FRAB 146 (09)
31 March 2022

HM Treasury

Financial Reporting Advisory Board
Sustainability Subcommittee Update (FRAB-SSC 02)

Issue:	An update from the FRAB Sustainability Subcommittee[1] (FRAB-SSC) based on the subcommittee meeting held, and sustainability reporting developments since the last FRAB meeting. This includes the discussion of a paper considering the impacts of climate-related matters on public sector financial statements and whether to develop related application guidance.
Impact on guidance:	No impacts on guidance are proposed in the paper. HM Treasury and FRAB-SSC are considering the impact of developments on climate-related and sustainability reporting in the private sector, on public sector annual reports and accounts (ARAs).
IAS/IFRS adaptation?	No adaptations or interpretations are proposed in the paper; however, the subcommittee may bring insights around interpretations of the IFRS framework to FRAB in the future.
Impact on WGA?	No immediate impact on WGA in the paper. Future advice from the subcommittee on climate-related and sustainability reporting may impact WGA's non-financial reporting.
IPSAS compliant?	IPSAS has not yet issued comprehensive guidance on financial reporting for climate change or sustainability non-financial reporting.
Interpretation for the public sector context?	Some interpretations and adaptations may be necessary to fit sustainability reporting effectively to public sector conditions.
Impact on budgetary and Estimates regimes?	N/A
Alignment with National Accounts	N/A - However, ESA10 guidance on non-financial reporting incorporates satellite accounts enlarging the scope of the accounting framework by adding nonmonetary information, e.g., on pollution and environmental assets.
Recommendation:	The FRAB members are invited to comment on the paper and approve subcommittee's recommendation for the Treasury to develop application guidance to address the financial reporting implications of climate change on public sector accounts.
Timing:	The Board should approve the subcommittees recommendation at the meeting.

[1] For clarity, the 'FRAB Sustainability Working Group' has been renamed the 'FRAB Sustainability Subcommittee' with references and corresponding acronyms updated going forward and in the previous paper, FRAB 145 (16).

DETAIL

Background

1. At FRAB 145 in November 2021, the Board approved the terms of reference and work plan for the FRAB Sustainability Subcommittee (FRAB-SSC) with an initial focus on how public sector Annual Reports and Accounts (ARAs) can best reflect financial reporting matters concerning climate change, as well as to provide advice and guidance to FRAB on climate-related and sustainability reporting matters in the public sector.
2. At FRAB 145, James Osborne volunteered to join the subcommittee. Ian Webber[2], a preparer representative of FRAB; and Nina Johansson, the newly appointed sustainability advisor from CIPFA also joined the second meeting. The Treasury coordinated the meeting (FRAB-SSC 02) on 8 March 2022, circulating the agenda and papers in advance.

Summary

3. This paper sets out the **Recommendations** from the sustainability subcommittee meeting requiring the Board's review and approval; and **Updates** FRAB on the developments in sustainability reporting. The Board is asked to approve the subcommittee's recommendation for the Treasury to develop application guidance to address the financial reporting implications of climate change on public sector accounts.
4. The associated papers for the FRAB-SSC 02 meeting have been included as annexes for the Board's reference:

Annex	Associated paper FRAB-SSC (02)	Details
Annex 1	01 - Agenda	The proposed meeting agenda and details.
Annex 2	02 - Minutes	A summarised set of minutes (to be published on gov.uk) Full minutes from the subcommittee meeting have been provided for the Board's review. The draft minutes were circulated to the subcommittee for review and comment prior to their inclusion herein
Annex 3	03 – Summary and updates	The paper provides an update on the sustainability reporting landscape; outlines the required decisions regarding the proposed application guidance.
Annex 4	04 - Impact of climate-related matters on public sector financial statements	The paper considers the impacts of climate-related matters on public sector financial statements and whether to develop application guidance to support preparers.

[2] Directly after FRAB-SSC 02, Ian Webber offered his assistance at future FRAB-SSC meetings, which the Treasury welcomed.

Recommendations

5. The subcommittee discussed the development of application guidance to address the financial reporting implications of climate change in public sector accounts. The subcommittee agreed that application guidance, which directs and informs preparers, would be useful in ensuring a level of consistency and transparency across the public sector, while aiding preparers in judgemental or complex areas of reporting. Based on the discussion at FRAB-SSC 02, the application guidance should:
    - Direct users to existing guidance (e.g., IFRS educational material) and leverage existing materials and publications (including the FRC report, existing public sector guidance);
    - Guide preparers through the financial reporting implications and approach towards present obligations from the Climate Change Act 2008;
    - Consider and advise on the level of climate-related disclosure for both financial and risk reporting;
    - Consider disclosure of other climate-related information (e.g., expenditure) relevant to users.
    - Audience: primarily be aimed at central government, with relevant authorities deciding whether to adopt and adapt the application guidance as necessary.
    - Stakeholders/contributors: The Treasury should establish a working group of experienced reporters and wider public sector preparers to develop, contribute and consult during development.

Question for FRAB: Does the Board agree with the subcommittee's recommendation for the Treasury to develop application guidance to address the financial reporting implications of climate change on public sector accounts?

Updates

6. An update on the sustainability reporting developments since FRAB 145 was provided at the subcommittee meeting, and as discussed in the minutes (Annex 2). This section covers those updates, the developments since FRAB-SSC 02 on 8 March 2022, and those areas raised by subcommittee members at the meeting.

Government

7. The government announced its commitment to mandate the use of the International Sustainability Standards Board's (ISSB's) International Sustainability Disclosure Standards (ISDSs) for UK companies in the Treasury's Greening Finance: A Roadmap to Sustainable Investing[3]. As part of the Treasury's Sustainable Finance Bill, BEIS is seeking powers for the Secretary of State to be able to adopt ISDS for use in the UK. With the successful bill passage, these should be in place in 2023.
8. BEIS is publishing a consultation in early 2022 seeking views on proposals for the endorsement and adoption of ISDS for use by UK registered companies. The consultation will also seek views on the scope of companies required to report on a

[3] www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing

mandatory basis. The provisions for the ISDS adoption and reporting framework will be introduced via secondary legislation with a proposed timeline of coming into force in 2024.

9. The Public Accounts Committee (PAC) questioned the Treasury when the new sustainability standards would be reflected in department accounts[4]. Cat Little (Director General, Public Spending) responded to confirm the UK government's intention to adopt ISDSs across the UK.

10. On 2 March 2022, the Environmental Audit Committee (EAC) investigated whether the UK's economic goals – as measured by GDP growth – are consistent with environmental sustainability. The overarching view was that GDP is a good measure of activity within the economy; however, the measure fails to address inequality and sustainability. (Supplementary update)[5]

IFRS Foundation

11. On 3 November 2021, the Technical Readiness Working Group (TRWG) published[6] a programme of work, as well as a climate prototype and supplement on climate-related disclosure requirements. The prototype is broadly focussed around the TCFD pillars (governance, strategy, risk management, and metrics and targets) with annexes to define certain terms and for specific sectors and industries.

12. The published prototype has not been through a comprehensive review process by member organisations, the IFRS Foundation or the International Sustainability Standards Board (ISSB); however, the document builds on a joint paper on Reporting Enterprise Value[7] previously published by component organisations. After establishing the ISSB at COP26 in November 2021, the IFRS Foundation has been continuing the process of setting up the new board.

Central government

13. The Treasury is updating the annual Sustainability Reporting Guidance for 2022-23, with coordination from various teams across Defra and BEIS. The new guidance will be updated to:

    - consider the necessary updates to the carbon offsetting arrangements driven by developments at COP26. BEIS is considering the required updates to the Environmental Reporting Guidance, relevant for public sector entities.
    - develop the Taskforce for Climate-related Financial Disclosure (TCFD) recommendation section. A paper on the TCFD recommendations is planned for discussion at the next subcommittee meeting.
    - Reflect changes to legislation and guidance issued by the Treasury and other government departments in the interim (e.g., the anticipated publication of the UK Green Taxonomy).

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[4] Q109 to Q112 from PAC Oral evidence: Achieving Net Zero: Follow Up, HC 642 on 17 November 2021.
[5] Supplementary updates were added to the 'Updates' section after the FRAB-SSC meeting including on new developments, as well as key topics raised by subcommittee members for discussion at the meeting.
[6] www.ifrs.org/groups/technical-readiness-working-group/#resources
[7] impactmanagementproject.com/structured-network/global-sustainability-and-integrated-reporting-organisations-launch-prototype-climate-related-financial-disclosure-standard/

Wider public sector

14. The Treasury is in discussions with other relevant authorities and will bring a paper to the subcommittee to provide an overview of the existing sustainability reporting requirements across the public sector at the next meeting.

15. In February 2022, CIPFA published two short articles[8] on public sector sustainability reporting. These identified four enabling factors around:

    - Frameworks and definitions – building a comparable framework which appreciates different reporting and operating environments.
    - Capacity – recognising limitations and challenges of applying frameworks and definitions without sufficient external support, as well as assurance capabilities.
    - Metrics – focussing on understandability and incremental benefits
    - Voluntary vs. regulation – in the private sector investor and consumer demand has driven changes but is this relevant for the public sector

    In addition to highlighting the relevance of oversight and assurance for public sector entities, and the challenges faced on successfully measuring and assessing outcomes (e.g., environmental performance), as opposed to auditors' usual focus on inputs for the financial statements. (Supplementary update)

[8] CIPFA articles on Sustainability Reporting, How transparency and accountability can strengthen public value and Make mistakes now to protect us for the future, February 2022

HM Treasury

FRAB 146 (09)
FRAB-SSC (02) 01
8 March 2022

FRAB Sustainability Subcommittee (FRAB-SSC)

Annex 1

Agenda

Time: 1500 to 1600 on Tuesday 8 March 2022

Joining Instructions: [removed after meeting]

Timetable

	Time	Item	Paper	Details
1	1500to 1510	Introduction	FRAB-SSC (02) 01 – Summary and updates	Meeting objectives: update group, formalise membership, discuss scope, develop the terms of reference, propose a work plan.
2	1510 to 1425	Updates	FRAB-SSC (02) 01 – Summary and updates	The Treasury to update the subcommittee on developments in the private sector, government policy and external standard setters. Discuss progress of the Sustainability Reporting Guidance for 2022-23. Invite updates from other members.
3	1525 to 1550	Financial reporting implications of climate change for the Public Sector (PS)	FRAB-SSC (02) 03 - Impact of climate related matters on public sector financial statements	Discuss the paper considering the financial reporting implications of climate change for the PS. Discuss the main financial reporting impacts of climate change on PS financial statements and the areas specific to the PS not addressed in the paper. Discuss the need for application guidance on the financial reporting implications of climate change for the PS. Agree on the recommendations for FRAB.
4	1550 to 1600	Forward look and AOB	FRAB-SSC (02) 01 – Summary and updates	Discuss the forward look agenda and decide whether the topics to be covered in the next meeting are appropriate: TCFD recommendations, public sector sustainability reporting overview, and update on the development of climate-related financial reporting application guidance for the PS.

Related papers

Paper No. and Minutes	Paper title
FRAB 145 (16), FRAB 146 (01)	FRAB-SSC 01 – Sustainability Update (last paper presented to FRAB)

FRAB Sustainability Subcommittee (FRAB-SSC)

Annex 2

Minutes

Time: 1500 to 1600 on Tuesday 8 March 2022
Location: Virtual via MS Teams

Attendees

Name	Initials	Position	FRAB Role
Michael Sunderland (Chair)	MS	HM Treasury (HMT)	Relevant authority
Andrea Pryde	AP	PwC	Independent member
Karen Sanderson	KS	CIPFA	Relevant authority
Conrad Hall	CH	Newham Council	CIPFA/LASAAC Chair
Lynn Pamment	LP	Jersey Audit Office	FRAB Chair
James Osbourne	JO	National Audit Office	Auditor representative
Ian Webber	IW	MoD	Preparer representative
Nina Johansson	NJ	CIPFA sustainability advisor	-
Max Greenwood (Secretariat)	MG	HMT	-

Detail

1. The minutes for the FRAB-SSC meeting were circulated and have been adjusted in response to feedback from subcommittee members in advance of the FRAB meeting[9].
2. These minutes should be read in conjunction with the agenda and papers (FRAB-SSC (02) 01, FRAB-SSC (02) 02 and FRAB-SSC (02) 03).

Matters arising

Item	Details
Decision – Application guidance	Develop application guidance on the financial reporting implications of climate change which: • Directs users to existing guidance (e.g., IFRS educational material) and leverages of existing materials and publications (including the FRC report, existing public sector guidance); • Guides preparers through the financial reporting implications and approach towards present obligations from the Climate Change Act 2008; • Considers and advises on the level of climate-related disclosure for both financial and risk reporting; • Considers disclosure of other climate-related information (e.g., expenditure) relevant to users.
Decision – Agenda	FRAB-SSC 03 in May 2022 should cover: • Progress on developing application guidance for financial reporting considerations for climate change; • Overview of existing public sector sustainability reporting frameworks; • Discussion on applying TCFD recommendations to the public sector; • Update on ISSB exposure draft (if available); • Overview of PAC/Parliament discussions on the topic (standing agenda item);

[9] The detailed minutes have been provided to the Board for their review at FRAB 146; however, these minutes will be summarised for publication on Gov.uk.

Summary minutes

Introduction

3. Welcome to new members and observers:
   - Lynn Pamment, an independent FRAB member of FRAB;
   - James Osbourne, an auditor representative of FRAB;
   - Nina Johansson, the newly appointed sustainability advisor at CIPFA. Nina introduced herself, having a background in both commercial and policy experience in Sweden;
   - Ian Webber, a preparer representative of FRAB who authored the Technical Accounting Centre of Excellence (TACoE) article on Sustainability and Climate Change (refer to Annex 6), circulated in advance of the meeting;

Update

4. There had been a slight decrease in activity, based on the significant level of publications and announcements in advance of COP26, covered in the last FRAB-SSC meeting. The IFRS Foundation continues to establish the new International Sustainability Standards Board (ISSB). The Treasury is expected to publish the UK's Green Taxonomy in the near future. The Treasury expects recommendations on emissions reporting from the NAO's public sector decarbonisation study which is drawing to a close.
5. Based on the ISSB's expected focus on enterprise value, the subcommittee discussed the impact/intersection of their financial reporting and wider sustainability reporting work. While the group understand the importance of sustainability reporting, in line with the agreed work plan, the financial reporting considerations would be addressed first, based on FRAB's existing remit and expertise.
6. At COP26 (UN Climate Change Conference), the World Bank invited IPSASB to explore a consultive process to consider the sustainability reporting framework on the public sector. Consequently, IPSASB has included an agenda item for discussion at the March meeting of the Board, with an announcement from Ian Carruthers, IPSASB Chair, that the Board plan to lead a global consultation on developing a sustainability reporting framework for the public sector[10]. FRAB-SSC should consider the direction of travel of IPSASB, which could be around wider sustainability reporting. The Board is releasing a consultation paper on accounting for natural resources, which is due to be approved at the March meeting. CIPFA has also issued short discussion papers on public sector sustainability reporting.

Developing application guidance

7. The subcommittee agreed that application guidance would be helpful for preparers and help toencourage consistency. Members noted the breadth and volume of existing topical guidance in the private sector (e.g., on asset valuations) which should be leveraged from and/or referenced where appropriate. In the private sector, the Financial Reporting Council (FRC) conducted a Climate Thematic Review which raised findings around 'greenwashing' and the need for consistency between the

[10] IPSASB's made the announcement on 16 March 2022, after the FRAB-SSC 02 meeting; however, the summary minutes have been adjusted to include the corresponding details for completeness.

management commentary and financial statements - particularly on net-zero pledges. A member directed the subcommittee to existing guidance on public sector financial reporting with respect to climate change from the New South Wales Government[11] in Australia.

8. As a result of cross-government training, which opened up the idea that the Climate Change Act 2008 (CCA2008) may create provisions, TACoE received a high volume of queries from preparers. In response, TACoE published an article to address uncertainty around which climate-related matters are liable to be a provision under IAS 37. The paper broadly aligned with FRAB 143 (07); however, covered the wider implication of climate change on the IFRS framework. Future application guidance could present an official position to drive consistency and a common set of approaches, including on whether there's a difference in financial reporting treatment of the CCA2008 between the private and public perspective.

9. The subcommittee discussed parliamentary interest and recent discussions on the topic, raising the need for a standing agenda item in future FRAB-SSC meetings. Furthermore, the subcommittee discussed the impact of climate change risks on the balance sheet and whether there's a need for consistency for disclosure and reporting approaches. In addition to the impact on the balance sheet, the subcommittee considered the importance of information on climate-related expenditure and the utility to the users of the statements.

10. For the level of disclosure, appropriate attention should be placed on materiality, as well as a cost/benefit analysis, considering the usefulness of additional information to users, compared to the resourcing implications for preparers. Furthermore, the subcommittee must consider the ease of disaggregating climate-related financial reporting information, given the nature and complexity of certain models.

11. There's considerable uncertainty around the timing and value of future liabilities; and subsequently a variety of risks which need to be built into business plans (e.g., climate adaption). The subcommittee must be clear on the basis of a possible change and ensure they only include requirements where there's a reasonable basis of measurement.

12. The subcommittee agreed that HM Treasury should develop application guidance which signposts preparers to existing material (e.g., IFRS educational materials), sets-out a clear direction and approach (where possible), and guides preparers through when to recognise a present obligation and provision under IAS 37, with respect to the CCA2008. Members also voiced a preference for a checklist for preparers where possible.

[11] www.treasury.nsw.gov.au/sites/default/files/2021-03/Guidance%20on%20the%20Effect%20of%20Climate%20Change%20on%20Financial%20Statements.pdf

Forward look agenda

13. The subcommittee agreed on the provisional agenda for FRAB-SSC 03, planned for May 2022, to include:

- An update on developing application guidance for financial reporting considerations with respect to climate change;
- Overview of existing public sector sustainability reporting frameworks
- Discussion on applying TCFD recommendations to the public sector
- Update on ISSB exposure draft (if available)
- Overview of PAC/Parliament discussions on the topic (standing agenda item)

HM Treasury

FRAB Sustainability Subcommittee (FRAB-SSC)

FRAB 146 (09)
FRAB-SSC (02) 02
8 March 2022

Annex 3

Summary and updates

Background

1. This paper supplements the FRAB Sustainability Subcommittee (FRAB–SSC) meeting on 8 March 2022. This paper follows on from the last FRAB meeting and accompanying paper, FRAB 145 (16), in November 2021 where the Board approved the terms of reference and work plan. Additionally, James Osborne (NAO) volunteered to join the subcommittee.

Summary

2. This paper updates members on the reporting landscape (Updates) and lays out the decisions for the group concerning the subsequent recommendations to FRAB (Decisions), with the associated papers as follows:

Associated paper FRAB-SSC (02)[12]	Details
01 – Agenda	The proposed meeting agenda and details.
04 – Impact of climate related matters on public sector financial statements	Considers the climate-related financial reporting considerations for the public sector (including on users, materiality and consolidation); introduces the existing climate-related financial reporting guidance; as well as, summarising other public sector specific financial reporting implications of climate change; with a proposal for developing future application guidance - setting out the main advantages, the intended audience, the focus, the proposed contributors and an expected timeline.

Updates

[The text from this section has been moved to the Updates section of main paper for conciseness and clarity]

[12] The paper references 02 and 03 have been held for the minutes and this paper, respectively. The draft minutes to this meeting will be circulated to the group for review, before both the minutes and all meeting papers are consolidated and distributed to FRAB in a single paper for review, prior to the next FRAB meeting on 31 March 2022.

Decisions

3. The group is asked to review the papers in advance of the meeting.

Impact of climate-related matters on public sector financial statements

4. The group should discuss the contents of FRAB-SSC (02) 03 and consider:

   - whether the Treasury should develop application guidance for account preparers on climate-related financial reporting

   And if so,

   - whether the committee is content with the proposal for developing the application guidance as follows:
     - audience: primarily central government, with relevant authorities deciding whether to adopt and adapt the application guidance as necessary.
     - focus: reference to existing IFRS education material; explicitly detail any public sector adaptions and interpretations; and identify and explain any climate-related matters specific to the public sector.
     - stakeholders/contributors: establish a working group of experienced reporters and wider public sector preparers to develop, contribute and consult during development.

Forward look agenda

5. The group should consider the forward look agenda and decide whether the topics planned for discussed at the next meeting are appropriate:

   - TCFD recommendations for the public sector,
   - An overview of existing sustainability reporting requirement across the public sector,
   - Update on the climate-related financial reporting application guidance and working group (if the proposal is agreed by this committee and approved by FRAB at the next meeting).

HM Treasury

FRAB-Sustainability Subcommittee (FRAB-SSC)

Annex 4

Impact of climate-related matters on public sector financial statements

Background

1. This paper will consider climate-related matters in public sector financial statements, the extent of existing supporting guidance and the case for developing specific application guidance on this topic. The paper will refrain from covering more general climate-related financial reporting matters (i.e. reporting in annual reports and accounts outside the financial statements), where a different and more extensive body of guidance already exists and which will be considered through other elements of the subcommittee's work plan. For example. the Taskforce for Climate-related Financial Disclosure (TCFD) recommendations will be covered in a later paper.
2. FRAB 143 (07) set out the former academic FRAB member's analysis and assessment of the potential implications of the Climate Change Act 2008 on government financial reporting. The IFRS Foundation published guidance[13] on addressing climate related matters under the IFRS framework, introduced in para. 23 to 25 of FRAB 144 (10).
3. The IFRS Foundation educational material supports preparers in applying the existing IFRS framework to climate-related matters. However, certain climate-related risks are arguably unique to the public sector (detailed later in the paper). Moreover, as the public sector adapts and interprets IFRS Standards, the existing educational material and guidance may not be directly applicable to public sector financial statements. This paper considers the need for application guidance in this area.

Financial reporting considerations

Primary users and materiality judgements

4. The primary user of central government financial statements is Parliament. Parliament has clearly demonstrated its interest in climate related risks through its oversight functions, including the Public Accounts Committee (PAC), Environmental Audit Committee (EAC), select committees, as well as parliamentary questions to the House.
5. Practise Statement 2: Making Materiality Judgements provides an overview of the general characteristics of materiality and a process to make materiality judgements. The scale and nature of climate-related risks, and the interests and roles of the primary users of public sector financial statements means such risks can easily become relevant to the decision-making of users, and therefore preparers may need to consider such risks in the context of their financial statements.

[13] www.ifrs.org/news-and-events/news/2020/11/educational-material-on-the-effects-of-climate-related-matters/

6. In short, **climate-related matters may be material to public sector financial statements**. IFRS Standards require account preparers to make materiality judgements in decisions about recognition, measurement, presentation and disclosure.

Observations and findings from the private sector

7. In 2020, the Financial Reporting Council (FRC) conducted a Climate Thematic Review[14] which concluded that "consideration and disclosure of climate change in the financial statements lags behind narrative reporting. The FRC identified areas of potential non-compliance with the requirements of International Financial Reporting Standards (IFRS)". While the sampled 2019 financial statements were weighted towards sectors and industries perceived to face greater risks concerning climate change, similar issues could be present for certain public sector financial statements.

8. Furthermore, the FRC report highlights the importance of consistency between the narrative report and the financial statements. The vast majority of central government department Annual Reports and Accounts (ARAs) for 2020-21 discussed climate change or GHG/carbon emissions. However, based on mandated requirements within the Sustainability Reporting Guidance (SRG) and Financial Reporting Manual (FReM), we would expect all non-exempted central government bodies to cover this topic. Our review of central government departments did not identify any material adjustments related to climate change. While this is not necessarily outside of our expectations, there is a risk that departments and accounting officers aren't adequately considering the effects of climate change.

9. A lack of guidance on climate-related matters, could lead to inconsistency for public sector financial statements, with different relevant authorities and public sector organisations taking varying approaches to guidance and reporting. Divergence is more likely in contentious or judgemental areas. Furthermore, public sector entities may struggle in those areas where IFRS cannot be directly applied to the public sector, having been adapted or interpreted in the FReM.

10. Based on private sector findings, the diversity of public sector entities and the varying extent to which climate related policies are central to the organisational remit and focus **there is a prima facie risk of under reporting of climate related matters in the core financial statements. That said, there is limited specific evidence to demonstrate this and the strength of the public audit regime in central government provides some assurance that material risks at being duly reflected in financial statements.**

Whole of Government Accounts

11. For the first time, the Whole of Government Accounts (WGA) is incorporating climate change and sustainability in the upcoming 2019-20 report, with HM Treasury Audit and Risk Assurance Committee showing support for this (FRAB 145 (02)). The initial focus is on reporting against the Government's Greening Government Commitments i.e. outside the financial statements.

[14] FRC Climate Thematic Review: www.frc.org.uk/our-purpose/climate-thematic-review-2020

12. Public sector IFRS based financial statements are general purpose financial reports. WGA financial statements do not report separate expenditure based on thematic areas[15], and the FReM (the accounting basis for the statements) does not require this. As a consolidated set of financial statements, the WGA is dependent on the information included in individual returns and consistent financial reporting treatment. The notes, disclosures and commentary of individual financial statements would not currently allow the WGA team to accurately identify and quantify financial adjustments related specifically to climate change.

13. The public sector's large and diverse balance sheet is likely being impacted by climate change, with certain public sector bodies already making related adjustments. **Climate change is already having an impact on the government's balance sheet, however this is not separately identifiable within the existing reporting regime, nor does it necessarily follow (though there may be a case to be made) that it should be.**

Existing climate-related financial reporting guidance in the public sector

National Audit Office

14. The NAO publishes support and guidance on the environment and sustainability; however, to date, this has focussed on sustainability reporting, climate risk management and governance. The NAO published a good practice guide[16] to Audit and Risk Assurance Committees (ARACs) on climate change risk, which also included detail on the specific types of climate change risk applicable to government.

15. The good practice guide included a survey on ARAC Chairs. While the significant majority (81%) considered climate-related risks as relevant to their organisations, over half didn't have a climate and sustainability risk policy (55%), nor a specific individual accountable for sustainability and climate change (53%). Furthermore, the majority (70%) said that climate change risks had either never been discussed at an ARAC meeting or were discussed less often than annually. While the guide didn't focus specifically on the financial risks of climate change, certain associated risks are likely to be financial in nature. As climate change becomes more prevalent, its important ARACs, boards and public sector bodies adequately identify, monitor and disclose the relevant financial reporting implications.

Government Finance Function

16. The Government Finance Function (GFF) supports finance professionals across the Civil Service by publishing guidance, articles and blogs; offering training and facilitating cross government insights. Guidance on climate change and sustainability is published on their digital platform, with links to external articles. Currently, there's limited guidance on the financial reporting implications of climate change.

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[15] In the past, the Treasury has been asked to tally government expenditure related to the COVID-19 pandemic and EU Exit. Gathering financial information from government departments and public sector bodies by thematic area had to be undertaken by commissions, outside of the WGA process.

[16] www.nao.org.uk/report/climate-change-risk-a-good-practice-guide-for-audit-and-risk-assurance-committees/. The guide categorises risks into physical, transitional risks (either adaption or mitigation), and other risks specific to government.

17. The Technical Accounting Centre of Excellence (TA CoE) has published a paper on 'the Climate Change Act and Technical Accounting'. This follows similar lines and reaches the same conclusion as FRAB 143 (07) - that the Act itself isn't an adjusting event. However, the paper also covers restructuring under IAS 37, and deems that the Act creates a valid expectation which, when combined with an entity taking steps in a detailed formal plan, may require an accounting adjustment.

Overall assessment

18. There is a lack of existing public sector guidance on financial reporting for climate change. In addition to the support networks covered in this section, professional bodies also publish guidance on this topic for the public sector; however, this again focusses on sustainability reporting and risks, rather than specifically financial reporting and financial risks. **The absence of guidance increases the risks of inadequate or inconsistent application to financial reporting.** Although, we recognise that most public sector ARAs are reviewed by the NAO or other audit bodies, providing a level of assurance.

Developing application guidance

Main advantages

19. Developing central application guidance would also:

- convey our expectation that public sector bodies should be considering whether their financial statements are materially impacted by climate change. In its simplest form the guidance could be anchored in directing preparers to the IFRS Foundation's existing education material.
- encourage consistency in financial reporting treatment across the public sector. Considering the financial reporting implications of climate change is complex and requires a significant level of judgement, and guidance may temper risks around inconsistency or divergent practice.
- improve the quality of consolidated financial information. In addition to encouraging consistent financial reporting treatment, application guidance could direct preparers to identify climate-related financial information more clearly, improving quality and insights on consolidation.
- improve the quality and effectiveness of financial reporting by identifying public sector climate-related financial risks; and providing guidance on more complex or judgmental matters, including those areas where IFRS Standards have been interpreted and adapted.
- ensure consistent assumptions on climate change are applied across central government where appropriate (e.g., considering independent assessments from the Climate Change Committee).
- encourage an effective and consistent level of disclosure is applied to central government ARAs

20. The proposed focus and development process for the application guidance are addressed in the rest of this section.

Audience

21. The application guidance will primarily be aimed at central government (where the Treasury has an existing mandate). Despite this focus, the wider public sector will also be considered for and consulted with, during development. Relevant authorities would then choose whether to adopt and adapt the guidance independently.

Focus and structure

22. To avoid duplication of existing material, the application guidance will primarily direct users to the existing education material from the IFRS Foundation. The material explores the effects of climate change on financial statements, identifying the following areas that could be impacted:

- asset impairment
- changes in the useful life of assets;
- changes in the fair valuation of assets;
- effects on impairment calculations because of increased costs or reduced demand;
- changes in provisions for onerous contracts because of increased costs or reduced demand;
- changes in provisions and contingent liabilities arising from fines and penalties; and
- changes in expected credit losses for loans and other financial assets.

23. Subsequently, the guidance should explicitly detail any specific public sector adaptions and interpretations of the referenced educational material. Then, the guidance should describe and explain the climate-related matters specific to the public sector. A short initial summary has been included in Annex 5.

24. The guidance could also provide additional guidance to preparers on:

- more complex or judgemental areas for consistency
- identifying relevant information for the reporting process e.g. a consistent source for climate related assumptions.
- other guidance and support available

Contributors and stakeholders

25. In developing the application guidance, the Treasury proposes establishing a working group to support the process.

    The group should include:

- experienced reporters - Certain central government bodies are already considering the financial reporting implications of climate change.
- wider public sector preparers – Ensuring wider public sector considerations are considered at the outset and encourage a more diverse range of experience and expertise to support challenge.

    The group could include:

- external financial reporting experts – from professional bodies, regulators, firms etc.
- auditors – from the NAO or elsewhere with suitable relevant experience

Timeline

26. Once approved by FRAB at the next meeting, the Treasury would identify working group members outside of the meeting. The complexity of the topics, available time from department resources at year-end, and wider consultation process may require a longer development time than initially proposed in the subcommittees' work plan. The Treasury will update the sub-committee on the working group and application guidance's progress at the next meeting.

Annex 5
Public sector considerations in financial reporting for climate change

IAS 1 Presentation of Financial Statements

Materiality

The considerations surrounding materiality judgements for the primary users of the financial statements have been discussed earlier in the paper. Certain climate-related matters may be material by nature rather than value.

Risks and objectives

Climate change has a pervasive impact on the objectives of certain public sector bodies. For example, Flood Re identifies climate change as a key risk which threatens their objectives.

More broadly public sector bodies are responsible for determining which risks are material to users. Managing Public Money (MPM, A4.3.3)[17] states that, 'the board should make a strategic choice about the style, shape and quality of risk management within each organisation'. The Orange Book[18] outlines that 'the board of each public sector organisation should actively seek to recognise risks and direct the response to these risks. It is for each accounting officer, supported by their board, to decide how. Public sector bodies are expected to report their principal risks in their ARA.

As IAS 1 has been interpreted for the public sector there may be a need for further guidance.

IAS 16, IAS 36, IAS 38

The carrying amount of assets such as property, plant and equipment, assets recognised in relation to mineral resources, goodwill and intangible assets could be overstated if the impairment calculations do not account for the effect of climate-related risks. Assets in scope of IAS 16 are the most significant for the public sector balance sheet.

The government has a longer time horizon than the private sector. They hold significant national infrastructure assets with long economic lives (e.g., railway infrastructure held by Network Rail). As the insurer of last resort, the related contingent liabilities and maintenance obligations also stretch well into the future. Stresses to the operating environment in the distant future, are likely to impact the useful economic lives and maintenance requirements of these public assets. Other investment assets may become obsolete or unprofitable in the future.

[17] MPM was published in May 2021 and is aimed at central government and public sector bodies that manage public resources.
[18] The Orange Book was revised in February 2020 and 'sets out the main principles underlying effective risk management in all government departments and arm's length public bodies'.

Government policy goals can involve the use of assets to balance economic, environmental and social considerations in a way that market participants would not. This policy context, a thematic issue in many aspects of public sector reporting, may give rise to specific issues which require guidance in respect of climate related matters.

These standards have all been interpretated and adapted for the public sector which may in itself give rise to the need for further guidance.

IFRS 4, IFRS 17

The government hold financial guarantees and insurance contracts, whose measurement is impacted by climate change. Climate-related matters may increase the frequency or magnitude of insured events or may accelerate the timing of their occurrence. Climate-related matters may, therefore, affect the assumptions used to measure insurance contract liabilities applying IFRS [4 and] 17.

Public sector entities issue insurance contracts that the open market is unwilling or unable to. This may prompt the need for further guidance in accounting for climate related risks in such cases.

IAS 37

Increased uncertainty

Central government bodies are required to report remote contingent liabilities to Parliament. There is often a lack of observable data due to their remoteness, leading to a higher degree of uncertainty and increased level of judgement. Climate change increases certain systemic risks yet further with climate modelling playing a key part.

Restructuring costs

Restructuring costs under IAS 37, where the Climate Change Act 2008 creates a valid expectation which, when combined with an entity taking steps in a detailed formal plan, may require adjustment (mentioned previously).

Very long-term

Certain contingent liabilities have a very long life (e.g. nuclear decommissioning). They are likely to continue to persist into the future as the effects of climate change become more noticeable. Subsequently, cash flows associated with very long-life contingent liabilities will be impacted by the effects of climate change.

International law

Under the United Nations Convention on the Law of the Sea (UNCLOS) 1982, OSPAR decision 98/3, the Energy Act 2004 and the Petroleum Act 1998, the government would become responsible for decommissioning most oil, gas and renewable energy installations in the event that operators are unable to fulfil their decommissioning commitments (WGA 2018-19, non-quantifiable remote contingent liabilities).

Climate change will impact the operations and profitability of certain installations. Furthermore, rises in sea level could complicate decommissioning.

Insurer of last resort

Government acts as the insurer of last resort[19], taking on risks that the market chooses not to take on, both to protect the civil society and provide stability when unforeseen events occur. Taking on these risks creates liabilities that are uncertain but might lead to future expenditure if specific conditions are met or specific events happen.

[19] In March 2020, the Treasury published the Government Insurer of Last Resort www.gov.uk/government/publications/government-as-insurer-of-last-resort--2

FRAB Sustainability Subcommittee (FRAB-SSC)

Climate-related risks for the public sector

Summarised from the NAO's good practice guide

Risk and type	Details
Acute risk (physical risks)	Indirect economic and social impacts through supply chain disruptions, subsequent impacts from infrastructure damage (e.g., lack of transport, communication, manufacturing) or market shifts (e.g., increases in insurance premiums, changes in the need for government support, consumer attitudinal and expectation changes). Categorised as acute (e.g., specific weather-related event) or chronic (e.g., sea level rise from the gradual impact of rising temperatures)
Productivity risk (adaption risk)	Climate change reduces the productivity for the factors of production. (e.g., increased temperatures could reduce the productivity of the workforce).
Financial risk (adaption risk)	Climate change adaptation will be costly, and government organisations will need to balance this alongside a number of other strategic priorities.
Valuation risk (adaption risk)	Climate change is likely to have a deteriorating effect on public assets and infrastructure, with a resulting economic impact on government organisations
Strategic uncertainty risk (adaption risk)	Significant degree of uncertainty brought about by climate change makes government organisation's long-term spending decisions highly challenging. Challenging for organisations to predict the long-term impact that climate change adaptation will have on the country and their service users to determine their approaches.
Reputational risk (adaption risk)	Organisations fail to adapt quickly to the threats posed by climate change and the transition to net zero and suffering reputational damage as a result. Applies to adaption and mitigation.
Policy and regulatory risks – (mitigation risk)	Changes to government policy could have a significant impact on the way organisations need to operate (ticketer regulation, environmental tax measures). For government organisations, there is an increased risk of irregular spending in the event that additional policy or regulatory requirements are enforced to mitigate climate change.
Litigation and liability risks – (mitigation risk)	As the value of loss and damage arising from climate change grows, litigation risk is also likely to increase. There is a risk that organisations become liable for breaching future climate-related regulatory orders by failing to mitigate the impact of climate change. For the government, the Climate Change Act

	2008 sets legally enforceable emissions budgets – government organisations should be aware of the role they play in helping government meet these targets.
Technology risk (mitigation risk)	Changes in technology to support the transition to net zero can impact organisation's operations. Additionally, financial impact as markets adapt to new technologies. Organisations may be reliant on technologies which could be superseded by more energy-efficient approaches or become more expensive due to policy measures.
Policy leadership risk (other government specific risk)	The government fails to support its various policy objectives with a clear and coherent strategy; leading to ineffective delivery.
Value for money risk (other government specific risk)	The government inaction and decisions not being made quickly enough to address the net zero challenge; leading to increased costs in the long term.
Accountability risk (other government specific risk)	The government fails to clearly set out the roles and responsibilities of public bodies in achieving net zero; leading to relevant climate-related risks not being identified or managed.
Coordination and delivery risk (other government specific risk)	The government organisations fail to collaborate effectively to address the system-wide challenges of climate change, and fail to share lessons, develop skills and work effectively across boundaries; leading to increased social and economic costs or failure to achieve statutory or strategic targets.

Annex 6
Sustainability Article published by the
Technical Accounting Centre of Excellence (TACoE)

Published on the Government Finance Function's digital platform on 7 January 2022
The layout of this Article has been adjusted slightly to accommodate its appendage to the FRAB paper

Technical Accounting

No.17

Climate Change Act and Technical Accounting

The Technical Accounting Centre of Excellence (TA CoE) would like to share information about how to account for climate change following the targets set for organisations by 2050 and whether this creates a commitment under International Accounting Standard (IAS) 37, Provisions, Contingent Liabilities and Contingent Assets.

Introduction

This paper differentiates the following key concepts:

(a) The financial reporting impact of climate risk and uncertainty
Climate change impacts financial reporting through the existing accounting framework. This is the main focus of this paper given concerns raised in recent events around the legally binding climate commitments.

(b) Non-financial reporting
Non-financial reporting incorporates organisational information on matters other than the accounts and associated notes. This can incorporate a wide range of topics including the environment, employees, social matters, human rights, anti-corruption and bribery. While sustainability reporting can cover a range of non-financial reporting matters, the key frameworks and topics being considered by corporate reporting are:

- Environmental Social and Governance (ESG)
- Corporate Social Responsibility (CSR)

Recent Developments

The IFRS Foundation Trustees announced three significant developments to provide the global financial markets with high-quality disclosures on climate and other sustainability issues:

1. The formation of a new International Sustainability Standards Board (ISSB) to develop, in the public interest, a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors' information needs;

2. A commitment by leading investor-focused sustainability disclosure organisations to consolidate into the new board. The IFRS Foundation will complete consolidation of the Climate Disclosure Standards Board (CDSB - an initiative of CDP) and the Value Reporting Foundation (VRF - which houses the Integrated Reporting Framework and the Sustainability Accounting Standards Board (SASB) Standards) by June 2022;

3. The publication of prototype climate and general disclosure requirements developed by the Technical Readiness Working Group (TRWG), a group formed by the IFRS Foundation Trustees to undertake preparatory work for the ISSB. These prototypes are the result of six months of joint work by representatives of the CDSB, the International Accounting Standards Board (IASB), the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), the VRF and the World Economic Forum, supported by the International Organization of Securities Commissions (IOSCO) and its Technical Expert Group of securities regulators. The TRWG has consolidated key aspects of these organisations' content into an enhanced, unified set of recommendations for consideration by the ISSB.

The Climate Change Act (2008)

The Climate Change Act sets legally binding targets to reduce greenhouse gas ('carbon') emissions in the UK to net zero by 2050, with the associated duty sitting with the Secretary of State. The UK is the first country to legislate in this way. Relevant provisions of the Act include the following:

- The duty, in Section 4.1, is 'to set for each succeeding period of five years beginning with the period 2008-2012 ("budgetary periods") an amount for the net UK carbon account (the "carbon budget"), and to ensure that the net UK carbon account for a budgetary period does not exceed the carbon budget.'

- Section 4.3 specifies a duty on the Secretary of State 'to explain how the proposals and policies set out in the report affect different sectors of the economy.'

- Section 13 specifies a duty 'to prepare proposals and policies for meeting carbon budgets.'

- A reporting duty in Section 56 is 'to lay reports before Parliament containing an assessment of the risks for the United Kingdom of the current and predicted impact of climate change.'

The Act also established the Committee on Climate Change ('CCC'), to advise the government. In May 2019, that committee recommended that the 2050 target should be tightened, from its original target of an 80% reduction from the level in 1990, to an absolute target of zero net emissions.

Financial reporting impact of climate risk and uncertainty

A key question is, does this legally binding commitment create a liability for government entities under **IAS 37**?

The Conceptual Framework defines a liability as 'a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.' Is there a present obligation with respect to that outflow, which requires identifying a past event? This, under IAS 37, would be an obligating event, 'an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.'

The Conceptual Framework (para 4.45) states: 'If new legislation is enacted, a present obligation arises only when, as a consequence of obtaining economic benefits or taking an action to which, that legislation applies, an entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.' If new decommissioning legislation applies to a nuclear plant that had already been built (i.e., the action occurred before the legislation), then there is a liability as soon as the legislation is enacted, and thereby a requirement to provide for decommissioning.

IAS 37 provides an example relating to environmental legislation, where (under new legislation) an entity is required to fit smoke filters to its factories by 30 June 20X1. As at 31 December 20X0, the entity had not fitted the smoke filters. It is argued not to have an obligation at that date because there is no obligating event, either for the costs of fitting smoke filters or for fines under the legislation. While there is a (new) need to replace/update assets, the implication of that legislative requirement is for higher future capital expenditure, not a requirement for the entity to recognise a provision now. In contrast with the above example of nuclear power, the issue is concerned not with the past actions of the entity, but instead with events that lie ahead. To the extent that the Climate Change Act also relates to achieving a future state, rather being held accountable for past actions, the implication appears to be that the Act should not trigger the recognition of provisions in the government's accounts; the legal requirement is to achieve net zero by 2050, and not 'to rectify damage already caused.'

IAS 37 includes within its definition of restructuring ‘fundamental reorganisations that have a material effect on the nature and focus of the entity’s operations’ (para. 14). This is arguably consistent with the transition to net zero. Para. 72 of IAS 37 notes that a constructive obligation to restructure arises only when, first, an entity has a detailed formal plan for the restructuring and, second, when it has raised a valid expectation in those affected that it will carry out the restructuring. The latter requirement is met in the government’s case by it having passed a legally binding Act. While the Act creates several obligations on the government, which are increasingly leading to legal challenge, the CCC arguably does not provide a detailed formal plan. The burden will be shared with the private sector and key steps will need to follow, while theoretically the legislation could be amended or repealed, each department may have carbon plans and carbon budgets, and these could be seen as a detailed plan which can be estimated, and other implications tested.

If a department plans to move to net zero by, for example, moving from petrol/diesel vehicles to electric vehicles at the end of the existing assets life then no liability is required. In effect future capital spend is changed but the value of the assets does not, although residual values may need to be re-examined.

If a positive step is being taken i.e., to replace existing assets, which may have a useful life beyond the expected replacement date, these should be retested under IAS 16 – Property, Plant and Equipment, for useful life and impairment. Similarly, any energy assets, including infrastructure/pipelines which may either become either “stranded assets” or operate at reduced capacity should be reviewed for impairment when the plans are advanced.

Non-Financial Reporting

HM Treasury issue Sustainability Reporting Guidance (SRG) which is anchored around Defra’s Greening Government Commitments (GGCs).

The ISSB’s Technical Readiness Working Group (ISSB-TRWG) considers the potential private sector implications, as well as existing climate and sustainability frameworks. In terms of a timetable, the ISSB hope to release an exposure draft early next year, with the full standard expected later in 2022. There is likely to be a large number of standards issued in a relatively short time scale.

The first likely ISSB standard will be similar to International Accounting Standard (IAS) 1 – Presentation of Financial Statements, and focus on climate related risks. This is not to say entities need to wait for formal standards as integrated reporting is already mandated with minimum requirements.

The table below summarises non-financial reporting requirements, including the issuing body and where further guidance can be found:

Requirement Scope	Background	Metrics and details	Responsible department	Guidance location
The Greening Government Commitments (GGCs) All central government departments and their arms-length bodies – except in the rare	Defra sets five-year targets for all central government departments and tracks their performance. Defra manages the GGC process with input across government (BEIS for GHG emissions, DfT for travel, etc.) before consolidating the central government performance in an annual	Metrics on: GHG emissions, waste and water. Commentary on: climate change and adaptation, biodiversity and the natural environment; procurement of	Overseen by Defra. Policy support from HMT, BEIS, DfT, Cabinet Office.	FReM21-22 para. 5.4.7 to 5.4.15 which also forms linked to the Sustainability Reporting Guidance (SRG)

case of exceptions given based on size, safety or not classified as a public body under ONS classification.	report. The mandatory reporting requirements aligned to GGCs are as agreed with the Environmental Audit Committee.	food and catering services; sustainable construction.		Introduced in 2010-11 and continuously developed with guidance from Defra.
Sustainability Development Goals (SDGs) All central government departments and their Arms-length Bodies (ALBs)	In 2015, the United Nations (UN) Member States adopted 2030 Agenda for Sustainable Development which "provides a shared blueprint for peace and prosperity for people and the planet, now and into the future".	This mandatory reporting requires departments to identify where their performance counts towards one of the seventeen agreed SDGs. These include: 11 – sustainable cities and communities: 12 – resource consumption and protection: and 13 – climate action.	Cabinet Office	FReM para. 5.4.13 Introduced 2017-18
EU Non-financial Reporting Directive (NFRD) All of public sector entities either through the FReM, CA2006 or other legislation.	In 2014, the EU law introduced to require certain companies to disclose information to provide an understanding of the undertaking's development performance, position and impact of its activity. Certain requirements including anti-corruption and anti-bribery matters have been addressed outside of the department's ARA.	This mandatory reporting requires departments to provide details on environmental protection, social responsibility, respect for human rights and diversity.	BEIS and HMT	FReM para. 5.4.4.c Introduced in 2017-18

References

A. International Sustainability Standards Board (ISSB)
B. Climate Disclosure Standards Board
C. Value Reporting Foundation
D. Technical Readiness Working Group (TRWG)
E. IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Get in touch

The TA CoE would like to hear about your experiences accounting for climate change, including non-financial reporting elements. What problems did you encounter? How did you resolve them? What lessons did you learn? Would you be prepared to share these with finance colleagues in other departments? If so, please email the TA CoE at: DFinStrat-TechnicalAccountingCOE@mod.gov.uk

Contact Technical Accounting Centre of Excellence (TA CoE)

If you have any ideas for future articles that you would like the TA CoE to cover, again please get in touch. The intention is to use One Finance as a technical resource that colleagues can tap into.

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