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

An analysis of NZX50 30 June 2022 reporters

pwc

September 2022

Following our earlier report looking at how climate change was reflected in the financial statements of NZX50 March reporters, we analysed NZX50 companies reporting in June. Similar to our first report, we examined both how climate-related impacts on the financial statements were disclosed and how auditors considered climate-related impacts in key audit matters (KAMs).

This report comes at a time when there is increasing interest from investors and regulators in how companies are handling Environmental, Social, Governance (ESG) factors and how the impacts are reflected in financial statements.

Several of the companies reporting in June are from sectors that will be significantly impacted by climate change e.g. energy and transport. Is this evident in their financial reports?

Key findings:

21 businesses on the NZX50 with June 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 (physical or transition risks).

19 reporters included non-financial climate-related information outside of the financial statements.

3 reporters mentioned upcoming climate-related financial disclosures in their financial statements while 11 mentioned this in the front-half of their annual report or in a separate sustainability report (outside the financial statements).

6 businesses noted the use of green finance.

3 audit reports included mention of climate change in KAMs.

How did NZX50 June reporters respond to climate risks?

Information on how climate change impacts the financial statements of businesses continues to be rare with only three June reporters out of 21 including any details (for 31 March 2022 NZX50 reporters, three out of 15 included details of the impact of climate-related risks in their financial statements). However, on the bright side, those that have included details of their considerations tended to go into more detail than what we saw in the financial statements of March reporters.

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

- property valuation (two reporters)
- impairment testing of intangible assets (one reporter).

It is not surprising to see that these reporters are more mature in their thinking about potential climate-related impacts on their financial statements. All three are from sectors that are considered among the most vulnerable to climate change (two from the energy and one from the transport sector).

Similar to the March reporters, none of the June reporters we reviewed quantified the impacts of climate risk or made an adjustment to the numbers in the financial statements.

As large NZX listed companies (those whose quoted equity securities' combined market price exceeds $60 million) are going to have to comply with the External Reporting Board's (XRB's) new Climate-related Disclosure Standards starting next year, we expect that the thinking of these entities will mature as they prepare to report under those standards. And in line with that, we expect to see more discussion about how climate-related risks and opportunities impact the financial statements of these businesses.

Climate-related risks actually have a broad impact on financial statements. Depending on the business' supply chain, customer base and physical location (among other criteria) there are many ways in which the financial statements could be affected. We just have to look at the recent extreme weather events in the West Coast, Canterbury and Napier to see the physical risks that the changing climate poses.

However, we are still learning about how climate change might impact our sea levels, climate and weather. So, it is likely that the quantification of the potential impact of these physical risks in most entities' financial statements will continue to evolve as entities develop a better understanding of these risks.

Transitional risks of climate change, such as changes in customer behaviour or government policy to encourage greener, and more environmentally friendly behaviours, might eventuate earlier than the physical impacts of climate change. Therefore, we may see quantification of the impacts of transitional risks of climate change before we see the quantification of physical impacts.

In the meantime, we hope to see more qualitative disclosures, as a minimum, to help investors understand the impact of climate-related matters on the reporting entity.

What does the FMA say?

In New Zealand, the Financial Markets Authority (FMA) published its 'Approach to oversight of financial statements' in July 2022. The FMA states that regulated entities should not only consider climate change when applying accounting standards, but also its likely effect in the context of the financial statements (taken as a whole). This includes the level of disclosures relevant for investors to understand the impact of climate-related matters on the reporting entity, if that impact is assessed to be material.

The FMA said that in its financial reporting reviews it will focus on:

- entities' assessment of climate change and its effect on their financial statements; and, where relevant, entities' consideration of climate-related matters when applying accounting standards including level of disclosures; and
- consistency between the information presented outside of the financial statements relating to climate change and the financial statements.

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.

What's the role of green finance?

We are seeing green finance continuing to play a key role in funding initiatives. Of the 21 reporters we examined, six noted the use of green finance (compared to four out of the 14 March reporters we reviewed earlier this year).

There is a mix of different types of green finance, with some labelled 'green' because the funds were used for related initiatives, or because the coupon payable on the borrowing is linked to sustainability KPIs to incentivise the borrower to meet its sustainability goals.

Is the information included anywhere else?

Climate-related information is increasingly included in the 'front half' of annual reports in an effort to address growing stakeholder expectations. This also gives businesses a way to outline their approach to transitioning to a low carbon economy.

Substantially all June reporters (19 of 21 in June, compared to eight of 14 in March) provided some level of non-financial climate related information outside the financial statements. 17 entities included this information in the 'front half' of their annual report. Two businesses published this information in a separate sustainability report. Similar to the March reporters, those in June also used a mix of different frameworks to report against.

Framework used in sustainability reports	Number of entities
Taskforce on Climate-related Disclosures (TCFD)	7
Global Reporting Initiative (GRI)	2
TCFD and GRI	7
Does not specify	3

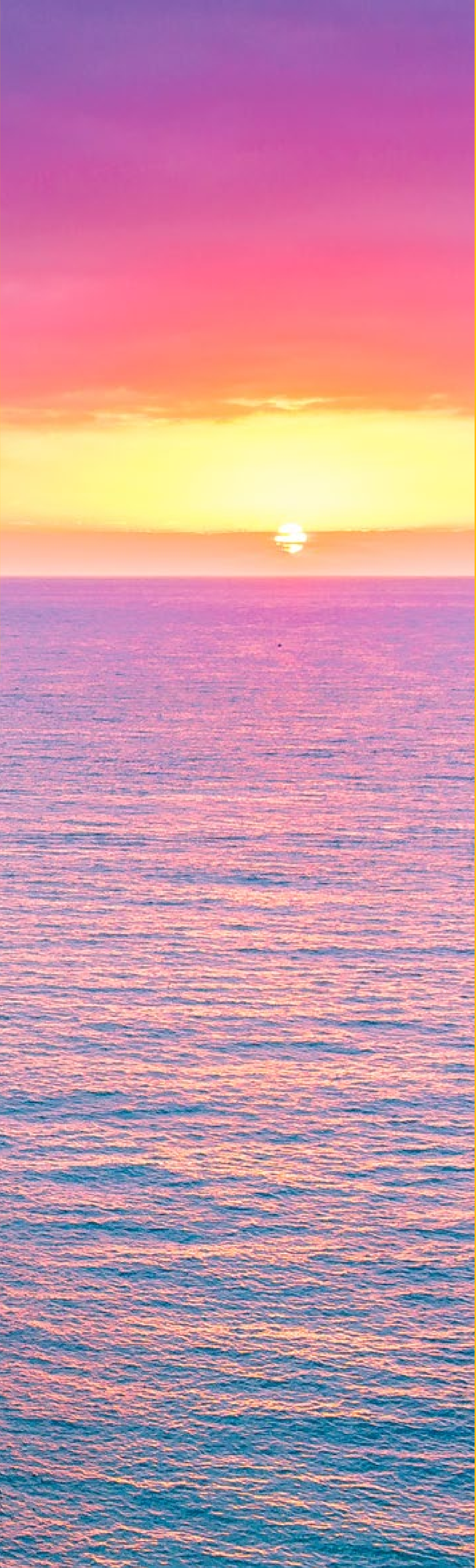
We continue to see rapid developments in the non-financial reporting space. This will likely drive better disclosures in financial statements as companies get a better grip on the climate-related risks and opportunities facing their organisation and as they develop plans to address these. As we stated in our previous report, governments, regulators and supranational organisations like the EU are starting to impose or expand mandatory requirements with particular frameworks being required. This will help comparability within a jurisdiction. However, until there is a common global standard, it will be difficult to compare across jurisdictions.

What's the state of climate-related disclosures in New Zealand?

New reporting standards are currently being developed by the XRB in line with the TCFD Framework and will require organisations to assess the risks and opportunities of climate change 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, 14 of the 21 reporters mentioned this fact (three in the financial statements and 11 in their non-financial disclosures). Clearly entities are starting to prepare for the implementation of the Aotearoa New Zealand Climate Standards.

As comparatives will be required, we recommend companies start thinking about this reporting now.



How are auditors responding?

Only three of the 21 audit reports mentioned climate change in key audit matters (KAMs). In two instances the KAM related to the valuation of property. In the other, it related to the impairment assessment of intangible assets. These KAMs were in the audit reports of the same three entities who had made climate risk disclosures in the financial statements.

This is important because KAMs show where auditors applied the most effort and/or judgement in the financial statements and provide transparency. Auditors should reference climate risk in KAMs if it is of significance to the financial statements. With very little discussion of climate risk in the financial statements, it's not surprising this is not being carried through into KAMs currently.

Enhancing climate risk disclosures in financial statements

We encourage finance professionals to take the opportunity to upskill in this very important area. There are many resources available including our web page designed to help navigate the financial reporting challenges arising from climate change, and the XRB's web page dedicated to its climate-related disclosure framework.

It is critically important that finance teams engage with others in their organisation to get a good understanding of the climate risks faced by their organisation and the plans in place to address these. This can then be factored into measurement considerations or in disclosures.

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