Croner-i Navigate

Sustainability disclosures in UK Annual Reports

What accountants and auditors need to know

Improving disclosure of how net zero targets impact financial statements

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In 2023 the FRC released a thematic review assessing the reporting of climate-related metrics and targets.

In this paper Glynnis Carthy CA(SA) analyses the key findings of the FRC relating to the disclosure of the impact of net zero targets on the financial statements.

Further detail and analysis of the thematic review is set out in the Navigate Learning Insight course Climate-related metrics and targets and comprehensive guidance on sustainability reporting can be found in Navigate Sustainability.

Thematic review

In 2023 the Financial Reporting Council (FRC) issued the Thematic review of climate-related metrics and targets (2023) (Thematic). The Thematic considered the Taskforce for Climate-related Financial Disclosures (TCFD) metrics and targets disclosures for listed entities in various sectors.

Specific impact on financial statements

One of the key questions the FRC assessed in this Thematic was whether companies explain how their climate-related and net zero carbon targets have affected the financial statements.

It concluded that the lack of company-specific disclosures meant that it was often difficult to determine the extent to which the impact of targets on the financial statements had been considered.

Areas for improvement

Companies should consider whether their climate-related targets and transition plans could have an impact on the financial statements. Companies should include an assessment of the IASB's educational material Effects of climate-related matters on financial statements (issued in July 2023).

When there is a reasonable expectation that climate-related targets and transition plans could affect the financial statements, the FRC expects companies to:

- Explain the assessments undertaken and any impact on the financial statements; and
- Provide an appropriate level of disclosure, including any significant judgements or assumptions that have been made in reaching their assessment.

Assumptions and estimates

Investors want greater connectivity between narrative reporting and climate-related assumptions and estimates in financial statements. They also want to understand how net zero plans have been taken into account when companies prepare their financial statements.

The FRC stated:

'Most companies provided some information about how climate had been considered in the financial statements. However, fewer outlined the judgements and estimates applied when considering the financial statements impact of climate-related targets and transition plans, despite considerable investor interest in this. This was especially noticeable in the materials and buildings and energy sectors, where a larger impact might be expected.'

Many explanations were at a high-level only – for example, simply noting that the company had considered climate in preparing the financial statements and that there was no impact. Fewer companies included specific disclosures that explain how the impact of climate-related targets and transition plans which they had announced had been considered in the financial statements.

Better practice examples linked the assumptions in financial statements (for example, useful lives of assets) to climate-related targets and explained (i) the assessments that the company had undertaken, and (ii) any impacts on the financial statements.

Consistency of narrative and financial reporting

In addition, the FRC found some apparent inconsistencies between narrative and financial statement disclosures. For example, targets were included in the narrative reporting that might reasonably be expected to have a material impact on the financial statements, yet there was no discussion in the financial statements.

The FRC noted that better practice examples include an appropriate level of disclosure and disclose any significant judgements or assumptions that have been made when there is a reasonable expectation that the climate-related targets and transition plans could impact the financial statements.

Best practice climate reporting examples can be found in Reported Disclosures within *Navigate Sustainability*.

Expert: Rachel Farris FCA CTA

Lead Technical Writer for accounting.

Rachel Farris FCA CTA leads the work on Navigate UK GAAP Accounting and Navigate IFRS Accounting, and focuses on company law and practice management products such as Engagement Letter Toolkit.

Starting her career in Deloitte's audit department, she has followed a diverse path that has included working in the tax departments of Deloitte in the UK and PwC in New Zealand, giving her a real breadth of experience and expertise. Before joining Croner-i, Rachel worked in the accounting consulting team of PwC New Zealand, advising on a wide range of technical accounting issues under IFRS, specialising particularly in assets, share-based payments and not-for-profit entities.

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