November 2020

Effects of climate-related matters on financial statements

This document is intended to support the consistent application of requirements in IFRS® Standards

Climate change is a topic in which investors and other IFRS stakeholders are increasingly interested because of its potential effect on companies' business models, cash flows, financial position and financial performance. Most industries have been, or are likely to be, affected by climate change and efforts to manage its impact. However some companies, industries and activities will be affected more than others.

IFRS Standards do not refer explicitly to climate-related matters. However, companies must 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. Information is material[1] if omitting, misstating or obscuring it could reasonably be expected to influence decisions that primary users of financial statements (hereafter, investors) make on the basis of those financial statements, which provide financial information about a specific company. For example, information about how management has considered climate-related matters in preparing a company's financial statements may be material with respect to the most significant judgements and estimates that management has made.

The table below sets out examples illustrating when IFRS Standards may require companies to consider the effects of climate-related matters in applying the principles in a number of Standards. The list is *non-exhaustive*—there could be other instances where climate-related matters are relevant when applying IFRS Standards, for example those on the measurement of defined benefit obligations. Related information can be found in an article by Nick Anderson, member of the International Accounting Standards Board. This educational material complements that article, adding for example specific paragraph references to IFRS requirements to assist those applying IFRS Standards. For purposes of illustration, the descriptions in the table do not always explain the relevant requirements completely; it is therefore important to refer to the requirements in the Standards when preparing financial statements. This document does not address management commentary.

In addition to the specific requirements outlined in the table below, IAS 1 *Presentation of Financial Statements* contains some overarching requirements that could be relevant when considering climate-related matters. For example, paragraph 112 of IAS 1 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 any of the financial statements. This paragraph, together with paragraph 31 of IAS 1, requires a company to consider whether any material information is missing from its financial statements—ie a company is required 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 particular transactions, other events and conditions on the company's financial position and financial performance. Companies will therefore 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. These overarching requirements in IAS 1 may be especially relevant for companies whose financial position or financial performance is particularly affected by climate-related matters.

1 Companies may find the IFRS Practice Statement 2 *Making Materiality Judgements* useful in assessing whether the effect of climate-related matters is material. The article by Nick Anderson includes further information on making materiality judgements.

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IFRS Standards[2]	Effects of climate-related matters on financial statements
IAS 1 *Presentation of Financial Statements* Paragraphs 25–26, 122–124, 125–133	**Sources of estimation uncertainty and significant judgements** 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, IAS 1 requires disclosure of information about those assumptions and the nature and carrying amount of those assets and liabilities. This means disclosure 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. Companies must present that disclosure in a manner that helps investors understand the judgements that management makes about the future. Although the nature and extent of the information provided can vary, it might include for example the nature of the assumptions or the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity. IAS 1 also requires disclosure of the judgements (apart from those involving estimations) that management has made that have the most significant effect on the amounts recognised in the financial statements. For example, a company operating in an industry particularly affected by climate-related matters might test an asset for impairment applying IAS 36 *Impairment of Assets* but recognise no impairment loss. That company would be required to disclose judgements management has made, for example, in identifying the asset's cash-generating unit if such judgements are among those that have the most significant effect on the amounts recognised in the company's financial statements. **Going concern** IAS 1 requires management to assess a company's ability to continue as a going concern when preparing financial statements. In assessing whether the going concern basis of preparation is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, 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 upon a company's ability to continue as a going concern, IAS 1 requires disclosure of those uncertainties. When management has concluded that there are no material uncertainties related to the going concern assumption that require disclosure but reaching that conclusion involved significant judgement (for example, about the feasibility and effectiveness of any planned mitigation), IAS 1 requires disclosure of that judgement.[3]

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2 This column cites paragraphs that support the explanations provided in the table. Climate-related matters may also be relevant in applying other paragraphs in IFRS Standards.

3 See Agenda Decision: IAS 1 *Presentation of Financial Statements*—disclosure requirements relating to assessment of going concern (July 2014).

IFRS Standards[2]	Effects of climate-related matters on financial statements
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 of completion to increase. If, as a result, the cost of inventories is not recoverable, IAS 2 requires the company to write down those inventories to their net realisable value. Estimates of net realisable value are based on the most reliable evidence available, at the time that estimates are made, of the amount the inventories are expected to realise.
IAS 12 *Income Taxes* Paragraphs 24, 27–31, 34, 56	IAS 12 generally requires companies to recognise deferred tax assets for deductible temporary differences and unused tax losses and credits, to the extent it is probable that future taxable profit will be available against which those amounts can be utilised. 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 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 IAS 38 paragraphs 9–64, 102, 104, 118, 121, 126	Climate-related matters may prompt expenditure to change or adapt business activities and operations, including research and development. IAS 16 and IAS 38 specify requirements for the recognition of costs as assets (as an item of property, plant and equipment or as an intangible asset). IAS 38 also requires disclosure of the amount of research and development expenditure recognised as an expense during a reporting period. IAS 16 and IAS 38 require companies to review the estimated residual values and expected useful lives of assets at least annually, and to reflect changes—such as those that might arise from climate-related matters—in the amount of depreciation or amortisation recognised in the current and subsequent periods. Climate-related matters may affect the estimated residual value and expected useful lives of assets, for example, because of obsolescence, legal restrictions or inaccessibility of the assets. Companies are also required to disclose the expected useful lives for each class of asset and the nature and amount of any change in estimated residual values or expected useful lives.

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IFRS Standards[2]	Effects of climate-related matters on financial statements
IAS 36 *Impairment of Assets* Paragraphs 9–14, 30, 33, 44, 130, 132, 134–135	IAS 36 sets out requirements for when companies need to estimate recoverable amounts to assess impairment of goodwill and impairment of assets such as property, plant and equipment, right-of-use assets and intangible assets. A company is required to assess whether there is any indication of impairment at the end of each reporting period. 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 that a manufacturing plant may be impaired, requiring the asset to be tested for impairment. IAS 36 also notes that 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 estimating the recoverable amount using value in use, IAS 36 requires a company to do that reflecting an estimate of the future cash flows it expects to derive from an asset and expectations about possible variations in the amount or timing of those future cash flows. A company is required to base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of future economic conditions. This requires companies to consider whether climate-related matters affect those reasonable and supportable assumptions. IAS 36 requires future cash flows to be estimated for an asset in its current condition, so excluding any estimated cash flows expected to arise from future restructurings or enhancing the asset's performance. IAS 36 requires disclosure of the events and circumstances that led to the recognition of an impairment loss, for example, the introduction of emission-reduction legislation that increased manufacturing costs. Disclosure of key assumptions used to estimate the asset's recoverable amount, as well as information related to reasonably possible changes in those assumptions, is also required in specified circumstances.
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IFRIC 21 *Levies* IAS 37 paragraphs 14–83, 85–86 IFRIC 21 paragraphs 8–14	Climate-related matters may affect the recognition, measurement and disclosure of liabilities in the financial statements applying IAS 37, 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 and an indication of the uncertainties about the amount or timing of any related outflows of economic benefits. Where necessary to provide adequate information, IAS 37 also requires disclosure of the major assumptions made about future events reflected in the amount of a provision.[4]

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4 IAS 37 requires these disclosures unless, in extremely rare cases, disclosure of the information can be expected to prejudice seriously the company's position in a dispute with other parties. In that case, disclosure of the general nature of the dispute is required together with the fact that, and reason why, the information has not been disclosed (paragraph 92).

IFRS Standards[2]	Effects of climate-related matters on financial statements
IFRS 7 *Financial Instruments: Disclosures* Paragraphs 31–42, B8	IFRS 7 requires disclosure of information about a company's financial instruments, including information about 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, for lenders, it may be necessary to provide information about the effect of climate-related matters on the measurement of expected credit losses or on concentrations of credit risk. For holders of equity investments, it may be necessary to provide information about investments by industry or sector, identifying sectors exposed to climate-related risks, when disclosing concentrations of market risk.
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 in a number of ways. For example, loan contracts might include terms linking contractual cash flows to a company's achievement of climate-related targets. Those targets may affect how the loan is classified and measured (ie the lender would need to consider those terms in assessing whether the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding). For the borrower, those targets may affect whether there are embedded derivatives that need to be separated from the host contract. Climate-related matters may also affect a lender's exposure to credit losses. For example, wildfires, floods or policy and regulatory changes could negatively affect a borrower's ability to meet its debt obligations to the lender. Further, assets could become inaccessible or uninsurable, affecting the value of collateral for lenders. In recognising and measuring expected credit losses, IFRS 9 requires use of all reasonable and supportable information that is available without undue cost or effort. Climate-related matters may therefore be relevant—for example, they could affect the range of potential future economic scenarios, the lender's assessment of significant increases in credit risk, whether a financial asset is credit impaired and/or the measurement of expected credit losses.
IFRS 13 *Fair Value Measurement* Paragraphs 22, 73–75, 87, 93	Climate-related matters may affect the fair value measurement of assets and liabilities in the financial statements. For example, market participants' views of potential climate-related legislation could affect the fair value of an asset or liability. Climate-related matters may also affect disclosures about fair value measurements. Specifically, fair value measurements categorised within Level 3 of the fair value hierarchy use unobservable inputs significant to their measurement. IFRS 13 requires that unobservable inputs reflect the assumptions that market participants would use when pricing, including assumptions about risk which may include climate-related risk. IFRS 13 requires disclosure of the inputs used in those fair value measurements and, for recurring fair value measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs might result in a significantly higher or lower fair value measurement.

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IFRS Standards[2]	Effects of climate-related matters on financial statements
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 of insured events that could be affected by climate-related matters include business interruption, property damage, illness and death. Climate-related matters may, therefore, affect the assumptions used to measure insurance contract liabilities applying IFRS 17. Climate-related matters may also affect required disclosures about (a) the significant judgements and changes in judgements made in applying IFRS 17, and (b) a company's exposure to risks, concentrations of risk, how it manages risks and sensitivity analysis showing the effect of changes in risk variables.