



EFFECTS OF CLIMATE-RELATED MATTERS ON FINANCIAL STATEMENTS

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BACKGROUND

On 28 November 2019, an article written by Nick Anderson, IASB Board member, '[IFRS Standards and climate-related disclosures](#)' was published by the IFRS Foundation. The article provides an overview intended to help investors understand what already exists in current International Financial Reporting Standards ('IFRS') requirements, and guidance on the application of materiality, and how these relate to climate and other emerging risks.

On 20 November 2020, the IFRS Foundation published educational material '[Effects of climate-related matters on financial statements](#)' in response to stakeholders requests for further information to highlight how existing requirements in the IFRS Standards may require companies to consider climate-related matters when their effect is material to their financial statements. This educational material complements the Nick Anderson article, adding for example, specific paragraph references to IFRS requirements to assist in the application of the IFRS Standards. The educational material is intended to support the consistent application of requirements in IFRS Standards.

This publication provides a summary of the article written by Nick Anderson and the IFRS Foundation educational material.

EXECUTIVE SUMMARY

The IFRS Foundation has published educational material to provide information on how existing IFRS Standards may require companies to consider climate-related matters when their effect is material to the financial statements.

NICK ANDERSON ARTICLE: IFRS STANDARDS AND CLIMATE-RELATED DISCLOSURES

While the phrase 'climate-change' is not included in the IFRS requirements, IFRS Standards do address issues that relate to climate-change risks and other emerging risks. The key messages set out in the article written by Nick Anderson that are intended to help analysts and investors better understand the requirements and guidance in IFRS Standards and other non-authoritative material developed by the IASB are as follows:

MAKING MATERIALITY JUDGEMENTS

[IFRS Practice Statement 2: Making Materiality Judgements](#) provides companies with guidance on how to make materiality judgements when preparing their financial statements in accordance with IFRS standards. The Practice Statement is not mandatory, but companies may find it useful when they make materiality judgements in respect of disclosures about climate-related and other emerging risks.

APPLYING MAKING MATERIALITY JUDGEMENTS TO CLIMATE-RELATED RISKS AND OTHER EMERGING RISKS

As set out in the Practice Statement *Making Materiality Judgements*, qualitative external factors, such as the industry in which the company operates, and investor expectations, may make some risks material and may warrant disclosures in financial statements, regardless of their quantitative impact. Companies may need to consider such risks in the context of their financial statements rather than solely as a matter of corporate-social-responsibility reporting.

FINANCIAL REPORTING CONSIDERATIONS

Financial reporting implications arising from climate-related and other emerging risks may include, but are not limited to:

- asset impairment, including goodwill;
- changes in the useful life of assets;
- changes in the fair value of assets;
- effects on impairment calculations because of increased costs or reduced demand;
- changes in provisions for onerous contracts because of increased costs or reduced demand;
- changes in provisions and contingent liabilities arising from fines and penalties; and
- changes in expected credit losses for loans and other financial assets.

DISCLOSING CLIMATE-RELATED AND OTHER EMERGING RISKS

The assessment of materiality needs to be made on the basis of size (quantitative factors) and nature (qualitative factors), or a combination of both. The Practice Statement further emphasises that an item of (qualitative) information could influence primary users' decisions regardless of its (quantitative) size. The majority of climate-related information is currently disclosed within the management commentary (or equivalent) and not in the financial statements. For some companies, applying the definition of materiality and the principles in the materiality practice statement could result in some of this information needing to be reflected within the financial statements (either directly or by reference).

MANAGEMENT COMMENTARY - PROVIDING CONTEXT TO THE FINANCIAL STATEMENTS

The Board is currently updating its *Management Commentary* Practice Statement to set out a rigorous, principle-based approach for explaining a company's purpose, business model, strategy and performance, incorporating the long-term drivers of its success.

EDUCATIONAL MATERIAL: EFFECTS OF CLIMATE-RELATED MATTERS ON FINANCIAL STATEMENTS

IFRS Standards do not refer explicitly to climate-related matters. However, companies may be required to consider climate-related matters in applying IFRS Standards when the effect of those matters is material in the context of the financial statements taken as a whole (e.g. with respect to the most significant judgements and estimates).

IAS 1 *Presentation of Financial Statements* contains some overarching requirements that could be relevant when considering climate-related matters. For example, IAS 1.112 requires disclosure of information not specifically required by IFRS Standards and not presented elsewhere in the financial statements but that is relevant to an understanding of the financial statements. This paragraph, together with IAS 1.31, requires a company to consider whether any material information is missing from its financial statements. Companies will need to consider whether to provide additional disclosures when compliance with the specific requirements in IFRS Standards is insufficient to enable investors to understand the impact of climate-related matters on the company's financial position and financial performance. That is, an entity (which may be a company or consolidated group) is required to consider whether additional disclosures need to be provided because the specific requirements of IFRS Standards are insufficient to enable investors and other users of financial statements to understand the impact of particular transactions, other events and conditions on the the entity's financial position and financial performance.

The educational material sets out examples which illustrate when IFRS Standards may require companies to consider the effects of climate-related matters. They illustrate the application of the principles on those Standards; specific paragraph references and a summary of matters to consider are set out below. However, the examples are non-exhaustive and there may be circumstances in which climate-related matters are relevant to the application of other IFRSs, such as in the measurement of defined benefit obligations in accordance with IAS 19 *Employee Benefits*. For full details, reference should be made to the full text of the educational material.

IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

Paragraphs 25-26, 122-124, 125-133

Sources of estimation uncertainty and significant judgements

In accordance with IAS 1, if assumptions a company makes about the future have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, disclosure of those assumptions and the nature and carrying amount of those assets and liabilities is required. This means disclosures of assumptions about climate-related matters may be required, for example when those matters create uncertainties that affect assumptions used to develop estimates, such as estimates of future cash flows when testing an asset for impairment or the best estimate of expenditure required to settle a decommissioning obligation. IAS 1 also requires the disclosure of the judgements (apart from those involving estimations) that have the most significant effect on the amounts recognised in the financial statements.

Going Concern

If climate-related matters create material uncertainties related to events or conditions that cast significant doubt upon a company's ability to continue as a going concern, IAS 1 requires disclosure of those uncertainties.

IAS 2 INVENTORIES

Paragraphs 28-33

Climate-related matters may cause a company's inventories to become obsolete, their selling prices to decline or their costs to complete to increase. If, as a result of these matters, the cost of inventories is not recoverable, IAS 2 requires the company to write down those inventories to their net realisable value.

IAS 12 INCOME TAXES

Paragraphs 24, 27-31, 34, 56

Climate-related matters may affect a company's estimate of future taxable profits and may result in the company being unable to recognise deferred tax assets in respect of unused tax losses and credits, and deductible temporary differences, or being required to derecognise deferred tax assets previously recognised.

IAS 16 PROPERTY, PLANT AND EQUIPMENT AND IAS 38 INTANGIBLE ASSETS

IAS 16 paragraphs 7, 51, 73, 76 and IAS 38 paragraphs 9-64, 102, 104, 118, 121, 126

Climate-related matters may result in expenditure to change or adapt business activities and operations, including research and development. Both IAS 16 and IAS 38 require the review of estimated residual values and expected useful lives of assets at least annually, and to reflect changes, such as those arising from climate-related matters, in the amount of depreciation or amortisation recognised. Climate-related matters such as obsolescence, legal restrictions or inaccessibility of the assets may affect the estimated residual value and expected lives of assets. Changes in estimated residual values or expected useful lives are required to be disclosed.

IAS 36 IMPAIRMENT OF ASSETS

Paragraphs 9-14, 30, 33, 44, 130, 132, 134-135

Climate-related matters may give rise to indications that an asset (or a group of assets) is impaired. For example, a decline in demand for products that emit greenhouse gases could indicate a manufacturing plant may be impaired, requiring the asset (or related cash-generating unit) to be tested for impairment. External information such as significant changes in the environment (including, for example, changes in regulation) in which a company operates with an adverse effect on the company is an indication of impairment.

If a company is estimating recoverable amount using value-in-use, cash flow projections are based on management's best estimate of the range of future economic conditions. This requires companies to consider whether climate-related matters affect those assumptions. A value-in-use test requires future cash flows to be estimated for an asset in its current condition, meaning that these exclude any estimated cash flows expected to arise from future restructurings or enhancements to the asset.

IAS 36 also requires disclosure of the events and circumstances that led to the recognition of an impairment loss (e.g. the introduction of emission-reduction legislation that increased manufacturing costs).

IAS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS AND IFRIC 21 LEVIES

IAS 37 paragraphs 14-83, 85-86 and IFRIC 21 paragraphs 8-14

Climate-related matters may affect the recognition, measurement and disclosure of liabilities, for example, related to:

- levies imposed by governments for failure to meet climate-related targets or to discourage or encourage specified activities;
- regulatory requirements to remediate environmental damage;
- contracts that may become onerous (for example, due to potential loss of revenue or increased costs as a result of climate-related changes in legislation); or
- restructurings to redesign products or services to achieve climate-related targets.

IAS 37 requires disclosure of the nature of a provision or contingent liability, together with an indication of the uncertainties about the timing or amount of any related outflows of cash (or other economic benefits). Where necessary to provide adequate information, disclosure is also required of the major assumptions made about future events reflected in the amount of a provision.

IFRS 7 FINANCIAL INSTRUMENTS: DISCLOSURES

Paragraphs 31-42, B8

IFRS 7 requires disclosure of information about financial instruments, including the nature and extent of risks arising from financial instruments and how the company manages those risks. Climate-related matters may expose a company to risks in relation to financial instruments. For example, there may be effects on expected credit losses or concentrations of credit risk for lenders.

IFRS 9 FINANCIAL INSTRUMENTS

Paragraphs 4.1.1(b), 4.1.2A(b), 4.3.1, 5.5.1-5.5.20, B4.1.7

Climate-related matters may affect the accounting for financial instruments. For example, loan contracts may include terms linking contractual cash flows to achievement of climate-related targets affecting how the loan is classified and measured by lenders (such as whether the contractual cash flows are solely payments of principal and interest) or whether the targets mean that there are embedded derivatives for borrowers.

Climate-related matters may also affect a lender's exposure to credit risk. For example, wildfires, floods or policy and regulatory changes could affect a borrower's ability to meet its obligations, or cause assets to become inaccessible or uninsurable, affecting the value of the collateral for lenders.

IFRS 13 Fair Value Measurement

Paragraphs 22, 73-75, 87, 93

Market participants' views of potential climate-related matters, including potential legislation, could affect the fair value of an asset or liability.

Climate-related matters may also affect disclosures about fair value measurement, which may be required to be more comprehensive than in previous reporting periods. For example, for fair value measurements within the Level 3 categorisation of the fair value hierarchy, disclosure is required of unobservable inputs. Those inputs are required to reflect the assumptions that market participants would use when pricing, including assumptions about risk which may include climate-related risk.

IFRS 17 INSURANCE CONTRACTS

Paragraphs 33, 40, 117 and 121-128, Appendix A

Climate-related matters may increase the frequency or magnitude of insured events or may accelerate the timing of their occurrence. Examples which may be affected by climate-related matters include business interruption, property damage, illness and death.

Climate-related matters may also affect the disclosures required by IFRS 17, which include significant judgements and changes in judgements in applying the Standard, and exposure to risk and concentrations of risk and how these are managed.

Additional resources on climate-related matters and sustainability reporting may be accessed here:

[IASB educational material: the effects of climate-related matters on financial statements prepared applying IFRS Standards \(November 2020\)](#)

[Consultation Paper on Sustainability Reporting issued by the IFRS Foundation Trustees \(September 2020\)](#)

[Paris Agreement, 2015](#)

[Sustainable Finance and the Role of Securities Regulators and IOSCO: Final Report \(April 2020\)](#)

[Interconnected Standard Setting for Corporate Reporting: Accountancy Europe \(December 2019\)](#)

[Feedback Analysis on Interconnected Standard Setting for Corporate Report \(Accountancy Europe\) \(June 2020\)](#)

[IFRS Standards and Climate Related Disclosures: publication by IASB Board Member Nick Anderson \(November 2019\)](#)

Additional resources on climate-related matters and sustainability reporting may be accessed here:

[Statement of Intent to Work Together Towards Comprehensive Reporting: Summary of alignment discussions among leading sustainability and integrated reporting organisations CDP, CDSB, GRI, IIRC and SASB \(September 2020\)](#)

[Toward Common Metrics and Consistent Reporting of Sustainable Value Creation: World Economic Forum \(January 2020\)](#)

[Measuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation: World Economic Forum \(September 2020\)](#)

[Enhancing Corporate Reporting: The Way Forward - IFAC \(September 2020\)](#)



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