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Improving IFRS Accounting Judgments Disclosure

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Previous communications from Canadian Securities Commission staff noted deficiencies in accounting judgments financial statement note disclosure provided in accordance with IAS 1 *Presentation of Financial Statements* paragraph 122-124. The following guidance will help to ensure that sufficient depth of disclosure is provided related to significant judgments management has made in preparing their financial statements.

What are Basic Elements of Good Disclosure?

Good disclosure should describe a situation in enough detail for a reader to understand the following:

- What is the issue? (Include relevant context / background information.)
- How was the issue accounted for? (Discuss any accounting policy choices made and alternatives considered.)
- What are the reasons supporting the accounting?
- Which financial statement accounts are affected?
- Why is it relevant to the issuer? (Discuss magnitude of exposure.)

Note: While this discussion focuses on disclosure of accounting judgments, the basic elements of good disclosure can apply to any financial statement note disclosures.

Often, boilerplate disclosure is the result of the issuer failing to clearly explain one or more of the elements of good disclosure. Most common deficiencies relate to a lack of sufficient context or background information, not discussing key reasons supporting the conclusion and omitting discussion of the magnitude of exposure.

What Makes a Good Accounting Judgment Note?

- An accounting judgment involves a decision in accounting treatment (e.g. going concern vs. liquidation basis, accrual vs. no accrual, write down vs. no write down, functional currency X vs. functional currency Y).
- In describing the decision to apply a certain accounting treatment, it is also important to discuss the reasons behind that decision.

For example, management concludes that the going concern assumption is applicable and discloses the reasons for this. Reasons may include management's assessment of cash outflows for the next 12 months compared to sources of available cash, analysis of sales backlog, anticipated contracts or production start dates, etc.

Once an accounting judgment or decision is made, accounting for the issue often results in making calculations that involve the use of accounting estimates. IAS 1.122 requires separate disclosure of accounting judgments apart from accounting estimates, which are disclosed under IAS 1.125-133.

In practice, many issuers create two separate sections, one to discuss accounting judgments and the other to discuss accounting estimates. The following is a simple illustration of this approach for an asset retirement provision.

- In the judgments section, the discussion would focus on facts and circumstances supporting management's conclusion that a provision is required.
- In the estimates section, the discussion would focus on key assumptions that have a material effect on the measurement of the provision (IAS 1.129) (e.g. discount rates, engineer's cost estimates and applicable sensitivity analysis).

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It is still possible to achieve the objective of IAS 1.122 by discussing the issue in one paragraph by clearly identifying the elements of judgment and estimates. However, it may be challenging to draft the disclosure to ensure that accounting judgments are clearly differentiated from areas involving estimation uncertainty. The following is a simple illustration of this combined approach.

Example:

In evaluating whether an asset retirement obligation exists, management applies judgment to evaluate whether they have a constructive obligation because legislation does not exist. During the year, an asset retirement provision of $X was recognized for ABC plant.

Measurement of the obligation involves the following material assumptions: the discount rate, estimated timing of plant closure and engineer's estimates of the costs to restore the site to its original condition. These assumptions are subject to estimation uncertainty. Engineer's estimates are based on established industry practice for plants of similar size. Everything else being equal, if the discount rate were to change by X%, this would result in a $X change in the provision. Refer to Note x for more information on the asset retirement obligation.

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