Business models and climate-risk disclosure

MODULE 1 | 1.5.1 | STUDENT COMPANION

Two forces are reshaping the auditor's world. **Business models** keep evolving, and each new model moves the places where a material misstatement can hide. **Climate change** creates physical and transition risks, disclosure of them is becoming mandatory, and they reach straight into the financial statements through impairment, useful lives, provisions, fair values, credit losses and going concern.

Why business models matter to the auditor

A business model describes how an organisation creates value, delivers it to customers and captures some of it as revenue and profit. Models keep changing as technology changes how organisations transact, and most successful businesses borrow pieces of existing models. Innovations include new forms of outsourcing and offshoring, free basic services with paid upgrades, crowdsourcing, subscriptions, online marketplaces and cloud-based services, while mergers and acquisitions can turn a manufacturer into a business that earns most of its profit from software. Understanding how the entity makes its money is a requirement of the risk assessment standard, because that is where the risks of material misstatement start.

Business models and the risks they create

Business model	Where a material misstatement tends to hide
Subscription	Cash arrives in advance: revenue must be deferred until the service is delivered, and management may want to capitalise the cost of winning customers
Cloud-based, or relying on cloud providers	Data is processed on someone else's systems, so the auditor needs evidence about controls the entity doesn't run itself
Outsourcing and offshoring	Reliance on controls at third parties, plus foreign currency and transfer pricing issues
Free basic service, paid upgrades	How revenue and costs are allocated between paying and non-paying customers
Online marketplace	Principal or agent: is it selling goods itself, or arranging for someone else to sell them?

If you don't understand how a business makes money, you can't judge where its numbers might be wrong

Principal or agent? Lantern and Loom (imagined)

Signs of control include being primarily responsible for delivering the goods, carrying the inventory risk and setting the price. Reporting $100 when it is only an agent would make revenue more than six times too high, with no change in profit: very material to investors who focus on revenue growth.

Customer pays $100 for a lamp made and shipped by an outside brand	If Lantern and Loom is the principal	If it is an agent
Does it control the lamp before the customer gets it?	Yes	No: it arranges the sale
Revenue reported	$100	$15 (its fee)
Cost of sales	$85	Nil
Profit	$15	$15

Two kinds of climate-related risk

Physical risks
From the changing climate itself

- **Acute**
  Sudden events: floods, bushfires, cyclones
- **Chronic**
  Long-term shifts: rising temperatures, changing rainfall, rising sea levels

Transition risks
From the shift to a lower-emissions economy

- **Policy and law**
  New laws and carbon pricing
- **Technology**
  Changes in technology
- **Market**
  Changes in what customers and investors want
- **Reputation**
  Damage to reputation

From voluntary to mandatory disclosure

When	What happened
2017	A task force set up by the international Financial Stability Board published a framework for voluntary climate disclosures, built around governance, strategy, risk management, and metrics and targets
2023	The International Sustainability Standards Board built on that framework in its climate standard, IFRS S2
2025 on	Australia's own version (AASB S2) became mandatory for the largest companies for financial years starting on or after 1 January 2025, with smaller entities phasing in over the following years

Where climate reaches the financial statements



The financial statement auditor considers climate when:

- Assessing the risks of material misstatement
- Auditing management's accounting estimates
- Evaluating going concern
- Reading the other information for consistency

Case note: the Eraring closure date

On 17 February 2022 Origin Energy told the market operator (AEMO) that its Eraring power station in New South Wales (2,880 MW, the largest coal-fired power station in Australia) could close as early as August 2025, seven years earlier than its previous plan of 2032. Origin pointed to the rapid growth of cheaper renewable energy, which was making coal plants less economic to run. Under an agreement with the New South Wales government signed in May 2024, the closure moved to August 2027, and on 20 January 2026 Origin extended it again, to April 2029, the latest date that agreement allows. Each time the expected date moves, the estimates below move with it, so a closure decision changes the numbers as soon as it is made, not when the plant stops.

What an auditor would ask	Effect of an earlier closure (a later date reverses each effect)
Depreciation	A shorter useful life means faster depreciation of the plant
Rehabilitation provision	The work arrives sooner, so the present value of the provision rises
Recoverable amount	Must be reassessed, which may mean impairment
Contracts	Coal supply and staff contracts may contain onerous terms or redundancy costs

Source: Origin Energy announcements to the ASX (17 February 2022; 23 May 2024; 20 January 2026).

The consistency test. If a company's climate report promises to exit a polluting activity by a certain year, but its impairment model assumes the assets keep earning cash for years after that, one of the two is wrong. The auditor reads the other information in the annual report, including climate disclosures, for consistency with the financial statements, and challenges any gap.

Practice questions

MODULE 1 | 1.5.1 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Find the risk in the business model

For each business, identify a likely risk of material misstatement created by its business model.

Business (all imagined)	A likely risk of material misstatement
(a) **Beanloop Pty Ltd:** a coffee-bean subscription. Customers pay 12 months in advance for monthly deliveries of freshly roasted beans, and the company pays online influencers a fee for each new subscriber.	
(b) **Tradiehub Pty Ltd:** an app linking homeowners with tradespeople. The homeowner pays the full job price through the app; Tradiehub keeps 12% and passes the rest to the tradesperson.	
(c) **Budgetbird Pty Ltd:** a budgeting app that is free for basic use, with premium features at $8 a month. Free and paying users share the same servers and support team.	
(d) **Fernhaven Apparel Ltd:** designs clothing in Melbourne. Its own subsidiary in Vietnam makes the garments and sells them to the parent in US dollars; a logistics company runs its warehouse.	
(e) **Tixly Pty Ltd:** an event-ticketing platform run entirely on a cloud provider's servers. It collects ticket money and pays event organisers after each event.	

Question 2 - Physical or transition?

Classify each event as a physical risk (acute or chronic) or a transition risk (policy and law, technology, market or reputation).

Climate-related event	Physical or transition? Which kind?
(a) A flood closes a distribution centre for six weeks	
(b) The government introduces a price on emissions from large emitters	
(c) Rising average temperatures cut a wheat grower's yields year after year	
(d) Drivers switch to electric vehicles, cutting demand at a chain of service stations	
(e) Cheaper battery storage makes a gas-fired peaking plant uneconomic	
(f) Rising sea levels threaten a council's seawalls and foreshore assets	
(g) A cyclone damages a port's loading equipment	
(h) An activist campaign damages a coal miner's standing with customers and lenders	

Question 3 - Spot the inconsistency

Carrick Basin Coal Ltd (imagined) mines thermal coal. Its climate report, published in its annual report, commits it to 'exit thermal coal mining by 2032'. In its financial statements, the impairment model for its only mine assumes coal is produced and sold until 2045, the processing plant is depreciated over a useful life ending in 2045, and the rehabilitation provision assumes the site closes in 2045. Identify the inconsistency and explain what the auditor should do.

Worked answers

MODULE 1 | 1.5.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Business model risks (suggested)

Business	Likely risk of material misstatement
(a) Beanloop	Revenue taken when cash arrives instead of as each monthly delivery is made; influencer fees capitalised as contract costs when they may not qualify, or amortised over the wrong period
(b) Tradiehub	Principal or agent: if it doesn't control the work, its revenue is the 12% fee, so reporting the full job price would overstate revenue
(c) Budgetbird	Allocating shared server and support costs between free and paying users; subscription revenue in the right period
(d) Fernhaven Apparel	Transfer pricing with the subsidiary; translating US dollar balances; inventory held by the logistics company, relying on a third party's controls
(e) Tixly	Evidence about the cloud provider's controls (a service organisation); ticket money owed to organisers is a liability, not revenue

Question 2 - Classifying the events

Event	Classification
(a) Flood	Physical: acute
(b) Emissions price	Transition: policy and law
(c) Rising temperatures	Physical: chronic
(d) Switch to electric vehicles	Transition: market
(e) Cheaper batteries	Transition: technology
(f) Rising sea levels	Physical: chronic
(g) Cyclone	Physical: acute
(h) Activist campaign	Transition: reputation

Question 3 - Carrick Basin Coal (sample answer)

- **The inconsistency:** the climate report says mining ends by 2032, but the impairment model, useful life and rehabilitation provision all assume 2045. Either the commitment or the accounting is wrong.
- **If the commitment stands:** thirteen years of cash flows may not exist, so the mine may be impaired; depreciation should be faster; rehabilitation comes sooner, raising the provision; and onerous contracts or redundancy costs may arise.
- **What the auditor does:** get evidence on the commitment's status (board minutes, transition plans, contracts), challenge management's assumptions alert to bias, and raise the gap with both management and those charged with governance.
- **Then report:** if the statements stay materially misstated, modify the opinion; if the climate report is wrong and isn't corrected, describe that misstatement of the other information in the auditor's report.