IFRS® Accounting

Educational Module 35

Transition to the *IFRS for SMEs* Accounting Standard

IFRS for SMEs®

Accounting Standard

Third Edition

International Accounting Standards Board

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

including the full text of
Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*
of the *IFRS for SMEs* Accounting Standard issued by
the International Accounting Standards Board in February 2025

with extensive explanations, self-assessment questions and case studies

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The requirements of Section 35 *Transition to the* IFRS for SMEs *Accounting Standard* of the *IFRS for SMEs* Accounting Standard are set out in this module and shown with grey shading. Appendix B of the *IFRS for SMEs* Accounting Standard contains the glossary (Glossary) and is part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 35.

This module has been prepared by International Accounting Standards Board (IASB) technical staff. The educational notes and examples inserted by the staff are not shaded. These educational notes and examples do not form part of the *IFRS for SMEs* Accounting Standard and have not been approved by the IASB.

INTRODUCTION

What is the *IFRS for SMEs*® Accounting Standard?

The *IFRS for SMEs* Accounting Standard (Standard) is intended for use by entities that publish general purpose financial statements and that do not have public accountability (referred to as small and medium-sized—see Section 1 *Small and Medium-sized Entities* of the Standard).

The objective of general purpose financial statements is to provide information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

More information about the Standard and its supporting materials is available on the IFRS Foundation website: www.ifrs.org.

What does this module cover?

This educational module supports the requirements for transition to the Standard in accordance with its Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*. The module:

- focuses on the requirements applicable to a first-time adopter of the Standard;
- introduces the requirements and reproduces the text of the Standard along with explanatory notes and examples designed to enhance understanding of those requirements;
- identifies the significant judgements required in accounting for the transition to the Standard;
- includes questions designed to test your understanding of the requirements in Section 35; and
- includes case studies that provide a practical opportunity to apply the Section 35 requirements.

After completing the module, you should be able to:

- determine when an SME is a first-time adopter of the Standard;
- explain why an SME that has applied the Standard in a previous period can apply Section 35;
- identify the date of transition to the Standard;
- understand what is required, what is permitted and what is prohibited when selecting an SME's accounting policies in accordance with the Standard;

- determine the appropriate adjustments to assets, liabilities and equity at the date of transition;
- understand the mandatory exceptions and optional exemptions to retrospective application of the Standard on first-time adoption provided in Section 35;
- provide the disclosures required for an SME applying Section 35; and
- understand the significant judgements that are required in accounting for the transition to the Standard.

Which version of the Standard does this module refer to?

Any reference in this module to 'the *IFRS for SMEs* Accounting Standard' is to the third edition of the Standard, issued February 2025.

What is in the requirements?

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the reporting entity that is useful to existing and potential investors, lenders and other creditors when making decisions relating to providing resources to the entity.

Section 35 sets out the requirements for a first-time adopter of the Standard.

The objective of Section 35 is to provide a starting point for applying the Standard that balances the need for users of financial statements to obtain high-quality information (that is, information about the SME's assets, liabilities, equity, income and expenses that is useful for assessing the prospects for its future net cash inflows and management's stewardship of its economic resources) with the need to generate that information at a cost that does not exceed the benefits to users.

Section 35 specifies requirements for making adjustments to an SME's assets, liabilities and equity at its date of transition to the Standard. The date of transition to the Standard is the beginning of the earliest period for which full comparative information in accordance with the Standard is presented.

An SME's first financial statements that conform to the Standard are prepared using the requirements in the version of the Standard that is effective for that reporting period, as modified by any specified exceptions and exemptions (see paragraphs 35.9–35.11).[1]

What has changed in the third edition of the Standard?

The IASB changed Section 35 in the third edition of the Standard by adding:

- an exception to the requirement for retrospective application of the Standard on first-time adoption for contracts with customers completed before the date of transition; and
- an option permitting first-time adopters to apply Section 23 *Revenue from Contracts with Customers* of the Standard retrospectively or prospectively.

Transition requirements are explained on page 78 of this educational module.

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1 The third edition of the *IFRS for SMEs* Accounting Standard (2025) is effective for annual periods beginning on or after 1 January 2027. Earlier application of these amendments is permitted, for example, in reporting periods in 2025 or 2026. Previously, the second edition of the Standard (2015) was the current version to be applied.

REQUIREMENTS AND EXAMPLES

Scope of this section

35.1 This section applies to a **first-time adopter of the *IFRS for SMEs* Accounting Standard**, regardless of whether its previous accounting framework was **full IFRS Accounting Standards** 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.

Educational notes

A first-time adopter of the *IFRS for SMEs* Accounting Standard (Standard) is an entity that is presenting its first annual financial statements in accordance with the Standard, regardless of whether its previous financial reporting framework was full IFRS Accounting Standards or another set of accounting standards or whether it has ever prepared general purpose financial statements before. Full IFRS Accounting Standards are the Standards and Interpretations issued by the International Accounting Standards Board (IASB). They comprise International Financial Reporting Standards, International Accounting Standards, IFRIC Interpretations and SIC Interpretations.

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

Educational notes

Application of Section 35 is mandatory the first time that an entity applies the Standard in its annual financial statements. Compliance with the Standard requires the financial statements to include an explicit and unreserved statement of compliance (see paragraph 3.3 of the Standard). The purpose of Section 35 is to provide information that is useful to users of financial statements at a cost that does not exceed the benefits when an entity adopts the Standard for the first time.

An entity that has previously applied the Standard but whose most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with the Standard might resume using the Standard. At this point, it must choose whether to apply Section 35 or to comply with all the requirements in the Standard as if it had never stopped using the Standard all along. If the entity chooses the latter option, it retrospectively applies the Standard as if it had never stopped applying the Standard, and restates its comparative information accordingly. When an entity adopts the Standard for the second time, it may not need some or all of the reliefs provided in Section 35, or it might determine that the benefits of applying the Standard as if it had continued to do so without interruption would exceed the costs of preparing the information required by Section 35. Therefore, entities are given a choice on the re-adoption of the Standard, rather than being required to apply Section 35.

Example—Applying Section 35 more than once

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

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

In 20X4, SME A may choose to apply Section 35 again when preparing its 20X4 financial statements, or it may choose to apply the Standard retrospectively and therefore restate the 20X3 amounts as if it had never stopped using the Standard.

First-time adoption

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

Educational notes

The purpose of Section 35 is to provide requirements that ease transition from a previous financial reporting framework (for example, a local GAAP) to the Standard for an entity's first financial statements prepared in accordance with the Standard. Without Section 35, an entity would be required to apply all the requirements in the Standard retrospectively.

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

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

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

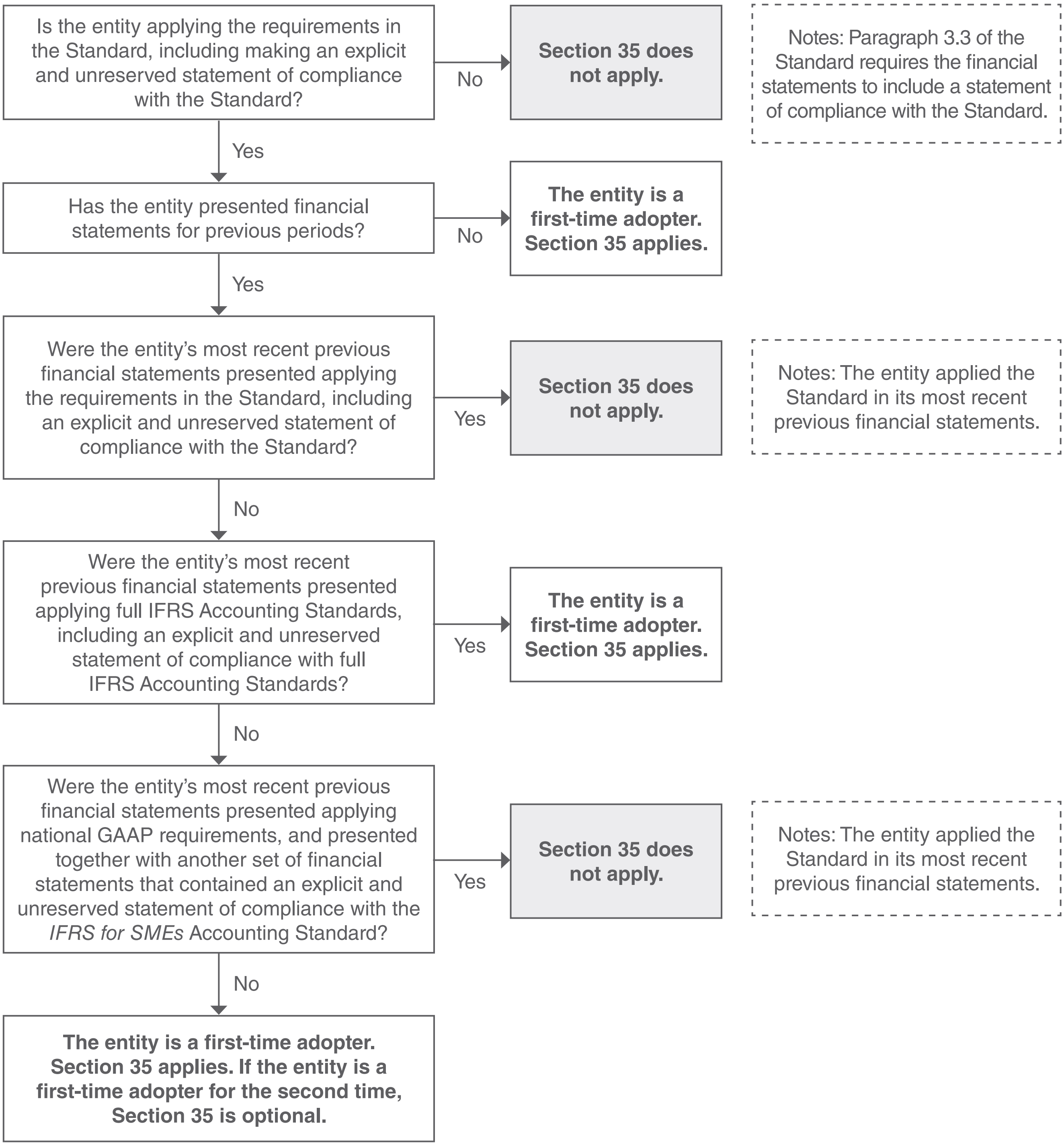
(c) presented its most recent previous financial statements in conformity with full IFRS Accounting Standards.

Educational notes

An entity cannot assert compliance with the Standard unless it complies with all the requirements in the Standard. For example, an entity cannot pick and choose between the requirements in the Standard and those of full IFRS Accounting Standards.

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

Figure 1—Determining whether the entity is a first-time adopter of the *IFRS for SMEs* Accounting Standard



Examples—First financial statements in accordance with the Standard

Ex 2 **An entity has prepared its financial statements in accordance with local GAAP every year since it was incorporated. For the year ended 31 December 20X3, it also prepared pro forma financial statements in accordance with the *IFRS for SMEs* Accounting Standard—except that those pro forma financial statements do not include comparative amounts or a statement of compliance with the Standard.**

The entity's financial statements for the year ended 31 December 20X4 comply with the Standard, including the requirements for comparative amounts and a statement of compliance. Consequently, those financial statements include comparative amounts for 20X3 and an explicit and unreserved statement of compliance with the Standard.

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

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

Note 2 Basis of preparation (extract)
These financial statements have been prepared applying the *IFRS for SMEs* Accounting Standard issued by the International Accounting Standards Board. This complete set of financial statements (for the year ended 31 December 20X4) is the entity's first financial statements that conform to the Standard.

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

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

Ex 4 **An entity has prepared its financial statements in accordance with local GAAP every year since it was incorporated. During 20X3 the entity published a statement of financial position as at 1 January 20X3 (its date of transition to the Standard), prepared applying Section 35. The entity intends this statement to be an opening statement of financial position for its 20X4 financial statements, which will be prepared applying the Standard.**

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

Ex 5 **An entity has prepared its financial statements in accordance with full IFRS Accounting Standards every year since it was incorporated. For the year ended 31 December 20X3, it also prepared pro forma financial statements in accordance with the *IFRS for SMEs* Accounting Standard except that those financial statements did not include comparative amounts or a statement of compliance with the *IFRS for SMEs* Accounting Standard.**

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

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

35.5 Paragraph 3.17 defines a complete set of financial statements.

Educational notes

In accordance with paragraph 3.17 of Section 3 *Financial Statement Presentation* of the Standard, a 'complete set of financial statements' includes:

(a) a statement of financial position as at the reporting date (see Section 4 *Statement of Financial Position* of the Standard).

(b) either (see Section 5 *Statement of Comprehensive Income and Income Statement* of the Standard):

   (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) an income statement and a 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 *Statement of Changes in Equity and Statement of Income and Retained Earnings* of the Standard).

(d) a statement of cash flows for the reporting period (see Section 7 *Statement of Cash Flows* of the Standard).

(e) notes, comprising a summary of significant accounting policies and other explanatory information (see Section 8 *Notes to the Financial Statements* of the Standard).

The entity is required to present comparative information for the previous comparable period.

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

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

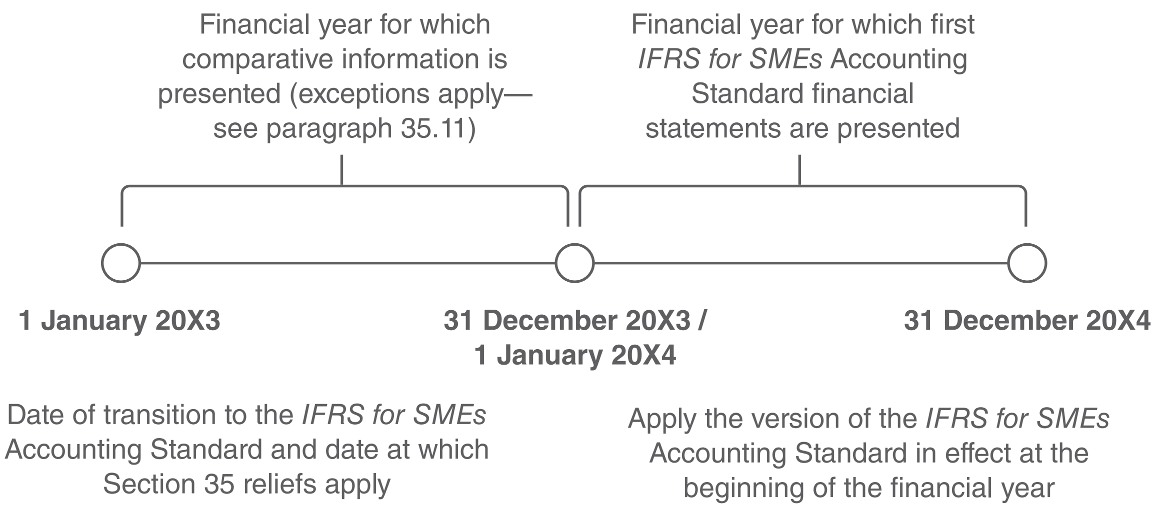
Educational notes

The date of transition to the Standard is important because it is this date that the exemptions in Section 35 from full retrospective application apply.

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

Figure 2—Illustration of the date of transition to the Standard

The illustration in Figure 2 on the date of transition to the Standard assumes the entity presents comparatives for one year.



Examples—Date of transition to the Standard

Ex 6 In 20X1 an entity's management decided to adopt the *IFRS for SMEs* Accounting Standard for the financial year ending 31 December 20X4. Until then, the entity had prepared its financial statements in accordance with local GAAP. Neither local GAAP nor local law requires entities to present comparative information.

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

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

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

Ex 7 The facts are the same as Example 6 except that local law requires the entity to present full comparative information in accordance with the *IFRS for SMEs* Accounting Standard for two prior periods.

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

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

Procedures for preparing financial statements at the date of transition

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

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

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

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

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

Educational notes

The general principle underlying subparagraphs 35.7(a)–35.7(d) is that a first-time adopter apply retrospectively all of the requirements in the version of the Standard that is in effect at the beginning of the current reporting period. Consequently, the first financial statements that conform with the Standard are presented as if the entity had always applied that version of the Standard. Paragraphs 35.9–35.11 provide exceptions and exemptions to the general principle.

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

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

Educational notes

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

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

Examples—Recognising all assets and liabilities required by the Standard (paragraph 35.7(a))

Ex 8 An entity's first financial statements that conform to the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

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

Because Section 19 *Business Combinations and Goodwill* of the Standard requires the acquirer, at the acquisition date, to recognise goodwill acquired in a business combination as an asset, the entity adjusts the balances it determined in accordance with its previous financial reporting framework at 1 January 20X3 (its date of transition) to recognise the goodwill as an asset on 1 January 20X3 (the date of transition to the Standard). This adjustment is recognised directly in retained earnings (see paragraph 35.8).[2,3]

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

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

See paragraph 35.10(a) and examples 30–32 for the optional exemption from this requirement.

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

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

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

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

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

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

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

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

The entity prepared 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.

On applying the Standard, provisions that existed at the date of transition or at the end of a comparative period that were not recognised under the previous financial reporting framework must be accounted for retrospectively. Estimates for provisions should reflect conditions at the date of transition or the end of the comparative period. This treatment provides a faithful representation of the entity's obligation and performance in a manner that is comparable over time and between entities.

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

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

If the constructive obligation arose in 20X3 and is not settled by 31 December 20X4, the entity recognises it as a liability at 31 December 20X3 and as an expense (or as part of the cost of an asset, see paragraph 21.5) in 20X3. In accordance with paragraph 21.11 of the Standard, 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 either directly in retained earnings at 1 January 20X3 (see paragraph 35.8) or as part of the cost of an asset (see paragraph 35.7(d)). In accordance with paragraph 21.11 the entity reviews the provision at 31 December 20X3 and 31 December 20X4 and recognises a remeasurement adjustment in profit or loss in each year that the amount of the liability changed.

In accordance with paragraphs 35.7(d) and 21.7 of the Standard, the liability is measured at the best estimate of the amount required to settle the obligation (that is, on 1 January 20X3 for the balances at the start of the comparative period, on 31 December 20X3 for the comparative figures and on 31 December 20X4 for the statement of financial position at the reporting date—see paragraph 21.7). The measurement of the obligation is based on reliable information that was available when financial statements for those periods were authorised for issue (that is, for the years ended 31 December 20X2, 31 December 20X3 and 31 December 20X4 respectively), and could reasonably be expected to have been obtained and taken into account (see paragraph 10.14A of the Standard). Management must not use the benefit of hindsight to change the estimate of the liability based on new information or new developments that were not available when the relevant financial statements were originally prepared under the entity's previous financial reporting framework (see paragraph 35.9(c)).

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

Ex 11 **An entity's financial statements for the year ended 31 December 20X4 are its first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard. Those financial statements include comparative information for one year (20X3).**

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

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

Any expenditure on research and development incurred in 20X3 and 20X4 should be recognised and presented as expenses in the statement of comprehensive income for the years ended 31 December 20X3 and 20X4. If any amortisation from a research and development cost was recognised as an asset in accordance with the entity's previous financial reporting framework—say, the asset was recognised in 20X2 and then recognised as an expense through amortisation in 20X3—the 20X3 comparative amounts prepared in accordance with the Standard should exclude that amortisation expense and derecognise it.

Ex 12 An entity's financial statements for the year ended 31 December 20X4 are its first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard. Those financial statements include comparative information for one year (20X3).

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

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

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

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

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

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

Ex 13 An entity's financial statements for the year ended 31 December 20X4 are its first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard. Those financial statements include comparative information for one year (20X3).

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

Applying paragraph 4.5, the entity (as a first-time adopter) must reclassify those inventories previously presented as non-current assets to current assets.

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

Ex 14 An entity's financial statements for the year ended 31 December 20X4 are its first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard. Those financial statements include comparative information for one year (20X3).

The entity prepared its financial statements for the year ended 31 December 20X3 in accordance with local GAAP. In accordance with the previous financial reporting framework, the entity accounted for all preference shares issued by the entity as equity instruments, even though the entity is required by the terms of the instrument to redeem its preference shares for CU1,000 on 31 December 20X7. The entity has classified these preference shares as a financial liability applying the requirements in Section 22 *Liabilities and Equity* of the Standard.

At 1 January 20X3 (its date of transition) the entity must classify the preference shares as a liability 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 Standard).

The entity presents the preference shares as a liability in its statement of financial position at 31 December 20X4 and in the comparative information presented for 20X3. The entity's statement of comprehensive income for the year ended 31 December 20X4 (and comparative information for 20X3) includes an expense for the finance costs arising on the financial liability (the preference shares) as determined using the effective interest method in accordance with Section 11 of the Standard.

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

Ex 15 An entity that operates a taxi business previously prepared its financial statements in compliance with full IFRS Accounting Standards. It recognised its taxi licences as intangible assets applying the revaluation model, that is, the carrying amount equals fair value at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. Revaluation increases were 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 prepared in accordance with the *IFRS for SMEs* Accounting Standard. Those financial statements include comparative information for one year (20X3). On the date of transition, the entity did not choose to apply the fair value as deemed cost exemption in paragraph 35.10(c) or the revaluation as deemed cost exemption in paragraph 35.10(d).

The Standard does not permit the use of the revaluation model for intangible assets. It requires all intangible assets to be measured after initial recognition at cost less any accumulated amortisation and less any accumulated impairment losses (see paragraph 18.18). Consequently, at 1 January 20X3 (the date of transition to the Standard) the entity remeasures its taxi licences to eliminate any revaluations recognised in accordance with full IFRS Accounting Standards in prior periods. Any amortisation charged in 20X3 on the revalued amounts will similarly be remeasured in the comparative information in the entity's first financial statements prepared in accordance with the Standard. The revised amortisation charge is based on the cost of the taxi licenses. The revaluation surplus (recognised in accordance with full IFRS Accounting Standards) is also derecognised in equity.

Therefore, in its first financial statements prepared in accordance with the Standard (that is, those for the year ended 31 December 20X4, including comparative amounts for 20X3), the entity presents the taxi licences as if they had always been measured at cost less any accumulated amortisation and less any accumulated impairment.

See paragraphs 35.10(c), 35.10(d) and 35.10(da) and examples 35–39 for exemptions relating to this requirement.

Ex 16 **An entity's financial statements for the year ended 31 December 20X4 are its first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard. Those financial statements include comparative information for 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 prepared its financial statements in accordance with the income tax requirements in the jurisdiction in which it operates, which required use of the last-in, first-out (LIFO) cost formula for measuring inventories.

The Standard does not permit the use of the LIFO cost formula (see paragraph 13.18 of the Standard). Therefore, at its date of transition the entity measures its inventories using the FIFO cost formula or a weighted average cost formula, the cost formulas permitted in the Standard. It adjusts its opening retained earnings at 1 January 20X3 accordingly (paragraph 35.8). Cost of sales for the year ended 31 December 20X3 is similarly adjusted when preparing comparative information in accordance with the Standard.

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

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

…

Educational notes

Paragraph 35.9 lists seven situations in which the IASB believes that the Standard cannot be retrospectively applied with sufficient reliability or without the use of hindsight because retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. Therefore, all first-time adopters of the Standard are required to comply with the exceptions to retrospective application in paragraph 35.9.

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

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

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

…

Educational notes

An entity adopting the Standard for the first time generally applies the derecognition requirements in Section 11 of the Standard to transactions occurring on or after the date of transition to the Standard. The exception in paragraph 35.9(a) requires that financial assets and financial liabilities that were derecognised in accordance with the entity's previous financial reporting framework before the date of transition are not recognised on applying the Standard, even if those items would not have been derecognised if the entity had always applied the Standard. Such items must not be recognised again unless they qualify for recognition under the Standard as a result of a later transaction or event occurring on or after the date of transition.

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

If an entity chooses to continue to recognise a financial asset or liability until disposed of or settled, it would test the financial asset for impairment if it is measured at cost or amortised cost (see paragraphs 11.21–11.26 of the Standard). If the asset or liability is a financial instrument to be measured at fair value, the entity would remeasure it at fair value (see Section 12 *Fair Value Measurement* of the Standard) on the reporting date and for the dates for which comparative information is presented.

Examples—Derecognition of financial assets (paragraph 35.9(a))

Ex 17 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

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

Ex 18 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were prepared in accordance with local GAAP. The local GAAP required the entity to recognise and 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 carrying amount. The bank carries both the credit risk and the slow payment risk. If the entity had applied Section 11 of the Standard, those trade receivables would have been derecognised when they were sold to the bank on 31 December 20X2.

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

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

…

(b) hedge accounting. An entity shall not change its hedge accounting before the date of transition to the *IFRS for SMEs* Accounting Standard for hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Part II of Section 11 *Financial Instruments*, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Part II Section 11.

…

Educational notes

At the date of transition to the Standard, an entity applies the hedge accounting requirements in Part II of Section 11 of the Standard to all hedging relationships that exist at the date of transition.

The hedge accounting requirements in the Standard under Part II of Section 11 can be applied prospectively only from the later of:

- the date of transition; or
- the date that the hedge relationship meets the requirements under Part II of Section 11, including being appropriately designated and documented.

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

Examples—Hedge accounting (paragraph 35.9(b))

Ex 19 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

Ex 20 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were presented in accordance with local GAAP. The entity had one active hedging relationship at the date of transition to the *IFRS for SMEs* Accounting Standard (that is, at 1 January 20X3). In conformity with its previous financial reporting framework, the entity had used hedge accounting to recognise the change in the fair value of the hedged item and the change in the fair value of the hedging instrument in profit or loss in the same period. The entity's hedged item is a foreign currency government bond, and its hedging instrument is an option.

Because Section 11 of the Standard does not permit designation of an option as a hedging instrument and because it also does not permit hedge accounting for risks other than interest rate risk for a debt instrument, the entity cannot use hedge accounting with effect from the date of transition to the Standard.

At its date of transition (1 January 20X3), the entity applies paragraph 11.68 and recognises the government bonds at their carrying amount under its previous local GAAP. In subsequent accounting periods, the entity will amortise the adjustments to the carrying amount as a result of applying hedge accounting previously, over the remaining life of the bond using the effective interest method.

At its date of transition, the entity recognises the option at its carrying amount under its previous local GAAP. In subsequent accounting periods, the entity will measure the option at fair value and recognise changes in fair value in profit or loss (see paragraph 11.54). Consequently, there will be no adjustment to the opening retained earnings at 1 January 20X3.

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

…

(c) **accounting estimates**.

…

Educational notes

The reason for this mandatory exemption 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 judgements or assumptions used in developing the estimates that the entity makes at the date of transition to the Standard must be consistent with the judgements or assumptions used in developing the estimates that it made for the same date under its previous financial reporting framework (after adjustments to reflect any differences in accounting policies).

If any previous estimates were wrong because of errors (for example, omissions or misstatements) at the time they were originally made, they are corrected retrospectively—that is, as 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 Standard. The receipt of information after the date of transition to the Standard is treated in the same way as a non-adjusting event after the end of the reporting period (see paragraphs 32.6 and 32.7 of the Standard).

Example—Accounting estimates (paragraph 35.9(c))

Ex 21 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

The entity's financial statements for the year ended 31 December 20X3 were prepared 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 Standard.

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

At its date of transition (1 January 20X3) the entity measures the provision at CU9,500. The entity does not adjust its opening retained earnings at 1 January 20X3 because the accounting estimate made applying its previous financial reporting framework was appropriate at the time that the estimate was made on 31 December 20X2. The accounting in the first financial statements that conform to the Standard must not be based on hindsight from new information. Furthermore, the entity will continue to measure the provision at CU10,000 for the comparative information presented (31 December 20X3).

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

Example—Correcting an error in an accounting estimate

Ex 22 **The facts are the same as in Example 21, except that the information about advances in new technology was available at 31 December 20X2, and the entity's management did not adjust the provision accordingly.**

The information should have been considered at that time. As a result, the liability was overstated at 31 December 20X2 and 31 December 20X3. The prior period error is corrected retrospectively (see also paragraph 35.14). At its date of transition (1 January 20X3) the entity measures the provision at CU4,750, and increases retained earnings at 1 January 20X3 by the same amount to present the retrospective restatement of the prior period error that occurred when using its previous financial reporting framework. Furthermore, the entity will measure the provision at CU5,000 for the comparative information presented (31 December 20X3), and recognise the increase in provision in 20X3 of CU250 (CU5,000 minus CU4,750) in profit or loss.

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 entity will recognise the increase in provision in 20X4, CU200 (CU5,200 minus CU5,000), in profit or loss.

Example—Moving to a permissible accounting estimate

Ex 23 **The facts are the same as in Example 21 except that in its financial statements that conform to local GAAP the entity did not recognise a liability for environmental restoration because it was not required to do so. The entity was required only to make a disclosure in its notes to the financial statements. If the entity had applied the *IFRS for SMEs* Accounting Standard, it would have recognised a provision in accordance with Section 21.**

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

This accounting treatment is akin to a retrospective application of a new accounting policy.

In its statement of financial position at 31 December 20X4 the entity recognises and 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 year ended 31 December 20X4 (that is, the period in which information about the new technology became available).

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

…

(d) **discontinued operations**.

…

Educational notes

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

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

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

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

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

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

If the previous financial reporting framework has no accounting requirements for discontinued operations, when the Standard is applied the requirements for discontinued operations are applied prospectively from the date of transition to the Standard.

Examples—Discontinued operations (paragraph 35.9(d))

Ex 24 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

In accordance with paragraph 35.9(d), the requirements for discontinued operations in the Standard are applied prospectively to operations that meet the definition of a discontinued operation on or after the date of transition (1 January 20X3). At 1 January 20X3 (the date of transition) the entity has a discontinued operation that met the definition in the Standard; part of its operations were held for sale. It does not dispose of the operations that satisfied the definition of a discontinued operation until early 20X3.

Applying paragraph 35.9(d), the entity does not restate the measurement of non-current assets included in its discontinued operations at 1 January 20X3. Consequently, the profit on disposal recognised in 20X3 is lower than it would have been had the Standard been applied retrospectively.

Ex 25 The facts are the same as in Example 24 except that the entity sold the operations in late 20X3 and at 31 December 20X2 the operations did not satisfy the definition of a discontinued operation in the Glossary because at that date they were not for sale.

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

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

…

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

…

Educational notes

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

Example—Non-controlling interests (paragraph 35.9(e))

Ex 26 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

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

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

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

…

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

…

Educational notes

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

In accordance with the Standard, if an entity receives a loan from the government bearing interest at a rate that is below the market rate, the benefit of having a rate of interest below the market rate is a government grant (see paragraph 24.1 of the Standard). For example, if an entity receives an interest-free loan from the government of the jurisdiction in which it operates, the interest-free element of the loan is a government grant. If, instead of being interest-free, the loan bears interest at 2% per annum at a time when the market rate is 5% per annum, the benefit of the 3% reduction is the government grant. See *IFRS for SMEs* Accounting Standard—Educational Module 24 *Government Grants* for examples of the accounting for government loans in accordance with the Standard.

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

Examples—Government loans (paragraph 35.9(f))

Ex 27 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

In accordance with the previous financial reporting framework, the entity was required to present government loans at their transaction value and recognise the nominal interest as a finance cost. Consequently, at 1 January 20X2 the entity recognised the loan at CU100,000 and recognised a finance cost of CU2,000 in profit or loss in 20X2 and in 20X3.

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

Ex 28 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

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

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

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

…

(g) completed **contracts** with **customers**. An entity shall not restate contracts that were completed before the date of transition to the *IFRS for SMEs* Accounting Standard. A completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with its previous GAAP.

…

Educational notes

A first-time adopter of the Standard shall not restate contracts that were completed before the date of transition to the Standard. For this purpose, a contract is completed if the entity has transferred all the goods or services identified in accordance with its previous GAAP.

Example—Completed contracts with customers (paragraph 35.9(g))

Ex 29 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

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

The entity is a construction company. In 20X2, the entity entered into 10 contracts with its customers of which six contracts were completed by 31 December 20X2.

In accordance with paragraph 35.9(g), at 1 January 20X3 the entity shall not restate the six contracts because they were completed before the entity's date of transition to the Standard. Depending on whether the entity chooses to apply the exemption in paragraph 35.10(o), it may be required to restate the four contracts that were still not complete as at 1 January 20X3.

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

…

Educational notes

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

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

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

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

…

Educational notes

An entity may apply Section 19 retrospectively to all business combinations before the date of transition to the Standard, and to all business combinations thereafter. Alternatively, the entity may retain the accounting under its previous financial reporting framework and apply the Standard for business combinations that are effected after the date of transition only.

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 Standard) for all the assets acquired and all the liabilities and contingent liabilities assumed in all business combinations whose date of acquisition is before the date of transition to the Standard.

Examples—Business combinations (paragraph 35.10(a))

Ex 30 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

The entity has two subsidiaries, one acquired in 20X0 and one acquired in 20X2. The entity's financial statements for the year ended 31 December 20X3 were prepared in accordance with local GAAP. In accordance with the previous financial reporting framework, 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 carrying amounts in the acquiree's individual financial statements, adjusted for the elimination of intercompany amounts.

Applying Section 19 of the Standard, the acquirer shall recognise at the acquisition date, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The acquirer shall recognise goodwill as the excess of the sum of consideration transferred, the amount of any non-controlling interest of the acquiree and the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree (in the case of a business combination achieved in stages), over the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed.

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

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 in accordance with the Standard. In addition, amortisation and impairment in 20X3 and 20X4 would be determined in accordance with the Standard.

If an entity applies paragraph 35.10(a), it does not remeasure the original local GAAP carrying amounts of the acquiree's identifiable assets and liabilities determined at the date of acquisition even though those values were based on carrying amounts in the acquiree's financial statements. That is, the carrying amount will be considered deemed cost on the acquisition date.

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

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

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

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

The only business combination that the entity (Entity A) entered into was the acquisition of 100% of the equity of another entity, Entity B, on 1 January 20X2 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 and liabilities assumed was CU8,000.

In accordance with local GAAP, Entity A, at initial recognition of the business combination in its consolidated financial statements, measured the acquired goodwill at CU5,000 (that is, 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 those 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 nil residual value over its remaining useful life of 10 years measured from 1 January 20X2. If the Standard had been applied by Entity A in its consolidated financial statements, the machinery would have been depreciated on the straight-line basis to nil residual value over its remaining useful life of 10 years measured from 1 January 20X2.

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

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

The group has undertaken an impairment review and concluded that none of its assets require impairment.

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

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

Ex 32 The facts are the same as in Example 31. However, in this example, Entity A in its consolidated financial statements applies Section 19 of the Standard retrospectively to its business combination instead of applying the exemption in paragraph 35.10(a).

At 1 January 20X3 Entity A, for its consolidated financial statements, measures goodwill at CU1,600 (the amount determined in accordance with Section 19 of the Standard—that is, CU2,000 × 4/5 years remaining useful life = CU1,600) instead of CU4,000 (amount measured using the previous financial reporting framework).

Entity A also measures Entity B's property, plant and equipment at CU2,700 higher than it was measured using the previous financial reporting framework at 31 December 20X2—that is, CU3,000 × 9/10 years remaining useful life = CU2,700).

Consequently, Entity A adjusts its consolidated retained earnings at 1 January 20X3, measured using its previous financial reporting framework, by an increase of CU300—that is, an increase in property, plant and equipment of CU2,700 minus a decrease in goodwill of CU2,400. Alternatively, because the acquisition was at the start of 20X2, this adjustment can be calculated as a reduction in amortisation charge of goodwill for 20X2 of CU600 minus additional depreciation of machinery for 20X2 of CU300.

In its first consolidated financial statements prepared in accordance with the Standard Entity A:

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

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

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

…

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

…

Examples—Share-based payment transactions (paragraph 35.10(b))

Ex 33 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

The share-based payment transaction is an equity-settled share-based payment transaction. If the entity chooses to use the exemption in paragraph 35.10(b), it does not apply Section 26 *Share-based Payment* to the share-based payment transaction even though the shares do not vest until after the date of transition. The entity will recognise and measure the issue of shares in 20X4 as required by its local law.

Ex 34 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

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

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

Because the obligation was settled before the date of transition to the Standard (1 January 20X3), the entity can choose 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.

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

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

…

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

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

…

Educational notes

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

Fair value

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

Previous financial reporting framework revaluation

The Standard does not provide further guidance on what constitutes a previous GAAP revaluation. However, paragraph 17.15B of Section 17 *Property, Plant and Equipment* of the Standard describes a 'revalued amount', saying 'an entity shall measure an item of property, plant and equipment whose fair value can be measured reliably at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses'.

Examples—Fair value as deemed cost (paragraph 35.10(c))

Ex 35 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

Paragraph 17.15 of the Standard requires an entity to choose either the cost model or the revaluation model as its accounting policy and apply that policy to an entire class of property, plant and equipment. Therefore, the entity is required to use either the cost model or the revaluation model for all three buildings.

If the entity chooses the cost model as its accounting policy, in accordance with paragraph 35.10(c), on the date of transition to the Standard (1 January 20X3), the entity can choose to measure an item of property, plant and equipment at its fair value and use that as its deemed cost on 1 January 20X3. The exemption is available on an item-by-item basis. In this example, because the entity was, under its previous GAAP, measuring two of the buildings using the cost model and the third building using fair value, it can apply the exemption for the third building only, considering its fair value as the deemed cost. In this case, there will be no adjustment to the retained earnings at 1 January 20X3 (the date of transition to the Standard) for any of the buildings.

An entity with several buildings carried at fair value that chooses to measure its properties using the cost model can choose to use fair value as deemed cost for some items in the class, and can choose to apply the cost model in accordance with Section 17 retrospectively for other items in the class. If the entity does not choose to use the exemption in paragraph 35.10(c) for some or all items and does not use any other exemptions in Section 35 (for example paragraph 35.10(da)), it would, in accordance with paragraph 35.8 and paragraphs 17.9–17.26, adjust its retained earnings and property, plant and equipment at 1 January 20X3 for the effects of measuring the buildings using the cost model in accordance with Section 17. The exemption is available for any item of property, plant and equipment, not just for buildings.

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

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

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

Example—Revaluation as deemed cost (paragraph 35.10(d))

Ex 37 **The facts are the same as in Example 36, except that in this example, in accordance with its previous financial reporting framework, the entity measured its head office building at a revalued amount, determined to be fair value less accumulated depreciation and less impairment losses, with revaluation increases included in a revaluation reserve.**

Paragraph 17.15 of the Standard requires an entity to choose either the cost model or the revaluation model as its accounting policy and apply that policy to an entire class of property, plant and equipment. Therefore, the entity is required to use either the cost model or the revaluation model for all three buildings.

Assume the entity chooses the cost model as its accounting policy (for all three buildings). On the date of transition to the Standard (1 January 20X3), in accordance with paragraph 35.10(d), the entity can choose to measure an item of property, plant and equipment at its revalued amount and use this as its deemed cost on 1 January 20X3. Accordingly, no adjustments would be made to retained earnings at 1 January 20X3 (the date of transition to the Standard) for the buildings.

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

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

…

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

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

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

Examples—Event-driven fair value measurement as deemed cost (paragraph 35.10(da))

Ex 38 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

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

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

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

However, on the date of transition to the Standard (1 January 20X3), in accordance with paragraph 35.10(da), the entity, if it has chosen to apply the cost model, can choose to use the 30 June 20X2 fair value (event-driven fair value measurement) as the deemed cost on 30 June 20X2. Consequently, the entity could choose to measure its property, plant and equipment at 1 January 20X3 as 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 less impairment losses at 31 December 20X2 (if any) determined in accordance with Section 27.

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

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

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

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

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

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

…

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

…

Example—Cumulative translation differences (paragraph 35.10(e))

Ex 40 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

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

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

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

…

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

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

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

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

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

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

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

…

Educational notes

Separate financial statements are those financial statements in which the entity could elect, in accordance with paragraphs 9.25–9.26 of the Standard, to account for its investments in subsidiaries, jointly controlled entities and associates either at cost less impairment, at fair value with changes in fair value recognised in profit or loss, or using the equity method following the procedures in paragraph 14.8.

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

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

Example—Separate financial statements (paragraph 35.10(f))

Ex 41 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

In accordance with the requirement in paragraph 9.26 of the Standard the entity must choose one of three possible accounting policies for each class of investment, that is, investment in subsidiaries, investment in associates and investment in jointly controlled entities. The three possible accounting policies are fair value with changes in fair value recognised in profit or loss, the equity method and cost less impairment.

Fair value

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

Equity method

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

Cost less impairment

If the entity chooses to measure its investment in its subsidiary, associate or jointly controlled entity at cost less impairment as its accounting policy, paragraph 35.10(f)(ii) permits the use of one of the two exemptions to determine the deemed cost of the investment. The two exemptions an entity could choose from are:

(a) fair value at the date of the transition; and

(b) the carrying amount on the date of transition measured using the previous financial reporting framework.

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

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

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

…

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

…

Educational notes

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

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

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

For compound financial instruments in which the liability component is outstanding at the date of transition, the entity determines the initial carrying amount of the liability and equity components on the basis of circumstances that existed when the instrument was issued.

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

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

(b) the portion that 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 choose not to separate those two components.

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

Examples—Compound financial instruments (paragraph 35.10(g))

Ex 42 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X9. Those financial statements include one year of comparative information (20X8).

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

On 1 January 20X1 the entity issued 500 convertible bonds. The bonds were issued at par with a face value of CU100 per bond and are for a five-year term, with no transaction costs. The total proceeds from the issue was CU50,000. Interest is payable yearly in arrears at an annual interest rate of 4%. Each bond is convertible, at the holder's discretion, into 25 ordinary shares at any time up to maturity. At the time the bonds were issued, the market interest rate for similar debt without the conversion option was 6%. At the end of the five-year term, if not converted, the bonds are repaid at par, including any accrued interest.

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

In this example, at the date of transition to the Standard (1 January 20X8) the liability component is no longer outstanding (that is, each bond would either have been converted into 25 ordinary shares or, on 31 December 20X5, it would have been redeemed for cash). Because the convertible bond is no longer outstanding, the entity can apply the exemption in paragraph 31.10(g) and therefore need not separate the proceeds from it into liability components and equity components. If the entity chooses the exemption, it retains the accounting that it used under its previous financial reporting framework at its date of transition (1 January 20X8) and there are no adjustments to retained earnings.

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

Ex 43 The facts are the same as in Example 42. However, in this example, the entity's first financial statements in accordance with the Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3). None of the bondholders has chosen 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 Standard (1 January 20X3) the entity cannot apply the exemption in paragraph 35.10(g).

Consequently, the entity must determine the carrying amount of the liability at 1 January 20X3 (the date of transition) in accordance with the Standard.

When the instrument is issued, the liability component must be measured first at fair value, and the equity component is measured as 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. The fair value of the liability component is calculated by determining its present value using the discount rate of 6% which was the market interest rate for similar debt that did not have the conversion option. The calculations are:

	CU	
Proceeds from the bond issue	50,000	(a)
Present value of principal at the end of five years, see calculations after the table	37,363	(b)
Present value of interest payable annually in arrears for five years	8,425	(c)
Present value of liability, which is the fair value of the liability component	45,788	(d) = (b) + (c)
Residual, which is the fair value of the equity component	4,212	(e) = (a) – (d)

Calculations:

Present value of principal of CU50,000 at 6%

CU50,000 ÷ ((1.06) ^ 5) = 37,363

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

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

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

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

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

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

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

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

Calculation:

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

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

…

(h) deferred income tax. A first-time adopter may apply Section 29 *Income Tax* prospectively from the date of transition to the *IFRS for SMEs* Accounting Standard, while applying the exception in paragraph 29.3A retrospectively.

…

Educational notes

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

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

…

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

…

Educational notes

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

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

…

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

…

Educational notes

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

Entities choosing 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 Standard. Any identified impairment losses must be recognised at the date of transition.

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

Example—Extractive activities (paragraph 35.10(j))

Ex 44 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

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

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

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

The entity thereafter accounts for its oil and gas assets in accordance with paragraphs 34.11–34.11F of the Standard.

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

…

(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* Accounting Standard contains a lease (see paragraph 20.3) on the basis of facts and circumstances existing at that date, instead of when the arrangement was entered into.

…

Educational notes

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

When accounting for such arrangements, the terms of the lease agreement and the circumstances existing at the inception of the lease determine whether there is in substance a lease and, if so, whether it is a finance lease or operating lease (the lease classification). However, paragraph 35.10(k) allows a first-time adopter to elect in determining whether an arrangement existing at the date of transition to the Standard contains a lease on the basis of facts and circumstances existing at the date of transition, instead of when the arrangement was entered into.

Examples—Arrangements containing a lease (paragraph 35.10(k))

Ex 45 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

The entity's financial statements for the year ended 31 December 20X3 were prepared in accordance with local GAAP. The previous financial reporting framework required the entity to account for arrangements as leases only if the terms of the agreement took the form of a contractual lease, regardless of whether the arrangement conveyed the right to use an asset in return for payments.

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

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

If the entity chooses to make the assessment on the date of transition (1 January 20X3), it accounts for the lease prospectively from that date. The entity would determine whether the lease was an operating lease or finance lease at the date of transition. If the lease is an operating lease, the entity would not need to adjust its statement of financial position on the date of transition provided that the lease payments have been recognised as an expense under the previous financial reporting framework in accordance with the Standard. However, if the lease is a finance lease, then the entity would need to account for a finance lease at the date of transition by recognising the related asset and financial liability for the finance lease and adjusting retained earnings accordingly, in accordance with paragraph 35.8 and Section 20.

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

Ex 46 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

The entity's financial statements for the year ended 31 December 20X3 were prepared in accordance with local GAAP. On 1 January 20X0 the entity entered into an agreement with a supplier to buy a minimum quantity of gas to be used in its production process for a specified period of time (a take-or-pay arrangement).

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

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

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

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

…

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

…

Educational notes

Retrospective application of paragraph 17.10(c) of the Standard at the date of transition to the Standard requires an entity to construct a historical record of all changes to a decommissioning liability that would have been made in the past. It also requires an adjustment to the initial cost recorded for property, plant and equipment on acquisition and its related 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 decommissioning liabilities that occurred before the date of transition to the Standard. If a first-time adopter uses this exemption, it must:

- measure the liability at the date of transition to the Standard in accordance with Section 21 and recognise the liability as measured; and
- increase the carrying amount of the property, plant and equipment at the date of transition to the Standard by the amount of the liability.

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

Ex 47 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

The entity depreciates its plant on a straight-line basis over its 20-year estimated useful life to a nil estimated residual value in accordance with local GAAP. This depreciation is the same as it would be applying the Standard. Consequently, on 1 January 20X3 the remaining useful life is 18 years.

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

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

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

If the entity does not choose to use the exemption in paragraph 35.10(l), it measures the liability at 1 January 20X1 in accordance with Section 21 using information available at 1 January 20X1. Consistent with the principles of accounting for changes in accounting estimates, in this case, changes in the decommissioning liability between 1 January 20X1 and 31 December 20X2 affect the amount of the decommissioning liability, cost of plant and depreciation prospectively from the date of the change in accounting estimate. The entity would also need to unwind the discount between 1 January 20X1 and 31 December 20X2 to arrive at the amount of liability to include in its statement of financial position at 1 January 20X3 (its date of transition to the Standard). The entity also calculates depreciation on the plant between 1 January 20X1 and 31 December 20X2 using the revised cost to arrive at the amount to include in its statement of financial position at 1 January 20X3.

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

…

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

…

Educational notes

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

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

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

Example—Operations subject to rate regulation (paragraph 35.10(m))

Ex 48 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

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

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

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

…

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

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

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

…

Educational notes

The Standard states (in the Glossary) that the currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:

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

(b) the currency is not exchangeable into a relatively stable foreign currency.

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

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

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

Examples—Severe hyperinflation (paragraph 35.10(n))

Ex 49 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

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

Ex 50 **An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).**

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

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

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

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

Ex 51 The facts are the same as in Example 50. However, in this example, the currency ceased to be subject to severe hyperinflation from 1 April 20X3 (not 1 June 20X2).

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

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

…

(o) **revenue**. A first-time adopter is permitted to apply Section 23 *Revenue from Contracts with Customers* either retrospectively or prospectively in accordance with paragraph A27. The entity shall treat references to the date of initial application, in paragraphs A27, A32, A35 and A36, as referring to the date of transition to this Standard. The first-time adopter is not required to provide the disclosure in paragraph A31.

Educational notes

Section 23 *Revenue from Contracts with Customers* was revised in the third edition of the Standard, introducing a single comprehensive framework for determining when to recognise and how to measure revenue from contracts with customers. Appendix A *Effective date and transition* of the Standard includes transition requirements for when an entity applies the third edition of the Standard for the first time. An entity is required to apply the amended and revised sections in the third edition of the Standard retrospectively. However, Appendix A includes reliefs on applying the amendments.

An entity that is a first-time adopter of the Standard shall treat the references to the date of initial application in paragraphs A27, A32, A35 and A36 of the Standard as referring to the date of transition to the Standard. Therefore, an entity is permitted to apply the revised Section 23 consistently to all contracts with customers prospectively from the date of transition to the Standard.

If an entity prospectively applies the revised Section 23, that means the entity shall apply the revised Section 23 to contracts that begin after the date of transition to the Standard. The entity shall not change its accounting policy for any contracts that were already in progress at that date. For those contracts in progress at the date of transition to the Standard, an entity prospectively applying the revised Section 23 discloses the accounting policy for recognising revenue for those contracts and the revenue recognised in the current period from those contracts.

If an entity retrospectively applies the revised Section 23, it is permitted to use one or more of three exemptions:

(a) for completed contracts, an entity is not required to restate contracts that:

  (i) begin and end within the same reporting period; or

  (ii) were completed at the beginning of the earliest period presented.

(b) for completed contracts that have variable consideration, an entity is permitted to use the transaction price at the date the contracts were completed instead of estimating amounts of variable consideration for the comparative reporting periods.

(c) for completed contracts that were modified before the beginning of the earliest period presented, an entity is not required to retrospectively restate those contract modifications in accordance with paragraphs 23A.3–23A.4. Instead, the entity is permitted to reflect the aggregate effect of all modifications that occurred before the beginning of the earliest period presented when it:

  (i) identifies the fulfilled and unfulfilled promises;

  (ii) determines the transaction price; and

  (iii) allocates the transaction price to the fulfilled and unfulfilled promises.

IFRS for SMEs Accounting Standard—Educational Module 23 *Revenue from Contracts with Customers* provides more details about the revised Section 23 including its transition requirements and reliefs.

Example—Application of Section 23 by a first-time adopter

Ex 52 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include one year of comparative information (20X3).

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

The entity is a construction company. In 20X2, the entity entered into 10 contracts with its customers of which six contracts were completed by 31 December 20X2. Of the remaining four contracts, three were completed on 30 June 20X3 and the other one contract was completed on 31 July 20X4.

In accordance with paragraph 35.9(g), at 1 January 20X3 the entity shall not restate the six contracts because they were completed before the entity's date of transition to the Standard (see educational notes and discussion on paragraph 35.9(g)).

In accordance with paragraph 35.10(o), an entity could:

- apply Section 23 prospectively. This means that the revenue from the four contracts with customers entered into in 20X2 that were not yet completed by 1 January 20X3 (date of transition to the Standard) will continue to be recognised and measured under the previous version of Section 23 in the second edition of the Standard. Revenue from contracts with customers entered into by the entity after 1 January 20X3 will be recognised and measured under the revised Section 23.
- apply Section 23 retrospectively. This means revenue from contracts with customers is recognised and measured under the revised Section 23. Based on the fact pattern provided, the entity is required to restate the four contracts that were still in progress as at 1 January 20X3. For contracts that were entered into by the entity in 20X3, the revenue from those contracts will be restated and recognised and measured under the revised Section 23 unless the entity elects to apply the exemption to contracts that were completed in 20X3.

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

Educational notes

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

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

Examples—Impracticability of restating assets and liabilities at the date of transition

Ex 53 An entity's first financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard are presented for the year ended 31 December 20X4. Those financial statements include two years' comparative information (20X3 and 20X2).

The entity's financial statements for the years ended 31 December 20X3 and 31 December 20X2 were prepared in accordance with local GAAP. The previous financial reporting framework permitted use of the LIFO cost formula for inventory and the entity chose to use this cost formula because it was used by competitors in its industry.

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

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

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

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 in accordance with the Standard) the entity would disclose the fact that, in its statement of comprehensive income for 20X2 and its line items (for example, cost of sales expense and profit or loss) for the year ended 31 December 20X2 have not been restated on transition and therefore are not comparable with the same line items presented for 20X3 and 20X4. The disclosure would explain that the lack of comparability is 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 54 The facts are the same as in Example 53. However, in this example, all of the inventories held by the entity at 1 January 20X2 were sold before 31 December 20X3.

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

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

In its financial statements for the year ended 31 December 20X4 (the first financial statements that conform to the Standard) the entity would disclose:

- the fact that, in its statement of financial position, the 31 December 20X2 comparative information for the line item inventories has not been restated using the FIFO cost formula to measure those inventories held by the entity before 1 January 20X2. The amount of inventories at 31 December 20X2 that have not been restated should be disclosed. For completeness, the entity may wish to specify in the disclosure that the inventories at 31 December 20X3 and 31 December 20X4 were measured using the FIFO cost formula.

- the fact that, as a consequence, its statement of comprehensive income and its line items (for example, cost of sales expense and profit or loss) for the years ended 31 December 20X2 and 20X3 are not comparable with those for the year ended 31 December 20X4.
- an explanation of the lack of comparability—for example, that the lack of comparability is a result of all inventories at 1 January 20X2 (the date of transition to the Standard) and some inventories at 31 December 20X2 being measured using the LIFO cost formula because fire destroyed the records necessary for the entity to make the adjustment required to measure those inventories using the FIFO cost formula.

Disclosures

Explanation of transition to the *IFRS for SMEs* Accounting Standard

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

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

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

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

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

Reconciliations

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

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

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

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

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

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

Educational notes

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

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

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

Example—Disclosure of the effects of adopting the *IFRS for SMEs* Accounting Standard

Ex 55 **An entity is required to disclose how the transition from its previous financial reporting framework to the *IFRS for SMEs* Accounting Standard affected its reported financial position, financial performance and cash flows. This disclosure can be presented as follows:**

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

…

Note 2 Basis of preparation and accounting policies (extract)

These consolidated financial statements have been prepared in accordance with the *IFRS for SMEs* Accounting Standard (Standard) issued by the International Accounting Standards Board. The statements are presented in the currency units (CU) of ABC Land.

Before 20X4 the consolidated financial statements were prepared in accordance with ABC GAAP as issued by the Accounting Standards Board of ABC Land. The financial effects of the transition to the Standard are set out in Note 3.

…

Note 3 Transition to the *IFRS for SMEs* Accounting Standard
The consolidated financial statements for the year ended 31 December 20X4 are Entity A's first consolidated financial statements that comply with the Standard. Entity A's date of transition to the Standard is 1 January 20X3. Its last financial statements prepared in accordance with ABC GAAP were for the year ended 31 December 20X3. The transition to the Standard has resulted in a number of changes in Entity A's accounting policies compared to those applying ABC GAAP. This explanatory note to the consolidated financial statements describes the differences between the profit or loss presented under ABC GAAP and the newly presented amounts under the Standard for the reporting period ended 31 December 20X3 (that is, for the comparative information), as well as the differences between the equity presented under ABC GAAP and the newly presented amounts applying the Standard at the date of transition (1 January 20X3) and at 31 December 20X3. It also describes all the required changes in accounting policies made on first-time adoption of the Standard. In the 'Reconciliation of equity' table, equity determined in accordance with the Standard is reconciled to equity determined in accordance with ABC GAAP at both 1 January 20X3 (the date of transition to the *IFRS for SMEs* Accounting Standard) and 31 December 20X3 (the end of the latest period presented in the most recent consolidated financial statements prepared in accordance with ABC GAAP).

Reconciliation of equity

		at 1 January 20X3			*at 31 December 20X3*		
Notes		*ABC GAAP CU*	*Effect of transition CU*	*IFRS for SMEs CU*	*ABC GAAP CU*	*Effect of transition CU*	*IFRS for SMEs CU*
3.1	Intangible assets	530	(245)	285	446	(196)	250
3.2	Property, plant and equipment	1,268	57	1,325	1,192	48	1,240
3.3 & 3.6	Financial assets other than cash	303	(5)	298	638	(19)	619
3.4 & 3.6	Inventories	470	113	583	230	148	378
	Cash	50	–	50	29	–	29
	Total assets	**2,621**	**(80)**	**2,541**	**2,535**	**(19)**	**2,516**

continued ...

... continued

3.2	Lease payable	–	72	72	–	58	58
3.3	Financial liabilities	320	57	377	126	58	184
3.5	Employee benefits	–	132	132	–	148	148
	Total liabilities	**320**	**261**	**581**	**126**	**264**	**390**
	Assets minus liabilities	**2,301**	**(341)**	**1,960**	**2,409**	**(283)**	**2,126**
3.3	Issued capital and convertible loan	1,975	(55)	1,920	1,975	(55)	1,920
	Retained earnings	326	(286)	40	434	(228)	206
	Total equity	**2,301**	**(341)**	**1,960**	**2,409**	**(283)**	**2,126**

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

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

Note: This reconciliation of equity is accompanied by the following notes. Two additional items of information relating to this reconciliation are that:

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

Notes to the reconciliation of equity

3.1 Intangible assets

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

3.2 Property, plant and equipment

Leased assets

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

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

Profit for the year ended 31 December 20X3 is CU3 higher in accordance with the Standard than it would have been under ABC GAAP because of the net effect of:

- depreciation expense for the leased assets is (+CU11).
- finance costs for the recognised lease liability are (+CU4).
- operating lease expenses are (–CU18).

Impairment

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

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

3.3 Financial instruments

Financial assets

ABC GAAP requires that investments in publicly traded non-convertible preference shares are measured at historical cost. The Standard requires those financial assets to be measured at fair value with changes in fair value recognised in profit or loss. Consequently, in the consolidated statement of financial position at 1 January 20X3 (the date of transition) the entity increases the carrying amount of its investments by CU28.

A CU10 increase in the fair value of investments in publicly traded non-convertible preference shares (financial assets) in 20X3 is recognised in profit or loss determined in accordance with the Standard.

Financial liabilities

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

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

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

3.4 Inventory

In accordance with ABC GAAP, inventories are measured using the last-in, first-out (LIFO) cost formula. In accordance with the Standard, inventories are measured using the weighted average cost formula.

Accordingly, in the consolidated statement of financial position at 1 January 20X3 (the date of transition) the carrying amount of inventories was increased by CU94.

Because of the change in cost formula, the cost of goods sold is CU21 lower in 20X3 using the weighted average cost formula (applying the Standard) than it would have been using the LIFO cost formula (applying ABC GAAP).

3.5 Employee benefits

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

In accordance with ABC GAAP, the obligations to pay pensions to employees and former employees are not recognised in the consolidated statement of financial position. Post employment benefits are recognised as an expense only when paid.

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

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

3.6 Revenue

Applying ABC GAAP, Entity A estimated the expected volume rebates using the probability-weighted average amount of rebates approach based on historical data and considering current sales performance. Entity A included an allowance for rebates in financial liabilities.

Applying the Standard, retrospective volume rebates give rise to variable consideration. To estimate the variable consideration to which it will be entitled, Entity A applied the most likely amount method for contracts with a single volume threshold and the expected value method for contracts with more than one volume threshold. At the date of transition, Entity A recognised refund liabilities of CU33 on 1 January 20X3 (31 December 20X3: CU36) for the expected future rebates. Additionally, revenue from contracts with customers for the year ended 31 December 20X3 was reduced by CU24.

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.

Educational 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).

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

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

Example—Distinguishing correction of errors from changes in accounting policies

Ex 56 The facts are the same as in Example 55. 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 is a CU80,000 overstatement of the retained earnings of the entity at 1 January 20X3. The error resulted in profit for the year ended 31 December 20X3 being overstated by CU20,000.

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

…

Note 12 Correction of prior period error

In 20X4 the entity discovered and corrected mathematical mistakes that had resulted in the understatement of amortisation expense related to intangible assets other than research and development over the previous four years. The correction of the error has been accounted for retrospectively, and the comparative information for 20X3 has been restated.

The effect of the change is a CU20,000 reduction in profit for the year ended 31 December 20X3. Furthermore, opening retained earnings for 20X3 have been reduced by CU80,000, which is the amount of the error relating to periods before 20X3.

…

…

Reconciliation of consolidated equity

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

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

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

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

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

Ex 57 An entity is preparing general purpose financial statements for the first time for the year ended 31 December 20X4. The financial statements will comply with the *IFRS for SMEs* Accounting Standard. The disclosure of this fact can be presented as follows:

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

...

Note 2 Basis of preparation and accounting policies (extract)

These financial statements have been prepared in accordance with the *IFRS for SMEs* Accounting Standard (Standard) issued by the International Accounting Standards Board. They are presented in the currency units (CU) of ABC Land.

...

Note 3 Adoption of the *IFRS for SMEs* Accounting Standard

Although the entity was formed and started trading 10 years ago, these statements are its first general purpose financial statements, and have been prepared applying the Standard.

The financial statements include comparative information for the year ended 31 December 20X3. Financial statements were prepared for the year ended 31 December 20X3 but those statements were not general purpose financial statements and were not prepared in accordance with the Standard.

In accordance with Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*, the entity chose to use the following exemptions from applying the requirements in the Standard retrospectively:

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

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Accounting Standard (Standard) to transactions or other events often requires an entity to use its judgement. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful to a user of financial statements in assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6 of the Standard, an entity discloses the judgements management has made when applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with paragraph 8.7 of the Standard, an entity discloses information that explains key assumptions about 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 Standard require disclosure of information about particular judgements and estimation uncertainties.

The application of the Standard

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

Exemptions

The number of complex judgements and estimations otherwise required by an entity adopting the Standard will be reduced if it chooses to apply many of the exemptions in paragraph 35.10. For example, judgement or estimation would be required:

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

However, applying the exemptions in paragraph 35.10 of the Standard does not eliminate the need to make estimates and judgements. For example, if an entity elects to measure an item of property, plant and equipment at its fair value at the date of transition to the Standard it must make the estimates and judgements that are necessary to determine that fair value. Section 12 explains how fair value measurements are determined and the types of estimates and judgements required.

Impracticable to restate and/or disclose

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

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

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

However, an entity may use the exemption only if it is impracticable to follow the general requirements in Section 35. In other cases, the entity may need to apply judgement.

TRANSITION REQUIREMENTS

The third edition of the *IFRS for SMEs* Accounting Standard (Standard) is effective for annual reporting periods beginning on or after 1 January 2027. Early application is permitted. Changes made to Section 35 from the second edition of the Standard are summarised on page 6.

COMPARISON WITH FULL IFRS ACCOUNTING STANDARDS

The requirements in full IFRS Accounting Standards (see IFRS 1 *First-time Adoption of International Financial Reporting Standards*) and those in the *IFRS for SMEs* Accounting Standard (see Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*) vary as at February 2025. The main differences are that:

- Section 35 is written in simpler language than that used in IFRS 1.
- Section 35 does not require the statement of financial position at the date of transition to be presented in the financial statements in which an entity first adopts the *IFRS for SMEs* Accounting Standard whereas IFRS 1 requires the statement of financial position at the date of transition to IFRS Accounting Standards to be presented in the first IFRS financial statements.
- Section 35 requires a reconciliation of the previous year's profit or loss whereas IFRS 1 requires a reconciliation of total comprehensive income.
- Section 35 includes an impracticability exemption that is not in IFRS 1. Restatement for adjustments is not required if impracticable. Similarly, disclosures, including comparative disclosures, are not required if providing them is impracticable (see paragraph 35.11).
- Section 35 differs from IFRS 1 in the detail of the exceptions in paragraph 35.9, although most are similar to exceptions in IFRS 1 (other than paragraph 35.9(d) and paragraph 35.9(g)). The differences in the detail will cause differences in practice.
- Section 35 contains an exception regarding discontinued operations in paragraph 35.9(d) that is absent from IFRS 1.
- Section 35 contains an exception in paragraph 35.9(g) on completed contracts that is an optional exemption in IFRS 1.
- Section 35 differs from IFRS 1 in the detail of the exemptions in paragraph 35.10, although most are similar to exemptions in IFRS 1. In many cases, the requirements in IFRS 1 are stricter. The differences in the detail will cause differences in practice.
- Section 35 contains an exemption in paragraph 35.10(h) allowing a first-time adopter of the *IFRS for SMEs* Accounting Standard to apply Section 29 *Income Tax* from the date of transition to the Standard. This exemption is not present in IFRS 1.
- IFRS 1 contains some exemptions and exceptions that are not included in Section 35 because they are not relevant to the accounting requirements in the *IFRS for SMEs* Accounting Standard. These exemptions and exceptions include, for example, exemptions relating to embedded derivatives; impairment of financial assets; insurance; employee benefits; assets and liabilities of subsidiaries, associates and joint ventures; and designation of previously recognised financial instruments.

This table sets out the disclosure requirements in IFRS 1 compared with the disclosure requirements in Section 35. 'X' means a disclosure requirement has no equivalent.

IFRS 1 paragraph	Section 35 paragraph
X	35.11
22	X
23	35.12
23A	35.12A(a)–(b)
23B	35.12A(c)
X	35.13(a)
24(a)	35.13(b)
24(b)	35.13(c)
24(c)	X
25	X
26	35.14
27A	X
28	35.15
29	X
29A	X
30	X
31	X
31A	X
31B	X
31C	X
32	X
33	X
D2	X
D9D(b)–(c)	X

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements in Section 35 *Transition to the* IFRS for SMEs *Accounting Standard* by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those supplied on page 88.

Mark the box next to the most correct statement.

Question 1

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

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

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

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

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

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

☐ (f) (d) and (e).

Question 2

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

- ☐ (a) SME A presented financial statements for the years ended 31 December 20X1 and 20X4 in compliance with the *IFRS for SMEs* Accounting Standard. For the years ended 31 December 20X2 and 20X3, SME A prepared financial statements in compliance with full IFRS Accounting Standards only.
- ☐ (b) SME 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* Accounting Standard in all respects except in name. The SME made an explicit and unreserved statement of compliance with the local GAAP (not the *IFRS for SMEs* Accounting Standard). In previous years, the SME applied full IFRS Accounting Standards.
- ☐ (c) SME 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* Accounting Standard in all respects except in name. The SME makes an explicit and unreserved statement of compliance with both the local GAAP and the *IFRS for SMEs* Accounting Standard. In previous years, the SME applied full IFRS Accounting Standards.
- ☐ (d) SME D has not presented financial statements for previous years—it is not required to do so. In 20X4, the SME voluntarily adopted the *IFRS for SMEs* Accounting Standard and presented financial statements that conform to that Standard (including an explicit and unreserved statement of compliance with the *IFRS for SMEs* Accounting Standard).
- ☐ (e) SMEs C and D.
- ☐ (f) SMEs B and C.
- ☐ (g) SMEs A, C and D.
- ☐ (h) SMEs A, B and C.

Question 3

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

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

Question 4

An SME that has never presented financial statements decides to apply the *IFRS for SMEs* Accounting Standard in 20X8. The SME's financial statements for the year ended 31 December 20X8 conform to the Standard (including an explicit and unreserved statement of compliance with the Standard in the notes). Full comparative information in accordance with the Standard is provided for one year.

What is the SME's date of transition to the Standard?

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

Question 5

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

What is the SME's date of transition to the Standard?

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

Question 6

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

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

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

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

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

☐ (b) CU75,000—that is, using the revaluation made in accordance with the previous financial reporting framework as deemed cost at the date of transition to the *IFRS for SMEs* Accounting Standard (calculation: CU90,000 deemed cost – CU15,000 accumulated depreciation).

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

☐ (d) any of (a)–(c).

Question 7

On 1 January 20X1 an SME acquired a business for CU100,000 in which the fair value of the identifiable acquired assets was CU90,000. The acquired business 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, that is, in the consolidated statement of comprehensive income for the year ended 31 December 20X1. The SME has not entered into any other business combinations.

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

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

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

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

☐ (b) nil—that is, no restatement of the goodwill; goodwill expensed immediately in accordance with the previous financial reporting framework.

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

☐ (d) (a) or (b).

☐ (e) any of (a)–(c).

Question 8

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

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

Goodwill of CU5,000 arose on the second business combination (that is, the business acquired on 1 January 20X4).

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

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

☐ (b) nil—that is, no restatement of the goodwill. Goodwill is expensed immediately in accordance with the previous financial reporting framework.

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

☐ (d) (a) or (b).

☐ (e) any of (a)–(c).

Question 9

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

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

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

☐ (b) nil—that is, no restatement of the goodwill. Goodwill is expensed immediately in accordance with the previous financial reporting framework.

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

☐ (d) (a) or (b).

☐ (e) any of (a)–(c).

Question 10

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

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

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

☐ (c) (a) and (b).

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

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

☐ (f) (d) and (e).

Question 11

An SME presents its first financial statements that conform to the *IFRS for SMEs* Accounting Standard for the year ended 31 December 20X4. Those financial statements include one year of comparative information (that is, 20X3).

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

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

Which one of the following four reconciliations is the SME not required to disclose?

☐ (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* Accounting Standard for 20X3.

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

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

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

Answers

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

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

Q3 (c)—see paragraph 35.6.

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

Q5 (b)—see paragraph 35.6. If 31 December 20X8 is the reporting date and full comparative information is presented for two years (20X7 and 20X6), then the beginning of the earliest period for which the SME 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). Because the SME has chosen not to apply Section 19 to the second business combination, it is not permitted to apply Section 19 to the first business combination. If the SME 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 SME can choose either to follow the requirements in Section 19 or to use the exemption in paragraph 35.10(a).

Q10 (c)—see paragraph 35.11.

Q11 (b)—see paragraph 35.13.

APPLY YOUR KNOWLEDGE

You can apply your knowledge of the requirements in Section 35 *Transition to the* IFRS for SMEs *Accounting Standard* of the *IFRS for SMEs* Accounting Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those on pages 91 and 96.

Case study 1

Entity Z started its operations on 1 January 20X0 and chose a reporting date of 31 December. The entity has been preparing its financial statements in accordance with its local income tax basis since 1 January 20X0. In accordance with this 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 apply the *IFRS for SMEs* Accounting Standard and to use the first-in, first-out (FIFO) cost formula for measuring inventories. The financial statements for the year ended 31 December 20X3 are the entity's first annual financial statements in accordance with the *IFRS for SMEs* Accounting Standard and they include an explicit and unreserved statement of compliance with the *IFRS for SMEs* Accounting Standard.

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

The table 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**	**2,200**
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**

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

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

Note: Before preparing the disclosures, you must first determine the effects of applying the *IFRS for SMEs* Accounting Standard.

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

Date	Units bought	Cost per unit CU	Cost CU	Units 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**

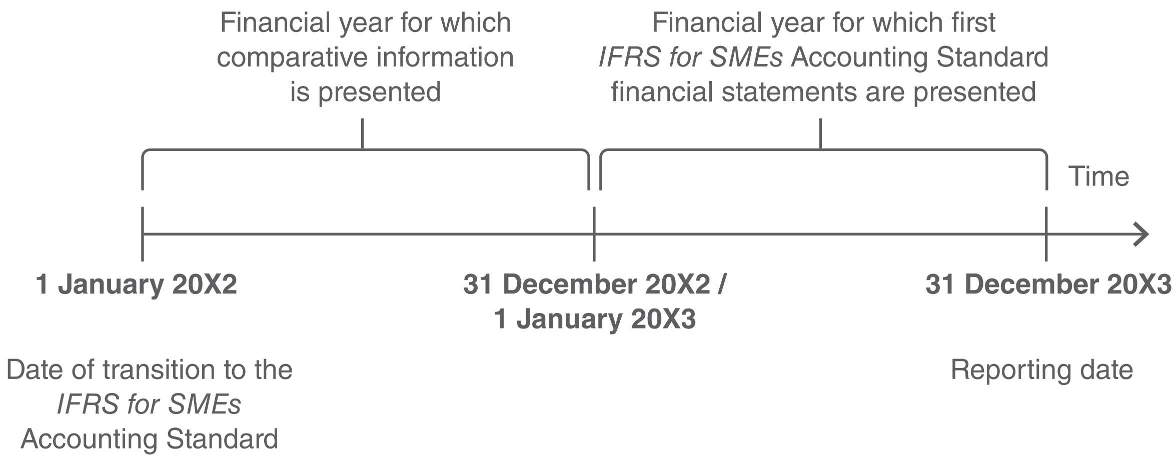
Reconciliation:

	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* Accounting Standard is 1 January 20X2, which is the beginning of the comparative period (that is, the period ended 31 December 20X2). This is based on the facts that:

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

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

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

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

		1 January 20X2			*31 December 20X2*		
		Previous financial reporting framework	*Difference*	*IFRS for SMEs*	*Previous financial reporting framework*	*Difference*	*IFRS for SMEs*
Note		*CU*	*CU*	*CU*	*CU*	*CU*	*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

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

3.8 Inventory

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

Case study 2

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

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

In accordance with local GAAP, Entity Y applied some accounting policies that differ from the accounting policies required or allowed by the *IFRS for SMEs* Accounting Standard. The material differences are as follows:

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

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

(c) Financial assets that Section 11 *Financial Instruments* requires to be measured at fair value through profit or loss were, in accordance with local GAAP, carried at cost. As a consequence, at 1 January 20X4 the carrying amount is CU420 lower than if the *IFRS for SMEs* Accounting Standard had been used. In 20X4 the increase in fair value of such financial assets was CU180.

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

(e) A hedge relationship that hedges the foreign exchange risk of a particular forecast sale (that is, forward foreign exchange contract) exists at the date of transition. This hedge relationship qualifies for hedge accounting under Part II of Section 11. In accordance with local GAAP, the hedging instrument was carried at cost (nil). Consequently, CU431 of unrealised foreign exchange gains on the hedging instrument was not recorded in equity. The sale was made during 20X4 and the fair value of the hedged financial assets decreased by CU40 between the start of 20X4 and the date of the sale.

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

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

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

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

	Local GAAP CU	*Local GAAP CU*
Issued capital	1,500	
Retained earnings	5,060	
Total equity		**6,560**

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

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

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

Note: Paragraph 35.13(b)(ii) requires a similar reconciliation of equity at the end of the latest period presented in Entity Y's most recent annual financial statements that were determined in accordance with its previous financial reporting framework (that is, at 31 December 20X4 in this case study).

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 (local GAAP) for the latest period presented in Entity Y's most recent annual financial statements and its profit determined in accordance with the *IFRS for SMEs* Accounting Standard for the same period (that is, 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 reconciliation of equity at the entity's date of transition to the *IFRS for SMEs* Accounting Standard (1 January 20X4) can be presented as follows:

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

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

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

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

2 Intangible assets in accordance with local GAAP 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* Accounting Standard.

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

4 Fixed and variable production overhead was excluded from cost of inventories in accordance with local GAAP. These overheads amounting to CU400 were included in accordance with the *IFRS for SMEs* Accounting Standard.

5 Unrealised gains on forward foreign exchange contracts were not recognised in accordance with local GAAP but are recognised in accordance with the *IFRS for SMEs* Accounting Standard. These gains, amounting to CU431, are included in the hedging reserve because the contracts hedge forecast sales.

6 A pension liability was not recognised in accordance with local GAAP which uses a cash basis. This liability, amounting to CU66, is recognised in accordance with the *IFRS for SMEs* Accounting Standard.

7 A restructuring provision relating to head office activities was recognised in accordance with local GAAP. This provision, amounting to CU250, does not qualify for recognition as a liability in accordance with the *IFRS for SMEs* Accounting Standard.

8 The adjustments to retained earnings are:

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

Answer to Case study 2—Part B

The reconciliation of profit for 20X4 can be presented as follows:

Reconciliation of profit for 20X4

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

Notes to the reconciliation of profit for 20X4:

1 The fair value of forward foreign exchange contracts that are effective hedges of forecast transactions decreased by CU40 during 20X4. Applying the *IFRS for SMEs* Accounting Standard, this amount is recognised in other comprehensive income. The hedging gain recognised in other comprehensive income at the time of the sale (CU391) is reclassified to profit or loss in accordance with Part II of Section 11 *Financial Instruments* of the *IFRS for SMEs* Accounting Standard.

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

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

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

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

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

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

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

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

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

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