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IFRS Developments

Accounting for the effects of natural disasters under IFRS – Japan

(Update of the Edition issued in May 2011)

What you need to know

- While the tragedy in Japan continues to evolve, entities are raising a number of questions about the related financial reporting effects under IFRS.
- Entities may incur impairments to assets both directly and indirectly related to operations in the region and should evaluate whether they need to provide additional disclosure.
- Future operating losses do not meet the definition of a liability and are recognised in periods in which the costs are incurred.
- Insurance recoveries are recognised only when they are virtually certain.
- Entities should consider the effect of the disaster on the qualification for hedge accounting.

Overview

While the tragedy in Japan continues to evolve, entities are raising a number of questions about the related financial reporting effects. This article provides a reminder of existing accounting requirements that should be considered when accounting for the effects of natural disasters. Considerations include:

- Asset impairments
- Insurance recoveries
- Hedge accounting
- Restructuring
- Decommissioning obligations
- Other obligations
- Classification in statement of comprehensive income
- Financial statement disclosure requirements
- Regulatory reporting and disclosure considerations

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Asset impairments

If an entity determines that the events resulting from a natural disaster are an impairment indicator, an impairment test must be performed in accordance with IAS 36 Impairment of Assets for the respective asset(s) and/or cash-generating unit(s). Indicators of impairment as a result of a natural disaster may include:

- A significant decrease in the market price of the asset (cash-generating unit)
- A significant adverse change in the extent or manner in which an asset (cash-generating unit) is being used or in its physical condition
- A current expectation that the asset (cash-generating unit) will be sold or otherwise disposed of significantly before the previous expected date

Asset impairments may be indicated as a direct or indirect result of the events in Japan. For example, damage to a manufacturing facility located in the region would be a direct indicator. A jump in operating costs at a facility outside the region resulting from the replacement of a supplier in the region with a more costly supplier may be an indirect indicator.[1]

The complete destruction of a non-current asset will result in the write-off of that asset as opposed to an impairment analysis. This means that no future economic benefits are expected from either the asset's use or its disposal.

Entities consider accrued decommissioning costs when evaluating the consequences of damage to assets in the disaster. Estimates of the amount and timing of future cash flows may have changed if the asset has been impaired or destroyed, which could affect the carrying value of the asset.
Refer to *Decommissioning obligations* on page 8 for guidance on accounting for decommissioning costs.

Decisions about the recognition and measurement of losses are made independently of those relating to any compensation that might be receivable from an insurance policy. Refer to *Insurance recoveries*.

Entities with lending activities need to consider the requirements in IFRS 9 *Financial Instruments* / IAS 39 *Financial Instruments: Recognition and Measurement*, when evaluating loans made to debtors with operations (or collateral underlying the loan) in areas affected by natural disasters. This analysis also considers debtors who may have no operations in the affected areas, but have significant sales or suppliers in affected areas.

Other assets for which specific impairment guidance exists include:

- Inventory (IAS 2 Inventories)
- Debt securities (IFRS 9 / IAS 39), and other investments, including equities measured at cost under the exemption (IAS 39)
- Equity method investments (IAS 28 *Investments in Associates and Joint Ventures*

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[1] The likelihood of a supply interruption or an increase in costs being an indicator of impairment and/or triggering an impairment depends on the significance and duration of the expected change. Short-term, temporary disruptions are not typically indicative of an impairment.

- Construction contracts (IAS 11 *Construction Contracts*)
- Investment property (IAS 40 *Investment Property*)
- Deferred tax assets (IAS 12 *Income Taxes*)

Insurance recoveries

An entity may experience a loss related to a natural disaster either through the impairment of an asset or the incurrence of a liability. For example, as a result of damage from a natural disaster an entity may determine that an item of property, plant and equipment is impaired in accordance with IAS 36, or that a receivable from a customer is impaired in accordance with IFRS 9 / IAS 39. Alternatively, an entity may incur costs to repair a damaged facility or determine that it has a liability to remediate environmental damage.

The accounting for insurance claims will differ based on a variety of factors, including the nature of the claim, the amount of proceeds (or anticipated proceeds) and the timing of the loss and corresponding insurance recovery. In addition, any accounting for insurance proceeds will be affected by the evaluation of coverage in a given situation as well as an analysis of the ability of an insurer to satisfy a claim.

The accounting for insurance recoveries is discussed in the following types of categories:

- Property, plant and equipment
- Business interruption
- Other recoveries

Property, plant and equipment

Entities often maintain insurance to mitigate the losses associated with property damage. The accounting for insurance compensation for property, plant and equipment is addressed in IAS 16 *Property, Plant and Equipment* and IAS 37 P*rovisions, Contingent Liabilities and Contingent Assets*.

Impairment or loss of items of property, plant and equipment and any compensation from third parties (e.g., insurers) are accounted for separately, as follows:

- Impairments of property, plant and equipment are recognised in accordance with IAS 36
- Items of property, plant or equipment are derecognised on disposal or when no future economic benefits are expected from the asset's use or disposal
- Compensation from third parties for property, plant and equipment that is impaired, lost or given up is included in profit and loss when it becomes 'receivable'

Decisions about the recognition and measurement of losses are made independently of those relating to the recognition of any compensation that might be receivable. It is not appropriate to take potential proceeds into account when accounting for the losses. For example, when a building is completely destroyed, the asset must be written off regardless of whether the entity can recover its losses through an insurance policy and intends to repair or replace the facility. When an item of property, plant and equipment is destroyed or damaged in one accounting period, and entitlement to the insurance proceeds cannot be determined until a subsequent period, the loss is recognised when incurred, notwithstanding the expected insurance recovery.

Although IAS 16 does not define the point at which compensation becomes ‘receivable’, IAS 37 requires that reimbursement from a third party is recognised as a separate asset only when it is ‘virtually certain’ that the reimbursement will be received. Virtually certain is not defined in IAS 37, but it is certainly a much higher hurdle than ‘probable’[2] and arguably more challenging than the term ‘highly probable’ used in IFRS 9 / IAS 39.[3] In practice, virtually certain is interpreted as being at least 95% likely to occur. To the extent that the inflow of economic benefits is only probable (the event is more likely than not to occur), IAS 37 prohibits recognition of an asset and requires disclosure of the contingent asset.

In the context of a potential insurance recovery, a conclusion that recovery is virtually certain would require evidence confirming that the insurer will be covering the claim. In the case of a natural disaster, it is often unclear which events and costs are covered in insurance policies and significant uncertainty will exist as to whether or not any compensation will be available. Until such uncertainties are adequately resolved, it would not be appropriate to recognise an asset.

The likelihood of receiving compensation should be assessed continually to ensure that developments are appropriately reflected in the financial statements. The asset and the related income are recognised in the period in which it becomes virtually certain that a reimbursement will be received. If a previously unlikely receipt becomes probable, then the contingent asset is disclosed.

This assessment extends to the analysis of information available after the end of the reporting period and before the date of approval of the financial statements. In applying IAS 10 Events after the Reporting Period, an asset is recognised only if the information that becomes available in the subsequent period provides evidence to confirm that, as at the end of the reporting period, recovery was virtually certain.

The following example has been simplified in that it assumes the complete destruction of the insured asset. These concepts would also apply to a recognised partial impairment of the insured asset under IAS 36.

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[2] More likely than not.

[3] Indicating a much greater likelihood of happening than the term ‘more likely than not’ [IAS 39 F.3.7].Note that IFRS 9 (2013 and 2014) do not carry forward F.3.7 from IAS39, however the considerations remain unchanged in IFRS 9 [IFRS9.BC6.95]

Example — Recognition of an insurance recovery

Assume Entity A, with a 30 June 2016 year-end, owned property with a net book value of CU100 just before a natural disaster that completely destroys the property in April 2016. The fair value of the property was CU130 based on an independent appraisal shortly before the natural disaster. Also assume that Entity A's insurance policy provides for compensation for any insured loss based on the fair value of the property.

Entity A would recognise a CU100 loss on the property in the period the natural disaster occurred. A CU130 insurance recovery for the incurred loss would be recognised in the period it is determined to be virtually certain that the insurance entity will settle the claim. If settlement was only probable, the claim would be disclosed, but not recognised.

Impact on financial statements as at 30 June 2016

	Threshold met a 30 June 2016	Threshold only met after 20 June 2016 but before the financial statements are approved
Claim is virtually certain	Recognise an asset of CU130 and a gain of CU 30	Disclose the claim
Claim probable, but not virtually certain	Disclose the claim	Disclose the claim
Claim not probable	No disclosure	No disclosure

Similar considerations apply to the recognition of a receivable for the reimbursement of repair and maintenance costs under an insurance policy, even when an impairment or a write-off of the insured asset is not required and regardless of whether compensation is greater than, equal to or less than the costs incurred. For example, if an entity believes it is entitled to a CU1,500 insurance reimbursement as a result of damage to an asset that is not impaired, but for which the entity has incurred repair costs of only CU1,000 at the year-end, the CU1,500 compensation will only be recognised once the virtually certain recognition threshold is met.

Business interruption

Business interruption policies require careful analysis of the policy's terms and conditions due to the wide variety of terms relating to the nature and level of losses covered. Many policies cover temporary relocation costs (e.g., duplicate rent) that may be easily quantified after the loss event. Others cover lost revenue or operating margins that typically are measured over a longer term and require comparisons with similar periods in prior years. In these cases, no compensation would be available if revenue or operating margins recover during the measurement period. For example, a claim under a policy with a quarterly measurement period would not be valid if a retailer were to lose an entire month's revenue, but then recovered that revenue before the end of the quarter.

Similar to the treatment of compensation from property, plant and equipment, insurance recoveries for business interruption are only recognised when it is virtually certain that the entity will receive the benefit. This may only be at the earlier of when the proceeds have been received or confirmation has been given by the insurer of the amount of any settlement.

Other recoveries

Natural disasters can often result in additional obligations, for example, obligations to repair environmental damage. When the cost of meeting those obligations is covered by insurance, the related reimbursements would be accounted for in accordance with IAS 37. Decisions about the recognition of a provision are made independently of those relating to the recognition of any related reimbursement. A receivable is recognised only when settlement of the insurance claim is virtually certain. Accordingly, the receivable may be recognised at a later date than the provision for the related obligation. IAS 37 also limits the amount that can be recognised for a reimbursement of expenditure required to settle a provision to the amount of the provision recognised.

Example — Recognition of an insurance reimbursement

Assume that after a natural disaster, Entity A recognises a CU1m provision for its obligation for environmental rehabilitation, which it will undertake itself. Entity A's insurance policy covers the cost of hiring an external contractor to perform the environmental rehabilitation. Before the end of the reporting period, the insurer has confirmed it will pay Entity A CU1.5m as the environmental rehabilitation is performed.

Entity A would recognise a CU1m provision for environmental rehabilitation costs and a corresponding insurance reimbursement asset that is limited to CU1m. In addition, Entity A would assess the additional CU 0.5m for meeting the virtually certain recognition threshold of contingent assets.

Classification of insurance proceeds on the statement of cash flows

IAS 7 *Statement of Cash Flows*, requires cash flows related to property, plant and equipment to be classified in cash flows from investing activities. Cash flows from operating activities are described as the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. We believe that evaluating cash flows from insurance proceeds requires careful consideration of the nature of the claim. If the claim relates partially to business interruption and partially to property, plant and equipment, the cash in-flows would be allocated between cash flows from operating activities (e.g., for the business interruption portion of the claim) and cash flows from investing activities (e.g., for the property, plant and equipment portion of the claim). Insurance proceeds used for fixed asset expenditures that qualify for recognition in property, plant and equipment are classified as cash flows from investing activities. Insurance proceeds used for items that are not property, plant and equipment (i.e., repairs and maintenance) are classified as operating activities.

Hedge accounting

The natural disaster and subsequent events in Japan may have been disrupted many business transactions that may be postponed or cancelled. For example, IFRS reporting entities may have been forecasting purchases of Japanese goods or sales of their goods to Japanese entities. Prior to the disaster, many such transactions may have constituted 'highly probable' hedged transactions in cash flow hedges under IFRS 9 / IAS 39. However, purchases and sales that were considered highly probable a few weeks prior to the natural disaster, may no longer be highly probable or might not be expected to occur at all.

Entities consider whether any hedges of forecast transactions may cease to qualify for hedge accounting as a result of the disaster. The disaster could affect the probability of hedged forecast transactions occurring at the same time and in the same amounts as originally designated. If the forecast transaction is no longer highly probable, the entity must assess whether to cease hedge accounting. If so, it reclassifies accumulated gains or losses on the hedging instrument from other comprehensive income into profit or loss as a reclassification adjustment.

For entities that use statistical methods such as regression analysis to assess ongoing qualification for hedge accounting, new data incorporating the effects of the disaster must be added to the assessment and cannot be discarded. Whilst regression analysis often allows aberrant data to be incorporated into a multi-period analysis in a way that helps to preserve hedge accounting, it is possible that, in this case, the data could be so aberrant as to cause the entity to conclude that the regression analysis outputs no longer support the use of hedge accounting.

If an entity concludes that hedge accounting is no longer appropriate, it is permitted under IFRS 9[4] / IAS 39 to identify the specific event or change in circumstances that caused the hedging relationship to fail the effectiveness criteria, and continue to follow hedge accounting up until the precise date of such an event. In this situation, that is likely to be the date of the initial earthquake.

Restructuring

As a result of a natural disaster, an entity may decide to sell or abandon certain assets or execute a restructuring plan. A restructuring is a programme that is planned and controlled by management, and materially changes either the scope or manner in which business is conducted.
IAS 37 addresses the accounting for costs associated with exit or disposal activities. Exit activities may include:

- Sale or termination of a line of business
- Closure of a business location in a country or region or relocation of business activities from one country or region to another
- Changes in management structure, for example, eliminating a layer of management
- Fundamental reorganisations that have a material effect on the nature and focus of an entity's operations

Recognition

Restructuring costs are recognised only when the general recognition criteria in IAS 37 are met, i.e., there is a present obligation (legal or constructive) as a result of a past event, in respect of which a reliable estimate can be made of the probable cost. For constructive obligations to restructure, IAS 37 also requires that the entity has both a detailed formal plan and has raised a valid expectation in the parties affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. (For further guidance on constructive obligations, refer to Other obligations on page 10.)

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[4] The rules for hedge effectiveness are different in IFRS and IAS 39. Further, IFRS 9 allows a rebalancing mechanism.

IAS 37 provides examples of the entity's actions that may provide evidence that the entity has started to implement a plan; for example, dismantling the plant, selling assets, or making a public announcement of the main features of the plan. However, it also emphasises that the public announcement of a detailed plan to restructure will not automatically create an obligation. The important principle is that the announcement is made in such a way and in sufficient detail to give rise to valid expectations in other parties such as customers, suppliers and employees that the restructuring will be carried out.

In order for an announced plan to give rise to a constructive obligation, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. Any extended period before commencement of implementation, or if the restructuring will take an unreasonably long time, will mean that recognition of a provision is premature, because the entity is still likely to have a chance of changing the plan.

The criteria set out above for the recognition of restructuring provisions mean that a board decision, if it is the only relevant event arising before the end of the reporting period, is not sufficient to create a constructive obligation.

In summary, the conditions for recognising a restructuring provision require the plan to be detailed and specific, to have gone beyond the directors' powers of recall and to be put into operation without delay or significant alteration.

Measurement

A restructuring provision is measured using IAS 37's measurement requirements, i.e., the provision is measured at the best estimate of the expenditure required to settle the present obligation, taking into account the risks and uncertainties of the obligation and when the time value of money is material, discounting to present value. A restructuring provision includes only the direct expenditures arising from the restructuring, which are those that are necessarily entailed by the restructuring and not associated with the ongoing activities of the entity. The costs often incurred as part of a restructuring include employee termination benefits under a one-time termination plan, contract termination costs, and costs to consolidate or close a facility.

Other considerations

When an entity sells an operation, it is precluded from recognising an obligation until it is committed to the sale (i.e., there is a binding sale agreement). In such a case, the assets of the operation are also reviewed for impairment in accordance with IAS 36.

In addition, costs related to the future conduct of the business are recognised as the related services are provided. Future operating losses are not recognised unless they relate to an onerous contract. Careful consideration is needed to distinguish costs of recovering from a natural disaster that relate to future conduct of the business from those that relate to a restructuring.

Decommissioning obligations

Decommissioning obligations arise when an entity is required to dismantle or remove an asset at the end of its useful life and to restore the site on which it has been located to its former state, for example, when an oil rig or nuclear power station reaches the end of its economic life.

Rather than allowing an entity to build up a provision for the required costs over the life of the facility, IAS 37 requires that the liability be recognised as soon as the obligation arises, which will normally be at commencement of operations. Similarly, IAS 16 requires the initial cost of an item of property, plant and equipment to include an estimate of the amount of the costs to dismantle and remove the item and restoring the site on which it is located.

IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* applies to any decommissioning, restoration or similar liability that has been both included as part of the cost of an asset measured in accordance with IAS 16 and recognised as a liability in accordance with IAS 37. A natural disaster can significantly change the timing and amount of the estimated cash flows required to settle the decommissioning, restoration or similar liability. IFRIC 1 addresses how the effect of the following events that change the measurement of an existing decommissioning, restoration or similar liability are accounted for:

<table>
<tr><th>Event</th><th>Accounting</th></tr>
<tr><td>A change in the timing and amount of the estimated outflow of resources embodying economic benefits (e.g., cash flows) required to settle the obligation</td><td rowspan="2">The adjustment to the liability is recognised in the carrying value of the related asset or in comprehensive income,
depending on whether the asset is measured at cost or revaluation*</td></tr>
<tr><td>A change in the current market-based discount rate (this includes changes in the time value of money and the risks specific to the liability)</td></tr>
<tr><td>An increase in the liability that reflects the passage of time (also referred to as the unwinding of the discount)</td><td>The periodic unwinding of the discount is recognised in profit or loss as a finance cost as it occurs</td></tr>
</table>

* If the related asset is measured using the cost model, the change in the liability is added to or deducted from the cost of the asset to which it relates. When the change gives rise to an addition to cost, the entity considers the need to test the new carrying value for impairment. Because of the nature of natural disasters, impairment of any increase in the value of the related asset may be a very real possibility. Conversely, reductions over and above the remaining carrying value of the asset are recognised immediately in profit or loss. The adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life.

Example — Reduction in the economic life of an asset

After a natural disaster, it is determined that a power plant may have to be closed earlier than previously expected. The entity determines that the remaining useful economic life of the asset has reduced from 35 years to 10 years.

Accordingly, the present value of the decommissioning liability will increase because of the shorter period over which cash flows are discounted. Any such increase is added to the carrying value of the asset, which is tested for impairment. The remaining carrying value is depreciated prospectively over the following 10 years.

If the related asset is measured using the revaluation model, changes in the liability alter the revaluation surplus or deficit previously recognised for that asset. Changes to the provision are recognised in other comprehensive income and increase or decrease the value of the revaluation surplus in respect of the asset, except to the extent that:

- A decrease in the provision reverses a previous revaluation deficit that was recognised in profit or loss
- A decrease in the provision exceeds the carrying amount of the asset that would have been recognised under the cost model

Or

- An increase in the provision exceeds the previous revaluation surplus relating to that asset

in which case the change is recognised in profit or loss. Changes in the provision might also indicate the need for the asset (and therefore all assets in the same class) to be revalued.

Other obligations

Future operating losses

Entities may incur other losses directly or indirectly related to a natural disaster. An entity may anticipate having future operating losses for a period of time after a natural disaster. For example, an entity may have repair costs, lost revenue due to plant closures or losses due to an overall decline in the economy. Additional costs might be incurred in renting alternative production facilities, providing transport or accommodation for employees or outsourcing business functions.

Future operating losses and costs do not meet the definition of a liability. Therefore, they are not recognised until they have been incurred.

Onerous contracts

Onerous contracts are contracts in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it; they are recognised as provisions. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. For example, when a manufacturing entity has contracts to sell goods at a fixed price and, because of the natural disaster, it cannot deliver the goods itself without procuring the goods from a third party, the provision for the onerous contract will reflect the lower of the penalty for terminating the contract or the present value of the net cost of fulfilling the contract (i.e., the excess of the cost to procure the goods over the fixed price to be received).

When a natural disaster has occurred, contracts should be reviewed to determine if there are any special terms that may relieve an entity of its obligations (e.g., force majeure). Finally, before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract.

Constructive obligations

Additional non-legal obligations may arise as a result of a natural disaster. For example, an entity with no previous environmental obligations may establish a constructive obligation that it will repair environmental damage as a result of the disaster. Such a constructive obligation will only result in the recognition of a provision if, by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities and as a result, it has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

IAS 37's general recognition requirements would have to be met. That is, there is a present obligation as a result of a past event[5] (in this case a constructive obligation); it is probable[6] that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

Contingent liabilities

Contingent liabilities are not recognised, but they are disclosed. A contingent liability is:

- A possible obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity

Or

- A present obligation that is not recognised because it is either not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability

When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

When a previously contingent liability, for example, a legal obligation to repair environmental damage as a result of a natural disaster, is no longer contingent and it meets IAS 37's recognition requirements, it is recognised and measured in accordance with IAS 37.

Expenditure to be settled by a third party

When the expenditure required to settle a provision is expected to be settled by a third party (e.g., an insurer) and the entity will not be liable if the third party fails to pay, the entity has no liability and no provision is recognised.

Classification in statement of comprehensive income

IAS 1 *Presentation of Financial Statements* requires that when items of income or expense (a term covering both profit and loss, and other comprehensive income) are material, their nature and amount are disclosed separately. The standard provides examples of circumstances that would give rise to the separate disclosure of items of income and expense, which include:

- Write-downs of inventories to net realisable value, or of property, plant and

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[5] When it is unclear whether there is a present obligation, IAS 37 notes that a past event gives rise to a present obligation if it is 'more likely than not' that a present obligation exists at the end of the reporting period.

[6] More likely than not.

equipment to recoverable amount, as well as reversals of such write-downs

- Restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring
- Disposals of items of property, plant and equipment
- Disposals of investments
- Discontinued operations
- Litigation settlements
- Other reversals of provisions

This information may be given on the face of the income statement, on the face of the statement of comprehensive income or in the notes. In line with the permissive approach taken to the format of the performance statements under IFRS, the level of prominence given to such items is left to the judgement of the entity concerned. However, regarding discontinued operations above, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* requires certain information to be presented on the face of the income statement.

IAS 1 does not permit an entity to present any items of income or expense as extraordinary items in the statement of comprehensive income or the separate income statement.

Financial statement disclosure requirements

The financial statement disclosure for entities directly and/or indirectly affected by recent events in Japan will vary depending on the magnitude of their losses and the availability of information. In many cases, the financial statement disclosure requirements are addressed based on the nature of the loss (e.g., asset impairments, hedging, decommissioning costs) or the timing of the loss (e.g., events after the reporting period). Because the events in Japan may result in new obligations and uncertainties that an entity may not have previously experienced, the following discussion provides a brief summary of some of the financial statement disclosures addressing provisions, contingencies, uncertainties and subsequent events.

Provisions

For each class of provision, an entity provides a reconciliation of the carrying amount of the provision at the beginning and end of the period showing:

- Additional provisions made in the period, including increases to existing provisions
- Amounts used, i.e., incurred and charged against the provision, during the period
- Unused amounts reversed during the period
- Any increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

Comparative information is not required. In addition, for each class of provision an entity discloses the following:

- A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.

- An indication of the uncertainties about the amount or timing of those outflows. When necessary to provide adequate information, an entity discloses the major assumptions made concerning future events (this refers to future developments in technology and legislation and is of particular relevance to environmental liabilities).
- The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Contingent liabilities

Unless the possibility of any outflow is remote, an entity must disclose by class of contingent liability:

- A description of the nature of the contingent liability
- An estimate of its financial effect
- An indication of the uncertainties relating to the amount or timing of any outflow
- The possibility of any reimbursement

An entity may only refrain from providing these disclosures in situations when the disclosures can be expected to seriously prejudice the position of the entity in a dispute with other parties on the subject matter of the contingent liability. Use of this exception is expected to be extremely rare.

Contingent assets

When an inflow of economic benefits is probable an entity must disclose:

- A brief description of the nature of the contingent assets at the end of the reporting period
- When practicable, an estimate of their financial effect, measured using the principles set out for provisions in IAS 37

When any of the information above is not disclosed because it is not practicable to do so, that fact is stated. IAS 37 emphasises that the disclosure must avoid giving misleading indications of the likelihood of income arising.

Sources of estimation uncertainty

Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. IAS 1 requires disclosure of information about the assumptions concerning 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* (with the exception of assets and liabilities measured at fair value based on recently observed market prices). Entities affected both directly and indirectly by the natural disasters in Japan may be required, under IAS 1, to disclose information about those assets and liabilities that are subject to significant estimation uncertainty.

IAS 1 requires that in respect of those assets and liabilities that are subject to estimation uncertainty, such as long-lived assets subject to impairment, the footnotes must include details of their nature and their carrying amount as at the end of the reporting period. The disclosures are required to be presented in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information provided will vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures that an entity would make include:

- The nature of the assumption or other estimation uncertainty
- The sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity
- 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
- An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved

Disclosure of some of these key assumptions is already required by other standards. For example, IAS 37 requires disclosure, in certain instances, of major assumptions concerning future events affecting classes of provisions and IAS 36 requires disclosure, in certain circumstances, of each key assumption on which management has based its cash flow projections.

When it is impracticable to disclose the extent of the possible effects of an assumption or other source of estimation uncertainty at the end of a reporting period, the entity must disclose that it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions used could require a material adjustment to the carrying amount of the asset or liability affected. However, in all cases, the entity must disclose the nature and carrying amount of the specific asset or liability affected by the assumption.

Subsequent events

Entities directly affected by the events in Japan with reporting periods ending before the recent earthquakes that have not issued their financial statements will likely need to disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made. Additionally, entities that may be indirectly affected by the events, such as an entity with a concentration of revenue from customers in the affected areas, need to consider whether subsequent events disclosures are necessary to keep the financial statements from being misleading.

Regulatory reporting and disclosure considerations

The recent events in Japan also may trigger a number of regulatory reporting and disclosure requirements.

Regulatory reporting obligations

Entities must consider the direct and/or indirect effects of the events in Japan on their regulatory reporting obligations. As previously discussed, interim impairment tests may result in impairment charges as a result of events in Japan. Reporting regulations in some countries may require certain disclosures when an entity discovers or concludes that it will need to record a material impairment charge. Such disclosure may be required prior to the preparation of its financial statements to be included in its next interim or annual reports.

Management commentary

When discussing the results of operations for the period, entities need to clearly disclose any significant effect on income from continuing operations related to the events in Japan.

Such discussion should also provide forward-looking information considering any material trends and uncertainties resulting from these events on an entity's liquidity and capital resources and results of operations. As an example, these disclosures might include a discussion of any risk of impairment or other charges to the extent not yet recognised. They might also include disclosure of any expected changes in business practices that will affect operations and liquidity, including situations in which the relationship between costs and revenues could be materially affected.

Risk factor disclosures

Entities must consider updating any required risk factor disclosures if there have been material changes or new risk factors resulting from the events in Japan.

Changes in internal control over financial reporting

Management must consider the effect these events have on its internal controls and procedures and related conclusions as of the end of the reporting period (e.g., if the ability to report in an accurate or timely fashion is affected).

Other

Reporting entities may need to consider providing related disclosures in other areas of periodic reports and registration statements, including the description of the business and properties.

Next Steps

- While it may be too early to predict the full extent of the accounting and reporting implications from the events in Japan and the ensuing rebuilding process, entities should begin to analyse any direct or indirect effects on financial reporting.

- Entities should monitor the situation, including potential standard setting or regulatory actions (e.g., any decision to provide relief from reporting deadlines).