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Financial Reporting Supervision

Observations on Selected Financial Reporting Issues – Years ending on or after 31 December 2023

IAASA
Irish Auditing & Accounting Supervisory Authority

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1. Financial reporting environment

1.1 Introduction

In its role as Ireland's accounting enforcer, IAASA examines the annual financial statements and half-yearly financial reports of certain[1] issuers to ensure that their financial reports comply with the relevant reporting framework.

In publishing this *Observations* Paper, IAASA hopes to assist issuers in preparing high quality financial reports by offering observations on selected financial reporting topics.

The matters set out in this Paper may be subject to detailed scrutiny by IAASA in its 2024 cycle of financial report examinations.

1.2 Continued uncertainty in the economic outlook

Easing growth momentum amid declining inflation and robust labour market

"The EU economy continues to show resilience in the face of the formidable shocks it has endured in recent years, but it has lost momentum. Economic activity in the EU was very subdued in the first half of 2023.

Weakness in domestic demand, in particular consumption, shows that high, and still increasing consumer prices for most goods and services, are taking a heavy toll ... This is despite declining energy prices and an exceptionally strong labour market, which has seen record low unemployment rates, continued expansion of employment and rising wages.

Meanwhile, the sharp slowdown in the provision of bank credit to the economy shows that monetary policy tightening is working its way through the economy … indicators point to slowing economic activity … with continued weakness in industry and fading momentum in services, despite a strong tourism season in many parts of Europe.

The weaker growth momentum in the EU is expected to extend to 2024, and the impact of tight monetary policy is set to continue restraining economic activity. As the outlook for global growth and trade remains broadly unchanged … the EU economy cannot count on strong support from external demand."

European Commission, Summer 2023 Economic Forecast, 11 September 2023

[1] The Authority's financial statement review remit derives from Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (the EU Transparency Directive), as transposed into Irish law

Inflation with domestic price increases at their highest level in 38 years

"… prices for consumer goods and services in July 2023 increased by 5.8% on average when compared with July 2022 … Prices have been rising on an annual basis since April 2021, with annual inflation of 5.0% or more recorded in each month since October 2021."

Central Statistics Office statement, Consumer Price Index July 2023, 10 August 2023

High inflation has led to tighter monetary policies

"**Risk analysis**

International risks – banking sector uncertainty and geopolitical tensions

Despite downward revisions to inflation for next year, stubbornly high inflation has led central banks to continue with tighter monetary policies. High profile failures in the banking sector earlier this year have demonstrated the difficulty with which the global economy is adapting to higher interest rates. Financial uncertainty will likely continue throughout the year …

Another challenge for the global economy is the development of the war in Ukraine and relations between the US and China. While energy prices have shown signs of stabilising, food prices remain elevated and further shocks from the war may contribute to further inflationary pressures. The growing tensions between the US and China, meanwhile, could facilitate increased trade barriers and general uncertainty and contribute to a weaker international outlook.

Domestic risks – pharma and ICT vulnerabilities and continued inflation

… the ICT and pharma sectors contribute significantly to Irish economic activity. While exports and employment in the ICT sector have continued through the first quarter of 2023, the decline in pharma-related exports should be monitored closely. Given the robust growth of these sectors in recent years, it is likely that activity will moderate. However, any significant downturn in activity may have greater implications for the domestic outlook.

With a record low unemployment rate yet growing job vacancies, there is some risk that wage growth rises above current expectations. Should earnings growth pass through to wage-based price increases, a higher-for-longer interest rate cycle will likely be needed to address inflation. Any worsening in domestic financial conditions would dampen investment activity and consumer sentiment. Rising interest rates are also likely to act as a drag on the demand- and supply sides of the housing market. Additionally, the continued challenges being faced by key sectors to meet labour demand may escalate capacity challenges in the economy and reduce key outputs, such as housing completions."

Quarterly Economic Commentary – Summer 2023, The Economic and Social Research Institute, June 2023

Uncertainty affects us all

"For companies, investors, auditors and regulators, the current uncertainties and the risks associated with them come in many flavours: geopolitical, technological, regulatory, market-related, interest-rate related, climate-related and supply chain-related, you name it.

Economic uncertainty surrounds us. To illustrate, here are some recent article news headlines: '*Business and markets rattled by uncertainty …*'; '*European markets in red as uncertainty looms …*'; and '*Economic uncertainty is on the rise*'.

The last meeting of the Financial Stability Board (FSB), where the IASB is a participant, included discussions about yet another uncertainty – that is, possible implications to financial stability from recent developments in the banking sector.

Uncertainty affects us all."

Andreas Barckow, Chair of the International Accounting Standards Board (IASB) addressing the IFRS Foundation Conference, 26 June 2023

1.3 Some general financial reporting pointers

In preparing periodic financial statements, management, Directors, and Audit Committees should:

- ☑ consider the impact of climate change in the short-, medium- and long-term on their operations and on the recognition and measurement of assets and liabilities
- ☑ ensure consistency between front end reporting and the financial statements including in respect of climate change impacts
- ☑ tailor disclosures on the significant judgements, and the sources of estimation uncertainty and changes in the key assumptions underpinning assets, liabilities, income, expenses, and cash flows to their particular circumstances
- ☑ apply the recognition, measurement, presentation, and disclosure requirements of financial reporting standards to provide users of their financial reports with information that is comparable, relevant, verifiable, timely and understandable

And should not:

- ☒ "greenwash" when it comes to disclosing the impact of climate change
- ☒ place over reliance on alternative performance measures (APMs) when commenting on performance
- ☒ reduce the understandability of their financial statements by obscuring material information with immaterial information nor by aggregating material items that have different natures or functions

2. Observations on selected financial reporting issues

2.1 Macro-economic impacts

The current macro-economic environment – with inflationary pressures, interest rate increases brought on by monetary policy actions by central banks, elevated energy prices, and concerns over consumer sentiment – continues to present challenges for many issuers.

2.1.1 Re-financing and other financial risks

As a consequence of interest rate increases already in effect and the possibility of still further increases, many issuers will incur increased borrowing and re-financing costs, adding to the risk that they may encounter difficulties in meeting their financial obligations.

It is expected that impacted issuers will provide transparency about the impact of interest rate risks and liquidity risks on their financial position, performance and cash flows.

The impact of interest rates increases on the financial statements may be particularly pronounced for issuers that are dependent on borrowings subject to variable interest rates. Fixed interest debt may present re-financing risks.

Issuers exposed to interest rate risk are required to provide a sensitivity analysis showing how profit or loss and equity would have been affected by the reasonable possible changes in the interest rates. This sensitivity analysis must be prepared considering a reasonable possible change in the interest rates and the range of these possible changes should reflect the fact that the interest rate has experienced more volatility in recent times. Different classes of financial instruments may require different types of sensitivity analysis. In addition, changes in the macro-economic environment may require changes in the methods and assumptions used in the preparation of the sensitivity analysis, which should be disclosed if significant.

Cash flow challenges due to inflation and interest rate increases may prompt issuers to seek additional financing or to amend the terms of existing facilities. Issuers (borrowers and lenders) should provide transparency on financing re-negotiated during the year, disclosing the main changes in the terms of debt agreements and their financial impact. Substantial modification of financial instruments results in their de-recognition followed by recognition of a new financial instrument. IFRS 9 *Financial Instruments* provides guidance on determining whether a modification of a financial liability is substantial. No explicit guidance for financial assets is provided in IFRS 9; however, issuers should disclose the accounting policy applied to determine when a modification of a financial assets results in its de-recognition. For modifications that do not result in derecognition, accounting requirements in IFRS 9.B5.4.5 and B5.4.6 and the disclosure requirements in paragraph 35J of IFRS 7 *Financial Instruments: Disclosures* should be considered.

2.1.2 Covenants

The effects of inflation and interest rates may impact an entity's ability to meet the covenant requirements included in facility agreements. Issuers are reminded that a liability shall be classified as current when the issuer no longer has an unconditional right to defer settlement for at least twelve months after the reporting period [paragraphs 69 and 73 of IAS 1 *Presentation of Financial Statements* refer].

2.1.3 Cash and cash equivalents

IAS 7.45 and 46 require disclosure of the components of cash and cash equivalents, including the policy adopted for determining their composition. Moreover, It is expected that, if relevant, issuers will disclose the amount of significant cash and cash equivalent balances held that are not available for use by the issuer (e.g., because of legal restrictions such as subsidiaries operating in a country with exchange controls). The reasons for the existing cash restrictions should be explained.

2.1.4 Going concern

Increased vulnerability of some issuers in the current macro-economic environment may raise questions about their to continue as going concerns.

In assessing the appropriateness of the going concern assumption, issuers shall consider all the available information about the future which is at least, but is not limited to, twelve months from the end of the reporting period [IAS 1.25 and 26 refer]. Prior to concluding whether the going concern basis is appropriate, issuers may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of alternative financing (including factors outlined in IFRS 7.B11F).

In the current macro-economic environment, issuers, in assessing the entity’s ability to continue as a going concern, may need to:

(a) consider a greater number of factors than in the past, and

(b) reflect the impact of those factors evolving more quickly than may have traditionally been the case[2].

Issuers aware of material uncertainties related to events or conditions that may cast significant doubts about going concern need to provide entity-specific disclosures about the risks, including how the issuer is responding to them.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should, consider the impact of the macro-economic environment (including inflation, interest rates, and consumer sentiment) when preparing their 2023 year-end financial reports.

[2] For example, the collapse of Silicon Valley Bank, the second-biggest bank failure in US history, took place over less than 48 hours. Customers withdrew nearly a quarter of the bank's total deposits within a single day. It is reported that the speed of its demise was facilitated by a digital environment marked by easy cash withdrawals and the spread of information on social media and other spaces online, where panic among a few can rapidly evolve into a widespread movement

2.2 Fair-value measurement and disclosures

2.2.1 General considerations

In the current macro-economic environment, an increased level of uncertainty exists regarding the fair values of investment properties. Commercial real estate markets in many jurisdictions are characterised by declining prices and weakening investor demands accompanied by a decrease in market activity. Residential real estate markets in Ireland and elsewhere are facing supply shortages, construction cost inflation, high demand and an increasingly costly financing landscape. Fair value changes on the financial position and performance can result in a material impact for issuers applying the fair value model to their investment properties. Similar considerations apply when estimating the recoverable amount of assets measured at cost for the purpose of impairment testing in accordance with the requirements of IAS 36 *Impairment of Assets*.

Investment property valuations are exposed to changes in the macro-economic environment. Issuers are expected to reflect changes in factors such as interest rates and or investor demand in the fair value measurement of investment property. The impact of increasing overall costs due to inflation and potentially decreasing vacancy expectations should be considered when forecasting future cash flows.

While IAS 40 *Investment Property* underpins the practice of independent valuers determining the fair value of investment property, responsibility for ensuring that fair value measurements comply with the requirements of IFRS 13 *Fair Value Measurement* rests with the issuer.

Issuers are expected to:

(a) clearly explain their methodological assumptions (e.g., for the determination of all key inputs such as the capitalisation rate or the rate of return),

(b) explain any significant changes to the previous reporting period and the reasons for those changes,

(c) consider whether, in cases when the fair value measurement of investment property is based on prices in comparable transactions (‘market approach’) any decline in real estate market activity, the limited information of comparable transactions in recent periods really reflects the current macro-economic environment. It may be necessary to apply additional valuation methods to assess whether the price estimated using the market approach is within a reasonable range of values, and

(d) in cases where it is relevant and material, issuers should explain how the impact of climate change and other environmental factors have been considered in the fair value measurement.

IFRS 13 requires disclosure of a sensitivity analysis for unobservable valuation inputs when reasonably possible alternative assumptions would change fair value significantly [IFRS 13.93(h) refers].

2.2.2 Fair values of financial instruments measured at amortised cost

IFRS 7.25 requires the disclosure of the fair value for each class of financial asset and financial liability, including those that are measured at amortised cost. This enables the users of the financial statements to assess financial risk by comparing these values with the carrying amounts. Such disclosures are of particular importance in the current macro-economic conditions as issuers, and particularly those which might be experiencing difficulty in meeting their financial obligations, may need to sell some financial investments to generate additional liquidity.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should, critically evaluate the assumptions underpinning fair value calculations.

2.3 Transparency Directive Regulations

Regulation 5(4)(c)(ii) of the Transparency (Directive 2004/109/EC) Regulations 2007 (as amended) (the Regulations) specifies that '*the management report includes a fair review of the* ***development*** [bold emphasis added] *and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.'*

Like previous financial reporting examination cycles, IAASA continues to engage with issuers on disclosures in the management report. Given the level of compliance with the Regulations has been and continues to be a recurring topic, IAASA published a paper titled *Transparency Regulations – information requests* in May 2023. With the objective of encouraging issuers to adequately consider the requirements of the Regulations, IAASA included a non-exhaustive list of questions/information requests which IAASA has asked of issuers during previous examination cycles.

In 2023, IAASA continued to engage with issuers on disclosures in the management report including:

(a) climate-related matters,

(b) review of the issuer's financial performance and financial position, and

(c) the economic environment in the locations in which the issuer's activities are located and how the issuer's operations and investments were impacted.

IAASA has noted that issuers have disclosed climate reduction targets and explanations in the management report as to how those targets will be met through a combination of decarbonisation initiatives and nature-based carbon capture projects. However, the practical difficulties in implementing the projects were not always sufficiently discussed or explained in the management report.

In addition, IAASA noted that information that was provided to IAASA during financial statement examinations had not always been adequately disclosed in the management report.

IAASA notes that certain issuers continue to disclose or publicly announce information regarding their climate goals in publications other than the periodic financial statements, e.g., in investor presentations and press releases. It is not always apparent to IAASA as to why such information is not included in the management report as part of the fair review of the development of the issuer's business.

It is IAASA's expectation that information which is sufficiently significant to warrant inclusion in, for example, an investor presentation or a press release is likely also relevant for disclosure in the management report as part of the fair review of the development of the issuer's business.

IAASA has continued to receive undertakings from issuers to enhance their financial reporting treatments and disclosures in this area.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should ensure that the management report contains a fair review of the development and performance of the business by expanding the management report to include:

(a) information regarding the evidence used to set climate targets and the actions planned to achieve those targets, and

(b) the practical difficulties in implementing those actions and achieving those targets.

Information included in investor presentations and press releases should be considered to determine if it warrants inclusion in the management report.

2.4 IAS 36 *Impairment of Assets*

IAS 36.9 states that:

> '*An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.*'

Against the background of both macro-economic uncertainties and changes in operational environments due to climate risks, the recognition and measurement of impairments under IAS 36 will likely be a key consideration in 2023 financial statements. Preparers and auditors need to ensure that assumptions used for impairment testing are reasonable and supportable [IAS 36.33(a) refers].

2.4.1 Market capitalisation

IAS 36.12(d) states that:

> *'In assessing whether there is any indication that an asset may be impaired an entity shall consider, as a minimum the following indications:*
>
> *External sources of information*
>
> *….*
>
> *(d) the carrying amount of the net assets of the entity is more than its market capitalisation.'*

IAASA has engaged with issuers in instances where there is a shortfall in market capitalisation against net assets and has, amongst other matters:

(a) requested and examined the results of the impairment reviews,

(b) requested explanations of any significant variance between the market capitalisation and the carrying amount of net assets at the reporting date, and

(c) requested explanations as to why variances between the market capitalisation and the carrying amount of net assets did not result in an impairment charge.

Issuers are reminded to consider the carrying amount of net assets against the market capitalisation and, where material, disclose explanations for any significant differences [IAS1.112(c) refers].

2.4.2 Climate risks in value in use (VIU) calculations

IAS 36.44 states that:

> '*Future cash flows shall be estimated for the asset in its current condition…*'

Issuers are reminded that climate risks may be an indicator that an asset is impaired; if so, the issuer must factor this risk into its VIU calculations. Issuers must update the key assumptions used to reflect the impact of climate risks on the VIU calculations.

Issuers are reminded that where there are impairments, or indications of impairment, the consistency between judgements and estimates and related uncertainties disclosed in the financial statements must be considered against information disclosed in the notes, the management report and in any non-financial statements.

In assessing whether or not issuers have considered climate risks on impairment indicators IAASA has:

(a) requested clarification as to whether (i) the climate change risks, and/or (ii) any future expenditure related to the issuer's climate targets by a target date, are reflected in the VIU calculations,

(b) requested explanations of how the progression of certain projects are consistent with the climate targets, and

(c) requested explanations as to why the directors assessed the impact of climate risk as minor where the issuer has invested in decarbonisation and nature-based projects to achieve climate targets.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should consider and, if relevant and material, disclose the judgments made when market capitalisation is lower than the carrying amount of net assets.

Management, Directors, and Audit Committees should ensure that the assumptions and calculations used for impairment testing are reasonable and supportable and reflect climate risks.

2.5 Financial instruments – IFRS 7 *Financial Instruments: Disclosures* & IFRS 9 *Financial Instruments*

Where changes in financial instruments have occurred in the reporting period, issuers are reminded to consider disclosures in compliance with paragraphs 33 and 34 of IFRS 7, which list the qualitative and quantitative disclosures required for each type of risk arising from financial instruments.

IAASA engaged with issuers – in particular financial institutions – on topics including expected credit losses (ECLs), significant increase in credit risk (SICR), forward-looking information (FLI) and post model adjustments (PMAs).

Issuers are reminded that accounting for expected credit losses under IFRS 9 and the related disclosures in IFRS 7 remains an area of focus for IAASA. Given macro-economic uncertainties, IAASA notes that different borrowers may be impacted differently. Issuers, in particular, financial institutions, should consider paragraphs B5.5.1 and B5.5.4 of IFRS 9 for risks associated with specific sectors when considering collective or individual assessments.

For issuers exposed to increasing interest rates and borrowing costs, IAASA reminds them of the importance of disclosures to enable users of the financial statements to evaluate the nature and extent of their exposure to such risks, and any changes to that exposure, in accordance with IFRS 7.31.

2.5.1 Expected credit losses (ECL) and significant increase in credit risk (SICR)

IFRS 7.35F(a) states that:

> '*An entity shall explain in its credit risk management practices and how they relate to the recognition and measurement of expected credit losses. To meet this objective an entity shall disclose information that enables users of financial statements to understand and evaluate:*
>
> *(a) how an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition including, if and how:*
>
> *(i) financial instruments are considered to have low credit risk in accordance with paragraph 5.5.10 of IFRS 9, including the classes of financial instruments to which it applies and*
>
> *(ii) the presumption in paragraph 5.5.11 of IFRS 9, that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted.*'

IFRS 7.35G(a) states that:

> '*An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of IFRS 9. For this purpose an entity shall disclose:*
>
> *(a) the basis of inputs, assumptions and the estimation techniques used to:*
>
> *(i) …;*
>
> *(ii) determine whether the credit risk of financial instruments has increased significantly since initial recognition.*'

IAASA has engaged with issuers on this topic and has, amongst other matters:

(a) requested details of the quantitative criteria used to assess whether there has been a SICR,

(b) requested explanations as to when the change in lifetime probability of default (PD) would result in a transfer from Stage 1 to Stage 2,

(c) requested information on the maximum change in lifetime PD that would not result in a stage transfer, and

(d) requested details of the qualitative reviews performed.

2.5.2 Forward-looking information (FLI)

Paragraph 35G(b) and (c) of IFRS 7 states that:

'*An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of IFRS 9. For this purpose an entity shall disclose:*

(a) …

(b) how forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information

(c) changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.'

In assessing whether or not issuers have disclosed the required information in the context of FLI IAASA has:

(a) requested the probability weightings used in macroeconomic scenarios,

(b) requested details as to how scenario probability weightings were determined,

(c) requested explanations as to how the number of scenarios used by the issuer was determined,

(d) requested explanations as to how macro-economic variables were determined, and

(e) requested details of any changes made in estimation techniques or significant assumptions during the reporting period.

2.5.3 Post model adjustments (PMAs)

The requirements of paragraph 35G(c) IFRS 7 are relevant in the context of PMAs.

IAASA has engaged with issuers on PMAs in 2023 and will continue to so for 2023 reports. In assessing whether or not issuers have disclosed the required information in the context of FLI, IAASA has requested:

(a) a description of the policy used in determining that a review of impairment models is required,

(b) a description of the qualitative and quantitative indicators used where a decision to review the loss given default (LGD) component of the impairment model was considered,

(c) a description of the key changes made to the impairment model parameters, including any limitations to the model that resulted in PMAs,

(d) details of the judgements made to remove previous year PMAs and a description of specific changes to the model that resulted in such adjustments no longer being required,

(e) a breakdown of specific PMAs made together with explanations of the limitations within the current model that resulted in those adjustments.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should continue to consider the extent of disclosures made to comply with paragraphs 31, 33 and 34 of IFRS 7 if changes have occurred in the reporting period,

Particularly for financial institutions, management, Directors, and Audit Committees should consider the risks associated with specific sectors [IFRS 7. B5.5.1 and B5.5.4 refer], expected credit losses (ECL) and significant increase in credit risk (SICR) [IFRS 7.35F(a) and IFRS 7.35G(a) refer], forward-looking information (FLI), and post model adjustments (PMAs) [IFRS 7.35G(b) refers].

2.6 IFRS 8 *Operating Segments*

IFRS 8.5 states that '*an operating segment is a component of an entity:*

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),

(b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

(c) for which discrete financial information is available …'

The identification of operating segments has implications on the recognition and measurement of impairments as operating segments are used to determine the level at which impairment testing is performed. For example, goodwill acquired in a business combination must be allocated to each of the acquirer's cash-generating units (CGUs) or group of CGUs. Each CGU to which the goodwill is allocated shall:

(a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes, and

(b) not be larger than an operating segment as defined by IFRS 8.5 before aggregation.

This requirement – which is set out in paragraph 80 of IAS 36 *Impairment of Assets* – results in goodwill being tested for impairment at a level that reflects the way an issuer manages its operations and with which the goodwill would naturally be associated [IAS 36.82].

IFRS 8 outlines the use of the '*management approach'* [IFRS 8.5(b) refers]. IFRS 8.BC9 states that '*entities will report segments that correspond to internal management reports …*'.

In addition, correctly identifying the person or group of people who carry out the function of Chief Operating Decision Maker (CODM) is one of the steps that assists issuers in correctly identifying their operating segments.

Given that the identification of operating segments has implications on the level at which the performance of impairment tests are performed, IAASA published a Paper *IFRS 8 Operating Segments – Identification of Chief Operating Decision Maker* in 2020. In that Paper, IAASA included a non-exhaustive list of information requests to issuers

IAASA has continued to examine issuers' disclosures of their operating segments and, in particular, has reviewed the CODM reporting package to ensure that they are reporting the segments that correspond to their internal management reports.

Geo-political disruptions, and acquisitions and disposals of businesses may have a direct impact on the composition of internal structures or geographical markets in which an entity operates.

In this context, issuers should consider the impact of such changes in the context of IFRS 8 reporting requirements (including paragraphs 29 and 30 with regard to the re-statement of previously reported information).

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should:

(a) consider changes in management reporting and the structure of the internal organisation in terms of IFRS 8 *Operating Segments*,

(b) comply with the requirements of IFRS 8.29 and 30 where such changes occur, and

(c) consider the interaction of IFRS 8 and IAS 36 when performing impairment testing.

2.7 Alternative performance measures (APMs)

ESMA's APM Guidelines have been applicable since 2016. These Guidelines are supplemented by a series of Questions and Answers providing responses to questions posed by stakeholders in relation to the practical application of the Guidelines.

IAASA reminds issuers that they should carefully consider the requirements of those Guidelines, and ensure compliance, to the fullest extent possible, with each of the requirements.

IAASA notes that the Guidelines apply to measures disclosed outside the financial statements (such as the management report, remuneration report, ad-hoc disclosures and prospectuses) unless they are defined or specified in the applicable financial reporting framework.

Arising from its examinations of financial reports, IAASA has received undertakings from issuers in relation to a range of non-compliance in the application of the Guidelines. Instances of non-compliance included:

(a) incorrect labels were used to describe the APM,

(b) APM's were not defined,

(c) adjusted APMs were not defined, or the adjustment was not adequately explained, and

(d) missing linkage between the APM and its definition within the financial statements.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should carefully consider each of the requirements of the ESMA APM Guidelines and ensure compliance, to the fullest extent possible, with each of the requirements of those guidelines.

2.8 European single electronic format (ESEF)

2023 was the second year that the IFRS consolidated annual financial statements of issuers were required to be prepared in accordance with ESEF requirements, and the first year that the notes and accounting policies were required to be marked up, following the “block tagging” approach.

IAASA’s observations from their review of ESEF files during the year include:

2.8.1 Block tagging

The requirements for marking up the notes and accounting policies are different to those for marking up the primary financial statements [section 1.9 of the ESEF Reporting Manual refers]. Issuers have adopted different approaches to these requirements: some apply the lowest level of granularity to individual tables within the notes while others apply a higher level of granularity to individual notes. Issuers must ensure consistency in their approach across reporting periods, and they must also ensure that the text content of the tag presents the words and numbers in the same order as the human readable report.

2.8.2 Inline XBRL viewers

A viewer is a tool that allows inline XBRL reports to be viewed interactively in a web browser, displaying both the human-readable layer and the tags. It provides an easier way to view, access and explore details of the tagged information in such reports. In 2023, 36% of issuers made their report available on their websites with an inline XBRL viewer (up from 23% in 2022), thus eliminating the need for users to download large files and use specialised tools to access the full content of the reports. Issuers should consider making a validated version of their annual financial report available on their websites with an inline viewer.

2.8.3 Use of extensions/custom tags

When extensions/custom tags are used, issuers must ensure that they are (i) correctly anchored to the closest core taxonomy element(s), and (ii) appropriately marked up using XBRL markup language.

2.8.4 Consistent tagging of the same fact

Where a fact is reported in more than one area of the financial statements, issuers must ensure that the fact is consistently tagged.

ESMA has recently published an updated ESEF Reporting Manual applicable to the 2023 financial year. The purpose of the ESEF Reporting Manual is to promote a harmonised and consistent approach for the preparation of annual financial reports in the format specified in the Regulatory Technical Standard (RTS) on ESEF. It provides guidance on common issues that may be encountered when creating ESEF documents and explains how to address/resolve them.

Finally, issuers are reminded of likely future CRSD requirements to provide the management report in electronic format (i.e., XHTML) and the sustainability report to be marked up to ESEF (i.e., iXBRL).

Matters for consideration by management, Directors, and Audit Committees

Management, Directors and Audit Committees should continue to ensure that they publish ESEF compliant reports.

2.9 Amendments to IFRSs

2.9.1 Amendments to IAS 12 *Income Taxes*: International Tax Reform – Pillar Two Model Rules (issued 23 May 2023)[3]

Issuers should consider the application of the mandatory temporary exception from the recognition and disclosure of deferred taxes arising from implementation of the OECD's Pillar Two Model Rules. For reporting periods in which Pillar Two legislation is substantively enacted but not yet effective, disclosure of known or reasonably estimable information that helps users of financial statements understand the issuer's exposure arising from Pillar Two income taxes should be provided. To comply with these requirements, an issuer must disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the reporting date.

2.9.2 Amendments to IAS 1 Presentation of Financial Statements and IFRS Practice Statement 2: Disclosure of Accounting Policies (issued on 12 February 2021)[4]

Issuers' attention is drawn to the amendments to IAS 1, where added guidance is provided to assist them determine when accounting policy information needs to be disclosed. The amendments require issuers to disclose their material accounting policy information rather than their significant accounting policies.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should:

(a) consider both the tax impacts of Pillar Two and the extent of disclosures provided on related deferred taxes

(b) carefully review their accounting policy disclosures to ensure compliance with the amended requirements

[3] Amendments to IAS 12 *Income Taxes*: International Tax Reform – Pillar Two Model Rules was issued by the IASB on 23 May 2023. While, under IASB rules, entities may apply the exception immediately, the disclosure requirements are required for annual periods commencing on or after 1 January 2023. However, as of the time of publication of this Paper, the amendments have not been endorsed by the EU. See https://www.efrag.org/News/Public-436/EFRAG-Endorsement-Status-Report---Update for the most recent endorsement status

[4] Amendments to IAS 1 *Presentation of Financial Statements* and IFRS Practice Statement 2: *Disclosure of Accounting Policies* was issued by the IASB on 12 February 2021. It was endorsed by the EU on 2 March 2022 and has an EU effective date of 1 January 2023

APPENDIX

IAASA'S FINANCIAL REPORTING RELATED PUBLICATIONS

Readers may find it helpful to refer to other IAASA financial reporting related publications, available on the IAASA website, including:

Observations papers	Observations on selected financial reporting issues – years ending on or after 31 December 2022 Observations on selected financial reporting issues – years ending on or after 31 December 2021
Financial reporting decisions	Financial Reporting Decisions (January 2023) Financial Reporting Decisions (February 2022)
Information notes	Transparency Regulations – information requests (May 2023) IFRS 13 Fair Value Measurement – information requests (March 2023) Climate-related disclosures in financial reports – IAASA information requests (October 2022) Reporting Climate Change (January 2022) Applying IFRS 9 Financial Instruments – expected credit losses (January 2022)
Other publications	Outcome of financial statement examinations completed in 2022 (March 2023) Policy Paper: Publication of information regarding IAASA's financial reporting supervision activities (revised December 2022) (December 2022)
Annual reports	2022 Annual Report (June 2023 2021 Annual Report (July 2022)

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