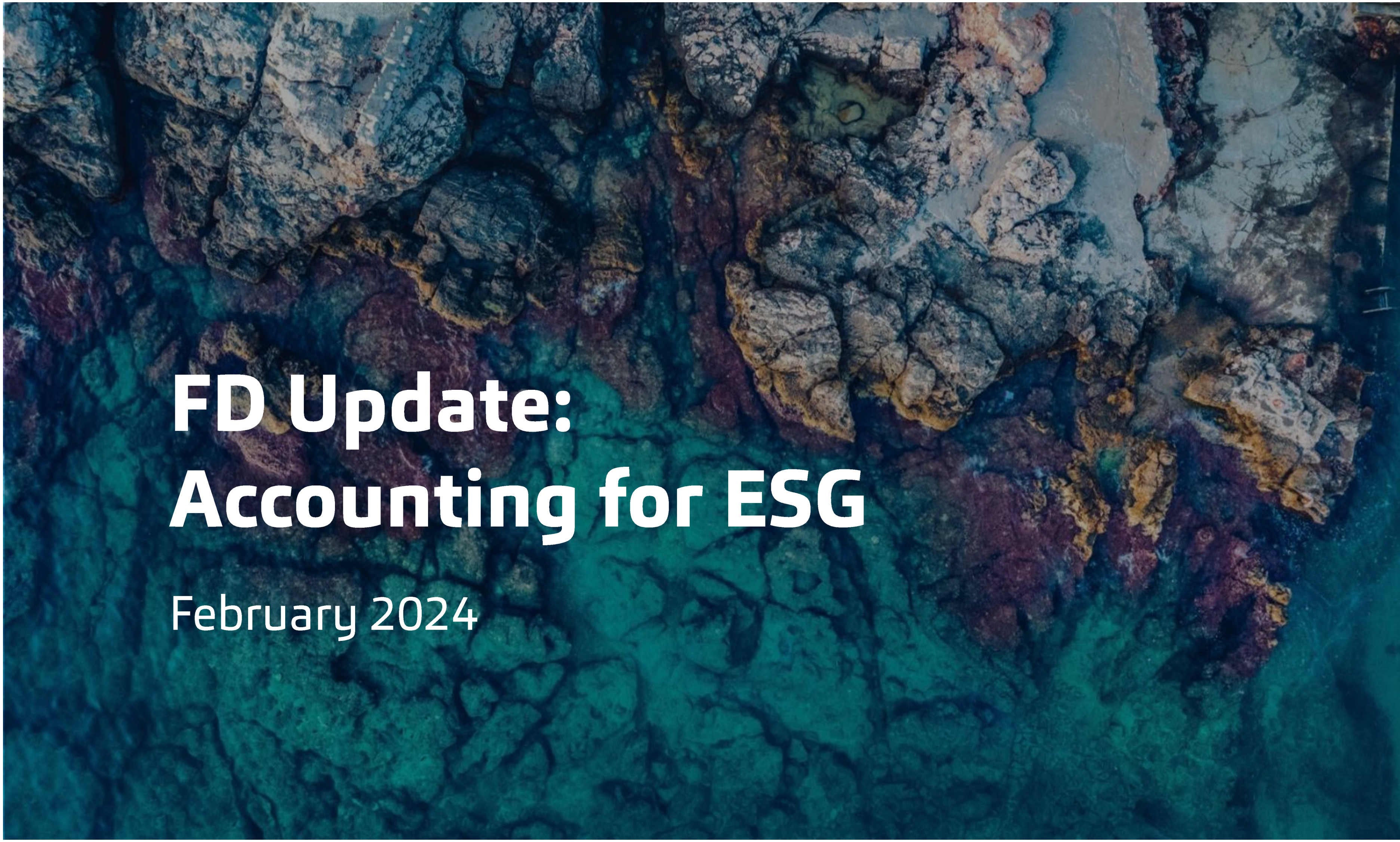

FD Update: Accounting for ESG

February 2024

Now, for tomorrow

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Thank you for joining us

If you've not received a copy of the slides, you can download them from our website, via the QR code here, or via the link in the Chat, where you will also find other useful information.

Please use the Q&A to ask any questions. We will do our best to answer them during the webinar or will raise it on your behalf during the Q&A at the end with all of our presenters – so don't go away!

Any outstanding questions will be responded to directly, except in cases where the question has been asked anonymously.

Feedback & CPD Certificates

This is a CPD Course and provides 1 hour of relevant CPD.

Please use our feedback form to request your CPD certificate for attending. Certificates will be sent out by the end of March, once your attendance has been verified.

We appreciate all feedback, which helps us to plan future events to ensure they meet your needs.

The recording from today's webinar will also be available in the next couple of weeks.

www.surveymonkey.co.uk/r/FDupdateFeb24ESG

Our Speakers

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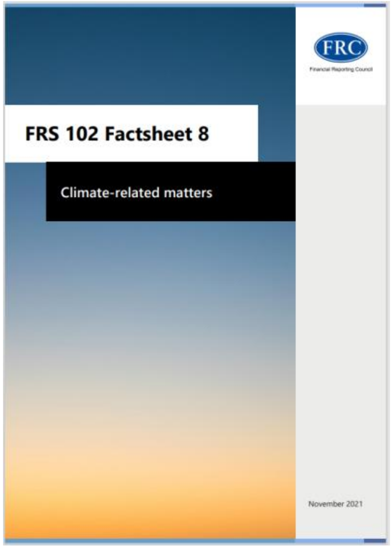
Climate risk in the financial statements

How does climate risk impact my financial statements?

- Both the IASB and FRC consider existing requirements to require organisations to consider climate-related matters when their effect is material to the financial statements
- Consideration of climate risk (and other ESG risks) is an integral component of MHA's audit approach
- Climate risk increasingly factored into material valuations, provisions and going concern assessment
- Importance of 'connectivity' between front half disclosures and financial statement assumptions



FRC

Financial Reporting Council

FRS 102 Factsheet 8

Climate-related matters

November 2021

IFRS Accounting

Republished July 2023

Educational material

Effects of climate-related matters on financial statements

In June 2023, the International Sustainability Standards Board (ISSB) issued IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*. In the light of these new IFRS Sustainability Disclosure Standards, the IFRS Foundation is republishing this educational material to remind stakeholders of the long-standing requirements in IFRS Accounting Standards to report on the effects of climate-related matters in the financial statements when those effects are material. Consideration of the ISSB's Standards may help companies better identify matters, including climate change, that affect the financial statements and help companies apply IFRS Accounting Standards.

This educational material was first published in November 2020 and is intended to support the consistent application of requirements in IFRS Accounting Standards. The educational material has been updated to reflect an agenda decision published by the IFRS Interpretations Committee in July 2022 and minor editorial changes.

Climate change is a topic in which investors and other IFRS stakeholders are increasingly interested because of its potential effect on companies' business models, cash flows, financial position and financial performance. Most industries have been, or are likely to be, affected by climate change and efforts to manage its impact. However some companies, industries and activities will be affected more than others.

IFRS Accounting Standards do not refer explicitly to climate-related matters. However, companies must consider climate-related matters in applying IFRS Accounting Standards when the effect of those matters is material in the context of the financial statements taken as a whole. Information is material[1] if omitting, misstating or obscuring it could reasonably be expected to influence decisions that primary users of financial statements (hereafter, investors) make on the basis of those financial statements, which provide financial information about a specific company. For example, information about how management has considered climate-related matters in preparing a company's financial statements may be material with respect to the most significant judgements and estimates that management has made.

The table below sets out examples illustrating when IFRS Accounting Standards may require companies to consider the effects of climate-related matters in applying the principles in a number of Standards. The list is *non-exhaustive*—there could be other instances where climate-related matters are relevant when applying IFRS Accounting Standards, for example those on the measurement of defined benefit obligations. Related information can be found in an article by Nick Anderson, member of the International Accounting Standards Board. This educational material complements that article, adding for example specific paragraph references to IFRS requirements to assist those applying IFRS Accounting Standards. For purposes of illustration, the descriptions in the table do not always explain the relevant requirements completely; it is therefore important to refer to the requirements in the Standards when preparing financial statements. This document does not address management commentary.

1 Companies may find the IFRS Practice Statement 2 Making Materiality Judgements useful in assessing whether the effect of climate-related matters is material. The article by Nick Anderson includes further information on making materiality judgements.

Physical vs Transitional climate risks

Physical risks

- Risks associated with disruption to business activities arising from climate change
- **Acute risks:** one off disruptions such as hurricanes, floods and fire
- **Chronic risks:** more gradual changes such as changing rain patterns and rising sea levels

Transitional risks

- Risks arising with the transition to a low carbon economy
- **Policy and legal risks:** government, regulation, carbon pricing and capping
- **Technology risks:** risk of obsolescence due to 'greener' technology
- **Market risk:** significant change in consumer behaviour and expectations with consumers looking for low carbon goods and services
- **Reputational risk:** Stakeholders have higher expectations of how businesses respond to climate change issues

Going concern

- Changing weather patterns have already led to some business failures
- Are there any climate-related risks impacting your sector, supply chain, customers / distribution channels, lending requirements?

News ▸ Scottish fashion industry

Hunter Boots falls into administration

A combination of climate change, the pandemic and supply chain issues have seen debts spiral to more than £100m

NEWS By **Paula Murray**
09:38, 22 JUN 2023

Bookmark

The document filed to Companies House stated that “unsesasonal weather in the US“, the group’s largest market, led to “a significant decline in revenues“, while global Covid restrictions including store closures and event cancellations hammered profit margins ever further.

Goodwill, intangibles, PPE

- Climate-induced changes may indicate that an asset ceases to be available, becomes commercially obsolete or needs to be replaced sooner than previously expected

- These can impact on:
  - Useful economic lives
  - Net realisable value / recoverable amount – changes in estimated cash flows or increased risk associated with achieving cash flow

- Impact of climate / ‘net zero’ commitments in cash flow projections

Inventories

- Impact of emerging technology, changing consumer patterns, or declining sales price on obsolescence
- Rising costs due to climate change can increase inventory ‘cost’ – may need to be written down to estimated selling price less costs to complete/sell

Trade receivables and investments at amortised cost

- Impact of climate risks (physical and transitional) on customer base
- UK GAAP: specific evidence of an impairment trigger arising from climate risk
- IFRS: sectoral / macroeconomic impacts affecting expected credit loss models or provisioning tables
- Impact of ESG-related performance criteria (eg debt covenants)

Financial instruments at fair value

- Level 1 and 2 fair values: typically no/minimal impact, observable data already reflects market perception of climate risk
- Level 3 fair values (valuation techniques using unobservable inputs): additional adjustments may be necessary to reflect climate risk impact

Provisions and contingent liabilities

- Impact of net zero targets and commitments – potential constructive obligation
- IFRIC tentative decision (November 2023): use of carbon offsetting creates a present obligation for the period in which the emissions to be offset have been generated
- Consider impact of ESG-related regulation on asset decommissioning, contract performance and fines/penalties


The Sustainability Horizon

UK & EUROPE

2019
Streamlined Energy and Carbon Reporting introduced in the UK, requiring disclosure of energy consumption (in kWh), together with scope 1 and 2 emissions (metric tonnes)

2021
Taskforce for Climate-related Financial Disclosures (TCFD) framework mandatory for premium listed groups in the UK

2023
TCFD implemented into UK Companies Act and now mandatory in full for 2023 for both large private and public companies where turnover exceeds £500m and average employees exceed 500

IFRS sustainability reporting
Incorporates TCFD reporting, will be considered for use in UK reporting from 2025, traditional materiality approach. Call for Evidence issued by Department for Energy Security and Net Zero on scope 3 reporting under IFRS S2 (October 2023)

ISSA 5000
Proposed IAASB assurance standard for sustainability assurance engagements, expected from 2025

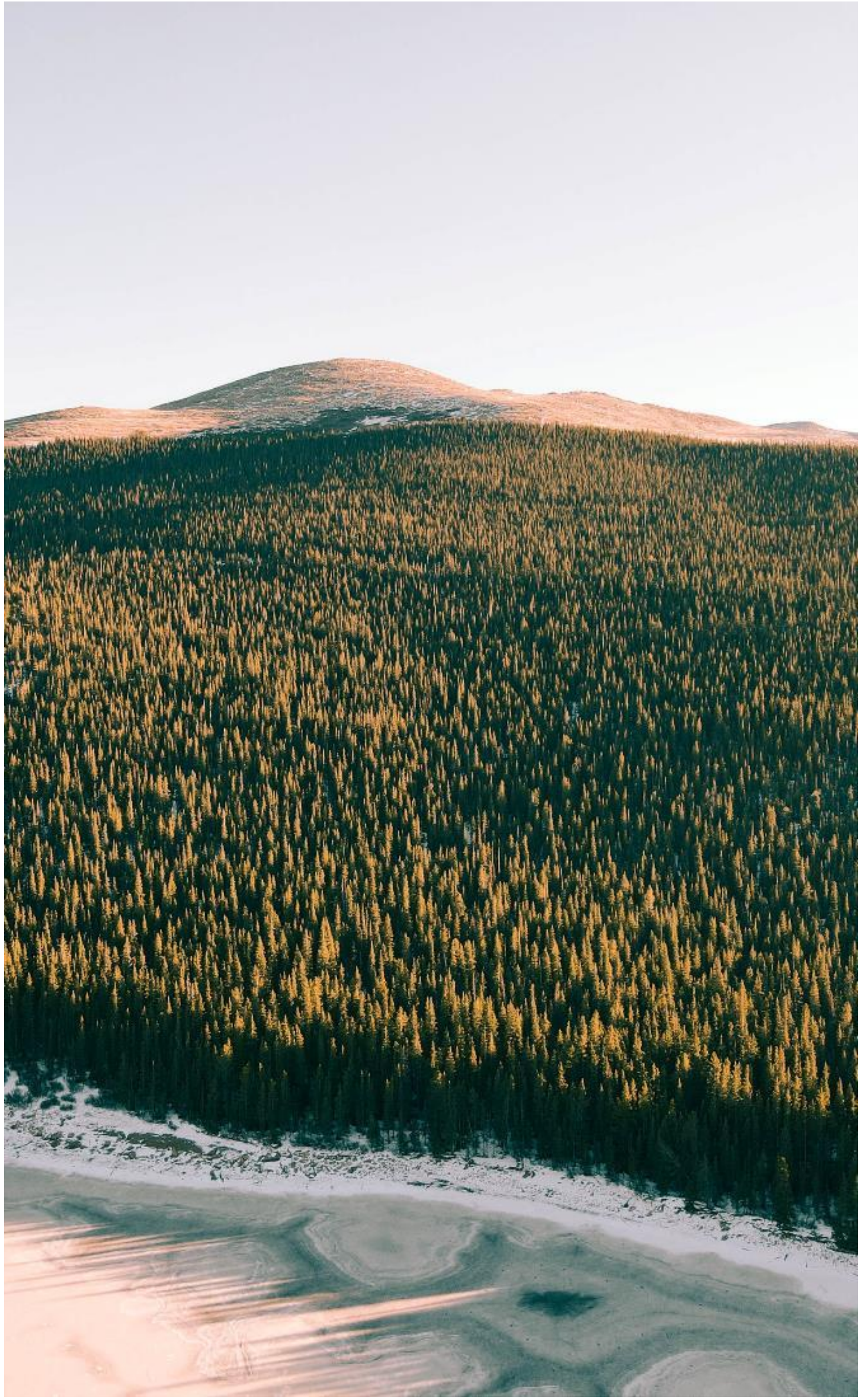
Corporate Sustainability Reporting Directive (CSRD)
Wide-ranging new European Sustainability Reporting Standards, applicable to non-EU groups with material EU turnover or large EU subsidiaries/branches from 2027/28, applies 'double materiality'

Taskforce for Nature-related Financial Disclosures (TNFD)
Considers environmental impact on ecosystems, biodiversity and indigenous communities, applies 'double materiality', effective date not yet known

Scope 4 emissions reporting
Not yet required by established frameworks, Scope 4 considers the emissions 'avoided' by a business, such as the carbon footprint of tenants and deliveries

Preparing for the tsunami

- Understand and capture broader ESG framework of the business
- Understand which reporting frameworks apply
- Identify overlaps and divergences between frameworks
- Identify data gaps



Preparing for the tsunami

	CSRD / ESRS	EU Green Taxonomy	California legislation	ISSB / TCFD	TNFD	GRI	CDP
Topics considered							
Environmental – climate	Y	Y	Y	Y	Y	Y	Y
Environmental – biodiversity and other matters	Y	Y	N	Planned	Y	Y	N
Social issues	Y	Y	N	Planned	Y	Y	N
Governance matters	Y	N	N	Planned	N	Y	N
Implementation							
Mandatory / voluntary	Mandatory	Mandatory	Mandatory	Voluntary (for now)	Voluntary	Voluntary	Voluntary
Materiality basis	Double	N/A	Traditional	Traditional	Double	Double	Double
Consider value chain impact	Y	N	N	Y	Y	Y	Y
Assurance required (limited vs reasonable assurance)	Mandatory – Limited and Reasonable (later)	Voluntary	Mandatory – Limited assurance	Voluntary	Voluntary	Voluntary	Voluntary

United Kingdom

- Adoption of ISSB standards and the future of TCFD
- Streamlined Energy and Carbon Reporting
- Energy Savings and Opportunities Scheme

Corporate sustainability should not come at the expense of corporate profitability

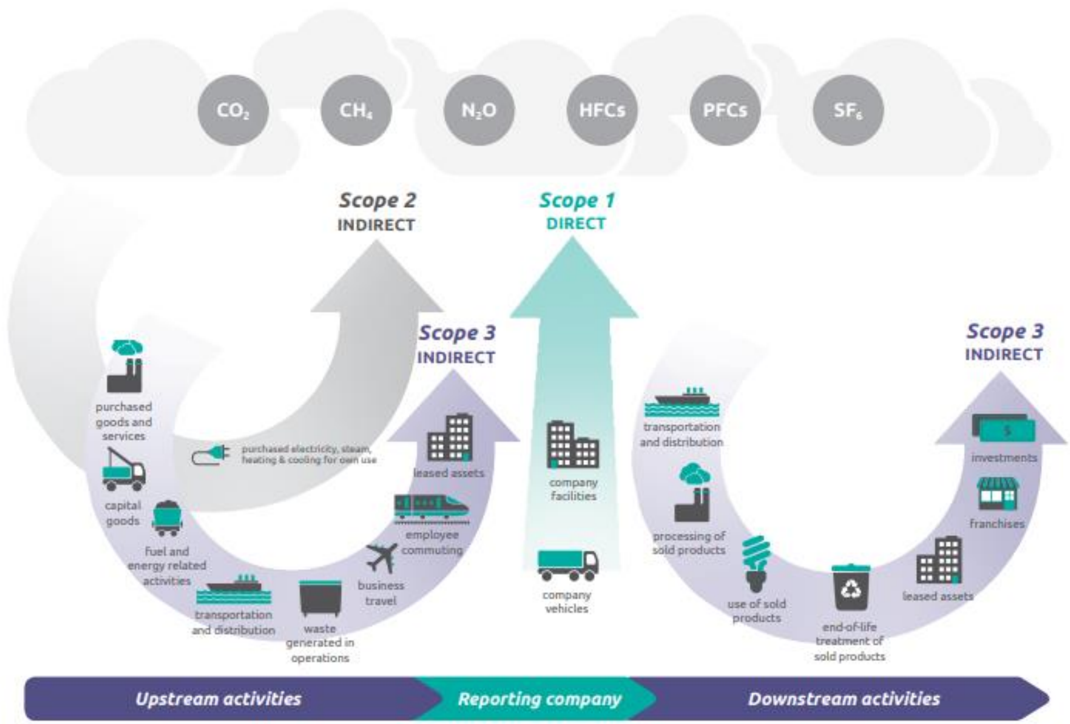
- Mark Lumsdon-Taylor, Partner and Head of ESG, MHA

UK adoption of ISSB standards

- International Sustainability Standards Board, forms part of IFRS Foundation
- Issued two standards in 2023:
  - IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*
  - IFRS S2 *Climate-related Disclosures*
- In substance, IFRS S2 is based on the Taskforce for Climate-related Financial Disclosure (TCFD) and provides granular requirements for more detailed information
- UK Government considering the best means to adopt ISSB standards:
  - Could replace TCFD requirements in UK Listing Rules
  - Could be incorporated by expanding Streamlined Energy and Carbon Reporting
  - UK Endorsement Board considering whether to endorse IFRS S1 and S2 for use in the UK as a standalone requirement
  - Companies Act 2006 already amended to require similar disclosure to TCFD for larger companies

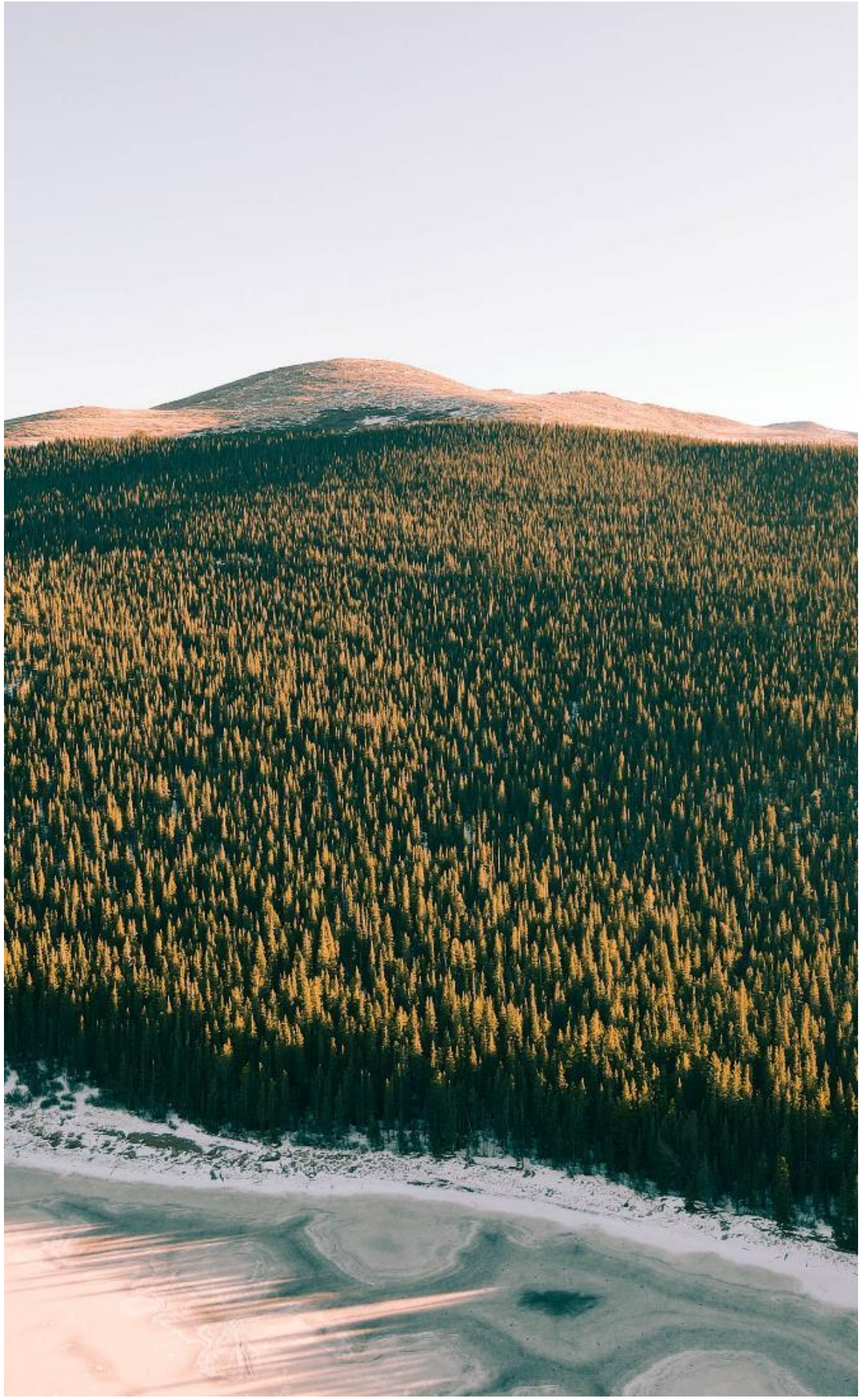
Streamlined Energy and Carbon Reporting (SECR)

- SECR disclosure currently required for all companies defined as ‘large’ under the Companies Act 2006, covering scope 1 and 2 emissions
- UK Government consulted on expanding SECR to include scope 3 in late 2023



SECR - FAQs

- What is the 40,000 kWh exemption?
- How much is 40,000 kWh?
- Does a company acting as landlord need to include property emissions in its SECR reporting?
- Does a company leasing a property need to report its emissions?



Energy Savings and Opportunities Scheme (ESOS)

- Scope: Companies meeting either:

> 250 employees	or	Revenues > £44m *and* gross assets > £38m

- Companies meeting these criteria at 31 December 2022 must register their compliance with Environment Agency by **5 June 2024**

- If one UK entity in a group exceeds the threshold, then all the UK entities in the group are automatically in scope (the highest UK parent company acts as "responsible undertaking")

- UK subsidiaries of overseas groups are in scope where the group's corporate activities in the UK exceed these thresholds

Energy Savings and Opportunities Scheme (ESOS)

- Multiple routes to compliance:
  - Commissioning ESOS energy audits through an approved ESOS Lead Assessor
  - ISO 50001 certification – a global standard for organisations to develop and improve their energy management systems
  - DECs (Display Energy Certificates) and accompanying recommendation reports
  - GDAs (Green Deal Assessment)
  - A mixture of the above methods – so long as 95% of the company's total energy consumption is covered, can use a mix of approaches

European Union

- Corporate Sustainability Reporting Directive (CSRD)
- Corporate Sustainability Due Diligence Directive (CSDDD or CS3D)
- Green Taxonomy

Implementing CSRD is like converting to IFRS while adopting SOx – it's not difficult, it's impossible!

- Mark Vaessen,
President,
Accountancy Europe

CSRD

- Requires companies to provide detailed sustainability reporting under European Sustainability Reporting Standards (ESRS) issued by EFRAG
- 13 initial standards, to be supplemented with sector-specific requirements and standards for SMEs
- Approx 1,200 data points across Environmental, Social and Governance topics
- Considers the entire value chain – both supply chain and distribution channels to customers/end users
- Applies double materiality concept:
  - Outside-in' – effect of climate change and other ESG impacts on the business (typically investor perspective)
  - 'Inside-out' – effect of the business' activities, supply chain and distribution channels on its material stakeholders, viewed from the stakeholders' perspective
- Requires independent assurance – limited assurance, and eventually reasonable assurance

CSRD scope

Phase 1	Phase 2	Phase 3	Phase 4
Report in 2025 on 2024 data	Report in 2026 on 2025 data	Report in 2027 on 2026 data	**Report in 2028 on 2027 data**
Groups currently subject to Non-Financial Reporting Directive: • Large listed groups • Banks and insurance entities with >500 employees	Large entities currently not subject to NFRD meeting 2 of the 3 thresholds: • Gross assets > €25m • Revenues > €50m • Employees >250	• Listed SMEs on an EU-regulated exchange • Small credit institutions • Insurance captives	**Non-EU groups with EU revenues > €150m and either:** **EU-incorporated subsidiary meeting 2 of the 3 thresholds:** • **Gross assets > €25m** • **Revenues > €50m** • **Employees >250** **OR** **EU-registered branch with revenues >€40m**

CSRD: How to prepare

- UK subsidiary of an EU group – understand HQ expectations of data to be collected

- UK group with EU operations – start planning resources now

  - Double materiality is the most significant paradigm shift – start identifying your stakeholders now, including those without a voice (climate, ecosystems etc)

  - Identify data gaps and potential sources

  - Consider data quality – eventually your sustainability data will need to be of similar quality to your financial data

CSDDD

- Not yet finalised
- Requires companies to identify, prevent, mitigate or cease adverse environmental impacts and human rights abuses in the value chain
- Civil fines/penalties and damages for non-compliance
- Expected from 2026
- Scope:
    - EU companies with > 500 employees and global revenues > €150m
    - EU companies with > 250 employees and global revenues > €40m, where >50% of revenues generated in 'high impact' sector
    - Non-EU companies with > €150m EU revenues
    - Non-EU companies with > €40m EU revenues, where >50% of revenues generated in 'high impact' sector

CSDDD: How to prepare

- Consider your governance – are strategic decisions sufficiently formalised?
- Understand your supply chain – less than 2% of businesses have visibility beyond the second tier
- Critique your procurement and supply chain management – are these processes sufficiently robust?
- You are not alone – if your business is in scope, your suppliers and customers would likely also be in scope

EU Green Taxonomy

- Established under the European Green Deal to increase market transparency and mitigate greenwashing (June 2020)
- First and foremost a classification tool but also requires companies to disclose the extent to which their activities align with the 6 objectives, e.g. % revenue, opex, capex
- Scope: EU-based groups currently subject to the NFRD
- Six environmental objectives:

Climate change adaptation

Climate change mitigation

Sustainable use and protection of marine resources

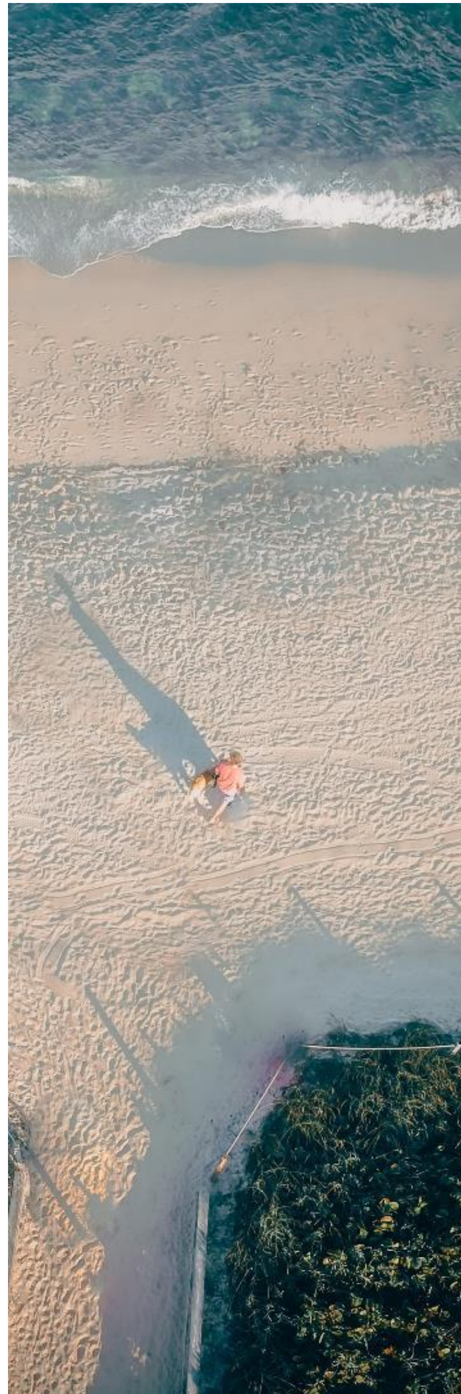
Transition to circular economy

Pollution prevention and control

Protection and restoration of biodiversity and ecosystems

Other major developments

- Taskforce for Nature-related Financial Disclosure (TNFD)
- USA and California



…in contrast to many pushing the Doomsday climate narrative, TNFD is balanced out by a strong sense of a science-based approach and, importantly, of Opportunity…

- Professor Robert G Eccles, Harvard Business School

Taskforce for Nature-related Financial Disclosure (TNFD)

- Launched in September 2023
- Not yet mandatory but broadly welcomed by ISSB, EFRAG, SEC
- Applies double materiality approach
- Considers impacts between a business and nature (land, ocean, freshwater, atmosphere)
- Considers interactions with indigenous and local communities in the supply chain

USA and California

- SEC published proposals to expand climate-related disclosures in the 10-K, but has not yet finalised these – expected March/April 2024

- California has signed three bills into statute:

  - AB1305 Voluntary Carbon Market Disclosures requires the disclosure of emissions claims, the use and sale of carbon offsets (effective 1 January 2024)

  - SB253 Climate Corporate Data Accountability Act requires disclosure of scope 1, scope 2 and scope 3 emissions calculated in accordance with the Greenhouse Gas Protocol from 2026 (on scopes 1 and 2) and 2027 (scope 3). Limited assurance will be required, increasing to reasonable assurance later on

  - SB261 Greenhouse Gases: Climate-related Financial Risk mandates TCFD disclosures from 1 January 2026 and every two years thereafter

Questions

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Save the date

Upcoming CPD courses

Employment Law update

Date: Thursday 29th February
Time: 10am – 11am
CPD: 1 hour

Finance Directors Update Course

Date: Thursday 19th September
Time: 8.30am – 12.30pm
CPD: 3 hours

www.mha.co.uk/events