net zero
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TRANSITIONING LAWS

ACCOUNTING FOR THE IMPACTS OF CLIMATE-RELATED LAWS

WHAT ARE TRANSITION LAWS?

Transition Laws are laws and regulations introduced to reduce greenhouse gas emissions, build resilience and meet the goals of the Paris Agreement.

WHY IS ACCOUNTING FOR THEIR IMPACT IMPORTANT?

Transition laws are reshaping business realities — influencing markets, financial performance, and the way companies account for climate-related risks.

CHANGING MARKET AND FINANCIAL DYNAMICS

Transition Laws can materially affect the private sector — for example, by shifting market forces, changing the cost of doing business, and impacting profits and expenditure.

ACCOUNTING FOR CLIMATE-RELATED RISKS

Where financially material, the IFRS Accounting Standards require climate-related risks to be treated like any other — including how impacts are evaluated, disclosed and integrated into financial reporting.

THE COST OF INACTION OR POOR DISCLOSURE

Despite IASB guidance, many financial statements lack the information needed. This can mislead investors, expose directors and auditors to risk, and slow the transition by prolonging investment in high-emission activities.

ZOOMING OUT: BACKGROUND TO THE IFRS ACCOUNTING STANDARDS

IFRS
FOUNDATION

The IFRS Foundation aims to bring **transparency**, **accountability**, and **efficiency** to financial markets around the world by ensuring that companies provide comparable and reliable financial information.

INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB)

Together, the **IASB** and **ISSB** provide a connected reporting system.

BUT HERE WE FOCUS SPECIFICALLY ON FINANCIAL REPORTING.

INTERNATIONAL SUSTAINABILITY STANDARDS BOARD (ISSB)

IFRS ACCOUNTING STANDARDS

Global accounting standards that set out how companies should **report their financial performance and position**. The goal is for financial statements to be consistent, transparent and comparable across jurisdictions.

SUSTAINABILITY DISCLOSURE STANDARDS

IFRS S1 — GENERAL REQUIREMENTS FOR DISCLOSURE OF SUSTAINABILITY-RELATED FINANCIAL INFORMATION

IFRS S2 — CLIMATE-RELATED DISCLOSURES

The IASB has confirmed its standards are sufficient to address climate risk – the problem instead lies in their application.

The IFRS Sustainability Disclosure Standards (**IFRS S1 + S2**) are designed to complement, not replace, traditional IFRS Accounting Standards.

Over **140 jurisdictions endorse IFRS**, with 116 requiring most listed companies and financial institutions to comply.

CASE STUDIES ON TRANSITION LAWS

The **NZLA aims to support the application of these requirements** in the context of Transition Laws and contribute to the growing body of guidance (including the IASB's Illustrative Examples). We look at **five areas where Transition Laws are being introduced**, stepping through their potential accounting consequences and key considerations when **preparing financial statements**.

01 CARBON PRICING MECHANISMS

Some Transition Laws introduce carbon pricing mechanisms. These provide a financial incentive to decarbonise and can take a variety of forms (e.g. carbon taxes, emissions trading schemes and carbon border adjustment mechanisms (CBAMs)).

02 ASSET RETIREMENT OBLIGATIONS

Some Transition Laws institute a ban on high-emitting activities, forcing assets to be retired before the end of their useful life (e.g. Netherlands' phase-out of coal-fired power plants).

03 REHABILITATION BONDS

Some Transition Laws require financial assurance to cover the cost of rehabilitating the environmental impact of operations (e.g. Queensland's Financial Provisioning Scheme).

04 ELECTRIC VEHICLE REGULATIONS

Some Transition Laws provide legislative targets and/or incentives to encourage the transition to electric vehicles (e.g. UK's Zero Emissions Vehicle Mandate).

05 INSURANCE AND UNINSURABILITY

Climate change is increasingly affecting the cost and availability of insurance, which is sometimes required by contract (e.g. construction all risk insurance).

CLIMATE RISK AS FINANCIAL RISK

Transition Laws all signal a clear direction of travel and will impact the private sector; updating the frameworks they work within by changing market forces, impacting expenditure, profits and the cost of doing business, and affecting how companies operate and manage their financial and business risk.

In this way, **Transition Laws can give rise to financially material consequences** that are highly relevant for companies' financial reporting and frequently stimulate new opportunities.

Climate risk includes transition risk, investment risk, and financial statement risk. For example, a major energy company faces climate risk as new regulations limit fossil fuel use (transition risk), investors divest over stranded asset concerns (investment risk), and it's obligated to reassess asset valuations and future cash flows in its financial statements (financial statement risk).

KEYS TO COMPLIANCE

NUMBERS

'Numbers' refers to the amounts presented in the financial statements. This includes the value of **assets and liabilities included on the balance sheet**, income and expense amounts in the income statement, and amounts shown in the statement of cash flows.

KEY QUESTION TO ASK

Do any amounts in the financial statement need to be adjusted?

DISCLOSURE

'Disclosure' refers to the 'material information' included in the footnotes. Where material, disclosures should provide a sufficient understanding of how climate matters were considered in the financial statements and how this affects the company's financial position and performance.

KEY QUESTIONS TO ASK

Is material information missing from the footnotes to the financial statements?

Will those using the financial statements understand how the financial impacts of the Transition Law have been considered?

CONSISTENCY

'Consistency' refers to the need for the financial statements (including the assumptions and estimates used) to be consistent with other information in the annual report. Inconsistency may indicate misstated financial statements, misstated narrative reporting or both.

KEY QUESTION TO ASK

Does the information in the financial statements match the company's wider reporting on the Transition Law(s), including other information in the annual report?

HOW THIS APPLIES IN PRACTICE FOR NUMBERS...

EXAMPLES OF HOW ASSETS AND LIABILITIES COULD BE OVER OR UNDER-STATED ON THE BALANCE SHEET

Consider what material climate-related information looks like, including: which assets and liabilities are affected, how assumptions and estimates were made, whether adjustments were necessary, and whether the financial statements align with other disclosures.

CHANGES TO DEPRECIATION OF PROPERTY, PLANT & EQUIPMENT (PPE)

Does the Transition Law reduce the remaining asset lives (sometimes units of production) or the recoverable value of assets, requiring increased amounts of depreciation in the future?

ADJUSTMENTS TO DECOMMISSIONING PROVISIONS

Do provisions for decommissioning obligations need to be re-estimated (e.g. to reflect the earlier timing of activities to meet the obligations and/or improved estimates of the costs involved in meeting the obligations)?

Are there previously off balance sheet decommissioning obligations that, given the increased certainty of the timing of closure, need to be recognised on the balance sheet?

IMPAIRMENT OF PPE OR GOODWILL AND OTHER INTANGIBLES

Does the Transition Law mean assets may be impaired and should be tested?

Have changes in expected future cash flows (revenues and costs) been considered in impairment testing and have impairment charges been necessary to reduce assets to their recoverable values?

COMPLIANCE: SAFEGUARDING YOUR BUSINESS & UNLOCKING OPPORTUNITIES

Comprehensive financial statements that provide material information relating to climate risk (including Transition Laws) have the **power to unlock investment in businesses and technologies**. This investment can accelerate the transition to net zero and yield net benefits for individual companies, as well as people, the economy and the planet.

Compliance also avoids the legal and reputational risks that can result from failing to satisfy the IFRS Accounting Standards. Non-compliance can, for example, lead to liability for:

01 **NEGLIGENCE AND NEGLIGENT MISSTATEMENT**

02 **FRAUDULENT AND NEGLIGENT MISREPRESENTATION**

03 **BREACH OF FIDUCIARY DUTIES**

In very rare cases, non-compliance can lead to disqualification and criminal liability.

04 **DISQUALIIFICATION AND CRIMINAL LIABILITY**