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Have you disclosed the impacts of climate-related matters clearly?

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Investors are challenging the lack of sufficient disclosure of climate-related information in financial statements and are seeking transparency and clarity in disclosures. The current reporting season is an opportunity for companies to close this information gap by enhancing their disclosures of the impact of climate-related matters.

What's the issue?

All companies are facing climate-related risks and opportunities. Some are affected more than others. As the impact of climate change intensifies, investors and regulators are increasingly seeking greater transparency of climate-related information in financial statements.

Although financial statements are not the only source of information about climate-related matters – companies are also expected to provide more comprehensive disclosures in the front part of the annual report or elsewhere – they play an important role.

How a company reflects the impacts of climate-related matters in the financial statements will depend on its specific facts and circumstances, including the nature and extent of those impacts on the company. Therefore, companies are required to consider materiality carefully in deciding what information to provide about these matters. Information may be material even though there is no current-period financial impact.

We focus here primarily on how current requirements in IFRS® Standards facilitate disclosure of climate-related information in the financial statements. For a more comprehensive discussion on potential impacts, including measurement and recognition impacts, see our **Climate change resource centre**.

We also highlight other matters that companies need to consider, largely reflecting investors' and regulators' expectations – e.g. consistency between the front part of the annual report and the financial statements.

Getting into more detail

Climate-related risks, either due to physical effects of climate change or the transition to a lower-carbon economy, and opportunities are causing companies to make strategic decisions in response. For some companies, the risks and opportunities are immediate and easily identifiable; for others, they may be less immediate, may exist across their broader value chain and may be less apparent.

Not surprisingly, users of financial statements want to understand how climate-related matters impact companies, including their business models, cash flows, financial position and financial performance. They need information to assess how the company is managing these climate-related risks and opportunities, and the impact on the company's long-term prospects.

Investors are particularly concerned that they are not getting sufficient information about companies' downside exposures. Therefore, in this article we focus on

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IFRS Standards do not refer explicitly to climate-related risks or climate-related matters, but they implicitly require relevant disclosures in the financial statements when climate-related matters considered in preparing the financial statements are material. To respond to investors' and regulators' expectations, companies may need to go further in view of the overarching requirements in IAS 1 *Presentation of Financial Statements*.

climate-related risks. A company's response to climate-related risk may impact a number of accounting areas, including disclosure.

IFRS Standards do not refer explicitly to climate-related risks or climate-related matters, but they implicitly require relevant disclosures in the financial statements when climate-related matters considered in preparing the financial statements are material[1].

Relevance of information through the lens of investors

Investors want information about how climate-related risks and opportunities impact companies because it affects their decision-making. Companies need to make materiality judgements when deciding what information about climate-related matters to disclose in the financial statements. Under IFRS Standards, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that primary users of financial statements make on the basis of those financial statements, which provide financial information about a specific company. [IAS 1.7]

The significance of the impacts will vary by company and will depend on multiple factors, including the industry it operates in, geographic location, applicable laws and regulations, its goods/services and supply chains.

For certain companies, particularly those considered to be in high-risk industries[2], the impacts could be significant and could have major implications for their future business model, investment priorities, products, costs of doing business, supply chain resilience and access to, and costs of, capital.

Considering materiality carefully will be a key issue in addressing user expectations. Materiality involves both quantitative and qualitative considerations. Even if the information is not material in amount, it may be material in nature. For example:

- For some companies – e.g. those in higher-risk industries – the impacts may be quantitatively material.
- For others with no significant quantitative impact in the current reporting period, management may need to provide an explanation because this could be qualitatively material to users.
- For those that have not yet fully assessed the potential future impact on the financial statements, this fact may be qualitatively material and so an explanation may be needed.

IFRS Standards' disclosure requirements and climate-related information

Overarching requirements

Users expect companies to improve the clarity and transparency of climate-related disclosures. To meet these expectations, companies need to consider the specific disclosure requirements in individual standards as well as the overarching requirements of IAS 1.

For example, paragraph 112 of IAS 1 requires disclosure of information that is relevant to an understanding of the financial statements but is not specifically required by IFRS Standards or presented elsewhere in the financial statements. Paragraph 17(c) of IAS 1 notes that, in certain circumstances, a company may need to include additional disclosures to achieve a 'fair presentation' in the financial statements.

1. See the International Accounting Standards Board's related educational material.
2. Examples of high-risk industries include energy, finance, transportation, materials and buildings, agriculture, food and forestry products.

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Better connectivity between non-financial and financial reporting is key. Although the nature of the information provided in the front part of the annual report and the financial statements may differ, it needs to be consistent when appropriate. If key assumptions underlying the financial statements differ from those disclosed in the front part of the annual report – e.g. a net zero commitment – then companies may need to consider explaining these differences in the annual report.

Key judgements and estimates

Many companies face uncertainty when considering the impacts of climate-related risks in recognising and measuring assets and liabilities. Investors and regulators expect robust disclosures of the most significant assumptions, estimates and judgements made in preparing the financial statements to understand whether and how they are affected by climate-related matters. When there is a high level of uncertainty, companies may also consider providing sensitivity analyses and related disclosures.

IAS 1 requires specific disclosures on key judgements and estimates made by management in preparing the financial statements, including disclosure of:

- judgements that management has made in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements; and
- information about the assumptions that management has made about the future, and other major sources of estimation uncertainty at the reporting date, that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year. [IAS 1.122, 125]

In some cases, changes in key assumptions related to climate-related risk may not be expected to result in material adjustments in the measurement of assets and liabilities in the next financial year, but the chance of material adjustments in the longer term may be significant. In these circumstances, and given the expectations of investors, companies may need to consider disclosing key assumptions related to climate-related risk even though the risk of material adjustments in the next financial year may be considered to be low.

IFRS Standards facilitate these disclosures. The following articles contain relevant disclosure considerations for certain key areas that involve significant judgements and estimates.

Topic	Related articles
Impairment of non-financial assets	What's the impact on cash flow projections used for impairment testing of non-financial assets?
Useful lives and residual values of Property, Plant and Equipment (PP&E) and intangible assets	What's the impact on useful lives and residual values of PP&E and intangible assets?
Measurement of financial assets	What's the impact on expected credit losses?
Environmental and decommissioning provisions	Have you recorded all of your environmental and decommissioning obligations?
Going concern assessments	What's the impact on the going concern assessment and related disclosures?

Consistency between the front part of the annual report and the financial statements

Users and other stakeholders are becoming increasingly interested in understanding how the key assumptions and judgments underlying the information disclosed in the front part of the annual report on climate-related matters reconcile with the financial statements – in particular, when they are not consistent.

Better connectivity between non-financial reporting and financial reporting is key.

Although the information provided in the front part of the annual report may be different in nature from the financial statements, it should be consistent where

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appropriate. Furthermore, if a company has made and disclosed climate-related commitments in the front part of the annual report, then the assumptions used in the financial statements should be consistent, where appropriate.

However, there may be differences in assumptions between the front part of the annual report and the financial statements that are a consequence of requirements in IFRS Standards, as described below.

- The Standards' requirements may not permit the climate-related matters described in the front part of the annual report to be considered in the recognition or measurement of amounts in the financial statements. For example, the 'potential' restructuring of a company's business discussed in the front part of the annual report may not lead to the recognition of obligations in respect of a restructuring in the financial statements, because 'potential' restructurings would not generally meet the criteria for recognition as a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The front part of the annual report may also discuss risks associated with potential new laws and regulations. Potential laws and regulations are long-term risks but they do not generally affect the financial statements because laws and regulations typically give rise to obligations in the financial statements only when they are enacted (or substantively enacted).
- Certain climate-related matters may have been discussed in the front part and considered by management when preparing the financial statements, but management concluded that no related information needed to be disclosed. This could be because these matters were judged either to have a low probability of occurring or would occur so far into the future that the impacts on the financial statements were not material and management concluded that it was not a significant judgement that required disclosure.

In such instances, to address the information gap, disclosure of the significant differences in assumptions and the reasons for the differences may help users to understand and to reconcile the information in the front part of the annual report with the financial statements. For example, a company may consider discussing why key assumptions used in estimates in the financial statements are different from net zero commitments/scenarios and impacts disclosed in the front part of the annual report – e.g. discussion of differences between the key assumptions used in impairment testing and 'Paris-aligned' assumptions[3] used in the front part of the annual report.

Regulatory expectations

Climate-related information is a key area of focus for many regulators. Some have already issued guidance emphasising the importance of considering climate-related matters in the preparation of annual reports, including financial statements. Companies should consider relevant guidance from their local regulators.

For example, the European regulator (ESMA[4]) highlights climate-related information in its **statement** as one of the key topics that European national securities regulators will focus on when reviewing listed companies' 2021 annual reports.

Similarly, the Australian regulator (ASIC[5]) has identified **climate risk** as one of its key areas of focus for financial reports for a number of years – specifically the impacts on asset impairment assumptions. The UK FRC[6] also continues to focus on climate in its **thematic reviews**.

Other regulators are likely to follow suit and focus on this topic.

3. 'Paris-aligned' assumptions/benchmarks are indices that align with the Paris Agreement, which seeks to limit the rise in global temperatures to well below 2°C above pre-industrial levels, and to pursue efforts to keep the rise to 1.5°C.
4. European Securities and Markets Authority.
5. Australian Securities and Investments Commission.
6. Financial Reporting Council.

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Standard-setting developments

Companies should stay abreast of standard setting for both sustainability and financial reporting developments.

The International Sustainability Standards Board (ISSB) will soon release proposals for IFRS Sustainability Disclosure Standards on climate-related disclosures and general disclosure requirements. Adopting these proposed standards will support companies in providing information about their exposure to climate-related risks and opportunities that is relevant to an understanding of the company's enterprise-value. An important aim of these standards will be to enhance connectivity between the financial statements and other information in the annual report. For more information, see our **Sustainability reporting** page.

The International Accounting Standards Board may provide additional guidance, because its most recent agenda consultation listed climate-related risks as a potential project for its 'to-do' list. For more information, see our article **Shaping the future standard-setting agenda**.

Actions for management to take now

- Consider climate-related risks and opportunities and their financial impacts when preparing financial statements.
- Consider materiality from both a quantitative and qualitative perspective in relation to disclosures of key judgements and assumptions related to climate risk.
- Provide clear and robust disclosures, especially of the key judgements and estimates affected by climate-related matters.
- Ensure consistency of assumptions used in relevant areas of the company's financial statements and that they are in sync to the extent appropriate with information related to climate-related risks discussed elsewhere in the annual report. Consider providing additional explanations in the annual report where inconsistencies arise.
- Consider relevant regulatory guidance.
- Stay abreast of sustainability and financial reporting developments.

References to 'Insights' mean our publication **Insights into IFRS**

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