Accounting for climate: summary for EU policymakers

In December 2020, the Climate Disclosure Standards Board published a report on 'Accounting for climate'[1], in order to help support report preparers in integrating climate-related matters into financial statements. It does not seek to create new accounting standards in relation to climate-related matters. Instead, this guidance built on the existing position of the International Accounting Standards Board (IASB) and International Financial Reporting Standards (IFRS) Foundation on how such matters should be integrated using existing IFRS Standards. This executive summary provides an overview of the information presented in this report, split by each of its core three chapters.

Chapter 1: Are climate-related matters relevant to financial reporting?

Climate change and the IFRS standards

In 2019, IASB published a paper which clarified how existing IFRS requirements may address material climate-related risks.[2] It explained that investors may expect disclosure in financial statements regardless of numerical impact, and therefore businesses should consider whether:

a. Climate-related matters materially affect their financial statements, due to the magnitude of the effect; and

b. The nature of climate-related matters results investors expecting disclosure (whether or not the company has determined the magnitude of the impact to be material).

This was followed up with educational material published by the IFRS Foundation in November 2020, complementing the 2019 IASB paper, containing a non-exhaustive list of IFRS Standards for which companies may need to consider climate-related matters in their reporting.[3]

Regulation, assurance and climate-related financial reporting

There have been a number of regulatory and legal developments in various jurisdictions with regards to reporting of climate-related matters, the most significant being the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations with the expectation that regulators, governments and other relevant bodies will increasingly focus on whether material climate-related matters are being reflected in financial reporting. Auditors are also increasingly considering the implications of climate as part of their own process and professional responsibilities, with clarification being offered by the International Auditing and Assurance Standards Board (IAASB) on how existing standards require such consideration.[4] As well as this, the Commonwealth and Climate Law Initiative (CCLI) published a paper in October 2019, summarising analysis of directors' climate-related duties in several jurisdictions, including that directors may also face personal liability for breach of disclosure obligations to provide a true and fair view of corporate performance and prospects.[5]

Investor expectations

Investors are crucial in the effective allocation of capital needed to reach climate-related global goals such as the Paris Agreement and the UN Sustainable Development Goals, for which in order to be successful they require both quantitative and qualitative information on the impacts of climate-related matters. Beyond narrative reporting, the largest investor groups in the world (representing over $103 trillion in assets under management) have called in September 2020 for companies to improve their disclosures of the effects of climate-related matters in their financial reporting, confirming that they do indeed consider climate-related risks to be material.[6]

1 Climate Disclosure Standards Board (2020), Accounting for climate [PDF], available at: https://www.cdsb.net/climateaccounting

2 IFRS Foundation (2019), IFRS Standards and climate-related disclosures [PDF], available at: https://www.ifrs.org/content/dam/ifrs/news/2019/november/in-brief-climate-change-nick-anderson.pdf

3 IFRS Foundation (2020), Effects of climate-related matters on financial statements [PDF]. Available at: https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf

4 IAASB (2020) The Consideration of Climate-Related Risks in an Audit of Financial Statement. [PDF]. Available from: https://www.ifac.org/system/files/publications/files/IAASB-Climate-Audit-Practice-Alert.pdf

5 Commonwealth and Climate Law Initiative (2019) Directors' Liability and Climate Risk: Comparative Paper – Australia, Canada, South Africa and the United Kingdom. [PDF]. Available from: CCLI-Directors'-Liability-and-Climate-Risk-Comparative-Paper-October-2019-vFINAL.pdf (ox.ac.uk)

6 PRI (2020) Investor groups call on companies to reflect climate-related risks in financial reporting. [Online]. Available from: https://www.unpri.org/news-and-press/investor-groups-call-on-companies-to-reflect-climate-related-risks-in-financial-reporting/6434.article

Chapter 2: How should climate-related matters be factored into a company's financial reporting

After making the case for inclusion of climate-related matters in financial statements clear, the next chapter explains in detail the how climate-related matters should be considered in relation to four IFRS Standards that are deemed as relevant for most companies in a range of sectors and geographies. The following table provides a high-level overview of how each is relevant to climate under its existing requirements. In addition, illustrative examples of how these may be applied across different sectors are featured in the 'Accounting for climate' guidance.

Standard	Summary
IAS 1 Presentation of Financial Statements	• Under IAS 1, companies must consider whether to provide information not specified under other IFRS Standards if that information is necessary for primary users to understand the impact of events or conditions, such as climate-related matters on companies' financial position, performance and cash flow. • This falls under two broad categories – sources of estimation uncertainty and information not presented elsewhere. Other relevant matters addressed by IAS 1 are disaggregation of line items and going concern issues.
IAS 37 Provisions, Contingent Liabilities and Contingent Assets	• Under IAS 37, companies need to consider how the pace and severity of physical climate change risks, as well as accompanying transition risks such as government policy and regulatory measures, may impact the recognition, measurement and disclosure of provisions, contingencies and onerous contracts.
IAS 36 Impairment of Assets	• Under IAS 36, companies shall consider whether there is any indication that an asset may be impaired. If such an indication exists, the entity shall estimate the recoverable amount of the asset. • Companies should consider any climate-related events that could affect the related cash flows for the impairment calculations, the impact on any cash flows arising from residual values of the asset after its useful life and disclose assumptions used to determine the recoverable amount of assets (cash-generating units). • If impairment reviews and calculations do not consider the effect of material climate-related risks (including determining if these are potential indicators of impairment), the carrying amounts of assets such as (but not limited to) property, plant and equipment, assets recognised in relation to mineral resources, intangible assets and goodwill could be overstated.
IAS 16 Property, Plant and Equipment	• Under IAS 16, companies should review the residual value and the useful life of an asset at least at the end of each financial year. • Climate-related factors, such as changing consumer preferences or the introduction of carbon taxation, may affect the useful lives of assets. Therefore, as part of this review preparers should consider whether climate-related factors might impact the useful life and the residual value of assets held by the company.

Chapter 3: Next steps for preparers

Finally, the last chapter of the guidance outlines some key takeaways that may be useful for preparers starting out in integrating material climate-related matters into their financial reporting.

Take a methodical approach to assessing materiality

The following four step process can be used for assessing and integrating climate-related issues into financial reporting:

1. Identify the climate-related factors, including the regions and sectors in which the company operates and impacts (short and long-term), that have the potential to be material;
2. Assess whether the climate-related matters identified in step 1 are, in fact, material to the company;
3. Organise the climate-related information in a way that communicates the information clearly and concisely; and
4. Review the draft climate-related disclosures to determine whether all material information has been identified.

Ensure consistency with narrative and TCFD reporting

Preparers should be mindful that narrative and financial reporting to climate should not be considered in silos. As a minimum, assumptions and judgements used in preparing the financial statements should not contradict information disclosed as part of the climate-related narrative reporting, including TCFD, by a company.

Work on company collaboration and buy-in

In order to ensure a complete and robust integration of climate-related matters into financial reporting, those preparing the financial statements should work in collaboration with others across the organisation. The support of experts, whether internal or external, may be required to assess both whether and which climate-related matters may be material to the business and how this is then appropriately reflected in the reporting. For successful collaboration to occur, buy-in from key internal stakeholders should be obtained early in the reporting process, which may include: CEO, CFO, chief sustainability officer (CSO), General Counsel, director of Strategic Planning & Analysis, director of Investor Relations and other managers responsible for climate-related matters

Consider the integration of climate-related matters as iterative process

Although the importance of climate issues should not be understated, preparers should still recognise that this is an emerging practice. Considering the significant and systemic risks of climate-related matters, combined with its inherent uncertainty, integration will be an iterative process. As a result, companies should seek to develop a realistic implementation path over time to effectively integrate climate-related matters into financial reporting.

The way forward: working with financial standards setters

We are encouraged to see that the topic of connecting financial and sustainability reporting, starting from climate-related financial implications is identified as a priority in both the IASB's third agenda consultation and EFRAG's own proactive research agenda consultation.

We will continue our work in this area[7] and believe further engagement by EFRAG with the IASB is needed to ensure that financial impacts of climate change are properly reflected into the financial statements and to support preparers to put this into practice.

With the contribution of the LIFE Programme of the European Union.

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7 CDSB (2020) Accounting for Climate Supplementary Paper 1 (online). Available from https://www.cdsb.net/climateaccounting