ICAEW
REPRESENTATION 80/24

CLIMATE-RELATED AND OTHER UNCERTAINTIES IN THE FINANCIAL STATEMENTS

Issued 26 November 2024

ICAEW welcomes the opportunity to comment on the Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements* published by International Accounting Standards Board on 31 July 2024, a copy of which is available from this link.

ICAEW welcomes the IASB's development of examples to improve the reporting of climate-related uncertainties in financial statements. We think the examples usefully guide preparers through the considerations that may be required when applying IFRS Accounting Standards. We broadly support the fact patterns and technical content of the examples and have provided specific comments where we have suggestions for improvements.

We support the IASB's objective of improving the connections between the information an entity provides in its financial statements and the information it provides in other parts of its general-purpose financial reports, however we do not think the examples significantly improve connectivity. We suggest that separate educational material is needed to achieve this.

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KEY POINTS

IMPROVING THE REPORTING OF UNCERTAINTIES

1. ICAEW welcomes the opportunity to comment on this exposure draft (ED). We recognise the need for improved reporting on the effects of uncertainties, and in particular the need for greater connectivity between the information an entity provides in its financial statements and in other parts of its general-purpose financial reports. This is a difficult challenge to address, and we support the creation of these examples as a useful step towards improving this.
2. We agree that IFRS Accounting Standards sufficiently capture information about the effects of climate-related and other risks if applied correctly, as stated in paragraph BC6(a). The examples helpfully highlight some of the factors preparers may need to consider to ensure appropriate and material information about uncertainties is identified and disclosed.

FOCUS ON CONNECTIVITY

3. While the examples provide useful guidance, we do not believe they help entities to significantly strengthen connections between information in their financial statements and their sustainability-related financial disclosures. Our response includes suggestions for how this could be improved within the examples. We further believe the development of separate, connectivity-focused educational material, developed in collaboration with the International Sustainability Standards Board (ISSB), would have a greater impact in this area.

PLACEMENT OF THE EXAMPLES

4. With the exception of examples one and two, we agree with including the examples as illustrative examples accompanying IFRS Accounting Standards. The illustrative examples are a useful tool to highlight best practice and allow for greater flexibility than the Standards themselves.
5. We suggest that examples one and two would be more appropriate in IFRS Practice Statement 2: Making Materiality Judgements (PS2), given their focus on materiality judgements and their relevance to guidance included within PS2.

SPECIFIC SUGGESTIONS

6. We have outlined specific concerns with some of the examples and proposed improvements. In particular, we recommend that the IASB provide additional detail in example 1, clarifying circumstances where disclosures about the lack of exposure to a particular risk (‘negative disclosures’) may be considered material information. This would help avoid creating an expectation that such disclosures are required as standard, especially concerning transition plans.

ANSWERS TO SPECIFIC QUESTIONS

Question 1 – 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.

Support for the examples

7. We believe that the examples provide a helpful reminder to preparers that climate and other risks should be robustly considered throughout the financial statements, along with outlining useful guidance on some of the high-level considerations that may be required by IFRS Accounting Standards.

8. The examples are also a good demonstration that climate-related risks and other uncertainties can impact the financial statements, and when those impacts are material IFRS Accounting Standards provide an appropriate basis to disclose the relevant information.

9. On this basis, we agree that the examples are a useful vehicle to guide IFRS preparers through various considerations they may need to make when reporting the effects of climate-related and other uncertainties. We think the examples will help improve the reporting of these uncertainties by providing some support to preparers in ensuring they apply the Standards appropriately.

10. We do not, however, believe that the examples alone resolve the concerns identified in BC1 that information about the effects of climate-related risks in the financial statements sometimes appear to be inconsistent with information entities provide outside the financial statements. We believe that this will require a greater focus on connectivity and have provided suggestions below.

Need for greater focus on connectivity

11. We agree that there is a need for entities to strengthen the connections between the information they provide in their financial statements and the information they provide in other parts of their general-purpose financial reports, including sustainability-related disclosures. We believe the disconnect between the information provided is an important issue that needs to be addressed, through collaboration between relevant standard setters.

12. Because of the scale of the challenge, we do not think it is practical or realistic that these examples could resolve the concerns that exist around connectivity. However, given the ED states that one of the objectives of the project is to strengthen connections between information that entities provide inside and outside the financial statements, we suggest that there could be wider activity with a greater focus on connectivity.

13. We believe the examples are a good opportunity for the IASB to emphasise that IFRS Accounting Standards and an entity's applicable sustainability reporting standards need to be read and considered in conjunction with one another, rather than being treated as two entirely separate sets of requirements. The examples are also an opportunity to provide some initial demonstrations as to how this might be done.

14. We suggest this linkage could be achieved by referring to examples of disclosures relating to climate risks and uncertainties required by sustainability standards, such as ISSB Sustainability Disclosure Standards, and adding narrative to consider how these risks may also be reflected in the financial statements.

15. We also recommend the IASB and ISSB consider producing complementary educational materials, with a focus on linking reporting across the financial statements and sustainability

reports. We suggest this could include an example of an entity's reporting, worked through in its entirety, showing preparers what a 'good' disclosure might look like. Example disclosures would also provide guidance on presentation and how to structure a note on climate-related and other uncertainties in a way that is useful to users.

Placement of the examples

16. In general, we agree with including the examples as illustrative examples accompanying IFRS Accounting Standards. We are aligned with the view presented in the ED that this would allow for flexibility and ease of access for preparers.

17. We support the proposal in BC45 to publish the examples as a package in a single document, in addition to including them individually as examples accompanying the relevant standards. We agree that this would usefully provide one point of reference for stakeholders and would make it easier to draw connections between the examples.

18. As an exception to our support for including the examples as illustrative examples accompanying IFRS Accounting Standards, we recommend that the IASB considers including examples one and two in PS2. This is the guidance that preparers often turn to when considering how to make materiality judgements. It is this guidance that states that information about the lack of exposure to a particular risk could be material information, which links to examples one and two. If these examples are not included within PS2, it may be useful to cross-reference from the examples to PS2 and vice versa, to ensure readers access all relevant guidance.

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.

19. We support the IASB's approach to developing the examples, including the decision to focus the examples on the requirements most relevant to reporting the effects of uncertainties. We also agree it is necessary for the examples to be high level so that the principles can be applied to a variety of real-life scenarios. That said, we have some general and example-specific concerns and recommendations that we have detailed below.

General comments

20. We note that several examples demonstrate an entity considering making disclosures based on paragraphs 31 and 125 of IAS 1 *Presentation of Financial Statements*. We are concerned that there may be an over-reliance on these paragraphs in the examples, which is

disproportionate to the frequency with which these paragraphs are applied in practice. We would expect compliance with the specific requirements in the relevant IFRS Accounting Standards to usually result in the disclosure of appropriate information, and for additional disclosures based on paragraphs 31 and 125 of IAS 1 to be less common. We suggest that there may be too much focus on these paragraphs, as four of the eight examples focus on them in the 'Application' section (examples 1, 2, 4, and 5). The reliance on these paragraphs in the examples may suggest that there is a benefit to some separate, additional guidance on how these paragraphs should be used more widely.

21. While the ED states that it has been generalised to cover 'other' uncertainties in addition to those related to climate, the examples are predominantly climate-focused. There are numerous other sources of potential risk and uncertainty, including geopolitical, nature, water, and non-climate ESG issues such as anti-bribery and fair labour practices. It may be useful to make it explicit in the examples that the considerations apply equally to other sources of uncertainty, or alternatively, to expand the fact patterns to include references to other uncertainties, enabling preparers to draw analogies more easily. We suggest this approach could help avoid creating the expectation that similar sets of examples might be developed for a wide range of risks.

Specific comments: example one

22. Example one outlines a scenario in which an entity's assessment that its transition plan does not have a material impact on its financial statements is itself determined to be material information, based on paragraph 31 of IAS 1. An entity's assessment of when it is material information to confirm that something has an immaterial impact on the financial statements is practically challenging and inherently judgemental. We are concerned that some entities may misinterpret this example as suggesting that negative disclosures are commonly required, which could risk deterring them from disclosing or expanding their transition plans. We believe that it would be helpful if the example set clearer parameters around the circumstances in which such disclosures might be required, and that the example should draw more closely on the guidance in PS2 to achieve this.

23. Specifically, we recommend that the IASB makes it more explicit that such negative disclosures may be required where an entity is not exposed to a risk to which other entities in its industry are exposed, and that fact could reasonably be expected to influence its primary users' decisions. However, we also recommend that the IASB makes clear that primary users are expected to have a reasonable knowledge of business and economic activities and to review and analyse the information included in the financial statements diligently, which we expect will contribute to limiting the circumstances in which negative disclosures are required.

Specific comments: example five

24. We suggest that it would be useful if the example provided more context on when announced regulations have sufficient credibility and certainty to potentially warrant additional disclosures. There are circumstances where announced regulations have a lower likelihood of coming into effect, such as when they pertain to periods far in the future. It would therefore be helpful if the example expanded on these considerations to explain the conclusions.

25. Paragraph 5.7 explains that the entity determines no additional disclosure is required after considering paragraph 125 of IAS 1, as the government is not discussing the regulation within the next two years, so the entity's assumptions are unlikely to change in the next financial year. We would suggest that there is uncertainty in the next financial year, as the assumption is dependent on a third party's legislative agenda. This could be subject to change, which may result in changes to the entity's assumptions. On this basis, we would suggest that paragraph 125 of IAS 1 may require the entity to make additional disclosures.

26. The concern that users of the financial statements may have in this scenario is that the entity is unable to use its tax losses before the new regulation is effective, as stated in paragraph 5.11(a). In contrast, paragraph 5.10 frames the risk as the entity assuming that the announced regulation would become effective earlier than scheduled. We recommend updating the wording in paragraph 5.10 to align with paragraph 5.11(a), to make clear that the risk is whether the entity can use its tax losses before the new regulation is effective, rather than the entity's assumptions about the effective date.

Specific comments: example six

27. This example illustrates how a credit institution might disclose information about particular risks on its credit risk exposures, and how these relate to its measurement of expected credit losses. We expect that credit institutions already identify various classes of risk, and we note there are already disclosures around risks such as flood risks made by many UK banks. While one of the risks a credit institution identifies might be climate, it would not be the only one. We suggest that it might be useful to include other cross-cutting risks in this example, to provide guidance to preparers as to how these could be considered.

28. It is challenging to quantify climate-related expected credit losses across banks' portfolios. Portfolios can change quickly, as loans are often for short periods, such as three to five years, and will be replaced with new business that has not been written at the point of calculation. It would be useful if the example expanded on considerations such as this.

Specific comments: example eight

29. This example considers how an entity might disaggregate the information it provides about its property, plant and equipment (PP&E) based on dissimilar risk characteristics. However, the example does not clearly explain how disaggregating the two types of PP&E, and effectively treating them as two separate classes, provides useful information to users. For instance, it is unclear whether the split of assets is particularly relevant to the entity's investors for a specific reason or if the suggestion is that the high-emission PP&E might be impaired. We suggest that it would be useful for this example to expand on the factors that make the disaggregated PP&E carrying values material information to users. Additionally, we note that an entity's assets might be exposed to a variety of risks - climate-related and otherwise - and to disaggregate based on these could result in information that is excessively detailed and unhelpful to users.

30. Such risks can also be cross-cutting, which further complicates the process of disaggregation. It would be useful for the example to expand on when, and how, an entity might determine that material information will result from the disaggregation of information based on dissimilar risk characteristics, particularly when there are multiple risks involved.

Question 3—Other comments
Do you have any other comments on the Exposure Draft?

31. We believe there is a need for a clearer understanding among both preparers and users of an entity's reporting as to the role of the financial statements and the circumstances in which a liability exists. An entity may make numerous commitments about its strategy or plans regarding a variety of topics. However, these would not necessarily create an obligation that meet the criteria to be recognised as a liability in the financial statements.

32. We suggest that educational material that explains when commitments may, or may not, be liabilities would be helpful in bridging gaps that exist in understanding and expectation between users and preparers. This could be a relatively simple piece of educational material, such as an article.