TCFD Disclosure on the IFRS Financial Statements

---- The measuring financial impact of Climate Change and COVID-19 ----

IFRS Digital Reporting Workshop 18

Date and time : 31st Aug 2020, 18:30-20:30 JST

Impact on the Financial statements(FSs) from Climate Change

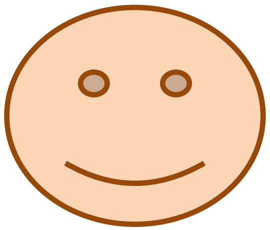
This year, partly due to the impact of COVID-19, investors seem to be paying more attention to the "accounting estimation" contained in the FSs. From some disclosure related authorities and investors, we have heard that "The risk disclosure from climate change and the importance of COVID-19 are almost the same." Yes, both are seeking the disclosure of how management decides on the assumption/s of the estimation of future cashflow, whether it is climate change or COVID-19.

The TCFD final report requested companies to explain the impact on the FSs. It has a table of the accounting items that might be influenced by Climate Change risk and opportunities. However, the discussion of TCFD disclosure on the IFRS FSs is very rare. CDSB issued a report in 2018 to explain how to disclose TCFD requirement on the IFRS FSs. AASB following them and issued a similar report in the later 2018 and early 2019. November of 2019, a board member of IASB Nick Anderson wrote an article about it. We discussed the Disclosure whether TCFD disclosure on the IFRS FSs is possible, useful, or not, considering the impact of COVID-19 together.

	Who join the discussion?
Attendees (Japan) *attendees have joined this workshop as private,	19 Investors, 13 Investor(Analysts) organization & sell-side analyst, 7 pension & insurance & bank, 6 Information providers/Researchers, 6 Company side (include Independent non -executive director , support service), 7 Auditor, 7 Regulator, Accounting setter & stock exchange, other 1 (former)
Attendees (outside Japan)	1 Investors (London) 1 Bank (Paris)

Challenging TCFD on the Financial Statement.

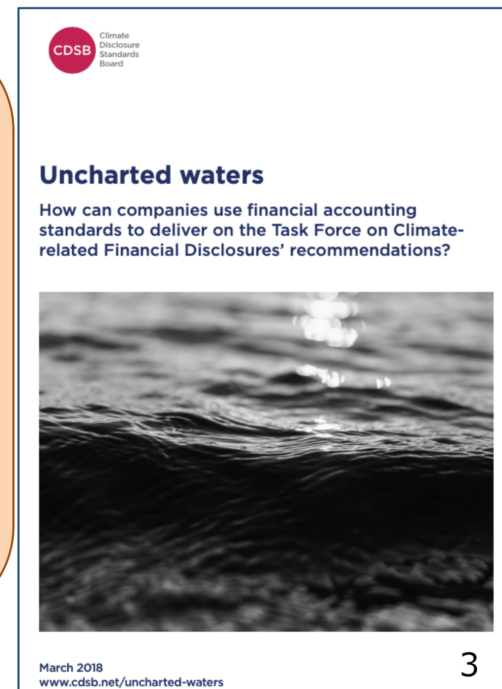
- CDSB “Uncharted water”



Data Analyst

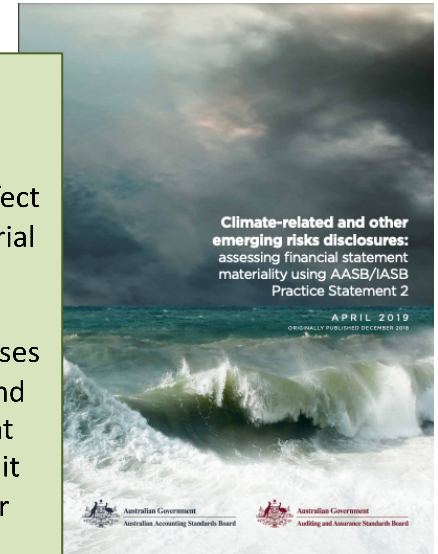
In 2015, initially, climate change might be a cause of enormous losses to the non-life insurance industry, it was aid that it could be a trigger to call to the financial crisis of 2008. The Paris Agreement also came into effect, and TCFD has been established 2016 and its final report was published in 2017. In 2018, the Non-Financial reporting Directive (NFRD) in the EU issued separate guidance about disclosure on climate change. But I think the CDSB issued the report named “Uncharted Water” (how to disclose TCFD on IFRS FSs) because the discussion of non-financial disclosure was active.

It describes IFRS7, 9, 15, 17, IAS36, 37. The definition of assets and liabilities, for example, in case that it is not clear whether the future benefits can be received in coal mines and gas fields or not, if they are not recorded as assets, they also cannot be impaired. And conversely, even if they are not assets, they can be disclosed in a footnote. Regarding IFRS9 the life cycle and sensitivity analysis of financial products and the analysis of scenarios should be useful even in climate change. You will also find information about TCFD in asset impairments, provisions, contingent liabilities, etc. IFRS17 may be the most important part of the debate about the impact of climate change, but at the timing, this report came out, it hadn't started, and just beginning to be known to investors.

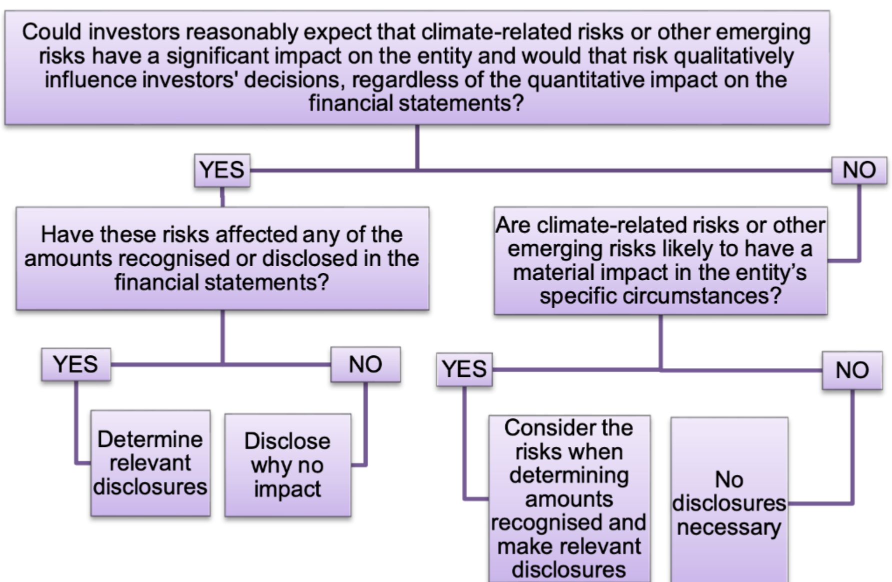


AASB guide for disclosure Climate Change and Covid-19

Practice Statement No.2 is Key



This guidance lists two things that companies should consider. The first is whether investors think that it is important information reasonably expected that risks such as climate change will have an impact. The second is whether it is important on the practice statement. It provides the judgment chart.
Practice Statement 2 seeks to clarify what is material. For example, even if you have no bank balance at all, but it can affect investor's decision making, it is material. Even if impairment loss is not recognized, in a specific industry, it may be material false statements if this is not explained. The financial industry (banking, insurance, asset management) and some non-financial industries (energy, transportation, materials, agriculture, etc.) listed in the TCFD recommendations are significantly affected by climate change. Therefore, information on climate change and the estimation of impairment losses should be disclosed. The financial industry is exposed to the effects of climate change on loans and corporate bonds, and the non-financial industry may not need to reflect the risk of climate change, but you should write so. How is impairment and the useful life of an asset affected, how is it affected in measuring fair value, what is considered if the expected credit loss is credited to an oil field, the coal mining industry, etc. Or, in the case of IAS37 contingent liabilities, the provision for contingent liabilities may result in fines for fulfilling the obligation to restore the original state or for violating environmental legislation. You need to consider those issues.



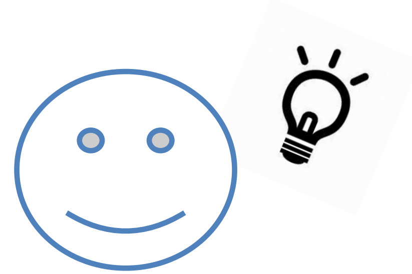
Auditor

AASB has also issued guidance on the disclosure of COVID-19. Very similar to TCFD, the only difference is the replacement of climate change risk with the new coronavirus. The idea is exactly the same, "whether it affects the rational decision-making of financial statement users" and whether it is expressed in the FSs should be considered in Practice Statement 2. Asset impairment, fair value measurement, and other accounting treatments are exactly the same, and what we have to think about with the new coronavirus is how cash flow will change in the future, just like climate variability. And you have to disclose that you have decided that you don't have any exposure.

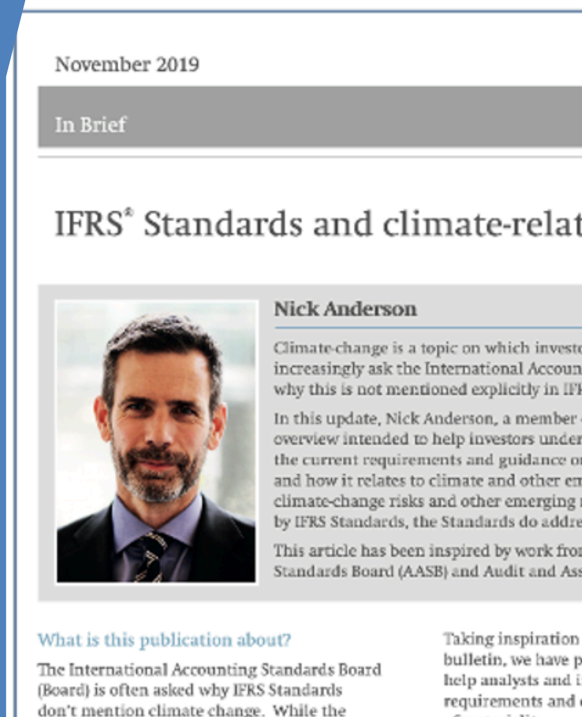
What IFRS requires company to disclose

What is material for investors?

IFRS does not set standards special for the climate change, COVID-19. Both are built into IFRS. Nick Anderson's article on TCFD contains six points. 1. Materiality. 2. Focus on qualitative external factors. 3. Explain the relationship FSs and investors, 4. Explain the practice statement, 5. Explain using cases, 6. Introduce the tool called management commentary.
1.Materiality; it is important that "the investor may make a different decision if there is no such information", prepares must think from the standpoint of the investor . 2. Qualitative external factors, the prepare should not judge by himself, must take qualitative external factors into consideration. Even if he thinks that it is not important, the other people think so, it is important. 3. The position of investors; the conceptual framework presupposes that investors have a certain level of literacy. 4. Practice statements; Climate change is not the only problem. COVID-19, Wars, Minority issue, and investors have to grasp what they think is "important". So IFRS itself does not say that climate change is important. but even if IFRS does not have requirements, it says that investors think so you must disclose what investors consider important. The practice statement states that fossil fuel power generation and regulations do not require disclosure of estimations unless they are impaired under IAS36. But if investors are interested in fossil fuels now, they should be disclosed as important matters.
Lastly, IFRS 17, it is difficult to understand insurance, because each country usually has accounting standards for insurance companies. This makes accounting very complicated. The purpose of IFRS17 is that if there is no insurance accounting and it is a general company has many insurance contracts, what kind of accounting will be needed. It's not insurance company accounting, but insurance contract accounting. Any companies can apply IFRS17 if they have insurance contracts with IFRS 15, IAS 37, IFRS 7, and IFRS 9. Regarding disclosure, insurance liabilities are measured by IAS 37. Therefore, the disclosure is basically the same, and the fair value is finally evaluated. There is also the IFRS7 part, and disclosure of the estimation is also required. The same goes for the fact that if the risk is high, it must be disclosed.



IFRS Expert


November 2019

In Brief

IFRS® Standards and climate-relat

Nick Anderson

Climate-change is a topic on which investo
increasingly ask the International Accoun
why this is not mentioned explicitly in IF

In this update, Nick Anderson, a member
overview intended to help investors under
the current requirements and guidance o
and how it relates to climate and other em
climate-change risks and other emerging
by IFRS Standards, the Standards do addre

This article has been inspired by work fro
Standards Board (AASB) and Audit and Ass

What is this publication about?

The International Accounting Standards Board (Board) is often asked why IFRS Standards don't mention climate change. While the

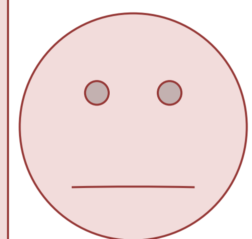
Taking inspiration
bulletin, we have p
help analysts and i
requirements and
of materiality.

https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en

Japanese companies; Climate risk disclosure

We conducted a survey of companies that submitted their security report (有価証券報告書 Yuho) by the end of July, that is the settlement of accounts from April 2019 to the end of March 2020. Unlisted companies are categorised as "other". Approximately 4062 companies submitted Yuho, and among them, companies with the keywords "climate change" or "TCFD" were counted among "risks of business, etc.” 8.5% of companies included the term "climate change." In addition, the word "TCFD" was included in 34 companies in total. Analysing by industry, there are many companies are in foods, electrical equipment, and chemistry sectors. However, since the number of companies classified is large in these sectors, focusing on the ratio, mining, oil / coal products, and electricity / gas has many companies.

Next, we compared this recent year with the previous year. In the previous year, only 95 companies, or about 2.4%, disclosed "climate change", but we can see that the number of disclosure companies has increased by more than 300 in the past year. By industry, the number of disclosure companies has increased from the previous year in the sectors that originally had a large number, the wholesale industry, that is, the trading company sector, and the banking industry compared to the previous year. *Next, we looked at the status of disclosure in the Yuho and the voluntary report. The TCFD Consortium was established in November 2019 to see how companies that support TCFD disclose what kind of "climate change" is disclosed by disclosure media, and how it differs between voluntary disclosure and regulatory one. November 2019, there were 149 supporting companies, and 120 TCFD supporting companies disclosed "TCFD" in voluntary disclosure (integrated reports, sustainability reports, CSR reports) reports. It was 81% of the number of the supporters. At the same time, 36 companies disclosed "climate change" or "TCFD" in Yuho , and only 24% of the number of supporters.*



Bank Researcher

Climate Change Disclosure in Yuho (regulatory disclosure)

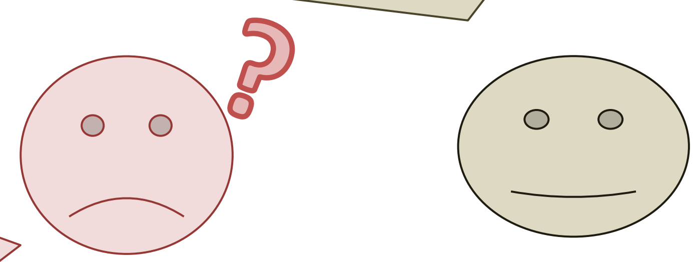
Data from EDINET, Bloomberg

	2019				2018				Increased number	
	number of company	Mentioned "Climate Change"	Mentioned "TCFD"	Ratio	number of company	Mentioned "Climate Change"	Mentioned "TCFD"	Ratio	Mentioned "Climate Change"	Mentioned "TCFD"
Listed company	3728	317	32	8.50%	3707	88	4	2.40%	229	28
Other	334	16	2	4.80%	330	7		2.10%	9	2
total	4062	333	34	8.20%	4037	95	4	2.40%	238	30

How companies are thinking TCFD

At our company, discussions have not progressed to the point of dropping TCFD into FSs, but since last year we have been discussing how to get this information into Yuho since the previous year. The board also discussed a lot about how to think about TCFD in our strategy. Trading companies are businesses in which coal and thermal power plants have a massive impact on climate change. Especially for fuel coal, we made a management decision not to increase interests in the future, and reduce the ratio of thermal power plants and shift to renewable energy. Then disclose them in Yuho and other voluntary reportings The big difference between COVID-19 and climate change is that climate change has long-term implications, and COVID-19 is now affected. We shut down our factories and changed our accounting estimates, and made impairment. For climate change, it is practically difficult to factor in the impact of climate change within five years, as accounting estimates are within five years under IFRS. Even if it tries to affect into WACC, it isn't easy to reflect it in FSs. Because it is not possible to give a number as to what kind of risk premium should be applied.
On the other hand, due to the impact of climate change, the damage caused by the typhoon last year impaired fixed assets in the domestic solar panel business under IAS 36. Since they were insured, we recognised the earnings. I think that it can be reflected in FSs only when it is realised. Australia is also affected by climate change, such as drought, which makes it impossible to obtain grains, but considering how to estimate the impairment of assets in the Australian food business. It is difficult to reflect it in cash flow or WACC. Still, climate change is definitely will affect FSs in the long-term. As a strategy, the business needs to carry out a long-term analysis. Reputation is essential, but we recognise that it is more important to analyse and quantify the impact on cash flow across various fields, and how to disclose it to investors. However, from an auditing point of view, it is necessary to discuss a little more about whether the numbers used in the estimation at that time are really objective and whether they can withstand the audit.

Governance, strategy, KPIs, and risk are major focus points in the TCFD framework. The reason is that it is a major long-term strategic factor for companies. I understand that it is difficult to reflect it in BS and PL. However, I am interested in how management thinks about material risks that cannot be quantified, such as what is going on in terms of governance and what they think about long-term strategies. Then, if it is difficult to reflect it in FSs, how you recognise internally (risks such as financial impact on future business)?



Investor

Accounting Department, Trading Company

View from non-life insurance company

Insurance liabilities are a major component of insuarance company's FSs, and they are responsible for paying for accidents that have already occurred, predicting how much will be paid in the end, and accumulating them as liabilities, which will occur during the contract period in the future. Those two types of liabilities for accidents are recorded as insurance liabilities.
According to the current FSs under J-GAAP, the liability for future payments is basically recorded in the liability of the insurance premium received from the customers and amortised over the insurance period. Currently the prospects are not factored in. On the other hand, the IFRS 17 insurance contract standard will come into effect from 2023, and in principle it is required to reflect the latest estimate at the end of each reporting period in the liability measurement on a cash flow basis.
Most non-life insurers have short-term contracts, so even if you anticipate the impact of cash flow, it will not reflect that long-term impact. On the other hand, when it comes to fire insurance, there are long-term contracts that reflect the long-term effects. Future prospects need to take into account a variety of factors, not just climate change.
Therefore, it is difficult to cut out and disclose only the climate change part. In addition, the expected prerequisites are subject to audit. However, the IFRS standard does not require an explanation that cuts out only the climate change part. In practice, it is difficult to extract only climate change risk because all risks are considered comprehensively. As reinsurance pricing reflects the most recent disaster situation in Japan, future prospect rarely will appear as deficit in FSs. Still, insurance companies are aware of the risk of taking long-term insurance. Until just a few years ago, there was fire insurance for more than 30 years, but a few years ago we took measures to shorten the underwriting to a maximum of 10 years.

insurance company

Yes, a non-life insurance contract is a short period. But even if it's short, whether you pay more than you initially thought in 3 or 5 years, the investor may want to know. IFRS FS can tell it to investors?

Investor

IFRS17, for example, you received a premium of 100 yen, but if the future payment, it seems likely to be 120 yen, the difference needs to be recognised as additional liability. So you can see how much shortage, in IFRS FS.

It's the first discussion of TCFD, such as the fact that typhoons have come every year in the last few years and that payments have increased. Reinsurance is also insured for non-life insurance. Disclosure may prevent the situation like the Lehman shock in 2008. So, is IFRS 17 better?

However, insurance companies frequently review their insurance premiums, such as automobile insurance and the risk of earthquakes, so I don't think they will run out of insurance premiums in 5 or 10 years. I'm not worried from a very short-term perspective.

Instead of our conclusion…

Comments after discussion

- As a non-life insurance company, it is very important to incorporate not only climate change but all factors into accounting, and it is also required by standards. Of course, if the amount of payment changes due to climate change after the insurance contract were sold, it needs to be dealt with, but I think it is difficult to cut out only climate change and think about it.

- Life insurance companies have long insurance contracts and large assets, so we must seriously consider whether the assets themselves are stranded assets. We also announced the ESG investment basic policy in April of this year and are urgently promoting ESG integration. Overseas, for example, AXA and Allianz are operating not only non-life insurance but also life insurance, so I think they were quick to move. In Japan, also, companies that have both is increasing, but originally it was divided into the non-life insurance and the life insurance under the business law. Climate change is included in risk management in our Yuho disclosure, but for life insurance, not only climate change but also population decline is a big problem. So it is difficult to pick up only climate change.

- Even IASB, the accounting system does not specialise in climate change. It is one of the various risks. On the other hand, there is a sense of crisis in the world that the impact of climate change is getting bigger and bigger, and we need to do something now, and we expect to change the behaviour of companies under social pressure through disclosure. Then the intention seems different from accounting is working... such like that it is difficult to convey only by qualitative disclosure, and that quantitative numbers are easier to convey. This intention itself is not bad, and while we have to solve climate change issues as a human being, I feel uncomfortable in terms of accounting. Among the various risks, it is difficult to answer only about climate change is taken out. It may be necessary to consider separately how to deal with this climate change policy-wise in a slightly better way.

Discussion is to be continued….