, and the date of transition is 1 January 20X3.

The entity would include an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard in the notes to its financial statements for the year ended 31 December 20X4, as in the following example.

2. Basis of preparation

These financial statements have been prepared applying the *International Financial Reporting Standard for Small and Medium-sized Entities* (the *IFRS for SMEs* Standard) issued by the International Accounting Standards Board. This complete set of financial statements (for the year ended 31 December 20X4) is the entity's first financial statements that conform to the *IFRS for SMEs* Standard.

Ex 3 **A jurisdiction's local SME standard has some differences from the *IFRS for SMEs* Standard—a few recognition and measurement requirements are materially different. SMEs in that jurisdiction are required to use the local SME standard. An entity's first financial statements that conform to the local SME standard are prepared for the year ended 31 December 20X4. Those financial statements include an explicit and unreserved statement of compliance with the local SME standard and also, except for particular requirements, with the *IFRS for SMEs* Standard.**

The entity's financial statements prepared for the year ended 31 December 20X4 do not comply with all of the requirements in the *IFRS for SMEs* Standard. Consequently, the entity is not a first-time adopter of the *IFRS for SMEs* Standard in its 31 December 20X4 financial statements.

Ex 4 **There are some differences between a jurisdiction's local SME standard and the *IFRS for SMEs* Standard. SMEs in that jurisdiction are required to follow the local SME standard. An entity's first financial statements that conform to the local SME standard are prepared for the year ended 31 December 20X4. Those financial statements also conform to the *IFRS for SMEs* Standard and the entity includes an explicit and unreserved statement of compliance with both the *IFRS for SMEs* Standard and the local SME standard.**

The entity's financial statements prepared for the year ended 31 December 20X4 conform to all of the requirements in the *IFRS for SMEs* Standard. Consequently, the

entity is a first-time adopter of the *IFRS for SMEs* Standard in its 31 December 20X4 financial statements.

Note: the circumstances described in this example could occur when:

- differences between the *IFRS for SMEs* Standard and the local SME standard relate to disclosure requirements and the entity complies with all of the disclosure requirements of both standards;
- differences between the *IFRS for SMEs* Standard and the local SME standard relate to recognition and measurement requirements that are specific to transactions not entered into by the SME or that are not material to the SME; and/or
- the local SME standard permits a number of accounting policy choices for recognition and measurement requirements and the entity selects those choices that are consistent with the recognition and measurement requirements of the *IFRS for SMEs* Standard.

Ex 5 **Ever since it was incorporated an entity has presented its financial statements in accordance with local GAAP. During 20X3 the entity published a statement of financial position as at 1 January 20X3 (its date of transition to the *IFRS for SMEs* Standard), prepared applying Section 35 of the *IFRS for SMEs* Standard. The entity intends this to be an opening statement of financial position for its 20X4 financial statements, which will be prepared applying the *IFRS for SMEs* Standard.**

The opening statement of financial position does not constitute a complete set of financial statements (see paragraph 35.5) and so would not be the entity's first financial statements that conform to the *IFRS for SMEs* Standard.

Ex 6 **Ever since it was incorporated an entity has presented its financial statements in accordance with full IFRS Standards. For the year ended 31 December 20X3 it also prepared proforma financial statements in accordance with the requirements of the *IFRS for SMEs* Standard except that those financial statements included neither comparative figures nor a statement of compliance with the *IFRS for SMEs* Standard.**

The entity's financial statements for the year ended 31 December 20X4 comply with the *IFRS for SMEs* Standard. Consequently, those financial statements include comparative figures for 20X3 and an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard.

The complete set of financial statements prepared for the year ended 31 December 20X4 is the entity's first financial statements that conform to the *IFRS for SMEs* Standard. In 20X4 the entity is a first-time adopter of the *IFRS for SMEs* Standard. The entity includes in the notes to its financial statements for the year ended 31 December 20X4 the disclosure illustrated in Example 2.

35.5 Paragraph 3.17 defines a complete set of financial statements.

Notes—complete set of financial statements

In accordance with paragraph 3.17 a 'complete set of financial statements' includes:

(a) a statement of financial position as at the reporting date (see Section 4).
(b) either (see Section 5):
  (i) a single statement of comprehensive income for the reporting period displaying all items of income and expense recognised during the period including those items recognised in determining profit or loss (which is a subtotal in the

statement of comprehensive income) and items of other comprehensive income; or

(ii) a separate income statement and a separate statement of comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.

(c) a statement of changes in equity for the reporting period (see Section 6).

(d) a statement of cash flows for the reporting period (see Section 7).

(e) notes, comprising a summary of significant accounting policies and other explanatory information (see Section 8).

Comparative information in respect of the previous comparable period is required.

Paragraph 3.3 requires an entity whose financial statements comply with the *IFRS for SMEs* Standard to make an explicit and unreserved statement of such compliance in the notes. Unless financial statements comply with all the requirements of the *IFRS for SMEs* Standard, they cannot contain the statement of compliance.

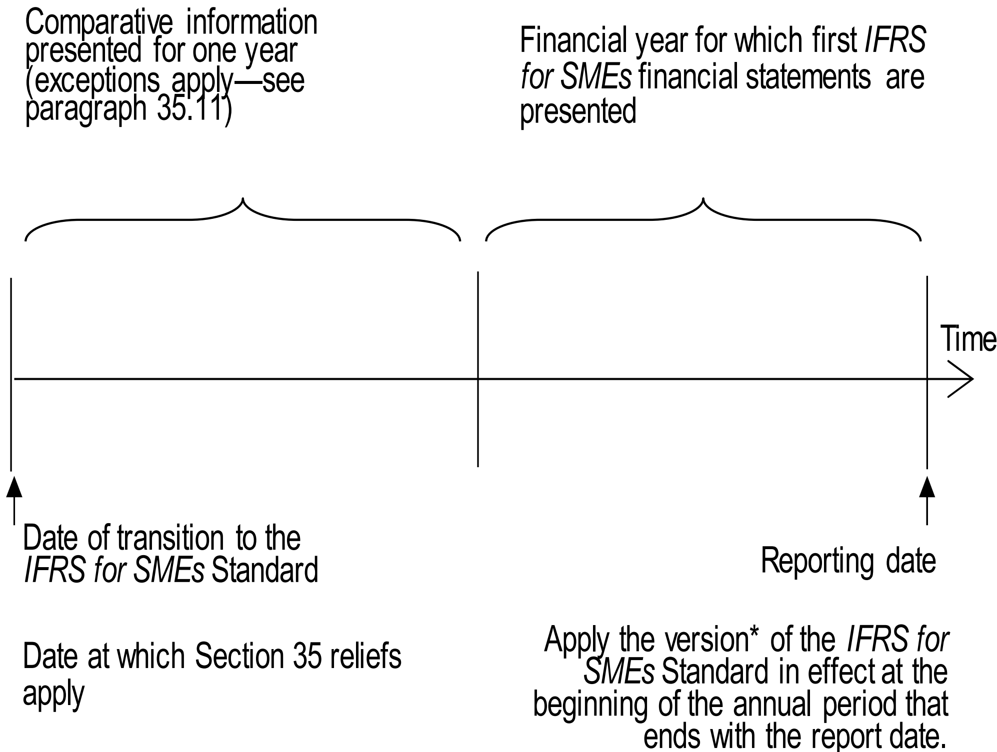
35.6 Paragraph 3.14 requires an entity to disclose, in a complete set of financial statements, comparative information in respect of the previous comparable period for all monetary amounts presented in the financial statements, as well as specified comparative narrative and descriptive information. An entity may present comparative information in respect of more than one comparable prior period. Consequently, an entity's **date of transition to the *IFRS for SMEs*** is the beginning of the earliest period for which the entity presents full comparative information in accordance with this Standard in its first financial statements that conform to this Standard.

Notes—date of transition to the *IFRS for SMEs* Standard

The date of transition to the *IFRS for SMEs* Standard is important because it is at this date that Section 35's exemptions from full retrospective application apply. The date of transition to the *IFRS for SMEs* Standard is the beginning of the earliest period for which an entity presents full comparative information under the *IFRS for SMEs* Standard in its first financial statements that comply with the *IFRS for SMEs* Standard.

The statement of financial position at the date of transition to the *IFRS for SMEs* Standard is prepared to determine the appropriate adjustments to the entity's assets, liabilities and equity at the date of transition (see paragraphs 35.7–35.11). The statement of financial position is prepared as a starting point for an entity's accounting under the *IFRS for SMEs* Standard and does not need to be included in the financial statements.

Figure 2 Illustration of the date of transition to the *IFRS for SMEs* Standard and the reporting date assuming the entity presents comparatives for one year



* Apply that version of the *IFRS for SMEs* Standard at the date of transition and for all periods presented in the first *IFRS for SMEs* financial statements

Examples—date of transition to the IFRS for SMEs Standard

Ex 7 **In 20X1 an entity's management decided to adopt the *IFRS for SMEs* Standard for the financial year ending 31 December 20X4. Until then, the entity had presented its financial statements in accordance with local GAAP. Neither local GAAP nor local law requires entities to present comparative information.**

The *IFRS for SMEs* Standard requires comparative information be presented in compliance with the *IFRS for SMEs* Standard for at least one year (see paragraph 3.14). The entity's financial statements for the year ending 31 December 20X4 will be the entity's first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements must include comparative information for at least one prior year (ie 20X3) and an explicit statement of compliance with the *IFRS for SMEs* Standard.

If the entity chooses to present only one year of comparative information, then the entity's date of transition to the *IFRS for SMEs* Standard is 1 January 20X3—the beginning of the earliest period for which the entity presents full comparative information in accordance with the *IFRS for SMEs* Standard in its first financial statements that conform to that Standard.

If the entity chose to present, for example, two years of full comparative information in accordance with the *IFRS for SMEs* Standard (ie 20X2 and 20X3), then the entity's date of transition to the *IFRS for SMEs* Standard is 1 January 20X2—the beginning of the earliest period for which the entity presents full comparative information in accordance with the *IFRS for SMEs* Standard in its first financial statements that conform to the *IFRS for SMEs* Standard.

Note: to comply with the *IFRS for SMEs* Standard the entity must present and disclose comparative information for at least one year, even if this is not required by local law.

Ex 8 **The facts are the same as Example 7 except that local law requires the entity to present full comparative information in accordance with the *IFRS for SMEs* Standard for two prior periods.**

The entity's financial statements for the year ended 31 December 20X4 are the entity's first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements include comparative information for both 20X2 and 20X3 and an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard.

The entity's date of transition to the *IFRS for SMEs* Standard is 1 January 20X2—the beginning of the earliest period for which the entity presents full comparative information in accordance with the *IFRS for SMEs* Standard in its first financial statements that conform to the *IFRS for SMEs* Standard.

Procedures for preparing financial statements at the date of transition

35.7 Except as provided in paragraphs 35.9–35.11, an entity shall on its date of transition to the *IFRS for SMEs* (ie the beginning of the earliest period presented):

(a) recognise all **assets** and **liabilities** whose **recognition** is required by the *IFRS for SMEs*;

(b) not recognise items as assets or liabilities if this Standard does not permit such recognition;

(c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of **equity**, but are a different type of asset, liability or component of equity under this Standard; and

(d) apply this Standard in measuring all recognised assets and liabilities.

Notes—financial statements at date of transition to the *IFRS for SMEs* Standard

The general principle underlying subparagraphs 35.7(a) −35.7(d) is that a first-time adopter should apply retrospectively all of the requirements in the version of the *IFRS for SMEs* Standard that is in effect at the beginning of the annual period that ends with the report date. Consequently, the first *IFRS for SMEs* financial statements are presented as if the entity had always applied that version of the *IFRS for SMEs* Standard. Paragraphs 35.9−35.11 provide exceptions and exemptions to the general principle.

The *2015 Amendments to the IFRS for SMEs* (2015 version of the *IFRS for SMEs* Standard) is effective for annual periods beginning on or after 1 January 2017. However, earlier application of these amendments is permitted, for example in the 2015 and 2016 reporting periods. The Board decided that early application of the amendments to the *IFRS for SMEs* Standard should be permitted to assist entities and jurisdictions that were in the process of adopting, or planning to adopt, the *IFRS for SMEs* Standard. The Board noted that early application would also permit entities to use the revised *IFRS for SMEs* Standard for financial statements prepared for earlier years. For example, some entities may not be required to file financial statements or may need a significant length of time in order to file them. Consequently, these entities might be preparing financial statements a long time after their reporting date and may want to apply the amendments to earlier years.

Before the 2015 version of the Standard is applied, the 2009 version of the Standard was the current version to be applied.

In order to prepare and present its first financial statements that comply with the *IFRS for SMEs* Standard, an entity will need to convert its opening balances for the earliest comparative period to be presented in those first *IFRS for SMEs* financial statements so that the balances are stated after applying the requirements in the *IFRS for SMEs* Standard (including using the exceptions and exemptions in paragraphs 35.9−35.11). The Standard does not require the statement of financial position at this date (the date of transition) to be presented in the first *IFRS for SMEs* financial statements.

35.8 The **accounting policies** that an entity uses on adoption of this Standard may differ from those that it used for the same date using its previous financial reporting framework. The resulting adjustments arise from transactions, other events or conditions before the date of transition to this Standard. Consequently, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this Standard.

Notes—adjustments to items of income and expense and assets and liabilities

Adjustments to items of income and expense and assets and liabilities related to transactions, to other events or to conditions that occurred before the entity's date of transition to the *IFRS for SMEs* Standard are recognised directly in retained earnings (or, if appropriate, in another category of equity) at the date of transition.

Adjustments to items of income and expense and assets and liabilities related to transactions, to other events or to conditions that occurred in the period between the entity's date of transition to the *IFRS for SMEs* Standard and the reporting date of the entity's first financial statements that comply with the *IFRS for SMEs* Standard are recognised in profit or loss of the period in which they arise.

Examples—recognise all assets and liabilities required by the *IFRS for SMEs* Standard (paragraph 35.7(a))

Ex 9 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In compliance with that financial reporting framework, the entity recognised goodwill that arose from a business combination that occurred in 20X0 as an expense in 20X0. On the date of transition, the entity does not choose the exemption in paragraph 35.10(a).

Because paragraph 19.22(a) requires the acquirer, at the acquisition date, to recognise goodwill acquired in a business combination as an asset, the entity adjusts the balances it determined in accordance with its previous financial reporting framework at 1 January 20X3 (its date of transition) to recognise the goodwill as an asset on 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard). This adjustment is recognised directly in retained earnings (see paragraph 35.8).[2][3]

The adjustment to goodwill and retained earnings at 1 January 20X3 is measured net of the accumulated amortisation and any impairment that would have been recognised between 20X0 and 1 January 20X3 had the goodwill been accounted for in accordance with Section 19 *Business Combinations and Goodwill* (see paragraph 35.7(d)).

Similarly, the comparative information presented for 20X3 also needs to be adjusted for recognition of the amortisation of goodwill in profit or loss for the year ended 31 December 20X3.

See paragraph 35.10(a) and examples 31–33 for the optional exemption from this requirement.

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[2] For simplicity, in this example, and in all other examples in this module, the effect of income tax has been ignored.

[3] In this and other examples the adjustment is recognised in retained earnings. However, paragraph 35.8 would permit this adjustment to be in another category of equity, if appropriate, and legal requirements may prescribe the component of equity to be used.

Ex 10 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

On 1 January 20X2 the entity entered, as lessee, into the lease of a machine. If the entity had always accounted for the lease in accordance with the *IFRS for SMEs* Standard, the lease agreement would have been classified as a finance lease and in the entity's statement of financial position at 31 December 20X2 the leased asset and the lease liability would have been measured at CU97,413[4] and CU88,649 respectively.

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In compliance with that financial reporting framework the entity accounted for all leases as operating leases. Consequently, the entity accounted for the lease payments as an expense in profit or loss evenly over the lease term. Because the lease required equal monthly payments the entity did not recognise an asset or liability in its statement of financial position.

At 1 January 20X3 (its date of transition) the entity recognises an asset of CU97,413 and a liability of CU88,649 (the obligation to make future minimum lease payments) for the finance lease. Consequently, it increases its opening retained earnings by CU8,764 (ie CU97,413 less CU88,649).

Ex 11 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity presented its financial statements for the year ended 31 December 20X3 in accordance with local income tax requirements. Under that financial reporting framework, recognition of a liability for a constructive obligation is prohibited.

Upon adopting the *IFRS for SMEs* Standard, provisions that existed at the date of transition or at the end of a comparative period that were not recognised under previous financial reporting framework must be accounted for retrospectively. The estimate should reflect conditions at the date of transition or the end of the comparative period respectively. This treatment provides a faithful representation of the entity's obligation and performance in a manner that is comparable across time and between entities.

Section 21 *Provisions and Contingencies* requires an entity to recognise a provision for a constructive obligation existing at the reporting date as a result of a past event when it is probable that the entity will be required to transfer economic benefits in settlement and when the amount of the obligation can be estimated reliably (see paragraphs 21.4(a) and 21.6).

If the constructive obligation arose in 20X4 and is not settled by 31 December 20X4, the entity recognises it as a liability and as an expense (or as part of the cost of an asset – see paragraph 21.5) in 20X4.

If the constructive obligation arose in 20X3 and is not settled by 31 December 20X4, the entity recognises it as a liability at 31 December 20X3 and as an expense (or as part of the cost of an asset – see paragraph 21.5) in 20X3. In accordance with paragraph 21.11

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[4] In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

the entity reviews the provision at 31 December 20X4 and recognises the remeasurement adjustment in profit or loss in 20X4.

If the constructive obligation arose before 20X3 the entity recognises a liability at 1 January 20X3 and either an adjustment to equity directly in retained earnings at 1 January 20X3 (see paragraph 35.8) or as part of the cost of an asset (see paragraph 35.7(d)). In accordance with paragraph 21.11 the entity reviews the provision at 31 December 20X3 and 31 December 20X4 and recognises the remeasurement adjustments in profit or loss in the year of the change in the amount of the liability (that is, in 20X3 and 20X4 respectively).

In accordance with paragraph 35.7(d) the liability is measured at the best estimate of the amount required to settle the obligation or to transfer it to a third party as expected at the date the measurement is being made (ie on 1 January 20X3 for the balances at the start of the comparative period, on 31 December 20X3 for the comparative figures and on 31 December 20X4 for the statement of financial position at the reporting date—see paragraph 21.7). The measurement of the obligation is based on reliable information that was available when financial statements for those periods were authorised for issue (ie for the years ended 31 December 20X2 (for the 1 January 20X3 measurement), 31 December 20X3 and 31 December 20X4 respectively), and could reasonably be expected to have been obtained and taken into account (see paragraph 10.19). Management must not use the benefit of hindsight to make changes in the estimate of the liability based on new information or new developments that were not available when the relevant financial statements were originally prepared under the entity's previous accounting framework (see paragraph 35.9(c)).

Examples—not recognising items as assets or liabilities if the *IFRS for SMEs* Standard would not permit recognition (paragraph 35.7(b))

Ex 12 **An entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements include comparative information for only one year (20X3).**

The entity presented its financial statements for the year ended 31 December 20X3 in accordance with its local income tax requirements. In accordance with that previous financial reporting framework the entity capitalised all expenditure on research and development activities as intangible assets.

Paragraph 18.14 requires expenditure incurred internally on an intangible asset (including research and development expenditure) to be recognised in profit or loss when incurred unless it forms part of the cost of another asset that meets the recognition criteria in the *IFRS for SMEs* Standard. Consequently, in accordance with paragraph 35.8 the entity adjusts its opening balances on 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard) in order to derecognise the research and development intangible item with a corresponding adjustment to retained earnings.

Any expenditure on research and development incurred in 20X3 and 20X4 is presented in expenses in the statement of comprehensive income for the years ended 31 December 20X3 and 20X4. If any amortisation was, in accordance with the entity's previous financial reporting framework, recognised as an expense in 20X3, the 20X3 comparative figures prepared in accordance with the *IFRS for SMEs* Standard exclude that amortisation.

Ex 13 **An entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements include comparative information for only one year (20X3).**

The entity presented its financial statements for the year ended 31 December 20X3 in compliance with a local GAAP. In its statement of financial position at 31 December 20X3 the entity recognised a liability measured at CU2,000 (20X2: CU1,500) that does not satisfy the recognition criteria in the *IFRS for SMEs* Standard because the item is a contingent liability in accordance with paragraph 21.12.

If the entity had prepared its financial statements for the year ended 31 December 20X4 in compliance with its previous financial reporting framework, its statement of financial position would have included a liability for the item of CU2,200.

Applying the *IFRS for SMEs* Standard the entity would exclude the contingent liability from its statement of financial position at 1 January 20X3. Consequently, on 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard) the entity decreases liabilities and increases its opening retained earnings (ie at 1 January 20X3) by CU1,500 (paragraph 35.8).

Assuming the item would still be a contingent liability in accordance with paragraph 21.12 at 31 December 20X4, the entity's statement of financial position at 31 December 20X4 does not include a liability for the item. Nor is a liability recognised for that item in the comparative information (ie at 31 December 20X3) as presented in its 31 December 20X4 financial statements. Similarly, the entity's statement of comprehensive income for the year ended 31 December 20X4 (and comparative information for 20X3) does not include income or expenses relating to the contingent liability.

Unless the possibility of an outflow of resources is remote, the entity would disclose the contingent liability (see paragraph 21.15) in its 31 December 20X4 financial statements.

Examples—reclassification of items (paragraph 35.7(c))

Ex 14 **The entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements include comparative information for only one year (20X3).**

The entity presented its financial statements for the year ended 31 December 20X3 in compliance with a local GAAP. In compliance with that previous financial reporting framework the entity presented some inventories as non-current assets in its statement of financial position. Applying paragraph 4.5 of the *IFRS for SMEs* Standard, all its inventories would be classified as current assets.

Applying paragraph 4.5 of the *IFRS for SMEs* Standard, the first-time adopter must reclassify those inventories previously presented as non-current assets to current assets.

Provided that the total amount of inventories recognised in accordance with both reporting frameworks are measured at the same amount, there is no adjustment to retained earnings at 1 January 20X3.

Ex 15 **The entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements include comparative information for only one year (20X3).**

The entity presented its financial statements for the year ended 31 December 20X3 in accordance with local GAAP. In accordance with that previous financial reporting framework the entity accounted for all preference shares issued by the entity as equity instruments, even though the entity must redeem its preference shares for CU1,000 on 31 December 20X7.

In accordance with paragraph 22.5(e) of the *IFRS for SMEs* Standard, the preference shares are financial liabilities—with mandatory redemption by the issuer for a fixed amount at a fixed future date. Therefore, at 1 January 20X3 (its date of transition) the entity must classify the preference shares as liabilities and remeasure the amount at amortised cost in accordance with Section 11. The entity adjusts its opening balances at 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard).

The entity presents the preference shares as a liability in its statement of financial position at 31 December 20X4 and in the comparative information presented for 20X3. Similarly, the entity's statement of comprehensive income for the year ended 31 December 20X4 (and comparative information for 20X3) includes an expense for the finance costs arising on the financial liability (ie the preference shares) as determined using the effective interest method in accordance with Section 11. If an amount was deducted from retained earnings for dividends paid on the preference shares, it would be added back.

Examples—measuring recognised assets and liabilities (paragraph 35.7(d))

Ex 16 **An entity that operates a taxi business previously prepared its financial statements in compliance with full IFRS Standards. It accounted for its taxi licences (intangible assets) using the revaluation model, that is, the carrying amount equals fair value at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. Revaluation increases are recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.**

The entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements include comparative information for only one year (20X3). On the date of transition, the entity did not choose to apply the fair value or revaluation as deemed cost exemptions in paragraphs 35.10(c) and 35.10(d).

The *IFRS for SMEs* Standard does not permit the use of the revaluation model, which is allowed under full IFRS Standards, for intangible assets. It requires all intangible assets to be measured after initial recognition at cost less any accumulated amortisation and any accumulated impairment losses (see paragraph 18.18). Consequently, at 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard) the entity adjusts its balances for its taxi licences to eliminate the effects of any revaluations accounted for in accordance with full IFRS Standards in prior periods. Any amortisation charged in 20X3 on the revalued amounts will similarly be eliminated from the comparative information in the entity's first financial statements that conform to the *IFRS for SMEs* Standard, and replaced with a revised amortisation charge based on cost. Within equity, the revaluation surplus (recognised applying full

IFRS Standards) is also eliminated.

In other words, in its first financial statements that conform to the *IFRS for SMEs* Standard (ie those for the year ended 31 December 20X4, including comparative amounts for 20X3), the entity presents the taxi licences as if they had always been measured at cost less any accumulated amortisation and any accumulated impairment.

See paragraphs 35.10(c), 35.10(d) and 35.10(da) and examples 36–40 for exemptions relating to this requirement.

Ex 17 **An entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs* Standard. Those financial statements include comparative information for only one year (20X3). The entity uses the first-in, first-out (FIFO) cost formula to measure the cost of its inventories.**

Before 20X4 the entity presented its financial statements in accordance with the income tax requirements of the jurisdiction in which it operates, including use of the last-in, first-out (LIFO) cost formula for measuring inventories.

The *IFRS for SMEs* Standard does not permit the use of the last-in, first-out (LIFO) cost formula (see paragraph 13.18). Therefore, at its date of transition the entity measures its inventories using the FIFO cost formula and it adjusts its opening retained earnings at 1 January 20X3 accordingly (paragraph 35.8). Cost of sales for the year ended 31 December 20X3 is similarly adjusted when preparing comparative information in accordance with the *IFRS for SMEs* Standard.

In other words, in its financial statements for the year ended 31 December 20X4 (and the comparative amounts for 20X3) the entity measures inventories using the FIFO cost formula.

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

…

Notes—exceptions

Paragraph 35.9 lists six situations where the Board believes that either retrospective application of the *IFRS for SMEs* Standard cannot be performed with sufficient reliability or there is potential for abuse because retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. Therefore, the exceptions to retrospective application in paragraph 35.9 are mandatory for all first-time adopters of the *IFRS for SMEs* Standard.

Because paragraph 35.9 sets out exceptions to the principles that underlie paragraphs 35.7 and 35.8, an entity cannot apply paragraph 35.9 to other items, transactions, events or circumstances.

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

(a) **derecognition** of **financial assets** and **financial liabilities**. Financial assets and liabilities derecognised under an entity's previous accounting framework before the date of transition shall not be recognised upon adoption of the *IFRS for SMEs*. Conversely, for financial assets and liabilities that would have been derecognised under the *IFRS for SMEs* in a transaction that took place before the date of transition, but that were not derecognised under an entity's previous accounting framework, an entity may choose (a) to derecognise them on adoption of the *IFRS for SMEs* or (b) to continue to recognise them until disposed of or settled.

...

Notes—exception—derecognition of financial assets and financial liabilities

An entity adopting the *IFRS for SMEs* Standard for the first time generally applies the derecognition requirements of Sections 11 and 12 to transactions occurring on or after the date of transition to the *IFRS for SMEs* Standard. Consequently, financial assets and financial liabilities that were derecognised in accordance with the entity's previous financial reporting framework before the date of transition should not be recognised upon adoption of the *IFRS for SMEs* Standard even if those items would not have been derecognised if the entity had always applied the *IFRS for SMEs* Standard (instead of its previous financial reporting framework). Such items must not be recognised again unless they qualify for recognition under the *IFRS for SMEs* Standard as a result of a later transaction or event occurring on or after the date of transition.

For financial assets and financial liabilities that would have been derecognised by the entity's date of transition if the entity had always applied the *IFRS for SMEs* Standard (instead of its previous financial reporting framework) the entity can choose to derecognise them on transition (that is, they would not appear in a statement of financial position prepared as at the date of transition) or continue to recognise them until disposed of or settled (see paragraph 35.9(a)).

If an entity chooses option (b), it would test the financial asset for impairment (if it is measured at cost or amortised cost (see paragraphs 11.21–11.26)) or remeasure the financial asset or financial liability at fair value (if measured at fair value (see paragraphs 11.27–11.32)) on the reporting date and for dates for which comparative information is presented.

Examples—exception—derecognition of financial assets (paragraph 35.9(a))

Ex 18 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In compliance with that previous financial reporting framework the entity derecognised particular financial assets—trade receivables that the entity sold to a bank, at less than their face amount, before the date of transition to the *IFRS for SME* Standard. The entity simultaneously agreed to buy back from the bank any part of those receivables that remained outstanding for more than 120 days. If Section 11 of the *IFRS for SMEs* Standard had been applied, those trade receivables would not have been derecognised—they would have been measured at CU10,000 on 31 December 20X2 with a liability for the amount advanced from the bank.

The entity excludes the financial assets from its transition date (1 January 20X3) statement of financial position (that is, the financial assets—trade receivables—remain derecognised). The liability for the amount advanced by the bank to the entity (that would have been recognised had the entity always applied the *IFRS for SMEs* Standard) would not have been recognised when applying the previous financial reporting framework. To be consistent with the trade receivables remaining derecognised at 1 January 20X3, the liability to the bank will also not be recognised at 1 January 20X3.

If, after the date of transition to the *IFRS for SMEs* Standard, all the debtors paid in full within 120 days then the trade receivables would never be recognised again by the entity. If some of the debtors did not pay within the 120-day period, the entity would recognise the trade receivable (asset) and a corresponding liability to buy back the trade receivable from the bank. It would also test the trade receivable for impairment. Consequently, the statement of financial position at 31 December 20X4 (and the comparative information at 31 December 20X3) would include any trade receivables bought back from the bank which have not subsequently been settled by the debtor or impaired to nil by the entity.

Ex 19 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. The local GAAP required the entity to measure some of its trade receivables at amortised cost at 31 December 20X2 even though they were previously sold to a bank at less than their face amount. The bank carries both the credit risk and the slow payment risk. If the entity had applied Section 11 of the *IFRS for SMEs* Standard, the financial asset would have been derecognised when it was sold to the bank on 31 December 20X2.

The entity can choose either to continue to recognise the trade receivable until its settlement or to exclude the trade receivable (derecognise the trade receivable) at its date of transition (1 January 20X3).

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

…

(b) hedge accounting. An entity shall not change its hedge accounting before the date of transition to the *IFRS for SMEs* for hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Section 12 *Other Financial Instrument Issues*, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Section 12.

…

Notes—hedge accounting

At the date of transition to the *IFRS for SMEs* Standard an entity applies the hedge accounting requirements of Section 12 *Other Financial Instrument Issues* (unless it chooses the option in paragraphs 11.2 and 12.2 to apply the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*) to all hedging relationships that exist at the date of transition.

Hedge accounting under Section 12 can be applied prospectively only from the later of:

- the date of transition; and
- the date that the hedge relationship meets the requirements under Section 12 (or under IAS 39 if this option is chosen), including being appropriately designated and documented.

The designation and documentation of a hedge relationship must be completed on or before the date of transition to the *IFRS for SMEs* Standard if the hedge relationship is to qualify for hedge accounting from that date.

Examples—exception—hedge accounting (paragraph 35.9(b))

Ex 20 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. The entity had no active hedging relationships at the date of transition to the *IFRS for SMEs* Standard. However, in conformity with its previous financial reporting framework, prior to 20X3 the entity used a type of hedge accounting that would not qualify for hedge accounting in accordance with the *IFRS for SMEs* Standard.

Because the hedging relationships no longer exist on the date of transition to the *IFRS for SMEs* Standard the entity does not make any adjustments for past hedge accounting at 1 January 20X3.

Ex 21 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3). The entity applies Section 11 and 12 in full in accordance with paragraphs 11.2 and 12.2 of the *IFRS for SMEs* Standard.**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. The entity had only one active hedging relationship at the date of transition to the *IFRS for SMEs* Standard (that is, at 1 January 20X3). In conformity with its previous financial reporting framework, the entity had used hedge accounting to recognise the change in the fair value of the hedged item (investment in B-rated foreign currency government bonds measured, before hedge accounting was applied, at amortised cost) and the change in the fair value of the hedging instrument (an option) in profit or loss in the same period (that is, the period of the change in fair value). Section 12 of the *IFRS for SMEs* Standard does not permit designation of an option as a hedging instrument, nor does it permit hedge accounting for risks other than interest rate risk for a debt instrument.

Because Section 12 of the *IFRS for SMEs* Standard does not permit designation of an option as a hedging instrument and because it also does not permit hedge accounting for risks other than interest rate risk for a debt instrument, the entity cannot use hedge accounting with effect from the date of transition to the *IFRS for SMEs* Standard.

At its date of transition (1 January 20X3) the entity assumes that hedge accounting will not be available in the future. Applying paragraph 12.22 at the date of transition, the entity will measure the government bonds at their carrying amount under its previous (local) GAAP; in subsequent accounting periods the entity will amortise the adjustments to the carrying amount, as a result of applying hedge accounting previously, over the remaining life of the bond using the effective interest method. The entity will include the option at its carrying amount under the entity's previous (local) GAAP; in subsequent accounting periods the entity will measure the option at fair value and recognise changes in fair value in profit or loss (see paragraph 12.8). Consequently, there will be no adjustment to opening retained earnings at 1 January 20X3.

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

…

(c) accounting estimates.

…

Notes—accounting estimates

The reason for having this exemption in Section 35 is to prevent an entity from using the benefit of hindsight to adjust accounting estimates on the basis of information that was not available when the amounts were originally estimated in accordance with the entity's previous financial reporting framework.

Estimates are an integral part of financial reporting. The estimates that the entity makes at the date of transition to the *IFRS for SMEs* Standard must be consistent with the estimates that it made for the same date under its previous financial reporting framework (after adjustments to reflect any differences in accounting policies).

When the previous estimates were wrong because of errors (eg omissions or misstatements) at the time they were originally made, they are corrected retrospectively, ie retrospective restatement of a prior period error (see paragraph 35.14).

On the other hand, previous estimates are not changed as a result of information that became available only after the date of transition to the *IFRS for SMEs* Standard. The receipt of information after the date of transition to the *IFRS for SMEs* Standard is treated in the same way as a non-adjusting event after the end of the reporting period (see paragraphs 32.6 and 32.7).

Example—exception—accounting estimates (paragraph 35.9(c))

Ex 22 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In its statement of financial position at 31 December 20X3 the entity measured its environmental restoration liability at CU10,000 (20X2: CU9,500).

The requirements for recognising and measuring the provision using its previous financial reporting framework are the same as those in Section 21 *Provisions and Contingencies* of the *IFRS for SMEs* Standard.

In late 20X4 unexpected advances in technology greatly reduced the expected costs of environmental restoration. Consequently, the entity measured the liability at CU5,200 in its statement of financial position at 31 December 20X4. Had information about that new technology been available at 31 December 20X3 and at 31 December 20X2, on those dates the entity would then have measured the liability at CU5,000 and CU4,750 respectively.

At its date of transition (1 January 20X3) the entity measures the provision at CU9,500. The entity does not adjust its opening retained earnings at 1 January 20X3 because the accounting estimate made applying its previous financial reporting framework was appropriate at the time that the estimate was made on 31 December 20X2. In other words, the accounting in the first financial statements that conform to the *IFRS for SMEs* Standard must not be based on hindsight from new information.

In its statement of financial position at 31 December 20X4 the entity measures the liability in accordance with Section 21 at CU5,200 (20X3: CU10,000). In accordance with Section 10, the effect of the change in the accounting estimate is included in profit or loss for the period in which information about the new technology became available (that is, the year ended 31 December 20X4).

Examples—not accounting estimates

Ex 23 **The facts are the same as in Example 22 except that the information about advances in new technology was available at 31 December 20X2 and the entity's management chose to ignore it.**

The information should not have been ignored, and the liability was overstated at 31 December 20X2 and 31 December 20X3. The prior period error is corrected retrospectively (see also paragraph 35.14). At its date of transition (1 January 20X3) the entity measures the provision at CU4,750, and increases retained earnings at 1 January 20X3 by the same amount, to present the retrospective restatement of the prior period error that occurred when using its previous financial reporting framework.
In its statement of financial position at 31 December 20X4 the entity measures the liability in accordance with Section 21 at CU5,200 (20X3: CU5,000).

Ex 24 **The facts are the same as in Example 22 except that in its financial statements that conform to local GAAP the entity did not recognise a liability for environmental restoration because it was not required to do so; it was only required to give disclosure in its notes to the financial statements. If the entity had applied the *IFRS for SMEs* Standard it would have recognised a provision in accordance with Section 21.**

In accordance with paragraphs 35.7 and 35.8, the entity measures and recognises the provision at CU9,500 at its date of transition (1 January 20X3) and decreases its retained earnings at 1 January 20X3 for the effect of applying the requirements of Section 21 at 1 January 20X3. The provision is recognised at CU9,500 (not CU4,750) because CU9,500 is the estimate as at 1 January 20X3; the additional information was not known until later.

This treatment is retrospective application of the new accounting policy.

In its statement of financial position at 31 December 20X4 the entity measures and recognises the liability in accordance with Section 21 at CU5,200 (20X3: CU10,000).
In accordance with Section 10, the effect of the change in the accounting estimate is included in profit or loss for the year ended 31 December 20X4 (that is, the period in which information about the new technology became available).

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

…

(d) **discontinued operations**.

…

Notes—discontinued operations

In the Glossary of the *IFRS for SMEs* Standard a discontinued operation is defined as 'a component of an entity that either has been disposed of, or is held for sale, and

(a) represents a separate major line of business or geographical area of operations;

(b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or

(c) is a subsidiary acquired exclusively with a view to resale.'

In accordance with the *IFRS for SMEs* Standard, if a component is classified as a discontinued operation, its post-tax profit or loss and any post-tax gain or loss attributable to impairment or on disposal is classified separately in the statement of comprehensive income (see paragraph 5.5).

An entity's previous financial reporting framework may have a different definition of a discontinued operation or specify different accounting for discontinued operations. In such cases, no reclassification or remeasurement is recognised for discontinued operations previously accounted for using the previous financial reporting framework.

If there are no special accounting requirements for discontinued operations in the previous accounting framework, when the *IFRS for SMEs* Standard is adopted the requirements for discontinued operations are applied prospectively from the date of transition to the *IFRS for SMEs* Standard.

Example—exception—discontinued operations (paragraph 35.9(d))

Ex 25 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3, and for earlier years, were presented in accordance with local GAAP. The requirements in the local GAAP for discontinued operations are similar to those in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, requiring only two amounts (total assets and total liabilities) to be included in the statement of financial position for discontinued operations. However, there is one difference—instead of measuring the discontinued operation at the lower of its carrying amount and fair value less costs to sell, the local GAAP required the discontinued operation to be measured at fair value less costs to sell. In early 20X3 the entity sold operations that satisfy the definition of a discontinued operation in the *IFRS for SMEs* Standard and in its local GAAP. In accordance with local GAAP, at 31 December 20X2 the entity measured the assets and liabilities at fair value less costs to sell. The resulting profit on sale recognised in 20X3 was lower than had the *IFRS for SMEs* Standard been applied in 20X2 and 20X3.

In accordance with paragraph 35.9(d), the requirements for discontinued operations in the *IFRS for SMEs* Standard are applied prospectively to operations that meet the definition of a discontinued operation on or after the date of transition (1 January 20X3). At 1 January 20X3 (the date of transition) the entity has a discontinued operation—it does not dispose of the operations that satisfied the definition of a discontinued operation until early 20X3.

Applying paragraph 35.9(d), the entity does not restate the discontinued operations at 1 January 20X3. Consequently, the profit on disposal recognised in 20X3 is lower than it would have been had the *IFRS for SMEs* Standard been applied retrospectively.

Ex 26 **The facts are the same as in Example 25 except that the entity sold the operations in late 20X3 and at 31 December 20X2 the operations did not satisfy the definition of a discontinued operation in the Glossary because at that date they were not held for sale.**

The exemption in paragraph 35.9(d) does not apply because at 31 December 20X2 the operations did not satisfy the definition of a discontinued operation in the Glossary as they were not held for sale at that date. Consequently, the business disposed of would be classified as a discontinued operation in the entity's first financial statements that conform to the *IFRS for SMEs* Standard (ie in the comparative information—20X3).

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

…

(e) measuring **non-controlling interests**. The requirements of paragraph 5.6 to allocate **profit or loss** and **total comprehensive income** between non-controlling interest and **owners** of the **parent** shall be applied prospectively from the date of transition to the *IFRS for SMEs* (or from such earlier date as this Standard is applied to restate **business combinations**—see paragraph 35.10(a)).

…

Notes—non-controlling interests

Although the adjustments to the subsidiary's assets and liabilities on the date of transition to the *IFRS for SMEs* Standard affect the measurement of non-controlling interests, the first-time adopter does not change the accounting that it followed for non-controlling interests under its previous financial reporting framework before its date of transition, unless it decides to apply the *IFRS for SMEs* Standard to restate business combinations from an earlier date (see paragraph 35.10(a) and Section 19).

Example—exception—non-controlling interests (paragraph 35.9(e))

Ex 27 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In accordance with the previous financial reporting framework, the entity was required to present consolidated financial statements, but it was not required to allocate part of its consolidated total comprehensive income to the non-controlling interest.

In accordance with paragraph 35.9(e), in its consolidated statement of financial position as at the date of transition the entity does not adjust the opening retained earnings at 1 January 20X3 to reallocate the part of the group's retained earnings that in accordance with paragraph 5.6 would have been attributed to the non-controlling interest if the entity had previously applied the *IFRS for SMEs* Standard.

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

…

(f) government loans. A first-time adopter shall apply the requirements in Section 11 *Basic Financial Instruments*, Section 12 and Section 24 *Government Grants* prospectively to government loans existing at the date of transition to this Standard. Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan on a basis that is consistent with this Standard, it shall use its previous GAAP **carrying amount** of the loan at the date of transition to this Standard as the carrying amount of the loan at that date and shall not recognise the benefit of any government loan at a below-market rate of interest as a **government grant**.

Notes—government loans

A government grant is 'assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity'. (See the Glossary)

In accordance with the *IFRS for SMEs* Standard if an entity receives a loan from the government bearing interest at a rate that is below the market rate, the benefit of having a rate of interest below the market rate is a government grant. For example, if an entity receives an interest-free loan from the government of the jurisdiction in which it operates, the interest-free element of the loan is a government grant. If, instead of being interest-free, the loan bears interest at 2 % per annum at a time when the market rate is 5 % per annum, the benefit of the 3 % reduction is the government grant. See Module 24 for examples of the accounting for government loans in accordance with the *IFRS for SMEs* Standard.

If the measurement of and accounting for a government loan at a below-market rate of interest applied by an entity in accordance to its previous accounting framework is different to that required by the *IFRS for SMEs* Standard, paragraph 35.9(f) requires the entity to include the loan in its statement of financial position at its date of transition to the *IFRS for SMEs* Standard at the carrying amount determined by the entity's previous accounting framework.

Examples—exception—government loans (paragraph 35.9(f))

Ex 28 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

On 1 January 20X2 the entity received a five-year government loan of CU100,000 bearing interest at 2 % per annum. Market interest rates were 5 % per annum at this date.

In accordance with the previous financial reporting framework, the entity was required to present government loans at their face value and recognise the nominal interest as a finance cost. Consequently, at 1 January 20X2 the entity

recognised the loan at CU100,000 and recognised a finance cost of CU2,000 in profit or loss in 20X2 and in 20X3.

In accordance with paragraph 35.9(f), at 1 January 20X3 the entity recognises the government loan at CU100,000 and does not adjust its opening retained earnings at 1 January 20X3. In 20X3 and subsequent years the entity will account for the loan in accordance with Section 11 at amortised cost. Consequently, it will charge interest of CU2,000 in profit or loss each year.

Ex 29 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

On 1 January 20X2 the entity received a government loan that bears interest at a rate below the market rate.

In accordance with the previous financial reporting framework, the loan was recognised in the entity's statement of financial position at 31 December 20X2 at CU100,000. The amount repayable to the government on 31 December 20X5 is CU103,030.

In accordance with paragraph 35.9(f), at 1 January 20X3 the entity recognises the government loan at CU100,000 and does not adjust its opening retained earnings at 1 January 20X3. In 20X3 and subsequent years the entity will account for the loan in accordance with Section 11 at amortised cost. Consequently, over the three years to 31 December 20X5 it will charge interest of CU3,030 in total in profit or loss; the interest will be allocated CU1,000 to 20X3, CU1,010 to 20X4 and CU1,020 to 20X5 using the effective interest method (see Module 11) starting from 1 January 20X3, the entity's date of transition to the *IFRS for SMEs* Standard.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:
…

Notes—exemptions

Retrospective application of particular requirements in the *IFRS for SMEs* Standard could require significant cost or effort and, in some cases, it may be impracticable. Consequently, the Board decided that the costs of applying particular requirements in the *IFRS for SMEs* Standard retrospectively may exceed the benefits of doing so. Paragraph 35.10 therefore provides several optional exemptions from the general principle of full retrospective application for first-time adopters of the *IFRS for SMEs* Standard.

Because paragraph 35.10 sets out exemptions to the principle of comparability that underlies paragraphs 35.7 and 35.8, an entity cannot apply these exemptions to other similar transactions, other events or conditions.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

(a) business combinations. A first-time adopter may elect not to apply Section 19 *Business Combinations and Goodwill* to business combinations that were effected before the date of transition to this Standard. However, if a first-time adopter restates any business combination to comply with Section 19, it shall restate all later business combinations.

…

Notes—business combinations

For all business combinations that occurred before the date of transition to the *IFRS for SMEs* Standard, an entity may either apply Section 19 *Business Combinations and Goodwill* retrospectively to that business combination or else retain the accounting under its previous financial reporting framework.

If the entity elects to restate any business combination effected before the date of transition to comply with Section 19, it must restate all later business combinations.

In some cases, full retrospective application of Section 19 could be onerous or impracticable. An entity that chooses not to use the exemption in paragraph 35.10(a) will, for example, need to establish the fair values at the date of acquisition (not the date of transition to the *IFRS for SMEs* Standard) for all the assets acquired and all the liabilities and contingent liabilities assumed in all business combinations whose date of acquisition is before the date of transition to the *IFRS for SMEs* Standard.

Example—exemption—business combinations (paragraph 35.10(a))

Ex 30 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3). The entity has two subsidiaries, one acquired in 20X0 and one acquired in 20X2.**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In accordance with local GAAP, the entity, at initial recognition, measured the acquired goodwill at the excess of the cost of the business combination over the acquirer's interest in the acquiree's net assets measured at the carrying amount of the acquiree's net assets in the acquiree's financial statements at the date of acquisition. In other words, on acquisition, the acquiree's assets and liabilities were recorded in the consolidated financial statements at the same carrying amounts as in the acquiree's individual financial statements, although intercompany amounts were eliminated.

Applying paragraph 19.14 an acquirer, at the acquisition date, would need to allocate the cost of a business combination by recognising at their fair values at that date the acquiree's identifiable assets and liabilities and provisions for contingent liabilities that satisfy specified recognition criteria. Paragraph 19.14 also requires any difference between the cost of the business combination and the acquirer's interest in the fair value of the identifiable assets, liabilities and provisions for contingent liabilities so recognised to be accounted for as goodwill.

However, because the entity is a first-time adopter in 20X4, applying paragraph 35.10(a) it can choose not to restate the two business combinations that were affected before the date of transition (1 January 20X3).

Consequently, on 1 January 20X3 the entity can choose to measure goodwill at the same amount as it was measured at that date in accordance with local GAAP, subject to an impairment test as of 1 January 20X3 performed in accordance with the *IFRS for SMEs* Standard. Furthermore, amortisation and impairment in 20X3 and 20X4 would be determined in accordance with the *IFRS for SMEs* Standard.

If an entity applies paragraph 35.10(a), there is no need to remeasure the original local GAAP carrying amounts of the acquiree's assets and liabilities determined at the time of the business combination (date of acquisition) even though those values were based on carrying amounts in the acquiree's financial statements (ie the carrying amount will be considered deemed cost on the acquisition date).

If the first-time adopter chose to restate any business combination, it must also restate all later business combinations. Consequently, in this example, the mutually exclusive options available to the first-time adopter are:

- no restatement (if the entity elects to use the exemption in full);
- restate the business combination occurring in 20X2 (if the entity elects to use the exemption only in respect of business combinations before 20X2); or
- restate both business combinations occurring in 20X0 and 20X2 (if the entity does not elect to use the exemption).

Ex 31 **Entity A's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The only business combination that Entity A entered into was the acquisition of 100 % of the equity of another entity, Entity B, on 1 January 20X2 in exchange for CU10,000. On 1 January 20X2 the carrying amount of the acquiree's net assets was CU5,000. At that time the fair value of its identifiable assets, liabilities and contingent liabilities was CU8,000.

In accordance with local GAAP, Entity A, at initial recognition of its subsidiary in its consolidated financial statements, measured the acquired goodwill at CU5,000 (ie the excess of the cost of the business combination (CU10,000) over the acquirer's interest in the acquiree's net assets measured at the carrying amount of the acquiree's net assets in the acquiree's financial statements at the date of acquisition (CU5,000)).

The CU3,000 difference between the carrying amount and fair value of the acquiree's net assets on 1 January 20X2 is entirely attributable to machinery that the acquiree is depreciating on a straight-line basis to a nil residual value over its remaining useful life of 10 years measured from 1 January 20X2. If the *IFRS for SMEs* Standard had been applied by the Entity A in its consolidated financial statements, the machinery would have been depreciated on the straight-line basis to a nil residual value over its remaining useful life of 10 years measured from 1 January 20X2.

Under the previous financial reporting framework, in its consolidated financial statements, Entity A amortised goodwill on a straight-line basis to a nil residual value over 5 years. If the *IFRS for SMEs* Standard had been applied, goodwill of CU2,000 (CU10,000 cost of business combination less CU8,000 fair value of identifiable assets, liabilities and contingent liabilities) would have been amortised on the straight-line basis to a nil residual value over 5 years.

Entity A elected to apply the exemption in paragraph 35.10(a), that is, it elected not to apply Section 19 to its business combinations that occurred before the date of transition.

The group is highly profitable and none of its assets require impairment.

Because Entity A elects to use the exemption in paragraph 35.10(a), at 1 January 20X3 it does not restate the carrying amount of the machinery and it measures goodwill at CU4,000 (the amount determined in accordance with its previous financial reporting framework—ie CU5,000 × 4/5 years remaining useful life = CU4,000) and consequently it does not adjust its consolidated retained earnings at 1 January 20X3.

In its consolidated statement of financial position at 31 December 20X4 the group measures goodwill at CU2,000 (20X3: CU3,000). The group's profit for the year ended 20X4 is arrived at after the group has deducted CU1,000 (ie CU5,000 × 1/5 years of useful life = CU1,000) as an expense for the amortisation of goodwill (20X3: CU1,000).

Ex 32 **The facts are the same as in Example 31. However, in this example Entity A in its consolidated financial statements did not elect to apply the exemption in paragraph 35.10(a), that is, it applies Section 19 retrospectively to its business combination.**

At 1 January 20X3 Entity A, for its consolidated financial statements, measures goodwill at CU1,600 (the amount determined in accordance with Section 19—ie CU2,000 × 4/5 years remaining useful life = CU1,600) rather than the CU4,000 at which it would be measured using the previous financial reporting framework. Entity A must also measure Entity B's property, plant and equipment at CU2,700 higher than it was measured by using the previous financial reporting framework at 31 December 20X2—ie CU3,000 × 9/10 years remaining useful life = CU2,700). Consequently, Entity A adjusts its consolidated retained earnings at 1 January 20X3 as measured by using its previous financial reporting framework by increasing it by CU300 (ie CU2,700 increase in property, plant and equipment less CU2,400 decrease in goodwill. Alternatively, because the acquisition was at the start of 20X2, this can also be calculated as the reduction in amortisation charge of goodwill for 20X2 of CU600 less additional depreciation for machinery for 20X2 of CU300).

In its first consolidated financial statements that conform to the *IFRS for SMEs* Standard Entity A:

- at 31 December 20X3 (the comparative information), recognises the goodwill at CU1,200 (CU2,000 × 3/5 years remaining useful life = CU1,200), rather than at CU3,000 using its previous financial reporting framework, and recognises the property, plant and equipment at CU2,400 more than it would have been measured at by using the previous financial reporting framework (CU3,000 × 8/10 years remaining useful life = CU2,400);

- at 31 December 20X4, recognises the goodwill at CU800 (CU2,000 × 2/5 years remaining useful life = CU800), rather than at CU2,000 using its previous financial reporting framework, and recognises the property, plant and equipment at CU2,100 more than it would have been measured at by using the previous financial reporting framework (CU3,000 × 7/10 years remaining useful life = CU2,100); and
- for each of the years ended 31 December 20X4 and 20X3, recognises the expense amortisation of goodwill at CU400 (CU2,000 × 1/5 years of useful life = CU400), rather than at CU1,000 using its previous financial reporting framework, and recognises the additional depreciation expense for the property, plant and equipment at CU300 (ie CU3,000 × 1/10 years of useful life = CU300).

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(b) **share-based payment transactions**. A first-time adopter is not required to apply Section 26 *Share-based Payment* to equity instruments that were granted before the date of transition to this Standard, or to liabilities arising from share-based payment transactions that were settled before the date of transition to this Standard.

…

Examples—exemption—share-based payment transactions (paragraph 35.10(b))

Ex 33 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. That previous financial reporting framework prohibited the recognition of equity-settled share-based payment transactions as an expense.

In 20X1 the entity awards shares to its employees which they will receive in 20X4 in return for their services in that three-year period if the profit in that three-year period exceeds a specified amount. In accordance with local GAAP such a transaction does not affect total equity. However, the entity reclassifies amounts within equity as required by the local law to reflect the issue of shares.

The share-based payment transaction is an equity-settled share-based payment transaction. Therefore, if the entity elects to use the exemption in paragraph 35.10(b) it does not apply Section 26 to the share-based payment transaction even though the shares do not vest until after the date of transition. The entity will account for the issue of shares in 20X4 as required by its local law.

Ex 34 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In 20X0 the entity issued share appreciation rights in a cash-settled share-based payment arrangement to the employees in exchange for services. The entity settled the share appreciation rights (that is, paid cash to the employees) in 20X2.

The entity's previous financial reporting framework recognised cash-settled share-based payment transactions only when the cash was paid by the entity to the employees.

Because the obligation was settled before the date of transition to the *IFRS for SMEs* Standard (1 January 20X3), the entity can elect to apply the exemption in paragraph 35.10(b) and therefore not make any adjustments for the cash-settled share-based payments at the date of transition.

Note: assuming that in accordance with local GAAP the amount paid to settle the share appreciation rights was recognised as an expense in profit or loss in 20X2 or before, even if the entity did not elect to apply the exception there would have been no effect on amounts reported for 20X3 or 20X4.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(c) **fair value** as deemed cost. A first-time adopter may elect to measure an item of **property, plant and equipment**, an **investment property**, or an **intangible asset** on the date of transition to this Standard at its fair value and use that fair value as its deemed cost at that date.

(d) revaluation as deemed cost. A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment, an investment property, or an intangible asset at, or before, the date of transition to this Standard as its deemed cost at the revaluation date.

…

Notes—fair value or revaluation as deemed cost

Fair value or a previous revaluation amount may be used as the deemed cost for some specified assets at the date of transition to the *IFRS for SMEs* Standard. Either the fair value, or a previous revaluation amount determined in accordance with the entity's accounting policies using its previous financial reporting framework, may be chosen by the first-time adopter to be used as the deemed cost on the date of transition.

Fair value

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Previous financial reporting framework revaluation

The *IFRS for SMEs* Standard does not provide further guidance on what constitutes a GAAP revaluation. However, in relation to the revaluation model in Section 17, paragraph 17.15B describes a revalued amount as: 'an entity shall measure an item of property, plant and equipment whose fair value can be measured reliably at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses' (see paragraph 17.15B).

Examples–exemption—fair value as deemed cost (paragraph 35.10(c))

Ex 35 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. In accordance with that previous financial reporting framework, the entity measured its head office building at fair value, with changes in fair value recognised in profit or loss in the period of the change in fair value. Its two other buildings, also offices used by the entity, were measured at cost less accumulated depreciation and accumulated impairment losses and this measurement is deemed to be consistent with the cost model in Section 17.

Paragraph 17.15 requires an entity to choose either the cost model or the revaluation model as its accounting policy and apply that policy to an entire class of property, plant and equipment. This requires the entity to use the cost model for all three buildings or the revaluation model for all three buildings. The entity chooses to measure all three buildings using the cost model.
On the date of transition to the *IFRS for SMEs* Standard (1 January 20X3), in accordance with paragraph 35.10(c), the entity can elect to measure an item of property, plant and equipment at its fair value and use that as its deemed cost on 1 January 20X3. Accordingly, no adjustments are made to retained earnings at 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard) for property, plant and equipment.

Note: the exemption is available on an item-by-item basis. In this example the entity was already accounting for its two other buildings using the cost model so it only needed to use deemed cost for the one building. An entity with several buildings carried at fair value and choosing to measure its properties using the cost model, can elect to use fair value as deemed cost for some items in the class, and elect to apply the cost model in accordance with Section 17 retrospectively for other items in the class. If the entity does not elect to use the exemption in paragraph 35.10(c) for some or all items and does not use any other exemptions in Section 35 (for example paragraph 35.10(da)), it would, in accordance with paragraph 35.8 and paragraphs 17.9–17.26, adjust retained earnings and property, plant and equipment at 1 January 20X3 for the effects of measuring the buildings using the cost model in accordance with Section 17. The exemption is available for any item of property, plant and equipment and not just for buildings.

Ex 36 **The facts are the same as in Example 35. However, in this example, in accordance with its previous financial reporting framework the entity measured its three buildings at their acquisition costs and it neither depreciated nor impaired its buildings. The entity again chooses to measure all three buildings using the cost model.**

Paragraph 17.15A requires property, plant and equipment that is to be measured using the cost model to be measured after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses.

The entity cannot elect to use the acquisition cost of the buildings as the deemed cost at 1 January 20X3 because it is not fair value and it is not a revalued amount (and nor is it an event-driven fair value measurement—see paragraph 35.10(da)). Consequently, at 1 January 20X3 (its date of transition) the entity must retrospectively account for its buildings (by adjusting retained earnings and property, plant and equipment) in accordance with Section 17 at cost less accumulated depreciation less accumulated impairment (as it has elected to use the cost model) except to the extent that it elects to measure particular items of property, plant and equipment on 1 January 20X3 at a deemed cost measured in accordance with paragraph 35.10(c), 35.10(d) or 35.10(da). If an entity uses fair value as deemed cost for any items, it adjusts retained earnings and property, plant and equipment on the date of transition (1 January 20X3) for the effects of measuring the property, plant and equipment at its deemed cost (fair value on 1 January 20X3).

Examples—exemption—revaluation as deemed cost (paragraph 35.10(d))

Ex 37 **The facts are the same as in Example 35, except that, in this example, in accordance with its previous financial reporting framework, the entity measured its head office building at a revalued amount, determined to be fair value less accumulated depreciation less impairment losses, with revaluation increases included in a revaluation reserve.**

Paragraph 17.15 requires an entity to choose either the cost model or the revaluation model as its accounting policy and apply that policy to an entire class of property, plant and equipment. This requires the entity to use the cost model for all three buildings or the revaluation model for all three buildings. The entity chooses to measure all three buildings using the cost model.

On the date of transition to the *IFRS for SMEs* Standard (1 January 20X3), in accordance with paragraph 35.10(d), the entity can elect to measure an item of property, plant and equipment at its revalued amount and use this as its deemed cost on 31 December 20X2. Accordingly, no adjustments would be made to retained earnings at 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard) for the buildings.

Note: if the entity did not elect to use the exemption in paragraph 35.10(d) and does not use any other exemptions in Section 35, for example paragraphs 35.10(c) or 35.10(da), it would, in accordance with paragraph 35.8 and paragraphs 17.9–17.26, adjust equity and property, plant and equipment on 1 January 20X3 for the effects of measuring the head office building at cost less accumulated depreciation less accumulated impairment in accordance with Section 17.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(da) event-driven fair value **measurement** as deemed cost. A first-time adopter may have established a deemed cost in accordance with its previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event, for example, a valuation of the business, or parts of the business, for the purposes of a planned sale. If the measurement date:

(i) is at or before the date of transition to this Standard, the entity may use such event-driven fair value measurements as deemed cost at the date of that measurement.

(ii) is after the date of transition to this Standard, but during the periods covered by the first financial statements that conform to this Standard, the event-driven fair value measurements may be used as deemed cost when the event occurs. An entity shall recognise the resulting adjustments directly in retained earnings (or, if appropriate, another category of equity) at the measurement date. At the date of transition to this Standard, the entity shall either establish the deemed cost by applying the criteria in paragraph 35.10(c)–(d) or measure those assets and liabilities in accordance with the other requirements in this section.

…

Examples—exemption—event driven fair value measurement as deemed cost (paragraph 35.10(da))

Ex 38 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. On 30 June 20X2 the fair values of all the entity's property, plant and equipment were determined as part of a proposed sales transaction that was later abandoned. In its 31 December 20X2 and 20X3 local GAAP financial statements the entity continued with its previous policy and measured property, plant and equipment at acquisition cost (and it neither depreciated nor impaired its property, plant and equipment).

In accordance with paragraph 35.10(da)(i), the entity elects, in its first IFRS financial statements, to deem the cost of its property, plant and equipment to be the fair value determined on 30 June 20X2 (the date of valuation).

Paragraph 17.15 requires an entity to choose either the cost model or the revaluation model as its accounting policy and apply that policy to an entire class of property, plant and equipment. This requires the entity to use either the cost model for an entire class or the revaluation model for the entire class.

However, on the date of transition to the *IFRS for SMEs* Standard (1 January 20X3), in accordance with paragraph 35.10(da), the entity, if it has elected to apply the cost model, can elect to use the 30 June 20X2 fair value (event-driven fair value measurement) as the deemed cost on the 30 June 20X2. Consequently, the entity could elect to measure its property, plant and equipment at 1 January 20X3 as follows—the revalued amount determined as at 30 June 20X2 less depreciation for the period 1 July

20X2 to 31 December 20X2 determined in accordance with Section 17, and impairment losses at 31 December 20X2 (if any) determined in accordance with Section 27.

In accordance with paragraph 35.8, the entity adjusts its retained earnings and property, plant and equipment at 1 January 20X3 for the effects of measuring the property, plant and equipment at its deemed cost (as described above).

Note: if the entity did not elect to use the exemptions in paragraph 35.10(da), it would need to adjust retained earnings and property, plant and equipment at 1 January 20X3 for the effects of measuring the property, plant and equipment at cost less depreciation less any impairment in accordance with Section 17.

Ex 39 **The facts are the same as in Example 38. However, in this example, the valuation was on 30 June 20X3, not 30 June 20X2.**

The date of transition to the *IFRS for SMEs* Standard (1 January 20X3) is before the date of the fair value measurements. In accordance with paragraph 35.10(da)(ii), the entity can, and does, elect to use the fair value measurement as deemed cost from 30 June 20X3. Consequently, at 1 January 20X3, the date of transition to the *IFRS for SMEs* Standard, the entity must measure its property, plant and equipment either at cost less accumulated depreciation and impairment, or by electing the option in paragraph 35.10(c) to use fair value at 1 January 20X3 as deemed cost or by electing the option in paragraph 35.10(d) to use a previous GAAP revaluation as deemed cost. The latter option is not available to this entity because it has not previously incorporated a revaluation in its local GAAP accounts.

The entity elects to measure its property, plant and equipment at cost less accumulated depreciation and impairment on 1 January 20X3 and, in accordance with paragraph 35.10(da)(ii), incorporates the fair value as deemed cost on 30 June 20X3. When incorporating the fair value as deemed cost on 30 June 20X3, the entity adjusts its retained earnings or another category of equity (for example, because local legislation requires the adjustment in a particular reserve category such as revaluation reserve).

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(e) cumulative translation differences. Section 30 *Foreign Currency Translation* requires an entity to classify some translation differences as a separate component of equity. A first-time adopter may elect to deem the cumulative translation differences for all **foreign operations** to be zero at the date of transition to the *IFRS for SMEs* (ie a 'fresh start').

…

Example—exemption—cumulative translation differences (paragraph 35.10(e))

Ex 40 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. The previous financial reporting framework prohibited exchange gains and losses on monetary items receivable from or payable to a foreign operation that are in substance part of the entity's net investment in that foreign operation from being presented as a separate component of equity.

Paragraphs 30.12 and 30.13 require exchange differences that arise from a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised in other comprehensive income and reported as a separate component of equity in the consolidated financial statements.

If the group chooses to use the exemption in paragraph 35.10(e) there is no need to adjust its consolidated retained earnings on the date of transition (1 January 20X3) for the cumulative translation difference that would otherwise be reported as a separate component of equity in accordance with paragraph 30.13. Translation differences arising after the date of transition will be required to be recognised in other comprehensive income and reported as a separate component of equity in the consolidated financial statements.

Note: if the entity did not elect to use the exemption in paragraph 35.10(e), it would, in accordance with paragraph 35.7(c) and paragraphs 30.12 and 30.13, transfer from consolidated retained earnings an amount equal to the cumulative translation difference into a separate component of equity at 1 January 20X3.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(f) **separate financial statements**. When an entity prepares separate financial statements, paragraph 9.26 requires it to account for its investments in **subsidiaries**, **associates** and jointly controlled entities either:

(i) at cost less **impairment**;

(ii) at fair value with changes in fair value recognised in profit or loss; or

(iii) using the equity method following the procedures in paragraph 14.8.

If a first-time adopter measures such an investment at cost, it shall measure that investment at one of the following amounts at the date of transition:

(i) cost determined in accordance with Section 9 *Consolidated and Separate Financial Statements*; or

(ii) deemed cost, which shall be either fair value at the date of transition to the *IFRS for SMEs* or previous GAAP carrying amount on that date.

…

Notes—separate financial statements

Separate financial statements are financial statements presented by a parent, or by an entity that is not a parent but is an investor in an associate or a venturer in a jointly controlled entity, which are additional to the financial statements that it is required to prepare in accordance with paragraphs 9.1–9.23A, Section 14 or Section 15 of the *IFRS for SMEs* Standard.

The *IFRS for SMEs* Standard does not require presentation of separate financial statements (see paragraph 9.24).

The entity applies the same accounting policy for all investments in a single class (subsidiaries, associates or jointly controlled entities). Consequently, an entity could, for example, elect to measure investments in associates at fair value and investments in subsidiaries at cost less impairment. However, it cannot use cost less impairment for some of its investments in associates and fair value for other investments in associates.

Example—exemption—separate financial statements (paragraph 35.10(f))

Ex 41 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

The law of the jurisdiction in which the entity operates requires all entities to present separate financial statements. The previous financial reporting framework required the entity to account for investments in subsidiaries, associates and jointly controlled entities in its separate financial statements at cost less all dividends received (until the balance is written down to nil, after which dividends are recognised in profit or loss).

In accordance with the requirement in paragraph 9.26 to measure each category of investment (ie investment in subsidiaries, investment in jointly controlled entities and investments in associates) in its separate financial statements, the entity must choose an accounting policy of either cost less impairment, fair value or the equity method.

Fair value

If the entity chooses fair value, no exemption is available to the entity. The entity measures its investment in its subsidiary, jointly-controlled entity or associate at fair value at the date of transition to the *IFRS for SMEs* Standard and consequently adjusts opening retained earnings on the date of transition (1 January 20X3).

Equity method

If the entity chooses the equity method, no exemption is available to the entity. At the date of transition to the *IFRS for SMEs* Standard the entity measures its investment in its subsidiary, jointly-controlled entity or associate at transaction price (including transaction costs) plus or minus the entity's share of its subsidiary's/associate's/jointly controlled entity's post-acquisition profit or loss and other comprehensive income (see paragraph 14.8). Consequently, the entity also adjusts opening retained earnings at its date of transition (1 January 20X3).

Cost less impairment

If the entity chooses the cost model, paragraph 35.10(f) permits the use of two exemptions to determine the deemed cost of the investment. These are:

(a) fair value at the date of the transition (ie deemed cost); or

(b) the carrying amount on the date of transition measured using the previous financial reporting framework subject to an impairment test (ie deemed cost).

The entity measures its investment in its subsidiary, jointly controlled entity or associate at cost in accordance with Section 9 or at deemed cost (ie in accordance with (a) or (b) above) at the date of transition to the *IFRS for SMEs* Standard. If that carrying amount is different from the amount determined by using its previous financial reporting framework, then the entity adjusts opening retained earnings on its date of transition (1 January 20X3) accordingly.

The method used by the entity applying its local GAAP is different from the cost method required by Section 9 because the local GAAP required dividends received to be deducted from the cost of the investment. Consequently, if the entity chooses to measure its investments at cost in accordance with Section 9 it will need to adjust the carrying amount of its investment and retained earnings.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(g) **compound financial instruments**. Paragraph 22.13 requires an entity to split a compound financial instrument into its liability and equity components at the date of issue. A first-time adopter need not separate those two components if the liability component is not outstanding at the date of transition to this Standard.

…

Notes—compound financial instruments

On issuing a compound financial instrument that contains both a liability and an equity component, an entity applying paragraph 22.13 of the *IFRS for SMEs* Standard allocates the proceeds between the liability component and the equity component. The allocation is not revised in a subsequent period (paragraph 22.14).

If an entity chooses not to use the exemption in paragraph 35.10(g), the entity would, in accordance with paragraph 35.7(c) and Section 22, prepare its statement of financial position on the date of transition to the *IFRS for SMEs* Standard as if it had always applied paragraph 22.13 to all compound financial instruments issued.

The exemption in paragraph 35.10(g) provides relief only in respect of those compound financial instruments that have been settled before the date of transition to the *IFRS for SMEs* Standard. Therefore, the entity must determine whether the liability component of such compound financial instruments is outstanding at the date of transition. If the liability component is outstanding it must apply paragraph 22.13 to that instrument on the date of transition to the *IFRS for SMEs* Standard as if it had always applied paragraph 22.13 to that instrument.

Accordingly, for compound financial instruments outstanding at the date of transition, the entity determines the initial carrying amount of the components on the basis of circumstances that existed when the instrument was issued.

For compound financial instruments where the liability component is no longer outstanding at the date of transition, retrospective application of paragraph 22.13 involves separating two portions of equity:

(a) the first portion, which is in retained earnings and represents the cumulative interest accreted on the liability component; and

(b) the other portion, which represents the original equity component of the financial instrument.

In accordance with paragraph 35.10(g), if the liability component is no longer outstanding at the date of transition, the entity may elect not to separate the two portions of equity.

Jurisdictional legislative requirements may affect the equity categories, in particular, for the original equity component of the financial instrument.

Examples—exemption—compound financial instruments (paragraph 35.10(g))

Ex 42 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X9. Those financial statements include only one year of comparative information (20X8).**

The entity's financial statements for the year ended 31 December 20X8 were presented in accordance with local GAAP. The previous financial reporting framework required the entity to account for convertible debt that it had issued entirely as a liability. However, if bond holders exercise their conversion rights, the carrying amount of the converted bond would be transferred from liabilities to equity.

On 1 January 20X1 the entity issued 500 convertible bonds. The bonds were issued at par with a face value of CU100 per bond and are for a five-year term, with no transaction costs. The total proceeds from the issue was CU50,000. Interest is payable yearly in arrears at an annual interest rate of 4%. Each bond is convertible, at the holder's discretion, into 25 ordinary shares at any time up to maturity. At the time the bonds were issued, the market interest rate for similar debt that does not have the conversion option was 6%. At the end of the five-year term, if not converted, the bonds are repaid at par, including any accrued interest.

Applying paragraphs 22.13–22.15 an entity must allocate the proceeds received from the issue of the bonds between the liability and the equity component of the instrument issued. That allocation is not revised in subsequent periods. The Appendix to Section 22 *Liabilities and Equity* illustrates the accounting required for this example.

In this example, at the date of transition to the *IFRS for SMEs* Standard (1 January 20X8) the liability component is no longer outstanding (that is, each bond would either have been converted into 25 ordinary shares or, on 31 December 20X5, it would have been redeemed for cash). Consequently, in accordance with paragraph 35.10(g) the entity may elect to use the exemption from computing the effects of separating the

convertible bonds into the liability component and the equity component. If it chooses the exemption, the entity retains the accounting that it used under its previous financial reporting at its date of transition (1 January 20X8) and there are no adjustments to retained earnings.

Note: if the entity did not elect to use the exemption in paragraph 35.10(g), it would, in accordance with paragraph 35.7(c) and Section 22, adjust its retained earnings and components of equity (determined in accordance with relevant law) as at 1 January 20X8 for the effects of retrospectively accounting for the bond in accordance with Section 22. This would include revised measurement of interest expense at 6%.

Ex 43 **The facts are the same as in Example 42. However, in this example, the entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3). None of the bondholders had elected to convert their bonds into ordinary shares by 31 December 20X4.**

Because the liability component of the convertible bonds is outstanding at the date of transition to the *IFRS for SMEs* Standard (1 January 20X3) the entity cannot apply the exemption in paragraph 35.10(g).

Consequently, the entity must determine the carrying amount of the liability at 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard) in accordance with the *IFRS for SMEs* Standard as follows.

When the instrument is issued, the liability component must be measured first, and the difference between the total proceeds on issue (which is the fair value of the instrument in its entirety) and the fair value of the liability component is assigned to the equity component. The fair value of the liability component is calculated by determining its present value using the discount rate of 6%. The calculations are illustrated below.

	CU
Proceeds from the bond issue (A)	50,000
Present value of principal at the end of five years (see calculations below)	37,363
Present value of interest payable annually in arrears for five years	8,425
Present value of liability, which is the fair value of liability component (B)	45,788
Residual, which is the fair value of the equity component (A) less (B)	4,212

Calculations:

Present value of principal of CU50,000 at 6 %

CU50,000 / (1.06) ^ 5 = 37,363

Present value of the interest annuity of CU2,000 (= CU50,000 × 4 %) payable at the end of each of five years.

The CU2,000 annual interest payments are an annuity—a cash flow stream with a limited number (n) of periodic payments (C), receivable at dates 1 to n. To calculate the present value of this annuity, future payments are discounted by the periodic rate of interest (i) using this formula:

$$PV = \frac{C}{i} \times [1 - \frac{1}{(1+i)^n}]$$

Consequently, the present value of the CU2,000 interest payments is:

(CU2,000 / 0.06) × [1 –[(1 / 1.06)^5]] = CU8,425

After issue, the entity (issuer) will amortise the bond discount according to the following table:

	(a) Interest payment (CU)	(b) Total interest expense (CU) = 6% × (e)	(c)Amortisation of bond discount (CU) = (b) –(a)	(d) Bond discount (CU) = (d) − (c)	(e) Net liability (CU) = 50,000 − (d)
1/1/20X1				4,212	45,788
31/12/20X1	2,000	2,747	747	3,465	46,535
31/12/20X2	2,000	2,792	792	2,673	47,327
31/12/20X3	2,000	2,840	840	1,833	48,167
31/12/20X4	2,000	2,890	890	943	49,057
31/12/20X5	2,000	2,943	943	0	50,000
Totals	10,000	14,212	4,212		

Consequently, in accordance with paragraph 35.7(c) and Section 22, at 1 January 20X3 the entity presents the convertible bond as CU47,327 liability (a decrease of CU2,673) and CU4,212 equity (an increase of CU4,212) and adjusts its retained earnings for the effects of retrospectively accounting for the bond in accordance with Section 22 by CU1,539.

Working:

	Liability	Equity—conversion right	Equity—retained earnings (interest)
Previous financial reporting framework	CU50,000	–	(CU4,000)
IFRS for SMEs Standard (see the end of 20X2 above)	CU47,327	CU4,212	(CU5,539)
Difference	CU2,673	(CU4,212)	CU1,539

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(h) deferred income tax. A first-time adopter may apply Section 29 *Income Tax* prospectively from the date of transition to the *IFRS for SMEs*.

…

Notes—deferred tax

Paragraph 35.10(h) gives a free choice to a first-time adopter to either apply Section 29 with full retrospective application or to apply Section 29 prospectively from the date of transition to the *IFRS for SMEs* Standard.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(i) **service concession arrangements**. A first-time adopter is not required to apply paragraphs 34.12–34.16 to service concession arrangements entered into before the date of transition to this Standard.

…

Notes—service concession arrangements

A service concession arrangement is an arrangement whereby a government or other public sector body (the grantor) contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals. Paragraphs 34.12–34.16 specify the requirements for service concession arrangements. For service concession arrangements entered into before the date of transition, the entity may continue to use its accounting under its previous financial reporting framework until the end of the agreement even if the agreement ends after the date of transition.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(j) extractive activities. A first-time adopter using full cost accounting under previous GAAP may elect to measure oil and gas assets (those used in the exploration, evaluation, development or production of oil and gas) on the date of transition to the *IFRS for SMEs* at the amount determined under the entity's previous GAAP. The entity shall test those assets for impairment at the date of transition to this Standard in accordance with Section 27 *Impairment of Assets*.

…

Notes—extractive activities

Full cost accounting is a commonly used accounting treatment across jurisdictions. Under full cost accounting, exploration and development costs are accounted for in cost centres that typically relate to a large geographic area, such as a country. A full cost centre typically includes costs associated with successful and unsuccessful exploration and development projects. Section 35 permits a first-time adopter that has previously used this basis of accounting to elect to measure the related oil and gas assets at the date of transition to the *IFRS for SMEs* Standard at the amount determined under the entity's previous financial reporting framework. Entities electing to use the

exemption must test both exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to the *IFRS for SMEs* Standard. Any identified impairment losses must be recognised at the date of transition.

Following transition to *IFRS for SMEs* Standard, an entity applies paragraphs 34.11–34.11F to exploration and evaluation assets. These require an entity to determine an accounting policy that specifies which expenditures are recognised as exploration and evaluation assets in accordance with paragraph 10.4 and apply the policy consistently. Entities are exempt from applying paragraph 10.5. Exploration and evaluation assets are measured on initial recognition at cost and after initial recognition entities apply Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*, subject to the impairment provisions set out in paragraphs 34.11D–34.11F.

Example—exemption—extractive activities (paragraph 35.10(j))

Ex 44 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP, which permitted the entity to use full cost accounting to account for all of its oil and gas properties located in Country X in a single cost centre.

In preparing its first financial statements that conform to the *IFRS for SMEs* Standard, the entity elects to measure its oil and gas assets at 1 January 20X3 at the amount determined under its previous financial reporting framework (that is, in accordance with full cost accounting).

Because the cost centre for accounting for the entity's oil and gas assets under full cost accounting is a larger unit of account than the unit of account that the entity chooses to use when applying the *IFRS for SMEs* Standard, the entity allocates the cost centre's carrying amount to the underlying oil and gas assets in that cost centre on a pro rata basis using reserve volumes or reserve values at that date. The entity then applies Section 27 *Impairment of Assets* to test those underlying oil and gas assets for impairment.

Subsequently, the entity accounts for its oil and gas assets in accordance with paragraph 34.11–34.11F.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(k) arrangements containing a **lease**. A first-time adopter may elect to determine whether an arrangement existing at the date of transition to the *IFRS for SMEs* contains a lease (see paragraph 20.3) on the basis of facts and circumstances existing at that date, instead of when the arrangement was entered into.

…

Notes—arrangements containing a lease

Some arrangements do not take the legal form of a lease but convey rights to use assets in return for payments. Such arrangements are in substance leases of assets and paragraph 20.3 requires such arrangements to be accounted for in accordance with Section 20 *Leases*. Examples of such arrangements include some outsourcing arrangements, telecommunication contracts that provide rights to capacity, and take-or-pay contracts.

When accounting for such arrangements, the lease classification, whether there is in substance a lease and, if so, whether it is a finance lease or operating lease, is based on the initial terms of the lease agreement and the circumstances existing at the inception of the lease. However, paragraph 35.10(k) allows a first-time adopter to elect to determine whether an arrangement existing at the date of transition to the *IFRS for SMEs* Standard contains a lease on the basis of facts and circumstances existing at the date of transition, rather than when the arrangement was entered into. Paragraph 35.10(k) does not exempt the entity from making the determination.

Example—exemption—arrangements containing a lease (paragraph 35.10(k))

Ex 45 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

The previous financial reporting framework required the entity to account for arrangements as leases only if the terms of the agreement took the form of a contractual lease, regardless of whether the arrangement conveyed the right to use an asset in return for payments.

On 12 April 20X1 the entity entered into an arrangement that contained a lease as defined in the *IFRS for SMEs* Standard. However, the entity did not account for the arrangement as a lease because it did not take the form of a contractual lease. The entity accounted for the payments as an expense in accordance with its previous financial reporting framework.

On the date of transition to the *IFRS for SMEs* Standard (1 January 20X3) the entity must assess whether it is party to any arrangement that contains a lease, in accordance with paragraphs 20.2 and 20.3. The entity makes that assessment either based on the facts and circumstances that existed when the arrangement was entered into (12 April 20X1) or, if it elects to do so, it can, in accordance with paragraph 35.10(k), make that assessment based on the basis of facts and circumstances existing at the date of transition (1 January 20X3). Applying the *IFRS for SMEs* Standard the arrangement would meet the definition of a lease.

If the entity chooses to make the assessment on the date of transition (1 January 20X3), it would account for the lease prospectively from that date. At the date of transition, the entity would determine whether the lease is an operating lease or finance lease. If the lease is an operating lease, the entity would not need to adjust its statement of financial position on the date of transition provided that the lease payments have been expensed under the previous financial reporting framework in accordance with the

IFRS for SMEs Standard. However, if the lease is a finance lease then the entity would need to, in accordance with paragraph 35.8 and Section 20, account for a finance lease at the date of transition by recognising the related asset and financial liability for the finance lease and adjusting retained earnings accordingly.

Note: if the entity chooses to make the assessment based on the facts and circumstances that existed when the arrangement was entered into (12 April 20X1) then if the lease is a finance lease the entity would need to retrospectively account for the finance lease existing from 12 April 20X1.

Ex 46 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

On 1 January 20X0 the entity entered into an agreement with a supplier to buy a minimum quantity of gas to be used in its production process for a specified period of time (a take-or-pay arrangement).

On 1 January 20X2 there was a change in the contractual terms of the arrangement.

If the entity uses the exemption in paragraph 35.10(k) it may determine whether the arrangement contains a lease by applying the criteria in paragraphs 20.2 and 20.3 on the basis of facts and circumstances existing on the date of transition (1 January 20X3), as permitted by the exemption in paragraph 35.10(k).

Alternatively, if the entity does not use the exemption in paragraph 35.10(k), it applies those criteria on the basis of facts and circumstances existing on 1 January 20X0 and then reassesses the arrangement on 1 January 20X2 due to the contractual change (paragraph 20.8).

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(l) decommissioning liabilities included in the cost of property, plant and equipment. Paragraph 17.10(c) states that the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce **inventories** during that period. A first-time adopter may elect to measure this component of the cost of an item of property, plant and equipment at the date of transition to the *IFRS for SMEs*, instead of on the date(s) when the obligation initially arose.

…

Notes—decommissioning liabilities included in the cost of property, plant and equipment

Retrospective application of paragraph 17.10(c) at the date of transition to the *IFRS for SMEs* Standard would require an entity to construct a historical record of all changes to the liability that would have been made in the past. It will also require an adjustment to the initial cost recorded for property, plant and equipment on acquisition and in relation to depreciation charged in prior periods. In many cases this will not be practicable. Paragraph 35.10(l) allows an entity an exemption from these requirements for changes in such liabilities that occurred before the date of transition to the *IFRS for SMEs* Standard. If a first-time adopter uses this exemption, it must:

- measure the liability at the date of transition to the *IFRS for SMEs* Standard in accordance with Section 21 and recognise this in liabilities; and
- increase the carrying amount of the property, plant and equipment at the date of transition to the *IFRS for SMEs* Standard by the amount of the liability.

Example—exemption—decommissioning liabilities included in the cost of property, plant and equipment (paragraph 35.10(l))

Ex 47 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. The previous financial reporting framework prohibited recognition of the decommissioning liability that arose on 1 January 20X1 due to the construction of the entity's plant. Consequently, an estimate of the cost of meeting that obligation was not included in the cost of the related item of property, plant and equipment or recognised as a liability. The plant was recorded at CU20,000.

At 1 January 20X3, in accordance with the *IFRS for SMEs* Standard, the liability would be measured at CU1,210. It is assumed that the appropriate risk adjusted discount rate for the liability between 1 January 20X1 and 31 December 20X2 is 10% per year.

The entity depreciates its plant on the straight-line basis over its 20-year estimated useful life to a nil estimated residual value in accordance with local GAAP. This is also the appropriate depreciation in accordance with the *IFRS for SMEs* Standard. Consequently, on 1 January 20X3 the remaining useful life is 18 years.

In accordance with paragraph 17.10(c) the entity must include in the initial measurement of its property, plant and equipment, the present obligation to decommission its plant.

If the entity elects to use the exemption in paragraph 35.10(l) it would:

- measure the liability to dismantle the plant that arose from its construction of its plant in its statement of financial position at 1 January 20X3 at CU1,210;
- increase the carrying amount of the plant at 1 January 20X3 by CU1,210, so that the plant would be measured at CU19,210 at 1 January 20X3 ((CU20,000 × 18/20) + CU1,210); and
- measure the annual depreciation for 20X3 and 20X4 at CU1,067 (CU19,210 ÷ 18).

Note: if the entity did not choose to use the exemption in paragraph 35.10(l), it would measure the liability at 1 January 20X1 in accordance with Section 21 using information available at 1 January 20X1. Consistent with the principles of accounting for changes in accounting estimates, when the exemption in paragraph 35.10(l) is not applied, changes in the decommissioning liability between 1 January 20X1 and 31 December 20X2 affect the amount of the decommissioning liability, cost of plant and depreciation prospectively from the date of the change in accounting estimate. The entity would also need to unwind the discount between 1 January 20X1 and 31 December 20X2 to arrive at the amount of liability to include in its statement of financial position at 1 January 20X3 (its date of transition to the *IFRS for SMEs* Standard). The entity would also calculate depreciation on the plant between 1 January 20X1 and 31 December 20X2 using the revised cost to arrive at the amount to include in its statement of financial position at 1 January 20X3.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(m) operations subject to rate regulation. If a first-time adopter holds items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation (ie to provide goods or services to customers at prices/rates established by an authorised body) it may elect to use the previous GAAP carrying amount of those items at the date of transition to this Standard as their deemed cost. If an entity applies this exemption to an item, it need not apply it to all items. The entity shall test those assets for impairment at the date of transition to this Standard in accordance with Section 27.

…

Notes—operations subject to rate regulation

Rate regulation is not defined in the *IFRS for SMEs* Standard. Full IFRS Standards includes a definition of rate regulation as 'a framework for establishing the prices that can be charged to customers for goods or services and that framework is subject to oversight and/or approval by a rate regulator'. Full IFRS Standards defines a rate regulator as 'an authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity'.

Where a first-time adopter has property, plant and equipment or intangible assets that are or were used in operations subject to rate regulation, it might have included, in accordance with its previous GAAP, a regulatory component in the carrying amount of the assets that would not be included if applying the *IFRS for SMEs* Standard.

Paragraph 35.10(m) allows a first-time adopter to elect to treat the previous carrying amount as deemed cost, subject to an impairment review to ensure this amount is not greater than recoverable amount.

Example—exemption— operations subject to rate regulation (paragraph 35.10(m))

Ex 48 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

The entity's activities are subject to rate regulation. Its previous financial reporting framework required it to include as part of its cost of property, plant and equipment an allowance which includes an imputed cost of equity.

If the entity chooses not to use the exemption in paragraph 35.10(m), the entity would, in accordance with paragraph 35.8, adjust the carrying amount of its property, plant and equipment on the date of transition to the *IFRS for SMEs* Standard to eliminate the imputed cost of equity and adjust retained earnings as if it had always applied the *IFRS for SMEs* Standard.

Paragraph 35.10(m) allows a first-time adopter to elect to treat the previous carrying amount as deemed cost, subject to an impairment review at the date of transition to ensure this amount is not greater than recoverable amount at that date. If the entity chooses to use the exemption in paragraph 35.10(m), it will leave the carrying amount of property, plant and equipment unchanged at its date of transition to the *IFRS for SMEs* Standard (1 January 20X3). Consequently, it will make no adjustment to retained earnings. Should the entity need to reduce the carrying amount of its property, plant and equipment to recoverable amount, it will also adjust retained earnings accordingly at its date of transition.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

…

(n) **severe hyperinflation**. If a first-time adopter has a **functional currency** that was subject to severe hyperinflation:

(i) if its date of transition to this Standard is on, or after, the **functional currency normalisation date**, the entity may elect to measure all assets and liabilities held before the functional currency normalisation date at fair value on the date of transition to this Standard and use that fair value as the deemed cost of those assets and liabilities at that date; and

(ii) if the functional currency normalisation date falls within a twelve month comparative period, an entity may use a comparative period of less than twelve months, provided that a complete set of financial statements (as required by paragraph 3.17) is provided for that shorter period.

Notes—severe hyperinflation

The *IFRS for SMEs* Standard states (see Glossary) that 'the currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:

(a) a reliable general price index is not available to all entities with transactions and balances in the currency; and

(b) exchangeability between the currency and a relatively stable foreign currency does not exist'.

A functional currency normalisation date is the date when an entity's functional currency no longer has either, or both, of the two characteristics of severe hyperinflation, or when there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation (see Glossary).

Paragraph 35.10(n)(i) permits a first-time adopter to measure its assets and liabilities on the date of transition at their fair values on that date and treat this as deemed cost. This option is only available if the entity's functional currency has previously been subject to severe hyperinflation and is no longer, for whatever reason, subject to severe hyperinflation by the date of transition to the *IFRS for SMEs* Standard.

Paragraph 35.10(n)(ii) provides that where a first-time adopter's functional currency has previously been subject to severe hyperinflation and ceases to be, for whatever reason, subject to severe hyperinflation during a twelve-month comparative period to an entity's first IFRS financial statements, the entity is permitted to use a comparative period of less than twelve months because the preparation of information in accordance with the *IFRS for SMEs* Standard for periods before the functional currency normalisation date may not be possible. This option is only available if a complete set of financial statements is provided for the shorter period; that is, if the comparatives are presented consistently for that shorter period. When an entity applies paragraph 35.10(n)(ii) the date of transition becomes the first day of that shorter period presented. The relief in paragraph 35.10(n)(i) can then also be used and the entity may measure its assets and liabilities on the first day of that shorter period at their fair values on that date and treat this as deemed cost.

Examples—exemption— severe hyperinflation (paragraph 35.10(n))

Ex 49 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

Since 20X0 the entity's functional currency has been subject to severe hyperinflation. From 1 June 20X2 the currency, although still hyperinflationary, ceased to be subject to severe hyperinflation.

The entity's functional currency normalisation date is 1 June 20X2, which is before the entity's date of transition to the *IFRS for SMEs* Standard (1 January 20X3). Consequently, the entity may elect to measure all its assets and liabilities held at the date of transition at fair value and use those fair values as deemed cost.

Ex 50 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

Since 20X0 the entity's functional currency has been subject to severe hyperinflation. On 1 June 20X2 the entity completed a restructuring which involved changing its mix of products and customers; its functional currency changed to FCU, a currency that is neither subject to severe hyperinflation nor hyperinflation.

Although the entity's functional currency changed, the entity still has some operations and assets in the jurisdiction whose currency is subject to severe hyperinflation.

The entity's functional currency normalisation date is 1 June 20X2, which is before the entity's date of transition to the *IFRS for SMEs* Standard (1 January 20X3). Consequently, the entity may elect to measure all its assets and liabilities held at the date of transition at fair value and use those fair values as deemed cost.

Ex 51 **The facts are the same as in Example 49. However, in this example, the currency ceased to be subject to severe hyperinflation from 1 April 20X3 (not 1 June 20X2).**

The entity's functional currency normalisation date is 1 April 20X3, which is part way through what would otherwise be the comparative period to the entity's first financial statements that conform to the *IFRS for SMEs* Standard. The entity elects to present comparative information for the nine months ended 31 December 20X3, rather than for the twelve months ended 31 December 20X3. If the entity elects to present comparative information for the nine-month period, its date of transition becomes 1 April 20X3 (the functional currency normalisation date). Consequently, the entity may elect to measure all its assets and liabilities held at 1 April 20X3 at fair value and use the fair values as deemed cost.

35.11 If it is **impracticable** for an entity to make one or more of the adjustments required by paragraph 35.7 at the date of transition, the entity shall apply paragraphs 35.7–35.10 for such adjustments in the earliest period for which it is practicable to do so, and shall identify which amounts in the financial statements have not been restated. If it is impracticable for an entity to provide any of the disclosures required by this Standard, including those for comparative periods, the omission shall be disclosed.

Notes—impracticable

'Impracticable' is a high hurdle—applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so (see the Glossary). The application of a requirement is not impracticable simply because it would be expensive, for example, if an entity would have to incur the cost of a valuer's fees. This is a tougher test than 'undue cost or effort'.

It would be impracticable to restate the assets and liabilities at the date of transition for one or more of the adjustments required by paragraph 35.7 if, for example, the effects are not determinable because a fire destroyed the records which are necessary to perform the calculations.

Examples—impracticable to restate assets and liabilities at the date of transition

Ex 52 **An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include two years' comparative information (20X3 and 20X2).**

The entity's financial statements for the years ended 31 December 20X3 and 31 December 20X2 were presented in accordance with local GAAP. The previous financial reporting framework permitted use of the last-in, first-out (LIFO) cost formula for inventory and the entity chose to use this cost formula as it was used by competitors in its industry.

When applying the *IFRS for SMEs* Standard, the entity, in accordance with paragraph 13.18, uses the first-in, first-out (FIFO) cost formula for inventories which also reflects how the entity manages its inventories. However, because the entity's inventory records were destroyed in a fire on 31 December 20X1, it cannot restate inventories (that is, it is impracticable to do so) at 1 January 20X2 (the date of transition to the *IFRS for SMEs* Standard).

All of the inventories held by the entity at 1 January 20X2 were sold before 31 December 20X2.

Because it is impracticable to restate the entity's statement of financial position at 1 January 20X2 for use of the FIFO cost formula for inventories, in accordance with paragraph 35.11, the entity measures inventories using the LIFO cost formula at 1 January 20X2.

At 31 December 20X2 the entity's inventory would be measured using the FIFO cost formula. Consequently, in its financial statements for the year ended 31 December 20X4 (the first financial statements that conform to the *IFRS for SMEs* Standard) the entity would disclose the fact that, in its statement of comprehensive income for 20X2, the line items cost of sales expense and profit or loss for the year ended 31 December 20X2 have not been restated on transition and so are not comparable with the same line items presented for 20X3 and 20X4. The disclosure would explain that the lack of comparability is as a result of the inventories at 1 January 20X2 being measured using the LIFO cost formula because fire had destroyed the records necessary for the entity to measure inventory using the FIFO cost formula.

Ex 53 **The facts are the same as in Example 52. However, in this example, all of the inventories held by the entity at 1 January 20X2 were sold before 31 December 20X3.**

Because it is impracticable for the entity to restate its inventories at 1 January 20X2 for use of the FIFO cost formula, in accordance with paragraph 35.11, the entity measures inventories using the LIFO cost formula at 1 January 20X2.

At 31 December 20X2 some of the entity's inventory would be measured using the FIFO cost formula (that is, inventories bought on or after 1 January 20X2) and some would be measured using the LIFO cost formula (that is, inventory bought before 1 January 20X2). At 31 December 20X3 all of the entity's inventory would be measured using the FIFO cost formula.

Consequently, in its financial statements for the year ended 31 December 20X4 (the first financial statements that conform to the *IFRS for SMEs* Standard) the entity would disclose:

- the fact that, in its statement of financial position, the 31 December 20X2 comparative information for the line item inventories has not been restated to measure those inventories held by the entity prior to 1 January 20X2 using the FIFO cost formula. The amount of inventories at 31 December 20X2 that have not been restated should be quantified. For completeness the entity may wish to specify in the disclosure that the inventories at 31 December 20X3 and 31 December 20X4 have been measured using the FIFO cost formula.
- the fact that, as a consequence, in its statement of comprehensive income, the line items cost of sales expense and profit or loss for the years ended 31 December 20X2 and 20X3 are not comparable with those for the year ended 31 December 20X4.
- an explanation of the lack of comparability—for example, the lack of comparability is as a result of the inventories at 1 January 20X2 (the date of transition to the *IFRS for SMEs* Standard) and some at 31 December 20X2 being measured using the LIFO cost formula because fire had destroyed the records necessary for the entity to make the adjustment required to measure inventory using the FIFO cost formula.

Disclosures

Explanation of transition to the *IFRS for SMEs*

35.12 An entity shall explain how the transition from its previous financial reporting framework to this Standard affected its reported **financial position**, financial **performance** and **cash flows**.

35.12A An entity that has applied the *IFRS for SMEs* in a previous period, as described in paragraph 35.2, shall disclose:

(a) the reason it stopped applying the *IFRS for SMEs*;

(b) the reason it is resuming the application of the *IFRS for SMEs*; and

(c) whether it has applied this section or has applied the *IFRS for SMEs* retrospectively in accordance with Section 10.

Reconciliations

35.13 To comply with paragraph 35.12, an entity's first financial statements prepared using this Standard shall include:

(a) a description of the nature of each change in accounting policy;

(b) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this Standard for both of the following dates:

  (i) the date of transition to this Standard; and

  (ii) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework.

(c) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this Standard for the same period.

Notes—disclosures

An entity's first financial statements under the *IFRS for SMEs* Standard must comply with all of the disclosure requirements in the *IFRS for SMEs* Standard. Section 35 does not provide any optional exemptions from disclosure requirements. Although paragraph 35.11 provides a general 'impracticable' exemption from disclosures, this is a high hurdle to clear.

The entity's explanation of how the transition from its previous financial reporting framework to the *IFRS for SMEs* Standard affected its reported financial position, financial performance and cash flows is most relevant to external stakeholders in understanding the changes in the entity's financial information. The narrative description of each change in accounting policy (see paragraph 35.13(a)) and the quantitative effects of the adoption of the *IFRS for SMEs* Standard (see paragraph 35.13(b) and (c)) on equity (which includes the effects of all changes in the measurement of recognised assets and recognised liabilities) and profit or loss helps users—for example, potential suppliers or bank lenders—to assess whether to provide the entity with a loan or other form of credit.

Additional disclosures are required when an entity adopts the *IFRS for SMEs* Standard for a second time. Such an entity is required to disclose why it stopped applying the *IFRS for SMEs* Standard, why it resumed application of the *IFRS for SMEs* Standard and whether it applied Section 35.

Example—explanation of the impacts of adopting the *IFRS for SMEs* Standard

Ex 54 **One way an entity could disclose how the transition from its previous financial reporting framework to the *IFRS for SMEs* Standard affected its reported financial position, financial performance and cash flows is shown below.**

Notes to the consolidated financial statements for the year ended 31 December 20X4 (extract)

Note 2 Basis of preparation and accounting policies (extract)

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

Before 20X4 the consolidated financial statements were prepared in accordance with AGAAP as issued by the Accounting Standards Board of A Land. The financial effects of the transition to the *IFRS for SMEs* Standard are set out in note 3 below.

...

Note 3 Transition to the *IFRS for SMEs* Standard

These consolidated financial statements for the year ended 31 December 20X4 are Entity A's first consolidated financial statements that comply with the *IFRS for SMEs* Standard. Entity A's date of transition to the *IFRS for SMEs* Standard is 1 January 20X3. Its last financial statements prepared in accordance with AGAAP were for the year ended 31 December 20X3.

The transition to the *IFRS for SMEs* Standard has resulted in a number of changes in Entity A's accounting policies compared to those used when applying AGAAP.

This explanatory note to the consolidated financial statements describes the differences between the profit or loss presented under AGAAP and the newly presented amounts under the *IFRS for SMEs* Standard for the reporting period ended 31 December 20X3 (ie comparative information), as well as the differences between the equity presented under AGAAP and the newly presented amounts under the *IFRS for SMEs* Standard at the date of transition (1 January 20X3) and at 31 December 20X3. It also describes all the required changes in accounting policies made on first-time adoption of the *IFRS for SMEs* Standard.

In the table below equity determined in accordance with the *IFRS for SMEs* Standard is reconciled to equity determined in accordance with AGAAP at both 1 January 20X3 (the date of transition to the *IFRS for SMEs* Standard) and 31 December 20X3 (the end of the latest period presented in the most recent consolidated financial statements prepared in accordance with AGAAP).

Reconciliation of equity

Note		*at 1 January 20X3*			*at 31 December 20X3*		
		AGAAP	*Effect of transition*	*IFRS for SMEs Standard*	*AGAAP*	*Effect of transition*	*IFRS for SMEs Standard*
		CU	CU	CU	CU	CU	CU
3.1	Intangible assets	530	(245)	285	446	(196)	250
3.2	Property, plant and equipment	1,268	57	1,325	1,192	48	1,240
3.3 & 3.6	Financial assets other than cash	303	(5)	298	638	(19)	619
3.4 & 3.6	Inventories	470	113	583	230	148	378
	Cash	50	-	50	29	-	29
	Assets total	**2,621**	**(80)**	**2,541**	**2,535**	**(19)**	**2,516**
3.2	Lease payable	–	72	72	–	58	58
3.3	Financial liabilities	320	57	377	126	58	184
3.5	Employee benefits	–	132	132	–	148	148
	Liabilities total	**320**	**261**	**581**	**126**	**264**	**390**
	Assets less liabilities	**2,301**	**(341)**	**1,960**	**2,409**	**(283)**	**2,126**
3.3	Issued capital and convertible loan	1,975	(55)	1,920	1,975	(55)	1,920
	Retained earnings	326	(286)	40	434	(228)	206
	Equity total	**2,301**	**(341)**	**1,960**	**2,409**	**(283)**	**2,126**

Reconciliation of consolidated profit or loss for the year ended 31 December 20X3

Note		*AGAAP*	*Effect of transition*	*IFRS for SMEs Standard*
		CU	CU	CU
3.6	Revenue	1,058	(24)	1,034
3.4 & 3.6	Cost of sales	(630)	29	(601)
	Gross profit	428	5	433
3.1, 3.2 & 3.5	Operating expenses	(263)	48	(215)
	Operating profit	165	53	218
3.3	Fair value of financial assets	–	10	10
3.2 & 3.3	Financial expenses	(7)	(5)	(12)
	Profit or loss for the period	**158**	**58**	**216**

Presented below are the notes to the above reconciliation of equity. Two additional items of information relating to this reconciliation of equity are:

- *the entity declared and paid CU50 dividends in 20X3; and*
- *no pensions are currently being paid to any former employees.*

Notes to the reconciliation of equity

3.1 Intangible assets

Research and development costs recognised as an asset in accordance with AGAAP are recognised as an expense in accordance with the *IFRS for SMEs* Standard. At 1 January 20X3, the cumulative transition adjustment to remove the research and development asset decreased the carrying amount of intangible assets by CU245. Consequently, in 20X3 the amortisation expense for intangible assets was CU49 lower in accordance with the *IFRS for SMEs* Standard than it was in accordance with AGAAP. During 20X3 no expenditure related to research and development was incurred.

3.2 Property, plant and equipment

Leased assets

Some lease contracts, that in accordance with AGAAP were accounted for by recognising lease payments as an expense on the straight-line basis, are classified as finance leases in accordance with the *IFRS for SMEs* Standard.

On 1 January 20X3 (the date of transition) Entity A recognised for the first time CU87 assets (for contractual rights of use of the leased assets) and CU72 liability (for contractual obligations to make future lease payments).

Consequently, profit for the year ended 31 December 20X3 is CU3 higher in accordance with the *IFRS for SMEs* Standard than it would have been under AGAAP because of the net effect of the following:

- Depreciation expense for leased assets is CU11 higher.
- Finance costs for the recognised lease liability are CU4 higher.
- Operating lease expenses are CU18 lower.

Impairment

The impairment tests for property, plant and equipment required by AGAAP and the *IFRS for SMEs* Standard differ only in one respect—unlike the *IFRS for SMEs* Standard (which requires the discounting of cash flows when computing an item's value in use), AGAAP uses undiscounted cash flows when computing an item's value in use. Consequently, in the consolidated statement of financial position at 1 January 20X3 (the date of transition) the carrying amount of plant was reduced by CU30 to recognise an impairment applying the *IFRS for SMEs* Standard.

Because the depreciable amount of the plant is lower, depreciation expense for the year ended 31 December 20X3 is CU2 lower in accordance with the *IFRS for SMEs* Standard than it was when applying AGAAP.

3.3 Financial instruments

Financial assets

In accordance with AGAAP, investments in publicly traded non-convertible preference shares are measured at historical cost. In accordance with the *IFRS for SMEs* Standard those investments are measured at fair value with changes in fair value recognised in

profit or loss. Consequently, in the consolidated statement of financial position at 1 January 20X3 (the date of transition) the entity increases the carrying amount of its investments by CU28.

The CU10 increase in the fair value of the investments in 20X3 is recognised in profit or loss determined in accordance with the *IFRS for SMEs* Standard.

Financial liabilities

In accordance with AGAAP, convertible debt is classified entirely as equity. In accordance with the *IFRS for SMEs* Standard, on issuing convertible debt (a compound financial instrument), the proceeds are allocated between the liability component and the equity component.

Consequently, in the consolidated statement of financial position at 1 January 20X3 (the date of transition) a reclassification of CU57 was made from equity (issued capital and convertible loan (CU55) and retained earnings (CU2)) to liability for the liability component of convertible debt issued by Entity A that was outstanding on 1 January 20X3.

Consequently, profit for the year ended 31 December 20X3 is CU1 lower in accordance with the *IFRS for SMEs* Standard than it would have been under AGAAP because additional finance costs for the liability component are CU1 for the year.

3.4 Inventory

In accordance with AGAAP, inventories are measured using the last-in, first-out (LIFO) cost formula. In accordance with the *IFRS for SMEs* Standard the entity measures inventories using the weighted average cost formula. Consequently, in the consolidated statement of financial position at 1 January 20X3 (the date of transition) the carrying amount of inventories was increased by CU94.

Because of the change in cost formula, the cost of goods sold is CU21 lower in 20X3 using the weighted average cost formula (applying the *IFRS for SMEs* Standard) than it would have been using the LIFO cost formula (in accordance with AGAAP).

3.5 Employee benefits

Entity A and its subsidiaries provide their employees with a final salary pension scheme. The scheme is unfunded.

In accordance with AGAAP, the obligations to pay pensions to employees and former employees are not recognised in the consolidated statement of financial position, that is, post-employment benefits are recognised as an expense only when paid.

Applying the *IFRS for SMEs* Standard in the consolidated financial statements Entity A recognises a liability for the group's obligations under the defined benefit plan using the projected unit credit method and the net change in the liability in a period is recognised as an expense.

Consequently, in the consolidated statement of financial position at 1 January 20X3 (the date of transition) liabilities are higher by CU132, and the 20X3 expenses are CU16 higher (CU6 cost of sales and CU10 operating expenses) under the *IFRS for SMEs* Standard.

3.6 Revenue

Consignment sales

Under AGAAP Entity A recognised revenue related to items subject to consignment agreements when the items were delivered to the recipient (buyer) regardless of whether the recipient had sold the item to a third party (final consumer) on behalf of the entity (seller). The *IFRS for SMEs* Standard requires that the sales revenue related to such transaction must be recognised by the entity (seller) only when goods are sold by the recipient to a third party. Consequently, in the consolidated statement of financial performance for the year ended 31 December 20X3 revenue is CU20 lower applying the *IFRS for SMEs* Standard. At 1 January 20X3 receivables are lower by CU11 and inventory is higher by CU6 applying the *IFRS for SMEs* Standard; at 31 December receivables are lower by CU31 and inventory is higher by CU18

Cash on delivery sales

Internet sales represent around 28% of the group's sales. Entity A does not accept credit cards for Internet sales; all Internet sales are subject to a payment condition (cash on delivery sales). Items sold through the Internet are delivered to customers within a range of 5 to 40 days from the date of the sale, depending on the distance and logistic conditions.

Under AGAAP, revenue related to such sales was recognised when the orders were received through the Internet. The *IFRS for SMEs* Standard requires that the sales revenue related to such transactions is recognised when delivery is made and cash is received by the seller or its agent. Consequently, applying the *IFRS for* SMEs Standard in the consolidated statement of financial performance for the year ended 31 December 20X3 revenue is CU4 lower and cost of goods sold is CU2 lower. At 1 January 20X3 receivables are lower by CU22 and inventory is higher by CU13 applying the *IFRS for SMEs* Standard; at 31 December receivables are lower by CU26 and inventory is higher by CU15.

35.14 If an entity becomes aware of **errors** made under its previous financial reporting framework, the reconciliations required by paragraph 35.13(b) and (c) shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies.

Notes—errors

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements (see the Glossary).

Errors are 'omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements' (see the Glossary).

The correction of prior period errors and changes in accounting policy (unless the *IFRS for* SMEs Standard specifically permits or requires another treatment, or it is impracticable) are accounted for retrospectively (that is, comparative information is presented as if the error had never occurred or the new accounting policy had always been applied—see paragraphs 10.21 and 10.22, and 10.11(c) and 10.12).

While preparing for the transition to the *IFRS for SMEs* Standard, an entity may discover that it has made errors under the previous GAAP. If an error was made prior to the date of transition, the error should be corrected by an adjustment to retained earnings at the date of transition in the same manner as adjustments resulting from changes in accounting policies from previous GAAP to the *IFRS for SMEs* Standard as required by paragraph 35.7. However, the reconciliations of equity and profit or loss required by paragraph 35.13 require the correction of the prior period error to be distinguished from adjustments resulting from changes in accounting policies on transition to the *IFRS for SMEs* Standard.

Example—distinguish the correction of errors from changes in accounting policies

Ex 55 **The facts are the same as in Example 54. However, in this example, in 20X4, the entity discovered a systematic error in the calculation of amortisation expense for intangible assets other than research and development for 20X0–20X3. The cumulative effect of the error on the retained earnings of the entity at 1 January 20X3 is a CU80,000 overstatement. The error resulted in profit for the year ended 31 December 20X3 being overstated by CU20,000.**

Notes to the financial statements for the year ended 31 December 20X4 (extract)

…

Note 12 Correction of prior period error

In 20X4 the entity discovered, and corrected, mathematical mistakes that had resulted in the understatement of amortisation expense related to intangible assets other than research and development over the previous four years. The correction of the error has been accounted for retrospectively, and the comparative information for 20X3 has been restated. The effect of the change is a CU20,000 reduction in profit for the year ended 31 December 20X3. Furthermore, opening retained earnings for 20X3 have been reduced by CU80,000, which is the amount of the error relating to periods before 20X3.

Reconciliation of consolidated equity

Note		*at 1 January 20X3*					*at 31 December 20X3*				
		AGAAP original	*Correction of prior periods errors*	*AGAAP restated*	*Effect of transition*	*IFRS for SMEs Standard*	*AGAAP original*	*Correction of prior periods errors*	*AGAAP restated*	*Effect of transition*	*IFRS for SMEs Standard*
		CU	CU	CU	CU	CU	CU	CU	CU	CU	CU
3.1	Intangible assets	530	(80)	450	(245)	205	446	(100)	346	(196)	150
3.2	Property, plant and equipment	1,268	–	1,268	57	1,325	1,192	–	1,192	48	1,240
3.3 & 3.6	Financial assets	303	–	303	(5)	298	638	–	638	(19)	619
3.4 & 3.6	Inventories	470	–	470	113	583	230	–	230	148	378
	Cash	50	–	50	-	50	29	–	29	-	29
	Assets total	**2,621**	**(80)**	**2,541**	**(80)**	**2,461**	**2,535**	**(100)**	**2,435**	**(19)**	**2,416**
3.2	Lease payable	–	–	–	72	72	–	–	–	58	58
3.3	Financial liabilities	320	–	320	57	377	126	–	126	58	184
3.5	Employee benefits	–	–	–	132	132	–	–	–	148	148
	Liabilities total	**320**	**–**	**320**	**261**	**581**	**126**	**–**	**126**	**264**	**390**
	Assets less liabilities	**2,301**		**2,221**	**(341)**	**1,880**	**2,409**		**2,309**	**(283)**	**2,026**
3.3	Issued capital and convertible loan	1,975	–	1,975	(55)	1,920	1,975	–	1,975	(55)	1,920
	Retained earnings	326	(80)	246	(286)	(40)	434	(100)	334	(228)	106
	Equity total	**2,301**	**(80)**	**2,221**	**(341)**	**1,880**	**2,409**	**(100)**	**2,309**	**(283)**	**2,026**

Reconciliation of consolidated profit or loss for the year ended 31 December 20X3

Note		*AGAAP original* CU	*Correction of prior periods errors* CU	*AGAAP restated* CU	*Effect of transition* CU	*IFRS for SMEs Standard* CU
3.6	Revenue	1,058	–	1,058	(24)	1,034
3.4 & 3.6	Cost of sales	(630)	–	(630)	29	(601)
	Gross profit	428	–	428	5	433
3.1, 3.2 & 3.5	Operating expenses	(263)	(20)	(283)	48	(235)
	Operating profit	165	–	145	53	198
3.3	Fair value of financial assets	–	–	0	10	10
3.2 & 3.3	Financial expenses	(7)	–	(7)	(5)	(12)
	Profit or loss for the period	**158**	**(20)**	**138**	**58**	**196**

35.15 If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this Standard.

Example—disclosure that the entity did not present financial statements for previous periods

Ex 56 **An entity is preparing general purpose financial statements for the first time for the year ended 31 December 20X4. Those financial statements will comply with the *IFRS for SMEs* Standard. The entity could disclose information about this fact as follows.**

Notes to the financial statements for the year ended 31 December 20X4 (extract)

Note 2 Basis of preparation and accounting policies (extract)

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

...

Note 3 Adoption of the *IFRS for SMEs* Standard

Although the entity was formed and started trading ten years ago, these are its first general purpose financial statements. The financial statements have been prepared applying the *IFRS for SMEs* Standard. The financial statements include comparative information for the year ended 31 December 20X3. Financial statements were prepared for the year ended 31 December 20X3 but they were not general purpose financial statements and were not prepared in accordance with the *IFRS for SMEs* Standard.

Module 35 – Transition to the *IFRS for SMEs*

In accordance with Section 35 *Transition to the IFRS for SMEs* the entity elected to use the following exemptions from applying the requirements of the *IFRS for SMEs* Standard retrospectively:

1. at 1 January 20X3 the entity measured each item of property, plant and equipment at its fair value and has used that fair value as its deemed cost at that date;
2. at 1 January 20X3 the entity determined whether an arrangement existing at that date contained a lease on the basis of facts and circumstances existing at the date of transition, rather than the date when the arrangement was entered into;
3. …

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements—apart from those involving estimates—that its management has made when applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.
Furthermore, applying paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs* Standard require disclosure of information about particular judgements and estimation uncertainties.

The application of the *IFRS for SMEs* Standard

Once an entity applies the *IFRS for SMEs* Standard for the first time, not only does it have to make significant estimates and judgements related to the requirements presented in Section 35 *Transition to the* IFRS for SMEs, but it also becomes subject to the significant estimates and judgements required to apply Sections 1 to 34 of the Standard. For details about such significant estimates and judgements, see the modules for those sections.

Exemptions

Choosing to apply many of the exemptions in paragraph 35.10 will reduce the amount of complex judgements and estimations otherwise required by an entity adopting the *IFRS for SMEs* Standard, for example, considerable:

- judgement would be required to determine the fair values at the date of acquisition of assets acquired and liabilities and contingent liabilities assumed in a business combination if these were not made at the time of the business combination (paragraph 35.10(a));
- judgement would be required to determine the appropriate valuation of share-based payment transactions retrospectively if valuations were not obtained in prior periods (paragraph 35.10(b)); or
- estimation may be required to measure the liability for decommissioning costs at the date the obligation arose if the option to measure the liability at the date of transition is not selected (paragraph 35.10(l)).

However, applying the exemptions in Section 35.10 does not eliminate the need to make estimates and judgements. For example, if an entity elects to measure an item of property, plant and equipment at its fair value at the date of transition to the *IFRS for SMEs* Standard it must make the estimates and judgements that are necessary to determine that fair value. The requirements in paragraphs 11.27–11.32 explain how fair value measurements are determined and the types of estimates and judgements required.

Impracticable to restate and/or disclose

The impracticability exemption option provided in paragraph 35.11 may exempt the entity from:

(a) applying retrospectively some of the adjustments required in paragraphs 35.7–35.9; and/or

(b) disclosing information required in paragraphs 35.12–35.15.

However, using this exemption is not a free choice and so an entity may need to apply judgement. An entity may use the exemption only when it is impracticable to follow the general requirements in Section 35.

Module 35 – Transition to the *IFRS for SMEs*

COMPARISON WITH FULL IFRS STANDARDS

When accounting for and reporting on first-time adoption of the *IFRS for SMEs* Standard (for periods beginning on 1 January 2017, the main differences between the requirements of full IFRS Standards (see IFRS 1 *First-time Adoption of International Financial Reporting Standards*) and the *IFRS for SMEs* Standard (see Section 35 *Transition to the* IFRS for SMEs) are:

- The IFRS for SMEs Standard is drafted in simpler language than that used in full IFRS Standards;
- The *IFRS for SMEs* Standard includes an 'impracticability' exemption (which is not in IFRS 1). Restatement for one or more adjustments is not required if impracticable. Similarly, any disclosures, including comparative disclosures, are not required if providing them is impracticable (see paragraph 35 11).
- The exceptions specified in paragraph 35.9(a)–35.9(c) and 35.9(e)–35.9(f) are similar to the exceptions in IFRS 1. However, there are differences in the detail, which will cause differences in practice.
- The exception in paragraph 35.9(d) regarding discontinued operations is absent from IFRS 1.
- For most of the exemptions in paragraph 35.10 there are similar exemptions under IFRS 1. However, there are some differences in the detail (in many cases IFRS 1 contains stricter requirements), which will cause differences in practice.
- Paragraph 35.10(h) allows a first-time adopter of the *IFRS for SMEs* Standard to apply Section 29 *Income Tax* from the date of transition to the *IFRS for SMEs* Standard. This exemption is not present in IFRS 1.
- There are a number of exemptions and exceptions in IFRS 1 that are not included in Section 35 because they are not relevant to the accounting requirements in the *IFRS for SMEs* Standard (eg exemptions relating to embedded derivatives, impairment of financial assets, insurance, employee benefits, assets and liabilities of subsidiaries, associates and joint ventures, and designation of previously recognised financial instruments).
- Section 35 does not require the statement of financial position at the date of transition to be presented in the financial statements in which an entity first adopts the *IFRS for SMEs* Standard whereas IFRS 1 requires the statement of financial position at the date of transition to IFRS Standards to be presented in the first IFRS financial statements.
- Section 35 requires a reconciliation of the previous year's profit or loss whereas IFRS 1 requires a reconciliation of total comprehensive income.
- Section 35 does not require a number of the other disclosures in IFRS 1, for example, in relation to the:
  - use of fair value as deemed cost (paragraph 30 of IFRS 1);
  - use of deemed cost for investments in subsidiaries, jointly controlled entities and associates (paragraph 31 of IFRS 1); or
  - use of deemed cost for oil and gas assets (paragraph 31A of IFRS 1).

Module 35 – Transition to the *IFRS for SMEs*

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for transition to the *IFRS for SMEs* applying the *IFRS for SMEs* Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out beneath it.

Mark the box next to the most correct statement.

Question 1

Which of the following entities is a first-time adopter of the *IFRS for SMEs* Standard in the current period?

☐ (a) An entity that has decided to use the *IFRS for SMEs* Standard with effect from some future date.

☐ (b) An entity that presents its first annual financial statements using the *IFRS for SMEs* Standard for the current period, except that the entity's accounting policy for research and development costs is to capitalise all costs as a separate intangible asset.

☐ (c) An entity that presents its first annual financial statements that conform to the *IFRS for SMEs* Standard for the current period, except that the entity does not make an explicit statement of compliance with the *IFRS for SMEs* Standard.

☐ (d) An entity that presents its first annual financial statements that conform to the *IFRS for SMEs* Standard for the current period. Its previous accounting framework was full IFRS Standards.

☐ (e) An entity that presents its first annual financial statements that conform to the *IFRS for SMEs* Standard for the current period. Its previous accounting framework was local GAAP.

☐ (f) Both (d) and (e).

Question 2

Which of the following entities is a first-time adopter of the *IFRS for SMEs* Standard in its 31 December 20X4 annual financial statements?

☐ (a) Entity A presented financial statements for the years ended 31 December 20X1 and 20X4 in compliance with the *IFRS for SMEs* Standard. For the years ended 31 December 20X2 and 20X3 Entity A prepared financial statements in compliance with full IFRS Standards only.

☐ (b) Entity B's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to local GAAP, which is consistent with the *IFRS for SMEs* Standard in all respects except in name. The entity made an explicit and unreserved statement of compliance with the local GAAP (not the *IFRS for SMEs* Standard). In previous years the entity applied full IFRS Standards.

☐ (c) Entity C's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to local GAAP, which is consistent with the *IFRS for SMEs* Standard in all respects except in name. The entity made an explicit and unreserved statement of compliance with both the local GAAP and the *IFRS for SMEs* Standard. In previous years the entity applied full IFRS Standards.

☐ (d) Entity D has not presented financial statements for previous years—it is not required to do so. In 20X4 the entity voluntarily adopted the *IFRS for SMEs* Standard and presented financial statements that conform to that Standard (including an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard).

☐ (e) Both entities C and D.

☐ (f) Both entities B and C.

☐ (g) Entities A, C and D.

☐ (h) Entities A, B and C.

Question 3

An entity's date of transition to the *IFRS for SMEs* Standard is:

☐ (a) The beginning of the latest period for which the entity presents full comparative information in accordance with the *IFRS for SMEs* Standard in its first financial statements that conform to the *IFRS for SMEs* Standard.

☐ (b) The beginning of the earliest period for which the entity presents partial comparative information in accordance with the *IFRS for SMEs* Standard in its first financial statements that conform to the *IFRS for SMEs* Standard.

☐ (c) The beginning of the earliest period for which the entity presents full comparative information in accordance with the *IFRS for SMEs* Standard in its first financial statements that conform to the *IFRS for SMEs* Standard.

☐ (d) The beginning of the earliest period for which the entity presents full comparative information in accordance with the *IFRS for SMEs* Standard in its latest financial statements that conform to the *IFRS for SMEs* Standard.

Question 4

An entity that had never presented financial statements decided to adopt the *IFRS for SMEs* Standard in 20X8. The entity's financial statements for the year ended 31 December 20X8 conformed to the *IFRS for SMEs* Standard (including an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard in the notes). Full comparative information in accordance with the *IFRS for SMEs* Standard is provided for one year.

What is the entity's date of transition to the *IFRS for SMEs* Standard?

- ☐ (a) 1 January 20X5.
- ☐ (b) 1 January 20X6.
- ☐ (c) 1 January 20X7.
- ☐ (d) 1 January 20X8.

Question 5

The facts are the same as in question 4 except that full comparative information in accordance with the *IFRS for SMEs* Standard is provided for two years.

What is the entity's date of transition to the *IFRS for SMEs* Standard?

- ☐ (a) 1 January 20X5.
- ☐ (b) 1 January 20X6.
- ☐ (c) 1 January 20X7.
- ☐ (d) 1 January 20X8.

Question 6

An entity acquired a machine on 1 January 20X1 for CU100,000. From 20X1 to 20X3, in accordance with its previous financial reporting framework, the entity depreciated the machine using the straight-line method over 10 years and with an estimated nil residual value. However, on 31 December 20X4, under its previous financial reporting framework, the entity revalued the machine to its fair value of CU90,000. Consequently, the entity measured the machine at CU75,000 (ie CU90,000 revaluation less CU15,000 accumulated depreciation) in its statement of financial position at 31 December 20X5.

In 20X6 the entity decided to adopt the *IFRS for SMEs* Standard. At 1 January 20X6, when the fair value of the machine is CU80,000 management estimated that, in accordance with the *IFRS for SMEs* Standard:

- the remaining useful life of the machine to be 5 years;
- the residual value of the machine to be zero; and
- the straight-line method of depreciation to be most appropriate.

The entity's first financial statements that will conform to the *IFRS for SMEs* Standard will be for the year ended 31 December 20X7. The entity chooses to apply the cost model in accordance with Section 17 *Property, Plant and Equipment* for all its plant and machinery. In its statement of financial position at 1 January 20X6 (its date of transition) the entity could measure the machine at:

☐ (a) CU50,000 (ie as if the machine had always been accounted for in accordance with Section 17 *Property, Plant and Equipment*—CU100,000 historical cost less CU50,000 accumulated depreciation).

☐ (b) CU75,000 (ie using the revaluation made in accordance with the previous financial reporting framework as deemed cost at the date of the revaluation—CU90,000 deemed cost less CU15,000 accumulated depreciation).

☐ (c) CU80,000 (ie fair value on the date of transition to the *IFRS for SMEs* Standard).

☐ (d) Any of (a) to (c) above.

Question 7

On 1 January 20X1 an entity acquired a business for CU100,000, when the fair value of the identifiable acquired assets was CU90,000 (the business acquired had no liabilities and no contingent liabilities). In accordance with the previous financial reporting framework, management accounted for the CU10,000 goodwill as an expense immediately (ie in the entity's consolidated statement of comprehensive income for the year ended 31 December 20X1). This is the only business combination that the entity entered into.

In 20X6 the entity decided to adopt the *IFRS for SMEs* Standard. Its first financial statements that will conform to the *IFRS for SMEs* Standard will be for the year ended 31 December 20X7.

If the entity had applied the *IFRS for SMEs* Standard at the time of the business combination (1 January 20X1) it would have allocated a useful life of 10 years to the goodwill. Assume that in accordance with the *IFRS for SMEs* Standard no impairment of that goodwill would have been required between 1 January 20X1 and 31 December 20X5.

In its consolidated statement of financial position at 1 January 20X6, the entity would measure the goodwill at:

☐ (a) CU5,000 (ie as if the goodwill had always been accounted for in accordance with Section 19 *Business Combinations and Goodwill*—CU10,000 historical cost less CU5,000 accumulated amortisation).

☐ (b) Nil (ie no restatement of the goodwill; goodwill expensed immediately in accordance with the previous financial reporting framework).

☐ (c) The estimated fair value of the goodwill on the date of transition to the *IFRS for SMEs* Standard.

☐ (d) Either (a) or (b) above.

☐ (e) Any of (a) to (c) above.

Question 8

The facts are the same as in question 7 except that there are two business combinations (the entity acquired businesses on 1 January 20X1 and on 1 January 20X4).

Management has decided that in preparing the entity's consolidated statement of financial position at 1 January 20X6 it will choose the exemption in paragraph 35.10 (ie not to apply Section 19 *Business Combinations and Goodwill* to the business acquired on 1 January 20X4).

Goodwill of CU5,000 arose on the acquisition of the second business (ie the business acquired on 1 January 20X4).

In its consolidated statement of financial position at 1 January 20X6, the entity must measure the goodwill for the first business combination (ie acquired on 1 January 20X1) at:

☐ (a) CU5,000 (ie as if the goodwill had always been accounted for in accordance with Section 19 *Business Combinations and Goodwill*—CU10,000 historical cost less CU5,000 accumulated amortisation).

☐ (b) Nil (ie no restatement of the goodwill; goodwill expensed immediately in accordance with the previous financial reporting framework).

☐ (c) The estimated fair value on the date of transition to the *IFRS for SMEs* Standard.

☐ (d) Either (a) or (b) above.

☐ (e) Any of (a) to (c) above.

Question 9

The facts are the same as in question 8. However, in this example, management has decided that in preparing the entity's consolidated statement of financial position at 1 January 20X6 it will not apply Section 19 *Business Combinations and Goodwill* to the accounting for the acquisition of the first business (ie the business acquired on 1 January 20X1).

In its consolidated statement of financial position at 1 January 20X6, the entity could measure the goodwill for business acquired on 1 January 20X4 at:

☐ (a) CU4,000 (ie as if the goodwill had always been accounted for in accordance with Section 19 *Business Combinations and Goodwill*—CU5,000 historical cost less CU1,000 accumulated amortisation).

☐ (b) Nil (ie no restatement of the goodwill; goodwill expensed immediately in accordance with the previous financial reporting framework).

☐ (c) The estimated fair value on the date of transition to the *IFRS for SMEs* Standard.

☐ (d) Either (a) or (b) above.

☐ (e) Any of (a) to (c) above.

Question 10

An entity concludes that it is impracticable to restate the statement of financial position at the date of transition to the *IFRS for SMEs* Standard for one or more of the adjustments required by paragraph 35.7. Which of the following statements is correct?

☐ (a) The entity must apply paragraphs 35.7–35.10 for such adjustments in the earliest period for which it is practicable to do so.

☐ (b) The entity must identify which amounts in the financial statements have not been restated to conform to the *IFRS for SMEs* Standard.

☐ (c) Both (a) and (b) are correct.

☐ (d) The entity cannot make an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard.

☐ (e) The entity is not considered a first-time adopter of the *IFRS for SMEs* Standard.

☐ (f) Both (d) and (e) are correct.

Question 11

An entity's first financial statements that conform to the *IFRS for SMEs* Standard are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (ie 20X3).

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP.

The entity is required to explain how the transition from the previous financial reporting framework to the *IFRS for SMEs* Standard affected its reported financial position, financial performance and cash flows. To comply with this requirement, an entity's first financial statements that conform to the *IFRS for SMEs* Standard must present a number of reconciliations.

Which one of the following four reconciliations is <u>not</u> required to be disclosed?

☐ (a) A reconciliation of its profit or loss in accordance with its previous financial reporting framework for 20X3 to its profit or loss in accordance with the *IFRS for SMEs* Standard for 20X3.

☐ (b) A reconciliation of its profit or loss in accordance with its previous financial reporting framework for 20X4 to its profit or loss in accordance with the *IFRS for SMEs* Standard for 20X4.

☐ (c) A reconciliation of its equity under its previous financial reporting framework to its equity in accordance with the *IFRS for SMEs* Standard at 1 January 20X3.

☐ (d) A reconciliation of its equity under its previous financial reporting framework to its equity in accordance with the *IFRS for SMEs* Standard at 31 December 20X3.

Module 35 – Transition to the *IFRS for SMEs*

Answers

Q1 (f) See the definition of a first-time adopter of the *IFRS for SMEs* Standard in the Glossary and paragraph 35.4.

Q2 (g) See the definition of a first-time adopter of the *IFRS for SMEs* Standard in the Glossary and paragraphs 35.2 and 35.4.

Q3 (c) See paragraph 35.6.

Q4 (c) See paragraph 35.6. If 31 December 20X8 is the reporting date and full comparative information is presented for one year (20X7), then the beginning of the earliest period for which the entity presents full comparative information is 1 January 20X7.

Q5 (b) See paragraph 35.6. If 31 December 20X8 is the reporting date and full comparative information is presented for two years (20X7 and 20X6), then the beginning of the earliest period for which the entity presents full comparative information is 1 January 20X6.

Q6 (d) For (a) see paragraphs 35.7 and 35.8. For (b) see paragraph 35.10(d). For (c) see paragraph 35.10(c).

Q7 (d) For (a) see paragraphs 35.7 and 35.8. For (b) see paragraph 35.10(a). Electing fair value as deemed cost is not available for goodwill (see 35.10(c)).

Q8 (b) See paragraph 35.10(a). As the entity has chosen not to apply Section 19 to the second business combination, it is not permitted to apply Section 19 to the first business combination. If the entity restates the business combination on 1 January 20X1 to comply with Section 19, it must also restate the business combination on 1 January 20X4.

Q9 (d) For (a) see paragraphs 35.7 and 35.8. For (b) see paragraph 35.10(a). For the second business combination the entity can choose (a) to follow the requirements of Section 19 or (b) to use the exemption in paragraph 35.10(a).

Q10 (c) See paragraph 35.11.

Q11 (b) See paragraph 35.13.

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for transition to the *IFRS for SMEs* applying the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those set out beneath

Case study 1

Entity Z started its operations on 1 January 20X0 and elected a reporting date of 31 December. The entity has been preparing its financial statements in accordance with its local income tax basis (the entity's previous financial reporting framework) since 1 January 20X0.

In accordance with its previous financial reporting framework, the entity used the last-in, first-out (LIFO) cost formula for measuring its inventories.

In 20X3 the management of the entity decided to adopt the *IFRS for SMEs* Standard and to use the first-in, first-out (FIFO) cost formula for measuring inventories. The financial statements for the year ended 31 December 20X3 are the entity's first annual financial statements that conform to the *IFRS for SMEs* Standard and they include an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard.

Entity Z provides full comparative information for only its most recent previous year in its annual financial statements (ie comparative information is provided only for the year ended 31 December 20X2).

The table below sets out information about the entity's inventories since it began trading:

Date	Units bought	Cost per unit CU	Cost CU	Units sold in the year	Cost of goods sold in the year (LIFO) CU	Inventories at 31 December CU
08/01/20X0	5,000	2	10,000			
23/04/20X0	2,000	2	4,000			
07/09/20X0	4,000	3	12,000			
31/12/20X0				10,800	**25,600**	**400**
21/01/20X1	2,000	3	6,000			
05/02/20X1	1,500	4	6,000			
02/10/20X1	1,000	5	5,000			
31/12/20X1				4,500	**17,000**	**400**
31/03/20X2	1,000	6	6,000			
07/05/20X2	500	7	3,500			
25/08/20X2	4,000	7	28,000			
31/12/20X2				5,200	**35,700**	**2200**
12/04/20X3	3,000	8	24,000			
24/08/20X3	2,700	9	24,300			
22/10/20X3	3,000	10	30,000			
31/12/20X3				9,100	**80,300**	**200**

Required:

Part A:

What is Entity Z's date of transition to the *IFRS for SMEs* Standard?

Part B:

Prepare the notes that Entity Z would present in its first financial statements that conform to the *IFRS for SMEs* Standard to explain how the transition from the previous financial reporting framework to the *IFRS for SMEs* Standard affected its reported financial position and financial performance.

Note: before preparing the disclosures, it is necessary first to determine the effects of adopting the *IFRS for SMEs* Standard for each of the scenarios, as follows.

The table below presents information about the entity's inventories as if the entity had always used the FIFO cost formula for measuring inventories.

Date	Units	Cost per unit CU	Cost CU	Unit sold in the year	Cost of goods sold in the year (FIFO) CU	Inventories at 31 December CU
08/01/20X0	5,000	2	10,000			
23/04/20X0	2,000	2	4,000			
07/09/20X0	4,000	3	12,000			
31/12/20X0				10,800	**25,400**	**600**
21/01/20X1	2,000	3	6,000			
05/02/20X1	1,500	4	6,000			
02/10/20X1	1,000	5	5,000			
31/12/20X1				4,500	**16,600**	**1,000**
31/03/20X2	1,000	6	6,000			
07/05/20X2	500	7	3,500			
25/08/20X2	4,000	7	28,000			
31/12/20X2				5,200	**35,000**	**3,500**
12/04/20X3	3,000	8	24,000			
24/08/20X3	2,700	9	24,300			
22/10/20X3	3,000	10	30,000			
31/12/20X3				9,100	**80,800**	**1,000**

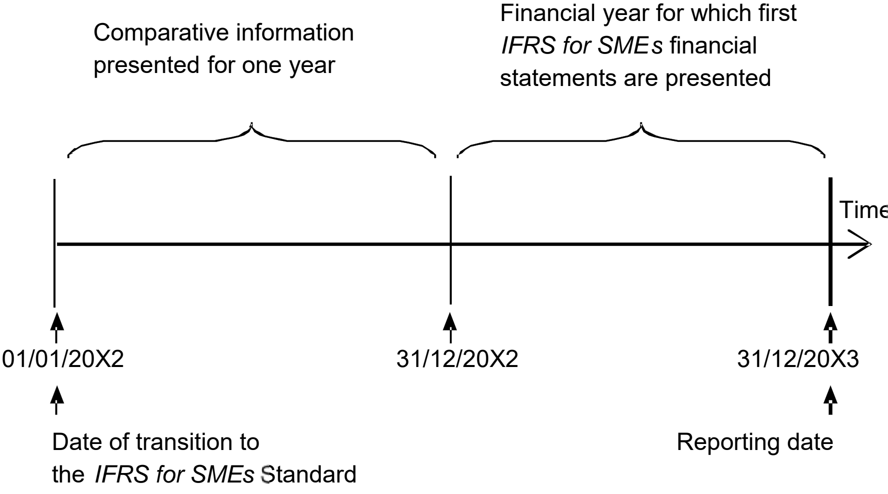
Reconciliation:

	Cost of goods sold in the year				Inventories at 31 December			
	20X0 CU	20X1 CU	20X2 CU	20X3 CU	20X0 CU	20X1 CU	20X2 CU	20X3 CU
Total FIFO	25,400	16,600	35,000	80,800	600	1,000	3,500	1,000
Total LIFO	25,600	17,000	35,700	80,300	400	400	2,200	200
Difference	**(200)**	**(400)**	**(700)**	**500**	**200**	**600**	**1,300**	**800**

Answer to case study 1—Part A

The date of transition to the *IFRS for SMEs* Standard is 1 January 20X2. This is the beginning of the comparative period (ie period ended 31 December 20X2). This considers that

- the financial statements for the year ended 31 December 20X3 are the first set of financial statements presented by Entity Z that conform to the *IFRS for SMEs* Standard;
- the 20X3 financial statements are the first set of financial statements that contain an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard; and
- Entity Z presents comparative information in respect of the most recent previous comparable period only (ie 20X2).



Answer to case study 1—Part B

Entity Z should disclose:

Extract from the notes to the financial statements for the year ended 31 December 20X3

Note 3 Transition to the *IFRS for SMEs* Standard

The transition to the *IFRS for SMEs* Standard has resulted in a number of changes in the reported financial statements, notes thereto and accounting principles compared to what has been presented in prior year financial statements.

Before the adoption of the *IFRS for SMEs* Standard, Entity Z's financial statements were based on jurisdiction X's tax law (previous financial reporting framework). The following reconciliations and notes describe how the differences between the *IFRS for SMEs* Standard and the previous financial reporting framework have affected Entity Z's financial position at 1 January 20X2 and 31 December 20X2 and profit or loss for the reporting period ended 31 December 20X2.

Reconciliation of equity at 1 January 20X2 and 31 December 20X2

		1 January 20X2			*31 December 20X2*		
Note		*Previous financial reporting framework* *CU*	*Difference* *CU*	*IFRS for SMEs Standard* *CU*	*Previous financial reporting framework* *CU*	*Difference* *CU*	*IFRS for SMEs Standard* *CU*
	...						
3.8	Inventories	400	600	1,000	2,200	1,300	3,500
	...						

Reconciliation of profit or loss for the year ended 31 December 20X2

Note		*Previous financial reporting framework* *CU*	*Difference* *CU*	*IFRS for SMEs Standard* *CU*
	...			
3.8	Cost of sales	35,700	(700)	35,000
	Gross profit			
	...			

3.8 Inventory

Changes in inventory, and consequently the cost of sales, arise from the remeasurement of inventories from the last-in, first-out (LIFO) cost formula applying the previous financial reporting framework to the first-in, first-out (FIFO) cost formula applying the *IFRS for SMEs* Standard.

Case study 2

Entity Y started its operations on 1 January 20X0 and elected a reporting date of 31 December. The entity has been preparing its financial statements in accordance with local GAAP (YGAAP) since 1 January 20X0.

In 20X4 the entity's management decided to adopt the *IFRS for SMEs* Standard from the following year. The financial statements for the year ended 31 December 20X5 are the first set of financial statements presented by Entity Y that comply with the *IFRS for SMEs* Standard, including an explicit and unreserved statement of compliance with the *IFRS for SMEs* Standard. Those financial statements include only one year of comparative information (ie the year 20X4). The entity's date of transition to the *IFRS for SMEs* Standard is 1 January 20X4.

In accordance with YGAAP, Entity Y adopted some accounting policies that differ from the accounting policies required or allowed by the *IFRS for SMEs* Standard. The following is the list of the effects of those material differences.

(a) Depreciation of the entity's sales office in accordance with YGAAP was calculated without reference to its residual value, and as a consequence, at 1 January 20X4 the carrying amount of property, plant and equipment was CU80 lower than it would have been if the entity had applied the *IFRS for SMEs* Standard. Profit for 20X4 was CU20 lower than if the *IFRS for SMEs* Standard was used.

(b) Intangible assets, in accordance with YGAAP at 1 January 20X4, included CU150 for items that in accordance with the *IFRS for SMEs* Standard would have been recognised in goodwill because they do not qualify for recognition as separate intangible assets. The entity has chosen not to apply the exemption in paragraph 35.10(a) which would permit it not to apply Section 19 to the earlier business combination that gave rise to the intangible assets. There is no effect on profit for 20X4 because the estimated useful life of the intangible assets applying YGAAP was the same as that for the goodwill applying the *IFRS for SMEs* Standard.

(c) Financial assets that Sections 11 *Basic Financial Instruments* and 12 *Other Financial Instrument Issues* require to be accounted for at fair value through profit or loss were, in accordance with YGAAP, carried at cost. As a consequence, at 1 January 20X4 the carrying amount is CU420 lower than if the *IFRS for SMEs* Standard had been used. In 20X4 the increase in fair value of such financial assets was CU180.

(d) Because fixed and variable production overheads are excluded from the cost of inventory in accordance with YGAAP, the carrying amount of inventories at 1 January 20X4 is CU400 lower than if the *IFRS for SMEs* Standard had been used. For the same reason, the cost of sales for 20X4 is CU47 lower than if the *IFRS for SMEs* Standard had been used.

(e) A hedge relationship, which qualifies for hedge accounting under paragraph 12.16, that hedges the foreign exchange risk of a particular forecast sale (ie forward foreign exchange contract) exists at the date of transition. In accordance with YGAAP, the hedging instrument was carried at cost (nil). Consequently, the CU431 of unrealised foreign exchange gains on the hedging instrument was not recorded in equity. The sale was made during 20X4 and the fair value of such financial assets decreased by CU40 between the start of 20X4 and the date of the sale.

(f) In accordance with YGAAP, the cash basis was used to account for a particular pension liability. Consequently, at 1 January 20X4 an employee benefit liability of CU66 is omitted from the entity's statement of financial position and its profit for the year 20X4 is CU130 higher (ie cost of sales lower by CU50, distribution costs lower by CU30 and administrative expenses lower by CU50) than if it had used the *IFRS for SMEs* Standard.

(g) At 1 January 20X4, a restructuring provision of CU250 relating to head office activities was recognised in accordance with YGAAP, but does not qualify for recognition as a liability in accordance with the *IFRS for SMEs* Standard. In 20X4 (after the date of transition to the *IFRS for SMEs* Standard) the CU250 restructuring provision qualified for recognition in accordance with the *IFRS for SMEs* Standard. The appropriate line in the income statement for this expense is administrative expenses.

The following information was extracted from the statement of financial position of Entity Y as at 31 December 20X3 (ie at 1 January 20X4, the date of transition to the *IFRS for SMEs* Standard):

	YGAAP CU	YGAAP CU
Property, plant and equipment	8,299	
Goodwill	1,220	
Intangible assets	208	
Financial assets	3,471	
Total non-current assets		13,198
Trade and other receivables	3,710	
Inventories	2,962	
Other receivables	333	
Cash and cash equivalents	748	
Total current assets		7,753
Total assets		20,951
Interest-bearing loans	9,396	
Trade and other payables	4,124	
Restructuring provision	250	
Other liabilities	621	
Total liabilities		14,391
Total assets less total liabilities		6,560

	YGAAP CU	YGAAP CU
Issued capital	1,500	
Retained earnings	5,060	
Total equity		6,560

The following information was extracted from the statement of financial performance of Entity Y for the year ended 31 December 20X4:

	YGAAP CU
Revenue	20,910
Cost of sales	(15,283)
Gross profit	**5,627**
Distribution costs	(1,907)
Administrative expenses	(2,842)
Finance income	1,446
Finance costs	(1,902)
Profit for the year	**422**
Loss on translating foreign operation	(158)
Total comprehensive income for the year	**264**

Required:

Part A: prepare the reconciliations of Entity Y's equity determined in accordance with its previous financial reporting framework (YGAAP) and its equity determined in accordance with the *IFRS for SMEs* Standard at the date of transition to the *IFRS for SMEs* Standard.

Note: a similar reconciliation of equity at the end of the latest period presented in Entity Y's most recent annual financial statements that were determined in accordance with its previous financial reporting framework would also be required by paragraph 35.13(b)(ii), ie at 31 December 20X4 in this example.

Note: in this case study, for simplicity, income tax has been ignored.

Part B: prepare the reconciliation of Entity Y's profit determined in accordance with its previous financial reporting framework (YGAAP) for the latest period presented in Entity Y's most recent annual financial statements to its profit determined in accordance with the *IFRS for SMEs* Standard for the same period (ie for the year ended 31 December 20X4).

Note: in this case study, for simplicity, income tax has been ignored.

Answer to case study 2—Part A

The following is the reconciliation of equity at 1 January 20X4 (date of transition to the *IFRS for SMEs* Standard):

Reconciliation of equity at 1 January 20X4 (date of transition to the *IFRS for SMEs* Standard)

Note		*YGAAP*	*Effect of transition to the IFRS for SMEs Standard*	*IFRS for SMEs Standard*
		CU	CU	CU
1	Property, plant and equipment	8,299	80	8,379
2	Goodwill	1,220	150	1,370
2	Intangible assets	208	(150)	58
3	Financial assets	3,471	420	3,891
	Total non-current assets	13,198	500	13,698
	Trade and other receivables	3,710	–	3,710
4	Inventories	2,962	400	3,362
5	Other receivables	333	431	764
	Cash and cash equivalents	748	–	748
	Total current assets	7,753	831	8,584
	Total assets	**20,951**	**1,331**	**22,282**
	Interest-bearing loans	9,396	–	9,396
	Trade and other payables	4,124	–	4,124
6	Employee benefits	–	66	66
7	Restructuring provision	250	(250)	–
	Other liabilities	621	–	621
	Total liabilities	**14,391**	**(184)**	**14,207**
	Total assets less total liabilities	**6,560**	**1,515**	**8,075**
	Issued capital	1,500	–	1,500
5	Hedging reserve	–	431	431
9	Retained earnings	5,060	1,084	6,144
	Total equity	**6,560**	**1,515**	**8,075**

Notes to the reconciliation of equity at 1 January 20X4:

1. Depreciation in accordance with YGAAP ignored an asset's residual value, but in accordance with the *IFRS for SMEs* Standard an asset's depreciable amount is net of its residual value. The cumulative adjustment increased the carrying amount of property, plant and equipment by CU80.

2. Intangible assets in accordance with YGAAP included CU150 for items that are transferred to goodwill because they do not qualify for recognition as intangible assets in accordance with the *IFRS for SMEs* Standard.

3 Particular financial assets are, in accordance with the *IFRS for SMEs* Standard, measured at fair value with changes in fair value recognised in profit or loss. In accordance with YGAAP those financial assets were measured at cost. As a consequence, at 1 January 20X4 the carrying amount is CU420 lower than if the *IFRS for SMEs* Standard had been used.

4 Inventories include fixed and variable production overhead of CU400 in accordance with the *IFRS for SMEs* Standard, but this overhead was excluded in accordance with YGAAP.

5 Unrealised gains of CU431 on forward foreign exchange contracts are recognised in accordance with the *IFRS for SMEs* Standard, but were not recognised in accordance with YGAAP. The resulting gains of CU431 are included in the hedging reserve because the contracts hedge forecast sales.

6 A pension liability of CU66 is recognised in accordance with the *IFRS for SMEs* Standard, but was not recognised in accordance with YGAAP, which used a cash basis.

7 A restructuring provision of CU250 relating to head office activities was recognised in accordance with YGAAP, but does not qualify for recognition as a liability in accordance with the *IFRS for SMEs* Standard.

9 The adjustments to retained earnings are as follows:

	CU
Depreciation (note 1)	80
Financial assets (note 3)	420
Production overhead (note 4)	400
Pension liability (note 6)	(66)
Restructuring provision (note 7)	250
Total adjustment to retained earnings	1,084

Answer to case study 2—Part B

The following is the reconciliation of profit for 20X4:

Reconciliation of profit for 20X4

Note		*YGAAP*	*Effect of transition to the IFRS for SMEs Standard*		*IFRS for SMEs Standard*
		CU	CU		*CU*
1	Revenue	20,910	391		21,301
2, 3	Cost of sales	(15,283)	(97)	(a)	(15,380)
	Gross profit	5,627	294		5,921
2, 4	Distribution costs	(1,907)	(10)	(b)	(1,917)
2, 5	Administrative expenses	(2,842)	(300)	(c)	(3,142)
6	Other income	–	180		180
	Finance income	1,446	–		1,446
	Finance costs	(1,902)	–		(1,902)
	Profit for the year	**422**	**164**		**586**

Notes to the reconciliation of profit for 20X4:

1 The fair value of forward foreign exchange contracts that are effective hedges of forecast transactions decreased by CU40 during 20X4. Applying the *IFRS for SMEs* Standard, this amount is recognised in other comprehensive income. The hedging gain recognised in other comprehensive income at the time of the sale (CU391) is reclassified to profit or loss in accordance with Section 12 of the *IFRS for SMEs* Standard.

2 A pension liability is recognised in accordance with the *IFRS for SMEs* Standard, but was not recognised in accordance with YGAAP. The pension liability increased by CU130 during 20X4, which caused increases in cost of sales (CU50), distribution costs (CU30) and administrative expenses (CU50).

3 Cost of sales is higher by CU47 in accordance with the *IFRS for SMEs* Standard because inventories include fixed and variable production overheads in accordance with the *IFRS for SMEs* Standard but not in accordance with YGAAP.

4 Depreciation of property, plant and equipment decreased by CU20 during 20X4 because, unlike YGAAP, depreciation of a building in accordance with the *IFRS for SMEs* Standard takes account of the building's residual value.

5 A restructuring provision of CU250 was recognised in accordance with YGAAP at 1 January 20X4, but did not qualify for recognition in accordance with the *IFRS for SMEs* Standard until the year ended 31 December 20X4. This increases administrative expenses for 20X4 in accordance with the *IFRS for SMEs* Standard.

6 Financial assets at fair value through profit or loss increased in value by CU180 during 20X4. They were carried at cost in accordance with YGAAP. Fair value changes have been included in 'Other income'.

The calculations and explanatory notes below do not form part of the answer to this case study:

(a) CU97 = CU50 pension liability increase (see note 2) + CU47 production overhead (see note 3).

(b) CU10 = CU30 pension expense increase (see note 2) less CU20 depreciation decrease (see note 4).

(c) CU300 = CU50 pension liability increase (see note 2) + CU250 restructuring provision (see note 5).