STAFF QUESTIONS AND ANSWERS

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CLIMATE CHANGE: RELEVANT IPSASB GUIDANCE

This Questions & Answers (Q&A) publication is issued by the staff of the International Public Sector Accounting Standards Board® (IPSASB®) to discuss the relevance of International Public Sector Accounting Standards™ (IPSAS™) and related Recommended Practice Guidelines (RPG) to reporting on both climate change and the United Nations' (UN's) Sustainable Development Goals (SDGs) in the general purpose financial reports (GPFR) of public sector entities.

The objective of this document is to summarize the accounting requirements and recommended practice guidelines that may be applicable to climate change.

This publication is not an authoritative pronouncement, and it is not an interpretation of an authoritative IPSASB pronouncement. It does not amend or override the requirements of existing IPSAS or provide further implementation guidance. This Q&A is not exhaustive and is not a substitute for reading the full text of IPSAS or RPG.

Background

General purpose financial reports are a cornerstone of sound financial management. The objective of GPFR is to provide users with information required for accountability and decision making. GPFR typically include the general purpose financial statements (financial statements), as well as other relevant financial and non-financial information that may be useful to readers. As part of its objective to serve the public interest, the IPSASB develops IPSAS, which are the accounting standards to be applied in the preparation of financial statements of public sector entities. The IPSASB also develops RPG, which provide guidance and best practices that public sector entities are encouraged to follow when preparing their broader GPFR. Both IPSAS and RPG are intended to enhance the quality and transparency of public sector financial reporting by providing better information for public sector financial management and decision making.

The IPSASB has initiated a project on Natural Resources. A number of queries have been received on how this project relates to the topics of reporting on climate change and the UN SDGs, and which existing IPSAS and RPG are relevant to reporting on these topics. This Q&A therefore provides the IPSASB staff's views on these matters.

Q1. How can financial reporting support delivery of the UN's SDGs?

Accountants are in a unique position to ensure that an entity's core accounting and internal reporting systems support collaboration between the accounting, finance, and sustainability functions in developing a consistent approach and response to sustainable development issues generally, and to reporting on progress towards SDGs in particular. Many of the SDGs developed by the UN relate directly to climate change.[1] Governments which have adopted the SDGs will need to define how these impact the service performance objectives of public sector entities, and develop reporting on the achievement of these using existing IPSASB guidance as described later.

The International Federation of Accountants (IFAC), along with a number of leading accounting bodies and international organizations, have published disclosure recommendations for SDGs which, while not specific to only the climate change-related goals, are aligned with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). The recommendations of the TCFD are aimed at the private sector but many are also relevant to governments and public sector entities. The TCFD consists of representatives from various private and public sector entities—more information can be found at: https://www.fsb-tcfd.org/about/. The disclosure recommendations cover the following topics:

- The identification of sustainable development risks and opportunities;
- Changes to what an entity does and how it does it in order to achieve the SDGs; and
- The communication of the implications for and the impact on achievement of the SDGs.

More information and the full set of the recommendations are at: https://www.ifac.org/knowledge-gateway/contributing-global-economy/publications/sustainable-development-goals-disclosure-sdgd-recommendations.

The Climate Disclosure Standards Board has released a publication which bridges financial accounting standards with the TCFD recommendations. This publication can be found at: https://www.cdsb.net/sites/default/files/uncharted_waters_final.pdf. In addition, The Corporate Reporting Dialogue – an initiative bringing together the major standard setters and framework developers globally – has released a report showing high levels of alignment between the frameworks on the basis of the TCFD's recommendations:
https://corporatereportingdialogue.com/corporate-reporting-dialogue-shows-high-level-of-alignment-between-major-global-reporting-frameworks-on-tcfd-recommendations/

Q2. What existing IPSASB literature is relevant to climate change reporting?

The following RPG are relevant to climate change reporting:

- RPG 1, *Reporting on the Long-term Sustainability of an Entity's Finances,* provides guidance on broader disclosures about long-term fiscal sustainability and includes guidance on the projection of inflows and outflows based on assumptions regarding policy decisions, future economic and other conditions. If climate change is relevant to a public sector entity's projected inflows and outflows, the entity should assess the financial impacts from climate change and take them into account when developing its projections. In addition, if an entity has specific policies or programs to address SDGs, RPG 1 may be relevant to disclosures of the long-term financial impact of these goals.

[1] See SDG 6, 7, 11, 12, 13, 14 and 15 at https://sustainabledevelopment.un.org/?menu=1300.

- RPG 2, *Financial Statement Discussion and Analysis,* recommends the provision of information on the external trends, risks and uncertainties that are impacting or may impact a public sector entity's financial position, financial performance and cash flows. If these trends, risks or uncertainties include climate change, RPG 2 calls for discussion of this impact.
- RPG 3, *Reporting Service Performance Information,* provides good-practice recommendations on reporting information on the services that a public entity provides, its service performance objectives and the extent of its achievement of those objectives. Climate change is relevant to the extent that it is affecting or may affect the services performed by the entity and the extent to which it is achieving its service performance objectives. In addition, if the entity has established specific targets to achieve climate change-related SDGs, RPG 3 will also be relevant to the reporting of these targets and the extent to which they have been achieved.

In addition to these RPG, a number of IPSAS may be relevant to the consequences of climate change on a public sector entity's financial position, financial performance, and cash flows. The applicability of both the RPG and these IPSAS is discussed in Question 7 below.

The IPSASB staff have also prepared a background paper on Emissions Trading Schemes (ETS), which are currently being administered, or participated in, by many governments. The background paper, which is based on initial research and is not an official pronouncement by IPSASB, provides information on ETS and the IPSASB staff's views on the economic impact of some of the main schemes. See https://www.ipsasb.org/publications/emissions-trading-schemes-staff-background-paper. The IPSASB decided to make the paper available publicly as a resource for stakeholders, including national standard setters, as well as users and preparers of general purpose financial reports, for their consideration when accounting for ETSs.

Q3. What is the relationship between the IPSASB's Natural Resources project and climate change initiatives?

The IPSASB initiated the Natural Resources project based on the following feedback to its Strategy and Work Plan 2019-2023 Consultation:

- Respondents noted an existing gap in the IPSAS literature on the recognition, measurement, presentation, and disclosure of natural resources, particularly for subsoil minerals and energy resources prior to extraction.
- Constituents highlighted that the lack of accounting guidance means that governments often have little information on the value of their natural resources until after they are extracted. They note because of the lack of guidance, there is a risk that the sale of their extraction rights can occur without regard to value, sustainability or intergenerational fairness.
- Natural resources account for a significant proportion of total government resources in many jurisdictions.[2] Therefore, the recognition of natural resources as assets could lead

[2] The IMF October 2018 Fiscal Monitor highlighted that for the 31 countries included in the report, natural resource assets were equal to 38% of Gross Domestic Product.

to accounting information which is more representatively faithful of a jurisdiction's underlying economic reality, particularly in resource-based and resource-rich economies.

In light of the above feedback, and to better manage the scope of the Natural Resources project, the IPSASB decided to focus its standard setting activities and resources on addressing the accounting issues related to the potential recognition, measurement, presentation, and disclosure of natural resource assets and related liabilities. In the current stage of the project, the IPSASB is developing a consultation paper to address these accounting issues as they relate to subsoil resources, living resources, and water.

Since the IPSASB initiated its Natural Resources project, a number of constituents have also inquired about the contribution the project outputs could make towards the much broader reporting issues in relation to climate change and environmental sustainability. This staff Q&A highlights current IPSAS guidance to consider when reporting on public sector programs and initiatives related to the SDGs and climate change, and it also provides specific references to IPSAS literature and other relevant guidance.

Q4. How should a public sector entity disclose its assessment of climate change-related risks?

As the impacts of climate change become more observable all around the world, best practice for governments and other public sector entities is to communicate how they are affected by climate change. As noted above in Question 2, RPG 1 provides recommendations on the disclosures of how climate change is expected to affect an entity's projected inflows and outflows over a specified time horizon. RPG 2 provides recommendations on disclosures which can be tailored to describe how climate change has affected an entity's financial position, financial performance, and cash flows in the current period.[3] RPG 2 also recommends presenting an analysis of significant changes and trends.[4] This information can help users of the financial statements evaluate the impact of climate change-related risks and uncertainties on the current reporting period as well as expected outcomes.

In addition to RPG 2, IPSAS 1, *Presentation of Financial Statements*, requires an entity to provide information on key sources of estimation uncertainty, which could include climate change-related risks if these risks are expected to have a material impact on the carrying amounts of assets and liabilities in the future or on an entity's ability to continue as a going concern.[5]

Q5. When governments or public sector entities have strategies and programs in place to manage climate change risks, how should these be reported?

RPG 2 can also be used to provide additional narrative information for users of the financial statements of how risks and uncertainties are being managed, and how they have changed between reporting periods. RPG 2 provides guidance on the disclosure of information about an entity's objectives and strategies relating to its financial position, financial performance and cash flows, and

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[3] RPG 2.27-31 provide recommendations regarding the discussion of risks and uncertainties as well as how these risks are managed by the entity.

[4] RPG 2.16 recommends including an analysis of the changes and trends in an entity's financial position, financial performance and cash flows.

[5] IPSAS 1.140-148 require the disclosure of key sources of estimation uncertainty which could have a significant risk of causing a material adjustment to the carrying amounts of assets or liabilities within the next financial year. IPSAS 1.38-41 contain requirements on the assessment of going concern and related disclosures.

these disclosures can include its priorities and resources that must be managed to achieve its climate change-related objectives.[1]

Achieving an entity's climate change objectives and strategies may be expected to have financial consequences in the future. Some examples of how climate change can impact fiscal sustainability include:

(a) Climate change can have an impact on assumptions about economic growth, and therefore, projected inflows of taxation and other contributions;
(b) New programs may have to be introduced, and existing programs modified in order to combat climate change. These may include programs to mitigate the impact of flooding or water shortages; and
(c) Climate change can directly impact assets and liabilities. Jurisdictions will be affected differently depending on factors such as geographical location and the extent to which the public finances are dependent on, for example, royalties and other inflows from subsoil assets.

As financial statements generally focus on historical information and an entity's current financial position and financial performance, entities may also want to provide further information related to broader financial reporting needs, such as projections of outflows and inflows. RPG 1 provides recommendations on how such projections should be developed and how information on the assumptions used to make these projections should be disclosed.[6] Assumptions on climate change and programs to mitigate the impact of such change and their impact on cash flows, as well as the expected impact of climate change on assets and liabilities, should be considered in the development of projections.

Q6. If a government or public sector entity is delivering services which could be significantly impacted by climate change, how should these impacts be disclosed?

The service delivery objectives of governments and other public sector entities may need to change, in order to address the effects of climate change or adapt them, with new programs being created and existing service delivery mechanisms reconfigured. RPG 3 provides a principles-based framework for reporting service objectives and the extent to which those service objectives have been achieved.[7] It also discusses how to address circumstances where service delivery objectives have changed during the reporting period.[8] RPG 3 allows entities to tailor the format of reporting, to select

[6] RPG 1.16-40 provide general recommendations on how the projections should be developed and presented, while RPG 1.41-53 provide detailed recommendations on development and presentation principles and methodologies. In addition, RPG 1.54-58 provide recommendations on disclosures regarding an entity's long-term fiscal sustainability information and narrative discussion of the projections presented.

[7] RPG 3.32-37 provide general principles for the presentation of service performance information.

[8] RPG 3.57 provides recommendations on service delivery objectives which have changed during the reporting period.

performance indicators which are suitable to their circumstances, and to provide further narrative discussion and analysis on the information reported.

Q7. *Are there any other ways that climate change can potentially impact the general purpose financial statements? If so, which IPSAS might be applicable*?

Yes, a number of IPSAS may be applicable to the effects of climate change and impact the general purpose financial statements:

- IPSAS 1, *Presentation of Financial Statements*, provides guidance on the overall considerations for the presentation of financial statements, including their structure and minimum content requirements. As mentioned in Question 4 above, IPSAS 1 requires the disclosure of key sources of estimation uncertainty, which may include climate change-related risks, when the estimation uncertainty could have a material impact on the carrying amounts recognized in the financial statements.[2]
- IPSAS 17, *Property, Plant and Equipment*, provides guidance on the recognition and measurement of tangible assets. IPSAS 17 requires an entity to review, at least annually, the estimated residual value and useful life of its assets.[9] Depending on the specific facts and circumstances of an asset, these estimates may be impacted by climate change. For example, changing weather patterns (such as more frequent heavy rainfall) may negatively impact the useful lives of certain buildings and other such property, plant and equipment assets.
- IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, provides guidance on the recognition, measurement and disclosure of provisions. Provisions may arise from a legal obligation to comply with certain climate change-related laws and regulations. In addition, depending on the details of any plans to mitigate or adapt to the impacts of climate change and how such plans are communicated to external parties, certain announcements may be considered constructive obligations which require recognition in the financial statements. In certain circumstances, changes in climate change laws and regulations, or changes in the estimated costs to comply with such laws and regulations, could also lead to the recognition of provisions for onerous contracts.[10]
- IPSAS 21, *Impairment of Non-Cash-Generating Assets,* and IPSAS 26, *Impairment of Cash-Generating Assets,* provide guidance on when and how to measure impairments of non-cash-generating and cash-generating assets. It is possible for climate change-related laws and regulations to adversely affect the expected cash flows and/or service potential that can be generated by an asset, which in turn may impact the recoverable service amount or recoverable amount of the asset.[11]
- IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 41, *Financial Instruments*[12], both provide guidance on the impairment of financial instruments. Changes to climate change-related laws and regulations may negatively impact the valuation of financial instruments if these instruments consist of investments in

[9] IPSAS 17.67 contains the requirement to review estimates of residual values and useful lives.

[10] IPSAS 19.18 defines constructive obligations while paragraph 22 requires constructive obligations to be recognized in the financial statements. IPSAS 19.76-80 provide guidance on onerous contracts.

[11] Guidance on the determination of the recoverable service amount is detailed in IPSAS 21.35-50 while the determination of the recoverable amount is detailed in IPSAS 26.31-70.

[12] IPSAS 41, *Financial Instruments* is applicable from January 1, 2022 with early adoption encouraged.

entities which operate in sectors such as agriculture or real estate.[13] Climate change-related risks may also impact an entity's interest rate when refinancing its debt or bonds.

Q8. What other climate change reporting initiatives should a public sector entity consider in developing its financial reports?

A number of initiatives are underway which aim to address climate change-related reporting issues. Relevant information can be found at the following websites:

- *Interconnected Standard Setting for Corporate Reporting* by Accountancy Europe: https://www.accountancyeurope.eu/publications/interconnected-standard-setting-for-corporate-reporting/
- *Sustainable Finance and the Role of Securities Regulators and IOSCO – Final Report* by The Board of The International Organization of Securities Commissions: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf
- *Sustainability reporting and its Relevance to the IFRS Foundation (May 5, 2020 Virtual Presentation)* by the IFRS Foundation: https://www.ifrs.org/news-and-events/2020/05/sustainability-reporting-and-its-relevance-to-the-ifrs-foundation/
- The Impact Management Project is a forum of organizations working to build consensus on how to measure, compare, and report impacts on environmental and social issues: https://impactmanagementproject.com/
- In addition, the United Nations Climate Change Conference, which has been delayed until November 2021, will include discussions on how to refine and implement TCFD: https://www.ukcop26.org/

Guidance available via these sources can be used in conjunction with the relevant RPG in developing financial reports addressing climate change issues.

[13] Guidance on impairment considerations is located in IPSAS 29.67-79 and IPSAS 41.73-93.

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