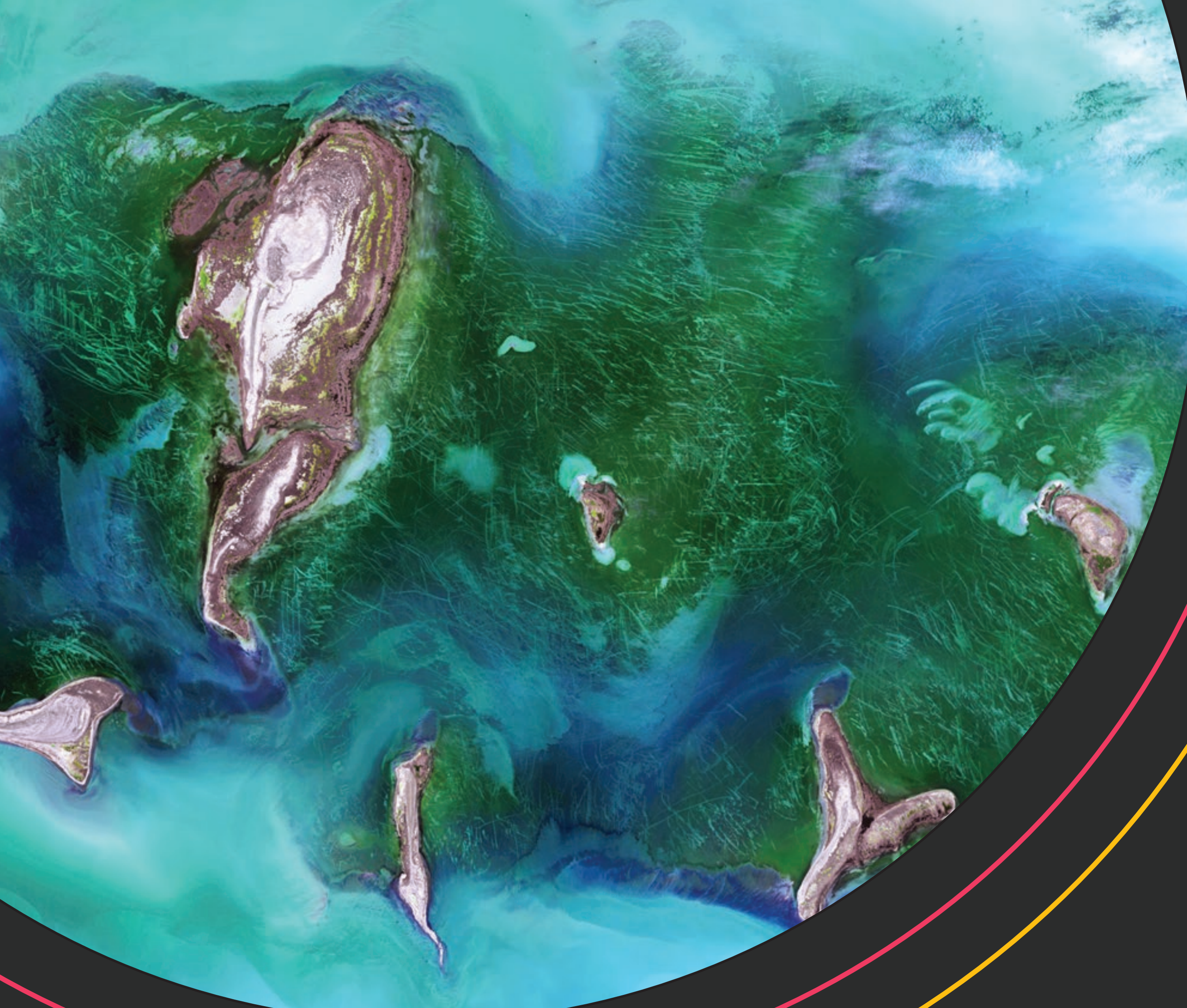

How is the impact of climate change reflected in the financial statements of the NZX50?

An analysis of NZX50 31 March 2022 reporters

pwc

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Climate change is a key concern for investors

Environmental, Social, Governance (ESG) factors are now one of the key considerations for many stakeholders including investors. Climate risk, in particular, is a focus area with a number of investor groups becoming increasingly vocal about how the impacts of climate change are reflected in financial statements.

In this report, we have reviewed the annual reports of 31 March 2022 NZX50 reporters and examined:

- how climate-related impacts on the financial statements were disclosed
- how auditors considered climate-related impacts in key audit matters (KAMs).

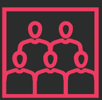
Key findings:

15 businesses on the NZX50 with March year ends have completed their financial reporting.

3 reporters discussed the impact of climate-related risks in their financial statements.

0 businesses included a quantification of the impacts of climate risk in the financial statements.

9 reporters included some non-financial climate-related information.



7 entities included non-financial climate related information in the front-half of their annual report and 2 businesses published this information in a separate sustainability report.

4 companies mentioned the use of green finance.

2 reports included mention of climate change in KAMs.

How are New Zealand reporters responding to climate risks?

Currently, information on how climate change impacts the financial statements of businesses is rare with only three reporters out of 15 including any details. When information is provided, it is often a brief statement saying that climate change is not material to the financial statements without a clear explanation about why that is the case.

In the three reporters' financial statements that mentioned climate risk, it was included in relation to:

- property valuation (two reporters)
- financial risk management (one reporter).

Also, none of the companies we reviewed included a quantification of the impacts of climate risk or made an adjustment to the numbers in the financial statements.

However, climate-related risks actually have a broad impact on the financial statements. Depending on what your business is, your supply chain, customer base and physical location (among other criteria) could be impacted.

Regulators around the world have become vocal on this topic. Where there has been no mention of climate change at all, within estimates and judgements for example, management should make sure that it has been validated that there is no impact.

The role of green finance

Of the 15 reporters we examined, four mentioned the use of green finance.

Finance plays a key role in funding green initiatives and we are seeing a rise in so-called 'green finance'. However, it is difficult to tell whether the funding disclosed by the companies we reviewed are labelled 'green' because the funds were used for green initiatives, or because the coupon payable on the borrowing is linked to sustainability KPIs to incentivise the borrower to meet its sustainability goals.

Is climate-related information material to investors?

When considering what climate change information is material, it's important for businesses to reflect on whether investors could reasonably expect that climate-related risks could affect the amounts and disclosures in the financial statements. Similarly they should think through whether they have indicated the importance of the information in their decision making. For example, the conclusion may be that climate change is not expected to cause a material impairment charge even if cash flow forecasts include the impacts of climate risk.

Equally, climate change may only be expected to be quantitatively material in the future, but may not have an effect on the current period's balance sheet.

Disclosing this information may be useful to the users of the financial statements when they are trying to assess how climate change might impact a company.

If information is not in the financial statements, is it included elsewhere?

As a result of growing stakeholder expectations globally, but also here in New Zealand, we are seeing an increase in the inclusion of climate-related information in the 'front-half' of annual reports. Organisations are starting to lay out a road map to their transition to a lower carbon economy.

More than half of the reporters (nine out of 15) provided some level of non-financial climate-related information outside the financial statements. Seven entities included this information in the front-half of their annual report and two businesses published this information in a separate sustainability report. Most did so without mentioning how those risks and opportunities were reflected in the financial statements. There were also two different frameworks used to report against.

Framework used in sustainability reports	Number of entities
Taskforce on Climate-related Disclosures (TCFD)	4
Global Reporting Initiative (GRI)	2
TCFD and GRI	1
Does not specify	2

Around the world we are seeing many companies make net-zero commitments. New Zealand companies are following suit to a lesser extent. Apart from investors, this trend has been partly driven by governments taking steps to motivate the private sector – something that might come into play more with the introduction of New Zealand's emissions reduction plan, recently published by the Government. This describes how this country is going to meet emissions budgets and make progress towards meeting New Zealand's 2050 emission reduction target. We would therefore expect greater reporting of a company's net-zero commitments and how it plans to get there in future annual reports.

We have seen rapid developments in the non-financial reporting space over the past year. This will likely drive better disclosures in financial statements as companies get a better grip on the climate-related risks and opportunities facing their organisation and as they develop plans to address these.

For a while now, a number of different frameworks have been released that companies could follow voluntarily to make disclosures in their annual reports on ESG. What's changed in the past 12 months or so is that governments, regulators and supranational organisations like the EU are starting to impose or expand mandatory requirements. This should help with consistency within a jurisdiction but not comparability between them.

However, in the last year, the International Financial Reporting Standards Foundation (IFRS) established the new International Sustainability Standards Board (ISSB). The ISSB is progressing with the development of standards that are seen as a major step towards developing a global, consistent baseline for sustainability reporting standards. These standards will be expected to address sustainability more broadly. The first exposure drafts address climate risk, unsurprisingly, given that investors have said there is an urgent need for information on this issue.

Climate-related Disclosures in New Zealand

Earlier this year, the Government passed legislation to mandate climate-related disclosures for publicly listed companies and large Financial Market Conduct (FMC) entities. The new reporting standards are currently being developed by the External Reporting Board (XRB) in line with the TCFD Framework and will require organisations to assess the risks and opportunities of climate to their business across four thematic areas: governance, strategy, risk management, and metrics and targets.

The disclosures are expected to be required for financial years commencing in 2023. Although this disclosure is not yet mandatory, only two companies disclosed in their financial statements that they will have to apply these standards in a relatively short period of time. Five other reporters mentioned this fact outside of the financial statements in their non-financial disclosures.

We recommend that directors and management teams stay up to date with the climate-related disclosures framework as it evolves.

What are auditors considering?

Key audit matters (KAMs) provide transparency about the matters that, in the auditor's judgement, were of most significance in the audit of financial statements. If climate change is of significance, you would expect the auditor to reference this in KAMs.

If companies have not included discussion about climate risk in the financial statements then an auditor would be unlikely to note it in a KAM.

Therefore it is not surprising that only two of 15 auditors mentioned climate change in KAMs. In both cases the KAM related to the valuation of investment property. These were in the audit reports of the financial statements noted earlier, where climate risk disclosures were included in the valuation of investment property notes. Given the reporters had only limited reference in the financial statements, the auditor included a passing reference in the KAM to climate risk. For example, the auditor had held discussions with management and external valuers to understand the impact of climate change and related risks on the property portfolio.

How to enhance climate risk disclosures in financial statements

Finance teams should engage internally with other parts of their organisation to get a good understanding of the climate risks faced by the organisation and the plans in place to address these. This will help in gaining a better understanding of what a business needs to factor into measurement of assets or liabilities or provide disclosure for.

It is also important to consider the consistency and proportionality between financial and non-financial disclosures, and make judgements and assumptions on a consistent basis whether for non-financial or financial reporting.

Finally, companies should focus on quality of insight, rather than quantity, to ensure they give stakeholders the information they need.

Contacts

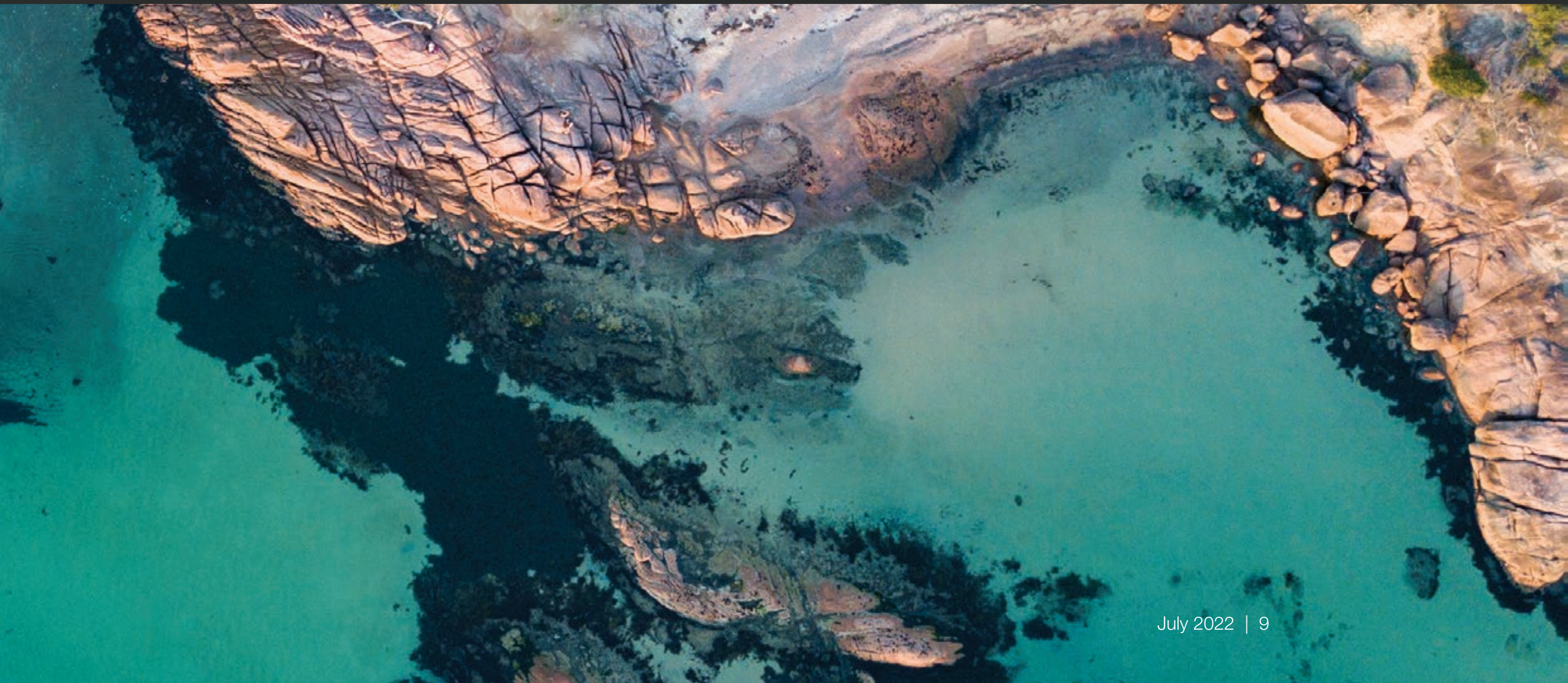
Karen Shires
Chief Risk and Reputation Officer
karen.f.shires@pwc.com
+64 21 501 043

Jonathan Skilton
Partner
jonathan.m.skilton@pwc.com
+64 21 355 879

Tiniya du Plessis
Partner
tiniya.b.du.plessis@pwc.com
+64 21 495 856

Mariann Trieber
Executive Director
mariann.m.trieber@pwc.com
+64 210 621 812

Ciara O'Keeffe
Manager
ciara.n.okeeffe@pwc.com
+64 210 843 0780



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