



Are you clear on climate reporting in the financial statements?

Guide to your key actions

July 2024



Three key actions to be clear on climate

Regulators and investors are focusing on how companies report on climate-related matters. They are demanding clarity, particularly in the financial statements. This guide helps you take the right actions to be clear on climate.



Get the accounting right

There is no single accounting standard that addresses all climate-related matters.

To get the accounting right, you need to determine the impacts of each matter separately and apply specific requirements in IFRS® Accounting Standards.

Use the questions in this talkbook as a starting point to assess the impact on your financial statements. You can also visit our [Clear on climate reporting hub](#) for further insights.

Please note: these questions do not cover every impact; you need to assess your specific facts and circumstances.



Get the financial statement disclosures right

Investors and regulators demand clarity on climate in companies' reports. You need to provide relevant and transparent disclosures to enable investors and regulators to understand your financial statements.

Don't forget the overarching requirements of IAS 1 *Presentation of Financial Statements* to provide information that could influence investors' decisions.



Tell a connected story

Companies talk about climate at the front and the back of their annual report.

To tell a connected story, you need to provide a coherent, connected and integrated picture across your financial statements, management discussion and analysis (MD&A) and sustainability-related disclosures.

Get the accounting right

There's no single accounting standard on climate, but there are requirements

To get your accounting right, you need to do the following.

- **Understand** the nature of the specific climate-related matter.
- **Determine** the accounting standards to apply.
- **Assess** the impact on your financial reporting.

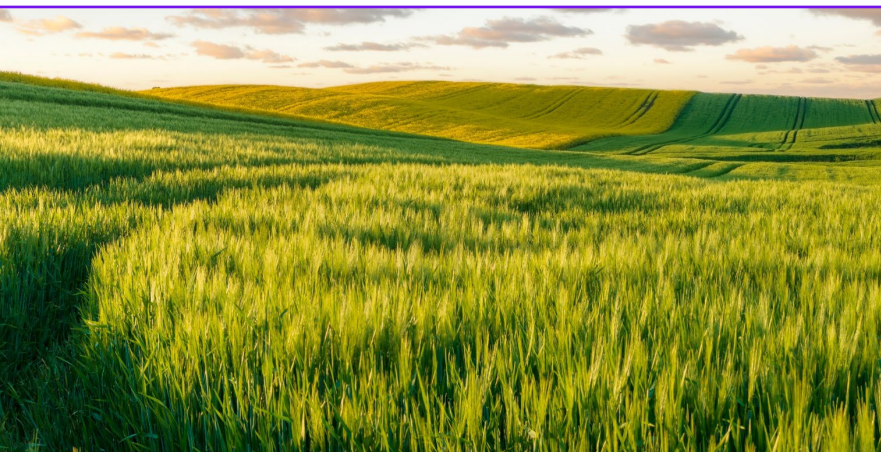
Assessing the impact of climate-related matters on financial reporting requires judgements about the future. The uncertainties around climate make those judgements particularly sensitive. That is why it is important to be clear on climate in your financial report.

Some common questions and the potential financial reporting impacts

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Are you exposed to carbon-related regulation?

Accounting standard	IFRS 15, IAS 2, IAS 16, IAS 36, IAS 37
Financial reporting impact	Provisions: Measurement PP&E: Useful life and impairment Revenue and costs



How do you measure your liability for pollutants?

- A [provision](#) for emitted pollutants is measured at your best estimate of the future clean-up costs.
- Making this estimate may require specialist knowledge of environmental issues – e.g. the quantities and types of contaminants involved, the local geography and remediation costs.

Will compliance costs or taxes impact your prices?

- New climate-related policies or legislation may affect your company's revenues or operating costs – e.g. a carbon tax.

Does the regulation affect how you plan to use your assets? Do you need to write them down?

- You may need to review your existing pool of assets if new restrictions are introduced – e.g. on using diesel trucks.
- Such restrictions may mean that you need to [depreciate](#) non-current assets more quickly, change their residual values or write them down.

Do you take part in an emissions scheme?

How do you account for emissions allowances and grants?

- If you receive emissions allowances from the government or purchase them, then you may account for them either as intangible assets or inventory.
- Emissions allowances received are measured initially at their fair value or a nominal amount – i.e. zero. Those purchased are measured at cost.

How do you account for the liability if you exceed the emissions target?

- If your company would incur a monetary penalty if it failed to meet an emissions target, then it would recognise a liability for that amount.
- Some schemes require a company to purchase emissions allowances to settle the liability. If there is no active market, then measuring the liability is more complex.

Do you receive carbon credits that you can monetise?

- If you receive carbon credits – e.g. for generating green energy – then you could sell or trade them.
- These carbon credits could be recognised as assets if they meet relevant criteria. Measuring these assets could be complex if they are not actively traded.

Accounting standard

IAS 2, IAS 20, IAS 37, IAS 38

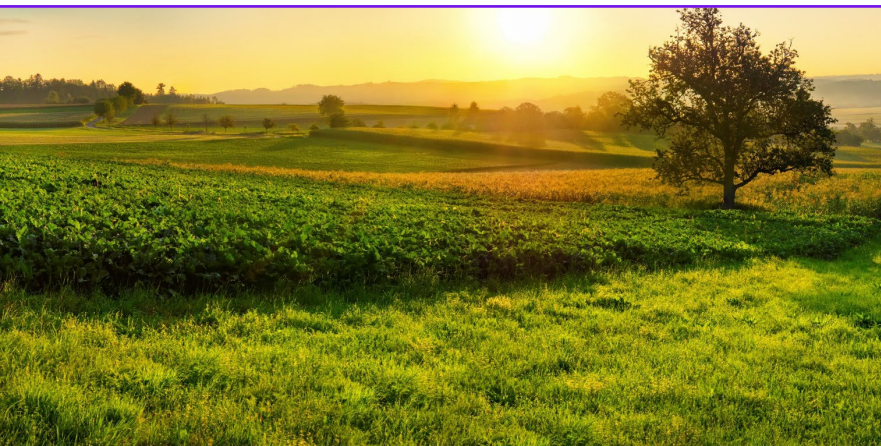
Financial reporting impact

Intangible assets: Recognition

Inventory: Recognition

Provisions: Recognition and measurement

Government grants: Recognition and measurement



Have you made a net-zero commitment?

Have you determined the financial reporting impact of your planned actions?

- Assess your detailed net-zero plan – including specific actions and timelines – which may evolve over time.
- You need to make this assessment for each planned action separately and at each reporting date.

Have you assessed when your planned actions may trigger a liability?

- Setting and announcing a net-zero target, on its own, does not automatically trigger a liability.
- Two tests must be met.
 - Test 1: Do you have a constructive obligation?
 - Test 2: Do you meet the criteria to recognise a liability?

Are you telling a connected story in your annual report?

- Information about your net-zero and similar plans may be provided through different channels, including the front part of an annual report or a sustainability report.
- You need to tell a clear and connected story throughout your reporting. Read our [talkbook](#) and use our illustrative example to help you tell a connected story.

Accounting standard

IAS 2, IAS 16, IAS 36, IAS 37

Financial reporting impact

Inventory: Net realisable value

PP&E: Useful life and impairment

Provisions: No liability until two tests are met



Have you committed to purchase carbon credits?

Accounting standard

IAS 36, IAS 37

Financial reporting impact

Provisions: No liability until CO₂ emitted
PP&E: Impairment



Does your public announcement result in a constructive obligation related to carbon credits?

- At each reporting date, you need to consider whether your public statement on net-zero commitments is sufficiently specific to create a constructive obligation.
- This requires judgement based on the specific facts and circumstances – a public statement does not automatically create a valid expectation.

Do you need to recognise a liability?

- A constructive obligation to purchase carbon credits does not automatically result in a liability in the financial statements.
- You need to determine whether you have a present obligation as a result of a past event and if the other criteria to recognise a liability are met – i.e. if it is probable that an outflow of cash or other resources will be required and if you can measure it reliably.

Have you considered your plan to purchase carbon credits in impairment testing?

- If you are committed to purchasing carbon credits in the future – e.g. from 2030 – then you need to consider this in the cash flow estimates for impairment testing.

Do you have polluting assets?

Do you need or plan to replace them?

- If so, polluting assets may need to be depreciated more quickly or written down – e.g. because of changes to the company’s strategy or asset management policies.

Have you recorded all environmental liabilities related to them?

- Changes in (or new) legislation may result in your company needing to record additional liabilities.
- Even if there is no legal requirement to clean up existing environmental damage but you have made a public announcement that you are committed to doing so, then you may need to recognise an [environmental liability](#) if the specific criteria in the provisions standard are met.

Do you plan to renegotiate a lease of any polluting asset?

- Changes in economic incentives to use or cease using a leased asset in the future – e.g. a [polluting asset](#) – could cause a lease contract’s terms to be renegotiated.
- Ending or changing these terms before the lease contract expires could trigger a lease modification and result in a change in the measurement of the lease asset and lease liability.

Accounting standard	IFRS 16, IAS 16, IAS 36, IAS 37
Financial reporting impact	Leases: Modifications PP&E: Useful life and impairment Provisions: Recognition



What about impairment testing and going concern?

Have you considered climate-related matters in cash flow projections for impairment testing?

- You need to reflect the impacts of climate-related matters in the cash flow forecasts and terminal value used in [impairment testing](#). If they are ignored, then the carrying amounts of assets – e.g. goodwill, property, plant and equipment (PP&E), right-of-use assets and intangible assets – could be overstated.

Have you considered the impact of climate-related matters on the discount rate?

- If sufficient data is not available, or it is not possible to reliably quantify the impact of climate-related matters on the cash flows, then you may need to adjust the [discount rate](#).

Do the forecasts for assessing going concern consider different scenarios?

- Consider different possible scenarios, including a severe but plausible downside scenario.
- Additional disclosures may be required – e.g. significant judgements made on the assessment of [material uncertainties](#).

Accounting standard

IFRS 16, IAS 1, IAS 16, IAS 36, IAS 38

Financial reporting impact

Going concern

Non-current assets: Impairment



What about your inventory and production costs?

Will the cost of your products rise?

- [Inventory](#) and production costs may increase due to carbon taxes, emissions schemes, changes in production processes or substitution of raw materials for more environmentally friendly materials.

Could your products or raw materials be banned?

- Products that are considered to contribute to climate change may see governmental limits or bans.

Could shifting customer trends impact your inventory?

- Shifts in customer trends to more climate-friendly and sustainable products could decrease demand for your less-green products and cause inventory write-downs.

Would reusable or returnable items qualify as inventory?

- Reusable or returnable packaging or parts – e.g. reusable bottles – that are returned to the seller for re-use are not inventory.
- As they will be used over more than one period, they are generally treated as PP&E.

Accounting standard

IAS 2, IAS 16

Financial reporting impact

Inventory: Cost and net realisable value
PP&E: Classification



How might climate-related matters affect your borrowing?

Accounting standard

IFRS 9, IFRS 16, IAS 1

Financial reporting impact

Financial instruments: Current/non-current classification of liabilities, identification of derivatives

Going concern

Leases: Identification and measurement



Do you have loans with climate-linked covenants?

- If you fail to meet carbon emissions targets or similar conditions in the loan agreement, then you may breach covenants. Breaches may impact the classification of the loan as current or non-current and need to be disclosed.
- In some cases, a breach of a loan covenant could cause the lender to request immediate repayment.
- You would need to consider the breach as part of a broader assessment to determine your company's ability to continue as a [going concern](#).

Is your borrowing rate impacted by climate-related risks?

- Lenders might include environmental aspects when pricing a loan. For example, if they grant a discount on the interest rate when certain climate-related targets are met, then your company's interest costs could fall.
- Your borrowing may be a hybrid contract with an [embedded derivative](#).

Are you financing green technology through a lease?

- [Leases](#) can be an attractive way of financing investments in green technology due to the flexibility they provide.
- However, identifying and measuring on-balance sheet lease liabilities can be challenging.

Do you provide financing?

How do you classify loans linked to climate targets?

- Classifying a [loan with climate-related features](#) will depend on how those features affect the cash flows. Amendments to IFRS 9 provide guidance on how to determine if such a loan can be measured at amortised cost or fair value through other comprehensive income (FVOCI). They also introduce additional disclosures.

Do you reflect climate-related risks appropriately in measuring credit losses?

- The impact of climate-related risks on [expected credit losses](#) (ECL) will vary depending on their expected severity and timing, the direct and indirect impact on the borrowers and the duration of the lender's loan portfolio.
- The impact on ECL today could be limited because the more significant effects of climate change may be expected to emerge over the medium to longer term.
- However, it is important to monitor the speed and scale of these matters and consider their possible impacts on the measurement of ECL.

Do your credit risk disclosures address exposure to clients with higher climate-related risks?

- Your company may need to expand its credit risk disclosures to highlight sectors with higher exposure to climate-related risks and how these risks are considered in credit risk management practice.

Accounting standard

IFRS 9

Financial reporting impact

Financial assets: Credit risk and classification



What about your staff benefits?

Accounting standard

IFRS 2, IAS 19

Financial reporting impact

Employee benefits: Short-term, long-term and termination benefits

Share-based payment: Performance conditions



Do they reflect preferences for greener alternatives – e.g. providing low-interest loans to finance the purchase of an electric car?

- If so, then these may give rise to [short-term benefits](#) recorded in profit or loss.

Do they include climate-related performance criteria?

- For share-based payment arrangements, these criteria would generally meet the definition of a non-market condition and would not affect the fair value of the share-based payment.
- For other long-term employee benefits, a climate-related condition would be included in the measurement of the liability.

Are your staff affected by site closures or restructurings?

- If so, then these could have a significant impact on long-term employee obligations (e.g. defined benefit arrangements) and may involve paying termination benefits to large numbers of employees.

At a glance | Climate-related matters and financial reporting impacts

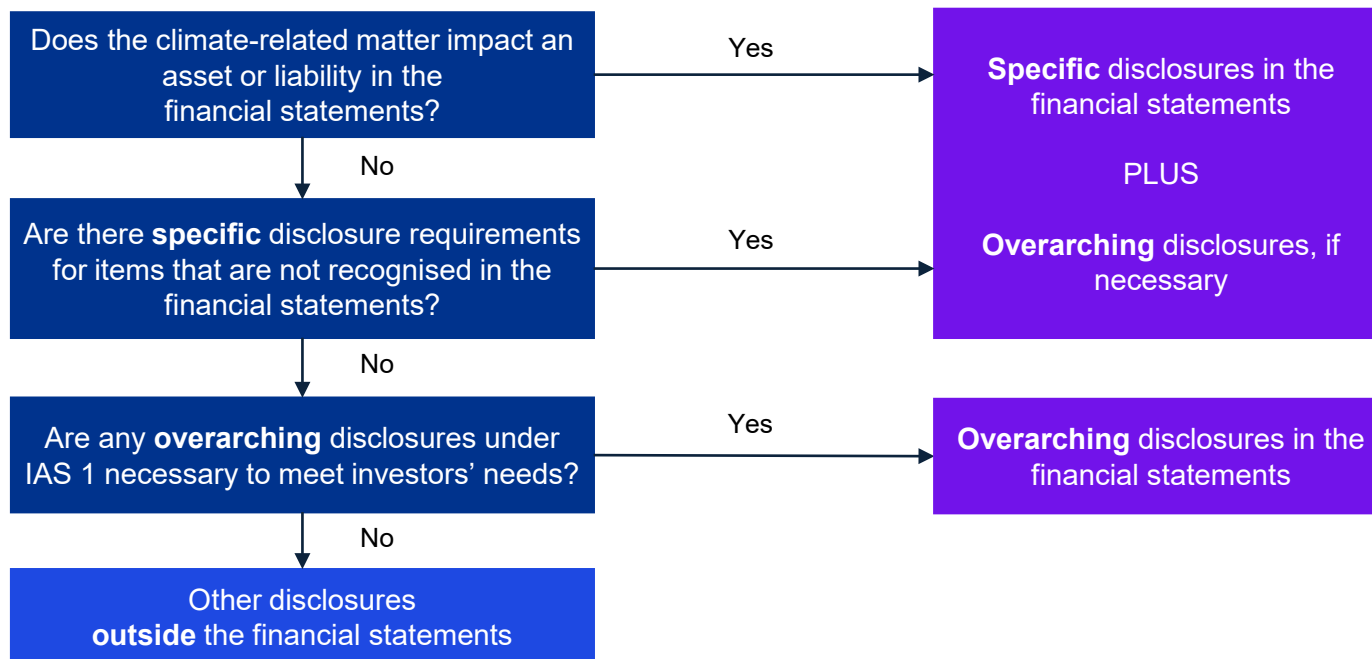
Example climate-related matter	Accounting standard	Financial reporting impact
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Do you take part in an emissions scheme?	IAS 2, IAS 20, IAS 37, IAS 38	Intangible assets: Recognition Inventory: Recognition Provisions: Recognition and measurement Government grants: Recognition and measurement
Have you made a net-zero commitment?	IAS 2, IAS 16, IAS 36, IAS 37	Inventory: Net realisable value PP&E: Useful life and impairment Provisions: No liability until two tests are met
Have you committed to purchase carbon credits?	IAS 36, IAS 37	Provisions: No liability until CO ₂ emitted PP&E: Impairment
Do you have polluting assets?	IFRS 16, IAS 16, IAS 36, IAS 37	Leases: Modifications PP&E: Useful life and impairment Provisions: Recognition
What about impairment testing and going concern?	IFRS 16, IAS 1, IAS 16, IAS 36, IAS 38	Going concern Non-current assets: Impairment
What about your inventory and production costs?	IAS 2, IAS 16	Inventory: Cost and net realisable value PP&E: Classification
How might climate-related matters affect your borrowing?	IFRS 9, IFRS 16, IAS 1	Financial instruments: Current/non-current classification of liabilities, identification of derivatives Going concern Leases: Identification and measurement
Do you provide financing?	IFRS 9	Financial assets: Credit risk and classification
What about your staff benefits?	IFRS 2, IAS 19	Employee benefits: Short-term, long-term and termination benefits Share-based payment: Performance conditions

Get the financial statement disclosures right

Companies need to be clear on climate in the financial statements

- Investors expect companies to provide clear and transparent information in the financial statements to inform their decisions.
- IFRS Accounting Standards do not explicitly refer to climate. But they require companies to make relevant disclosures about material climate-related matters.

To get your disclosures right, ask yourself ...



Get your **specific disclosures** right



Have you identified all specific disclosure requirements?

- Consider the disclosures required by the specific IFRS accounting standards.
- In some cases, a disclosure may be required even though there is no current-period financial statements impact.

Are your disclosures clear about the assumptions you've made?

- You need to provide disclosures in the financial statements that are specific to your circumstances and provide clear and meaningful insights into the significant judgements and estimates you've made.
- This might mean enhancing sensitivity disclosures, and also disclosures about the key assumptions made and major sources of estimation uncertainty.

Do you have carbon-exposed assets?

- You may need to disaggregate information about categories of PP&E that are exposed to specific climate-related risks that do not affect other assets.

Are your disclosures in sync with other sections of your annual report?

- It is important that the information in the back and front end of your annual report is in sync to the extent appropriate and the related disclosures complement each other.

Get your overarching disclosures right



Have you made sensitive financial statement judgements?

- Disclose assumptions and estimates affecting financial statement judgements if there is a significant risk that changes could have a material effect on the financial statements in the next year.
- This may be required even if the uncertainty is not expected to be resolved within the next year.

Are you exposed to uncertain regulatory and other outcomes?

- Explain the effect of the uncertainty on your financial performance and position if users would need this to understand the financial statements.

Will your disclosures help investors understand the judgements you've made about the future?

- Your disclosures of significant assumptions and judgements on climate-related matters in the financial statements need to be clear and transparent.

Have you made public statements about your climate-related strategy?

- Explain whether and how announcements about climate-related strategies and commitments have been reflected in the financial statements if their effects may otherwise be misunderstood.

Tell a connected story

The front and back of your annual report need to tell the same story

- Investors expect to recognise the same business in the front of an annual report that they see in the financial statements.
- If they don't see that connected story, they can lose confidence in the report.

To tell a connected story...

- **Join the disclosure dots** between the front-end narrative and the financial statement notes.
- **Ensure** the **different components** within your front-end disclosures are themselves **connected**.
- **Watch out for front-end explanations** that might cause readers to misunderstand what's been recognised in the financial statements.



Join the disclosure dots on climate-related matters



Is your financial report connected?

- Investors need to be able to connect the information in the financial statements with the picture of the underlying business in the rest of your report.
- Explain whether and how your announced climate-related strategies and commitments have affected the financial statements.

Is your sustainability report connected?

- Your sustainability disclosures need to be derived from data and assumptions consistent with those used to prepare the financial statements when appropriate.
- You need to clearly explain any differences.
- Your sustainability disclosures need to enable investors to understand the related current and anticipated financial effects.

Is your MD&A connected?

- Your MD&A needs to provide the broader strategic context in which to understand your sustainability disclosures.
- It needs to clearly explain how your sustainability and wider strategies connect.

Ensure different components are connected



Are the components of your annual report connected?

- Investors expect the financial statements, MD&A and sustainability-related disclosures to tell a connected story.
- A connected story should convey a consistent understanding of the company's business model and strategy. Companies may face direct challenge if investors and regulators can't see this.
- Connectivity is particularly important if your company is making significant changes to its business model and strategy – e.g. in response to climate-related matters and other uncertainties.

Does your reporting process support connectivity?

- Connected reporting requires that a single view of the business model and strategy should underpin the whole report.
- If the various elements of an annual report are developed separately, then it's unlikely to deliver a coherent narrative.

At a glance | IFRS Accounting Standards mentioned

IFRS 2

Share-based Payment

IFRS 9

Financial Instruments

IFRS 15

Revenue from Contracts with Customers

IFRS 16

Leases

IAS 1

Presentation of Financial Statements

IAS 2

Inventories

IAS 16

Property, Plant and Equipment

IAS 19

Employee Benefits

IAS 20

Accounting for Government Grants and Disclosure of Government Assistance

IAS 36

Impairment of Assets

IAS 37

Provisions, Contingent Liabilities and Contingent Assets

IAS 38

Intangible Assets

Find out more

To find out more about these and other potential impacts go to our **Clear on climate reporting hub**.

The site is evergreen, so please take a look and bookmark it today.

Follow 'KPMG IFRS' on LinkedIn or visit kpmg.com/clearonclimatereporting.



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