Current developments in IFRS

Following several years of complex implementation projects for new IFRS requirements, most companies are enjoying a stable accounting framework at present. Nevertheless, challenges remain. On the one hand, COVID-19 continues to raise a variety of issues. On the other, companies need to address how sustainability topics impact their financial reporting. This article aims to help spark a discussion with your finance teams.

Topics for the 2021 financial year

While some companies continue to struggle with the negative impact of **COVID-19** and need to consider issues such as their ability to continue as a going concern and the potential impairment of assets, the situation has improved significantly for many others in 2021. These improvements give rise to new questions such as:

- Should impairment losses recognized in the previous year be (partially) reversed?
- Do estimates (e.g. for the recognition of variable revenues, employee compensation or bad debts) need to be updated?

In addition, most **IBOR reference rates** are due to be replaced at the end of 2021. In Switzerland, for example, there will be a switch to the SARON. This will have an impact on variable-rate receivables and liabilities, hedges as well as on the hedge accounting of interest rate risks. The International Accounting Standards Board (IASB) has issued special simplifications to make it easier for companies to transition to the new reference interest rates from an accounting perspective. The main questions, then, are:

- Have all affected receivables, liabilities and hedges been identified?
- Is there a process in place to allow the necessary contractual and accounting amendments to be implemented in a timely manner?

"Climate change affects us and the generations that follow in many ways."

Sustainability topics

Climate change affects us and the generations that follow in many ways. It is triggering weather extremes, loss of biodiversity and a need to make behavioral changes. This leads to new trends, legislation, risks and opportunities, all of which ultimately impact existing business models to varying degrees, depending on the company and industry. Against this background, it is not surprising that investors and other stakeholders are increasingly interested in transparent, reliable and comparable reporting on environmental, social and governance (ESG) factors.

Until now, there has been no uniform global framework for these topics. The IFRS Foundation has responded by setting up the International Sustainability Standards Board (ISSB). The ISSB, which is currently still in the process of being established, is to develop uniform standards for accountability on sustainability issues. The intention is to build on the work of the Financial Stability Board Task Force on Climate-Related Financial Disclosures and to focus initially on climate-related aspects.

Even without applicable accountability requirements, companies should consider the impact of sustainability issues on their IFRS accounting. Since IFRSs already address existing issues, sustainability-related factors will inevitably impact companies' accounting, even without special requirements. Examples of relevant issues and impacts are:

- *Budgets:* New legal requirements as well as changes in customer and supplier behavior can have a positive or negative impact on budgeted income and expense. This, in turn, can affect the recoverability of intangible assets (including goodwill), property, plant and equipment, inventories, deferred tax assets, etc.
- *Property, plant and equipment:* New legal requirements, technological advances (e.g. in relation to CO_2 reduction), changes in customer behavior, voluntary commitments (e.g. net zero targets) and the threat of reputational damage may lead to certain (environmentally harmful) assets being decommissioned earlier than originally planned. This may affect scheduled depreciation, trigger impairment and affect provisions associated with these assets (see below).
- *Emission allowances:* To limit emissions, a growing number of countries are relying on emission allowance systems (e.g. CO_2 certificates or caps). This leads, for example, to questions on how to account for allocations received for free, certificate purchases/sales or return obligations. It also raises questions about when – in other words, at what point – provisions should be recognized for excess emissions.
- *Provisions:* Decommissioning and restoration obligations often arise as a result of legal or contractual provisions. However, public announcements or operational practice can also trigger de facto obligations of this kind. If the "damage" in question has already occurred, provisions must be made.

- *Employee compensation:* In order to provide incentives for sustainable behavior, specific sustainability indicators might be included in share-based payments or other remuneration agreements. Depending on the specific design, this can have different implications on measurement.
- *ESG/green bonds:* Sustainable finance is becoming increasingly popular. Examples include bonds where interest rates depend on compliance with certain sustainability indicators or issue proceeds are used for projects to reduce pollution. Investors will be particularly interested in the question of how to classify – and thus value – these financial instruments. Issuers will need to analyze whether such financing contains a derivative that must be separated.

Depending on their industry and individual situation, companies can expect these factors to have an impact on their IFRS financial statements sooner or later. With that in mind, they should keep a close eye on the issues and current developments and prepare for corresponding questions from investors and other stakeholders. The most important things to ask yourself right now include:

- Do we already have a sustainability strategy (that we can communicate)?
- Have we performed a company-specific impact analysis?
- Has a process been established to update the impact analysis regularly?
- Is there a plan for creating the necessary structures and integrating them into existing company processes?

Further topics for future financial years

The volume of financial disclosures under IFRS is often criticized. Preparers complain that preparing the financial statements is taking more and more time and effort. Users think that some disclosures are not very specific or too standardized and that the really interesting aspects get lost in the immense volume of information provided. The IASB therefore launched its **Disclosure Initiative** some time ago in order to strengthen the principle of materiality and make information more relevant.

The next stage of the Disclosure Initiative will come into effect at the start of the 2023 financial year. From this date onward, companies will only have to present those accounting policies that are material for understanding their financial statements. This refinement is an improvement and may help reduce the pages and pages of – sometimes verbatim – quotes from IFRS requirements that are currently found in today's financial statements. Companies may wish to use this change as an opportunity to set up a Better Business Reporting project. The following questions may help:

- Which accounting policies are not (absolutely) essential to enable users' understanding?
- Is there potential to make the notes more relevant overall and prioritize certain disclosures?

In the 2023 financial year, application of the new standard **IFRS 17 Insurance Contracts** becomes mandatory, which will bring far-reaching consequences for insurance companies. IFRS 17 represents a paradigm shift, i.e. initial application will trigger extensive changes in accounting and the related systems and processes. This will lead to improved international comparability and transparency of the financial statements of insurance companies. However, the extent of the amendments required and the effort required to implement those changes should not be underestimated. Ask the following questions to help determine the current status at your organization:

- Where does our IFRS 17 implementation project currently stand?
- What are the challenges?
- Does the project include identifying and implementing any necessary system and process adjustments?
- Do the consolidated financial statements for 2021 contain sufficient disclosures on the status of the project and the expected impacts of initial application of IFRS 17?

Conclusion

With no significant IFRS amendments for the 2021 financial year, companies can focus on recording any (reversal) effects relating to COVID-19 and implementing the new reference interest rates.

Sustainability is now firmly on the agenda of many organizations. It is important to consider a wide variety of perspectives and also to keep accounting issues in mind. Any such projects should be set up holistically while further developments need to be monitored.

Frank Richter
Director, Head of DPP IFRS
KPMG Switzerland

+41 58 249 30 73
frankrichter1@kpmg.com

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