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Dear IASB members,

Invitation to comment – Exposure Draft ED/2024/6 *Climate-related and Other Uncertainties in the Financial Statements: Proposed illustrative examples*

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the International Accounting Standards Board's (IASB or the Board) Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements: Proposed illustrative examples*.

We welcome and support the Board's effort to illustrate the practical application of IFRS accounting standards to report the effects of climate-related and other uncertainties in the financial statements. We also acknowledge the collaboration with the International Sustainability Standards Board and expect both Boards' continuous efforts to facilitate connected general purpose financial reporting.

We find illustrative examples accompanying IFRS accounting standards to be a good, balanced vehicle to provide the financial reporting community with guidance on how to reflect the climate-related risks and other uncertainties in the financial statements. We believe the proposed examples are most effective as a single document. We understand that, as they are illustrative examples, they will be included in several different standards, if finalised. We, therefore, encourage the Board to consider ways to maintain accessibility and support updates in the future since they address uncertainties that are rapidly evolving. In addition, we suggest that the final amendments acknowledge that entities' disclosures are likely to progressively improve, as it will take time to fully grasp the extent of disclosures needed to respond to the informational needs of the primary users of financial statements.

We are aware that the proposed examples do not address all climate-related scenarios and they necessarily illustrate simplified fact patterns. The proposed examples provide helpful guidance on the application of IFRS accounting standards. To make them even more effective, we encourage the Board to make further refinement to the proposed examples in order to:

- Help entities better understand the manner in which they should consider risks in their financial reporting.
- Avoid unintended consequences or misapplication of IFRS accounting standards.

- Acknowledge the disclosure requirements beyond IAS 1 *Presentation of Financial Statements* and IFRS 18 *Presentation and Disclosure in Financial Statements*, for example, disclosure requirements under IAS 16 *Property, Plant and Equipment*, IFRS 15 *Revenue from Contracts with Customers*, IFRS 16 *Leases*, IFRS 7 *Financial Instruments: Disclosures*, IAS 36 *Impairment of Assets* or guidance in other standards or practice statements, e.g., IFRS Practice Statement 2 *Making Materiality Judgements*. This could help to ensure the proposed examples do not rely too heavily on requirements in IAS 1 or IFRS 18.

In addition, as the proposed examples focus on climate, rather than other uncertainties, in the final amendments, we encourage the Board to make clear (not just in the Basis for Conclusions) that they are also applicable to other uncertainties. We also encourage the Board, as a second step, to develop additional examples focusing on other risks, such as geopolitical risks.

While we agree the proposed illustrative examples provide helpful guidance given the time constraints, we continue to believe additional standard setting is needed to address climate-related and other uncertainties, for example incorporating long-term risks in impairment testing.

A summary of our responses to the questions are set out in Appendix 1 and supplementary comments on each example are included in Appendix 2. Should you wish to discuss the contents of this letter with us, please contact Michiel van der Lof at the above address, or on +31 6 212 52634.

Yours faithfully

Ernst + Young Global Limited

Appendix 1: Responses to specific questions

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.

We believe that providing examples of how to apply IFRS accounting standards in specific facts and circumstances can be a good approach when it helps entities understand the thought process to follow. We also understand the factors considered in choosing this approach given the time constraints. To support implementation, we encourage the Board to reinforce, in the Basis for Conclusions to the final amendments, the basic principles of illustrative examples (i.e., that they only illustrate the standards to which they refer, should not be considered a checklist and do not intend to cover all possible relevant situations).

We believe the proposed examples are most effective as a single document. We understand that, as they are illustrative examples, they will be included in several different standards, if finalised. We, therefore, encourage the Board to consider ways to maintain accessibility and support updates in the future since the proposed examples address uncertainties that are rapidly evolving. A possible approach could be to issue a single document that contains the illustrative examples, as well as including them in the Illustrative Examples to each of the relevant standards. This approach would: aid accessibility; better illustrate the considerations, together as a package; and allow for updates in the future for potential challenges in disclosures related to uncertainties other than those climate-related risks.

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.

In general, we agree with the IASB's approach. We acknowledge the practical challenges in application of some IFRS accounting standards due to current complexity, uncertainties and pace of change entities face, which might result in a lack of information disclosed in the financial statements. We also agree that achieving consistency in general purpose financial information is important to provide useful information for reasonable economic decision making.

We understand the need to use hypothetical and simplified fact patterns. Considering the importance of disclosures about climate-related risks and the implementation of sustainability disclosure standards by several jurisdictions, some entities have already considered such uncertainties and provided disclosure in their financial statements. To be helpful, we suggest that some refinements to the proposed examples be made. We discuss this further, by example, in Appendix 2.

The proposed examples mainly address the application of disclosure requirements in IFRS accounting standards, with particular focus on those in IAS 1 and IFRS 18. We believe the proposed examples relying on IAS 1.31 and IAS 1.125 will be helpful to illustrate how overarching requirements should be used to develop relevant disclosures. It would be helpful if, in Examples 1 and 2, there is recognition of materiality with respect to disclosures such that the information provided by entities about climate-related uncertainties should be proportionate to the other risks entities face.

Primary users of financial statements need information about how relevant uncertainties affect the financial statements. Therefore, we agree with the IASB's focus on both climate-related and other uncertainties in this project. The proposed examples focus on climate-related risks rather than other uncertainties. We encourage the Board to make clear (not just in the Basis for Conclusions) that they are also applicable to other uncertainties. We also encourage the Board, as a second step, to develop additional examples focusing on other risks, such as geopolitical risks.

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

To support implementation, we suggest that, if finalised, the amendments make clear the IASB's expectations that sufficient time should be allowed for entities to implement the guidance in the examples.

As discussed in our response to Question 1, we encourage the Board to consider ways to support updates in the future since the proposed examples address uncertainties that are rapidly evolving.

We have provided further comments on the proposed examples in Appendix 2.

Appendix 2: Additional comments on the proposed examples

We note the following additional comments on the proposed examples.

Example 1 and Example 2

Many entities are now providing information outside the financial statements, in compliance with sustainability reporting requirements in some jurisdictions, and have already considered the issues raised in these examples.

We believe it is critical that Example 1 explains more about how and why the lack of an effect from the entity's transition plan impacts the decision making of primary users of financial statements. Without these clarifications, we believe this example will cause confusion.

While the proposed examples necessarily use simplified fact patterns and there is analysis of only a few factors in Examples 1 and 2, this might mean stakeholders find it difficult to distinguish between them in terms of what primary users' reasonable expectations are and lead some to focus only on factors such as the entity's industry or the entity's own disclosures when considering their own facts. The analysis in paragraph 1.3 of Example 1 provides some, but not all, details. This may be confusing, particularly when compared to the discussion in paragraph 2.3 of Example 2, which is brief but also conclusive. To help clarify the basis for the entity's conclusion in paragraph 1.9 of Example 1, we suggest linking the conclusion to paragraph 1.3.

In addition, to reinforce the notion of connectivity that is discussed in paragraph BC21 of the exposure draft, we recommend that the Board:

- In Example 1, clarifies the inconsistency between paragraph 1.3 (stating the asset is fully depreciated) and paragraph 1.7 (stating users expect the asset will be impaired). We believe it would be helpful for stakeholders to understand why the users of financial statements would expect an impairment in such a situation. For example, facts could be added that indicate why users of financial statements would expect this information despite the assets being fully depreciated (e.g., because the users are not aware that the assets are fully depreciated). Alternatively, paragraph 1.3 could be revised such that the assets will be almost fully depreciated when the entity starts using the new green infrastructure.
- In Example 2, change to the facts (in paragraph 2.2) such that the entity discloses outside of the financial statements (e.g., in its sustainability reporting) the lack of impact on the entity's financial position, financial performance and cash flows. That is, while financial statements should stand alone, clarity may be needed on what information outside of the financial statements could inform users expectations.

Paragraph BC32 of the exposure draft notes that Example 1 and Example 2 assume that the entity does not apply IFRS Sustainability Disclosure Standards. We believe the interaction between sustainability reporting and the financial statements is important to ensure connected financial reporting and it would also be helpful to address the interaction explicitly in these proposed examples. We, therefore, recommend the Board remove the first sentence of paragraph BC32 if retained in the final amendments.

We acknowledge that IFRS Practice Statements explain how to determine what is material (e.g., IFRS Practice Statement 2, paragraph 51, Example K). However, practice statements are not part of the authoritative literature of IFRS accounting standards, nor would these examples be, if finalised. Therefore, to further assist entities, together with reference to the IFRS Practice Statements, the examples could refer to the description of material in IAS 1.7: "Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances." and "… Financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena."

We also encourage the Board to explicitly use the terms 'quantitively significant' and 'qualitative factors' (or quantitatively material and qualitatively material) as part of its consideration of what is material to be clear that this assessment is part of determining whether the information is material. We also believe it would be helpful to clarify that Example 1 is intended to focus on the risks that are relevant to the entity.
To help further support the analysis in these examples:

- Paragraph 1.1 of Example 1 and paragraph 2.1 of Example 2 could refer to IAS 1.15 (regarding fair presentation) and IAS 1.112(c) in addition to IAS 1.31.
- Paragraph 1.2 of Example 1 could be clarified to explain that there is no provisioning in this case, beyond the asset retirement obligation discussed in paragraph 1.3 of the example.
- Paragraph 1.4 of Example 1 could also include more to explain that IAS 1.31 should be considered based on a materiality judgement, referring to IAS 1.17(c) and IAS 1.BC30H to help understand the application of IAS 1.31.

In addition, we believe it would be helpful to explain within the proposed examples how an entity would weigh this assessment against the requirement in IAS 1.30A not to obscure material information.

Example 3

Impairment of assets is one of the most relevant accounting considerations of climate-related and other uncertainties. As such, we encourage the IASB to take the following into consideration, which includes application of measurement requirements as well as disclosure requirements in IAS 36 *Impairment of Assets*:

- One of the application issues in IAS 36 is the determination of key assumptions used for a value-in-use calculation. That might be one of the fundamental concerns that come from primary users of financial statements. We encourage the Board to make clear that key assumptions include not only financial assumptions (such as discount rates and growth rates) but also business assumptions. To acknowledge this, we suggest the example includes other assumptions (such as, sales prices, raw material costs, research & development investments, climate pathways assumed by the entity (and their sensitivity)) among those considered by entities when determining key assumptions.

- Aside from the application of disclosure requirements, we suggest that, as a second step, guidance be provided about calculations of value-in-use.

  The IASB staff research revealed that some stakeholders had concerns about calculations entities made in value-in-use. We suggest that the IASB consider whether some explanations, or factors to be considered, could be provided. We note the following:

  - Determination of value-in-use often requires determining the terminal value as part of cash flow projections. In practice, terminal value is often calculated based on the cash flows in the final year budget. However, the factors considered in the cash flow projections for the initial period and those relevant to the terminal value may not be the same, particularly where changes are needed to respond to climate change in the future. Providing explanations or factors to be considered in such cases would be helpful, for example, if an entity's transition plan related to long-term climate-related commitments would reasonably affect the determination of normal or sustainable cash flows, how the elements (cash flows, growth rate, discount rate so on) should be determined (e.g., by extrapolating a discounted cash flow beyond the initial budget to assist with determining the terminal value). In particular, we would suggest including an explanation that IAS 36.35 allows for budget periods longer than five years subject to specific conditions. We refer to the agenda paper 24B of the March 2022 IASB meeting where this issue was discussed in paragraph 22(b).
  - Illustrating how to apply IAS 36 Appendix A (using present value techniques to measure value in use) based on various scenarios (e.g., climate pathways) would be helpful to enhance practice in impairment testing. For example, the selection of scenarios to be disclosed as key assumptions and the relationship with the disclosure of sensitivity analysis.
  - There is a brief mention of 'external sources' in this example, which could be further developed to list some of the types of external sources considered. For example, by including a reference to the scenarios for carbon pricing provided by the Network for Greening the Financial System (NGFS), International Energy Agency (IEA), and the World Economic Outlook (WEO).

Example 4

We believe the guidance in paragraph 4.6 will help entities identify when there is a significant risk of a material adjustment to the carrying amounts of assets within the next financial year, in particular, by highlighting that such a risk may stem from a reasonably possible change in one the key assumptions even though the uncertainty will remain in the long term.

We also believe that paragraph 4.8 it is helpful to emphasise the objective of the disclosure requirement in IAS 1.125, as set out in IAS 1.129 (i.e., to help users of financial statements understand the judgements that management makes about key sources of estimation uncertainty). However, we think the clarity and consistency of the example could be improved by both:

- Adding the word "key" to paragraph 4.3 when listing the assumptions in sub-paragraphs (a) - (d) and introducing the list accordingly in the next sentence (e.g. "In determining the CGU's recoverable amount, the entity considers various scenarios and makes several key assumptions related to the climate-related transition risks to which it is exposed. Such assumptions include the following…")
- Amending the first sentence of paragraph 4.7 to refer to "assumptions in paragraph 4.3", rather than in paragraph 4.6.

Paragraph 4.4 of the Example 4 states that "IAS 36 does not require an entity to disclose information about the assumptions used in determining a CGU's recoverable amount …". We agree, however, IAS 36.132 encourages entities to provide additional disclosures of the assumptions used to determine the recoverable amount of assets (cash-generating units). Therefore, while we agree that IAS 1.125 applies in this example, it would be useful to acknowledge IAS 36.132 in the example.

Furthermore, the conclusion in this example appears to have created a conflict since the considerations listed in IAS 36.132 are only encouraged disclosures, but the example indicates this information would be required when material. Therefore, we ask the Board to consider whether the example implies that IAS 36.132 should be required, rather than only encouraged such that standard setting is needed to clarify this. More generally, we ask the Board to consider removing all voluntary disclosures (e.g. IAS 16.79, IAS 38.128 and IAS 7.50).

Example 5

We encourage the Board to clarify the fact pattern in this example. In particular, the term "announced regulation" in paragraph 5.2 of Example 5 is not defined in IFRS accounting standards, which raises the concern that differences in legal and political traditions across jurisdictions will determine whether something is considered an "announced regulation". We recommend the Board clarify the likelihood of the regulation being introduced in the facts or define "announced regulation" such that it is capable of being applied consistently across jurisdictions and explain how this interacts with the notion of substantively enacted in IAS 12.

To further support the analysis, we also recommend that paragraph 5.7 refer to IAS 1.15 (regarding fair presentation) and IAS 1.112(c) in addition to IAS 1.31.

Example 6

The proposed guidance in this example is broadly in line with emerging practice by banks providing information on the exposures within their lending portfolios to climate-related risks, in particular. The challenge entities face is that they can only disclose the information for climate-related risks that they have factored into their credit risk models, and their credit risk models are presently continuing to evolve and be enhanced to reflect climate-related risks. That is, this is a work in progress for many banks, but it is not a simple exercise as any enhancements to the models must be subject to internal scrutiny and governance by the entities and, in some cases, external approval by banking regulators. The level of granularity and information suggested in the exposure draft will be appropriate in some instances and the example is a helpful illustration, but it cannot be mandatory due to the model development processes noted above.

The suggested disclosure is also consistent with the direction of travel reached recently by the IASB in the conclusion they reached for the *Post Implementation Review of IFRS 9, Expected Credit Loss*. This was that the fundamental principles of the expected credit loss model in IFRS 9 *Financial Instruments* are sound but that additional guidance for disclosures in IFRS 7 would be beneficial with respect to disclosures. This is to improve consistency and comparability between entities, and also to indicate a minimum threshold for the level of information required. The exposure draft provides a useful conclusion that is consistent with this intention in the context of climate-related risks and other uncertainties.

In addition, we note that in paragraph 6.3(b) it is not clear whether "the effects depend on factors" is intended to refer to the nature of the effects or the significant or magnitude. We recommend this statement be edited to clarify the intent.

Example 7

We acknowledge that Example 7 illustrates one way to disclose additional information about an obligation even though the provision related to the obligation in the example is quantitatively immaterial. To further support the analysis, we recommend that the Board:

- Explains how the entity makes a materiality judgement using the information in the fact pattern, i.e., that it is material despite being quantitively insignificant. Paragraph 7.3 of the example provides three factors that are considered. We encourage the Board to clarify how these three factors have been considered in reaching the conclusion, which could include reference to paragraphs 52-55 of IFRS Practice Statement 2. For example, if the timing of the settlement of the obligation becomes earlier than expected, the present value of the costs will be significantly increased.
- Explain whether or how the "increasing risk" could affect the timing of recognition of the provision or the amount of the provision, which might illustrate how to apply paragraph 42 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. For example, is the increasing risk general or specific? If specific, is it related to a known policy or regulatory initiative?
- Remove "extremely" from paragraph 7.2, which refers to an "extremely long time". It is not clear what time period is envisaged; we recommend removing "extremely" as we believe "long time" would be sufficient to give context to the assessment.

Example 8

We acknowledge that it is important for information to be aggregated or disaggregated when primary users make assessment of climate-related risks.

Example 8 deals with how to apply aggregation and disaggregation requirements in IFRS 18 when entities disclose relevant information specified in IAS 16.73. IAS 16.37 provides information about how to determine classes of property, plant and equipment. While IAS 16.37 only provides examples of classes, the terms 'nature' and 'use in an entity's operations' in IAS 16.37 could be read as examples of characteristics to consider to meet the disclosure requirement. IFRS 18.B110 provides examples in addition to those in IAS 16.37. As such, we encourage the Board to expand the guidance in Example 8 to explain the interaction between both requirements to avoid misapplication of one or both standards. For example, the illustrative example could illustrate disclosure of only some information (e.g., the carrying amounts), rather than all information that IAS 16 requires for classes of property, plant and equipment. This would also be helpful to ensure appropriate application of other related disclosure requirements, for example, disaggregation of revenue in IFRS 15 and IFRS 16, and disclosures in IAS 36.

We also encourage the Board to include reference to IAS 1 in this example, if finalised, to be clear that this example is applicable prior to adoption of IFRS 18.