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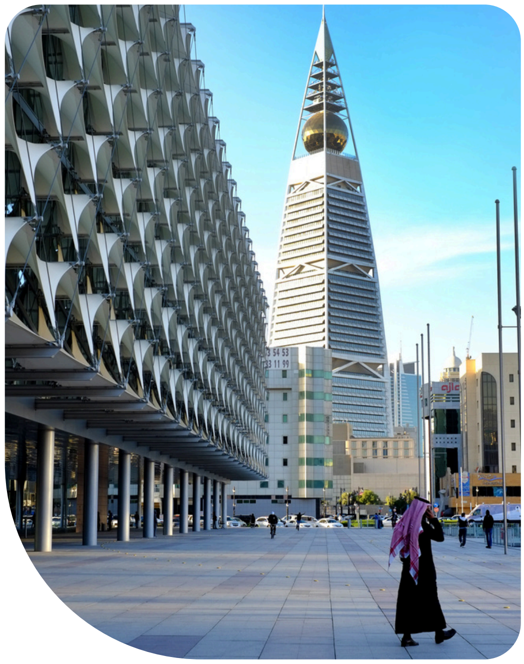
IFRS Alerts 2023



December 2023 Hyperinflation update

Issue 2023-05

According to the World Economic Outlook (WEO) report issued by the International Monetary Fund (IMF) in October 2023, and based on economic conditions that currently exist in Ghana, Sierra Leone and Haiti, these countries are now considered to be hyperinflationary from 31 December 2023. Therefore, reporting entities in those countries will be required to apply IAS 29 'Financial Reporting in Hyperinflationary Economies'. Consequently, any entities from those countries with interim or annual reporting requirements at 31 December 2023 or thereafter should reflect IAS 29 in their IFRS financial statements.

The WEO report also identifies that South Sudan might no longer be a hyperinflationary economy from 31 December 2023.

From 31 December 2023 onwards there are thirteen countries around the world where IAS 29 should be applied, when entities want to state they are in full compliance with IFRS. These countries are: Argentina, Ethiopia, Ghana, Haiti, Iran, Lebanon, Sierra Leone, Sudan, Suriname, Turkey, Venezuela, Yemen (which should be closely monitored) and Zimbabwe.

Recapping the requirements of IAS 29

IAS 29 requires the financial statements of any entity whose functional currency is the currency of a hyperinflationary economy to be restated for changes in the general purchasing power of that currency, so that the financial information provided is more meaningful.

Indicators of hyperinflation

IAS 29 lists factors that indicate when an economy is hyperinflationary. One of the indicators of hyperinflation is if cumulative inflation over a three-year period approaches, or is in excess of 100 per cent.

The mechanics of restatement

IAS 29 requires amounts in the statement of financial position that are not already expressed in terms of the measuring unit current at the end of the reporting period, are restated by applying a general price index. In summary:

- assets and liabilities linked by agreement to changes in prices, such as index linked bonds and loans, are adjusted in accordance with the agreement;
- non-monetary items carried at current amounts at the end of the reporting period (such as net realisable value and fair value) are not restated;
- all other non-monetary assets and liabilities are restated;
- monetary items (ie money held and items to be received or paid in money) are not restated because they are already expressed in terms of the monetary unit currency at the end of the reporting period; and
- all items in the statement of comprehensive income should be expressed using the measuring unit current at the end of the reporting period, so all amounts need to be restated from the dates when the items of income and expenditure were originally recorded in the financial statements.

Other important factors that should be taken into consideration when applying IAS 29
IAS 29 sets out specific requirements on how to restate prior period comparatives. It requires corresponding figures for the previous reporting period to be restated by applying a general price index so that the comparative financial statements are presented in terms of the measuring unit current at the end of the reporting period.

IAS 29 may result in the creation of additional temporary differences under IAS 12 'Income Taxes'. This is because the restatement of items under IAS 29 will often lead to adjustments to the carrying amounts of items without corresponding changes to their tax bases. Be mindful that IAS 12 requires these adjustments to be recognised in profit or loss.

Impairment testing should also not be overlooked. IAS 29 requires any restated non-monetary items to be reduced when it exceeds its recoverable amount, even if those assets were not previously considered impaired under historical cost accounting. It will be important when preparing financial statements to consider whether the restatement of asset carrying values affects the results of impairment tests that were conducted in previous reporting periods, and whether there are any indicators of impairment for assets that were not tested for impairment in previous periods.

IFRIC decisions relating to hyperinflation
The IFRS Interpretations Committee (IFRIC) have previously considered a number of accounting issues in relation to dealing with hyperinflation. These include:

- translating a hyperinflationary foreign operation and presenting exchange differences;
- accounting for cumulative exchange differences before a foreign operation becomes hyperinflationary;
- presenting comparative amounts when a foreign operation first comes hyperinflationary; and
- consolidation of a non-hyperinflationary subsidiary by a hyperinflationary parent.

We encourage careful consideration of these issues when preparing IFRS financial statements and applying IAS 29.

Our thoughts
IAS 29 is not a Standard that can be quickly implemented, particularly in group situations. Careful consideration needs to be given to the IFRIC guidance dealing with situations where there is a hyperinflationary parent that has subsidiaries who also report in a hyperinflationary currency versus situations where a non-hyperinflationary parent has subsidiaries that report in a hyperinflationary currency. Also be mindful of how a hyperinflationary parent with subsidiaries that do not report in a hyperinflationary currency should be accounted for given the requirements set out in IAS 21 'The Effects of Changes in Foreign Exchange Rates'.

Any reporting entity considering IAS 29 for the first time will have to adapt their existing accounting systems to be able to process the hyperinflationary adjustments. It is important they understand the mechanics of adjusting for hyperinflation so they can restate in their financial statements both current and comparative periods.

IASB issues amendments to the IFRS for SMEs to help entities respond to the Pillar Two tax rules

Issue 2023-04

The International Accounting Standards Board (IASB) has amended the IFRS for SMEs. The amendments, entitled 'International Tax Reform—Pillar Two Model (Amendments to the IFRS for SMEs)' are based on the amendments to IAS 12 'Income Taxes' issued in May 2023, and address the impacts of the introduction of the Organisation for Economic Co-operation and Development's (OECD) Pillar Two Model Rules. The amendments introduce a temporary exception and targeted disclosure requirements.

Background
The OECD published its Pillar Two Model Rules in December 2021 to ensure that large multinational companies (i.e. groups with revenue of EUR750 million or more in two of the last four years) would be subject to a minimum 15% tax rate. The reform is expected to apply in most jurisdictions for accounting periods starting on or after 1 January 2024.

However, while the reaction from jurisdictions around the world to implement the changes has been positive, there have been major stakeholder concerns about the uncertainty over the accounting for deferred taxes arising from the implementation of these rules. Those concerns mainly refer to identifying and measuring deferred taxes, because determining whether the Pillar Two Model Rules will create additional temporary differences is very difficult, and also which tax rate will be applicable (considering the number of factors affecting its determination).

Following similar amendments to IAS 12 'Income Taxes', issued in May 2023, the IASB has issued these 'out-of-cycle' amendments to the IFRS for SMEs to provide direction on what they expect entities to disclose.

The amendments

- Introduce a temporary recognition exception for entities applying the IFRS for SMEs from recognising deferred tax assets and liabilities arising from Pillar Two Model Rules, and from the related disclosures on deferred tax assets and liabilities that would otherwise be required.
- Provide clarification on the disclosures required by entities applying the IFRS for SMEs. This includes disclosing the current tax expense/income arising from Pillar Two Model Rules, and a statement that it has applied the exemption from recognising deferred tax balances relating to Pillar Two Model Rules.

Entities can benefit from this temporary exception immediately and are required to provide the disclosures set out in the amendments for reporting periods beginning on or after 1 January 2023.

Our thoughts
As with the previous amendments to IAS 12, we welcome these amendments because many of our clients around the world have indicated they are concerned at the amount of time, cost and effort that will be required to assess the accounting implications associated with the tax consequences arising from the implementation of the Pillar Two Model Rules.

Similarly, we commend the IASB for moving quickly to extend the guidance and relief to entities who report under the IFRS for SMEs, as they too face uncertainty due to the Pillar Two Model Rules.

Lack of exchangeability
Issue 2023-03

The International Accounting Standards Board (IASB) has amended IAS 21 'The Effects of Changes in Foreign Exchange Rates' to clarify the approach that should be taken by preparers of financial statements when they are reporting foreign currency transactions, translating foreign operations, or presenting financial statements in a different currency, and there is a long-term lack of exchangeability between the relevant currencies.

The amendments
The amendments include both updates to guidance to assist preparers in correctly accounting for foreign currency items and increases the level of disclosure required to help users understand the impact of a lack of exchangeability on the financial statements. The amendments:

- introduce a definition of whether a currency is exchangeable, and the process by which an entity should assess this exchangeability. This includes application guidance included in a new Appendix A
- provide guidance on how an entity should estimate a spot exchange rate in cases where a currency is not exchangeable
- require additional disclosures in cases where an entity has estimated a spot exchange rate due to a lack of exchangeability, including the nature and financial impact of the lack of exchangeability, and details of the spot exchange rate used and the estimation process.

The additional disclosure requirements provide useful information about the additional level of estimation uncertainty, and risks arising for the entity due to the lack of exchangeability.

The amendments to IAS 21 are effective for accounting periods on or after 1 January 2025, with earlier application permitted.

Our thoughts
Until now IAS 21 included guidance on the exchange rate to be used when exchangeability between two currencies was temporarily lacking but was silent on the approach to be taken when a lack of exchangeability was not temporary. Although lack of exchangeability may occur relatively infrequently, in such cases economic conditions can often deteriorate quickly. Diversity in applying existing IAS 21 guidance may therefore lead to material differences in how events and transactions are reported. These amendments provide guidance that will increase comparability between financial statements and provide more useful information to users.

IASB issues amendments to enhance the transparency of supplier finance arrangements
Issue 2023-02

The International Accounting Standards Board (IASB) has amended IAS 7 'Cash flow Statements' and IFRS 7 'Financial Instruments: Disclosures' through the increase of disclosure requirements to enhance the transparency of supplier finance arrangements and their effects on an entity's liabilities, cash flows and exposure to liquidity risk.

The amendments require additional disclosures that complement the existing disclosures in these two Standards. They require entities to disclose:

- the terms and conditions of the arrangement
- the amount of the liabilities that are part of the arrangements, breaking out the amounts for which the suppliers have already received payment from the finance providers, and stating where the liabilities are included on the statement of financial position
- ranges of payment due dates
- liquidity risk information.

These additional disclosure requirements address investors wanting more visibility around supplier finance arrangements, which in some jurisdictions around the world are better known are reverse factoring arrangements.

The amendments to IAS 7 and IFRS 7 are effective for accounting periods on or after 1 January 2024.

Our thoughts
We welcome these amendments. In jurisdictions where supplier financing arrangements are common, we acknowledge there is a need to explain to the users of financial statements what the effects of such arrangements are on an entity's liabilities and its cash flows. These amendments will provide the visibility investors require on such arrangements because the disclosures made could impact their assessment of debt covenant arrangements and leverage ratios.

IASB amends IAS 12 to help entities respond to the 'Pillar Two' tax rules

Issue 2023-01

The International Accounting Standards Board (IASB) has issued amendments to IAS 12 'Income taxes' to give entities temporary relief from accounting for deferred taxes arising from the Organisation for Economic Co-operation and Development's (OECD) international tax reform. The amendments introduce both a temporary exception and some targeted disclosure requirements.

Background

The OECD published its Pillar Two Model Rules in December 2021 to ensure that large multinational companies (ie groups with revenue of EUR750 million or more in two of the last four years) would be subject to a minimum 15% tax rate. The reform is expected to apply in most jurisdictions for accounting periods starting on or after 1 January 2024.

However, while the reaction from jurisdictions around the world to implement the changes has been positive, there have been major stakeholder concerns about the uncertainty over the accounting for deferred taxes arising from the implementation of these rules. Those concerns mainly refer to identifying and measuring deferred taxes because determining whether the Pillar Two Rules will create additional temporary differences is very difficult and also which tax rate will be applicable (considering the number of factors affecting its determination). Therefore, the IASB has acted quickly to address these concerns and provide direction on what they expect entities to disclose.

The amendments:

- Provide a temporary recognition exception to accounting for deferred taxes arising from the implementation of the international tax reform (Pillar Two Model Rules). The aim of this exception is to provide some consistency in applying IAS 12 when preparing financial statements as the rules are phased in.
- Additional disclosure requirements – these are targeted at a reporting entity's exposure to income taxes arising from the OECD reforms in periods in which the Pillar Two Model legislation is enacted or substantively enacted but not yet in effect. The aim of these disclosures is to help investors with their understanding of the reporting entity's exposure to these tax reforms, particularly before any domestic offshore legislation takes effect. The amendments provide guidance on how this information could be disclosed to meet the above objective.

Entities are able to benefit from the temporary exception immediately as soon as the amendments are published but in providing this exemption they are required to provide the disclosures to investors for annual reporting periods beginning on or after 1 January 2023. However, in some jurisdictions, such as Europe, the endorsement process will probably not be completed before 30 June 2023 resulting in reporting entities operating in jurisdictions where the Pillar Two Rules have been enacted or quasi enacted, being in a situation that the amendments are aiming to avoid.

We are of the view that if this happens, reporting entities are able to develop their own accounting policy in accordance with the guidance of Paragraph 10 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. We consider that the value of the information being provided (ie relevancy, reliability, faithful presentation) is outweighed by the costs of attempting to update the deferred tax balances for Pillar Two Model Rules.

Put another way, given these amendments to IAS 12 make it clear that no deferred tax is required to be recognised as a result of Pillar Two Model Rules, trying to identify and estimate any deferred tax for one period (i) in a way that might not be consistent with how other reporting entities would do it and (ii) with the only perspective to reverse it in a following period, may not end up providing reliable, consistent and decision useful information for the users of the financial statements.

Our thoughts

We welcome these amendments because many of our clients around the world have indicated they are concerned at the amount of time, cost and effort that will be required to assess the accounting implications associated with the tax consequences arising from the implementation of the Pillar Two Model Rules.

Considering some jurisdictions around the world have already substantially enacted the Pillar Two Model Rules, we commend the IASB for the speed in which they published these amendments and encourage reporting entities to consider what new disclosures are now required well ahead of any reporting obligations they might have. Listed entities in particular should take into account any views expressed by their local regulator in developing their accounting policy on this matter.

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