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The KPMG view

IFRS Standards | Exploring topical issues in financial reporting

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PODCAST TRANSCRIPT

Areas of focus for 2024 year ends

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Brian O'Donovan
Global IFRS Leader

KPMG International Group

Introduction

Hello – I'm Brian O'Donovan, global IFRS and corporate reporting leader at KPMG.

I'm here to kick off our year-end podcast about priorities for this reporting season.

My headline theme is driving clarity in financial statements. Now, investors and regulators have been raising real concerns about the clarity of financial reporting. And artificial intelligence has fundamentally changed how we all communicate. So maintaining stakeholder confidence and trust remains high on the agenda for all companies.

Investors and the public at large are also calling for companies to be clear on climate – for example, around their net-zero commitments. Emissions and green schemes have become ever more common and the financial reporting issues ever more complex.

And of course, companies need to be ready for the additional scrutiny that comes with sustainability reporting.

There's a lot to get right this year – and potentially wrong...

I believe that connectivity provides the unifying principle to achieve clarity in financial reporting. It's the glue that binds together the different elements of an annual report into a single, integrated, coherent whole. The financial statements, the sustainability disclosures and management's discussion and analysis – taken together – should provide a complete picture of a company's business model and strategy, connecting the dots between the financial and non-financial information.

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Irina Ipatova
Associate Partner

KPMG International Standards Group

To help you achieve that connectivity and provide clarity, I've asked members of the KPMG International Standards Group to share their thoughts. They'll highlight key points to consider, and they'll direct you to some really helpful resources.

Are you clear on climate reporting?

Emissions schemes, carbon credits, net zero

Are you clear on climate and emissions schemes in your financial reporting?

Whether you are subject to mandatory emissions targets or reduce your emissions voluntarily as part of your net-zero transition plan, you face this question from investors and regulators.

I'm Irina Ipatova and I would like to highlight three key areas for you to focus on in preparing your 2024 annual report to help you address the investor and regulator concerns.

First, be clear on your accounting policies: IFRS Accounting Standards do not provide specific guidance on emissions or green schemes and you develop your own accounting policies. For example:

- If you are subject to mandatory emissions targets and receive emissions allowances from the government, then you need to be clear on whether you account for them as inventory or intangible assets, whether you recognise them at cost or fair value and where you present the related income and expenses in the statement of profit or loss. You also need to be clear on how you measure the liability for pollutants emitted above the threshold.
- If you are setting voluntary emissions targets and purchase carbon credits, then you also need to be clear on your accounting policy for those. And don't forget – setting and announcing your net-zero target, on its own, does not trigger a liability. You need to consider how you plan to achieve this target and assess the financial reporting impact of each planned action separately.

Second, be clear on your assumptions and judgements: Many schemes setting mandatory emissions targets allow companies to settle their liabilities by surrendering emissions allowances or carbon credits which can be purchased on a market or in a private transaction. Carbon markets are still developing, and prices for carbon credits and emissions allowances can vary greatly. Also, the compliance period for some emissions schemes may not match your annual reporting cycle and you may need to make a judgement about whether you will meet the emissions target in determining whether you have a liability at the reporting date. That is why it is critical to be clear on your assumptions and judgements related to carbon pricing and the emissions liabilities.

And last but not least, connect the dots with the information presented outside the financial statements: climate-related topics, particularly net-zero commitments are drawing attention of a wide range of stakeholders, and many companies provide detailed information about those in the front part of their annual reports, separate sustainability reports or other public statements. Make sure that in preparing your financial statements, you connect the dots with the information presented outside of them, and that you tell a consistent and clear story.

For more information, check out our clear on climate reporting hub, our net-zero commitments talkbook and our digital guide on emissions and green schemes in the financial reports. In addition, our talkbook Are you clear on climate reporting in the financial statements? guides you through some key actions you can take.

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Avi Victor
IFRS Technical Director

KPMG International Standards Group

Impairment

Are you clear on how climate-related matters are reflected in the recoverable amount when testing non-current assets for impairment? Are you connecting the dots between the impacts of climate-related matters on your financial statements and the related disclosures in the front part of your annual report?

I'm Avi Victor and I'd like to highlight some areas to focus on when preparing your 2024 financial statements.

Investors and regulators are expecting you to provide robust disclosures to understand whether climate-related matters are reflected in the recoverable amount and – if so – how.

First, be clear on assumptions and judgements used in calculating the recoverable amount. It is essential that the assumptions underlying the cash flow projections are in sync with your budgets, business plans and any climate-related commitments that your company has made. These assumptions also need to be in sync with the information disclosed in the front part of the annual report.

Second, if the assumptions differ, then you need to be clear about this. Sometimes there may be a difference, because of the IFRS requirements. For example, under value in use, the cash flow forecast can't reflect certain asset enhancements or uncommitted restructurings due to the restrictions in IAS 36 – the Impairment of Assets standard – even when they are included in your company's budgets.

In these situations, when there's a difference between the information in the front part of the annual report and the assumptions used to calculate the recoverable amount, investors and regulators expect you to explain why there is a difference.

Also, if you are reporting under the European Sustainability Reporting Standards [ESRS] or the standards developed by the International Sustainability Standards Board [ISSB], then you will need to explain the reasons for any inconsistencies between the data and assumptions disclosed in the front part and those used in the financial statements. For example, you will need to explain whether and how the carbon prices used in internal pricing schemes are consistent with those used for assessing impairment or the useful lives of non-current assets.

And third, be clear about any estimation uncertainty. If there is a high level of estimation uncertainty, for example in the case of future carbon prices, then additional disclosures may be required, such as sensitivity analyses.

So overall what is the key takeaway? Clarity and connectivity are critical when performing your impairment tests and providing the relevant disclosures in the financial statements.

To help you reflect the impact of climate-related matters on your impairment testing of non-current assets, we have created a digital guide that answers your questions on several key issues. Take a look at our pages for more information.

One final point here – if your company is affected by Pillar Two taxes, don't forget to consider the impact of top-up taxes in your impairment assessment and ensure that your disclosures are clear on this point.

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Gabriela Kegalj
Partner

KPMG in Canada

Are you clear on presentation?

Are you clear on presentation? With recent changes made to some presentation and disclosure requirements by the International Accounting Standards Board – the IASB – we certainly hope so.

I'm Gabriela Kegalj and I would like to highlight key changes to presentation and new disclosures that may impact your 2024 annual reports.

First, changes to presentation and new disclosures relating to liabilities. You may have been busy this past year revisiting your company's older and newer lending arrangements to determine whether the newly effective amendments to IAS 1 *Presentation of Financial Statements* change how you classify liabilities in the balance sheet.

- Will some of your long-term debt now be presented as short-term?
- Or perhaps debt you previously classified as current might now need to be classified as non-current?
- To get that right, you probably spent some time deep in the details of your loan documentation that discuss the terms and conditions your company, as borrower, needs to comply with – including any 'covenants'.

While only a minimal number of paragraphs changed, the impact may not be minimal on your accounts – especially if you have convertible debt outstanding. Depending on the terms and conditions of the conversion feature, some of these may now be current liabilities.

Remember, the changes are applied retrospectively. Your investors will be expecting a clear explanation of any such changes in classification and of the ripple effect on related ratios.

They will also be looking to new disclosures in the notes to help them understand the risk that any of your non-current liabilities that are subject to future covenants could become repayable within the next year.

You'll have to provide clear quantitative and qualitative information, including:

- the nature of the covenants and when your company must comply with them;
- the carrying amount of related liabilities; and
- any facts and circumstances that indicate the company may have difficulty complying with covenants within the next 12 months.

Second, newly effective disclosures about reverse factoring arrangements. Although you may have already been providing some disclosure on these arrangements, amendments to IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures* now include additional specific disclosure requirements to help users assess the effects of supplier finance arrangements on your company's liabilities, cash flows and liquidity risk.

Don't forget – you'll get some transitional relief in this first year only – from disclosing comparative information and from providing some quantitative data.

And last but not least – if you are subject to Pillar Two top-up taxes, don't forget about the relevant disclosures. If Pillar Two taxes are already effective in jurisdictions where your company operates, then you will need to disclose the respective current tax expense separately. If they are not effective yet, then you will need to provide a disclosure about their potential impact.

So, as you prepare your year-end accounts, have a look at our *Illustrative disclosures: Guide to annual financial statements* where we include some new examples regarding these amendments.

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Kelly Coyne
Manager

KPMG International Standards Group

Hi – I'm Kelly Coyne and I am going to talk about IFRS 18. The new standard addresses the calls for clarity about presentation and disclosures in financial reporting by investors and regulators.

Although your company's net profit will not change as a result of the new standard, how you *present* your results on the face of the income statement and how you *disclose* information in the notes will change.

Importantly – if you regularly provide 'alternative performance measures' or 'non-GAAP measures' in, say, your annual report or press releases, some of these – referred to as management-defined performance measures – will now form part of the audited financial statements.

The new requirements are all about helping companies better tell their story and mark a step towards more connected reporting. So, how much effort will be required to adopt this new standard? Well, IFRS 18's implications will vary from company to company, across different lines of business.

That's why we encourage all companies to start planning your IFRS 18 implementation early. Your management team will need to make new judgements, navigate complexities and oversee changes to systems, processes and controls to comply with the new presentation and disclosure requirements. IFRS 18 is applied retrospectively so, depending on how many comparative periods your company presents in the income statement, you will need to start gathering information soon: from 2026 (if you present only one year of comparatives) or even from 2025 (if you present two years of comparatives), which is only two months away.

This may all seem like a lot to consider. So: for more information check out our IFRS 18 *First Impressions* publication.

Sinéad Slattery
IFRS Technical Director

KPMG International Standards Group

Are you telling a connected story?

Are you telling a connected story? I'm Sinéad Slattery and I'd like to talk about connectivity between financial statements and other publicly available information.

Sustainability reporting standards are now becoming effective in various jurisdictions. Investors and regulators will be looking more closely than ever for relevant and consistent information across all parts of your annual report this year. And that means better connectivity between the front part of the annual report, sustainability reporting and the financial statements.

So, what do I mean exactly by 'a connected story'? The term is sometimes used in a narrow sense when discussing climate-related risks. Investors want to know how the climate-related risks they read about in the front of a company's annual report have been reflected in its financial statements. But there is a growing focus on companies providing a coherent, connected and integrated picture of their entire business. Telling a connected story involves providing a consistent narrative that connects the dots between the financial and non-financial information in the annual report.

It doesn't matter what sector you're in: if you report to stakeholders, the pressure to present a connected picture will apply. We have taken a look at how companies are responding by analysing the 2023 annual reports of 35 major banks and 47 insurers around the world, looking at the nature and extent of their climate-related disclosures. Our analysis focused on five key areas: financial reporting, financed and insurance-associated emissions, transition plans, nature-related disclosures and assurance. It's clear that progress continues but the opportunity for banks and insurers to tell a connected story remains. They are on a journey to connect the pieces together and create a narrative that is more meaningful and clear for their users.

So what about an example of where connectivity might be needed? One nice connectivity example that springs to mind is around the consistency of data and assumptions used in preparing the sustainability reporting and the financial statements. Both the International Sustainability Standards Board (ISSB)'s first two IFRS® Sustainability Disclosure Standards and the European Sustainability

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Reporting Standards (ESRS) require connectivity with the financial statements and have specific requirements for companies to provide information about the consistency of data and assumptions. Avi gave a good example earlier of consistency in internal carbon prices and there are several requirements in ESRS looking for reconciliations or to illustrate consistency of data and assumptions – for example, ESRS E1, the climate change standard, requires the net revenue amounts used in the GHG emissions intensity metric disclosed in the sustainability statement to be reconciled to the relevant line item or notes in the company's financial statements. Our new publication ESRS Foundations highlights the key areas where connectivity is required when applying ESRS.

So how are the standard setters responding to those investor and regulator expectations I mentioned earlier? Well, the IASB has been looking at ways to highlight and clarify the existing requirements in its accounting standards to improve the reporting of financial information about climate-related and other uncertainties in the financial statements. The IASB has proposed new illustrative examples to help companies target areas of known investor and regulator concern. The examples are based on existing requirements of IFRS Accounting Standards. Companies need to consider how the proposals would impact their financial reporting and identify any potential gaps to fill. And remember, information is required if it could reasonably be expected to influence users' decisions.

Brian O'Donovan
Global IFRS Leader

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Closing comments

Thank you everyone.

We've gathered information and guidance on all these subjects and many more, and made it available online.

Visit KPMG's Global Corporate Reporting Institute for all your trusted KPMG content on corporate reporting.

And to keep up with our latest insights and guidance, you can follow KPMG IFRS on LinkedIn. Thank you very much for joining us.

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