

[PAPER FOR PUBLIC EFRAG FRB MEETING]

This paper provides the technical advice from EFRAG FR TEG to the EFRAG FRB, following EFRAG FR TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG FRB. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG FRB are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

EFRAG's Preparatory document of [Draft] Endorsement Advice

International Tax Reform-Pillar Two Model Rules Amendments to IAS 12

Notes to Constituents:

EFRAG has not yet received from the European Commission the letter requesting an endorsement advice in respect of International Tax Reform - Pillar Two Model Rules (Amendments to IAS 12), as such letter will be sent only following the issuance of the Amendments, expected in May 2023.

Considering the tight timeline of the forthcoming due process, in anticipation of the endorsement advice, EFRAG is issuing this preparatory document for comments, on the basis of the content of the IASB Exposure Draft Tax Reform - Pillar Two Model Rules (Proposed amendments to IAS 12) ("the ED") and the discussions held by the IASB on 11 April 2023 during which the IASB decided to finalise the amendments to IAS 12. Provided that the final content of the Amendments is not substantially different than the contents of the ED and the discussions held by the IASB in April 2023, this preparatory document will be used as in the preparation of EFRAG's Final Endorsement Advice.

The following appendices sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendments. In it, EFRAG assesses how the Amendments satisfy the technical criteria set out in the Regulation (EC) No 1606/2002 for the adoption of international accounting standards. It provides a detailed evaluation for the criteria of relevance, reliability, comparability and understandability, so that financial information is appropriate for economic decisions and the assessment of stewardship. It evaluates separately whether the Amendments lead to prudent accounting and finally considers whether the Amendments would not be contrary to the true and fair view principle.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS Standards in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS Standard or Interpretation against the technical criteria for European endorsement, as currently defined. These are explicit criteria which

have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRS Standards or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

INVITATION TO COMMENT ON EFRAG’S ASSESSMENTS ON INTERNATIONAL TAX REFORM - PILLAR TWO MODEL RULES (AMENDMENTS TO IAS 12)

Once filled in, this form should be submitted by 24 May 2023 using the ‘Comment publication link’ available at the bottom of the respective news item. All open consultations can be found on EFRAG’s web site: [Open consultations: express your views](#).

EFRAG expects to be asked by the European Commission to provide it with advice and supporting material on International Tax Reform - Pillar Two Model Rules (Amendments to IAS 12) (“the Amendments”). In order to do so, EFRAG has been carrying out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

Before finalising its assessment, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interests of transparency, EFRAG will wish to discuss the responses it receives in a public meeting, so it is preferable that all responses can be published.

EFRAG’s initial assessments, summarised in this questionnaire, will be updated for comments received from constituents when EFRAG is in the process of finalising its Letter to the European Commission regarding endorsement of the Amendments.

Your details

1 Please provide the following details:

- (a) Your name or, if you are responding on behalf of an organisation or company, its name:

- (b) Are you a:

Preparer User Other (please specify)

- (c) Please provide a short description of your activity:

(d) Country where you are located:

(e) Contact details, including e-mail address:

EFRAG’s initial assessment with respect to the technical criteria for endorsement

2 EFRAG’s initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, the Amendments are not contrary to the principle of true and fair view and meet the criteria of understandability, relevance, reliability, comparability and lead to prudent accounting. EFRAG’s reasoning is set out in Appendix 2 below.

(a) Do you agree with this assessment?

Yes No

If you do not agree, please provide your arguments and what you believe the implications of this could be for EFRAG’s endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 below that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

The European public good

3 In its assessment of the impact of the Amendments on the European public good, EFRAG has considered a number of issues that are addressed in Appendix 3 below.

Improvement in financial reporting

4 EFRAG has identified that in assessing whether the endorsement of the Amendments is conducive to the European public good it should consider whether the Amendments are an improvement over current requirements across the areas which have been subject to changes (see paragraphs 3 to 4 of Appendix 3 below). To summarise, EFRAG’s initial assessment is that the Amendments are likely to improve the quality of financial reporting.

Do you agree with the assessment?

Yes No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG’s endorsement advice.

Costs and benefits

- 5 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of the Amendments in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this invitation to comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in paragraphs 6 to 12 of Appendix 3 below. To summarise, EFRAG’s initial assessment is that the Amendments are likely to reduce the costs for preparers and will not result in increased costs to users.

Do you agree with this assessment?

Yes No

If you do not agree, please explain why you do not agree and (if possible) explain broadly what you believe the costs involved will be?

- 6 In addition, EFRAG is assessing the benefits that are likely to be derived from the Amendments. The results of the initial assessment of benefits are set out in paragraph 13 to 16 of Appendix 3 below. To summarise, EFRAG’s initial assessment is that both preparers and users are likely to benefit from the Amendments.

Do you agree with this assessment?

Yes No

If you do not agree with this assessment, please provide your arguments and indicate how this could affect EFRAG’s endorsement advice.

- 7 EFRAG’s initial assessment is that the benefits to be derived from implementing the Amendments in the EU, as described in paragraph 6 above, are likely to outweigh the costs involved, as described in paragraph 5 above.

Do you agree with this assessment?

Yes No

If you do not agree with this assessment, please provide your arguments and indicate how this could affect EFRAG’s endorsement advice.

Overall assessment with respect to the European public good

- 8 EFRAG has initially concluded that endorsement of the Amendments would be conducive to the European public good (see paragraphs 17 to 20 of Appendix 3 below).

Do you agree with this conclusion?

Yes No

If you do not agree, please explain your reasons.

EFRAG’s Preparatory Draft Letter to the European Commission Regarding Endorsement of International Tax Reform-Pillar Two Model Rules Amendments to IAS 12

John Berrigan
Director General, Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels

[XX] June 2023

Dear Mr Berrigan

Endorsement of International Tax Reform - Pillar Two Model Rules amendments to IAS 12

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on the International Tax Reform - Pillar Two Model Rules (Amendments to IAS 12) (“the Amendments”), which were issued by the IASB on xx May 2023. An Exposure Draft of the Amendments was issued on 9 January 2023. EFRAG provided its comment letter on that Exposure Draft on 13 March 2023 to the IASB.

The objective of the Amendments is to introduce a mandatory temporary exception to the requirements in IAS 12 *Income Taxes* (“IAS 12”) to recognise and disclose information about deferred tax assets and liabilities arising from the OECD’s Pillar Two Model Rules. The Amendments also introduce new disclosure requirements.

The temporary exception shall be applied immediately upon issue of the Amendments and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (“IAS 8”). The disclosure requirements shall be applied for annual reporting periods beginning on or after 1 January 2023. An entity is not required to apply the disclosure requirements in interim financial reports for any interim period ending on or before 31 December 2023. A description of the Amendments is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words whether the Amendments would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, leads to prudent accounting and is not contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our conclusions below.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

Based on the above reasoning, EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship and raise no issues regarding prudent accounting. EFRAG has also assessed that the Amendments do not create any distortion in its interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that

the Amendments are not contrary to the true and fair view principle. EFRAG’s reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendments is conducive to the European public good. EFRAG’s reasoning is explained in Appendix 3 to this letter.

Our advice to the European Commission

As explained above, we have concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, raise no issues regarding prudent accounting, and that they are not contrary to the true and fair view principle. We have also concluded that the Amendments are conducive to the European public good. Therefore, we recommend the Amendments for endorsement without further delay.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Wolf Klinz

Chair of the EFRAG FRB

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

- 9 The Organisation for Economic Co-operation and Development (OECD) published the 'Pillar Two model rules' (the "Pillar Two rules") in December 2021. These rules aim to address the tax challenges arising from the digitalisation of the economy and were agreed by more than 135 countries. These rules:
 - (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable in each jurisdiction representing at least a minimum rate of 15%; and
 - (c) typically require the ultimate parent entity of the group to pay top-up tax (in the jurisdiction in which it is domiciled).
- 10 Stakeholders informed the IASB of concerns about the implications for income tax accounting resulting from jurisdictions implementing the Pillar Two rules within a short period of time. Those concerns relate to:
 - (a) How to apply IAS 12 to account for top-up tax. They noted that it is unclear how an entity accounts for deferred taxes (if any) related to top-up tax. In this regard, it is unclear whether the Pillar Two rules create additional temporary differences, whether entities are required to remeasure existing deferred taxes and which tax rate to use to measure deferred taxes.
 - (b) The usefulness of the information that could result from accounting for deferred taxes related to top-up tax. The IASB's stakeholders said that, in some cases, accounting for deferred taxes related to top-up tax could be extremely complex and, therefore, the costs of doing so might outweigh the benefits.
 - (c) The urgent need for clarity in the light of the imminent enactment of tax law to implement the rules in some jurisdictions. Some jurisdictions are expected to enact tax law to implement the Pillar Two rules in the first half of 2023. Consequently, stakeholders said that there is little time to resolve the current uncertainties and that, without further clarification, an entity might incur costs in developing and applying its own interpretations of the IAS 12 requirements which could result in diversity in accounting practice and information that is not necessarily useful for users.

The issue(s) and how it has been addressed

- 11 As the rules are expected to be implemented in some jurisdictions in the near term, the IASB concluded that it would not be feasible to determine how to apply the principles and requirements in IAS 12 before new tax laws are expected to be enacted.
- 12 Therefore, the IASB introduced a mandatory temporary exception to the requirements in IAS 12 to recognise and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes. This will not affect the accounting for current taxes arising from implemented Pillar Two rules.

- 13 As from the IASB's point of view it was not possible to determine – at present – how much time to determine how to apply the principles and requirements in IAS 12 to account for deferred taxes related to top-up tax will require, the IASB decided not to specify how long the temporary exception will be in place.

What has changed?

- 14 **Paragraph 4A** is added to IAS 12 to indicate that the Standard applies to income taxes arising from tax law enacted or substantively enacted to implement Pillar Two rules. It also indicates that as an exception to the requirements in IAS 12, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes. The Amendments do not specify how long the exception would be in place. Furthermore, **paragraph 88A** is added to IAS 12 to require an entity disclosing the application of such exception.
- 15 For periods when the law is enacted or substantively enacted but not yet in effect IAS 12 includes a new disclosure objective that requires that an entity discloses information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes. In meeting the disclosure objective an entity shall disclose known or reasonably estimable information about its exposure at the end of the reporting period. That information does not need to reflect all the specific requirements of the legislation and could be provided in the form of an indicative range. To the extent information is not known or reasonably estimable, an entity would instead be required to disclose a statement to that effect and should disclose information about the progress the entity has made in assessing its exposure to Pillar Two income taxes.
- 16 For periods when the law is in effect, an entity discloses separately its current tax expense (income) related to Pillar Two income taxes.

When do the Amendments become effective?

- 17 The temporary exception and the disclosure that an entity has applied the exception should be applied immediately upon issue of the Amendments and retrospectively in accordance with IAS 8.
- 18 The disclosure requirements (other than the requirement to disclose that the entity has applied the exception) should be applied for annual reporting periods beginning on or after 1 January 2023 but an entity is not required to apply the disclosure requirements in interim financial reports for any interim period ending on or before 31 December in 2023.

Appendix 2: EFRAG's technical assessment on the Amendments against the endorsement criteria

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

- 1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that the Amendments:
 - (a) are not contrary to the principle set out in Article 4(3) of Council Directive 2013/34/EU (The Accounting Directive); and
 - (b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 2 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.
- 3 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive'* (Recital 9 of the IAS Regulation).
- 4 EFRAG's assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.
- 5 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendments is appropriate both for making decisions and assessing the stewardship of management.
- 6 EFRAG's assessment on whether the Amendments are not contrary to the true and fair view principle set out in Article 4(3) of Council Directive 2013/34/EU is based on the assessment of whether it meets all other technical criteria and whether they lead to prudent accounting. EFRAG's assessment also includes assessing whether the Amendments do not interact negatively with other IFRS Standards and whether all necessary disclosures are required. Detailed assessments are included in this appendix in the following paragraphs:

- (a) relevance: paragraphs 7 to 13;
- (b) reliability: paragraphs 14 to 18;
- (c) comparability: paragraphs 19 to 24;
- (d) understandability: paragraphs 25 to 31;
- (e) whether overall they lead to prudent accounting: paragraphs 32 to 34; and
- (f) whether they would not be contrary to the true and fair view principle as noted in paragraphs 35 to 38.

Relevance

- 7 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.
- 8 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.
- 9 EFRAG observes that the application of the mandatory exception will prevent entities from accounting for deferred tax assets and liabilities arising from Pillar Two rules. The application of the exception has to be disclosed. If the exception had not been in place, an entity might have recognised deferred taxes that could help users evaluate future events. However, such deferred tax information would provide relevant information to users only if it was reliable.
- 10 EU jurisdictions are in the process of transposing the EU Directive into local law. Therefore, as the scenario is still evolving, EFRAG considers that it is currently unclear how an entity would account for deferred taxes related to top-up tax, as it is unclear whether additional temporary differences arise from the Pillar Two model rules, what tax rate would have to be applied in measuring deferred taxes, or whether existing deferred taxes need to be remeasured.
- 11 In addition, the IASB introduces new disclosure requirements with the objective of compensating for the potential loss of information. For periods when the law is enacted or substantively enacted but not yet in effect, an entity shall disclose information that helps users of financial statements understand the entity’s exposure to Pillar Two income taxes at the end of the reporting period. For periods when the law is in effect, an entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes. The former disclosures help users to evaluate future events while the latter also help users to confirm or correct their past evaluations.
- 12 For periods when the law is enacted or substantively enacted but not yet in effect, the IASB has established objective-based instead of prescriptive disclosure requirements. An entity shall disclose known or reasonably estimable information that helps users of financial statements understand the entity’s exposure to Pillar Two income taxes arising from that legislation. To meet the disclosure objective, an entity shall disclose qualitative and quantitative information about the exposure. Such approach aims to provide relevant information to the users of financial statements. For entities that have no such information or cannot estimate it on a reliable basis – as they are still assessing their exposure –, the IASB decided to require an entity to disclose a statement to that effect and information about the entity’s progress in assessing its exposure. EFRAG notes from the feedback

received that entities prefer to disclose their own assessments than prescriptive disclosure requirements. The IASB final approach for disclosures represents a balanced compromise to provide relevant information under cost benefit considerations. Similar feedback was received by EFRAG during the Exposure Draft consultation.

- 13 EFRAG's overall assessment is that the introduction of the exception to recognise deferred taxes arising from Pillar Two rules and the introduction of disclosures requirements would not result in a loss of relevant information for users of financial statements. With the proposed disclosure requirements the users of financial statements will receive relevant information in periods when the law is enacted or substantially enacted but not yet in effect and when the law is in effect.

Reliability

- 14 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 15 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.
- 16 EFRAG notes that the application of the exception to the recognition of deferred taxes arising from Pillar Two rules might prevent entities from accounting for deferred tax assets and liabilities whose existence is not yet clearly established, and if existing, would be subject to a high level of measurement uncertainty. EFRAG considers that the fact that Pillar Two rules legislation and guidance are not fully developed leads to uncertainties on the recognition and measurement of deferred taxes arising from Pillar Two rules. Absent the introduction of the exception, an entity would have little time to resolve the uncertainties about how to apply IAS 12 and might develop an interpretation of IAS 12, which could result in the Standard being applied inaccurately with users being provided with unreliable information.
- 17 Furthermore, EFRAG notes that the disclosure objective requiring an entity to disclose information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes:
- (a) shall be provided to the extent that the information is known or reasonably estimable; and
 - (b) only refers to the current period and that no forward-looking information is required.

These aspects make the information to be provided by an entity to satisfy the disclosure objective more reliable.

- 18 EFRAG's overall assessment is that the requirements in the Amendments will result in reliable information for periods when the law is enacted or substantively enacted but not yet in effect and when the law is in effect.

Comparability

- 19 The notion of comparability requires that like items and events are accounted for in a consistent way over time and by different entities, and that unlike items and events should be accounted for differently.
- 20 EFRAG has considered whether the Amendments result in transactions that are:

- (a) economically similar being accounted for differently; or
 - (b) transactions that are economically different being accounted for as if they are similar.
- 21 The Amendments introduce a mandatory exception to recognising and disclosing information about deferred tax assets and liabilities related to income taxes arising from Pillar Two rules. The disclosure requirements will compensate for the potential loss of information. Such an approach will:
- (a) result in greater comparability between entities’ financial statements as the top-up tax effects can be identified and thus result in more useful information for users of financial statements. Deferred taxes will be recognised without top-up tax effects. Any information related to the exposure to top-up tax or the current top-up tax will be in the notes of the financial statements;
 - (b) eliminate the risk that entities might develop divergent accounting policies that are inconsistent with the principles and requirements in IAS 12 due to accounting uncertainties and that might be inconsistent with the accounting policies developed by other entities; and
 - (c) reduce diversity in practice which would be expected due to the accounting uncertainty and complexity of the issue.
- 22 EFRAG observes that not requiring prescriptive targeted disclosure in periods when the law is enacted or substantially enacted but not yet in effect and requiring entities to provide information to satisfy a disclosure objective instead could lead to less comparable disclosures. However, EFRAG has heard during its consultation period that prescriptive information prepared in accordance with IAS 12 requirements might not be useful for users and could result in misleading information. In addition, we understand that it is not feasible to require entities to disclose prescriptive information prepared in accordance with Pillar Two rules because some entities will likely be in the process of assessing their exposure and may not have reliable information that is readily available. Therefore, in EFRAG’s view, having entity-specific (and thus, more relevant) information outweighs the lack of comparable information.
- 23 In periods when the law is in effect the notes to the financial statements will include comparable information.
- 24 EFRAG’s overall assessment is that the requirements in the Amendments will result in comparable information.

Understandability

- 25 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.
- 26 Although there are a number of aspects related to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.
- 27 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.

- 28 In EFRAG’s view, the Amendments do not introduce any complexity that may impair understandability. Instead, the exception introduced by the Amendments will provide affected entities with relief from accounting for deferred tax assets and liabilities in relation to a complex new tax law to be enacted in multiple jurisdictions in a short period of time.
- 29 Furthermore, EFRAG notes that the disclosure requirements introduced by the Amendments for periods when the law is enacted or substantially enacted but not yet in effect enable an entity to apply judgment to determine what type of information could satisfy the disclosure objective. In our view, the complexity of the information an entity should disclose derives from the complexity of the underlying Pillar Two rules rather than from the disclosure requirements introduced by the Amendments.
- 30 In periods when the law is in effect current top-up tax has to be recognised and explained in the notes which is understandable information.
- 31 Therefore, EFRAG’s overall assessment is that the Amendments satisfy the understandability criterion in all material respects.

Prudence

- 32 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated and liabilities or expenses are not understated.
- 33 EFRAG observes that the application of the exception will prevent entities from accounting for deferred tax assets and liabilities arising from Pillar Two rules (if any). In general, not recognising deferred tax liability potentially arising from Pillar Two rules may raise concerns about the lack of prudent accounting as specified in paragraph above. However, as indicated in paragraph 10 above, it is not yet clear whether the new legislation will create additional deferred tax assets or liabilities at all. Under such conditions, any recognition of deferred tax liabilities, despite motivated by the prudence principle, may be highly unreliable (as explained in paragraph 16 above) and may result in information not relevant to users (as explained in paragraphs 7 to 13 above) . The exception will also result in not questionable or imprudent deferred tax assets being recognised.
- 34 EFRAG has therefore concluded that the Amendments raise no issues in relation to prudence as defined above.

True and Fair View Principle

- 35 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:
- (a) does not lead to unavoidable distortions or significant omissions in the representation of that entity’s assets, liabilities, financial position and profit or loss; and
 - (b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity’s assets, liabilities, financial position and profit or loss.
- 36 EFRAG has assessed that the Amendments do not create any negative interactions with other IFRS Standards. Accordingly, EFRAG has assessed that the Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view.

- 37 EFRAG has concluded that the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity’s assets, liabilities, financial position and profit or loss are required.
- 38 As a result, EFRAG concludes that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

- 39 Accordingly, for the reasons set out above, EFRAG’s assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

- 1 EFRAG considered whether it would be conducive to the European public good to endorse the Amendments. In addition to its assessment included in Appendix 2, EFRAG has considered a number of issues in order to identify any potential negative effects for the European economy on the application of the Amendments. In doing this, EFRAG considered:
 - (a) Whether the Amendments improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how they fit into IFRS Standards as a whole;
 - (b) The costs and benefits associated with the Amendments; and
 - (c) Whether the Amendments could have an adverse effect to the European economy, including financial stability and economic growth.
- 2 These assessments allow EFRAG to draw a conclusion as to whether the Amendments are likely to be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether the Amendments are likely to improve the quality of financial reporting

- 3 EFRAG notes that the Amendments are designed to:
 - (a) provide affected entities with relief from accounting for deferred tax assets and liabilities in relation to a complex new tax law to be enacted in multiple jurisdictions in a short period of time;
 - (b) avoid entities developing divergent interpretations of IAS 12, which could result in the Standard being applied inconsistently;
 - (c) allow time for jurisdictions to enact new tax law and for entities and the IASB to assess the impact of the law.
- 4 EFRAG has therefore concluded that the Amendments are likely to improve the quality of financial reporting.

EFRAG's initial analysis of the costs and benefits of the Amendments

- 5 EFRAG has considered that a less extensive cost-benefit analysis of the effects of the narrow-scope Amendments is proportionate and needed than would be the case for Standards or Interpretations that have a wider scope. Furthermore, the urgency of the relief limits the extent to which any formal effect analysis can be carried out.

Cost for preparers

- 6 EFRAG notes that the main objective of the Amendments is to provide entities with relief from accounting for deferred tax assets and liabilities in relation to a complex new tax law to be enacted in multiple jurisdictions in a short period of time. Therefore, the Amendment reduces the complexity and costs around recognition of deferred taxes arising from Pillar Two rules.

- 7 EFRAG considers that there will be insignificant costs for preparers related to the preparation of the disclosure requirements:
- (a) For disclosures required when the law is enacted or substantively enacted, but not yet in effect:
 - (i) an entity has flexibility in disclosing information that best meets the disclosure objective but without resulting in undue cost or effort;
 - (ii) an entity should disclose its own assessment on its exposure to paying top-up tax. If such information is unavailable because an entity has not made sufficient progress an entity is required disclose a statement to that effect as well as information about progress made in assessing its exposure to paying top-up tax.
 - (iii) The disclosures will only apply for a limited period of time.
- 8 For disclosures required when the law is in effect, an entity will disclose separately its current tax expense (income) related to Pillar Two income taxes. An entity might incur relevant costs to estimate Pillar Two income taxes, but these costs will be incurred regardless of this disclosure requirement. In our view any additional costs of this disclosure requirement are insignificant.
- 9 Overall, EFRAG’s assessment is that the Amendments are likely to reduce the costs for preparers.

Costs for users

- 10 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.
- 11 Except for obtaining an understanding of the exposure of an entity to pay Pillar Two income taxes and assessing what the impact on the entity’s average tax rate going forward could be, users are not expected to incur implementation cost insofar as the Amendments do not affect previous period financial statements as they relate to a regulation that will only be enacted or substantively enacted from 2023 onwards.
- 12 Overall, EFRAG’s assessment is that implementation of the Amendments will not result in increased costs to users; that is, it is likely to be cost neutral.

Benefits for preparers and users

- 13 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.
- 14 Overall, EFRAG’s assessment is that preparers are likely to benefit from the exception to recognise deferred taxes arising from Pillar Two legislation, as they will have more time to analyse how an entity should account for deferred taxes arising from Pillar Two legislation.
- 15 EFRAG’s assessment is that users are likely to benefit from the Amendments, as the information resulting from it will avoid entities developing diverse interpretations of IAS 12, which could result in the Standard being applied inconsistently. They will also understand an entity’s exposure to paying top-up tax and therefore will enhance their analysis.
- 16 EFRAG’s overall assessment is that the overall benefits of implementing the Amendments are likely to outweigh their costs.

Conclusion

- 17 EFRAG believes that the Amendments will generally bring improved financial reporting when compared to existing requirements. As such, their endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.
- 18 EFRAG has not identified the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.
- 19 Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.
- 20 Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, EFRAG assesses that endorsing the Amendments is conducive to the European public good.