Climate change impact and the NZX50: evaluating financial reports and responses to new climate-related disclosure requirements

An analysis of NZX50 December 2023 reporters

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In this publication we continue our investigation into NZX50 companies and their preparation to adopt the Aotearoa New Zealand Climate Standards (NZ CS). We explore the disclosure of climate-related risks in financial statements and how auditors considered climate-related impacts in key audit matters (KAMs).

This report looks at NZX50 December 2023 reporters. Importantly, these reporters were the first to mandatorily prepare their climate-related disclosures (CRD) in compliance with the NZ CS issued by the External Reporting Board (XRB).

This report follows our earlier analysis of March, June and July to December 2022, and March and June to September 2023 reporters.

Overall key findings (compared to December 2022 NZX50 reporters):

6 (2022: 6) businesses on the NZX50 with December year ends have completed their financial reporting.

3 (2022: 2) reporters discussed the impact of climate-related risks in their financial statements.

1 (2022: 1) business disclosed the use of green finance.

2 (2022: 1) audit reports mentioned climate change in KAMs.

3 businesses quantified the impacts of the 2023 extreme weather events (2 in the financial statements and 1 outside of the financial statements in the annual report).

4 businesses discussed the 2023 extreme weather events (2 in the financial statements and 2 outside of the financial statements in the annual report).

Key findings from the first climate-related disclosures (CRD):

3 reporters published their first CRD in accordance with the Aotearoa New Zealand Climate Standards at the same time as their financial statements.

3 reporters published their CRD as a separate document, after publishing their annual report.

All reporters took the exemption of not quantifying the impact of risks and opportunities in their CRD statement.

3 reporters had a combination of reasonable or limited public assurance.

An overview of NZX50 December 2023 reporters

Our review revealed that a larger proportion of reporters mentioned climate change in their financial statements compared to last year. Among the reporters who commented on the effect of climate-related matters in their financial statements, most concluded there were no material impacts on the financial statements from climate-related matters.

This is despite all reporters making commitments to reduce carbon emissions, and three reporters identifying specific financial statement line items that were impacted by Cyclone Gabrielle, an extreme weather event. These included impairment of goodwill, insurance proceeds, property, plant and equipment revaluation loss, government grants and capitalised costs.

While we have observed reporters moving away from a passing mention of climate in the financial statements and providing more helpful disclosures, the discussion of financial reporting impacts of climate-related matters remains brief overall.

What are we seeing in the first CRD statements?

It may take time to develop the capability to produce high-quality climate-related disclosures. Therefore, it is not surprising that three out of the six December 2023 reporters did not publish their CRD at the same time as their annual reports. Instead, they released a separate statement almost four months after their reporting date.

To address the challenges associated with the adoption and implementation of NZ CS, the XRB is taking a phased approach, providing exemptions to certain disclosure requirements in the initial three reporting periods. These exemptions include not disclosing current and anticipated financial impacts in the first CRD reporting period[1].

While NZ CS 1 mandates that greenhouse gas (GHG) emissions disclosures undergo assurance, the requirement for assurance on those disclosures only applies to reporting periods ending on, or after, 27 October 2024 (likely to be an entity's second climate statement).

In line with these factors, we have found the following:

- All December 2023 reporters have taken the exemption of not quantifying the impact of risks and opportunities. All reporters included a qualitative discussion of the climate-related risks and opportunities.
- Three reporters had a combination of reasonable or limited public assurance.

Other findings include:

- All reporters included three scenarios using the global 'orderly', 'disorderly' and 'hot house' references. Three have linked these through to their own risks and opportunities.
- Both the orderly and hot house scenarios were consistent in their assumed degree of warming, with the former being below 1.5 degrees and the latter exceeding 3 degrees for all reporters. However, the assumptions for the disorderly scenario varied among the reporters, with discrepancies in the assumed degree of warming (<2.6, <2, <1.6, 1.5, >2 degrees).
- While the scenario analyses were largely qualitative, two reporters presented some quantification, which was focused on business drivers rather than monetary impacts (e.g. expectations related to future changes in fuel demand and carbon prices).
- The majority of reporters noted that they had collaborated with external advisors, industry experts, and sector peers to develop their scenario analyses.
- The reporters identified key drivers of change either using the XRB recommended STEEP (social, technology, environmental, economic, and political) methodology or similar approaches. They also determined time horizons that they considered meaningful to their respective businesses, aligning them with specific agreements or lease terms.
- Two reporters stated commitments to achieve time-specific net zero targets (either Scope 1 and 2, or full carbon net zero) while the others discussed various carbon reduction objectives.

1 For a summary of exemptions provided under the NZ CS and challenging areas of the requirements refer to PwC's Aotearoa New Zealand's climate-related disclosures: 2024 and beyond

Interestingly, reporters generally called out more risks than opportunities. Over time this should change as the risks are better understood and businesses seek to ensure commercial outcomes that underpin a sustainable business are met.

Unsurprisingly, all reporters identified acute physical risks associated with extreme weather events (such as physical damage, deterioration and loss of assets) given the impacts of flooding and Cyclone Gabrielle. Chronic risks associated with rising temperatures and sea level rise featured in all reports (e.g. risks of supply disruptions, need for new technology and processes, potential managed retreat from exposed locations and others), and some also called out intense rainfall, flooding and coastal erosion.

We observed that reporters largely focused on transition risks related to:

- Changing consumer demand towards low-carbon goods and services.
- Regulatory changes with potential impacts ranging from increasing cost of compliance and reputational impacts in case of non-compliance, to the necessity to alter or upgrade existing processes and infrastructure and volatility of fuel and carbon prices.
- Reduced availability and increased costs of funding as a result of inability to meet investor and funder expectations for decarbonisation.

In terms of opportunities, most reporters mentioned the development of new technologies and the potential for gaining a competitive advantage through alignment with decarbonisation targets and sustainability initiatives.

We observed that the disclosures of risks and opportunities are becoming less generic, with most entities' climate-related disclosures focusing on risks and opportunities specific to their industry, operations, and strategic priorities.

Developing a Climate Statement is a complex undertaking for any organisation. Preparation of compliant disclosures requires significant time, expertise and engagement across the business. We will continue to closely monitor NZX50 companies as they embark on, and progress in, their journey of applying the NZ CS.

What are we seeing in financial statements?

Some examples of how reporters aimed at achieving coherence between their CRDs and financial statements are included below:

- One reporter identified physical and transition risks (e.g. introduction of policies around low-carbon building materials and design, land use, mandatory energy performance ratings, and restrictions on water and energy use, and insurance retreat from coastal locations with at-risk properties potentially becoming permanently unprofitable or stranded) that could impact the valuation of its investment properties. The entity specifically included commentary in the financial statements on the consideration of climate change on key estimates and assumptions related to the valuation of investment property.
- One reporter with green loans disclosed in the financial statements has identified a corresponding transition risk in their climate-related disclosures around a possible inability to meet investor and funder expectations for decarbonisation, providing a linkage between their financing and environmental strategy.
- One reporter outlined in their sustainability report that it recognised a liability in respect of the ongoing obligation to reduce the extent of legacy contamination and remediate the ex-refinery site, and referenced a specific note on this in the financial statements.

As part of the process of preparing their CRD statement in accordance with NZ CS, reporters are required to identify any material climate-related risks and opportunities relevant to their business. While the NZ CS provides an exemption in the first year of adoption from quantifying the financial impacts of climate change, it does not apply to the financial statements.

Consideration of the NZ CS should help companies identify and better understand climate related matters relevant to their business. In line with that, we expect to see more reporters providing quality discussion about the impact of climate change in their financial statements. This includes disclosures of why the impact was not material, in instances where climate change did not have a material impact but where it could be reasonably expected that there were some effects from climate related risks.

What guidance is there for reporters?

Companies must consider climate-related matters in applying IFRS Accounting Standards when the effect of those matters is material in the context of the financial statements taken as a whole. To emphasise this, the International Accounting Standards Board (IASB) recently re-published its educational material: Effects of climate-related matters on financial statements. This highlights potential impacts, and required disclosures, to be provided in financial statements to reflect the effects of climate-related matters.

The Financial Markets Authority (FMA) has recently published their plan for monitoring climate-related disclosures. In the first years of the CRD regime, the FMA expects to take a broadly educative and constructive approach, considering the novelty and timing challenges for some reporters. However, when it comes to the impact of climate risks on the financial statements, the disclosure requirements are determined by the well-established financial reporting standards and are subject to existing compliance rules.

For the key considerations an organisation should think about when determining the impact of climate change on the financial statements and on achieving connectivity between the financial statements and CRD statements, refer to our In Brief: The importance of reflecting climate change in the financial statements.

What are auditors reporting and what are they expecting to see from reporters?

Out of the six audit reports included in the financial statements of NZX50 December 2023 reporters, two made reference to climate change in Key Audit Matters (KAMs). This was related to property valuations (same as last year) and the valuation of unharvested agricultural produce.

In line with the FMA's statement in October 2022, auditors are expected to observe at regulated entities:

- high-quality technical papers for all material areas impacted by climate risk, including materiality assessments and accounting considerations of decisions made to support financial statement disclosures; and
- adequate documentation in minutes of board and audit committee meetings that includes discussions, analysis and conclusions for accounting areas impacted by climate change.

Continued regulatory focus: learnings from ESMA's report on disclosures of climate-related matters in the financial statements

On 25 October 2023, the European Securities Markets Authority (ESMA) released its report 'The Heat is On: Disclosures of Climate-Related Matters in the Financial Statements' as part of its strategic priorities to promote high-quality sustainability disclosures. Given the spotlight on disclosures of climate-related matters, the guidance and examples in the report will be helpful for all entities using IFRS accounting standards to consider, not just those reporting in the European market.

The report includes:

- an educational illustration, using selected examples included in the 2022 annual financial statements of European non-financial corporate issuers;
- a non-exhaustive reflection of IFRS accounting standard requirements that might be relevant for climate-related matters; and
- enforcers' views on how issuers might provide more relevant and transparent information to the market in relation to climate-related matters in IFRS financial statements.

The report includes disclosure examples, overlaid with relevant commentary, and key areas of continued focus on the following topics (these are the areas where the implications of climate-related matters are often expected to be the most material for the preparation of financial statements):

- Significant judgements, major sources of estimation uncertainty and accounting policies.
- Impairment of non-financial assets.
- Useful lives of tangible and intangible assets.
- Provisions.
- Other accounting topics:
  - Share-based payments.
  - Segments.

The report sets out a reminder of the importance of connectivity between disclosures in the financial statements and non-financial reporting. This concept of connectivity is currently being explored across several standard-setters, including the External Reporting Board[2] (XRB), IASB, ISSB.

Where do I find more information?

For more on how climate change can impact the financial statements, please also refer to our PwC New Zealand webpage on financial reporting implications of climate related matters.

2 In November 2023, the XRB issued Staff Guidance on Climate-related matters in financial statements to help CREs understand the requirements in New Zealand accounting standards relating to climate-related matters in financial statements.

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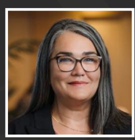

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