Climate in the financial statements - impairment

CLIMATE-RELATED DISCLOSURES WEBINAR SERIES

—

25 June 2025

FUELLING PROSPERITY

We passionately believe that the flow-on effect from focusing on helping **fuel the prosperity** of our clients significantly contributes to ensuring that our communities, and ultimately our country and all New Zealanders, will enjoy a more prosperous future.

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Agenda

01 Context

02 Impairment indicators

03 Climate change in cash flow models

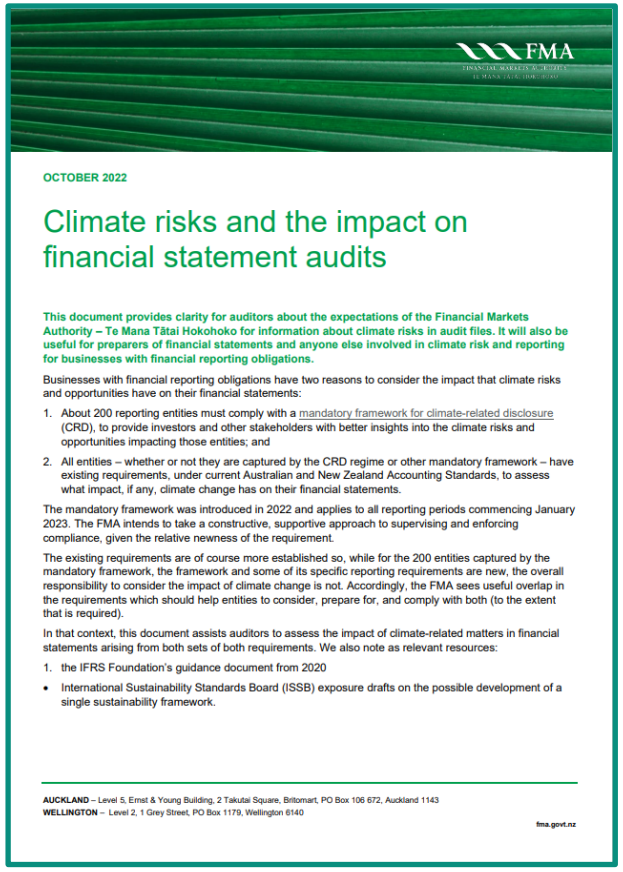
04 Disclosures in the financial statements

05 Connectivity with the front end of annual report or other entity reports

01
Context

*Climate reporting entities

Climate-related matters are not just for CREs * to consider



FMA

OCTOBER 2022

Climate risks and the impact on financial statement audits

This document provides clarity for auditors about the expectations of the Financial Markets Authority – Te Mana Tātai Hokohoko for information about climate risks in audit files. It will also be useful for preparers of financial statements and anyone else involved in climate risk and reporting for businesses with financial reporting obligations.

Businesses with financial reporting obligations have two reasons to consider the impact that climate risks and opportunities have on their financial statements:

1. About 200 reporting entities must comply with a mandatory framework for climate-related disclosure (CRD), to provide investors and other stakeholders with better insights into the climate risks and opportunities impacting those entities; and
2. All entities – whether or not they are captured by the CRD regime or other mandatory framework – have existing requirements, under current Australian and New Zealand Accounting Standards, to assess what impact, if any, climate change has on their financial statements.

The mandatory framework was introduced in 2022 and applies to all reporting periods commencing January 2023. The FMA intends to take a constructive, supportive approach to supervising and enforcing compliance, given the relative newness of the requirement.

The existing requirements are of course more established so, while for the 200 entities captured by the mandatory framework, the framework and some of its specific reporting requirements are new, the overall responsibility to consider the impact of climate change is not. Accordingly, the FMA sees useful overlap in the requirements which should help entities to consider, prepare for, and comply with both (to the extent that is required).

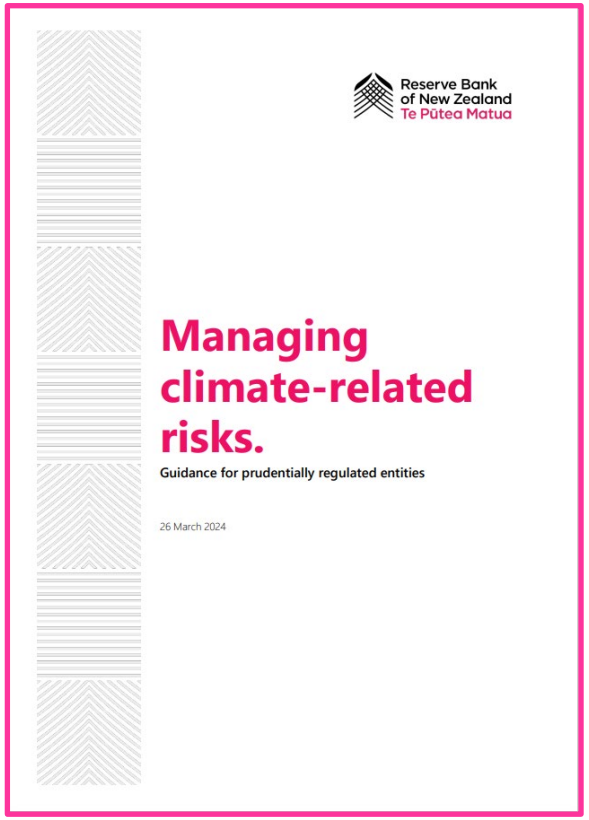
In that context, this document assists auditors to assess the impact of climate-related matters in financial statements arising from both sets of both requirements. We also note as relevant resources:

1. the IFRS Foundation's guidance document from 2020

- International Sustainability Standards Board (ISSB) exposure drafts on the possible development of a single sustainability framework.

AUCKLAND – Level 5, Ernst & Young Building, 2 Takutai Square, Britomart, PO Box 106 672, Auckland 1143
WELLINGTON – Level 2, 1 Grey Street, PO Box 1179, Wellington 6140

fma.govt.nz

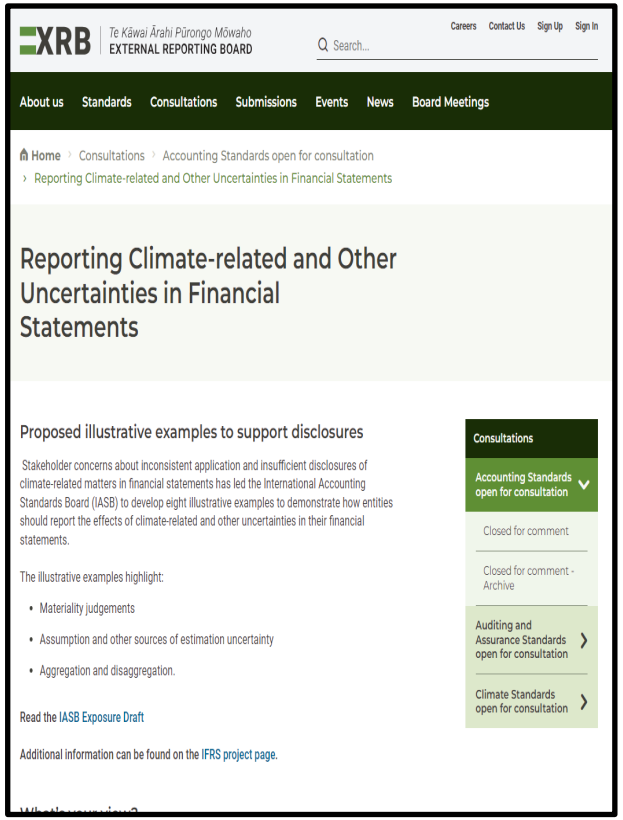


Reserve Bank of New Zealand
Te Pūtea Matua

Managing climate-related risks.

Guidance for prudentially regulated entities

26 March 2024



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Reporting Climate-related and Other Uncertainties in Financial Statements

Proposed illustrative examples to support disclosures

Stakeholder concerns about inconsistent application and insufficient disclosures of climate-related matters in financial statements has led the International Accounting Standards Board (IASB) to develop eight illustrative examples to demonstrate how entities should report the effects of climate-related and other uncertainties in their financial statements.

The illustrative examples highlight:

- Materiality judgements
- Assumption and other sources of estimation uncertainty
- Aggregation and disaggregation.

Read the IASB Exposure Draft

Additional information can be found on the IFRS project page.

Consultations

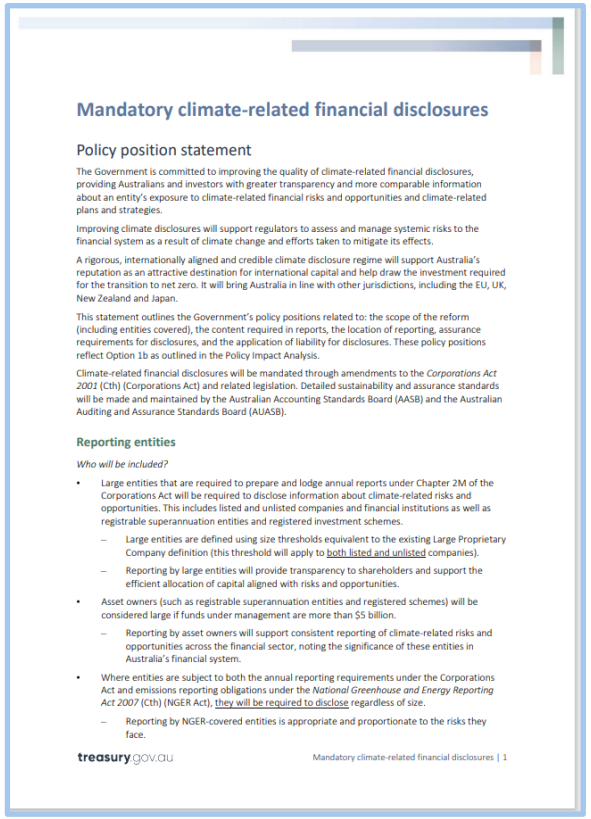
Accounting Standards open for consultation

Closed for comment

Closed for comment - Archive

Auditing and Assurance Standards open for consultation

Climate Standards open for consultation



Mandatory climate-related financial disclosures

Policy position statement

The Government is committed to improving the quality of climate-related financial disclosures, providing Australians and investors with greater transparency and more comparable information about an entity's exposure to climate-related financial risks and opportunities and climate-related plans and strategies.

Improving climate disclosures will support regulators to assess and manage systemic risks to the financial system as a result of climate change and efforts taken to mitigate its effects.

A rigorous, internationally aligned and credible climate disclosure regime will support Australia's reputation as an attractive destination for international capital and help draw the investment required for the transition to net zero. It will bring Australia in line with other jurisdictions, including the EU, UK, New Zealand and Japan.

This statement outlines the Government's policy positions related to: the scope of the reform (including entities covered), the content required in reports, the location of reporting, assurance requirements for disclosures, and the application of liability for disclosures. These policy positions reflect Option 1b as outlined in the Policy Impact Analysis.

Climate-related financial disclosures will be mandated through amendments to the *Corporations Act 2001* (Cth) (Corporations Act) and related legislation. Detailed sustainability and assurance standards will be made and maintained by the Australian Accounting Standards Board (AASB) and the Australian Auditing and Assurance Standards Board (AUASB).

Reporting entities

Who will be included?

- Large entities that are required to prepare and lodge annual reports under Chapter 2M of the Corporations Act will be required to disclose information about climate-related risks and opportunities. This includes listed and unlisted companies and financial institutions as well as registrable superannuation entities and registered investment schemes.
  - Large entities are defined using size thresholds equivalent to the existing Large Proprietary Company definition (this threshold will apply to both listed and unlisted companies).
  - Reporting by large entities will provide transparency to shareholders and support the efficient allocation of capital aligned with risks and opportunities.
- Asset owners (such as registrable superannuation entities and registered schemes) will be considered large if funds under management are more than $5 billion.
  - Reporting by asset owners will support consistent reporting of climate-related risks and opportunities across the financial sector, noting the significance of these entities in Australia's financial system.
- Where entities are subject to both the annual reporting requirements under the Corporations Act and emissions reporting obligations under the *National Greenhouse and Energy Reporting Act 2007* (Cth) (NGER Act), they will be required to disclose regardless of size.
  - Reporting by NGER-covered entities is appropriate and proportionate to the risks they face.

treasury.gov.au

Mandatory climate-related financial disclosures | 1

Climate-related risks and opportunities

Physical risks

Risks related to the physical impacts of climate change.

Acute

Chronic

Transition risks

Risks related to the transition to a low-emissions, climate-resilient global and domestic economy, including mitigation and adaptation.

Policy

Legal

Technology

Market

Reputation

Climate-related Opportunities

The potentially positive climate-related outcomes for an entity. Efforts to mitigate and adapt to climate change can produce opportunities.

Resource Efficiency

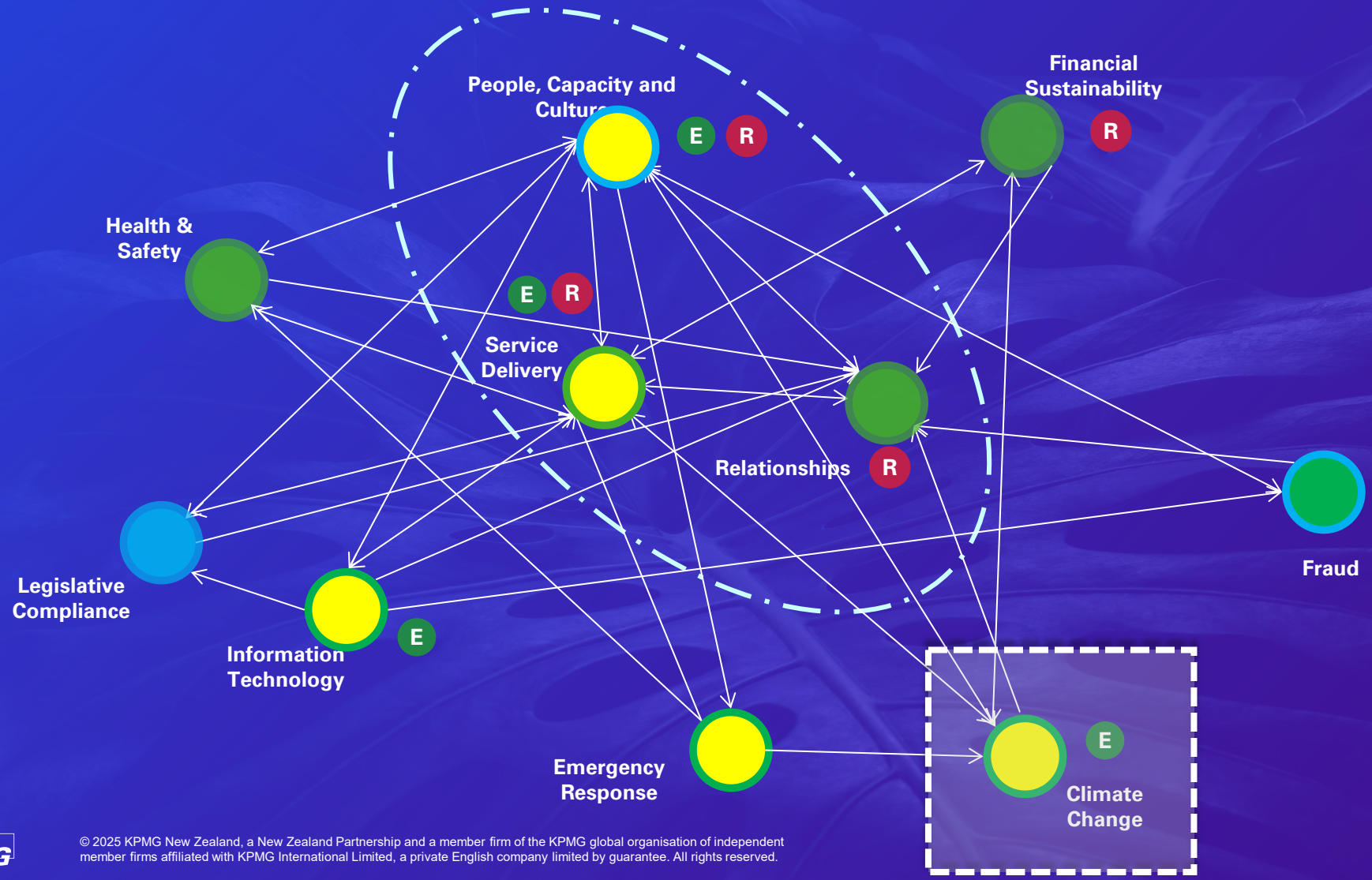
Cost Savings

Low-emissions Energy

New Products

Value Chain Resilience

Interconnectivity



KEYS

E Emitter risk

- People & Culture
- IT
- Climate Change
- Service delivery

R Receiver risk

- People & Culture
- Service Delivery
- Relationships
- Financial Sustainability

Relation to Residual Risk and Risk Appetite

Colour of circle = Current Residual Risk Rating

Outline of circle = Target Residual Risk rating

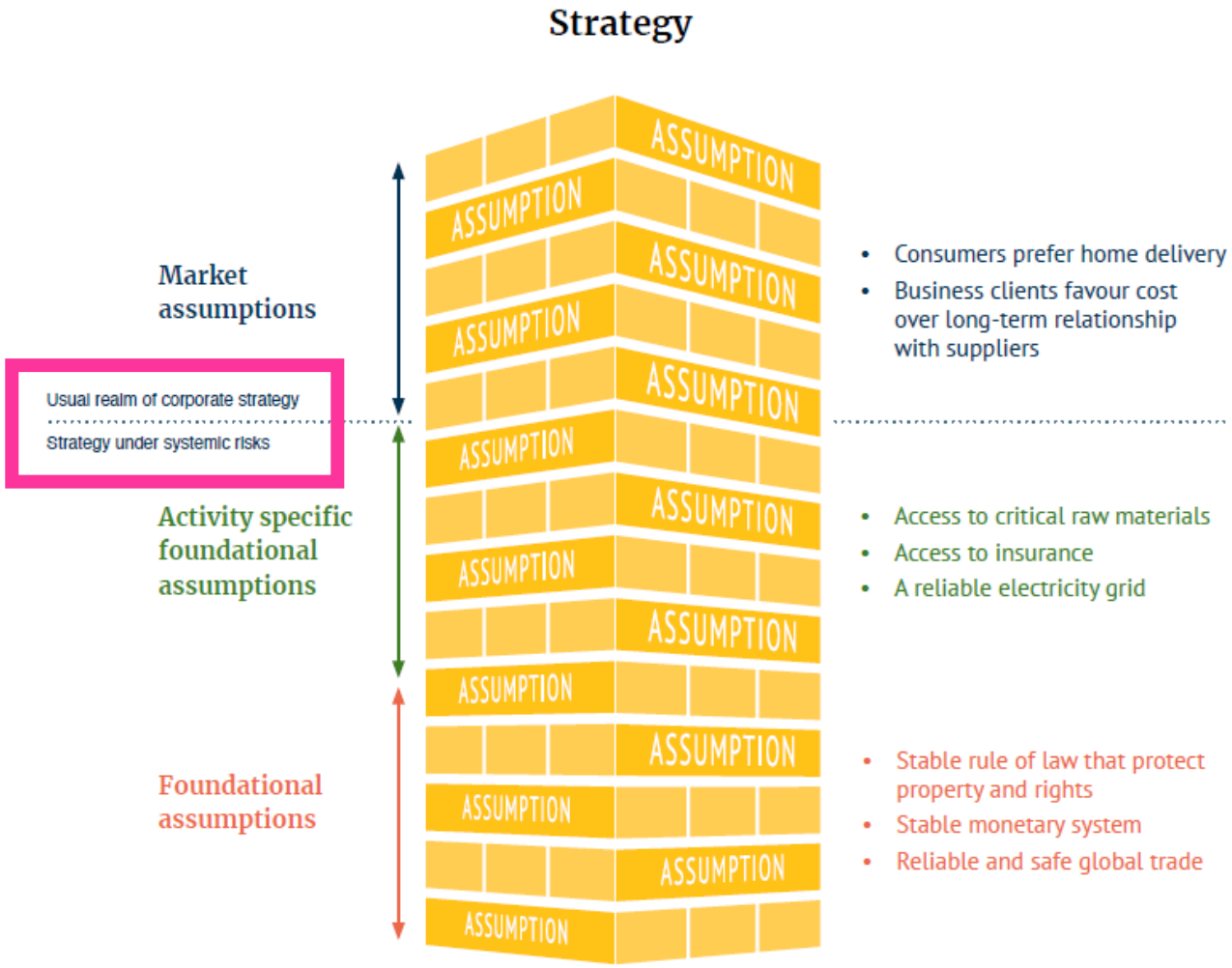
Example = Medium Residual Risk rating with a Low Residual Risk Target/Risk appetite

Residual Risk and Risk Appetite Key

- Critical Risk
- High Risk
- Medium Risk
- Low Risk

Need to understand...

...the resilience of the business model and strategy...

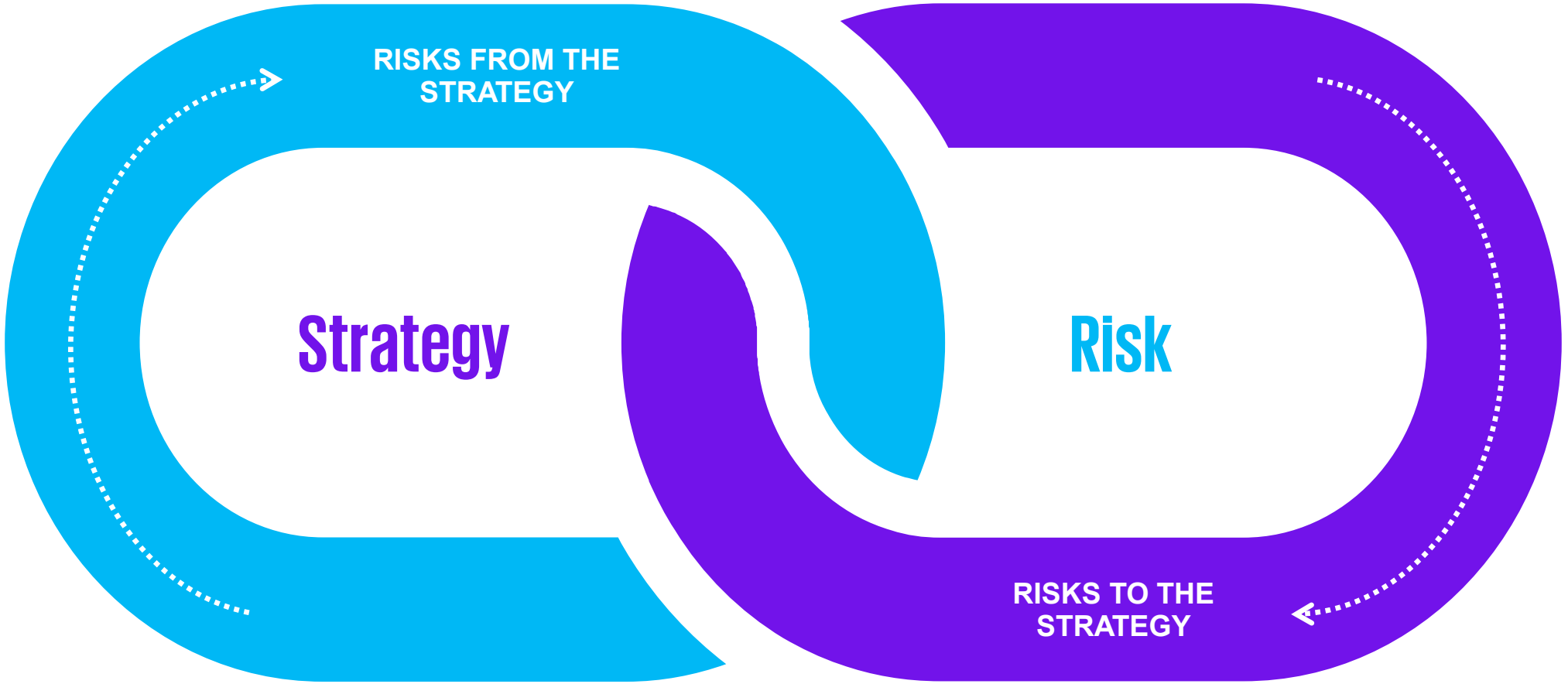


https://www.chapterzero.nz/resources-and-insights/transition-planning-a-guide-for-directors

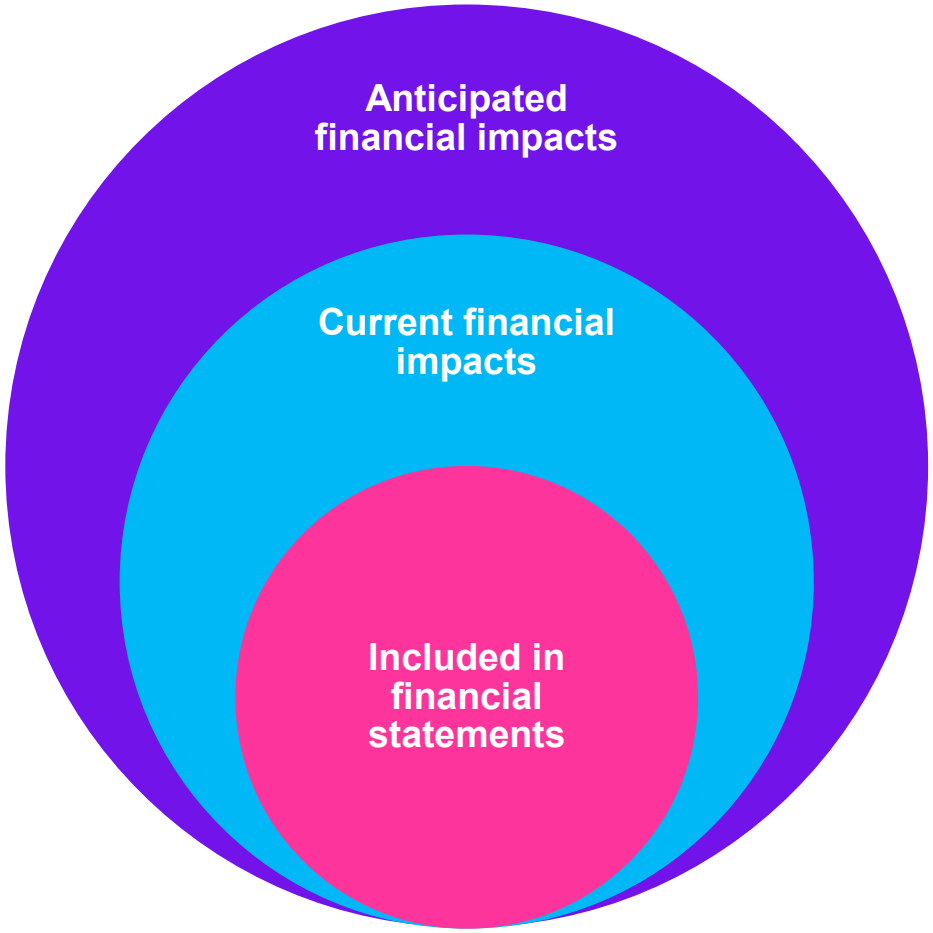
Consider the full value chain

What are the all the activities, resources and relationships related to the business model and external environment in which the entity operates?

Linkage of strategy and risk



Financial impacts



The impact of climate considerations on impairment calculations

- Where to reflect climate-related matters?
- Which approach to apply?
- How to reflect climate-related matters in the terminal value?

02

Impairment indicators

Impairment indicators: Recap

The effects of climate-related risks are considered when assessing whether indicators of impairment exist.

External indicators of impairment:

- Significant changes have taken place during the period or will take place in the near future in the technological, market, economic, or legal environment in which the entity operates.
- Market required rates of return on investments have increased during the period.
- The carrying amount of net assets > market capitalisation.

Internal indicators of impairment:

- Evidence from internal reporting indicates that the economic performance of an asset (or CGU) will be worse than expected.
- Voluntary environmental commitments (e.g., net zero targets)

Debrief: Impairment indicators

- Entity uses technology emitting high GHG emissions.
- New legislation is expected to pass next year which will restrict certain production methods.
- To continue production after 20X3 requires significant investments in technology and PP&E.
- Entity will also have to abandon certain assets earlier than expected.

Is this an indicator of impairment and why?

A **Yes, if the legislation is expected to have a significant adverse effect on the assets.**

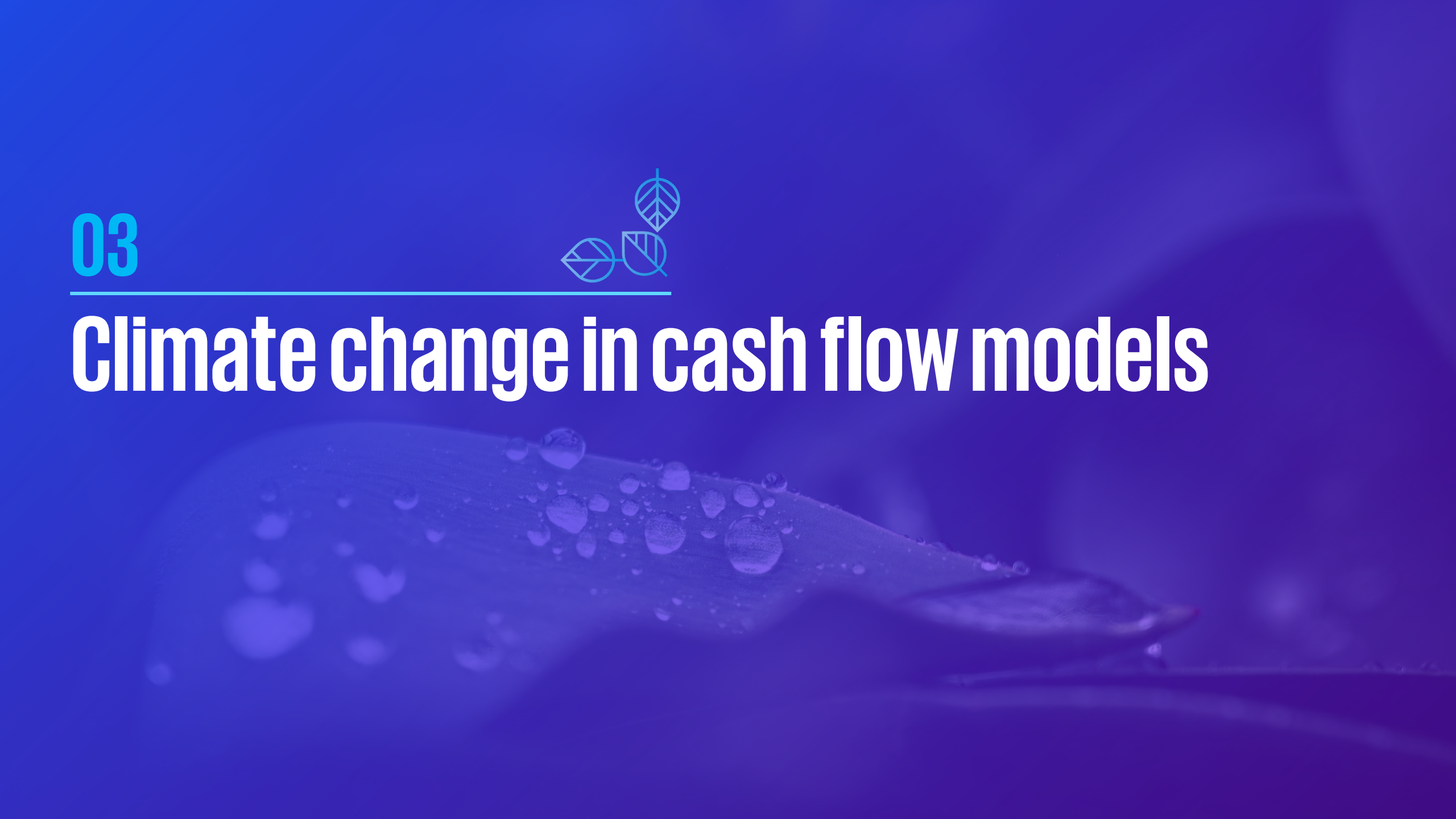
B Yes, because new legislation is an indicator of impairment for most entities.

C No, because the legislation has not been officially passed as of the current year.

D No, if the impact on the assets is due to required legislation rather than being due to a voluntary action.

03

Climate change in cash flow models



Where do you reflect climate-related matters?

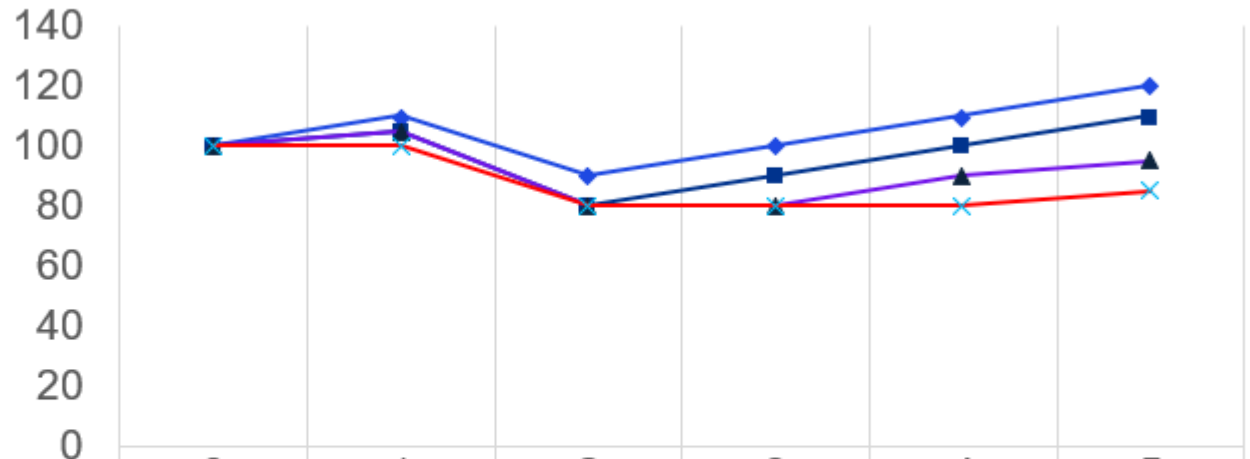
In valuation practice, the impact of climate-related matters is generally reflected in the cash flows (rather than in the discount rate) whenever possible.

- If sufficient data is not available; or
- It's not possible to reliably quantify the impact of a climate-related matter on the cash flows.

→ Adjustments to the discount rate may need to be made.

Traditional vs. Expected Cash Flow approach: Which one to use?

Cash flow projections for the next 5 years:



Probability		0	1	2	3	4	5
10%	Upside	100	110	90	100	110	120
55%	Base case	100	105	80	90	100	110
20%	Downside	100	105	80	80	90	95
15%	Worst case	100	100	80	80	80	85

Traditional approach:	105	80	90	100	110
ECF approach:	105	81	87	96	104

10%*120+55%*110+
20%*95+15%*85

Question for you ...

Which approach to cash flow projections do you use:

A. Traditional

B. Expected cash flows

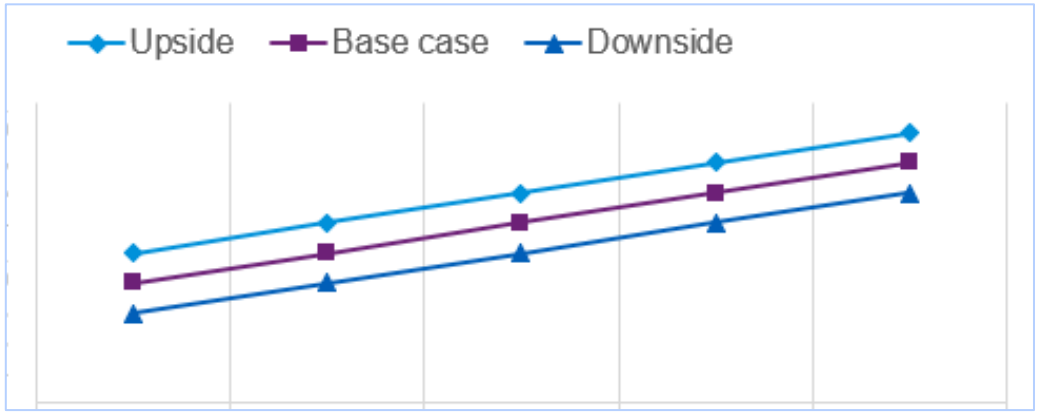
C. It depends ... on what?

Traditional vs. Expected Cash Flow approach: Which one to use?

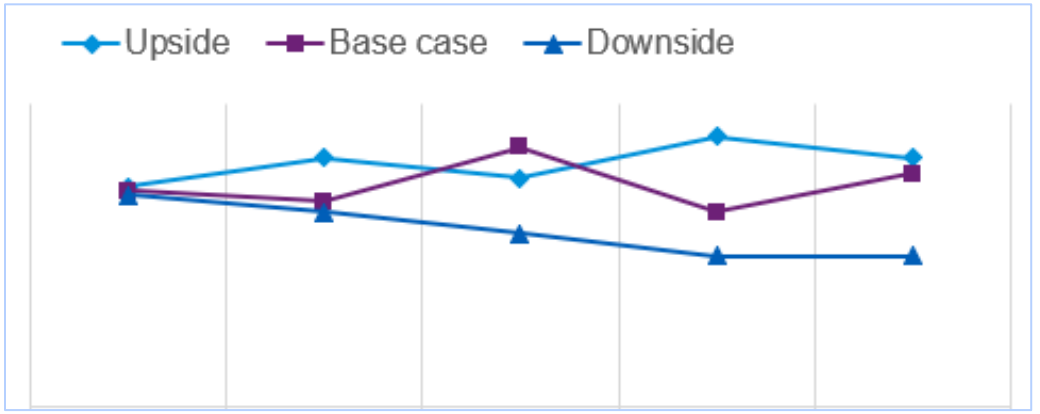
Which approach is more appropriate to be used to reflect climate-related matters?

IT DEPENDS

Traditional approach



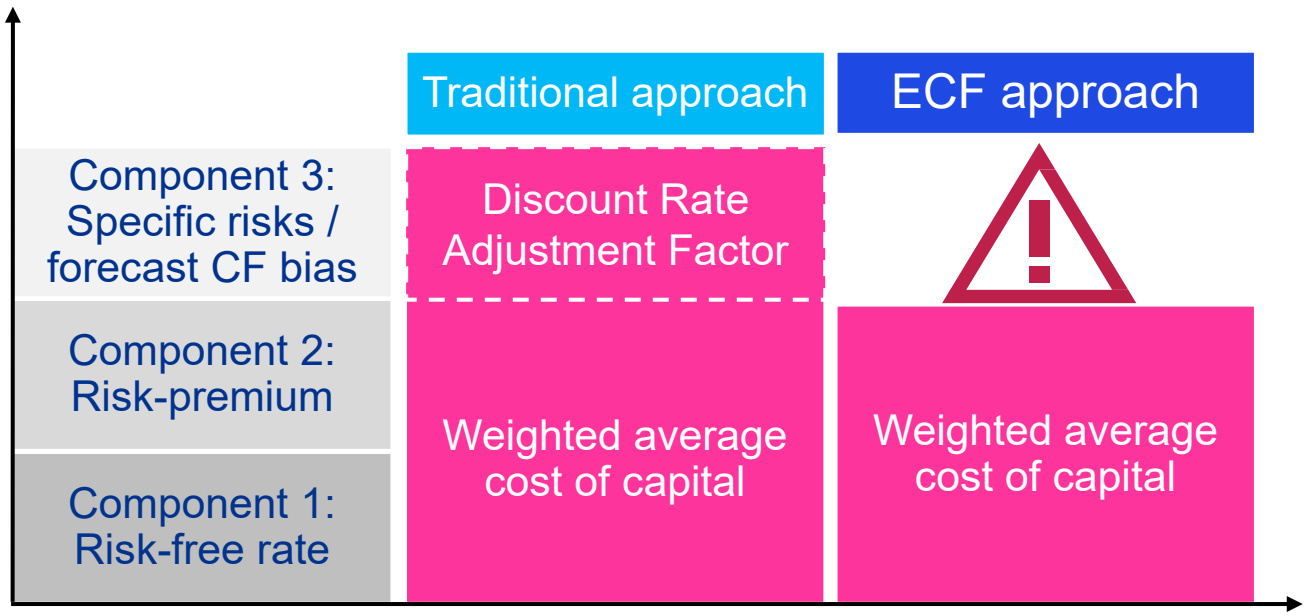
ECF approach



Traditional vs. Expected Cash Flow approach : Discount rate

$$R_e = r_f + (\beta \times (r_m - r_f)) + a$$

A premium for risks not reflected in the beta factor (e.g. forecasting risk).



Under the ECF approach, the discount rate excludes risks reflected in the cash flows.

Debrief: Approaches

Is the following statement true or false?

Under the Traditional approach, the discount rate excludes risks reflected in the cash flows.

A True

B **False**

Maintenance vs. expansion capex and restructurings under VIU

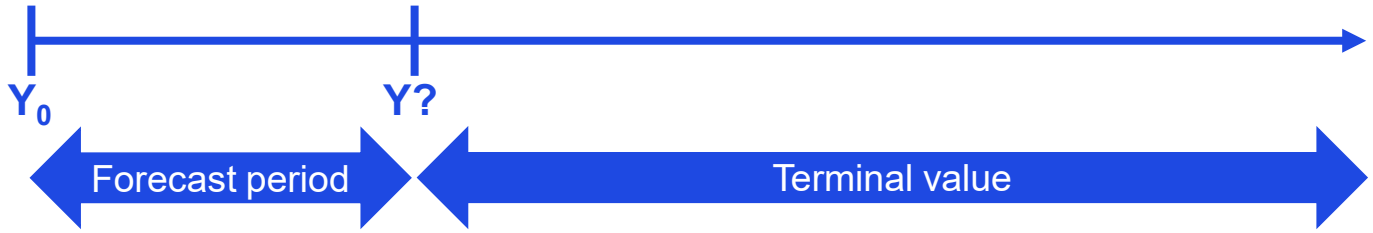
JUDGMENT

Maintenance Capex

Expansionary Capex

Impact of climate change on terminal value & forecast period

The terminal value is the parameter likely to be most affected by climate-related matters.



The **terminal value =** present value of the cash flows to be generated from the end of the forecast period until

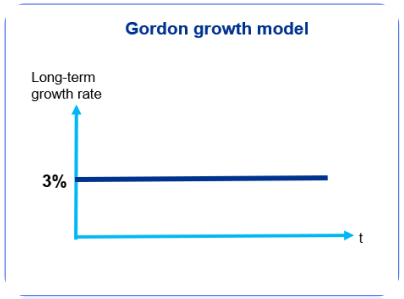
- the end of the asset's or CGU's life, or
- into perpetuity if it does not have a limited useful life

What elements of the terminal value do you think climate change may affect?

Terminal value: Models

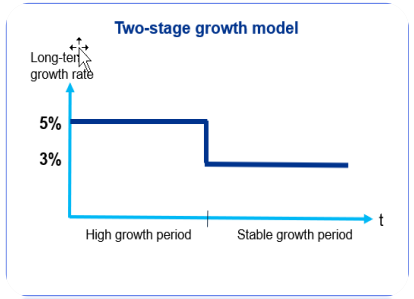
Gordon growth model

A one-stage model that is used when the business is expected to have a ***stable*** long-term growth rate in the terminal period.



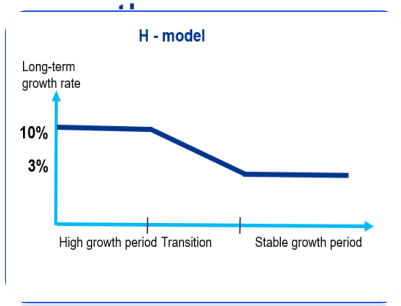
Two-stage growth model

Model used when the business is expected to have an initial phase of higher growth in the terminal period followed by a phase of stable long-term growth.



H-model

Similar to the two-stage model except that the initial phase is not constant but declines over time to reach the subsequent phase of stable long-term



Terminal (exit) multiple method

Method uses a market multiple (e.g. Enterprise value-to-EBIT).

Method applies only to FVLCD.

Terminal value: Capex & the long-term growth rate

Long-term growth rate assumptions must be consistent with assumptions on capital expenditures (e.g. higher growth rates require a higher level of investment in capital).

Capital expenditures included in the cash flows used to calculate the terminal value may require an adjustment to reflect the capital expenditure in the steady state (e.g. lumpy).

NZ IAS 36 contains restrictions on reflecting capital expenditures in a VIU calculation and on the long-term growth rate.

Debrief: Terminal value models

Entity D has a cash flow that starts with a phase of higher growth in the terminal period followed by a phase of stable long-term growth.

Which model is the most appropriate to determine the terminal value in this scenario?

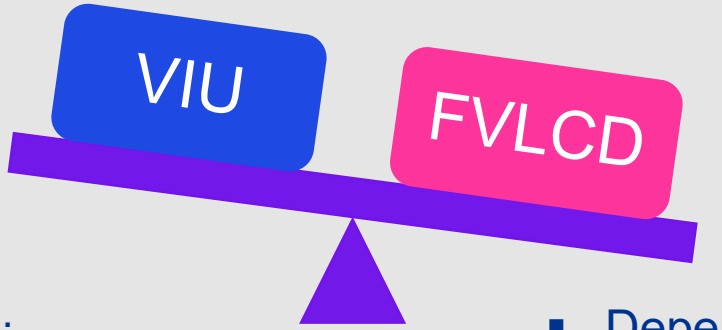
A Gordon growth model.

B **Two-stage growth model.**

C H-model.

D A Terminal (exit) multiple method.

Don't forget about "fair value less cost of disposal" (FVLCD)



- Restrictions in calculations
- Depends on the **market participant's** perspective.

CGU identification remains an important factor to consider.

04

Disclosures in the financial statements

Disclosure requirements

- Disclosures required by NZ IAS 36
- Disclosures required by NZ IAS 1 – Overarching requirements
- Disclosures required by NZ IAS 1 – Key accounting judgments
- Disclosures required by NZ IAS 1 – Estimation uncertainty
- Guidance issued by regulators

Ensure consistency, where appropriate, in key assumptions and judgments underlying the information disclosed in the front part of the annual report or other entity reports.

Debrief: Disclosures

Is the following statement true or false?

The requirement in NZ IAS 36 to disclose key assumptions used to estimate the recoverable amount applies also to those that are climate-related.

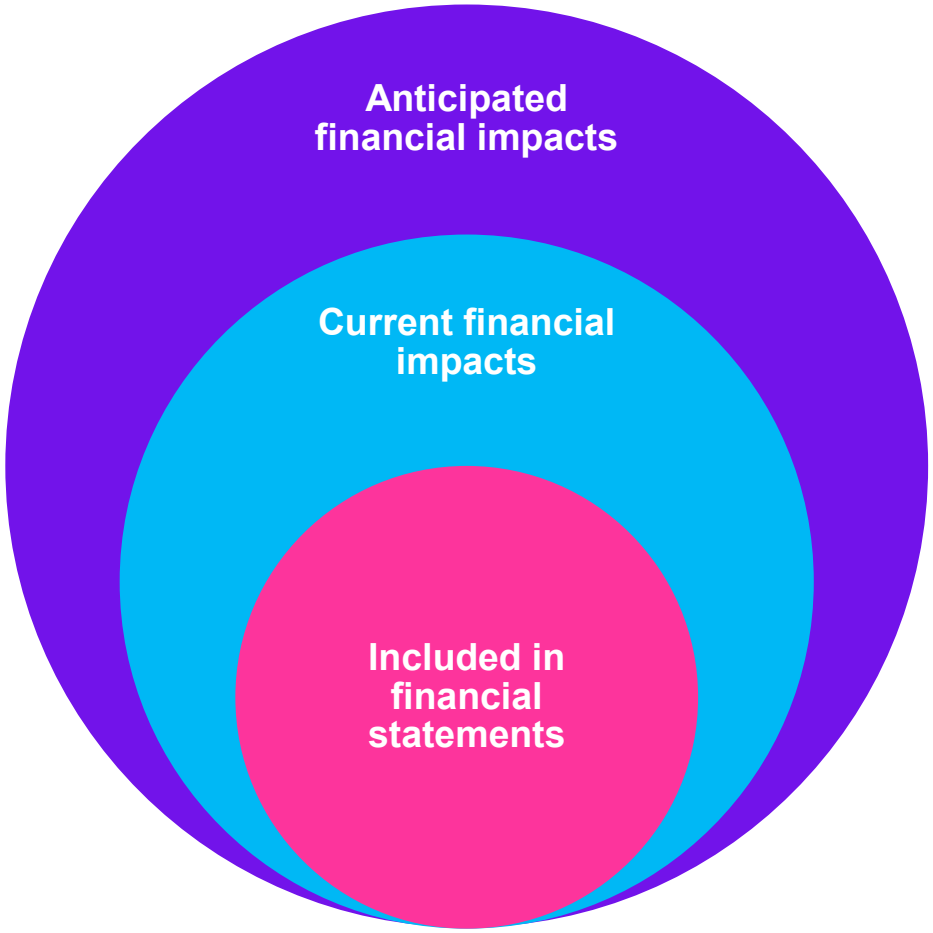
A **True**

B False

05

Connectivity with the front end of annual report or other entity reports

Financial impacts



Consistency with the 'front end' and other entity reports

Although the data and assumptions may differ from the financial statements, they need to be consistent, where appropriate, with any differences explained.

Evaluate whether inconsistencies exist and whether they are appropriate.

Data and assumptions may not be consistent with those used to estimate VIU. For example, due to the NZ IAS 36 constraints on reflecting:

- Asset enhancements or improvements
- Uncommitted restructurings
- The length of the forecast period (5-year limit)

06

Wrap-up

Key points to remember

Climate-related factors may trigger some of the internal or external indicators of impairment.

01

The impact of climate-related matters is generally reflected in the cash flows, whenever possible.

02

In certain cases, climate-related matters may be more appropriately captured by applying the ECF approach.

03

When climate-related matters are significant, consider whether the discount rate reflects the return required by a market participant.

04

Clear, transparent and connected disclosures about the impact of climate-related matters on impairment testing are key.

05

Questions?

Thank You

Ngā Mihi

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