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Closing Out

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Closing Out is a one stop guide for corporate reporting issues to be aware of when approaching year-end and interim reporting. It highlights areas relevant to preparers of annual and interim reports, including:

- Accounting and reporting issues arising from the ongoing uncertain macroeconomic and geopolitical environment including the continuing impacts of climate change, high interest rates and inflation, energy security concerns, cyberattacks, Russia-Ukraine and other international conflicts and tensions.
- Areas of regulatory focus throughout the annual report as highlighted in the Financial Reporting Council's (FRC's) Annual Review of Corporate Reporting 2022/2023 ('the FRC annual review').
- The FRC's thematic reviews on climate-related metrics and targets, fair value measurement and large private companies, and the outputs from recent projects carried out by the FRC Lab.
- New requirements for 31 March 2024 year-ends onwards and an overview of forthcoming developments affecting corporate reporting, including sustainability reporting.

Although this publication discusses financial reporting in terms of IFRS Accounting Standards, it is also relevant to those preparing accounts under FRS 101 and FRS 102. However, there are significant differences between the requirements of IFRS Accounting Standards and FRS 102 in respect of the following areas discussed in this publication: financial instruments, revenue recognition, business combinations and lease accounting by lessees.

Deloitte's full guidance is available on DART, a comprehensive online library of accounting and financial disclosures literature. It provides access to the full IFRS Accounting Standards, IFRS Sustainability Disclosure Standards, EU sustainability reporting requirements and UK accounting standards, linking to and from Deloitte's authoritative, up-to-date manuals which provide related guidance.

This publication is updated periodically to reflect current issues and new developments in corporate reporting.

Last updated: April 2024

Key regulatory expectations for 2023/2024

The Annual Review of Corporate Reporting 2022/2023 ('the FRC annual review') outlines the FRC's top ten findings from its 2022/23 review cycle. In view of these findings and the current economic uncertainty, the FRC expects to see the following for 2023/2024 reporting:

- The strategic report should clearly describe the risks facing the business and explain their impact on the strategy, business model, going concern and longer-term viability.
- For companies in scope, there should be a clear statement of consistency with the TCFD recommendations which explains, unambiguously, whether management considers they have included disclosures that are consistent with the TCFD framework, including consideration of the all-sector guidance (and, where relevant, sector-specific guidance).
- Entities subject to the Climate-related Financial Disclosure Regulations (the CFD Regulations) (see Sustainability reporting) should present certain climate-related information within the annual report and accounts, as required by those regulations, and there is no "comply or explain" option.
- Disclosures about uncertainty should be sufficient for users to understand the positions taken in the financial statements and the potential effect of changes in estimations. In particular, entities should:
  - provide the values of key assumptions and sensitivities, or a range of reasonably possible outcomes, for impairment tests and material sources of estimation uncertainty;
  - describe significant accounting judgements;
  - re-assess disclosures and assumptions each year to ensure they remain relevant and that the range of outcomes used for sensitivity disclosures remains appropriate; and
  - ensure that there is clear linkage and consistency between narrative reporting on uncertainties such as inflation and climate change, and the assumptions made in the financial statements.
- Transparent disclosures should be included regarding the nature and extent of material risks arising from financial instruments. These should include:
  - changes in investing, financing and hedging arrangements;
  - the use of factoring and reverse factoring in working capital financing;
  - the approach to and significant assumptions made in the measurement of expected credit losses; and
  - where material, concentrations of risks and information about covenants.
- Management should ensure that they carry out a critical review of the annual report and accounts as a whole to ensure that it:
  - is clear, concise and understandable;
  - is internally consistent and connected;
  - omits immaterial information; and
  - contains any additional information necessary to understand particular transactions, events or circumstances.
- Management should also ensure that a robust pre-issuance review is carried out to consider issues commonly challenged by the FRC, including presentational matters, such as cash flow and current/non-current classification and whether accounting policies address all significant transactions.

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Applying a materiality mindset

'In order to communicate clearly and compellingly, boards and management have to apply judgement and determine what information is material for reporting. Information is typically understood to be material when omitting, misstating, or obscuring it could be reasonably expected to influence investor decision-making.'

FRC Lab, Materiality in practice: applying a materiality mindset (2023)

In October 2023, the FRC Lab released its report, 'Materiality in practice: applying a materiality mindset', which aims to help boards and management report clearly and in a compelling way on those issues that they consider to be of greatest importance to stakeholders. While some information is always required regardless of materiality by law, regulation or accounting standards, the majority of corporate reporting information is subject to a materiality assessment. Determining what information is important is often subjective. The FRC Lab has developed a toolkit to help entities adopt a materiality mindset when it comes to reporting.

Investor needs and decision-making

The FRC Lab asked investors what questions they ask when making investment decisions; their responses focused on understanding:

- How does this business generate value?
- What is the future strategy?
- What potential risks are there?

In addition, investors were asked how they use and evaluate information in the annual report to make these investment decisions; they use the information to:

- Challenge their own assumptions.
- Understand and assess the board's and management's plans, performance, and stewardship of the entity.
- Evaluate how the entity's performance compares to its peers and competitors.
- Provide an informative comparison to their investment portfolio.
- Build and challenge valuations.

Understanding how investors consider these questions, and how they evaluate and use information, provides a helpful initial step for management and the board when determining what information is material for reporting.

A holistic approach to materiality

Materiality is intrinsically linked to the entity's strategy and business model. The FRC Lab report outlines three perspectives on materiality that entities and their advisers told them they use in practice:

- quantitative financial thresholds: typically a set monetary threshold for correcting errors and including disclosures about significant transactions;
- qualitative financial aspects: generally an informal understanding of 'what's important' that frames narrative reporting; and
- sustainability-related information: a separate assessment of sustainability-related issues, typically collecting multiple stakeholder viewpoints and mapping these on a matrix.

Each perspective is dependent on the other, and while each has a role, the FRC Lab notes that *"Materiality means connecting wider considerations, such as strategy, risks and controls. Looking at just one perspective in isolation can cause companies to miss interdependencies and potentially lead to duplication of effort."* The report provides a step-by-step guide on how to approach materiality more holistically with these three perspectives in mind and leverage existing processes and the right people. The guide also helps management identify any process or operational control gaps to be filled.

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Embedding a materiality mindset

The FRC Lab report includes practical tips for how entities can embed a materiality mindset when thinking about their annual report and accounts. Boards and preparers should reflect on 'how the report works as a package', taking into account the following recommendations:

- Ensure the key messages identified upfront are communicated clearly and consistently in the annual report and other materials, such as investor presentations.
- Assess whether all the information necessary to understand the entity's business model, strategy and future prospects are included.
- Ensure the messaging is balanced, i.e. material information should be presented more prominently.
- Where issues are qualitatively material but quantitatively immaterial, ensure the disclosures are sufficient and balanced.
- Ensure there is connectivity across the narrative disclosures and the financial statements.

For the issues covered in this *Closing Out*, this materiality mindset can help in determining whether information included in the annual report 1) will be decision-useful for investors; 2) is holistically material and takes into account a range of perspectives; and 3) enables the annual report to work as a package.

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Topical issues for 31 March 2024 year-ends and beyond

Macroeconomic uncertainty

Macroeconomic uncertainty and the challenges for corporate reporting

Entities are still grappling with significant uncertainty due to the ongoing uncertain macroeconomic and geopolitical environment, which includes the persistent effects of climate change, higher interest rates and inflation, energy security concerns, cyberattacks, and international conflicts and tensions such as the Russia-Ukraine war. Investors and regulators are expecting entities to be transparent in how they are dealing with this challenging landscape.

Entities therefore need to consider how to assess and address these sources of uncertainty when preparing their annual reports. Whilst entities may by now be familiar with the challenges of reporting in times of uncertainty, timely and high-quality annual reporting that reflects the ongoing uncertainties entities face and their response to those uncertainties remains as important to investors, creditors, and broader stakeholders as ever.

General inflation and interest rates

Higher levels of inflation and market interest rates in many economies affect multiple aspects of financial reporting which depend on the forecasts of future cash flows and present value calculations. While inflation and interest rates are now stabilising or decreasing in some economies, the considerations below may still be applicable as entities continue to be exposed to the associated risks.

In respect of impairment of non-financial assets, IAS 36 *Impairment of Assets* identifies an increase in market interest rates as an indication that an asset may be impaired. This may not always be the case, for example when the increase in market interest rates does not affect the appropriate discount rate for the asset in question (for example, if short-term interest fluctuations would not affect the rate of return demanded of a longer-life asset) or if the entity expects to recover higher interest charges through prices charged to its customers, or the increased rate is too small to raise concerns over the headroom of an asset's recoverable amount over its carrying amount. However, the possibility of an impairment loss should not be overlooked and a general increase in interest rates should lead to a proper consideration of whether a full impairment review is required.

Inflation can have an impact on the measurement of longer-term provisions such as decommissioning obligations. Entities should ensure that the inputs used in measuring provisions follow a consistent approach in incorporating the effects of inflation. Nominal cash flows, which include the effect of inflation, should be discounted at a nominal rate and real cash flows, which exclude the effect of inflation, should be discounted at a real rate.

Inflation and the resulting increase in the cost of living may lead to products becoming less affordable (either because of increased production costs or reduced customer spending power). Write-downs of inventory to net realisable value and recognition of onerous contract provisions in respect of commitments to purchase inventory which cannot then be sold at a profit may be required. Inflation, specifically in salaries, can also be an important actuarial assumption factored in the measurement of defined benefit obligations accounted for under IAS 19 *Employee Benefits*. Where inflation is a major source of estimation uncertainty, an entity should consider the need to disclose the information required by paragraphs 125-133 of IAS 1 *Presentation of Financial Statements*, such as a sensitivity analysis.

Both interest rates and inflation can affect the measurement of lease liabilities and right-of-use assets under IFRS 16 *Leases*. They can also lead to additional exposure to credit losses as borrowers' ability to repay their obligations is reduced, resulting in:

- Increases in expected credit losses to be recognised under IFRS 9 *Financial Instruments*, if it is expected that levels of default might increase due to increases in borrowers' cost of living. Changes in expected credit losses models used by financial institutions or 'management overlays' to supplement those models should be accompanied by disclosures to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows.
- Expected credit losses becoming more significant to entities other than financial institutions if they expect an increase in bad debts as customers struggle to pay outstanding amounts.

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Assumptions used for discount rates and cash flows should be internally consistent within a particular calculation and consistent across calculations performed for different purposes.

The FRC annual review highlights a number of areas where reporting may be affected in particular by higher inflation and interest rates:

- **Strategic report**: consider how resilient the business model is to an inflationary environment, any changes in principal risks and uncertainties and the effect on stakeholders.
- **Pension schemes**: explain clearly the investment strategy and associated risks, consider whether reductions in pension liabilities arising from increased discount rates may lead to recognition of an asset, explain the basis for any such recognition and any related tax impacts.
- **Discount rates**: ensure that a consistent approach is followed, i.e. nominal cash flows (including the effect of inflation) are discounted at a nominal discount rate and real cash flows (excluding the effect of inflation) at a real discount rate.
- **Material assumptions and sensitivities:** where inflation and interest-rate related assumptions, including discount rates, represent a source of significant estimation uncertainty, explain how the assumptions have been calculated. Consider whether sensitivity ranges based on reasonably possible changes to inflation and discount rate assumptions remain appropriate.
- **Inflationary clauses in contracts:** consider whether inflationary features embedded in revenue, supply, leasing and other financing contracts need to be separated and accounted for as derivatives and ensure that appropriate disclosure is given as to the nature of such clauses and how they are accounted for such that a user can understand their potential impact on the financial statements.

Volatility in energy prices

Prompted by volatility in energy prices and actions taken to reduce the effects of climate change, entities are increasingly entering into long-term renewable energy contracts such as *physical power purchase agreements* (PPAs).

Physical PPAs are agreements under which an entity agrees to purchase a specified quantity of electricity generated by a renewable energy generation facility (e.g. a wind or solar farm) at a fixed price over a defined period. The seller, which is typically the owner or operator of the renewable energy generation facility, agrees to deliver the electricity to the buyer's premises or to the grid on the buyer's behalf. Generally, the buyer also receives renewable energy credits (RECs) from the renewable energy generator. The timing/volume of electricity produced from renewable energy sources may be unpredictable, and may require the buyer to sell part of the electricity contracted in the PPA if it is produced at a time when it is not required by the buyer.

Assessing the appropriate accounting for physical PPAs can be complex, including the assessment of whether the PPA is a lease of the generation facility under IFRS 16, and if not, whether the contracts meet the 'own-use' requirements in IFRS 9:2.4 (such that the PPA is accounted for as an executory contract and not as a derivative under IFRS 9). The assessment of how to account for a PPA may require management to make significant judgements, for example when determining whether the frequency or volume of electricity sold by the buyer are such that the own-use requirements are not met. Therefore, the buyer should consider the disclosure requirements in IAS 1:122 regarding the judgements made in the process of applying an entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements. In addition, the buyer should consider disclosing the key terms of the PPAs (e.g. price, duration and volume of electricity contracted) along with the entity's objective for entering into the contracts.

Alternatively, entities may enter into *virtual power purchase agreements* (VPPAs) which are periodically settled net in cash for an amount which reflects the difference between the fixed price in the contract for each unit of electricity generated and the spot market price for electricity at the periodic settlement date. In a typical VPPA, as in a physical PPA, the buyer receives a specified number of RECs.

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Similar to physical PPAs, an assessment is required of whether VPPAs meet the own-use requirements in IFRS 9:2.4. However, in a VPPA, only the RECs are delivered under the contract and as a result the own-use assessment relates only to the RECs. The variable pricing element, linked to the price of electricity, represents a non-closely embedded derivative. If the purchase of RECs meets the own-use requirements and is accounted for as an executory contract, the non-closely related embedded derivative is accounted for separately at fair value through profit or loss (FVTPL). Although, in theory it may be possible to establish a hedging relationship in which the non-closely related embedded derivative is used as a hedging instrument for the highly probable purchase of electricity at spot rate, in practice it is unlikely to be achieved due to the variability in the volume (the notional amount) of the contract.

In June 2023, the IFRS Interpretations Committee discussed a request about applying the own-use requirements to physical delivery contracts to purchase electricity from renewable electricity sources. Following the Committee's recommendation, the IASB is undertaking a narrow-scope standard-setting project on how to apply the own-use requirements to physical power purchase agreements when the electricity:

- cannot be stored economically; and
- is required to either be consumed or sold within a short time, as determined by the market structure in which the electricity is bought and sold.

The IASB is expected to publish an exposure draft of its proposals in Q2 of 2024.

Uncertainty and financial risks disclosures

Interest and inflation risk

Where relevant, entities are expected to explain how changes in the macroeconomic environment affect their financial risks exposures (including the exposure arising from some financial instruments that are not recognised on the statement of financial position, such as certain loan commitments) and how they manage these risks.

For example, entities that are exposed to interest rate risk due to their floating rate financial liabilities need to provide a sensitivity analysis showing how profit or loss and equity would have been affected by reasonably possible changes in interest rates. Entities should ensure that the range of reasonably possible changes in interest rates reflects, where appropriate, the recent volatility in interest rates. It may be appropriate to provide separate sensitivity analysis for different classes of financial instruments.

As required by paragraph 40(c) of IFRS 7 *Financial Instruments: Disclosures*, if an entity changes the methods and / or assumptions used in preparing sensitivity analysis (for example, in response to change in the macroeconomic environment), these changes need to be disclosed along with the reasons for the changes.

Similarly, volatile markets may give rise to increased risk concentration, for example for financial institutions whose borrowers are exposed to refinancing risk (especially in sectors such as commercial real estate). Entities should consider whether additional information should be disclosed in respect of increased risk exposures.

Liquidity risk

To help users understand an entity's liquidity risk, IFRS 7 requires specific tabular disclosure of the contractual maturity of financial liabilities, and importantly requires an explanation of how liquidity risk is managed. As a reminder, IFRS 7:B10 requires that the maturity analysis should reflect undiscounted contractual cash flows and include both principal and interest payments.

Entities that rely on the extended financing terms provided by supplier finance arrangements to manage liquidity risk through the option to pay the financial institution later than it would have paid the supplier(s) should ensure that the impact of these arrangements is properly disclosed (e.g. terms and conditions of the arrangements, impacts on the financial statements). Indeed, if a financial institution were to withdraw the arrangement this could adversely affect the entity's ability to settle liabilities, particularly if the entity were already in financial difficulties. Similar considerations may be relevant in respect of reliance on factoring arrangements (see Supplier Finance Arrangements).

Also, higher inflation and interest rates may affect an entity's ability to comply with covenants included in loan arrangements. When this is the case, an entity should consider providing relevant disclosure about such covenants and the impact of potential breaches.

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Uncertainty and fair value measurement and disclosure
In the current macroeconomic situation, fair values may be subject to an increased level of uncertainty. Changes in fair value may have a material impact on an entity's financial position and performance – for example, when investment properties are accounted for applying the fair value model or when the recoverable amount of cash generating units (CGUs) for the purposes of performing impairment tests applying IAS 36 is based on fair value less costs of disposal. It is important that fair value measurements and disclosures reflect the current macroeconomic conditions. This may require changes to the methods or assumptions previously used.

For example, an entity that previously determined the fair value of its investment properties based on comparable transactions may find itself with limited relevant data due to a decline in activity in the real estate market. As a result, the entity may need to apply additional valuation methods to ascertain that the fair values estimated using the comparable transactions approach are within a reasonable range of values in the circumstances. The entity would also need to consider the requirements in paragraph 91 of IFRS 13 *Fair Value Measurement* to describe any significant changes in valuation measurements (such as changes in valuation techniques and transfers between levels in the fair value hierarchy) and the reasons for those changes. In addition, entities will need to ensure that their disclosures comply with the disclosure objectives in IFRS 13, paying attention to the disclosure of all key inputs such as capitalisation rate and/or rate of return.

It is worth remembering that the disclosure requirements in IFRS 13 extend to fair value measurements performed for disclosure purposes only. For example, IFRS 7:25 requires an entity to disclose the fair value of financial assets and financial liabilities measured at amortised cost (except when their carrying amount is a reasonable approximation of fair value). The disclosures required by IFRS 13 include the level of the fair value hierarchy and a description of the valuation techniques and the inputs for fair value measurement of financial instruments within level 2 and 3 of the fair value hierarchy. As indicated above, a description should be provided of significant changes in the fair value measurement techniques and the reasons thereof. In addition, in the higher interest rate environment, the conclusion that the carrying amount of a financial instrument (especially fixed rate debt instruments) approximates its fair value may no longer be appropriate.

Fair value measurement returned to the FRC's top ten findings during its 2022/23 monitoring cycle and has been the subject of a thematic review in 2023. Details of the FRC's findings and the thematic review are included in the Fair value measurement section of this publication.

Uncertainty and IFRS 9

Expected credit losses
Applying IFRS 9, expected credit losses (ECL) reflect a current probability weighted calculation of cash shortfalls arising on debt instruments, lease receivables, contract assets, written loan commitments and financial guarantees. The estimation of ECL should consider the impact of the current economic environment on a borrower's ability to repay, specifically the impact arising from inflation, higher interest rates, lower corporate profitability and reduced household incomes. The general widening of credit spreads will lead to an increased likelihood of exposures moving from 12 months to lifetime ECL. This reflects the fact that the current uncertain macroeconomic and geopolitical environment may have given rise to a significant increase in credit risk relative to the credit risk that existed when the exposure was first recognised. This may be more concentrated for exposures to certain sectors and geographies reflecting the disproportionate burden inflation and interest rates may have on those groups compared with others.

Hedge accounting
When a transaction has been designated as the hedged item in a cash flow hedge relationship, the entity will need to consider whether the transaction is still a "highly probable forecasted transaction" and if not, whether it is still expected to occur. Because of that, the current economic environment may affect an entity's ability to apply hedge accounting – for example, when an entity uses interest rate swaps to hedge future debt issuances that are no longer expected to occur as a result of an increase in interest rates.

If an entity determines that a forecasted transaction is no longer highly probable, but still expected to occur, the entity must discontinue hedge accounting prospectively. Gains and losses previously recognised in other comprehensive income are retained in the cash flow hedge reserve until the forecasted transaction occurs. If the forecasted transaction is no longer expected to occur the entity must immediately reclassify to profit or loss any accumulated gain or loss recognised in the cash flow hedge reserve in respect of the hedging instrument.

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In addition, increases in credit risk may cause a hedge relationship to fail the hedge effectiveness assessment if credit risk dominates the value changes resulting from the economic relationship between the hedging instrument and the hedged item. As such, entities need to assess, for example, whether an increased risk of counterparty default because of the current environment should lead to a discontinuation of hedge accounting.

Where relevant, entities may need to consider providing detailed disclosures on the effectiveness of hedging relationships during, and at the end of, the reporting period, and information on discontinued hedging relationships.

Reporting on financial instruments, including in relation to ECL and hedging arrangements, appeared as one of the FRC's top ten findings in its 2022/23 review. Further details of its findings and expectations are included in the Financial instruments section of this publication.

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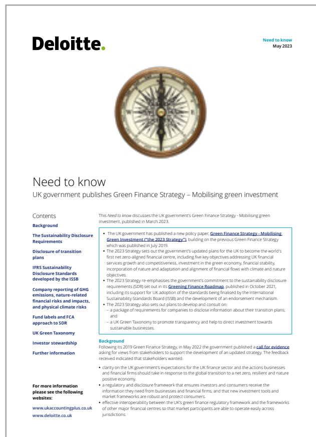
FRC focus area



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Need to know
May 2023

Need to know
UK government publishes Green Finance Strategy – Mobilising green investment

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Background
The Sustainability Disclosure Requirements
Disclosure of transition plans
IFRS Sustainability Disclosure Standards developed by the ISSB
Company reporting of GHG emissions, nature-related financial risks and impacts, and physical climate risks
Fund labels and FCA approach to SDR
UK Green Taxonomy
Investor stewardship
Further information

For more information please see the following websites:
www.ukaccountingplus.co.uk
www.deloitte.co.uk

This *Need to know* discusses the UK government's Green Finance Strategy - Mobilising green investment, published in March 2023.

- The UK government has published a new policy paper, Green Finance Strategy - Mobilising Green Investment ("the 2023 Strategy"), building on the previous Green Finance Strategy which was published in July 2019.
- The 2023 Strategy sets out the government's updated plans for the UK to become the world's first net zero-aligned financial centre, including five key objectives addressing UK financial services growth and competitiveness, investment in the green economy, financial stability, incorporation of nature and adaptation and alignment of financial flows with climate and nature objectives.
- The 2023 Strategy re-emphasises the government's commitment to the sustainability disclosure requirements (SDR) set out in its Greening Finance Roadmap, published in October 2021, including its support for UK adoption of the standards being finalised by the International Sustainability Standards Board (ISSB) and the development of an endorsement mechanism.
- The 2023 Strategy also sets out plans to develop and consult on:
  – a package of requirements for companies to disclose information about their transition plans; and
  – a UK Green Taxonomy to promote transparency and help to direct investment towards sustainable businesses.

Background

Following its 2019 Green Finance Strategy, in May 2022 the government published a call for evidence asking for views from stakeholders to support the development of an updated strategy. The feedback received indicated that stakeholders wanted:

- clarity on the UK government's expectations for the UK finance sector and the actions businesses and financial firms should take in response to the global transition to a net zero, resilient and nature positive economy.
- a regulatory and disclosure framework that ensures investors and consumers receive the information they need from businesses and financial firms, and that new investment tools and market frameworks are robust and protect consumers.
- effective interoperability between the UK's green finance regulatory framework and the frameworks of other major financial centres so that market participants are able to operate easily across jurisdictions.

A Deloitte Need to Know: UK government publishes Green Finance Strategy discusses the government's proposals and commitments in relation to the SDR.

Sustainability reporting

Reporting requirements for sustainability- and climate-related matters continue to develop at pace. Many UK listed companies have been required to report on their consistency with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations for some time now (see TCFD reporting in the UK), with a wider set of companies and LLPs required to report on climate-related governance, strategy, risk management and metrics and targets under the Climate-related Financial Disclosure (CFD) Regulations for the first time in 2023 (see Climate-related Financial Disclosure Regulations). In June 2023, the International Sustainability Standards Board (ISSB) published its first two standards: IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures* ("the ISSB standards"), and in its 2023 Green Finance Strategy, the UK government reaffirmed its intention to adopt these standards for use in the UK, a process which is currently ongoing (see ISSB adoption in the UK). In addition, the UK Transition Plan Taskforce (TPT) has published a framework for developing and reporting on transition plans and the UK government intends to launch consultations on mandatory application of this framework and the development of a UK Green Taxonomy in due course.

These plans all form part of the UK government's Sustainability Disclosure Requirements (SDR), which were first introduced in its October 2021 policy paper Greening Finance: A Roadmap to Sustainable Investing ("the Roadmap") and are intended to create a streamlined disclosure framework bringing together new and existing sustainability reporting disclosure requirements for UK businesses, the financial sector and investment products.

In 2023, the UK government issued a call for evidence seeking views on the non-financial reporting requirements applicable to UK entities, with a view to a) simplifying and streamlining the sustainability and non-financial reporting regime in place in the UK while b) considering the best way to integrate the ISSB standards, and any additional sustainability-related reporting initiatives such as the TPT framework, into the UK's sustainability reporting regime. The government has published a summary of responses to its non-financial reporting review call for evidence, and also an impact assessment which sets out the first stage of planned measures to reform the UK non-financial reporting framework (see Other narrative reporting requirements).

Meanwhile, European Sustainability Reporting Standards (ESRSs) are taking effect as early as 1 January 2024 for many businesses based both in and outside of the EU under the Corporate Sustainability Reporting Directive (CSRD) (see Europe), and in the US, two state senate bills have been signed into law in California requiring climate-related disclosures for certain public and private US entities doing business in California from 2026, and a new climate-related rule has been published for SEC registrants (see USA). Looking at sustainability matters more broadly, the Taskforce on Nature-related Financial Disclosures (TNFD) has published its framework (see Worldwide) and the ISSB consulted in 2023 on its agenda for the next two years to assess whether it should address other sustainability topics and, if so, which ones it should focus on.

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Climate-related financial disclosures

Regulatory expectations on climate reporting across the annual report

The FRC and FCA expect businesses to consider climate-related matters and their effects when providing a balanced and comprehensive analysis of their position and performance, together with a description of the principal risks and uncertainties that they face. The FRC annual review reiterates that disclosures about climate change in the narrative and sustainability reporting should be consistently reflected in entities' financial statements. Entities should also bear in mind the five key themes from the FRC's 2022 thematic review of TCFD disclosures and climate in the financial statements, which are equally relevant to those reporting under the CFD Regulations:

- **Granularity and specificity:** information about climate change should adequately explain the potential impact on different businesses, sectors and geographies. The FRC noted its expectation that the specificity and granularity of entities' climate-related disclosures will improve as their processes to manage climate related risks and opportunities become increasingly embedded into governance and management structures. It also noted that the link with financial planning should be clear and quantified.
- **Balance:** entities should ensure that the discussion of climate-related risks and opportunities is balanced. In particular, discussions on the opportunities arising from climate change and the transition to a low carbon economy should specify the expected size of the opportunity relative to existing, more carbon-intensive businesses, and linked to any dependencies on new or future technology. Balance is also necessary in describing the probabilities and dependencies of risks and opportunities. For example, the loss of current, carbon-intensive, income streams might be an inevitable function of decarbonisation whilst replacement income streams might currently be dependent on nascent or developing technologies. Disclosure of these dependencies is important to avoid giving the impression that transition risks will naturally be balanced out by opportunities in a lower carbon economy.
- **Interlinkage with other narrative disclosures:** the FRC observed that in many cases the TCFD disclosures were not integrated with other elements of the narrative reporting and it recommends that entities consider the effects of climate-related scenario analysis on, for example, the entity's business model, strategy and viability statement, or that they explain how climate-related risks have been assessed and prioritised compared to other risks.
- **Materiality:** entities should ensure that they explain how they have applied materiality to their TCFD disclosures, being clear on how they have taken into account Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (which includes the Guidance for All Sectors and Supplemental Guidance for Financial and Non-Financial Groups) (the "all-sector guidance") and other documents referenced in the Listing Rules when determining whether their disclosures are consistent with the TCFD recommendations. Where a disclosure is omitted, it should be clear whether this is because it is considered immaterial. The FRC has indicated that it may challenge companies claiming consistency with a recommended disclosure where it is not clear that all relevant and material elements of the recommended TCFD disclosures – including the all-sector guidance and, where appropriate, the relevant supplemental guidance - have been addressed.

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- **Connectivity between TCFD and the financial statements:** the degree of emphasis placed on climate change risks and uncertainties in the narrative reporting should be consistent with the extent of disclosure about how those uncertainties have been reflected in judgements and estimates applied in the financial statements. The FRC confirmed that it may challenge entities disclosing significant climate risks or net zero transition plans in narrative reporting, but without an appropriate explanation as to how this has been taken into account when preparing their financial statements. Entities should also consider explaining whether:
  - assumptions and sensitivities considered in TCFD scenarios, including any Paris-aligned scenarios, are consistent with those applied in the financial statements or explain any differences;
  - the effects of any emissions reduction commitments and strategies have been appropriately reflected in the financial statements;
  - the scale of growth of businesses and extent of progress against climate-related opportunities discussed in the narrative reporting is reflected in the segmental disclosures; and
  - discussion of matters which may have an adverse effect on asset values or useful lives in the narrative reporting is consistent with related disclosures in the financial statements.
- **Governance:** entities should provide specific information on the oversight of climate-related matters, such as consideration of climate-related performance objectives and the effect of climate on decisions about major capital expenditure, acquisitions, and disposals. Entities should also consider disclosing how climate-related risks are controlled and how climate-related metrics affect remuneration policies.
- **Strategy:** information on strategy should be granular and the level of detail included in scenario analyses should be consistent, including quantitative measures. Entities' discussions of risks and opportunities should not be disproportionately weighted towards opportunities. Where climate-related risks and opportunities are discussed, it is important to quantify the potential impact of each to the extent possible rather than only using qualitative descriptors such as 'high' or 'low'. This is particularly important in indicating the extent to which the impact of climate opportunities might, or might not, outweigh those of risks.
- **Risk management:** climate-related matters should be integrated into overall risk management processes. Particularly, processes for assessing the priority and materiality of climate-related risks should be well explained. To the extent possible, the potential impact of climate-related risks and opportunity should be quantified rather than only described using terms such as 'high' or 'low'. This is particularly important in indicating the extent to which the impact of climate-related opportunities might, or might not, outweigh those of risks.
- **Metrics and targets:** metrics should not only focus on Scope 1 and 2 greenhouse gas (GHG) emissions but also include other climate-related risk and opportunity metrics. Historical data and explanations of movements should be provided to support the reader's understanding of progress against targets (see Metrics and Targets for further considerations).
- **Assurance:** Entities should clearly explain the level of any assurance given and what it covered. Terms such as 'verified' should be avoided as it may imply a higher level of assurance than has actually been obtained.

TCFD reporting in the UK

Since 2021, premium-listed commercial companies have been required by the Listing Rules (LR 9.8.6R(8)) to make climate-related financial disclosures consistent with the recommendations and recommended disclosures of the Task Force on Climate-related Financial Disclosures (TCFD), on a 'comply or explain' basis. This requirement was extended via LR 14.3.27R to companies with a standard listing of shares or Global Depositary Receipts (GDRs) representing equity shares, for periods beginning on or after 1 January 2022.

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Companies in scope of the Listing Rules must include a clearly identifiable statement in their annual report setting out whether they have made disclosures consistent with the TCFD's recommendations and recommended disclosures. Where those disclosures are included in a document other than the annual report, the statement must identify which disclosures are located elsewhere and explain why. If companies have not made disclosures consistent with all relevant TCFD's recommendations and recommended disclosures in either the annual report or another document, they must disclose this fact, explain the reasons, and outline any steps being taken to ensure the disclosures are made in future periods, and the expected timeline for doing so.

In its annual review, the FRC considered premium listed companies' TCFD-aligned disclosures against the requirements of the Listing Rules. In keeping with its planned regulatory approach, the majority of points raised with companies related to ways to improve disclosures in their next annual report, and referring companies to the expectations set out in its 2022 thematic review. For a small number of companies, the FRC raised substantive queries regarding the clarity of the required statement of consistency with the TCFD framework. Other points raised related to:

- lack of clarity with regards to the description of governance processes;
- lack of clarity with regards to descriptions of risks and opportunities, particularly the expected timeframes and finance/transition plans;
- improvements needed in risk management disclosures; and
- missing or unclear information provided in relation to metrics and targets.

The FRC expects companies to provide a clear statement of consistency with TCFD, when required by the Listing Rules. This statement should explain unambiguously whether management considers they have given sufficient information to comply with the framework in the current year.

The FRC has also noted that it is more likely to enter into substantive correspondence with entities that do not meet the expectations set out in both its 2022 thematic review on TCFD disclosures and climate in the financial statements and its 2023 thematic review on climate-related metrics and targets. This will particularly be the case when climate is considered significant to the entity, and it does not provide the recommended disclosures that are 'particularly expected' by the Listing Rules. These include those relating to governance, risk management, and certain disclosures relating to strategy to the extent that the entity does not face transitional challenges in obtaining relevant data or embedding relevant modelling or analytical capabilities.

Many companies in the scope of TCFD disclosures under the Listing Rules will also be in scope of the CFD Regulations and therefore need to ensure that their disclosures comply with those requirements as well (see Climate-related Financial Disclosure Regulations).

Metrics and targets

In July 2023, the FRC published a thematic review of climate-related metrics and targets having identified areas for improvements in its correspondence with 75 entities about TCFD and climate-related disclosure during 2022-23 especially in relation to metrics and targets.

Clarity of reporting

When determining the location and format of disclosures, entities should consider whether reporting is clear and concise, to ensure key messages are not obscured, and to use specific cross references to relevant information reported elsewhere.

The FRC's expectations include:

- Considering how to ensure reporting is clear and concise, using the '4Cs' of effective communication:

1. Company specific
2. Clear, concise and understandable
3. Clutter free and relevant
4. Comparable

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- Presenting targets in a way that allows them to be easily understood, e.g. with the use of tables or graphics to help communicate complex information such as metrics and targets.
- Ensuring linkage between risks and opportunities and the metrics used to measure, monitor or manage them is clear.
- Considering the connectivity across disclosures to ensure coherent messaging.
- Considering whether additional disaggregation of metrics and targets would aid the understandability of risks and opportunities for different business lines.
- Ensuring that where metrics are reported in more than one place, any inconsistencies are explained.

Statement of consistency
The FRC expects companies to provide a clear statement of the extent of consistency with TCFD in the annual report, including all information required by the Listing Rules. The FRC highlights that good practice examples set out clearly the process undertaken to determine what information to include.

Companies are also expected to consider the impact on the company's statement of consistency with TCFD when Scope 3 emissions are material but not reported.

Data challenges
The FRC expects entities to provide clear explanations of metrics and targets reported, including, where relevant, any data limitations, methodologies, reporting boundaries and any changes to data.

Entities should aim to be transparent in their disclosures and explain the actions they are taking to develop the extent and reliability of the data collected for climate-related reporting, including that outside of their direct control.

The FRC encourages entities to disclose challenges in data collection, especially difficulties in relation to the identification, collection and reporting of Scope 3 GHG emissions. Where assumptions have been applied, details should be provided outlining the limitations of the reliability of any data, and the extent of any assurance acquired.

Transition plans
The FRC expects entities to consider the TCFD guidance, including relevant supplemental guidance on Metrics, Targets and Transition plans as included in the list of relevant documents in the Listing Rules, when reporting on targets and the plans to meet them. It also encourages entities to consider the Transition Plan Taskforce disclosure framework (see UK developments) when preparing disclosures explaining their targets and transition plans.

Climate-related targets
In relation to any climate-related targets, the FRC expects entities to:

- clearly explain what 'net zero' or 'carbon neutrality' terms mean in the context of the entity, ensuring that disclosures about such commitments are not misleading;
- clearly explain whether net zero targets or commitments include Scope 3 emissions;
- provide explanations of targets, including relevant information such as the time period, reporting boundaries, the emissions scopes covered, and any metrics used to measure them;
- explain areas of significant challenges or uncertainties, such as new technology, required to meet targets;
- ensure that linkages between targets are explained if a number of targets need to be met in order to achieve an overall objective;
- explain whether carbon offsetting represents a significant part of an entity's strategy to reach net zero; and
- provide comparative information alongside current reporting to enable performance against the target to be assessed. If any updates are made to targets, such as restatements or updates to baselines, these should be disclosed and explained.

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Greenwashing

The FRC is committed to enforcing transparent disclosures of entities' plans to address climate-related risk and opportunities. It has stated that it will challenge entities where they consider reporting of climate-related metrics or targets to be unclear or potentially misleading, and will refer any false or misleading claims including the omission of material facts to the FCA where they breach FCA rules.

The FRC highlights key areas for entities to focus on when reporting on metrics and targets:

- **Ensure overall clarity and balance:** e.g. the balance between risks and opportunities, and not obscuring key messages through volume.
- **Avoid undue focus on immaterial areas:** e.g. focus on immaterial "green" business areas over material carbon intensive ones.
- **Avoid terminology implying greater environmental benefit:** e.g. saying something is sustainable or carbon positive without explanation.
- **Avoid misleading presentation and comparison:** e.g. inappropriate metric comparisons to imply a greater level of performance.
- **Provide clear scope and boundaries of metrics and targets including exclusions:** e.g. highlighting where higher emitting parts of the business are not covered by a target.
- **Explain the methodology, purpose and scope of any "avoided emissions" or similar metrics:** ensuring that comparisons are appropriate and the relationship to the entity's emissions is explained.
- **Explain areas of uncertainty that could impact achievement of targets:** e.g. future plans dependent on technological advances.

Climate-related metrics

In relation to any climate-related metrics that entities report, the FRC expects entities to:

- report material cross-sector climate-related metrics and keep relevant standard industry metrics under review;
- ensure that any linkage between risks and opportunities and metrics used to measure, monitor or manage them is clear, and also explain which metrics are used to track net zero progress;
- consider whether additional disaggregation of metrics and targets by business line or geography would aid understandability;
- provide definitions and methodologies for entity-specific metrics; and
- state and explain the reporting period for the metric if different to the financial statements.

Assurance

Entities should clearly and accurately explain the level and scope of any external assurance given, ensuring the terminology used to describe the assurance does not imply a higher level of assurance than has been obtained.

Directors' remuneration

Entities should clearly describe climate-related targets and actual achievements against them as part of the directors' remuneration report, in a manner consistent with the TCFD disclosures.

- The FRC also encourages entities to be transparent about the structure of their bonuses and awards. This allows a better understanding of the link to the entity's strategy and future priorities.

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Impacts of targets on the financial statements
The FRC expects entities to:

- consider the impact of climate-related targets and transition plans on the financial statements, taking into account the IASB's educational material;
- provide an appropriate level of disclosure, including any significant judgements or assumptions that have been made in reaching their assessment, when there is a reasonable expectation that the climate-related targets and transition plans could impact the financial statements;
- avoid boilerplate wording such as 'climate has been incorporated into our impairment review assumptions' which provide limited insight without describing the relevant assumptions, uncertainties and the position taken; and

consider explaining why certain targets do not have a material impact where investors may reasonably expect them to do so.

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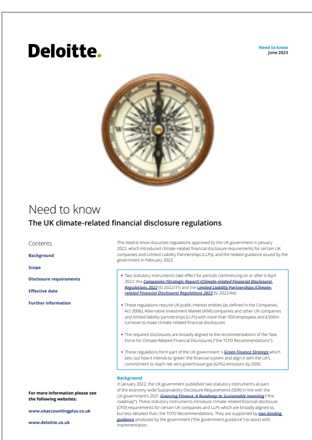

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Need to know
June 2023

Need to know

The UK climate-related financial disclosure regulations

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Background

Scope

Disclosure requirements

Effective date

Further information

This *Need to know* discusses regulations approved by the UK government in January 2022, which introduced climate-related financial disclosure requirements for certain UK companies and Limited Liability Partnerships (LLPs), and the related guidance issued by the government in February 2022.

- Two statutory instruments take effect for periods commencing on or after 6 April 2022: the ***Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022*** (SI 2022/31) and the ***Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022*** (SI 2022/46).
- These regulations require UK public interest entities (as defined in the Companies Act 2006), Alternative Investment Market (AIM) companies and other UK companies and limited liability partnerships (LLPs) with more than 500 employees and £500m turnover to make climate-related financial disclosures.
- The required disclosures are broadly aligned to the recommendations of the Task Force for Climate-Related Financial Disclosures ("the TCFD Recommendations").
- These regulations form part of the UK government`s ***Green Finance Strategy*** which sets out how it intends to 'green' the financial system and align it with the UK's commitment to reach net zero greenhouse gas (GHG) emissions by 2050.

Background

In January 2022, the UK government published two statutory instruments as part of the economy-wide Sustainability Disclosure Requirements (SDR) in line with the UK government's 2021 ***Greening Finance: A Roadmap to Sustainable Investing*** ("the roadmap"). These statutory instruments introduce climate-related financial disclosure (CFD) requirements for certain UK companies and LLPs which are broadly aligned to, but less detailed than, the TCFD Recommendations. They are supported by ***non-binding guidance*** produced by the government ("the government guidance") to assist with implementation.

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

A Deloitte Need to Know: The UK climate-related financial disclosure regulations discusses the scope of the CFD Regulations and availability of exemptions in more detail including guidance from the government's FAQs.

Climate-related Financial Disclosure Regulations

Certain UK companies and LLPs are in scope of the Climate-Related Financial Disclosure (CFD) Regulations which took effect for periods commencing on or after 6 April 2022 and therefore affect entities with a 31 March year-end for the first time in 2024 and beyond.

The following entities are in scope of the CFD Regulations:

- All UK companies that are already required to produce a non-financial information statement (i.e. UK public interest entities (PIEs)), being UK companies that have more than 500 employees and:
  - have transferable securities (whether debt or equity) admitted to trading on a UK regulated market;
  - are banking companies; or
  - are insurance companies.
- UK companies with securities admitted to the Alternative Investment Market (AIM) with more than 500 employees.
- UK companies which are not included in the categories above, which have more than 500 employees and a turnover of more than £500m.
- Traded and banking LLPs with more than 500 employees.
- LLPs which have more than 500 employees and a turnover of more than £500m.

Where the entity is a parent, it should consider the size of itself and all of its subsidiaries when assessing whether it meets the turnover and employee criteria. Exemptions exist for subsidiary companies and LLPs included in consolidated information, but the application of these is complex and not always intuitive.

The CFD Regulations include eight disclosure requirements:

a) a description of the entity's governance arrangements in relation to assessing and managing climate-related risks and opportunities;

b) a description of how the entity identifies, assesses, and manages climate-related risks and opportunities;

c) a description of how processes for identifying, assessing, and managing climate-related risks are integrated into the entity's overall risk management process;

d) a description of:

  i. the principal climate-related risks and opportunities arising in connection with the entity's operations, and

  ii. the time periods by reference to which those risks and opportunities are assessed;

e) a description of the actual and potential impacts of the principal climate-related risks and opportunities on the entity's business model and strategy;

f) an analysis of the resilience of the entity's business model and strategy, taking into consideration different climate-related scenarios;

g) a description of the targets used by the entity to manage climate-related risks and to realise climate-related opportunities and of performance against those targets; and

h) a description of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and of the calculations on which those key performance indicators are based.

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These disclosure requirements are based on those set out in the TCFD recommendations and can be categorised under governance, risk management, strategy and metrics and targets. The first four requirements a)-d) are always required, while the latter four e)-h) do not need to be disclosed if not necessary for an understanding of the entity's business. However, the reason for any such omissions must be explained.

Companies are required to report this information in a clearly identifiable non-financial and sustainability information (NFSI) statement within the strategic report. This was previously called the non-financial information (NFI) statement and was only required by UK PIEs. Companies newly required to prepare an NFSI statement in accordance with the CFD Regulations are only required to include the climate-related financial disclosures set out above in that statement. PIEs will need to rename the NFI statement to the NFSI statement, and include the disclosures required by the CFD Regulations as well as the existing disclosures that they were previously required to make in the NFI statement.

LLPs are required to report the information in the energy and carbon report, except for traded and banking LLPs, which need to include it in the strategic report.

The UK government has issued a set of non-binding FAQs to help with application of the CFD requirements and to set out its expectations as to what should be disclosed. It also encourages in-scope entities to review the FRC's Guidance on the Strategic Report when considering how best to integrate the CFD information with other disclosures in the strategic report. The government FAQs also highlight that the climate-related financial disclosures should be consistent with the disclosures in the financial statements. For instance, estimates, assumptions and judgements used in preparing the financial statements are expected to be consistent with the estimates, assumptions and judgements used in the climate-related financial disclosures.

Interaction between the TCFD Listing Rules and the CFD Regulations

Many companies with a premium or standard listing of shares on the London Stock Exchange will find themselves subject to both the requirements under the CFD Regulations and the TCFD disclosures set out in the Listing Rules. The government FAQs confirm that for companies subject to both sets of requirements, disclosure in a manner consistent with all of the TCFD recommendations and recommended disclosures should meet the requirements of the CFD Regulations as well.

However, while the Listing Rules permit the TCFD disclosures to be presented in a separate document outside the annual report, this is not permitted by the CFD Regulations. Therefore, the annual report itself needs to contain sufficient disclosure to meet the CFD requirements.

Companies subject to both sets of requirements may find themselves explaining some inconsistencies with the TCFD recommendations yet still meeting the requirements of the CFD Regulations. This may be because of the increased level of detail expected TCFD disclosures under the Listing Rules, which require companies to have regard to the all-sector guidance when assessing consistency with the TCFD recommendations. However, as the CFD Regulations do not permit a "comply or explain" approach, companies explaining inconsistencies in their TCFD statement of consistency should evaluate their disclosures carefully to determine whether sufficient information is included in the annual report to meet the requirements under the CFD Regulations.

Although there is no requirement to state compliance with the CFD Regulations, it may be helpful if the statement of consistency with TCFD also confirms whether a company has complied with the CFD Regulations, particularly where inconsistencies with TCFD are explained.

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Climate-related risks in the financial statements

For some time regulators have been urging entities to pay particular attention to climate-related matters and their effects when providing a balanced and comprehensive analysis of the development and performance of the entity's operations and financial position together with a description of the principal risks and uncertainties that it faces (for example, climate-related matters are a repeated feature of the FRC's key disclosure expectations and the ESMA common enforcement priorities).

Achieving connectivity between information in the financial statements and information provided elsewhere in the annual report helps entities provide a comprehensive and integrated view of their financial performance and financial position. In the context of climate-related matters, connectivity helps users of the financial statements understand better an entity's risks and opportunities arising from climate change. It also assists entities reduce the risk of perceived greenwashing.

ESMA published in October 2023 a report titled *The Heat is On: Disclosures of Climate-Related Matters in the Financial Statements*. The report outlines four high level principles used to identify connectivity within the annual financial report:

1. *Consistency and coherence:* Do assumptions appear consistent within and across the different components of the annual financial report?
2. *Complementarity:* Is there complementarity between the information included in the non-financial section of the annual financial report and the financial statements?
3. *Cross-referencing:* Are there links within and across the different components of the annual financial report?
4. *Avoidance of repetition:* Is the information specific and useful to an understanding of the financial statements or is it merely repeating the contents of the non-financial section of the annual financial report?

The ESMA report also presents an enforcers' view of how entities may provide more relevant and transparent information in relation to climate-related matters in financial statements. In particular, the report provides a collection of examples of climate-related disclosures that are consistent with ESMA common enforcement priorities. Whilst the report is targeted towards European issuers, the themes addressed are consistent with the FRC's expectations and will be of interest to UK companies.

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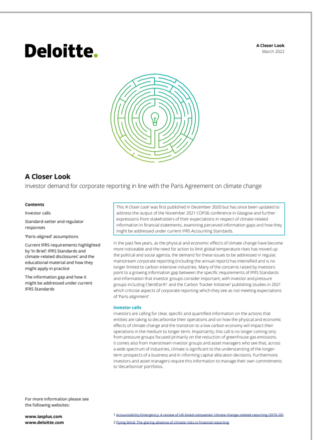

A Deloitte [A Closer Look] discusses investor demand for corporate reporting in line with the Paris Agreement on climate change.

Consistency of information

Entities should consider whether the degree of emphasis placed on climate-related matters elsewhere in the annual report is consistent with how climate-related matters have been reflected in the judgements and estimates applied in the financial statements. Forecasts used for financial reporting purposes should reflect the entity's strategic plans and planned actions at the reporting date and should be based on best estimates at the reporting date (for example, when short- or medium-term actions are necessary to meet a stated longer-term decarbonisation commitment reflected in the annual report). Particular focus should be placed on climate-related commitments and targets, such as the reduction of greenhouse gas emissions and decarbonisation plans. Where relevant, an entity should disclose in its financial statements the timing and the financial impacts of planned investments and transition plans. If the discussion of an entity's climate-related plans includes both short-term commitments and longer-term plans and aspirations, it is important that these are distinguished from each other, and that there is clarity regarding which firm commitments are incorporated into the entity's budgets and accounting assumptions.

If climate-related matters are material, it is expected that they are considered in the preparation of financial statements, even if IFRS Accounting Standards do not explicitly refer to those matters. It cannot be assumed that investors or regulators will be satisfied with boilerplate disclosures stating that climate-related matters have been considered (for instance, in impairment tests) without further explanation as to how and to what extent they affect (or do not affect) financial statements. For example, investors want to understand whether an entity's forecasts used for financial reporting are aligned with the goals of the Paris Agreement. There are multiple possible scenarios and ranges of possible outcomes under different climate change trajectories. It is important for entities to be clear about the assumptions used and to make greater use of sensitivity analyses.

Where applicable, entities should explain any deviations between the assumptions used in impairment tests (including sensitivity analysis) or provisions recognised (or not) and their climate-related commitments, plans and/or strategy. For example, such a deviation may arise when the climate-related commitment of the entity does not give rise to a constructive obligation applying IAS 37 *Provision, Contingent Liabilities and Contingent Assets* such that no related provision has been recognised.

Impairment of non-financial assets

Exposure to climate-related risks (physical or transition risks) could be an indication of impairment or could affect the estimated cash flows used in determining the recoverable amount of an asset or group of assets. The effect of climate-related risks on either forecast cash flows or discount rates can also be a key assumption requiring disclosure under IAS 36, in which case an explanation of the key assumption and its forecast effects on the entity's future cash flows should be provided.

For example, when an input used in performing an impairment test is linked to climate-related matters and is identified as a key assumption, entities need to consider the disclosure of the quantified assumption used (e.g. carbon pricing, including the entity's anticipated ability to recover carbon costs through pricing of its output, or timing and amount of the replacement of certain assets) and the basis or source of such quantifications (noting that greater weight should be given to external evidence).

Similarly, disclosure may be required when climate-related matters impact the business plan assumptions used to estimate the recoverable amount of assets, the period considered beyond the business plan and the financial assumptions used (such as the discount rate and the growth rate).

Further, IAS 36 requires that the value in use of a CGU includes the cash outflows necessary to maintain the current level of benefits expected to arise from the assets of the CGU but excludes those relating to the enhancement of assets. In some cases, distinguishing between the two (for example, as part of a decarbonisation plan) may not be straightforward and may represent a key assumption that should be disclosed.

Other areas of the financial statements

Entities may also need to consider the following specific topics when assessing the impact of climate-related matters on their financial statements:

- If an entity has concluded that climate-related matters are not expected to have a material financial impact on its operations and/or in the measurement of its assets and liabilities, regulators expect the entity, in particular if it operates in a highly-exposed sector, to disclose the assessments performed, judgements made and the time horizon used to reach such a conclusion. The disclosures should be tailored to the specific circumstances of individual entities.

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A Closer Look
March 2022

A Closer Look

Investor demand for corporate reporting in line with the Paris Agreement on climate change

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Standard-setter and regulator responses

'Paris-aligned' assumptions

Current IFRS requirements highlighted by 'In Brief: IFRS Standards and climate-related disclosures' and the educational material and how they might apply in practice

The information gap and how it might be addressed under current IFRS Standards

This *'A Closer Look'* was first published in December 2020 but has since been updated to address the output of the November 2021 COP26 conference in Glasgow and further expressions from stakeholders of their expectations in respect of climate-related information in financial statements, examining perceived information gaps and how they might be addressed under current IFRS Accounting Standards.

In the past few years, as the physical and economic effects of climate change have become more noticeable and the need for action to limit global temperature rises has moved up the political and social agenda, the demand for these issues to be addressed in regular, mainstream corporate reporting (including the annual report) has intensified and is no longer limited to carbon-intensive industries. Many of the concerns raised by investors point to a growing information gap between the specific requirements of IFRS Standards and information that investor groups consider important, with investor and pressure groups including ClientEarth[1] and the Carbon Tracker Initiative[2] publishing studies in 2021 which criticise aspects of corporate reporting which they see as not meeting expectations of 'Paris-alignment'.

Investor calls

Investors are calling for clear, specific and quantified information on the actions that entities are taking to decarbonise their operations and on how the physical and economic effects of climate change and the transition to a low carbon economy will impact their operations in the medium to longer term. Importantly, this call is no longer coming only from pressure groups focused primarily on the reduction of greenhouse gas emissions. It comes also from mainstream investor groups and asset managers who see that, across a wide spectrum of industries, climate is significant to the understanding of the longer-term prospects of a business and in informing capital allocation decisions. Furthermore, investors and asset managers require this information to manage their own commitments to 'decarbonise' portfolios.

For more information please see the following websites:

www.iasplus.com
www.deloitte.com

1 Accountability Emergency: A review of UK-listed companies' climate change-related reporting (2019-20)

2 Flying blind: The glaring absence of climate risks in financial reporting

A Deloitte A Closer Look provides a background on investor expectations in respect of climate as well as what requirements are highlighted by the IFRS Foundation's publication 'In Brief: IFRS Standards and climate-related disclosures' and the IASB's educational material on the effects of climate-related matters on financial statements and how they might apply in practice.

- Entities that are either legally required or have decided voluntarily to offset their carbon emissions should ensure that appropriate disclosure is provided of the resulting impact on their financial performance and financial position. This may include, for example, disclosure of the accounting policies used for the recognition, measurement and presentation of the associated financial statements items (e.g. assets for GHG allowances or carbon offsets and/or provisions for emissions), the main terms and nature of the schemes in which they participate and the amount of GHG credits or renewable energy certificates owned, owed, consumed or sold.
- Financial institutions engaged in green financing (e.g. issuance of ESG-indexed loans) need to consider disclosing the information necessary for users of their financial statements to understand the impacts and assess the nature and extent of the specific risks associated with these financial instruments (e.g. the key characteristics of the instruments, carrying amounts, maturities, environmental criteria, the specific risks associated with those instruments, their impact and sensitivity on cash flows and how these risks are managed). Disclosure may also be required if significant judgements was involved in the application of the entity's accounting policy, for example when assessing whether the contractual cash flows of ESG-linked financial assets are payments of principal and/or interest on the principal amount outstanding.

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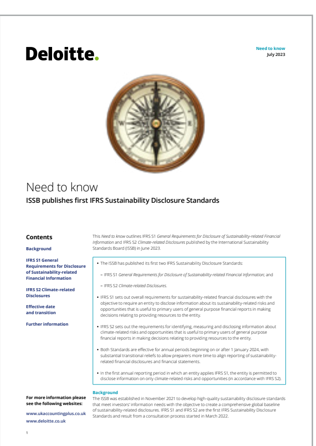

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Need to know
July 2023

Need to know
ISSB publishes first IFRS Sustainability Disclosure Standards

Contents

Background

IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

IFRS S2 Climate-related Disclosures

Effective date and transition

Further information

This *Need to know* outlines IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures* published by the International Sustainability Standards Board (ISSB) in June 2023.

- The ISSB has published its first two IFRS Sustainability Disclosure Standards:
  - IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information;* and
  - IFRS S2 *Climate-related Disclosures.*
- IFRS S1 sets out overall requirements for sustainability-related financial disclosures with the objective to require an entity to disclose information about its sustainability-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity.
- IFRS S2 sets out the requirements for identifying, measuring and disclosing information about climate-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity.
- Both Standards are effective for annual periods beginning on or after 1 January 2024, with substantial transitional reliefs to allow preparers more time to align reporting of sustainability-related financial disclosures and financial statements.
- In the first annual reporting period in which an entity applies IFRS S1, the entity is permitted to disclose information on only climate-related risks and opportunities (in accordance with IFRS S2).

Background
The ISSB was established in November 2021 to develop high-quality sustainability disclosure standards that meet investors' information needs with the objective to create a comprehensive global baseline of sustainability-related disclosures. IFRS S1 and IFRS S2 are the first IFRS Sustainability Disclosure Standards and result from a consultation process started in March 2022.

For more information please see the following websites:

www.ukaccountingplus.co.uk
www.deloitte.co.uk

1

A Deloitte Need to know: ISSB publishes first IFRS Sustainability Disclosure Standards discusses the content and requirements of the ISSB standards in more detail.

UK developments

ISSB Sustainability Disclosure Standards and adoption in the UK

In June 2023, the ISSB published its first two standards: IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures* ("the ISSB standards"):

- **IFRS S1** sets out overall requirements for an entity to disclose information about its sustainability-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity.
- **IFRS S2** sets out the requirements for identifying, measuring and disclosing information about climate-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity.

In developing these standards, the ISSB has drawn on existing standards and frameworks that are used widely by entities, including IFRS Accounting Standards, the TCFD Recommendations and the Sustainability Accounting Standards Board (SASB) Standards. In addition, the ISSB is in the process of updating references to jurisdiction-specific laws and regulations in the SASB Standards to improve their international applicability.

The UK government's Green Finance Strategy reaffirmed the government's intention to adopt the ISSB standards for use in the UK following a formal assessment of the standards. This assessment is now underway, with the government having established two advisory committees: the first responsible for considering public policy; and the second, which is supported by the FRC, a technical advisory committee responsible for considering how the standards will sit alongside existing UK reporting requirements. This latter committee launched a call for evidence in 2023 inviting views on whether, and how, the ISSB standards should be endorsed for use in the UK.

The UK government has stated its intention to finalise the endorsement decision on the ISSB standards in 2024. Once endorsed, consideration will then be given to the scope and timing of mandatory adoption of UK-endorsed ISSB standards for UK entities, with a phased implementation being considered. The FCA has also announced plans to consult on proposals to update the Listing Rules to refer to UK-endorsed ISSB standards and is aiming to finalise its policy position on this matter by the end of 2024, with new requirements taking effect for accounting periods beginning on or after 1 January 2025. The UK government will consider separately how to integrate UK-endorsed ISSB standards into the UK legislative framework, and the scope of entity that it intends to apply the standards in due course, taking into account feedback from its call for evidence on the UK non-financial reporting framework.

ISSB work plan

Following the publication of its Request for Information *Consultation on Agenda Priorities*, published in May 2023, the ISSB is expected to finalise its work plan in the first half of 2024.

In December 2023, the ISSB published amendments to the SASB Standards to enhance their international applicability. The SASB Standards, which provide industry-specific guidance, facilitate the implementation and application of IFRS S1 for preparers.

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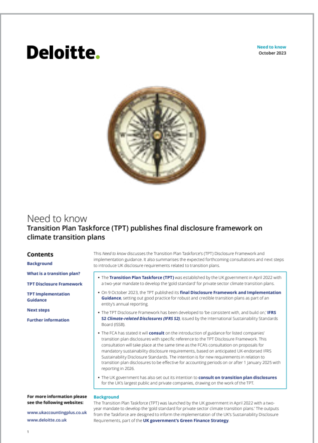

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Need to know
October 2023

Need to know
Transition Plan Taskforce (TPT) publishes final disclosure framework on climate transition plans

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TPT Disclosure Framework
TPT Implementation Guidance
Next steps
Further information

This *Need to know* discusses the Transition Plan Taskforce's (TPT) Disclosure Framework and implementation guidance. It also summarises the expected forthcoming consultations and next steps to introduce UK disclosure requirements related to transition plans.

- The **Transition Plan Taskforce (TPT)** was established by the UK government in April 2022 with a two-year mandate to develop the 'gold standard' for private sector climate transition plans.
- On 9 October 2023, the TPT published its **final Disclosure Framework and Implementation Guidance**, setting out good practice for robust and credible transition plans as part of an entity's annual reporting.
- The TPT Disclosure Framework has been developed to 'be consistent with, and build on,' **IFRS S2 *Climate-related Disclosures (IFRS S2)***, issued by the International Sustainability Standards Board (ISSB).
- The FCA has stated it will **consult** on the introduction of guidance for listed companies' transition plan disclosures with specific reference to the TPT Disclosure Framework. This consultation will take place at the same time as the FCA's consultation on proposals for mandatory sustainability disclosure requirements, based on anticipated UK-endorsed IFRS Sustainability Disclosure Standards. The intention is for new requirements in relation to transition plan disclosures to be effective for accounting periods on or after 1 January 2025 with reporting in 2026.
- The UK government has also set out its intention to **consult on transition plan disclosures** for the UK's largest public and private companies, drawing on the work of the TPT.

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Background
The Transition Plan Taskforce (TPT) was launched by the UK government in April 2022 with a two-year mandate to develop the 'gold standard for private sector climate transition plans.' The outputs from the Taskforce are designed to inform the implementation of the UK's Sustainability Disclosure Requirements, part of the **UK government's Green Finance Strategy**.

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A Deloitte Need to know: Transition Plan Taskforce publishes final disclosure framework discusses the TPT framework in more detail.

Transition Plan Taskforce Disclosure Framework

The Transition Plan Taskforce (TPT) was established by the UK government with the aim of developing a 'gold standard' for private sector climate transition plans, applicable to the UK but globally transferrable. In October 2023, the TPT launched its final Disclosure Framework. The framework sets out recommendations and good practice for robust and credible transition plan disclosures, structured around the following three principles:

- **Ambition:** transition plans should reflect the urgency to act, arising from the observed changes in the climate and the latest scientific findings about climate change.
- **Action:** A transition plan should translate ambitious objectives and priorities into concrete steps to be taken in the short, medium and long term.
- **Accountability:** A transition plan is integral to an entity's wider corporate strategy. Delivery of a transition plan should therefore be fully integrated into the entity's organisational processes for business and financial planning, and for governance.

The recommendations in the framework are structured around five elements: (1) Foundations; (2) Implementation strategy; (3) Engagement strategy; (4) Metrics & targets; and (5) Governance. These recommendations are then sub-divided into a further 19 sub-elements and are designed to be consistent with, and build on, IFRS S2.

The framework recommends that an entity adopts a 'strategic and rounded' approach in setting its strategic ambition. This includes considering three inter-related channels in designing its transition plan – decarbonising the entity, responding to the entity's climate-related risks and opportunities, and contributing to an economy-wide transition.

It also recommends that material information about the transition plan, including progress updates, is reported annually as part of broader climate-related disclosures in the entity's general purpose financial reports. It further indicates that, as good practice, an entity should publish a standalone transition plan periodically – at least every three years, and sooner where there are significant changes to the plan.

The TPT Disclosure Framework is currently a voluntary framework. However, companies required under the FCA's Listing Rules to make a statement of consistency with the TCFD recommendations are required to 'describe their plans for transitioning to a low-carbon economy' and in its December 2022 Primary Market Bulletin, the FCA encouraged companies to go further and consider the proposed TPT outputs when making transition plan disclosures.

The FCA has stated that it plans to consult on introducing guidance aligned with the TPT Framework, at the same time as consulting on proposals for mandatory sustainability disclosure requirements based on anticipated UK-endorsed IFRS Sustainability Disclosure Standards (see ISSB standards and adoption in the UK), with the intention for any new requirements to be effective for accounting periods beginning on or after 1 January 2025 and reporting in 2026. In its Green Finance Strategy, the UK government signalled its intention to launch a consultation on mandatory application of this framework for the UK's largest and most economically significant public and private companies.

The Deloitte Corporate Reporting Insights 2023 series includes a report on how the first 50 FTSE 100 December 2022 reporters report their transition plans compared to the TCFD recommended disclosures and expected future requirements. The full report can be found here.

UK Green Taxonomy

In its 2021 Roadmap, the UK government confirmed its intention to implement a UK Green Taxonomy to provide a clear framework for entities and investors to be able to determine whether an economic activity is environmentally sustainable (or "taxonomy-aligned"). The Green Finance Strategy reconfirms this intention and notes that the taxonomy will be developed drawing on the experience of those already developed in other jurisdictions (such as the EU Green Taxonomy) to arrive at a system which is proportionate, usable and decision-useful. The UK government has also signalled its intent to work with other jurisdictions to maximise interoperability for entities that operate cross-border.

The UK government intends to consult on the Taxonomy in 2024 and there will be a voluntary testing period of at least two years once the Taxonomy is finalised, before any mandatory reporting obligations are introduced. This testing period is designed to help identify and resolve any implementation challenges.

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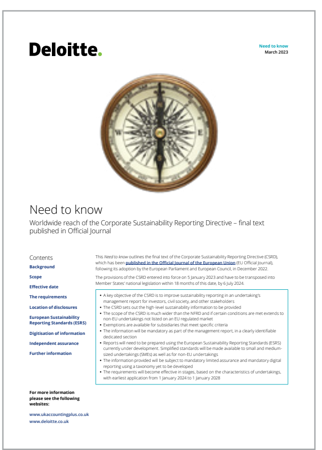
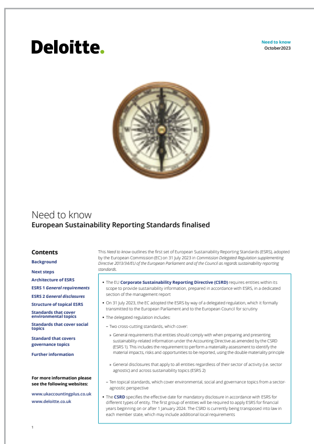


A Deloitte Need to Know: Worldwide reach of the CSRD discusses the scope and requirements of the CSRD in more detail.



A Deloitte Need to Know: ESRSs finalised discusses the requirements of the first set of ESRSs in more detail.

Other global developments

Europe

The European Union (EU) finalised its Corporate Sustainability Reporting Directive (CSRD) in December 2022. Alongside the EU Green Taxonomy and the European Sustainability Reporting Standards (ESRS), the CSRD forms part of the wider EU Sustainable Finance Package, a set of measures which is intended to improve the flow of capital towards sustainable activities.

The CSRD aims to improve sustainability reporting in an entity's management report for investors, civil society and other stakeholders, thereby contributing to the transition to a fully sustainable and inclusive economic and financial system in line with the European Green Deal and the UN Sustainable Development Goals.

The scope of the CSRD is wide, including all entities (including non-EU entities) with securities listed on an EU-regulated market, with only limited exceptions. It also extends to certain non-listed EU entities (including EU subsidiaries of non-EU parents).

The first set of ESRS includes:

- Two cross-cutting standards, which address:
  - General requirements that entities should comply with when preparing and presenting sustainability-related information (ESRS 1). This includes the requirement to perform a materiality assessment applying the double-materiality principle.
  - General disclosures that apply to all entities regardless of their sector of activity (i.e. sector agnostic) and across sustainability topics (ESRS 2).
- Ten topical standards, which cover environmental, social and governance topics from a sector agnostic perspective.

The effective date of the CSRD is staggered depending on the size of the entity or group. Entities (including non-EU entities) with debt or equity instruments listed on an EU regulated market which are large (or which are the parent of a large group), and have more than 500 employees during the year will need to prepare the required sustainability reporting for periods beginning on or after 1 January 2024. The time and effort needed for an effective and timely transition to the new requirements may be substantive. Key organisational decisions in terms of governance, data collection, internal controls, and procedures supporting the mandatory assurance requirement will need to be carefully considered.

For periods beginning on or after 1 January 2025, the 500 employee threshold is removed and the requirements apply to all large EU entities and large non-EU entities with debt or equity instruments listed on an EU regulated market. The scope then expands to small and medium-sized EU and non-EU listed entities from 1 January 2026, and to additional group-wide reporting requirements for non-EU entities with significant EU activity from 1 January 2028.

In addition, the EU Taxonomy Regulation (and supporting delegated acts) sets out a system for classifying economic activities contributing to environmental objectives. It requires an entity in scope of the regulation to include information in its non-financial information statement (as part of the sustainability reporting in a dedicated section of the management report once the CSRD is in effect) on how and to what extent the entity's activities are associated with environmentally sustainable economic activities.

More information about the CSRD can be found in chapter H2 of GAAP in the UK on the Deloitte Accounting Research Tool (DART).

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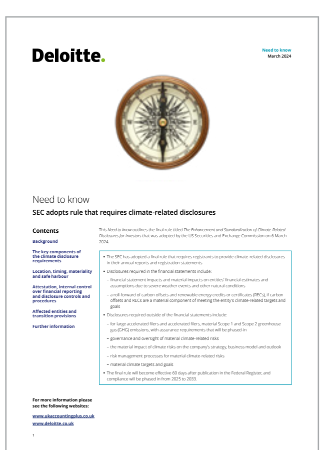

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Need to know
March 2024

Need to know

SEC adopts rule that requires climate-related disclosures

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The key components of the climate disclosure requirements
Location, timing, materiality and safe harbour
Attestation, internal control over financial reporting and disclosure controls and procedures
Affected entities and transition provisions
Further information

This *Need to know* outlines the final rule titled *The Enhancement and Standardization of Climate-Related Disclosures for Investors* that was adopted by the US Securities and Exchange Commission on 6 March 2024.

- The SEC has adopted a final rule that requires registrants to provide climate-related disclosures in their annual reports and registration statements
- Disclosures required in the financial statements include:
  - financial statement impacts and material impacts on entities' financial estimates and assumptions due to severe weather events and other natural conditions
  - a roll-forward of carbon offsets and renewable energy credits or certificates (RECs), if carbon offsets and RECs are a material component of meeting the entity's climate-related targets and goals
- Disclosures required outside of the financial statements include:
  - for large accelerated filers and accelerated filers, material Scope 1 and Scope 2 greenhouse gas (GHG) emissions, with assurance requirements that will be phased-in
  - governance and oversight of material climate-related risks
  - the material impact of climate risks on the company's strategy, business model and outlook
  - risk management processes for material climate-related risks
  - material climate targets and goals
- The final rule will become effective 60 days after publication in the Federal Register, and compliance will be phased in from 2025 to 2033.

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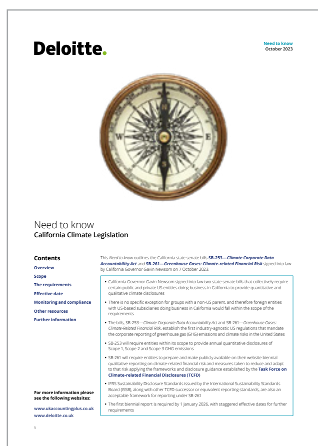
A Deloitte Need to know: SEC adopts rule that requires climate-related disclosures discusses the SEC rule in more detail.



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Need to know
October 2023

Need to know

California Climate Legislation

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Effective date
Monitoring and compliance
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This *Need to know* outlines the California state senate bills **SB-253—*Climate Corporate Data Accountability Act*** and **SB-261—*Greenhouse Gases: Climate-related Financial Risk*** signed into law by California Governor Gavin Newsom on 7 October 2023.

- California Governor Gavin Newsom signed into law two state senate bills that collectively require certain public and private US entities doing business in California to provide quantitative and qualitative climate disclosures
- There is no specific exception for groups with a non-US parent, and therefore foreign entities with US-based subsidiaries doing business in California would fall within the scope of the requirements
- The bills, SB-253—*Climate Corporate Data Accountability Act* and SB-261—*Greenhouse Gases: Climate-Related Financial Risk*, establish the first industry-agnostic US regulations that mandate the corporate reporting of greenhouse gas (GHG) emissions and climate risks in the United States
- SB-253 will require entities within its scope to provide annual quantitative disclosures of Scope 1, Scope 2 and Scope 3 GHG emissions
- SB-261 will require entities to prepare and make publicly available on their website biennial qualitative reporting on climate-related financial risk and measures taken to reduce and adapt to that risk applying the frameworks and disclosure guidance established by the **Task Force on Climate-related Financial Disclosures (TCFD)**
- IFRS Sustainability Disclosure Standards issued by the International Sustainability Standards Board (ISSB), along with other TCFD successor or equivalent reporting standards, are also an acceptable framework for reporting under SB-261
- The first biennial report is required by 1 January 2026, with staggered effective dates for further requirements

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A Deloitte Need to know: California Climate Legislation discusses the California law in more detail.

USA

In March 2024, the US SEC adopted a rule requiring registrants, including foreign, to provide climate-related disclosures in their annual reports and registration statements. Compliance will be phased in from 2025 to 2033.

Disclosures required in the financial statements include:

- financial statement impacts and material impacts on entities' financial estimates and assumptions due to severe weather events and other natural conditions; and
- a roll-forward of carbon offsets and renewable energy credits or certificates (RECs), if carbon offsets and RECs are a material component of meeting the entity's climate-related targets and goals.

Disclosures required outside of the financial statements include:

- for large accelerated filers and accelerated filers, material Scope 1 and Scope 2 greenhouse gas emissions, with assurance requirements that will be phased-in

Governance and oversight of material climate-related risks;

- the material impact of climate risks on the company's strategy, business model and outlook;
- risk management processes for material climate-related risks; and
- material climate targets and goals.

In October 2023, California Governor Gavin Newsom signed into law three bills that require certain public and private US entities doing business in California to provide quantitative and qualitative climate disclosures. The senate bills, SB-253—*Climate Corporate Data Accountability Act* and SB-261—*Greenhouse Gases: Climate-Related Financial Risk*, establish the first industry-agnostic US regulations that mandate the corporate reporting of GHG emissions and climate risks in the United States.

- **SB-253** – this bill will apply to public and private US-based businesses with total annual revenues exceeding $1 billion and that do business in California. In scope entities will be required to provide quantitative disclosures of Scope 1, Scope 2 and Scope 3 GHG emissions on a digital platform (to be created by the regulator) on an annual basis. There will be a phased introduction to the reporting requirements, with disclosure of Scope 1 and Scope 2 GHG emissions for the prior fiscal year, and limited assurance on those disclosures, starting in 2026. Disclosure of Scope 3 emissions for the prior year will be required in 2027. Starting in 2030, reasonable assurance will be required for Scope 1 and Scope 2 GHG emission disclosures, and subject to further consideration, there may also be limited assurance required for Scope 3 emissions disclosures.
- **SB-261** – this bill will apply to public and private US-based businesses, excluding those in the insurance industry, with total annual revenues exceeding $500 million and that do business in California. In scope entities will be required to prepare and make publicly available on their website biennial qualitative reporting on climate-related financial risk, and measures taken to reduce and adapt to that risk, applying the frameworks and disclosure guidance established by the TCFD, or any successor or equivalent reporting. IFRS Sustainability Disclosure Standards issued by the ISSB are considered equivalent standards because they fully incorporate the TCFD's recommendations. The disclosures will be required biennially on the entity's corporate website, with the first set of disclosures required on or before 1 January 2026.

The bills, as written, do not clearly define what "doing business in California" means. However, on the basis of the "doing business in California" concept under California tax law, early indications are that the threshold for doing business in the state might be quite low. There is also no specific exception for groups with a non-US parent, and therefore foreign entities with US-based subsidiaries doing business in California would fall within the scope of the requirements.

In addition the California assembly bill, AB-1305 Voluntary Carbon Market Disclosures, is intended to combat greenwashing of climate-related emission claims and establishes requirements for both US and international entities that market or sell voluntary carbon offsets (VCOs) within California as well as entities that operate in California and make certain climate-related emission claims in that State (whether or not they purchase or use VCOs).

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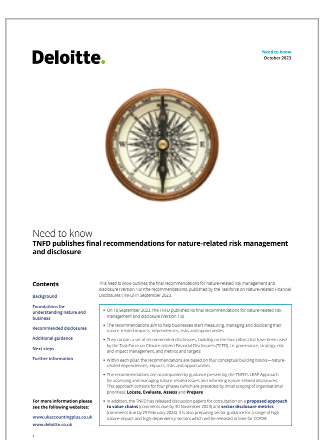

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Need to know
October 2023

Need to know
TNFD publishes final recommendations for nature-related risk management and disclosure

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Foundations for understanding nature and business

Recommended disclosures

Additional guidance

Next steps

Further information

This *Need to know* outlines the final recommendations for nature-related risk management and disclosure (Version 1.0) (the recommendations), published by the Taskforce on Nature-related Financial Disclosures (TNFD) in September 2023.

- On 18 September 2023, the TNFD published its final recommendations for nature-related risk management and disclosure (Version 1.0)
- The recommendations aim to help businesses start measuring, managing and disclosing their nature-related impacts, dependencies, risks and opportunities
- They contain a set of recommended disclosures, building on the four pillars that have been used by the Task Force on Climate-related Financial Disclosures (TCFD), i.e. governance, strategy, risk and impact management, and metrics and targets
- Within each pillar, the recommendations are based on four conceptual building blocks—nature-related dependencies, impacts, risks and opportunities
- The recommendations are accompanied by guidance presenting the TNFD's LEAP Approach for assessing and managing nature-related issues and informing nature-related disclosures. This approach consists for four phases (which are preceded by initial scoping of organisational priorities): **Locate, Evaluate, Assess** and **Prepare**
- In addition, the TNFD has released discussion papers for consultation on a **proposed approach to value chains** (comments due by 30 November 2023) and **sector disclosure metrics** (comments due by 29 February 2024). It is also preparing sector guidance for a range of high nature-impact and high-dependency sectors which will be released in time for COP28

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A Deloitte Need to know: TNFD publishes final recommendations for nature-related risk management and disclosure discusses the TNFD framework in further detail.

Worldwide

The Taskforce for Nature-related Financial Disclosures (TNFD) was launched in 2021 to develop and deliver a risk management and disclosure framework for organisations to report and act on evolving nature-related risks, with the ultimate aim of supporting a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes. In September 2023, the TNFD published its final recommendations for nature-related risk management and disclosure. The recommendations are designed to:

- meet the corporate reporting needs of a wide range of organisations across geographies, sectors and jurisdictions, including allowing for different approaches to materiality;
- help provide better information to support strategy and risk management at the board and management level, and ultimately improve capital allocation and asset valuation decisions by corporates;
- promote more informed investment, credit and insurance underwriting decisions by financial institutions; and
- enable a stronger understanding of the concentrations of nature-related risks and opportunities, based on insights into nature dependencies and impacts.

The recommended disclosures build on the four pillars that have been used by the TCFD, i.e. governance, strategy, risk and impact management, and metrics and targets. Within each pillar, the recommendations are based on four conceptual building blocks - nature-related dependencies, impacts, risks and opportunities. TNFD's disclosure recommendations also leverage the wording used by the ISSB to describe core content in IFRS S1, with the TNFD adding impact management to IFRS S1's 'risk management' content.

The Green Finance Strategy includes a specific reference to the TNFD, stating that the UK government intends to consider how the final TNFD framework could be incorporated into UK policy and legislation.

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Other narrative reporting requirements

The FRC annual review confirmed that, aside from climate-related reporting requirements (i.e. TCFD), no substantive challenges were raised in relation to non-financial reporting disclosures such as SECR and it observed that entities may be becoming more familiar with these newer requirements.

However, with reference to the strategic report, the FRC questioned where such reports did not appear fair, balanced, and comprehensive. It challenged where the strategic report had not discussed material balances, transactions and cash flow items or significant changes in balances from the prior year, reminding entities that the strategic report should not only focus on the financial performance of the entity, but also address significant movements in financial position and cash flows. The FRC highlighted one particular instance where no discussion of the entity's performance relative to pre-pandemic levels had been disclosed, nor a description of its principal risks and related mitigation strategies or key performance indicators. The annual review also noted that several companies, including large private companies, did not produce a section 172 statement which is a requirement for all companies except those that qualify as small or medium-sized.

Entities should also ensure that the strategic report describes risks facing the business, particularly in the current economic and geopolitical environment, and the risk mitigation strategies in place. Where relevant, risks and uncertainties should be linked to discussion of the entity's strategy, business model and other information disclosed elsewhere in the financial statements. Linkages between information presented within the strategic report and the financial statements should be identified and explained clearly. The FRC encourages entities to refer to its Guidance on the Strategic Report and What Makes a Good Annual Report and Accounts publication, which provides principle-based guidance when preparing a strategic report.

The FRC also queried a number of private companies on non-disclosure of directors' emoluments. In addition, individual companies were challenged regarding whether presentation, disclosure and delivery of the accounts was compliant with the requirements of the Companies Act 2006 and the Accounting Regulations (SI 2008/410).

In 2023, the UK government issued a call for evidence seeking views on the non-financial reporting requirements applicable to UK entities, with a view to simplifying and streamlining the sustainability and non-financial reporting regime in place in the UK. In March 2024, it issued a feedback statement and also an impact assessment which set out the first stage of planned measures to reform the UK non-financial reporting framework.

Following the summary of responses to the call for evidence, the impact assessment outlines key planned changes including:

- Uplift in size thresholds - the Companies Act 2006 company size thresholds are to be increased by 50% in order to reflect historical and future inflation.
- Removing requirements from the Directors' Report: a number of current requirements within the Directors' Report will be removed either because they are duplicative or no longer considered to provide useful information. This includes information on financial instruments, important events, likely future developments, research and development, branches, employment of disabled persons, engagement with employees, and engagement with suppliers, customers and others.
- Removing requirements from the Directors' Remuneration Report and Directors' Remuneration Policy: content which was introduced into UK law as a result of implementing the EU Shareholder Rights Directive will be removed. For example, the requirement to compare the annual percentage change in each director's remuneration to the average percentage change of employee remuneration as a whole, over a five-year comparison period.

Outside of the reporting framework, changes will also be made to enable annual reports to be shared digitally with members in the first instance.

The government intends to make the changes via secondary legislation with a commencement date for the proposals of 1 October 2024. The statutory instrument to implement these changes is due to be laid before Parliament in Summer 2024. Further proposals relating to the UK's non-financial reporting framework are expected to be published for public comment in 2024.

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FRC focus area

'Corporate governance disclosures are an opportunity to build trust and understanding, and demonstrate why the UK is an attractive investment market, rather than being a compliance exercise.'

The FRC's Review of Corporate Governance 2023

Corporate governance

Focus areas for corporate governance reporting

In November 2023, the FRC published its Review of Corporate Governance Reporting which is based on a review of reporting by 100 companies drawn from across the premium listed market. The FRC notes a general improvement in governance reporting especially relating to workforce and other stakeholder engagement and remuneration. However, the review also draws attention to improvements needed in areas such as monitoring and review of the risk management and internal control systems, avoiding boilerplate language in the application of the Corporate Governance Code (the Code), and focusing on reporting the outcomes of governance processes and policies. Both preparers and reviewers of annual reports, particularly members of the audit committee, should consider the FRC's findings ahead of their next reporting period.

The review highlights the continuing need for high quality governance which is linked to effective decision-making by boards and management, for greater clarity as to how a company is applying the Code's principles, and for clearer explanations where there are departures from Code provisions so that shareholders and stakeholders have greater confidence in the quality of governance.

The FRC outlines a number of key messages across the review to draw attention to the areas that need further improvement, including:

- Reporting on board considerations and decisions, the company's activities and the associated outcomes to reduce boilerplate disclosure and provide more concise and meaningful disclosures to users.
- Where there are departures from the Code, in addition to the timeline of anticipated compliance, reporting on how alternative arrangements provide benefits to shareholders and other stakeholders.
- Setting out the practices and policies implemented for corporate culture, together with the objectives set and progress made.
- Providing greater context to a company's purpose statement than just a market slogan i.e. explaining why the company exists, what it does, what markets it operates in, what it is seeking to achieve and how it will achieve it.
- Reporting on intermediary outcomes or milestones from stakeholder engagement, which allows users to know the company is working on feedback received and explaining why companies consider stakeholder engagement mechanisms to be effective.
- Discussing how stakeholder feedback is being reflected on and considered in board decision making.
- Avoiding declaratory statements on how companies impact their surrounding communities but providing more meaningful insight into community considerations and how any negative effects are being addressed.
- Demonstrating how diversity objectives and initiatives link to company strategy and how these initiatives have contributed to improving their diversity targets.
- Discussing the specific internal and external safeguards used to protect the external auditor's independence.
- Describing the process of review, findings and recommendations relating to the external audit process.
- Discussing how and why principal risks have changed from the previous year, together with any explanation of changes to the mitigation strategy.
- Describing how the company's purpose and values are linked to executive remuneration arrangements.

Monitoring and reviewing the effectiveness of the risk management and internal control systems

The FRC notes there has been 'little year on year improvement' in the quality of reporting of the assessment of risk management and internal controls systems and highlights the monitoring and review activities as an area for particular focus. Only 20 companies provided insightful information on how the monitoring and review activities were conducted or what areas were covered. With the increased focus on the UK's approach to internal controls, the FRC notes that most companies need to do more work to demonstrate robust systems, governance, and oversight.

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Provision 29 of the Code states that 'The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.'

The FRC has set out its observations regarding what makes good reporting in this area:

- A clear statement describing the review undertaken: Avoid using general, boilerplate language such as "the board (or a relevant committee) reviews the effectiveness of risk management and internal control systems". Instead, provide a definitive and clear statement of who performed the review and the scope of the review undertaken during the year.
- Process for the review: Good reporting on the process for the review includes details of how the board or its delegated committee have undertaken the review, who was consulted, what reports or evidence were received, and what areas were covered by the review.
- Reporting the outcomes of the review: Where the board has determined the risk management and internal controls systems to be effective, this should be clearly stated in the annual report together with how the board reached this conclusion. In addition, where material weaknesses or inefficiencies have been identified, the company should explain the nature of the weakness or inefficiency and include the future actions the board has taken or will take to remediate these.

The FRC highlights that good reporting in this area will provide shareholders, markets, and other stakeholders with confidence in the systems companies have in place to identify, assess, and manage risk effectively and sustain their resilience.

Cyber and information technology

The FRC also outlines its observations on cyber and information technology reporting. While the Code does not require reporting in these areas, the FRC commends companies who outlined the cyber risks and opportunities and the importance of cyber security to their business. The FRC notes that boards should be comfortable with understanding the cyber risks in their business and how they are managed.

In addition, the FRC looked at the extent to which artificial intelligence (AI) was reported in the sample of companies. Just under half of companies mentioned AI in their reports, however none of these companies disclosed the board's involvement in their approach to or oversight of AI. The FRC encourages boards to have a clear view on how AI is being used and developed in a responsible manner and to ensure the necessary governance processes are implemented. This may warrant further training and education of boards.

Listing Rule on diversity

A new FCA Listing Rule requiring a statement on diversity on company boards and executive management in the annual report came into effect for periods commencing on or after 1 April 2022 for both premium and standard listed UK companies.

Companies are required to:

- Provide a statement setting out whether the company has met the following targets on board diversity as at a chosen reference date within its accounting period:
  - At least 40% of the individuals on its board of directors are women;
  - At least one of the senior positions on the board of directors is held by a woman – the chair, the chief executive, the senior independent director, or the chief financial officer; and
  - At least one individual on the board of directors is from a minority ethnic background.

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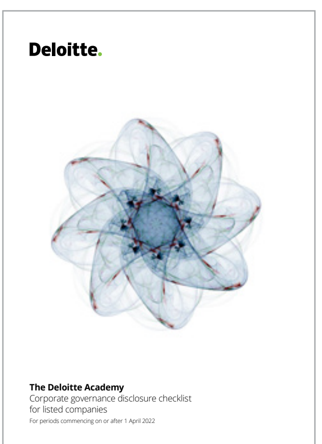

A Deloitte Corporate Governance Disclosure Checklist is designed for use by preparers in companies and covers the detailed requirements and the limited exemptions.

In cases where the company has not met all these targets, state the targets it has not met and the reasons for not meeting those targets.

- Set out the reference date used for the statement and, if it is not the same as the year end date, an explanation as to why.
- Disclose numerical data: a table in a set format for each of the ethnic background and the gender identity or sex of the individuals on the board and in executive management.
- Provide an explanation of the approach to collecting the data used for the purposes of making all the disclosures above; that should be consistent for all elements of the reporting and across all individuals. The explanation should include the method of collection and/or source of the data, and where data collection is done on the basis of self-reporting by the individuals concerned, it should include a description of the questions asked.

In addition to the Listing Rule, there has been a change to DTR 7.2.8AR which now requires the description of the diversity policy applied to the board to also cover the main board committees: remuneration, audit and nomination committees.

The Deloitte Corporate Reporting Insights 2023 series includes a report on whether the first 30 FTSE 350 December 2022 reporters were already complying with the diversity Listing Rule requirements or moving their disclosures closer towards full compliance. The full report can be found here.

UK Corporate Governance Code 2024

In January 2024, the FRC issued an updated UK Corporate Governance Code ("the 2024 Code") following a consultation last year as part of the 'Restoring trust in audit and corporate governance' reform package. The 2024 Code will apply for accounting periods commencing on or after 1 January 2025 with the exception of Provision 29 – the declaration on the effectiveness of the risk management and internal control framework – which will apply for accounting years commencing on or after 1 January 2026 to allow sufficient time for implementation. Until then, existing Provision 29 of the 2018 UK Corporate Governance Code applies.

Final form of the declaration on the effectiveness of the risk management and internal control framework

Code Principle O will require the board to establish and maintain an effective risk management and internal control framework.

This amended Principle is reinforced by an extension of the existing Code provision (Provision 29) in relation to the board's responsibility to monitor the company's risk management and internal control framework and, at least annually, carry out a review of its effectiveness. Building on this review and monitoring activity, the board will need to:

- describe how it has monitored and reviewed the effectiveness of the framework;
- make a declaration of effectiveness of the material controls as at the balance sheet date; and
- describe any material controls which have not operated effectively as at the balance sheet date, the action taken, or proposed, to improve them and any action taken to address previously reported issues.

This declaration will cover "material controls" which are intended to cover controls over both financial and non-financial reporting.

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Other changes which boards should focus on

Activities and outcomes - governance reporting should focus on board decisions and their outcomes in the context of a company's strategy and objectives.

Culture – Provision 2 has been amended to include that boards should not only assess and monitor culture, but also how the desired culture has been embedded.

'Audit committees and the external audit: Minimum Standard' - to avoid duplication, the updated Code removes those elements covering the work of the audit committee in relation to external audit and instead refers companies to the Standard.

Diversity - Principle J has been amended to promote diversity, inclusion and equal opportunity, without referencing specific groups. The list of diversity characteristics has been removed to indicate that diversity policies can be wide ranging.

Malus and clawback remuneration arrangements - strengthened reporting on the circumstances for, and use of, malus and clawback.

The remuneration policy – existing Provision 40 setting out characteristics of effective remuneration policy and practices has been removed.

Guidance to support the 2024 UK Corporate Governance Code

In addition to the updated Code, the FRC has also issued supporting guidance. The new guidance aims to bring together the most relevant content from previous publications into a single, condensed, digitally accessible and user-friendly resource. The FRC has reiterated that the guidance is not part of the Code, but a separate collection of information designed to help the application of the Code to different companies' needs.

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FRC focus area

Directors' remuneration

Although the FRC does not currently have statutory powers over the full annual report pending Parliamentary time to pass primary legislation to form and establish the remit of the Accounting, Reporting and Governance Authority (ARGA), in its 2022/23 annual review it has proactively reviewed a sample of directors' remuneration reports (DRR). 90% of the companies reviewed received letters highlighting areas of non-compliance or lack of consistency between the DRR and information included elsewhere in the annual report.

The areas highlighted by the FRC's review as requiring improvement are as follows:

1. Greater clarity of remuneration-linked targets and achieved performance against these targets for the annual bonus and long-term incentive plan awards. The FRC review noted that executive remuneration is a sensitive topic and explaining the intricacies of these targets, along with the monitoring and measurement of performance against these targets is of critical interest to users of the annual report. It also noted that most companies did not provide detail on their prospective remuneration-linked targets for the next financial year. While this is an area of permitted non-disclosure, the FRC encourages greater transparency in this area and states that the transparency of the link between remuneration and company performance will continue to be a key focus area going forward.

2. Consistency with other areas of reporting, specifically relating to performance measures and targets disclosed in the DRR compared to performance measures disclosed as APMs and targets under TCFD. Where these performance measures differ from those included as APMs or sustainability targets, companies should explain these differences and the reasons for them.

Capital maintenance and distributable reserves

The FRC raised several questions in relation to the lawfulness of dividends and share repurchases where these had not been supported by the last audited accounts or, for public companies, where the required interim accounts had not been filed at Companies House. Further clarity was required where the process to rectify unlawful dividends in breach of Companies Act 2006, as disclosed in the company's report and accounts, appeared not to have been followed. In addition, it was not always clear whether certain transactions relating to share-based payments and dividends receivable from subsidiaries had been treated as resulting in realised or unrealised profits when calculating distributable profits in support of dividend payments.

Companies should ensure that they comply with the legal requirements for making distributions and share repurchases, including the requirement for public companies to file interim accounts that show sufficient distributable profits to support the transaction, if the distribution or repurchase exceeds distributable profits reported in the most recent annual accounts.

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Large private companies

In January 2024, the FRC published its thematic review on reporting by the UK's largest private companies. The review surveyed 20 large private companies, focusing on areas across the annual report which were considered of most importance to users and where the FRC expected the highest risk of poor compliance. Overall, the quality of reporting was described as "mixed", and in particular private companies need to consider how they explain complex or judgemental matters.

The FRC found that the best strategic reports focused on elements of company development, performance and position that were key in understanding the company and were consistent with disclosures in the financial statements. Within the strategic report, private companies are encouraged to provide clearer disclosure on their group structure, principal activities and how the reporting company forms part of the wider group's operations.

Companies should avoid boiler-plate wording relating to accounting policies for complex balances and transactions and continue to review these policies to ensure they are complete, relevant and accurate. This is particularly critical for revenue, where companies are encouraged to tailor their accounting policies for users of the financial statements to understand the nature of revenue streams, the timing of revenue recognition and how the value of the revenue is determined.

For judgements and estimates, better reporters included the detail of the specific judgement involved within an account balance or transaction and the rationale behind the conclusion reached. Where a sensitivity analysis was provided, the degree of estimation uncertainty within the carrying amount of an asset or liability was also more apparent.

Most disclosures related to material provisions lacked sufficient detail for users of financial statements to understand the risks affecting the company. Companies should provide clearer and more detailed disclosure on the nature of the obligation and associated uncertainty in the timing and amount of the provision.

The nature of financial instrument risks, specifically liquidity risks, were identified as not being disclosed in sufficient detail. Disclosure in this area could be enhanced by describing the specific nature of the risk and demonstrating its relevance by quantifying the exposure of the risk and sensitivity to potential changes.

The FRC noted that a number of these issues could have been avoided if companies had undergone a critical review of the annual report prior to finalisation. Companies are encouraged to perform internal reviews, with the objective to evaluate whether the annual report as a whole is clear, concise, and understandable and omits immaterial information. This review would also evaluate internal consistency and wider presentation and disclosure matters.

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Non-GAAP and alternative performance measures (APMs)

Significant economic changes or unusual events often lead to a desire to highlight their effects on performance or what an entity's profit may have been had an event not occurred. However, care must be taken in following such an approach. The pervasive nature of the impact of such changes or events means that a separate presentation may not faithfully represent an entity's overall financial performance and may be misleading to users' understanding of the annual report and financial statements.

For example, an 'excluding impact of the increase in energy prices' profit figure would reflect an economic environment that did not exist in 2023.

In general, when evaluating whether the effects of an economic or geopolitical event can appropriately be reflected via a non-GAAP measure or alternative performance measure (APM), factors including, but not limited to, the following should be considered:

- Can the item to be excluded from an adjusted measure be demonstrated to directly relate to the event or economic condition?
- Is the item incremental to normal operations rather than a reflection of 'the new normal'?
- Is the item objectively quantifiable, as opposed to an estimate or projection?

Instead of seeking to present the wide-ranging impacts of such an event separately in profit or loss, it is more likely to be appropriate to disclose, in the notes, qualitative and quantitative information on the significant impacts, the judgements and assumptions applied in the recognition, measurement and presentation of assets, liabilities and impacts on the numbers in the profit or loss. Such impacts should be provided in a clear and unbiased way.

In addition, the definition and calculation of APMs should be consistent over time. Entities that apply IFRS 17 *Insurance Contracts* for the first time (see Insurance contracts) should use caution when making adjustments to APMs linked to insurance contracts and/or when disclosing new APMs. In particular, entities should carefully assess whether the intended adjustments or new APMs provide transparent and useful information, improve comparability, reliability and/or comprehensibility of the APMs and of the financial information disclosed.

When including non-GAAP measures or APMs in management reports, entities should also consult the ESMA Guidelines on Alternative Performance Measures (updated in 2020) and the FRC's Thematic review: Alternative Performance Measures (APMs) 2021 which remain relevant.

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FRC focus area

Macroeconomic uncertainty

Impairment of assets

Impairment of assets has consistently been in the top ten topics, and it is the most frequently challenged area by the FRC in the 2022/23 annual review. The issues involved are generally the same as in previous years, though the effect of inflation and higher interest rates on cash flow projections and discount rates may have resulted in more instances of impairment, or reduced headroom in recoverable amounts, prompting more detailed disclosures under IAS 36 *Impairment of Assets*.

For further guidance, including examples of better disclosure practice, the FRC encourages entities to refer to its previous reviews on impairment of non-financial assets, the financial reporting effects of Covid-19, and discount rates.

Key inputs and assumptions

Entities should ensure that they provide adequate disclosures about the key inputs and assumptions used in their impairment testing, including justifying the use of financial budgets/forecasts for periods longer than five years or using a post-tax discount rate instead of pre-tax.

Impairment reviews and disclosures should appropriately reflect information provided elsewhere in the annual report and accounts (including the going concern and viability assessments), as well as events or circumstances that are indicators of potential impairment (such as the general economic environment).

Entities are also reminded that, particularly in the current environment of high inflation, inputs used in value-in-use (VIU) calculations need to be consistent in incorporating the effect of inflation (i.e. nominal cash flows should be discounted at a nominal rate and real cash flows should be discounted at a real rate).

Impairment method

Entities should ensure the forecasts used for VIU calculations reflect the asset in its current condition. When descriptions of forecasts used in VIU calculations included restructuring programmes or meeting carbon reduction targets, the FRC queried whether cash flows actually related to improving or enhancing an asset, rather than reflecting its current condition. Therefore, it should be made clear how these costs and benefits have been addressed in the VIU calculation, particularly when VIU disclosures cross-refer to forecasts used in going concern and viability assessments.

Entities are reminded that where there is significant exposure to climate risks, they should clarify how VIU calculations took account of those risks, for example the assumptions made in respect of carbon costs and the entity's ability to recover these through pricing of its output.

Descriptions of cash-generating units (CGUs), and explanations of how they have been determined, should be consistent with information about the entity's operations elsewhere in the report and accounts.

Sensitivity to key assumptions

Entities should ensure that they explain the sensitivity of recoverable amounts to reasonably possible changes in assumptions, particularly where increased economic uncertainty has widened the range of possible outcomes. Quantitative disclosures required include the amount of headroom in the recoverable amount over the carrying amount, the key assumptions, or the sensitivity of the headroom to changes in the key assumptions.

Indicators of impairment

The FRC raised queries with entities when it was not clear whether a parent's investments in subsidiaries had been assessed for impairment; for example, when the net assets, or the carrying amount of subsidiaries in their parent entity accounts, exceeded their market capitalisation at the reporting date, and the disclosures did not evidence that an impairment assessment had been performed or the basis thereof.

The FRC also questioned entities whose TCFD disclosures identified significant climate-related risks to parts of its business, but who had not made it clear whether these risks had been considered as indicators of impairment. Assessing exposure to climate-related risks as a possible indicator of impairment is discussed in more detail within the section Climate-related risks in the financial statements.

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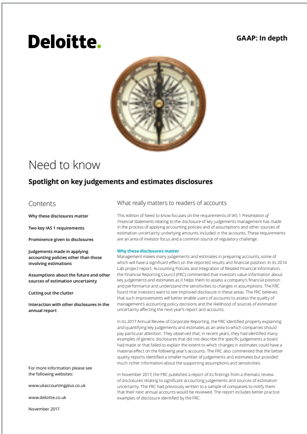
FRC focus area

Macroeconomic uncertainty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GAAP: In depth

Need to know

Spotlight on key judgements and estimates disclosures

Contents

A Deloitte Need to Know: Spotlight on key judgements and estimates disclosures discusses the disclosure of significant judgements and sources of estimation uncertainty in more detail.

Judgements and estimates

When reporting in uncertain times, it is particularly important to provide users of the financial statements with sufficient information to enable them to understand the key assumptions and judgements made when preparing financial information. Depending on an entity's specific circumstances, many of the areas discussed in this publication may give rise to a significant judgement over the characterisation of an item or transaction or a source of estimation uncertainty over its measurement, for which disclosures may be required by IAS 1:122-133.

The disclosure provided about the key assumptions, including the sensitivity analysis based on a range of reasonably possible outcomes, should reflect the conditions at the reporting date. When key assumptions, or the range of reasonably possible changes to those assumptions, are affected significantly as a result of non-adjusting events after the reporting date, information about those changes, including an estimate of the financial effect, should be provided separately.

Judgements and estimates rose back to the second most challenged area by the FRC during its 2022/23 annual review, having fallen down the order in the previous year. The majority of questions asked related to estimation uncertainty, and in many cases referred to disclosures which did not provide enough information to be useful, or which appeared inconsistent with information disclosed elsewhere in the annual report. The FRC has emphasised the need for clearer and detailed disclosure relating to judgements and estimates, especially in the current economic and geopolitical climate and it encourages entities to refer to its previous Thematic review: Judgements and estimates for guidance and best practice.

Key sources of estimation uncertainty

In respect of estimation uncertainty, it is important to distinguish between estimates which have a significant risk of material adjustment to the carrying amount of assets and liabilities in the next financial year (and hence require disclosure under IAS 1:125) and those which might affect assets and liabilities over a longer timescale (and hence are not within the scope of that paragraph but might usefully be disclosed separately).

In making high quality disclosure of estimation uncertainty, it is also important to:

- Quantify the specific amount at risk of material adjustment.
- Provide sufficient granularity in the descriptions of assumptions and/or uncertainties to enable users to understand management's most difficult, subjective or complex judgements.
- Clearly distinguish the disclosure of other estimates, and associated sensitivities, from significant estimates and explain their relevance.
- Provide meaningful sensitivities and/or ranges of reasonably possible outcomes for significant estimates and key assumptions (which, due to the economic factors discussed in the section Macroeconomic uncertainty and the challenges for corporate reporting, might be wider than in previous reporting periods); these should not be limited to those required by specific IFRS Accounting Standards.
- Quantify the assumptions underlying significant estimates when investors need this information to fully understand their effect.
- Explain any changes to past assumptions if the uncertainty remains unresolved.
- Clearly distinguish sources of estimation uncertainty with a significant risk of resulting in a material adjustment within one year from any other estimates disclosed.

The FRC has also challenged entities where estimation uncertainty had been disclosed in the prior year but was not provided in the current year despite other information included elsewhere in the annual report suggesting that it was still relevant. Another area of challenge related to estimation uncertainty that arose due to the use of discount rates, however the information on the derivation of the discount rate had not been described. The FRC expects disclosure on how discount rates have been derived when the effect of discounting is material.

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Significant accounting judgements

Disclosures should explain the significant judgements involved in applying accounting policies – the FRC confirmed that a list is not sufficient - and include quantified sensitivities where judgements involve a significant source of estimation uncertainty. The FRC reiterated that when entities conclude that no material uncertainty exists relating to going concern but the conclusion requires significant judgement, details of the judgement should be disclosed.

The FRC noted that in some cases significant judgements in relation to accounting treatments appeared to have been made but were not disclosed as significant judgements. In other cases, significant judgements disclosed in the prior year were not included this year, despite information elsewhere in the report and accounts suggesting that they should have been. Entities should ensure that the annual report is internally consistent when discussing significant judgements and sources of estimation uncertainty.

The FRC also queried where significant judgements related to the impairment of operating subsidiaries were included in the group accounts but had not been included in the parent entity accounts in relation to impairment of investments in subsidiaries.

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FRC focus area

Cash flow statements

The FRC identified fewer 'routine' errors this year, with several questions relating to relatively unusual or more complex transactions which in some cases would have been avoided if the transaction, and the rationale for the treatment of its cash flows, had been more clearly explained.

The guidance and better disclosure examples in the FRC's [cash flow and liquidity disclosures thematic review]() are still relevant. The thematic review provides details around the issues the FRC raises as well as the consistency checks it performs when reviewing cash flow statements.

Entities should also be aware that in response to deficiencies in the reporting of cash flows, the IASB has added the cash flow statement to its work plan as one of its priorities for 2022-2026. It will initially consider whether IAS 7 *Statement of Cash Flows* requires targeted improvements or whether it should be reviewed comprehensively.

Classification of cash flows

In the parent entity financial statements, classification issues specifically related to amounts borrowed from subsidiaries which were classified as operating rather than financing cash flows and amounts lent to subsidiaries which were classified as operating rather than investing cash flows.

The FRC also challenged the classification of material repayments of debt that was acquired in a business combination as investing, as repayments of debt would generally be expected to be financing cash flows. However, there may be some scenarios where investing is appropriate, and therefore a clear explanation of the rationale for the classification used should be provided.

Entities should also ensure that the classification of cash flows and cash and cash equivalents comply with relevant definitions and criteria in the standard. For example, the acquisition-related costs of a business combination should be classified as operating rather than investing cash flows as they do not give rise to an asset.

Reported cash flows

The FRC noted inconsistencies between amounts in the statement of cash flows and amounts disclosed elsewhere in the annual report, for example amounts described in the cash flow statement as relating to current balances being included in non-current items, and payment of contingent consideration referred to in the narrative report not being identifiable in the cash flow statement.

Other issues related to inappropriate reporting of cash flows on a net basis, for example where a single net amount for notes payable was presented rather than separate cash flows for advances and repayments, and to the inclusion of non-cash investing and financing transactions, which should be excluded from the cash flow statement and disclosed elsewhere if material. Entities should also ensure that the parent entity cash flow statement (where provided) is compliant with IAS 7.

Disclosures

Within the reconciliation of changes in liabilities from financing activities, the FRC queried insufficient disaggregation of information and where items could not be linked to the cash flow statement. Seemingly missing disclosures were also questioned, for example where there were no disclosures of restrictions over cash and cash equivalents, but other disclosures indicated that cash equivalents had been pledged as security for borrowings.

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FRC focus area

Macroeconomic uncertainty

Financial instruments

Similar to the prior year, the FRC raised questions in its 2022/23 annual review about expected credit loss (ECL) provisions, with most queries relating to smaller financial institutions. Other challenges related to unclear accounting treatment and policies and the basis on which cash and overdraft balances were offset.

The FRC expects transparent disclosure of the nature and extent of material risks arising from financial instruments, including changes in investing, financing and hedging arrangements; the use of factoring and reverse factoring in working capital financing; the approach to and significant assumptions made in the measurement of expected credit losses; concentrations of risks and information about covenants (where material). In particular, the effects of refinancing and changes to covenant arrangements should be explained.

Scope, recognition and measurement

Entities need to provide clearer explanations of the accounting treatment in certain areas, including:

- cash flow hedge accounting movements;
- non-controlling interests classified as financial liabilities measured at fair value through profit and loss;
- deferred equity consideration relating to a business combination, presented within equity;
- debt restructurings involving an exchange of instruments;
- net own credit adjustments that significantly reduce the fair value of financial liabilities (for an entity reporting under FRS 102, and applying IAS 39 to its financial instruments); and
- classification of arrangements to repurchase own shares as debt or equity.

The FRC expects accounting policies to be provided for all material financing (including factoring and reverse factoring) and hedging arrangements, and any changes in the arrangements. Entities engaging in share buyback arrangements should also ensure that a liability is recognised in respect of the obligation arising, where appropriate.

ECL provisions and credit risk

The FRC expects entities to discuss their approach and significant assumptions in measuring ECL provisions, including the factors considered in determining whether there had been a significant increase in credit risk for a financial instrument, and the entity's definition of default. Historical default rates used in making ECL assessments should also be reviewed and adjusted, particularly in the context of forecast future economic conditions and changes in credit risk.

For financial institutions, the FRC noted some cases where insufficient information was given to explain how forecasts of future economic conditions had been incorporated into the determination of ECL, the details of key assumptions used and any overlay adjustments made to ECL models.

Offsetting of cash and overdrafts

The FRC made enquiries when cash and overdraft balances were offset but it was unclear whether the qualifying criteria for offset had been met, and also, when overdraft balances in the parent entity accounts were greater than those in the consolidated accounts but no disclosures were provided about offsetting financial assets and financial liabilities.

Cash and overdraft balances should be offset only when the qualifying criteria have been met. For example, balances that are part of a cash-pooling arrangement that includes a legal right of offset may be offset in the balance sheet only when there is also an intention either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

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Other disclosures

The FRC also identified areas for improvement related to:

- inconsistencies in information disclosed about borrowings or committed facilities;
- lack of disclosures about the collateral held as security for financial instruments;
- disclosures that indicated that financial assets had been pledged as security, but no details of the amount or nature of the security were provided; and
- inadequate information about liquidity risk associated with contingent consideration.

Entities should ensure the nature and extent of material risks arising from financial instruments (including inflation and rising interest rates) and related risk management are adequately disclosed, including the methods used to measure exposure to risks and any changes from the previous period, and any hedging arrangements put in place to fix interest rates or hedge against the effects of inflation. Sufficient information also needs to be given about banking covenants, hedging arrangements and the effect of financing arrangements (including changes in the arrangements) to enable users to understand their terms and the potential impact of any changes or breaches, unless considered remote.

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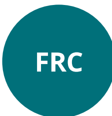

FRC focus area

Macroeconomic uncertainty

Income taxes

Entities should consider how lower or more volatile profit levels stemming from the current macroeconomic environment might influence income tax accounting.

The most common issues raised by the FRC in relation to income tax in its 2022/23 annual review related to support for the recoverability of deferred tax assets and clarification of reconciling items within effective tax rate reconciliations.

Most challenges related to entities reporting under IAS 12 *Income Taxes*. However, there was also a specific FRS 102 finding in relation to non-disclosure of the expected net reversal of deferred tax assets within the next financial period.

The FRC's thematic review on deferred tax assets includes guidance on improved disclosure in relation to deferred tax assets and its thematic review on tax disclosures addresses other areas of disclosure including the effective tax rate reconciliation, which remain relevant.

Recoverability of deferred tax assets (DTAs)

IAS 12 requires detailed supporting evidence for the recognition of material DTAs where entities have a recent history of losses. Entities should take into account the uncertain economic environment and changes in tax regimes when making forward-looking assessments to support recognition of DTAs in particular and consider whether additional disclosures about significant judgements or sources of estimation uncertainty are required. Entities should consider how lower or more volatile profit levels stemming from the current macroeconomic environment might influence income tax accounting. For example, a reduction in current-period income or the incurrence of losses, coupled with a reduction in forecast income, could result in a reassessment of whether it is probable that some or all of an entity's DTAs can be recovered. If declining earnings or impairments generate losses, entities will need to consider whether there is sufficient income within the carry-back and carry-forward periods available under tax law to fully or partially realise the related DTA.

Recognition of deferred tax assets and liabilities

Applying IAS 12, an entity may not have recognised deferred tax liabilities for taxable temporary differences associated with subsidiaries, branches and associates, and interests in joint arrangements, because it concluded that it controlled the timing of the reversal of the temporary differences and it had been deemed probable that the temporary differences would not reverse in the foreseeable future. Conversely, an entity may have recognised deferred tax assets for deductible temporary differences associated with such investments because it determined it probable that the temporary differences would reverse in the foreseeable future (and it was determined to be probable that the deferred tax asset could be recovered). If an entity or its subsidiaries have liquidity issues or other challenges resulting from the current macroeconomic environment such that there is a change in intent with respect to the repatriation of undistributed earnings in an investee, it may be appropriate to reconsider these conclusions.

Disclosure is also important in this area, in particular of entity-specific information about the nature of the evidence supporting the recognition of deferred tax assets when there is a recent history of losses, and deferred tax judgements and estimates, including relevant sensitivities and/or the range of possible outcomes in the next 12 months.

The FRC has highlighted that where deferred tax assets and liabilities are presented on a gross basis, entities should be clear as to whether they have assessed the balances against the criteria for offset. The assessment against the offset criteria should factor in an ability to group relieve losses in the UK. The FRC also noted that the description of deferred tax liabilities arising from business combinations should be consistent with the nature of the assets acquired.

It is also important to assess deferred tax balances arising from tax requirements in other jurisdictions, for example as a result of one-off transactions such as business combinations – entities should ensure the relevant domestic tax requirements have been properly understood and applied and any changes in domestic tax requirements that might impact the temporary differences, and their expected reversal, have been identified, for example changes in tax being prompted by the implementation of Pillar Two model rules (see below).

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Effective tax rate reconciliation
Material reconciling items in the effective tax rate reconciliation should be adequately described and presented separately. Entities should also ensure they use the appropriate effective tax rate; when businesses operate outside the UK, it may be more meaningful to aggregate reconciliations prepared using the domestic rate in each individual jurisdiction and disclose a weighted average tax rate applied to the accounting profit.

Other disclosures

- The movements in current tax balances should reconcile to the current tax expense and cash outflows disclosed, i.e. there should be consistency in tax-related disclosures throughout the annual report and accounts.
- The basis for recognising and accounting for current and deferred tax in relation to share-based payments should be clearly explained.
- Sufficient detail should be disclosed in relation to uncertain tax provisions.
- Meaningful descriptions should always be provided for the types of temporary difference to which deferred tax balances relate.
- Clear explanations should be provided for any deferred tax asset movements that are recognised directly in equity.
- Accounting policies relating to Research and Development Expenditure Credits (RDEC) and related tax implications should be clearly stated.
- Tax on gains recognised in other comprehensive income should be considered, and explanation provided if no tax is charged on such gains.
- The effects of changes in tax regimes and of the difficult economic environment should be considered when making forward looking assessments to support the recognition of tax.

OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS)
In February 2023, the OECD released technical guidance on its 15% global minimum tax agreed as the second 'pillar' of a project to address the tax challenges arising from digitalisation of the economy. This guidance elaborates on the application and operation of the Global Anti-Base Erosion (GloBE) Rules agreed and released in December 2021 which lay out a co-ordinated system to ensure that multinational enterprises with revenues above €750 million pay tax of at least 15% on the income arising in each of the jurisdictions in which they operate.

Since that time many countries have enacted (or are in the process of enacting) Pillar Two-related laws. As such, entities that may be subject to the rules will need to monitor the legislation process in the jurisdictions in which they operate and assess whether the Pillar Two legislation has been enacted (or substantively enacted) in any such jurisdictions. A Deloitte Global Pillar Two Legislative Tracker provides updates on legislation being introduced to implement Pillar Two. (The Finance Bill No.2 2023, which includes the UK's implementation of the OECD Pillar Two tax rules, was substantively enacted on 20 June 2023.)

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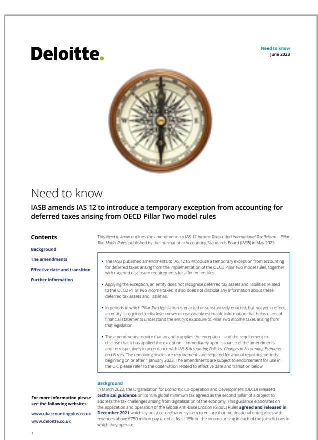

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Need to know
June 2023

Need to know

IASB amends IAS 12 to introduce a temporary exception from accounting for deferred taxes arising from OECD Pillar Two model rules

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Effective date and transition

Further information

This *Need to know* outlines the amendments to IAS 12 *Income Taxes* titled *International Tax Reform—Pillar Two Model Rules*, published by the International Accounting Standards Board (IASB) in May 2023.

- The IASB published amendments to IAS 12 to introduce a temporary exception from accounting for deferred taxes arising from the implementation of the OECD Pillar Two model rules, together with targeted disclosure requirements for affected entities.
- Applying the exception, an entity does not recognise deferred tax assets and liabilities related to the OECD Pillar Two income taxes. It also does not disclose any information about these deferred tax assets and liabilities.
- In periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity is required to 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.
- The amendments require that an entity applies the exception—and the requirement to disclose that it has applied the exception—immediately upon issuance of the amendments and retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The remaining disclosure requirements are required for annual reporting periods beginning on or after 1 January 2023. The amendments are subject to endorsement for use in the UK, please refer to the observation related to effective date and transition below.

Background

In March 2022, the Organisation for Economic Co-operation and Development (OECD) released **technical guidance** on its 15% global minimum tax agreed as the second 'pillar' of a project to address the tax challenges arising from digitalisation of the economy. This guidance elaborates on the application and operation of the Global Anti-Base Erosion (GloBE) Rules **agreed and released in December 2021** which lay out a co-ordinated system to ensure that multinational enterprises with revenues above €750 million pay tax of at least 15% on the income arising in each of the jurisdictions in which they operate.

For more information please see the following websites:

www.ukaccountingplus.co.uk
www.deloitte.co.uk

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A Deloitte Need to know: IASB amends IAS 12 for deferred taxes arising from OECD Pillar Two model rules outlines these amendments in more detail.

Amendments to IAS 12

In May 2023, the IASB published amendments to IAS 12 to introduce a temporary exception from accounting for deferred taxes arising from the implementation of the Pillar Two model rules, together with targeted disclosure requirements for affected entities. Applying the exception, an entity does not recognise, or disclose information about, deferred tax assets and liabilities related to the Pillar Two income taxes. Instead, an entity is required to disclose that it has applied the exception. An entity also discloses separately its current tax expense (income) related to Pillar Two income taxes.

Disclosures required if the Pillar Two legislation is not yet enacted or substantively enacted but not yet effective

The amendments to IAS 12 require an entity to disclose qualitative and quantitative information about its exposure to Pillar Two income taxes 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 should instead disclose a statement to that effect and information about its progress in assessing its exposure.

Examples of information an entity could disclose to meet these disclosure requirements include:

- Qualitative information such as information about how an entity is affected by Pillar Two legislation and the main jurisdictions in which exposures to Pillar Two income taxes might exist.
- Quantitative information such as:
  - An indication of the proportion of an entity's profits that might be subject to Pillar Two income taxes and the average effective tax rate applicable to those profits; or
  - An indication of how the entity's average effective tax rate would have changed if Pillar Two legislation had been in effect.

Disclosures required if the Pillar Two legislation is not yet enacted or substantively enacted

Whilst the amendments to IAS 12 specify the disclosures to be provided once the legislation is enacted or substantively enacted, an entity should nevertheless assess whether disclosures are required in earlier periods.

Indeed, IAS 1:17(c) indicates that fair presentation may require an entity to provide disclosures in addition to the information specifically required by an IFRS Accounting Standard to enable users of its financial statements to understand the impact of particular events and conditions on the entity's financial position and financial performance.

Accordingly, entities should assess whether the level of commitment in the jurisdictions in which they operate to the implementation of Pillar Two rules indicates that the tax laws in one or more of these jurisdictions are expected to incorporate the Pillar Two model rules. If this is the case and if the entity concludes that the rules may have a significant effect on its operations, it should disclose that fact along with relevant information (for example, the information required by the amendments to IAS 12 as described above).

Entities that do not expect a material exposure to Pillar Two income taxes

The fact that a multinational entity does not expect to be exposed to Pillar Two income taxes or that it expects its exposure to be immaterial may be relevant information that the entity should consider disclosing (along with the reason why it does not expect to have material exposure to Pillar Two income taxes). This information is more likely to be relevant if the entity has revenues above €750 million (and therefore is within the scope of the Pillar Two model rules).

An entity may be required to make various assumptions in determining its potential exposure. IAS 1:125 requires disclosure about assumptions about the future and other sources of estimation uncertainty that have a significant risk of resulting in material adjustments within the next financial year. Where an entity assesses that its potential exposure to Pillar Two income taxes is likely to be immaterial, it might nevertheless consider that there is a significant risk, for example, that changes in assumptions could result in the exposure being material. In which case it should consider if further information should be disclosed to meet the requirements of IAS 1:125.

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FRC focus area

Revenue

In the FRC's 2022/23 review cycle, the number of queries regarding revenue recognition and related disclosures were lower than in preceding years, indicating that entities have become more familiar with application of the IFRS 15 recognition model.

The most common areas of challenge included variable consideration, principal/agent considerations and contract balances. Queries were mostly centred around insufficient information to demonstrate compliance with certain requirements. For more guidance, entities should refer to the FRC's 2019 Thematic Review: IFRS 15 *Revenue from Contracts with Customers* and the 2020 follow up report.

Variable consideration

Where material variable consideration exists, accounting policies should include sufficient information to explain how it is estimated, the circumstances in which it arose and how the constraint has been applied.

Principal versus agent

There should be adequate information, including about the contractual arrangements in place, relating to the assessment of principal versus agent. Significant judgements in relation to revenue recognition should also be disclosed.

Specific to professional services firms, where disbursements have been excluded from revenue, their treatment should still be explained and should indicate whether the entity is acting in the capacity of an agent or a principal.

Contract balances

The FRC encourages adequate disclosure and information about contract assets such as related judgements, the materiality of the amounts, the nature of contracts, costs and the basis for recognition where there have been significant movements in contract balances.

Performance obligations

Accounting policies should be in place for all significant performance obligations and should address timing of revenue recognition, the basis for recognising any revenue over time and the methodology applied in detail.

Other disclosures

- The nature of significant revenue streams as well as the accounting policies applied to these should be disclosed.
- Where sales are made with a right of return, the right of return liability should be disclosed.
- Entities are reminded to adequately disclose and explain inflationary features in contracts with customers and the accounting thereof.

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FRC focus area

Macroeconomic uncertainty

Provisions and contingencies

The types of challenges raised with entities in the FRC's 2022/23 annual review cycle were broadly the same as in the prior year, including:

- clarification on the discount rates used for certain provisions, specifically when it was unclear if inflation assumptions included in the cash flows and discount rates were internally consistent. Questions were also raised when the discount rate did not appear to reflect the risks specific to the liability;
- omission of disclosure requirements for certain provisions and contingent liabilities under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets;*
- requests for more information when descriptions of provisions balances were unclear or not meaningful;
- queries relating to potential undisclosed contingent liabilities or unrecognised provisions based on information included elsewhere in the annual report;
- requests for further information to explain the basis for recognition of insurance reimbursement assets when it was unclear whether its realisation was virtually certain; and
- clarification where it appeared entities had presented provisions net of the related reimbursement asset, instead of recognising gross amounts.

Entities should ensure that the inputs used in measuring provisions follow a consistent approach in incorporating the effects of inflation. Nominal cash flows, which include the effects of inflation, should be discounted at a nominal rate and real cash flows, which exclude the effects of inflation, should be discounted at a real rate. Details of how the inflation assumptions have been calculated should be provided where they have a material impact on the financial statements.

Clear and specific descriptions of the nature and uncertainties should be given for each material exposure for which a provision is recognised or a contingent liability is disclosed, as well as the timeframe over which it is expected to crystallise and the basis for determining the best estimate of the probable or possible outflow. The FRC strongly encourages entities to refer to the best practice examples and key disclosure expectations included in its 2021 thematic review on provisions and contingencies.

Presentation of financial statements

The most common areas of challenge included the rationale behind the classification of current and non-current balances , particularly regarding intercompany balances, non-disclosure of material impairment losses on the face of the income statement and the adequacy of accounting policy disclosure for material balances or amounts. In particular, the non-disclosure of material impairment losses in respect of trade receivables prompted a number of enquiries from the FRC, resulting in four entities restating their income statements. Further questions were asked where entities had seemed to inappropriately combine or offset items in the same line item in the income statement or aggregate material items of a dissimilar nature.

The FRC encourages entities to provide clearer and more detailed disclosure about the decisions made regarding presentational matters such as level of aggregation and offsetting and material accounting policies. Additional entity-specific disclosure should be provided where compliance with the specific requirements of relevant IFRS Accounting Standards does not result in sufficient disclosure for a user to understand the impact of particular transactions, events and conditions, on the entity's financial performance and position.

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FRC focus area

Macroeconomic uncertainty

Fair value measurement

In challenging economic environments and with the additional risks posed by climate change, the degree of estimation uncertainty and management judgement in the area of fair value measurement is likely to be increased. Many IFRS Accounting Standards require or permit fair value measurements. Therefore, clear and transparent disclosures of fair value measurements are increasingly important.

Compliance with IFRS 13 *Fair Value Measurement* has returned to the FRC's top ten query list and has been the subject of a thematic review in 2023. The thematic review highlights the following areas where the FRC notes improvements can be made and makes a number of specific recommendations. The FRC expects entities to consider the examples provided of better disclosure and opportunities for improvement and to incorporate them in their future reporting where relevant and material.

Determining fair value

Whilst a recent transaction price usually reflects fair value, there may be circumstances where this is not the case, for example, in transactions with related parties, or where changes in market conditions have affected the investee's growth prospects or the expected achievement of milestones. In such cases, entities should adjust the transaction price to ensure it reflects fair value.

Where an entity intends to value an investment using the transaction price for a similar, but not identical instrument, it should ensure it understands any differences between the instruments. Where adjustments are needed, the basis on which the valuation has been carried out should be stated, together with any significant judgements and adjustments made and the reasons for those adjustments and where possible, sensitivity should be quantified.

Fair value measurements should use market participants' assumptions rather than the entity's own assumptions and they should reflect the characteristics of the relevant assets, liabilities or equity instruments being fair valued. Assumptions should also be current assumptions as at the measurement date; the FRC will challenge entities where historical data is used.

If the highest and best use of a non-financial asset measured at fair value differs from its current use, that fact should be disclosed as well as the reason for using the asset in a manner other than highest and best use. Where the highest and best use of a non-financial asset is in combination with other assets and liabilities (e.g. a business) disclosures should explain how the fair value determined for the group of assets and liabilities has been allocated to individual assets.

Specialist third-party advice

Where an entity is required to value a material item and no internal expertise exists, entities should consider the need for specialist third party advice. Where such advice has been obtained, entities should consider disclosing that fact.

Transparent disclosures

High quality disclosures are essential to address the overall disclosure objective of the standard. Consequently, entities should be transparent about the valuation approach, underlying assumptions, management judgement and estimation uncertainty in fair value measurements, while avoiding boilerplate and immaterial information.

Entities are reminded that information in addition to the specific requirements may be necessary to provide useful and relevant information for the users (e.g. a description of the nature of the item being measured at fair value and the characteristics of the item that are considered in the determination of the relevant inputs).

Information on fair value measurements should be consistent across the annual report and accounts and should reflect the significant risks facing the business. Management commentary should complement and further explain fair value measurements when this enhances the users' understanding.

Where climate-related matters materially affect fair value measurement, the FRC expects an explanation of how the impact has been incorporated into the measurement and, if relevant, to quantify any significant estimation uncertainty. The information provided should be consistent across the annual report. Simply stating that the risk has been incorporated into the fair value measurement would not be sufficient.

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Sensitivity analyses

Sensitivity analyses provide useful information and the FRC challenges entities that do not provide disclosures of the effect of reasonably possible alternative assumptions on the fair value of financial assets and liabilities.

Quantification of unobservable inputs

Entities should disclose the significant estimation uncertainty in relation to fair value measurements and provide meaningful quantitative details of the significant unobservable inputs for measurements categorised within Level 3 of the fair value hierarchy.

Other matters

IFRS 13 disclosures should be provided at a class level. The class of assets and liabilities is determined on the basis of their nature (for example, debt vs equity investments), characteristics and risks (including climate change). When determining an appropriate level of detail and aggregation or disaggregation of information, entities should ensure the level results in useful disclosures.

Most of the FRC's queries arise from unclear or omitted disclosure of recurring Level 3 measurements, for which the significant unobservable inputs and adjustments should be quantified. Other level 3 disclosures often omitted include the reconciliation of opening and closing balances and quantitative sensitivity for financial instruments.

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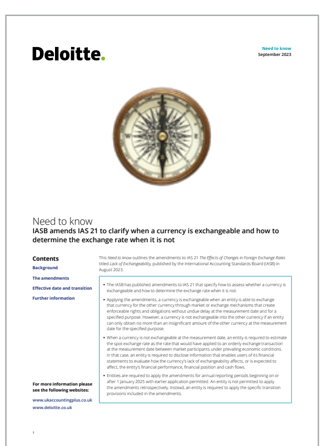

A Deloitte Need to know: IASB amends IAS 21 to clarify when a currency is exchangeable and how to determine the exchange rate when it is not discusses the amendments and provides further guidance.

Other financial reporting considerations

Currency and hyperinflation

The higher levels of general inflation have contributed to an increase in the number of jurisdictions that are subject to hyperinflation (as that term is defined in IAS 29 *Financial Reporting in Hyperinflationary Economies*). Entities are therefore increasingly facing the following challenges:

- Determining whether an economy is hyperinflationary as defined in IAS 29 can sometimes prove difficult. The definition includes several characteristics of hyperinflation, although hyperinflation is most often evidenced when the cumulative inflation rate over three years approaches or exceeds 100%. It can also be challenging to decide which general price index should be applied to amounts in the financial statements.
- Entities may face difficulties in determining an entity's functional currency in circumstances where both a local and international currency are in common use. This can be particularly significant where the local currency is hyperinflationary. IAS 29 is only applied by entities whose functional currency is the currency of a hyperinflationary economy (rather than by any entity operating in that economy). It should also be noted that IAS 21 *The Effects of Changes in Foreign Exchange Rates* specifically states that "[a]n entity cannot avoid restatement in accordance with IAS 29 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its parent)".
- When exchanges between a local currency and globally traded currencies are restricted, it may be difficult to identify a suitable exchange rate for translating monetary items in individual financial statements and translating the financial statements of a foreign operation in its parent's presentation currency. Although this issue is not specific to hyperinflationary economies, a shortage of 'hard' currency and therefore a need for exchange restrictions is often a feature of economies whose local currency is losing value.

When inflation or exchange issues result in a significant judgement or give rise to a source of estimation uncertainty, disclosure should be provided as required by IAS 1:122 and 125.

Based on data available at the time of writing, including the latest inflation forecasts from the International Monetary Fund (IMF) published in October 2023 and the indicators laid out in IAS 29, the following economies are widely considered to be hyperinflationary for the purposes of applying IAS 29 and for retranslation of foreign operations in accordance with IAS 21 in financial statements for reporting periods ending on or after 31 March 2024:

- Argentina
- Ethiopia
- Ghana
- Haiti
- Iran
- Lebanon
- Sierra Leone
- Sudan
- Suriname
- Syria
- Türkiye
- Venezuela
- Yemen
- Zimbabwe

As at 31 March 2024, other countries whose currencies should be monitored for hyperinflation include Angola, Burundi, Egypt, Laos, Malawi, Nigeria, Pakistan and Sri Lanka.

Both the IMF inflation forecasts released in October 2023 and local data from the South Sudan National Bureau of Statistics show the three-year cumulative inflation in South Sudan to be significantly below 100%. As a result, based on information available at the time of writing, the economy in South Sudan is widely considered no longer to be hyperinflationary for reporting periods ending on or after 31 December 2023.

Entities should be aware that the list of economies widely considered to be hyperinflationary for the purposes of applying IAS 29 may change by the time of their reporting date.

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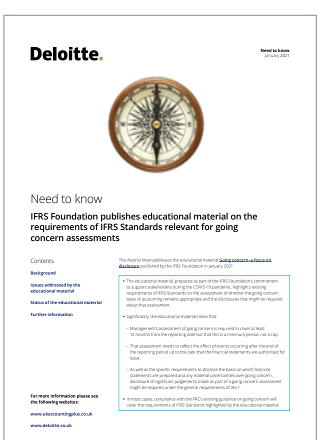
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Need to know
January 2021

Need to know

IFRS Foundation publishes educational material on the requirements of IFRS Standards relevant for going concern assessments

Contents

Background

Issues addressed by the educational material

Status of the educational material

Further information

This *Need to know* addresses the educational material Going concern–a focus on disclosure published by the IFRS Foundation in January 2021.

- The educational material, prepared as part of the IFRS Foundation's commitment to support stakeholders during the COVID-19 pandemic, highlights existing requirements of IFRS Standards on the assessment of whether the going concern basis of accounting remains appropriate and the disclosures that might be required about that assessment.
- Significantly, the educational material notes that:
  - Management's assessment of going concern is required to cover at least 12 months from the reporting date but that this is a minimum period, not a cap.
  - That assessment needs to reflect the effect of events occurring after the end of the reporting period up to the date that the financial statements are authorised for issue.
  - As well as the specific requirements to disclose the basis on which financial statements are prepared and any material uncertainties over going concern, disclosure of significant judgements made as part of a going concern assessment might be required under the general requirements of IAS 1.
- In most cases, compliance with the FRC's existing guidance on going concern will cover the requirements of IFRS Standards highlighted by the educational material.

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

A Deloitte Need to Know: IFRS Foundation publishes educational material on the requirements of IFRS Standards relevant for going concern assessments discusses the IASB's educational material in more detail.

Defined benefit pensions – UK High Court ruling

In June 2023, the UK High Court issued a ruling in the case of Virgin Media Limited v NTL Pension Trustees II Limited and others relating to the validity of certain historical pension changes. This case may have implications for other defined benefit schemes in the UK.

Between 1997 and 2016, it was possible to be 'contracted-out' from the Additional State Pension (also known as the State Second Pension, being an amount payable in excess of the basic state pension) in exchange for reduced National Insurance contributions. In such cases, members accrued certain benefits under Section 9(2B) of the Pension Schemes Act 1993, which replaced earlier provisions on Guaranteed Minimum Pensions (GMP). Contracted-out schemes had to pass an overall scheme quality test related to the members' Section 9(2B) rights.

When making an amendment affecting Section 9(2B) rights, Section 37 of the Pension Schemes Act 1993 and Regulation 42 of the Occupational Pension Schemes (Contracting-out) Regulations 1996 require actuarial confirmation that a scheme would continue to satisfy the scheme quality test for those rights. The case focused on the consequences of failing to obtain such actuarial confirmation.

The Virgin Media case related to the validity of a trust deed and rules change from 1999, for which no Section 37 actuarial confirmation had been located. The court was asked to proceed on the assumption that no Section 37 actuarial confirmation was issued, because at the time of the case no such confirmation had been found. This means that the final outcome for members is still uncertain.

The court decided that the failure to obtain actuarial confirmation meant that the benefit amendment was invalid and void, both in relation to past and future 9(2B) benefits. The court also decided that the requirement for actuarial confirmation applied to changes that would improve 9(2B) benefits as well as those that would or could adversely affect those benefits.

The ruling is expected to be appealed in 2024. Many legal firms have indicated that the ruling brings with it considerable legal uncertainty, with some indicating that scheme trustees may decide to wait until there is more clarity before investigating further.

Entities with defined benefit pension schemes that were contracted out between 1997 and 2016 should assess whether the ruling is relevant (i.e. because amendments were made that could have impacted Section 9(2B) rights) and if so, whether actuarial confirmations were obtained. Entities not currently able to determine whether actuarial confirmations were obtained or to estimate the accounting impact of not having obtained actuarial confirmations should consider disclosure of the existence of the Virgin Media case, the fact that it could have a potential impact on the entity and that the impact continues to be assessed.

Going concern

It is possible that economic pressures or changes might render a business model unviable or access to necessary financing might be limited. In such circumstances, it is necessary to assess whether the entity might be unable to continue as a going concern, which in accordance with IAS 1 should be for a period of at least, but not limited to, 12 months from the reporting date. In line with the FRC's *Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks*, when assessing whether the going concern basis is appropriate, UK entities should consider a period of at least 12 months from the date the financial statements are authorised for issue.

Financial statements are prepared on a going concern basis unless management intends either to liquidate the entity or to cease trading or has no realistic alternative but to do so. When making its assessment, if management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity must disclose those uncertainties or significant judgements taken in reaching a conclusion that no material uncertainty exists.

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Events after the reporting date

The emergence of new issues or new developments after the period end may require careful consideration to distinguish between adjusting events providing evidence of conditions that existed at the end of the reporting period and non-adjusting events indicative of conditions that arose after the reporting period.

As well as determining in which reporting period the event itself should be accounted for, this distinction is important to forward-looking calculations and related disclosures. For example, an impairment review under IAS 36 or expected credit loss calculation under IFRS 9 and disclosure of sensitivities to reasonably possible changes in forecasts should be based on conditions at the reporting date and are not affected by subsequent, non-adjusting events. It may be helpful to provide additional disclosure of how assessments have changed since the reporting date, but this should be clearly identified as being distinct from the information as at the reporting date.

Business combinations

Business combinations can be highly significant, in some cases fundamentally changing the nature or scope of an entity's operations. As such, entities should give clear and consistent explanations of the impact of a business combination throughout the annual report, with careful thought given as to how to convey the information in an understandable and concise way. Similarly:

- An explanation of factors giving rise to goodwill should be provided and, if possible, should include considerations specific to the business combination in question, rather than only providing boilerplate disclosures.
- Disclosures related to contingent consideration should include entity-specific explanations of the arrangements and the potential variability in the amounts payable.

The mechanics of business combination accounting can also be complex, with significant judgements sometimes needed in determining, for example, whether elements of a deal form part of the business combination for accounting purposes or should instead be accounted for as separate transactions (for example, the requirements to determine whether share-based payments form part of consideration or are accounted for as a post-combination expense are complex). Care should be taken in performing this exercise and clear disclosure provided of the judgements made in either applying IFRS 3 *Business Combinations* or, in cases where it is not clear whether a transaction meets the definition of a business combination or should be accounted for as an asset purchase, determining whether IFRS 3 is applicable at all.

In December 2023, IOSCO issued Recommendations on Accounting for Goodwill aimed at enhancing the reliability, faithful representation and transparency of goodwill recognised and disclosed in the financial statements. IOSCO makes four recommendations to preparers of financial statements:

- properly recognise all identifiable intangible assets and provide entity-specific disclosure of the factors that make up the goodwill recognised in a business combination;
- obtain sufficient evidence to demonstrate that assumptions used in impairment tests are reasonable and supportable;
- ensure consistency between assumptions used in goodwill impairment tests and non-financial disclosures; and
- clearly disclose impairment tests of goodwill, including how key assumptions are determined.

In respect of the last recommendation, IOSCO notes that good practices include disclosing:

- the percentage by which the fair value or the value in use exceeds the carrying amount of a CGU or a group of CGUs, especially when there is a significant risk of a material adjustment to the carrying amounts of goodwill within the next financial year;
- the degree of uncertainty associated with the key assumptions. For example, uncertainty regarding assumptions within a valuation model that may involve future expectations for economic recovery from a business downturn that may have uncertain time horizons; and
- potential events and / or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.

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Earnings per share (EPS)

Basic and diluted EPS are often seen as important metrics of an entity's performance and, as such, are often included in the first announcement of results for a period as well as in the full financial statements. However, the calculation of those figures can be highly complex and might not always be well understood by users. Although the disclosure requirements of IAS 33 *Earnings per Share* are relatively limited in this respect, it should be noted that the general requirements of IAS 1 to disclose significant judgements made in preparing the financial statements can also apply to the calculation of EPS (for example, if judgement is needed in determining the substance of a share reorganisation).

The following are also noted as details of EPS calculations that can easily be misapplied:

- The determination of whether potential ordinary shares are dilutive or antidilutive must be based on profit or loss from continuing operations.
- Share reorganisations that involve a bonus element require retrospective adjustment in the weighted average number of ordinary shares used for the calculation of basic and diluted EPS for all periods presented.
- When preference shares are classified as equity, earnings used for the calculation of basic and diluted EPS are adjusted for all the effects of those preference shares, including dividends and any premiums arising on redemption.

The guidance on the use of non-GAAP measures discussed in section Non-GAAP and alternative performance measures is also applicable to the presentation of adjusted EPS figures. In particular, these should not be given more prominence than 'statutory' EPS measures and the methodology applied in their calculation, including the basis used for tax on adjusting items, should be clearly disclosed.

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Interim financial reporting

Timely and high-quality interim disclosure is important to primary users of financial statements. Deloitte's *Model half-yearly financial report for the year ended 30 June 2023* publication illustrates typical disclosures which will be required of a UK listed company in its half-yearly financial report in accordance with IAS 34 *Interim Financial Reporting*, together with an overview of applicable requirements and key messages and expectations from the FRC and ESMA that should be considered in conjunction with the messages in this publication, when preparing half-yearly financial reports.

The areas of consideration which are most likely to be relevant when preparing interim financial statements – in addition to those already described throughout this publication – are discussed below.

Important events and transactions

Entities preparing condensed interim financial statements are required, in accordance with IAS 34:15, to provide "an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period". A non-exhaustive list of events that may be considered for disclosure, if significant, is provided in IAS 34:15B. Additionally, IAS 34:16A specifies disclosures which should be made in the notes to the condensed interim financial statements, including in respect of changes in accounting policies and methods of computation (for example, see Insurance contracts).

As entities respond to the ongoing uncertainties stemming from the current macroeconomic and geopolitical environment, there are likely to be other important events that may require disclosure in the notes to the condensed interim financial statements.

Estimates

Given the ongoing level of uncertainty, entities may need to revise their estimates (for example, as a result of changes in interest rates) during the interim period and provide disclosures in accordance with IAS 34:16A(d). Where this is the case, disclosures should clearly describe the reasons for the change in estimates and the estimation methods used, particularly if assets and liabilities have been subject to greater use of estimation methods than at the most recent year end.

Impairment of assets

The requirements of IFRS Accounting Standards in respect of impairment losses and reversals of impairment losses apply to condensed interim financial statements.

For many assets (including goodwill, property, plant and equipment, right-of-use assets, intangible assets and investments in subsidiaries, joint ventures and associates) this means assessing at the reporting date whether there is an indication of impairment or reversal of a previous impairment (except for reversals of previous goodwill impairments which are prohibited) and, if so, determining the recoverable amount (the higher of value-in-use and fair value less costs of disposal) in accordance with IAS 36. Entities need to assess the existence of impairment indicators as at an interim reporting date irrespective of the conclusion reached at the most recent annual reporting date.

In addition, although there is a general requirement to test goodwill for impairment at the same time each year, goodwill must also be tested at the interim reporting date if there is an indication that the goodwill may be impaired.

Due to uncertainties in the environment, forecast cash flows previously used in value-in-use or fair value less costs of disposal calculations at the most recent annual reporting date may no longer reflect conditions at a subsequent interim reporting date. When this is the case, entities will need to prepare new or updated forecasts that reflect management's revised expectations and the updated conditions at the interim reporting date.

If material impairment losses are recognised during an interim period, entities should consider additional disclosures about these losses as required by IAS 34:15B(b).

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Going concern
The going concern requirements set out in IAS 1:25 and 26 apply to interim financial statements. Therefore, management will need to consider whether there are material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern for a period of at least 12 months from the end of the interim reporting period. In making this assessment, management will need to take into account all information available up to the date of authorisation of the interim financial statements.

In addition, the entity will need to consider whether new or updated information is required to be disclosed about its going concern assessment in the condensed interim financial statements.

In assessing whether the going concern basis is appropriate, UK entities should consider a period of at least 12 months from the date the financial statements are authorised for issue.

Recognition and measurement
The principles for recognising assets, liabilities, income and expenses in the condensed interim financial statements are the same as in annual financial statements. IAS 34:41 requires that the measurement procedures used in interim financial statements produce information that is reliable, with all material relevant financial information being appropriately disclosed. Accordingly, the challenges described elsewhere in this publication, for example the measurement of the recoverable amount of non-financial assets and of expected credit loss allowances on financial assets, will need to be addressed in the same manner in interim financial statements. IAS 34 nevertheless acknowledges that, whilst reasonable estimates are often used for both annual and interim financial statements, interim financial statements will generally require a greater use of estimation methods than annual financial reports.

Other disclosures
As explained above, the overarching objective in IAS 34 is that the interim financial statements should provide an explanation and an update to the relevant information included in the annual financial statements. In addition to the specific considerations explained above, entities will need to consider any additional disclosures that may be needed to meet this overarching objective, which in the current volatile and uncertain environment may require additional disclosure for significant impacts arising as a result of the events after the end of the interim reporting period.

Whilst IAS 1 generally does not apply to the structure and content of condensed interim financial statements prepared in accordance with IAS 34, IAS 1:4 clarifies that IAS 1:15-35 apply to such statements. Both IAS 1:17 and 31 require additional information to that required by individual Standards, when necessary to enable a user's understanding of the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. In the current context when an entity's financial situation may have changed significantly since its last annual financial statements, some of the disclosures that are normally only required by individual IFRS Accounting Standards for a complete set of (annual) financial statements may be used to provide relevant information on the consequences of circumstances that have emerged during the interim reporting period.

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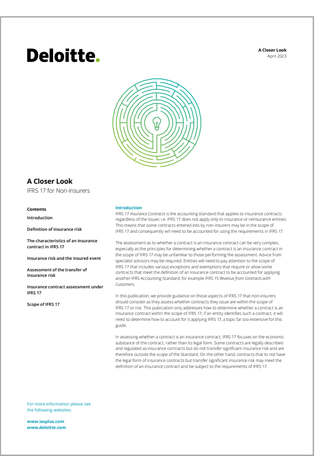

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A Closer Look
April 2023

A Closer Look
IFRS 17 for Non-insurers

Contents

Introduction

Definition of insurance risk

The characteristics of an insurance contract in IFRS 17

Insurance risk and the insured event

Assessment of the transfer of insurance risk

Insurance contract assessment under IFRS 17

Scope of IFRS 17

Introduction

IFRS 17 *Insurance Contracts* is the accounting standard that applies to insurance contracts regardless of the issuer, i.e. IFRS 17 does not apply only to insurance or reinsurance entities. This means that some contracts entered into by non-insurers may be in the scope of IFRS 17 and consequently will need to be accounted for using the requirements in IFRS 17.

The assessment as to whether a contract is an insurance contract can be very complex, especially as the principles for determining whether a contract is an insurance contract in the scope of IFRS 17 may be unfamiliar to those performing the assessment. Advice from specialist advisors may be required. Entities will need to pay attention to the scope of IFRS 17 that includes various exceptions and exemptions that require or allow some contracts that meet the definition of an insurance contract to be accounted for applying another IFRS Accounting Standard, for example IFRS 15 *Revenue from Contracts with Customers.*

In this publication, we provide guidance on those aspects of IFRS 17 that non-insurers should consider as they assess whether contracts they issue are within the scope of IFRS 17 or not. This publication only addresses how to determine whether a contract is an insurance contract within the scope of IFRS 17; if an entity identifies such a contract, it will need to determine how to account for it applying IFRS 17, a topic far too extensive for this guide.

In assessing whether a contract is an insurance contract, IFRS 17 focuses on the economic substance of the contract, rather than its legal form. Some contracts are legally described and regulated as insurance contracts but do not transfer significant insurance risk and are therefore outside the scope of the Standard. On the other hand, contracts that to not have the legal form of insurance contracts but transfer significant insurance risk may meet the definition of an insurance contract and be subject to the requirements of IFRS 17.

For more information please see the following websites:

www.iasplus.com
www.deloitte.com

A Deloitte A Closer Look provides guidance on aspects of IFRS 17 that non-insurers should consider when they assess whether contracts they issue are within the scope of IFRS 17.

New IFRS requirements and future developments

This section highlights the key new requirements under IFRS Accounting Standards as well as those available for early adoption, subject to endorsement for use in the UK. For a full list of new and forthcoming IFRS requirements, please refer to the Appendix.

New IFRS requirements for periods commencing on or after 1 January 2023

A complete list of new IFRS requirements for periods commencing on or after 1 January 2023 is included in the Appendix, with some key new requirements discussed in more detail below.

Insurance contracts

Many entities will reflect the application of IFRS 17 in their annual financial statements for the first time in 2023. For many insurers, this will also be the first time they apply IFRS 9 given entities with significant business activities were offered the option to defer the application of IFRS 9 until the initial application of IFRS 17.

It is widely anticipated that the impact of the adoption of these standards on insurance entities will be very material. However, other entities will also be affected by IFRS 17. Whilst the specific facts will dictate the level of information disclosed, all entities should ensure that their disclosures are clear, concise, and entity-specific. Entities need to consider the requirements in IAS 8 on disclosures required for initial application of an IFRS Accounting Standard, accompanied by the detailed requirements of IFRS 17 and IFRS 7.

Entities need to be mindful that when the retrospective application of IFRS 17 has a material effect on the statement of financial position as at the transition date (i.e. the beginning of the annual reporting period immediately preceding the date of initial application of IFRS 17), IAS 1:40A requires that this third statement of financial position be included in the annual financial statements in the year of initial application of IFRS 17.

In November 2023, the FRC released its Thematic Review: IFRS 17 *Insurance Contracts* Interim Disclosures in the First Year of Application. The FRC's review covered a small sample of interim financial statements and focused on the adequacy of disclosures relating to the effect of the transition to IFRS 17 in the first year of adoption. Particular attention was given to some of the key financial reporting issues to consider under IFRS 17 including transition disclosures, accounting policies, significant judgements and estimates, estimates of future cash flows and contractual service margin (CSM), discount rates, risk adjustment, measurement models, APMs and the first-time application of IFRS 9 alongside IFRS 17.

Overall, the FRC was pleased with the quality of disclosures reviewed but highlights improvements in reporting that could be made with recommendations set out in the report. The FRC has set out its findings in the report alongside examples of better practice and it expects entities to take these into account in future reporting. In particular, the FRC expects entities to:

- provide both quantitative and qualitative disclosures that are entity-specific and decision-useful, which meet the objectives of IFRS 17 and enable users to understand how insurance contracts are measured and presented in the financial statements;
- ensure that accounting policies relating to IFRS 17 are sufficiently clear and detailed with consistent explanations of key judgements, accounting policy choices and methodologies, especially where IFRS 17 is not prescriptive;
- provide information about the underlying methodologies and assumptions made to determine the specific amount at risk of material adjustment in relation to sources of estimation uncertainty, and provide meaningful sensitivities and/or ranges of possible outcomes;
- provide a sufficiently disaggregated level of both quantitative and qualitative information to allow users to understand the financial effects of material portfolios of insurance (and reinsurance) contracts;
- clearly explain the impact of transition to IFRS 17, including the underlying methodology used to measure insurance contracts at the measurement date, and the disclosure of reconciliations of the CSM and revenue by transition method; and
- ensure that APMs and any changes to such measures are adequately explained, not given undue prominence and are reconciled to the most directly reconcilable line item in the financial statements.

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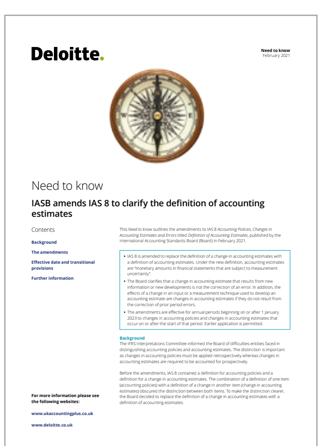
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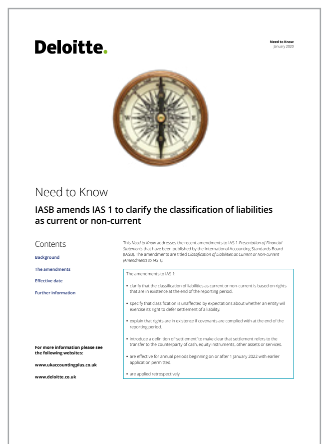
Need to know

IASB amends IAS 8 to clarify the definition of accounting estimates

Contents

A Deloitte Need to Know: Amendments to IAS 8 - Definition of Accounting Estimates discusses the amendments to IAS 8 in more detail.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Need to Know

IASB amends IAS 1 to clarify the classification of liabilities as current or non-current

Contents

A Deloitte Need to Know: Classification of liabilities as current or non-current discusses the amendments to IAS 1 in more detail.

While the FRC acknowledges that it may not be possible for insurance entities to implement all of the recommendations in their 2023 annual reports, it nevertheless expects them to continue to develop and improve their financial reporting under IFRS 17 as better practice emerges. A follow up thematic will also be carried out in respect of first annual financial statements under IFRS 17.

Disclosure of accounting policies

The 2021 amendments to IAS 1 and IFRS Practice Statement 2 *Disclosure of Accounting Policies* require entities to disclose material accounting policy information. Previously, entities were required to disclose their 'significant accounting policies'.

The amendments enhance the guidance available to entities to assess whether accounting policy information is material. For example, IAS 1:117B indicates that an entity is likely to consider that accounting policy information is material if it relates to material transactions, events or conditions and the accounting policy:

- changed during the period resulting in a material change to the information in the financial statements;
- was chosen from alternatives permitted by IFRS Accounting Standards;
- was developed in accordance with IAS 8, in the absence of an IFRS Accounting Standard which specifically applies;
- relates to an area for which the entity is required to make significant judgements and assumptions; or
- relates to complex accounting.

The amendments also highlight that if an entity chooses to disclose immaterial accounting policy information, that information should not obscure material accounting policy information (IAS 1:117D). This requirement, in particular, should be considered when an entity establishes the extent of disclosures on standardised accounting policy information which duplicates or summarises the requirements of the relevant IFRS Accounting Standards.

Forthcoming IFRS requirements for periods commencing on or after 1 January 2024

A complete list of forthcoming IFRS requirements for periods commencing on or after 1 January 2024 is included in the Appendix, with some key new requirements discussed in more detail below.

Classification of liabilities as current or non-current

The 2020 and 2022 amendments to IAS 1:

- introduce a definition of 'settlement' which clarifies that settlement refers to the transfer to the counterparty of cash, equity instruments, other assets or services;
- clarify that the classification of liabilities as current or non-current is based on rights that are in existence at the end of the reporting period;
- specify that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability;
- specify the impact of covenants on an entity's right to defer settlement for at least 12 months; and
- introduce a requirement to disclose information in the notes which enables users of financial statements to understand the risk that non-current liabilities with covenants may become repayable within 12 months.

In particular, the amendments establish that only covenants that an entity is required to comply with on or before the end of the reporting period affect the entity's right to defer settlement of a liability for at least 12 months after the reporting date. Conversely, a covenant that is only required to be complied with after the end of the reporting period does not affect whether such a right exist. However, if an entity expects that it may have difficulty complying with future covenants it should disclose information about this risk (as noted above) and consider the impact on going concern and liquidity risk.

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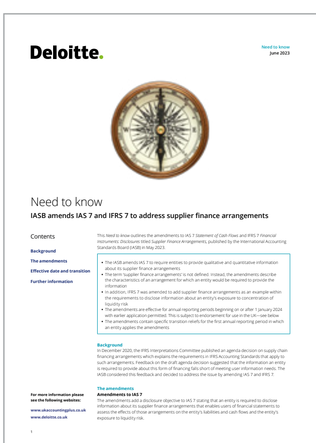
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Need to know
June 2023

Need to know
IASB amends IAS 7 and IFRS 7 to address supplier finance arrangements

Contents

Background
The amendments
Effective date and transition
Further information

A Deloitte Need to Know: Supplier finance arrangements discusses the amendments in more detail.

Supplier finance arrangements

In 2023, the IASB amended IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures* to require entities to provide additional disclosures about their supplier finance arrangements. This information includes:

- the terms and conditions of the supplier finance arrangements in place;
- the carrying amounts of the associated liabilities and the line items on which these amounts are presented;
- the range of payment due dates for both the financial liabilities associated with supplier finance arrangements and comparable trade payables that are not part of a supplier finance arrangement; and
- the carrying amounts of liabilities for which suppliers have already received payment from finance providers.

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New UK GAAP requirements and future developments

International tax reform – Pillar Two model rules

In July 2023, the FRC issued *Amendments to FRS 102 and FRS 101 – International tax reform – Pillar Two model rules* introducing a temporary exception to the accounting for deferred taxes arising from the implementation of the OECD's Pillar Two model rules, together with targeted disclosure requirements. The amendments are similar to those made to IAS 12 (see Income Taxes). The temporary exception introduced into FRS 102 applied immediately and retrospectively upon issue of the amendments. The effective date for the disclosure requirements is accounting periods beginning on or after 1 January 2023, with early application permitted.

Periodic review of UK and Republic of Ireland accounting standards

In March 2024, the FRC issued *Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review 2024* (the 2024 periodic review amendments) which introduce changes to FRS 102 and other UK and Republic of Ireland financial reporting standards as a result of the second major review of FRS 102.

The amendments are focused on updating UK GAAP accounting requirements to reflect changes in IFRS Accounting Standards and making other incremental improvements and clarifications.

The following principal amendments have been made.

- New accounting requirements have been introduced for revenue in FRS 102 and FRS 105 based on the five-step model for revenue recognition from IFRS 15 *Revenue from Contracts with Customers*, with appropriate simplifications. The extent to which this will change an entity's revenue recognition in practice will depend on the nature of its contracts with customers.
- New lease accounting requirements have been introduced in FRS 102, based on the on-balance sheet model from IFRS 16 *Leases*, with appropriate simplifications. This is expected to affect the financial statements of most entities that are lessees. No equivalent change has been made to FRS 105.

In addition, the following improvements and clarifications to FRS 102 have been made:

- Greater clarity for small entities in the UK applying Section 1A *Small Entities* regarding which disclosures need to be provided in order to give a true and fair view.
- A revised Section 2 *Concepts and Pervasive Principles*, updated to reflect the IASB's *Conceptual Framework for Financial Reporting*, issued in 2018.
- A new Section 2A *Fair Value Measurement*, replacing the Appendix *Fair Value Measurement* to Section 2 and updated to reflect the principles of IFRS 13 *Fair Value Measurement*.
- New disclosure requirements about supplier finance arrangements within Section 7 *Statement of Cash Flows*.
- Additional guidance within Section 26 *Share-based Payment* to aid preparers in applying the principles in certain situations.
- New guidance in Section 29 Income Tax on accounting for uncertain tax positions.
- A number of improvements and clarifications to existing guidance in Section 34 *Specialised Activities* and consequential changes as a result of other amendments.
- Removal of the option to newly adopt the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement* under paragraphs 11.2(b) and 12.2(b) (unless needed to achieve consistency with group accounting policies), in preparation for the eventual removal of this option. Entities already applying the IAS 39 option are permitted to continue to apply it.

The 2024 periodic review amendments also include many smaller proposed improvements and clarifications, affecting almost all Sections of the standard, although most of those changes are unlikely to have a significant impact in practice.

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The FRC has not made changes to introduce an expected credit loss model, consistent with IFRS 9 *Financial Instruments*, and no changes have been made to align the standards with IFRS 17 *Insurance Contracts*. The FRC has stated that any alignment with IFRS 17 or further alignment with IFRS 9 will be part of a future project and subject to further consultation.

The principal effective date of the amendments is accounting periods beginning on or after 1 January 2026, with early application permitted provided all amendments are applied at the same time. Earlier effective dates apply to new disclosures about supplier finance arrangements in Section 7 of FRS 102 (periods beginning on or after 1 January 2025, with early application permitted) and a new requirement in Section 6 *Transition to this FRS* of FRS 103 *Insurance Contracts* (periods beginning on or after 1 January 2024). Transitional provisions are included.

Review of FRS 101 *Reduced Disclosure Framework* (2023/24 cycle)

In December 2023, the FRC published an exposure draft (FRED 85) proposing minor amendments to FRS 101 for consistency with IAS 1 as part of its annual review cycle. The deadline for submission of comments to the FRC was 4 March 2024.

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Appendix

New and revised IFRS Standards and Interpretations

IAS 8:30 requires entities to consider and disclose (in annual financial statements) the potential impact of new and revised IFRS Accounting Standards that have been issued but are not yet effective. The sufficiency of these disclosures is a current area of regulatory focus.

The list below reflects a cut-off date of 31 March 2024. The potential impact of the application of any new and revised IFRS Accounting Standards issued by the IASB after that date, but before the financial statements are issued, should also be considered and disclosed.

The table below provides a summary of the pronouncements as at 31 March 2024, for various quarterly reporting periods:

For each, a link is provided to a Deloitte publication presenting an overview of the new or amended IFRS Accounting Standard.

To be available for application in the UK, the standard or amendment must have been endorsed by the UK Endorsement Board.

This table can be used for all annual accounting periods. A 1st quarter ending on 31 March 2024 would mean that the annual reporting period began on 1 January 2024. Similarly, 2nd quarters ending on 31 March 2024 refer to annual periods that began on 1 October 2023, 3rd quarters ending on 31 March 2024 refer to annual periods that began on 1 July 2023, and 4th quarters ending on 31 March 2024 refer to annual periods that began on 1 April 2023.

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Pronouncement	Effective date	Application to 31 March 2024			
		Q1	Q2	Q3	Q4
IFRS 17 *Insurance Contracts* (with amendments)	1 January 2023	Already applied	Mandatory	Mandatory	Mandatory
Definition of Accounting Estimates (Amendments to IAS 8)	1 January 2023	Already applied	Mandatory	Mandatory	Mandatory
Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)	1 January 2023	Already applied	Mandatory	Mandatory	Mandatory
Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2)	1 January 2023	Already applied	Mandatory	Mandatory	Mandatory
International Tax Reform — Pillar Two Model Rules (Amendments to IAS 12) – application of the exception and disclosure of that fact	23 May 2023	Already applied	Mandatory	Mandatory	Mandatory
International Tax Reform — Pillar Two Model Rules (Amendments to IAS 12) – other disclosure requirements	1 January 2023	Already applied	Mandatory	Mandatory	Mandatory
Non-current Liabilities with Covenants (Amendments to IAS 1), along with Classification of liabilities as current or non-current (Amendments to IAS 1)	1 January 2024	Mandatory	Optional	Optional	Optional
Lease Liability in a Sale and Leaseback (Amendments to IFRS 16)	1 January 2024	Mandatory	Optional	Optional	Optional
Supplier Finance Arrangements (Amendments to IAS 7 and IFRS 7)	1 January 2024	Mandatory	Optional	Optional	Optional
Lack of Exchangeability (Amendments to IAS 21)	1 January 2025*	Optional	Optional	Optional	Optional

* Please refer to the current endorsement status at Adoption Status Report | UK Endorsement Board (endorsement-board.uk)

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Recent IFRS Interpretations Committee agenda decisions

Along with its activity developing formal interpretations of IFRS Accounting Standards and proposing that the IASB make amendments to these standards, the Committee regularly publishes summaries of issues that it has decided not to add to its agenda, generally accompanied by a discussion of the accounting issue submitted.

In August 2020, The Trustees of the IFRS Foundation issued an updated *IFRS Foundation Due Process Handbook* establishing that the explanatory material in the agenda decisions published by the IFRS Interpretations Committee derives its authority from the IFRS Standards themselves and, therefore, that its application is required with the general requirements of IAS 8 for retrospective application applying when an agenda decision results in a change of accounting policy.

The *IFRS Foundation Due Process Handbook* and each *IFRIC Update* also note that it is expected that an entity would be entitled to sufficient time to make that determination and implement any necessary accounting policy change (for example, to obtain new information or adapt its systems). Determining how much time is sufficient to make an accounting policy change is a matter of judgement that depends on an entity's particular facts and circumstances. Nonetheless, an entity would be expected to implement any change on a timely basis and, if material, consider whether disclosure related to the change is required by IFRS Standards.

The following agenda decisions have been published by the Committee in the last 12 months:	
September 2023 *IFRIC Update*	IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments*— Premiums Receivable from an Intermediary
	Homes and Home Loans Provided to Employees
	IFRS 9 *Financial Instruments*—Guarantee over a Derivative Contract
November 2023 *IFRIC Update*	IAS 27 *Separate Financial Statements* – Merger between a Parent and Its Subsidiary in Separate Financial Statements

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Key changes made to this publication since December 2023

Section	Change
Sustainability reporting	Overview of the US SEC final rule added
Other narrative reporting requirements	Summary of the government's feedback statement and impact assessment following its call for evidence on the UK non-financial reporting regime
Corporate governance	New section on the FRC's UK Corporate Governance Code 2024
Large private companies	New section summarising the FRC's thematic review of the UK's largest private companies
Income taxes	Link to Deloitte Global Pillar Two Legislative Tracker added
Other financial reporting considerations – business combinations	New section on IOSCO Recommendations on Accounting for Goodwill
New UK GAAP requirements and future developments	New section on key amendments to FRS 102 and other FRSs as a result of the FRC's 2024 periodic review
Appendix	New and revised IFRS Standards and Interpretations - List of pronouncements updated

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Deloitte resources

There are several resources prepared by Deloitte that can assist throughout the reporting season. Many have been highlighted throughout this publication; key resources are listed below.

Corporate Reporting Insights 2023

The Deloitte Corporate Reporting Insights 2023 page contains a number of reports with topical observations designed to help navigate new disclosure requirements, emerging practices, and growing expectations for greater transparency and accountability. In 2023, topics covered included diversity and inclusion, artificial intelligence, climate transition plans and audit tendering.

On the board agenda 2024

On the Board Agenda 2024 has two objectives – first, to act as a reminder of key matters in the corporate governance environment heading into the reporting season, and second, to help boards set the agenda for the year ahead. There have been a number of recent updates to the Government's reform agenda which have added to current levels of uncertainty but to be resilient and emerge stronger, boards will need to focus on performance and high standards at their companies, innovative activities to promote growth, differentiation to enhance customer experience and attract talent and transparency to enhance trust.

The Deloitte Accounting Research Tool (DART)

DART is a comprehensive online library of accounting and financial disclosures literature, allowing access to the full IFRS Accounting Standards, IFRS Sustainability Disclosure Standards, EU sustainability reporting requirements and UK accounting standards, linking to and from:

- Deloitte's authoritative, up-to-date manuals which provide guidance for reporting under UK GAAP (including UK legal and regulatory requirements), IFRS Accounting Standards, IFRS Sustainability Disclosure Standards and EU sustainability reporting requirements; and
- Model financial statements for entities reporting under UK GAAP and IFRS Accounting Standards.

To apply for a subscription to DART, click here to start the application process and select the *GAAP in the UK* package.

For more information about DART, including pricing of the subscription packages, click here.

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