Year-end Financial Reporting Reminders

Extract, IFRS® Discussion Group Report on the Meeting – December 12, 2023

The Group discussed several topics relating to the preparation of 2023 year-end financial statements.

Issue 1: Disclosures about estimation uncertainties and sensitivities given market volatility

Analysis

Companies are facing significant uncertainty in the current economic environment due to global supply-chain disruptions, labour shortages, shifts in consumer demand, and market volatility. In the face of such uncertainty, companies need to apply judgment in making some estimates that impact the preparation of their financial statements, for example, estimates of the fair value of investment properties, the recoverable amount of long-lived assets, expected credit loss allowances, and the carrying amount for deferred tax assets. However, not all estimates are created equal, and some may involve such significant estimation uncertainty that they fall in the scope of paragraph 125 of IAS 1. That paragraph indicates that:

An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period.

These disclosure requirements apply to those estimates that require management's most difficult, subjective, or complex judgments. Once an entity has identified these estimates, it must present disclosures in a manner that helps users understand the judgments that management makes about the future and other sources of estimation uncertainty. Paragraph 129 of IAS 1 sets out the following examples of the types of disclosures that an entity might consider:

(a) the nature of the assumption or other estimation uncertainty;

(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and

(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

Sometimes it is impracticable to disclose the extent of the possible effects of an assumption (or other source of estimation uncertainty) at the reporting period end. In those cases, minimum disclosures are required. The above disclosures are not required for assets and liabilities measured at fair value based on a quoted market price in an active market.

As a best practice, entities should revisit their existing disclosures at year-end to determine if they:

- quantify the amount of the assets or liabilities at risk of material adjustment in the next financial year due to estimation uncertainty;
- provide sufficient granularity in the description of assumptions and meaningful ranges of reasonably possible outcomes;
- provide "sensitivity" analysis of the impact of changes to the assumptions on related carrying amounts of assets and liabilities; and
- enable users to distinguish between the estimates that represent management's most complex, judgmental, or subjective estimates from other estimates.

Example

- A mining company has determined that one of its mines has an impairment indicator.
- The cash flows from this mine will continue for 15-20 years.
- The most significant assumption that impacts the recoverable amount in the impairment test is the long-term commodity price.
- The company uses the forward price of the commodity for the first two years, but estimates the long-term price for the remaining years using its own assumptions.
- Significant volatility in the market has made predicting the long-term commodity price difficult and subjective.
- No impairment loss is recognized at year-end.
- The actual long-term price used by other companies in the same sector may differ significantly.

Disclosure Requirements

The company thinks it should disclose information about how it developed its estimate of the long-term commodity price to meet the requirements in paragraph 125 of IAS 1. This is because a reasonable change in this assumption within the next year would lead to a material adjustment to the carrying amount of its mining assets (e.g., a material impairment loss). The company also notes that estimating the commodity price beyond the forward pricing information was difficult, complex, and judgmental. The disclosures that the company might provide regarding this significant estimation uncertainty include:

- quantitative information about the price assumption (e.g., prices used at different points in time);
- information about different scenarios that have been considered, as well as their weightings;
- sensitivities of the carrying amount to different price assumptions; and
- other information that may be relevant to users, including how the entity has incorporated climate risk into the scenarios.[1]

These disclosures would signal to users that a significant estimation uncertainty exists regarding the long-term commodity price used. This uncertainty could materially impact the carrying value of its mining assets at year-end as well in the next year, even though no impairment loss has been recognized. Note that IAS 36 Impairment of Assets requires some of these disclosures but only in specific circumstances.

The Group's Discussion

The Group agreed with the analysis, and noted several other factors an entity should consider when preparing disclosures about estimation uncertainties and sensitivities. Some Group members noted that many IAS 1 disclosure requirements are not prescriptive. Therefore, entities often need to apply significant judgment to determine the nature and extent of disclosures needed to meet these requirements. Another Group member highlighted the importance of applying the requirements in paragraph 129 of IAS 1 along with those in paragraph 125 (i.e., paragraph 125 does not take precedence over paragraph 129). They also noted that for assets measured at fair value using level 3 inputs (e.g., investment properties measured at fair value), an entity might be able to meet the requirements for disclosure of measurement uncertainty by referencing the related financial statement note addressing the requirements in IFRS 13 Fair Value Measurement.[2] One Group member highlighted the importance of considering climate risk in the disclosures of significant estimation uncertainty. They think that investors are increasingly demanding information that helps them assess entities' climate resilience, and considering climate risk as part of any entity's sensitivity analysis is one way to provide this information. Some Group members also noted that

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[1] As noted in the September 2023 IASB Staff paper (agenda reference 14B) on the Climate-related Risks in the Financial Statements project, some entities may focus on complying with specific disclosure requirements. However, they should not overlook the broader requirements of IAS 1 to provide additional disclosure when the specific requirements in IFRS Accounting Standards are insufficient to meet users' needs (paragraph 31 of IAS 1) or to provide information that is not presented elsewhere in the financial statements but is relevant to understanding them (paragraph 112(c) of IAS 1). Refer to the IASB's "Effects of Climate-related Matters on Financial Statements" (republished July 2023).

[2] IFRS 13 establishes a fair value hierarchy that categorizes into three levels the inputs to valuation techniques used to measure fair value. Level 3 inputs, which are given the lowest priority in the fair value hierarchy, are unobservable inputs for assets and liabilities.

entities should consider the requirements in paragraphs 122-124 to disclose information about significant judgments that management has made in the process of applying the entity's accounting policies.

Issue 2: Disclosure of material accounting policy information

Analysis

Recent amendments to IAS 1 and IFRS Practice Statement 2: *Making Materiality Judgements* require entities to disclose *material* accounting policy information instead of *significant* accounting policies.[3] This is not a "search and replace" exercise but one which requires entities to apply judgment to ensure their accounting policies meet the needs of users. The amendments are effective for annual reporting periods beginning on or after January 1, 2023.

The amendments include enhanced guidance for assessing whether accounting policy information is material. This includes a three-step approach, which asks:

1. Is the transaction, event, or condition material in size, nature, or both?
2. If so, is the accounting policy information itself material to the financial statements?
3. If so, material accounting policy information should be disclosed.

Accounting policy information is expected to be material if users of an entity's financial statements would need it to understand other material information in the financial statements. For example, an entity is likely to consider accounting policy information material to its financial statements if that information relates to material transactions, events, or conditions and the accounting policy:

(a) was changed during the reporting period, resulting in a material change to information in the financial statements;

(b) was chosen from options permitted by IFRS Accounting Standards;

(c) was developed in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors in the absence of an IFRS Accounting Standard that specifically applies;

(d) relates to an area where the entity is required to make significant judgments or assumptions in applying the accounting policy and these are disclosed under paragraph 122 or 125 of IAS 1; or

(e) relates to complex accounting (such as when an entity applies more than one IFRS Accounting Standard to a material class of transactions).

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[3] Paragraph IN6 of IFRS Practice Statement 2 states: "A Practice Statement is non-mandatory guidance developed by the International Accounting Standards Board. It is not a Standard. Therefore, its application is not required to state compliance with IFRS Accounting Standards."

If an entity determines that accounting policy information is material, it needs to decide what to disclose. The amendments acknowledge that users generally find accounting policy information more useful when it focuses on how an entity has applied the requirements of IFRS Accounting Standards to its own specific facts and circumstances, and when it relates to an area for which the entity has exercised judgment. Users generally find accounting policy information less useful when it includes standardized information or information that only duplicates or summarizes the requirements of IFRS Accounting Standards. If an entity discloses immaterial accounting policy information, such information should not obscure material accounting policy information.

As a result of the amendments to IAS 1, entities are expected to consider areas where they can *enhance and tailor* their accounting policy disclosures and areas where they can *scale back* their existing disclosures.

Example of Enhancing and Tailoring a Disclosure

- An entity has acquired a material subsidiary during the year.
- Management has to make a significant judgment around the determination of control because the entity holds less than a majority of the voting equity in the investee, but also holds decision-making rights by contract that give it the current ability to direct certain activities of the investee.
- The entity thinks the determination of control constitutes material accounting policy information.

To satisfy the requirements in IAS 1 and paragraph 9(b) of IFRS 12 Disclosure of Interests in Other Entities, the entity should consider enhancing its existing accounting policy for consolidation to describe how control is assessed in this situation. This disclosure should include the nature of the contractual rights considered, the relevant activities to which they apply, and the judgment made in determining whether the contractual rights (together with voting rights) are sufficient to confer control.

Example of Scaling Back a Disclosure

- An entity has not undertaken any hedging activity in the past three years.
- The entity's financial statements contain a detailed accounting policy note on the requirements necessary to apply hedge accounting.

The entity should consider removing this note or replacing it with a note that is more useful to financial statement users. For example, the entity might consider disclosing that it does not undertake hedging activities that qualify for hedge accounting under IFRS 9.

The Group's Discussion

The Group agreed with the analysis and noted some other factors an entity should consider when disclosing material accounting policy information. One Group member thought that entities should consider ordering their financial statement notes based on relevancy to the company as this might help them identify accounting policy information that is material. Another Group member thought that entities are often reluctant to scale back their disclosures to avoid non-compliance with regulatory reporting or audit requirements. They thought that this analysis of IAS 1 and IFRS Practice Statement 2 is a helpful reminder that entities are encouraged to scale back the disclosure of accounting policy information that is immaterial. One Group member commented that in the financial services sector, expected credit loss is often a material accounting policy for entities. Therefore, they thought that entities in this sector should consider ways to enhance this disclosure to help users understand how this amount was calculated.

Issue 3: Impairment of assets in the scope of IAS 36

Analysis

Adverse changes in the marketplace and declines in commodity prices in certain sectors have increased entities' focus on the impairment test. Below is a non-exhaustive list of factors entities should consider when reviewing assets in the scope of IAS 36 Impairment of Assets for impairment.

When to test

Entities are required to perform an impairment test on goodwill, indefinite-life intangible assets, and intangible assets not yet available for use annually, and whenever there are indicators of impairment. Entities are required to perform an impairment test on other assets in scope of IAS 36 only if there are indicators of impairment. Special rules, which are highlighted below, apply to newly acquired goodwill.

Have there been any changes in the business?

Entities should consider whether any of the following have taken place since the entity performed its last impairment test:

- an acquisition or divestiture of a business or group of assets;
- the introduction or withdrawal of products or services;
- a restructuring; or
- a sub-lease of property.

If any of the above transactions have taken place, this could result in the identification of new cash-generating units (CGUs) or a change in existing CGUs.

Have you assessed whether there are any indicators of impairment (or impairment reversal) at the reporting period end?

IAS 36 sets out a *minimum* list of impairment indicators that entities should review. Entities should pay particular attention to impairment indicators for assets or CGUs that have little or no headroom (i.e., excess of the recoverable amount over the carrying amount) at the time of the last test, as they may be more susceptible to impairment. Entities should also consider whether increases in market interest rates could cause the recoverable amount of an asset or CGU to fall below its carrying amount. When performing this assessment, entities should consider all relevant factors (e.g., whether the interest rate impacts the rate of return demanded for the asset given its estimated life; whether the company is able to recover higher interest costs through prices charged to its customers). Also, entities that recognized impairment losses in prior periods (other than for goodwill) should consider whether there are any indicators that the impairment loss may no longer exist or may have decreased, as this will trigger the estimation of a new recoverable amount.

Compliance with value-in-use (VIU) rules

An impairment loss arises when the carrying amount of an asset or CGU exceeds its recoverable amount. The recoverable amount is the higher of the VIU and fair value less costs of disposal. Entities calculating VIU should demonstrate that they comply with the VIU rules, which include rules for the preparation of cash flow projections, excluded cash flows (e.g., from uncommitted restructurings and asset enhancements), the cash flow projection period, growth rates used beyond the projection period, and the discount rate. Also, in uncertain times, entities may find it more effective to incorporate risk into their calculation of VIU by using multiple cash flow scenarios that are probability weighted, rather than using a single set of cash flows where the risk is incorporated into the discount rate (paragraph 32 and Appendix A of IAS 36).

Comparing "like" with "like"

Entities should allocate assets to the carrying amount of CGUs when those assets contribute to the cash inflows generated by those CGUs and are therefore factored into the recoverable amount. This involves identifying all corporate assets (such as head office, brands, and trademarks) that relate to a CGU, and determining whether they can be allocated on a reasonable and consistent basis to the CGU (or group of CGUs) in accordance with the requirements in paragraphs 100-103 of IAS 36. If this allocation is not performed, an entity is at risk of understating the carrying amount of its CGUs, and potentially overstating any headroom or understating an impairment loss.

Any newly acquired goodwill

Paragraph 96 of IAS 36 requires that any goodwill acquired in a business combination in the current annual period, that has been allocated to one or more CGUs, be tested for impairment before the end of the current annual period. For any goodwill that has not been allocated, it is required to be tested if there are any indicators of impairment (see paragraphs 84-85 of IAS 36 and IDG Report on Public Meeting, January 2012).

Disclosures

The disclosure requirements in IAS 36 are extensive. Entities with goodwill and indefinite-life intangible assets should pay particular attention to the disclosure requirements, as these can impact an entity even if no impairment loss or reversal is recognized in the reporting period.

The Group's Discussion

The Group agreed with the analysis of factors entities should consider when applying the requirements in IAS 36. One Group member noted that entities with investments in associates and joint ventures accounted for using the equity method should ensure that the associates and/or joint ventures also apply these impairment considerations. This is because impairment losses in the associate or joint venture might be material to the entity. Another Group member noted that entities with exploration and evaluation activities should apply the indicators in paragraph 20 of IFRS 6 when assessing whether these assets should be tested for impairment (see IDG Report on Public Meeting, December 2, 2013 and October 18, 2012 for discussion of impairment indicators in IFRS 6 and market capitalization).

Issue 4: Pillar Two financial statement disclosures

In 2021, with the support of more than 135 countries, the Organisation for Economic Co-operation and Development (OECD) agreed to move forward with a new global minimum tax (i.e., Pillar Two). Pillar Two requires that in-scope multi-national enterprises with revenues in excess of €750 million pay a minimum tax of 15 per cent on income in each jurisdiction in which they operate. The OECD has released Pillar Two model rules—which are complex and evolving. Each country is responsible for enacting the rules based on their own legislative process. As of today, some countries have already enacted or substantively enacted Pillar Two tax legislation. Pillar Two tax legislation is expected to be effective as early as January 1, 2024.

In response to these developments, in May 2023, the IASB issued amendments to IAS 12 *Income Taxes*. The amendments introduce:

(a) a mandatory temporary exception from recognizing and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes; and

(b) targeted disclosure requirements for affected entities.

IAS 12 requires an entity to disclose:

- **(once Pillar Two legislation is in effect)** current tax expense (income) relating to Pillar Two; and
- **(in periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect)** known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation. To meet this disclosure objective, entities shall disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the end of the

reporting period. These disclosures do not need to reflect all the specific requirements of the Pillar Two legislation and can be provided in the form of an indicative range. To the extent information is not known or reasonably estimable, an entity should instead disclose a statement to that effect and information about the entity's progress in assessing its exposure (paragraph 88C-88D of IAS 12).

The above disclosures apply for annual reporting periods beginning on or after January 1, 2023, with no requirement to make these disclosures in interim periods ending on or before December 31, 2023. In addition, entities are required to disclose use of the temporary exception.

Canadian entities within the scope of Pillar Two would need to consider what disclosures should be made regarding Pillar Two in their upcoming annual consolidated financial statements (i.e., at December 31, 2023) to comply with IFRS Standards. Factors to consider include:

- Does the entity have operations in at least one jurisdiction in which Pillar Two legislation has been enacted or substantively enacted before the year-end? If so, the disclosures in paragraphs 88C-88D of IAS 12 would apply.
- If qualitative information is disclosed, does it consider how the entity is affected by Pillar Two legislation and the main jurisdictions in which its exposures might exist? If quantitative information is disclosed, is the basis for its preparation clear and based on information available at the year-end?
- If Pillar Two legislation is not yet enacted or substantively enacted before year-end, is there information that the entity should consider disclosing to achieve fair presentation in accordance with the requirements in paragraph 17(c) of IAS 1?
- If Pillar Two legislation is enacted or substantively enacted after year-end and before the date the financial statements are authorized for issue, has the entity considered subsequent events disclosure (paragraph 22(h) of IAS 10 *Events After the Reporting Period* and paragraph 88 of IAS 12)?
- If the entity has disclosed that it expects the impacts of Pillar Two legislation to not be material, are these statements appropriate and supportable?

In addition to disclosure, where Pillar Two legislation has been announced in a jurisdiction, entities should consider the implications of the expected additional cash taxes on fair value measurement (e.g., in a business acquisition), impairment tests, and the going concern assessment.

The Group's Discussion

The Group agreed with the analysis. One Group member emphasized that Pillar Two disclosures are important because for those impacted entities, it may have a material impact on future taxes payable. Another Group member commented on the requirement for an entity to disclose known or reasonably estimable information about their exposure to Pillar Two in periods when the legislation is not yet in effect. They indicated that known and reasonably estimable information might change

over time, and that entities should adjust their disclosures as new information about the impact of Pillar Two on their financial statements becomes available.

Overall, the Group's discussion raised awareness of some financial reporting issues that entities should consider relating to the preparation of their 2023 year-end financial statements. No further actions were recommended to the AcSB.