IFRS Accounting

Staff paper

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Project	**Primary Financial Statements**
Topic	**Management performance measures—tax disclosure**
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Objective

1. This paper sets out staff analysis and recommendations on outstanding matters relating to the IASB's tentative decision on the Exposure Draft *General Presentation and Disclosures* to require an entity to disclose the tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation between a management performance measure and the most directly comparable subtotal or total specified by IFRS Accounting Standards. The outstanding matters are:
   (a) consideration of whether a wider range of approaches to calculating the income tax effect would improve the balance between costs and benefits; and
   (b) consideration of whether the IASB should require specific disclosure requirements for the approach(es) an entity uses to calculate the income tax effect.

2. This paper should be read in conjunction with Agenda Paper 21C of this meeting. In Agenda Paper 21C we recommend changes to the requirements proposed in the Exposure Draft for disclosing comparative information when changes are made to management performance measures. This paper recommends the requirements for changes to management performance measures apply to the disclosure of the tax

effect on reconciling items. The changes proposed for comparative information would therefore apply to the related disclosure requirements recommended in this paper.

Summary of staff recommendations in this paper

3. We recommend the IASB:
   (a) retain the option in its tentative decision of May 2022 of calculating the tax effects of the reconciling items at the statutory tax rate(s) applicable to the underlying transaction(s) in the relevant jurisdiction(s); and
   (b) replace the alternative option in its tentative decision of May 2022 of adding an allocation of other income tax effects to the tax effects described in (a) with options to:
      (i) calculate the tax effects of the reconciling items on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned; or
      (ii) calculate the tax effects of the reconciling items by another method that achieves a more appropriate allocation in the circumstances.

4. We also recommend the IASB:
   (a) confirm the requirement in paragraph 106(d) of the Exposure Draft for an entity to disclose how it has determined the income tax effects for items reconciling a management performance measure to the most directly comparable subtotal or total specified by IFRS Accounting Standards;
   (b) provide application guidance requiring the disclosure in (a) for each reconciling item if more than one method is used to calculate the tax effect; and
   (c) revise the requirement in paragraph 108 of the Exposure Draft to require an entity to disclose changes in management performance measures to apply to changes to the calculation of the tax effects of reconciling items.

Structure of the paper

5. This paper is structured as follows:

   (a) background (paragraphs 6–18);

   (b) staff analysis and recommendations:

      (i) specifying how to calculate the income tax effect of reconciling items (paragraphs 20–31);

      (ii) disclosure requirements for the income tax effect of reconciling items (paragraphs 32–39); and

   (c) Appendix—management performance measures disclosure requirements.

Background

6. This section is structured as follows:

   (a) Proposals in the Exposure Draft and IASB tentative decisions (paragraphs 7–11); and

   (b) targeted outreach feedback (paragraphs 12–18).

Proposals in the Exposure Draft and IASB tentative decisions

7. At its May 2022 meeting (Agenda Paper 21A) the IASB tentatively decided to confirm the proposed requirement in the Exposure Draft for an entity to disclose the tax effect and the effect on non-controlling interests for each item disclosed in the required reconciliation between a management performance measure and the most directly comparable subtotal or total specified in IFRS Accounting Standards.

8. The Exposure Draft specified the income tax effect be calculated on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances.

9. At its May 2022 meeting the IASB tentatively decided to revise the requirement specifying how to calculate the income tax effect. The revised requirement allows an entity to either:

   (a) calculate the tax effects of the underlying transaction(s) at the statutory tax rate(s) applicable to the transaction(s) in the relevant jurisdiction(s); or

   (b) calculate the tax effects as described in (a) and then allocate any other income tax effects related to the underlying transaction(s) based on a reasonable pro rata allocation of current and deferred tax, or another method that achieves a more appropriate allocation.

10. In its discussions the IASB noted the revised requirement specifying how to calculate the income tax effect means that the approach in paragraph 9(a) is effectively a backstop. The IASB asked the staff to consider whether it is possible to maintain this backstop while allowing entities to use a wider range of approaches that would improve the balance between cost and benefits.

11. The IASB did not make any decision on the disclosure requirement in paragraph 106(d) of the Exposure Draft for an entity to disclose how an entity determined the income tax effect of reconciling items (see Appendix).

Targeted outreach feedback

12. At its January 2023 meeting (Agenda Paper 21A) the IASB discussed feedback received in targeted outreach on the IASB's tentative decisions on the proposals in the Exposure Draft. Participants in the targeted outreach were asked if the IASB's tentative decision to revise the method used to calculate the tax effect of individual reconciling items (see paragraph 9) provides a better balance of costs and benefits than the proposal in the Exposure Draft (see paragraph 8).

13. Many participants agreed with the IASB's tentative decision to provide guidance on how to calculate the tax for the purpose of disclosing the tax effects of items reconciling a management performance measure to a subtotal or total specified in

IFRS Accounting Standards. These participants said providing a simplified approach to the tax calculation was a practical solution that would still provide useful information while reducing the cost of providing that information.

14. However, some of these participants said that the simplified approach may still be costly for some entities, for example when there are many transactions in many jurisdictions. A few of the participants that agreed with the simplified approach also raised the concern that in some circumstances the information may not be useful, for example, when allocations of tax relief will result in no tax paid.

15. Some participants disagreed with the simplified tax calculation because in their view:

    (a) the simplified approach does not sufficiently reduce the costs of the disclosures;

    (b) the information provided by the simplified approach would be incomplete and could be misleading; and

    (c) requiring disclosure of the tax effects, using either a simplified or a more complex approach, is inconsistent with the objective of disclosing management's view of performance.

16. A few participants suggested the IASB develop illustrative examples to demonstrate how the simplified tax approach would work in practice and provide application guidance specifying:

    (a) whether the simplified approach would apply to all reconciling items or could be applied only to individual items;

    (b) whether there are any restrictions on when the simplified approach could be used; and

    (c) what an entity would be required to disclose regarding the tax calculation method used.

Response to feedback

17. In Agenda Paper 21A of January 2023 we concluded that the outreach feedback generally supports the introduction of the simplified approach to calculating the tax effects of individual items reconciling a management performance measure to the most directly comparable total or subtotal specified by IFRS Accounting Standards. We acknowledge that not all participants agreed with the simplified tax calculation and that some of those that agreed still raised concerns over costs and usefulness of the information in some cases. However, we think this feedback is consistent with the fact that the approach is a practical compromise that reduces, but does not eliminate, the costs and reduces, but does not remove, the usefulness of the information provided.

18. The analysis in this paper directly responds to the IASB's request that we consider whether allowing entities to use a wider range of approaches would maintain the balance between cost and benefits. This paper also continues the IASB's consideration of the related disclosure requirements. We think that results of that analysis provide clarity over the questions participants raised during targeted outreach (see paragraph 16).

Staff analysis and recommendation

19. This section is structured as follows:

    (a) specifying how to calculate the income tax effect of reconciling items (paragraphs 20–31); and

    (b) disclosure requirements for the income tax effect of reconciling items (paragraphs 32–39).

Specifying how to calculate the income tax effect of reconciling items

20. We think that revising the requirement specifying how to calculate the income tax effect of reconciling items to include the requirement proposed paragraph 107 of the

Exposure Draft as an alternative would improve the balance between costs and benefits from the requirement tentatively decided in May 2022 (see paragraph 10).

Permitting a wider range of approaches

21. Making this change to the requirement specifying how to calculate the income tax effect would allow an entity to either:

    (a) calculate the tax effects of the underlying transaction(s) at the statutory tax rate(s) applicable to the transaction(s) in the relevant jurisdiction(s);

    (b) calculate the income tax effects of the reconciling items on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned; or

    (c) calculate the tax effects by another method that achieves a more appropriate allocation in the circumstances.

22. We think this alternative allows a wider range of approaches by allowing the full tax calculation to be based on another method that achieves a more appropriate allocation in the circumstances. That method is not specified and therefore allows entities to exercise their judgement to provide the best information available. This may result in more useful information than if the method was restricted.

23. As explained in the Basis for Conclusions on the Exposure Draft, the method for calculating income tax described in paragraphs 21(b)–21(c) would provide users of financial statements with a reasonable estimate of the income tax effect of adjustments, making it clear when the tax effect of an adjustment is materially different to the tax effect calculated applying the entity's effective tax rate. The IASB noted that these approaches are similar to the approach for determining the income tax effect on items of other comprehensive income set out in IAS 12 *Income Taxes*.

24. The simplified calculation in paragraph 21(a) provides a defined calculation of the tax effects of reconciling items that reduces complexity. Maintaining a method that is both defined and reduced in complexity addresses the concerns by some stakeholders

in comment letter feedback that the calculation in paragraph 21(b) may be excessively costly.

Whether to add guidance or restrictions

25. In Agenda Paper 21A of the May 2022 IASB meeting we recommended the choice of methods for calculating the tax effects of reconciling items apply to all reconciling items, and not on an item-by-item basis. This was because making allocations in some circumstances but not others was seen as contradictory to the objective of reducing complexity and could allow opportunistic allocations.

26. However, after considering the IASB's May 2022 discussion we do not think that further guidance or restrictions, such as requiring an entity to use the same method to calculate the tax effects for all reconciling items, should be added. We think that restricting the method that an entity may use would limit the alternatives and restrict judgement in providing the best information possible in the circumstances, thereby reducing the usefulness of the information provided.

27. For example, an entity might judge it is costly to obtain information for a specific transaction and use the simplified method to reduce the complexity and costliness in this case. It might however have information that allows it to provide more information about the tax effects of other adjustments without significant cost. Requiring the entity to provide less information by using the simplified approach for the sake of consistency would seem contrary to the aim of providing useful information.

28. Such restrictions were not considered necessary when the proposal was made in the Exposure Draft nor did feedback to the Exposure Draft suggest they were necessary.

29. However, we think that allowing a wider range of approaches for calculating the tax effects of reconciling items increases the need for transparency over the approach used. For example, we think 'applying another method that achieves a more appropriate outcome in the circumstances' (paragraph 21(c)) might mean that the

circumstances require different approaches to calculating the tax be taken for some or all reconciling items. In the next section we consider whether disclosure requirements are required to provide this transparency.

Conclusion and recommendation

30. We think the method for calculating the tax effect of reconciling items proposed in the Exposure Draft will provide a wider range of possible approaches that may lead to more useful information. We think that allowing this as an alternative to the simplified calculation would improve the balance of costs and benefits compared to the approach in the IASB's May 2022 tentative decision.

31. We recommend the IASB:

   (a) retain the option in its tentative decision of May 2022 of calculating the tax effects of the reconciling items at the statutory tax rate(s) applicable to the underlying transaction(s) in the relevant jurisdiction(s); and

   (b) replace the alternative option in its tentative decision of May 2022 of adding an allocation of other income tax effects to the tax effects described in (a) with options to:

      (i) calculate the tax effects of the reconciling items on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned; or

      (ii) calculate the tax effects of the reconciling items by another method that achieves a more appropriate allocation in the circumstances.

Question for the IASB
1. Does the IASB agree with the staff recommendation to revise its tentative decision of May 2022 specifying how to calculate the income tax effect of reconciling items as described in paragraph 31?

Disclosure requirements for the income tax effect of reconciling items

32. The IASB did not discuss disclosure requirements related to the income tax effect of reconciling items at its May 2022 meeting (Agenda Paper 21A) because different disclosure requirements may be appropriate depending on the outcome of the additional work it asked the staff to undertake. If the IASB agrees with the staff recommendation in paragraph 31 to permit a wider range of approaches to calculating the tax effect of reconciling items, we think disclosure requirements will be important to help users understand the approaches used.

Disclosure of how the entity determined the income tax effect

33. We think that the requirement proposed in paragraph 106(d) of the Exposure Draft for the entity to disclose how it determined the income tax effect would provide important information for users to understand the information being provided and should be retained.

34. For example, if an entity used the simplified approach as described in paragraph 31(a) disclosing this fact would result in material information because this approach can exclude some tax effects. Without disclosure of the fact the simplified method had been used, the disclosed tax effects of reconciling items could be misleading. It will also help users compare the bases for the calculations between different entities.

35. We also think that understanding if an entity uses different approaches to different reconciling items would be important to understanding the tax effects disclosed. The IASB has tentatively decided to include application guidance clarifying that, where doing so would be necessary for a user of financial statements to understand why a management performance measure communicates management's view of performance the explanations would refer to the individual reconciling items (see Appendix). We think a similar requirement should also apply to the disclosure of how the tax effects of reconciling items have been determined given the wider range of approaches that could be applied.

Disclosure of changes to calculating the tax effect

36. We also think that understanding if an entity has made changes to the method of calculation would be important to understanding the tax effects disclosed. Paragraph 108 of the Exposure Draft requires an entity to disclose information about when a management performance measure is added, removed or revised (see Appendix). We think the same information should be disclosed about changes an entity makes to the method of calculating tax on reconciling items.

37. We considered but rejected adding requirements to disclose information about the tax effects ignored by the simplified approach when that approach is applied. We think that requiring the disclosure of such information would reduce the effectiveness of the simplification in reducing complexity. Information about many of the items giving rise to these effects (changes in tax rates affecting previously recognised deferred tax assets or liabilities, recognition of previously unrecognised deferred tax assets, etc) is also available in the entity's tax disclosures required by IAS 12, for example, the tax reconciliation.

Conclusion and recommendation

38. We think that disclosing the method used for calculating the tax effect of items reconciling a management performance measure to the most directly comparable subtotal or total specified by IFRS Accounting Standards is necessary to understanding the information provided by the amount of income tax effect disclosed. It is also important for users to understand when those methods differ between reconciling items and when they are changed.

39. We recommend the IASB:

    (a) confirm the requirement in paragraph 106(d) of the Exposure Draft for an entity to disclose how it has determined the income tax effects for items reconciling a management performance measure to the most directly comparable subtotal or total specified by IFRS Accounting Standards;

(b) provide application guidance requiring the disclosure in (a) for each reconciling item if more than one method is used to calculate the tax effect; and

(c) revise the requirement in paragraph 108 of the Exposure Draft for an entity to disclose changes in management performance measures to apply to changes to the calculation of the tax effects of reconciling items.

Question for the IASB
2. Does the IASB agree with the staff recommendations in paragraph 39?

Appendix—management performance measures disclosure requirements

A1. This appendix includes:

(a) an extract of paragraphs 106 and 108 of the Exposure Draft outlining the disclosure requirements for management performance measures; and

(b) a summary of the IASB's tentative decisions that revise those requirements.

Extracts from the Exposure Draft

106 An entity shall disclose information about any management performance measures in a single note to the financial statements. That note shall include a statement that the management performance measures provide management's view of an aspect of the entity's financial performance and are not necessarily comparable with measures sharing similar descriptions provided by other entities. In addition, for each management performance measure an entity shall disclose in the notes:

(a) a description of why the management performance measure communicates management's view of performance, including an explanation of:

(i) how the management performance measure is calculated; and

(ii) how the measure provides useful information about the entity's performance;

(b) a reconciliation between the management performance measure and the most directly comparable subtotal or total included in paragraph 104;

(c) the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation required by paragraph 106(b); and

(d) how the entity determined the income tax effect required by paragraph 106(c).

108 If an entity changes the calculation of its management performance measures, introduces a new management performance measure or removes a previously disclosed management performance measure from its financial statements, it shall:

(a) disclose sufficient explanation for users of financial statements to understand the change, addition or removal and its effects;

(b) disclose the reasons for the change, addition or removal; and

(c) restate its comparative information, including in the required note disclosures, to reflect the change, addition or removal.

IASB tentative decisions

A2. At its January 2022 meeting (Agenda Paper 21A) the IASB tentatively decided to:

(a) confirm the proposals in the Exposure Draft, subject to drafting considerations, requiring an entity to disclose why a management performance measure communicates management's view of performance, including an explanation of:

(i) how the management performance measure is calculated; and

(ii) how the measure provides useful information about the entity's performance;

(b) provide additional application guidance to support the requirement in paragraph A2(a) clarifying that, where doing so would be necessary for a user of financial statements to understand why a management performance measure communicates management's view of performance the explanations would refer to the individual reconciling items;

(c) require an entity to disclose, for each reconciling item, the amount(s) related to each line item(s) in the statement(s) of financial performance.