KPMG

Interim Reporting Reminders and IASB Developments

Financial Reporting Webinar Series

Friday, 2 June 2023

Standards and amendments effective from 1 January 2023

Amendments:

- IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 *Interest Rate Benchmark Reform – Phase 2*

  [USD LIBOR panel will cease on 30 June 2023]

IFRS 17 *Insurance Contracts*

Amendments:

- IAS 1 and IFRS Practice Statement 2 *Disclosure of Accounting Policies*
- IAS 8 *Definition of Accounting Estimates*
- IAS 12 *Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction*

Imminent amendments (expected to be effective upon issue):

- IAS 12 *International Tax Reform – Pillar Two Model Rules*

1 January 2023

IAS 8: Accounting estimates vs accounting policies

Accounting estimates

- Monetary amounts in the financial statements that are subject to measurement uncertainty**
- Change applied prospectively

Developed by selecting the measurement technique and inputs to achieve the objective set out by an accounting policy

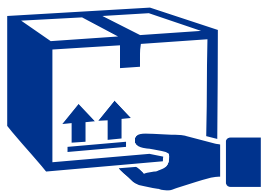
Accounting policies

- The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements
- Change applied retrospectively generally

Example

Fair value of an IP

Example



Change of cost formula of Inventory

***The amendments to IAS 8 introduce a new definition for accounting estimates*

Amendments to IAS 12: Narrow scope of Initial recognition exemption

Issue :

A company may be entitled to a tax deduction on a cash basis for a lease transaction that involves recognising a right-of-use (ROU) asset and a corresponding lease liability under IFRS 16 Leases. A temporary difference may then arise on initial recognition of the ROU asset and the lease liability.

Approaches that are currently applied

Approach	Outcome
1. Apply the IRE separately to the ROU asset and lease liability	Recognise the tax impacts in profit or loss when they are incurred and therefore recognise no deferred tax on the lease
2. Assess the ROU asset and lease liability together on a net basis	Recognise deferred tax on a net temporary difference that arises after the initial recognition and is not subject to the IRE
3. Not applying IRE	Recognise Deferred tax

There was diversity in practice

Deferred tax related to leases and decommissioning obligations

What are the amendments about?

The "initial recognition exemption" does not apply

What is the change?

→ Need to recognize deferred tax asset (related to lease liabilities) and deferred tax liability (related to right-of-use assets). However, the resulting deferred tax asset and liability would generally qualify for offset under IAS 12.74

→ Impact disclosures

<u>Approach 2</u>

Deferred tax arising from:	Leases	xxx	Total	Right-of-use assets	Lease liabilities	xxx	Total
1 Jan 2022	-	xxx	150	(100)	100	xxx	150
Charged/(credited) to profit or loss	(3)	xxx	100	20	(23)	xxx	100
31 Dec 2022	(3)	xxx	250	(80)	77	xxx	250

Timely update of hedge documentation

LIBOR phase out: status update

Final phase: the USD LIBOR panel will cease on 30 June 2023.

Who will be affected?

Entities that apply hedge accounting to hedges of benchmark interest rate risk, where the benchmark interest rate is subject to reform (e.g. LIBOR).

What to update?

Phase 1: When uncertainty exists

Phase 2: When uncertainty removed

Update the hedge documentation

This is neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship

only for the following changes…

- Update of the hedged risk
- Amending the description of the hedged item
- Amending the description of the hedging instrument
- Amending the description of how the entity will assess hedge effectiveness (*IAS 39 only…*)

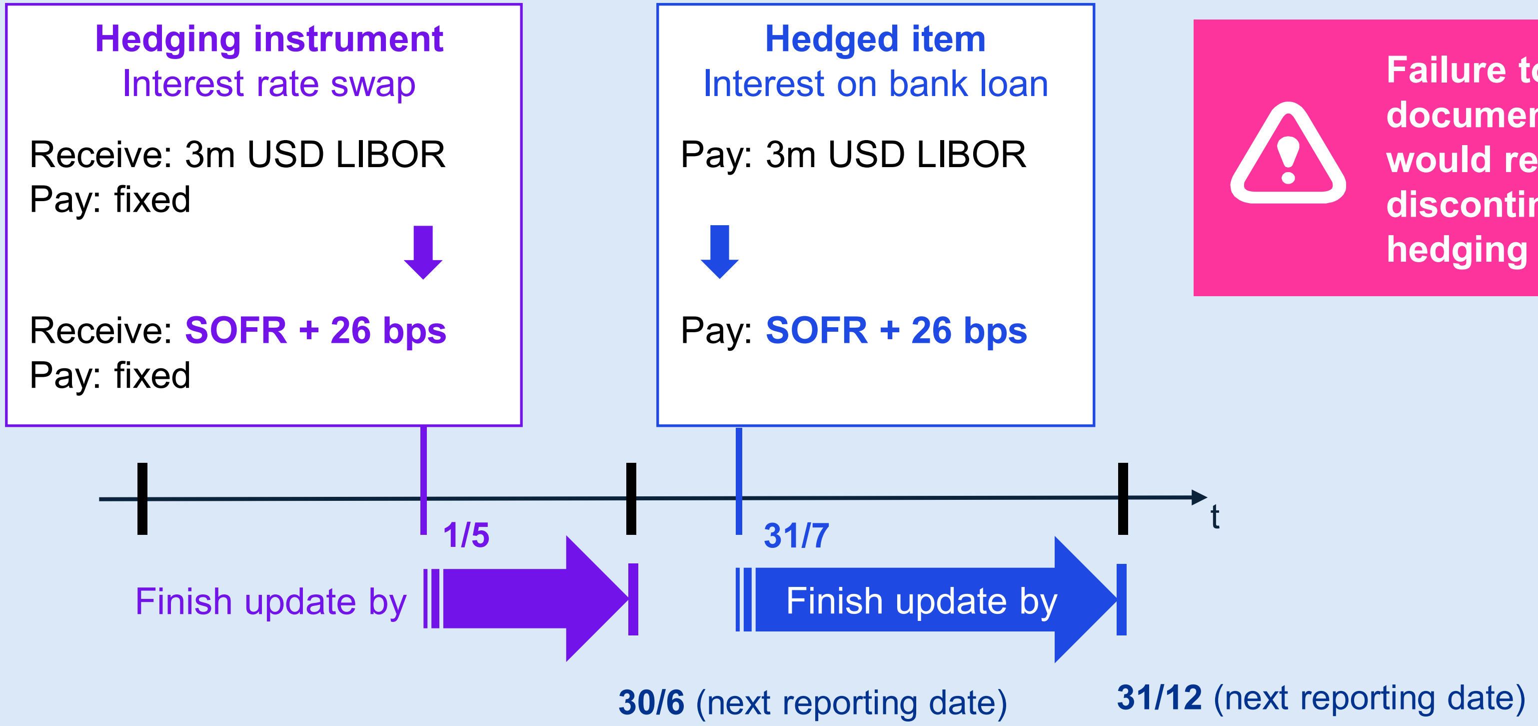
(only) to reflect changes owing to IBOR reform

Timely update of hedge documentation (cont'd)

When to update what?

By the end of the reporting period during which a change is made.
Hedge documentation may need to be updated more than once.

Example: cash flow hedge of interest rate risk

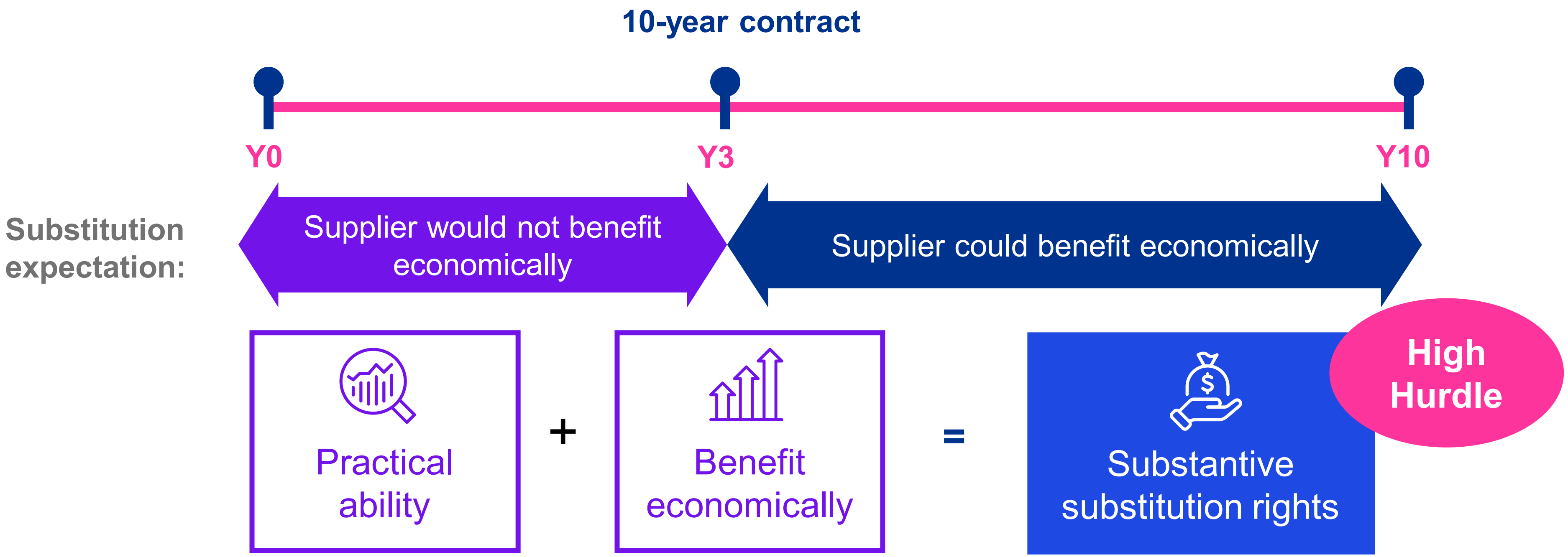


Failure to update hedge documentation in time would result in discontinuation of existing hedging relationships.

IFRIC agenda decision (April 2023): “Definition of a Lease – Substitution Rights (IFRS 16 Leases)”

Fact Pattern

A Ten-year contract under which the supplier provides multiple batteries that will be used in bus operated by the customer. The supplier can substitute a battery for an alternate battery at pretty much any time



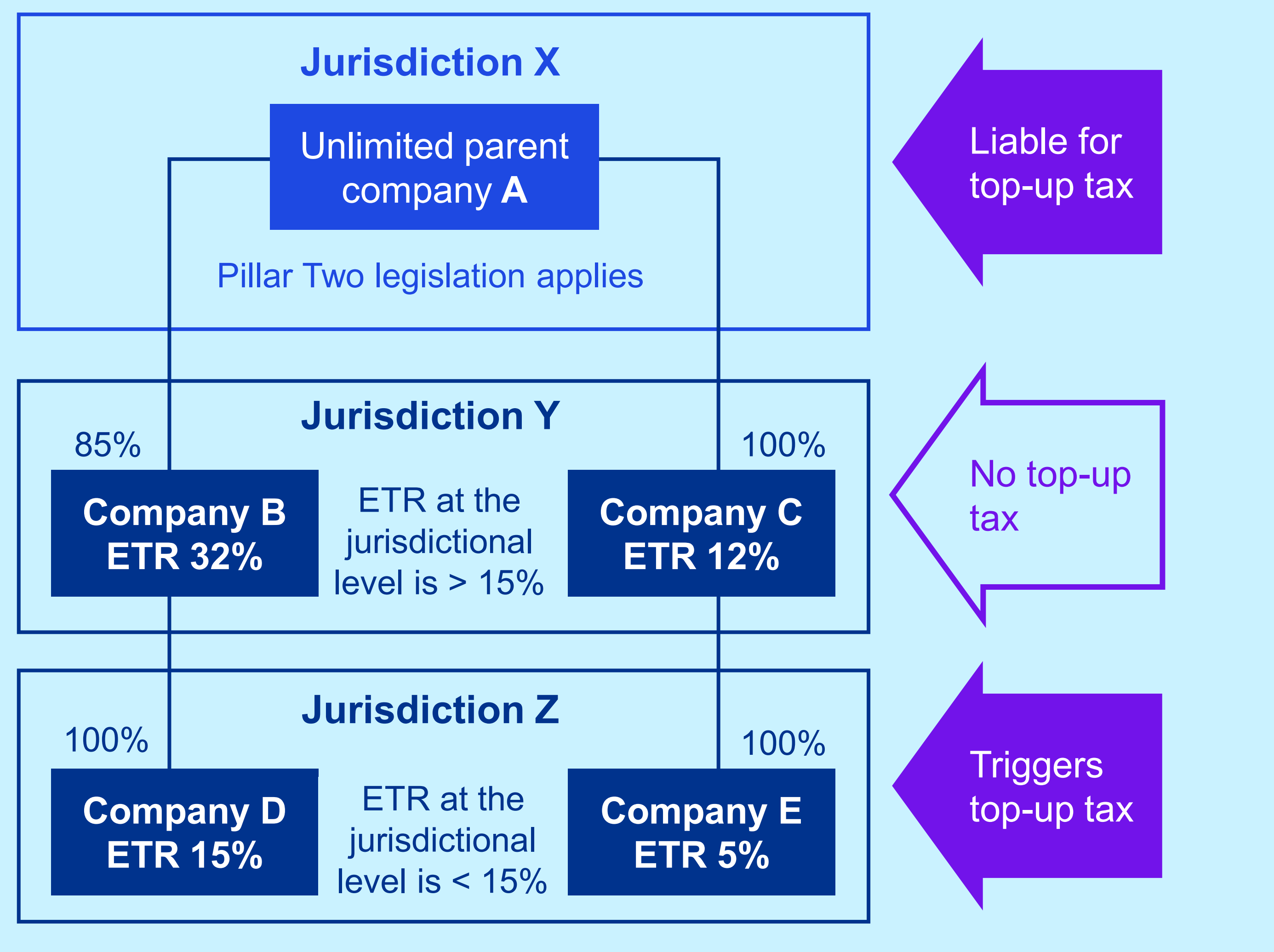
BEPS Pillar Two rules – scope

Pillar Two rules apply to **multinational groups** that have **consolidated revenues** of **EUR 750 million** or more in at least two of the last four years.

In many cases, the group company liable for the top-up tax will differ from the group company that triggered it.

Typically the ultimate parent will be liable to pay top-up tax for its low-taxed subsidiaries and the parent's local tax authority will have a right to collect it.

However, an intermediate parent or other group company can be liable for all or part of the top-up tax in some circumstances.



Summary of top-up tax calculation

The company liable for the top-up tax will need to do the following.

1. **Determine qualifying (covered) taxes** for all group companies in the same jurisdiction.
2. **Determine the GloBE income** for all group companies in the same jurisdiction using the same accounting framework as the consolidated financial statements – e.g. US GAAP or IFRS Accounting Standards.
3. **Calculate the ETR** by dividing qualifying (covered) taxes by GloBE income.

If the ETR is less than 15 percent, then:

4. **Determine excess profit** as GloBE income minus qualifying deductions.
5. **Determine the top-up tax rate**, which is the minimum 15 percent rate minus the **ETR**.
6. **Calculate ethe top-up tax** by multiplying the excess profit by the top-up tax rate.

The accounting framework will impact the amount of the top-up tax.

In addition, the ETR calculation differs under the GloBE rules and IAS 12.

$$\frac{\textbf{Qualifying taxes}\text{ (Step 1)}}{\textbf{GloBE income}\text{ (Step 2)}} = \textbf{ETR}\text{ (Step 3)}$$

If the ETR is less than 15%, then:

$$\textbf{Excess profit}\text{ (Step 4)} \times \textbf{Top-up tax rate}\text{ (Step 5)} = \textbf{Top-up tax}\text{ (Step 6)}$$

Amendments to IAS 12

International Tax Reform – Pillar Two Model Rules Amendments to IAS 12
23 May 2023

01 Mandatory exception from deferred tax accounting

- For income taxes arising from Pillar Two model rules
- Effective immediately

02 New disclosures

- Information that is known or can be reasonably estimated and helps users of the financial statements to understand the entity's **exposure to Pillar Two income taxes** at the **reporting date**
- Effective for **annual reporting periods** beginning on or after **1 January 2023**

Disclosures under the amended IAS 12

In the consolidated financial statements of the MNE group

For annual periods beginning on or after 1 January 2023, until…

Once tax law is enacted (or substantively enacted) but before top-up tax applies

- Information that is known or can be reasonably estimated and helps users of the financial statements to understand the company's **exposure** to Pillar Two income taxes at the **reporting date**.
- No need to reflect all of the specific requirements in the legislation, can be provided as an indicative range
  - Qualitative and quantitative information
- If information is not known or cannot be reasonably estimated at the reporting date, then a company discloses a statement to that effect and information about its progress in assessing the Pillar Two exposure

Pillar Two legislation becomes effective

After top-up tax applies

- **Current tax expense** related to top-up tax

Amendment to IAS 1
Term loan with covenants

Fact pattern

Term loan subject to working capital ratio requirement

- Five-year term loan, fully drawn down
- Loan includes a covenant requiring working capital ratio of 1.0 on 31 December 2024 and 1.5 on 30 June 2025
- Loan becomes repayable on demand if ratio is not met on specified covenant testing dates
- The WC ratio at 31 December 2024 is 1.3 and the company expects the ratio to be 1.4 at 30 June 2025.

Question

How should the loan be classified at 31 December 2024?

A: Current
B: Non-current

Amendment to IAS 1
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Question

How should the loan be classified at 31 December 2024?

A: Current
B: Non-current

New disclosures will apply

Amendment to IAS 1
Previously non-current convertible instruments may become current

Liabilities that can be settled in an entity's own shares (e.g. convertible instruments)

- Conversion option is an **equity instrument** under IAS 32
  - Timing of share settlement does not affect the classification of the host liability
- Conversion option is **not an equity instrument** under IAS 32
  - Timing of share settlement affects the classification of the host liability

Change in practice

Comment due date:
19 July 2023

Exposure draft of amendments to the classification and measurement of financial instruments

SPPI assessment of financial assets

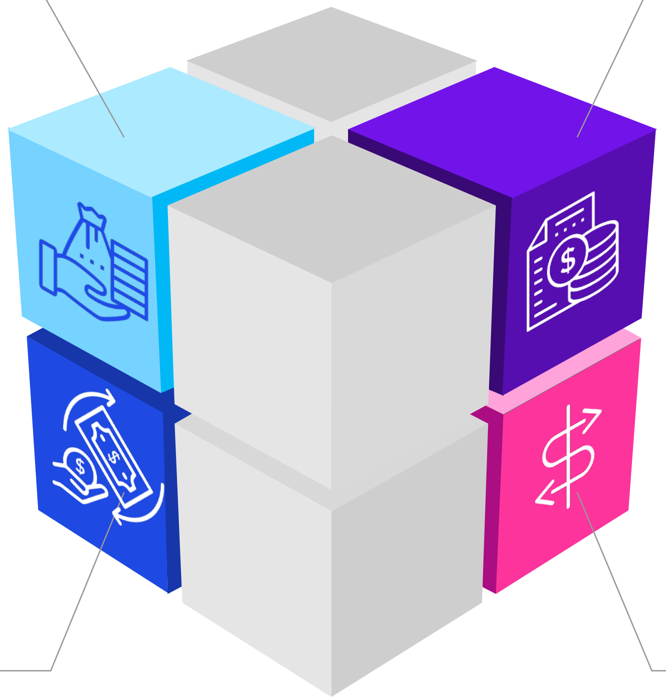
Elements of interest in basic lending arrangements

- Considering what the lender is compensated for, including the direction and magnitude of any change

Not limited to ESG-linked features!

Contingent features that change the timing and amount of contractual cash flows

- The contingent event must be specific to the debtor



Non/limited recourse features

- Right to cash flows is limited to those arising from specified assets

Contractually-linked instruments

- Waterfall payment structure creates concentration of credit risk
- The underlying pool can have financial instruments outside the scope of IFRS 9

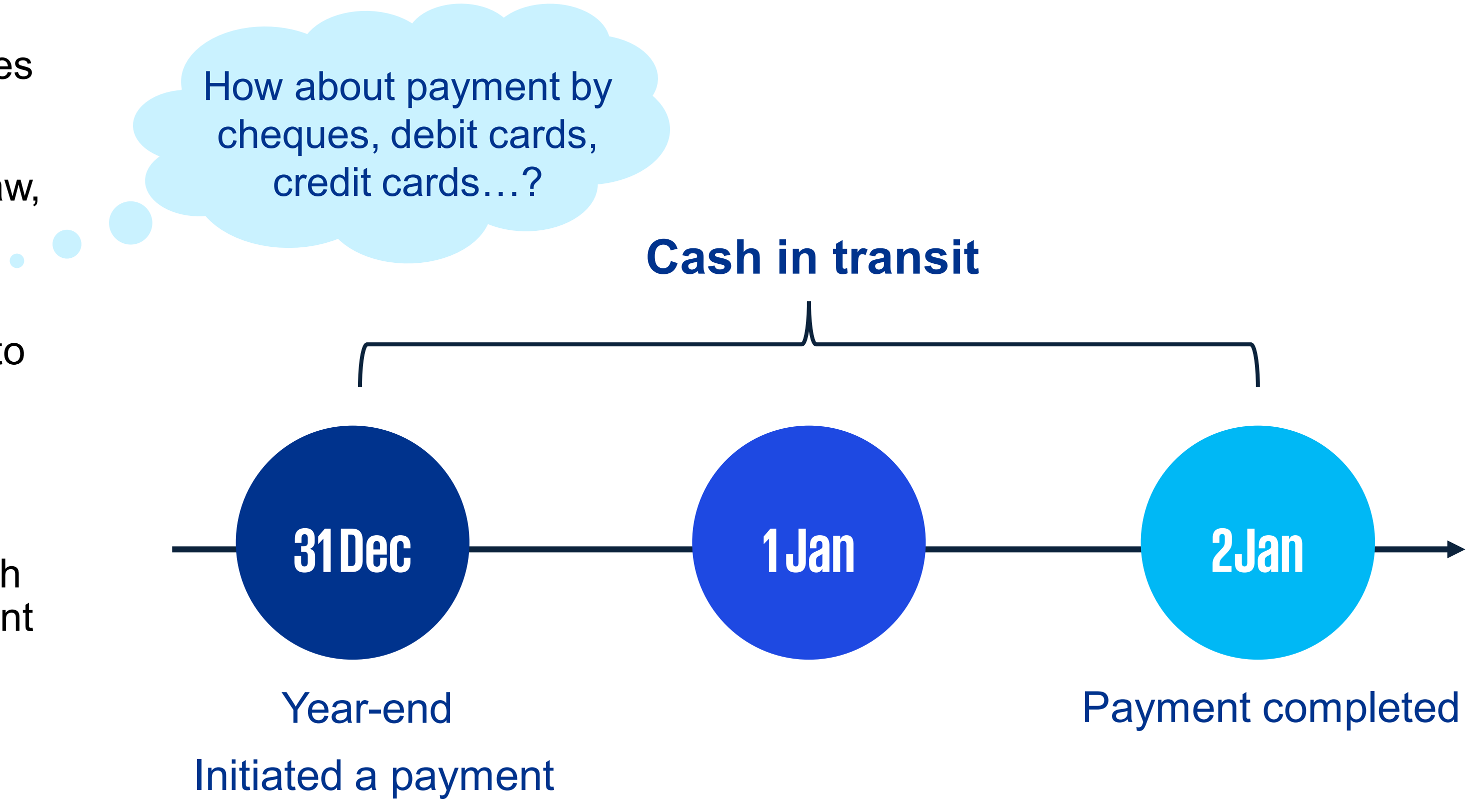
Comment due date:
19 July 2023

Exposure draft of amendments to the classification and measurement of financial instruments (cont'd)

Electronic cash transfer

Payment system-by-payment system election to derecognise financial liabilities before they are legally released, only if:

1. the entity has no ability to withdraw, stop or cancel the payment instruction;
2. the entity has no practical ability to access cash to be used for settlement due to the payment instruction; and
3. the settlement risk associated with the payment system is insignificant



Webinar dates and topics for 2023

- 22 February – Capital Market and HKEX Listing Rules Update
- 28 April – Sustainability Reporting Developments
- **2 June– Interim Reporting Reminders and IASB Developments**
- **11 August – Accounting impact from abolition of MPF offsetting arrangement**
- **13 October – TBC**
- **14 December – Year-end updates**

For more details and access to our webinar series:

https://home.kpmg/cn/en/home/services/audit/ifrs-news/financial-reporting-webinar-series.html

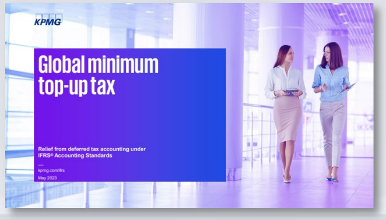
Resources

[Addressing financial asset classification issues - KPMG Global]

[IBOR reform - KPMG Global]

[Classifying liabilities as current or non-current - KPMG Global]

[Global minimum top-up tax - KPMG Global]



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