https://kpmg.com/xx/en/our-insights/ifrg/2024/climatechange-disclosures.html

Have you disclosed the impacts of climate-related matters clearly?

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What's the issue?

All companies are facing climate-related risks and opportunities. Some are affected more than others. As the impact of climate change intensifies, investors and regulators are increasingly seeking greater transparency of climate-related information in financial statements.

Companies are expected to provide more comprehensive disclosures in the front part of the annual report, sustainability report or elsewhere. Financial statements are not the only source of information about climate-related matters; however, they play an important role.

How a company reflects the impacts of climate-related matters in the financial statements will depend on its specific facts and circumstances, including the nature and extent of those impacts on the company. Therefore, companies are required to consider materiality carefully in deciding what information to provide about these matters. Information may be material even though there is no current-period financial impact.

This article focuses primarily on how current requirements in IFRS® Accounting Standards facilitate disclosure of climate-related information in the financial statements. For a more comprehensive discussion on potential impacts, including measurement and recognition impacts, see our Clear on climate reporting hub.

It also highlights other matters that companies need to consider, largely reflecting investors' and regulators' expectations – e.g. consistency between the front part of the annual report and the financial statements.

Investors are challenging the lack of sufficient disclosure of climate-related information in financial statements and are seeking transparency and clarity in disclosures. The current reporting season is an opportunity for companies to close this information gap by enhancing their disclosures of the impact of climate-related matters.

IFRS Accounting Standards do not refer explicitly to climate-related risks or opportunities, but they implicitly require relevant disclosures in the financial statements when climate-related matters considered in preparing the financial statements are material. To respond to investors' and regulators' expectations, companies may need to go further in view of the overarching requirements in IAS 1 Presentation of Financial Statements.

Connectivity between non-financial and financial reporting is key. Although the nature of the information provided in the front part of the annual report and the financial statements may differ, it needs to be consistent when appropriate. If key assumptions underlying the financial statements differ from those disclosed in the front part of the annual report – e.g. a net zero commitment – then companies may need to consider explaining these differences in the annual report.

Getting into more detail

Climate-related risks – due to either the physical effects of climate change or the transition to a lower-carbon economy – and opportunities are causing companies to make strategic decisions in response. For some companies, the risks and opportunities are immediate and easily identifiable; for others, they may be less immediate, may exist across their broader value chain and may be less apparent.

Not surprisingly, users of financial statements want to understand how climate-related matters impact companies, including their business models, cash flows, financial position and financial performance. They need information to assess how the company is managing these climate-related risks and opportunities, and the impact on the company's long-term prospects.

Investors are particularly concerned that they are not getting sufficient information about companies' downside exposures. Therefore, in this article we focus on climate-related risks. A company's response to climate-related risk may impact a number of accounting areas, including disclosure.

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Relevance of information through the lens of investors

Investors want information about how climate-related risks and opportunities impact companies because it affects their decision-making. Companies need to make materiality judgements when deciding what information about climate-related matters to disclose in the financial statements. Under IFRS Accounting Standards, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that primary users of financial statements make on the basis of those financial statements, which provide financial information about a specific company. [IAS 1.7]

The significance of the impacts will vary by company and will depend on multiple factors, including the industry it operates in, geographic location, applicable laws and regulations, its goods/services and supply chains.

For certain companies, particularly those considered to be in high-risk industries[2], the impacts could be significant and could have major implications for their future business model, investment priorities, products, costs of doing business, supply chain resilience and access to, and costs of, capital.

Considering materiality carefully will be a key issue in addressing user expectations. Materiality involves both quantitative and qualitative considerations. Even if the information is not material in amount, it may be material in nature. For example:

- for some companies – e.g. those in higher-risk industries – the impacts may be quantitatively material;
- for others with no significant quantitative impact in the current reporting period, management may need to provide an explanation because this could be qualitatively material to users; and
- for those that have not yet fully assessed the potential future impact on the financial statements, this fact may be qualitatively material and so an explanation may be needed.

IFRS Accounting Standards' disclosure requirements and climate-related information

Overarching requirements

Users expect companies to improve the clarity and transparency of climate-related disclosures. To meet these expectations, companies need to consider the specific disclosure requirements in individual standards as well as the overarching requirements of IAS 1.

For example, paragraph 112 of IAS 1 requires disclosure of information that is relevant to an understanding of the financial statements but is not specifically required by IFRS Accounting Standards or presented elsewhere in the financial statements. Paragraph 17(c) of IAS 1 notes that, in certain circumstances, a company may need to include additional disclosures to achieve a 'fair presentation' in the financial statements.

Key judgements and estimates

Many companies face uncertainty when considering the impacts of climate-related risks in recognising and measuring assets and liabilities. Investors and regulators expect robust disclosures of the most significant assumptions, estimates and judgements made in preparing the financial statements to understand whether and how they are affected by climate-related matters. When there is a high level of uncertainty, companies may also consider providing sensitivity analyses and related disclosures.

IAS 1 requires specific disclosures on key judgements and estimates made by management in preparing the financial statements, including disclosure of:

- judgements that management has made in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements; and
- information about the assumptions that management has made about the future, and other major sources of estimation uncertainty at the reporting date, that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year. [IAS 1.122, 125]

In some cases, changes in key assumptions on climate-related risk may not be expected to result in material adjustments in the measurement of assets and liabilities in the next financial year, but the chance of material adjustments in the longer term may be significant. In these circumstances, and given the expectations of investors, companies may need to consider disclosing key assumptions related to climate-related risk even though the risk of material adjustments in the next financial year may be considered to be low.

IFRS Accounting Standards facilitate these disclosures. The following articles contain relevant disclosure considerations for certain key areas that involve significant judgements and estimates.

Topic	**Related articles**
Impairment of non-financial assets	What's the impact on cash flow projections used for impairment testing of non-financial assets?
Useful lives and residual values of property, plant and equipment (PP&E) and intangible assets	What's the impact on useful lives and residual values of PP&E and intangible assets?
Measurement of financial assets	What's the impact on expected credit losses?
Environmental and decommissioning provisions	Have you recorded all of your environmental and decommissioning obligations?
Going concern assessments	What's the impact on the going concern assessment and related disclosures?

Connectivity between the front part of the annual report and the financial statements

Users and other stakeholders are increasingly interested in understanding how the key assumptions and judgements underlying the information on climate-related matters disclosed in the front part of the annual report reconcile with the financial statements – in particular, when they are inconsistent[3].

Connectivity between non-financial reporting and financial reporting is key.

Although the information provided in the front part of the annual report may differ in nature from the financial statements, it needs to be consistent where appropriate. Furthermore, if a company has made and disclosed climate-related commitments in the front part of the annual report, then the assumptions used in the financial statements need to be consistent where appropriate.

However, differences can arise between the information in the front part of the annual report and the assumptions used to prepare the financial statements, as described in the examples below.

- A 'potential' (uncommitted) restructuring of a company's business discussed in the front part of the annual report may not lead to the recognition of a restructuring provision in the financial statements, because 'potential' restructurings generally do not meet the criteria for recognition as a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Similarly, a 'potential' restructuring is not reflected in the company's value in use calculation when testing for impairment under IAS 36 *Impairment of Assets*.
- The front part of the annual report may also discuss risks associated with 'potential' new laws and regulations. 'Potential' laws and regulations are long-term risks but they do not

typically give rise to obligations in the financial statements until they are enacted (or substantively enacted). In contrast, upcoming changes in laws and regulations may affect management's expectations about returns generated by an asset or a cash generating unit in performing impairment testing of non-current assets.

- Certain climate-related matters may have been discussed in the front part and considered by management when preparing the financial statements, but management concluded that no related information needed to be disclosed. This could be because these matters were judged either to have a low probability of occurring or would occur so far into the future that the impacts on the financial statements were not material and management concluded that it was not a significant judgement that required disclosure.

In such instances, to address the information gap, disclosure of the significant differences in assumptions and the reasons for these may help users to understand and reconcile the information in the front part of the annual report with the financial statements. For example, a company may consider discussing why key assumptions used in estimates in the financial statements are different from net-zero commitments/scenarios and impacts disclosed in the front part of the annual report – e.g. discussion of differences between the key assumptions used in impairment testing and 'Paris-aligned' assumptions[4] used in the front part of the annual report.

Regulatory expectations

Climate-related information remains a key area of focus for many regulators. Some regulators have also issued guidance emphasising the importance of considering climate-related matters when preparing annual reports, including financial statements.

For example, the European regulator (ESMA[5]) highlights climate-related matters in its statement as one of the key topics that European national securities regulators will focus on when reviewing listed companies' 2023 annual reports. ESMA also recently published a report on climate-related disclosures included in the 2022 annual financial statements of selected European companies. ESMA expects companies to consider the examples in the report when assessing and disclosing the degree to which climate-related matters play a role in the preparation of the financial statements.

Similarly, the Australian regulator (ASIC[6]) has identified climate-related risks as one of its key areas of focus for annual reports for a number of years – including greenwashing[7], disclosure of climate-related risks and the impacts on asset impairment assumptions.

The UK FRC[8] continues to focus on climate-related matters in both its routine and thematic reviews.

Other regulators are likely to follow suit and focus on this topic.

Standard-setting developments

The International Sustainability Standards Board has issued its first two IFRS Sustainability Disclosure Standards – IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*. The standards are designed to provide information to help investors assess the effect of sustainability-related risks and opportunities on a company's prospects and their requirements will support connectivity

between this information and the financial statements. For more information, see our ISSB Standards Today page.

The International Accounting Standards Board is exploring targeted actions to improve the application of IFRS Accounting Standards to climate-related and other uncertainties. Proposed actions include creating illustrative examples, clarifying or enhancing existing requirements and consultations with the IFRS Interpretations Committee.

In addition, the European Commission has issued its first set of 12 European Sustainability Reporting Standards (ESRSs). Together, these ESRSs require affected companies to provide information on their governance and strategy to address material sustainability topics; the impacts, risks and opportunities arising from those topics; and quantitative metrics and targets.

Actions for management to take now

- Consider climate-related risks and opportunities and their financial impacts when preparing financial statements.
- Consider materiality from both a quantitative and qualitative perspective in relation to disclosures of key judgements and assumptions about climate-related risk.
- Provide clear and robust disclosures, especially of the key judgements and estimates affected by climate-related matters.
- Ensure consistency of assumptions used in relevant areas of the company's financial statements and that they are in sync to the extent appropriate with information on climate-related risks discussed elsewhere in the annual report. Consider providing additional explanations in the annual report where inconsistencies arise.
- Consider relevant regulatory guidance.
- Prepare for mandatory adoption of ESRSs where relevant, monitor endorsement of IFRS Sustainability Disclosure Standards and consider voluntary adoption.

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[1] See the International Accounting Standards Board's related educational material.

[2] Examples of high-risk industries include energy, finance, transportation, materials and buildings, agriculture, food and forestry products.

[3] The UK Endorsement Board highlights key connectivity themes identified in its general research report and its analysis of UK companies' 2022 annual reports.

[4] 'Paris-aligned assumptions/benchmarks' are indices that align with the Paris Agreement, which seeks to limit the rise in global temperatures to well below 2°C above pre-industrial levels, and to pursue efforts to keep the rise to 1.5°C.

[5] European Securities and Markets Authority.

[6] Australian Securities and Investments Commission.

[7] 'Greenwashing' is the act of providing the public or investors with misleading or false information about the environmental impact of a company's products and operations.

[8] Financial Reporting Council.