THE BOTTOM LINE

Issue 19

Welcome to the latest edition of our financial and corporate reporting publication that aims to keep you in the loop with all the latest accounting and financial reporting developments, and the potential impact they may have on your business.

In our latest issue, we continue to focus on the quickly evolving sustainability landscape, specifically climate-related financial disclosures that are in the process of being legislated here in Australia. We look at the AASB's first draft sustainability standards and consider how these differ to the international equivalents issued by the ISSB. Moving abroad, we introduce a new IFRS standard to be implemented in the near future that will change the income statement as we know it, and also give an update on the status of IFRS 6 following an extensive review of this long-established standard.

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Climate reporting standards taking shape

In October 2023, to support the Australian Government's commitment and proposed policy to implement mandatory climate-related disclosures, the Australian Accounting Standards Board (AASB) released an exposure draft containing Australia's first sustainability reporting standards that focus on climate.

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The content of the exposure draft, [*ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information*] (ED SR1), is largely aligned with the IFRS Sustainability Disclosure Standards issued by the International Sustainability Standards Board (ISSB) to date, namely:

- IFRS S1 *General Requirements for Disclosure of **Sustainability**-related Financial Information* (IFRS S1)
- IFRS S2 *Climate-related Disclosures* (IFRS S2).

ED SR1 contains three proposed Australian Sustainability Reporting Standards (ASRS):

- ASRS 1 *General Requirements for Disclosure of **Climate**-related Financial Information* (ASRS 1);
- ASRS 2 *Climate-related Financial Disclosures* (ASRS 2); and
- ASRS 101 *References in Australian Sustainability Reporting Standards*.

The proposed effective date of ED SR1 is 1 July 2024 however it is Treasury that will determine which entities will have to make climate-related disclosures and when.

IFRS S1 COMPARED TO ASRS 1

The objective of IFRS S1 is to disclose information about the **sustainability**-related risks and opportunities that could reasonably be expected to affect an entity's prospects. It is a base standard, designed to be applied together with any other IFRS Sustainability Disclosure Standard, and contains all the foundational concepts and requirements when it comes to disclosures on sustainability topics not addressed by another IFRS Sustainability Disclosure Standard.

In terms of objective, ASRS 1 only requires identification of and disclosures about material **climate**-related risks and opportunities. The impact of this is that the proposed Australian disclosures do not extend to all sustainability topics but are, instead, limited to climate only. This is because the Australian Government has decided to mandate only climate-related financial disclosures at this stage.

While IFRS S1 was developed with for-profit entities in mind, the AASB envisions that ASRS 1 (and any other ASRS, including ASRS 2) should be capable of being applied by both for-profit and not-for-profit entities. Sector neutrality has been achieved by proposing tweaks to the objective paragraphs to include terminology relevant to not-for-profit entities.

Other differences between IFRS S1 and draft ASRS 1 are summarised in the table below.

IFRS S1	DRAFT ASRS 1	Reasoning for modification
Scope		
No specific requirement to disclose the fact that there are no material climate-related risks and opportunities	Explicit requirement to disclose the fact that the entity has concluded there are no material climate-related risks and opportunities and how this conclusion was reached	This is considered to be useful information for users
Sources of guidance		
Requires application of the Sustainability Accounting Standards Board (SASB) standards in the absence of an applicable IFRS Sustainability Disclosure Standard	No requirement to consider the SASB standards or other sources of guidance listed in IFRS S1. Where an entity elects to make industry-based disclosures, well-established and understood metrics in the same industry (classified in accordance with ANZSIC) must be considered	Relevance of SASB standards in Australia is questionable until such time as the content has been comprehensively globalised and undergone the AASB's own due process

Location of disclosures		
No specific requirements apart from identifying the report in which climate-related disclosures are located	Requires information to be provided in a manner that enables users to locate its disclosures	To make financial reports that contain climate disclosures more user-friendly
Interim reporting		
Appears to allow interim reporting (based on the example provided)	Guidance has been removed	To make it clear that interim reporting of climate-related financial disclosures is not required

IFRS S2 COMPARED TO ASRS 2

IFRS S2 is a topic-specific standard, focusing on material physical and transition risks and opportunities related to climate. ASRS 2 is based on IFRS S2 but has been modified in certain respects to cater for the Australian context.

Since ASRS 1's scope has been limited to climate, many of the ASRS 2 requirements surrounding governance, strategy and risk management were consequently duplicated. The proposed solution is to remove duplicated requirements in ASRS 2 and use cross-references to the corresponding paragraphs in ASRS 1 to direct users to the relevant requirements.

Differences between IFRS S2 and draft ASRS 2 are outlined in the table below:

IFRS S2	DRAFT ASRS 2	Reasoning for modification
Scope		
Applies to climate-related risks and opportunities	Scope is narrowed by applying to climate-related risks and opportunities in the context of climate change only	Clarifies that ASRS 2 does not apply to climate-related emissions other than greenhouse gas (GHG) emissions
Scenario analysis approach		
Not specifically defined but requires an approach that is commensurate with the entity's circumstances	Requires climate resilience assessments against at least two possible future states, one of which must be consistent with the most ambitious global temperature goal set out in the Climate Change Act 2022 (i.e. 1.5°C above pre-industrial levels) *	Ensures comparability across entities, especially regarding transition risk
GHG emissions		
Requires conversion of GHGs into a CO^2 equivalent using the global warming potential (GWP) from the latest Intergovernmental Panel on Climate Change (IPCC) assessment report as available at reporting date (i.e. 6th IPCC assessment report)	Requires conversion of GHGs into a CO^2 equivalent using the GWP from the IPCC assessment report referred to in the NGER scheme legislation (i.e. 5th IPCC assessment report)	Lessens regulatory burden for Australian entities required to use the GWP values based on the IPCC 5th assessment report under NGER scheme legislation
Permits GHG measurement methods other than the GHG Protocol Corporate Standard when required by a jurisdictional authority or exchange on which an entity is listed	Requires relevant methodologies under the NGER scheme legislation to be prioritised before making reference to other GHG measurement methodologies	To be consistent with Treasury's second consultation proposals

Requires the disclosure of location-based Scope 2 GHG emissions only	Requires the disclosure of market-based Scope 2 GHG emissions in addition to location-based Scope 2 emissions measures*. Transitional relief is available for the first three reporting periods.	To be consistent with Treasury's second consultation proposals
Under certain conditions, GHG emissions measurements using information from periods different to an entity's own reporting period are permitted	Scope 3 GHG emissions can be measured using data from the immediately preceding period where reasonable and supportable data is not available without undue cost or effort	To be consistent with Treasury's second consultation proposals
Sources of Scope 3 GHG emissions under the 15 categories taken from the GHG Protocol Standards are required to be disclosed	The 15 categories are included as examples an entity could consider when disclosing sources of its Scope 3 GHG emissions	Doubt over whether categorising sources of Scope 3 GHG emissions under the 15 categories would achieve international alignment. Furthermore, the 15 categories are not referenced in the IPCC guidelines or the Paris Agreement
Industry-based metrics		
Requires an entity to apply SASB Standards and consider industry-based metrics adapted from SASB standards	Requires that industry-based metrics disclosed by entities operating in the same industry (as classified by ANZSIC) be considered by entities electing to make industry-based disclosures	The AASB decided to exclude the industry-based guidance accompanying IFRS 1, as well as references to SASB standards, until this content has been thoroughly internationalised by the ISSB and has undergone the AASB's own due process

**Applies to entities that are required to produce climate-related financial disclosures under the Corporations Act 2001. Entities that are not required to, or choose to, comply with ASRS 2 are therefore not subject to this disclosure.*

COMMENCEMENT DATE FOR CLIMATE REPORTING

ED SR1 proposes an effective date of 1 July 2024. However, the first reporting period an entity captured by the reforms is required to apply these ASRS standards will depend on Treasury.

Just recently, following Treasury's exposure draft legislation in January this year, the Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 was introduced into Parliament. If enacted, it is this Bill that will mandate climate reporting for entities that lodge financial reports under Chapter 2M of the Corporations Act 2001 and meet certain size thresholds or have emissions reporting obligations under NGER scheme legislation.

The Bill delays the initial proposed commencement date of climate reporting obligations by at least six months. This means mandatory climate disclosures will now be phased in from 1 January 2025 at the earliest. However, this will be subject to the Bill passing through both Houses of Parliament before 2 December 2024. If passed later than this but before 2 June 2025, the commencement date will likely be 1 July 2025.

The entities subject to the reforms have not changed under the Bill (compared to the exposure draft legislation). For details on the type and size of entity that will need to prepare climate reports in the near future, refer to our previous article.

DO NOT IGNORE THE CHANGES THAT ARE COMING

While Group 2 and Group 3 entities have some time before mandatory climate reporting affects them, there is much to think about and do considering this is the most significant change in corporate reporting in Australia since the adoption of International Financial Reporting Standards (IFRS) in 2005.

Regardless of size, entities should consider their supply chain. As Group 1 and Group 2 entities start to measure and report their greenhouse gas emissions, Scope 3 could become integral to their emissions reduction strategies, prompting smaller entities that find themselves in Group 1 and Group 2 entities' value chains to provide their emissions data earlier than required by legislated reporting.

Finding and dedicating resources to ensure climate reporting obligations are understood and met is anticipated to be a challenge, especially in the initial stages as everyone upskills in this space. Entities that are proactive in this regard will no doubt reap the benefits later down the track.

A makeover for financial statement presentation

IAS 1 *Presentation of Financial Statements* will soon be replaced by a new IFRS Accounting Standard, likely to be numbered IFRS 18. While much of the existing content of IAS 1 will remain unchanged, IFRS 18 will introduce significant changes to the presentation of the primary financial statements, especially the statement of profit or loss.

BACKGROUND

Comparability and transparency are key qualities that primary users, such as investors, expect when it comes to financial information presented in financial statements. The International Accounting Standards Board (IASB) heard feedback that entities often fell short in this regard, particularly when reporting on their financial performance.

In response, the IASB undertook a project to facilitate clearer presentation of financial information in a more structured format to allow for improved comparability of this information between entities. Users of financial statements will then be better placed to make investing or lending decisions.

WHAT ARE THE KEY CHANGES?

While the current IAS 1 will be withdrawn and replaced by the proposed new IFRS 18, many of the existing requirements will remain unchanged and either be carried forward to the new standard or moved to other appropriate standards.

The income statement will be the most affected by the introduction of IFRS 18 and will look somewhat different to what many entities are used to.

IFRS 18 will introduce three sets of new requirements relating to the following:

- Classification of income and expenses into defined categories, and presentation of defined subtotals, in the statement of profit or loss;
- Enhanced disclosure requirements for Management-defined Performance Measures (MPMs); and
- Improved guidance for grouping of financial information.

New presentation requirements and financial information characteristic expected to be impacted:

Defined categories and subtotals

Defined categories for income and expenses

Currently, IAS 1 does not mandate how an entity must classify or categorise expenses when preparing the income statement. This will change under IFRS 18 which identifies and defines three major categories for income and expenses, namely:

- operating
- investing
- financing.

The operating category is essentially the default category and comprises anything that does not fit into the other two categories based on the definitions provided.

Interestingly, the classifications above do not necessarily align with the classifications used in the cash flow statement. Considering that the same labels will be used in the income statement and cash flow statement but have different meanings, this may cause confusion for users if not well understood.

Classifying income and expenses into each of the three categories above will require an entity to consider what its main business activities are. Some types of income and expenses could be classified differently due to the nature of an entity's main business activities. Entities with specified main business activities may classify investing and/or financing items as operating in certain cases.

For example, borrowing funds by a manufacturer will not be considered a main business activity and the manufacturer will most likely classify interest expense on the borrowings as financing in nature. In contrast, a bank that incurs interest expense on borrowings will classify such interest as operating in nature since providing finance to customers is one of its main business activities.

Defined subtotals

Currently, there are limited requirements in IAS 1 when it comes to line items and subtotals in the income statement.

IFRS 18 will introduce two newly defined subtotals that entities will be required to present in their income statement:

- operating profit or loss; and
- profit before financing and income tax.

Operating profit or loss represents the subtotal of all income and expenses categorised as operating while profit before financing and income tax is the subtotal of operating profit or loss and all income and expenses classified as investing.

Management-defined Performance Measures

Investors find management performance measures (such as 'Adjusted' profit, EBITDA, and Operating profit excluding non-recurring items) useful however it is not always clear to investors how these measures are calculated.

The IASB acknowledges the usefulness of these measures and has therefore defined what a 'Management-defined Performance Measure' (MPM) is and included specific requirements for their disclosure in the notes to the financial statements.

For IFRS 18's disclosure requirements to apply to an MPM, it must be:

- used in public communications outside of the financial statements (excluding social media posts and oral communications); and
- used to communicate to users of financial statements management's view of an aspect of the entity's financial performance.

Entities that do not engage in public communications to users (such as private companies) will not be subject to these new MPM disclosure requirements. Furthermore, only those MPMs that relate to an entity's financial performance are within scope. That is, MPMs related to financial position or cash flows are not captured by these disclosure requirements.

The MPM disclosures are required to be provided in a single note that covers the following:

- A reconciliation back to the most directly comparable subtotal specified by IFRS Accounting Standards;
- An explanation of why the MPM is reported;
- An explanation of how the MPM is calculated; and
- A description of any changes to the MPM.

Including MPMs in the notes to the financial statements means they will be subject to audit. Auditors will therefore need to be aware of publicly communicated MPMs by entities as these may need to be disclosed in the financial statements under the new requirements.

Grouping of information

Entities aggregate information about transactions and other events to form line items in the primary statements and/or disclosure in the notes. Most of the existing guidance on aggregation and disaggregation will be carried forward from IAS 1, however some of the key requirements introduced by IFRS 18 include:

- Classifying and aggregating items based on 'shared characteristics';
- Disaggregating items if the resulting disaggregation is material;
- Limiting the circumstances in which 'other' can be used to describe a group of items;
- Additional disclosures when classifying expenses by function, including the requirement to disclose, in a single note, expenses by nature for certain amounts (depreciation, amortisation, employee benefits, impairment and write-downs of inventories).

WHAT DO THESE CHANGES MEAN FOR ENTITIES?

The implications of IFRS 18 may be significant for entities depending on their current reporting practices.

Reviewing the current 'mapping' of income and expenses within the income statement and comparing this to the formalised structure introduced by IFRS 18 will be a good place to start. This will assist in identifying changes needed in reporting systems and processes to ensure alignment with the new requirements relating to classification of items and presentation of mandatory subtotals. This exercise will be particularly important for groups with a variation of business activities.

Listed entities will also need to be mindful of the financial performance MPMs they publicly communicate outside of their financial statements as these will be subject to the new MPM disclosure requirements. This is something auditors will need to be aware of too.

WHEN DO THESE CHANGES BECOME EFFECTIVE?

At the time of writing, IFRS 18 had not yet been issued by the IASB, however this is expected to occur in April 2024, with the Australian Accounting Standards Board (for Australian adoption) to follow suit shortly thereafter.

Entities will have until 1 January 2027 to implement the new standard as it is expected to apply to annual reporting periods beginning on or after this date. The new standard will need to be applied retrospectively meaning comparatives will need to be restated in the first year IFRS 18 is applied.

Consequential amendments to IAS 34 *Interim Financial Reporting* will require entities to present each of the required headings and subtotals in IFRS 18 in their interim financial statements in the first year of applying IFRS 18. Therefore, a June reporter with half-yearly reporting requirements will be required to report its H1 2027 income statement in accordance with IFRS 18's requirements.

Extractive activities: IFRS 6 to remain as is

The International Accounting Standards Board (IASB) has decided to retain IFRS 6 *Exploration for and Evaluation of Mineral Resources* following an extensive review that spanned a number of years and produced no compelling evidence that changing to the status quo would be beneficial.

IFRS 6 has been around for as long as IFRS Accounting Standards have been in existence. It was issued to provide a temporary solution that allowed entities involved in extractive activities to continue to apply their existing exploration and evaluation accounting expenditure policies. Without such a standard to deal with extractive activities, entities would have had to apply the requirements in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to develop appropriate accounting policies. Consequently, many extractive entities would then not have been able to capitalise exploration and evaluation costs.

The intention was that by issuing IFRS 6 as an interim measure, it would afford the IASB time to complete a comprehensive review of accounting for extractive activities.

That comprehensive review is now done following a Discussion Paper issued in 2010, and a research project on extractive activities that commenced in 2018 and concluded in 2023. The aim of this project was to gather evidence to determine whether to develop proposals to amend or replace IFRS 6.

The IASB has decided to retain IFRS 6 without any changes to the recognition, measurement and disclosure requirements for exploration and evaluation expenditure.

While there are diverse accounting policies for exploration and evaluation expenditure, often due to an entity's specific circumstances, this does not appear to be of major concern for stakeholders. The extractives industry has well-established accounting practices that precede IFRS 6, and the research identified some industry trends and evidence of alignment of accounting practices between similar entities.

Stakeholder feedback also suggested that users of financial statements are oftentimes more interested in information about the nature and results of the entity's activities and cash flows (liquidity), especially for smaller entities. Whether a small entity capitalises or expenses its exploration and evaluation expenditure is typically not material information.

As part of its next volume of *Annual Improvements to IFRS Accounting Standards*, the IASB will remove the word 'Temporary' from the heading of the section in IFRS 6 that permits entities to ignore the hierarchy requirements in IAS 8 when it comes to their accounting policies for exploration and evaluation expenditure.

The choice to either expense or capitalise exploration and evaluation expenditure therefore prevails.

Australian entities involved in extractive activities are, however, reminded that they must still apply the Australian-specific recognition and measurement requirements contained in AASB 6, the Australian counterpart to IFRS 6.

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