Financial Reporting Newsletter
Bringing you the latest information on recent IFRS and Financial Reporting topics
June 2023

Dear all,

We are pleased to welcome you to the new edition of our Financial Reporting Newsletter.

Our aim is to keep you updated with all the latest news and developments on IFRS and financial reporting along with the potential impact they may have on your business.

In this issue, we discuss:

IASB amends IAS 12 to introduce a temporary exception from accounting for deferred taxes arising from OECD Pillar Two model rules

IASB amends IAS 7 and IFRS 7 to address supplier finance arrangements

European Commission consults on delegated regulation for European Sustainability Reporting Standards

We hope that you find our newsletter insightful and if you would like to discuss any of the topics covered, please do not hesitate to contact us.

Best regards,

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IASB amends IAS 12 to introduce a temporary exception from accounting for deferred taxes arising from OECD Pillar Two model rules

Background

In March 2022, the Organisation for Economic Co-operation and Development (OECD) released technical guidance on its 15% global minimum tax agreed as the second 'pillar' of a project to address the tax challenges arising from digitalisation of the economy. This guidance elaborates on the application and operation of the Global Anti-Base Erosion (GloBE) Rules agreed and released in December 2021 which lay out a co-ordinated system to ensure that multinational enterprises with revenues above €750 million pay tax of at least 15% on the income arising in each of the jurisdictions in which they operate.

The IASB decided to respond to stakeholders' concerns about the potential implications of the imminent jurisdictional implementation of these 'Pillar Two' rules on the accounting for income taxes applying IAS 12 *Income Taxes*.

The amendments

The IASB amends the scope of IAS 12 to clarify that the Standard applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the OECD, including tax law that implements qualified domestic minimum top-up taxes described in those rules.

The amendments introduce a temporary exception to the accounting requirements for deferred taxes in IAS 12, so that an entity would neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.

The IASB acknowledges that entities need time to determine how to apply the principles and requirements in IAS 12 to account for deferred taxes related to Pillar Two income taxes. The IASB also needs time to engage further with stakeholders and consider whether, for example, any action is needed to support the consistent application of IAS 12.

The IASB therefore concluded that it would not be feasible to complete these activities before jurisdictions enact new tax laws and, consequently, before entities are required to reflect those laws in accounting for deferred taxes.

Applying the amendments, an entity is required to disclose that it has applied the exception. An entity also discloses separately its current tax expense (income) related to Pillar Two income taxes.

In periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect, an entity is required to disclose 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, an entity is required to disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the end of the reporting period. That information does not need to reflect all the specific requirements of the legislation and could 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 its progress in assessing its exposure.

Examples of information an entity could disclose to meet these disclosure requirements include:

- Qualitative information such as information about how an entity is affected by Pillar Two legislation and the main jurisdictions in which exposures to Pillar Two income taxes might exist;
- Quantitative information such as:

- An indication of the proportion of an entity's profits that might be subject to Pillar Two income taxes and the average effective tax rate applicable to those profits; or
- An indication of how the entity's average effective tax rate would have changed if Pillar Two legislation had been in effect.

The IASB has decided that the Pillar Two model rules (and the amendments to IAS 12) are also relevant to entities applying the IFRS for SMEs Accounting Standard. The IASB has therefore added to its work plan a narrow-scope standard-setting project to amend Section 29 Income Tax of the IFRS for SMEs. An exposure draft is expected in June 2023.

Effective date and transition

The amendments require that an entity applies the exception—and the requirement to disclose that it has applied the exception— immediately upon issuance of the amendments and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The remaining disclosure requirements are effective for annual reporting periods beginning on or after 1 January 2023. An entity is not required to disclose the information warranted by these requirements for any interim period ending on or before 31 December 2023.

Various jurisdictions have started the process of enacting tax legislation to implement the Pillar Two model rules. Entities that may be subject to them will need to monitor the legislation process in the jurisdictions in which they operate and assess whether the Pillar Two legislation has been enacted (or substantively enacted) in any such jurisdictions. Once the Pillar Two legislation has been enacted or substantively enacted, an entity will need to consider the IAS 12 impact of legislation on its financial statements.

In jurisdictions with endorsement and adoption processes for IFRS Accounting Standards, the amendments may not be available for immediate use. In such cases, before the amendments are available for use, an entity may, after considering the following factors, conclude that the deferred tax requirements in IAS 12 do not apply to income taxes arising from the Pillar Two model rules:

- *The Basis for Conclusions to the amendments notes uncertainties as to whether the Pillar Two model rules create additional temporary differences, whether there is a need to remeasure deferred taxes and if so which tax rate to use to measure deferred taxes, which in turn may result in diversity in the accounting applied by affected entities;*
- *The staff paper prepared for the IASB meeting on 11 April 2023 (Agenda Paper 12A, Appendix A, item 4) notes (in response to the request for clarification on whether Pillar Two legislation gives rise to temporary differences) that "one of the main reasons for introducing the temporary exception is to 'avoid entities developing diverse interpretations of IAS 12'";*
- *The February 2023 US FASB staff announcement that, under ASC 740 (the US GAAP standard addressing the accounting for income taxes, based on a framework similar to IAS 12), deferred taxes should not be recognised or adjusted for the effect of the Pillar Two legislation; and*
- *The limited informational value, in terms of relevance and reliability, that would be provided if the entity were to apply deferred tax accounting to Pillar Two income taxes including because:*
    - *Of the perceived complexities and uncertainties of the calculations required by the Pillar Two model rules (e.g. the tax rate that will apply to an entity's excess profit in future periods) which depend on a number of factors that are difficult, if not impossible, to forecast reliably;*
    - *Deferred tax assets and liabilities would only be recognised for a short period, until the amendments are available for use and require their derecognition.*

In line with the requirements of IAS 1 Presentation of Financial Statements, an entity should consider the nature and extent of the disclosures to be made in its financial statements, including those on material accounting policy information and judgements management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

IASB amends IAS 7 and IFRS 7 to address supplier finance arrangements

Background

In December 2020, the IFRS Interpretations Committee published an agenda decision on supply chain financing arrangements which explains the requirements in IFRS Accounting Standards that apply to such arrangements. Feedback on the draft agenda decision suggested that the information an entity is required to provide about this form of financing falls short of meeting user information needs. The IASB considered this feedback and decided to address the issue by amending IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures*.

The amendments

Amendments to IAS 7

The amendments add a disclosure objective to IAS 7 stating that an entity is required to disclose information about its supplier finance arrangements that enables users of financial statements to assess the effects of those arrangements on the entity's liabilities and cash flows and the entity's exposure to liquidity risk.

Supplier finance arrangements are characterised by one or more finance providers offering to pay amounts an entity owes its suppliers and the entity agreeing to pay according to the terms and conditions of the arrangements at the same date as, or a date later than, suppliers are paid. These arrangements provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the related invoice payment due date. Supplier finance arrangements are often referred to as supply chain finance, payables finance or reverse factoring arrangements.

Arrangements that are solely credit enhancements for the entity (for example, financial guarantees including letters of credit used as guarantees) or instruments used to settle directly with a supplier the amounts owed (for example, credit cards) are not supplier finance arrangements.

To meet the disclosure objective set out above, an entity is required to disclose in aggregate for its supplier finance arrangements:

- (a) The terms and conditions of the arrangements (for example, extended payment terms and security or guarantees provided). However, an entity is required to disclose separately the terms and conditions of arrangements that have dissimilar terms and conditions;
- (b) As at the beginning and end of the reporting period:
  - (i) The carrying amounts, and associated line items presented in the entity's statement of financial position, of the financial liabilities that are part of a supplier finance arrangement;
  - (ii) The carrying amounts, and associated line items, of the financial liabilities disclosed under (i) for which suppliers have already received payment from the finance providers;
  - (iii) The range of payment due dates (for example, 30-40 days after the invoice date) for both the financial liabilities disclosed under (i) and comparable trade payables that are not part of a supplier finance arrangement. Comparable trade payables are, for example, trade payables of the entity within the same line of business or jurisdiction as the financial liabilities disclosed under (i). If ranges of payment due dates are wide, an entity is required to disclose explanatory information about those ranges or disclose additional ranges (for example, stratified ranges);
- (c) The type and effect of non-cash changes in the carrying amounts of the financial liabilities disclosed under (b)(i). Examples of non-cash changes include the effect of business combinations, exchange differences or other transactions that do not require the use of cash or cash equivalents.

Some respondents to the 2021 Supplier Finance Arrangements Exposure Draft (ED) informed the IASB that the information necessary to disclose the carrying amounts, and associated line items, of financial liabilities that are part of supplier finance arrangements for which suppliers have already received payment from finance providers might not be readily available.

Other stakeholders, particularly users of financial statements, informed the IASB that without this disclosure, the information provided would be incomplete and would fail to satisfy user information needs.

The IASB evaluated the costs and benefits for preparers and users of financial statements and concluded that the benefits of requiring disclosure of this information outweigh the costs.

Amendments to IFRS 7

Under the existing Application Guidance in IFRS 7, an entity is required to disclose a description of how it manages the liquidity risk resulting from financial liabilities. The amendments include as an additional factor whether the entity has accessed, or has access to, supplier finance arrangements that provide the entity with extended payment terms or the entity's suppliers with early payment terms.

In the Guidance on implementing IFRS 7, the amendments add that concentrations of liquidity risk and market risk may arise from supplier finance arrangements resulting in the entity concentrating with finance providers a portion of its financial liabilities originally owed to suppliers.

Effective date and transition

An entity is required to apply the amendments to IAS 7 for annual reporting periods beginning on or after 1 January 2024. Earlier application is permitted. If an entity applies the amendments for an earlier period, it is required to disclose that fact.

In applying the amendments, an entity is not required to disclose:

- Comparative information for any reporting periods presented before the beginning of the annual reporting period in which the entity first applies the amendments;
- The information otherwise required under (b)(ii)-(iii) above as at the beginning of the annual reporting period in which the entity first applies those amendments; and
- The information otherwise required by the amendments to IAS 7 for any interim period presented within the annual reporting period in which the entity first applies those amendments.

An entity is required to apply the amendments to IFRS 7 when it applies the amendments to IAS 7.

The IASB did not change any disclosure requirements applicable to an entity's interim financial reports on an ongoing basis; an entity applies the requirements in IAS 34 Interim Financial Reporting.

European Commission consults on delegated regulation for European Sustainability Reporting Standards

Background

The EU Accounting Directive (as amended by the Corporate Sustainability Reporting Directive (CSRD)) requires certain entities to include in a dedicated section of their management report the information necessary to understand the entity's impacts on sustainability matters and how sustainability matters affect the entity's development, performance and position.

The CSRD specifies which entities are in scope and the financial year in which they are first required to provide sustainability information. The scope of the CSRD is wide and includes both EU and certain non-EU entities.

The European Commission (EC) is required to adopt sustainability reporting standards specifying the information that entities are to report in accordance with the CSRD. Draft European Sustainability Reporting Standards (ESRS) have been developed by EFRAG and were submitted to the EC in the form of technical advice in November 2022. The EC consulted with various European agencies and other stakeholders and made further amendments to these draft ESRS before publishing the draft regulation.

The EC indicates that consultations undertaken confirmed that the draft ESRS broadly meet the mandate of the CSRD and would achieve the intended policy goals in the context of the European Green Deal. At the same time, some respondents drew attention to the challenging nature of many of the disclosure requirements for many entities, and in particular for entities that have not previously been subject to legal requirements to report sustainability information.

In addition, as part of the EC's request to the European Supervisory Authorities (ESAs) to provide an opinion on the draft ESRS, the European Insurance and Occupational Pensions Authority (EIOPA) underlined the importance of avoiding fragmentation of sustainability reporting requirements across jurisdictions. To this end, they stated that compatibility between ESRS and IFRS Sustainability Disclosure Standards should be ensured so that European entities reporting according to ESRS are automatically considered to be compliant with IFRS Sustainability Disclosure Standards.

The draft regulation

To ensure entities disclose relevant, comparable and reliable information on all major sustainability-related topics, the CSRD requires entities within its scope to use ESRS that specify the information to report and, where relevant, specify the structure in which that information should be reported. The draft regulation applies to the first set of sector-agnostic ESRS developed by EFRAG. The additional standards to be developed by EFRAG (i.e. sector-specific standards, standards for listed SMEs and a standard for third-country undertakings) will be adopted through additional delegated acts.

The draft regulation includes the text of the ESRS in two annexes to the draft regulation. Annex I to the draft regulation includes the text of the ESRS, while Annex II includes acronyms and definitions.

The regulation would enter into force four months after the date of adoption. The regulation, and therefore the ESRS, are applicable for financial years beginning on or after 1 January 2024 in line with the requirements in the CSRD. The regulation would be binding in its entirety and directly applicable in all Member States.

The draft regulation is open for feedback until 7 July 2023. Feedback will be taken into account for finalising the draft regulation.

After the feedback period ends, it is expected that the regulation will be agreed by the EC before the end of August 2023. The scrutiny period by the European Parliament and the European Council would then begin and last for two months (with another possible two-month extension). It is necessary that this timeline is adhered to for ESRS to become effective from 1 January 2024.

Where can I go for more information?

This publication highlights just some of the recent IFRS and financial reporting topics that may be of interest to entities reporting under IFRS or another accounting framework. More detailed information can be found at www.iasplus.com

Contact Us

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