International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

28 November 2024

Dear Mr Barckow,

Re: Climate-related and Other Uncertainties in the Financial Statements – Proposed illustrative examples

On behalf of EFRAG, I am writing to comment on the exposure draft *Climate-related and Other Uncertainties in the Financial Statements – Proposed illustrative examples* issued by the IASB on 31 July 2024 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Accounting Standards in the European Union and the European Economic Area.

Overall comments

EFRAG considers that the ED's proposed examples will complement the current IASB educational material in helping to improve the reporting, auditing, supervision and enforcement of information on climate-related and other uncertainties in the financial statements. EFRAG also supports the IASB's reasons for including the examples as illustrative examples accompanying IFRS Accounting Standards (i.e. it allows for greater flexibility in content and format than if the examples were to be included in the Standards). EFRAG notes that the IASB's development of illustrative examples was called for by stakeholders during outreaches done by the IASB and EFRAG after the IASB project was initiated. Moreover, the examples are not creating or amending IFRS accounting requirements.

Overall, EFRAG considers the ED's proposed illustrative examples to be a pragmatic initial step towards addressing stakeholders' expectations. The eight illustrative examples in the ED cover a range of disclosures related to general and specific IFRS Accounting Standards requirements and they address the main challenging areas where climate-related and other uncertainties would be expected to be reported in the financial statements. Hence, EFRAG encourages the IASB to finalise and issue this first set of examples as soon as possible taking into account the related suggestions for improvement (including those set out in our response to Question 2). This should be done parallel to clarifying the interpretation of paragraph 125 of IAS 1 through standard setting.

Moreover, as the feedback received by EFRAG has not revealed any barriers to entities immediately considering these examples as guidance while preparing financial statements, we recommend that the wording on the implementation timeline in paragraph BC 49 of the ED encourages entities to, as soon as possible, consider these examples to change their reporting of climate-related and other uncertainties in the financial statements.

In addition, to fully enhance the reporting of climate-related and other uncertainties in the financial statements, EFRAG suggests the following further steps to be taken by the IASB after the issuance of the ED's proposed examples:

- *Standard setting activity*: EFRAG acknowledges that existing IFRS accounting requirements implicitly cater for climate-related and other uncertainties. That said, as set out in our response to Question 3, stakeholders have identified a few aspects where further standard-setting activities could occur. Hence, we recommend the IASB consider standard setting under limited circumstances wherever justified with prioritisation of the noted amendments related to IAS 36 and IAS 38 (i.e. within the IASB intangibles project).
- *Development of further appropriate examples*: EFRAG suggests that the IASB considers developing further examples related to other non-climate-related uncertainties; recognition, measurement, and presentation examples; and possibly walk-through examples. The latter can be located in educational material. The IASB should also monitor market developments and update the examples wherever needed.

Further actions are needed to address the root causes of expectation gaps, enhance connectivity and clarify the boundaries of reported information

Along with the above suggested next steps (i.e. post-completion of the ED's proposed examples), the following actions are needed to address the root causes of expectation gaps related to the information reflected in the financial statements and to further foster connectivity and clarify the boundaries between the information within and outside the financial statements, i.e. within the annual report[1].

[1] In an EU context, the key sections of the annual report are considered to be the financial statements, the sustainability statement/disclosures within the management report, and the rest of the management report. This is aligned with Paragraph 2 of Article 4 of the Transparency Directive (Directive 2004/109/EC) , which indicates that the Annual Financial Report comprises the audited financial statements, the management report; and statements related to the information made by the responsible issuing persons. In an IFRS general purpose financial reporting context as described in the ED, the annual report can be deemed as including financial statements and other general purpose financial reports.

Consider other aspects of strengthening connectivity: EFRAG acknowledges that strengthening the connections and consistency between information within and outside financial statements was considered in the development of the ED's examples. However, to a greater extent than done in the ED, there is also a need to go beyond consistency and consider the coherence and techniques of linkage of information across the annual report. These other aspects of connectivity are highlighted in the EFRAG connectivity project's initial paper[2]. Hence, as conveyed in EFRAG's response to the ISSB's agenda consultation, EFRAG recommends a greater focus on the connectivity of reported information and this can be done through the IASB and ISSB jointly developing connectivity-related illustrative examples covering sustainability reporting and financial statements information (e.g. examples related to climate-related transition plans). Moreover, to strengthen the connectivity of financial statements information, akin to the connectivity requirements within ISSB Standards and ESRS, and the guidance on coherence in the 2021 Management Commentary Exposure Draft, we recommend that the IASB includes an overarching principle in IAS 1 *Presentation of Financial Statements* (IFRS 18 *Presentation and Disclosure in Financial Statements*) addressing the connectivity of information within and outside the financial statements (i.e. within the annual report including but not limited to sustainability reporting information).

Further development of conceptual principles by the IASB and ISSB is needed to clarify the boundaries of different annual report sections: At the core, the expectation gaps being addressed by the ED often arise due to a lack of clarity of boundaries between the information within and outside the financial statements in the annual report. Hence, going beyond the scope of the ED, the IASB and ISSB should further clarify the definition of boundaries of the information in the annual report sections. This would help to avoid unnecessary duplication, and it can also help to identify where there are information gaps.

Outside the scope of the IASB project (and the ED) but within the scope of the IFRS Foundation's remit, EFRAG also reiterates its recommendation made in response to the ISSB Agenda Consultation for the development of a sustainability reporting conceptual framework, which among other things, could address questions related to application of concepts applied in both financial and sustainability reporting such as financial materiality and financial control and the migration of financial effects from sustainability reporting to financial statements.

[2] The EFRAG connectivity project's initial paper lays out the conceptual foundations, categories and benefits of connectivity and analyses' reporting boundaries across different annual report sections.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Vincent Papa or Sapna Heeralall.

Yours sincerely,

Wolf Klinz

EFRAG FRB Chairman

Appendix – EFRAG's responses to the questions raised in the ED

ED Question 1— Providing illustrative examples

The IASB is proposing to provide eight examples illustrating how an entity applies the requirements in IFRS Accounting Standards to report the effects of climate-related and other uncertainties in its financial statements. The IASB expects the examples will help to improve the reporting of these effects in the financial statements, including by helping to strengthen connections between an entity's general purpose financial reports. Paragraphs BC1–BC9 of the Basis for Conclusions further explain the IASB's rationale for this proposal. (a) Do you agree that providing examples would help improve the reporting of the effects of climate-related and other uncertainties in the financial statements? Why or why not? If you disagree, please explain what you would suggest instead and why. The IASB is proposing to include the examples as illustrative examples accompanying IFRS Accounting Standards instead of publishing them as educational materials or including them in the Standards. Paragraphs BC43–BC45 of the Basis for Conclusions further explain the IASB's rationale for this proposal. (b) Do you agree with including the examples as illustrative examples accompanying IFRS Accounting Standards? Why or why not? If you disagree, please explain what you would suggest instead and why.

Whether providing examples would help improve reporting in the financial statements

1 Based on the overall feedback received, EFRAG supports and considers that the examples in the ED are useful because:

(a) they help to bridge the expectations gap that may arise from the inconsistent reporting of climate-related information within and outside the financial statements and contribute to stakeholders' perception of inadequate or too high-level reporting of climate-related effects in the financial statements. The expectation gaps and perception of inadequate reporting of climate-related information in the financial statements were highlighted in EFRAG's outreach to stakeholders in 2023;

(b) they help in educating stakeholders and would therefore further assist in enhancing the quality, auditability, enforcement and supervision of reporting information on climate-related and other uncertainties in the financial statements;

(c) to some extent, they may strengthen the connectivity between climate-related information in the financial statements and related information in sustainability reports/other general-purpose financial reports. However, as noted below, more work is needed to enhance the connectivity in reporting.

2 EFRAG notes that the proposed illustrative examples are meant to support the application and enforcement of current IFRS accounting requirements and not to amend these requirements. Moreover, the IASB's development of illustrative examples occurred following stakeholders' feedback during the outreach done by the IASB and EFRAG[3] after the project was initiated. The feedback showed support (e.g. 61% of respondents to EFRAG outreach) for the development of illustrative examples to complement existing educational material. Stakeholders' feedback also supported the broadening of the IASB's project to include other uncertainties.

3 EFRAG considers the ED's proposed illustrative examples to be a pragmatic initial step towards addressing stakeholders' expectations. The eight illustrative examples in the ED cover a range of disclosures related to general and specific requirements in IFRS Accounting Standards. They address the main challenging areas where climate-related and other uncertainties would be expected to be reported in the financial statements. Hence, EFRAG encourages the IASB <u>to immediately finalise and issue this first set of examples taking into account the related suggestions (see our response to Question 2)</u>.

4 Thereafter, to fully enhance the reporting of climate-related and other uncertainties in the financial statements, EFRAG suggests the following further steps to be taken by the IASB after the issuance of the ED's proposed examples.

(a) *Performing standard-setting where justified* – See our response to ED Question 3 – Other comments.

[3] The outreach findings are summarised in the September 2023 EFRAG Secretariat Briefing: Climate-related Risks in Financial Statements. Survey feedback during this EFRAG outreach showed there was limited awareness amongst stakeholders of the existence of the IASB educational material and 61% of respondents supported the development of illustrative examples.

(b) *Development of other examples* - See our response to Question 2 in 15.

(c) *Develop a decision tree on the applicability of IFRS accounting requirements to determine the information to be disclosed* – The ED points to different factors that influence the decision to disclose (such as users' expectations in terms of information, the existence of a risk, whether there is an effect on the line items of primary financial statements, specific IFRS Accounting Standards' requirements, and the general requirements in IAS 1). EFRAG recommends a decision tree delineating the considerations on whether to disclose information.

5 *Implementation time frame for the proposed illustrative examples*: Paragraph BC49 of the ED states that entities would be entitled to sufficient time to implement any changes to the information disclosed in their financial statements as a result of the issuance of the illustrative examples. The wording in BC49 is analogous to the wording used for the effective dates of IFRIC Agenda Decisions whereby IFRS Accounting Standards are only being clarified and not amended. Based on the feedback received, EFRAG is not aware of any significant obstacles against entities immediately considering the examples for their reporting. Hence, EFRAG suggests that paragraph BC49 indicates that entities should implement any changes to their reporting as soon as possible considering the examples as guidance.

Whether illustrative examples should accompany IFRS Accounting Standards and other comments

6 *Support for the proposed vehicle for the illustrative examples*: EFRAG supports the illustrative examples accompanying IFRS Accounting Standards because:

(a) as articulated in the ED's Basis for Conclusions, this allows greater flexibility in content and format than if the examples were to be included in the Standards and the latter option might require the examples to be simplified or shortened such that their level of detail is not disproportionate in the context of the Standards;

(b) it provides a robust resource for auditors, audit committees and regulators to support compliance with IFRS Accounting Standards instead of having them as either educational material or as a practice statement.

7 *Other suggested steps to enhance accessibility*: Lastly, as the IASB is also exploring other ways to raise awareness of the requirements in IFRS Accounting Standards related to the reporting of climate-related and other uncertainties in the financial statements, EFRAG recommends that the IASB facilitates access to a central repository of illustrative examples and other educational material on climate-related and other uncertainties that can be

updated as new reporting challenges related to these aspects may arise. As the illustrative examples intend to accompany different IFRS Accounting Standards, the IASB may also consider cross-referencing between those standards and the illustrative examples, and also between examples, if needed.

Further actions are needed to address the root causes of expectation gaps, enhance connectivity and clarify the boundaries of reported information

8 Along with the above suggested next steps (i.e. post-completion of the ED's proposed examples), the following actions are needed to address the root causes of expectation gaps related to the information reflected in the financial statements and to further foster the connectivity of the information in the financial statements and the rest of the annual report.

9 *Consider other aspects of strengthening connectivity*: EFRAG acknowledges that the ED aims to reduce inconsistencies and improve connections in the information across different reports. However, as highlighted in the EFRAG's connectivity project's initial paper, coherence and techniques of linkage of reported information are also essential aspects of connectivity and should be considered to a greater extent than done in the ED. Hence, EFRAG suggests the following:

(a) *IASB-ISSB collaboration in developing examples*: As done for the presentation at the 2024 World Standard Setters Forum, the IASB and ISSB could collaborate in developing examples that illustrate the connectivity of their respective requirements as well as to jurisdictional sustainability reporting requirements including ESRS (i.e. because IFRS Accounting Standards are sustainability reporting-standards/framework-agnostic and ISSB Standards are GAAP-agnostic). These examples could incorporate the techniques of connectivity (e.g. cross-referencing while being cognisant of the constraints of cross-referencing information from other reports to the financial statements). Of particular interest would be examples related to climate-related transition plans that influence Capex and Opex outflows with possible effects on the financial statements.

(b) *Clarify the interaction of illustrative examples and sustainability reporting:* Paragraph BC32 of the ED explains the objectives and comments on the applicability of Examples 1 and 2 depending on whether ISSB Standards have been applied. EFRAG is aware that this paragraph has been interpreted[4] differently, which signals the need for a clearer articulation of the interaction between the proposed illustrative examples and disclosures under sustainability reporting requirements including ISSB Standards and ESRS (i.e. IFRS accounting requirements should be sustainability reporting standards/framework-agnostic). This will contribute to the connectivity of reported information.

(c) *Include connectivity requirements in IFRS accounting requirements:* The IASB should consider developing connectivity requirements for financial statement information akin to those in place for ESRS and ISSB Standards and in the coherence guidance included in the 2021 IFRS Practice Statement Exposure Draft *Management Commentary*. This need arises with the emphasis that stakeholders have placed on the importance of connectivity. Moreover, it is noted that incorporation of information by cross reference is allowed under IFRS 18 (for management performance measures) and IFRS 7 *Financial Instruments: Disclosures* (for credit risk and hedge accounting disclosures). Hence, the IASB should consider including an overarching principle in IAS 1 (IFRS 18) addressing the connectivity of information within financial statements to the information outside the financial statements and within the annual report (i.e. including but not limited to sustainability reporting information). Such an overarching principle would be expected to be worded in a manner that makes it clear that it only relates to information that is material in the context of financial statements (and excludes any other information that is immaterial and would obscure material financial statements information). The suggestion for explicit connectivity requirements in IFRS Accounting Standards was also made in the EFRAG connectivity project's initial paper.

10 *Conceptual Framework level work and IASB-ISSB collaboration needed to further clarify boundaries of information in different annual report sections*: At the core, the expectation

[4] One interpretation made was that the disclosures suggested by Examples 1 and 2 are only appropriate when IFRS Sustainability Disclosure Standards have not been applied. Implicit in such a view would be that information provided in sustainability disclosures ought not to be provided in the financial statements notwithstanding the expectation that financial statements ought to be self-sufficient in the context of their objectives. A different interpretation made was that the paragraph conveys an expectation whereby preparers will have to consider information disclosed under ISSB Standards whilst determining material information to be disclosed in the financial statements. It could be argued that it is not unreasonable to expect that enhanced sustainability reporting could result in increased consideration and reporting of entities' material risks and opportunities in the financial statements.

gaps being addressed by the ED often arise due to a lack of clarity of boundaries of information in different annual report sections. There is also a need to provide a clear delineation of the boundaries between the information reported in the financial statements and other related annual report sections to avoid unnecessary duplication and identify information gaps. Thus, to further clarify the boundaries and strengthen the complementarity of the financial reporting and sustainability reporting pillars, there are different roles to be fulfilled by the IASB and ISSB going beyond the scope of the ED. Specifically, EFRAG reiterates its recommendation to the ISSB Agenda Consultation for the development of a sustainability reporting conceptual framework by the ISSB. A sustainability reporting conceptual framework could, among other things, articulate the crystallisation and migration of financial effects from sustainability disclosures to the financial statements. It could also help differentiate the application of concepts that are common to both financial reporting and sustainability reporting such as financial materiality and financial control.

11 Finally, in light of the broadening interest in the content and boundaries of financial statements that is occurring in tandem with the rollout of mandatory sustainability reporting, we would encourage jointly prepared IASB-ISSB educational material on the boundaries of different IFRS general-purpose financial reports (i.e. financial statements, management commentary, ISSB sustainability-related financial disclosures).

ED Question 2 – Approach to developing illustrative examples

Examples 1–8 in this Exposure Draft illustrate how an entity applies specific requirements in IFRS Accounting Standards. The IASB decided to focus the examples on requirements:

(a) that are among the most relevant for reporting the effects of climate-related and other uncertainties in the financial statements; and

(b) that are likely to address the concerns that information about the effects of climate-related risks in the financial statements is insufficient or appears to be inconsistent with information provided in general purpose financial reports outside the financial statements.

Paragraphs BC10–BC42 of the Basis for Conclusions further explain the IASB's overall considerations in developing the examples and the objective and rationale for each example.

Do you agree with the IASB's approach to developing the examples? In particular, do you agree with the selection of requirements and fact patterns illustrated in the examples and the technical content of the examples? Please explain why or why not. If you disagree, please explain what you would suggest instead and why.

General comments on the illustrative examples

12 EFRAG welcomes the fact that the eight illustrative examples in the ED cover a range of disclosures related to general and specific IFRS Accounting Standards covering the main challenging areas where climate-related and other long-term uncertainties would be expected to be reflected in the financial statements. The areas addressed in the ED have also been highlighted in the feedback[5] to the 2023 EFRAG outreach and various thematic reviews[6] of reporting practices, including the October 2023 ESMA report, the April 2024 ESRB report and the May 2024 EY report. In the comments below, we highlight other areas that could benefit from having illustrative examples.

13 EFRAG suggests that the IASB indicates that the proposed examples can be relevant for entities operating in other sectors (for instance, Examples 6 and 7).

14 *Need for a caveat on the coverage of requirements*: In addition to the disclosure requirements mentioned in the proposed examples, EFRAG notes that other[7] requirements in IFRS Accounting Standards might also provide useful material information in relation to the illustrated fact patterns. Therefore, to avoid each of the examples being misconstrued as containing all the material information that should be considered for a particular Standard, EFRAG suggests that the IASB adds a caveat at the beginning of each example.

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[5] EFRAG's outreach findings summarised September 2023 EFRAG Secretariat Briefing: Climate-related Risks in Financial Statements

[6] ESMA, October 2023 *The Heat is On: Disclosures of Climate-Related Matters in the Financial Statements* ; ESRB, April 2024, Climate-related risks and accounting; EY, May 2024, Connected Financial Reporting: Accounting for Climate Change

[7] We note, for instance, that Example 6 in the ED only refers to the disclosure requirements in paragraphs 35A-38 of IFRS *7 Financial Instruments: Disclosures* but not the requirements in paragraphs 33 and 34 of IFRS 7, which refer, respectively, to the general qualitative and quantitative disclosures about each type of risk arising from financial instruments.

This caveat should make it clear that the purpose of the ED is to illustrate only some of the most relevant disclosure requirements in IFRS Accounting Standards that are applicable to the illustrated fact patterns and not all the material information that an entity would be required to disclose. Overall, stakeholders have noted the need for a consistent approach across the examples to either have a general caveat or a systematic inclusion of a footnote to reflect that some and not all requirements within a standard are covered by the example.

15 As noted earlier, EFRAG suggests that the IASB finalises and issues the ED's eight examples as soon as possible taking into account the improvements suggested in our responses to the examples themselves.

Next steps after finalising and issuance of ED's examples

16 As part of the next steps related to other examples after finalising the examples, EFRAG suggests that the IASB considers adding examples as follows:

(a) *Examples addressing recognition, measurement and presentation requirements:* In addition to the examples in the ED, which focus on illustrating disclosure requirements, EFRAG would consider it helpful to add examples related to recognition, measurement and presentation requirements. As suggested by the April 2024 ESRB report, these examples could, for instance, relate to how to incorporate climate-related risk into the expected credit loss (ECL) measurement under IFRS 9 *Financial Instruments* and into the determination of fair value under IFRS 13 *Fair Value Measurement*. Another recognition and measurement aspect that could benefit from an illustrative example would be the determination of value-in-use whilst determining impairment under IAS 36 *Impairment of Assets*. Stakeholders support a focus on these areas. It may also be useful to consider another example (besides Example 5) which reflects current practice, whereby an entity has deferred tax assets arising from tax losses and the entity considers uncertainties on the derecognition of those deferred tax assets. While developing these examples, EFRAG suggests that the IASB also takes into account the cost-benefit considerations, e.g. constraints relating to data availability, systems and methodological challenges.

(b) *Examples that are variants of the basic fact patterns of some of the examples:* EFRAG considers it helpful to include variants in basic fact patterns, for example, relating to Examples 3, 4, 5 and 7. For example, in illustrative Example 5, variants may include what would happen if the entity used all the deficits before the law became enforceable. Also, as indicated in paragraph 18 below, Example 2 may be used as a variant of Example 1.

(c) *Examples about other uncertainties:* Only one of the eight examples (Example 5) is not directly related to either environmental or climate-related uncertainties and this may create a perception that the reporting challenges pertain to these particular uncertainties only. Consistent with the principle-based nature of the IASB Accounting Standards, EFRAG recommends examples covering other non-climate-related uncertainties. These could include sustainability-related uncertainties (e.g. related to own workforce that potentially affects income and expenses) and non-sustainability-related uncertainties.

(d) *An example related to climate-related commitments:* EFRAG recommends an illustrative example focused on the expected disclosures under the fact patterns of the March 2024 IFRIC agenda decision. While we agree with the IFRIC agenda decision on the criteria for the recognition of provision and acknowledge that the IAS 37 Exposure Draft *Provisions- Targeted Improvements* has an example related to the recognition of climate-related commitments, there are unaddressed expectations[8] related to disclosures of climate-related commitments.

(e) *Illustrate connectivity across the examples*: EFRAG notes that the ED's illustrative examples are circumscribed to the application of IFRS accounting requirements with only generic reference being made to the information in other sections of the annual report. In response to Question 1, EFRAG recommends examples that illustrate connectivity. We note that based on the IASB's remit of addressing IFRS accounting requirements and enhancing[9] management commentary (MC) guidance, there is latitude to apply both IFRS accounting requirements and MC guidance to illustrate connectivity.

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[8] In response to the November 2023 IFRIC agenda decision, stakeholders made suggestions for enhancing disclosures on a) management's assumptions and b) information about capital expenditure projects required to fulfil climate-related commitments and capital already committed to purchasing assets to fulfil those commitments. Moreover, during the outreach done by EFRAG so far, users have indicated that a disclosure of a time series of likely costs would be useful even if provisions are not recognised. It has also been expressed that it should be clear when items migrate from the sustainability statement/disclosures to the financial statements (i.e. what are the triggers for the recognition of provisions or contingent liabilities). Another suggestion has been that, if material for the purposes of the financial statements, information disclosed in the sustainability statement/disclosures could be included in the financial statements by cross-reference.

[9] Following the feedback to 2021 Exposure Draft, in June 2024 the IASB decided to finalise the update of the management commentary practice statement.

(f) *Walk-through examples*: EFRAG recommends that the IASB also consider providing walk-through examples as educational material at a future date to help preparers of financial statements.

(g) *Addressing the applicability of the ED's examples to small and medium-sized enterprises (SMEs):* EFRAG recommends the IASB to consider the applicability of the ED's illustrative examples for SMEs taking account of the principles of IFRS for SMEs. We are cognisant that some stakeholders have suggested examples of disclosures tailored for SMEs. However, other stakeholders' view is that these examples ought to be generally applicable to all entities and examples that are specific to SMEs might not be generally applicable. EFRAG agrees with this latter view and hence recommends that the applicability of the examples for SMEs needs to be considered through the lens of IFRS for SMEs.

Specific comments on the ED's illustrative examples

Examples 1 and 2 – Materiality judgements and the disclosure of additional information (IAS 1/IFRS 18)

17 EFRAG supports the inclusion of illustrative examples related to the application of judgements made in the qualitative materiality assessment. Such examples are particularly useful in light of the challenges[10] faced by stakeholders in determining if/when to apply the overarching requirements in paragraph 31 of IAS 1 (paragraph 20 of IFRS 18; see the above comments on climate-related commitments disclosures). Therefore, these examples could help entities when they report on whether the financial effects of climate-related uncertainties would be quantitatively and/or qualitatively material. The examples can also lessen the expectation gap on what is deemed material information by users of financial statements.

18 That said, EFRAG considers Example 1 to be more useful than Example 2. Notwithstanding some stakeholder concerns in paragraph 21 below, Example 1 is useful as it shows that entities should explain why there is no disclosure when users would expect that to be the case. However, the fact patterns of Example 2, which relates to instances where both a reasonably informed investor would not expect a disclosure and the entity deems the

[10] The 2024 EFRAG initial connectivity paper Connectivity considerations and boundaries of different annual report sections (grey areas of location: pages 55-57) and April 2024 IFASS report (Page 69) highlight multiple views on the applicability of IAS 1.31, including stakeholders who have concerns about the stretched application of IAS 1.31. Similar concerns have been raised in other commentary.

information immaterial (i.e. the entity has low emissions), make the example less useful as there are no expectation gaps at play. Considering this, EFRAG suggests that Example 2 be used as a variant of Example 1.

19 EFRAG also asks for clarification on the interaction of Examples 1 and 2 with paragraph BC32 of the ED. Refer to our comments in paragraph 9(b) above. In addition, similar to Example 5, it would be helpful to have an example where an entity has to disclose information it deems material for investors (e.g. related to transition plans).

20 EFRAG recognises that, as is the case in Examples 1 and 2, a non-exposure statement is intended to bridge the gap between users' expectations for entities to depict certain information in the financial statements. These expectations may arise from the risks, opportunities, and entities actions reported in the rest of the annual report outside the financial statements.

21 At the same time, EFRAG notes that some stakeholders are concerned that non-exposure statements might obscure material information and/or impose additional challenges of having practices/routines in order to monitor and assess the completeness of the underlying assertion about there being no material information. These stakeholders also question the boundaries/limits of such non-exposure statements. Accordingly, they have suggested that the IASB adds additional commentary in the Examples on when such confirmations would be necessary, thereby avoiding the suggestion that non-exposure statements are a general requirement under IFRS Accounting Standards. More generally, they have called for application guidance on a qualitative materiality assessment including for material non-exposure statements.

22 In light of the above, EFRAG suggests that the examples include how a materiality assessment is (ought to be) done by entities applying the four-step process of the Materiality Practice Statement (i.e. identify, assess, organise and review), including a qualitative materiality assessment that takes the expectations/needs of users into account. Moreover, paragraph 1.9 of the ED should be better articulated to illustrate in practice which type of information the IASB expects an entity to disclose.

Example 3 – Disclosure of assumptions: specific requirements (IAS 36)

23 EFRAG supports this disclosure as it is related to the impairment of non-financial assets, which is one of the challenging areas in the reporting of climate-related and other uncertainties in the financial statements. That said, notwithstanding our understanding that the examples are meant to only capture some and not all requirements within a Standard and our suggestion of a caveat to that effect, some stakeholders have indicated

that reference to only some of the factors considered in the impairment test in this example and omitting other key factors (e.g. the discount rate applied) may signal that the highlighted factors ought to be accorded more prominence than the omitted factors. This may inadvertently end up confusing the understanding and current practice of applying the impairment requirements towards climate-related information. Therefore, EFRAG suggests including the disclosure of key assumptions on the discount rate in this example as well as other areas stakeholders have conveyed would be useful, such as the impact of future regulatory changes.

24 In addition, to increase the usefulness of the information on the Cash Generating Unit's ('CGU's') carrying amount and recoverable amount under paragraph 134(f) of IAS 36, the example should also illustrate how to determine the extent of a 'reasonably possible change' in the key assumptions to be presented in the sensitivity analysis. Moreover, paragraph BC34(a) in the ED explains that the example illustrates disclosures about "potential future increases in the scope of these regulations". However, it is not clear whether that refers to the scope of existing regulations or expected new regulations.

Example 4 – Disclosure of assumptions: general requirements (IAS 1/IAS 8)

25 EFRAG supports this example as it relates to another potentially challenging area with regard to (a) the interpretation of the time horizon covered for disclosures of sources of estimation uncertainty under paragraph 125 of IAS 1 and (b) the extent to which the interpretation of the applicable time horizon can result in the duplication of information between the financial statements and the anticipated[11] financial effects disclosed under ESRS and ISSB Standards requirements.

26 However, EFRAG observes that confusion and multiple interpretations may result from the wording in paragraph 4.6 of the ED related to assumptions in the scope of paragraph 125 of IAS 1: "*These include assumptions about uncertainties that will not be resolved within the next financial year, but that have a significant risk of resulting in a material adjustment to the carrying amount of those assets if the entity were to revise those assumptions in the next financial year*".

[11] Both ESRS and ISSB Standards describe anticipated financial effects as relating to the material effects of an entity's risks and opportunities on financial performance, financial position and cash flows in the short-, medium- and long-term.

27 Feedback to the ED reveals different interpretations of this paragraph. Some stakeholders agree with the interpretation in Example 4 but other stakeholders call for the clarification of the applicable time horizon for the uncertainties to be done through standard setting. This mixed feedback is in itself indicative of the need for standard setting clarifications and in response to Question 3, EFRAG calls for standard setting activity for paragraph 125 of IAS 1. In our view, clarifications about IFRS Accounting Standard requirements should not be made through illustrative examples. Therefore, we recommend retaining and finalising the fact pattern after clarifying, the interpretation of paragraph 125 of IAS 1 through standard-setting.

28 In addition, EFRAG observes that for this example, the need to apply IAS 1 could be due to some of the guidance under IAS 36 (i.e. paragraph 132[12] of IAS 36) not having been considered in the determination of whether to disclose material information within the example's fact pattern. This example makes it clear that if voluntary disclosures are providing material information, they should be requirements or their inclusion should only be allowed if they do not obscure material information. This is another aspect of standard setting that could be considered (see our response to Question 3).

Example 5 – Disclosure of assumptions: additional disclosures (IAS 1/IFRS 18)

29 EFRAG supports including an example to address fact patterns that are not related to climate-related uncertainties. However, EFRAG also understands that this example was not developed based on real-world fact patterns and is seen as unrealistic and rare in practice.

30 EFRAG supports the intent of the example. That is, it illustrates the conjunctive application of specific requirements (IAS 12 *Income Taxes*) and general requirements (paragraphs 31 and 125 of IAS 1) and results in disclosures being made based on requirements of paragraph 31 of IAS 1 (i.e. to help users the effect of timing of regulation on the carrying amount of the deferred tax asset) given the disclosures could not be included based on requirements in IAS 12 and paragraph 125 of IAS 1. However, EFRAG considers that the proposed fact pattern requires improvement and should reflect real-world fact patterns. As is, this example is rare and therefore might have limited application in practice.

31 EFRAG considers that it would be more realistic if the illustrative example referred not only to the utilisation of tax losses but to the utilisation of deductible temporary differences as

[12] Paragraph 132 of IAS 36 states: 'An *entity is encouraged to disclose assumptions used to determine the recoverable amount of assets (cash-generating units) during the period*.'

the recoverability of tax losses carried forward should not be assessed separately from the recoverability of other sources of deferred tax assets.

Example 6 – Disclosure about credit risk (IFRS 7)

32 The example related to disclosures of credit risk is useful because, as shown by various thematic reviews[13] of reporting practices, including the April 2024 ESRB[14], financial institutions are at varied stages in their integration of climate-related risks into their risk frameworks. Moreover, though there may be multiple projects and scenarios available to estimate the size and impact of climate risk, there are limited projections of economic and financial effects. These situations arise due to limited data availability, systems and methodological challenges faced by several financial institutions. Of note, the ESRB publication highlights that for banks, expected credit loss models typically forecast three years ahead, which may be too short a horizon to cater for most climate-related risks. Hence, the disclosure of credit risk exposure and management is an aspect of reporting where there may be an expectation gap due to the disconnect between the signals conveyed in the sustainability disclosures and the disclosures in the financial statements.

33 Overall, other than the general concerns raised above, so far EFRAG is not aware of any specific concerns that stakeholders may have about this example. That said, EFRAG notes that there is a risk that paragraph 6.4 of the ED – which refers to the application of the requirements of disclosure on credit risk exposure in paragraphs 35A–38 of IFRS 7 – might only result in boilerplate disclosures. This is because, given the earlier-noted limitations of data availability and systems/methodological constraints, these requirements may unintendedly result in preparers only disclosing the broad processes underpinning the entity's credit risk management practices related to climate-related risk rather than disclosing the quantitative effects.

34 EFRAG also suggests that the example would benefit from including quantitative information with respect to collateral (paragraph 6.4 (c) of the ED) as per paragraph 35(k) of IFRS 7.

[13] EY, May 2024, Connected Financial Reporting: Accounting for Climate Change.

[14] ESRB, April 2024, Climate-related risks and accounting.

Example 7 – Disclosure about decommissioning and restoration provisions (IAS 37 Provisions, Contingent Liabilities and Contingent Assets)

35 EFRAG supports the inclusion of examples related to disclosure of provisions and contingent liabilities as this is a challenging area in the reporting of climate-related uncertainties. EFRAG considers that the proposed disclosures applying paragraph 85 of IAS 37 would provide useful information on decommissioning and site restoration costs, e.g. a description of the expected timing of the outflows and uncertainties about the amount and timing of these outflows.

36 Moreover, the focus on decommissioning and restoration provisions is apt as it is related to long-term uncertainties. However, some stakeholders have concerns about how entities measure such provisions because these are usually incurred far into the future. That is, discounting the related future cash flows can result in the carrying amount of the provisions being immaterial and unrecognised in the statement of financial position. Hence, as the entity may need to settle its decommissioning obligations and restoration costs earlier than expected, and considering the magnitude of the associated outflows, EFRAG suggests that the IASB considers whether entities disclosing the undiscounted amounts of future decommissioning obligations and restoration costs would provide useful information under this fact pattern. Such a disclosure can inform on the risk of outflows that would not be discernible from the discounted carrying amounts.

37 Related to the above, EFRAG is also of the view that the risk of early settlement of decommissioning obligations and restoration costs is indicative of recognition and measurement considerations that should be disentangled from the respective disclosure considerations in the ED's example.

38 Furthermore, EFRAG suggests that the IASB specifies whether the uncertainty of timing, the materiality of the gross obligation and qualitative factors such as users' awareness of the entity's exposures are considered in the conclusion. It should be made clear whether the disclosures stem from either applying paragraph 85 of IAS 37 or paragraph 125 of IAS 1.

39 Finally, EFRAG considers that, besides considering the risk of early settlement as per the ED example, there would also be useful information on decommissioning and site restoration costs if the entity considers a reasonably possible change in one of the key assumptions used to measure the provision (e.g. timing or discount rate) which could lead to a material adjustment to the carrying amount of the provision.

Example 8 – Disclosure of disaggregated information (IFRS 18)

40 EFRAG supports this example and its focus on applying the principles of aggregation and disaggregation under IFRS 18 to distinguish between assets that are highly vulnerable to climate-related transition risk and those that are not.

41 Though the example is useful as it conveys the risk associated with an entity's transition plan, some stakeholders are concerned that the disaggregation suggested by the example is inconsistent and more granular than the requirements of paragraph 73 of IAS 16 *Property, Plant and Equipment* (i.e. it goes below the level of property, plant and equipment ('PPE') asset class). Furthermore, the ED indicates that the entity should disaggregate the information it discloses applying paragraph 73 of IAS 16 for classes of PPE with dissimilar risk characteristics whenever the resulting disaggregated information is material. Some stakeholders are concerned that an entity would have to provide a further disaggregation below the PPE class, i.e. a disaggregation between PPEs that have a low exposure to climate-related transition risks and those that have a higher degree of exposure - for all disclosures in paragraph 73 of IAS 16 (i.e. paragraph 73 (a) – (e)). This would have to be done for each PPE class, where material. These stakeholders consider that providing disaggregated disclosures would be very costly.

42 Moreover, to encourage connectivity, EFRAG suggests that it would also be useful to illustrate how the level of disaggregation in the financial statements could be linked (e.g. via cross-referencing) with the related information in the sustainability disclosures.

43 In addition, EFRAG suggests that the IASB adds an example illustrating how an entity might disaggregate revenue (given its importance to users as a performance metric) on the basis of dissimilar risk characteristics applying IFRS 18, as well as by applying the disaggregation requirements in paragraphs 114-115 of IFRS 15 *Revenue from Contracts with Customers*.

44 Furthermore, EFRAG suggests adding an explanation as to why IFRS 18 requirements, in this instance, only affect the disclosures but not the presentation in primary financial statements.

ED Question 3 – Other comments

Do you have any other comments on the Exposure Draft?

45 *Enhancing IFRS accounting requirements:* EFRAG acknowledges that existing IFRS accounting requirements implicitly cater for climate-related and other uncertainties. That said, as noted in EFRAG's response to Example 4, there are mixed views on the applicable time horizon for the uncertainties addressed under paragraph 125 of IAS 1 and this in itself

indicates the need for standard setting for this paragraph. As noted earlier, EFRAG recommends clarification of this paragraph through standard setting as soon as possible parallel to finalising and issuing the ED's examples.

46 As noted earlier, after issuing the ED's examples, EFRAG recommends the IASB consider areas where stakeholders have identified that standard-setting activity may be necessary in respect of the following:

(a) *Specific IFRS Accounting Standards*:

(i) IAS 36 (i.e. challenges have been identified with paragraphs 34 and 35 in relation to the value in use calculation and the applicable time horizon for climate-related fact patterns, and paragraph 134 in relation to the required disclosure on goodwill of the CGU);

(ii) IAS 37 (i.e. attention has been drawn to the interpretation challenges related to the smoke-filter example);

(iii) IAS 38 *Intangible Assets* (i.e. the criteria for assessing whether internally generated assets qualify for recognition);

(iv) IFRS 7 (i.e. disclosures might need to be updated to cater for macro-economic risks);

(v) IFRS 9 (i.e. incorporating climate risks into the expected credit loss measurement);

(vi) IFRS 13 (i.e. clarify how to incorporate climate risks in the determination of fair value); and

(vii) accounting for pollutant pricing mechanisms.

On the above, EFRAG would recommend that the IASB undertakes standard-setting activity on existing IFRS Accounting Standards wherever justified under limited circumstances and with prioritisation of possible amendments to IAS 36 and IAS 38 under the intangibles project. EFRAG also underscores the importance of developing requirements for pollutant pricing mechanisms as there is a current gap in guidance (and this could be done within the intangibles project and the ongoing amendments to IAS 37, or as a separate project by adding the current pipeline project to the active agenda).

(b) *General IFRS accounting requirements*: EFRAG acknowledges that paragraph 31 of IAS 1 is an essential requirement within IFRS accounting literature, as it can be applied to ensure the reporting of material information in the financial statements (including in the context of connectivity), that is not required by specific IFRS accounting requirements. At the same time, as noted in our response to Question 2 – Examples 1 and 2, EFRAG is aware[15] that there are diverse interpretations of when paragraph 31 of IAS 1 is applicable and there is also a concern from some stakeholders about its stretched application. This has resulted in some stakeholders calling for related application guidance. Hence, EFRAG recommends that the IASB monitors whether the application of this paragraph is indicative of the need for future standard-setting activity.

47 *Standard setting related to IAS 36:* As noted in our response to Q2 on Example 4, the need to apply IAS 1 may arise due to paragraph 132 of IAS 36 only encouraging and not requiring disclosures of assumptions used towards determining the recoverable amount of the CGU during the period. If this paragraph is deemed not relevant to be considered in the Example 4 fact pattern, we would suggest that the IASB undertakes narrow-scope standard-setting to remove paragraph 132 of IAS 36 or make it mandatory.

48 Related to paragraph 132 of IAS 36, some stakeholders have called for the removal of all voluntary paragraphs in IFRS Accounting Standards but others disagree with this suggestion[16]. EFRAG concurs with the latter view as there needs to be a considered assessment of the IASB's reasons for allowing voluntary guidance (e.g. when scoping out particular paragraphs from being requirements but leaving them within Standards for consideration) before deleting such guidance. A case-by-case analysis on the merits of deleting specific voluntary paragraphs would be needed and EFRAG has not done that.

49 *Other uncertainties:* EFRAG supports the IASB's decision to broaden the project's scope beyond climate-related uncertainties to encompass other uncertainties. That said, EFRAG recommends that the IASB addresses the following conceptual questions:

(a) What is the distinction between risks and uncertainties? and

[15] April 2024 IFASS report (Page 69) highlights the multiple views on the applicability of IAS 1.31, including stakeholders who have concerns about the stretched application of IAS 1.31. Similar concerns have been raised in other commentary.

[16] Some stakeholders have conveyed that they consider voluntary guidance in IFRS Accounting Standards can foster higher-quality financial information, transparency and reliability, provided that they are being applied consistently.

(b) When do these uncertainties fall within or outside the boundaries of the financial statements?

50 *Editorial suggestions*: EFRAG has the following editorial suggestions:

(a) Consider including only a reference to the relevant IFRS Accounting Standard instead of copying the exact disclosure requirements themselves;

(b) Align the wording in the examples with the wording in IFRS Accounting Standards. For instance, paragraphs 1.8 and 2.8 of Examples 1 and 2 of the ED use 'more likely' in contrast to 'likely' (paragraph 24 of IAS 1) and paragraph 4.4 of Example 4 of the ED refers to 'assumptions' in contrast to 'reasonable and supportable assumptions' (paragraph 33 of IAS 36);

(c) Examples 1 and 2: Align the terminology used in paragraph 1.3(c) of the ED ('the entity has no asset retirement obligations') with the terminology used in IAS 37 and IFRIC 5 *Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*. In addition, there is a need to better connect paragraph 1.9 of the ED with paragraph 1.3 of the ED. Paragraph 1.9 only notes that the entity should explain why the transition plan has no effect on its financial position and financial performance without providing any additional guidance regarding what kind of information entities should disclose to explain that assessment;

(d) Example 4: EFRAG notes that the word 'scenario' in paragraph 4.3 of the ED may be misunderstood if it is used only to describe ordinary estimation uncertainty for one parameter. There may also be a drafting error in paragraph 4.6(d)[17] of the ED which refers to the sensitivity to changes of assumptions of 'CGU's carrying amount' instead of 'CGU's recoverable amount'.

[17] Paragraph 4.6(d) of the ED states: '*the sensitivity of the CGU's carrying amount to changes in the assumptions*—the carrying amount of the CGU is highly sensitive to the assumptions. Relatively small changes in these assumptions could result in a reduction of the CGU's recoverable amount and a material impairment loss'.