This paper has been prepared by the EFRAG Secretariat for discussion at a joint public meeting of EFRAG FR and SR TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG SRB or EFRAG SR TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG SRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Sector EDs: additional information about anticipated financial effects – Issues paper

Objective

1 The objective of this paper is for EFRAG SR TEG to share work done with and receive inputs from EFRAG FR TEG to support the discussion on the additional requirements with respect to anticipated financial effects to be included in the Mining, Quarrying and Coal mining (MIN) and Oil and Gas (OG) sector Exposure Drafts (EDs).

Background

2 The EFRAG Secretariat continues its research and development of sector-specific standards. An important topic for the MIN and OG sector EDs is the anticipated effects which refer to both rehabilitation (and similar) provisions and the implications of closure of assets or stranded assets.

3 The authors of Paananen, Runesson & Samani (2021) [1] note: "We study a **particular type of liability that has no direct claimants and is difficult to measure mainly due to its longevity**. This means that, although there is a public interest in environmental liabilities, few capital market actors (such as investors and creditors) actively demand disclosure on how they are estimated (Michelon et al., 2020). Further, due to their inherent uncertainty, companies are reluctant to provide information about these liabilities. These factors taken together **creates an information vacuum** related to environmental liabilities, **increasing the risk of the public having to take responsibility for clean-up costs in case of company failure**." Emphasis added.

4 In this paper we set out the financial reporting position accompanied by the research of the EFRAG Secretariat to explain the additional disclosures proposed in the MIN and OG sector EDs.

Position under IFRS

5 IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is the relevant standard related to the recognition, measurement and disclosures on financial provisions for rehabilitation. The required information about the relevant property, plant and equipment for the operating site falls under IAS 16 *Property, Plant and Equipment*.

6 IAS 37 requires the existence of a present obligation for the recognition of a provision. Such obligation may be triggered by legislation or contracts. In the case of constructive obligations, an obligation may be derived from an undertaking's actions that created a

[1] Mari Paananen, Emmeli Runesson & Niuosha Samani (2021) Time to clean up environmental liabilities reporting: disclosures, media exposure and market implications, Accounting Forum, 45:1, 85-116, DOI: 10.1080/01559982.2021.1872909

valid expectation that it will discharge such responsibilities. (Please refer to Appendix 1 for some extracts from IAS 37).

7 There is no requirement in IFRS to disclose provisions by operational site as the standard only requires disclosures by class of provisions. IAS 1 *Presentation of Financial Statements* also requires information about sources of estimation uncertainty.

Concerns about the current requirements: Liabilities

Academic research: globally

8 Academic research[2] has found substantial variations exist in companies' choice to disclose the discount rate when accounting for decommissioning and environmental liabilities. This was based on a large international sample across the mining, utilities, and oil and gas sectors.

9 Furthermore, the research notes that when a company with a decommissioning liability becomes insolvent the clean-up liability remains attached to the asset, which may therefore become less attractive to a potential buyer. Therefore, if eventually the asset remains unsold, the taxpayer ends up picking up the decommissioning tab. ICAS points out that this scenario is likely to be more frequent in a post-COVID world.

10 The report recommends that:

(a) Standard setters should require disclosing the discount rates applied to facilitate comparability and thus allow for users of financial statements and other key stakeholders to see inside the 'black box' of accounting for decommissioning liabilities; and

(b) Preparers should include, and auditors demand, enhanced disclosures, to include not only the discount rate but also undiscounted future estimated cash flows and timing of decommissioning activities, augmented by a comprehensive narrative on the major uncertainties surrounding these items.

Academic research: Companies in the EU

11 Focusing on European-listed firms with environmental liabilities reporting under IFRS from 2005 to 2015, academic research (Paananen et al 2021) found similar diversity in disclosure practices.

12 The authors note: "We study a particular type of liability that has no direct claimants and is difficult to measure mainly due to its longevity. This means that, although there is a public interest in environmental liabilities, few capital market actors (such as investors and creditors) actively demand disclosure on how they are estimated (Michelon et al., 2020). Further, due to their inherent uncertainty, companies are reluctant to provide information about these liabilities. These factors taken together creates an information vacuum related to environmental liabilities, increasing the risk of the public having to take responsibility for clean-up costs in case of company failure."

13 While they find that disclosures about environmental liabilities have increased over time, only 35% of the companies with a material environmental liability disclose both discount rates and time horizons and 19% report neither key input. Disclosures of discount rates and time horizons are 40% and 53%, respectively (material environmental liabilities: 53% and 63%). In 2016, the corresponding figures for discount rates and horizons are 53% and 59%, respectively (material environmental liabilities: 58% and 64%).

[2] Giovanna Michelon, Mari Paananen and Thomas Schneider (2020) Black box accounting: Discounting and disclosure practices of decommissioning liabilities.

14 However, external pressure in the form of media exposure remediates this situation and has a positive impact on firms' disclosure practices, and improved information content. The authors conclude that more explicit disclosure guidelines from the IASB, such as requiring disclosure on key inputs used to estimate the environmental liabilities, would contribute to companies being more forthcoming with information. Further, such guidelines would empower auditors and other enforcers to demand more detailed disclosure.

IASB workplan

15 In January 2020 the IASB added a project to its workplan to:

(a) align the IAS 37 liability definition and recognition requirements with its Conceptual Framework;

(b) clarify which costs to include in the measure of a provision; and

(c) specify whether the discount rate used to reflect time value of money includes non-performance risk.

16 This project is likely to result in changes to the disclosure requirements but usually disclosures are considered only towards the end of such a project.

GRI Mining Exposure Draft

17 The following is the correspondent requirement in the mining GRI Exposure Draft:

For financial provisions made by the organization for closure and rehabilitation, including environmental and socioeconomic post-closure monitoring and aftercare for mine sites, report:

- the total undiscounted monetary value, and a breakdown of this total by mine site;

- the methodology used to calculate the undiscounted financial provisions for closure and rehabilitation.

EFRAG Secretariat research

18 EFRAG Secretariat conducted research on 6 large European undertakings in the Oil & Gas industry (BP, Equinor, ENI, Repsol, Shell and TotalEnergies). By looking at financial statements, EFRAG Secretariat explored the reporting practices of these undertakings related to disclosures on potential write-off situations for recognized oil and gas reserves and stranded assets. Beyond disclosures related to stranded assets, our research led to observations on the breakdown of assets, asset retirement obligations (ARO) and dismantling / decommissioning provisions and the 1,5° trajectory.

19 The main take aways on stranded assets are the following:

(a) The level of transparency on potential write-off situations for recognized reserves is very heterogeneous from one company to another. This can be explained by the very general nature of the disclosures required by IFRS, which are not sector specific, and thus do not require any specific disclosures on recognized reserves. This finding is corroborated by the article "The Interplay between International Financial Reporting and Local Disclosure Rules: Evidence from the Oil and Gas Industry" (Hellman & al. 2023) which provides evidence that the IFRS adoption in Canada weakened the connection between financial reporting and O&G reserve reporting.

(b) One company reports relevant disclosures in a systematic manner to "provide a further perspective on the risk of stranded assets carried in the Consolidated balance sheet" as at year end. This best practice consists of disclosing:

(i) Which assets are potentially the most sensitive to the energy transition (in the case study the assets with the most at risks are: a: exploration and evaluation assets, b: refineries and c: oil sands reserves)

(ii) A narrative on the evolution of the carrying amount of those assets (in the case study, the narrative starts in 2016)

(iii) The depreciation methodology of the reserves (in the case study: a and c: the methodology is unit of production, b: the methodology is straight line basis)

(iv) Quantitative information on the level of the reserves or depreciation level in the future: for the assets a and c: the estimated remaining reserves according to the production plans, by 2030, 2040 and 2050; for other assets (b) : the period over which the assets are depreciated (20 years) and the date when the assets would be fully depreciated (14 years)

(v) A narrative stating that assets are depreciated in the same pattern as the depletion of the reserves (for the assets a and c)

(vi) A narrative stating that this information “provide a further perspective on the risk of stranded assets carried in the Consolidated Balance Sheet” at year end.

20 The main take aways on breakdown of assets are the following:

(a) We found it difficult to reconcile the asset breakdown in the Property Plant & Equipment (PP&E) disclosure with the assets described as being potentially the most sensitive to energy transition. This is the case even for the company considered as a best practice example for the stranded assets disclosures, as the breakdown in the PP&E disclosure (“exploration and evaluation”, “production”, “manufacturing supply and distribution”, “other”) does not match the assets described in the “Climate change and energy transition” disclosure.

(b) The report “Assessment of oil and gas companies’ climate strategy” published by Reclaim Finance in April 2023 complemented our analysis of the European O&G financial statements. In particular, the methodology of this report underlines the relevance of breaking down the capex as follows: CAPEX allocated to renewables, CAPEX dedicated to upstream, other Oil and Gas CAPEX and other CAPEX. This breakdown is not always disclosed (in particular, many companies have a category which includes renewables and activities not related to renewables (eg: circular economy, hydrogen, future mobility solutions....). This breakdown would allow calculating the ratio of renewable capex on total capex and the ratio of fossil fuel capex on total capex.

21 The main take away on ARO (accounting for asset retirement obligations) and dismantling / decommissioning provisions is the following:

(a) All companies describe their accounting policy on asset retirement obligations, and dismantling / decommissioning provisions in general terms but do not systematically disclose the triggering event for recording such provision.

For example, one company reports that “its policy was not to recognize decommissioning and restoration provisions associated with manufacturing facilities in Oil in line with industry practice. This was on the basis that these assets were considered to have indefinite lives.” In 2020, this company changed its policy, as “the changed macroeconomic fundamentals were considered, together with the company’s plan to rationalize the group’s manufacturing portfolio. It was also

reconsidered whether it remained appropriate not to recognise decommissioning and restoration provisions for manufacturing facilities".

(b) Those accounting policies do not either give information on the estimated retirement dates for the assets for which an ARO is booked. However, two companies in our sample disclose a quantified sensitivity analysis in case the retirement of the assets would occur earlier than what is assumed in the financial statements (by two years for one company, by five years for the other company). This means that the information on the estimated retirement dates could be made available.

(c) For all companies analysed, we found it difficult to understand for which asset an "asset retirement obligation" (ARO) or a decommissioning / dismantling provision is recorded.

(d) ESRS E1-9 requires a reconciliation between assets at risk of transition and financial statements, ESRS E2-6 requires a reconciliation between pollution-related provisions and financial statements. Sector-agnostic ESRS do not require disclosures on the assets which include a component related to an asset retirement obligation. This disclosure would be relevant not only for the for Oil & Gas sector but also for the Mining, Quarrying and Coal sector.

22 Following the request of information users, one company reports the additional impacts that would result from using the impairment of the net zero Emissions 1.5°C scenario of the International Energy Agency (in its World Energy Outlook 2022 report).

23 The EFRAG Secretariat notes that requiring additional financial information goes beyond the topic of connectivity between financial and sustainability statements and therefore does not consider such additions lightly.

24 However, given that IFRS[3] does not require information about discount rate, time buckets or undiscounted cash flows used for these liabilities, and the deficiencies in current practice[4], adding requirements in this area is important. As mentioned above, these liabilities have no claimants or claimants who would struggle to enforce such obligations if the financial provisions are insufficient to rehabilitate operational sites post-closure.

25 The EFRAG Secretariat notes that the aspects considered in this paper are in scope of financial reporting, nevertheless, it considers that this information is particularly relevant also to the users of sustainability statements. To avoid duplication, incorporation by reference will always be possible. What is particularly important for users with a sustainability focus, is the information of the undiscounted amount of expected cash outflows, as the focus of financial reporting is the recognised discounted amount.

26 In addition, the information mentioned above should be required by operational site to allow for the evaluation of the adequacy of such provisions. IFRS may ask for such information for material sites, but due to financial materiality considerations in IFRS will not require such information to the necessary level of granularity. Therefore, if this is considered to be necessary given the broader stakeholders under ESRS compared to IFRS[5], it would need to be included under ESRS.

[3] The EFRAG Secretariat assumes the same is true for local gaap.

[4] The Secretariat notes that some entities do provide this information on a voluntary basis, but this is not consistent across the board.

[5] Per the IFRS Conceptual Framework: The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

27 In addition, the EFRAG Secretariat considers appropriate to include a question to constituents in the consultation to assess whether the cost to be reported should be limited to the outflows or resources that meet the accounting recognition criteria (more likely than not) or if for sustainability reporting the threshold for reporting should be lower.

28 The EFRAG Secretariat also notes that costs related to own workforce with respect to the closure of sites would not fall under these liabilities. They would fall under IAS 19 *Employee costs,* for termination benefits if the requirements have been met. Furthermore, costs for re-training or re-skilling etc. are unlikely to meet the recognition criteria under IFRS.

29 Additional paragraphs about PPE/impairment/

The proposed disclosure in EDs

Disclosure requirement related to [draft] ESRS E1-1 Transition plan for climate change mitigation

….

30 A breakdown of the assets presented in the PP&E disclosure as follows:

(a) Assets dedicated to upstream,
(b) Other Oil and Gas assets
(c) Assets allocated to renewables and
(d) Other assets.

31 Assets dedicated to upstream and for the other Oil and gas assets, which assets are the most at risk of transition. For those assets:

(a) What would be the reserves left in 2030 and 2050 or what is the average remaining useful time; and
(b) What is the depreciation methodology.

32 For all assets, on which assets is an ARO or a dismantling / decommissioning provision is recognised[6]. For those assets:

(a) What is the accounting policy for booking the provision, and in particular what is the triggering event to book such a provision.
(b) What is the average retirement date for the assets on which an ARO is booked, and
(c) Sensitivity analysis if the assets where retired earlier (eg: 5 years earlier)

33 If the company reports that the GHG emission reduction targets are not compatible with limiting global warming to 1.5°C as required in ESRS E1-4, what would be the additional impairment if the target was compatible with limiting global warming to 1.5°C.

Disclosure Requirement related to ESRS E1-9 Anticipated financial effects from material physical and transition risks and potential climate-related opportunities

34 In addition to the information provided following E1-9, the undertaking shall disclose how it expects the management of climate change-related risks and opportunities to affect the medium and long-term financial position, performance and development.

35 This disclosure shall include:

(a) …;

(b) …;

[6] This question is also relevant for the Mining, Quarrying and Coal standard

(c) …;

(d) early closure of existing assets and impacts on useful life of the existing assets.

Disclosure Requirement: Closure of assets focus

36 In addition to the information provided following ESRS E2, the undertaking shall disclose its policies, targets, actions, metrics and financial effects related to closure of assets.

37 When disclosing information provided following ESRS E2-1, the undertaking shall indicate whether it has a policy addressing the systematic adoption of closure plans for operational sites addressing decommission, rehabilitation or restoration and monitoring of sites.

38 The undertaking shall disclose its pollution-related closure actions and resources, including:

(a) if a closure plan exists or is foreseen for each of its operational sites that have already reached the end of its operational life. If this is not the case, the undertaking shall disclose the list of sites for which there is no existing or foreseen site rehabilitation plan.

(b) the undertaking shall disclose for which sites it has on-going closure activities and resources related to pollution.

39 The undertaking shall disclose information about how it manages its responsibilities related to closure and post-closure of operational sites.

40 The undertaking shall disclose the material financial liabilities it expects to incur for closure and rehabilitation, per operational site, including [environmental and social] post-closure monitoring and aftercare for mine sites, in particular:

(a) amount recognized in the financial statements;

(b) undiscounted monetary value of a) split by relevant time bucket;

(c) discount rate used to calculate a);

(d) potential additional liabilities that do not meet the recognition criteria at the reporting date; and

(e) whether the operational site has been sold to a third party.

Proposed way forward

41 Taking into account the information the EFRAG Secretariat considers to be missing to understand the anticipated financial effects in these sectors and the existing practice in for these European companies, [the] EFRAG [Secretariat] proposes additional disclosures in DR E1-9 as well as the focus on asset closures. It also proposes the following questions to constituents for the consultation:

1 Do you agree with the necessity of the information in the additional requirements to in DR E1-9 as well as the DR MIN/OG x Focus on asset closures given the lack of current disclosures in this regard?

2 In addition to the datapoints above, would you consider that the requirements currently in ESRS E1-9 are sufficient? If so, please explain why.

3 Could you indicate real life examples of potential write-off situations not captured by financial reporting?

4 Are there any additional requirements that are missing and should be included in the MIN/OG EDs?

Questions for EFRAG FR and SR TEG

41. Does EFRAG FR and SR TEG agree with the drafting proposed in the ED's?

Appendix 1: Extracts from IFRS

5 The following are extracts from IAS 37 pertaining to the required information around provisions for rehabilitation etc.

Definitions

10 A constructive obligation is an obligation that derives from an entity's actions where:

(a) *by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and*

(b) *as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.*

Future events

48 Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

49 Expected future events may be particularly important in measuring provisions. For example, an entity may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an entity does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

50 The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Disclosure

84 For each class of provision, an entity shall disclose:

(c) *the carrying amount at the beginning and end of the period;*

(d) *additional provisions made in the period, including increases to existing provisions;*

(e) *amounts used (ie incurred and charged against the provision) during the period;*

(f) *unused amounts reversed during the period; and*

(g) *the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.*

Comparative information is not required.

85 An entity shall disclose the following for each class of provision:

(a) *a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;*

(b) *an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the*

major assumptions made concerning future events, as addressed in paragraph 48; and

(c) *the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.*

6 The following are extracts from IAS 1.

Sources of estimation uncertainty

125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period.

126 Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. For example, in the absence of recently observed market prices, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the effect of technological obsolescence on inventories, provisions subject to the future outcome of litigation in progress, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about such items as the risk adjustment to cash flows or discount rates, future changes in salaries and future changes in prices affecting other costs.

127 The assumptions and other sources of estimation uncertainty disclosed in accordance with paragraph 125 relate to the estimates that require management's most difficult, subjective or complex judgements. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgements become more subjective and complex, and the potential for a consequential material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.

128 The disclosures in paragraph 125 are not required for assets and liabilities with a significant risk that their carrying amounts might change materially within the next financial year if, at the end of the reporting period, they are measured at fair value based on a quoted price in an active market for an identical asset or liability. Such fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period.

129 An entity presents the disclosures in paragraph 125 in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other sources of estimation uncertainty. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures an entity makes are:

(a) the nature of the assumption or other estimation uncertainty;

(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and

(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

130 This Standard does not require an entity to disclose budget information or forecasts in making the disclosures in paragraph 125.

131 Sometimes it is impracticable to disclose the extent of the possible effects of an assumption or another source of estimation uncertainty at the end of the reporting period. In such cases, the entity discloses that it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from the assumption could require a material adjustment to the carrying amount of the asset or liability affected. In all cases, the entity discloses the nature and carrying amount of the specific asset or liability (or class of assets or liabilities) affected by the assumption.

132 The disclosures in paragraph 122 of particular judgements that management made in the process of applying the entity's accounting policies do not relate to the disclosures of sources of estimation uncertainty in paragraph 125.

133 Other IFRSs require the disclosure of some of the assumptions that would otherwise be required in accordance with paragraph 125. For example, IAS 37 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. IFRS 13 Fair Value Measurement requires disclosure of significant assumptions (including the valuation technique(s) and inputs) the entity uses when measuring the fair values of assets and liabilities that are carried at fair value.