ACCOUNTING STANDARDS BOARD

EFFECT OF CLIMATE-RELATED MATTERS ON FINANCIAL STATEMENTS

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The effect of climate-related matters on financial statements

This document has been prepared by the Secretariat of the ASB. The document outlines high-level considerations for entities in dealing with the effect of climate-related matters on financial statements and how the Standards of GRAP can be used to appropriately reflect these matters. It is not a substitute for a complete review of the relevant Standards and the application of their principles to specific transactions or events. The document does not introduce any new requirements or change any existing requirements in the Standards of GRAP.

The effect of climate-related matters on financial statements

Entities are affected by climate change, some more than others, which impacts their operations and delivery of their mandate. Climate change refers to long-term shifts in temperatures and weather patterns[1]. For purposes of this document, climate-related matters encompass the events that result from climate change e.g. natural disasters, drought, etc. This document provides guidance on considering the impact of climate-related matters on the entity when reporting in its financial statements. The document does not address all instances of climate-related matters - there could be other instances where climate-related matters are relevant when preparing financial statements. References to the Standards of GRAP in this document apply to the version of Standards applicable on 1 April 2024.

Entities should apply judgement when assessing whether the effect of climate-related matters are material to their financial statements. Items are material if they could, individually or collectively, influence the decisions or assessments users make on the financial statements. Entities are encouraged to apply the *Guideline on the Application of Materiality to Financial Statements* when determining materiality.

[1] As defined by the United Nations.

Fundamental principles

There are fundamental principles in financial reporting that entities should consider when assessing the effect of climate-related matters on financial statements. These are outlined below.

Additional disclosures

To achieve fair presentation in financial statements, GRAP 1 on *Presentation of Financial Statements* requires that entities provide additional information that is not required by the Standards of GRAP but is relevant to the understanding of its financial statements. Entities need to consider whether to provide additional disclosures when applying the Standards of GRAP are insufficient to enable users to understand the effect of climate-related matters on the entity's cash flows, its financial position and financial performance.

Assumptions and estimates

GRAP 1 requires disclosure of information about the assumptions used in determining the carrying amounts of assets and liabilities. Disclosure of assumptions about climate-related matters may be required when those matters create uncertainties that affect the assumptions used to develop estimates, such as the estimates used in determining the residual values of assets.

Significant judgements

Entities should provide disclosures that help users understand the judgements management makes in applying its accounting policies that have the most significant effect on the amounts recognised in the financial statements. Climate-related matters may impact the judgement management makes when applying its accounting policies. For example, significant judgement may be required when determining whether an entity has a constructive obligation for the commitments it makes to undertake climate-related activities.

Going concern

In assessing whether the going concern basis of preparation is appropriate, an entity considers all available information about the future, which is at least 12 months from the end of the reporting period. If climate-related matters create material uncertainties related to events or conditions that cast significant doubt on an entity's ability to continue as a going concern, GRAP 1 requires disclosure of those uncertainties.

GRAP 100 on *Discontinued Operations* should be considered if functions at entities are ceased due to them not being sustainable as a result of climate change.

Legislative disclosure

Legislation may require entities to provide disclosure in their financial statements on climate-related matters. Entities should apply these reporting requirements in addition to those required in the Standards of GRAP. Refer to FAQ 4.14 in the *Frequently Asked*

Questions on the Standards of GRAP for guidance on the interaction of legislated disclosure requirements and disclosure requirements in the Standards of GRAP.

Key components of the financial statements

Assets

Non-monetary assets

Non-monetary assets include inventories, investment properties, property, plant and equipment, intangible assets, biological assets and agricultural produce, living and non-living resources, and heritage assets. The table below explains the effect of climate-related matters on non-monetary assets.

Non-monetary asset	Effect of climate-related matter
Inventories	Changes in climate may cause an entity's inventories to become obsolete, their costs of completion to increase or their selling prices to decline. Where the cost of inventories is not recoverable, GRAP 12 on *Inventories* requires an entity to write down their inventories to their net realisable value. If the inventories are held for distribution in a non-exchange transaction, they should be measured at the lower of their cost or current replacement cost.
Property, plant and equipment Intangible assets Investment property Living and non-living resources	Some entities, such as municipalities, engage in waste disposal activities. They are required by legislation to restore and rehabilitate the land and the waste disposal site they use. Climate-related events may affect the estimates used to account for the land or the landfill site asset e.g. the useful life estimate of the landfill site asset. The *Guideline on Accounting for Landfill Sites* explains the accounting for land, the landfill site asset and the restoration and rehabilitation of the land and the landfill site asset. An entity may incur expenditure to change or adapt its activities, including research and development, to respond to changes in climate. The Standards of GRAP on assets include requirements for recognising the costs as assets. GRAP 31 on *Intangible Assets* also requires disclosure of the amount of research expenditure recognised as an expense. Measures to reduce climate change may affect the residual values and useful lives of assets, for example, because of obsolescence or legal restrictions on the use of assets. Entities are required to review the residual values and useful lives of assets at least annually, and to account for those changes in accordance with GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors*.

	Where entities apply the revaluation model to assets, climate change could affect the frequency of revaluations. For example, urbanisation as a reaction to climate change could result in sharp price increases to property, which impacts the frequency of property revaluations. GRAP 110 on *Living and Non-living Resources* requires entities to explain their custodial responsibilities, including the legislation that establishes the custodial responsibilities. This can include the entity's role and responsibility to manage and preserve the resources from the effects of the climate.
Heritage assets	Heritage assets may include natural assets such as conservation areas and recreational parks. Entities usually have responsibilities for the preservation of these assets. Climate change may require additional measures to preserve heritage assets. Costs incurred to enhance or restore a heritage asset to preserve its indefinite useful life should be capitalised as part of its cost when the recognition criteria in GRAP 103 on *Heritage Assets* are met. Day-to-day operating costs or the costs to maintain or to hold the heritage asset are not capitalised and are recognised in surplus or deficit as they are incurred.
Impairment of non-monetary assets measured on the cost model or revaluation model	An entity is required to assess whether there is any indication that an asset is impaired at each reporting date. GRAP 21 on *Impairment of Non-Cash-Generating Assets* and GRAP 26 on *Impairment of Cash-Generating Assets* include that significant changes in the environment in which an entity operates with an adverse effect on the entity, is an indication of impairment. Climate-related matters may provide indications that an asset is impaired. For example, a wildfire caused by climate change can physically damage assets. The damage to the assets is an indicator of impairment. When there is an indicator, the asset is tested for impairment. An impairment loss arises when an asset's carrying amount is lower than its recoverable amount or its recoverable service amount. In determining the asset's recoverable amount/ recoverable service amount, an entity may be required to calculate the asset's value in use. When calculating value in use, entities should consider whether climate-related matters affect the reasonable and supportable assumptions used in the value in use calculation.

	GRAP 21 and GRAP 26 require disclosure of the events and circumstances that led to the recognition of an impairment loss. Disclosure of key assumptions used to estimate the asset's recoverable amount/recoverable service amount is also required.
Biological assets and agricultural produce	Biological assets and agricultural produce are measured at fair value less costs to sell. A change in climate can either positively or negatively affect the biological asset or agricultural produce, thus giving rise to change in valuation of the asset at reporting date. Gains or losses on remeasurement are recognised in surplus or deficit for the year. GRAP 27 on *Agriculture* requires disclosure of restrictions on the entity's use or capacity to sell biological assets. These restrictions could be ethical to support climate action. Agricultural activity is often exposed to climatic, disease and other natural risks. If an event occurs that gives rise to a material item of revenue or expense, GRAP 27 requires disclosure on the nature and amount of that item.

Monetary assets

Monetary assets include financial assets, lease receivables, plan assets of defined benefit plans and statutory receivables. The table below explains the effect of climate-related matters on the specific monetary asset.

Monetary asset	**Effect of climate-related matter**
Financial assets	A contractual right arising from activities to reduce the effects of climate change can give rise to a financial asset for the entity. Entities may provide loans with terms linked to the counterparty's achievement of climate-related targets. Entities should pay careful attention to the classification of these types of financial assets i.e. whether they should be measured at fair value or at amortised cost. Entities are required in GRAP 104 on *Financial Instruments* to provide information on credit risk, liquidity risk, and where relevant to users of the financial statements, exposure to market risk. Climate-related matters may expose an entity to these risks. For example, for lenders, it may be necessary to provide information about the effect of climate-related matters on the concentrations of credit risk.

Impairment of financial assets and statutory receivables	Climate-related matters may affect an entity's exposure to credit risk. For example, natural disasters or regulatory changes by government in their response to climate change could negatively affect the counterparty's ability to pay. Impairment losses are determined by comparing the carrying value of the asset to the amount determined based on the cash flows that an entity expects to collect, and when an entity expects to collect them. Even if an entity expects to receive all the cash flows but over a delayed period, an impairment loss has occurred. For financial assets at amortised cost, the cash flows are discounted using the effective interest rate of the asset. For statutory receivables, when the time value of money is material, the cash flows are discounted using a risk-free rate, adjusted for any specific risks relevant to the receivable. If investments in residual interests are measured at cost, an entity uses the market rate at reporting date to discount the cash flows. Disclosure about how impairment losses have been identified and determined will be important to the users of financial statements to understand the impact on the estimates used.

Liabilities

Liabilities include financial liabilities, lease liabilities, provisions and liabilities related to employee benefits. Entities should understand what promises, commitments or obligations they have that arise from climate-related matters to determine whether a liability exists at the reporting date. The table below explains the effect of climate-related matters on the liabilities of the entity.

Liability	**Effect of climate-related matter**
Financial liabilities	A contractual obligation arising from climate-related activities can give rise to a financial liability for the entity. Government entities may have green bonds in issue that raise money for climate-related projects. Where there are commitments attached to the issuance of the bonds, entities may need to consider whether the requirement to use the green bond for a specific purpose results in a restriction/debt covenant.
Provisions	Provisions for activities relating to climate action are recognised in accordance with GRAP 19 on *Provisions,*

	Contingent Liabilities and Contingent Assets. Some types of provisions include: • Provision for the restructuring of an entity to achieve climate-related targets. The provision recognised is the best estimate of the expenditure required to settle the obligation at the reporting date. Restructurings may result in the recognition of termination benefits for employees. Employee benefits liabilities are dealt with in GRAP 25 on *Employee Benefits.* • Onerous contracts that may arise, for example, due to increased costs as a result of climate-related changes in legislation, such as the introduction of carbon taxes. The provision reflects the lower of the costs of fulfilling the contract and any compensation or penalties from a failure to fulfil the contract. <u>Provisions arising from legislation</u> There may be legislative or regulatory requirements applicable to entities to discourage them from negatively contributing to climate change, or require them to respond to environmental damage, such as: • The restoration and rehabilitation of land and the environment where the entity used the land and its environment for its operations. IGRAP 2 on *Changes in Existing Decommissioning, Restoration and Similar Liabilities* contains requirements for the recognition of the rehabilitation provision. • Natural disaster response or emergency relief due to changes in climate. • Levies or taxes imposed for failure to meet climate-related targets or to discourage certain activities. • The restoration and rehabilitation of the land and the landfill site that the entity used to conduct its waste disposal activities. The Guideline on *Accounting for Landfill Sites* assists entities in accounting for the rehabilitation provision. Entities should ensure that the disclosures on provisions help users to understand the uncertainties relating to the amount or timing of any outflows and the major assumptions made

	concerning future events in recognising and measuring provisions.
Contingent liabilities	Commitments to undertake climate-related activities can result in contingent liabilities for the entity. Contingent liabilities are not recognised. Entities are required to disclose the nature, financial effect, uncertainties and possibility of reimbursement of the contingent liability.

Revenue

Revenue may arise from exchange or non-exchange transactions. Climate changes may affect citizens' behaviour that impact the entity's ability to generate revenue. For example, changes in electricity consumption patterns may impact the entity's estimates of revenue from electricity sales. Revenue from exchange transactions are accounted for in accordance with GRAP 9 on *Revenue from Exchange transactions* while revenue from non-exchange transactions are accounted for in accordance with GRAP 23 on *Revenue from Non-exchange Transactions (Taxes and Transfers).*

Expenses

Climate-related matters may affect the recognition of expenses for entities. For example, entities may incur additional insurance expenses because of higher premiums as insurers manage their increased risk exposure on climate change. The key consideration in accounting for the expense is whether an obligation exists. An entity must demonstrate that a past event has occurred (through a contract, legislation or past practice) which means that there is no realistic alternative but to incur an outflow of economic benefits or service potential, in order to recognise a liability and a related expense. See the section above on "Liabilities".

Other issues

Presentation of budget and actual information

Entities are required to present information that compares actual and budget information in the financial statements. Unexpected occurrences because of climate-related matters that result in budget adjustments or material variances between budget and actual amounts should be explained.

Segment reporting

Climate-related matters may impact an entity's segment reporting disclosure. Consideration should be given to whether the:

- Presentation of information in management's internal reporting on segments reflect any climate-related effects, and whether this is consistent with the information presented in the segment report in the financial statements.
- Assessment and disclosure of geographical segments should change due to climate-related events.

References

IFRS Foundation. (July 2023). IFRS® Accounting Education material: *Effects of climate-related matters on financial statements.*

IFRS Foundation. (May 2023). IFRS® for SMEs Accounting Standard Education material: *Effects of climate-related matters on financial statements prepared in accordance with the IFRS for SMEs Accounting Standard.*