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## Cover Note

### Objective

- 1 The objective of this session is to seek the input of EFRAG CFSS and FR TEG members related to the IASB project on Climate-related and Other Uncertainties in the Financial Statements (hereafter referred to as the COUFS project or the project). In September 2023, following its outreach, the IASB decided on the project direction and the related actions it would take including developing examples (see paragraph 4 below). As a result, at the December 2023 ASAF meeting, the IASB will discuss the development of examples to help improve the application of IFRS Accounting Standards (see agenda paper 05-02). Inter alia, the IASB seeks to:
  - (a) explore whether to develop new examples building on two examples in the IFRS Practice Statement 2 *Making Materiality Judgments* (Materiality Practice Statement) and tailor these for climate-related matters. The two examples are Example C- materiality judgements that lead to the disclosure of information in addition to specific disclosure requirements; and Example K- influence of external qualitative factors on materiality judgment (see slides 14–15 of the agenda paper 05-02);
  - (b) identify other areas besides materiality where examples would be useful (e.g., slide 22 of agenda paper 05-02 highlights examples related to the application of IAS 36 *Impairment of Assets* and expected credit loss under IFRS 9 *Financial Instruments*); and
  - (c) ascertain the best vehicle for presenting examples on materiality and other areas.
- 2 Hence, the input of the EFRAG CFSS and FR TEG members is sought on the above in preparation for EFRAG’s participation at the December 2023 IASB ASAF meeting.
- 3 The rest of the paper is structured as follows:
  - (a) Overview of the COUFS project;
  - (b) EFRAG outreach and other discussions where EFRAG was involved;
  - (c) EFRAG Secretariat’s analysis of IASB project direction and ASAF questions
  - (d) Summary of key issues and suggestions by EFRAG Secretariat

## Overview of the COUFS project

- 4 At the July 2023 EFRAG TEG-CFSS meeting<sup>1</sup>, an overview of the IASB project was provided. Moreover, agenda paper 05-02 has a recap of the project objectives, background and IASB outreach findings. In September 2023, following its outreach, the IASB decided<sup>2</sup> to:
- (a) explore the possibility of targeted amendments to improve disclosures about estimates in the financial statements;
  - (b) generalise the scope of the project to encompass other uncertainties;
  - (c) discuss with IFRS Interpretations Committee issues on the recognition of liabilities when applying IAS 37, and on the application of IAS 36 to measure value-in-use when an asset was subject to highly variable future cashflows over an extended period;
  - (d) explore the development of practical examples; and
  - (e) translate and make more visible existing educational material and publish an article about the role of financial statements.
- 5 Furthermore, the IASB decided not<sup>3</sup> to explore clarifying or enhancing requirements in IFRS Accounting Standards in relation to:
- (a) connections between items of information in the financial statements and between the financial statements and other general purpose financial reports;
  - (b) assessing whether information is material; and
  - (c) the ‘catch-all’ disclosure requirement in paragraph 31 of IAS 1 Presentation of Financial Statements.

## EFRAG outreach and other discussions where EFRAG was involved

- 6 From June to July 2023, the EFRAG Secretariat conducted outreach to various stakeholders on the IASB project including through a survey and gathering the views of EFRAG CFSS and FR TEG members at the July 2023 meeting. Thereafter, in September 2023, EFRAG issued a [Secretariat Briefing](#), which conveyed stakeholders suggested several courses of action by the IASB. These included the issuance of illustrative examples that are industry-specific; enhanced IASB educational material including material that is tailored for stakeholders outside the traditional financial reporting community; issuance of application guidance for some of the more challenging reporting areas; and limited amendments to the core of IFRS Accounting Standards requirements (i.e., IAS 1.125 requirements on time horizon, the impairment test requirements under IAS 36, and similar to sustainability reporting requirements, having explicit requirements for connectivity within IFRS Accounting requirements). Stakeholders also expressed support for broadening the scope of the project beyond climate risk. Although some stakeholders also expressed concerns that, if a change of scope occurred, the IASB may fail to come up with timely solutions to the concerns raised on the reporting of climate-related risks.

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<sup>1</sup> See [agenda paper 10-01](#) for 4 July 2023 EFRAG TEG-CFSS meeting.

<sup>2</sup> For further information on IASB decisions please refer to the September 2023 IASB Update [here](#).

<sup>3</sup> The IASB considerations included time constraints, the external environment being a moving target and the risks of unintended consequences.

- 7 At the October 2023 EFRAG FR TEG and SR TEG joint meeting, several EFRAG FR TEG members agreed with the IASB decision to explore targeted amendments and emphasised the usefulness of providing examples. They pointed to the principle-based nature of IFRS Standards that needs to be retained, and the risk of disclosure overload if amendments to IAS 1 were made. They also opined that the perception of missing information on climate-related risks reflected expectation gaps on what can be included in the financial statements rather than a lack of compliance or any problem with IFRS Accounting requirements. At the same time, an EFRAG FR TEG member affirmed the concern on impairment tests and noted the IASB could extend the current 5-year time horizon in IAS 36 to better address some specific risks. It was also suggested that the COUFS project could stimulate the IASB to revisit some IFRS Accounting Standards to be more aligned with the new environment (e.g., IAS 38 in relation to the R&D investments). There was also a general sense that more needs to be done on connectivity by the IASB and ISSB than is currently the case.
- 8 A few EFRAG SR TEG members (a minority) expressed their expectation of a more fundamental overhaul of current financial reporting requirements to reflect climate-related impacts, risks, and opportunities in the financial statements. In reaction, several FR TEG members conveyed that such an approach would be inconsistent with the objectives of financial reporting.
- 9 At the October 2023 EFRAG Academic Panel meeting, similar views to some of those raised at the joint TEGs meeting were expressed (i.e., the importance of maintaining the character of a principle-based Standard, and a need for only minimal and targeted amendments). The academic panel also pointed to the lack of clarity on what is meant by other uncertainties within the project. For instance, due to the differences in the notion of risks (which was previously used to describe the project, i.e., climate-related risks in the financial statement) and uncertainty (which is how the project is now described, i.e., climate-related and other uncertainties in the financial statements).
- 10 At the September 2023 IFASS meeting, which EFRAG participated in and currently chairs<sup>4</sup>, several participants expressed support for the targeted amendments and broadening the scope of the project to include other uncertainties. However, an overall observation of a lack of ambition was also expressed about the IASB decision to limit the targeted amendments to estimation uncertainty (i.e., the decision to explore clarifying or enhancing only IAS 1.125 and not address IAS 1.31 related to materiality). There was a call for the IASB to be brave in its decisions. Suggestions made included a need for overarching connection requirements within IFRS Accounting Standards (i.e., requirements that can serve as a bridge to information outside the financial statements including management commentary). The need to address the application of materiality was also raised. In addition, the point was made that even though opportunities should not be disclosed in the financial statements, their appropriate placement should be considered and clarified.
- 11 The quality of the IASB educational material (i.e., Nick Anderson’s article and the related educational material published thereafter) was also commended by IFASS participants. However, it was noted that this educational material led to no significant changes in reporting practices. Moreover, IFASS participants considered that examples have limitations (e.g., they differ from and often fail to portray real-world situations). Similarly,

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<sup>4</sup> EFRAG chairs IFASS from March 2022 to after the Spring meeting of 2025.

the EFRAG Secretariat Briefing highlights that the IASB educational material is considered useful albeit with scope for improvement. The high-level nature and non-authoritative stature of the educational material and the limited stakeholder awareness of its existence were noted. These observations strengthen the case for amendments to IFRS Accounting Standards rather than primarily relying on educational material to drive changes in preparers' reporting behaviour.

- 12 In past comment letters on the materiality practice statement (issued in [March 2016](#)) and management commentary (issued in [December 2021](#)), EFRAG supported the inclusion of examples that illustrate both decisions to include and omit information.

### **EFRAG Secretariat's analysis of the IASB project direction and ASAF meeting questions**

- 13 *Overall project direction:* Taking account of the overall feedback received on possible IASB standard setting choices during EFRAG's outreach, the EFRAG Secretariat views the IASB could and should go further than exploring limited targeted amendments to IAS 1 related to disclosure of estimation uncertainty. Although we acknowledge the IASB is consulting the IFRS Interpretations Committee on impairment requirements on 28 November 2023, as noted in paragraph 6, there is an expectation from stakeholders that the IASB should explore the amendment of impairment requirements (e.g., clarifying the treatment of incremental versus maintenance Capital Expenditure–Capex whilst determining future cash flows). In the EFRAG Secretariat's view, such an exploration should be done through a standard setting research project rather than via IFRIC consultation. Furthermore, we consider the development of connection requirements within IFRS Accounting Standards (e.g., IAS 1) that would be related to information outside the financial statements would not only be pertinent to sustainability-related information including climate-related matters but would be part of enhancing the reporting in management commentary which forms part of IFRS general purpose financial reporting and for which the IASB has a project that is in post ED phase and awaits finalisation.
- 14 Though the EFRAG Secretariat expected more actions than what the IASB decided, we understand the intended development of examples that the IASB will be discussing with ASAF members in December. As noted in the EFRAG Secretariat Briefing, in addition to targeted amendments to IFRS requirements (e.g., IAS 1 and IAS 36), stakeholders called for additional application guidance to help entities' materiality assessment of climate risks and illustrative examples on the assessment of materiality of sustainability risks for inclusion in the financial statements.
- 15 Finally in respect of project direction, while we consider encompassing other uncertainties coheres with a principle-based Standard, we also note the lack of clarity on what is in the scope of uncertainties (i.e., both climate-related and other uncertainties) as decided by the IASB. Specifically, whether it encompasses risks across all time horizons or only long-term risks as had been portrayed in earlier communication by the IASB, and whether it encompasses some or any opportunities and under which circumstances would opportunities be reflected in financial statements. Hence, we suggest all these questions be clarified to ensure stakeholders are on the same page when sharing perspectives on possible examples, educational material, standard setting amendments, or any other vehicle for influencing reporting practices.

- 16 *Materiality examples:* The EFRAG Secretariat agrees with the IASB proposed tailoring of **Examples C and K** in the materiality practice statement to illustrate the consideration of climate-related matters. The proposed examples could help clarify the application of IAS 1 requirements. That said, the jury is out on whether examples in and of themselves can change preparer reporting behaviour and whether they are enforceable. Hence, as noted in our response below on vehicle for examples, we suggest primacy be accorded to placing examples within specific Standards with limitations (i.e., Standards where there has been feedback suggesting the need for clarification). We note that examples C and K also simply state that the company considers the information to be material without stating how this judgment was made. We would suggest that the example describe how materiality judgment could be made (e.g., assess if a matter is severally raised during analyst calls). We also suggest that these examples include but not be limited to climate-related matters to reflect the principle-based nature of IFRS Accounting Standards.
- 17 We also note that parallel to the concerns of omitted climate-risk information, there are concerns about the disclosure of information that could obscure other material information (i.e., disclosure overload). Thus, consistent with EFRAG's recommendation in the 2015 comment letter response to the materiality practice statement noted in paragraph 12, we suggest the IASB consider including examples of climate-related matters (uncertainties or risks) fact patterns where preparers would not be expected to disclose such matters. For instance, an example where it may be necessary to disclose management judgement whenever management has concluded that a particular risk that would be expected to affect a particular entity has not (yet) materially impacted the asset values.
- 18 *Other examples besides materiality examples:* We would support the inclusion of other examples besides materiality examples. We agree with the suggested example on **Entity A** in slide 22 of the agenda paper 05-02 related to the application of IAS 36 as it aligns with the feedback received as noted earlier. We also note that several thematic reviews<sup>5</sup> of reporting by EU companies have pointed to the need for clarification in respect of the application IAS 37 requirements. Thus, IAS 37 examples such as those that were included in the April 2023 IASB staff paper Agenda reference: 22-Appendix B)<sup>6</sup> would be helpful. However, we are less sure of the suitability of an example on **Entity B** related to IFRS 9 requirements for expected credit loss as we are not aware of there being diversity in practice due to the lack of clarity of related IFRS 9 requirements.
- 19 *Attributes of examples:* We consider that both stand-alone examples (i.e., specific requirements) and walk-through examples (i.e., multiple requirements) as contemplated in agenda paper 05-02 would be useful. It aligns with the suggestion made at the June EFRAG CFSS and TEG meeting that the IASB structures the educational material not only "by standards" but also "by topic and case studies" (e.g., net zero commitment), providing more specific guidance on how each topic could impact the current IFRS Accounting

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<sup>5</sup> The thematic reviews include: a) [ESMA, March 2023, Report- 2022 Corporate reporting enforcement and regulatory activities](#); b) [Finanstilsynet, March 2023, Report on Information on climate-related matters in annual financial reports.](#); c) [Autorité des Marchés Financiers -AMF, 2022, Overview of the information provided in the 2021 financial statements on the effects of climate change and the commitments made by companies.](#); d) [Leo van der Tas, Yukti Aggarwal, and Danijela Maksimovic, September 2022, Effects of climate change on financial statements of entities listed in the Netherlands](#), MAB- Maandblad voor Accountancy en Bedrijfseconomie.; e) [Mazars, 2022, Financial reporting of European companies on climate issues- Findings from 2021 financial statements.](#)

<sup>6</sup><https://www.ifrs.org/content/dam/ifrs/meetings/2023/april/iasb/ap22-appendix-b-provisions-drafting-suggestions-for-illustrative-examples.pdf>

Standards requirements. Regardless of the type of examples, it would be useful for these to reflect real-world complexity rather than being stylised. Along this line, we reiterate the suggestion made by EFRAG stakeholders that the examples should be industry-specific.

- 20 *Vehicle of presenting examples:* With the noted limitations of educational material (see paragraph 11), the EFRAG Secretariat's view is that including examples through application guidance as an integral part of IFRS Accounting Standards would be the most effective choice as it would:
- (a) ensure greater authority and awareness among entities than that provided through educational materials.
  - (b) provide the IASB with additional time to understand and monitor the continuous development in the sustainability reporting (and in other IASB-related projects<sup>7</sup>) and entities' (and users') behaviour.

An alternative to educational material could be a practice statement as suggested at the September 2023 IFASS meeting. Such a practice statement could be on reporting uncertainties and include examples of climate-related matters and any other uncertainties that are deemed to be underreported currently.

- 21 At the same time, it is important to emphasise that we do not consider that examples should be included in all specific IFRS Accounting requirements where climate-related uncertainties may be considered. examples should not be included in all Standards flagged in the 2020 IASB educational material (i.e., IAS 1, IAS 2 *Inventories*, IAS 12 *Income Taxes*, IAS 16, IAS 38, IAS 36, IAS 37, IFRIC 21 *Levies*, IFRS 7 *Financial Instruments: Disclosures*, IFRS 9, IFRS 13 and IFRS 17). Examples should only be included as part of the application where they clarify the application of the principle and there are noted areas that require clarification (e.g., IAS 36). Other examples (both walkthrough and specific) could be presented in a comprehensive practice Statement rather than educational material as was suggested at the 2023 September IFASS meeting.

### Summary of EFRAG Secretariat's key issues and suggestions

- 22 *Summary of key issues:* As noted above; the EFRAG Secretariat considers that the IASB decisions on project direction fall short of overall expectations conveyed during EFRAG outreach; there is a lack of clarity on what is meant uncertainties; and the limitations of existing and potential examples should be taken into account by the IASB.
- 23 *Summary of key suggestions:* As noted above; the EFRAG Secretariat suggests the IASB should further clarify what is encompassed within uncertainties; repurposed Examples C and K in the materiality statement should include explanations of how the preparer could have assessed if a matter is material (e.g., via recurrence during analyst calls); and there should be the targeted inclusion of examples within particular IFRS Accounting Standards (e.g., IAS 36) along with a comprehensive practice statement for uncertainties with walkthrough and specific examples.

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<sup>7</sup> Other IASB related projects are Amendments to the Classification and Measurement of Financial Instruments (IFRS 9), Provisions—Targeted Improvements (IAS 37) and Power Purchase Agreements.

**Questions for EFRAG FR TEG and EFRAG CFSS members**

ASAF Questions

- 24 Do EFRAG FR TEG-CFSS members have any comment on the following ASAF questions related to the materiality examples as detailed in slides 12-15 of the agenda paper 05-02?
- (a) Would materiality examples significantly improve how entities apply IFRS Accounting Standards in reporting the effects of climate-related and other uncertainties?
  - (b) What is your experience of the application of Examples C and K by preparers in practice?
  - (c) What are the challenges in applying the concepts illustrated in Examples C and K in your jurisdiction?
  - (d) What recommendations do you have about the possible content of the example, as described on slide 13 of the agenda paper in 05-02?
- 25 Do EFRAG FR TEG-CFSS members have any comment on the following ASAF questions related to examples other than on materiality as detailed in slides 20-22 of the agenda paper 05-02?
- (a) Would examples (other than materiality) significantly improve how entities apply IFRS Accounting Standards in reporting the effects of climate-related and other uncertainties?
  - (b) What areas of IFRS Accounting Standards and fact patterns do you think should be illustrated through examples? Should the examples illustrate the application of specific requirements (stand-alone examples) or walk-through requirements across multiple Standards (walk-through examples)?
- 26 What are your views regarding the best vehicle and timing for the examples?

EFRAG Secretariat Questions

- 27 As noted in paragraph 22 (summary of EFRAG Secretariat's key issues), the EFRAG Secretariat considers that the IASB decisions on project direction fall short of overall expectations conveyed during EFRAG outreach; there is a lack of clarity on what is meant uncertainties; and the limitations of existing and potential examples should be taken into account by the IASB. Do you agree or disagree with these key issues?
- 28 As noted in paragraph 23 (summary of EFRAG Secretariat's key suggestions), the EFRAG Secretariat suggests the IASB should further clarify what is encompassed within uncertainties; repurposed Examples C and K in the materiality statement should include explanations of how a preparer could have assessed if a matter is material (e.g., recurrence of an issue during analyst calls); and there should be the targeted inclusion of examples within particular IFRS Accounting Standards (e.g., IAS 36) along with a comprehensive practice statement for uncertainties with walkthrough and specific examples. Do you agree or disagree with the EFRAG Secretariat's suggestions?

**Next steps**

29 The EFRAG Secretariat will continue to monitor the IASB discussions.

**Agenda Papers**

30 In addition to this cover note, agenda paper 05-02 – *AP3\_Climate-related and Other Uncertainties in the FS\_ASAF December 2023 final* – has been provided for the session.