Pauline Wallace
Chair
UK Endorsement Board
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18 November 2024

Dear Pauline

UKEB Draft Comment Letter on IASB Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements - Proposed illustrative examples*

Thank you for the invitation to comment on the UKEB's Draft Comment Letter on the IASB's Exposure Draft — Climate-related and Other Uncertainties in the Financial Statements - Proposed illustrative examples.

As part of the network of member firms of PricewaterhouseCoopers International Limited, the UK firm's views on the IASB's Exposure Draft are incorporated into our global network's comment letter to the IASB. We therefore attach PricewaterhouseCoopers International Limited's comment letter to the IASB in response to your invitation to comment, which we hope will be useful.

If you have any questions in relation to this letter please do not hesitate to contact me.

Yours sincerely

Head of UK Corporate Reporting Services
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23 October 2024

Andreas Barckow
Chair
International Accounting Standards Board (IASB)

Exposure Draft Climate-related and Other Uncertainties in the Financial Statements Proposed illustrative examples

Dear Andreas,

We are responding to your invitation to comment on the Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements - Proposed illustrative examples* on behalf of the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. This response summarises the views of member firms that contributed to our discussions during the comment period.

We support the overall objective of improving the information that entities provide about the effects of climate-related risks and other uncertainties in the financial statements. Providing illustrative examples will help entities in reporting such effects and strengthen the connections between information reported outside the financial statements and the financial statements themselves.

However, we have significant concerns related to Example 1. Specifically, this example implies that an entity's management is required to:

- consider any and all risks that a hypothetical investor might be interested in as it relates to the entity; and
- include negative confirmation in the financial statements that such risks are not material to the entity.

We are concerned that the implications of the underlying principle in Example 1 are much broader than only relating to climate related risks and we worry about the practical implications of trying to implement such a requirement. In addition, we do not believe that this type of analysis and disclosure is currently required under IAS 1, and we are therefore concerned that this example goes beyond the technical requirements of the Standard. Additionally, this could lead to voluminous boilerplate disclosures that might dilute the key

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information that investors are seeking. Therefore, we suggest that Example 1 should be deleted, but we also make some suggestions to improve it if the IASB decides to keep it.

We acknowledge that IFRS Sustainability Disclosure Standards require disclosure of material information about climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects in the short, medium and long-term, even if there is no direct effect of that risk or opportunity on the current financial statements.[1] However, we think that the principles of materiality as currently applied under IFRS Accounting Standards are not the same as the approach outlined in the IFRS Sustainability Disclosure Standards given the differing objectives of financial statements and sustainability information. On that basis, the financial statements do not need to address all of the risks and opportunities that an entity identifies based on the IFRS Sustainability Disclosure Standards, either positively or negatively.

If Example 1 is retained, we think that the example should be revised to explain that the reason for including the related disclosures is solely as a result of the entity providing detailed information in its other public documents (for example, its sustainability report or management commentary). The additional disclosure in the financial statements would therefore be needed for to ensure connectivity and consistency for a user of public information. We would also encourage the IASB to consider whether examples 1 and 2 are better suited for inclusion in IFRS Practice Statement 2: Making Materiality Judgements.

The appendix to this letter sets out our responses to the questions in the Exposure Draft including additional comments on the examples where relevant.

Please contact Gary Berchowitz if you would like to discuss our responses.

Yours sincerely,

Global Chief Accountant and Head of Reporting

[1] IFRS Sustainability Disclosure Standard S1 paragraph 17

Appendix

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. (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? 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. (b) Do you agree with including the examples as illustrative examples accompanying IFRS Accounting Standards?

We agree with the IASB's proposal, and we believe that providing illustrative examples on reporting climate-related and other uncertainties in the financial statements will assist preparers in enhancing the transparency and accuracy of the financial statements. This will also strengthen the connectivity between the sustainability reports and the financial statements. Our detailed reasoning and comments on all examples to the extent relevant are provided in our response to question 3.

We support the IASB's proposal to include examples 3 to 8 accompanying the relevant IFRS Accounting Standards. However, in accordance with our concerns regarding Example 1 in our cover letter, we recommend that Example 1 should not be incorporated into the IFRS Accounting Standards.

With respect to example 2, we do not agree with including this example as accompanying IFRS Accounting Standards. Example 2 deals with materiality judgements (as does example 1). We acknowledge that the concept of materiality underpins all IFRS Accounting Standards as a principle; however, we would not expect the IFRS Accounting Standards to have explicit guidance on deciding on the outcome of a materiality judgement, because this will be specific to facts and circumstances. Judgement on materiality is a complex topic and these examples seem overly simplistic and might cause confusion. However, examples 1 and 2 do make that specific judgement on materiality and the actual outcome: whether something needs to be disclosed (Example 1) or not (Example 2). On that basis we believe that Example 2 (and Example 1, if retained) would appear to be better placed in IFRS Practice Statement 2: Making Materiality Judgements. Further elaboration on this suggestion can be found in our response to question 3.

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. 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?

Yes, we agree with the IASB's approach to developing the examples in the Exposure Draft. We believe that the focus of the examples on requirements that are among the most relevant for reporting the effects of climate-related and other uncertainties in financial statements aligns well with the increasing need for transparency and consistency in financial reporting.

We generally concur with the selection of requirements and fact patterns illustrated in the examples, except for our concerns and considerations listed in our response to question 3 below. These examples address key concerns about the sufficiency and consistency of information regarding climate-related risks, both within financial statements and in general purpose reporting outside the financial statements. This approach helps bridge the gap between financial disclosures and broader sustainability reporting, thereby enhancing the overall quality and reliability of the information provided to stakeholders.

The technical content of the examples is also appropriate, and it provides relevant guidance on how to apply specific IFRS Accounting Standards in the context of climate-related and other uncertainties. This practical guidance is helpful for entities as they navigate the complexities of integrating climate-related risks into their financial reporting.

Please see our comments on individual examples in our response to question 3.

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

Yes, we have the following comments, and we have separated them into (a) key concerns and (b) additional considerations you may want to consider:

(a) Key concerns

Example 1 - Materiality judgements leading to additional disclosures (IAS 1 / IFRS 18)

Example 1 illustrates that when making materiality judgements, an entity must assess qualitative factors, which might be material and therefore their presence could reasonably be expected to influence decisions made by the primary users of the entity's financial statements, even if there is no quantitative effect on the entity's financial position or financial performance.

Expectations of potential investors and identification of potential areas of uncertainties

Paragraph 1.7 in the proposed example would require entities to assess the disclosure requirements based on the 'expectations' that hypothetical users of the financial statements might have about matters that did not give rise to financial impacts in the current period and are not expected to have significant financial impact on the entity in future periods.

We acknowledge that IFRS Sustainability Disclosure Standards require disclosure of material information about climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects in the short, medium and long-term, even if there is no direct effect of that risk or opportunity on the current financial statements. However, we think that the principles of materiality as currently applied under IFRS Accounting Standards are not the same as the approach outlined in the IFRS Sustainability Disclosure Standards given the differing objectives of financial statements and sustainability information. This is due to the fundamentally different scope of the sustainability reporting compared to the financial statements, in particular due to the inclusion of information about risks and opportunities that arise in the value chain, the fact that the time horizons used in sustainability reporting are generally longer than the time horizons used in financial reporting, and the fact that sustainability reporting includes in its scope the effects of risks which might not yet be captured in the financial statements. On that basis, the financial statements do not need to address all of the risks and opportunities that an entity identifies based on the IFRS Sustainability Disclosure Standards, either positively or negatively.

The principle in Example 1 concerns illustrating how an entity makes materiality judgments in the context of financial statements in accordance with the requirement in paragraph 31 of IAS 1. Not only would this apply to climate and sustainability risks and uncertainties, but this principle could also be viewed as much wider reaching in that other risks and uncertainties could be deemed material for some users. Consequently, the entity would need to create a process to consider all potential risks and uncertainties as well as an inventory of potential users and what they might be expecting.

An entity would also need to then consider which of the identified immaterial risks and user groups require a negative confirmation that there is no (or no material) impact on the financial statements. Paragraph 1.4 in Example 1 talks about disclosure of the “lack of effect”. As such, for entities to prepare and develop controls over such matters and for auditors to provide assurance over this potentially large collection of risks and uncertainties as well as covering potentially diverse interests of users would be challenging. This might result in entities providing disclosures on risks that are not significant to the entity and therefore distract from key messages.

Principle on disclosure requirements on lack of effect on financial statements

We agree with the IASB’s proposal to provide illustrative examples of circumstances where paragraph 31 of IAS 1 applies, warranting additional disclosures in financial statements. However, we believe that paragraph 1.4 in Example 1 that requires entities to disclose information about the “lack of effect” of the entity’s transition plan on its financial position and financial performance after the entity performed the impairment test and addressed the requirements in IAS 36, is overly broad and potentially introduces a new principle without clear scope. We are aware of limited examples in the past where disclosures stating that a certain risk had no impact, was included in financial statements by preparers.

For example, during the banking crisis when potential exposure to Greek assets was deemed significant enough for investors to know about; such that some preparers in the financial services industry included disclosure thereon even if they did not have any exposure. This is in line with Example K in IFRS Practice Statement 2 - *Making Materiality Judgements*. However, this example is applied narrowly to a specific situation. We believe that Example 1 goes over and above a narrow scenario and the cases in which this type of disclosure is warranted will be rare. To date when these highly irregular situations have arisen, IFRS preparers have typically applied paragraph 31 of IAS 1 appropriately.

If the IASB's objective is to introduce a new disclosure principle and materiality judgments within accounting standards, we believe that illustrative examples are not the appropriate mechanism for such changes. We believe that Example 1, in contrast to the other examples, does introduce such new principles.

Based on the above concerns about the expectations of potential investors, the identification of potential areas of uncertainties and the introduction of a new principle on disclosure requirements on lack of effect on financial statements, we believe that Example 1 should be deleted.

Considerations if Example 1 is retained

If the IASB decides to retain Example 1, we suggest the following updates:

- As outlined in our response to question 1, we suggest that the IASB should include examples 1 and 2, considering the proposed amendments below, as part of the IFRS Practice Statement 2 *Making Materiality Judgements* instead of including them as illustrative examples to IAS 1/IFRS 18. This is because whilst materiality underpins accounting standards, the actual judgements taken are entity specific and therefore would not form part of accounting standards themselves.

- We suggest that the IASB should clarify in more detail, within Examples 1 and 2, the specific statements made by entities in public information outside financial statements that would reasonably trigger the need by a user for more information on how those statements impact on the financial statements. For example, paragraph 1.2 in Example 1 now states that the entity discloses *“how it plans to reduce greenhouse gas emissions over the next 10 years”*. We think that it would be helpful to include more detail on what the entity disclosed in this regard that would have created an expectation in the mind of a user of the financial statements that there might be an impact on the financial statements. For example, if the entity explains that such reduction is planned to be achieved by exchanging old manufacturing facilities for new ones, a user might reasonably ask about the useful life as well as (the lack of) impairment impact of the old line.

- We think that the example should be revised to explain in paragraph 1.6 that the reason for including the related disclosures is solely as a result of the entity providing detailed information (refer above) in its other general purpose financial report outside the financial statements. We think that the concept in paragraph 1.8 about considering all information outside the financial statements and the industry in general, is overly broad. We suggest clarifying in paragraph 1.8(a) that this is only as a result of providing detailed information and we suggest removing paragraph 1.8(b).

Example 2 - Materiality judgements not leading to additional disclosures (IAS 1 / IFRS 18)

As explained above, we suggest that the IASB should clarify that the entity in the fact pattern does not address material (climate) risks or opportunities at all in information reported outside the financial statements. Alternatively, we suggest that the IASB should clarify that the entity’s sustainability report indicates that the impact is not material and as a result the entity has no need to provide a negative confirmation in their financial statements.

As with Example 1, Example 2 might be better placed as part of the IFRS Practice Statement 2 *Making Materiality Judgements*.

General considerations

Effective date and announcements

We understand that materials accompanying IFRS Accounting Standards, including illustrative examples, are not an integral part of the IFRS Accounting Standards and, as such, do not have an effective date or transition requirements, as explained by the IASB in the Basis for Conclusions paragraph BC46.

We recognise that the IASB used similar wording in paragraph BC49 as for IFRIC Agenda Decisions, stating that entities are entitled to sufficient time to implement any changes to the information disclosed in their financial statements as a result of the issuance of the illustrative examples. However, we suggest, also in line with implementations of IFRIC agenda decisions, to clarify in paragraph BC48 that if entities provide additional disclosures, this would typically not be considered to be as a result of an error. The IASB might also think about a communications plan to make this guidance public. This is particularly important

when each example is appended to the 'parent' standard – preparers may benefit from an overarching summary or announcement.

Applicability of other IFRS Accounting Standards

We suggest that the IASB should include, in the first paragraph of each example, that disclosures in other IFRS Accounting Standards might still be applicable. We believe that this will aid financial statement preparers in applying all relevant IFRS Accounting Standards, not just those specific to the examples. For example, an entity facing a situation as outlined in Example 3 might also need to disclose sensitivities under paragraph 125 of IAS 1.

(b) Other considerations

Example 3—Disclosure of assumptions: specific requirements (IAS 36)

Paragraph 3.2 in Example 3 explains that the entity is subject to regulation in some of the jurisdictions in which it operates. If there is a systemic regulation risk in such territories, future changes in the legal and regulatory environments and general expectations affecting the market in which the entity operates might already be implicitly included in the discount rate based on the way in which WACC is derived from industry discount rates. Therefore, we believe that the fact pattern should mention that potential future legal or regulatory changes, including possible increases in emission allowance costs should not be considered in formulating cash flow scenarios to prevent double counting to the extent that they are already included in the discount rate.

We suggest that the IASB should clarify that, despite climate-related risk introducing another risk factor into the modelling, the established methods for calculating the cost of capital should continue to be used. There might be different scenarios where environmental regulations are forecast to be put in place at different times or with different levels of stringency, and sometimes multiple scenarios might need to be built for impairment testing to deal with these inherent uncertainties. Generally, given the potential uncertainties associated with these scenarios, we believe that best practice would be to incorporate these into various scenarios in the cash flows, rather than adjusting the discount rate. However, entities should remain cautious that the same risks are not double counted in both the discount rate and cash flows which might result in understating the calculation of the recoverable amount

Example 4—Disclosure of assumptions: general requirements (IAS 1/IAS 8)

We support the IASB's proposal to include Example 4. We believe that it is useful for preparers of financial statements to illustrate the application of the requirements in IAS 36 and paragraph 125 of IAS 1.

The focus of paragraph 125 of IAS 1 on the risk of material change to carrying amounts in the next financial year often causes confusion in practice. The wording of paragraph 4.6 in Example 4 uses the same language as can be found in paragraph 125 of IAS 1:

"The entity concludes that some of the assumptions it made in determining the CGU's recoverable amount have a significant risk of resulting in a material adjustment to the

carrying amount of the non-current assets within the next financial year. These include assumptions about uncertainties that will not be resolved within the next financial year, but that have a significant risk of resulting in a material adjustment to the carrying amount of those assets if the entity were to revise those assumptions in the next financial year."

The key point is that while the uncertainty might not be resolved within one year, assumptions might change during that time period - a fact drawn out in bullet (c) of paragraph 4.6 which follows. We would consider it helpful to reword paragraph 4.6 as follows, rather than merely repeating paragraph 125 of IAS 1, which is already used in paragraph 4.5 of the example anyway. We suggest the following wording:

"The entity concludes that, given the likelihood that some of the assumptions made in determining the CGU's recoverable amount might change within the next financial year, and the possible impacts if that were to happen, there is a significant risk of a material adjustment to the carrying amount of assets in the next 12 months."

<u>Example 5—Disclosure of assumptions: additional disclosures (IAS 1/IFRS 18)</u>

We agree with the proposal of the IASB to include Example 5 that provides guidance on other uncertainties, such as new regulations. We do find that the example is complex, mainly because of the specific fact pattern around the complexity of the timing of the new regulation. However, we understand that this example is useful in drawing out disclosure requirements in paragraph 31 of IAS 1. We therefore suggest clarifying in paragraph 5.1 that this example illustrates that, where paragraph 125 of IAS 1 does not require disclosures due to the timing of the new regulation (that is, the introduction of new legislation and any impact goes beyond the 12 months noted in paragraph 125), the requirement in paragraph 31 of IAS 1 is still applicable. This helps in explaining this concept and the difference compared to Example 4.

Given the broad potential impact of this new regulation and in line with our comments on Example 1 and 2, we suggest that the IASB should clarify that the entity also discloses the impact of the regulation in its general purpose financial report outside the financial statements.

Additionally, we suggest clarifying that this fact pattern does not impact the going concern principle more widely.

<u>Example 7—Disclosure about decommissioning and restoration provisions (IAS 37)</u>

We agree with the proposal of the IASB to include Example 7 that provides guidance on how additional information might need to be disclosed where a recognised provision is immaterial but could become material when assumptions change. We suggest clarifying the quantitative and qualitative aspects of the provision and the related disclosure. For example, we suggest adding in paragraph 7.1 that the recognised provision is 'quantitatively immaterial' and in paragraph 7.3 that the information about the related obligations is considered 'qualitatively material' and sothe entity discloses information based on paragraph 85 of IAS 37.

Based on the fact pattern, there seems to be a risk that the amount of the provision changes materially if the closure date of the facilities is brought forward. This would then also require

at least consideration of disclosures on the uncertainty around the carrying amount of the provision including related sensitivities applying paragraph 125 of IAS 1, in addition to the disclosure requirements in paragraph 85 in IAS 37. It would therefore be worth highlighting that there is no significant risk of material adjustment to the carrying amount of the provision within the next 12 months, and on that basis, no disclosure under paragraph 124 of IAS 1 is required. We believe that this would help to illustrate when the requirements in IAS 1 to disclose material possible changes and sensitivities arise, in line with the other examples.

We also suggest that the IASB should clarify that the entity concludes that the estimate for settling the obligation for determining the carrying amount of the provision is appropriate based on facts and circumstances at the current reporting date, but the cost could end up being higher because there is a risk that the carrying amount of the recognised provision could be higher.