2009

IFRS Foundation: Training Material for the *IFRS® for SMEs*

Module 35 – Transition to the *IFRS for SMEs*

IFRS™

IFRS Foundation: Training Material for the *IFRS*® *for SMEs*

including the full text of
Section 35 *Transition to the IFRS for SMEs*
of the International Financial Reporting Standard (IFRS)
for Small and Medium-sized Entities (SMEs)
issued by the International Accounting Standards Board on 9 July 2009

with extensive explanations, self-assessment questions and case studies

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Contents

INTRODUCTION 1
Learning objectives 1
IFRS for SMEs 2
Introduction to the requirements 2

REQUIREMENTS AND EXAMPLES 4
Scope of this Section 4
First-time adoption 5
Procedures for preparing financial statements at the date of transition 12
Disclosures 48

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS 57
The application of the *IFRS for SMEs* 57
Exemptions 57
Impracticable to restate and/or disclose 58

COMPARISON WITH FULL IFRSs 59

TEST YOUR KNOWLEDGE 60

APPLY YOUR KNOWLEDGE 67
Case study 1 67
Answer to case study 1 69
Case study 2 71
Answer to case study 2 74

Module 35—Transition to the *IFRS for SMEs*

This training material has been prepared by IFRS Foundation education staff and has not been approved by the International Accounting Standards Board (IASB). The accounting requirements applicable to small and medium-sized entities (SMEs) are set out in the *International Financial Reporting Standard (IFRS) for SMEs*, which was issued by the IASB in July 2009.

INTRODUCTION

This module focuses on the accounting procedures that a first-time adopter of the *IFRS for SMEs* follows as specified in Section 35 *Transition to the IFRS for SMEs* of the *IFRS for SMEs*. It introduces the learner to the subject, guides the learner through the official text, develops the learner's understanding of the requirements through the use of examples and indicates significant judgements that are required in accounting for the transition to the *IFRS for SMEs*. Furthermore, the module includes questions designed to test the learner's knowledge of the requirements and case studies to develop the learner's ability to account for the first-time adoption of the *IFRS for SMEs* and to make the disclosures required in an entity's first financial statements that conform to that IFRS.

Learning objectives

Upon successful completion of this module you should know the financial reporting requirements for a first-time adopter of the *IFRS for SMEs*. Furthermore, through the completion of case studies that simulate aspects of the real-world application of that knowledge, you should have enhanced your competence to account for the transition to the *IFRS for SMEs*. In particular you should, in the context of the *IFRS for SMEs*, be able:

- to distinguish when an entity is a first-time adopter of the *IFRS for SMEs*;
- to identify the date of transition to the *IFRS for SMEs;*
- to 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;*
- to prepare an opening statement of financial position;
- to demonstrate an understanding of the mandatory exceptions and optional exemptions to retrospective application of the *IFRS for SME* on first time adoption provided within Section 35;
- to provide the disclosures required for a first-time adopter of the *IFRS for SMEs*; and
- to demonstrate an understanding of significant judgements that are required in accounting for the transition to the *IFRS for SMEs*.

Module 35 – Transition to the *IFRS for SMEs*

IFRS for SMEs

The *IFRS for SMEs* 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* includes mandatory requirements and other material (non-mandatory) that is published with it.

The material that is not mandatory includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* and explains its purpose, structure and authority.
- implementation guidance, which includes illustrative financial statements and a disclosure checklist.
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching its conclusions in the *IFRS for SMEs*.
- the dissenting opinion of an IASB member who did not agree with the publication of the *IFRS for SMEs*.

In the *IFRS for SMEs* the Glossary is part of the mandatory requirements.

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

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. The objective of Section 35 is to provide a suitable starting point for accounting in accordance with the *IFRS for SMEs*, and also to ensure that the financial statements 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. Consequently, Section 35 prescribes the accounting treatment and disclosure requirements for a first-time adopter of the *IFRS for SMEs*.

An entity can be a first-time adopter of the *IFRS for SMEs* only once.

An entity's first financial statements that comply with the *IFRS for SMEs* are prepared using the requirements in the version of the *IFRS for SMEs* that is effective at the entity's initial reporting date, as modified by any specified exemptions (see paragraphs 35.9–35.11).

An entity's first financial statements prepared in accordance with the *IFRS for SMEs* must include an explicit and unreserved statement of compliance with the *IFRS for SMEs*, 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* affected its reported financial position, financial performance and cash flows.

Section 35 specifies requirements for preparing an entity's opening statement of financial position as of its date of transition to the *IFRS for SMEs* that it prepares as a starting point for its accounting under this IFRS. The date of transition to the *IFRS for SMEs* is the beginning of the earliest period for which full comparative information in accordance with this IFRS is

presented. For example, if an entity's first annual financial statements that comply with the *IFRS for SMEs* 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 *IFRS for SMEs* . 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* 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 at 1 January 20X3) are recognised directly in the retained earnings (or, if appropriate, in another category of equity) at the date of transition to the *IFRS for SMEs* (see paragraph 35.8).

Module 35 – Transition to the *IFRS for SMEs*

REQUIREMENTS AND EXAMPLES

The contents of Section 35 *Transition to the IFRS for SMEs* of the *IFRS for SMEs* are set out below and shaded grey. Terms defined in the Glossary of the *IFRS for SMEs* are also part of the requirements. They are in **bold type** the first time they appear in the text of Section 35. The notes and examples inserted by the IFRS Foundation education staff are not shaded. Other annotations inserted by the IFRS Foundation staff are presented within square brackets in ***bold italics***. The insertions made by the staff do not form part of the *IFRS for SMEs* and have not been approved by the IASB.

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 IFRSs** 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

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

Paragraph 35.4 requires that the first-time adopter of the *IFRS for SMEs* must make an explicit and unreserved statement of compliance in its first annual complete set of financial statements that conform to the *IFRS for SMEs*. To assert compliance, an entity must comply with all the requirements of the *IFRS for SMEs*. An entity cannot pick and choose among the requirements of the *IFRS for SMEs* and those of full IFRSs

Applying Section 35 involves four main steps:

(1) Determine whether the entity is a first-time adopter of the *IFRS for SMEs*.
(2) Determine the date of transition to the *IFRS for SMEs*.
(3) Prepare the opening statement of financial position at its date of transition to the *IFRS for SMEs*.
(4) Prepare financial statements that comply with the *IFRS for SMEs*, including the required disclosures to explain the effect of the transition from the previous financial reporting framework to the *IFRS for SMEs*.

35.2 An entity can be a first-time adopter of the *IFRS for SMEs* only once. If an entity using the *IFRS for SMEs* stops using it for one or more **reporting periods** and then is required, or chooses, to adopt it again later, the special exemptions, simplifications and other requirements in this section do not apply to the re-adoption.

Notes

An entity that resumes using the *IFRS for SMEs* must comply with all the requirements of the *IFRS for SMEs* as if it had never stopped using the IFRS. Consequently, the entity restates the comparative information presented from the date it stopped applying the *IFRS for SMEs*, ie it retrospectively applies the *IFRS for SMEs* back to the date on which it first adopted the IFRS.

Example—an entity can be a first-time adopter only once

Ex 1 **An entity meets the conditions to be a first time adopter in 20X0. In 20X0 and 20X1the entity issued two complete sets of financial statements—one conforming to the *IFRS for SMEs* and the other conforming to local GAAP. In 20X2 and 20X3 the entity issued financial statements only in accordance with local GAAP. In 20X4 the entity prepares financial statements only in accordance with the *IFRS for SMEs*.**

An entity can be a first-time adopter of the *IFRS for SMEs* only once. Section 35 was applied in the entity's 20X0 financial statements. Consequently, Section 35 cannot be applied again when preparing the entity's 20X4 financial statements.

In 20X4, the entity would restate the 20X3 amounts to what they would have been had the entity never ceased using the *IFRS for SMEs*.

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 IFRS.

Notes

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

35.4 An entity's first financial statements that conform to this IFRS 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* ***[Refer: paragraph 3.3]***. Financial statements prepared in accordance with this IFRS 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 IFRS in all respects; or

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

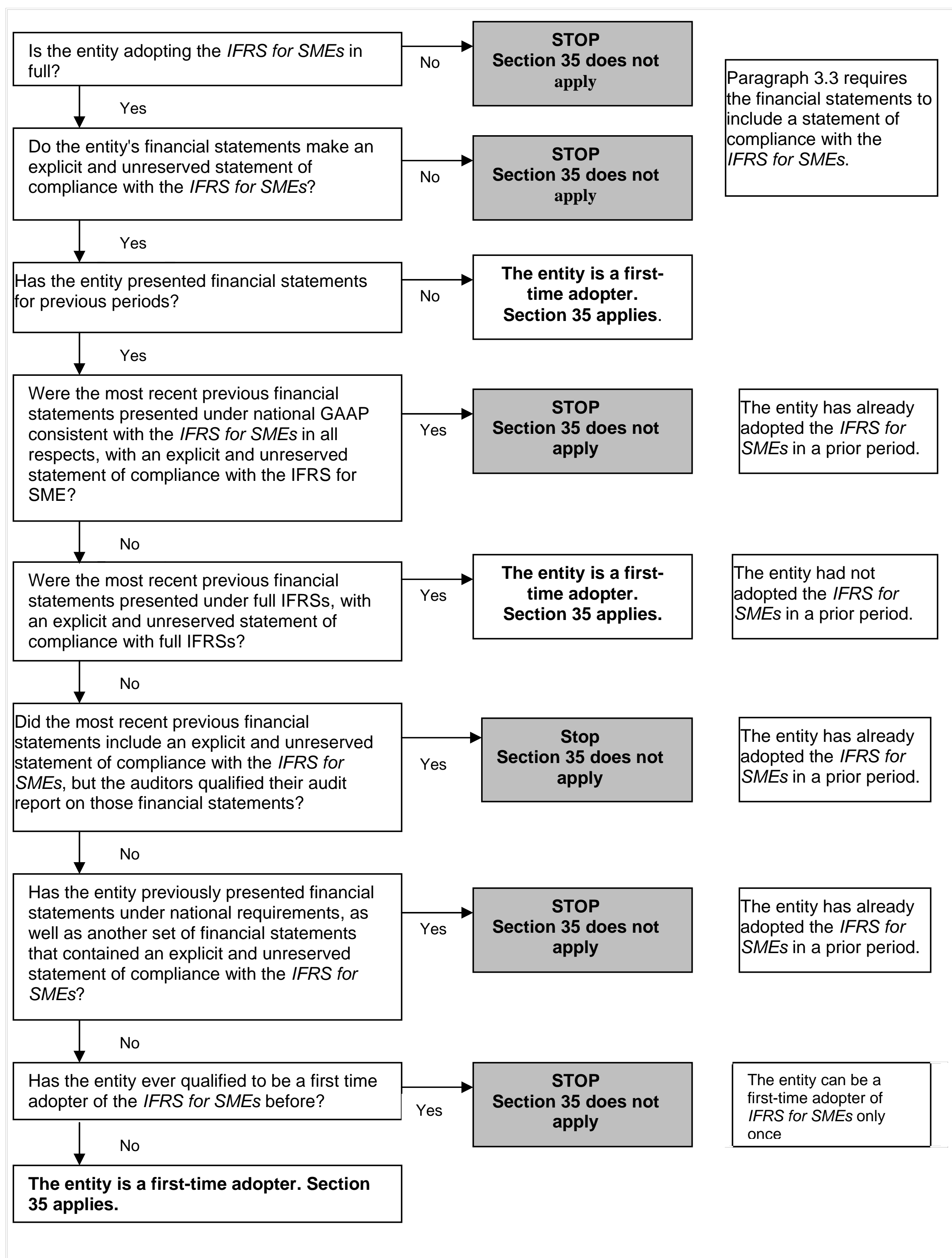
Notes

An entity cannot assert compliance with the *IFRS for SMEs* unless it complies with all the requirements of this IFRS.

Determining whether an entity is a first-time adopter of the *IFRS for SMEs* 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 on the next page illustrates the decision process to make such judgement.

Module 35 – Transition to the *IFRS for SMEs*

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



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

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* except that those proforma financial statements included neither comparative figures nor a statement of compliance with the *IFRS for SMEs*.**

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

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*. In 20X4 the entity is considered to be a first-time adopter of the *IFRS for SMEs*. 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* in the notes to its financial statements for the year ended 31 December 20X4, as in the following example:

2. Basis of preparation

These consolidated financial statements have been prepared in compliance with the *International Financial Reporting Standard (IFRS®) for Small and Medium-sized Entities (SMEs)* 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.*

Ex 3 **A jurisdiction's local SME standard has some differences from the *IFRS for SMEs* (for example a few recognition and measurement requirements are materially different). SMEs in that jurisdiction are required to use the local SME standard. An SME'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 with the *IFRS for SMEs* except for particular requirements.**

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

Ex 4 **A jurisdiction's local SME standard has some differences from the *IFRS for SMEs*. SMEs in that jurisdiction are required to follow the local SME standard. An SME'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* and include an explicit and unreserved statement of compliance with both the *IFRS for SMEs* and the local SME standard.**

The financial statements prepared for the year ended 31 December 20X4 conform to all of the requirements in the *IFRS for SMEs*. Consequently, the entity is a first-time adopter of the *IFRS for SMEs* in its 31 December 20X4 financial statements.

Notes: the circumstances described in this example could occur when;

- differences between the *IFRS for SMEs* and the local SME standard relate only to disclosure requirements and the entity complies with all of the disclosure requirements of both standards.
- differences between the *IFRS for SMEs* and the local SME standard relate only to recognition and measurement requirements that are specific to transactions not addressed by the SMEs or that are not material to the SME.

Ex 5 **Ever since it was incorporated an entity has presented its financial statements in accordance with local GAAP. On 1 January 20X3 (its date of transition to the *IFRS for SMEs*) the entity published its opening statement of financial position as at 1 January 20X3.**

The opening statement of financial position is not the entity's first financial statements that conform to the *IFRS for SMEs*.

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

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

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*. In 20X4 the entity is a first-time adopter of the *IFRS for SMEs*. The entity includes in the notes to its financial statements for the year ended 31 December 20X4 the disclosure specified in example 2.

35.5 Paragraph 3.17 of this IFRS defines a complete set of financial statements.

Notes

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).

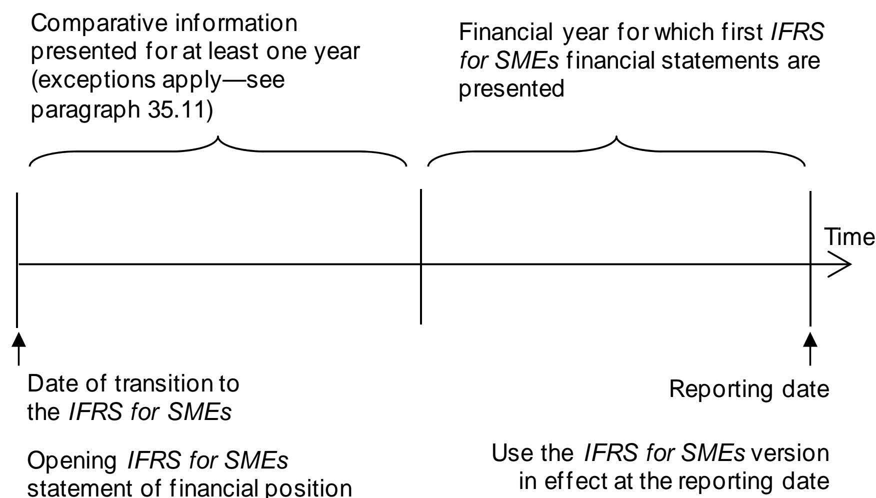
In addition, paragraph 3.14 requires an entity to present comparative information in respect of the previous comparable period.

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. Therefore, 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 IFRS in its first financial statements that conform to this IFRS.

Notes

The opening statement of financial position is prepared at the date of transition to the *IFRS for SMEs* (see paragraphs 35.7–35.11).

Figure 2: Illustration of the difference between the date of transition to the *IFRS for SMEs* and the reporting date.



Paragraph 2.2 of *the IFRS for SMEs* states that the objective of financial statements is to provide information about the financial position, performance and cash flows of the entity that is useful to a users in making economic decisions (see paragraph P7). Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. They include relevance, reliability (eg free from material error and bias and provide a faithful representation) and comparability.

Comparability of financial information can be:

(a) within an entity's financial statements over time; or

(b) between different entities at the same time.

In the context of first-time adoption of the *IFRS for SMEs*, comparisons are useful between:

(a) the financial position and performance of the entity under its previous financial reporting framework and its financial position and performance under the *IFRS for SMEs*.
(b) the financial position and performance of the entity under the *IFRS for SMEs* in the period between the date of transition to the *IFRS for SMEs* and the reporting date of the first complete set of financial statements that conforms with the *IFRS for SMEs* (ie between the reporting date and comparative periods for which information is provided).
(c) different entities adopting the *IFRS for SMEs* for the first time at a particular time.
(d) first-time adopters of the *IFRS for SMEs* and entities that already apply the *IFRS for SMEs*.

Paragraph 35.12 requires an explanation of the changes in the entity's financial information from the previous financial reporting framework to the *IFRS for SMEs* ((a) above). Section 35 reflects the IASB's decision that it is important to achieve comparability over time within a first-time adopter's first complete set of financial statements that conforms with the *IFRS for SMEs* ((b) above) and between different entities adopting the *IFRS for SMEs* for the first time at a given date ((c) above). Achieving comparability between first-time adopters of the *IFRS for SMEs* and entities that already apply the *IFRS for SMEs* ((d) above) is a secondary objective.

The transition from a previous financial reporting framework to the *IFRS for SMEs* is likely to require changes in accounting policies. To enhance the comparability of financial information, retrospective application is generally required for all changes in accounting policies. Because retrospective restatement might be impracticable or would not be cost-beneficial, there are specified cases in which it is not required (see paragraphs 35.10 and 35.11). In other cases retrospective application would require judgements by management about past conditions when the outcome of the particular transaction or event is already known. In such cases, retrospective application is prohibited to prevent abuse (see paragraph 35.9).

In accordance with paragraph 3.14, except when this IFRS permits or requires otherwise, an entity is required to present and disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements, including the notes. An entity therefore includes comparative information for all amounts that have been adjusted as required in Section 35. Comparative narrative information is disclosed only when it is relevant to an understanding of the current period's financial statements.

Examples—date of transition to the *IFRS for SMEs*

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

The *IFRS for SMEs* requires comparative information be presented in compliance with the *IFRS for SMEs* for at least one year (see paragraph 3.14). 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*. 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*.

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

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

Note: to comply with the *IFRS for SMEs* the entity must present and disclose comparative information for at least one year, even though local law does not require it.

Ex 8 **The facts are the same as example 7. However, in this example local law requires entities to present comparative information for at least 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*. Those financial statements include comparative information for both 20X2 and 20X3 and an explicit statement of compliance with the *IFRS for SMEs*.

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

Ex 9 **An entity that was incorporated on 1 January 20X4 prepared its financial statements for the year ended 31 December 20X4 in accordance with the *IFRS for SMEs*.**

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*. Those financial statements cannot include comparative information because it came into existence only in the current year. The entity would disclose that fact and the absence of comparative information would not prevent the entity from complying with the *IFRS for SMEs* (see paragraph 35.15). In this example the date of transition is 1 January 20X4.

Note: on the other hand, if the entity was in existence in 20X3 but did not prepare any financial statements (perhaps only a tax return), it must disclose the comparative information required by the *IFRS for SMEs*, unless that would be impracticable.

Procedures for preparing financial statements at the date of transition

35.7 Except as provided in paragraphs 35.9–35.11, an entity shall, in its opening statement of financial position as of 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*;

Notes

The general principle underlying subparagraphs 35.7(a) to (d) is that a first-time adopter should apply retrospectively all the Sections of the version of *IFRS for SMEs* that are effective at the end of its first *IFRS for SMEs* reporting period. Consequently, the first *IFRS for SMEs* financial statements are presented as if the entity had always applied the *IFRS for SMEs*. Paragraphs 35.9–35.11 provide exceptions to the general principle.

Examples—recognise all assets and liabilities (paragraph 35.7(a))

Ex 10 **An entity's first financial statements that conform to the *IFRS for SMEs* 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. In compliance with that financial reporting framework, the entity recognised goodwill that arose from a business combination that occurred in 20X0 as 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 its balances determined in accordance with its previous financial reporting framework to arrive at its opening statement of financial position at 1 January 20X3 by recognising the goodwill as an asset on 1 January 20X3 (the date of transition to the *IFRS for SMEs*). This adjustment is recognised directly in retained earnings (see paragraph 35.8).[1]

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 using local GAAP 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 29, 30 and 31 for exemptions from this requirement.

Ex 11 **An entity's first financial statements that conform to the *IFRS for SMEs* are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (ie 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*, the lease agreement would have been classified as a financial 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[2] 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

(1) For simplicity, in this example, and in all other examples in this module, the effect of income tax has been ignored.
(2) In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

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 equally monthly payments the entity did not recognise an asset or liability in its statement of financial position.

In its opening statement of financial position at 1 January 20X3 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 12 **An entity's first financial statements that conform to the *IFRS for SMEs* are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (ie 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.

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 transfer economic benefits in settlement and 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 in 20X4.

If the constructive obligation arose in 20X3 and is not settled by 31 December 20X3, the entity recognises a liability at 31 December 20X3 and an expense in 20X3. In accordance with paragraph 21.11 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 an adjustment to equity directly in retained earnings at 1 January 20X3 (see paragraph 35.8). 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 (ie in 20X3 and 20X4 respectively).

In accordance with paragraph 35.7 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 on the reporting date (ie on 1 January 20X3 for the opening statement of financial position, on 31 December 20X3 for the comparative figures and on 31 December 20X4 for the statement of financial position at that 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, 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 liability was originally estimated under the entity's previous accounting framework (see paragraph 35.9(c) and supporting notes below).

Note: upon adopting the *IFRS for SMEs*, 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.

[Paragraph 35.7 continued—Except as provided in paragraphs 35.9–35.11, an entity shall, in its opening statement of financial position as of its date of transition to the IFRS for SMEs *(ie the beginning of the earliest period presented):]*

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

Examples—not recognise items as assets or liabilities (paragraph 35.7(b))

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*. Those financial statements include comparative information for only one year (20X3).**

An 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 accounted for 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) 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*. Consequently, in accordance with paragraph 35.8 the entity adjusts its opening balances from 1 January 20X3 (the date of transition to the *IFRS for SMEs*) in order to derecognise the research and development intangible item incurred before 1 January 20X3 with a corresponding adjustment to retained earnings.

Note: 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 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* exclude that amortisation.

Ex 14 **An entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs*. 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) for an item that does not satisfy the recognition criteria in Section 21 of the *IFRS for SMEs* (ie the item is, instead, 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.

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

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 statements of comprehensive income for the year ended 31 December 20X4 (and comparative information for 20X3) do not include an expense relating to the contingent liability. However, in the entity's 31 December 20X4 financial statements, those amounts would be disclosed in the note that sets out the reconciliations to equity and profit or loss determined in accordance with its previous financial reporting framework (see paragraphs 35.12 and 35.13).

Note: unless the possibility of an outflow of resources is remote, the entity would disclose the contingent liability (see paragraph 21.15).

[Paragraph 35.7 continued—Except as provided in paragraphs 35.9–35.11, an entity shall, in its opening statement of financial position as of its date of transition to the IFRS for SMEs (ie the beginning of the earliest period presented):]

(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 IFRS; and

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

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*. 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 presents the part of its deferred tax assets and deferred tax liabilities that are expected to be settled within 12 months of the reporting date as current assets and current liabilities respectively in its statement of financial position.

Because paragraph 29.28 prohibits the presentation of deferred tax assets (liabilities) as current assets (liabilities), the first-time adopter must reclassify the portion of deferred tax assets (liabilities) previously presented as current assets (liabilities) to non-current assets (liabilities).

Provided that the total amount of deferred tax (current and non-current) recognised in accordance with both reporting frameworks would be measured at the same amount, there is no adjustment to retained earnings at 1 January 20X3.

Ex 16 **The entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs*. 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) the preference shares are financial liabilities—with mandatory redemption by the issuer for a fixed amount at a fixed future date. Consequently, in its opening statement of financial position (ie at 1 January 20X3) 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*).

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 statements of comprehensive income for the year ended 31 December 20X4 (and comparative information for 20X3) include 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. The notes disclose the reconciliations from the equity and profit or loss determined in accordance with its previous financial reporting framework to the equity and profit or loss determined in accordance with the *IFRS for SMEs* (see paragraphs 35.12 and 35.13).

[Paragraph 35.7 continued—Except as provided in paragraphs 35.9–35.11, an entity shall, in its opening statement of financial position as of its date of transition to the IFRS for SMEs (ie the beginning of the earliest period presented):]

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

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

Ex 17 **An entity that previously prepared its financial statements in compliance with full IFRSs accounted for its property, plant and equipment using the revaluation model (ie carrying amount= fair value at the date of revaluation less any subsequent accumulated depreciation and 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*. 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* does not permit the use of the revaluation model, which is allowed under full IFRSs. It requires all items of property, plant and equipment to be measured after initial recognition at cost less any accumulated depreciation and any accumulated

impairment losses (see paragraph 17.15). Consequently, in its opening statement of financial position the entity adjusts its balances for property, plant and equipment at 1 January 20X3 (the date of transition to the *IFRS for SMEs*) to eliminate the effects of any revaluations accounted for in accordance with full IFRSs in prior periods. Any depreciation 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*, but replaced with new depreciation.

In other words, in its first financial statements that conform to the *IFRS for SMEs* (ie those for the year ended 31 December 20X4, including comparative amounts for 20X3), the entity presents property, plant and equipment as if it had always been accounted for using the cost-depreciation-impairment model. However, any differences between the amounts recognised in accordance with the *IFRS for SMEs* and the amounts recognised in accordance with full IFRSs (ie the revaluation-depreciation-impairment model) must be disclosed in the note that sets out the reconciliations to equity and profit or loss determined in accordance with its previous financial reporting framework (see paragraphs 35.12 and 35.13).

See paragraph 35.10(d) and examples 34–38 for exemption relating to this requirement.

Ex 18 **An entity's financial statements for the year ended 31 December 20X4 are its first financial statements that conform to the *IFRS for SMEs*. 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* does not permit the use of the last-in, first-out (LIFO) cost formula (see paragraph 13.18). Consequently, in its opening statement of financial position the entity measures its inventories using the FIFO cost formula and it adjusts its opening retained earnings at 1 January 20X3 accordingly (see paragraph 35.8). Consequently, cost of sales for the year ended 20X3 is similarly adjusted when preparing comparative information in accordance with the *IFRS for SMEs*.

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. The note to the entity's 31 December 20X4 financial statements that sets out the reconciliations from the equity and profit or loss determined in accordance with its previous financial reporting framework to the equity and profit or loss determined in accordance with the *IFRS for SMEs* includes adjustments for the measurement of inventories because of the change from the LIFO to the FIFO cost formula (see paragraphs 35.12 and 35.13).

35.8 The **accounting policies** that an entity uses in its opening statement of financial position under this IFRS 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 IFRS. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this IFRS.

Notes

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

Adjustments of items of income and expense related to transactions, to other events or to conditions that occurred in the period between the date of transition to the *IFRS for SMEs* and the reporting date of the entity's first financial statements that comply with the *IFRS for SMEs* are recognised in profit or loss of the period in which they arise. This treatment enhances faithful representation and comparability of the financial information across time and with other entities whose financial statements conform to the *IFRS for SMEs*.

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

Notes

Paragraph 35.9 lists five situations where the IASB believes either that retrospective application of the *IFRS for SMEs* cannot be performed with sufficient reliability or that 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. Consequently, the exceptions to retrospective application in paragraph 35.9 are mandatory for all first-time adopters of the *IFRS for SMEs*.

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 by analogy to other items, transactions, events or circumstances.

[Paragraph 35.9 continued—On first-time adoption of this IFRS, 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 should 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* for the first time generally applies the derecognition requirements of Sections 11 and 12 prospectively for transactions occurring on or after the date of transition to the *IFRS for SMEs*. 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* even if those items would not have been derecognised if the entity had always applied the *IFRS for SMEs* (instead of its previous financial reporting framework). Such items must not be recognised again unless they qualify for recognition under the *IFRS for SMEs* 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 date of transition if the entity had always applied the *IFRS for SMEs* (instead of its previous financial reporting framework) the entity can choose to (a) derecognise them on transition (ie they would not appear in the opening statement of financial position) or (b) to continue to recognise them until disposed 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's 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 19 **An entity's first financial statements that conform to the *IFRS for SMEs* 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. In compliance with that previous financial reporting framework the entity derecognised particular financial assets—trade receivables that the entity sold to a bank before the date of transition to *IFRS for SME* at less than their face amount. The entity simultaneously agreed to buy back from the bank any part of those receivables that remained outstanding for more than 120 days. If the *IFRS for SMEs* 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 corresponding liability for the amount advanced from the bank.

The entity excludes the financial assets from its opening statement of financial position at 1 January 20X3 (ie the financial assets—trade receivables—remain derecognised).

Note: if after the date of transition to the *IFRS for SMEs* 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 repurchase 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 'repurchased' from the bank and not subsequently settled or impaired to nil.

Ex 20 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 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 the *IFRS for SMEs*, that financial asset would have been derecognised when it was sold to the bank on 31 December 20X2.

The entity can choose to either continue to recognise the trade receivable until its settlement or exclude the trade receivable from its opening statement of financial position at 1 January 20X3 (ie derecognise the trade receivable).

Note: if the entity chooses to continue to recognise the trade receivable until its settlement, the entity tests the financial asset for impairment (see Sections 11 and 12).

[Paragraph 35.9 continued—On first-time adoption of this IFRS, 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 the 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 Instruments 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* an entity applies the hedge accounting requirements of Section 12 *Other Financial Instrument Issues* 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 IAS39 if this option is chosen), including being appropriately designated and documented.

At the date of transition to the *IFRS for SMEs*, the entity reflects in its opening statement of financial position only those hedging relationships that qualify for hedge accounting under Section 12.

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

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

Ex 21 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 had no active hedging relationships at the date of transition to the *IFRS for SMEs*. However, in conformity with its previous financial reporting framework, the entity has used a type of hedge accounting (recognised change in the fair value of the hedged item and the change in the fair value of the hedging instrument in profit or loss in the period of the change) for many items that would not qualify for hedge accounting in accordance with the *IFRS for SMEs*.

Because the hedging relationships no longer exist on the date of transition to the *IFRS for SMEs* the entity does not make any adjustments for past hedge accounting in preparing its opening statement of financial position (ie at 1 January 20X3).

Ex 22 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 had only one active hedging relationship at the date of transition to the *IFRS for SMEs* (ie at 1 January 20X3). In conformity with its previous financial reporting framework, the entity has used hedge accounting to recognise the change in the fair value of the hedged item (investment in B-rated government bonds carried at amortised cost) and the hedging instrument (an option) in profit or loss in the same period (ie the period of the change in fair value). Because the *IFRS for SMEs* does not permit designation of an option as a hedging instrument and does not permit hedging of the total change in fair value of a debt instrument, Section 12 does not provide requirements for the discontinuance of that type of hedge accounting.

Because the *IFRS for SMEs* does not permit designation of an option as a hedging instrument and because it also does not permit hedge accounting for the entire change in the fair value of a liability, the entity cannot use hedge accounting with effect from the date of transition to the *IFRS for SMEs*.

The entity prepares its opening statement of financial position (ie at 1 January 20X3) as if the entity had never applied hedge accounting. That will require adjustment to opening retained earnings at 1 January 20X3.

[Paragraph 35.9 continued—On first-time adoption of this IFRS, 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* 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).

Notes:

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*. The receipt of information after the date of transition to this IFRS 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 23 **An entity's first financial statements that conform to the *IFRS for SMEs* 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. 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*.

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, the entity would then have measured the liability at CU5,000 and CU4,750 respectively.

In its opening statement of financial position (ie at 1 January 20X3) the entity measures the provision at CU9,500 (ie it does not adjust its opening retained earnings at 1 January 20X3 because the accounting estimate made using its previous financial reporting framework was appropriate at the time that the estimate was made on 31 December 20X2).

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

(ie the year ended 31 December 20X4). In other words the accounting in the first financial statements that conform to the *IFRS for SMEs* must not be based on hindsight from new information.

Examples—not accounting estimates

Ex 24 **The facts are the same as in example 23. However, in this example, 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 31December 20X3. The prior period error is corrected retrospectively. In its opening statement of financial position (at 1 January 20X3) the entity measures the provision at CU4,750 (ie it increases its opening retained earnings at 1 January 20X3) 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). The prior period error is corrected retrospectively (see also paragraph 35.14).

Ex 25 **The facts are the same as in example 23. However, in this example, 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. If the entity had applied the *IFRS for SMEs* it would have recognised a provision in accordance with Section 21 *Provisions and Contingencies*.**

In accordance with paragraph 35.8, the entity measures and recognises the provision at CU9,500 in its opening statement of financial position at 1 January 20X3 (ie it decreases its opening retained earnings at 1 January 20X3 for the effect of applying the requirements of Section 21 at 1 January 20X3).

Note: this treatment is akin to the 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 (ie the period in which information about the new technology became available).

[Paragraph 35.9 continued—On first-time adoption of this IFRS, 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 *IFRS for SMEs* a discontinued operation is defined as follows:

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 coordinated 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*, if a component is classified as a discontinued operation, its post-tax profit or loss and any gain or loss on measurement to fair value less costs to sell or on the 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* is adopted the requirements for discontinued operations are applied prospectively from 1 January 20X3.

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

Ex 26 **An entity's first financial statements that conform to the *IFRS for SMEs* 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. Local GAAP has no special requirements for discontinued operations. In early 20X2 the entity sold particular operations that satisfy the definition of a discontinued operation in the *IFRS for SMEs*.

In accordance with paragraph 35.9(d), the requirements for discontinued operations in the *IFRS for SMEs* are applied prospectively to operations that meet the definition of a discontinued operations on or after the date of transition (1 January 20X3). At 1 January 20X3 (the date of transition) the entity does not have a discontinued operation—it had disposed of the operations that satisfied the definition of a discontinued operation in early 20X2.

Note: if instead the operation had been held for sale in 20X2 and disposed of in 20X3, it would be classified as a discontinued operation in the entity's first financial statements that conform to the *IFRS for SMEs* because it would satisfy the definition of a discontinuing operation on the date of transition (1 January 20X3).

Ex 27 **The facts are the same as in example 26. However, in this example the entity sold the operations that satisfy the definition of a discontinued operation in 20X3 (at 31 December 20X2 the entity had no discontinued operation).**

The exemption in paragraph 35.9(d) does not apply because the discontinuance occurred after the date of transition. 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* (ie in the comparative information—20X3).

[Paragraph 35.9 continued—On first-time adoption of this IFRS, 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 IFRS is applied to restate business combinations see paragraph 35.10).

Notes—non-controlling interests

Although the adjustments to the subsidiary's assets and liabilities on the date of transition to the *IFRS for SMEs* 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, unless it decides to apply this IFRS 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 28 **An entity's first financial statements that conform to the *IFRS for SMEs* 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. 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 opening statement of financial position the group does not adjust its 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*.

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

Notes

Retrospective application of particular requirements in the *IFRS for SMEs* could require significant cost or effort and, in some cases, it may be impracticable. Consequently, the IASB decided that the costs of applying particular requirements in the *IFRS for SMEs* 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*. An entity decides which exemptions (if any) it will follow based on the concept of the balance between benefit and cost (see paragraphs 2.13 and 2.14).

A first-time adopter may freely choose to apply certain exemptions and not apply others. However, if a first-time adopter chooses to apply (or not to apply) a specific exemption, it must then apply (or not) the specific exemption for all similar transactions, other events or conditions, as required by paragraph 10.7 (consistency of accounting policies).

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

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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 IFRS. 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 this IFRS, an entity may either apply Section 19 *Business Combinations and Goodwill* retrospectively or else retain its previous financial reporting framework to account for those business combinations.

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.

Note: 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*) 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*.

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

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

In accordance with paragraph 19.14 the acquirer, at the acquisition date, allocates the cost of a business combination by recognising the acquiree's identifiable assets and liabilities and a provision for contingent liabilities that satisfy specified recognition criteria at their fair values at that date. Paragraph 19.14 also requires any difference between the cost of the business combination and the acquirer's interest in the net 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, it can choose not to restate the two business combinations that were effected 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*. Furthermore, amortisation and impairment in 20X3 and 20X4 would be determined in accordance with the *IFRS for SMEs*.

There is no remeasurement of original local GAAP carrying amounts 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).

Notes:

Other exemptions may be applied to these assets on the transition date (eg use of fair value as deemed cost for particular assets in accordance with paragraph 35.10(c)).

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

- no restatement (if the entity elects to use the exemption in full);or
- restate business combination occurring in 20X2 (if the entity elects to use the exemption only in respect of all 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 30 **An entity's first financial statements that conform to the *IFRS for SMEs* are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (ie 20X3).**

The only business combination that the group entered into was the acquisition of 100 per cent of the equity of another entity 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, the entity, at initial recognition, 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* had been applied by the group, it would also have depreciated the machine 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, the group amortised goodwill on a straight-line basis to a nil residual value over 5 years. If the *IFRS for SMEs* had been applied by the group, it would have amortised CU2,000 goodwill (ie CU10,000 less CU8,000) on the straight-line basis to a nil residual value over 5 years.

The group elected to apply the exemption in paragraph 35.10 (ie 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 the group elects to use the exemption in paragraph 35.10, in its consolidated opening statement of financial position (at 1 January 20X3) 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 opening 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 31 **The facts are the same as in example 30. However, in this example the group did not elect to apply the exemption in paragraph 35.10 (ie it applies Section 19 retrospectively to its business combination).**

In its consolidated opening statement of financial position (ie at 1 January 20X3) the group 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. However, the group must also measure its 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, the group adjusts its consolidated opening retained earnings at 1 January 20X3 as measured by using its previous financial reporting framework by increasing it by CU300 when preparing its opening statement of financial position (ie CU2,700 increase in property, plant and equipment less CU2,400 decrease in goodwill).

In its first financial statements that conform to the *IFRS for SMEs* the group recognises:

- at 31 December 20X3 (ie the comparative information), the goodwill at CU1,200 (ie CU2,000 × 3/5 years remaining useful life=CU1,200) and the property, plant and equipment at CU2,400 more than it would have been measured at by using the previous financial reporting framework (ie CU3,000 × 8/10 years remaining useful life=CU2,400);
- at 31 December 20X4, the goodwill at CU800 (ie CU2,000 × 2/5 years remaining useful life=CU800) and the property, plant and equipment at CU2,100 more than it would have been measured at by using the previous financial reporting framework (ie CU3,000 × 7/10 years remaining useful life=CU2,100); and
- for each of the years ended 31 December 20X4 and 20X3, the expense amortisation of goodwill at CU400 (ie CU2,000 × 1/5 years of useful life=CU400) and the additional depreciation expense for the property, plant and equipment at CU300 (ie CU3,000 × 1/10 years of useful life=CU300).

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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 IFRS, or to liabilities arising from share-based payment transactions that were settled before the date of transition to this IFRS.

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

Ex 32 **An entity's first financial statements that conform to the *IFRS for SMEs* 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. That previous financial reporting framework prohibited the recognition of equity-settled share-based payment transactions. In 20X2 the entity granted shares to its employees in return for their services in that period. 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.

If the entity elects to use the exemption in paragraph 35.10(b) it makes no adjustment to its equity classification in its opening statement of financial position on 1 January 20X3—the date of its transition to the *IFRS for SMEs*.

Note: if the entity did not elect to use the exemption in paragraph 35.10(b) it would, in accordance with paragraph 35.7(c) and paragraphs 26.3 and 26.4, adjust its retained

earnings and contributed equity balances in its opening statement of financial position on the date of transition (ie at 1 January 20X3) for the effects of measuring the services received in exchange for the entity's shares at fair value (see paragraph 26.7).

Ex 33 **An entity's first financial statements that conform to the *IFRS for SMEs* 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. 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 (ie 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* (at 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 or before 20X2, even if the entity did not elect the exception there would have been no effect on amounts reported for 20X3 or 20X4.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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 IFRS 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 *[ie its previous financial reporting framework]* 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 IFRS 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*. 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 basis for the deemed cost on the date of transition.

Fair value

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

Previous financial reporting framework revaluation

The revaluation of property, plant and equipment and intangible assets is not permitted by the *IFRS for SMEs*, and therefore ‘revaluation’ is not a defined term. However, the ‘revalued amount of an asset’ is defined in the Glossary of full IFRSs as ‘the fair value of an asset at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment loss’.

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

Ex 34 **An entity’s first financial statements that conform to the *IFRS for SMEs* 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. In accordance with that previous financial reporting framework, the entity measured property, plant and equipment at fair value, with changes in fair value recognised in profit or loss in the period of the change in fair value.

Paragraph 17.15 requires the measurement of all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses.

However, on the date of transition to the *IFRS for SMEs* (ie at 1 January 20X3), in accordance with paragraph 35.10(c), the entity can elect to measure its property, plant and equipment (on an item-by-item basis) at its deemed cost (ie its fair value 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*) for property, plant and equipment.

Note: the exemption is available on an item-by-item basis. An entity can therefore elect to use fair value as deemed cost for some items in the class, and elect to apply the cost-depreciation-impairment 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, it would, in accordance with paragraph 35.7(c) and paragraphs 17.9–17.26, adjust retained earnings and property, plant and equipment in its opening statement of financial position on the date of transition (ie at 1 January 20X3) for the effects of measuring the property, plant and equipment using a cost-depreciation-impairment model in accordance with Section 17.

Ex 35 **The facts are the same as in example 34. However, in this example, in accordance with its previous financial reporting framework the entity measured its property, plant and equipment at its acquisition cost (ie it neither depreciated nor impaired its property, plant and equipment).**

Paragraph 17.15 requires the measurement of all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses.

The entity cannot elect acquisition cost of the property, plant and equipment to be the deemed cost at 1 January 20X3 because it is not fair value and it is not a revalued amount. Consequently, in its opening statement of financial position at 1 January 20X3

the entity must retrospectively account for its property, plant and equipment in accordance with Section 17 (ie using the cost-depreciation-impairment model) except to the extent that it elects to measure particular items of property, plant and equipment on 1 January 20X3 at deemed cost in accordance with paragraph 35.10(c). If an entity uses fair value as deemed cost for any items, it adjusts retained earnings and property, plant and equipment in its opening statement of financial position on the date of transition (ie at 1 January 20X3) for the effects of measuring the property, plant and equipment at its deemed cost (fair value on 1 January 20X3).

Note: if the entity did not elect to use the exemption in paragraph 35.10(c), it would, in accordance with paragraph 35.7(c) and paragraphs 17.9–17.26, adjust retained earnings and property, plant and equipment in its opening statement of financial position on the date of transition (ie at 1 January 20X3) for the effects of measuring the property, plant and equipment under the cost-depreciation-impairment model in accordance with Section 17.

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

Ex 36 **The facts are the same as in example 34. However, in this example, in accordance with its previous financial reporting framework, the entity measured its property, plant and equipment at revalued amounts (ie fair value less accumulated depreciation less impairment losses) with revaluation increases included in a revaluation reserve. The entity revalued its property, plant and equipment to fair value on 31 December 20X2.**

Paragraph 17.15 requires the measurement of all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses.

However, on the date of transition to the *IFRS for SMEs* (ie at 1 January 20X3), in accordance with paragraph 35.10(d), the entity can elect to measure its property, plant and equipment at its deemed cost (ie its revalued amount (fair value) determined 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*) for property, plant and equipment.

Note: if the entity did not elect to use the exemption in paragraph 35.10(d), it would, in accordance with paragraph 35.7(c) and paragraphs 17.9–17.26, adjust equity and property, plant and equipment in its opening statement of financial position on the date of transition (ie at 1 January 20X3) for the effects of measuring the property, plant and equipment under the cost-depreciation-impairment model in accordance with Section 17.

Ex 37 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 was privatised on 30 June 20X2 and on that date the fair values of all property, plant and equipment were determined as part of the transaction. In its 31 December 20X3 local GAAP

financial statements the entity measured property, plant and equipment at the fair value of the property, plant and equipment as determined at 30 June 20X2.

In accordance with paragraph 35.10(d), the entity elects to deem the cost of its property, plant and equipment to be the fair value determined on 30 June 20X2 (ie the date of valuation).

Paragraph 17.15 requires the measurement of all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses.

However, on the date of transition to the *IFRS for SMEs* (ie at 1 January 20X3), in accordance with paragraph 35.10(d), the entity can elect to use the 30 June 20X2 revaluation (event-driven valuation) as the deemed cost. Consequently, the entity could elect to measure its property, plant and equipment in its opening statement of financial position 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 35.7(c), the entity adjusts its retained earnings and property, plant and equipment in its opening statement of financial position on the date of transition (ie at 1 January 20X3) for the effects of measuring the property, plant and equipment at its deemed cost (as described above) on 1 January 20X3.

Note: if the entity did not elect to use the exemptions in paragraphs 35.10(c) or (d), it would, in accordance with paragraph 35.7(c) and paragraphs 17.9–17.26, adjust retained earnings and property, plant and equipment in its opening statement of financial position on the date of transition (ie at 1 January 20X3) for the effects of measuring the property, plant and equipment using the cost-depreciation-impairment model in accordance with Section 17.

Ex 38 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 full IFRSs. In accordance with IAS 16 *Property, Plant and Equipment* the entity followed an accounting policy of measuring its machinery after recognition using the revaluation model. The entity has only one machine.

The machine was acquired at 1 January 20X0 for CU10,000, and its estimated useful life is 10 years measured from the date of its acquisition. It is depreciated on the straight-line basis to nil residual value.

In accordance with IAS 16, the entity revalued its machine to CU9,500 at 30 June 20X2. In its statement of financial position at 31 December 20X2 the entity measured the machine at CU8,867 (CU9,500 gross less CU633 depreciation for the six-month period ended 31 December 20X2).

Use of the revaluation model is not permitted by the *IFRS for SMEs* (see paragraph 17.15). It requires all items of property, plant and equipment to be measured after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses.

However, on the date of transition to the *IFRS for SMEs* (ie at 1 January 20X3), in accordance with paragraph 35.10(d), the entity can elect to use the revalued amount determined in accordance with IAS 16 as the deemed cost at which to measure the machine in its opening statement of financial position at 1 January 20X3. Because the requirements for depreciation of the machine are the same under full IFRSs and under the *IFRS for SMEs*, the entity would not adjust its retained earnings in its opening statement of financial position on the date of transition (ie at 1 January 20X3) because the deemed cost is CU8,867 (ie the same amount at which the machine was measured under its previous financial reporting framework).

Note: if the entity did not elect to use the exemptions in paragraphs 35.10(c) or (d), it would, in accordance with paragraph 35.7(c) and paragraphs 17.9–17.26, reduce property, plant and equipment in its opening statement of financial position on the date of transition (ie at 1 January 20X3) by CU1,867 (CU8,867 using the revaluation model in IAS 16 less CU7,000 cost model in Section 17—ie CU10,000 × 7/10 years remaining useful life=CU7,000). Consequently, retained earnings would be reduced by CU1,867 for the effects of measuring the property, plant and equipment retrospectively under the cost-depreciation-impairment model in accordance with Section 17.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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 39 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 previous financial reporting framework prohibited classification of 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 the initial recognition of 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 in its opening consolidated statement of financial position on the date of transition (ie at 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.

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 adjust its opening consolidated statement of financial position on the date of transition (ie at 1 January 20X3) by transferring from consolidated retained earnings an amount equal to the cumulative translation difference into a separate component of equity.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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, or

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

If a first-time adopter measures such an investment at cost, it shall measure that investment at one of the following amounts in its separate opening statement of financial position prepared in accordance with this IFRS:

(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 *[previous financial reporting framework]* carrying amount on that date.

Notes—separate financial statements

Separate financial statements are those presented by a parent entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

The *IFRS for SMEs* 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. 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 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 40 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 law of the jurisdiction in which the entity operates requires all entities to prepare 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, using the equity method.

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 the cost less impairment model or the fair value model.

Fair value model

If the entity chooses the fair value model, 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* and consequently adjusts opening retained earnings in its opening statement of financial position on the date of transition (ie at 1 January 20X3).

Cost model

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:

(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*. If that carrying amount is different from the amount determined by using its previous financial reporting framework, then the entity adjusts opening retained earnings in its opening statement of financial position on the date of transition (ie at 1 January 20X3) accordingly. If amounts were recognised in other components of equity under the equity method, a transfer to retained earnings may be required.

Note: if the entity did not elect to use the exemption in paragraph 35.10(f), it would, in accordance with paragraph 35.7(c) and Section 9, adjust its opening statement of financial position on the date of transition (ie at 1 January 20X3) by adjusting retained earnings by the cumulative difference between the carrying amount of its investments in subsidiaries, joint ventures and associates measured using the equity method (in accordance with the previous financial reporting framework) and its carrying amount measured in accordance with paragraph 9.26 (ie using its chosen measurement basis, either cost or fair value). If amounts were recognised in other components of equity using the equity method a transfer to retained earnings may be required.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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 IFRS.

Notes—compound financial instruments

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, present its opening statement of financial position on the date of transition to the *IFRS for SMEs* 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*. Accordingly, 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 in preparing its opening statement of financial position.

Classification (liability/equity) is determined in accordance with the substance of the contractual arrangement when the instrument first satisfies the recognition criteria in Section 22. The entity does not consider events after that date (other than changes in the terms of the instruments). For example, changes in market prices do not result in revision of the classification of a convertible 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.

Paragraph 22.13 requires compound instruments to be separated into liability and equity components at inception. If the liability component is no longer outstanding, retrospective application of paragraph 22.13 involves separating two portions of equity:

(a) The first portion is in retained earnings and represents the cumulative interest accreted on the liability component.

(b) The other portion 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 original liability (possibly within retained earnings) from the original equity (usually capital in nature) component of the financial instrument (ie the inter-equity classification is not required).

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

Ex 41 **An entity's first financial statements that conform to the *IFRS for SMEs* are presented for the year ended 31 December 20X9. Those financial statements include only one year of comparative information (ie 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, when the bond holders exercise their conversion rights, the carrying amount of the converted bond is transferred from liabilities to equity.

On 1 January 20X1 the entity issued 500 convertible bonds. The bonds are 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 were CU50,000. Interest is payable yearly in arrears at an annual interest rate of 4 per cent. 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 is 6 per cent. At the end of the five year term, if not converted, the bonds are repaid at par, including any accrued interest.

In accordance with 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* (ie at 1 January 20X8) the liability component is no longer outstanding (ie 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 compound financial instruments into the liability component and equity component. If it chooses the exemption, the entity retains the accounting that it used under its previous financial reporting framework in its opening statement of financial position (ie at 1 January 20X8), accordingly there are no adjustments to retain 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 opening statement of financial position on the date of transition (ie at 1 January 20X8) by adjusting retained earnings and components of equity (determined in accordance with relevant law) for the effects of retrospectively accounting for the bond in accordance with Section 22. This would include revised measurement of interest expense at 6 per cent.

Ex 42 **The facts are the same as in example 41. However, in this example, the entity's first financial statements that conform to the *IFRS for SMEs* are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (ie 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* (ie at 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 20X8 (the date of transition to the *IFRS for SMEs*) in accordance with the *IFRS for SMEs* as follows

When the instrument is issued, the liability component must be valued 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 per cent. 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)–(B)	4,212

Calculations:

Present value of principal of CU50,000 at 6 per cent

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

Present value of the interest annuity of CU2,000 (= CU50,000 × 4 per cent) 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 the following 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/.06) × [1 − [(1/1.06)^5]] = CU8,425

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

	(a) Interest payment (CU)	(b) Total interest expense(CU) = 6% x (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, in its opening statement of financial position on the date of transition (ie 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 (see the end of 20X2 above)	CU47,327	CU4,212	(CU5,539)
Difference	CU2,673	(CU4,212)	CU1,539

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(h) **Deferred income tax**. A first-time adopter is not required to recognise, at the date of transition to the *IFRS for SMEs*, **deferred tax assets** or **deferred tax liabilities** relating to differences between the **tax basis** and the **carrying amount** of any assets or liabilities for which recognition of those deferred tax assets or liabilities would involve undue cost or effort.

Notes—deferred tax

Paragraph 35.10(h) exempts a first-time adopter from recognising a deferred tax asset or a deferred tax liability at the date of transition to the *IFRS for SMEs* only when recognition of that deferred tax asset or liability would involve undue cost or effort (ie it is not a 'free' choice but rather the exemption is available only when measuring a particular deferred tax asset or a deferred tax liability would cause undue cost or effort). Furthermore, the exemption does not apply to the recognition of the underlying asset that gives rise to the deferred tax asset or liability.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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 IFRS.

Notes—service concession arrangements

A service concession arrangement is an arrangement whereby a government or other public sector body 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.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(j) **Extractive activities**. A first-time adopter using full cost accounting under previous GAAP *[previous financial reporting framework]* 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 *[previous financial reporting framework]*. The entity shall test those assets for impairment at the date of transition to this IFRS in accordance with Section 27 *Impairment of Assets*.

Notes—extractive activities

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 generally 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* 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*. Any identified impairment losses must be recognised at the date of transition.

Following transition to *IFRS for SMEs*, an entity applies paragraph 34.11, which specifies that an entity which is engaged in the exploration(1) for, evaluation(2) or extraction(3) of mineral resources (extractive activities) accounts for expenditure on the acquisition or development(4) of tangible or intangible assets for use in extractive activities by applying Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*, respectively.

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

Ex 43 **An entity's first financial statements that conform to the *IFRS for SMEs* are presented for the year ended 31 December 20X4. Those financial statements include only one year of comparative information (ie 20X3).**

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(1) Exploration is not defined in the *IFRS for SMEs*. IFRS 6 defines 'exploration for and evaluation of mineral resources' as only a single term. In Appendix A of the IASB Discussion Paper *Extractive Activities*, exploration is described as the detailed examination of a geographical area of interest that has shown sufficient mineral-producing potential to merit further exploration. Exploration activities include: conducting topographical, geological, geochemical and geophysical studies; and carrying out exploratory drilling, trenching and sampling activities.

(2) Evaluation is not defined in the *IFRS for SMEs*. IFRS 6 defines 'exploration for and evaluation of mineral resources' as only a single term. In Appendix A of the IASB Discussion Paper *Extractive Activities*, evaluation is described as an activity that involves determining the technical feasibility and commercial viability of mineral deposits that have been found through exploration.

(3) Extraction is not defined in the *IFRS for SMEs* or in Appendix A of IASB Discussion Paper *Extractive Activities*. However, the extraction of minerals or oil and gas is commonly also referred to as the production of minerals or oil and gas. In Appendix A of the IASB Discussion Paper *Extractive Activities*, production is described as the extraction of the natural resources from the earth and the related processes necessary to make the produced resource marketable or transportable.

(4) Development is a defined term in the *IFRS for SMEs*, but that definition is not related to the development of mineral resources (see the Glossary). In Appendix A of the IASB Discussion Paper *Extractive Activities*, development is described as the establishment of access to the mineral reserve and other preparations for commercial production. Development activities often continue during production.

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. (Under full cost accounting, exploration and development costs relating to individual oil and gas properties are accounted for in cost centres that include all properties within a large geographical area, such as a country.)

In preparing its first financial statements that conform to the *IFRS for SMEs*, the entity elects to measure its oil and gas assets in its opening statement of financial position at 1 January 20X3 at the amount determined under its previous financial reporting framework (ie 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*, the entity allocates the cost centre's carrying amount to the underlying oil and gas assets in that cost centre. The entity chooses to allocate that amount to each of its oil and gas assets 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 to its opening statement of financial position, the entity accounts for its oil and gas assets in accordance with paragraph 34.11.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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, rather than when the arrangement was entered into.

Notes—arrangements containing a lease

Some arrangements such as particular outsourcing arrangements that provide rights to capacity do not take the legal form of a lease but convey rights to use assets in return for payments. Paragraph 20.3 requires such arrangements to be accounted for in accordance with Section 20 *Leases*. Such a lease classification is based on the initial terms of the lease agreement and the circumstances existing at the inception of the lease.

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* contains a lease on the basis of facts and circumstances existing at the date of transition, rather than when the arrangement was entered into. However, it does not exempt the entity from making the determination.

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

Ex 44 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 previous financial reporting framework required the entity to account for lease arrangements only if the terms of the agreement take the form of a contractual lease, regardless of whether the arrangement conveys rights to use assets 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*. However, the entity did not account for the arrangement as a lease but 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* (ie at 1 January 20X3) the entity must asses 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 (ie 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 (ie at 1 January 20X3).

Ex 45 **An entity's first financial statements that conform to the *IFRS for SMEs* 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.

On 1 January 20X0 the entity entered into an agreement with a supplier to purchase 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.

On the date of transition to the *IFRS for SMEs* (ie at 1 January 20X3), 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 paragraph 20.4 on the basis of facts and circumstances existing on that date, 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 reassesses the arrangement on 1 January 20X2 due to the contractual change.

[Paragraph 35.10 continued—An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this IFRS:]

(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*, rather than 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 this IFRS 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*. If a first-time adopter uses this exemption, it must:

- measure the liability at the date of transition to *IFRS for SMEs* in accordance withSection 21.
- estimate the amount that would have been included in the cost of related asset when the liability first arose by discounting the liability to that date using an estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period.
- calculate the accumulated depreciation on that amount, as at the date of transition to the *IFRS for SMEs* based on the depreciation policy and useful life estimate in accordance with the *IFRS for SMEs* at the date of transition.

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

Ex 46 **An entity's first financial statements that conform to the *IFRS for SMEs* 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 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*, the liability would be measured at CU1,210 . Assume that the appropriate risk adjusted discount rate for the liability between 1 January 20X1 and 31 December 20X2 is 10 per cent 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*. Consequently, on 1 January 20X3 the remaining useful life is 18 years.

In accordance with paragraph 17.10(c) an 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 opening statement of financial position at 1 January 20X3 at CU1,210.
- discount the liability by two years to estimate the amount that would have been included in the cost of the related asset when the liability first arose. The estimate of the amount to add to the plant at 1 January 20X1 is CU1,000 (ie CU1,210/(1.1^2)). Consequently the additional accumulated depreciation on the plant at 1 January 20X3 would be CU100 (ie CU1,000 × 2/20 years).
- in its opening statement of financial position at the date of transition to the *IFRS for SMEs*, the plant should be measured at CU18,900 (ie CU21,000 cost of plant less 2 years × CU1,050 depreciation per year).

Note: if the entity did not choose to use the exemption in paragraph 35.10(l), in its opening statement of financial position at 1 January 20X3, it would measure the liability at 1 January 20X1 in accordance with Section 21 using information available at that date. Consistent with the principles of accounting for changes in accounting estimates, when the exemption in paragraph 35.10(i) is not applied, changes in decommission liability between 1 January 20X1 and 31 December 20X2 affect the amount of decommission liability, cost of plant and depreciation prospectively from the date of the change in accounting estimate.

35.11 If it is **impracticable** for an entity to restate the opening statement of financial position at the date of transition for one or more of the adjustments required by paragraph 35.7, 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 the data presented for prior periods that are not comparable with data for the period in which it prepares its first financial statements that conform to this IFRS. If it is impracticable for an entity to provide any disclosures required by this IFRS for any period before the period in which it prepares its first financial statements that conform to this IFRS, the omission shall be disclosed.

Note

‘Impracticable’ is a high hurdle—applying a requirement is impracticable only when the entity cannot apply it after making every reasonable effort to do so. This is a tougher test than ‘undue cost or effort’. For example, applying a requirement is not impracticable simply because it would be expensive (eg the entity would incur the cost of a valuer’s fees).

For a particular prior period, it would be impracticable to restate the opening statement of financial position 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.

Examples—impracticable to restate the opening statement of financial position at the date of transition

Ex 47 **An entity's first financial statements that conform to the *IFRS for SMEs* are presented for the year ended 31 December 20X4. Those financial statements include two years' comparative information (ie 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 required use of the last-in, first-out (LIFO) cost formula for inventory.

In accordance with paragraph 13.18 the entity uses the first-in, first-out (FIFO) cost formula for inventories. However, because the entity's inventory records were destroyed in a fire on 31 December 20X1, it cannot restate inventories (ie it is impracticable to do so) in its opening statement of financial position at 1 January 20X2 (the date of transition to the *IFRS for SMEs*).

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 opening statement of financial position for use of the FIFO cost formula for inventories, in accordance with paragraph 35.11, the entity measures inventories using the LIFO cost formula in its opening statement of financial position (ie 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*) 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 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 48 **The facts are the same as in example 47. 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 to restate the entity's opening statement of financial position for use of the FIFO cost formula for inventories, in accordance with paragraph 35.11, the entity measures inventories using the LIFO cost formula in its opening statement of financial position (ie at 1 January 20X2).

At 31 December 20X2 some of the entity's inventory would be measured using the FIFO cost formula (ie inventories purchased on or after 1 January 20X2) and some would be measured using the LIFO cost formula (ie inventory purchased before 1 January 20X2).

At 31 December 20X3 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*) the entity would disclose the following:

- the fact that, in its statement of financial position, the line item inventories at 31 December 20X2 are not comparable with the amount presented at 31 December 20X3 and 20X4.
- the fact that, in its statement of comprehensive income, the line items cost of sales expense and profit or loss for the years ended 31 December 20X2, 20X3 and 20X4 are not comparable.
- an explanation of the lack of comparability—eg the lack of comparability is as a result of the inventories at 1 January 20X2 (the date of transition to the *IFRS for SMEs*) 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. The disclosure would include the proportion of inventories held at 31 December 20X2 measured using the LIFO cost formula at 1 January 20X2.

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 IFRS affected its reported **financial position**, financial **performance** and **cash flows**.

Reconciliations

35.13 To comply with paragraph 35.12, an entity's first financial statements prepared using this IFRS 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 IFRS for both of the following dates:

(i) the date of transition to this IFRS, 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 IFRS for the same period.

Notes

An entity's first financial statements under the *IFRS for SMEs* must comply with all of the disclosure requirements in the *IFRS for SMEs*. 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 meet (as noted above).

The entity's explanation of how the transition from its previous financial reporting framework to the *IFRS for SMEs* affected its reported financial position, financial performance and cash flows is most relevant to external stakeholders in understanding 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* (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 help users, for example potential suppliers or bank lenders, to assess whether to provide the entity with a loan or other form of credit.

Example—explanation of the impacts of adopting this IFRS

Ex 49 **One way an entity could disclose how the transition from its previous financial reporting framework to the *IFRS for SMEs* affected its reported financial position, financial performance and cash flows is shown below.**

Extract from the notes to the consolidated financial statements for the year ended 31 December 20X4

Note 2 Basis of preparation and accounting policies

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

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* are set out in note 3 below.

...

Note 3 Transition to the *IFRS for SMEs*

These consolidated financial statements for the year ended 31 December 20X4 are the group's first consolidated financial statements that comply with the *IFRS for SMEs*. The group's date of transition to the *IFRS for SMEs* 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* has resulted in a number of changes in the entity's accounting policies compared to those used when applying AGAAP.

The following explanatory notes to the consolidated financial statements describe the differences between the equity and profit or loss presented under AGAAP and the newly presented amounts under *IFRS for SMEs* for the reporting period ended at 31 December 20X3 (ie comparative information), as well as the equity presented in the

opening statement of financial position (ie at 1 January 20X3). It also describes all the required changes in accounting policies made on first-time adoption of the *IFRS for SMEs*.

In the table below equity determined in accordance with the *IFRS for SMEs* is reconciled to equity determined in accordance with AGAAP at both 1 January 20X3 (the date of transition to the *IFRS for SMEs*) 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

		at 1 January 20X3			*at 31 December 20X3*		
Note		*AGAAP*	*Effect of transition*	IFRS for SMEs	*AGAAP*	*Effect of transition*	IFRS for SMEs
		CU	CU	CU	CU	CU	CU
3.1	Intangible assets	530	(245)	285	446	(196)	250
3.2	Property, plant and equipment	1,288	57	1,345	1,202	44	1,246
3.3	Financial assets	333	28	361	658	(20)	638
3.4	Inventories	470	94	564	230	115	345
	Assets total	**2,621**	**(66)**	**2,555**	**2,536**	**(57)**	**2,479**
3.2	Lease payable	–	72	72	–	58	58
3.3	Financial liabilities	320	50	370	126	50	176
3.5	Employee benefits	–	132	132	–	148	148
	Liabilities total	**320**	**254**	**574**	**126**	**256**	**382**
3.3	Issued capital	1,975	(50)	1,925	1,975	(50)	1,925
	Retained earnings	326	(270)	56	434	(262)	172
	Equity total	**2,301**	**(320)**	**1,981**	**2,409**	**(312)**	**2,097**

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

Note		*AGAAP* CU	*Effect of transition* CU	*IFRS for SMEs* CU
3.6	Net sales	1,058	(58)	1,000
3.2, 3.4 & 3.5	Cost of goods sold (COGS)	(630)	21	(609)
	Gross profit	428	(37)	391
3.1, 3.2 & 3.5	Operating expenses	(263)	38	(225)
	Operating profit	165	1	166
	Fair value of financial assets	–	10	10
3.2, 3.3 & 3.5	Financial expenses	(7)	(3)	(10)
	Profit (or loss) for the period	**158**	**8**	**166**

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

- The entity declared and paid CU50 dividends in 20X3.

- In this example, for simplicity, the unwinding of the discount for the liability component of the convertible debt (compound financial instrument) has been ignored.

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*. At 1 January 20X3, the cumulative transition adjustment 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* than it was in accordance with AGAAP. During 20X3 the entity did not incur any expenditure related to research and development.

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*.

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

Consequently, profit for the year ended 31 December 20X3 is CU3 higher in accordance with the *IFRS for SMEs* 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* differ only in one respect—unlike the *IFRS for SMEs* (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 its opening statement of financial position at 1 January 20X3 (the date of transition) the entity reduces the carrying amount of its plant by CU30.

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* than it is in accordance with the 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* those investments are measured at fair value with changes in fair value recognised in profit or loss. Consequently, in its opening 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*.

Financial liabilities

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

Consequently, in the opening statement of financial position at 1 January 20X3 (the date of transition) a reclassification of CU50 was made from equity to liability for the liability component of convertible debt issued by the entity that was outstanding on 1 January 20X3.

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* the entity measures inventories using the weighted average cost formula. Consequently, in its opening statement of financial position at 1 January 20X3 (the date of transition) the entity increases the carrying amount of inventories by CU94.

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

3.5 Employee benefits

The entity provides its employees with a final salary pension scheme. The scheme is unfunded.

In accordance with AGAAP, the entity does not recognise its obligations to pay pensions to its employees and former employees (ie post-employment benefits are recognised as an expense only when paid).

In accordance with the *IFRS for SMEs* the entity recognises a liability for the entity'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 its opening statement of financial position at 1 January 20X3 (the date of transition) the entity increased its liabilities by CU132, and the 20X3 expenses is CU16 higher under the *IFRS for SMEs*.

3.6 Revenue

Consignment sales

Under AGAAP the entity used to recognise 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* 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 (as illustrated in paragraph 23A.6). Consequently, in its statement of financial performance for 31 December 20X3 revenue is CU20 lower using the *IFRS for SMEs*.

Cash on delivery sales

Internet sales represent around 28 per cent of the entity's sales. The entity does not accept credit cards on 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 the entity used to recognise revenue related to such sales when the orders were received through the Internet. The *IFRS for SMEs* requires that the sales revenue related to such transactions must be recognised when delivery is made and cash is received by the seller or its agent (in accordance with paragraph 23A.7). Consequently, in its statement of financial performance for 31 December 20X3 profit is CU38 lower using the *IFRS for SMEs*.

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

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 standard specifically permits or requires another treatment) are accounted for retrospectively (ie 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).

In accordance with paragraph 35.7 an entity applies the *IFRS for SMEs* in recognising and measuring its assets and liabilities in its opening statement of financial position. Because the accounting policies that an entity uses in accordance with the *IFRS for SMEs* are different from those in its previous financial reporting framework (and to the extent that the entity elects particular exemptions), adjustments are made to retained earnings in the entity's opening statement of financial position. Because separate presentation of the correction of prior period errors (in accordance with paragraph 35.14) is required, users of the entity's first financial statements that conform to the *IFRS for SMEs* can evaluate the effects of changes in accounting policies (and other effects of transitioning to the *IFRS for SMEs)* separately from the effects of prior period errors.

While preparing for the transition to the *IFRS for SMEs*, 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 in the opening statement of financial position in the same manner as adjustments resulting from changes in accounting policies from previous GAAP to the *IFRS for SMEs* as required by paragraph 35.7. However, the reconciliations or 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*.

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

Ex 50 **The facts are the same as in example 49. 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.**

Extract from the notes to the financial statements for the year ended 31 December 20X4

…

Note 12 Correction of prior period error

In 20X4, the entity 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 is 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 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	*AGAAP restated*	*Effect of transition*	IFRS for SMEs
		CU	CU	CU	CU	CU	CU	CU	CU
3.1	Intangible assets	530	(80)	450	(245)	205	346	(196)	150
3.2	Property, plant and equipment	1,288	–	1,288	57	1,345	1,202	44	1,246
3.3	Financial assets	333	–	333	28	361	658	(20)	638
3.4	Inventories	470	–	470	94	564	230	115	345
	Assets total	**2,621**	**(80)**	**2,541**	**(66)**	**2,475**	**2,436**	**(57)**	**2,379**
3.2	Lease payable	–	–	–	72	72	–	58	58
3.3	Financial liabilities	320	–	320	50	370	126	50	176
3.5	Employee benefits	–	–	–	132	132	–	148	148
	Liabilities total	**320**	–	**320**	**254**	**574**	**126**	**256**	**382**
3.3	Issued capital	1,975	–	1,975	(50)	1,925	1,975	(50)	1,925
	Retained earnings	326	(80)	246	(270)	(24)	334	(262)	72
	Equity total	**2,301**	**(80)**	**2,221**	**(320)**	**1,901**	**2,309**	**(312)**	**1,997**

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

Note		*AGAAP original*	*Correction of prior periods errors*	*AGAAP restated*	*Effect of transition*	IFRS for SMEs
		CU	CU	CU	CU	CU
3.6	Net sales	1,058	–	1,058	(58)	1,000
3.2, 3.4 & 3.5	Cost of goods sold (COGS)	(630)	–	(630)	21	(609)
	Gross profit	428	–	428	(37)	391
3.1, 3.2 & 3.5	Operating expenses	(263)	(20)	(283)	38	(245)
	Operating profit	165	–	145	1	146
	Fair value of financial assets	0	–	0	10	10
3.2, 3.3 & 3.5	Financial expenses	(7)	–	(7)	(3)	(10)
	Profit (or loss) for the period	**158**	**(20)**	**138**	**8**	**146**
	Retained earnings at the beginning of the year			**246**	**(270)**	**(24)**
	- as previously stated			326	(350)	(24)
	- effect of the correction of prior periods errors			(80)	80	–
	- cash dividends			(50)	–	(50)
	Retained earnings at the end of the year			**334**	**(262)**	**72**

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 IFRS.

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

Ex 51 **An entity prepared general purpose financial statements for the first time for the year ended 31 December 20X4. Those financial statements comply with the *IFRS for SMEs*. The entity could disclose information about this fact as follows:**

Extract from the notes to the financial statements for the year ended 31 December 20X4

Note 2 Basis of preparation and accounting policies

These consolidated financial statements have been prepared in accordance with the *International Financial Reporting Standard for Small and Medium-sized Entities* issued by the International Accounting Standards Board in July 2009. They are presented in the currency units (CU) of A Land.

...

Note 3 Adoption of the *IFRS for SMEs*

These are the entity's first financial statements. They are prepared in accordance with the *IFRS for SMEs*. The financial statements include comparative information for the year ended 31 December 20X3.

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* retrospectively:

1. at 1 January 20X3 the entity measures each item of property, plant and equipment at its fair value and use that fair value as its deemed cost at that date;
2. at 1 January 20X3 the entity determines whether an arrangement existing at that date contains 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. etc.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* to transactions and events often requires judgement. Information about significant judgements and key sources of estimation uncertainty are useful in assessing the financial position, performance and cash flows of an entity. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with 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* require disclosure of information about particular judgements and estimation uncertainties.

The following are examples of significant estimates and other judgements required when applying Section 35.

The application of the *IFRS for SMEs*

Once an entity applies the *IFRS for SMEs* 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 this IFRS. For details about such significant estimates and judgements, see the training material for those modules.

Exemptions

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

- Considerable judgement will be required to determine the fair values at the date of acquisition of assets acquired and liabilities and contingent liabilities assumed if these were not made at the time of the business combination (paragraph 35.10(a)).
- Considerable judgement will be required to determine the appropriate valuation of these share-based payment transactions retrospectively if valuations were not previously obtained (paragraph 35.10(b)).
- Considerable estimation may be required to reconstruct cost information or other transactional data for property, plant, and equipment and other long-term assets if entities did not retain the necessary historical information (paragraph 35.10(c) and (d).

On the other hand, applying some of the exemptions in Section 35.10 requires judgements. For example, if an entity elects to measure an item of property, plant and equipment's cost at its fair value at the date of transition to the *IFRS for SMEs* it must make the estimates and judgements that are necessary to determine that fair value. The guidance provided in paragraphs 11.27–11.32 is useful in informing those estimates and judgements.

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.

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

However, using this exemption is not a free choice. 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 IFRSs

The primary differences between the requirements for accounting and reporting on first-time adoption of the *IFRS for SMEs* (see Section 35 *Transition to the* IFRS for SMEs) and full IFRSs (see IFRS 1 *First-time Adoption of International Financial Reporting Standards*) include:

- The *IFRS for SMEs* is drafted in plain language and includes significantly less guidance on how to apply the principles.
- The *IFRS for SMEs* includes an 'impracticability' exemption (which is not in IFRS 1). Restatement for one or more adjustments is not required if impracticable. Similarly comparative disclosures are not required if providing them is impracticable (see paragraph 35.11).
- The exceptions specified in paragraph 35.9(a), (b) and (e) are similar to the exceptions in IFRS 1. However, there are differences in the detail, which will cause differences in practice.
- Most of the exceptions in paragraph 35.10 are also permitted under IFRS 1 except that 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.
- Paragraph 35.10(h) allows a first-time adopter of the *IFRS for SMEs* to not recognise, at the date of transition to the *IFRS for SMEs*, deferred tax assets or deferred tax liabilities. This exemption is not present in IFRS 1.
- There are a number of exemptions in IFRS 1 that are not included in Section 35 because they are not relevant to the accounting requirements in the *IFRS for SMEs* (eg exemptions relating to insurance, employee benefits, assets and liabilities of subsidiaries, associates and joint ventures, and designation of previously recognised financial instruments).
- Section 35 does not require a number of the disclosures in IFRS 1; for example in relation to the following:
    - 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); and
    - 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* by answering the questions below.

Once you have completed the test check your answers against those set out below this test.

Assume that all amounts are material.

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* in the current period?

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

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

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

☐ (e) An entity that presents its first annual financial statements that conform to the *IFRS for SMEs* 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* 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.* For the years ended 31 December 20X2 and 20X3 Entity A prepared only financial statements in compliance with full IFRSs.

☐ (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* 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*).

☐ (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* 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*.

☐ (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* and presented financial statements that conform to that standard (including an explicit and unreserved statement of compliance with the *IFRS for SMEs*).

☐ (e) Both entities C and D.

☐ (f) Both entities B and C.

Question 3

The date of transition to the *IFRS for SMEs* is:

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

Question 4

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

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

- ☐ (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. However, in this example, full comparative information is provided for two years.

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

- ☐ (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 to a 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 gross less CU15,000 accumulated depreciation) in statement of financial position at 31 December 20X5.

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

- 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* will be for the year ended 31 December 20X7. In its opening statement of financial position at 1 January 20X6 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 historic cost less CU50,000 accumulated depreciation).

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

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

☐ (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 group's consolidated statement of comprehensive income for the year ended 31 December 20X1). This is the only business combination that the entity entered into.

At 1 January 20X6 the entity estimated the fair value of the goodwill in respect of the acquired business is CU8,000.

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

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

In its opening consolidated statement of financial position at 1 January 20X6 the group 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 historic 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) CU8,000 (ie estimated fair value of the goodwill on the date of transition to the *IFRS for SMEs*).

☐ (d) Either (a) or (b) above.

☐ (e) Any of (a) to (c) above.

Question 8

The facts are the same as in question 7. However, in this example 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 group's opening statement of financial position at 1 January 20X6 they 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). At 1 January 20X6 the entity estimated the fair value of the goodwill in respect of the second acquired business is CU4,500.

In its opening consolidated statement of financial position at 1 January 20X6 the group 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 historic cost less CU5,000 accumulated amortisation).

☐ (b) nil (ie no restatement of the goodwill recognised as an expense immediately in accordance with the previous financial reporting framework).

☐ (c) CU8,000 (ie estimated fair value on the date of transition to the *IFRS for SMEs*).

☐ (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 have decided that in preparing the group's opening statement of financial position at 1 January 20X6 they 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 opening consolidated statement of financial position at 1 January 20X6 the group 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 historic cost less CU1,000 accumulated amortisation).

☐ (b) Nil (ie expenses immediately in accordance with the previous financial reporting framework).

☐ (c) CU4,500 (ie fair value on the date of transition to the *IFRS for SMEs*).

☐ (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 opening statement of financial position at the date of transition to the *IFRS for SMEs* 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 the data presented for prior periods that are not comparable with data for the period in which it prepares its first financial statements that conform to the *IFRS for SMEs*.

☐ (c) Both (a) and (b) are correct.

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

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

☐ (f) Both (d) and (e) are correct.

Question 11

An entity's first financial statements that conform to the *IFRS for SMEs* 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* 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* must present a number of reconciliations. Which one of the following four reconciliations is not 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* 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* for 20X4.

☐ (c) A reconciliation of its equity under its previous financial reporting framework to its equity in accordance with the *IFRS for SMEs* 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* 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* in the Glossary and paragraph 35.4.

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

Q3 (c) See paragraph 35.6.

Q4 (c) See paragraph 35.6. If 31/12/20X8 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 31/12/20X8 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). 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 (a) to use the exemption in paragraph 35.10(a).

Q10 (c) See paragraph 35.11.

Q11 (b) See paragraph 35.13.

Module 35 – Transition to the *IFRS for SMEs*

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for the transition to the *IFRS for SMEs* in accordance with the *IFRS for SMEs* by solving the case studies below.

Once you have completed the case studies check your answers against those set out below this test.

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* 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* and they include an explicit and unreserved statement of compliance with the *IFRS for SMEs*.

Entity Z provided 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 the Entity Z's date of transition to the *IFRS for SMEs*?

Part B:

Prepare the notes that Entity Z would present in its first financial statements that conform to the *IFRS for SMEs* to explain how the transition from the previous financial reporting framework to the *IFRS for SMEs* 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* 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**

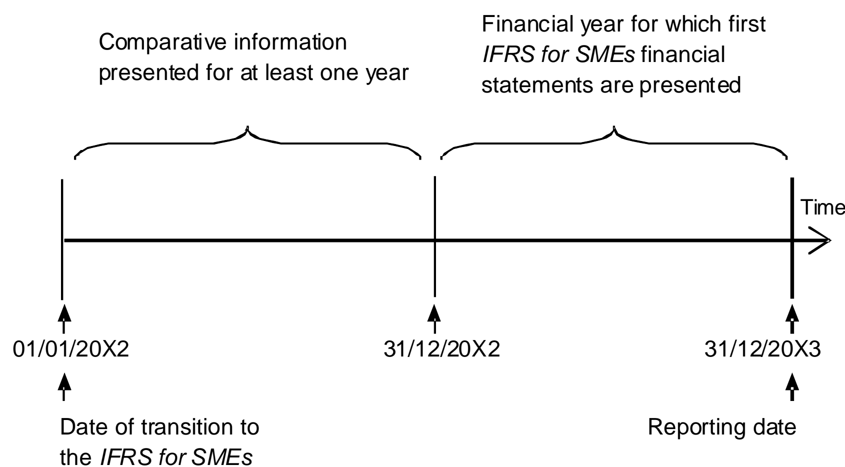
Reconciliation:

	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* is 1 January 20X2 (the same as 31 December 20X1). This is the beginning of the comparative period (ie 31 December 20X2). This considers the following facts:

- The financial statements for the year ended 31 December 20X3 is the first set of financial statements presented by Entity Z that is prepared in accordance with the *IFRS for SMEs.*
- The 20X3 financial statements are the first set to make an explicit and unreserved statement of compliance with the *IFRS for SMEs*.
- 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*: announcement and reconciliations

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

Before the adoption of the *IFRS for SMEs*, Entity Z financial statements were based on jurisdiction X's tax law (previous financial reporting framework). The following explanatory notes to the financial statements describe the differences between the *IFRS for SMEs* and the previous financial reporting framework for the reporting period ended at 31 December 20X2 as well as for the opening *IFRS for SMEs* statement of financial position at 1 January 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** *CU*	*Previous financial reporting framework* *CU*	*Difference* *CU*	**IFRS for SMEs** *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* *CU*
	...			
3.8	Cost of sales	35,700	(700)	35,000
	Gross profit			
	...			

3.8 Inventory

Changes in inventory arise from the remeasurement of inventories from the last-in, first-out (LIFO) cost formula from the previous financial reporting framework to the first-in, first-out (FIFO) cost formula used in accordance with the *IFRS for SMEs*.

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*. 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*, including an explicit and unreserved statement of compliance with the *IFRS for SMEs*. 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* is 1 January 20X4.

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

(a) Depreciation of the entity's sales office in accordance with the previous financial reporting framework 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 CU100 lower than what it would have been if the entity had applied the *IFRS for SMEs*. Profit for 20X4 was CU20 lower than if the *IFRS for SMEs* was used.

(b) Intangible assets, in accordance with the previous financial reporting framework at 1 January 20X4, included CU150 for items that in accordance with the *IFRS for SMEs* would have been recognised in goodwill because they do not qualify for recognition as separate intangible assets. The effect on profit for 20X4 is not material.

(c) Financial assets that Sections 11 *Basic Financial Instruments* and 12 *Other Financial Instruments Issues* require to be accounted for at fair value through profit or loss were, in accordance with the previous financial reporting framework, carried at cost. As a consequence, at 1 January 20X4 the carrying amount is CU420 lower than if the *IFRS for SMEs* 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 the previous financial reporting framework, the carrying amount of inventories at 1 January 20X4 is CU400 lower than if the *IFRS for SMEs* had been used. For the same reason, the cost of sales for 20X4 is CU47 lower than if the *IFRS for SMEs* had been used.

(e) A hedge relationship that 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 the previous financial reporting framework, the hedging instrument was carried at cost (nil). Consequently, the CU431 of unrealised foreign exchange gains on the unmatured hedging instrument was not recorded in equity. In 20X4 the decrease in fair value of such financial assets was CU40.

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

(g) At 1 January 20X4, a restructuring provision of CU250 relating to head office activities was recognised in accordance with the previous financial reporting framework, but does not qualify for recognition as a liability in accordance with the *IFRS for SMEs*. In 20X4 (after the date of transition to the *IFRS for SMEs*) the CU250 restructuring provision qualified for recognition in accordance with the *IFRS for SMEs*.

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*):

	YGAAP CU		*YGAAP* CU
Property, plant and equipment	8,299	Interest-bearing loans	9,396
Goodwill	1,220	Trade and other payables	4,124
Intangible assets	208	Restructuring provision	250
Financial assets	3,471	Other liabilities	621
Total non-current assets	13,198		
		Total liabilities	14,391
Trade and other receivables	3,710		
Inventories	2,962		
Other receivables	333	Total assets less total liabilities	6,560
Cash and cash equivalents	748		
		Issued capital	1,500
Total current assets	7,753	Retained earnings	5,060
Total assets	20,951	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 of 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 and its equity determined in accordance with the *IFRS for SMEs* at the date of transition to the *IFRS for SMEs* at 1 January 20X4.
Note: a similar reconciliation of equity at the end of the latest period presented in the entity's most recent annual financial statements that were determined in accordance with its previous financial reporting framework is required in paragraph 35.13(b)(ii).

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 for the latest period presented in the entity's most recent annual financial statements to its profit determined in accordance with the *IFRS for SMEs* 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*):

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

Note		*Previous financial reporting framework* CU	*Effect of transition to the* IFRS for SMEs CU	IFRS for SMEs CU
1	Property, plant and equipment	8,299	100	8,399
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	520	13,718
	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**	**1,351**	**22,302**
	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**	**1,535**	**8,095**
	Issued capital	1,500	–	1,500
5	Hedging reserve	–	431	431
9	Retained earnings	5,060	1,104	6,164
	Total equity	**6,560**	**1,535**	**8,095**

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

1 Depreciation in accordance with the previous financial reporting framework ignored an asset's residual value, but in accordance with the *IFRS for SMEs* an asset's depreciable amount is net of its residual value. The cumulative adjustment increased the carrying amount of property, plant and equipment by CU100.

2 Intangible assets in accordance with the previous financial reporting framework 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*.

3 Particular financial assets are, in accordance with the *IFRS for SMEs,* measured at fair value with changes in fair value recognised in profit or loss. In accordance with the previous financial reporting framework

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* had been used. The resulting gains are included in retained earnings.

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

5 Unrealised gains of CU431 on unmatured forward foreign exchange contracts are recognised in accordance with the *IFRS for SMEs*, but were not recognised in accordance with previous financial reporting framework. 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*, but was not recognised in accordance with the previous financial reporting framework, which used a cash basis.

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

9 The adjustments to retained earnings are as follows:

	CU
Depreciation (note 1)	100
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	1,104

Answer to case study 2—Part B

The following is the reconciliation of total comprehensive income for 20X4:

Reconciliation of total comprehensive income for 20X4

Note		*Previous financial reporting framework* CU	*Effect of transition to the* IFRS for SMEs CU		IFRS for SMEs CU
	Revenue	20,910	–		20,910
1, 2	Cost of sales	(15,283)	(97)	(a)	(15,380)
	Gross profit	5,627	(97)		5,530
5	Other income	–	180		180
1, 3	Distribution costs	(1,907)	(10)	(b)	(1,917)
1, 4	Administrative expenses	(2,842)	(300)	(c)	(3,142)
	Finance income	1,446	–		1,446
	Finance costs	(1,902)	–		(1,902)
	Profit for the year	422	(227)		195
6	Cash flow hedges	–	(40)		(40)
	Loss of translating of foreign operation	(158)	–		(158)
	Other comprehensive income	(158)	(40)		(198)
	Total comprehensive income	264	(267)		(3)

Notes to the reconciliation of total comprehensive income for 20X4:

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

2 Cost of sales is higher by CU47 in accordance with the *IFRS for SMEs* because inventories include fixed and variable production overhead in accordance with the *IFRS for SMEs* but not in accordance with the previous financial reporting framework.

3 Depreciation of property, plant and equipment decreased by CU20 during 20X4 because, unlike the previous financial reporting framework, depreciation of buildings in accordance with the *IFRS for SMEs* takes account of the building's residual value.

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

5 Financial assets at fair value through profit or loss increased in value by CU180 during 20X4. They were carried at cost in accordance with the previous financial reporting framework. Fair value changes have been included in 'Other income'.

6 The fair value of forward foreign exchange contracts that are effective hedges of forecast transactions decreased by CU40 during 20X4.

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 1) + CU47 production overhead (see note 2).

[b] CU50 = CU30 pension expense increase (see note 1) less CU20 depreciation decrease (see note 3).

[c] CU300 = CU50 pension liability increase (see note 1) + CU250 restructuring provision (see note 4).