



Non-financial reporting – What really matters?

An audit committee perspective

Board Leadership Center (India)



The concept of ‘non-financial reporting’ is not new. In light of the emerging socio-economic inequality, environmental issues exacerbated with climate change and scarcity of natural resources, there is an increase in need for businesses to demonstrate how responsibly the business has been undertaken by them. Hence, reporting on non-financial parameters has gained significant momentum in the recent past. Disclosures on matters other than financial reporting are commonly referred to as non-financial information, non-GAAP¹ performance measures or Extended External Reporting (EER). Such information may form part of a company’s mainstream periodic report, e.g., an annual report or may also be presented as a separate report(s), such as sustainability or Environmental, Social and

Governance (ESG) report, integrated report, Corporate Social Responsibility (CSR) report, greenhouse gas statements, Business Responsibility and Sustainability Report (BRSR) and reporting on Key Performance Indicators (KPIs) which depicts a company’s performance over the reporting period in terms of various non-financial metrics, such as number of complaints handled, number of supervisions performed, etc. At times, this information is also communicated through investor presentations.

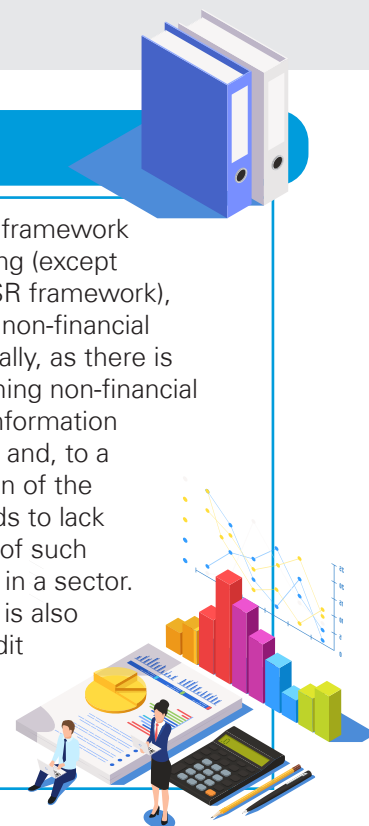
Unlike financial information, which is based on historical data, non-financial information encapsulates historical data, combined with forward-looking forecasts.

Relevance and imperatives of non-financial reporting

Reporting of appropriate non-financial information enable company’s stakeholders, in particular investors, investment analysts and, at times, the end consumers to assess the company’s underlying business performance, forecast the company’s long-term value and how sustainable are the company’s operations. Such information also enables them to better inform their analysis and understanding of the more complex areas of the financial statements. Also, many companies have been using non-financial metrics as an input to determine their executive compensation.

Since investors and financial markets are placing greater reliance on such measures to make informed investment decisions, this is an area of focus for the regulators as well. However,

in the absence of a regulatory framework governing such kind of reporting (except those relating to CSR and BRSR framework), evaluation and assessment of non-financial information is critical. Additionally, as there is no authoritative guidance defining non-financial metrics, disclosure of such information involves significant judgement and, to a large extent, is at the discretion of the companies. This invariably leads to lack of comparability and reliability of such information across companies in a sector. Hence, non-financial reporting is also gaining prominence on the audit committee agenda.



1. Generally Accepted Accounting Principles.

Role of an audit committee in oversight of non-financial information



The presentation and use of such non-financial information can vary from company to company. Accordingly, no one size can fit all. An audit committee can act as a catalyst between the management and investors by assessing management's rationale for presenting non-financial information and can also evaluate the appropriateness and sufficiency of the related disclosures. Some of the key points for an audit committee to consider:

- **Discussion with the management:** It is important to understand the rationale of the management for providing such non-financial information, roles and responsibilities of those involved with the information, including employees (from various functions who provide inputs for such information - e.g., finance, procurement and supply chain, human resource), committees of the board (e.g., remuneration committee, risk management committee) and internal and external auditor. For this purpose, an audit committee is required to hold timely discussion with the management and seek responses against:
 - Has the management devised guidelines, policies or procedures to determine how non-financial information is being generated and presented?
 - Is there an internal control framework in place to evaluate completeness and accuracy of such non-financial information and reporting?
 - While presenting non-financial information, has it been ensured that such information is being computed and presented consistently over a period, for instance, quarter on quarter? In case of deviations, has the management communicated the rationale?
 - While determining appropriateness of non-financial metrics, has the management compared those metrics to those of its peers in the industry?
 - What is the role and responsibilities of the internal and the external auditors with respect to such information? Have the responsibilities been laid out in their scope of engagement in accordance with the relevant statute?
 - Have appropriate consultations been done with experts for areas requiring specialised knowledge and deliberation e.g., metrics

to identify impact of climate change on the company?

An audit committee may engage with the investors directly to ensure that the presented measures aid investors' understanding of the company's performance.

- **Clarity on the role of auditors:** External auditor of a company provides opinion on the financial statements including commenting on the adequacy and effectiveness of internal controls over financial reporting. While performing its role, an external auditor is required to consider other information which is mainly limited to the information provided in the Management and Discussion Analysis (MD&A) and other information which forms part of the annual report of the company and report any material inconsistency between the other information and the financial statements. Management is primarily responsible for such other information. As such other non-financial information is not within the scope of audit by an external auditor, an audit committee may leverage the external auditors' work while evaluating such information.

On the other hand, it is equally important for the external auditors to have an understanding of these non-financial information and to maintain a continuous dialogue with the internal auditors of the company which provides critical inputs relating to the operations and performance of the company to the management to generate such non-financial information.

- **Understanding adjusted information:** Many a times, companies tend to disclose financial data with certain adjustments to corroborate their non-financial performance measures. Understanding the rationale for such adjustments would be crucial to evaluate the relevance of such information especially, when one cannot directly make out these adjustments from the financial statements or information. They may likely to pose a good picture about the company's performance while in essence, that information may not be relevant or could prove to be misleading. An audit committee may also seek assurance on such adjusted information. There may necessarily be a linkage of such adjusted information with the reported financial information.

ESG reporting – An emerging non-financial reporting area



Companies are subject to an increasing set of non-financial reporting requirements relating to ESG factors. Assessment of ESG risks and opportunities for their businesses and proper ESG disclosures is the need of the hour for companies to be prepared for the changing demands. While the **E**nvironmental and **S**ocial matters have gained significant attention especially in the wake of climate change and the pandemic, it is the **G**overnance which is most critical and essential component for the success in the journey towards

a sustainable business. Good governance should be embedded in the culture of an organisation.

An audit committee's strong understanding of internal controls, policies and reporting will enable it to challenge the management, including the finance function, to develop systems and processes for identification of ESG risks and opportunities, create strategies to manage those risks and seize these opportunities, and develop metrics and reporting to monitor these areas.

Questions for an audit committee



Which ESG frameworks and reporting standards are most adopted in the industry in which the company operates?

Has the committee gained an understanding of the ESG risks, in particular those relating to climate change and resultant impact on the financial statements?

Does the committee understand the ESG issues that may have an impact on the company's strategy and business model?

What kind of ESG disclosures are required by the providers of company's capital? Is the company adequately meeting their needs?

Does the company obtain any assurance on the ESG information? Is the committee aware of what is being assured and who is providing such assurance?

Is the committee keeping pace with how management is responding to the ESG risks and opportunities?

Are the ESG related disclosures adequately linked with the financial information, wherever applicable?

Has the committee evaluated whether the judgements and assumptions used in ESG related disclosures are reasonable and appropriate?

Next steps



Non-financial reporting is on a journey on which some countries and/or companies have travelled further than others. Depending upon the maturity levels of the company, the area is expected to accelerate in times to come. To enhance credibility of the information presented and thereby gaining investors' confidence, regulators could also devise certain mechanisms to provide assurance on such non-financial information.

The Securities and Exchange Board of India (SEBI) has introduced a new reporting requirement for top 1,000 listed companies in India effective 1 April 2022. These companies would be mandatorily required to submit a new report on ESG parameters namely the BRSR. The disclosures under BRSR are primarily based on the nine principles of the National Guidelines for Responsible Business Conduct (NGRBC). The new BRSR disclosures will enable better comparability and consistency across companies and sectors in India. The new reporting requirement is a stepping stone for companies to demonstrate their commitment and initiatives towards a responsible and sustainable business.

Recently, the IFRS Foundation has announced the formation of the International Sustainability

Standards Board (ISSB). The ISSB will develop a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors' information needs. Several leading investor-focussed sustainability disclosure organisations will participate and consolidate in the ISSB such as, Climate Disclosure Standards Board (CDSB) and Value Reporting Foundation (VRF). Formation of ISSB is set to pave way for putting sustainability reporting under the same lens as financial reporting. Companies in India should watch out for the development in this area.

For each industry sector, there is a growing need to come out with a minimum set of standard ESG parameters, which each company in that sector is expected to publish.

Companies may provide additional parameters relevant to their context. This could facilitate better comparability amongst companies across industries.

Defining what could ideally comprise of non-financial information will enable an audit committee to effectively perform its oversight role. Until then, an audit committee must exercise due diligence while evaluating need and relevance of such information.

We would like to thank our Audit Committee council members for their time in providing us with their valuable insights and perspectives that have contributed to preparing this point-of-view document.

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