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Climate-related and Other Uncertainties in the Financial Statements

Cover Note

Objective

- 1 The objective of this session is to seek EFRAG FR TEG-CFSS' views on the July 2024 IASB's Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements - Proposed illustrative examples (ED)* in order to provide feedback at the ASAF meeting on 26-27 September 2024.
- 2 The structure of the paper is as follows:
 - (a) Background;
 - (b) Information about the ED;
 - (c) Next steps;
 - (d) Agenda papers; and
 - (e) Appendix: Summary of main feedback received.

Background

- 3 Stakeholders' feedback to the 2021 IASB Third Agenda Consultation highlighted that information reported by entities about climate-related risks in financial statements was either insufficient or seemed to be inconsistent with information reported elsewhere (e.g., other parts of the Annual Report). This led to the IASB adding a related project to its maintenance workplan, and the project was activated in March 2023 to explore targeted actions to improve the reporting of climate-related and other uncertainties in the financial statements.
- 4 In September 2023, after outreach to stakeholders on the nature and causes of concern related to the reporting on climate-related risks in the financial statements, the IASB decided to respond to stakeholders' concerns by, inter alia, exploring possible illustrative examples. Based on further outreaches¹ conducted between September 2023 and March 2024, in April 2024, the IASB tentatively decided:

¹ The IASB's outreaches included the following meetings: Capital Markets Advisory Committee in October 2023, Global Preparers Forum in November 2023, IFRS Interpretations Committee in November 2023, Accounting Standards Advisory Forum in December 2023 and March 2024.

- (a) to provide examples to illustrate how an entity applies IFRS Accounting Standards to report the effects of climate-related and other uncertainties in its financial statements;
 - (b) to include the examples as illustrative examples that would accompany IFRS Accounting Standards; and
 - (c) to publish an Exposure Draft (the ED) to obtain feedback from stakeholders about the examples with a 120-day comment period. The ED was published on 31 July 2024 with a comment period ending on 28 November 2024.
- 5 The findings of outreach conducted² by EFRAG in Q2-Q3 2023 were aligned with those of the IASB outreach. Moreover, discussions at the EFRAG FR TEG-CFSS in November 2023 were supportive of the September 2023 IASB project direction decisions.

Information about the ED

- 6 The ED has 3 sets of questions relating to:
- (a) Q1 - Providing illustrative examples;
 - (b) Q2 - Approach to developing illustrative examples; and
 - (c) Q3 - Other comments.

Q1 - Providing illustrative examples

- 7 *What types of uncertainties and fact patterns to illustrate?* The ED indicates that stakeholders were mainly concerned about the reporting of the effects of climate-related uncertainties. The IASB therefore concluded that examples illustrating the application of IFRS Accounting Standards to climate-related uncertainties would be most helpful in responding to these concerns. However, the IASB noted that the principles and requirements illustrated apply equally to other types of uncertainties.
- 8 *Should the examples be stand-alone³ or walk-through⁴?* The IASB also concluded that stand-alone examples would be more effective in helping to improve the reporting of the effects of climate-related and other uncertainties in the financial statements compared to walk-through examples. These examples can more precisely target particular matters or requirements that give rise to stakeholder concerns.
- 9 *Vehicle for the examples* - The IASB has also considered whether to publish examples as educational material, include them as illustrative examples accompanying IFRS Accounting Standards, or include them in the Standards.
- 10 The IASB decided to propose including the examples as illustrative examples accompanying IFRS Accounting Standards as they:

² After the IASB initiated the project in March 2023 and started its outreach, EFRAG concurrently conducted similar outreach on the nature and causes of concerns and possible solutions for the perceived inadequate reporting. EFRAG's outreach and analysis of multiple thematic reviews of EU companies' reporting practices led to the publication of an [EFRAG Secretariat Briefing on climate-related risks in the financial statements](#).

³ These are examples with narrow fact patterns illustrating particular requirements in an IFRS Accounting Standard

⁴ These are examples with broad fact patterns illustrating several requirements in a selection of IFRS Accounting Standards

- (a) are easily accessible because they are included alongside other guidance accompanying the Standards;
- (b) are used by preparers in applying the Standards and are helpful to auditors and regulators in supporting their audit and enforcement activities; and
- (c) allow for greater flexibility in content and format than if the examples were to be included in the Standards.

Q2 - Approach to developing illustrative examples

11 The ED proposes the following eight examples:

- (a) **Example 1 — Materiality judgements leading to additional disclosures (IAS 1/IFRS 18):** to illustrate how an entity makes materiality judgements when assessing whether to provide additional disclosures beyond those specifically required by IFRS Accounting Standards when applying paragraph 31 of IAS 1/paragraph 20 of IFRS 18. In particular, the example illustrates how an entity considers qualitative factors in making these materiality judgements.
- (b) **Example 2 — Materiality judgements that do not lead to additional disclosures (IAS 1/IFRS 18):** to illustrate when materiality judgements do not lead to the disclosure of additional information in the financial statements.
- (c) **Example 3 — Disclosure of assumptions: specific requirements (IAS 36):** to illustrate how applying the disclosure requirements in IAS 36 *Impairment of Assets* could result in an entity disclosing information about the climate-related assumptions it uses to determine the recoverable amounts of assets.
- (d) **Example 4 — Disclosure of assumptions: general requirements (IAS 1/IAS 8):** to illustrate how an entity determines whether an assumption has a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial (paragraph 125 and 129 of IAS 1/ paragraph 31A and 31E of IFRS 18).
- (e) **Example 5 — Disclosure of assumptions: additional disclosures (IAS 1/IFRS 18):** to illustrate how applying paragraph 31 of IAS 1/paragraph 20 of IFRS 18 could result in an entity disclosing information about assumptions it makes about the future even if other IFRS Accounting Standards do not require such disclosure.
- (f) **Example 6 — Disclosure about credit risk (IFRS 7):** to illustrate how applying the disclosure requirements in IFRS 7 could result in an entity disclosing information about the effects of climate-related risks on its credit risk exposures and credit risk management practices, as well as information about how these practices relate to the recognition and measurement of expected credit losses.
- (g) **Example 7 — Disclosures about decommissioning and restoration provision (IAS 37):** to illustrate how an entity might disclose information about plant decommissioning and site restoration obligations even if the carrying amount of the associated provision is immaterial.
- (h) **Example 8 — Disclosure of disaggregated information (IFRS 18):** to illustrate how applying the new principles of aggregation and disaggregation in IFRS 18 may result

in an entity disaggregating information it provides about a class of property, plant and equipment on the basis of their dissimilar risk characteristics.

Questions for EFRAG FR TEG-CFSS

Providing illustrative examples

- 12 Do you agree that providing examples would help improve the reporting of the effects of climate-related and other uncertainties in the financial statements?
- 13 Do you agree with including the examples as illustrative examples?

Approach to developing illustrative examples

- 14 Do you agree with the approach to developing the examples, including the selection of requirements, fact patterns and technical content?

Other comments

- 15 Do you have any other comments?

Next steps

- 16 There will be an EFRAG FR TEG and an EFRAG SR TEG meeting on 12 September 2024 to discuss the draft comment letter and for EFRAG FR TEG to recommend it to the EFRAG FRB.
- 17 There will also be a joint EFRAG FR and SR Board on 18 September 2024 to discuss the draft comment letter and for EFRAG FRB to approve it.

Agenda Papers

- 18 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 04-02 – ASAF paper; and
 - (b) Agenda paper 04-03 – *IASB ED: Climate-related and Other Uncertainties in the Financial Statements - Proposed illustrative examples* – for background.

Appendix – Summary of key messages for the EFRAG draft comment letter

Disclaimer – Below is the cover letter which is included in EFRAG’s draft comment letter (DCL). It does not represent EFRAG’s official position as it will be discussed by EFRAG FR and SR TEG on 12 September and then by EFRAG FRB and SRB on 18 September.

Overall comments- Providing illustrative examples

- 1 EFRAG agrees with the IASB’s focus on providing illustrative examples and educational material to address the need for improved reporting of climate-related and other uncertainties in the financial statements. Notwithstanding the inherent limitations of any illustrative example (e.g., they may be seen as either too simple or too complex), the illustrative examples in ED are useful because, to a large extent, they cover topics where challenges in reporting climate-related and other uncertainties may arise. As a result, these examples can help to bridge the expectations gap that may arise from the inconsistent reporting of climate-related information within and outside the financial statements; and, to some extent, they may help to strengthen the connectivity of reported information in the financial statements and sustainability reports/other general purpose financial reports.
- 2 Nonetheless, EFRAG considers that the illustrative examples in the ED should only be seen as an initial step in addressing stakeholders’ expectations and that the door should be open for further steps, including developing other examples and undertaking standard setting activity where justified. Specifically, EFRAG suggests that the IASB should consider providing additional illustrative examples that go beyond climate-related risks and to also provide walk-through⁵ examples as educational material at a future date, to help preparers of financial statements. Furthermore, EFRAG suggests that the IASB should monitor the developments on climate-related risks and other uncertainties over the next years in order to explore whether other aspects need to be considered.
- 3 *Focus on connectivity:* EFRAG acknowledges the steps taken by the IASB and ISSB, including their staff working jointly to develop the ED examples, and the examples take account of information in other general purpose financial reports. That said, as conveyed in [EFRAG’s response](#) to the ISSB agenda consultation, EFRAG recommends that both the IASB and ISSB should further focus on the connectivity of reported information, including by developing examples that illustrate connectivity in the reporting of their respective requirements as well as between IFRS financial statements and other jurisdictional sustainability reporting requirements including ESRS.
- 4 *Vehicle for illustrative examples:* EFRAG would have preferred that the illustrative examples be in the main body of the Standards and therefore endorsed in the EU. At the same time, we take account of the IASB considerations namely that incorporating illustrative examples into IFRS Accounting Standards might require the examples to be simplified or shortened such that their level of detail is not disproportionate in the context of the Standards. Conversely, if the illustrative examples accompany the IFRS Accounting Standards, it allows

⁵ Walk-through examples are examples with broad fact patterns illustrating several requirements in a selection of IFRS Accounting Standards instead of only focussing on particular requirements IFRS Accounting Standards.

for greater flexibility in content and format than if the examples were to be included in the Standards. We therefore understand why the IASB has decided to include these examples as illustrative examples accompanying IFRS Accounting Standards.

Comments on the illustrative examples- Approach to developing illustrative examples

- 5 EFRAG welcomes that the eight illustrative examples in the ED cover a range of disclosures related to general and specific IFRS Accounting Standards requirements. We agree that the topics addressed by these examples include the main areas where climate-related and other long-term uncertainties would be expected to be reflected in the financial statements but where challenges could be currently arising. At the same time, as further detailed in the Appendix, we have provided some general suggestions, including possible additional examples on recognition and measurement requirements (e.g. determination of expected credit loss). To avoid each of the examples being misconstrued as containing all the material information that should be considered for a particular Standard, we recommend that the IASB include a caveat indicating that each example focuses on a selection and not all of the key material information that is required to be disclosed by the related IFRS Accounting Standard.
- 6 We have also provided specific comments in relation to the examples in the ED. In our comments on Example 4 (IAS 1 *Presentation of Financial Statements*), we observe the multiple interpretations of the time horizon requirements of IAS 1.125, which is related to disclosures of sources of estimation uncertainty. We note that clarification of IFRS requirements should not be done through examples and present a question to constituents on whether standard setting activity is needed to clarify the requirements of IAS 1.125.

Other comments

- 7 EFRAG notes that, as seems to be the case in Example 4, IAS 1 requirements should not be expected to be applied to remedy inappropriately worded voluntary paragraphs within specific IFRS Accounting requirements (i.e. when paragraphs related to material information are only encouraged within specific IFRS Accounting Standards.). Finally, we also note that the IASB should clarify conceptual questions, including the difference between risks and uncertainties and whether/ when these uncertainties fall within or outside the boundaries of the financial statements.