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Climate-related Risks in the Financial Statements
Cover Note

Objective

1 The objectives of the session are:

(a) to provide the EFRAG FR TEG and CFSS with an overview of the IASB's project Climate-related Risks in the Financial Statements ("the CRFS project"); and

(b) to seek EFRAG FR TEG and CFSS members' feedback on the reporting of climate-related risks in the financial statements. This input will be part of EFRAG's feedback to an ongoing IASB outreach on the topic, including during the July 2023 IASB ASAF meeting. It will also inform the EFRAG research project on connectivity between financial and sustainability reporting information.

(c) To provide a verbal[1] update on the findings from an EFRAG Secretariat survey sent to EFRAG CFSS and EFRAG Working Groups, to gather their feedback on the reporting of climate-related risks in the financial statements.

Overview of the IASB project

2 Following its Third Agenda Consultation, where respondents (including EFRAG) assigned a high-priority ranking to a project on climate-related risks in the financial statements, the IASB added this project to its pipeline of projects.

3 The IASB initiated the CRFS project (i.e., moved it to the active maintenance project workplan) in March 2023. As outlined in agenda paper 10-03, the purpose and focus of the CRFS project include:

(a) To explore whether and how companies can provide better information about climate-related risks;

(b) To explore the nature and causes of stakeholder concerns about the reporting of climate-related risks in the financial statements;

(c) To consider the possible courses of action, if any.

4 Thereafter, as a precursor to deciding the scope and direction of the CRFS project, as depicted in the diagram below the IASB has been doing outreach on the matters outlined in the above paragraph, and the possible scope of this project.

[1] The survey closed on 29 June after the upload of this paper. A written report on the findings will be shared at a later date.

5 The CRFS project will not seek to:

(a) develop an Accounting Standard on climate-related risks, or extensive application guidance on how to consider the effects of such risks when applying Accounting Standards;

(b) broaden the objective of financial statements or change the definitions of assets and liabilities; and

(c) develop accounting.

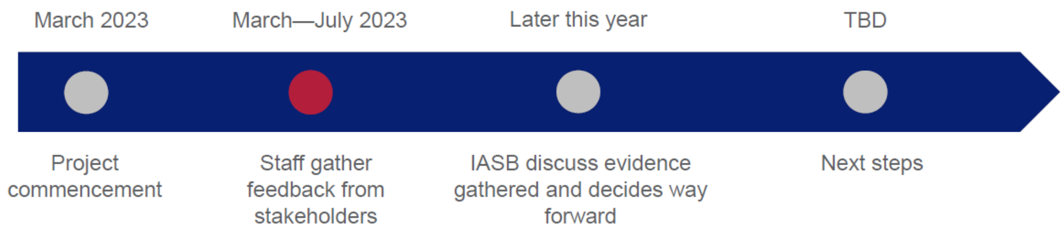
6 The potential causes of the issues that the CRFS project intends to address may include:

(a) unclear or insufficient requirements in IFRS Accounting Standards;

(b) lack of compliance with current requirements by preparers; and

(c) investor information needs that go beyond the objective of financial statements and should rather be addressed by the ISSB IFRS S2 *Climate-related Disclosures.*

7 The Figure below depicts the IASB tentative project plan.



Source: IASB July ASAF meeting paper (see agenda paper 10-02)

EFRAG Secretariat comments

8 The IASB notes that stakeholders have aired concerns about the possible inconsistent application of Accounting Standards to climate-related risks and insufficient information about these risks in the financial statements. Nonetheless, as highlighted in the IASB Educational Material, published in November 2020, although IFRS Accounting Standards do not explicitly refer to climate-related risks, they still require companies to consider climate-related matters in their financial statements when the effect of those matters is material information for investors. Hence, as intended by the CRFS project, it is necessary to identify the causes of the concerns expressed by stakeholders.

9 As part of the selection and initiation of the EFRAG research project on connectivity, the EFRAG Secretariat has gotten a flavour of stakeholders' concerns on the reporting of climate-related risks in financial statements.

10 The comments and questions raised by constituents during the EFRAG Agenda Consultation and at other forums where EFRAG engages with other stakeholders (e.g., IFASS meetings) include:

(a) climate-related risks are often perceived as remote, long-term risks and may not be appropriately considered in the financial statements;

(b) investors need better qualitative and quantitative information about the effect of climate-related risks on the carrying amounts of assets and liabilities reported in the financial statements;

(c) why are companies that have made net zero commitments not recognising liabilities or not reporting impairments of the value of their assets as a result of those commitments?

(d) are assets vulnerable to climate risk (transition and physical risk) disclosed in sustainability disclosures identifiable or reconcilable to financial statements?

(e) when will sustainability-related targets and transition plans be considered constructive obligations and trigger either the recognition of provisions or disclosure of contingent liabilities?

(f) the absence of sensitivity analysis of recoverable amounts to a variation of key assumptions directly linked to climate change; and

(g) how should companies factor long-term uncertainties into the measurement of amounts in financial statements?

Recent EFRAG discussions

11 EFRAG discussed the issues related to presenting and disclosing information on climate-related risks during the recent EFRAG IAWG meeting in June. The members provided the following comments:

(a) Different members described their reporting of climate-related risks, with a member indicating that climate risk was mentioned multiple times in the annual report of his group.

(b) the climate risks and opportunities are implicit and embedded in the relevant financial statement amounts (e.g., it would be part of the risk adjustment under IFRS 17, and the best estimate in accordance with IFRS 17 requirements should include all risks and opportunities).

(c) the opportunities (i.e., the positive climate-related impacts) and other risks should be considered in the scope of the project.

(d) the risk disclosures are mandated under both IFRS 17 and IFRS 7; however, the climate-related risks disclosures are not explicitly mentioned, and these should be required.

(e) the ESG information provided by insurers is mainly qualitative and idiosyncratic, and, for capital market participants, there is a push towards requiring the disclosure of more useful, quantitative information.

(f) in 2021 Mazars published a report on financial reporting on climate issues, where the following findings were mentioned:

  (i) The disclosures mainly concern the valuation of non-financial assets and investments, the accounting treatment of carbon schemes and the accounting for sustainable finance. Environmental issues other than climate change (biodiversity, water, pollution, etc.) are also sometimes mentioned in the financial statements. They may give rise to provisions (generally for pollution clean-up) which are not disclosed in detail. As for social ad governance issues, they are rarely mentioned in the financial statements, except sometimes as a criterion for share-based payments.

  (ii) There is an increasing trend of providing voluntary disclosures on climate risks, opportunities and commitments; the preparers often provide non-mandatory disclosures on specific issues (e.g., additional investments).

  (iii) The climate risks identified mainly concern transition risks, i.e. the risks for a company to adapt to changes (technological, regulatory, etc.) triggered by climate change. The physical risks and opportunities related to climate change are rarely mentioned.

  (iv) A small majority of preparers disclose their commitments in regard to climate change, however, a third of these preparers do not provide any details.

(v) The accounting impacts of climate change issues are wide-ranging. Although few have a material impact on the measurement of assets and liabilities, they are nevertheless often subject to detailed disclosures in the notes.

Based on the findings of the report and the provided examples, it was suggested by an IAWG member that the IASB should consider the requirements for new transactions emerging associated with mitigating climate risk, for instance, on the accounting treatment of voluntary carbon credits. Furthermore, the IASB could provide educational material clarifying the meaning of certain climate-related terminology (e.g., neutrality, compensating, commitments, targets) to help ensure consistent reporting.

(g) EIOPA had already issued guidance on providing information regarding climate risk and ORSA (Own Risk and Solvency Assessment) and SFCR (Solvency and Financial Condition Report) reports also require the consideration of climate risk.

Questions for the EFRAG FR TEG and CFSS members

12 In your jurisdiction, have you identified concerns about the reporting of climate-related risks in financial statements? What is its/their nature and prevalence? Please refer to slide 11 of Agenda Paper 10-03 for the possible nature of concerns.

13 What are the causes of the concerns you identified? Please refer to slides 12–13 of Agenda Paper 10-03 for possible causes of concern.

14 How could the IASB address these concerns? Do you think the benefits may outweigh the costs of those actions? Please refer to slide 14 of Agenda Paper 10-03 for possible courses of action.

15 Should the IASB consider changing the scope of the project and cover other risks in addition to those related to climate, or add opportunities as well as risks? Please refer to slide 15 of Agenda Paper 10-03 for considerations on changing the scope.

16 Have you found the IASB's educational material issued in November 2020 useful? Do you have suggestions on how to improve it?

Agenda Papers

17 In addition to this cover note, Agenda Paper 10-03 – *Climate-related risks in the financial statements* (ASAF Agenda paper AP7) – has been provided for background. Please note that Agenda Paper 10-02 has not been provided.

Useful References

18 Apart from the agenda paper for the ASAF meeting, other useful references include:

(a) The educational material published by the IASB, published in November 2020, is available here (examples of IFRS Standards which may require companies to consider the effects of climate-related matters identified in this document are: IAS 1, IAS 2, IAS 12, IAS 16, IAS 36, IAS 37, IFRIC 21, IFRS 7, IFRS 9, IFRS 13, and IFRS 17);

(b) An article on the topic, published in November 2019, is available here: IFRS Standards and climate-related disclosures*; and*

(c) 2023 ESMA Report *2022 Corporate reporting enforcement and regulatory activities* (see pages 24-29).