INTERNATIONAL FINANCIAL REPORTING BULLETIN

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BDO

BACKGROUND

A number of regulators and enforcers around the world including the European Securities and Markets Authority (ESMA); the International Organization of Securities Commissions (IOSCO); and the UK's Financial Reporting Council (FRC), have issued their enforcement priorities or key focus areas for 2022/23 annual financial reports.

The regulators have discussed the effects of the current economic environment affected by factors such as the COVID-19 pandemic, supply chain challenges, Russia's invasion of Ukraine, rising energy prices and supply shortages, inflationary pressures, exchange rate volatility, and rising interest rates.

A common theme arising from the guidance set out by various regulators is that entities are experiencing times of unprecedented uncertainty. This uncertainty results in numerous accounting implications such as going concern; significant judgements, estimates and estimation uncertainty; impairment of non-financial assets; assessment of control, joint control and significant influence, and others.

EXECUTIVE SUMMARY

Factors such as the COVID-19 pandemic, evolving geo-political risks, energy supply shortages, and inflationary pressures are leading to an uncertain economic environment.

There are numerous accounting implications across multiple areas such as going concern assessments, judgements and estimates, impairment of non-financial assets, etc. This IFRB discusses many of these implications.

This IFR Bulletin (IFRB) discusses some of these implications and considerations for entities while preparing their annual financial statements for the year ending 31 December 2022 and beyond.

ACCOUNTING IN TIMES OF UNCERTAINTY

Following are some considerations that entities should keep in mind when preparing their financial statements in current times of uncertainty. All examples provided in the publication are intended to be illustrative in nature and should not be relied upon as templates. Entities must carefully consider their own facts and circumstances. In some cases, this publication refers to the views and expectations of regulators and enforcers. Unless otherwise specified, BDO does not endorse or recommend these views.

Going concern

Due to deteriorating economic conditions and geopolitical uncertainties, many entities have experienced a significant downturn in revenue, rising costs or both. Many entities operating in areas affected by Russia's invasion of Ukraine were required to shut down or significantly scale down their operations. Rising energy prices have contributed to stress on operating margins for energy intensive industries. A rising debt burden on account of rising interest rates may be difficult for some highly leverages entities. Entities may not be able to pass on the rising operating costs, resulting from high inflation, to customers in all cases. Factors such as these require greater attention to be paid to an entity's assessment of going concern.

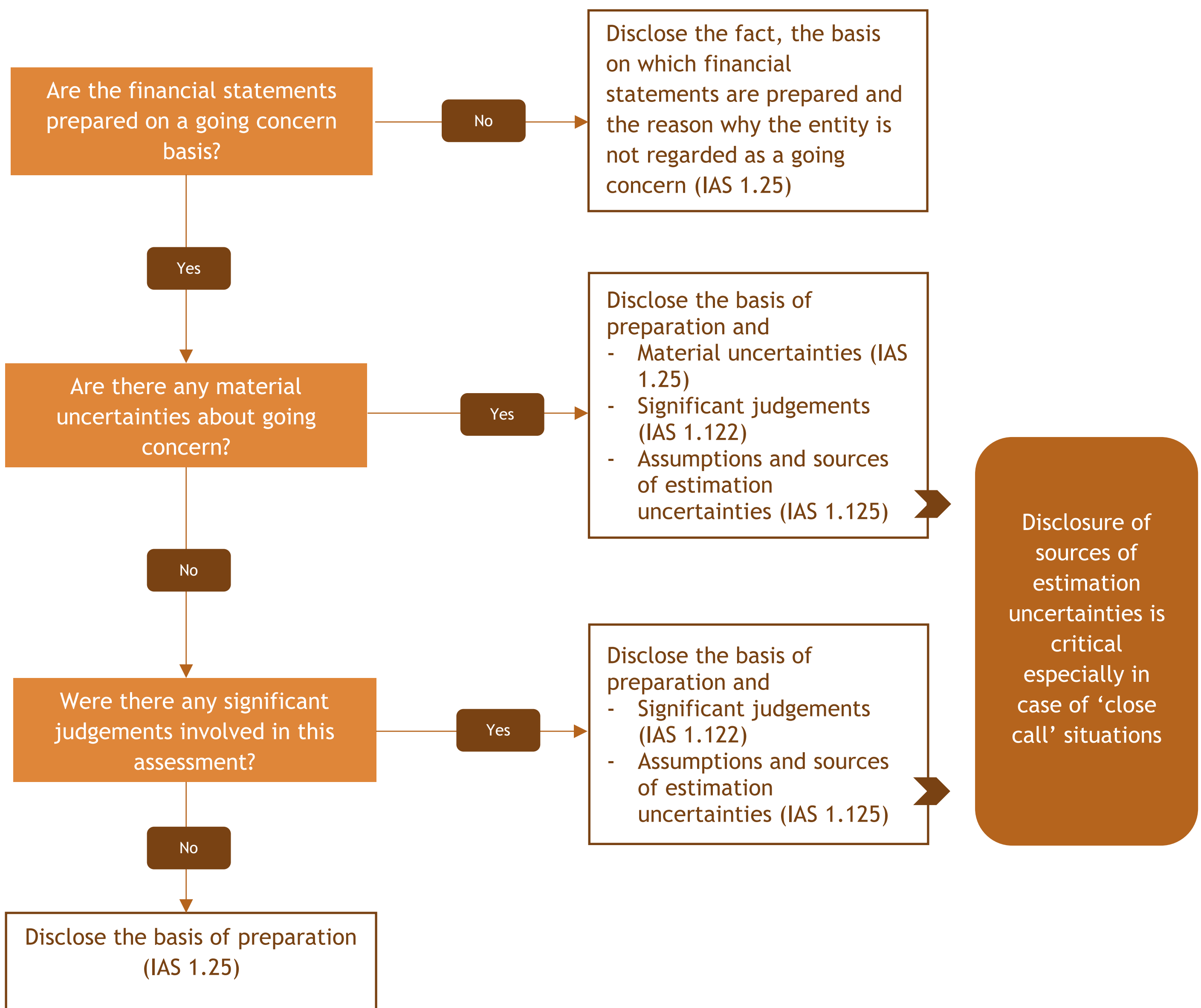
Entities need to consider the following points when performing a going concern assessment:

- Detailed scenario analysis should be performed when the entity is significantly affected by the factors such as those discussed above (e.g. considering multiple uncertain future events).
- As required by IAS 1 *Presentation of Financial Statements*, in assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period (IAS 1.26). In some jurisdictions, regulators or auditing standards may require this period to be twelve months from the date of the financial statements are authorised for issue.

- As required by IAS 10 *Events after the Reporting Period*, if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so, an entity shall not prepare its financial statements on a going concern basis (IAS 10.14). Said another way, an event or events after reporting period that results in the entity no longer being a going concern is always an adjusting event. In a rapidly evolving economic environment, it is critical to consider all information available until the date the financial statements are authorised for issue.
- In case of a group of entities, going concern assumption is assessed at the group level. If going concern assumption is appropriate at group level, consolidated financial statements are prepared on a going concern basis even if there is a significant doubt about a subsidiary's ability to continue as a going concern.

IAS 1.25 requires an entity to disclose material uncertainties related to its ability to continue as a going concern. However, IAS 1.122 and IAS 1.125 contain overarching requirements to disclose significant judgements, assumptions and sources of estimation uncertainty. It should be noted that these overarching requirements also apply to going concern assessment. Therefore, entities are required to disclose significant judgements, assumptions and sources of estimation uncertainty involved in going concern assessment.

The following diagram summarises the requirements of IAS 1 with respect to going concern assessment:



In January 2021, to support consistent application of IAS 1 with respect to specific going concern requirements and the overarching disclosure principles, the IFRS Foundation issued educational material *Going Concern – a focus on disclosure*. The educational material was issued in the context of the COVID-19 pandemic. However, the guidance in the educational material is relevant in the current economic environment also.

BDO issued *IFRB 2021/03 Going Concern – IFRS Foundation Publishes Guidance on Disclosures* that summarising the guidance provided by the educational material. The IFRB may be accessed here.

Other expectations set out by regulators or preferred disclosure practices that entities may consider following with respect to going concern assessment include:

- Disclosure of the period of the going concern assessment and explain the reasons for selecting that period.
- Disclosure of entity-specific granular information to enable users to understand how the entity will meet its liabilities over the going concern assessment period. This may include disclosure of covenants the entity was subject to, the 'headroom' in any impairment calculations, information on waivers sought, any expected breach of covenants.
- Discussion of effect of any post balance sheet liquidity event.
- In case of reliance on government support, disclosure of the nature, timing and extent of government support assumed when assessing going concern.
- Disclosure of clear and quantified assumptions with explanations as to how the assumptions had been determined. In case of multiple scenarios, disclosure of quantified assumptions for each.
- Disclosure of information on techniques used in making going concern assessment such as stress testing.

Overall, the disclosures should be company specific, sufficiently granular and both quantitative and qualitative in nature. Boilerplate disclosures should be avoided.

Following are some examples of disclosures on going concern assessment:

Going concern assessment - Disclosure of assessment period
The Group has experienced significant increases in operating costs due to rising inflation and energy prices. The Group has also experienced a declining demand in the last two years (20% decline in 2021 and 10% decline in 2022) for its Pneumatic Conveying systems segment which accounts for 70% of the Group' revenue. Therefore, the Group has performed a going concern assessment. The Group has considered the period up to 31 December 2024 for the going concern assessment (the assessment period). The Group has considered this assessment period because approximately 80% of its long-term revenue contracts entered before 31 December 2022 are expected to conclude by 31 December 2024.

Going concern - Disclosure of stress testing
The Company has carried out stress tests against the base case scenario that would result in the Company not being able to meet its debt servicing obligations. The stress testing considers the effect of sustained revenue reduction and increase in interest rates on its floating rate borrowings. The Company will not be able to service its debt obligations in case of a revenue reduction of 50% over the period from February 2023 to December 2023 at the current operating margins, combined with an increase of 10% in the interest rates on its floating rate borrowings. The Board does not consider this scenario plausible. In view of subsidies declared by the Government for the solar energy sector at the end of October 2022, the Company expects an increase in customer demand for its solar panels in 2023.

In 2023, as at the date these financial statements were authorised for issue, the Company has experienced a marginal increase in revenue as compared to the comparative period in 2022.

The Company has also planned several mitigating actions including reduction in discretionary capital expenditure, termination of some leases of premises, rationalising variable pay to employees etc., which will aid in increasing the available headroom against the Company's borrowing facilities.

Going concern - Disclosure of material uncertainties

The borrowing owed to the consortium of banks led by Bank A includes a covenant that requires the Company to maintain a current ratio above 1.2 (refer note xx). The covenant is tested every 31 March, 30 June, 30 September and 31 December based on the quarterly/annual financial statements. A breach of the covenant results in the loan becoming repayable on demand. The loan is otherwise payable in instalments after 31 December 2024.

Slow post-COVID-19 pandemic recovery and inflationary pressures have resulted in a reduced customer demand for the Company's products, which has affected the Company's short-term liquidity.

The Company, therefore, was not able to meet the current ratio covenant as on 30 September 2022 and 31 December 2022. The borrowing, amounting to CU 3.6 million, is classified as a current liability as on 31 December 2022. The Company is negotiating a waiver of the breach for a period of one year with the consortium of banks. The negotiation is in advanced stages and the management expects to receive the waiver by the end of February 2023.

The Board undertook a going concern assessment based on the information available, including cash flow projections, up until the date these financial statements are authorised for issue. The base case and stress case scenarios in the going concern assessment assume that the waiver for breach is received. Assuming that the waiver is received, the Board believes that going concern assumption is appropriate under stress case also (refer below for the details of the base case and the stress case). The receipt of the waiver of the breach represents a material uncertainty which may cast significant doubt on the Company's ability to continue as a going concern. However, the Board is confident that the waiver will be obtained, and the Company will have adequate resources to meet its obligations and continue its operations for a period of twelve months from the end of the reporting period. Accordingly, these financial statements are prepared on a going concern basis.

Judgements, estimates and estimation uncertainties

Significant judgements and estimates are involved in a number of areas of financial statement such as impairment assessment, fair value measurements, accounting for deferred taxes, employee benefits, inventory valuation, assessment of control/joint control/significant influence, contingent consideration, expected credit loss (ECL) measurements, etc.

In times of uncertainty, judgements, estimates and estimation uncertainties have an even more critical role in accounting. Given the rapidly evolving circumstances, significant judgements and estimates need to be assessed, updated and monitored continuously to ensure that they reflect current circumstances. Entities may need to revise their assumptions and valuation models to consider multiple scenarios and possible outcomes. For example, due to supply chain stresses and inflationary pressures, entities may need to revise their assumptions used to determine the recoverable amounts of non-financial assets. In view of global energy supply disruptions and rising energy prices, entities in energy intensive industries need to consider multiple scenarios with varying energy prices in their cash flow projections to determine recoverable amounts in impairment analysis of non-financial assets.

IAS 1.122 and IAS 1.125 provide requirements for disclosure of significant judgements and significant estimates.

IAS 1.122 (emphasis added)

An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

IAS 1.125 (emphasis added)

*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**….*

What is the difference between significant estimates and other estimates?

Significant estimates within the scope of IAS 1.125 are those estimates that have a **significant risk** of resulting in a **material adjustment** to the **carrying amount of assets and liabilities** within **the next financial year**. IAS 1.125 explicitly requires a disclosure of significant estimates and major sources of estimation uncertainty.

IAS 1.112(c) requires disclosure of information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them. Therefore, entities should disclose other estimates where these estimates provide material and relevant information to users. However, these should be clearly distinguished from significant estimates.

How should these disclosures be made?

IAS 1.129 requires an entity to present the disclosures required by IAS 1.125 in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other sources of estimation uncertainty. Following are some examples of the type of disclosures that an entity makes:

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;

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

Entities may consider it appropriate to include disclosure of this information in the related note rather than in a separate note for all significant estimates. For example, information about significant estimates made related to the impairment of a loan portfolio in the associated note. Entities may aggregate a list of significant estimates made and cross-reference to the applicable note containing the information.

Following are some expectations set out by certain regulators for significant judgements and estimates:

Significant judgements
• Separately identify the judgements that do not relate to a source of estimation uncertainty and those that do.
• Give detailed descriptions of the specific, material judgements made by the directors in applying their accounting policies.

Significant estimates
• Clearly specify which estimates have a significant risk of material adjustment to the carrying amount of assets and liabilities in the next financial year.
• Quantify the specific amount at risk of material adjustment.
• Provide sufficient granularity in the descriptions of assumptions and/or uncertainties to enable users to understand management's most difficult, subjective or complex judgements.
• Clearly distinguish the disclosure of other estimates, and associated sensitivities, from significant estimates and explain their relevance.
• Provide meaningful sensitivities and/or ranges of reasonably possible outcomes for significant estimates. For example, sensitise the most relevant assumptions, choose alternate assumptions that are considered reasonably possible.
• Quantify the assumptions underlying significant estimates when investors need this information to fully understand their effect
• Explain any changes to past assumptions if the uncertainty remains unresolved.
• Sources of estimation uncertainty and the related disclosures should be updated at the balance sheet date.

Following are several examples of disclosures of significant estimates and judgements:

Disclosure of significant estimates

The preparation of the Group's consolidated financial statements includes the use of estimates and assumptions.

Significant estimates:
The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

- Impairment of non-financial assets: Estimate of future cash flows (refer note xx)
- Fair value of assets acquired and liabilities assumed in business combinations (refer note xx)

Other areas of judgement and accounting estimates:
The recognition and measurement of certain material assets and liabilities are based on assumptions and estimates, apart from the significant estimates discussed above. These assumptions and estimates are:

- Revenue recognition: Provision for customer incentives (refer note xx)
- Recognition of deferred tax assets (refer note xx)
- Determination of useful economic life and residual value of property, plant and equipment (refer note xx).

Significant estimates - description of estimation uncertainty and amount at risk of material adjustment
Provision for inventory obsolescence The Group adopts a usage-based approach for the recognition and measurement of provisions for inventory obsolescence. The Group analyses historical trends of usage of old raw materials and determines inventory provisioning percentages. These percentages are reassessed annually. The Group also considers forward looking information, including estimated customer demand, and wherever required, recognises a higher inventory provisioning considering this information. Raw materials exceeding three years of historical usage are fully provided for. The management believes that the period of three years is appropriate as most of the raw materials have a long shelf-life. As at 31 December 2022, provision for obsolete inventory was CU3.5 million (31 December 2021: CU2.7 million).

Impairment of non-financial assets

The generally deteriorating economic situation and the effects of the current geopolitical situation have increased the risk of impairment of non-financial assets. Entities should exercise greater caution with respect to impairment if the entity is significantly affected by factors such as:

- Entities with high energy consumption that may be adversely affected by rising energy costs
- Entities experiencing significant exposure to supply chain stresses
- Entities experiencing significant increases in costs on account of inflation
- Entities that are unable to pass-on increase in costs to customers
- Entities significantly exposed to the effects of Russia's invasion of Ukraine, physical damage to assets or idle assets in affected regions
- Industries with material implications of climate-related risks in the medium or long term e.g. industries highly dependent on fossil fuels

Following are some important considerations when performing assessment of impairment of non-financial assets:

- Determination of discount rate (refer section on 'Discount rates' below for further discussion).
- Inputs used for value-in-use calculations should be consistent with information disclosed elsewhere in the financial statements.
- High-quality disclosures:
  - Disclosures of key assumptions regarding external conditions and the company's strategy, including the effects on the assumptions of potential reduced customer demand, increased costs and other factors that affect the business in the current environment.
  - Disclosure of key assumptions extends beyond the major numerical inputs (e.g. revenue growth percentage and discount rate) and should include assumptions made by management in forming numerical assumptions (e.g. assumptions concerning the

performance of current and new products, access to new markets, the assumed price of key inputs such as electricity, etc.).

- Explanation of sensitivity of recoverable amounts to changes in assumptions. This is particularly important where the range of possible outcomes has widened due to heightened uncertainties.
- Explanation of composition of CGUs and the basis for allocation of goodwill to CGUs or groups of CGUs.

Discount rates

A number of IFRS Accounting Standards require discount rates to be determined. In the current economic environment with high inflation and rising interest rates, the determination of discount rates is critical and discount rates determined in the past may no longer be appropriate. In many cases, discount rates may need to increase compared to prior reporting periods (e.g. discount rates used to estimate the recoverable amount in an impairment test).

Different IFRS Accounting Standards provide different requirements for the determination of discount rates, several of which are as below:

IFRS Accounting Standard	Discount rate
IAS 36 *Impairment of Assets*	Pre-tax rate that reflects current market assessment of the time value of money and the risks specific to the asset for which CF estimates have not been adjusted.
IAS 19 *Employee Benefits*	Market yields on high quality corporate bonds. For currencies for which there is no deep market in high quality corporate bonds, the market yields on government bonds denominated in that currency shall be used.
IFRS 16 *Leases*	Incremental borrowing rate (when the interest rate implicit in the lease cannot be readily determined).
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*	Pre-tax rate that reflects current market assessment of the time value of money and the risks specific to the liability for which CF estimates have not been adjusted.
IFRS 2 *Share-based Payments*	Risk-free rate used in option pricing models such as Black-Scholes (following the principles in IFRS 13 *Fair Value Measurement*).

Following are some factors that need to be considered when determining the discount rate:

- Avoiding double-counting of risks or omitting the effects of some risk factors when estimating fair value

  As required by IFRS 13.B14(c), to avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. If the cash flow estimates are adjusted for certain risks, the discount rate should not reflect that risk.

The following table summarises the above principle:

	Cash flow estimated adjusted for the risk	Cash flow estimated not adjusted for the risk
Discount rate reflects the risk	Double counting of risk factor	Appropriate discount rate
Discount rate does not reflect the risk	Appropriate discount rate	Risk factor omitted

- Pre-tax vs post-tax discount rate

  IAS 36.55 and IAS 37.47 require use of a pre-tax discount rate.

  Entities often use weighted average cost of capital (WACC) as a starting point for determining the discount rate to be used for IAS 36 and IAS 37. WACC is usually a post-tax rate which needs to be converted to a pre-tax rate to comply with the requirements of IAS 36 and IAS 37. In simple scenarios, the pre-tax rate may be arrived at by grossing up the post-tax discount rate by the standard rate of tax. However, as noted in IAS 36.BCZ85, this may not always give the correct result. In complex scenarios or where multiple tax rates are involved, entities may need to apply iterative process to arrive at the appropriate pre-tax rate.

- Internally consistent assumptions

Assumptions about discount rate and cash flows should be internally consistent. Cash flows are discounted using the discount rate applicable for the currency in which the cash flows are denominated. Discount rate is determined considering the underlying economic factors of the currency in which the cash flows are determined.

- Real vs nominal discount rate

  Nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation.

  In a high inflationary environment, it is essential to ensure this consistency. An error here may give a result that is materially incorrect.

- Specialist involvement

Entities may need to involve a specialist to determine the discount rate if the choice of discount rate is expected to have a material effect on the measurement of assets and liabilities. This is a likely scenario in the current high inflation and high interest rate environment.

- High quality disclosures

Determination of discount rate may involve significant judgement or be a source of significant estimation uncertainty. Entities would need to provide clear, entity-specific disclosures of how the discount rate was determined, including the assumptions used.

Events after the reporting period

IAS 10 *Events after the Reporting Period* defines events after the reporting period as events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue.

Entity needs to determine whether the event after the reporting period is adjusting (events that provide evidence of conditions that existed at the end of the reporting period) or non-adjusting (events that are indicative of conditions that arose after the reporting period). This assessment may require significant judgement.

Amounts recognised in financial statements are adjusted to reflect material adjusting events. For material non-adjusting events, the entity should disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.

Times of uncertainty and rapid change increase the risk that a material event will occur after the reporting period but before the financial statements are authorised for issue, making this assessment a critical one. Entities should monitor and assess on a continuous basis to identify and account for material events after the reporting period.

What should the entity do if going concern assumption is determined to be inappropriate after the reporting period?

In a quickly evolving economic environment, an entity's situation may deteriorate significantly after the end of the reporting period such that the going concern assumption is no longer appropriate. The effect of the going concern assumption not being appropriate is so pervasive that IAS 10.14-16 requires a fundamental change in the basis of preparation and the entity shall not prepare its financial statements on a going concern basis, even if the events resulting in this conclusion take place after the reporting period.

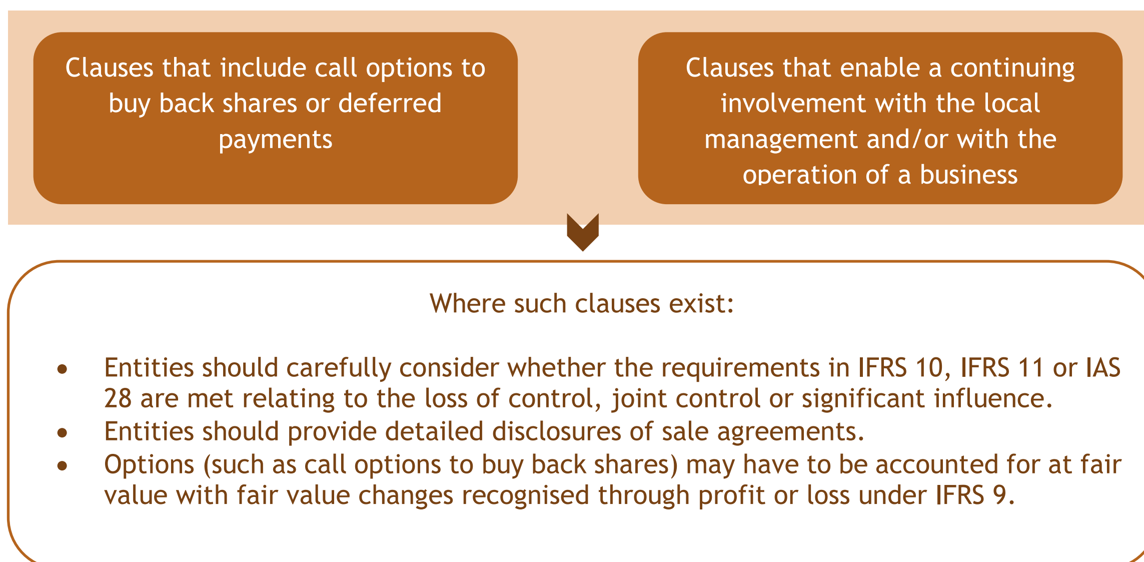
Assessment of control, joint control and significant influence

In the light of changing geo-political risks, entities may need to reassess control (IFRS 10 *Consolidated Financial Statements*), joint control (IFRS 11 *Joint Arrangements*) or significant influence (IAS 28 *Investments in Associates and Joint Ventures*), especially for investees located in areas affected by Russia's invasion of Ukraine.

Assessment of control, joint control and significant influence (continued)

Following are several factors noted by regulators for consideration by companies in their assessment of control, joint control and significant influence:

- Effect on the investee of measures taken by Russia such as nationalisation of assets
- Clauses in contracts to dispose of interests in other entities such as:



- Entities should provide detailed disclosures with regards to any changes made to their assessment of control, joint control and/or significant influence and as to whether they consider that control, joint control or significant influence has been lost.

It should be noted that the decision to abandon operations in areas affected by Russia's invasion of Ukraine, restrictions on access to information or on the use of financial resources may not necessarily lead to the loss of control or significant influence over an investee. Entities will need to assess each case based on facts and circumstances.

Effects of inflation

Most major economies have experienced rising inflation in recent months. Rising inflation has a number of implications in financial reporting, including:

- Discount rate

  Rising inflation and interest rates leads to higher discount rates used for multiple purposes in financial reporting. Refer section on 'Discount rates' above for further discussion.

- IFRS 2 *Share-based Payments*

  Inflation may have other macro-economic effects such as lower demand for goods and services. This may affect entity's performance and have a corresponding effect on share-based payments with performance conditions (e.g. the entity meeting certain revenue or net income targets).

- IFRS 9 *Financial Instruments*
    - Inflationary clauses in contracts

      There may be inflationary features embedded in revenue, supply, leasing and other financing contracts. The entities need to evaluate whether these need to be separated and accounted for as a derivative. The entities need to disclose information relevant to the users' understanding related to such inflationary clauses in the financial statements.
    - Rising inflation will have an effect on the measurement of ECL. Especially for floating rate debt instruments, rising inflation may lead to increase in default risk and measurement of ECL.
    - There may be an increase in prepayment rates of floating rate securities, resulting in higher prepayment risk.
    - There may be greater number of instances of debt modifications where borrowers are not able to service the debt on due dates.
- IFRS 16 *Leases*

  Variable lease payments dependent on inflation or other price indices (e.g. the consumer price index) would require remeasurement as a result of rising inflation.

  Modifications to lease contracts also require lessees to reassess the discount rate used to measure the lease.
- IAS 2 *Inventories*

  Inflation may lead to increases in estimated costs necessary to make the sale. If the estimated selling prices do not increase correspondingly, for example in case of long-term fixed rate contracts, this may lead to a reduction in the net realisable value and possibly higher inventory write-downs.
- IAS 19 *Employee Benefits*

  Inflation affects actuarial assumptions used in measurement of defined benefit plans and other long-term employee benefits. Higher discount rates may be required for actuarial valuations. Assumptions of future salary increases may need to be reassessed as a result of inflation.
- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

  Governments may provide loans at below market rate of interest to some entities, which need to be accounted for in accordance with IAS 20. It should be noted that for existing loans, reassessment of whether the loan is below-market rate of interest is not required or permitted under IAS 20.
- IAS 36 *Impairment of Assets*

  A higher discount rate would result in a lower value in use of assets or cash generating units. This may be a possible indicator of impairment. Entities may need to reassess their estimated cash flows used in calculation of value in use of assets or cash generating units.

- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

  Contracts may become onerous due to increase in costs without a corresponding increase in revenue, for example in case of long-term fixed rate revenue contracts. For example, if rising input costs mean that the costs of constructing a building for a customer have increased such that the contract is no longer profitable, that contract may be onerous. Onerous contracts are required to be recognised as a provision with the loss being recognised 'up front'.

  IAS 37 has recently been amended to clarify which costs are included in the assessment of whether a contract is onerous, which may increase the number of contracts that are onerous. These amendments are effective for annual reporting periods beginning on or after 1 January 2022.

Financial instruments

Following are some factors related to financial instruments that entities should be mindful of:

- Reclassification of financial assets

  Financial assets which are fixed rate debt instruments classified as at fair value through profit or loss or at fair value through other comprehensive income would experience a decrease in fair value in a rising interest rate environment. Entities may wish to reclassify such financial assets into the amortised cost measurement category to avoid recognising these decreases in value. However, reclassification of financial assets under IFRS 9 *Financial Instruments* is permitted only in case of change in business model for managing those financial assets, which is expected to occur rarely in practice.

  As noted by regulators, entities should note the following points regarding reclassification of financial assets:

  Reclassification are expected to be very infrequent, even in the context of the current macroeconomic environment. A change in business model is a very high threshold. For example, shutting down a significant component of the business.

  A Change in a business model must be significant to the entity's operations and demonstrable to external parties (e.g. press releases, public announcements etc.)

  The entity should provide clear and detailed explanation of the change in business model.

- Challenges to Expected Credit Loss (ECL) models

  Entities, especially financial institutions, may face significant challenges in developing ECL models for the current macroeconomic environment due to lack of experience in modelling for such circumstances. Therefore, it is critical to provide sufficiently transparent disclosures of the effect of the changing economic environment on the ECL calculation. This would enable users of financial

statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows.

Different groups of borrowers may be affected differently by the current macroeconomic developments. For example, rising energy costs are expected to have sector-specific effects. The ability to pass on the effects of inflation to clients and customers varies across the economic sectors. Therefore, entities should provide enhanced disclosures of sector-specific drivers in ECL measurement and risk concentrations related to specific sectors.

- Focus on disclosures
  - Adequate disclosures of the nature and extent of risks arising from financial instruments and related risk management should be provided.
  - Entities should disclose the methods used to measure exposure to risks and any changes from the previous period and any hedging arrangements put in place to fix interest rates or hedge against the effects of inflation.
  - Where material, detailed sensitivity analyses should be provided for entity's exposure to interest rate risk, commodity price risks and related liquidity risks, including a description of the methodologies and assumptions applied and the changes from the previous period.
  - Accounting policies should be disclosed for all material financing and hedging arrangements and any changes in the arrangements.
  - Disclosures should be provided for banking covenants and changes to any covenants.

Key considerations for disclosures

High-quality disclosures are key in the current environment to enable users to evaluate the nature and extent of risks the entity is exposed to. Regulators have consistently emphasised the importance of high-quality disclosures.

Following are some key considerations to be kept in mind for disclosures:

Disclosures should be clear, concise and understandable and not include immaterial information.

Clear disclosures should be provided of significant management judgements and key assumptions underlying major sources of estimation uncertainty, including information about the sensitivity of reported amounts to changes in assumptions.

Disclosures should be entity-specific and should meet the disclosure objectives of the relevant IFRS Accounting Standards and not just the specific disclosure requirements of the standards. Entities should provide additional disclosures (beyond the specific disclosure requirements in respective) where needed to enable users to understand the impact of particular transactions, events and other conditions on the entity's financial performance and financial performance.

Boilerplate disclosures should be avoided.

Annexure:

Guidance issued by regulators

Following table provides links to guidance issued by some regulators for annual financial statements for the year 2022 or the results of their reviews conducted in the last one year.

Regulator	Guidance
International Organization of Securities Commissions (IOSCO)	IOSCO Statement on Financial Reporting and Disclosure during Economic Uncertainty
European Securities and Markets Authority (ESMA)	Public Statement on European common enforcement priorities for 2022 annual financial reports
Financial Reporting Council (FRC), UK	Annual Review of Corporate Reporting (2021/22)
Financial Reporting Council (FRC), UK	Key matters for 2022/23 reports and accounts
Accounting and corporate regulatory authority, Singapore	Areas of Review Focus for FY 2022 Financial Statements
Johannesburg Stock Exchange	Report on proactive monitoring of financial statements in 2022

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