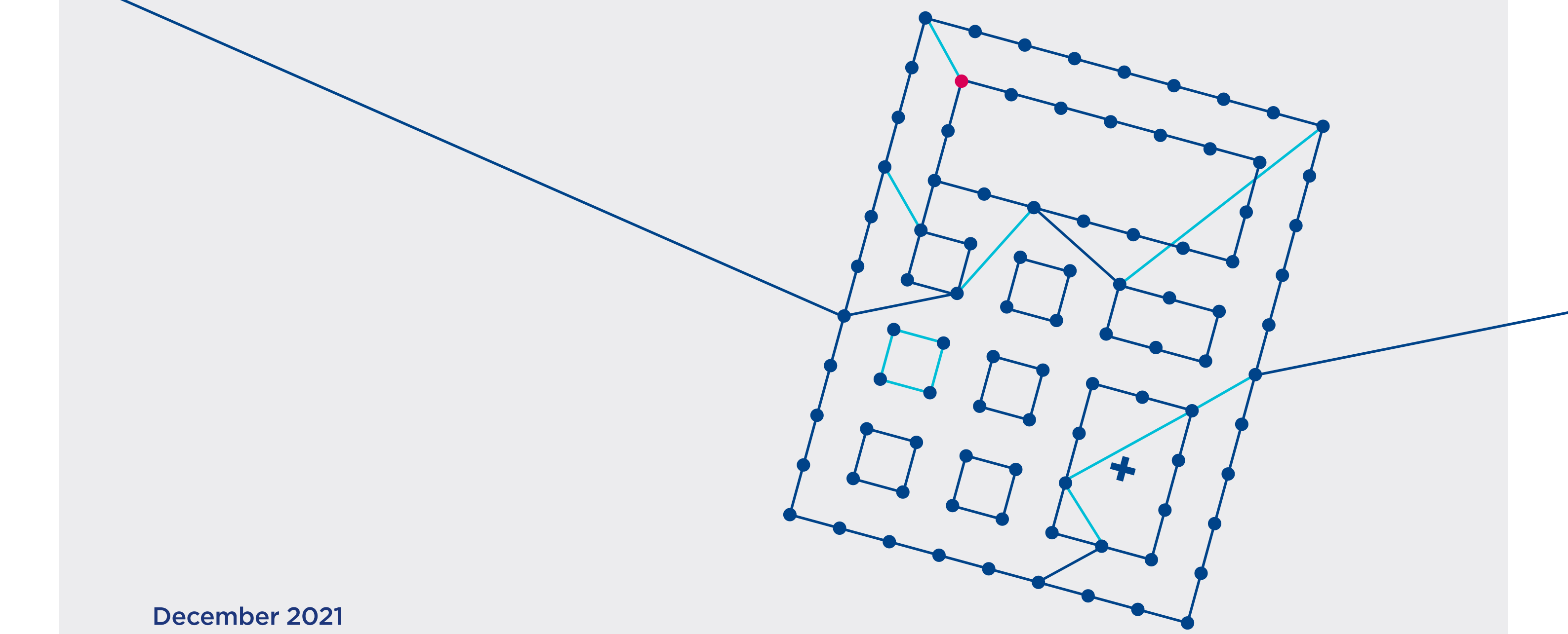
CDSB Climate Disclosure Standards Board

KPMG

Accounting for climate

Integrating climate-related matters into financial reporting

Supplementary paper 2



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cdsb.net/ClimateAccounting

CDSB is an international consortium of business and environmental NGOs. We are committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital.

We do this by offering companies a framework for reporting environmental information with the same rigour as financial information. In turn, this helps them to provide investors with decision-useful environmental information via the mainstream corporate report, enhancing the efficient allocation of capital. Regulators also benefit from compliance-ready materials.

Recognising that information about natural capital and financial capital is equally essential for an understanding of corporate performance, our work builds the trust and transparency needed to foster resilient capital markets. Collectively, we aim to contribute to more sustainable economic, social and environmental systems.

For more information, visit cdsb.net or follow Climate Disclosure Standards Board on LinkedIn and Twitter @CDSBGlobal.

We welcome your input and discussions. If you would like to comment on this document, please contact us at info@cdsb.net.

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Contents

Introduction

In December 2020, CDSB released guidance titled "Accounting for climate: Integrating climate-related matters into financial reporting"[1] in order to answer three questions that are challenging preparers of financial statements:

- Are climate-related matters relevant to financial reporting?
- How should climate-related matters be factored into a company's financial reporting and what this might look like?
- What steps can companies take to integrate material climate-related matters into financial reporting?

The December 2020 guidance followed two papers published by the International Accounting Standards Board (IASB)[2] and the IFRS Foundation[3] clarifying that existing IFRS standards require the incorporation of material information about climate-related matters in financial reporting, even though the term 'climate-change' is not explicitly referenced in the standards. Building on the work of the IFRS Foundation and IASB, the December 2020 guidance highlighted the importance of assessing materiality in order to be able to provide information on climate-related impacts that addresses investors' common information needs, regardless of financial impact. In that paper, preparers were advised to consider whether:

a) climate-related matters materially affect their financial statements, due to the magnitude of the effect; or whether

b) the nature of climate-related matters results in investors expecting disclosure.

In November 2021, the IFRS Foundation announced the formation of a new International Sustainability Standards Board (ISSB) to develop a comprehensive global baseline of high-quality sustainability disclosure standards, on climate and other sustainability issues, to meet investors' information needs, building on the work of existing investor-focused reporting initiatives, including the Taskforce for Climate-related Financial Disclosure's (TCFD) recommendations.[4] The ISSB will sit alongside and work in close cooperation with the IASB, ensuring connectivity and compatibility between IFRS Accounting Standards and the IFRS Sustainability Disclosure Standards developed by the ISSB. In light of this announcement, we expect increased focus by the IFRS Foundation and its constituent boards on driving complete, consistent, and comprehensive disclosure of material sustainability-related information across mainstream annual reporting, including the financial statements.

The December 2020 guidance explored in detail how climate-related matters might be considered when applying the principles of specific standards and what the relevant disclosures might look like in the financial statements and notes. The standards covered were IAS 1 – *Presentation of Financial Statements*, IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*, IAS 36 – *Impairment of Assets* and IAS 16 – *Property, Plant and Equipment*.

In October 2021, a supplementary paper (referred to as Supplementary Paper 1) was released to provide guidance on how climate-related matters could be integrated in areas of the financial statements identified by the IASB and IFRS Foundation that were not considered in the December 2020 guidance.[5] This document explores climate reporting in the context of the following standards:

- IFRS 13 – Fair value measurement;
- IFRS 9 – Financial instruments: Recognition and measurement;
- IFRS 7 – Financial instruments: Disclosure;
- IAS 2 – Inventories;
- IAS 12 – Income taxes; and
- IFRS 17 – Insurance contracts

This additional supplementary paper considers certain other IFRS standards not covered in the two previous papers. Those standards include:

- IFRS 16 – Leases;
- IFRS 2 – Share-based payment;
- IAS 19 – Employee benefits;
- IFRS 15 – Revenue from contracts with customers;
- IFRS 6 – Exploration for and evaluation of mineral resources; and
- IAS 41 – Agriculture.

For each of the standards covered, this paper identifies essential accounting and disclosure matters relevant from a climate perspective. These are not exhaustive but illustrate key matters that companies might need to consider. Alongside this discussion, a number of illustrative examples have been developed, which are found in the appendix. Readers should be aware that the examples included in this guidance are only intended to demonstrate, as a starting point, the range of climate-related matters that preparers might need to consider as well as the relevant accounting considerations. The examples included in this supplementary paper are merely illustrative in nature and are not intended to be comprehensive or represent best or industry practice. We recognise that in practice, there is diversity of views and this is an emerging area of reporting.

Whether preparers are considering the financial statement impacts of a change in strategy (such as a new decarbonisation commitment) or are reassessing the implications of climate change on an existing business model and strategy, consideration of the potential recognition, measurement and disclosure implications from climate-related matters is vital. It is also important to remember that disclosure about why an entity is not exposed to a climate-related matter that is generally understood to affect its peers may be material if that information would affect investors' assessments of the entity.

IFRS 16

Leases

IFRS 16 – Leases

Context

Accounting for leases under IFRS 16 involves making significant judgements, assumptions and estimates in order to determine both the lease liability and the corresponding right of use asset. This includes assessing the lease term [IFRS 16.18-.19], the amount of lease payments to include [IFRS 16.27], and the discount rate to be applied to those payments [IFRS 16.26]. The decisions made may affect the recognition and/or measurement of lease assets and liabilities. There may also be important judgements around whether a contract is in scope of the standard, which would be the case if it conveys the right to obtain substantially all of the economic benefits from the use of an identified asset, and the right to direct the use of that asset [IFRS 16.B9].

Considering first the lessee perspective, as businesses across many sectors commonly lease assets for long periods of time, the scope for impact from climate-related factors on lease accounting is high, particularly in sectors with 'big-ticket' leases including, but not limited to, entities in retail, construction, telecommunications, transport or logistics.

When businesses identify and assess the impact of climate change on their operations, they may change the judgements made in order to reflect climate-related uncertainties (for example if chronic physical risks, increasing energy costs or government action cast uncertainty over the viability of certain sites) or changes in strategic plans driven by climate factors render assets either obsolete or critically important. They may also seek to modify existing leases.

Climate-related risks and opportunities can affect lessors too. However, the accounting challenges arising for lessors will be different, depending on whether the lease is classified as a finance or operating lease under IFRS 16.

- For finance leases, the lessor recognises a finance lease receivable and derecognises the underlying asset. Climate-related factors such as early cancellations or changes in consumer behaviour might affect the amount of lease receivables recognised in the balance sheet. This is part of the net investment in the lease, for which the lessor applies the derecognition and impairment requirements of IFRS 9.
- For operating leases, the lessor does not derecognise the underlying asset but recognises future contractual rental payments as receivables over the lease term. These payments may also be impacted by climate-related factors, as would the useful life/residual value of the underlying asset. The accounting for the lease receivable is covered by IFRS 9, whilst the underlying asset is most commonly covered by IAS 16.

Climate-related factors might also be a catalyst for entering into new contracts ranging from simple contracts for the lease of carbon efficient buildings or electric vehicles, or more sophisticated agreements e.g. for the purchase of 'green' power/electricity from solar farms, wind farms or through a public power grid. This may mean additional complexities for preparers of financial statements when applying the guidance in IFRS 16 around determining whether an arrangement contains a lease or is in fact a supply/service agreement (IFRS 15), a financial instrument (IFRS 9), or a service concession (IFRIC 12).

The remainder of this section addresses some of the more common potential implications from climate-factors on lease accounting for lessees.

Lease modifications and other changes in the lease term

As businesses globally commit to decarbonisation targets, this could require changes to the underlying lease agreements (lease modifications). This may be particularly relevant if the leased asset is polluting or not expected to be required in future after execution of changes to the business strategy to achieve targets.

For example, a company transitioning to net zero operations/facilities by a target date may seek to modify existing terms in order to:

- change the scope of existing lease arrangements to allow for carbon-related capital improvements, for example where landlords fund property improvement work; or
- terminate a lease early, for example curtailing leases of polluting equipment such as diesel engines or exiting contracts for assets in locations deemed unviable.

Under IFRS 16.A, a lease modification is defined as *"a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term)"*. When there is a modification to an existing lease, an entity would typically need to consider whether the modification would require treatment as a separate lease or not.

A lessee would account for a lease modification as a separate lease if:

- the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
- the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract [IFRS 16.44].

Climate-related factors could also result in changes in judgements around the lease term without there being a change in the legal agreement. For example, where a leased property has new strategic importance under a decarbonisation plan, a company may make the judgement that it is reasonably certain that it would continue the lease after an existing contractual break clause rather than assuming that the contract would end.

The lease term is defined under IFRS 16.18 as "*the non-cancellable period of a lease, together with both:*

a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option."

Where the lease contract is not modified, but information from a net-zero transition plan provides a significant change in circumstances that were not previously included in the determination of the lease term, and are within the control of the lessee, then the lessee would need to assess whether it is "*reasonably certain*" they would exercise an extension option, or not exercise a termination option [IFRS 16.20]. Where a change was identified, then the lease liability would be remeasured, using a revised discount rate.

Example A illustrates considerations around the appropriate lease term.

Applying the definition of a lease to new climate-related contracts

A lease is defined by IFRS 16.A as "*a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration*".

With the emergence of green products and services, green energy certificates, green technology and other 'green' arrangements intended to help companies in achieving their net zero ambitions, the assessment of whether a contract contains a lease or not may become more complex. For the lessee, it is critical to determine whether such green arrangements are to be recognised on balance sheet or not.

As detailed in the application guidance of IFRS 16, the key factors to consider when applying the lease definition are as follows, where all three criteria need to be met for there to be a lease:

- *Is there an identified asset?* For a lease to exist, there must be an identified asset. Whether explicitly or implicitly, the customer must have the right to receive substantially all of the capacity of that asset and the supplier must not have substantive substitution rights.
- *Does the lessee/the customer obtain substantially all of the economic benefits?* The economic benefits from using an asset include its primary output, by-products and other economic benefits from using the asset (e.g. renewable energy certificates, sub-leasing the asset).
- *Who has the right to direct the use of the asset – i.e. who takes the 'how and for what purpose' decisions?* Only if a company directs the right to use the asset will it have a lease arrangement.

Example B illustrates considerations around identifying a lease.

IFRS 2

Share-based payment

IFRS 2 – Share-based payment

Context

IFRS 2 sets out the recognition and measurement of share-based payment arrangements, which are agreements *"between the entity (or another group entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive:*

a) cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity, or

b) equity instruments (including shares or share options) of the entity or another group entity,

provided the specified vesting conditions, if any, are met". [IFRS 2. Appendix A]

As companies increasingly focus on climate-related targets in their strategy and operations, remuneration linked to achieving those climate-related targets is becoming more common - aligning employees' and directors' pay with progress towards climate goals.

The accounting for share-based payment arrangements depends on whether they are cash or equity settled (or there is a choice), as well as on the type of conditions imposed. Vesting conditions could be performance (market or non-market) or service conditions. Other arrangements may have non-vesting conditions. This section focusses on the accounting for climate-related performance conditions.

For employee share-based payment arrangements that do not have a climate-related performance condition, climate-related factors may still impact measurement, where they influence profits or achievement of other conditions. A future increase in volatility of earnings or share price, for example, may also be an increasing challenge for companies. For example, where the vesting of awards is subject to a profit target being achieved, an increase in uncertainty of future profits may make it more challenging for companies to estimate the number of awards that are expected to vest and consequently the share-based payment charge to record.

Climate-related factors may also impact the inputs to the valuation of share-based payment arrangements relating to unlisted shares, such as estimated share price and related volatility.

However, as many share-based payment arrangements are relatively short term, whereas climate impacts for many companies are expected over the medium to longer term, these future challenges are not the focus of this paper.

Employee share-based payment transactions with climate-related performance conditions

Climate-related performance conditions may commonly meet the definition of a non-market performance vesting condition. Following IFRS 2.19 and IFRS 2.33A, this means that this type of vesting condition is not considered when estimating the fair value of the employee share-based payment. Instead, the non-market performance vesting condition is considered in estimating the number of awards that the company expects to vest and for which a share-based payment amount should be recorded.

Climate-related performance conditions could therefore impact the number of awards that are expected to vest and actually vest, and consequently the share-based payment amounts recorded.

Example C illustrates the potential impact of climate- related performance conditions in the accounting for an employee share-based payment transaction.

There may be some arrangements where the performance target period extends beyond any service-related vesting condition. For example, awards subject to a 3-year service period from the grant date may be exercisable only if the business meets its GHG reduction targets. Those targets may relate to improved performance from a baseline year several years prior to grant date until a date several years in the future. In this case, the climate-related condition would be classified as a non-vesting condition. This means that it would be reflected in the measurement of the fair value of the award and consequently, the share-based payment charge recorded would not be adjusted for failure to meet this non-vesting condition.

Disclosures

Per IFRS 2.45, companies would need to disclose details of any climate-related performance conditions of their share-based payment arrangements to enable users to understand the terms of the arrangements.

There are extensive disclosure requirements under IFRS 2. For example, for share options granted during the period, companies are required to explain how expected share price volatility, which is an input to the valuation model, has been determined. In cases where climate-related factors have been considered in determining expected volatility, information about climate-related factors may need to be disclosed.

In addition, IFRS 2 requires companies to disclose information "*that enables users of the financial statements to understand how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined*" [IFRS 2.46].

In cases where companies consider the inputs to the valuation of the share-based payments to represent significant estimates as per IAS 1, companies may need to disclose their key assumptions, which may include climate-related assumptions, and sensitivity of the valuations to these key assumptions.

IAS 19

Employee Benefits

IAS 19 – Employee Benefits

Context

IAS 19 outlines the accounting requirements for employee benefits, including short-term benefits (e.g. wages and salaries, paid annual leave and short term bonus schemes), post-employment benefits including defined benefit and defined contribution pension benefits, other long-term benefits (e.g. long service awards and long-term bonus schemes) and termination benefits.

As climate-risks are expected to impact the economy more severely over the medium- to long-term, the employee benefits most likely to be significantly impacted by climate factors are long-term arrangements such as pension benefits or long-term bonus schemes. Whilst the accounting for such arrangements is complex and judgemental, the primary impacts relating to climate are expected to relate to the actuarial and fair value assumptions used.

Plan assets are held at fair value, following the principles of IFRS 13. Depending on the nature of the plan assets held, they may be exposed to climate-related risks to varying degrees. When considering what information is material to disclose on plan assets, the requirements of IAS19.139(b) may be particularly relevant when considering the impact of climate-related risk. This requires *"a description of the risks to which the plan exposes the entity, focused on any unusual, entity-specific or plan-specific risks, and of any significant concentrations of risk."*

Defined benefit obligations are accounted for using an actuarial valuation method, under IAS 19.67-.69. This requires the use of actuarial assumptions, including both demographic assumptions and financial assumptions [IAS 19.76]. These assumptions have the potential to be impacted by climate-related factors. This could include, for example, the future impact of physical risk in key operating locations on mortality rates or claim rates under medical plans. It is important that the information disclosed in the financial statements should explain the risks associated with defined benefit plans, as well as any material climate-related assumptions.

Considering shorter-term employee benefits in the scope of IAS 19, companies may amend the offering made to align employee behaviour with strategic priorities around climate-change. For example, a company may introduce climate-related performance criteria into employee incentive arrangements (which can be either in the scope of IAS 19 or within the scope of IFRS 2). A company may also offer employee benefits which reduce the company's scope 3 emissions (e.g. offering electric car schemes) which would generally be in the scope of IAS 19.

As companies change their business model and strategy to adapt to climate-related risks and opportunities, they may decide to invest in new technologies, restructure their businesses and/or close certain operating sites. These decisions can have a significant impact on long-term employee obligations (e.g. defined benefit arrangements) and may involve paying termination benefits to large numbers of employees.

Short-term employee benefits

Short-term employee benefits are accounted for using normal accruals accounting [IAS 19.8]. Where companies choose to offer additional benefits to employees to encourage them to adopt climate-positive behaviours, these would be accounted for under IAS 19. These could include company car schemes offering generous incentives to choose an electric car, employer contributions to fund energy efficiency improvements to employee homes or discounts on purchases of eco-friendly goods or services.

Example D illustrates how an entity accounts for an incentive arrangement that has been introduced to align remuneration towards a company's strategic priority.

Termination payments

Termination payments are "*employee benefits provided in exchange for the termination of an employee's employment as a result of either:*

a) an entity's decision to terminate an employee's employment before the normal retirement date; or

b) an employee's decision to accept an offer of benefits in exchange for the termination of employment. [IAS 19.8]

It can be judgemental to determine whether a payment made is a termination payment or other post-employment benefit.

Where an entity is severely impacted by climate risks, it may determine that a site-closure or other restructuring exercise is required. In that case, the accounting for the restructuring is determined by IAS 37. If a provision is required, it is recognised only when the entity has a formal plan with sufficient detail about the restructuring and has raised a valid expectation in those affected. Any termination payments are then accounted for under IAS 19.159-.171.

Whilst this can be a complex area of accounting, as the judgements made and considerations are expected to be similar for climate-related terminations as for any other cause, it has not been covered further here.

IFRS 15

Revenue from contracts with customers

IFRS 15 – Revenue from contracts with customers

Context

IFRS 15 deals with the accounting for revenue from contracts with customers across all industries. It also provides guidance around accounting for associated contract costs. Whilst the accounting challenges faced are often different across sectors, the basic revenue recognition model is consistent – a five step model focussing on reporting information to users about the "*nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer*" [IFRS 15.1].

Climate considerations are expected to have increasingly material impacts on business models across many sectors as changes in market demand and customer preferences drive changes in sales prices, volumes, and supply chain costs. Governments may implement levies or taxes that affect amounts reported as revenue from contracts with customers. Businesses' efforts to adapt to climate risks and opportunities may also encourage management to change standard contract clauses, seek new routes to market or make other future business model changes, for which the accounting must be determined. These are future commercial challenges which preparers must react to and address as and when they arise. They are not considered further in this paper.

Most contracts with customers are completed by the delivery of goods and services and the collection of the transaction price in the short term. Changing expectations about the future may not affect the amounts reported as revenue in the current period from such revenue streams. However, expectations about the future may affect useful lives or the carrying amounts of assets used in such revenue streams, including PPE, intangible assets (see December 2020 guidance) and certain costs to acquire or fulfil a contract where the amortisation period reflects anticipated future contracts.

Expectations about the future effects of climate consideration are more likely to impact revenue or costs in the current period when those amounts reflect estimates and judgements that consider the longer term. One area where this could be the case is the accounting for multi-period contracts, whether that is changes in the revenue recognised, changes in the costs to fulfil that multi-period contract or treatment of associated capitalised costs.

If either revenue or costs are adversely impacted by climate factors, then there is an increased risk that contracts may become onerous. The accounting for onerous contracts is covered in IAS 37.66-.69 and was discussed in our December 2020 guidance. However, we have included some discussion below about how climate factors can trigger revenue contracts to be onerous.

Multi-period contract accounting

Multi-period contracts are frequently complex and there are various accounting judgements that must be made under IFRS 15. Two examples of judgements that could be impacted by climate-factors are:

- *Variable revenue:* Climate-factors may influence the estimate of total consideration received from a customer where the contract has variable revenue clauses. Under IFRS 15.51, "*an amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event.*" Where contracts, such as long-term service or manufacturing contracts, include penalty clauses (e.g. for late delivery) or performance guarantees (e.g. meeting minimum service levels), the occurrence of adverse weather events (whether acute or chronic) could increase the likelihood of failing to meet these requirements and trigger a reduction of revenue. Where contracts include clauses such as profit-share or profit-caps (which can be common in certain government arrangements), unexpected cost rises associated with transition risks could impact the total consideration estimated.

- *Over-time recognition:* Multi-period contracts can be impacted by climate-factors where revenue is recognised over time by reference to an internal measure of progress that is based on the percentage of total estimated costs incurred to date. Where a performance obligation is identified that has a long performance period, an increase in future estimated costs, for example additional costs incurred to meet decarbonisation commitments, could change the measure of progress, and delay the recognition of revenue. As costs to fulfil an overtime performance obligation are expensed as incurred, this will affect reported results. Additional uncertainty due to potential climate-influenced costs will increase the level of judgement required when determining the appropriate total cost estimate. This may require disclosure under IAS 1.125-.129.

Example E illustrates the impacts of climate-risks on the assessment of variable revenue.

Contract costs

IFRS 15.91-.104 provides guidance on the recognition of both costs to obtain and fulfil a contract, as well as their amortisation. Contract assets arise in relation to costs to fulfil a contract, when costs are "*not within the scope of another Standard (for example, IAS 2 Inventories, IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets)*" and they meet all of the following criteria:

a) *"the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);*

b) *the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and*

c) *the costs are expected to be recovered."* [IFRS 15.95]

In certain manufacturing industries, companies may incur significant design, tooling or other costs that will provide economic benefits beyond any current contract term. Provided they meet the criteria above, such costs can be capitalised and depreciated or amortised over time. Where the costs are capitalised in accordance with IFRS 15, the period of amortisation includes anticipated future contracts. Estimating the appropriate amortisation period may be affected by climate-factors if they cause a future increase in obsolescence of these products, the need to rescope and redesign, or more general changes in market demand. In these cases, the assessment of whether "*costs are expected to be recovered*" as well as the appropriate amortisation period (assessed under IFRS 15.99) or subsequent recoverability of the assets (assessed under IAS 36) may become increasingly judgemental, potentially requiring additional disclosure.

Example F illustrates changes in the treatment of contract costs under IFRS 15.

Onerous contracts

Under IAS 37.67, a contract is assessed as onerous when "*the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it*". Increased climate volatility may impact the assessment of total transaction price. For example, influencing renewal assumptions for service contracts, thereby reducing the contract length and hence opportunity to recoup upfront costs.

Example G illustrates a contract that becomes onerous.

IFRS 6

Exploration for and Evaluation of Mineral Resources

IFRS 6 – Exploration for and Evaluation of Mineral Resources

Context

IFRS 6 is a sector-specific standard that provides additional flexibility in accounting for expenditure incurred on the exploration for and evaluation of mineral resources ("E&E" expenditure) [IFRS 6.3-.4] for those in the extractive industry (for example, mining of minerals or fossil fuels). Certain sectors within this industry may be particularly impacted by climate-factors.

The standard does not cover amounts incurred in activities that precede E&E activities (pre-exploration activities) or expenditure after the technical feasibility and commercial viability of extracting a mineral resource is demonstrated (development activities) [IFRS6.5].

The key provisions of the standard relate to:

- accounting policies in relation to the capitalisation or expensing of E&E expenditure; and
- Identifying when there is an indicator of impairment for E&E assets.

The flexibility afforded by IFRS 6 was effected through an exemption from certain requirements in IFRS and was described as 'temporary' when it was issued in 2004. The effect may be that amounts capitalised as E&E may be higher than would be permitted in the absence of the relief and impairment testing of amounts capitalised may be both delayed and performed at a more aggregated level than is required for non-E&E assets.

Accounting policy for capitalisation of E&E expenditure

IFRS 6 provides entities with an implicit accounting policy choice on which E&E expenditures are capitalised or expensed. That policy must result in information that is relevant and reliable and is determined based on the extent to which the type of E&E expense can be associated with finding specific mineral resources. Exceptionally, in determining the policy, an entity is not required to consider the requirements of other IFRSs dealing with similar issues or the definitions and recognition criteria in the Conceptual Framework.

Considering the significant exposure to climate change of sectors such as oil and gas who use IFRS 6, it will be important to consider the accounting policies used to ensure that entities are comfortable that they remain appropriate. IFRS 6 makes it easier to conclude that voluntary change in accounting policies is appropriate, allowing entities to make a change when, "*the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs, judged by the criteria for voluntary changes in accounting policies*" [IFRS 6.13]. The requirement to judge relevance and reliability would preclude a voluntary change that diverges further than the existing policy from the requirements of other IFRSs dealing with similar issues of the Conceptual Framework. In practice, this generally precludes an entity changing its policy to capitalise expenditures that are less closely related to a specific mineral resource – for example towards a policy that might be characterised as "full cost" and away from a policy more consistent with the successful efforts method.

Capitalised E&E expenditure is generally measured at cost less impairment and is classified as tangible or intangible according to its nature.

Impairment of E&E assets

IFRS 6 requires an impairment test immediately before the reclassification of E&E expenditure that occurs when the technical feasibility and commercial viability of extraction becomes demonstrable [IFRS 6.17].

Prior to that date, IFRS 6 provides relief from impairment testing on the basis that there will be insufficient information to make reasonable estimates of recoverable amount as forecast cash flow information necessary to estimate Value in Use or Fair Value less Cost of Disposal will not be available.

Instead, IFRS 6 modifies the application of *IAS 36 Impairment of Assets* to E&E assets to require an impairment test only when there is a change in circumstances. Such a change exists when specific facts and circumstances outlined in the standard indicate an impairment test is required [IFRS 6.19-.20]. The facts and circumstances outlined in IFRS 6.20 are non-exhaustive and are applied instead of the 'indicators of impairment' in IAS 36. Under IAS 36, the entity must consider at each reporting date whether there is a trigger for impairment. Examples of impairment circumstances arising under IFRS 6 could include a climate-driven strategic decision to cease expenditure on further exploration for and evaluation of resources in a particular area, or changes in the commercial viability of an exploration and evaluation asset due to climate-driven changes in market demand or government regulation.

If an impairment test is required, any impairment loss is measured, presented and disclosed in accordance with IAS 36. [IFRS 6.18].

Example H illustrates climate-related impairment of E&E expenditure.

IAS 41

Agriculture

IAS 41 – Agriculture

Context

The impact of climate factors on agricultural activity across the world is expected to be increasingly significant in the coming years. Physical risks (such as higher temperatures, weather variability such as fluctuations in rainfall, and more frequent extreme weather events leading to flooding and forest fires) may be more evident in the agricultural sector, affecting companies who produce crops or products that are especially climate sensitive. Climate change may also reduce crop yields, and lower livestock productivity, impacting companies who produce crops or products at the farm level. The cost of adaptations that stem from climate change (e.g., adaption to hotter summers or warmer winters) could lead to an increase in production costs or could transform the processes by which companies grow agricultural produce. Government action or changing customer preferences may also be expected to play their part in the changes.

IAS 41 is used to account for biological assets, agricultural produce at the point of harvest and government grants related to biological assets [IAS 41.1]. The standard provides guidance on the initial recognition, measurement, and disclosure of these assets. It does not apply to bearer plants (e.g. tea bushes, vines, oil palms) which are accounted for under IAS 16, or to animals or plants that are not subject to a process of management of biological transformation.

The standard is most relevant to companies who are involved in agricultural activities (e.g. fisheries, poultry, plantations etc) or companies that rely on biological assets or agricultural produce as the main input in their manufacturing processes (e.g. food and beverages, textiles, paper mills etc).

Measurement of biological assets and agricultural produce

Under IAS 41, biological assets and agricultural produce are measured at fair value less costs to sell, unless fair value cannot be measured at initial recognition, in which case cost is used. IFRS 13 provides guidance on both the measurement of fair values, as well as required disclosure. IFRS 13 was considered in Supplementary Paper 1. Changes in fair value less costs to sell are recognised in profit or loss. Where there is subsequent expenditure on a biological asset, IAS 41 allows that it is either capitalised or expensed as incurred [IAS 41. B62].

Although there is a presumption that fair value can be measured reliably for a biological asset, that presumption can be rebutted only on initial recognition for a biological asset for which quoted market prices are not available and for which alternative fair value measurements are determined to be clearly unreliable [IAS 41.30]. With the potential for additional uncertainties caused by climate change (e.g. erratic weather patterns), in some circumstances, for example where there is not an effective market, it may become necessary for an entity to rebut the fair value presumption on initial recognition of a biological asset. However, the entity must demonstrate that any fair value measurement is clearly unreliable. If this is applicable, then the general guidance on determining cost, as described in IAS 16 and IAS 2 applies. The general depreciation and impairment considerations are also relevant [IAS 41.33].

Example I illustrates considerations for accounting for biological assets at fair value.

Appendix

Appendix - Illustrative examples

Example	Standard	Topic	Industry
A	**IFRS 16**	Change in lease term	Software provider
B	**IFRS 16**	Identifying a lease	Energy
C	**IFRS 2**	Performance conditions	Retail
D	**IAS 19**	Short term employee benefits	Professional services
E	**IFRS 15**	Variable revenue	Logistics
F	**IFRS 15**	Contract costs	Manufacturing
G	**IFRS 15,** IAS 37	Onerous contracts	Contractor
H	**IFRS 6,** IAS 36	Impairment	Mining
I	**IAS 41,** IFRS 13	Fair value of biological assets	Forestry

Example A – Change in the assessment of lease term

Background

S Co, a large cloud-based software provider entered into a 15-year lease agreement with a third party for a data centre in the UK. There are break clauses at the end of year 5 and year 10. However, as the costs and disruption to switch data centres are deemed significant, and the software provider has long- term licencing arrangements spanning on average 11-14 years, following the principles of IFRS 16.18, at the start of the lease, the lease term is assessed to be 15 years. As the rate implicit in the lease cannot be calculated, S Co uses the incremental borrowing rate to calculate the lease liability.

After 3 years of the lease, S Co makes a commitment to be net zero in its operations and data centres by 2030. Its published net-zero transition plan requires significant changes to be made, particularly in relation to energy use in the data centres. Based on cost-benefit analysis, management identified that it may be more cost effective in the long term to relocate the data centre to an existing renewables powered facility in Iceland, rather than providing the UK data centre with access to renewable electricity. Following this significant change in circumstances, management decide that it is necessary to reassess their judgement around whether they would exercise the break clause. They determine that the benefits from reducing their emissions as well as projected future energy costs outweigh the temporary disruption from the change in location.

Application of accounting standards

Under the initial assessment at the start of the lease, following IFRS 16.18, S Co determined that it was reasonably certain that they would not exercise either of the termination options. This was based on the facts and circumstances available at the time around the economic incentive not to terminate. The lease term was assessed to be 15 years. The lease liability was measured as the present value of minimum lease payments for the full 15 years, discounted at the incremental borrowing rate. They disclose the significant judgement made around the lease term in the leases note.

Subsequently, in compliance with IFRS 16.20, management reassess that they are likely to exercise the break option, reflecting that it is in their control to set the new decarbonisation strategy and choose to use a location with better access to renewable power. They conclude that the circumstances which drove them to change their judgement on the lease term (i.e. the confirmation of that new strategy) did not exist when the lease was first created.

The lease liability is remeasured, following IFRS 16.39-.40, discounting the remaining lease payments for years 4 and 5 at a revised discount rate. This results in a significant decrease in both the recognised lease liability, and a corresponding adjustment to the right of use asset.

Illustrative disclosures

The software provider discloses the reason behind the change in judgement and makes other relevant disclosures required by lessees in accordance with IFRS 16.53-.60.

Example B – Identifying a lease

Background

To demonstrate its commitment to the government's transition roadmap to a lower carbon economy by 20X0, an energy retailer, Company X, enters into a 25-year contract to purchase all of the electricity produced by a new solar farm which is owned by Company Y.

The contract specifies that Y cannot supply electricity to X from another farm other than the solar farm explicitly specified in the contract (i.e. there is no substitution right).

In addition, Company Y will receive tax credits relating to the construction and ownership of the solar farm while Company X will receive renewable energy credits that accrue from use of the solar farm.

Company X designed the solar farm, including selecting its location, and can determine whether the assets are used (within the periods when the conditions are appropriate for the windfarm to operate).

X must assess whether the agreement contains a lease.

Application of accounting standards

IFRS 16.9 states, "*a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration*".

However, to assess whether a contract conveys the right to control the use of an identified asset for a period of time, IFRS 16.B21 states "*a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realised from a commercial transaction with a third party*".

Based on the above guidance, Company X concludes that it has the right to obtain substantially all of the economic benefits from use of the solar farm over the 25-year period because it obtains:

- The electricity produced by the solar farm over the lease term - i.e. the primary product from use of the asset; and
- The renewable energy credits - i.e. the by-product from use of the asset.

Although Y receives some economic benefits from the solar farm in the form of tax credits, these economic benefits relate to the ownership of the solar farm. The tax credits do not relate to use of the solar farm and therefore are not considered in this assessment.

In addition to obtaining all of the economic benefits, Company X determines that it has the right to direct the use of the solar farm, because it was able to pre-determine how and for what purpose the solar asset will be used by deciding the design and location of the solar farm.

Based on this analysis, X concludes that the contract with Y contains a lease and therefore accounts for it in accordance with the requirements of IFRS 16.

Illustrative disclosures

Extensive disclosures are required by lessees. These are addressed in IFRS 16.53-.60.

Example C – Climate-related performance conditions in a share-based payment arrangement

Background

A retailer has relaunched its long-term incentive plan (LTIP) to support its updated strategy of achieving net zero carbon emissions by 2050.

Under the new LTIP, executive directors and senior management are granted rights to receive free shares on vesting (awards) which is normally after three years, to the extent that performance conditions are achieved, and the individuals remain in employment with the company. The new LTIP includes a performance condition linked to the company's net zero commitment, the 'Zero Carbon Ambition'. The other performance conditions are otherwise consistent with past grants of similar LTIP awards.

The new LTIP has performance conditions and weightings as set out in the table below.

Performance condition*	Weighting	Target (80% vesting)	Maximum (100% vesting)
Relative TSR	35%	Median	Upper Quartile
ROCE	35%	7.25%	9.75%
Cumulative free cash flow	25%	£1,000m	£1,500m
Zero Carbon Ambition	5%	50% reduction	60% reduction

*These are for illustration purposes only. It is assumed that detailed information about the performance conditions is available.

The terms of the plan are such that the percentage weighting of the award assigned to a particular performance condition will vest upon satisfaction of that performance condition and the service condition. The vesting of the percentage weighting of the award assigned to the particular performance condition is independent of the other performance conditions.

Application of accounting standards

Following the definitions in IFRS 2 Appendix A, the company will account for the arrangement as an equity-settled share-based payment transaction as it is receiving employment services in exchange for granting the awards over its shares.

As the vesting of the proportion of the award assigned to each performance condition is independent of the other performance conditions, each of the 'weightings' is treated as a separate award and accounted for separately.

5% of the awards granted are subject to the Zero Carbon Ambition performance condition and are treated as a separate award for accounting purposes. The vesting of this award is subject to achieving the Zero Carbon Ambition 'target' as a minimum and meeting the service condition of three years.

The Zero Carbon Ambition condition meets the definition of a non-market performance vesting condition because it is related to specific performance targets associated with the company and is unrelated to the market price of the company's shares [IFRS 2. Appendix A]. Following IFRS 2.19, this condition is therefore not reflected in the grant-date fair value. Instead, it is considered in estimating the number of awards that are expected to vest and for which a share-based payment charge should be recorded.

In future years, the amount recorded will be adjusted if subsequent information indicates that the number of awards expected to vest differs from previous estimates, and to reflect the number of awards that eventually vest. On a cumulative basis, no amount is recognised for the employment services in respect of the 5% of award granted if the Zero Carbon Ambition 'target' is not met.

Illustrative disclosures

In the financial statements in the first year of the new scheme, the company discloses a description of the new equity settled LTIP scheme, including its service and performance conditions, maximum term of the arrangements and number of awards granted. Where material, the company separately identifies the number of awards granted that are subject to the Zero Carbon Ambition performance target and the maximum term attributed to such award.

It also includes discussion of how the grant-date fair value of the awards was calculated. Whilst climate factors could influence the volatility considered in this calculation, the climate-related performance criterion is not included.

The entity also discloses the share-based payment charge for the year relating to the new LTIPs. Where material, the company separately discloses the share-based payment charge for the awards that are subject to the Zero Carbon Ambition target.

Example D – Short-term employee benefits

Background

A professional services firm commits to reducing its emissions from employee and business travel by 50% over the next three years. To achieve this target, the firm has introduced several new initiatives, including introducing an electric car scheme for all employees. Under the new scheme, eligible employees will benefit from an electric car of their choice or can receive a cash alternative.

Application of accounting standards

Short-term employee benefits are those expected to be settled wholly before twelve months after the end of the annual reporting period during which employee services are rendered, but do not include termination benefits [IAS 19.8]. IAS 19 requires the company to recognise the undiscounted amount of the benefits expected to be paid in respect of the service rendered by employees in an accounting period in that period [IAS 19.11].

All eligible employees can choose an electric company car, or alternatively choose no car and receive a cash alternative. In order to incentivise employees to take up the scheme, the cash alternative is lower than the value of the cars available.

The company recognises an increase of £1m in the salaries and wages for the financial year in accordance with IAS 19, representing the annual value of vehicles provided plus total cash alternatives taken.

Illustrative disclosures

The company discloses employee benefits expenses in its financial statements in accordance with IAS 1.

IAS 19 does not require specific disclosures about short-term employee benefits. However, other IFRSs may require disclosures - for example, IAS 24 requires disclosures about employee benefits for key management personnel.

Example E – Variable revenue

Background

A logistics company signs a 10-year contract to manage a warehouse on behalf of its customer. The contract does not meet the definition of a lease. The logistics company agrees to performance clauses that allow for penalties to be incurred if minimum standards are not achieved for despatch times.

Application of accounting standards

The company assesses the contract and identifies that there is a single performance obligation to deliver service across 10 distinct time-periods. It concludes that the contract includes variable consideration.

Based on historical performance on similar contracts, when initially calculating the constrained transaction price, the company concluded that material penalties were highly unlikely to be incurred for failing to meet despatch times. It was assessed that it was highly probable that a significant reversal of revenue would not occur if the amount of penalties being faced was assumed to be nil [IFRS 15.56].

The company assessed the total anticipated costs to deliver the contract and used a percentage of completion method to recognise revenue over time. In the first year of delivery of the contract, the company incurred 12% of the anticipated total costs, recognising 12% of the total transaction price as revenue.

In year 2, the company faced material penalties for failing despatch time targets when local flooding caused significant access delays after a local bridge was weakened. A flood risk survey performed suggested that there was a non-trivial risk of local flooding becoming a more regular event within the next 10 years. They reassessed the assumption that penalties would not be incurred and reduced the total forecast transaction price accordingly, recognising a decrease in revenue recognised to date accordingly.

Illustrative disclosures

Extensive disclosures are required in relation to revenue contracts. These are addressed in IFRS 15.110-.129. In this example, where material, the change in assumption may require additional disclosure under various requirements including, but not limited to:

- IFRS 15.118 - where the assumption leads to a significant change in a contract asset or contract liability;
- IFRS 15.120 - where there is a change in the transaction price allocated to remaining performance obligations;
- IFRS 15.123 - where the assumption that penalties would not be incurred is deemed to "*significantly affect the determination of the amount and timing of revenue from contracts with customers*"; and
- IFRS 15.126 – since this requires disclosure of the methods, inputs and assumptions used to calculate the transaction price.

Example F – Accounting for contract costs

Background

A manufacturer designs a new component for gas boilers on behalf of its customer and signs a contract to sell an undetermined number of units of the product over time. The purchaser shares forecast unit orders which would be received over an estimated 15-year production run.

Application of accounting standards

Whilst there is significant bespoke design work completed prior to the delivery of the first unit, management assess that following IFRS 15.25, the design phase is not a performance obligation because there is no good or service transferred to the customer. Instead, management assess that the costs meet the definition of costs to fulfil a contract under IFRS 15.95, and they are capitalised and amortised over a period that includes the anticipated future contracts arising from further orders, which is estimated as 15 years.

After 5 years of the contract, the government introduces new climate legislation which mean that the design of the component will become obsolete. The manufacturer reduces the number of units forecast to be sold. They reassess the amortisation profile and conclude that it should be accelerated. The amortisation charge is adjusted prospectively. Management reassess the recoverability of the contract asset. Following IFRS 15.101, management assess that the remaining amount of consideration that they expect to receive will remain higher than the costs that relate to manufacturing the components that have not been recognised as expenses. As such, there is no impairment to the contract asset.

Illustrative disclosures

Extensive disclosures are required in relation to revenue contracts. These are addressed in IFRS 15.110-.129.

Example G – Onerous contract

Background

A contractor, C, enters into long term contracts with customers for repair and maintenance services. The average contract term is between 10 - 15 years. Due to the physical and transition impacts of climate change within its supply chain, the costs of certain parts sourced and used by the contractor in its business are forecast to increase significantly in the next decade.

C considers an existing 10-year repair and maintenance contract (5 years remaining) with a government agency and determines that the increased costs in spare parts may not be recouped from the agency.

C needs to reassess its current recognition of revenue.

Application of accounting standards

The contractor recognises revenue under the contract over time, based on the percentage of total anticipated costs incurred to date.

At the end of year 5 of the contract, C reassesses its assumptions around the total costs to complete and total revenue to be received and identifies significant additional unavoidable costs to deliver the contract. Following this reassessment, as the total estimated transaction price still to be received is lower than the total unavoidable costs required to complete the contract, the company assess that the contract is onerous.

As defined under IAS 37, *"an onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be* *received under it*" [IAS 37.10]. "*If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision*" [IAS 37.66].

A provision is therefore recognised by C for the excess of the unavoidable costs of meeting its obligations under the contract over the economic benefits expected to be received under it [IAS 37.10]. The contractor considers whether the fact that the contract became onerous was driven by climate-related additional costs would be material information to disclose.

Illustrative disclosures

Extensive disclosures are required in relation to revenue contracts under IFRS 15.110-.129 as well as for provisions arising from onerous contracts under IAS 37.

In some cases, the judgements and estimates surrounding the accounting for onerous contracts are material to include under IAS 1.122-.125.

Example H – Impairment of Exploration and Evaluation Expenditure

Background

A thermal coal mining company capitalises as intangible exploration and evaluation ("E&E") assets the costs of drilling rights, acquired rights to explore, costs of conducting topographical, geological, geochemical and geophysical studies, exploratory drilling costs, trenching costs, sampling costs and costs of evaluating the technical feasibility and commercial viability of extracting a mineral resource. Their capitalisation policy is based on a "successful efforts" technique, where costs are capitalised on a field-by-field basis with an assessment of commercial viability of the fields performed on an annual basis.

Following a review of the company's strategy and long-term viability in the context of increasing pressure from its major shareholders as well as environmental NGOs, the company's directors determine that they will complete work on existing fields but will halt exploratory activities specifically in relation to projects where no exploratory drilling has yet commenced. Prior to this decision, qualifying E&E expenditure in relation to all existing projects (including those where exploratory activities will be stopped, and those that will continue) has been recognised in the balance sheet as intangible E&E assets.

Application of accounting standards

Under IFRS 6.18, "*exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. When facts and circumstances suggest that the carrying amount exceeds the recoverable amount, an entity shall measure, present and disclose any resulting impairment loss in accordance with IAS 36*".

The company identifies an impairment trigger for the previously capitalised E&E expenditure in relation to halted fields because "*substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned*" [IFRS 6.20c]. The recoverable amount is assessed to be negligible and the previously capitalised costs are expensed, following the principles of IAS 36.

The company also considers whether there is any impairment trigger for capitalised expenditure in relation to fields where exploration and evaluation will proceed. Taking into account a range of factors, including, but not limited to, potential changes in future legislation around coal extraction, estimates of future global carbon prices and customer demand, their own projected access to finance, and increasing disruption to exploratory operations from climate activists, the company determines that there is an impairment trigger for these assets. The company estimates the recoverable amounts, and measures, presents and discloses any resulting impairment losses in accordance with IAS 36.

Illustrative disclosures

The company discloses the amount of impairment losses recognised in profit or loss during the period and the line item of the statement of comprehensive income in which the impairment loss is included. The company also discloses the events and circumstances that led to the recognition of the impairment loss, the recoverable amount and how that recoverable amount was determined.

Refer to IAS 36.126-.133 for full disclosure requirements

Additional considerations

The company's change of strategy may also have other implications on the financial statements which are not discussed above. Such considerations may include assessing the timing and amount of decommissioning obligations, adjustments of useful economic lives (UELs) of existing assets as well as consideration of IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*.

Example I – Determining the fair value of biological assets based on significant unobservable inputs

Background

A multinational group manufactures paper and packaging products. The primary raw material for the paper manufacturing process is wood fibre, sourced from newly harvested trees, including from its own forestry assets.

The group owns hectares of plantation forests across North America, Australia, and Indonesia. These forest assets are recognised as biological assets in the group's financial statements. The group's accounting policies explain that biological assets consist of standing timber, which is measured at fair value less cost to sell. Changes in fair value resulting from both net growth and change in the market value of standing timber are presented in the income statement.

The fair value measurements of the forest assets (standing timber) have been categorised as Level 3 fair value based on inputs to the valuation techniques used.

Based on research, the group understands that catastrophic wildfires fuelled by severe drought are increasingly more likely to occur in key geographies that the group operate in, driven by climate change. In addition, governments in many jurisdictions where the group operates are proposing to tighten policies on deforestation in a bid to combat climate change, potentially increasing the value of sustainably sourced paper and packaging products.

Application of accounting standards

The group measure its biological assets at fair value, both initially and at each period end [IAS 41.12]. Subsequent expenditure is expensed as incurred, in line with the company's policy and IAS 41.B62.

When measuring fair value, IFRS 13.11 requires an entity to consider "*the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date*". Such characteristics include, for example, the condition and location of the asset and restrictions, if any, on the sale or use of the asset.

Given the increased fire risks, the group adapts its model for calculating the fair value of its forest assets. The model continues to make use of the group's own estimates of yield, as well as observable futures markets prices for timber, correlated against its own model for forecasting future prices. The modelling considers both anticipated changes in demand for paper products in its key sales markets as well as assumptions around the global yields of forestry assets. This is because physical climate risks impact the viability of existing producing locations, and government legislation also changes the costs faced by producers and demand for sustainable products.

Illustrative disclosures

The group discloses the carrying amount for the standing timber including a reconciliation of changes in the carrying amount of the biological asset [IAS 41.49-.50].

IFRS 13 requires disclosures in a tabular format for recurring fair value measurements held within Level 3 of the fair value hierarchy. This includes the fair value measurement at the end of the reporting period; the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3); a description of the valuation technique(s) and the inputs used in the fair value measurement; quantitative information about the significant unobservable inputs used in the fair value measurement as well as a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period [IFRS 13.93].

Fair value hierarchy:

The fair value measurements for the standing timber have been categorised as Level 3 fair values based on the inputs to the valuation techniques used.

Valuation techniques and significant unobservable inputs:

The following table shows the valuation technique used in measuring Level 3 fair values as well as the significant unobservable inputs used.

Asset type	Valuation technique	Significant unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Standing timber	Discounted cash flows: The valuation model considers the present value of the net cash flows expected to be generated by the plantation. The cash flow projections include specific estimates for [x] years. These cash flow predictions include assumptions and estimates around the impact of climate-factors. The expected cash flows are discounted using a risk-adjusted discount rate. In this case, as the cash-flows were adjusted for the impact of climate risk, the discount rate was not adjusted.	• Estimated future timber market prices [x]/tonne. This is a weighted average price and considers key assumptions and estimates around the physical and transition climate risks which were identified by management. • Estimated yields [x]/hectare. As above, this is the weighted average yield and takes cognisance of the critical estimates and judgements around the impact of climate change on the Group's forest assets. • Estimated harvest and transportation costs [x] • Risk adjusted discount rate [x]%.	The estimated fair value would increase (decrease) if: • The estimated timber prices were higher (lower) • The estimated yields per hectare were higher (lower) • The estimated harvest and transportation costs were lower (higher) or • The risk adjusted discount rate were lower (higher).

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