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## Climate-related and other uncertainties in the Financial Statements - Issues Paper

### Objective

- 1 The objectives of this session are to:
  - (a) provide EFRAG FR TEG with a project update following the March 2024 [IASB](#) and [ASAF](#) meetings that discussed the examples developed by IASB staff illustrating how to apply requirements in IFRS Accounting Standards to reporting the effects of climate-related and other uncertainties in the financial statements (see agenda paper 09-02); and
  - (b) seek the input of EFRAG FR TEG members on the recent IASB discussions on the developed examples and related due process next steps (i.e., an exposure draft); and
  - (c) seek the input of EFRAG FR TEG on the tentative project direction (see agenda paper 09-03- Appendix B).
- 2 Later in April, the IASB will decide on the project direction. Hence, in addition to the views gotten during the ASAF meeting, EFRAG FR TEG members' views on the examples, the proposed related exposure draft, and the overall project direction suggested by IASB staff could be useful for the forthcoming IASB decision-making meeting. We note that, due to the delayed availability of March 2024 ASAF meeting papers, there was no TEG-CFSS session that would have allowed a discussion on these matters, and only written comments were gotten.
- 3 The rest of the paper is structured as follows:
  - (a) March 2024 IASB meeting discussions;
  - (b) Takeaways from the ASAF meeting; and
  - (c) EFRAG Secretariat's views.

### March 2024 IASB meeting discussion

- 4 At this meeting, the IASB was not asked to make any decisions, however, it discussed the progress made in exploring:
  - (a) examples to illustrate the application of current requirements in reporting the effects of climate-related and other uncertainties in the financial statements and the best vehicle of presenting them; and

- (b) possible standard-setting to clarify or enhance the requirements in IFRS Accounting Standards in relation to disclosure of information about estimates (i.e., about assumptions an entity 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, as per IAS 1.125).

5 Regarding the examples, the following was discussed:

- (a) **the approach taken to develop examples** illustrating how to apply requirements in IFRS Accounting Standards to report the effects of climate-related and other uncertainties in financial statements (see agenda paper 09-04). The IASB staff had proposed to:
  - (i) illustrate climate-related risks and other uncertainties consistently with the scope of the project decided in September 2023;
  - (ii) clarify that the fact patterns addressed by the examples are set out at a sufficiently high level to be applicable to a variety of entities operating in different industries and sectors;
  - (iii) clarify that the examples illustrate requirements in IFRS Accounting Standards which are considered to be amongst the most relevant for the disclosure of the effects of climate;
  - (iv) collaborate with ISSB staff, take into account IFRS Sustainability Disclosure Standards requirements and, when applicable, use the same terminology, to further connectivity;
  - (v) develop stand-alone examples (rather than walk-through examples) because they could be more focused and tailored to address particular matters or requirements related to those concerns; and
  - (vi) include the examples as illustrative examples accompanying IFRS Accounting Standards offering the best balance between accessibility, enforceability, consultation and flexibility in content and format.
- (b) Eight **illustrative examples** developed by the IASB staff, which are focused on the following accounting areas (see agenda paper 09-02):
  - (i) materiality judgements—how an entity makes materiality judgements in determining whether to disclose information about how climate-related and other uncertainties affected an entity’s financial statements, including illustrating connectivity in general purpose financial reporting [examples 1 and 2];
  - (ii) disclosure of assumptions and other sources of estimation uncertainty—disclosures about climate-related assumptions and other sources of estimation uncertainty affecting the entity’s assets and liabilities [from example 3 to example 7]; and
  - (iii) aggregation and disaggregation—disclosure of disaggregated information about assets and liabilities based on their exposure to climate-related and other risks when that information is material [example 8].

- 6 Regarding possible standard-setting, it was discussed the IASB staff proposal to gather formal feedback from stakeholders including in the ED additional questions about: (a) whether and, if so, why targeted amendments to IFRS Accounting Standards are needed to improve disclosures about estimates in the financial statements; and (b) what targeted amendments would improve disclosures in a cost-beneficial manner.

*Illustrative examples*

- 7 IASB members welcomed the proposed illustrative examples and provided the following comments:
- (a) Examples of materiality (Examples 1 and 2) are very helpful to support preparers in their materiality assessment;
  - (b) They are a good instrument to complement previous IASB educational material;
  - (c) Stakeholders' feedback on this package of examples should inform on whether future standard settings are needed;
  - (d) Some examples refer to obvious and simple fact patterns. It should be considered whether some more unusual fact pattern might be added to help people think more broadly;
  - (e) It should be clarified that they illustrate only some of the existing requirements in the IFRS Accounting Standards; therefore, readers should be aware that additional disclosures might be required or provided by the entities (completeness issue);
  - (f) Although helpful, these examples would be more fit to address preparers, regulators and auditors' rather than users' concerns. To manage users' expectation gap, the IASB should do a bit more as currently the same information might be reflected in different ways applying current recognition and measurement requirements.
- 8 Many IASB members highlighted the need to start addressing the issue of connectivity between financial statements and other sections of general purpose financial reporting. Indeed, cross-referencing information required by IFRS Accounting Standards and sustainability standards could be helpful (e.g., in the example 8 about the disclosure of disaggregated information the following sentence might be added: "this information includes the total amount of assets disclosed as more vulnerable to transition risk as disclosed in accordance with IFRS S2").

*Vehicle of presenting examples*

- 9 IASB members agreed with providing these developed examples through illustrative examples accompanying the respective IFRS accounting standards.
- 10 In addition, they agreed with the staff proposal to group all the examples and publish them as part of a single document where they could be reviewed as a package, making it easier for stakeholders to identify the connections between them.

*Next steps and overall project direction*

Next steps – issuance of an Exposure Draft (ED) on examples

- 11 IASB members generally agreed with the staff proposal to publish an Exposure Draft (ED) seeking comments from stakeholders on the examples.

- 12 However, IASB members expressed mixed views about the staff proposal to include in the ED additional questions about if and how targeted amendments to current IFRS Accounting Standards would be needed to improve disclosures about estimates on uncertainty of carrying values in the financial statements. Those members who had some reservations provided the following comments:
- (a) It might bring too general and broad feedback that the IASB staff should then analyse;
  - (b) It might distract respondents from the content of the examples;
  - (c) If needed, they suggested reframing any additional questions to avoid receiving general suggestions about any possible amendment to current disclosure requirements.
- 13 Some IASB members also highlighted the need to frame the questions in a way that will allow feedback from users.
- 14 Some IASB members suggested including a question on connectivity as this issue came up frequently. In contrast, a member suggested addressing this topic through a separate workstream in order to not delay this project.

Overall project direction

- 15 Aside from developing examples, the IASB is exploring, or has already explored, the following actions (see agenda paper 09-03- Appendix B):
- (a) Clarifying or enhancing requirements in IFRS Accounting Standards in relation to disclosure of information about estimates;
  - (b) Consulting with the IFRS Interpretations Committee (IFRIC) on the reflection of climate-related risks in IAS 36 and the application of IAS 37 with respect to climate-related commitments (this was done in November 2023. A tentative agenda decision on the application of IAS 37 to climate-related commitments was issued for consultation in December, finalised by IFRIC in March 2024, and will be presented for no-objection approval in April);
  - (c) Consider the interaction between climate-related risks and other IASB projects (Primary Financial Statements, Amendments to the Classification and Measurement of Financial Instruments Power Purchase Agreements, Post-implementation Review of IFRS 9— Impairment); and
  - (d) Other actions, namely the development of an article on the role of financial statements and improving accessibility via a central source of information on the IASB website.
- 16 The above will be discussed by the IASB in April.

**Takeaways from the March 2024 ASAF meeting**

The below paragraphs represent the EFRAG Secretariat’s high-level takeaways from the ASAF meeting. It is neither an official record/meeting summary (as that will be provided by the IASB) nor is it a complete portrayal of the meeting’s discussions

- 17 At ASAF, suggestions were made for a more balanced approach and other illustrations besides those related to climate-related risks. Similar to the IASB meeting, ASAF members

called for examples related to connectivity between financial statements and other general purpose financial reports.

- 18 Comments on the specific examples included but were not limited to the following:
- (a) Similar to the IASB meeting, ASAF members called for illustrations of more ambiguous fact patterns within the materiality assessment examples (i.e., Examples 1 and 2), and a member also called for additional clarity on how the materiality assessment is done.
  - (b) Members noted that examples illustrating additional current requirements could also be captured (such as the impact of cash flows beyond the 5-year time horizon in example 3, related to the value in use calculation and disclosures).
  - (c) In example 7, related to decommissioning and restoration provisions, they sought additional clarity on the types of uncertainties to be disclosed (e.g., the type of likelihood pattern or the time horizon to be illustrated).

#### **EFRAG Secretariat's views on the eight developed examples and project direction**

- 19 EFRAG Secretariat's view is informed by outreach done in preparation for the ASAF meeting, among other inputs<sup>1</sup>. We raise additional points to those made at the March IASB and ASAF meetings.

##### *General comments*

- 20 It would also be useful if the IASB also provided examples of:
- (a) how climate-related uncertainties may affect the determination of fair value under IFRS 13;
  - (b) disaggregation of revenue for business models affected by climate risk (i.e., examples should also cover income statement and not only statement of financial position disclosures); and
  - (c) where it is probable that the regulations will be effective (e.g., within 3 years) and the regulations will apply before the entity has been able to utilise all deductible temporary differences.

##### *Vehicle for the examples*

- 21 Based on the outreach done in 2023 and in preparation for the ASAF, we are aware many stakeholders prefer the incorporation of examples into the impacted IFRS Accounting Standards to ensure their enforceability. However, we also understand the reasons for including them in the Illustrative Examples accompanying the standards.

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<sup>1</sup> EFRAG Secretariat's view formulated in preparation for the March ASAF meeting reflects also past outreach feedback, November FR TEG-CFSS views, and written input received from EFRAG FR TEG and CFSS members on the March ASAF papers. EFRAG's outreaches were held in Q2 2023 and the feedback is summarised in the EFRAG Secretariat Briefing published in September ([here](#)).

*EFRAG Secretariat view on the eight developed examples (these are incremental points to those raised in IASB and ASAF meetings)*

- 22 Examples 1 and 2:
- (a) Paragraph 1.2 of example 1: more clarity could be provided regarding whether the impact of the transition plan based on IAS 36 requirements has been taken into account when assessing cash flows, the perpetual growth rate and/or the discount rate;
  - (b) Paragraph 2.5 of example 2: for clarity, the first sentence could be rephrased as follows: “In these circumstances, the entity concludes that *“a disclosure that there is no quantitative effect of transition risk on its activities is not material information”*”.
- 23 Example 3 – Value in use calculation and disclosures (IAS 36): It could be useful to suggest adding some reference to the potential impact on growth rate, as per paragraph 134(d)(iv) of IAS 36. The example could also illustrate how to determine the extent of a “reasonably possible change” as referred to in paragraph 134(f). In practice, the poor identification of what constitutes such a change is a common reason why sensitivity analyses are not as helpful as they should be.
- 24 Example 4 – Disclosures of assumptions and other sources of estimation uncertainty (IAS 1.125-129): The example interprets the time horizon(s) defined by IAS 1.125. We recommend that clarifications about current IFRS Accounting Standard requirements should be included in the main body of the standard and not made through Illustrative Examples.
- 25 Example 5 – Disclosure of additional information (IAS 1.31): We agree with the IASB staff's intention to illustrate disclosures about sources of information other than those about climate-related risk. However, we express some concerns about the scenario presented for the following reasons:
- (a) Risk of misinterpretation of the disclosure requirements about “not yet enacted/substantially enacted” new laws/regulations as mentioned in IAS 12;
  - (b) Disclosure of assumptions about a highly uncertain future event: for example, does it mean remote probability to occur? Would this example be consistent with IAS 37 requirements?
  - (c) Other ESG risks besides climate risk could be illustrated.
- 26 Example 6 – Credit risk disclosures (IFRS 7): it could be helpful to also develop examples of climate-related risks being reflected in the ECL (i.e., examples for recognition and measurement).
- 27 Example 7 – Disclosure about decommissioning and restoration provisions (IAS 37):
- (a) To explore whether a more commonly encountered fact pattern could be illustrated.
  - (b) To make more explicit why the information is provided even though it is not quantitatively material, as it may not be fully clear from the example.
  - (c) Consistent with Example 3, a sensitivity analysis would provide more useful information, with the long-term time horizon being one of the most relevant assumptions.

- (d) To explore whether information about the undiscounted amounts of future costs could be provided.

*EFRAG Secretariat’s view on overall project direction and ED on examples*

- 28 The EFRAG Secretariat agrees with the project direction including exploring standard setting for IAS 1.125, and the development of examples and educational material via articles (e.g., on boundaries of financial statements). We however reiterate that examples should not substitute standard setting or provide clarification (as is the case with example 4 which seems to clarify the interpretation of IAS 1.125). We also concur with the IASB and ASAF discussions supporting the need for examples related to connectivity.
- 29 We support the proposed publication of an ED on the examples as stakeholders' feedback is essential to ensure the enhancement of the currently developed examples and/or the development of further suitable examples. We are aware that there may be questions such as whether these examples will be endorsed under EU requirements. This latter aspect will have to be thought through.
- 30 Finally, we note that in the past (see November 2023 TEG-CFSS [meeting paper](#)), we also suggested the IASB should clarify what is encompassed within “other uncertainties” and whether/when these uncertainties fall within the boundaries of the financial statements (as opposed to the management report). As this matter is yet to be addressed (as far as we understand), the IASB should consider addressing it, for instance, through the envisioned article on the boundaries of the financial statements.

**Question for EFRAG FR TEG members**

- 31 Do EFRAG FR TEG members agree/disagree with and/or have any further comments on the eight developed examples, vehicle for the examples (i.e., an exposure draft), and the project direction, in addition to those expressed in paragraphs 7 to 30?
- 32 Do EFRAG FR TEG members have any views on the suggested ED on examples?

**Next steps**

- 33 At its April 2024 meeting, the IASB will decide on the project direction.
- 34 The IFRIC agenda decision on climate-related commitments will be presented for approval at the April meeting.

**Agenda papers**

- 35 In addition to this paper, the following papers are provided as background papers for this session:
- (a) Agenda paper 09-02 – Background paper – [AP14B](#) IASB meeting March 2024;
  - (b) Agenda paper 09-03 – Background paper – [AP14](#) IASB meeting March 2024; and
  - (c) Agenda paper 09-04 – Background paper – [AP14A](#) IASB meeting March 2024.