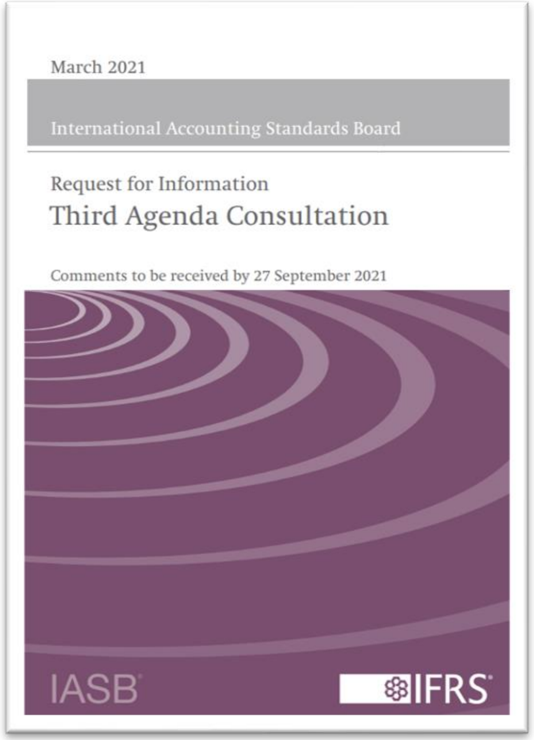
IFRS Accounting

Climate Uncertainties in the Financial Statements

Investor Outreach Germany
6. November 2024

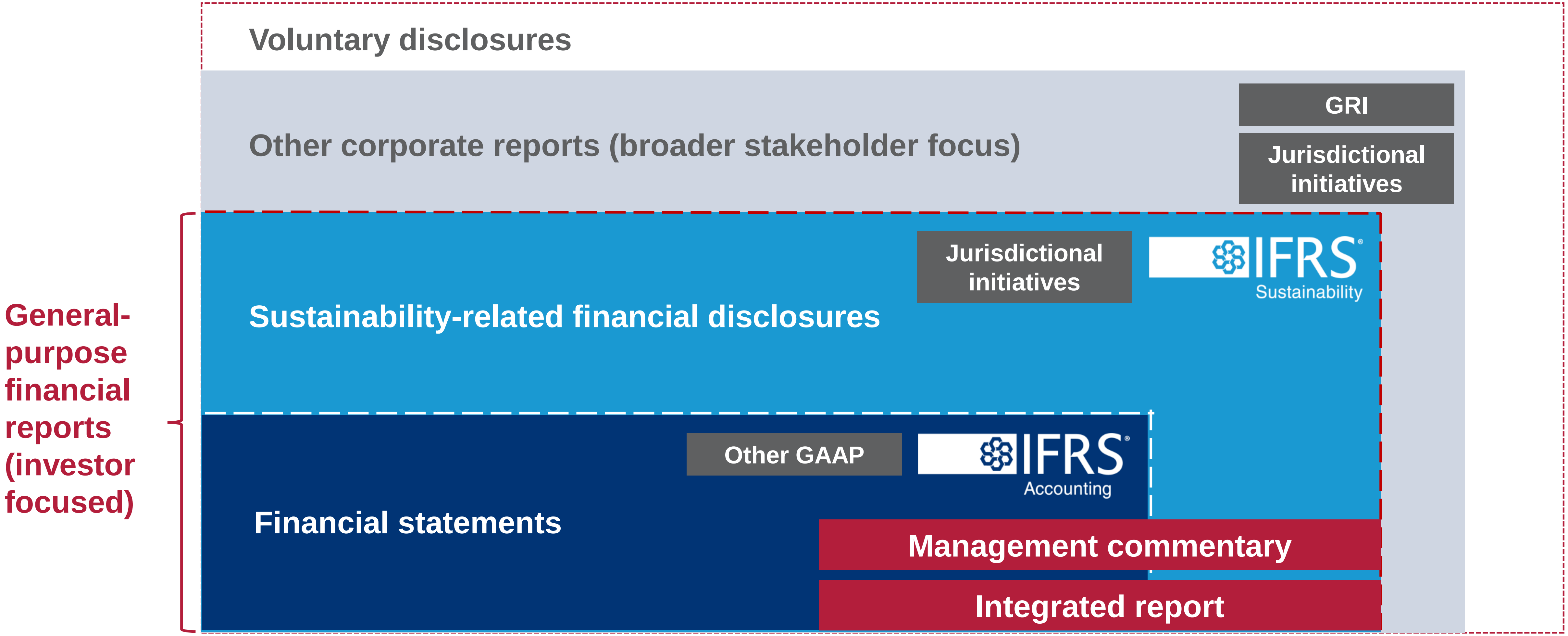
Origins of the project



- In the IASB's Third Agenda Consultation, respondents attributed **high-priority** to a project on climate-related risks in the financial statements

- Concerns that information about climate-related risks in financial statements is:
  - **insufficient**
  - **inconsistent** with information reported elsewhere by the company

Broader reporting landscape



Overview of the project

Project Objective

Explore **targeted actions** to improve the reporting of the effects of **climate-related and other uncertainties** in the financial statements

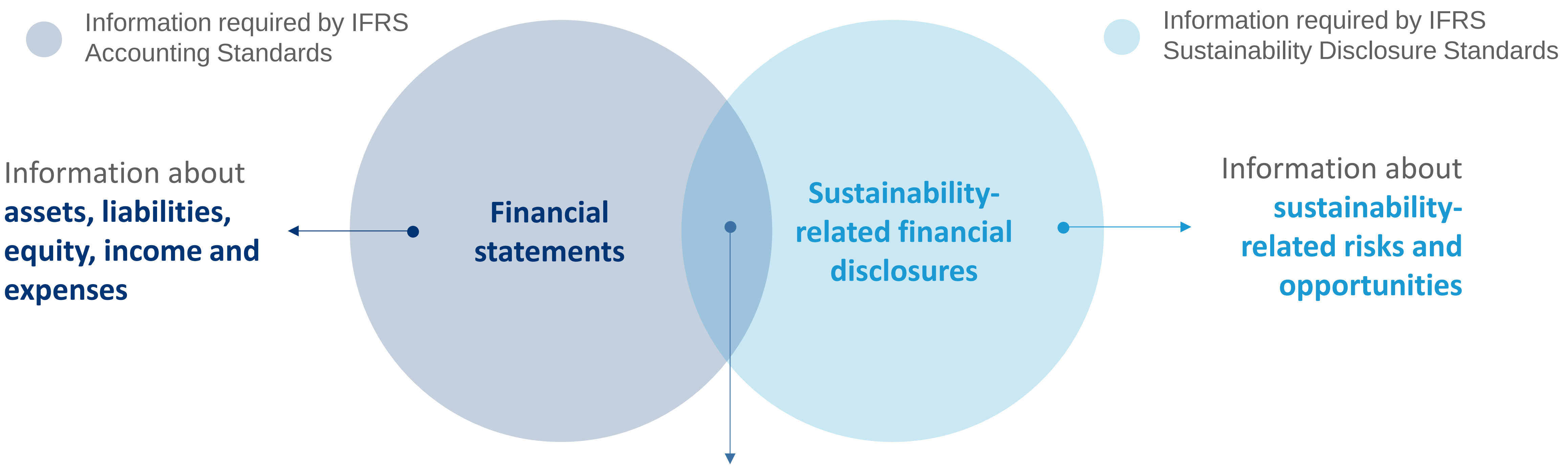
Working together

Throughout its work on this project, the IASB **collaborated** with ISSB members and technical staff

Main actions to improve reporting

- Improve the application of IFRS Accounting Standards
- Raise awareness of the requirements
- Strengthen connections

Connectivity and complementary objectives



Information about the effects of **sustainability-related risks and opportunities** on an entity's **assets, liabilities, equity, income and expenses**

Note: The diagram is not intended to represent relative proportions of reported information.

How climate matters affect the financial statements?

The effects of climate-related matters are pervasive across financial statements:

Property, plant and equipment	Insurance contracts	Levies	Income taxes
Intangible assets	Financial instruments	Fair value measurements	Inventories
Impairment of assets	Contingent liabilities	**Provisions**	Going concern

More information is provided in the educational material, *Effects of climate-related matters on financial statements*

Questions for investors

Question 1

Would the disclosures illustrated in the examples provide you with useful information? Do you agree with the selection of fact patterns illustrated?

Question 2

Would the examples be useful to you when encouraging companies to change some reporting practices?

Question 3

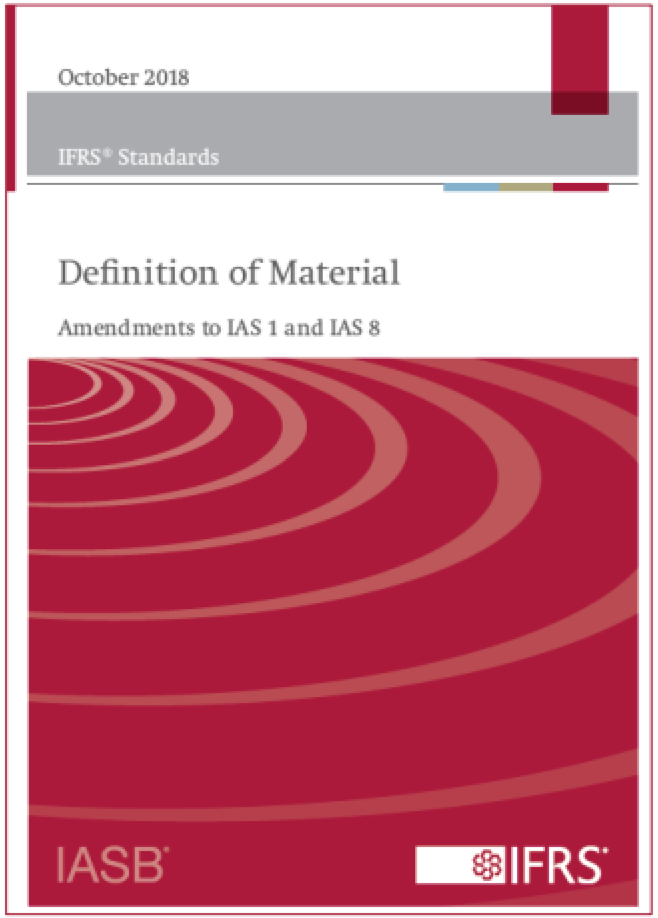
Do you have any other comments?

Illustrative Examples

	Background	Reporting outcome
Example 1 *Materiality judgements leading to additional disclosures*	The company discloses information about its transition plan outside its financial statements and operates in an industry exposed to climate-related transition risks	The **company concludes that disclosing that its transition plan has no effect** on its financial position and financial performance and **explaining why** would provide material information[1]

[1] Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Material information should be disclosed



Defining Materiality (IAS 1)

- Information is material if omitting, misstating or obscuring it could reasonably be expected to **influence decisions** that primary users make on the basis of the financial statements
- Requires an assessment of information both on its **nature or size, or both**, in the context of the financial statements as a whole
- Disclosure in **other documents will not compensate** for the omission of required disclosures in the financial statements

Climate-related commitments: An example

In 20X0, an entity publicly states its commitment to transition to 'net zero' from 20X9

20X0

20X5

20X9

by 20X9

to **reduce** its annual gross Scope 1 and Scope 2 GHG emissions by 60% by modifying its manufacturing methods, including the purchase of energy-efficient equipment

from 20X9

to **offset** its remaining Scope 1 and Scope 2 GHG emissions by buying and retiring carbon credits

Recognition criteria for a provision not given

Interpretations Committee analysis—provision

Recognition criteria	Present obligation as a result of a past event	Probable outflow of resources	Reliable estimate

Analysis

Obligation to **reduce** emissions is **not** a present obligation—costs to modify manufacturing methods are costs of operating in the future

Obligation to **offset** emissions becomes a present obligation only when entity has emitted gases it has committed to offset—ie in 20X9 onwards

Illustrating reported information—20X0—Accounting

Effects on recognition and measurement

No financial effects in the reporting period

Disaggregated information

No financial effects about which to provide disaggregated information

Related disclosures

The entity discloses:

- that its transition plan has no effect on its financial position and financial performance and explains why, if that information is material in the context of the financial statements
- the amount of contractual commitments to acquire property, plant and equipment (if any)

Sustainability Disclosures: Current and anticipated financial effects

Information about:

- effects of sustainability-related risks and opportunities
  - on the entity's financial position, financial performance and cash flows
  - for the reporting period (**current financial effects**)
- anticipated effects of sustainability-related risks and opportunities
  - on the entity's financial position, financial performance and cash flows
  - over the short, medium and long term,
  - taking into consideration how sustainability-related risks and opportunities are included in the entity's financial planning (**anticipated financial effects**).

* Note sustainability-related risks and opportunities include climate-related risks and opportunities.

Illustrating reported information—20X0—Sustainability

Current financial effects

The entity explains that its transition plan to address its climate-related risks has not had financial effects in the reporting period

Anticipated financial effects

The entity discloses information about the planned purchases of energy-efficient equipment and carbon credits and related sources of funding, including quantitative information

Other disclosures

The entity provides information about its transition plan and its net-zero target, including:

- how the entity plans to achieve its net-zero target and its gross GHG emissions target
- that its net-zero target covers gross Scope 1 and Scope 2 GHG emissions and that the entity plans to use carbon credits to offset any remaining such emissions

To note

An entity need not provide quantitative information about anticipated financial effects if the entity does not have the skills, capabilities or resources to provide that quantitative information

Interactions between financial statements and current financial effects disclosure

Financial Statements

Quantitative effect

Has the sustainability-related risk or opportunity affected the financial position, financial performance or cash flows?

Information about the effect

What information about that effect is provided in the financial statements?

Sustainability-related financial disclosures

Current financial effect

Quantitative and qualitative information about how the sustainability-related risks and opportunities have affected the financial position, financial performance and cash flows

IFRS Accounting

Financial Statement Disclosure: Air Liquide 2022

Footnote 31.4

Air Liquide's actions to limit transition risk impacts include:

Scope 2 reduction:

- Related to the 424 large air gas production units or ASUs, (scope 2 emissions) mainly by using renewable electricity: the deployment of the Group's actions in the 10 countries with the greatest potential will significantly reduce scope 2 emissions. Since 2018, Air Liquide has already signed 13 renewable energy supply contracts for an estimated annual quantity of 1.724 GWh/y (in a full year after start-up of renewable production units). As the ASUs are almost all electrified, they do not require any specific investment for the transition, because emission reduction will be managed through renewable energy purchase.
- **Energy costs, including renewable energy costs do not represent any financial risk** as they are 100% passed-through to the customer according to the terms of the 15 years or more contracts.

Scope 1 reduction:

- Related to the 62 large hydrogen production units or SMRs, (scope 1 emissions), by capturing CO_2. Air Liquide masters a complete portfolio of proprietary technologies for capturing CO_2. Thus, advanced Cryocap™ CO_2 capture technology equipment has been in industrial operation since 2015 on a hydrogen production unit in France. The Group was recently selected for financing via European subventions for two carbon capture projects on SMRs. Thus, the decarbonization of the Group's 10 largest SMRs will reduce scope 1 emissions by more than 40%. **No dismantling of existing SMRs before the end of the contract is necessary to achieve the Group's climate objectives.**

- The demand for low-carbon industrial gas at a higher price is growing and makes it possible **to remunerate the investment necessary for the decarbonization of Air Liquide's assets**, in particular for the production of hydrogen, as well as any additional costs linked to the supply of renewable electricity. In addition, financing programs in the form of subsidies or tax credits are also implemented in Europe and more recently in the United States in order to support, during a transition period, the decarbonization of existing industrial assets and new units of production. **Therefore, there is no indication of impairment for the related assets.**
- **Costs related to CO_2 emissions** (ex ETS scheme in Europe) **are 100% passed-through to the customer** according to the terms of the 15 years or more contracts. The Group also applies this business model to the supply of low carbon industrial gas, therefore **Air Liquide does not bear the risk associated with energy and CO_2 costs.**

The potential impacts of transition risk have been analyzed in the context of the 2022 Group's Financial Statements closing, based on the above mentioned facts and assumptions. **No significant impact has been identified, either on the useful life or on the value of the assets, on the client portfolio or on the cash flows generated by existing activities or on provisions for risks and charges.**

Source: ESMA "The Heat is On: Disclosures on Climate-Related Matters in the Financial Statements, "October 2023, Air Liquide Universal Registration Document 2022 pg 310

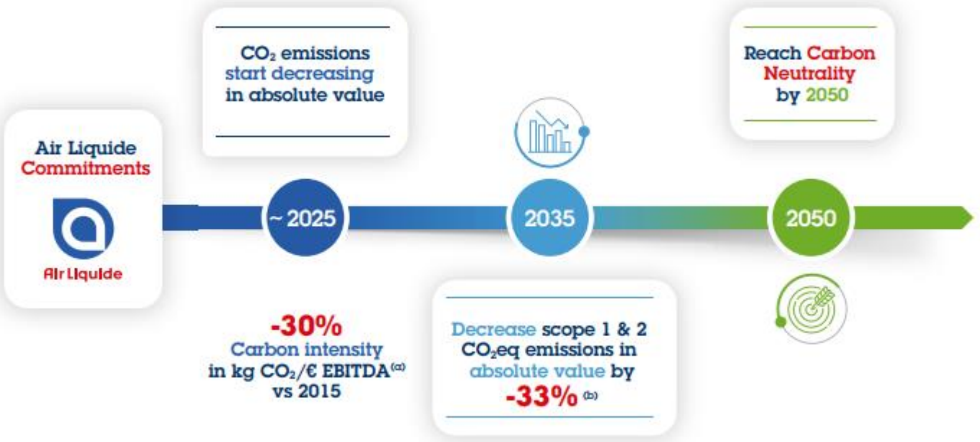
Sustainability Disclosure: Air Liquide 2022

Assets and Climate Risk

The main Group assets that impact the CO_2 footprint are:

- **424 large Air Gas** production **Units**, oxygen and nitrogen in particular, which do not generate direct emissions but require electricity. The CO_2 emissions linked to this electricity are accounted for in Scope 2;
- **62 large hydrogen** production **units**, which consume Natural Gas and emit CO_2 accounted for in Scope 1.

- In the Large Industries business, each air gas or hydrogen production unit is linked to a **long-term customer contract**, lasting **15 to 20 years**. Assets are amortized over the duration of the contract, which limits the risk of impairment.
- Industrial gases are **used in most industries** today and will be even more so during the energy transition due to the fact they are **at the heart of industry decarbonization solutions**. Demand will increasingly turn to low-carbon gases, in line with changing regulations.
- **Solutions have already been implemented to decarbonize existing** production **units**:
  - for **air gases** (Scope 2 emissions) mainly by using **low-carbon electricity**: the deployment of actions in the 10 countries with the greatest potential will significantly reduce Scope 2 emissions. Since 2018, Air Liquide has already signed 13 renewable power purchase agreements for about 460 MW. As these assets are more than 95% already electrified, they do not require any specific investment for the transition;
  - for **hydrogen production** units or "**SMR**" (Scope 1 emissions), **by capturing CO_2**. Air Liquide masters a **complete portfolio of proprietary technologies** for capturing CO_2. For example, an advanced Cryocap™ CO_2 capture system has been in **industrial operation since 2015** on a hydrogen production unit in France. The Group was recently selected for financing via European funds for two carbon capture projects on SMRs. The decarbonization of the Group's **10 largest SMRs** will **reduce Scope 1 emissions by more than 40%. No dismantling of existing SMRs before the end of the contract is necessary to achieve the Group climate objectives.**



- Finally, any **new investment** decision by Air Liquide now includes the constraint of **reducing CO_2 emissions, in line with the Group's decarbonization objectives**. The share of **electrolyzers** among hydrogen production units should therefore increase in the coming years. Air Liquide recently announced several 200 MW electrolyzer projects and entered into an electrolyzer manufacturing partnership and joint venture with Siemens Energy.

The potential impacts of the **risk related to the energy transition** were analyzed as part of the closing of the Group's financial statements (see note 31 to the Consolidated financial statements - page 309) and **no significant impact was identified, mainly for the reasons mentioned above**. The energy transition is above all a **growth opportunity for Air Liquide**, as the **Group has the technologies to decarbonize the assets of its industrial customers.**

Source: ESMA "The Heat is On: Disclosures on Climate-Related Matters in the Financial Statements, "October 2023, Air Liquide Universal Registration Document 2022 pg 40

Illustrative Examples

	Background	Reporting outcome
Example 2 *Materiality judgements not leading to additional disclosures*	The company discloses information about its greenhouse gas emissions policy outside its financial statements and operates in an industry with limited exposure to climate-related transition risks	The **company concludes that disclosing that its policy has no effect** on its financial position and financial performance would **not** provide material information

Illustrative Examples

	Background	Reporting outcome
Example 3 *Disclosure of assumptions: specific requirements*	The company tests an asset for impairment annually. Assumptions about the future price of emission allowances and the scope of emission regulations are key assumptions	The company **discloses information about the key assumptions**

Financial Statement Disclosure: Endesa 2022

3.2 Measurement Criteria: f. Impairment of non-financial assets

f.2. Calculation of recoverable amount

The recoverable amount is the higher of fair value less costs to sell and value in use. Value in use is the present value of estimated future cash flows through their use in normal business and, as the case may be, of their disposal or other form of sale, taking account of their current state.

In estimating value in use, Endesa prepares pre-tax cash flow projections based on the latest budgets available. These budgets include Endesa management's best estimates of the income and expenditure of the CGUs according to industry projections, past experience and future expectations.

These forecasts cover the next 3 years, except for the Cash Generating Units (CGUs) for each of the Non-Peninsular Territories (TNP) of the Balearic Islands, Canary Islands, Ceuta and Melilla, where the forecasts cover the next 5 years, while future cash flows until the end of the useful life of the assets, taking into account the residual value, if any, and applying reasonable growth rates that do not, in any case, increase or exceed growth rates for the industry.

The estimated future cash flows are discounted to present value using a pre-tax rate that reflects the cost of capital of the business and its geographical area. It considers the current time value of money and the risk premiums generally used by analysts for the business and the geographical area.

Key assumptions

With these premises, the approach used to assign value to the key assumptions considered has taken into account the following items and/or parameters:

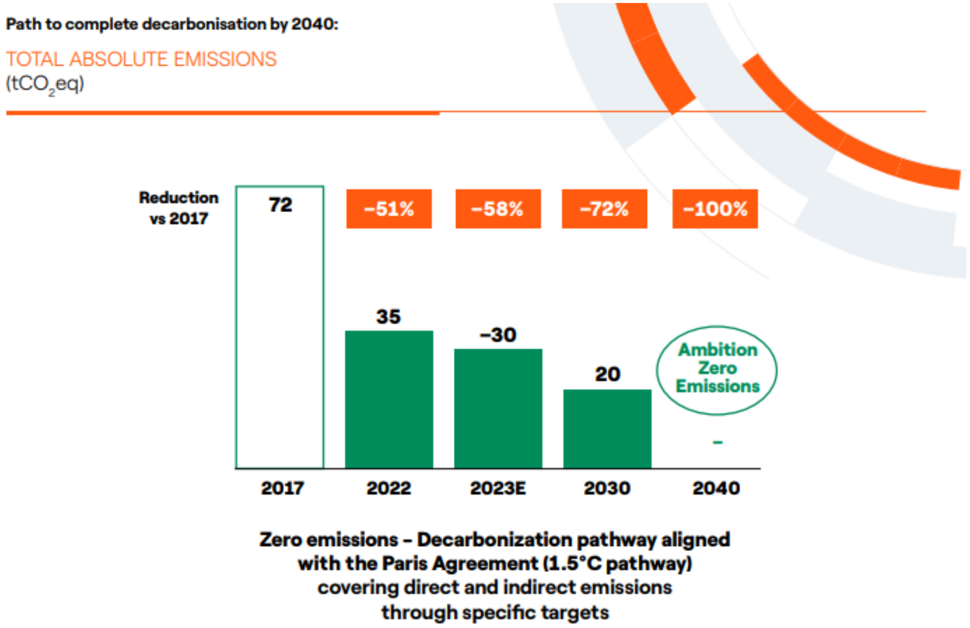
Item and/or parameter	Description
Trend of demand for electricity and gas	· The estimated growth was calculated on the basis of the growth forecast for Gross Domestic Product (GDP) and other assumptions used by Endesa with respect to trends in consumption of electricity and gas in these markets.
Regulatory measures	· A substantial part of Endesa's business is regulated and subject to wide-ranging complex regulations, which may be amended by the introduction of new laws, by amendments to existing laws in such a way that forecasts contemplate proper application of current regulations, and any other laws now in process that may come into force during the projected period.
Climate change	· Energy transition scenarios and climate change impacts used in the valuation models (see Note 5.1).

	2024	2025	2026
Price of Brent ($/bbl)	84	81	75
Carbon dioxide (CO_2/€/t)	93	98	102
TTF gas price (€/MWh)	50	44	35
PVB gas price (€/MWh)	47	42	35
Electricity demand – Iberian Peninsula (TWh)	248	254	260
Consumer Price Index (CPI) (average) (%)	2.7	1.9	1.9
Growth in Gross Domestic Product (GDP) Spain (%)	1.5	1.9	1.9
Arithmetic average daily electricity market price (€/MWh)	106	88	74

Source: ESMA "The Heat is On: Disclosures on Climate-Related Matters in the Financial Statements, "October 2023, Endesa Annual Report 2022 pg 250ff

Financial Statement Disclosure: Endesa 2022

5.1.1. Estimates … related … climate change …



- The estimation of the terminal value considers a long-term growth rate aligned with the expected trend in electricity demand in Spain over the 2026-2050 horizon. This is achieved using Endesa's energy models, which enable demand to be quantified taking into account assumptions related to temperature rises due to climate change and trends related to the Energy Transition in accordance with the Physical and Transition Scenarios chosen by Endesa for long-term planning, all consistent with the objectives of the Paris Agreement and the National Energy and Climate Plan 2021-2030 (NECP) (currently under review) as described in Section 5.3.2 Climate Strategy. Long-Term Scenarios of the Consolidated Management Report.
- Factoring in changes in the levels of hydro, wind and photovoltaic generation of Endesa's renewable assets associated with the projection of underlying weather conditions (temperature, precipitation, wind speed and solar power).
- Estimating the costs of decommissioning coal/fuel and combined cycle power plants, in line with Endesa's long-term goal of achieving full decarbonisation of the company by 2040 and 100% emission-free generation, and having also exited the gas business by that time.

Source: ESMA "The Heat is On: Disclosures on Climate-Related Matters in the Financial Statements, "October 2023, Endesa Annual Report 2022 pg 273ff

Sustainability Disclosure: Endesa 2022

Assumptions

The assumptions on the evolution of commodity prices used in the Reference *scenario* are consistent with the external scenarios that achieve the objectives of the Paris Agreement. The price of carbon dioxide (CO_2) is expected to grow steadily until 2030, following a progressive reduction in the supply of carbon permits coupled with growing demand and a progressive reduction in the price of coal, due to a decrease in demand. With regard to gas, it is estimated that price tensions will ease in the coming years as a result of a realignment between supply and demand at a global level. Lastly, a progressive stabilisation of the price of oil is foreseen, for which a peak in demand with respect to 2030 is estimated.

	2023 [2]	2030			
	Endesa	Endesa	Average Benchmark [1]	Benchmark high [1]	Minimum Benchmark [1]
Brent Price ($ / bl)	**83**	~74	~77	~91	~64
Average coal price Api2 (€ / MWh)	**130**	~83	~85	~110	~60
Carbon Dioxide (CO_2) (€ / t)	**84**	~120	~128	~150	~115
TTF gas price (€ / MWh)	**41**	~30	~26	~30	~16

[1] Source: IEA Announced Pledges Scenario, BNEF, IHS Green Case scenario, Enerdata Energreen. N.B. the scenarios used as a reference were published at different times of the year, and may not be up to date with the latest market dynamics.
[2] Closing price.

Endesa Sustainability Report 2022, pg 99

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Sustainability Disclosure: Endesa 2022

Current and anticipated financial effects

Scenario	Risk and opportunity category	Description	Time horizon	Description of the impact	Affected activity	Scope	Quantification – Type of impact	Quantification – Range: <€100 min	Quantification – Range: €100-300 min	Quantification – Range: >€300 min
Chronic physical	Market	**Risk/ Opportunity:** Increase or decrease **Electricity demand.**	Medium/ Long	Electricity demand is also influenced by temperature, fluctuations of which can impact the business. Although no structural changes are expected to materialise in the short or medium term, to assess the sensitivity of the Company's results to possible fluctuations in temperature, a sensitivity analysis is used in relation to energy prices consistent with variations in electricity demand.	Generation & Distribution	Endesa	EBITDA/year		● (green) / ● (orange)	
Chronic physical	Market	**Risk/ Opportunity:** Increase or decrease **renewable production.**	Medium/ Long	Renewable production is also influenced by the availability of the resource, the fluctuations of which can have an impact on the business. Although no structural changes are expected to materialise in the short or medium term, to assess the sensitivity of the Company's results to possible fluctuations in temperature, a sensitivity analysis is used in relation to energy prices consistent with variations in electricity compatible with the different climate scenarios and historic meteorological volatility. Statistically, the deltas considered are at +/-10% of annual renewable production.	Generation	Hydroelectric producibility	EBITDA/year	+10% ● (green) / -10% ● (orange)		
						Wind production	EBITDA/year	+10% ● (green) / -10% ● (orange)		
						Solar production	EBITDA/year	+10% ● (green) / -10% ● (orange)		

● Current policies bullish scenario. ● Current policy bearish scenario.

Endesa Sustainability Report 2022, pg 109

Illustrative Examples

	Background	Reporting outcome
Example 4 *Disclosure of assumptions: general requirements*	The company tests an asset for impairment but recognises no impairment loss. The company makes assumptions related to climate-related transition risks (eg commodity prices)	The company **discloses information about assumptions** that have a significant risk of material adjustment within the next financial year

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Illustrative Examples

	Background	Reporting outcome
Example 5 *Disclosure of assumptions: additional disclosures*	A company recognises a deferred tax asset based on an assumption about the effective date of announced government regulations that will significantly affect its operations	The company concludes that **information about the assumption is material** and discloses that information even if not specifically required by IFRS Accounting Standards
Example 6 *Disclosure about credit risk*	The company, a financial institution, identifies two loan portfolios that require it to manage credit risk arising from its customers' exposure to climate-related risks	The company **discloses information about the effects of climate-related risks** on its credit risk exposures and credit risk management practices, if that information material

Illustrative Examples

	Background	Reporting outcome
Example 7 *Disclosure about decommissioning and restoration provisions*	The company has decommissioning obligations for its petrochemical facilities. The present value of the costs to settle the obligations is immaterial because the company expects to maintain and operate the facilities for an extremely long time	The company concludes that **information about the obligations** is material and discloses that information, even though the provision's carrying amount is immaterial
Example 8 *Disclosure of disaggregated information*	The company owns PP&E with long useful lives whose use results in high amounts of greenhouse gas emissions. It has also invested in PP&E with lower emissions	The company concludes that **disaggregated information** between these two types of PP&E is material because of their dissimilar risk characteristics and provides disaggregated information

Illustrative Examples

Note

- The above slides outline the fact patterns and summarise the reporting outcomes illustrated in each example included in the Exposure Draft. These slides do not include all relevant facts and circumstances included in the illustrative examples or explain the application of IFRS Accounting Standards. These slides should be read alongside the full examples for a complete understanding.
- The full examples can be reviewed in the Exposure Draft.

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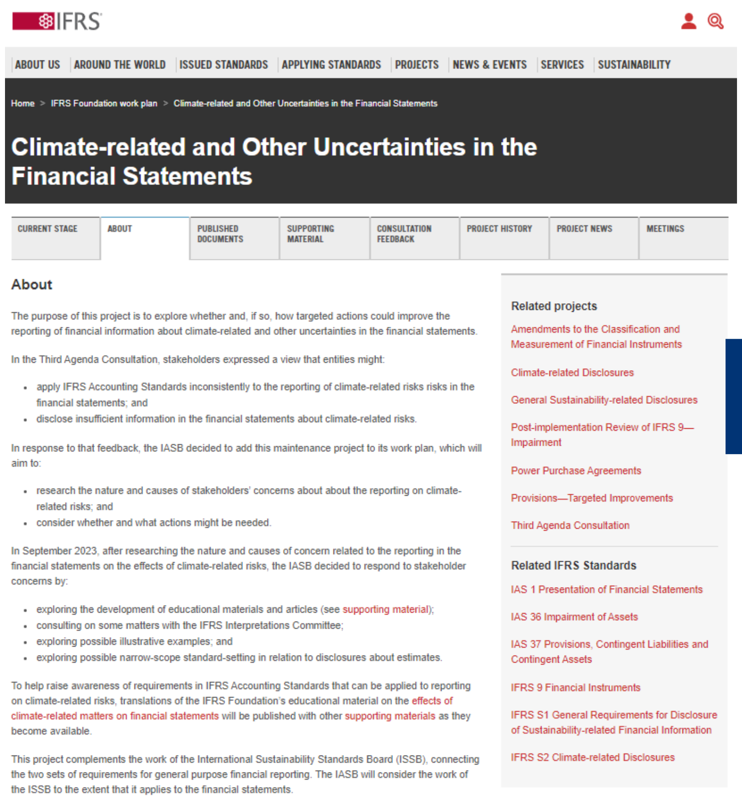
Information on accounting for climate-related matters

Visit our project page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Climate-related and Other Uncertainties in the Financial Statements

CURRENT STAGE | ABOUT | PUBLISHED DOCUMENTS | SUPPORTING MATERIAL | CONSULTATION FEEDBACK | PROJECT HISTORY | PROJECT NEWS | MEETINGS

About

The purpose of this project is to explore whether and, if so, how targeted actions could improve the reporting of financial information about climate-related and other uncertainties in the financial statements.

In the Third Agenda Consultation, stakeholders expressed a view that entities might:

- apply IFRS Accounting Standards inconsistently to the reporting of climate-related risks risks in the financial statements; and
- disclose insufficient information in the financial statements about climate-related risks.

In response to that feedback, the IASB decided to add this maintenance project to its work plan, which will aim to:

- research the nature and causes of stakeholders' concerns about about the reporting on climate-related risks; and
- consider whether and what actions might be needed.

In September 2023, after researching the nature and causes of concern related to the reporting in the financial statements on the effects of climate-related risks, the IASB decided to respond to stakeholder concerns by:

- exploring the development of educational materials and articles (see supporting material);
- consulting on some matters with the IFRS Interpretations Committee;
- exploring possible illustrative examples; and
- exploring possible narrow-scope standard-setting in relation to disclosures about estimates.

To help raise awareness of requirements in IFRS Accounting Standards that can be applied to reporting on climate-related risks, translations of the IFRS Foundation's educational material on the effects of climate-related matters on financial statements will be published with other supporting materials as they become available.

This project complements the work of the International Sustainability Standards Board (ISSB), connecting the two sets of requirements for general purpose financial reporting. The IASB will consider the work of the ISSB to the extent that it applies to the financial statements.

Related projects

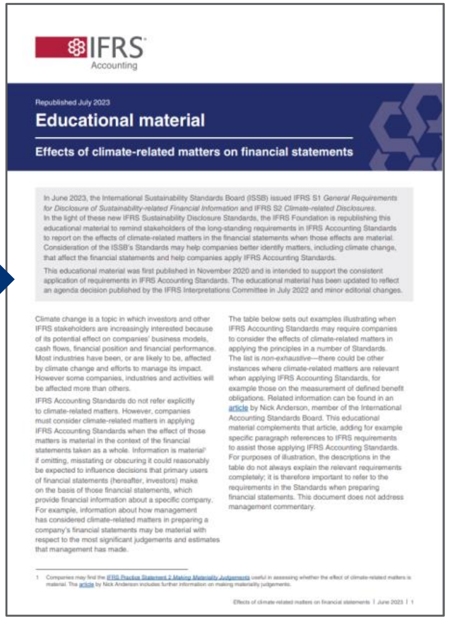
- Amendments to the Classification and Measurement of Financial Instruments
- Climate-related Disclosures
- General Sustainability-related Disclosures
- Post-implementation Review of IFRS 9—Impairment
- Power Purchase Agreements
- Provisions—Targeted Improvements
- Third Agenda Consultation

Related IFRS Standards

- IAS 1 Presentation of Financial Statements
- IAS 36 Impairment of Assets
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets
- IFRS 9 Financial Instruments
- IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information
- IFRS S2 Climate-related Disclosures

Includes

'Full IFRS'
Educational Material
(July 2023)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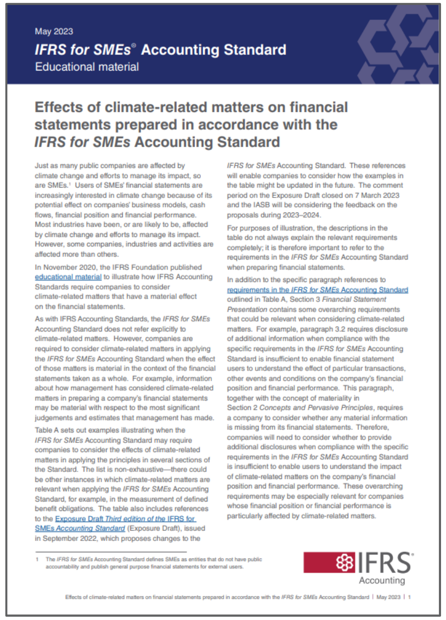
Republished July 2023

Educational material

Effects of climate-related matters on financial statements

IFRS for SMEs Accounting Standard Educational Material
(May 2023)


May 2023

***IFRS for SMEs*® Accounting Standard**

Educational material

Effects of climate-related matters on financial statements prepared in accordance with the *IFRS for SMEs* Accounting Standard

Translations available here

Conclusion

- Evolving landscape of financial reporting
- Project on climate-related risks and uncertainties in the financial statement
  - Stepping stone for future discussions
  - Illustrative examples as no intention to change existing requirements
- Many overlapping projects: power purchase agreements, provisions, intangibles, pollutant-pricing mechanisms

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