Technical update for accounting and finance functions

Our responses to your FAQs from the December 2022 virtual event

Accounting Advisory Services

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Section 1: Topical Accounting and Reporting Challenges

Participant Q1: Which FRC report sets out its key findings from the recent reporting reviews and its key disclosure expectations for the next reporting season?

The report, '**Annual Review of Corporate Reporting 2021/22**', published in October 2022, sets out the findings from the FRC's corporate reporting review activities during the year, improvement areas, examples of good disclosures, and matters that companies should focus on in the next reporting season. Companies should review the report and ensure that their Annual Report and Accounts ("ARA") meet the FRC's disclosure expectations, where material. This report can be accessed **here.**

In December 2022, the FRC announced its areas of focus for corporate reporting reviews in 2023/24. In selecting corporate reports for review, the FRC will give priority to companies in the following sectors: Travel, Hospitality, and Leisure; Retail and Personal Goods; Construction and Materials; and Industrial Transportation. In addition to its broader-scope routine reviews, the FRC will conduct four thematic reviews covering: IFRS 17 for insurers, IFRS 13 (with a focus on companies in the non-financial sector), Task Force on Climate-related Financial Disclosures ("TCFD") and climate in financial statements, and the ARA of large private companies.

It is key for companies to ensure that their ARAs consider the FRC's areas of focus and reporting expectations and are of high quality. The FRC also published a brand-new report in mid-December 2022 following our digital event, called 'What Makes a Good Annual Report and Accounts'. This report includes useful tips and guidance in this regard, which can be accessed **here**.

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Participant Q2: How is the disclosure of the basis for recognising deferred tax assets on losses determined in a consolidated set of accounts, where there could be several different companies with different factors providing comfort?

It may be that disclosure in the consolidated accounts is more significant than disclosures in separate financial statements due to an increased number of deferred tax assets, for example, if the group accounts consolidate several different deferred tax assets across different jurisdictions and financial statements, which therefore have different forecasts of taxable profit due to differences in tax legislation between jurisdictions. Financial reporting and taxation teams may wish to connect in advance of disclosure preparation to align on significant assumptions and judgements in deferred tax asset recoverability.

The FRC's comments in its thematic review of deferred tax assets are currently relevant.

However, materiality at a group perspective may need to be considered when determining the volume of the disclosure; materiality for the consolidated accounts may be higher than that of separate financial statements. The FRC's December 2022 publication 'What Makes a Good Annual Report and Accounts' comments on the balance between materiality and relevance when considering the extent of disclosure.

Participant Q3: Is there a difference in the disclosure of impairment assumptions between the individual accounts of a subsidiary and that of the group consolidated accounts?

There is generally no difference in disclosure requirements between consolidated and separate financial statements which are both prepared under IFRS. Both require the application of the disclosure requirements for impairments and expected credit losses outlined in IAS 36 *Impairment of Assets* and IFRS 7 *Financial Instruments: Disclosures* respectively.

However, if a UK-based subsidiary applies FRS 101, exemptions are available in respect of IFRS 7 disclosures, and certain IAS 36 impairment disclosures, provided that equivalent disclosures are included in the consolidated accounts of the group in which the entity is consolidated. This may result in reduced impairment and expected credit loss disclosures compared to the IFRS Group.

Similarly, subsidiaries that apply FRS 102 or other local GAAP may have different disclosure requirements to IFRS.

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Participant Q4: Is it a requirement to disclose all impairment assessments for all financial assets or only those with a material impact?

IFRS 7 does not refer to impairment assessments for individual financial assets. The important question for preparers to consider is whether they are making sufficient disclosure to meet the objectives of the standard.

The overall objective of the credit risk disclosures in IFRS 7 is to 'enable users of financial statements to understand the effect of credit risk on the amount, timing, and uncertainty of future cash flows' [IFRS 7.35B]. To achieve this the standard requires entities to disclose:

1) The methods, assumptions, and information used to measure Expected Credit Losses (ECLs).
2) Quantitative and qualitative information that allows users to evaluate the ECLs recognised, the changes in those ECLs, and the reasons for those changes.
3) Information about the entity's exposure to credit risk (including concentrations of credit risk).

The standard also provides various detailed requirements that underpin these objectives.

However, the standard does note that the entity has the flexibility to determine which aspects to emphasise and the appropriate level of aggregation or disaggregation to use, provided sufficient information is disclosed to meet the objectives above.

We also note that the FRC's Annual Review of Corporate Reporting (October 2022) identifies that for non-banking companies the following disclosures were sometimes missing:

- Credit risk disclosures for financial assets other than trade receivables (e.g., contract assets, lease receivables and related party receivables);
- Inputs, assumptions, and estimation techniques used to calculate ECLs; and
- Information about the entity's credit risk management practices including the definitions of default used and the reasons for selecting those definitions.

More generally we note that disclosures that are not material need not be provided in a set of financial statements, even if the standards contain a list of specific requirements or describe them as minimum requirements. [IAS 1.31, BC30H-BC30I]

However, in our view, the materiality of a disclosure item should not be determined solely by the materiality of the related financial statement line item. When making judgements about the materiality of disclosure, an entity considers the objectives of the disclosure and its relevance to the users together with the surrounding circumstances, including the consideration of qualitative factors.

The FRC's December 2022 publication 'What Makes a Good Annual Report and Accounts' also comments on the balance between materiality and relevance when considering the extent of disclosure.

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Section 2: ESG Reporting Developments

Participant Q5: Will ESG reporting be rolled out to medium-sized entities in the near future?

We expect that ESG reporting requirements will continue to expand and will affect medium-sized entities. We have listed a few key ESG reporting requirements below:

1) UK Companies Act 2006 Section 414 (Climate Financial Disclosures / UK CFD) – applies to companies with > 500 employees and >£500 turnover.
2) Streamlined Energy and Carbon Reporting ("SECR") (2019) – applies to UK companies meeting two or more criteria of over 250 employees; or annual turnover of more than £36m; or an annual balance sheet of over £18m.
3) Modern Slavery Statement – applies to any corporate doing business in the UK with a Turnover >£36m.
4) Gender pay gap – applies to any UK employer who has a headcount of 250 or more.

To receive ESG updates on new publications, webinars, and newsletters in real time via email, you can sign-in or create an account on our **ESG insights centre.**

Participant Q6: Are there any ESG assurance requirements for UK companies that are not SEC or EU regulated?

ESG assurance is not currently mandatory for UK companies. However, despite this, almost 70% of the largest 100 companies in the UK now have external assurance over selected ESG metrics in the front half of their Annual Report/in their ESG report. This is driven by regulatory, investor, and other stakeholder expectations. Obtaining ESG assurance can be considered best practice and it is often informed by a materiality assessment.

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Participant Q7: Are there more challenging tests/scenarios for companies to examine their sustainable business models?

Understanding the full risks and opportunities that underpin your strategy takes effective scenario planning – mapping out all the possible outcomes and understanding the common sensitivities. The extent of scenario planning you need to conduct, and the impact on your climate and business strategy will vary depending on the nature of your business. With limited scenario analysis, it's difficult to produce a well-informed climate strategy response.

The UK Transition Plan Taskforce ("TPT") recommends that an entity should perform sensitivity analysis to understand the key assumptions underlying an entity's transition plan, the dependencies embedded within the plan and the potential impact that fulfilling the assumptions may have on the plan. As proof of performing this exercise, the TPT expects entities to disclose the underlying assumptions used to assess the credibility of the plan and explain how they are baked into financial reporting. As such, companies need robust analysis to inform the assumptions used.

Click here to read more about our reaction to the latest TPT publication.

Participant Q8: Is there a summary of ESG requirements?

Click **here** to read the ESG Reporting Regulations Talkbook. This summarises incoming regulations, when and what they are, and to who they will be applicable to.

Participant Q9: Will KPMG publish a newsletter and pending legislation/reporting and voluntary climate-related disclosures so we can keep track of reporting requirements?

To receive ESG updates on new publications, webinars, and newsletters in real time via email, you can sign-in or create an account on our **ESG insights centre**.

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Resources

FRC | Corporate Reporting Review

FRC | What Makes a Good Annual Report and Accounts

GOV.UK | Climate-related financial disclosures for companies and limited liability partnerships (LLPs)

GOV.UK | Streamlined energy and carbon reporting

GOV.UK | Publish an annual modern slavery statement

GOV.UK | Gender pay gap reporting: guidance for employers

KPMG | ESG Insights Subscription

KPMG | Transition Plan Taskforce – Reaction to the latest publications

KPMG | Sustainability reporting

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