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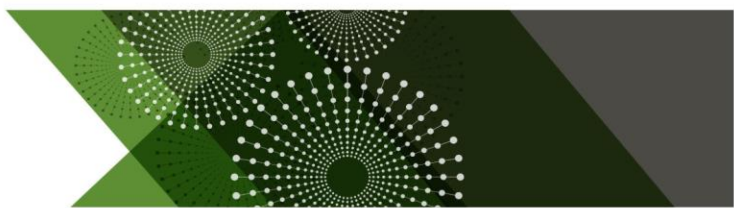
EXTERNAL REPORTING BOARD



Dr Andreas Barckow 28 November 2024

Chair of the International Accounting Standards Board
IFRS Foundation
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Submitted to: www.ifrs.org

Dear Andreas

Re: IASB ED proposing illustrative examples on Climate-related and Other Uncertainties in the Financial Statements

We appreciate the opportunity to comment on the IASB Exposure Draft IASB/ED/2024/6 "*Climate-related and Other Uncertainties in the Financial Statements*" (the ED). We commend the IASB for taking the initiative to address stakeholders' concerns to better reflect climate-related and other uncertainties in the financial statements as interest in this topic increases while challenges are still evolving.

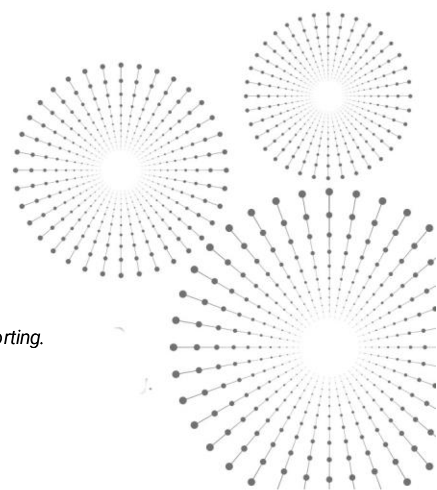
We consider the illustrative examples in the ED a valuable starting point. The examples align with specific IFRS® Accounting Standard requirements, and the carefully tailored scenarios and fact patterns help reinforce the requirements in the standards. However, we observe that the examples may offer limited practical guidance for entities already well-versed in IFRS Accounting Standards, who seek to effectively incorporate multi-faceted climate-related risks and other uncertainties into their financial statements. These entities seek to create reports that succinctly communicate connected information across financial and climate-related reporting, emphasising the need for cross-referencing between the reports which would reduce disclosure overload.

To support these entities, we suggest further expanding and refining the examples to better demonstrate the connection with climate reporting standards. Specifically, we recommend enhancing the examples to incorporate more climate-relevant nuances, reflecting the interconnected climate and sustainability risk and opportunities as they occur in practice.

Our specific recommendations and responses to the questions in the ED are outlined in Appendix 1 and 2 below. Should you have any queries or require further clarification on any matters raised, please feel free to contact Leana van Heerden (leana.vanheerden@xrb.govt.nz) or me.

Yours sincerely

Carolyn Cordery
Chair – New Zealand Accounting Standards Board



Appendix 1

1. In preparing this comment letter, we have closely collaborated with the XRB sustainability team, who are working directly with New Zealand's Climate Reporting Entities as they navigate their first year of climate-related disclosures. We have also engaged with financial statement preparers of these climate-reporting entities and technical advisors respectively. This collaboration has provided us with a comprehensive understanding of the diverse requirements and expectations these entities face, highlighting the interconnected nature of financial statements and climate-related disclosures. Our approach is therefore informed by both financial and climate-reporting perspectives, aiming to connect information between traditional financial reporting and emerging climate and sustainability frameworks.

2. With this foundation, we provide our responses to the specific questions in the ED, along with additional recommendations, in the following sections.

Question 1a—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.

3. We agree that examples can support improved reporting of climate-related and other uncertainties in financial statements, our stakeholders confirmed that examples will be helpful in demonstrating how IFRS Accounting Standards can apply to climate-related matters.

Question 1b—Providing illustrative examples

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.

4. Our outreach has highlighted varying perspectives on the placement and format of the examples. Some stakeholders were of the view that examples may be better suited as educational material, as individual examples may not be universally relevant to all entities and could become outdated if embedded within the standards. Others suggested that including the examples within the standards would promote greater consistency and provide a single, authoritative reference, rather than requiring preparers to consult multiple resources. On the other hand, it was noted that standalone examples within each standard might offer limited utility in addressing complex reporting needs. Lastly, stakeholders also noted that, irrespective of placement, there is an expectation from auditors and regulators that preparers will consider these examples within their reporting.

5. Based on this feedback and our own deliberations, we support the IASB's current approach of including these examples as illustrative examples accompanying IFRS Accounting Standards. We believe this placement strikes an effective balance by offering practical guidance that clarifies relevant disclosure requirements without the rigidity of embedding them directly into the standards.

6. To further improve accessibility, as suggested in paragraph BC45, we believe it would be beneficial to also publish the final illustrative examples relating to climate-related and other uncertainties in financial statements into one single, centralised document. This centralised document should also reference other complementary IASB material, such as IFRS Practice Statement 2: Making Materiality Judgements, Educational Material: Effects of climate-related matters on financial statements, and IFRIC Agenda Decision on Climate-related Commitments, to make it easier for preparers to navigate climate-related financial reporting guidance from one complete source.

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.

7. Overall, we appreciate the IASB's approach in developing examples that illustrate the application of IFRS Accounting Standards to climate-related matters, as stakeholders find this useful. However, we believe that the selection of requirements and fact patterns in the current examples could be enhanced to better reflect the complexities and practical challenges entities face in this area. Our detailed and technical feedback on each of the illustrative examples (1–6 and 8) are provided in Appendix 2 which highlights suggested expansions.

8. Additionally, to support the evolving understanding of climate-related risks, we recommend including an IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* example, to illustrate whether, and under what circumstances, climate-related disclosures in the financial statements might lead to the identification of a prior year error versus a change in estimate. Including such an example would provide valuable guidance to preparers and enhance the consistency of applying IAS 8 in relation to climate-related uncertainties.

9. Furthermore, we recognise that the IASB has expanded this project to include 'other uncertainties,' demonstrating that these illustrative examples are intended to apply beyond climate-related matters. However, aside from Example 5, none of the other examples fully incorporate or address 'other uncertainties'. Given the broad range of other uncertainties—such as geopolitical risks, technological disruptions, pandemic related health risks, etc. —that can significantly impact financial reporting, we believe it would be beneficial to add new examples or expand on the existing ones, to more specifically and comprehensively address other uncertainties. For example, expanding Illustrative Examples 1, 2 and 3 to include nuances that compound climate-risks with technological disruptions or supply chain challenges could result in additional or modified disclosures. Doing so would enhance the guidance provided and ensure that entities can apply the principles demonstrated in the examples to a wider variety of real-world scenarios.

10. Finally, the centralised resource referenced above (paragraph 6) could serve as a flexible tool that evolves alongside climate-related and sustainability-related reporting requirements. This resource could offer further support by:

    a. Addressing emerging climate-related accounting challenges, particularly around revenue recognition. For example, as "green premiums" become more common in pricing structures, additional guidance on recognising and disclosing complexities like additional charges or changes in pricing mechanisms would help preparers navigate revenue recognition; and

    b. Providing walk-through examples, such as when natural disasters lead to operational and supply chain disruptions. Complex scenarios involving climate-related uncertainties often span across multiple IFRS Accounting Standards, and providing detailed examples within a dedicated educational format would allow preparers to see practical applications across these standards. This format would also allow for updates to address evolving challenges in climate and sustainability reporting.

c. Acknowledging other relevant IFRS Standards such as IFRS 16 *Leases*, IFRS 7 *Financial Instruments: Disclosures*, and IAS 16 *Property, Plant and Equipment*, which also contain important disclosure requirements. These standards may intersect with climate-related and other uncertainties. Including the requirements from these standards in a centralized resource could offer a more comprehensive approach to disclosures, ensuring that all accounting standards potentially impacted by climate-related risks and uncertainties are considered by preparers.

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

Boundaries of IAS 1

11. Feedback received on the ED highlighted a significant concern about the application of IAS 1 *Presentation of Financial Statements*, particularly in how it frames the presentation and disclosure boundaries of financial statements. Traditionally, preparers and users apply IAS 1 with an overarching perspective, assessing whether the financial statements, as a whole, are misleading or incomplete. This approach aligns with the principle that financial statements should present a fair view when considered collectively.

12. The ED may be pushing the interpretation of IAS 1, particularly paragraph 31, beyond its current application. The concern is that these examples imply a shift toward an item-by-item analysis, where each line item must be scrutinised individually for missing information.

13. We caution that such an approach may distort the intent of IAS 1, which aims to ensure that the financial statements, viewed holistically, are not misleading. This divergence could place an undue burden on preparers and reduce the overall clarity of financial reports by encouraging excessive detailed disclosures that replaces materiality with minutiae.

Cross-referencing

14. Cross-referencing between financial statements and climate-related disclosures, is a key challenge highlighted by New Zealand Climate Reporting Entity preparers. Users often face difficulties in navigating and connecting related information across different reports, which can impair their understanding of how climate-related factors impact financial statements. While cross-referencing could enhance connectivity and reduce duplication of information, it also presents complexities, particularly in terms of audit and assurance requirements. Current audit practices do not typically support cross-referencing between financial statements and climate-related disclosures due to differing levels of assurance.

15. To address these challenges, we strongly recommend that the IASB, International Sustainability Standards Board (ISSB), and International Auditing and Assurance Standards Board (IAASB) collaborate to develop a framework for cross-referencing that balances users' needs with assurance requirements. Such collaboration would ensure that cross-referencing guidance is practical, enabling preparers to create reports that are more interconnected and aligned. This approach would ultimately help users access cohesive information across reports without unnecessary repetition.

Appendix 2: Feedback on Individual Illustrative Examples

Example 1—Materiality judgements leading to additional disclosures

16. The primary concern with Example 1 is its potential implications for other types of business risks beyond climate-related risks. If the intent of IAS 1.31 is to expand on information not otherwise covered in the financial statements, that could reasonably be expected to influence the decisions of users, this could set a precedent for requiring similar disclosures for a wide range of prevalent business risks. For example, in New Zealand, this may include cybersecurity risks or seismic risks. Such an approach could lead to excessive disclosures, increasing the volume of information while potentially diluting the focus on material financial impacts. This is also covered in paragraphs 11–13 above.

17. Additionally, we note that in the ED's paragraph 1.3, subparagraph (b) comments directly on the recoverable amount of the cash-generating units without first determining if an impairment indicator exists. This can be seen as inconsistent with IAS 36 *Impairment of Assets* paragraph 9 which firstly requires the entity to identify whether an impairment indicator exist. If an impairment indicator is present, the entity shall estimate the recoverable amount. To improve clarity, we recommend that the example specifies whether capital-intensive industries exposed to climate-related transition risks are inherently considered impairment indicators. Alternatively, the example should clarify what impairment indicators exist in this scenario that led to the assessment of the cash-generating unit's recoverable amount.

18. Example 1 could be enhanced by incorporating variations in fact patterns where certain nuances lead to a different outcome—for instance, a scenario in which the climate-related impact is material for financial statements and lead to further disclosures. This added complexity would provide preparers with a fuller depiction of materiality considerations and how climate-related matters may influence financial statements.

19. Lastly, to more fully address the connectivity with climate-related disclosure requirements, the background in Example 1 could be expanded to provide a more comprehensive view of the multi-faceted transition risks and transition plans entities face in practice.

20. Currently, Example 1 focuses primarily on emissions reductions, which may unintentionally suggest that transition risks can be limited to emissions reductions alone, implying that a transition plan could focus solely on reducing emissions. In reality, transition risks often extend far beyond emissions and may include shifts in market conditions, changes in customer solvency or preferences, climate migration, supply-chain disruptions due to climate-related conflicts, and rising costs of input goods and materials. Alongside these risks, entities may encounter significant transition opportunities, such as access to new markets, development of innovative low-carbon technologies, or enhanced operational efficiencies. Both the risks (especially non-GHG risks) and opportunities represent critical factors shaping an entity's transition plan and are frequently among the most material considerations for climate-related disclosures.

21. While Example 1 primarily emphasizes assets, it provides limited insight into the potential climate-related impacts on costs or revenues, which are typically among the most challenging aspects of a transition plan. Elaborating on transition plan cost and revenue impacts could provide an opportunity to emphasizing the boundaries of financial statements and potential disconnects between the two reports.

22. Expanding the background to address non-GHG transition risks, as well as emphasizing cost and revenue impacts, may not necessarily change the example's financial statement disclosures, but it would offer preparers a more realistic view of the practical climate-related challenges encountered.

Example 2—Materiality judgements not leading to additional disclosures

23. Referring to paragraph 19 above, Example 2 could similarly be enhanced by incorporating variations in fact patterns that lead to different outcomes. Alternatively, Examples 1 and 2 could be combined into a single example with additional nuanced expansions.

24. When examining Example 2 through the lens of climate-related disclosure requirements, we identified the following concerns:

    a. The assumptions in Example 2 about an entire industry's limited exposure to transition risks are problematic. This generalisation overlooks the systemic nature of climate-related risks, which are not always industry-specific, can evolve over time, and may affect entities within the same sector in unpredictable ways.

    b. Additionally, the example's paragraph 2.2 indicates the following:

        > *The entity discloses in a general purpose financial report outside the financial statements that it has low levels of greenhouse gas emissions, explaining that, where possible, it uses renewable energy and avoids high-emission activities. The entity also explains how it plans to keep emissions low by maintaining its current greenhouse gas emissions policy.*

        This may be interpreted to suggest that maintaining a policy alone is sufficient to guarantee low future GHG emissions. However, a policy that worked in the past cannot be assumed to work in the future, particularly given the use of terms like "where possible", which imply potential for limitations. The example lacks clarity on how this policy sufficiently addresses the climate-related risks and opportunities that the entity has identified.

        Additionally, terms like 'low levels' and 'keep emissions low' are relative and lack a specific reference point, making it unclear whether maintaining the existing policy is enough to make this topic immaterial.

        Moreover, an example based on a hypothetical entity with 'low' GHG emissions may have limited relevance for most entities. A more practical illustration might involve an entity with low exposure to specific transitions risks, such as supply chain disruptions, due to a policy that prioritises long-term contracts and relationships within a diversified supply-chain.

    c. Further, paragraph 2.3 states the following:

        > *In preparing its financial statements, the entity assesses the effect of its greenhouse gas emissions policy on its financial position and financial performance. The entity concludes that its greenhouse gas emissions policy has no effect on the recognition and measurement of its assets and liabilities and related income and expenses.*

        This statement may imply that relying solely on a GHG policy is sufficient for assessing the greenhouse gas emissions and other climate-related impacts on the recognition and measurement of assets, liabilities, and related income and expenses. However, this is overly simplistic and fails to account for external factors or future uncertainties.

Example 3—Disclosure of assumptions: specific requirements

25. We appreciate that Example 3 aims to highlight the importance of disclosing key assumptions related to future uncertainties when assessing the recoverable amount of assets. This focus is particularly relevant given the growing interest in connectivity between financial statements and climate-related disclosures. However, the facts and requirements presented in the example may offer limited practical guidance, as they appear largely self-evident. Our suggestions to enhance the scenario to better reflect practical challenges entities face are as follows:

    a. *Time horizon differences* - the example could benefit from addressing the different timeframes generally associated with financial reporting in comparison to climate reporting. According to IAS 36, paragraph 35, cash flow projections used for value-in-use calculations should generally be based on budgets and forecasts for a period not exceeding five years, unless longer-term forecasts can be reliably demonstrated. This five-year horizon may not always capture the medium-term and long-term impacts of climate-related risks, which often extend beyond the timeframe considered in financial reporting. Expanding the example to include longer-term climate-related financial impacts would provide a more comprehensive illustration, concluding that these impacts are either immaterial to the recoverable amount assessment, cannot be verified sufficiently to be incorporated directly into future cash flows, or may instead warrant adjustment of the discount rate based on IAS 36 requirements in paragraphs 30–32. This approach would better reflect the evolving considerations entities face in balancing financial and climate-related reporting.

    b. *Other uncertainties and transition opportunities* - the example focuses on expectations and key assumptions around carbon emission costs without mention of other uncertainties and transition opportunities. In reality, entities commonly seek to offset increasing costs through operational efficiencies or strategic initiatives. Furthermore, entities often encounter multiple uncertainties in their recoverability assessments, such as technological advancements and shifts in consumer demand, which IAS 36 paragraph 12 already acknowledges as potential indicators of impairment. Incorporating these mitigating actions and other uncertainties would offer a more balanced view that aligns with real-world challenges and provide more nuanced guidance on navigating impairment assessments.

    c. *Identifying key assumption* - the example could clarify how to determine the key assumptions most sensitive to changes in the recoverable amount. IAS 36, paragraph 134(d)(i), requires disclosure of assumptions to which the recoverable amount is most sensitive. The example could explain that these are typically assumptions with the greatest potential to materially impact the value-in-use calculation, whether through projected cash flows or the discount rate. Providing guidance on the process to identifying the key assumption—such as analysing historical data, considering external economic factors, or assessing climate-related risks—would offer preparers more practical insights, especially in scenarios involving multiple and heightened uncertainties.

26. A point of clarification in Example 3 relates to how anticipated regulatory changes requiring the entity to acquire emission allowances are incorporated into its recoverable amount assessment. IAS 36 requires that elements identified in IAS 36 paragraph 30 (b), (d) and (e) should be reflected either as adjustments to future cash flows or the discount rate. Currently, Example 3 implies that regulatory changes requiring the entity to acquire emission allowances are included in future cash flow projections. The example could be enhanced by including a nuance where regulatory changes are included in the calculation of the discount rate. This would help preparers and users distinguish when regulatory changes should impact future cash flow projections versus when they should adjust the discount rate, providing clarity and reducing the potential for inconsistent application.

Example 4—Disclosure of assumptions: general requirements

27. We find this example useful as it clarifies that IAS 1, paragraph 125, applies to assumptions that may not be resolved within the next financial year, but may have a material impact if they were to be revised in the next financial year. This is an important point that enhances preparers understanding of how to apply the standards in a broader context. However, feedback from stakeholders suggests that the example potentially overextends the scope of IAS 1, also refer to paragraphs 11 - 13 in our comment letter. Typically, when an impairment assessment is performed and the recoverable amount is greater than the carrying amount, additional disclosures are not extensive.

28. The approach taken in this example, which may require disclosures of the nature, qualitative, quantitative and sensitivity information of the assumptions, that may not be resolved within the next financial year but may have a material impact if they were to be revised in the next financial year, could lead to the expectation that climate-related assumptions and estimation uncertainties require extensive disclosure. This approach would then also need to be extended to other areas of risk and uncertainty. This broadening of disclosure requirements could result in excessive, unhelpful disclosures that obscure rather than clarify critical information for users of financial statements.

29. In addition, paragraph 4.4 of the ED states that IAS 36 does not require disclosure of assumptions for a cash generating unit without goodwill, indefinite-lived intangibles, or recognized impairment. However, IAS 36.132 requires disclosures when recoverable amount is based on value in use. We recommend referencing IAS 36.132 in paragraph 4.4 to clarify disclosure requirements and ensure preparers consider all relevant obligations, enhancing transparency and alignment with IAS 36.

Example 5—Disclosure of assumptions: additional disclosures

30. We are encouraged to see an example that focuses on uncertainties beyond climate-related risks, as this demonstrates a holistic approach to addressing various types of uncertainties that can impact financial reporting. While the example effectively highlights the need for additional disclosures, it is suggested that it also considers the broader implications for the entity's financial position and performance, rather than solely addressing the realisation of the deferred tax asset.

31. Given the fact patterns presented, these regulatory changes are expected to significantly affect profitability and potentially lead to asset impairment in future periods, therefore the realisation of the deferred tax asset is unlikely to occur in isolation. We suggest expanding this example to illustrate considerations over a multi-year timeline: Year 1 could address the initial impact following the government's announcement; Year 2 - Year 3 could consider further implications as the legislation undergoes further discussion and the timing becomes more certain; and Year 4 could address scenarios where the legislation is approved and effective, including a case where the entity may no longer be considered a going concern. Such an approach would provide preparers and users with a more comprehensive understanding of how regulatory uncertainties evolve and may impact financial reporting over time.

32. Lastly, like Example 4, the example potentially overextends the scope of IAS 1, refer to paragraphs 11 - 13 in our comment letter.

Example 6—Disclosure about credit risk

33. To make the example more broadly applicable to various industries, the background information could be adjusted to illustrate how discrete climate-related risks (such as droughts or floods) can interact and transmit to other areas within an entity's portfolio or its customers. While this update may not change the disclosure conclusions, it would help demonstrate how climate-related risks often interconnect, creating compounding effects that influence broader portfolio credit risk exposure. For instance, flooding that impacts agricultural output could lead to secondary economic effects on local property values, businesses, and employment. Demonstrating how these risk transmissions can affect credit exposures within and across portfolios or customers would enhance the example's realism, offering valuable insights into the interconnected nature of climate-related risks.

34. Furthermore, the unpredictable nature of events like floods and droughts makes incorporating these into forward-looking estimates challenging. Although forward-looking information is critical for Expected Credit Loss (ECL) measurement, the uncertainty associated with climate-related events may limit the verifiability of such disclosures, particularly for audit purposes. To address this, the example could acknowledge these challenges and, as required per IFRS 7 *Financial Instruments: Disclosures* paragraph 35D, place additional emphasis on the climate-related uncertainties and judgements applied in calculating the ECL estimates.

Example 8—Disclosure of disaggregated information

35. We find this example beneficial, as it addresses the new disaggregation requirements under IFRS 18 *Presentation and Disclosures in Financial Statements*, which involve categorising assets based on dissimilar risk characteristics. This guidance will be valuable for preparers, especially as they transition to adopting IFRS 18. By clarifying how entities can meet these requirements, the example provides a useful reference for implementing disaggregation.

36. However, as portrayed in this example, New Zealand stakeholders have identified several challenges with disaggregation based on dissimilar risk characteristics, particularly when it comes to practical application across varying asset types and evolving risk categories:

a. As risk categories evolve (e.g., from climate-related risks to nature-related disclosures and beyond), the required level of disaggregation could become excessive, reducing understandability and usefulness for users of financial statements. This concern is especially relevant if the disaggregated categories also necessitate further qualitative and quantitative disclosures (e.g., depreciation policies, asset lifespans) that may overwhelm users.

b. Additionally, this may lead to questions about how entities should prioritize the risk profiles, and the potential for overlapping or contradictory disaggregation requirements.

c. Lastly, many operations rely on integrated asset structures that work together across a value chain to deliver final products. Disaggregating assets based on their vulnerabilities to specific risks—such as climate-related or nature-related risks—may not provide meaningful insights to users and could risk being misleading by isolating assets that are operationally inseparable.

37. Stakeholders also expressed concerns about potential duplication if disaggregated information already included in climate-related disclosures must be restated within financial statement disclosures. Specifically, there are existing disclosure requirements in IFRS S2 regarding the vulnerability of assets to transition and physical risks, which may overlap with the disaggregation principles under IFRS 18. We refer to our comment letter paragraphs 14 - 15 for a cross-referencing framework that balances users' needs with assurance requirements.