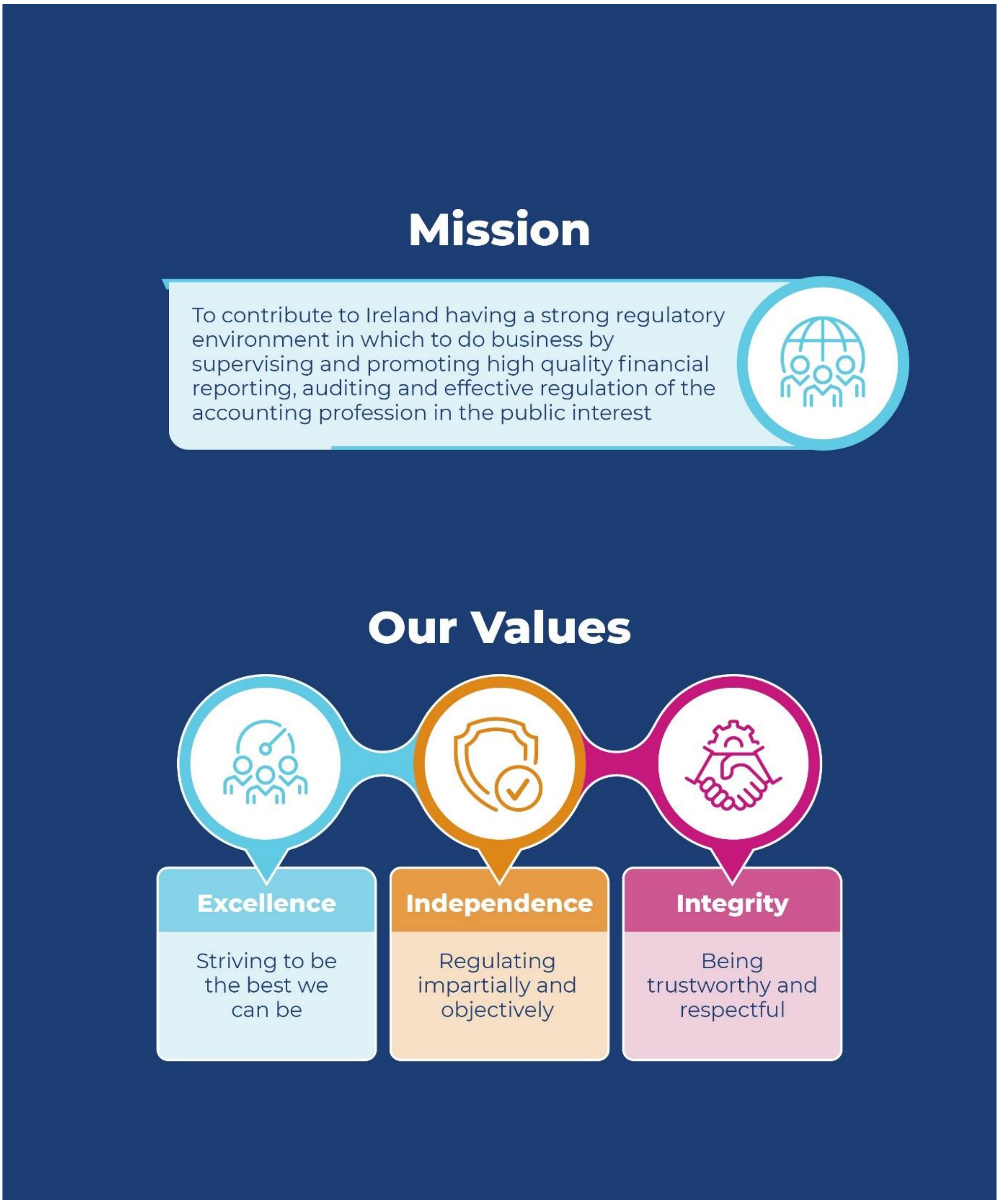
October 2022

Financial Reporting Supervision

Climate-related disclosures in financial reports – IAASA information requests

IAASA

Irish Auditing & Accounting Supervisory Authority



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1. Purpose of this publication

The primary purpose of this publication is to provide preparers, auditors and users of financial statements with information to encourage discussion as to whether issuers adequately consider the appropriateness and completeness of the climate-related disclosures provided in periodic financial reports.

With the aim of achieving this primary purpose, IAASA is publishing a selection of the climate-related information requests that it has made to issuers during the 2022 cycle of financial statement examinations.

2. Climate-related disclosures in financial reports

Given the increasing concerns globally regarding climate matters and the increasing demand for information from businesses regarding these matters, IAASA is examining issuers' financial statements to ensure that there is consistent treatment of climate-related information between the financial statements and information published elsewhere by the issuer (e.g., in the management report, in market announcements and in separate sustainability reports).

IAASA has noted that issuers' have made pronouncements regarding their climate-related actions including climate emissions reduction targets, commitments, and goals/ambitions. Given the significance and prevalence of such climate-related plans in certain issuer's management reports and financial statements, IAASA has engaged with issuers to determine the impact in the areas of:

(a) recognition and measurement of provisions,

(b) disclosures surrounding contingent liabilities,

(c) disclosures surrounding non-adjusting events after the reporting date,

(d) recognition and measurement of impairments,

(e) measurement of inventories,

(f) impact on capital expenditure commitments,

(g) sensitivity analysis,

(h) alternative performance measures (APMs)[1], and

(i) disclosures in the fair review of the development and performance of the business in the management report[2].

The following extracts from IAASA's 2022 *Observations* Paper[3] may provide some relevant context for readers:

"Some climate commitments may meet the definition of a provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in that they may create a constructive obligation resulting in a probable outflow of economic resources and be reliably estimated. If so, the climate commitment may need to be recognised and measured as a provision [IAS 37.14] or a contingent liability may need to be disclosed in the financial statements.

A constructive obligation might arise where an issuer has published, for example, environmental policies, targets, or goals, even though no legal obligation exists. In this context, attention is drawn to the definitions of 'constructive obligation' and 'contingent liability' [IAS 37.10].

IAS 37.85 sets out the disclosure requirements for each class of provision (nature, amounts, uncertainties) and IAS 37.86 provides the disclosure requirements for contingent liabilities (nature, amounts, uncertainties).

Other climate commitments may be achieved through planned future capital expenditure, where a promise made by an issuer to stakeholders results from legal or contractual requirements. In this context, attention is drawn to paragraph 74(c) of IAS 16 *Property, Plant and Equipment.*

1 As defined in the ESMA Guidelines on Alternative Performance Measures ('ESMA APM Guidelines')
2 Regulation 5(4)(c)(ii) of the Transparency (Directive 2004/109/EC) Regulations 2007 (as amended) refers
3 Available at 2022-FRSU-Observations-paper.pdf (iaasa.ie)

Issuers operate within constraints which typically derive from legal obligations. Constraints can also be constructive where obligations are derived from the actions of the issuer that create valid expectations in other parties that the entity will behave in a particular way.

IAASA reminds issuers that at its June 2022 meeting, the IFRS Interpretations Committee ['IFRS IC'] decided to finalise its Agenda Decision *Negative Low Emission Vehicle Credits (IAS 37 Provisions, Contingent Liabilities and Contingent Assets)*. The following is noted in relation to a possible constructive obligation arising:

> 'The possibility of a constructive obligation
>
> The Committee concluded that, if an entity determines that it has no legal obligation to eliminate its negative credits, it would then need to consider whether it has a constructive obligation to do so. It would have a constructive obligation if it has both:
>
> (a) in a calendar year, produced or imported vehicles with average fuel emissions higher than the government target; and
>
> (b) taken an action that creates valid expectations in other parties that it will eliminate the resulting negative credits – for example, made a sufficiently specific current statement that it will do so'
>
> **IFRS Interpretation Commission decision 'Negative low emissions vehicle credits'**

IAASA has engaged with issuers to assess whether or not they, as a result of their public announcements on climate targets, have created constructive obligations warranting recognition as a provision or a disclosure of a contingent liability or a contractual commitment for future capital expenditure.

Given the importance of this matter to a wide range of stakeholders, IAASA continues to engage with issuers on this topic.

Greenwashing – key risk

IAASA considers that greenwashing is risk indicator impacting certain issuers and, consequently, it is engaging with and will continue to engage with issuers. IAASA, together with other EU accounting enforcers are engaging with issuers to minimise the risk of greenwashing. IAASA has noted that certain issuers have made public announcements regarding their CO_2 emission reduction targets by specific dates in their management commentary. However, the financial impact from these climate announcements is not readily apparent from the disclosures in the financial statements. IAASA encourages issuers to ensure that there is an appropriate balance between the disclosures in the management commentary [see Section 2.5of the *Observations* paper] and the disclosures in the financial statements.

IAASA has challenged issuers' climate targets and has required some issuers to provide further explanations on their decarbonisation and nature-based projects which issuers undertake or commit to undertake to achieve climate targets.

IAASA is requesting explanations from issuers to identify any potential greenwashing matters. For example, the type of information IAASA has requested from issuers include:

(a) clarification as to whether or not the climate change risks and/or any expenditure related to the issuer's climate strategy and commitment to achieving net zero on Scope 1 and Scope 2 emissions by a specific date are included or factored into its value-in-use calculations [IAS 36.33(a) to (c)],

(b) provision of an analysis of the costs for decarbonisation and nature-based initiatives that were recognised in the financial statements where such information is not apparent from the disclosures in the financial statements,

(c) an explanation as to why sensitivity analysis does not include sensitivities on the issuer's own commitment of achieving net zero Scope 1 and Scope 2 emissions by a specific date [IAS 1.125 and IAS 1.129], and

(d) an explanation as to why the issuer's public announcement, that it will achieve a net zero on Scope 1 and Scope 2 emissions by a specific date, is not considered to be a constructive obligation and disclosed as a contingent liability [IAS 37.10 and IAS 37.86]."

And

"Regulation 5(4)(c)(ii) of the Regulations requires that '*the management report includes a fair review of the* ***development*** [bold emphasis added] *and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.'*

IAASA engaged with issuers on disclosures in the management report regarding climate related matters. IAASA has noted that issuers have disclosed climate reduction targets and explanations as to how these targets will be met through either decarbonisation or nature-based carbon capture projects in the management report. However, the practical difficulties in implementing the projects are not discussed or referenced in the management reports.

…

IAASA has noted that issuers disclose or publicly announce information regarding their climate goals in publications other than the management report and the financial statements, e.g., in investor presentations and press releases. It is not readily apparent to IAASA as to why this information is not included as part of the fair review of the development of the issuer's business. It is IAASA's expectation that information which is sufficiently significant to warrant inclusion in an investor presentation or a press release is also relevant for disclosure in the management report as part of the fair review of the development of the issuer's business."

3. IAASA information requests to issuers

In undertaking examinations of financial reports, IAASA has considered that the consistency of climate-related information between the financial statements and other pronouncements will likely be a recurring topic over the next number of examination cycles.

To better understand issuers' rationale for their climate-related disclosures, IAASA has sought additional information from issuers during its 2022 financial reporting examination cycle.

Set out below is a non-exhaustive list of information requests that IAASA has asked of issuers:

1. explain what the decarbonisation projects and the carbon-offset/ nature-based projects will cost between 2022 and 20XX in order for the Group to achieve its targeted/committed Scope 1 and Scope 2 emissions reductions by 20XX,

2. explain how the Group will achieve a Net Zero on Scope 1 and Scope 2 emissions by 20XX given that the Group's Scope 1 and Scope 2 emissions have been increasing each year since 20XX,

3. provide an analysis of the costs for the decarbonisation projects and the carbon-offset/nature-based projects that were recognised in the financial statements for the year,

4. explain whether or not climate risk is incorporated into the relevant valuations of the Group's property, plant and equipment and intangible assets,

5. explain whether or not the Group is exposed to:

   (i) levies imposed by Governments for failure to meet climate-related targets or to discourage certain activities,

   (ii) any regulatory requirements to remediate environmental damage,

   (iii) any onerous contracts (for example due to potential loss of revenue or increased costs as a result of climate-related changes in legislation), and

   (iv) any legal claims relating to climate related issues.

6. clarify whether the Group is engaged in carbon or greenhouse gas emissions schemes,

7. explain how the project's design takes into consideration the Group's strategy of being Net Zero by 20XX,

8. explain how the directors assessed that the impact of climate risk is minor compared to the impact of raw material price change,

9. explain what other evidence the Group assessed to ensure its commitment on being a Net Zero entity on Scope 1 and Scope 2 emissions was feasible by 20XX – given that the feasibility report/study was not completed for the project at the reporting date,

10. explain why the Group's public announcement that it will achieve a Net Zero on Scope 1 and Scope 2 emissions by 20XX is not considered a constructive obligation and, accordingly, disclosed as a contingent liability in accordance with IAS 37.86,

11. clarify whether or not the amounts for the project which were included in the Group's business plan and in the impairment model are also included as provisions in accordance with IAS 37.14 and, if not included as provisions, then explain why not,

12. clarify whether or not the climate change risks and/or any future expenditure related to the Group's strategy/commitment of being Net Zero on Scope 1 and Scope 2 emissions by 20XX are reflected in the value-in-use calculations,

13. explain how the progression of the project would be consistent with the Group's strategy/commitment of being Net Zero on Scope 1 and Scope 2 emissions by 20XX,

14. explain how much the de-carbonisation projects referred to in the annual report would, when completed, reduce the Group's Scope 1 and Scope 2 emissions,

15. clarify whether further de-carbonisation projects/carbon-offset/nature-based projects, in addition to those outlined in the annual report will be required to ensure that the Group achieves its target of being Net Zero on Scope 1 and Scope 2 emissions by 20XX,

16. explain why the annual report does not include sensitivities on the Group's own commitment of achieving Net Zero Scope 1 and Scope 2 emissions by 20XX [IAS 1.125 and IAS 1.129 refer],

17. provide a summary analysis of the costs incurred and to be incurred by the Group between 2021 and 20XX in order to achieve each of the Group's emissions targets,

18. explain how the Group will achieve a X% reduction in absolute Group wide Scope 1 and Scope 2 emissions by 20XX given that the Group's Scope 1 emissions increased in the current year compared to the prior year,

19. explain why the target of having X% of the Group's revenue derived from sustainable products by 20XX does not impact the net realisable value of inventories at the reporting date,

20. provide an analysis of the costs amounting to €Xm for environmental projects that were recognised in the financial statements for the year,

21. in relation to disclosure in the annual report, provide the amounts included for estimated capital expenditure for Project X for the goodwill impairment testing,

22. indicate the amounts recognised by the Group for carbon or greenhouse gas emissions schemes during 2021 and 2020,

23. explain why the directors did not consider the Group's target to achieve an X% reduction in absolute Group-wide Scope 1 and Scope 2 emissions by 20XX to be a non-adjusting event under IAS 10.3 and why the disclosures required by IAS 10.21 (i.e., the nature of the event and an estimate of its financial effect) were not required to be presented in the annual report,

24. confirm whether the capital amounts related to the Group's 20XX and 20XX targets are included in the categories '*contracted but not provided for in the financial statements*' and '*authorised by the Directors but not contracted for'* [IAS 16.74(c) refers],

25. provide a broad analysis of the revenue generated from sustainable products,

26. clarify whether or not the sustainable products that address sustainability challenges means that these products benefit the wider community but do not assist the Group in achieving its own emissions targets as the Group still incurs the same amount of carbon emissions to produce these products,

27. explain whether or not the revenue of €X million from sustainable products is an APM as defined in the ESMA APM Guidelines and, if so, indicate to IAASA how the principles of the ESMA APM Guidelines for this measure were met, and

28. provide to IAASA a reconciliation of the revenue from sustainable products to the turnover measure that is required by the EU Taxonomy Regulation [ESMA Questions and Answers on the ESMA Guidelines on Alternative Performance Measures question 19 refers].

4. Conclusions

IAASA will continue to focus on and engage with issuers in relation to their climate-related disclosures in their future periodic financial reports.

It is IAASA's expectation that management, directors and audit committees will:

(a) consider the information requests outlined in this Paper when determining their climate-related disclosures,

(b) consider whether or not entities' climate commitments require recognition as a provision or disclosure as a contingent liability,

(c) consider the broader impact of the IFRS IC agenda decision titled *Negative Low Emission Vehicle Credits (IAS 37 Provisions, Contingent Liabilities and Contingent Assets*[4], and

(d) ensure that there is a balance and consistency between the disclosures in the management commentary and the disclosures in the financial statements.

[4] IFRS Interpretation Commission decision 'Negative low emissions vehicle credits'

IAASA
Irish Auditing & Accounting
Supervisory Authority

Irish Auditing & Accounting
Supervisory Authority

Willow House
Millennium Park
Naas, Co. Kildare
W91 C6KT
Ireland

Phone: +353 (0) 45 983 600
Email: info@iaasa.ie

www.iaasa.ie