EFRAG Secretariat: Hocine Kebli,
Lina Lemessiou

AASB and AUASB Joint Bulletin
Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB Practice Statement 2
Cover Note

Objective

1 The objective of this paper is to ask EFRAG CFSS and EFRAG TEG members for their views on:

(a) The application of IFRS Practice Statement 2 *Making Materiality Judgements* (the 'IFRS Practice Statement') to reporting climate related and other emerging risk issues in the financial statements; and

(b) Any similar recent developments in EFRAG CFSS member jurisdictions in response to the increasing demand for climate-related and other emerging risks disclosures.

Background

2 The IFRS Practice Statement was issued by the IASB in September 2017, with the objective of providing entities with non-binding guidance for making materiality judgements and assessing their implications when preparing financial statements in accordance with IFRS Standards.

3 In December 2017, the Australian Accounting Standards Board (AASB) approved the guidance as an Australian Practice Statement. The Australian Practice Statement is essentially the same as its international equivalent, except that the AASB has added specific guidance for not-for-profit entities.

4 In December 2018, the AASB and the Australian Auditing and Assurance Standards Board (AUASB), published a joint Bulletin *Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB Practice Statement 2* (attached as agenda paper 13-02 for this meeting), to assisting preparers and auditors of financial statements to make materiality judgements on climate-related and other emerging risks using the Australian Practice Statement.

The Bulletin

5 Investors are increasingly interested in long-term value creation and are demanding more climate-related disclosures from entities, and more specifically information about an entity's exposure to, and management of, climate-related risks. Investors' decisions are being impacted by climate-related as well as other emerging

environmental, social and governance (ESG) risks, which are currently predominantly discussed outside the financial statements, if at all.

6 As set out in the IFRS Practice Statement, an entity needs to assess whether information is material to its financial statements regardless of whether such information is publicly available from a source outside the financial statements. That is, public availability does not relieve an entity of the obligation to provide material information in its financial statements (IFRS Practice Statement paragraphs 24 to 26). Furthermore, qualitative external factors such as the context in which the entity operates, and investor expectations, may result in the need for disclosure of material risks when preparing financial statements, regardless of their numerical impact (IFRS Practice Statement paragraphs 49 to 51).

7 The Bulletin recommends a two-step approach for entities preparing financial statements in accordance with Australian Accounting Standards whereby entities consider:

(a) whether investors could expect that climate-related risks or other emerging risks have a significant impact on the entity, and whether that risk would qualitatively influence investors' decisions regardless of the quantitative impact on the financial statements; and

(b) what disclosures about the impact of climate-related risks are material to the financial statements in light of the guidance in the Australian Practice Statement.

8 Even if it is determined that there is no material impact, entities are asked to disclose *why* there is 'no impact'.

9 The potential financial implications arising from climate-related and other emerging risks, as identified in the Bulletin, may include asset impairment; changes in the useful life of assets; changes in the fair value of assets; increased costs and/or reduced demand for products and services affecting impairment calculations and/or requiring recognition of provisions for onerous contracts; potential provisions and contingent liabilities arising from fines and penalties; and changes in expected credit losses for loans and other financial assets.

10 The Bulletin further discusses how climate-related risks in particular could affect the financial statements and which Australian Accounting Standards may need to be considered (see pages 7 to 9 of agenda paper 13-02).

11 Finally, the Bulletin addresses the relevant assurance considerations in respect of climate-related and other emerging risks, on an auditor's existing legal and professional duties (see pages 9 and 10 of agenda paper 13-02).

EFRAG Secretariat initial views

12 The EFRAG Secretariat observes that climate-related and other emerging risks are currently predominantly discussed outside the financial statements. However, IFRS Standards require consideration of contingencies, asset impairments and other matters that can be affected by such risks.

13 Moreover, although the IFRS Practice Statement discusses the effect of qualitative external factors, such as the industry in which the entity operates, and investor expectations may make such risks 'material' and warrant disclosures when preparing financial statements, it does not provide further guidance on the matter.

14 Therefore the EFRAG Secretariat welcomes initiatives to clarify the application of the IFRS Practice Statement to these issues.

15 The EFRAG Secretariat observes that other initiatives and frameworks are considering the application of materiality to non-financial information, including climate-related and other emerging risks, for example:

(a) The IASB staff is suggesting guidance on the application of materiality in the context of its project to revise the Management Commentary Practice Statement. In November 2018, EFRAG TEG and EFRAG CFSS discussed the IASB Staff proposals which suggested a two-step approach whereby an entity first, identifies business matters on which information is needed; and then, identifies what information is needed by users to assess those business matters.

(b) The Task Force on Climate-related Financial Disclosures (TCFD) recommends that entities provide climate-related disclosures in their public annual financial filings, and states that 'organisations should determine materiality for climate-related issues consistent with how they determine the materiality of other information included in their financial filings'.

(c) The Global Reporting Initiative (GRI) states that for materiality purposes the relevant topics are those that can 'reasonably be considered important in reflecting an entity's economic, environmental and social impacts, or influencing the decisions of stakeholders'. In this context, 'impact' refers to the effect an entity has on the economy, the environment and society.

(d) The Sustainability Accounting Standards Board (SASB) defines material issues as issues that are 'likely to impact the financial condition or operating performance of a company and therefore are most important to investors' and provides an interactive tool (the SASB Materiality Map) to identify and compare disclosure topics across industries.

16 Although most of the above initiatives address information presented outside the financial statements, the EFRAG Secretariat is of the view that some form of coordination and consistency in the way materiality is approached is desirable. If the IASB were to issue a similar Bulletin, it might be taken as representing best practice by frameworks that already use the concept of materiality.

17 Regarding the proposed approach in the Bulletin, it first requires an entity to consider any emerging risks that investors would reasonably expect to have a significant impact on the entity, regardless of their quantitative impact on the financial statements. Then, as a second step, the entity would look at whether these risks have affected the entity's past operations or are likely to have an effect in the future.

18 We consider that, in practice, considering these two steps sequentially would not always be operational, as judgements about material matters and material information on those matters are often done simultaneously. The reference to 'significant impact' (rather than material), which is not defined in the Bulletin, may also create complexity.

19 Finally, we are not convinced that the recommendation to disclose a lack of exposure to some emerging risks would always result in useful information.

Questions for EFRAG CFSS and EFRAG TEG members

20 **Question 1**: Do you agree with the application of IFRS Practice Statement 2 to disclosing climate-related and other emerging risk issues in the financial statements?

21 **Question 2**: Do you consider that the Bulletin has got the balance right in encouraging extra disclosures about climate-related and other emerging risks?

22 **Question 3**: Are there any similar recent developments in EFRAG CFSS and TEG members' jurisdictions in response to the increasing demand for climate-related and other emerging risks disclosures?

Agenda Papers

23 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 13-02 – ASAF 07A *AASB and AUASB Joint Bulletin*; and

(b) Agenda paper 13-03 – ASAF 07B *AASB slide presentation*.