What is the impact of external events on interim financial statements?

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In times of economic uncertainty, preparing the interim financial statements is likely to involve more than the usual update since the last annual financial statements. Investors and other users may also expect information above and beyond what is typically disclosed.

What's the issue?

Many companies are likely to be facing challenges as a result of external events – e.g. a natural disaster, geopolitical affairs or a pandemic – which may cause economic uncertainty. The evolving economic uncertainty creates a variety of issues and risks, including changes in consumer demand, disrupted supply chains, staff shortages, increased market volatility and changes to how companies operate.

Depending on the industry and the economic environment in which a company operates, external events could affect the recognition and measurement of companies' assets, liabilities, income and expenses. Also, as a consequence of these events, companies may be facing going concern difficulties due to liquidity pressures.

IAS 34 *Interim Financial Reporting* generally requires that all events and transactions are recognised and measured as if the interim period were a discrete stand-alone period – i.e. there are generally no recognition or measurement exemptions for interim financial reporting. *[Insights 5.9.80.10]*

Condensed interim financial statements (hereafter referred to as 'interim financial statements') typically focus on changes since the last annual financial statements. Companies are required to provide an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance since the last annual reporting date. Information disclosed in relation to those events and transactions updates the relevant information presented in the most recent annual financial report. In times of rapid or abrupt changes in the economic outlook and trading conditions, information in the interim financial statements may, for many companies, comprise more than the usual update since the last annual financial statements. *[IAS 34.15]*

If changes in circumstances have made significant disclosures in the last annual financial statements less relevant, then a company needs to consider providing additional supplementary disclosures in its interim financial statements. *[Insights 5.9.30.10]*

Although many disclosures required by other IFRS® Standards are not mandatory in interim financial statements, in uncertain circumstances companies may need to provide these disclosures to ensure that the interim financial statements provide relevant information to the users of those statements.

Getting into more detail

Our **Financial reporting in uncertain times resource centre** provides guidance on a broad range of topics covering the financial reporting impacts of operating in a changing environment – be it due to a natural disaster, geopolitical event, pandemic or other cause – and is relevant to both annual and interim financial statements.

Recognition, measurement and disclosure in interim financial statements

Generally, items are required to be recognised and measured as if the interim period were a discrete stand-alone period. However, there are specific requirements for income taxes. *[Insights 5.9.80.10]*

We address below some of the key areas that companies may need to consider when preparing their interim financial statements. Whether they are relevant depends on the company's specific circumstances – i.e. the nature and extent of the impact on the financial position, performance and cash flows of the company arising from external events.

Going concern

Management's going concern assessment may be significantly affected by disruptions caused by external events.

The considerations that apply for the going concern assessment when preparing annual financial statements also apply for interim financial statements. When assessing the uncertainties associated with a company's going concern assumption, management takes into account all available information for a period of at least 12 months from the date of the interim financial statements. For example, when a company with a calendar year end prepares its quarterly interim financial statements at 31 March 2022, it considers information for the period until, but not limited to, 31 March 2023 when assessing whether the going concern assumption is appropriate. *[Insights 5.9.10.30, 35]*

If there is a material uncertainty about the company's ability to continue as a going concern at the date on which the interim financial statements are authorised for issue, then that uncertainty is disclosed in those interim financial statements. This is the case irrespective of whether it was disclosed in the most recent annual financial statements. In addition, disclosure is required when management concludes that there are no material uncertainties but reaching that conclusion involved significant judgement (a 'close call'). For more information on what information to disclose, see our article on the impact of external events on the **going concern assessment and disclosures**.

Impairment of non-financial assets

Reviews for indicators of impairment and any resulting tests for **impairment of non-financial assets** under IAS 36 *Impairment of Assets* are performed at the interim reporting date in the same manner as at the annual reporting date. *[Insights 5.9.200.10]*

Companies may have tested their goodwill and intangible assets[1] for impairment when preparing their latest annual financial statements. However, due to new developments and new information in the current interim period, there may well be indicators of impairment at the interim reporting date that trigger testing of these assets again.

An impairment loss recognised for goodwill is not reversed in subsequent periods, even if it was recognised in an interim period of the same financial year. *[Insights 3.10.390.90, 5.9.210.30]*

For assets other than goodwill, there may be an indication that a previously recognised impairment loss has reversed. This may occur if asset values recover or if the uncertainty decreases or is resolved – e.g. in certain jurisdictions the level of uncertainty and risk arising from COVID-19 has decreased significantly. If there is such an indication, and the recoverable amount of the impaired asset or

1 Intangible assets with an indefinite useful life or intangible assets that are not yet available for use.

cash-generating unit subsequently increases, then the impairment loss is generally reversed. *[Insights 3.10.390.10]*

Testing for impairment in a previous period generally does not provide any relief from performing such a test in a current period when warranted. New developments and new information may continue to emerge, which may significantly change the inputs that had been used to calculate the recoverable amount in the previous period.

If a company recognises or reverses a material impairment loss on non-financial assets, then it provides in its interim financial statements an explanation of and an update to the relevant information included in the last annual financial statements. IAS 36 provides relevant disclosures to be considered in this regard. *[IAS 34.15B(b), 15C, 16A(d)]*

Property, plant and equipment (PPE) and intangible assets

Companies are required to review the residual value and the useful life of an asset at least at each financial year end. *[IAS 16.51, 38.109]*

If a company changes its usage or retention strategy for any of its PPE, then management should review whether the useful life and residual value of these assets, and the depreciation method applied to them, remain appropriate. This review may also be required after testing an asset or cash-generating unit for impairment. Any such changes are accounted for prospectively as a change in accounting estimate. *[IAS 16.61, 38.104, Insights 3.10.350.30]*

Impairment of financial assets

Companies are required to **measure the expected credit loss** at each reporting date, which includes any interim reporting date. *[IFRS 9.5.5.3, 5.5.5]*

If there are significant changes in the amount of expected credit losses, then the company provides in its interim financial report an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period. The disclosures under IFRS 7 *Financial Instruments: Disclosures* may be relevant to consider in this regard – e.g. information about changes in the amount of expected credit losses and the reasons for those changes, and information about changes in the concentration of credit risk attributed to financial assets. *[IAS 34.15B(b), 15C, IFRS 7.35B, 35H]*

Fair value measurement

The carrying amount of assets that are measured at **fair value** – e.g. investment property – is determined at the interim reporting date. Fair values may have changed significantly since the last measurement date, reflecting changes in cash flow forecasts, uncertainty or risks (e.g. credit, liquidity and forecasting risk). Rapid changes in market perceptions and economic projections create challenges when determining fair value based on the information available to market participants at the measurement date. Extrapolations based on the balance at the previous annual reporting date may not be appropriate.

Companies may need to consider using external valuers to determine the fair value of assets for which quoted prices are not available. This includes determining the fair value of non-financial assets – e.g. PPE and right-of-use assets that are valued using the revaluation model, and investment properties.

The specific disclosures required by IAS 34 for fair value measurement need to be provided.

Impact on employee benefits and employer obligations

Remeasurement of net defined benefit obligations/assets: Companies preparing interim financial statements should consider whether net **defined benefit obligations/assets** need to be remeasured. Under IAS 19 *Employee Benefits*, remeasurements are recognised in the period when they arise; therefore, if adjustments at the interim reporting date are considered to be material, then they need to be recorded at that date.

Actuarial valuations: An updated measurement of plan assets and obligations is required when a plan amendment, curtailment or settlement is recognised. In addition, significant market volatility may trigger the need for an updated actuarial valuation. *[IAS 34.IE.B9, Insights 4.4.360, 5.9.150]*

Inventories

Net realisable value: IAS 2 *Inventories* requires a company to measure its inventory at the lower of cost or **net realisable value** and update its estimate of the net realisable value at the interim reporting date. Issues arising from economic uncertainty such as growing inflationary pressures and limited or lost access to markets may affect this estimate. *[IAS 34.IE.B25]*

Write-down losses: If a company writes inventory down to its net realisable value at the interim reporting date, then any resulting losses need to be recognised immediately – i.e. they cannot be deferred because they are expected to be restored or absorbed by the annual reporting date. *[Insights 5.9.90]*

Companies need to disclose the write-down of inventories to net realisable value and their reversal. *[IAS 34.15B(a)]*

Cash and cash equivalents

External events may affect the classification of cash and cash equivalents – e.g. if an external event leads to a significant risk of change in the value of a deposit, then it may no longer qualify as cash and cash equivalents. Furthermore, restrictions imposed on cash and cash equivalent balances in response to external events may make them unavailable for use by the company/the group. In these instances, the amount of the significant cash and cash equivalent balances that is unavailable for use by the company/the group is disclosed together with commentary to explain the nature of the restrictions. Also, the nature of the restriction is assessed to determine whether the amount needs to be presented as an other financial asset rather than as cash and cash equivalents. *[IAS 7.6–7, 48]*

Discontinued operations and non-current assets held for sale

A company may decide to dispose of or abandon certain assets or operations because of an external event. Although it is not required by IAS 34, in our view if a company has operations that are discontinued at the interim reporting date or are disposed of or abandoned during the current interim period, then these operations should be presented separately in the condensed statement of profit or loss and other comprehensive income (OCI). In addition, in our view if an entity has non-current assets or a disposal group classified as held-for-sale or held-for-distribution at the interim reporting date, then we believe that these should be presented separately from other assets and liabilities in the condensed statement of financial position. *[Insights 5.9.40.20]*

However, non-current assets that are to be abandoned are not classified as held-for-sale because they will not be recovered principally through a sale transaction. Although IFRS Standards prohibit assets that will be abandoned from being classified as held-for-sale, if the assets to be abandoned are a major line of business or geographical area of operations, then they are reported in discontinued operations at the date at which they are abandoned. *[IFRS 5.13, 32, IE9]*

In addition, a decision to abandon a non-financial asset is an indicator of impairment. As such, companies would need to test the asset for impairment. Companies may also need to consider revisions to estimates to reflect the use of the asset over its shortened useful life and a residual value in a manner consistent with the decision to abandon it – e.g. when the asset is property, plant or equipment. *[IAS 36.12, 16.51]*

Operating segments

If the basis of segmentation or the basis of measurement of segment profit or loss changes during the interim period, then companies need to disclose a description of the differences from the last annual financial statements. *[IAS 34.16A(g)(v)]*

Income taxes

Effective tax rate: Under IAS 34, the income tax expense recognised in each interim period is based on the best estimate of the weighted-average annual income tax rate expected for the full year applied to the pre-tax income for the interim period.

The challenges caused by external events may cause companies to conclude that they cannot estimate their annual effective tax rate reliably. In this case, the actual effective rate, based on a year-to-date actual tax calculation, may represent the best estimate of the annual effective tax rate. *[IAS 34.30(c), Insights 5.9.160.80]*

Tax reliefs: In response to a specific external event, governments may introduce tax reliefs for certain types of income, additional tax deductions, a reduced tax rate or an extended period to use tax losses carried forward. Companies recognise tax credits that relate to a one-off event in the interim period in which the event occurs, rather than reflect them in their estimate of the annual effective tax rate. Conversely, a change in the tax rate that is substantively enacted in an interim period may be recognised as a one-off event or spread over the remainder of the annual reporting period via an adjustment to the estimated annual effective tax rate. *[IAS 34.IE.B19, Insights 5.9.160.30–35]*

Recoverability of deferred tax assets: A deferred tax asset is recognised for deductible temporary differences and unused tax losses (tax credits) carried forward, to the extent that it is probable that future taxable profits will be available. External events that trigger economic uncertainty may affect a company's projections about the probability of future taxable profits, which in turn could affect the recognition of **deferred tax assets** at the interim reporting date.

Subsequent events

Date of authorisation: Companies should consider disclosing the date on which the interim financial statements are authorised for issue and who gave that authorisation. This is not specifically required by IAS 34 but it may help users' understanding because any event that occurs after that date is not disclosed or adjusted for in those interim financial statements. *[IAS 10.17–18]*

Adjusting vs non-adjusting: A company discloses events that occurred after the interim reporting date but are not reflected in the interim financial statements. Determining those subsequent events that should be reflected (adjusting) vs those that are disclosed (non-adjusting) in the interim financial statements may require judgement. *[IAS 34.16A(h)]*

Unusual items

Companies may want to describe items of income or expense as 'unusual' or 'exceptional', either on the face of the primary statements or in the notes. IFRS Standards do not prohibit companies from presenting unusual or exceptional items. However, companies are not allowed to describe such items as 'extraordinary'. Furthermore, in our view if the description 'unusual' is used in the condensed statement of profit or loss and OCI, then its use should be infrequent and reserved for items that justify a prominence greater than that achieved by separate presentation or disclosure. For example, it may be appropriate to characterise items such as costs associated with a natural disaster as unusual. *[IAS 1.87, Insights 4.1.100.10, 30]*

Regardless of how items of income or expense are described, IAS 34 requires companies to disclose the nature and amount of items affecting assets, liabilities, equity, net income or cash flows that are unusual because of their nature, size or incidence. *[IAS 34.16A(c)]*

Current/non-current classification

Companies should consider the classification of assets and liabilities as current or non-current at the interim reporting date. For example, a loan for which provisions are breached at the interim reporting date, such that the liability becomes repayable on demand, would need to be classified as current, unless the company obtained a waiver before the interim reporting date.

Companies need to disclose any loan default or breach of a loan agreement that has not been remedied on or before the interim reporting date. *[IAS 34.15B(i)]*

Additional line items

Interim financial statements generally include the headings and subtotals that were included in the most recent annual financial statements. However, depending on the specific circumstances, companies may consider presenting additional line items if they consider them useful for users – e.g. presentation of impairments of non-financial assets. *[IAS 34.10]*

Disclosures

Companies should ensure that the minimum disclosure requirements of IAS 34 are supplemented by additional disclosures, if they are relevant to an understanding of their interim results, position and cash flows, including:

- changes in significant judgements and assumptions made, as well as areas of estimation uncertainty and judgements; and
- overarching disclosures of the impact of external events on the interim financial position, performance and cash flows. *[IAS 34.15, 15B(d), 15C, IAS 1.17(b)–(c)]*

IAS 34 contains other specific disclosure requirements for financial assets and/or financial liabilities. *[IAS 34.15B(h), (k), (l), 16A(j)]*

Given the magnitude of the economic changes, companies should provide in their interim financial statements sufficient disclosure to explain the significant events and transactions that have occurred since the annual financial reporting date. *[IAS 34.15B, 16A]*

Companies need to consider whether their interim financial statements provide sufficient information because investors and other users may expect information above and beyond what is typically disclosed.

Actions for management

When preparing interim financial statements in times of economic uncertainty:

- Assess the company's ability to continue as a going concern at the interim reporting date.
- Consider whether information disclosed in the last annual financial statements remains relevant. If not, then provide updated disclosures.
- Assess and reflect the impacts of external events in the interim financial statements – in particular, whether the uncertainties factor in all the necessary estimates and judgements.
- Assess whether the disclosures and explanations provided in the interim financial statements are sufficient for users to understand the significant events and transactions that have occurred since the annual reporting date.
- Provide additional disclosures to enable users of interim financial statements to understand the overall impact of external events on the financial position and performance of the company.
- Consider relevant regulatory guidance.[2]

2 Read the ESMA statement **Implications of Russia's invasion of Ukraine on half-yearly financial reports**.

References to 'Insights' mean our publication **Insights into IFRS®**

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