PSAB Public Sector Accounting Board

Climate-related questions to ask under existing GAAP

Extract, PSA Discussion Group Report on the Public Meeting – May 12, 2022

The submission is positioned as an application of existing standards set out in the PSA Handbook because the questions considered the implications of climate change when applying existing standards.

Climate change may affect financial statements of public sector entities in several different ways. Uncertainties about climate-related risks and events may have implications for an entity's financial position and results, including cash flows, assets, liabilities, net debt, reserves, revenue streams and cost of capital.

In September 2019, Chartered Professional Accountants (CPA) Canada published, *Climate-related Issues: Questions to Ask Under Existing Public Sector Generally Accepted Accounting Principles (GAAP) and Statements of Recommended Practice (SORPs)*. Produced with support from Natural Resources Canada's Climate Change Adaptation Program, the publication was considered part of the submission.

The submission asked the Group to discuss four questions:

1. To what extent does a public sector entity have a responsibility under existing GAAP to provide information in financial statements about climate change and the implications for its financial position and results?
2. If it has a responsibility to provide such information, how should an entity position climate-related information in the financial statements, especially in the notes and schedules? What climate-related information would an entity ideally include in its Financial Statement Discussion and Analysis (FSD&A)?[1]
3. What other questions should be asked under existing GAAP regarding the implications of climate change for financial statements?
4. Do you have any examples from, knowledge of, or experience with reporting of climate-related information in financial statements?

Group discussion

One Group member noted that assets and liabilities exist regardless of whether there is a specific standard on a topic. General standards on assets and liabilities being the "general application standards" are discussed in Topic C of this meeting. If one of the objectives of financial reporting is to provide good and relevant information, preparers should report climate-related matters that can reasonably be expected. The Group member added that while PSAS contains several specific standards for certain obligations, public sector entities have an obligation to report material facts including those involving climate change.

[1] For more information, see PSAB Statement of Recommended Practice (SORP) 1. SORPs are non-authoritative guidance established to set out best practice for reporting outside of financial statements when an entity chooses to do such reporting.

A question was also raised about the possibility of future constructive obligations for governments in relation to their responsibility to address climate change, assuming the obligations meet the liability definition and can be measured. Depending on the circumstances and degree of government commitment, promises with respect to climate-change mitigation, quality of drinking water and other matters (e.g., UNDRIP commitments) may create obligations that should be evaluated for meeting the liability definition.

Several Group members noted that the absence of a specific climate-related standard does not remove the responsibility of public sector entities to report, or at least disclose, such potential liabilities. Some Group members noted that impairment will likely become a more frequent occurrence as assets may be at risk because of climate change. Other Group members shared this perspective that, as service potential erodes, clean-up costs and other potential liabilities may arise in certain cases.

One Group member noted that while the private sector tends to be more profit driven, the public sector holds a significant amount of responsibility in how climate-related issues are addressed and reported. Governments have a social responsibility to steward the environment.

Several Group members noted that the FSD&A can be used more broadly to detail issues and expectations on climate change. An analysis of the variances and potential costs associated with climate change can be reported as part of the FSD&A. This would provide useful information to all stakeholders as to potential costs that can be assumed because of climate change.

Group members shared information that could be reported in the FSD&A:

- risks and likelihood of climate-related events and projected costs;
- infrastructure needed to combat climate change;
- financial risks, and health risks (e.g., water quality, ecosystem health, etc.);
- potential impairments of, or obligations related to, specific assets impacted by climate change; and
- reports on climate-related initiatives and objectives to assist with the above.

A Group member noted the risk of waiting for specific climate-change standards before reporting information in financial statements and other financial reports. They mentioned that accountants tend to be overly focused on financial risks while not emphasizing other risks and responsibilities such as the upkeep of our environment and the wellbeing of our ecosystems.

One Group member provided a few examples of situations that may merit reporting of climate-related information in financial statements:

- Impacts of continued drought:[2] Water levels at numerous lakes continue to reach new record lows, highlighting the ongoing severe drought experienced throughout several parts of the world. The Group members noted the significant impacts this has on the reservoirs. Many dams rely on the water flow to generate electricity and supply water to large cities and communities. A Group member said that such a significant event may permanently impair dams' service capacity and pose risk to maintaining sufficient water supply.
- Reducing coal-fired plants or ending coal production:[3] A Group member said that provinces and communities are moving to phase out coal-fired electricity entirely. Such assets would likely be set aside as permanent impairments.
- Few examples exist since few regulations or policies relating to climate-change measures are in place.

A Group member referenced the topic of sustainable finance discussed at the November 2019 Public Sector Accounting Discussion Group meeting. The federal government created an Expert Panel on Sustainable Finance to look at how the financial sector could help fight climate change by encouraging and directing funds toward initiatives that benefit the environment. The Group member noted that the report and materials shared at the November meeting discussed many opportunities to integrate the impacts of climate-change into financial reporting.

One Group member said that many Indigenous communities face emergencies resulting from climate change. Such issues have long-term financial and environmental impacts on Indigenous communities' wellbeing. Indigenous governments have broader responsibilities than other Canadian governments. They provide goods and service and have responsibilities to their communities that would otherwise be allocated to both municipal and provincial governments. For example, Indigenous governments may be responsible for housing, economic development, health and education, and employment of the community members. The impacts of climate change and extreme weather events have devastating effects on Indigenous communities.

Several Group members were encouraged to see that some Canadian municipalities (e.g., Montreal, Toronto, Vancouver, Edmonton, and Mississauga) are already reporting on environmental and climate-related matters. Group members indicated such examples are a good first step in public sector entities providing stakeholders with qualitive and quantitative information on climate-related matters and their potential costs and initiatives.

Another Group member noted that there is an obligation under existing GAAP to report on the financial impacts of events that have already occurred. They cited the extreme heat and drought that caused severe weather in British Columbia in the summer in 2021, and that the results and implications of the forest fires will be felt for years to come, financially and environmentally.

[2] Water levels at Lake Mead, a reservoir formed by the Hoover Dam on the Colorado River, continue to hit lows as severe droughts continue to sweep through the western United States. This affects the dam's service potential. Gia Yetikyel, "Hoover Dam's Lake Mead Hits Lowest Water Level Since 1930s," *Smithsonian Magazine*, June 18, 2021.

[3] Read more on the Province of Ontario's elimination of coal-fired electricity: Government Ontario, "End of Coal," last modified August 23, 2021.

Another Group member stated that further guidance on projections and measuring the potential impacts of climate change would help further advancing the reporting requirements. Group members noted that while there may be no explicit requirement to report on potential climate-related costs and projections in certain instances, this would not remove the obligation of public sector entities to report important information to stakeholders. Over and above what may be reported in adherence to GAAP, additional information would prove useful and helpful to stakeholders in understanding what public sector entities have to consider and budget for as the impacts of climate change continue to evolve.

One Group member noted that disclosures under MEASUREMENT UNCERTAINTY, Section PS 2130, is an area that could be improved upon. While the disclosure requirements in the Section remain general, preparers could improve the nature and extent of measurement uncertainty disclosures by providing users with better information. Improved reporting may lead to public sector entities making more proactive decisions on the environment and climate change. The Group member concluded that there is an opportunity for enhanced disclosure when applying this standard that may help to highlight climate-related impacts on the financial statements.

A Group member mentioned that the concept of materiality should not solely be focused on quantitative features but perhaps include important qualitative information that would be important to stakeholders. They highlighted that PSAB's Conceptual Framework proposals in its Concepts Underlying Financial Performance project offer improvements to the description of materiality, and that consideration of additional qualitative aspects of materiality may improve the information provided in financial statements.

Another Group member noted that public sector entities must stay well informed on climate-related issues. This area continues to evolve rapidly, and the Group member noted that there will be advancements and opportunities in enhancing how such information can be measured, predicted and assessed. Public sector entities will need to invest in the capacity and expertise necessary to support reporting and action in such areas.

A Group member compared the financial impacts of the COVID-19 pandemic to those of climate change. For example, both would affect measurement uncertainty, revenue streams, subsequent events and collection of receivables. Other Group members agreed there may be responsibilities for asking climate-change-related questions in preparing financial statements under current GAAP, and that some information is better reported in supplementary reports such as FSD&A.

Another Group member remarked that municipalities that do report additional climate-related information, environmental objectives, and details on natural assets and sustainable development as part of the reporting are well received by stakeholders. They said that their experience with such municipalities has shown stakeholders appreciate having this information made available.

Most Group members shared the view that a new set of standards specific to climate-related matters may not be needed. Instead, changes to existing standards and additional guidance may be the preferred option as many standards are currently in place that can enhance financial reporting in this area when viewed through a climate-change lens. The existing guidance may serve as a great starting point, providing the adequate principles relevant to financial reporting over climate risks. However, the application of such standards as they pertain to climate-change could be improved and could benefit from improved guidance on when and where such information should be reported.