



Financial Reporting Council

# FRS 102 Factsheet 8

## Climate-related matters

March 2024

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# 1. Climate-related matters for FRS 102 reporters

This factsheet has been prepared by FRC staff to inform preparers of annual reports under FRS 102 of climate-related matters they may need to consider when preparing financial statements and associated narrative reporting. This is a fast moving agenda that will continue to evolve and may significantly affect corporate reporting.

## Purpose of this factsheet

The first part of this factsheet outlines the ways in which climate-related matters may affect a set of financial statements prepared under FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, including:

- How the general requirements of FRS 102 should be applied in the context of climate-related matters – in particular, in the context of the risks, uncertainties, judgements and estimations that need to be considered when preparing financial statements.
- How climate-related matters could affect the recognition and measurement of items in the financial statements.
- How climate-related matters could affect the disclosures in the financial statements and what additional disclosures may be required.

The examples included in this factsheet are illustrative and should not be considered an exhaustive list of scenarios that may be encountered.

The second part of this factsheet summarises current and proposed legal and regulatory requirements applicable to companies in the UK in relation to climate and associated matters. This has been included to support entities in considering linkage between their financial and narrative reporting.

## Context

There is an increasing focus both on how companies report the impact of their activities on the environment and on the wider environmental and social challenges to which company business models must respond. Recent years have seen a wide range of stakeholders becoming much more interested in the potential impact of climate-related matters on the operations, financing and performance of companies. These stakeholders include investors, regulators, employees, non-governmental organisations (NGOs), customers and suppliers.

In November 2020 the FRC issued the Climate Thematic<sup>1</sup>, a thematic review of climate-related considerations for a sample of financial statements for large groups prepared under IFRS Accounting Standards. In the Climate Thematic, the FRC stated that future work in this area may include 'highlighting areas of the financial statements of UK Generally Accepted Accounting

<sup>1</sup> <https://www.frc.org.uk/frc-for-you/climate-thematic-review-2020>

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Practice (GAAP) reporters where climate change could be a consideration'. Further thematics were published in July 2022<sup>2</sup> in relation to the Task Force on Climate-related Financial Disclosures (TCFD) and climate disclosures, and in July 2023<sup>3</sup> in relation to climate-related metrics and targets.

The environmental, social, and governance (ESG) Statement of Intent<sup>4</sup>, published by the FRC in July 2021, stated that the FRC would 'develop guidance on the consideration by UK GAAP reporters of the effect of climate-related issues on the company's financial statements'; the updated ESG Statement of Intent<sup>5</sup>, published in January 2023, stated that the FRC would 'update our guidance on Climate-related risks for FRS 102 preparers'. This factsheet and its updates are designed to address these commitments.

## Users

The information needs of investors are changing to require more information about climate-related matters, and climate related matters may also be of interest to other stakeholders. The implementation (current and planned) of enhanced corporate reporting of climate-related matters under UK law, and other exercises to improve the quality of the reporting of climate-related matters, are intended to help meet these additional needs. For entities not currently captured by these legal or regulatory changes, users may differ but may still demand climate-related information, including to meet their own climate-related reporting needs (e.g. high street banks providing finance to small businesses). This factsheet is therefore not specific to any particular size of entity but instead sets out information useful for any FRS 102-preparing entity to enhance its consideration of climate-related matters.

<sup>2</sup> [https://media.frc.org.uk/documents/TCFD\\_disclosures\\_and\\_climate\\_in\\_the\\_financial\\_statements.pdf](https://media.frc.org.uk/documents/TCFD_disclosures_and_climate_in_the_financial_statements.pdf)

<sup>3</sup> [https://media.frc.org.uk/documents/Thematic\\_review\\_of\\_climate-related\\_metrics\\_and\\_targets\\_2023.pdf](https://media.frc.org.uk/documents/Thematic_review_of_climate-related_metrics_and_targets_2023.pdf)

<sup>4</sup> [https://media.frc.org.uk/documents/FRC\\_Statement\\_of\\_Intent\\_on\\_Environmental\\_Social\\_and\\_Governance\\_challenges\\_July\\_2021.pdf](https://media.frc.org.uk/documents/FRC_Statement_of_Intent_on_Environmental_Social_and_Governance_challenges_July_2021.pdf)

<sup>5</sup> [https://www.frc.org.uk/getattachment/28eee408-ea7f-4a9e-af5f-f144ec2804c1/ESG-Statement-of-Intent-Whats-Next\\_January-2023.pdf](https://www.frc.org.uk/getattachment/28eee408-ea7f-4a9e-af5f-f144ec2804c1/ESG-Statement-of-Intent-Whats-Next_January-2023.pdf)

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## 2. Financial reporting

FRS 102 contains no explicit references to climate-related matters; however, such matters should be considered for their effect upon the financial statements in the same manner as any other matters which could have a material effect upon the financial statements. The guidance in this factsheet sets out the ways in which financial statements prepared under FRS 102 should take into account both:

- Actions that the entity undertakes in connection with climate change (such as investment in carbon-reducing technology); and
- The impact climate change has on the entity (such as on the measurement of individual assets or on the long-term viability of the business).

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## Section 3 *Financial Statement Presentation*

### General requirements

Section 3 of FRS 102 requires financial statements to include disclosures that are sufficient to enable users to understand the effect of particular transactions, events and conditions on the entity's financial position and performance. If such an understanding is not provided by compliance with the specific requirements of FRS 102, additional disclosures are necessary (paragraph 3.2).

Small entities applying Section 1A of FRS 102 are not specifically required to comply with the full disclosure requirements of the remainder of FRS 102. However, they are required to provide disclosures in addition to those set out in Section 1A where necessary in order to give a true and fair view (paragraph 1A.6), and may need to exercise a greater amount of judgement in determining what additional disclosures are needed.

Although FRS 102 does not make any specific requirements for climate-related disclosures, all entities should consider any additional disclosures they need to make to enable users to understand the effect of climate-related issues on the financial statements. As an example, this could include climate-related fines or penalties that have been recognised as an expense in the period and which are material to the financial statements (and which may have been disclosed in the strategic report in the context of compliance with regulations). While there is no specific requirement to disclose such items, disclosure may be required to enable users to understand the effect of such items on the entity's financial position and financial performance, and to give a true and fair view as required by paragraph 3.2.

### Going concern

An entity's management must assess whether the entity is able to continue as a going concern. In making this assessment, management takes into account all available information about the future (paragraph 3.8).

Climate-related issues, including climate change itself, government action and the responses of entities and individuals all involve available information about the future. In many cases this information covers a future which is longer than the 12 months from signing date which paragraph 3.8 of FRS 102 specifies as a minimum: for example, government and corporate commitments to reach 'net zero' carbon emissions, or planned prohibitions on the sale of new fossil-fuelled vehicles. This available information may also introduce additional uncertainty about the future.

If management is aware of material uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, these uncertainties must be disclosed, even if management has concluded that the going concern basis is appropriate (paragraph 3.9). Even when climate-related matters do not cast significant doubt upon an entity's ability to continue as a going concern, if reaching such a conclusion requires significant judgement, such judgements would need to be disclosed (see Section 8 in this factsheet).

The increasing availability of information regarding future uncertainty therefore has several effects on the application of the existing FRS 102 requirements around going concern.

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## **Section 8 Notes to the Financial Statements**

### **Accounting policies, judgements and estimation uncertainty**

Section 8 of FRS 102 requires an entity to disclose the measurement bases used in preparing the financial statements, the accounting policies used, the judgements made by management in applying the accounting policies, and the key assumptions and associated key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (paragraphs 8.5, 8.6 and 8.7).

The application of these requirements to particular items in the financial statements is discussed in the relevant sections below. Note that disclosure of additional items beyond those specifically mentioned below may be needed to meet the requirements of Section 8 (paragraph 8.2(c)).



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## **Section 11 *Basic Financial Instruments***

## **Section 12 *Other Financial Instruments Issues***

## **Section 2A *Fair Value Measurement***

### **Recognition & measurement**

Financial instruments (which include items such as cash, trade receivables, borrowings and tradeable investments) are classified as either Basic (Section 11) or Other (Section 12), which determines whether they are measured at amortised cost or at fair value. Sections 11 and 12 include options for an entity to choose to apply the recognition and measurement provisions of IAS 39 or IFRS 9.

An entity might not expect climate-related matters to affect this assessment; however, variability in an interest rate based on achievement by the entity of certain climate-related targets could have an affect on the classification.

Climate-related matters may affect the measurement of financial instruments if they cause credit losses (e.g. through non-payment by borrowers; see also separate impairment section below) or affect an entity's ability to obtain finance (e.g. via some climate-related event triggering a credit crunch, or if the entity itself is seen as higher-risk).

The fair value of financial instruments could be affected by climate-related matters in numerous ways. For example, short-term issues such as climate-related crop shortages (or surpluses) may directly impact the fair market values of the commodities in question; over the long-term, expected improvements in technology and changes in legislation may impact the prospects of businesses, and market sentiment around these issues may affect the value of equity investments held in them.

### **Impairment**

The requirements of FRS 102 in relation to impairment of financial instruments, set out in paragraphs 11.21-11.26, differ from the impairment requirements in relation to non-financial assets as set out in Section 27 and discussed in that section of this factsheet.

Section 11 of FRS 102 requires an impairment loss to be recognised if there is objective evidence of impairment of any financial assets that are measured at cost or amortised cost.

As well as factors such as bankruptcy or financial difficulties of a debtor (paragraph 11.22), evidence of impairment could also include significant adverse changes in the technological, market, economic or legal environment in which the debtor operates (paragraph 11.23). Climate-related matters may cause or contribute to any of the above. A debtor's ability to repay could be impaired by climate-related factors specific to the entity, such as direct disruption to the business caused by forest fires or floods, or by those having a wider impact, such as general resource shortages in the country in which the entity operates.

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## Disclosures

Key Section 11 disclosure requirements that could be affected by climate-related matters include:

- Disclosure of any significant risks affecting an entity in relation to the financial instruments that it holds (paragraph 11.42).

For example, if an entity held equity investments concentrated in a sector particularly vulnerable to climate related matters, such as oil exploration, it could constitute such a risk and hence require disclosure.

For financial instruments measured at fair value through profit or loss:

- Disclosure of the risks, including (but not limited to) credit risks, market risk and liquidity risk, to which it is exposed via those instruments, and how those risks are mitigated (paragraph 11.48A).

For example:

If an entity had significant forward purchase and sale contracts, not matched in time and volume, for a commodity (such as coal) that was subject to changes in climate-related legislation, it would need to disclose the associated market risk to which it was exposed.

If an entity had debt with covenants linked to ESG measures then it would need to disclose the associated liquidity risk to which it was exposed.

- Disclosure of the valuation basis, for example market price or valuation technique; disclosures for valuation techniques need to include the assumptions made (paragraph 11.43).

For example, a commodity trader may wish to enter into a forward contract to purchase rare earth metals (needed for batteries in electric vehicles) with the aim of making a trading profit. There are no futures markets for such metals so the valuation of the instrument would contain assumptions in relation to factors such as expected production, demand, and currency fluctuations. These assumptions would need to be disclosed by the entity.

## Green bonds and other climate-linked instruments

The term 'green bonds' refers to a range of bonds issued by various organisations (governments, corporate entities and non-governmental organisations) primarily with the objective of funding green projects or initiatives. For example, such projects could include investment in green energy generation or improvements in energy efficiency for power distribution.

As with other bonds, the interest rate, term and security will vary across the market and offer opportunities for investors with different appetites for risk.

There is no separate accounting guidance for green bonds, so preparers (both issuers and holders) will need to consider the same factors in Sections 11 and 12 that they would for other bonds.

Preparers may also enter into other arrangements with climate-related terms, and will need to consider whether such arrangements are financial instruments within the scope of Sections 11 and 12, or whether other sections of FRS 102 are applicable.

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## Section 13 *Inventories*

Inventories are measured at the lower of:

- Cost; and
- Estimated selling price less costs to complete and sell (paragraph 13.4).

Climate-related matters may affect the value of inventories held by a business: rising costs can lead to higher inventory values; if not matched by rising selling prices, more inventories may need to be measured at estimated selling price less costs to complete and sell.

An entity is required to assess at the end of each reporting period whether any inventories are impaired. Obsolescence or declining selling prices can be indicators of impairment (paragraph 13.19). A climate-related example of possible obsolescence is spare parts for diesel or petrol vehicles where demand could drop more quickly than may have been anticipated when the items were acquired.

Judgements made or estimations involved in determining the recoverable amount, including climate-related matters, may need to be disclosed in line with Section 8.

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## Section 17 *Property, Plant and Equipment*

### Recognition

Climate-related matters may require an entity to direct its expenditure in ways not previously expected or experienced, such as acquiring new types of assets, or altering existing assets to make machinery 'greener' or to comply with new legislation. Careful consideration may be needed to determine whether these new types of expenditure qualify for inclusion in the cost of an asset (paragraph 17.10) or must be recognised as an expense (paragraph 17.11).

### Useful life & residual value

Climate-related matters may affect an entity's determination of the useful life (paragraph 17.18) of its property, plant and equipment assets.

An entity must consider annually any indicators that the residual value or useful life of an asset (paragraph 17.19), or the pattern by which its future economic benefits will be consumed (paragraph 17.23), have changed. Climate-related matters that could cause such a change include:

- A property may be situated in a location expected to be negatively affected by climate change, such as by rising sea levels, increasing temperatures, or an increased risk of wildfires.
- A machine may be affected by changes in legislation designed to reduce dependence on fossil fuels.
- A vehicle may become obsolete sooner than expected due to rapid technological change in a climate-related area, such as battery technology.

### Impairment

See Section 27 below for discussion of impairment of assets.

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## Section 18 *Intangible Assets other than Goodwill*

## Section 19 *Business Combinations and Goodwill*

### Useful life & residual value

In respect of goodwill recognised in accordance with Section 19, and other intangible assets recognised in accordance with Section 18, Section 18 requires an entity to amortise the depreciable amount of the intangible asset over its useful life (paragraph 18.21). Having initially estimated the useful life, Section 18 requires an entity to consider, on an annual basis, whether any factors have caused the useful life or residual value of the intangible asset to change (paragraph 18.24). Climate-related matters that could cause such a change could include:

- Trademarks, brands and customer relationships may be affected by changes in public perception and behaviour, or by government action.
- Patents and licences may be impacted by changes in legislation designed to address climate-related matters, such as reducing dependence on fossil fuels (e.g. oil extraction).
- Entities may wish to re-direct capital expenditure into new, more climate-friendly areas outside their previous experience, which may therefore require them to determine new accounting policies and treatments, and to consider the effect on useful lives and residual values of existing assets.
- Software may be made obsolete sooner than expected due to rapid technological change in climate-related areas.

### Research and development

Climate-related matters may prompt or require an entity to consider changes to its activities and operations. Such changes could involve increased expenditure on research and development activities (e.g. developing alternative power sources for vehicles; new software to optimise energy efficiency; or improved battery storage technology).

Research expenditure must be expensed as incurred. Where an entity has adopted a policy of capitalising development expenditure, it must apply it consistently; judgement may be required to determine which expenditure meets the requirements (paragraph 18.8K). An entity that wishes to change its accounting policy to one of capitalising development expenditure must follow the appropriate requirements (paragraph 10.8).

Disclosure of such expenditure, both expensed and capitalised, is required (paragraphs 18.27 and 18.28).

### Impairment

See Section 27 below for discussion of impairment of assets.

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## Section 21 Provisions and Contingencies

Section 21 requires an entity to recognise a provision when: it has an obligation arising from a past event; it is probable that it will be required to transfer economic benefits in settlement; and the amount of the obligation can be measured reliably (paragraph 21.4). An obligation that is not probable or cannot be reliably measured should be disclosed as a contingent liability (paragraph 21.12). There are no specific climate-related references in Section 21 and therefore the extant principles of Section 21 must be applied to climate-related matters in order to determine what provisions and/or contingencies must be recognised and/or disclosed.

Both provisions and contingent liabilities could be affected by climate-related matters; for example:

- Climate-related risks and uncertainties may require the recognition of additional provisions and contingent liabilities. For example, a new government levy on polluting activities may be introduced, or litigation may arise from an increased focus on climate change. Contracts may become onerous, or businesses may plan to restructure to respond to climate-related disruption or to work towards climate-related targets.

When new levies are introduced, it may be unclear initially whether an obligating event has occurred. In line with paragraph 21.6, the entity would only recognise a provision once it begins the activities with which the levy is associated; prior to this it can avoid the cost by not undertaking the activities.

- Similarly, climate-related factors such as changes in legislation, changes in markets or the necessity for changes in location may result in restructuring activities as well as the possibility of contracts (e.g. leases or service contracts) becoming onerous if the operations to which they relate can no longer be conducted profitably (or at all).

The requirements of paragraph 21.11C should be applied when considering whether restructuring activities give rise to a constructive obligation; similarly, paragraph 21.11A should be applied in relation to onerous contracts.

- Climate-related risks and uncertainties may affect the measurement of provisions and contingent liabilities. For example, a provision for decommissioning an item of property, plant and equipment may increase if more stringent environmental regulations are put in place, or if the useful life of the asset is reduced (reducing the discount for time value of money).

In this situation, careful consideration of paragraph 21.7 may be needed. If there are a large population of sites with associated decommissioning costs then adopting a weighted portfolio approach, rather than assessing each individually, may be appropriate.

## Disclosures

The disclosure requirements of Section 21 include:

- For each class of provisions, the nature of the obligation along with an indication of the uncertainties about the amount and timing of outflows, and the amount of any expected reimbursement (paragraph 21.14).

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- For each class of contingent liabilities, the nature of the contingent liability and, when practicable, information about its estimated financial effect, an indication of uncertainties about the amount and timing of outflows, and the possibility of any reimbursement (paragraph 21.15).

As discussed in the relevant section of this factsheet, Section 8 of FRS 102 requires disclosure of the key assumptions and key sources of estimation uncertainty that have a significant risk of a material effect on the carrying value of assets and liabilities. Matters requiring disclosure could include uncertainties related to provisions and contingencies.

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## Section 24 Government Grants

Governments may fund grants to entities to encourage them to invest in green projects or undertake other green activities. Any such grants should be recognised and measured in accordance with Section 24 of FRS 102 using either the accrual or the performance model, as with other types of government grant (an accounting policy choice between these models is available on a class-by-class basis).

Grants may be described in other terms: for example, an incentive that is described as a 'green tax credit' but that is not calculated by reference to taxable profits or income tax liabilities may instead fall within the scope of this section.

If a grant is received from an organisation other than government, it may fall within the definition of a 'non-exchange transaction', i.e. receipt of value from another organisation without giving similar value back. For example, a charity may give a grant to a commercial organisation to undertake a green project. Section 34 states how such items should be treated by Public Benefit Entities (paragraphs PBE34.64 to PBE34.74); there is no specific guidance for other organisations.



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## Section 26 *Share-based Payment*

Increasingly, employee and executive pay (including bonuses and share-based payments) is being linked to ESG-related targets – for example reducing carbon dioxide emissions or purchasing raw materials from sustainable sources.

Accounting for any share-based payment can be complex; when the accounting depends on the measurement of ESG related performance conditions this complexity may be increased. As well as considering the application of the accounting requirements of Section 26, it will also be necessary to consider how the performance conditions are to be measured and, when applicable, assured.

For equity-settled arrangements, such targets may constitute a performance condition as described in paragraph 26.9 and should be taken into account in estimating the number of equity instruments expected to vest; they would not affect the calculation of the fair value of the instruments.

Climate-related matters may also affect the fair value of an instrument, for example if there are market conditions (such as share price) that could be directly or indirectly affected; or where a valuation model is used consideration may need to be given to any inputs into the model that could be affected.

In accounting for employee benefits other than share-based payments, such as short- and long-term bonus schemes, the applicable requirements of Section 28 will need to be taken into account (see below).

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## Section 27 Impairment of Assets

The carrying amounts of an entity's assets may be overstated if it does not consider climate-related matters in its impairment assessments.

Climate-related matters could affect impairment both when assessing whether there are indicators of impairment, and in determining the recoverable amount.

### Impairment indicators

Section 27 requires an entity to consider both external and internal sources of information (paragraph 27.9). Climate change is not specifically mentioned but it could impact on the sources of information that are mentioned, for example:

- Climate-related matters may drive changes in the economic or legal environment in which the entity operates, such as the introduction of penalties for excess carbon emissions, which could reduce the profitability of an asset.
- Climate-related matters may accelerate the obsolescence of an asset or change the way it needs to be used, such as drilling equipment used in extractive industries which may no longer be needed sooner than originally anticipated.

### Measuring recoverable amount

The recoverable amount of an asset is the higher of fair value less costs to sell and value in use (paragraph 27.11).

The fair value may be affected by climate-related matters. When the asset has a quoted price in an active market, such matters should already be reflected in that price. However, when a valuation technique is used to determine the fair value, consideration may need to be given to climate-related matters in applying the valuation technique.

The calculation of value in use is based on the discounted cash flows expected to be generated by the asset (paragraph 27.15) in its current condition (paragraph 27.19). This calculation involves several estimations, any of which may be affected by climate-related matters:

- Ongoing cash inflows and outflows may be affected, for example by reduced demand for a less green product or by an increase in operating costs.
- Cash flows expected from the ultimate disposal of the asset may be affected if it cannot be sold for as high a value as previously anticipated: for example, facilities for manufacturing internal combustion engines (ICE) may have no disposal value if the production of ICE-powered vehicles is prohibited.
- Cash flow projections beyond the period covered by budgets or forecasts are typically made using a steady or declining growth rate unless an increasing rate can be justified (paragraph 27.17). Climate-related matters may affect the growth rate that can be used in such situations.

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An entity should be able to support the assumptions used in these calculations – they cannot therefore include speculative assumptions, e.g. in relation to future technological developments or legal changes.

As discussed above, Section 8 of FRS 102 requires disclosure of the key assumptions and key sources of estimation uncertainty that have a significant risk of a material effect on the carrying value of assets and liabilities, which may include uncertainty over the impairment of assets.

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## Section 28 *Employee Benefits*

As noted in the discussion of Section 26, employee and executive pay are increasingly linked to ESG-related targets.

Criteria-driven bonus plans and profit shares should be measured according to paragraph 28.8 or, if long-term in nature, paragraph 28.30. The requirement of paragraph 28.8 is to record an expense only when a legal or constructive obligation exists and a reliable estimate of that obligation can be made; paragraph 28.30 additionally requires the obligation to be measured at its present value.

Climate-related targets are likely to impact whether a reliable estimate of the obligation can be made. If the targets are measurable and attainable, and the entity has plans in place to work towards these targets, then making an estimate as to what degree the targets will be met should be possible. If, however, the targets are more open-ended or aspirational then making a reliable estimate may not initially be possible, in which case no expense or liability should be recognised until a reliable estimate can be made.

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## Section 29 Income Tax

Climate-related matters may affect income taxes in different ways:

- For current taxes, through any effect on taxable profits.
- For deferred taxes, through any effect on other balance sheet items that may result in the creation of a deferred tax balance (e.g. capital allowances for items of Property, Plant and Equipment). Uncertainty over the effect of climate change could also affect budgeted/forecasted taxable profits, the assessment of the likelihood of recovering deferred tax balances, and hence the ability to recognise deferred tax assets.
- Any doubts as to the future profitability of a business could trigger an entity to consider whether it is appropriate to derecognise deferred tax assets on the balance sheet. For example, a business unit that is not climate friendly may be carrying tax losses that cannot be offset against future profits on activities that are climate friendly.
- Tax incentives or penalties connected to climate-related factors could affect tax rates or whether items of income and expenditure are taxable. For example, a government may offer lower tax rates or enhanced capital allowances for ring-fenced green activities such as construction of green power sources.

Some governments may decide to impose green 'taxes' on entities based on some climate-related criteria (e.g. carbon emissions). However, unless such charges are calculated in relation to the taxable profits generated by a business, they are not income taxes within the scope of Section 29, since the definition of an income tax per the Glossary is 'taxes that are based on taxable profits. Income tax also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.' See Section 21 of this factsheet for discussion of climate related levies and recognition of provisions.

Governments may also offer benefits described as tax incentives that may not be determined in relation to income tax liabilities or taxable profits; such an incentive may need to be accounted for as a government grant – see Section 24 in this factsheet.

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## Other climate-related items, contracts and instruments

The previous sections of this factsheet have discussed how climate-related matters may affect reporting under the relevant sections of FRS 102. The purpose of this section is to document examples of items that may need to be presented in the financial statements that are primarily related to or driven by climate-related matters, but that may not sit clearly within one of the previous sections and are not explicitly addressed within FRS 102. This factsheet does not provide requirements in addition to those of FRS 102, but aims to provide guidance on what matters could be considered in relation to these items.

### Carbon offsetting

Entities may invest in environmental projects to offset their own carbon emissions. Such arrangements may involve payment to an environmental project, typically an amount per tonne of carbon dioxide equivalent that they wish to offset, which the project uses to continue its work. These projects take numerous forms: examples include planting trees, capturing methane gas from landfills, and distribution of low-energy lightbulbs. Alternatively, an entity could undertake its own carbon offsetting projects rather than paying another organisation to do so.

In accounting for carbon offsetting activities, preparers will need to consider whether the outflows involved constitute an expense or create an asset, by reference to the relevant sections of FRS 102. In some cases preparers will also need to consider whether they have a present obligation to purchase carbon offsets, which could lead to the recognition of a liability.

### Emissions trading schemes

Emissions trading schemes (also known as pollutant pricing mechanisms) are arrangements, usually organised by governments or supranational bodies, designed to assist in the reduction of emissions (usually carbon dioxide). They typically operate under a 'cap and trade' principle, where participating installations (e.g. power stations, cement works, or factories) receive an allocation of emission allowances, and must then monitor their emissions to ensure they have enough allowances to offset them. Installations with a surplus can then sell excess allowances and those with a deficit can purchase them. Marketplaces provide a means for these trades to take place and help set a market value on the allowances.

In accounting for emission allowances, preparers will need to consider for what purposes they hold emission allowances (i.e. to offset against carbon emissions, or to trade and generate profits based on changes in market price) and develop an accounting policy for how they should therefore be recognised, measured and disclosed.

An entity also needs to consider the presentation of any associated assets and liabilities. Some entities record emission allowances as inventory, others as intangible assets. FRS 102 does not provide specific guidance in this area.

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## 3. Narrative reporting

While the specific legal and regulatory requirements and the financial and narrative reporting framework vary according to the size and nature of an entity, all entities should be considering the issues discussed in this document and reflecting the impact of climate-related issues in their financial statements. Indeed, smaller entities which may present less narrative information may need to make additional efforts to ensure that all relevant matters have been considered and reflected.

The FRC's Climate Thematics identified that themes included by companies within their narrative reporting were not reflected in the financial statements. The key message in this section is therefore that enhancing consistency between the narrative reporting and the financial statements should be seen as one of the tenets of producing a high-quality annual report.

The legal and regulatory requirements discussed here are those that apply in the UK.

### Current requirements

All companies that are not micro-entities must prepare a Directors' Report; companies that are not small must also produce a Strategic Report; for Limited Liability Partnerships (LLPs) there is no requirement to produce a Directors' Report or Strategic Report (or equivalent), but large LLPs must prepare an Energy and Carbon Report.

### Directors' Report

The Directors' Report contains a basic set of disclosures about the company. Disclosure requirements relevant to climate related matters include:

- Streamlined Energy and Carbon Reporting (SECR), with regards to carbon emissions and energy consumption. SECR disclosures are generally required of companies meeting the large size criteria (unless energy usage is less than 40,000 kWh per year)<sup>6</sup>. The FRC published a Thematic Review on SECR<sup>7</sup> in September 2021 which examined the first year of reporting under these requirements for a range of businesses and provides recommendations for preparers.
- Stakeholder engagement disclosures, required by Part 4 of Schedule 7 to *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (SI 2008/410). These include detailed disclosure requirements relating to: engagement with employees, which apply to companies with more than 250 UK employees (or a parent company with more than 250 UK employees in a group headed by that company); and engagement with suppliers, customers and others, which apply to all large companies.

Any additional information a company chooses to present about climate-related matters should be consistent with the information presented on those matters in the financial statements.

<sup>6</sup> As set out in SI 2018/1155

<sup>7</sup> <https://www.frc.org.uk/getattachment/4d7be3a3-5b3a-4ada-8af0-913e83db6335/FRC-SECR-Thematic-Report-2021.pdf>

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## Strategic Report

Large companies must comply with Section 414CZA of the Companies Act 2006, which requires them to include, in the Strategic Report a “section 172(1) statement”, which explains how the directors are acting to promote the success of the company in accordance with Section 172 of the Companies Act 2006. Section 172 includes consideration of ‘the impact of the company’s operations on the community and the environment’.

Additionally, public interest entities (PIEs)<sup>8</sup>, companies traded on the Alternative Investment Market (AIM)<sup>9</sup>, companies and LLPs with more than £500m turnover, and traded and banking LLPs, in all cases having more than 500 employees, must include a ‘Non-financial and sustainability information’ (NFSI) statement<sup>10</sup> within the Strategic Report (or, for LLPs that do not prepare a Strategic Report, in the Energy and Carbon Report).

The NFSI statement must include climate-related (sometimes referred to as ‘TCFD-aligned’) financial disclosures, and, for PIEs with more than 500 employees, ‘information, to the extent necessary for an understanding of the company’s development, performance and position and the impact of its activity, relating to, as a minimum ... environmental matters (including the impact of the company’s business on the environment)’. Non-binding guidance<sup>11</sup> has been issued by the UK Government in respect of these requirements.

In June 2022, the FRC published an updated version of its *Guidance on the Strategic Report*<sup>12</sup>, a statement of best practice to be considered when preparing a Strategic Report. One of the principles included in the document is that ‘the strategic report should highlight and explain linkages between pieces of information presented within the strategic report and in the annual report more broadly.’ It also covers the need for a Strategic Report<sup>13</sup> to include details of the principal risks and uncertainties that affect it, which should include climate-related risks if they are material to an understanding of the development, financial performance, financial position or future prospects of the business. The *Guidance on the Strategic Report* includes consideration of climate-related matters and this factsheet should be read alongside it.

## Energy and Carbon Report

The Energy and Carbon Report prepared by large LLPs must include SECR disclosures and an NFSI statement (with TCFD-aligned disclosures).

<sup>8</sup> As set out in the Companies Act 2006 Section 414CA

<sup>9</sup> For financial years beginning after 6 April 2022 per <https://www.legislation.gov.uk/ukdsi/2021/9780348228519/contents>

<sup>10</sup> For financial years commencing prior to 6 April 2022 this is required only of PIEs, and retains the previous title of ‘Non-financial information’ statement

<sup>11</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1056085/mandatory-climate-related-financial-disclosures-publicly-quoted-private-cos-llps.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1056085/mandatory-climate-related-financial-disclosures-publicly-quoted-private-cos-llps.pdf)

<sup>12</sup> [https://www.frc.org.uk/getattachment/343656e8-d9f5-4dc3-aa8e-97507bb4f2ee/Strategic-Report-Guidance\\_2022.pdf](https://www.frc.org.uk/getattachment/343656e8-d9f5-4dc3-aa8e-97507bb4f2ee/Strategic-Report-Guidance_2022.pdf)

<sup>13</sup> As set out in the Companies Act 2006 Section 414CA



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## Listed companies

FRS 102 preparers that are listed may also be required to prepare a viability statement, and disclosures consistent with TCFD recommendations.

## Linkage to financial statements

As well as providing the required climate-related disclosures as part of their narrative reporting, and considering whether applying the requirements of FRS 102 means that climate-related matters affect the financial statements, entities must also ensure consistency between the matters presented and disclosed in the financial statements and those disclosed within narrative reporting.

Ultimately the narrative reporting and the financial statements should show a coherent linkage and entities may consider disclosing whether, and why, apparently significant matters disclosed within narrative reporting have, or have not, had a material effect on the financial statements.

## Future developments

In March 2023, the UK Government published an update to its Green Finance Strategy<sup>14</sup>, which sets out the Government's objectives in reinforcing and expanding the UK's position as a world leader in green finance. One of the commitments made in this document is to set up two committees to consider the endorsement of the IFRS Sustainability Disclosure Standards in the UK. These standards, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*<sup>15</sup> and IFRS S2 *Climate-related Disclosures*<sup>16</sup>, published in June 2023, will then provide the basis for future obligations within company law (to be considered alongside future reforms to the UK's non-financial reporting framework) and FCA requirements for listed companies. They set out, respectively, overall requirements for disclosing sustainability-related financial information, and requirements for identifying, measuring and disclosing climate-related risks and opportunities.

Between May and August 2023, the UK Government ran a call for evidence<sup>17</sup> for a review of the non-financial reporting requirements for UK companies. This review will consider opportunities to streamline existing non-financial reporting requirements, whether company size thresholds could be rationalised and simplified, and the future of the UK's non-financial reporting framework. The first changes arising from this review were announced in March 2024. As changes are made to legislation arising from this review there may be changes to the narrative reporting requirements discussed in this factsheet.

<sup>14</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1149690/mobilising-green-investment-2023-green-finance-strategy.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1149690/mobilising-green-investment-2023-green-finance-strategy.pdf)

<sup>15</sup> <https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf>

<sup>16</sup> <https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf>

<sup>17</sup> <https://www.gov.uk/government/calls-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence>

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During 2023, the ISSB conducted an agenda consultation<sup>18</sup> on potentially adding new projects to its agenda, including the following: biodiversity, ecosystems and ecosystem services; human capital; human rights; and integration in reporting (a potential joint project with the IASB), and expects to finalise its work plan in the first half of 2024.

<sup>18</sup> <https://www.ifrs.org/content/dam/ifrs/project/issb-consultation-on-agenda-priorities/issb-rfi-2023-1.pdf>

## Summary of requirements (effective as at 1 April 2024)

The key existing and proposed requirements outlined above may be summarised as follows:

Item	To be applied by	Effective
Directors' Report	Small, medium-sized and large companies <sup>19</sup>	Current
<u>Items to be presented within the Directors' Report:</u>		
Employee engagement	Companies with >250 employees <sup>20</sup>	Current
Engagement with suppliers, Customers & others in a business relationship	Companies exceeding 2 of the 3 large company size criteria <sup>21</sup>	Current
SECR	Companies exceeding 2 of the 3 large company size criteria <sup>22</sup>	Current
Strategic Report	Medium-sized and large companies <sup>19</sup>	Current
<u>Items to be presented within the Strategic Report:</u>		
Section 172	Large companies <sup>19, 23</sup>	Current
Environmental matters	Quoted companies <sup>24</sup>	Current
Non-financial and sustainability information	Public interest entities with >500 employees <sup>25</sup>	Current
Climate-related financial disclosures	Public interest entities, AIM companies, and those companies with >£500m turnover, in all cases with >500 employees <sup>26</sup> ; traded and banking LLPs with >500 employees <sup>27</sup>	Current
TCFD (4 pillars & 11 disclosures)	Premium listed companies and most listed companies <sup>28</sup>	Current

<sup>19</sup> As set out in the Companies Act 2006, Sections 384A-384B (micro entities), Sections 381-384 (small entities) and Sections 465-467 (medium-sized). A company not meeting the conditions set out in those sections is a large company.

<sup>20</sup> As set out in SI 2008/410 Sch 7 para 11A

<sup>21</sup> As set out in SI 2008/410 Sch 7 para 11C

<sup>22</sup> As set out in SI 2008/410 Sch 7 para 20B

<sup>23</sup> As set out in the Companies Act 2006, Section 414CZA

<sup>24</sup> As set out in the Companies Act 2006, Section 385

<sup>25</sup> As set out in the Companies Act 2006, Section 414CA

<sup>26</sup> As set out in the Companies Act 2006, Section 414CB

<sup>27</sup> As set out in SI 2008/1911 para 12A Section 414C

<sup>28</sup> All except standard listed investment entities and shell companies

Item	To be applied by	Effective
Viability statement	Premium listed companies <sup>29</sup>	Current
Energy and Carbon Report	Large LLPs <sup>30</sup>	Current
<u>Items to be presented within the Energy and Carbon Report:</u>		
SECR	Large LLPs <sup>31</sup>	Current
Climate-related financial disclosures	LLPs with >£500m turnover and >500 employees <sup>32</sup>	Current

Note that this table was updated in March 2024 to reflect changes in legislation and proposed legislation since its initial publication.

<sup>29</sup> As required by Listing Rule 9.8.6(R)(3)(b) of the FCA Handbook

<sup>30</sup> As set out in SI 2008/1911 para 12B Section 415

<sup>31</sup> As set out in SI 2008/1911 para 12B Section 415A

<sup>32</sup> As set out in SI 2008/1911 para 12B Section 416A



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