In Brief
Knowledge, Experience, Insight

November, 2019

Climate-related risks

At a glance

Climate change continues to receive increasing focus from governments, the global and New Zealand media and investors, who are issuing statements on the importance of climate-related risks to their decision making.

And now, the New Zealand Government has just released a discussion document on climate related financial disclosures that proposes that all entities issuing public debt or equity (listed issuers) will be required to implement the Task Force on Climate-related Financial Disclosure (TCFD) recommendations in a stand-alone report within the entity's annual report.

Entities need to consider the impact of climate related risks within their financial statements and also more widely, the impact these risks will have on the entity and what they need to report to their stakeholders.

Within the financial statements

In April 2019 the Australian Accounting Standards Board (AASB) and the Australian Auditing and Assurance Standards Board (AuASB) republished a joint guidance document which provides guidance to financial statement preparers and auditors on how to consider climate-related risks in the context of the financial statements, including their potential impact on the amounts recognised and associated disclosures.

Although the bulletin was developed for preparers and auditors of financial statements in Australia, it contains useful guidance for preparers and auditors of financial statements in New Zealand. For example, the joint bulletin provides guidance on:

1. what climate risks are;
2. making materiality judgements when determining climate-related risk disclosures; and
3. the implications of climate-related risks for financial reporting and auditing.

Other disclosures

Consideration needs to be wider than the impact of climate change risks on the financial statements. In New Zealand in October, the Government issued a discussion document on climate related financial disclosures that proposes that listed issuers, banks, general insurers and others be required to implement the TCFD recommended disclosures on a comply or explain basis. The TCFD is an industry led disclosure task force established by the Financial Stability Board. It has made recommendations on the type of information entities should disclose so stakeholders get a better understanding of the entity's exposures to climate-related risks. The discussion document proposes that these disclosures be made in a stand alone document within the annual report.

What's the issue?

Within the financial statements

Material information is required to be reported in financial statements. Accounting standards and practice statements make it clear that information is material if it could influence primary users' decisions, which can be the case regardless of how large or small the associated number is. Materiality judgements may lead to the disclosure of information that is not specifically required by Accounting Standards, where that information is necessary for users to understand the impact of transactions/events on an entity's financial position, performance and cash flows.

Given investors' statements on the importance of climate-related risks to their decision making, the requirements and guidance on making materiality judgements indicate that entities can no longer consider climate-related risks solely from a social corporate responsibility perspective. Rather, entities should also consider these risks in the context of their financial statements.

Other disclosures

The Government discussion document proposes that the TCFD recommendations form the basis for a comply or explain disclosure regime. There are 11 recommendations grouped into four themes of governance, strategy, risk management and metrics and targets. These recommendations include disclosure of the processes for identifying and assessing climate related risks and disclosure of greenhouse gas emissions.

What's the impact and for whom?

Within the financial statements

While relevant for entities in all industries, there are certain industries where climate-related risks are more likely to have an impact on the financial statements, including energy, resources, transportation, agriculture, and certain financial sector entities such as banks and insurers.

The AASB and AuASB's joint guidance document outlines recommendations for both preparers and auditors of financial statements. Entities preparing financial statements should consider whether investors could reasonably expect that climate-related risks could affect the amounts and disclosures in the financial statements, including whether there are any disclosures currently omitted that would be considered material in light of the requirements and guidance outlined above.

For example, climate change may be a relevant assumption in performing impairment testing of certain assets, affecting the amounts reported. Even where entities conclude they do not need to factor climate change into impairment testing assumptions, they may need to disclose why this is appropriate because investors may believe that climate change could have had an effect on the amounts reported.

Other potential financial reporting implications arising from climate-related risks include:

- changes in the useful lives of assets;
- changes in the fair value of assets;
- increased costs and/or reduced demand for products affecting impairment calculations and/or requiring recognition of provisions for onerous contracts;
- potential provisions and/or contingent liabilities arising from fines and penalties; and
- changes in expected credit losses for financial assets.

The increased focus on climate-related risks will also have an impact on how auditors carry out their role. They may consider climate-related risks as part of their risk assessment applying ISA (NZ) 315 *Identifying and Assessing Risks of Material Misstatement through Understanding the Entity and its Environment*, and/or the relevance of such risks to accounting estimates under ISA (NZ) 540 *Auditing Accounting Estimates and Related Disclosures*. Auditors will also need to focus on substantiating the disclosures entities make regarding climate-related risks to ensure they are supportable given the uncertainty surrounding such risks.

Other disclosures

Depending on the outcome of the Government discussion paper, listed issuers, banks, general insurers, asset owners (i.e. institutional investors) and asset managers (i.e. investment managers) may have to make substantially increased disclosures related to climate risk including the publication of greenhouse gas emissions.

What next?

Within the financial statements

Investor statements indicate that climate-related risks are becoming increasingly material. Preparers and auditors of financial reports need to consider this now, in the context of the financial statements, and how the amounts recognised and the associated disclosures could be affected.

Other disclosures

The Government is seeking feedback on its discussion paper by 13 December 2019. To read the discussion document and have your say on the proposals refer to the Ministry for the Environment website here.

Where do I get more details?

If you wish to discuss this or any other financial reporting related matter, please contact your usual PwC contact or one of the following sustainability and climate change specialists or financial reporting specialists:

Stephen Hogg
Partner, Auckland
stephen.s.hogg@pwc.com

Richard Day
Partner, Auckland
richard.m.day@pwc.com

Chris Ussher
Partner, Wellington
chris.j.ussher@pwc.com

Robert Harris
Partner, Christchurch
harris.r@pwc.com

Annabell Chartres
Director, Auckland
annabell.l.chartres@pwc.com

Lesley Mackle
Executive Director, Wellington
lesley.j.mackle@pwc.com