Principles for Responsible Investment

PRI AND CAAP CONSULTATION RESPONSE

IASB PROPOSED ILLUSTRATIVE EXAMPLES TO IMPROVE REPORTING OF CLIMATE-RELATED AND OTHER UNCERTAINTIES IN FINANCIAL STATEMENTS

November 2024

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To inform this paper, we have consulted our Global Policy Reference Group of signatories and select Climate Action 100+ signatories. Except where stated otherwise, the opinions, recommendations and findings expressed are those of PRI Association alone, and do not necessarily represent the views of the contributors or PRI signatories (individually or as a whole). It should not be inferred that any third party referenced endorses or agrees with the contents hereof. PRI Association is committed to compliance with all applicable laws and does not seek, require or endorse individual or collective decision-making or action that is not in compliance with those laws.

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United Nations Global Compact

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of over 5,300 signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research.

ABOUT CAAP

The Climate Accounting and Audit Project (CAAP) is a group of accounting and finance experts which is working with investors to ensure the requirements of the IASB and IAASB (in particular, the guidance on climate risk) are followed, and hence material climate risks are considered and that this is given appropriate transparency in company financial statements and the associated audit reports.

ABOUT THIS CONSULTATION

The International Accounting Standards Board (IASB) is consulting on eight examples to illustrate how companies apply IFRS Accounting Standards when reporting the effects of climate-related and other uncertainties in their financial statements. The eight illustrative examples focus on areas such as materiality judgements, disclosures about assumptions and estimation uncertainties, and disaggregation of information. The examples do not add to or change requirements in IFRS Accounting Standards. Instead, they provide guidance on how requirements in the Standards should be applied to provide investors with better information on climate-related risks and other uncertainties.

The IASB developed these illustrative examples in response to strong demand from stakeholders, particularly from investors. They expressed concerns that information about climate-related uncertainties in financial statements was sometimes insufficient or appeared to be inconsistent with information provided outside the financial statements.

We would be happy to discuss our work and input further, and can be reached to arrange this by email at benjamin.taylor@unpri.org and/or sueharding@hardinganalysis.com.

Yours Sincerely,

René van Merrienboer (Director, Sustainable Systems) and Benjamin Taylor (Senior Analyst, Driving Meaningful Data) on behalf of the PRI

David Pitt-Watson and Sue Harding on behalf of the Climate Accounting & Audit Project

DETAILED RESPONSE

We welcome the opportunity to comment on the Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements: Proposed illustrative examples* published by the IASB. This comment letter is submitted jointly by the Principles for Responsible Investment (PRI) and the Climate Accounting & Audit Project (CAAP).

KEY RECOMMENDATIONS

Our comment letter is in line with broad support among the investor community for these Illustrative Examples (IEs) and their application, as illustrated in other responses from associations such as Ceres, ICGN and IIGCC. To inform our response we consulted the PRI's Global Policy Reference Group of signatories, along with select CA100+ signatories.

We believe there remains an urgent need for improved financial statement disclosure by companies on how climate has been considered in the financial statements. While we agree the IEs can apply to facts and circumstances that are broader than climate, that is our focus in this letter.

The need remains for financial statements that provide information important to investors, particularly evident on climate-related matters such as climate risk and company decarbonisation. This is the case even for many companies having the largest emissions profiles (and therefore need to decarbonise) in the world. PRI and other investor groups have previously called on companies to reflect climate-related risks in financial reporting. The Climate Action 100+ Net Zero Company Benchmark assesses the degree to which companies incorporate material climate-related matters and Paris-aligned assumptions in their financial reports. However, there has only been minimal progress from companies in this area.

This gap in disclosure is evidenced in the work of the Carbon Tracker Initiative. In its latest report in the Still Flying Blind series, In a Holding Pattern, CTI found that less than 40% of 2022 year-end reports provided any meaningful disclosure on such matters. 63% of the financial statements reviewed were assessed as having provided no substantive disclosure. According their 2024 assessment results published by Climate Action 100+, only 2% of focus companies assessed (2023 year-end reports) have shown improvements in their overall Climate Accounting and Audit Assessment scores. The 2024 EY Global Climate Action Barometer demonstrates similar room for improvement: of the 1,400 companies surveyed – across 51 countries and operating in 13 sectors – only 36% of companies had referenced climate-related financial impact in their financial statements.

We agree with the IASB that the Standards themselves appear to be generally sufficient and we strongly support the finalisation and publication of the Illustrative Examples as a priority to improve the application of these Standards by companies as it relates to climate.

The information we expect to result from more robust application of requirements using these illustrations is important to decisions across investment activities, including capital allocation, securities investment, stewardship and company engagement and voting – decisions that are being

made now. Additionally, the materiality of climate to such decisions is only increasing year on year. Risk assessments, company commitments to emissions reduction targets including Net Zero by 2050, and investor interest in incorporating information on climate into their decision making has all increased since the IASB published its Educational Materials on climate four years ago.

We view the IEs as helpful examples to illustrate linkage between climate risk and information needed in the financial statements in order to understand them. This deliberate use of language comes from requirements in the standards themselves, and while the IEs will not be mandatory, the requirements they illustrate are already mandatory under the IASB Standards. The focus of the IEs is also appropriately on what appears to be the aspect found to be most wanting at the moment: qualitative materiality, and its application across a variety of fact patterns, each of which appear to us to reflect realistic situations seen in practice currently.

But the IEs will need to be embraced and applied – by companies, auditors, and regulators.

Finalising the IEs will not be enough. They must be embraced and thoughtfully applied to any reporting entity's (company's) own circumstances, directly or by analogy, based on the approaches the IEs illustrate on applying requirements of the standards. Support of companies, auditors, and regulators will all be necessary to achieve the reporting that is needed and expected by investors based on the requirements. If this is done, we believe the IEs can be very helpful in narrowing the evident and widespread gap in information disclosed based on how the standards are currently being applied by many companies, particularly in relation to climate. We suggest that the IASB consider its program beyond the publishing of the IEs, and how best to promote their use by companies, auditors, and regulators.

Appendices to this letter provide I. our responses to the questions posed, II. suggestions on individual IEs, and III. a summary of further issues relating to not only disclosure of decommissioning or Asset Retirement Obligations (AROs), but the recognition of provisions for such obligations currently off balance sheet, given the risk climate represents in potentially bringing these obligations forward. In the Appendices, we have also included commentary in response to some points raised in our discussions with other stakeholders on the topic of climate in financial statements, and by other draft comment letters in relation to the IASB's Exposure Draft.

Additionally, we draw attention to a recent Briefing by the Corporate Reporting Users Forum (CRUF), Missing-out climate risk. This looks at why companies and auditors are not typically communicating on climate in the financial statements and the audit report, and what can be done. Suggestions on the latter include a greater focus on reporting as communication, and an increased regulatory focus on compliance. These messages seem very timely in relation to how the IEs can best be put into practise to actually influence more understandable financial statement information, and the need for enforcement of the principles and requirements that the examples aim to illustrate.

Finally, we encourage the IASB to share with the US Financial Accounting Standards Board (FASB) their approach to this topic, and to encourage publication of similar corresponding guidance in relation

to US GAAP, in order to help ensure that accounting rules are correctly applied as it relates to climate in the world's largest capital market.

APPENDIX I – RESPONSE TO SPECIFIC QUESTIONS ASKED IN THE 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?**

Response to Question 1(a)

1. **We agree the IEs should help improve reporting – but this will only be achieved if they are embraced and widely considered.**

The set of draft IEs appear to tackle many of the issues we believe are being faced in practice. We provide more specific suggestions for each IE in Appendix II, and strongly support the IASB's finalising them as a matter of urgency.

However, finalising the IEs will not be enough. They must be embraced and thoughtfully applied to any reporting entity's (company's) own circumstances, directly or by analogy, based on the approaches the IEs illustrate on applying requirements of the standards. Support of companies, auditors, and regulators will all be necessary to achieve the reporting that is needed and expected by investors. If this is done, we believe the IEs can be very helpful in narrowing the evident and widespread gap in information disclosed based on how the standards are currently being applied by many companies, particularly in relation to climate.

We suggest that the IASB consider its program beyond the publishing of the IEs, and how best to promote their use by companies, auditors and regulators.

Response to Question 1(b)

1. **We agree that the materials are best presented in the form of IEs that accompany the related standards.**

Providing the materials in the form of IEs strikes a good balance. This will make them accessible alongside the standards and translated into other languages, and this form means their content is flexible (more so than brief examples typically included in the standards). This form is also appropriate as we agree that the IEs are not changing the standards. We also agree with the IASB's conclusion that the standards already appear to be sufficient, so targeting application is appropriate. Principle based standards mean not all circumstances will be covered in detail or explicitly, and that all parties using the standards will need to apply a degree of judgement. While the new IEs will not become mandatory, the requirements that they illustrate are already mandatory under the IASB Standards. Applying them will require a renewed focus on the principles and requirements on which each IE is based, and consideration in light of the company's own circumstances.

2. **Publishing the IEs in a single document will help to support their being embraced in an appropriate context**

We also support publishing the materials in a single document, as this could significantly expand accessibility of the IEs. A single document will likely facilitate consideration of the IEs in a way the distributed examples may not, by providing a reference document to those working on the disclosure of climate (in particular) across accounting topics. While some context on the application of the IEs could be added to the individual IEs accompanying the standards, a separate single document would also provide a place for wider context to be explained. For example, the background and the reason for the focus of these IEs on qualitative aspects of materiality.

A single document also gives an opportunity to cross reference to other illustrations and documents that may assist in the consideration of such matters. Such links could include:

- Other existing IEs that may relate, or relate by analogy, to disclosure of climate and other uncertainties. For example:
  - Example 2 relating to disclosure of provisions under IAS 37 (nuclear decommissioning obligations that could just as well relate to Oil and Gas or other decommissioning obligations).
- Additional existing IEs that may relate to recognition and measurement matters that relate or relate by analogy to climate and other uncertainties. For example:
  - Recognition examples accompanying IAS 37: 2A Contaminated land – legislation virtually certain to be enacted, Example 3 Offshore oilfield, and Example 6 Legal requirement to fit smoke filters which could apply to other legal requirements under climate-related legislation.
- Other relevant materials: including the Educational Materials Effects of climate-related matters on financial statements, the article by Nick Anderson that preceded it, and the IFRS Practice Statement 2 Making Materiality Judgements, perhaps with particular reference to Example C—materiality judgements that lead to the disclosure of information in addition to the specific disclosure requirements in IFRS Standards and Example K—influence of external qualitative factors on materiality judgements, which IEs 1 and 2 in this Exposure Draft are intended to build upon.

These suggestions are not intended to be exhaustive, and there may be additional existing illustrations and examples that would be helpful to companies, auditors, and regulators in considering such matters.

In terms of contextual notes that could make the use of the IEs more clear in their distributed form (in materials accompanying each of the relevant standards), these could either be included in the IEs themselves, or in the introductory notes that these accompanying documents typically have. We note that some of the suggestions may not be unique to this particular set of IEs, which suggests the introductory notes to IEs would be appropriate at least for some of the contextual notes. Suggested notes include making clear:

- **The narrow focus is only on the specific requirement(s) illustrated.** While each illustration links a fact pattern to at least one specific IFRS requirement and its application, each only illustrates the narrow aspect of the specific requirement(s) referenced.
- **Illustrations are based on the mandatory principles – to be considered by analogy to company specific circumstances.** The illustrations focus on how the principles referenced in the standards apply in the circumstances described. While the illustrations are not mandatory, the requirements/principles on which they are based are all part of the mandatory requirements of the standards. As such, the individual examples provide a basis for applying the requirements by analogy to company-specific circumstances.
- **None are comprehensive - other requirements are likely to also apply.** The IEs do not illustrate any of the other requirements that may be relevant in the circumstances described. For example, other aspects of recognition, measurement, presentation or disclosure requirements in other sections of the same standard, or the more overarching requirements of IAS 1, will likely also need to be considered. Additionally, if transactional aspects such as the accounting for carbon costs (credits and provisions) are the subject of illustration, then future estimates of such costs in impairment testing will not have been covered and might still need to be considered; the reverse is also true.
- Compliance with IFRS is nonetheless determined in-light-of applying the full set of principle-based requirements, to the underlying facts and circumstances of the company. Paragraphs 15-17 of IAS 1, relating to fair presentation and compliance with IFRSs are relevant for this. We note in particular that '*An entity shall not describe financial statements as complying with IFRSs unless they comply with all the requirements of IFRSs.'* and *'A fair presentation also requires an entity: …(c) to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.'*

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.

Response to Question 2

The reasonable expectations of investors needing to understand potential accounting impacts relating to climate are not currently being met. We agree with the approach being taken and consider the disclosure topics and fact patterns addressed in the draft IEs to be relevant to those we have heard raised, and the application of requirements that seem to need underlining in the context of climate in particular.

We also understand that the IASB plans to add an additional illustration relating climate targets and provisions and the Agenda Decision (AD) on IAS 37 published by the Interpretations Committee. We think this would be a helpful addition (see below).

See Appendix II for further suggestions on the individual draft IEs.

1. **IE on emissions reduction commitments and provisions should be added**

The recent AD provides a further illustration of the need for disclosure relating to climate. Indeed, if the financial statements of companies that have significant emissions reduction commitments had already provided financial statement disclosure of how such commitments had been considered relative to provisioning, there might not have been a need for the questions posed to the IC.

However, the AD did not address disclosure because the questions asked focused solely on recognition. Disclosure would provide understanding of why, in spite of sometimes transformational decarbonisation commitments being made, provisions are typically (and appropriately) not being seen under the requirements. It would likely help to providing an understanding of the financial statements, if disclosure was made on whether the company considers there are or are not constructive obligations associated with its climate-related commitments, and if there are, information on the key considerations leading to conclusions on whether recognition criteria were or were not met.

We understand that the IASB is considering in its project Provisions – Targeted Improvements, an additional IE on this topic. The Exposure Draft published earlier this month includes an example relating to recognition requirements, but omits disclosure (apart from a passing reference to the possibility of an effect on disclosure). This is not sufficient. We strongly encourage that this additional

IE more directly address disclosure. For additional information, see the comment letter previously submitted by the CAAP.

2. **We don't consider there is a need for other additional IEs at this moment; finalising these should be the priority**

We understand that some commentators may be asking for additional IEs – for example of when adjustments are made to the financial statements. We suggest this group of IEs be published first and as a matter of urgency. The current set of IEs is appropriately focused on disclosure, particularly where qualitative aspects of the materiality results in a conclusion that additional information should be disclosed. This is the currently common gap that is being addressed. The need for additional examples, relating to disclosure or wider issues of recognition and measurement, could be monitored subsequently.

In a principles based system, specifying the analysis of and requirements for each new/different set of facts and circumstance is to be avoided where the principles are sufficient to address them. Regarding cases where a quantitatively material adjustment has been made, the same principles that are illustrated in these IEs could already be used to consider additional qualitatively material information to be disclosed, potentially including the assumptions and estimates made in determining the adjustment amount. It would be very concerning if the IEs were to be read so narrowly to exclude disclosure needed to provide an understanding of the financial statements, simply because an adjustment had been made.

3. **We agree if used, the IEs will help address concerns that financial statement disclosure is insufficient and inconsistent with other reporting on climate**

Improved disclosure in the financial statements should also go a very long way towards addressing concerns over inconsistent reporting between these and the narrative disclosure of information on climate in sustainability and other reporting. This is needed to connect business and financial risks and plans to address them, to corresponding financial statement risk – the risk of financial statement information, including both the numbers on the face of the statements and the footnote disclosure, being misstated.

Misstatement in any respect is clearly a concern for investors that use this information. Enhancing the financial statement disclosure through use of the IEs would as a byproduct, significantly improve the consistency of reporting on climate, for example leading to more coherent information across sections of an annual report.

In the case of climate, the gap in providing an ability to understand the financial statements often leads to the perception of inconsistency. And in the other direction, investors often observe inconsistency, which means there is a need for disclosure that provides a more complete picture of how climate was considered in the financial statements. This is urgent, with the EU ESRS requirements applying from this year-end.

Consistency between the financial statements and other reporting is vital for investor confidence, and is already a significant concern. We are also concerned that with improved sustainability reporting on climate (which of course is welcomed – for example under local requirements, TCFD reporting, transition plan reporting, and ultimately ISSB or EU requirements), the inconsistency may increase, unless financial statement reporting is improved.

Inconsistency is a significant concern but not the only one. The financial statements (including footnote disclosures) must stand on their own. Under several overarching requirements of IAS1 – including for example paragraphs 31, 112c and 17c – IFRS accounts must already provide information that is sufficient to understand the financial statements. The application of IFRS accounting reflects a consideration of all relevant facts and circumstances of a company, not just consistency with information in a company's other reporting, including Sustainability Reporting.

Requirements for **consistency** are typically found in local reporting requirements. However, sustainability reporting when it exists, does not serve as a limitation on the information disclosed in IFRS financial statements today; it forms only part of the facts and circumstances that are of relevance in preparing the financial statements. If sustainability information were necessary to determine financial statement disclosure needs, this might even suggest that the set of IFRS financial statements presented would need to differ depending on the other information accompanying them in an annual report. Taking a relatively common situation, the IFRS financial statements presented in a company's local annual report (reflecting what was said in the narrative section of that report) would need to be altered when presented in the Form 20F filing with the US Securities and Exchange Commission, and perhaps different again if presented without any such accompanying information. We do not think it is appropriate to read this into the IFRS accounting requirements. Investor expectations include the same wider expectations of facts and circumstances intended to be considered in preparing the financial statements.

That said, a pre-publication reading of an annual report for consistency between sustainability reporting and the financial statements could serve as a very useful check on the sufficiency of both aspects of reporting. Such a reading for consistency is also the subject of existing requirements for the auditor of the financial statements in relation to 'other information' presented in the annual report, sometimes referred to as the auditor's consistency check.

In the future, more direct elements of connectivity may be built in, particularly into sustainability reporting and how it connects to financial reporting. We would also expect that as more facts and circumstances relating to sustainability/climate issues emerge, these will drive more informative sustainability and financial statement reporting - in tandem. See section 4 of our response to Question 3 for additional views on the importance of financial statements standing on their own.
In Appendix II, we also identify concerns in relation to IEs 1 and 2 and the implication that financial statement disclosure varies with (has a dependency on) Sustainability Reporting.

QUESTION 3 — ANY OTHER COMMENTS ON THE EXPOSURE DRAFT?

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

Response to Question 3

The following are additional points that we feel could improve the IEs – both how they are drafted and their application.

1. **Make clear that and why there is a focus on qualitative aspects of information that may suggest it is material to disclose**

As stated in IAS 1, materiality depends on the nature or magnitude of information, or both. We think it is appropriate that the IEs primarily focus on the aspect of this where there appears to be a significant gap in application – the qualitative aspects of information that means that it is material. Importantly, the need for information that is qualitatively material can be met by providing disclosure of quantitative information, descriptive text, or by a combination of both.

We note that quantitative materiality, referring to the significance of an amount such as the value of an asset that is at risk of impairment, or the amount of an adjustment made such as an impairment charge recorded or a provision made, can seem to be more obvious. It may also be what is meant when companies say something is 'not material', such as the impact of climate in the financial statements not being material; this may suggest it is not currently considered to be quantitatively material in the absence of any adjustment. But what about qualitatively material?

Most of the IEs focus on circumstances where no adjustment has been made to balance sheet amounts. However, investors also need to understand <u>why</u> adjustments that could be expected in the context of the company's climate related facts and circumstances and financial statements, have not been made.

Perhaps the most obvious example is where the amount at risk of adjustment is small, for example the amount of carbon-intensive assets at risk for early retirement or impairment, is quantitatively small. However, conveying this may still provide qualitatively material information to investors that are not able to detect this from the financial statement disclosure without additional information. This is essentially the situation in EX1. The same approach to considering additional disclosure would apply to a quantitatively material balance that is not adjusted for other reasons – due to an expectation of business-as-usual replacement timing or cash flows that provide sufficient headroom in the recoverable amount over the carrying amount of the assets being tested for impairment. In some cases, we consider information on the assumptions and estimates (including quantified amounts) made in determining this, may also be material information. For example, the carbon price and oil and gas commodity prices assumed in an impairment test, may be material information.

In our view, the focus of the IEs is appropriately on what appears to be the aspect found to be most wanting at the moment: qualitative materiality. The IEs do not suggest quantitative materiality is any less important – they just focus on what appears to be the more challenging aspects associated with qualitative materiality. We suggest that this context be made more clear, at least in the single document used to publish the IEs together.

2. **Make clear that the requirements for disclosure are set within a boundary**

Another, concern raised by some commentators is on the boundary of what might be considered for disclosure. Some have expressed apprehension, even alarm that the disclosures suggested could be unlimited, in other words they have no boundary. We do not believe this is the case.

To us, it is only improved application of the existing requirements that is being sought, within the requirements for disclosure in the financial statements under IFRS. The existing boundaries are twofold in considering potential disclosure of additional material information in the financial statements:

- **The topic has relevance to the financial statements** being presented. This means there is a reason to think the topic (facts and circumstances) could have a quantitatively material adjustment to the financial statement amounts.
- **The information represents material information**. 'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements'

This does not encompass anything any investor might like to know; it has meaningful boundaries. This is illustrated below, which can be used as an approach to analysing such matters.

- **What are the matters being considered (climate-related or other)?** These might include various transactions, other events, and circumstances that are taken into consideration regarding the fair presentation of the financial statements (IAS 1.15 -1.17). In considering climate, these would include aspects of physical and transition risk given the company's emissions profile including its value chain; and the company's emissions reduction strategies, commitments, targets, plans, etc.
- **Based on the financial statements, are there items that such climate-related matters may be relevant to?** These relate to the potential for quantitatively material adjustments to the financial statements. For example, significant asset values on the balance sheet (and whether the climate related matters could mean they are at risk of being overstated) or liabilities (at risk of being understated). Outside the company's financial statements, the IASB's Educational Materials are a good starting place (while not exhaustive), as these identify topics such as existing tangible and intangible assets on the balance sheet being at risk of impairment or shortened lives that would increase depreciation, and provisions for example relating to decommissioning obligations that may need to be increased as the timing of meeting them is brought forward. Some of these may stem from very long-term factors such as cash flows in impairment testing of long-term or even indefinite lived assets; supply availability and costs, as well as demand for products can also be relevant. Are there such items at risk of adjustment, or would such items be expected but their significance is unclear from the information in the financial statements?
- **What do the financial statements say?** Do they provide an understanding of how the climate matters (I.) have been considered in relation to the relevant financial statement items (II.) If not, it may be that qualitatively material information is needed to provide an understanding of the financial statements, and to avoid misstatement of the financial statements.

We suggest the IASB consider making these boundaries more clear. This could be done in the text of the IEs (we make suggestions using this analysis approach in Appendix II, (see in particular EX1 suggestion 2, and EX 2 suggestion 1). Other tools may also contribute to better understanding of the

financial statement reporting boundary, for example in the single document used to present all of the IEs included in the ED, articles, etc.

3. **Extend references to the many overarching requirements of IAS 1 – these are much wider than just the second half of paragraph 31**

IAS 1 para 31 is mentioned in several places across the IEs, in reference to providing material information: **'**An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance'. This requirement is repeated in paragraph 17c, in the context of achieving 'fair presentation and compliance with IFRSs'.

In addition, paragraph 112(c) indicates the notes shall '*provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them*.' We are aware that it is this paragraph that is referenced by some regulators that have sought additional disclosure on the sort of climate-related information, such as the UK's Financial Reporting Council.

We suggest consideration be given to broadening the references made in the IEs to not only reference paragraph 31, but also paragraphs 17c and 112c, and perhaps others. Even with such repetition in the standard, there is little evidence of application, given the observable gaps in reporting that does not seem to provide such information, most obviously in relation to climate. Calling out several of these overarching references may help underline the clear need for requirements to be met.

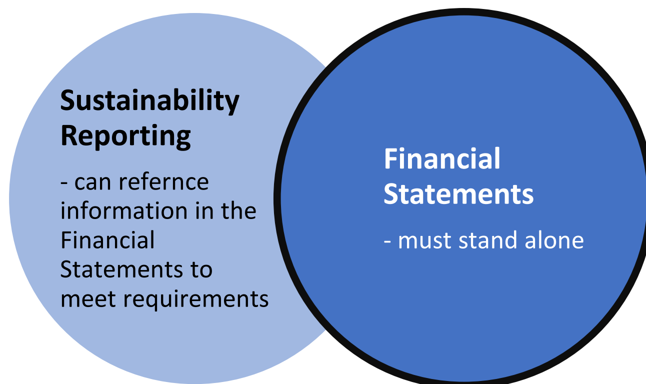
4. **The financial statements must stand on their own – sustainability reporting cannot fulfil financial statement requirements**

This in part relates to the earlier points on consistency and compliance with IFRS (see our response to Question 2, point 3). However, there is a further point to stress: that the financial statements must stand on their own, complying with IFRS accounting standards, independent of any accompanying or other information published by the company.

Sustainability reporting information is often made available within or outside the annual report, and improvements will be made as new requirements such as those produced by the ISSB are implemented. But none of this compensates for deficiencies in the application of IFRS financial statement reporting requirements. Information needed to make the financial statements complete must be in the financial statements.

While we don't see this as precluding cross references in the financial statements to outside information that may be helpful to investors, these should not be used to incorporate information that is necessary to fulfil financial statement requirements. Additionally, information needed to meet requirements for the financial statements would not be omitted just because the financial statements were presented together with other information, rather than on their own.

Some commentators have expressed concern that providing additional disclosure such as that suggested by the IEs would lead to duplication, even double counting of information for investors. Based on the above, we don't see this as a realistic concern. The IASB (as well as auditors and regulators) must hold the line and promote disclosure according to their own requirements for the financial statements. However, the ISSB's requirements address this by allowing for required information to be included in sustainability-related financial disclosures by cross-reference to another report published by the entity, including the financial statements.



APPENDIX II – COMMENTS ON INDIVIDUAL DRAFT IES

This Appendix provides additional suggestions on the individual draft IEs. Some common themes across them include:

- **IE Titles.** We recommend that each IE be given a more descriptive title that conveys both the nature of the fact pattern and the relevant disclosure consideration. The current draft only addresses the relevant standard containing the disclosure requirement, and even some of those lack in specificity of which aspect of an overall standard is illustrated.
- **Background/fact patterns.** The wording of some of these IEs can create the impression that their application would be more narrow than is necessary. Many will apply by analogy where facts and circumstances of a company may differ, but application of the principles can be replicated. Additionally, it is helpful if the relevant financial statement item and expected concern is made very clear, to demonstrate the logic connecting the climate issue to the accounts.
- **Notes for context – to make the use of the illustration more clear.** We have included some additional notes for each IE that could make their scope more clear, potentially improving how each is used. These could be added to the individual IEs, to the relevant IASB documents published to accompany the relevant standards that the IEs will be added to, and/or to the single document in which the group of IEs will be published. In addition, for those IEs not addressing overarching requirements of IAS 1, these would always be relevant to consider.

EX1 – MATERIALITY JUDGEMENTS LEADING TO ADDITIONAL DISCLOSURES (IAS 1.31/IFRS 18.20)

This example illustrates one of the most concerning gaps in disclosure of climate-related matters in the financial statements, the disclosure of material information that is needed to make the financial statements understandable to investors. While we have often heard comments over the last decade about the requirements of IAS 1.31 in relation to removing disclosure that obscures material information (aka cutting clutter), the second half of the paragraph on considering disclosure that needs to be added as it will provide material information, seems to have a much lower profile, which this illustration seeks to emphasise. We also note that paragraphs 17c and 112c have similar requirements, and suggest that a references to those also be added.

In spite of several very consistent references to overarching requirements, we find it often remains unclear how in cases similar to the illustration, the potential for impairment or changes to depreciation for shorter remaining lives or lower residual values, or for those with decommissioning or asset retirement obligations (AROs), these have been considered. Frequently, it cannot be determined from the information disclosed, whether climate:

- Has not been considered at all;
- Is in the process of being considered, but for example the company may not yet have identified how specific assets in the portfolio are to be impacted; or
- Such issues were already considered and no quantitatively significant adjustment resulted. This might be the case for a variety of reasons including: low asset carrying values, limited reliance on residual values, relatively short remaining lives, a ‘business-as-usual’ schedule of replacement, significant headroom under exists impairment tests, etc.

As a result, we consider this Illustration to focus on an extremely important element of IFRS requirements, qualitative aspects of information that mean it is material (see also item 1. of our response to Question 3).

We suggest the following would make the illustration both more clear and relatable to similar circumstances.

1. **Remove the potential implication that information in 'a general purpose financial report' outside the financial statements is necessary before additional financial statement disclosure would be considered under IAS 1.31.**

We strongly support the ISSB standards and also fully support coherent reporting, where for example sustainability reporting and financial statement reporting in an annual report appears to be consistent, connected, etc. We also consider that information on transition plans would generally be provided in sustainability reporting.

Nonetheless, we are concerned that the fact pattern may inadvertently suggest that it is the fact that disclosure was made in 'a general purpose financial report outside the financial statements' (we'll refer to this as sustainability reporting) that gives rise to the need for material information to be disclosed in the financial statements. While existing facts and circumstances are considered to inform judgements on both sustainability reporting and financial statement disclosure under the respective requirements, financial statement disclosure has no dependency on disclosure in the sustainability reporting. Sustainability reporting information is not (and should not be) a necessary condition within the IFRS accounting requirements for financial statement disclosure.

Additionally, the lack of any other information on climate-related risks being disclosed as part of the fact pattern may make the illustration less realistic. It may also add to the implication that financial statement disclosure only responds to information disclosed in sustainability reporting.

We suggest that it be made clear the same conclusion on financial statement disclosure would result in a circumstance where the fact or existence of the transition plan would lead to a reasonable expectation that assets in the balance sheet could be impacted (i.e. tested and potentially adjusted for impairment), regardless of any inclusion or lack of inclusion in sustainability reporting.

This point also applies to paragraph 1.8 of the ED (qualitative factors considered), whereas it is knowledge of industry transition risk and the company's own transition plans that give rise to potential concerns for overstatement of assets and the need for disclosure of additional material information in the financial statements, not the specific disclosures it makes in the sustainability reporting.

2. **More direct language could improve linkage between the transition plan and the relevant accounting items in Property, Plant and Equipment (PPE)**

When considering the potential relevance (in this case of a transition plan) to the understanding of the current financial statements, the terminology used in the IE is somewhat vague in suggesting 'future investments in energy-efficient technology and changing its raw materials and manufacturing

methods'. While the plan may focus on future capex and processes/materials that are less emissions intensive, the relevant accounting link would be to a potentially significant adjustment to financial statement items. Here it is the risk of significant impairment (or depreciation) – a quantitative adjustment to the existing PPE assets, as compared to development of new technologies or something else, for example.

We suggest clarifying the link between a plan for future capex and how this logically may raise concerns over the potential for early replacement of existing PPE and/or updating of facilities for new methods and raw materials, and therefore changes to the existing PPE on the balance sheet (i.e. impairment, shortened lives, reduced residual values for assets using old technology). In fact, this is the sort of linkage these illustrations can best help to make, so it's worth stepping through the logic in a direct manner to demonstrate the linkage very obviously, as this may help to achieve the aim of demonstrating the principles and how they apply, encouraging more understandable disclosure.

We also consider that paragraph 1.9 indicating that disclosure would explain why the transition plan has no effect on its financial statements, could be more clear. A cross reference back to paragraph 1.3, where the reasons are described could be helpful. The specific disclosure made would provide information on these reasons, for example the company could provide the disaggregated carrying amount of the PPE that will be replaced, could state the replacement would take place when the assets would reach their normal end of life and/or might indicate their average remaining lives. However, the point is to provide information that conveys an understanding of why it is that no adjustment has been made when, based on more limited information, the PPE values could not have been understood relative to the climate-related matters in the fact pattern.

3. User expectations – the risk of increased depreciation expense should be added to impairment risk

The illustration suggests that users might expect some assets to be impaired. This is appropriate, but it would be helpful to broaden this slightly to include depreciation. Where there is concern over impairment, there is often a parallel risk of potential shortened asset lives and/or reduced recoverable values for PPE that uses older technology, either of which would increase depreciation charges in the future, and require disclosure relating to changes in estimates.

Given the extremely high level of aggregation typical of PPE disclosure, it is also seldom clear whether various component assets are substantially depreciated and the carrying value therefore low, and remaining lives are not often disclosed. In other words, generally the situation cannot be understood currently without additional disclosure.

4. Notes for context – to make the use of the illustration more clear

These might usefully include:

- the IE only deals with impairment (and depreciation) in relation to existing PPE.
- it does not address any other aspects of the transition plan, any consideration of associated commitments and obligations re provisions and contingencies and not necessarily any element of disaggregation (EX8) that might contribute to a better understanding.

EX2 - MATERIALITY JUDGEMENTS NOT LEADING TO ADDITIONAL DISCLOSURES (IAS 1/IFRS 18)

We agree that the illustration of circumstances leading to no additional disclosure having applied the same principles illustrated in EX1, is helpful. Not all companies will have financial statement items that are sensitive to climate related matters including risks and uncertainties, emissions reduction commitments, etc.

See comments in relation to Example 1 and references to sustainability reporting, as these also applicable to this example.

1. **Adding linkage in the fact pattern to a potentially relevant asset, for example goodwill, would be more realistic for any consideration of disclosure to be made**

We suggest it might be more realistic to give the company some jeopardy in terms of potentially significant accounting issues, such as goodwill balances that are monitored for impairment. This would illustrate the linkage to potentially relevant accounting amounts; without this it is unclear why there would be any need to consider additional financial statement disclosure.

With goodwill potentially 'at risk', then it is the lack of climate-related risk, given the business and financial risk exposure of the industry and company, including limited exposure to transition risk, low emissions, and a policy to maintain such low levels of emissions, that all drives the conclusion that no additional disclosure is needed in relation to the goodwill impairment consideration.

2. **Remove the suggestion that 'no impact' needs assessing – no goodwill impairment charge would be sufficient**

The link to goodwill impairment consideration would also give a context to the statement there is no effect, i.e. no impairment adjustment. Otherwise, a general statement on 'no effect' may not only be unnecessary to the illustration, but difficult to support. Maintaining such an emissions policy could impact costs/margins, project costs capitalised, even revenue recognition, etc. in the current set of financial statements and beyond. Such impacts could be positive or negative, but supporting that they have all been nil, is not necessary to the illustration.

3. **Notes for context – to make the use of the illustration more clear**

These might usefully include:

- The IE only addresses goodwill impairment (or insert another potentially relevant topic).
- It does not address any other aspects of the emissions policy, etc.

EX3 – DISCLOSURE OF ASSUMPTIONS: SPECIFIC REQUIREMENTS (IAS 36)

This example is helpful in demonstrating the sort of disclosures required under IAS 36 on impairment, and implicitly confirming that such climate-related assumptions (here, the cost of emissions allowances under increasingly widespread regulation) should be both made (including beyond the application of standard growth rates commonly used after an initial forecast period) and be disclosed.

It may be helpful however to make this more explicit in the fact pattern as suggested in the following points.

1. **Adding to the fact pattern that amounts for allowances and provisions currently are not quantitatively material, would make more the IE more realistic**

It could be added to the background, that the amounts recognised for allowances and provisions for excess emissions are not currently quantitatively material. This would help illustrate that even if not currently quantitatively material, best estimates of future cash flow amounts would be included in such estimates. This is an important distinction between transactional accounting and how the cash flows are included in the best estimate of future cash flows used in impairment testing.

2. **Revise wording to ensure consideration in best estimates of climate-related cash flows in any test for impairment – regardless of why it is being performed**

The illustration is made in the context of testing goodwill for impairment 'at least annually'. We suggest removing this reference, as the illustration is on value-in-use calculations as part of any test for impairment, whether annual, driven by a climate related trigger, or driven by some other trigger that could be totally unrelated to climate.

3. **Notes for context – to make the use of the illustration more clear**

These might usefully include:

- in addition to stating that other costs of managing climate-related risk are not addressed, note 1 to the IE could also make clear that nor are other assumption made in the value in use calculation (whether climate related or not),
- the IE also excludes the actual accounting for the emission allowances, any provisioning for excess emissions, and the overarching disclosure requirements in IAS 1.

EX4 – DISCLOSURE OF ASSUMPTIONS: GENERAL REQUIREMENTS (IAS 1/IAS 8)

This illustration is helpful in addressing, in the context of very common circumstances of significant transition risk and assumptions being made in relation to impairment of non-current assets, disclosures that would be made in when there is a significant risk of changes resulting in a material adjustment in the next year. We agree there is nothing in paragraph 125 that suggests it only applies if uncertainty will be fully resolved in the next year. This does not appear to be a question of interpretation, rather application of the requirements as written. Further suggestions are included in the following points.

1. **Make it very explicit in the title that this only addresses the requirement re significant risk of a material adjustment in the next year (para 125)**

While it is apparent that this illustration only addresses the application of paragraph 125 (through 129) of IAS 1, it may be particularly important to make this explicitly clear in how it is titled, as well as any notes for context. This is because in our experience, some seem to hold a view that as long as disclosure is considered under para 125 (whether it is provided or not), other requirements can be

skipped, specifically the overarching requirements of paras 31, and 112c regarding any additional disclosure needed to make the financial statements understandable and para 17c relating to fair presentation, that apply whether or not there is likely change in the next year.

2. Notes for context – to make the use of the illustration more clear

These might usefully include:

- the overarching requirements of IAS 1 in paras 31, 112c and 17c have not been considered in the IE, even in relation to the narrow topic of impairment of non-current assets.
- other considerations relating to non-current assets have also not been addressed, for example relating to depreciation (changes to remaining lives or residual values).
- no other accounting balances that are potentially impacted by the range of assumptions referred to, such as the carrying amount of provisions and contingent liabilities related to asset retirement obligations, have been considered.

EX 5 – DISCLOSURE OF ASSUMPTIONS: ADDITIONAL DISCLOSURES (IAS 1/IFRS 18)

The fact pattern in this IE is relatable, in terms of emerging regulation to restrict the ability to operate and generate profits, at least in relation to emissions-intensive products and activities that may comprise a significant portion of some businesses. Additionally, deferred tax assets may not be one of the first topics that comes to mind in relation to climate, but for some companies with recovery of significant balances at risk, these will be important to consider. This example also helpfully addresses both the paragraph 125 disclosures and goes on to address the overarching requirements of para 31.

1. Make explicit that all of the separate requirements of para 125 and 31/112c/17c must be considered – there is no hierarchy (or decision tree)

We suggest making it more explicit that these requirements would all be considered. In the IE as drafted, no disclosure is added in relation to para 125, but even where a company does consider it necessary to add disclosures in relation to paragraph 125, the overarching requirements would still need consideration. There is no hierarchy or decision tree – the requirements are separate, and all must be met.

2. Notes for context – to make the use of the illustration more clear

These might usefully include:

- The IE excludes any other balances potentially impacted by regulatory limitations.

EX 6 – DISCLOSURE ABOUT CREDIT RISK (IFRS 7)

This example is helpful to include, given that lenders (the example focuses on loan portfolios) and investors in company equity and fixed income instruments may all be exposed to climate risk via portfolio companies that have the range of issues otherwise explored in the IEs. This is in fact a general point in relation to strong interest from investors that seek to understand their investment risk, including concentrations of climate risk, associated vulnerabilities, and the direction of travel in mitigating these.

1. **Add disaggregation of the balance sheet amounts in question**

We recommend that the IE be revised to specify that the company would quantify the amounts these two groups of climate-exposed assets represent on the balance sheet, and consider disaggregating other quantitative information needed to understand these instruments included in the financial statements.

2. **Notes for context – to make the use of the illustration more clear**

These might usefully include:

- the overarching requirements of IAS 1 are not addressed.

EX 7 – DISCLOSURE ABOUT DECOMMISSIONING AND RESTORATION PROVISIONS (IAS 37)

This IE addresses a key issue for many carbon intensive sectors, not only oil & gas, but also mining, utilities, and industrials sectors including cement and chemicals. With decarbonisation potentially bringing decommissioning or asset retirement obligations (AROs) forward in time, investors need to understand the measurement of balance sheet provisions such as those addressed in the IE. We have several suggestions to improve the IE, and we also raise concerns regarding off balance sheet obligations that do not appear to be addressed by the IEs. (See also Appendix III.)

1. **Highlighting a significant gap between the expected timing of closure (cessation of depreciation) vs the timing of decommissioning and restoration would make the fact pattern more realistic**

While the fact pattern assumes that the company will continue to maintain and operate the facilities for an extremely long time, it would be helpful to specify in the fact pattern that this means considerably beyond the remaining useful life that is being used for depreciation calculation. Where information is disclosed on assets in similar circumstances, this sort of gap is increasingly seen, and would add to the realistic nature of the example. This also relates to para 7.4(b) of the IE, where we suggest adding a reference to the impact of the facility's future use on the amount and timing of decommissioning and restoration costs, not just the impact on the timing of when the facility closes. Ultimately it is the timing of the costs that is necessary to determine the decommissioning provision.

2. **Quantitative materiality – the wording seems unclear**

In para 7.2 of the IE, it isn't clear to us when it refers to 'the costs…when discounted to present value, their effect on the carrying amount of the provision is immaterial'. This may be a small matter of redrafting to focus on the present value itself (rather than the costs) being considered quantitatively immaterial, and the context for this. For example, does it mean that the present value of these obligations is quantitatively immaterial? Is this considered relative to the financial statements as a whole, or some other reference point that could be stated?

3. **Make clear in the fact pattern <u>how</u> the best estimate of the provision amount was made**

Paragraph 7.2 indicates that ‘there is increasing risk that the entity might be required to close some of its petrochemical facilities earlier than it expects because of efforts to transition to a lower-carbon economy.’ It would be helpful to make clear that the timing the company expects, is also what has been assumed in calculating the provision. This would provide more context for understanding the ‘earlier’ reference – i.e. earlier than what has been assumed in the provision.

Indicating how the company has made its best estimate of future cash flows would provide context, for example it would be particularly helpful to base the illustration on a situation where the estimated costs and their timing has been determined on a probability weighted basis. (See next point for an existing IE that uses a different basis of determining the best estimate.)

Details such as this would be useful to make the illustration relatable, and using probability weighting would also demonstrate this approach to applying the requirements for provisioning, relative to companies that currently leave obligations off balance sheet on the basis they cannot determine a range of possible outcomes. While the standard itself suggests this should be an ‘extremely rare’ situation, it appears to have become prevalent for certain sectors and obligations. See Appendix III.

4. **Referencing the existing disclosure example 2 in the implementation guidance to IAS 37 on decommissioning costs might bring it into greater use**

We note that IAS 37 already has an Illustrative Example relating to nuclear decommissioning (see box below). We recommend adding a reference in the new example to the existing one. The existing example illustrates a different approach to measurement of the liability, basing it on timing of 60-70 years, corresponding to the earliest estimate of when the decommissioning will take place. The illustration goes on to say that disclosure would be made of the possibility of the timing to instead be extended to 100-110 years. It also quantifies the impact including the corresponding reduction in the provision, if that were to be assumed.

Existing Illustrative Example on Decommissioning costs (aka AROs) within IAS 37
Example 2, disclosure of provisions that have been recognised on the balance sheet

In 2000, an entity involved in nuclear activities recognises a provision for decommissioning costs of 300 million. The provision is estimated using the assumption that decommissioning will take place in 60–70 years’ time. However, there is a possibility that it will not take place until 100–110 years’ time, in which case the present value of the costs will be significantly reduced. The following information is disclosed:

‘A provision of 300 million has been recognised for decommissioning costs. These costs are expected to be incurred between 2060 and 2070; however, there is a possibility that decommissioning will not take place until 2100–2110. If the costs were measured based upon the expectation that they would not be incurred until 2100–2110 the provision would be reduced to 136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2 per cent.

While this isn't climate-specific, it is highly relevant for carbon-intensive businesses with decommissioning obligations. The energy transition and potential acceleration of asset closures, as well as the potential for re-purposing some facilities, mean there is potential for significantly

accelerated timing, or for some, timing may be deferred. This could mean significant adjustment of provisions on the balance sheet, and full recognition of some obligations that at the moment remain entirely off-balance sheet.

5. Assumptions and estimates – more information is needed to understand these obligations

The example also illustrates that in this case, the company booked a liability and disclosed certain information. Paragraph 7.4b of the IE calls for disclosure of the major assumptions made concerning future events, for example the future use of each of the main petrochemical facilities, where necessary to provide adequate information. This would also help make the gap between closure and ARO outflow assumptions understandable.

We consider that for some companies, there may also be a need to provide additional information on assumptions and estimates used in determining the provision, in order to understand the significance of related obligations, the risk of earlier than expected settlement, the size of the outflows that will be required to settle the obligations, etc. – in other words the factors that have driven the decision that information about the obligations is needed.

The need for such information is further supported in considering the overarching requirements of IAS 1 paras 31, 112c and 17c. In relation to potentially significant information on AROs, it is necessary to add consideration of disclosing information that broadly parallels company present value calculations, such as the:

- Current estimated costs of meeting the obligations – at the balance sheet date;
- Expected timing of cash flows to meet those obligations;
- Inflation rate(s) applied for the timing of the expected cash flows;
- Undiscounted cash flows (current costs, increased for inflation up to the expected timing);
- Discount rate(s) applied to the undiscounted cash flows; and
- Present value – the provision on the balance sheet (undiscounted cash flows discounted to the present).

Such disclosure would provide an understanding of the significant dynamics involved in estimating the financial amounts associated with the balance sheet provision. We note that some companies have begun providing such disclosures, particularly in the oil and gas sector (see Appendix III for bp disclosure that demonstrates this).

6. Notes for context – to make the use of the illustration more clear

Useful notes could specify that:

- The IE does not address accounting for the related PPE assets, depreciation or impairment.

See also Appendix III regarding additional concerns over the prevalence of unrecognised AROs, and generally limited disclosure provided.

EX 8 – DISCLOSURE OF DISAGGREGATED INFORMATION (IFRS 18)

We think this addresses another very important topic, with there frequently being a question how large or small a component, or the components of a highly aggregated amount, may be. We note that this could likely be a very helpful IE to consider in relation to many of the topics addressed in the previous seven IEs.

1. **Consider whether this could be brought forward for consideration before IFRS 18 implementation**

It's not clear why this example is 'deferred' until IFRS 18 becomes applicable starting with 2027 calendar year-end reporting. The language in IAS1 appears to be sufficient, perhaps utilising similar references to disaggregation (paragraphs 29-31), including the overarching requirements of not obscuring material information with other information (paragraph 30A) and providing material information (information to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance under paragraph 31/112c/17c.

2. **We support the context of 'whenever the resulting disaggregated information is material' – in the full sense of materiality including qualitative aspects of information**

Additionally, it is helpful that the illustration indicates disaggregation whenever the resulting disaggregated information is material. Full disaggregation across all disclosure requirements of paragraph 73 of IAS 16 may in some cases not provide material information. For example the carrying values of a subset of PPE assets may represent material information as it characterises the (in)significance of the remaining asset base, but a fully detailed reconciliation of all movements for a disaggregated, relatively insignificant component of PPE, may not be needed.

APPENDIX III - UNRECOGNISED AROS STILL NEED ADDRESSING

We applaud the steps the IASB is taking in the context of Illustrative Examples on disclosure as part of the project *Climate-related and Other Uncertainties in the Financial Statements*. However, there is one critical climate-related issue that still needs addressing. That is the prevalence of off balance sheet decommissioning (or asset retirement) obligations (AROs), in the face of climate-related risks and decarbonisation that may bring such obligations onto the balance sheet as provisions. We note that Shell has done this for certain of its previously off balance sheet amounts. In 2020 Shell recognised provisions of $0.9bn for certain shorter-term AROs for manufacturing facilities in Oil Products. Other longer-term AROs remain off balance sheet.

ARO obligations are generally incurred when the asset to which they relate is commissioned or purchased. Such obligations may exist under current legislation, or they may arise from a company's actions that confirm it accepts certain responsibilities to undertake such decommissioning activities, respectively legal or constructive obligations. They are independent of the future use of the asset (which may in fact result in further remediation and environmental obligations over time). Such AROs exist across many industries where this is likely to be important – not only oil & gas, but also mining, utilities, and industrial sectors including cement and chemicals.

There are several different elements of AROs that can be of concerns to investors, relating to:

- **Tangible assets that are on the balance sheet.** These include oil/gas/coal reserves, production facilities, etc. The corresponding provisions may be recognised on the balance sheet or remain off balance sheet.
- **Guarantees and joint/several liability by regulation/legal risk.** These often relate to assets previously sold or transferred, that are no longer on the balance sheet of the company.
- **Investment in joint ventures, associates, or company securities that are exposed to such risks**. Any ARO obligations are implicitly included in the value of such investments.

We focus here on the first category, although if significant risks are present, the second and third can present similar concerns.

While AROs may not specifically relate to climate given that they already exist as obligations, transition risk and decarbonisation pose additional risk that they may be brought forward in time. For AROs that are accounted for in provisions, their valuation is typically based on the discounted present value of expected cash flows to settle them in the future, which would be increased if timing is brought forward. Cost estimates may also be updated, whereby increases from the amounts expected previously would also increase the balance sheet provision. And for those that are currently off balance sheet, provisions may need to be increased by the full amount of obligation coming onto the balance sheet.

Disclosure of ARO provisions on the balance sheet

ARO provisions are typically calculated by estimating the present value of the obligations, based on estimates of the associated cash flows to settle them in the future. We note that some companies have begun providing disclosure of components of the calculation, particularly in the oil and gas

sector. The approach is illustrated in the table below, including information provided by bp on its asset retirement provisions for upstream assets.

Calculation components	Bp Annual Report and Form 20-F 2023 p184, 341
1. Current estimated costs of meeting the obligations – at the balance sheet date	**$17.9bn***
2. Expected timing of cash flows to meet those obligations	$5.5bn within 10 years, $5.8bn 10 to 20 years, $6.6bn after 20 years.
3. Inflation rate(s) applied for the timing of the expected cash flows	1.5%
4. Undiscounted cash flows (result of the current costs, increased for inflation up to the expected timing)	**$24.0bn**
5. Discount rate(s) applied to the undiscounted cash flows	4%
6. Present value – the provision on the balance sheet (result of undiscounted cash flows being discounted to the balance sheet date).	**$12.4bn****

*This is described as the 'undiscounted cash flows in real terms for upstream decommissioning'. However, it appears to be the current estimate of costs.
**bp also discloses sensitivity information for changes in estimated costs, timing, and inflation and discount rates.

While Bp provides disclosure that enables the understanding provided in this table, many companies do not appear to provide much of this information. For example, some only seem to make clear the amount included in provisions (point 6) apparent on the balance sheet or tables in a corresponding footnote. Neither the current estimate (in this case 44% higher), nor the undiscounted cash flows (in this case 93% higher), are disclosed.

While Illustrative Example 7 addresses certain aspects of disclosure relating to recognised provisions, we have two key concerns in relation to AROs that remain off balance sheet, including the appropriateness of non-recognition and disclosure of unrecognised AROs.

Non-recognition – is this appropriate?

In a small sample of six 2023 annual reports of European Oil & Gas majors that we reviewed, at least half had unrecognised AROs, with the other half having not provided sufficient information for their position to be understood. It is not clear whether they have none, or have not provided the disclosure required under IAS 37 paragraph 86 (addressed below).

For those that do provide some disclosure of the reasons for not-recognising provisions, these include statements that:

- **Bp (p184)** Obligations for 'downstream refineries are generally not recognized, as the potential obligations cannot be measured, given their **indeterminate settlement dates**. Obligations may arise if refineries cease manufacturing operations and any such obligations would be recognized in the period when sufficient information becomes available to determine potential settlement dates'.

- **ENI (p255)** 'Any decommissioning and restoration provisions associated with the other operating segments' assets, given their **indeterminate settlement dates**, also considering the **strategy to reconvert plants** in order to produce low carbon products, are recognised when it is possible to make a reliable estimate of the discounted abandonment costs'.
- **Shell (p312)** 'while there is a present obligation that has arisen from past events, the amount of the obligation cannot be reliably measured. This is because the **settlement dates are indeterminate**; and **other estimates, such as extremely long-term discount rates for which there is no observable measure, cannot be reliably determined'**.

All three examples cite indeterminate settlement dates as a reason for not recognising provisions. Related to this, ENI also mentions its strategy to transition facilities to low-carbon products. Having not recognised provisions previously, some companies are adopting strategies to transition facilities to low-carbon products. While this won't always be feasible or undertaken, this suggests an additional reason for timing being considered indeterminate.

'Indeterminate' is a term borrowed from US GAAP. It does not appear to be defined in US GAAP, and the requirements give many suggestions on how expected present value techniques should be used to address uncertainty, and confirm that uncertainty is factored into the measurement of the fair value of the liability through assignment of probabilities to cash flows.

The Merriam-Webster definition of indeterminate is 'not definitely or precisely determined or fixed'. However definite or precise determination is not the requirement under US GAAP or under IAS 37, which indicates that 'Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision.'

We have already suggested that it would be helpful to indicate in Illustrative Example 7 the approach taken by the company to determining the best estimate required for measurement of the provision. In particular, a case where the estimated costs and their timing were determined on a probability weighted basis, would add this approach alongside the existing Illustrative Example 2 on provisions, where a different approach has been taken.

While all relevant facts and circumstances should of course be taken into consideration when a company determines whether a provision is required, the question remains whether the IFRS requirements that should result in non-recognition only in 'extremely rare circumstances', are being applied appropriately. Without additional disclosure, it is not possible for investors to understand why this is so often considered to be the case.

Disclosure of unrecognised obligations (IAS 37 para. 86) - does lack of precise timing absolve companies of required disclosure?

The examples on AROs thus far (EX7 in the ED and existing Example 2) address disclosure relating to provisions. By analogy, we believe that EX7 which addresses a quantitatively immaterial provision amount, could also be directed at considering additional information needed to provide an understanding of a quantitatively material provision. For example, the bp example above shows the

disclosure of assumptions and estimates that the company has already provided in its 2023 financial statements. We have suggested this be called for in our comments on EX7.

But we think the disclosure of unrecognised amounts also needs improvement, applying the requirements in paragraph 86 relating to contingent liabilities. These call for a 'brief description of the nature of the contingent liability and, where practicable: (a) an estimate of its financial effect' and '(b) an indication of the uncertainties relating to the amount or timing of any outflow'. If it is 'not practicable' to disclose such information, that conclusion requires disclosure.

Referring back to how estimates of the financial effect of such provisions are made (the bp example above), estimated timing is a necessary component for calculating the present value of a provision. However, in a case of timing not being sufficiently known to support a reliable estimate, it would still be possible to disclose the element representing the current estimate of costs to settle the obligation (point 1 in the table). This would give a sense of size and importance of the off balance sheet AROs. Even if this amount is quantitatively small, confirmation of this could in some cases provide material information to investors that would otherwise not understand the limited extent of risk.

Additionally, the uncertainty on timing (in relation to the second point in the calculation), already requires disclosure under paragraph 86. A company could also consider going on to consider this in relation to factors in points 3-6, for example it might consider that providing estimated present value amounts based on assumed timing scenarios (i.e. if in 20 years or if 50 years and corresponding inflation and discount rates), would provide material information given the significant dynamics of AROs illustrated by the bp.

The ask in summary

We ask the IASB to consider additional guidance relating to these remaining concerns. Some may also be suitable topics for its Interpretations Committee, while for others a more robust challenge by auditors and accounting/audit regulators may be needed to encourage application. But the key questions are:

- Widespread Non-Recognition: Is the prevalence of unrecognised AROs appropriate?
- Minimal Disclosure:
  - Should a company that does not record a provision due to the uncertainty of timing, disclose at least an estimate of current cost to settle the obligation, or is it fully absolved of disclosing information on financial significance?
  - Are other required disclosures being provided for unrecognised AROs? And if not, why?