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## Emerging Economies Group meeting

Date	May 2023
Project	Climate-related risks in the financial statements
Topic	Project scoping
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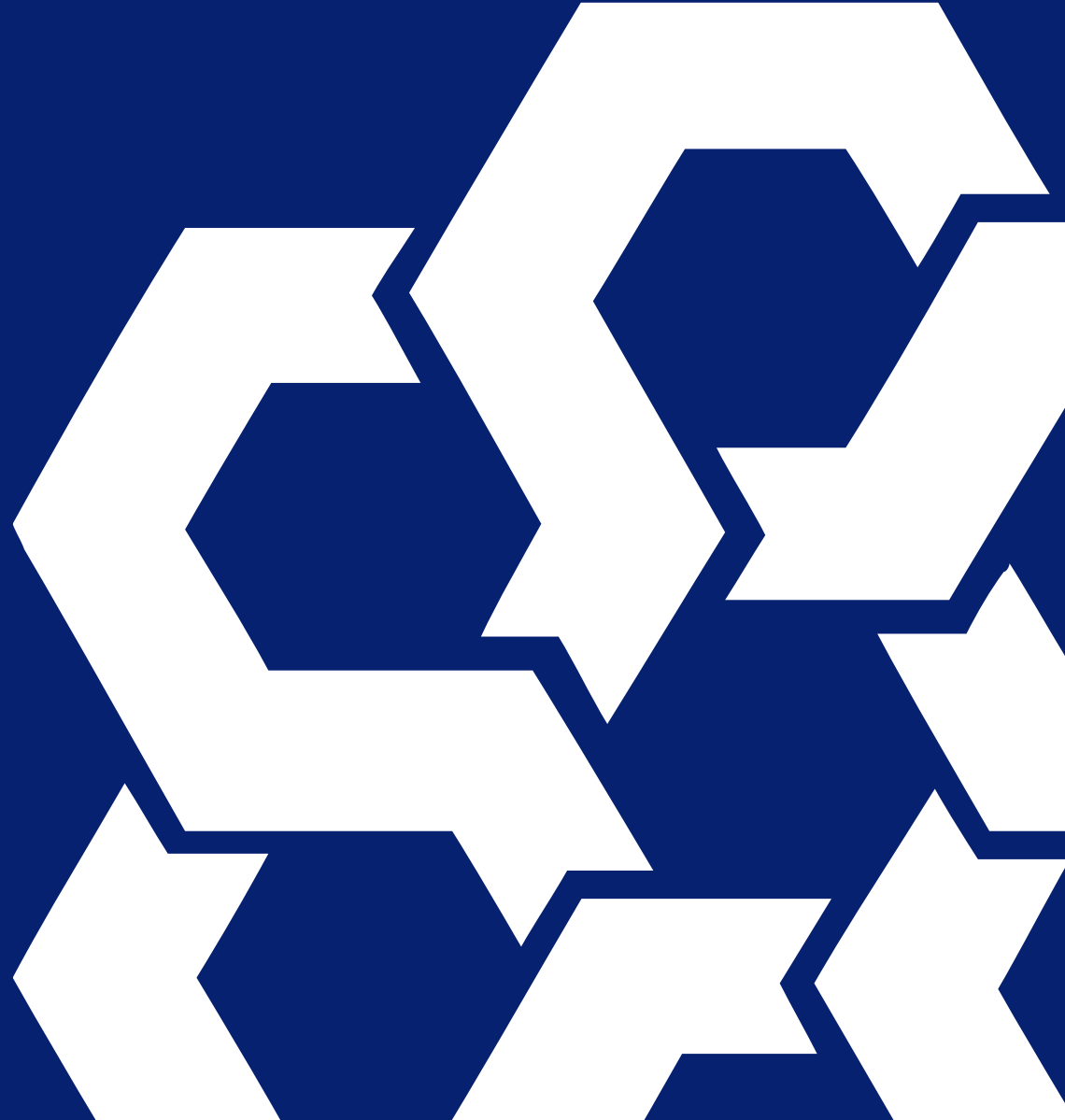
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## Purpose of the session

- To provide background about the project
- To obtain your feedback on stakeholder concerns about the reporting of climate-related risks in the financial statements.

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# Background



# Origin of the project



- Stakeholders, especially users of financial statements, are increasingly interested in the effects of climate-related risks on the financial statements
- Questions about why IFRS Accounting Standards do not explicitly refer to climate-related risks
- Concerns about possible inconsistent application of Accounting Standards to climate-related risks and insufficient information about climate-related risks in financial statements



- Educational material published to explain how Accounting Standards already require entities to consider the effects of climate-related risks in the financial statements
  - November 2020 educational material on the [Effects of climate-related matters on financial statements](#)
  - November 2019 article [IFRS Standards and climate-related disclosures](#)



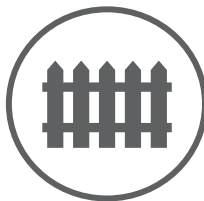
- In the Third Agenda Consultation, respondents attributed high-priority to a project on climate-related risks in the financial statements
- Feedback unclear about the nature and causes of concern and the possible courses of action to take
- IASB added a narrow-scope maintenance project to its agenda

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## Purpose and focus of the project



- **Explore whether and how financial statements can better communicate information about climate-related risks;**
- Explore the nature and causes of stakeholder concerns about the reporting of climate-related risks in the financial statements;
- Consider possible courses of action, if any.



- This project will not seek to:
  - develop an Accounting Standard on climate-related risks, or extensive application guidance on how to consider the effects of such risks when applying Accounting Standards;
  - broaden the objective of financial statements or change the definitions of assets and liabilities;
  - develop accounting requirements for pollutant pricing mechanisms<sup>1</sup>.

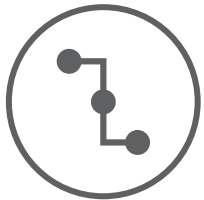
**IASB Accounting Standards already require entities to consider climate-related matters when the effect of those matters is material**

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<sup>1</sup> *Pollutant Pricing Mechanisms* is on a reserve list of projects that may be added to the IASB's work plan if stakeholders and the IASB have sufficient capacity.

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## How does this project relate to the work of the ISSB?



- **This project and the work of the International Sustainability Standards Board (ISSB) complement each other, helping investors to connect information included in different parts of general purpose financial reports.**
- Sustainability-related financial disclosures explain sustainability-related risks and opportunities and may also provide early indications of matters that will subsequently be reflected in financial statements. For example, a company's commitment to net zero emissions could, over time, result in liabilities being reported in the financial statements.
- We have a stable set of decisions on sustainability-related disclosures to inform this project<sup>1</sup>.

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<sup>1</sup> The ISSB has completed its deliberations on its first two standards and expects to issue an IFRS Sustainability Disclosure Standard around the end of Q2 2023.

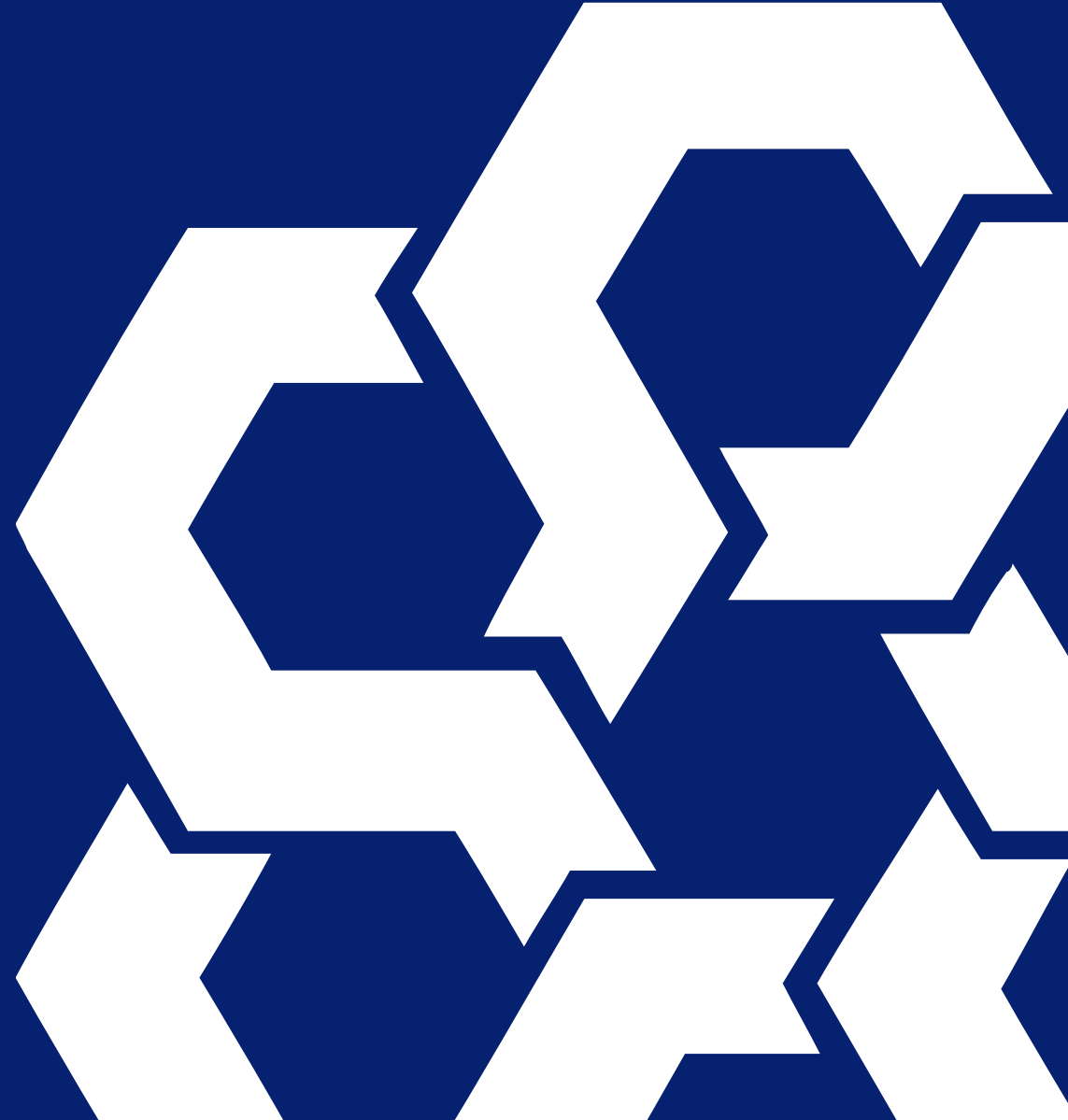
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# Tentative project plan



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Feedback requested in this meeting





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# Questions for EEG members

The Staff are seeking your feedback on:

## 1 Nature of concern

- a) What concerns do you have about the reporting of climate-related risks in the financial statements?
- b) How prevalent is the issue in your jurisdiction?

## 2 Causes of concern

What are the causes of the concerns you identified in question 1? See slides 12–13 for possible causes of concern.

## 3 Courses of action

- a) How could the IASB address these concerns? See slide 14 for possible courses of action.
- b) Do you think the benefits may outweigh the costs of those actions?

Note: In the Appendix we have included some examples of the type of feedback we are interested in.

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# Questions for EEG members

The Staff are seeking your feedback on:

**4****Scope of the project**

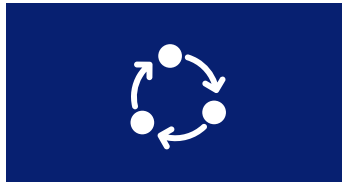
Should the IASB consider expanding the scope of the project to cover:

- risks in addition to those related to climate? and
  - opportunities as well as risks?
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## Possible nature of concerns

We would like your feedback on the nature of the concerns:



**Financial statement information appears inconsistent with disclosures made elsewhere about climate-related risks**

Recognition, measurement and disclosures in the financial statements cannot be reconciled to an entity's other disclosures



**Insufficient information about how climate related risks are reflected in the financial statements, in terms of:**

- a) estimates, assumptions, judgments made;
- b) separate effects of climate-related risks on amounts recognised in the financial statements

Note: This project may not address all concerns identified. The purpose of this meeting is, in part, to identify concerns to facilitate scoping of this project.

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## Possible causes of concerns

We would like your feedback on the possible causes of the concerns:



### **Unclear requirements in Accounting Standards**

Requirements might not be sufficiently clear and/or specific about whether and how the effects of climate-related risks should be considered when preparing an entity's financial statements.



### **Lack of compliance**

Entities might not be (adequately) considering climate-related risks when applying IFRS Accounting Standards because of:

- lack of awareness of requirements;
- misunderstanding of requirements;
- cost and complexity (for example, judgements—including judgements about materiality—might be difficult, information might not be available); or
- other reasons?

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## Possible causes of concerns (cont'd)

We would like your feedback on the possible causes of the concerns:



### **Limitations in IFRS Accounting Standards**

Requirements appear to prohibit or do not capture climate-related risks in measuring and recognising assets and liabilities and in requiring the disclosure of relevant information.



### **User information needs beyond the objective of financial statements**

Some information needs about climate-related risks might go beyond the objective of financial statements and may be more appropriately addressed by Sustainability Disclosure Standards.

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## Possible courses of action

We would like your feedback on courses of action:



To help entities properly consider climate-related risks, the IASB could explore

- possible minor amendments to IASB Accounting Standards
- limited new application guidance
- new illustrative examples
- educational materials

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# Expanding the scope of the project

## Initial staff comments

The IASB could consider expanding the scope of the project to cover:

- risks in addition to those related to climate; and
- opportunities as well as risks.

## Things to consider

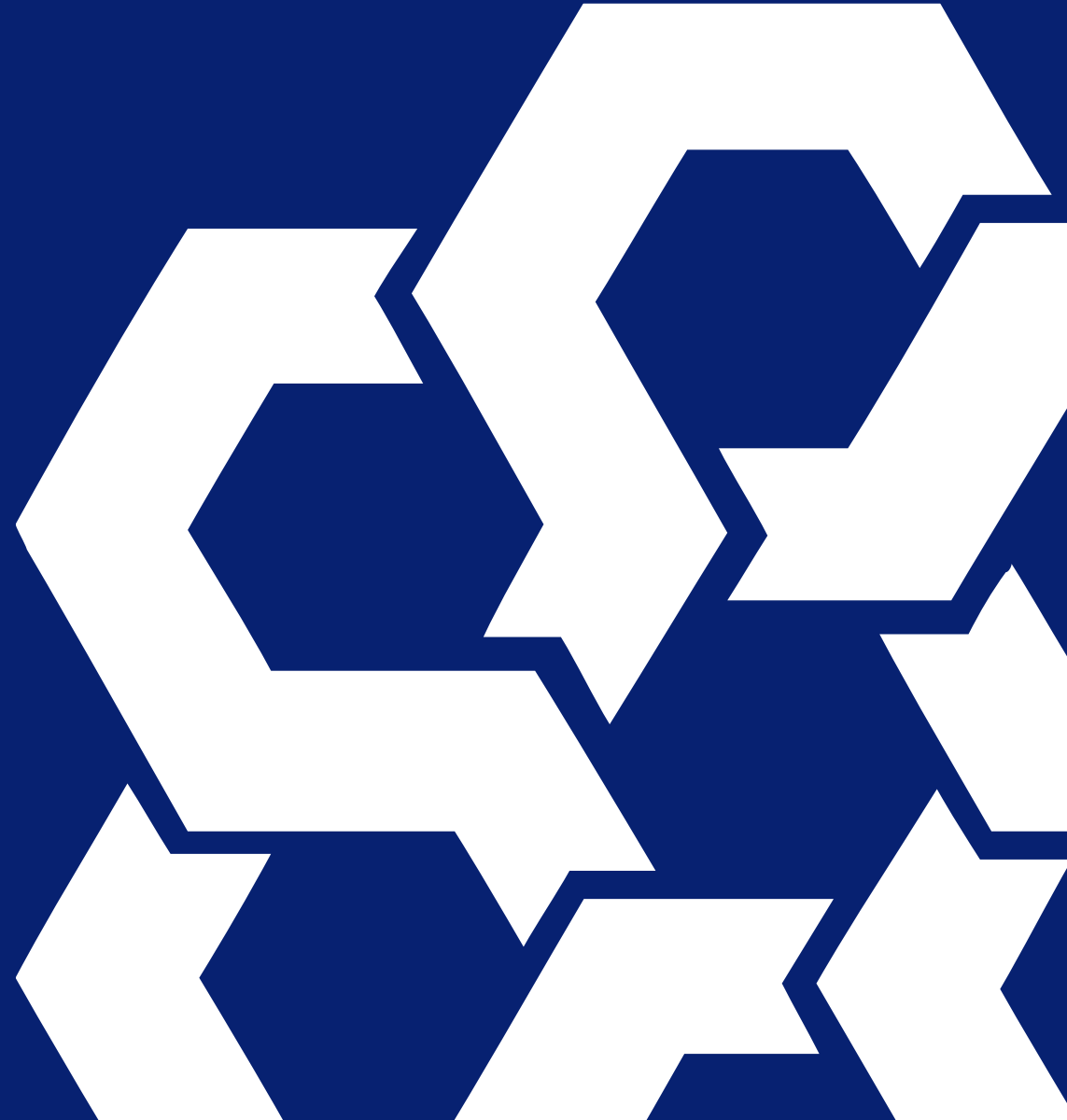
Consistency with the ISSB which in its work considers:

- both opportunities and risks; and
- sustainability-related risks and opportunities because it is not always possible for preparers to separate the financial effects of climate-related risks and opportunities from other sustainability-related risks and opportunities.

Some of the solutions to improve the reporting of climate-related risks in the financial statements may apply to other long-term risks.

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## Appendix—Examples of concerns





# Impairment of assets

<p><b>1 Nature of concern</b></p>	<p><b>Inconsistencies between financial statement information and other information</b></p> <p>Although entities have made net zero commitments they have not impaired the value of their assets as a result of those commitments.</p>
<p><b>2 What are the causes of concern?*</b></p> <p><b>Limitations in IFRS Accounting Standards</b></p> <p>IAS 36 <i>Impairment of Assets</i> requires cash flow projections to be based on the most recent budgets/forecasts for a maximum of five years, unless management is confident that its projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over a longer period.</p>	<p><b>3 What are the possible courses of action?*</b></p> <p><b>Minor amendments to Accounting Standards</b></p> <p>The IASB could consider:</p> <ul style="list-style-type: none"> <li>removing the restriction in IAS 36 cash flow projections to cover a maximum period of five years;</li> <li>amending paragraph 35 of IAS 36 to make it easier to apply the exemption to use financial budgets/forecasts of future cash flows for periods longer than five years</li> </ul> <p><b>Possible costs</b> for this course of action include:</p> <ul style="list-style-type: none"> <li>more difficult judgments</li> <li>risk of less reasonable and supportable information reflected in cash flow projections</li> </ul>

\*Note: For simplicity, this example does not include analysis of all causes of concern and all possible courses of action for this issue.

# Recognition of liabilities

<p><b>1</b> Nature of concern</p>	<p><b>Inconsistencies between financial statement information and other information</b></p> <p>Although entities have made net zero commitments they may have not recognised liabilities as a result of those commitments.</p>
<p><b>2</b> What are the causes of concern?*</p>	<p><b>3</b> What are the possible courses of action?*</p>
<p><b>Unclear requirements in Accounting Standards</b></p>	<p><b>New illustrative examples</b></p> <p>The project Provisions—Targeted Improvements is exploring possible targeted amendments to IAS 37 <i>Provisions Contingent Liabilities and Contingent Assets</i>. The IASB could consider adding an Illustrative Example on a net zero commitment to clarify that simply making a commitment to offset future greenhouse gas emissions does not in itself give rise to a present obligation for an entity and, therefore a provision would not be recognised until the entity has emitted the gas it has promised to offset.</p> <p><b>Possible costs</b> for this course of action – stakeholders may want to change the definition of a liability, but that is beyond the scope of the Provisions—Targeted Improvements project and this project.</p>
<p><b>User information needs beyond the objective of financial statements</b></p>	<p><b>Educational materials</b></p> <p>The IASB could consider publishing educational material to explain the objective of financial statements, the reasons for the definition of a liability and the importance of analysing financial statements and sustainability-related financial disclosures together.</p> <p><b>Possible costs</b> for this course of action – stakeholders may want to change the objective of financial statements, but that is beyond the scope of this project.</p>

\*Note: For simplicity, this example does not include analysis of all causes of concern and all possible courses of action for this issue.

# Disclosure of assumptions and other sources of estimation uncertainty

<p><b>1</b> Nature of concern</p>	<p>Insufficient information about how climate-related risks are reflected in the financial statements</p>
<p><b>2</b> What are the causes of concern?*</p>	<p><b>3</b> What are the possible courses of action?*</p>
<p><b>(Perceived) Limitations in IFRS Accounting Standards / Unclear requirements / Lack of compliance</b></p> <p>Under IAS 1 <i>Presentation of Financial Statements</i>, an entity is required to disclose assumptions made about the future and other sources of estimation uncertainty if they have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year (paragraph 125 of IAS 1).</p> <p>This paragraph may be perceived to prohibit disclosures of other assumptions and sources of estimation uncertainty.</p>	<p><b>Minor amendments to Accounting Standards</b></p> <p>The IASB could consider whether removing the reference to ‘the next financial year’ from paragraph 125 of IAS 1 could result in the disclosure of more information about climate-related risks than entities currently disclose and improve the information available to users.</p> <p><b>Possible costs</b> for this course of action:</p> <ul style="list-style-type: none"> <li>• could such an amendment result in the disclosure of large amounts of forward-looking information about a wide range of risks?</li> <li>• consider amendments to Sustainability Disclosure Standards</li> </ul> <p><b>Minor amendments to Accounting Standards</b></p> <p>The IASB could add requirements to disclose assumptions to specific Accounting Standards.</p> <p><b>Possible costs</b> for this course of action – costly to implement?</p>

\*Note: For simplicity, this example does not include analysis of all causes of concern and all possible courses of action for this issue.

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