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

An analysis of NZX50 March 2024 reporters

August 2024

In this publication we continue our series looking into NZX50 companies and their journey 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 March 2024 reporters, the second wave to mandatorily prepare their climate-related disclosures (CRD) in compliance with the NZ CS issued by the External Reporting Board (XRB) after they became effective in January 2023. We analysed the first reporters to prepare mandatory CRDs in our December 2023 reporters publication.

These March 2024 reporters operate in a range of sectors including property investment, retirement and care facilities, infrastructure, manufacturing, logistics, energy, travel and retail.

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

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.

Overall key findings (compared to March 2023 NZX50 reporters):

14[1] (2023: 13) businesses on the NZX50 with 31 March year ends have completed their financial reporting.

8 (2023: 6) reporters discussed the impact of climate-related risks in their financial statements.

3 (2023: 2) audit reports mentioned climate change in key audit matters (KAMs).

5 (2023: 4) businesses disclosed the use of green finance.

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

2 businesses provided a limited historical quantification of the impacts of the 2023 extreme weather events in their financial statements, such as fair value adjustments on specific assets and insurance receivables. None of the businesses disclosed quantitative impacts from anticipated forward-looking effects of climate change.

Key findings from NZX50 March 2024 reporter's first mandatory climate-related disclosures (CRD):

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

3 reporters included their CRD in the annual report, 11 published as a separate document.

All of the reporters took the adoption provision (at least partially) of not quantifying the impact of risks and opportunities in their CRD statements.

2 reporters included some quantification of the impacts of climate risk (physical or transition risks) in their CRDs.

12 reporters had either reasonable or limited assurance on their reported GHG emissions.

1 The composition of NZX50 March reporters has changed in 2024 compared to 2023, with two new entrants and one leaver.

An overview of NZX50 March 2024 reporters

The number of reporters who mentioned climate change in their financial statements has increased over the last two years (2024: 8, 2023: 6, 2022: 3). However, despite more focus and interest from investors, regulators and the public at large, the discussion of climate-related matters in financial reporting remains limited.

In line with our previous findings, there were few links between financial reporting and climate disclosures. For example, reporters who disclosed climate risks or opportunities directly linked to the value of investment properties in their Climate-Related Disclosures (CRDs) mentioned that the valuation of their investment properties could be impacted by climate change. However, they did not provide any specific revised valuation assumptions or estimates in the financial statements as a result of these climate risks.

Six out of eight reporters who mentioned climate risks in their financial statements made it clear that while those risks were considered implicitly in valuation of investments and investment properties through the general market assumptions, no explicit adjustments were made. All six acknowledged that climate risks will likely have a greater impact on property valuations in the future.

Others who disclosed risks, opportunities and impacts in their CRDs that could likely be linked to specific estimates and assumptions in the financial statements (for example, risks around increasing capital expenditure, repairs and maintenance, insurance costs and funding costs), did not have financial statement disclosures associated with what was identified and disclosed in the CRDs.

Ten reporters disclosed long-term goals to reduce their carbon emissions in their CRDs. Four mentioned in their annual reports the significant impact of extreme weather events (Cyclone Gabrielle and the Auckland flooding of early 2023) which manifested as damage to infrastructure and associated insurance claims. Two of these four quantified the actual impact in the reporting period on specific financial statement line items.

In the financial statements five reporters had green financing in place, mostly to finance low carbon and energy efficient buildings. One reporter's green loans were linked to having a science-based target and reducing emissions. The disclosed emission reduction targets, impact of extreme weather events and green financing may suggest climate risk matters which are not necessarily being discussed in the financial statements.

Next steps for reporters

The next step for the reporters, as they come out of the first CRD cycle, will be to expand their scenario analysis and identification of climate-related risks and opportunities, and start applying the mandatory requirements to quantify the current and anticipated financial impacts of those risks and opportunities.

It will be important to consider the linkage between the CRDs and financial statements. If there is no direct connection, that could be material information for the users of both CRDs and financial statements and require appropriate disclosure.

The IASB's proposed examples for climate-related financial reporting

In July 2024, the International Accounting Standards Board (IASB) published Exposure Draft Climate-related and Other Uncertainties in the Financial Statements, which proposes eight examples to be added to various IFRS Accounting Standards. These examples illustrate how an entity could apply the requirements in those standards to report the effects of climate-related, and other uncertainties, in its financial statements. The IASB expects that these examples will help to improve the reporting of the effects of climate-related, and other uncertainties, in the financial statements, by helping to strengthen connections between an entity's general purpose financial reports.

The examples focus on the materiality judgements, disclosure of assumptions - in general, and specifically for impairment of assets, disclosures about credit risk for financial institutions, as well as decommissioning and restoration provisions and disaggregated information about classes of property, plant and equipment.

These examples have not yet been formally issued, and are not meant to be an exhaustive list of all possible impacts climate-related risks and opportunities could have on financial reporting. Nevertheless we encourage companies to consider them when analysing the impacts of their CRD on their financial statements and determining the level of financial statement disclosures required as they can provide a helpful structure to that thought process.

Additionally, as we have seen from the first CRDs, scenario analysis, risks and opportunities are becoming more industry-specific and show sector-wide similarities. While such similarities may enhance comparability, we caution reporters against 'carbon copy' disclosures, as disclosures tailored to the specific entity are essential for informed capital allocation.

What are we seeing in the first CRD statements for NZX50 March 2024 reporters?

To address the challenges associated with the adoption and implementation of NZ CS, the XRB has taken a phased approach and provided a limited number of adoption provisions from some of disclosure requirements in NZ CS. Some are only available in the first, others are available in the first, second and third reporting periods. One of the provisions provides an exemption from quantifying the current and anticipated financial impacts of climate-related risks and opportunities in the first CRD reporting period.[2]

Assurance requirements outlined in NZ CS 1 over greenhouse gas (GHG) emissions disclosures only become mandatory for reporting periods ending on, or after, 27 October 2024.

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

- Four out of the 14 March 2024 reporters (three out of six December 2023 reporters) did not publish their CRD at the same time as their annual reports, issuing them at a later stage, but still in line with the deadline (four months after reporting date).

- One reporter used licensed software to develop a Climate Impact Accrual tool to assess the probability and impact of different classes of physical climate risks and calculate the annualised cost exposure after insurance/mitigation for their sites around the world with input from advisors. This was done for both current and future impacts of physical climate risks. Current and anticipated impacts of transition risks were disclosed qualitatively.

- One reporter quantified climate risks in a blend of financial and non-financial terms. For example as the percentage of its material portfolio company assets impacted by climate risks and the value of assets not insured due to unavailability or unaffordability as a consequence of climate change risk. This reporter also disclosed a 'Carbon & ESG adjustment' made to the weighted average cost of capital in response to an improvement in the 'ESG rating'. The direct financial impact of such adjustment could not be determined, but the reporter stated this was one of the inputs into valuation models that drove the recommended target share price.

- Other than two reporters, all others only included qualitative discussion of the climate-related risks and opportunities.

- Twelve reporters had either reasonable or limited assurance over greenhouse gas emissions disclosures.

2 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

Other findings include:

- All reporters included three scenarios using the global ‘orderly’, ‘disorderly’ and ‘hot house’ references, and to some extent linked these through to their own risks and opportunities.
- All three scenarios were broadly consistent in the assumed degree of warming across all reporters, with some identifying specific values (e.g. 1.4, 2.7 and 3.6 degrees for orderly, disorderly and hot house respectively), and others choosing more general terms (1.5 degrees or below, 2 degrees or below, and above 3 degrees respectively for the same scenarios).
- As expected, we are seeing a larger degree of alignment in the scenarios specifically required to be analysed by NZ CS (1.5 degrees and 3 degrees Celsius or greater), whereas the third scenario, which is not specifically prescribed by the standards, has more variability.
- The scenario analyses were largely qualitative, with limited quantification. This was focused on business drivers rather than monetary impacts (e.g. expectations related to carbon prices).
- Most reporters are aligning their scenarios to various frameworks, such as NGFS, IPCC’s Shared Socioeconomic Pathways or industry-specific ones, for example Climate Scenarios for the Construction and Property Sector.
- The majority of reporters disclosed that they collaborated with external advisors, industry experts, and sector peers to develop their scenario analyses.
- The reporters determined time horizons that they considered meaningful to their respective businesses, aligning them with the nature and long-term planning of their assets and pipeline of work (e.g. development and building timeframes for retirement communities, or expectations to progress development master plans for commercial property projects).
- Ten reporters have set long-term goals to reduce their carbon emissions, specifying various combinations of percentage reduction, assigned time horizons and scope of emissions, with various targets spanning to 2025, 2030, and even 2050. Most entities are predominantly focusing on reduction goals for Scope 1 and 2 emissions. Companies are employing a variety of specific initiatives to reduce emissions. Improving the energy efficiency and sustainability of properties is a central theme for property managers. Other examples include reducing emissions from business travel, lowering upfront embodied carbon in developments, and reducing average annual CO2 emissions per financed vehicle.

Setting carbon-reduction targets

The setting of carbon-reduction targets is an effective way for entities to communicate their climate-related commitments. However, it is important to note that not all objectives and aspirations qualify as a target. A goal or aspiration becomes a target if the entity uses a defined time horizon over which the target should be achieved, and the progress in achieving it can be measured. As mentioned above, most reporters did disclose the measurable characteristics and the time horizon of their carbon reduction objectives.

Focusing on and disclosing risks

In their reporting, companies continue to focus more on risks than opportunities. This may be a product of general users of CRDs paying attention to potential downside exposure in their investments. As user awareness of risks increases, companies will likely identify and disclose ways of capitalising on the opportunities that focusing on sustainable business development brings.

All reporters disclosed acute (event-driven) physical risks associated with extreme weather events, including storms, floods, cyclones and wildfires (including physical damage to assets, higher costs due to repairs, increased insurance premiums and local council rates, as well as disruptions to supply chains, business continuity, and travel).

Chronic risks (longer-term shifts) associated with rising temperatures, increased rainfall and sea level rise also featured in most reports. For example:

- Changes in weather patterns, rising sea levels, and heat stress can lead to significant damage and destruction of buildings and infrastructure, resulting in higher repair costs, increased insurance premiums, and additional capital expenditures for mitigation and adaptation measures.
- Frequent and severe weather events cause disruptions to supply chains, business continuity, and travel, impacting project timelines, construction activities, and the ability of tenants and customers to access services, leading to potential revenue loss and delays.

- Rising temperatures and increased rainfall contribute to higher demand for cooling, increased energy consumption and increased operating costs.

The NZX50 March 2024 reporters operating in the retirement village sector also mentioned specific impacts of risks like increased rainfall and rising temperatures on the health and wellbeing of residents.

Some reporters pointed out that there are built-in opportunities to reduce risks. For example, increased rainfall can lead to more rainwater harvesting, and properties that are 'stranded' can be bought and improved to gain value.

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

- Stricter building regulations, increased compliance obligations, and heightened market demand for low-carbon and energy-efficient buildings, which would necessitate significant investment in sustainable technologies and practices.
- Increased capital and operational expenditures due to retrofitting, higher insurance premiums, and rising costs of carbon-intensive materials and energy resilience measures.
- Failing to meet investor, regulatory, and societal expectations for sustainability and climate action can lead to withdrawal of financial support, higher debt costs, and potential legal and reputational risks.
- Shifts in customer behaviour towards sustainable options and increased demand for certified green buildings that would require businesses to adapt quickly or face reduced market share, revenue losses, and potential erosion of public trust.

As expected, reporters are expressing caution over 'first mover' risks such as cost and potential for failure in adopting new technology in response to climate change, saying that early adopters at the 'bleeding edge' may incur additional operating costs and potential for stranded assets.

Identifying opportunities

The reporters also acknowledged and disclosed climate-related opportunities, including those associated with being a first mover, such as:

- Investing in building resilient communities and properties, and enhancing sustainability ratings to attract premium tenants and reduce operational risks and costs.
- Improving and developing products and services to be more sustainable and efficient, reducing emissions and appealing to environmentally conscious customers and investors.
- Transitioning to clean energy sources and optimising resource efficiency to lower operating costs and enhance market positioning.
- Acquiring and improving undervalued or 'stranded' properties to unlock value, and adapting to reduced car usage by repurposing car parks.
- Preparing for regulatory changes, leveraging early adoption of low-carbon strategies for market share gains, and forming partnerships to address complex climate-related challenges.

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. We are also starting to see more alignment between risks and opportunities disclosed by entities within the same sector. While cross-learning and collaboration is important for comparability, and should inform the reporters' own assessments, tailoring disclosures for the entity's specific circumstances will ensure users can make informed decisions about capital allocation. As one reporter stated '[what] can be a risk for vulnerable buildings [is] an opportunity for resilient buildings'.

Is there coherence between CRDs and financial statements?

As mentioned above, 8 of the 14 NZX50 March 2024 reporters mentioned climate change in their financial statements compared to six last year. Of those reporters, most concluded there were no material impacts from climate-related matters. Climate change was mentioned briefly in the general information, financial risk management and valuation of investment property sections of these financial statements.

Four reporters mentioned the significant impact of extreme weather events Cyclone Gabrielle and Auckland flooding which manifested as damage to infrastructure and associated insurance claims. Out of the four, two reporters quantified the actual impact in the reporting period on specific financial statement line items, such as insurance receivables and valuation adjustments to investment properties. Additionally, one reporter disclosed the positive impact Cyclone Gabrielle and Auckland flooding had on their revenues as a result of increased sales of damaged and end of life vehicles.

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

- Six reporters who mentioned that valuation of their investment properties could be impacted by climate change in their financial statements disclosed a variety of physical and transition risks in their CRDs that could impact the valuation of their investment properties (for instance, regulatory changes requiring improved energy efficiency of properties or mandatory disclosure of energy and carbon performance for properties; increased frequency and severity of weather events, as well as sea level rise and sea surge events causing damage to properties or resulting in higher repairs and insurance costs; failure to keep up with expectations of tenants for energy efficiency, renewables, and low carbon technology impacting the revenue generating capability of properties and other similar risks).

- Two reporters with green loans in place have identified a corresponding transition risk around high debt costs due to failure to meet lender expectations regarding transitioning to a low carbon future. Other reporters who have green financing in place didn't specifically call out in their CRDs a risk around climate change impacting their ability to comply with the financing conditions and any impact on finance costs.

- One reporter disclosed climate risks related to changes in climate seasonality that have a flow on effect on electricity demand and market price volatility, and as a result - generation asset revenue and the pursuit of the new development opportunities for the company. This is directly related to the assumptions applied in determining fair value of generation assets, as well as electricity price path that drives the valuation of electricity derivatives, both of which were disclosed in the reporter's financial statements.

In preparing their CRD statement in accordance with NZ CS, reporters must identify any significant climate-related risks and opportunities relevant to their business. Although the NZ CS offers a first-year exemption from quantifying the financial impacts of climate change, this does not extend to financial statements. **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**.

Consideration of the NZ CS should help companies identify and better understand climate related matters relevant to their business. As outlined above, the Exposure Draft Climate-related and Other Uncertainties in the Financial Statements, published by the IASB in July 2024 proposes to add illustrative examples to various IFRS Accounting Standards to help improve the reporting of the effects of climate-related and other uncertainties in the financial statements, by helping to strengthen connections between an entity's general purpose financial reports.

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 did the audit reports include?

Out of the 14 audit reports included in the financial statements of NZX50 March 2024 reporters, three made reference to climate change in Key Audit Matters (KAMs). All three were related to property valuations, and two of these three were the same as last year.

FMA's climate disclosure monitoring and feedback

As we previously reported, in June 2023 the Financial Markets Authority (FMA) published their plan for monitoring climate-related disclosures. In the first years of the CRD regime it expects to take a broadly educative and constructive approach. The FMA has recently expanded its reporting team and will engage in more proactive monitoring, including sending letters to reporters as necessary.

The FMA reviewed all CRDs issued with December and January year-ends, focusing on ensuring that minimum disclosure requirements are met. While the FMA is contemplating the timing of individual feedback, any provided this round will be in the form of recommendations to align with the broadly educative and constructive approach. Improvements will be expected in subsequent rounds. We understand that the FMA plans to release its feedback statement on December 2023 and some of the March 2024 year-end CRDs in early November of 2024.

While the regulators acknowledge the novelty and timing challenges associated with the first CRDs, when it comes to the impact of climate risks on the financial statements, the disclosure requirements are determined by well-established financial reporting standards and are subject to existing compliance rules. The FMA continues to prioritise climate-related information in their desktop reviews, and has flagged that it is crucial for reporters to thoroughly document their decision-making processes regarding the level of disclosure.

In relation to the assurance of CRDs, the FMA notes that the level of assurance or verification (limited or reasonable), e.g. for greenhouse gas disclosures, must be clearly described in reports. If a report indicates that assurance has been conducted, the assurance findings must be included as an attachment.

FMA and XRB user guides

In June 2024, the FMA and the XRB issued joint user guides explaining the information disclosed in climate statements: What You Need to Know and Navigating Climate Statements. The two guides cater for different users, but highlight the importance of topics such as uncertainty, comparability and context when evaluating and judging the information they contain.

The key takeaways from both publications are that the CRD regime helps entities price risk and make informed capital-allocation decisions. It enables stakeholders to assess their actions and make evaluations based on the entity's individual circumstances.

These guides outline the key questions to consider when reading climate statements, including understanding the entity's exposure to climate-related risks and opportunities, and considering its approach to uncertainty and the context in which it operates.

The XRB and the FMA warn users against direct comparisons between climate statements of similar entities due to variations in disclosure methods and assumptions, as well as variability in sector, size, and geographic location. It is also important to keep in mind that climate statements do not require mandatory action but rather mandatory disclosure.

Investor views of climate disclosures

The XRB recently highlighted the interim report 'Effectiveness Evaluation of the Aotearoa New Zealand Climate-Related Disclosure Framework' published by the University of Otago in January 2024. The report describes the initial stages of research focusing on voluntary disclosures of the climate reporting entities leading up to the adoption of the CRDs, and explains the research methodology, baseline data and preliminary findings from this research. The report confirms that climate-related risks are viewed by investors as highly important, comparable to other financial risks, and their significance is expected to grow in the next one to five years. The investors see key challenges with voluntary reporting being around reliability, quality, and usefulness of climate-related information, and see the CRD framework as an important contribution to enhancing reliability and providing valuable material information.

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.

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