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Keeping your head above water

Recent issues in financial reporting

Financial Reporting Release
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In this issue

We have an abbreviated *Financial Reporting Release* for you this time. That's not because we have become less loquacious or anything – perish the thought – but rather because there's been fewer financial reporting developments to report than usual.

As you might expect, sustainability reporting developments continue to lead the way. These include:

- The International Sustainability Standards Board finalizing and publishing its inaugural set of IFRS Sustainability Disclosure Standards, or ISSB standards for short. With that act the Board has now been reduced to the role of anxious suitor who can only wait for the world's securities and other regulators in various jurisdictions to cast an appraising eye over the standards and say, yes, we will link up with you. Or not. It may take some time before we see the fruit that these unions will bear.
- The newly formed Canadian Sustainability Standards Board – up to now more a Board in name than in substance – announcing that it has achieved operational lift off and so now can begin lobbying for the uptake of ISSB standards in Canada. Are the regulators of Canadian public company reporting, the Canadian Securities Administrators, paying heed? Sort of...We guess.
- The SEC falling behind the sustainability reporting curve by deferring until October the completion and publication of its proposed climate-related rule. Lawsuits and even potential Congressional intervention are being threatened if the rule goes forward as proposed. Could these trigger delays in the development of Canadian sustainability reporting as well? You bet.
- The European Commission proposing dramatic last-minute changes to soften what had previously been regarded as a finished set of European sustainability reporting standards. This has prompted two immediate reactions – outrage from some stakeholder groups and some level of relief from preparers, including Canadian companies and their European subsidiaries subject to the requirements.

Accounting standards developments, by comparison to those momentous sustainability happenings, have been restrained both in number, effect and significance. Indeed, there's only one of consequence that is worth highlighting – an amendment to the IFRS tax standard relating to the recognition of deferred tax assets and liabilities standards arising from the new Pillar Two global tax rules by multi-national entities – narrow stuff to be sure but important, nonetheless.

Such are the circumstances relating to these developments that we've been reduced to only six pages of epistolary delight. What can we say? Sometimes you're lucky, sometimes you're not. We'll leave it to you to decide how fortune has treated you on this occasion.

International Sustainability Standards Developments

"The future ain't what it used to be."

– Yogi Berra

As promised, the ISSB issued its first set of international sustainability reporting standards in June. Whether the standards will become global in reach as well as in name depends on the world's securities and other regulators deciding to adopt them locally or consider them acceptable as "equivalent" for adoption optionally in lieu of local standards. For example, the US and Europe are developing their own standards and will have to consider whether ISSB standards are acceptable in lieu of all or parts of those local standards. As the Secretary General of the International Organization of Securities Commission observed, decisions by jurisdictional regulators will be "cold-blooded and cold-hearted" policy decisions that will involve considering whether local priorities and objectives coincide with global ones.

The standards are effective for years beginning on or after January 1, 2024, but jurisdictions are free to establish whatever effective date they want for local reporting purposes. One of the main reasons for the ISSB adopting the 2024 date is to allow companies to adopt them voluntarily as soon as they wish.

Summarizing the ISSB standards is beyond the scope of this publication (watch this space for more detailed PwC publications), but we would be remiss if we didn't highlight the significant changes the ISSB made in the last few months leading up to their publication. One key objective is to make the standards easier to apply, both in transition and beyond, and so enhance their appeal to jurisdictions. The changes:

- Allow you in the first year of reporting to disclose only climate-related matters instead of all material sustainability matters, delay publishing sustainability reports for up to a few months after you've published your financial statements (generally at the same time as second quarter reporting) and exclude Scope 3 GHG emissions from your reporting.
- Permit GRI and EU guidance to be considered in identifying material sustainability matters that require disclosure in the absence of a relevant IFRS Sustainability Standard.
- Add relief designed to make life easier, especially for smaller companies, when making certain of the more complex estimates and judgements by allowing them to consider only information that's available without undue cost or effort or, in some very narrow cases, proportional to an entity's resources, capabilities and skills. The aim of this guidance, says the Chair of the Board, is to ensure that "anyone can start" to apply the standards.
- Remove some of the initially proposed GHG emissions disclosures, and
- Increase the interoperability of ISSB and European standards.

PwC observation. Little understood, we think, is that even if there is widespread acceptance of the standards it will be at least a few years before reporting begins under them and assessments can be made of their effectiveness. That's because jurisdictions will have to decide whether and if so how to incorporate the standards into local regulatory reporting frameworks (including adding any supplemental requirements) and companies will need time to prepare to apply them. Consider, for example, that the UK has recently announced that it will need 12 months just to decide whether to endorse the standards, and Japan, which has already made that decision, has cautioned that it will need the better part of two years to convert them into local requirements.

Canadian Sustainability Reporting Developments, Part 1

"Researchers have already cast much darkness on the subject, and if they continue their investigations we shall soon know nothing at all about it."

– Mark Twain

And how is Canada progressing in its journey towards ISSB sustainability standards? Therein lies a tale.

A major step forward occurred this spring, when the newly formed Canadian Sustainability Standards Board announced that it expects to be fully operational by the beginning of the summer. The CSSB's mission is to support the uptake of ISSB standards in Canada, develop any supplemental standards that may be necessary to recognize special Canadian circumstances, and plead Canada's case before the ISSB in the development of future ISSB standards.

Will the CSA require Canadian public companies to follow ISSB standards in their sustainability disclosures, consistent with the CSSB initiative? That's unclear. In the spring, the CSA announced that it looks forward to working with the CSSB to develop international standards for Canadian sustainability reporting purposes that addresses the unique features of the Canadian markets but has yet to clarify exactly what that means. Last October, however, the CSA announced that it will be analyzing differences between ISSB and SEC requirements in developing a climate-related disclosure rule of its own. There also have been some press reports that the CSA is pausing the development of its reporting requirements pending a review of Canadian stakeholder feedback to the SEC on its climate-related rule.

PwC observation. We look forward to CSA clarifying its strategy for developing comprehensive Canadian public company sustainability regulatory reporting requirements. Our view continues to be that Canadian reporting would be best served by establishing ISSB standards as the primary basis for Canadian regulatory reporting, as IFRS does for financial statement reporting. At the same time we do acknowledge the need for guidance on the special circumstances of Canadian SEC registrants and smaller Canadian companies and that other factors uniquely relevant to Canada should be taken into consideration.

Canadian Sustainability Reporting Developments, Part 2

“This is not an occasion for firing with blank cartridges.”

– George Elliot, Middlemarch

Another Canadian regulator is having a say over Canadian sustainability reporting – the Office of the Superintendent of Financial Institutions (OSFI). In March – three months before the publication of the ISSB standards – it issued a guideline outlining its expectations for federally regulated financial institutions’ disclosure of climate-related risks and opportunities. In summary, OSFI wants Canada’s top banks and insurance companies to disclose specified climate-related information at least annually beginning with their 2024 financial years (i.e., first reporting in 2025) with other banks and insurers starting a year later. The guideline’s disclosures are broadly consistent with recommendations of the Task Force on Climate-Related Financial Disclosures, but OSFI has announced that it plans to eventually align them with the IFRS S2, *Climate-related Disclosures*. A key part of the guideline is establishing expectations concerning:

- The timing of publication of the information (no more than 180 days after the end of the year).
- Their location (report to shareholder or stand-alone report).
- The principles to be used in their preparation (e.g., disclosures and information should be relevant, specific, comprehensive, clear, balanced and understandable, reliable and verifiable, proportionate to the organization’s size, nature and complexity, consistent and subject to internal governances and controls that are substantially the same as those used for financial reporting).
- Independent assurance (companies should be working towards a future state in which this is expected).

PwC observation. OSFI introduced the guideline on the basis that transparent and timely climate-related disclosure is necessary to foster confidence in Canada’s financial system and so it took dead aim at intended targets with the only ammunition that was available at the time the guideline was issued – the TCFD disclosure recommendations. While the recommendations are already being considered by many in the financial services industry as the basis for their climate-related disclosures, we expect that the OSFI guideline will further standardize, expand and improve the reliability of reporting.

US Sustainability Reporting Developments

"I love deadlines; I like the whooshing sound they make as they fly by."

– Douglas Adams

A very brief word about the SEC developments relating to its proposed climate-related disclosure rule. There are none. It had been widely expected that the SEC would finalize and publish the rule in April but the month came and went with nothing happening. Based on updates to the regulatory agenda, it looks like the rules will be delayed until at least the fall.

PwC observation. In the US there has been both heated opposition to and fervent support of the SEC's proposed climate-related rule and the expectation is that the SEC is taking extra time to bolster its rule against the seemingly inevitable lawsuits and other attacks that will come on its publication. The only uncertainty, it seems, is who will be doing the attacking – opposers because the SEC failed to withdraw or sufficiently soften the rule, or supporters because it did. If, the CSA is waiting upon the SEC to finalize its requirements, any delays in the publication of the SEC's rule, or caused by the need for judicial review, might inevitably delay the completion of the CSA's initiative.

European Sustainability Reporting Developments

"If it weren't for the last minute, a lot of things wouldn't get done."

– Michael S. Traylor

Like the ISSB, the European Commission had intended to publish its very comprehensive European sustainability reporting standards in June, but just before this was supposed to happen, on June 9, the EC issued a revised draft of the standards for comment that proposed softening certain requirements. Major changes include:

- All standards, with the exception of the general disclosure one, are now subject to materiality assessments. Previously, mandatory disclosures were required irrespective of an entity's view as to whether they were material.
- More phase in options, especially for companies with less than 750 employees.
- Certain disclosures made voluntary and more flexibility.
- Enhanced international interoperability.

More details can be found here.

Comments on the proposals were due by the end of the first week of July and the final standard expected to be adopted by the European Commission by the end of July or the beginning of August (adoption by the end of August is necessary for the standards to be effective for years starting on or after January 1, 2024). This is followed by a two-month (extendable to four months) scrutiny period by the European Parliament and Council. If no objections are raised, ESRS will apply from the beginning of January 2024. If objections are raised, the standards can't be changed, but the process for the first set of ESRS would need to start from scratch.

PwC observation. The proposals have already caused some stakeholder groups to express significant concerns about the loss of the information that will result from amendments and the now heavy dependence on preparer materiality decisions. On the other hand, preparers are somewhat relieved about the somewhat reduced disclosure burden (but don't be mistaken in thinking that it isn't still significant!). Given the diversity in views, the finalization of the standards may come down to the wire.

Accounting Standards Developments

As we mentioned in the introduction, only one accounting standard development occurred in the period that we should be bringing to your attention – that relating to Pillar Two deferred income taxes.

PwC observation. The absence of significant developments shouldn't cause you to conclude that the Board isn't doing much, actually, it has 30 projects on the go. Many of them, however, relate to narrowly targeted improvements to existing standards, which will never bless these pages. There are a few major initiatives underway, e.g., reshaping the income statement, importing certain non-GAAP measures, now recharacterized as management performance measures, into the financial statements and thus subjecting them to audit, and accounting for rate regulation, but these aren't expected to be finalized until 2024 in the first two cases and 2025 in the last.

Pillar Two deferred income taxes

"The early bird gets the worm, but the second mouse gets the cheese."

– Steven Wright

The International Accounting Standards Board amended its income tax standard in May to provide a mandatory scope exception that precludes entities from recognizing deferred income tax assets and liabilities arising from the implementation of the new Pillar Two global tax framework. The exemption lasts until the Board figures out whether and how its deferred tax requirements apply.

The Pillar Two rules require the payment of a minimum amount of tax on income and generally apply to multi-national entities with revenues over about $1 billion. Any such entity that operates in jurisdictions that have enacted or substantively enacted the rules must apply the IFRS exception and disclose that they have applied it in interim and annual financial statements issued after the release of the amendment, if the entity's income taxes will be affected by enacted or substantively enacted tax law that implements the OECD's Pillar Two model rules.

The following additional disclosures are required for annual reporting periods beginning on or after 1 January 2023 (i.e. these would generally not be required in interim periods ending on or before December 31, 2023):

- Current income tax expense or income related to Pillar Two taxes, separately from other income taxes.
- In periods in which Pillar Two taxes are enacted or substantively enacted but not yet in effect, known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.

Additional disclosures often will be necessary under existing interim and annual financial statement and MD&A requirements as well. Details can be found here.

PwC observation. Determining the nature and extent of disclosure to help users of financial statements to understand the entity's exposures to Pillar Two income taxes will require judgement and the involvement of income tax experts.

For more information

This newsletter has been prepared for the clients and friends of PwC by Corporate Reporting Services (CRS). For further information on any of the matters discussed, please feel free to contact any member of CRS or your PwC engagement leader. This newsletter is available from the PwC Canada web site, which is located at https://www.pwc.com/ca/en/services/accounting-advisory-services.html.

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