

Connectivity – Update on Analysis of 2022 Annual Reports

Executive Summary

Project Type	Influencing
Project Scope	Research
Purpose of the paper	
<p>The UKEB approved a research project focused on connectivity between IFRS Sustainability Disclosure Standards and Accounting Standards at its [March 2023] meeting. This paper provides an update on Deliverable Two in the Climate-related Matters Project Initiation Plan (PIP). As noted in that PIP, this is the second scheduled update for the Board ahead of the final report, scheduled to be presented at the June 2023 meeting.</p>	
Summary of the Issue	
<p>Deliverable Two aims to:</p> <ol style="list-style-type: none">1. assess areas of potential disconnects between disclosures made by UK listed companies in (i) the sustainability report relating to the TCFD and SECR requirements, and (ii) their financial statements;2. seek initial stakeholder perspectives; and3. consider the potential impacts of the draft ISSB disclosure requirements. <p>The research is being prepared to support the UKEB response to both the ISSB Request for Information (Rfi) on its workplan and the IASB's project regarding Climate-related Risks in Financial Statements.</p> <p>This paper covers the following topics, set out in separate appendices:</p> <ul style="list-style-type: none">• Appendix A: Analysis of connectivity gaps—PPE and Intangible Assets• Appendix B: Aspects of draft IFRS Sustainability Disclosure Standards• Appendix C: Consideration of IFRS Accounting Standards <p>Board discussion at this meeting will be factored into the on-going work on this research. The [final report] incorporating the Board's feedback is scheduled to be presented at the June 2023 Board meeting.</p>	

Decisions for the Board

1. Do Board members have any questions or comments on the analysis of connectivity gaps presented in Appendix A?
2. Do the Board members have any comments on the proposed questions to gather stakeholder feedback for the final report? [see following section for proposed questions]

Recommendation

That the Board discuss and consider the nature of the disconnects identified.

Appendices

Appendix A: Analysis of connectivity gaps—PPE and Intangible Assets
Appendix B: Aspects of draft IFRS Sustainability Disclosure Standards
Appendix C: Consideration of IFRS Accounting Standards

Connectivity – Update on Analysis of 2022 Annual Reports

1. At the March 2023 UKEB meeting Board approved a research project focused on connectivity between IFRS Sustainability Disclosure Standards and Accounting Standards. This research is intended to support the UKEB response to both the ISSB RFI and the IASB's project Climate-related Risks in Financial Statements.
2. This paper provides an update on Deliverable Two in the Climate-related Matters [Project Initiation Plan](#) (PIP).

Scope and deliverables

3. The research is solely focused on identifying potential connectivity issues between narrative climate-related sustainability disclosures and the financial statements based on IFRS Accounting Standards. This work will not include any assessment of interoperability with other jurisdictional sustainability requirements nor seek to assess or comment on the current level of compliance with TCFD or SECR reporting requirements in the UK.
4. The specific outcomes for this deliverable are:
 - a) An analysis of connectivity gaps identified and the extent to which the cause may be due to incongruence between the accounting standards and the requirements of TCFD (as a proxy for draft S2).
 - b) The potential impact of the adoption of draft IFRS S1 and draft IFRS S2 on those gaps.
 - c) A summary of stakeholder views obtained from UKEB Working and Advisory Groups on the findings.
5. The UKEB research sample of nine FTSE 350, 2022 Annual Reports is not intended to provide a representative result. Rather, it will allow the identification and deeper analysis of potential connectivity issues and consideration of potential solutions using real examples from across a range of entities and industries impacted by climate change. The sample focusses on high emission industries which are highly likely to be impacted by climate-related matters.
6. In accordance with the Board's direction that this work is not intended to comment on the current level of compliance, the outcome of the research will be presented at a summary level and with anonymised illustrative examples.

Current Status

7. The project team have now concluded the analysis of six of the nine entities annual reports. These included entities in the general industrials, metals and mining, pharmaceutical, defence and aerospace, and travel and leisure industries.
8. The project team have identified the following connectivity themes to-date:
 - a) Plant Property and Equipment (PPE) and Intangible Assets (covered in Appendix A):
 - i. Depreciation and amortisation.
 - ii. Impairment.
 - iii. Costs to address climate-related matters.
9. Appendix A sets out the overall context and users' expectations for each of the three themes and then provides three examples for each theme.

Question for the Board

1. Do Board members have any questions or comments on Appendix A: Analysis of connectivity gaps—PPE and Intangible Assets

Next Steps

10. The UKEB Sustainability Working Group (SWG) is scheduled to meet on 25 May 2023 to consider any additional themes identified and the potential impacts of IFRS S1 and S2.
11. The SWG will be asked to comment on the questions below which will be reflected in the final draft of the report:
 - a) Do the themes identified represent areas that users of Annual Reports would reasonably expect to have a financial impact in the financial statements?
 - b) Do the examples represent disconnects where disclosure would have been relevant and useful to users of the financial statements?
 - c) To what extent may the application of draft IFRS S1 and S2 address these types of disconnects?
 - d) Are there possible solutions for any remaining areas of disconnect i.e., not addressed by the ISSB Standards?

Question for the Board

2. Do the Board members have any comments on the proposed questions to gather stakeholder feedback from the SWG for the final report?

12. The National Standard Setters Sustainability Forum and the other UKEB Advisory Groups will also be invited to comment on the draft report.

13. Any additional themes identified from the three remaining Annual Reports and Stakeholder feedback will be updated in the final report. The final report is scheduled to be presented at the June 2023 UKEB meeting.

Appendix A: Analysis of connectivity gaps—PPE and Intangible Assets

- A1. This report presents the current analysis of the following connectivity themes (based on review of six of the nine annual reports selected):
- a) Plant Property and Equipment (PPE) and Intangible Assets (covered in Appendix A):
 - i. Depreciation and amortisation.
 - ii. Impairment.
 - iii. Costs to address climate-related matters.
- A2. For each of the themes we set out the context and the user expectations, illustrated by examples from the annual reports reviewed so far. The examples are anonymised as previously agreed with the Board.

Theme 1: Depreciation and amortisation

Context

- A3. This theme includes consideration of how climate-related risks may impact depreciation or depletion of property, plant and equipment (PPE) assets, and amortisation of finite-lived intangibles.
- A4. Reduced estimates of remaining asset lives may result from the need to retire carbon-intensive PPE earlier than was previously expected. Additionally, estimated residual values may decline if carbon intensive assets become less desirable. Carbon intensity may be ascribed to various categories of PPE, for example fossil fuel reserves themselves (coal, oil, gas reserves), assets powered by fossil fuel (machinery and vehicles that run on fossil fuels), assets used to produce inventory that is powered by fossil fuels (machinery that produces internal combustion engines), etc. As a result, decreases in such asset lives and residual values may lead to higher depreciation expense.

User expectations

- A5. Users might expect visibility of how climate-related matters such as climate risks and emissions reduction targets have been considered in the estimates of remaining useful life/production and residual values. To the extent that changes in depreciation result, these should be disclosed, if material, in accordance with IAS 8 *Accounting Policies, Accounting Estimates and Errors* (paragraph 39).

- A6. If no adjustments are made, users may expect disclosure explaining why this is reasonable in consideration of the sustainability issues identified. In some cases, it may be expected that the carrying amount of relevant carbon-intensive assets, and information on their assumed remaining lives/residual values be disclosed to provide an understanding of the situation.
- A7. Users will benefit from information on how climate-related matters such as climate risks and emissions reduction targets have been considered in the estimates of remaining useful life/production and residual values. This will enable users to assess the reasonableness of the assumptions on which the estimates have been based, including where estimates have not been changed.

Potential disconnects with the financial statements

Depreciation and amortisation

Example 1: Depreciation and amortisation – Fleet renewal (1)		
Context		Annual Report disclosures relating to information on fleet renewals to reduce emissions are noted below for the Travel and leisure industry.
Sustainability disclosures	Travel and leisure industry	Company A “A modern fleet of aircraft is instrumental in driving down emissions and so we will be making a list price investment of \$21 billion over the coming years to continue to renew our fleet. All 168 new aircraft deliveries, scheduled between FY23 and FY29, will be Airbus NEO aircraft, which are at least 15% more fuel efficient and 50% quieter than the aircraft they replace.”
		Company B “Over the course of 2022, we signed agreements with Airbus and Boeing to acquire 87 new aircraft which will reduce our emissions by up to 20 per cent and we thank our shareholders for their approval.... plans to make a EUR 13.5bn investment between 2023-30 for 192 new, efficient aircraft.”
Users’ expectation of connectivity		There may be an expectation of information on whether these significant new additions to the fleet have implications for the existing fleet. For example, whether the retirement of existing (more carbon intensive) fleet may be retired earlier than expected, or whether the need to reduce residual values was considered.
Financial statement disclosure		Company A “Long term fleet plans and useful economic lives. ... During the course of 2020 as a result of the impact of COVID-19, the Group

Example 1: Depreciation and amortisation – Fleet renewal (1)	
	<p>permanently stood down 82 aircraft (of which ten were subsequently stood back up), their associated engines and rotatable inventories. ...”</p> <p>Company B</p> <p>“With the permanent standing down of these aircraft, coupled with the future committed delivery of 192 fuel efficient aircraft as detailed in note 15 (commitments), the Group considers the existing fleet assets align with the long-term fleet plans to achieve its climate strategy. All aircraft in the fleet, and those due to be delivered in the future, have the capability to utilise SAF¹ in their operations without impediment. Accordingly, no impairment has arisen in the current or prior year, nor have the useful lives and residual values of aircraft been amended, as a result of the Group’s decarbonisation plans.”</p>

Example 2: Depreciation and amortisation – Fleet renewal (2)	
Context	Annual Report disclosures relating to information on fleet renewals to reduce emissions are noted below for the Metals and mining industry.
Sustainability disclosures	Metals and mining industry
	<p>“We are introducing 10 fuel bulk carriers, ... to our roster of vessels, with the first vessel delivered in December 2022 – the remaining vessels are expected to be delivered by mid-2024. They offer significant environmental benefits, having the potential to cut CO2 emissions by up to 35% compared with vessels fuelled by conventional marine oil alone, while adoption of new technologies will eliminate the release of unburnt methane, as well as removing sulphur oxides, and reducing the volume of nitrogen oxides and particulate matter.”</p>
Users’ expectation of connectivity	There may be an expectation of information on whether these significant new additions to the fleet have implications for the existing fleet. For example, whether the retirement of existing (more carbon intensive) fleet may be retired earlier than expected, or whether the need to reduce residual values was considered.
Financial statement disclosure	No relevant disclosures noted.

¹ Sustainable Aviation Fuel.

Example 3: Depreciation and amortisation – Replacement of PPE	
Context	Annual Report disclosures relating to abating fossil fuel heat energy used to power production assets. The company disclosed that meeting its post-2030 emissions targets would require abatement of emissions associated with heat energy used in the dyeing process, including replacement of fossil fuel burning boilers. (emphasis added below):
Sustainability disclosures	General industrials
Users' expectation of connectivity	<p>“Post-delivery of our 2030 near-term targets, ... the key elements that will require continued abatement are the heat energy used in dyeing, the emissions from energy used by our suppliers and the emissions coming from product and people transportation. ...The emissions from heat energy in dyeing currently come from the burning of fossil fuels to produce steam which is used to heat the water used in dyeing. We see two emissions reduction roadmaps for this. Our steam generating boilers will all require normal replacement before 2050 and any replacements will be done with biomass or electric boilers. In parallel we will be continuing to expand the use of dyeing technologies that don't require high temperature water... We do not, at this stage, anticipate any additional capital or operational costs for achieving net-zero that would not occur anyway in terms of asset replacement cycles.”</p> <p>Users may benefit from an explanation of how the company assessed the lack of need for additional capital or operating costs, and that this resulted in no change in asset lives and residual values for its boilers, as well as why it is reasonable that no adjustments to the assumptions were necessary.</p> <p>It might also be considered material information to identify the carrying values of the associated asset pool, and information on remaining useful lives that evidence the lack of a need for change.</p>
Financial statement disclosure	<p>The company did not appear to address these points in its financial statements, instead focusing on physical risk and asset lives:</p> <p>“Fixed asset useful lives - Consideration was given as to whether the impact of physical risks relating to extreme weather events (e.g. flood risk damage) may require a reassessment of the estimated useful lives of fixed assets. As noted in the physical risks section in our TCFD disclosures, no significant impacts are currently expected in the short to medium term (pre-2045), after which point the majority of the Group's current fixed asset portfolio will be fully depreciated. As such, the reassessment of fixed asset useful lives to reflect potential impacts of climate change was not deemed necessary. In light of the above, the Group's current assessment is that the climate related risks detailed in the TCFD disclosures section of the Strategic Report do not have a material impact on the</p>

Example 3: Depreciation and amortisation – Replacement of PPE	
	key accounting policies, estimates and judgements that form the basis of these consolidated financial statements.”

Example 4: Depreciation and amortisation – Mitigation of physical risk		
	Context	Annual Report disclosures relating to physical risk and infrastructure rebuild noted the that the most significant physical risk associated with climate was from flooding and storm surges. Specifically:
Sustainability disclosures	Defence and Aerospace industry	<p>“ESG Strategy disclosure: Our most significant physical risk is dockyard disruption and we have assessed the risk of increased flooding and storm surges. The highest risk is seen in a 3oC scenario, where we expect to see more extreme weather patterns.”</p> <p>“Risk: Dockyard disruption – Dockyards owned/operated may be flooded due to an increase in sea level and higher frequency of extreme weather, resulting in storm surges. Our site is currently undertaking a significant infrastructure rebuild and climate-related risk is being factored into rebuild decisions. In the medium to longer term as the site develops, for the design of rebuild and new facilities we will consider climate-related risk in line with the latest standards.”</p>
	Users’ expectation of connectivity	Users may require clarity regarding the accounting for the existing assets and whether they are impaired, or the depreciation schedule has been altered for the assessment of physical risk and steps taken toward mitigation. An indication of the significance of the carrying value of the associated assets, and the costs involved and whether they are operating, or capital costs would also be relevant to connect this information to the financial statements.
	Financial statement disclosure	There did not appear to be any financial statement disclosures related to this sustainability disclosure.

Theme 2: Impairment

Context

- A8. Impairment of PPE and intangible assets includes the consideration of indicators of impairment, which give rise to requirements for the testing of impairment which entails the calculation of the recoverable amount of an asset and comparing this with the asset's carrying amount. This also includes consideration of climate-related risks and opportunities in impairment testing, regardless of whether it is required based on a climate-related indicator that requires testing or some other indicator, or as an annual test of goodwill or indefinite lived assets.
- A9. IAS 36 *Impairment of Assets* defines the recoverable amount of an asset or a cash-generating unit (CGU) as the higher of its fair value less costs of disposal (FVLCD) and its value in use (VIU).
- A10. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IAS 36 paragraph 6), while the VIU is defined by paragraph 6 of IAS 36 as the present value of the future cash flows expected to be derived from an asset or CGU.
- A11. Determining VIU is based on best estimates of expected cash flows over a forecast period, growth rates for periods thereafter, and a discount rate. The result must be risk adjusted, either via the cash flows being adjusted for risk or the discount rate.
- A12. Additionally, FVLCD emphasises assumptions that would be used by a market participant and provides greater latitude for consideration of how a market participant would use the asset if improvements were possible, whereas VIU is restricted to consideration of the value of the asset in its current condition.

User expectations

- A13. Users might expect information on how climate-related matters have been considered relative to indicators of impairment. As for impairment testing, users might expect information on how climate has been considered in determining the fair value or risk-adjusted best estimates of cash flows and discount rates used to determine recoverable amount. Disclosure of assumptions and estimates made, and adjustments relating to climate, might be considered material information for disclosure.
- A14. Articulating how climate-related risks and opportunities have been considered relative to indicators of impairment would enable users to consider the reasonableness of an entity's consideration of these matters.
- A15. On impairment testing, users will benefit from clarification of how climate has been considered in the risk adjusted best estimates of cash flows and discount rates used to determine recoverable amounts. Disclosure of assumptions and

estimates made, and adjustments relating to climate-related matters, might be considered material information for disclosure.

Examples of potential disconnect with the financial statements

Impairment – Transition risks and associated costs

Example 5: Impairment – Transition risks and associated costs – carbon taxes and cost of remediation			
Context	<p>A company made the following disclosure in relation to carbon tax: “The company highlights that future carbon taxes represent its most significant transitional risk.”</p> <p>The disclosures also indicated the expected carbon tax prices and expected costs before remediation and after. Further disclosure made were (emphasis added):</p>		
Sustainability disclosures	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="background-color: #e0f2f1; text-align: center; vertical-align: middle;">General Industrials industry</td> <td> <p>“As a major identified risk, we have also reviewed and updated our model for future carbon taxes. ...our current most significant transitional risk remains linked to the potential introduction of carbon emission taxes...Risk 1 Emerging regulation: Introduction of carbon taxes leading to increased energy prices. Under the company's low carbon scenario SSP1: Under SSP1 we expect that the range of carbon taxes could be between \$90 and \$160 per tonne of CO2e, and we anticipate that this would apply to our Scope 1 and 2 emissions. ...Without remediation, and hence based on current emissions levels persisting, the potential for carbon taxes under scenario SSP1 would see an additional annual cost of between \$27m and \$48m by 2030. ...Post-mitigation, where mitigation is taken as delivery of our Science Based Targets for reduction of Scope 1 and 2 emissions (reduction of Scope 1 and 2 emissions by 46.2% in absolute terms from a 2019 base year), this annual cost increase would range from \$15m to \$26m based on our above assumptions of carbon tax rates. We see the pre-mitigation potential costs remaining broadly constant through 2045 and 2070 while the post-mitigation costs would drop to immaterial levels by 2045 and beyond.”</p> </td> </tr> </table>	General Industrials industry	<p>“As a major identified risk, we have also reviewed and updated our model for future carbon taxes. ...our current most significant transitional risk remains linked to the potential introduction of carbon emission taxes...Risk 1 Emerging regulation: Introduction of carbon taxes leading to increased energy prices. Under the company's low carbon scenario SSP1: Under SSP1 we expect that the range of carbon taxes could be between \$90 and \$160 per tonne of CO2e, and we anticipate that this would apply to our Scope 1 and 2 emissions. ...Without remediation, and hence based on current emissions levels persisting, the potential for carbon taxes under scenario SSP1 would see an additional annual cost of between \$27m and \$48m by 2030. ...Post-mitigation, where mitigation is taken as delivery of our Science Based Targets for reduction of Scope 1 and 2 emissions (reduction of Scope 1 and 2 emissions by 46.2% in absolute terms from a 2019 base year), this annual cost increase would range from \$15m to \$26m based on our above assumptions of carbon tax rates. We see the pre-mitigation potential costs remaining broadly constant through 2045 and 2070 while the post-mitigation costs would drop to immaterial levels by 2045 and beyond.”</p>
General Industrials industry	<p>“As a major identified risk, we have also reviewed and updated our model for future carbon taxes. ...our current most significant transitional risk remains linked to the potential introduction of carbon emission taxes...Risk 1 Emerging regulation: Introduction of carbon taxes leading to increased energy prices. Under the company's low carbon scenario SSP1: Under SSP1 we expect that the range of carbon taxes could be between \$90 and \$160 per tonne of CO2e, and we anticipate that this would apply to our Scope 1 and 2 emissions. ...Without remediation, and hence based on current emissions levels persisting, the potential for carbon taxes under scenario SSP1 would see an additional annual cost of between \$27m and \$48m by 2030. ...Post-mitigation, where mitigation is taken as delivery of our Science Based Targets for reduction of Scope 1 and 2 emissions (reduction of Scope 1 and 2 emissions by 46.2% in absolute terms from a 2019 base year), this annual cost increase would range from \$15m to \$26m based on our above assumptions of carbon tax rates. We see the pre-mitigation potential costs remaining broadly constant through 2045 and 2070 while the post-mitigation costs would drop to immaterial levels by 2045 and beyond.”</p>		
Users' expectation of connectivity	<p>Users may require more transparency regarding the price/cost assumptions used in the estimated cash flows for impairment testing, and if those assumptions were consistent with the amounts disclosed in the sustainability disclosures.</p>		
Financial statement disclosure	<p>The company provides general information that confirms the risk of carbon taxes and ‘any potential mitigations’ were considered. It also confirms that no ‘specific significant financial impacts were identified’, which appears to focus on the result of the impairment test, with no information provided on the input assumptions such as carbon prices or cost.</p>		

Example 5: Impairment – Transition risks and associated costs – carbon taxes and cost of remediation	
Example 6: Impairment – Transition risks and associated costs – carbon taxes, emission trading scheme (ETS) permits and the impact on aircraft fleet	
Context	A company made the following disclosure regarding carbon tax, Sustainable Aviation Fuel, fleet renewals:
Sustainability disclosures	Travel and leisure industry
	“The future impact of climate change on the business has been incorporated into strategic plans, including the estimated financial impact within the base case cash flow projections of the future estimated price of ETS permits, the phasing out of the free ETS permits from 2024, the expected price and quantity required of Sustainable Aviation Fuel usage and fleet renewals.”
Users’ expectation of connectivity	Users may require greater transparency on the price/cost assumptions that are included in the estimated cash flows for impairment testing to enable them to form a view on the reasonableness of these assumptions.
Financial statement disclosure	<p>The company disclosed that such costs had been included in financial statement assumptions and estimates across several areas but did not appear to provide any quantitative disclosure. The company did mention the following areas where costs had been included in the financial statement assumptions:</p> <ul style="list-style-type: none"> a) the estimates of future cash flows used in impairment assessments of the carrying value of non-current assets; b) the estimates of future profitability used in our assessment of the recoverability of deferred tax assets in the UK; and c) the useful economic lives and related residual values for our less fuel-efficient aircraft.

Example 7: Impairment – Transition risks and associated costs – carbon removal costs	
Context	A company made the following disclosure on ‘carbon removals’:
Sustainability disclosures	Travel and leisure industry “Based on the latest roadmap ..., the Group expects to use approximately 100 MT of carbon removals between 2022 and 2050 to mitigate Scope 1 emissions and could potentially be removing 2 MT annually in 2030, conditional on clear and globally agreed verification and quality standards for removals, inclusion of removals in ETS schemes, and stable policy support.”
Users’ expectation of connectivity	Visibility on how these costs have been incorporated in determining the recoverable values used in impairment testing, and an indication of the quantitative assumptions made. Users may be particularly interested in the progress toward the 2030 target.
Financial statement disclosure	The financial statements did not appear to address either the inclusion of these amounts or provide an indication of their quantitative significance.

Theme 3: Costs to address climate-related matters

Context

- A16. This theme includes consideration of the costs incurred to address climate-related risks and to take advantage of climate-related opportunities. This section includes provisions for Asset Retirement Obligations (ARO), as these are included in the cost of the associated PPE.
- A17. There are at least two aspects to consider with respect to the appropriate accounting treatment of new climate-related costs incurred:
- a) Existing carbon-intensive assets which may be subject to the energy transition (e.g., by being phased out, modified, etc.) and physical assets that are at risk from climate change (e.g., by being made more resilient against flood or heat risk).
 - b) New assets, for example new intangibles for costs capitalised for the development of low carbon technologies. Some of these new technologies may be at risk of being unsuccessful, and decisions to expense or capitalise (subject to amortisation and impairment) taken accordingly.

User expectations

- A18. Users may expect visibility in the financial statements of material expenses and newly capitalised assets suggested by sustainability disclosures.

- A19. With respect to AROs, climate risks may result in the bringing forward of steps to fulfil obligations, to the extent the associated assets are retired sooner than previously expected. Both ARO liabilities and the value of the associated PPE may increase as a result. For example:
- a) For AROs that are currently recognised on the balance sheet as liabilities (and therefore already included in the value of the PPE assets) a shortened useful life may result in an increase to both the liability and the asset as the period of discounting is reduced.
 - b) For AROs that are not currently recognised as a liability, this is often due to their timing being indeterminate. As a result, a shortened useful life could result in the full fair value of the liability becoming recognised. In other cases, companies may assert that assets will be repurposed, for example a fossil fuel refining plant converted to producing hydrogen.
- A20. Users may expect to see information on how the company has considered the impact of climate on the timing of AROs being met, and any resulting adjustment to the liability that was recognised.

Examples of potential disconnects with the financial statements

Research and Development

Example 8: Research and development (R&D) costs incurred on customer decarbonisation			
Context	A company disclosed an R&D collaboration to help customers develop new technologies. The company disclosed that it is working to decarbonise its value chain, specifically (emphasis added):		
Sustainability disclosures	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="background-color: #e0f2f1; width: 15%; vertical-align: middle;">Metals and mining industry</td> <td>“Collaborating across industry to decarbonise our value chain: “As part of the Group’s ambition to reduce our Scope 3 emissions by 50% by 2040, we are focusing on hard-to-abate sectors such as steel – from which most of our value chain emissions derive. We are working with steelmakers in Europe and Asia to research efficient feed materials – capitalising on the premium physical and chemical qualities of our minerals, including iron ore pellets and lump iron ore. These premium products are suited for use in the direct reduced iron (DRI) process, a technically proven and significantly less carbon intensive steel production method. The collaboration agreements ...signed in 2022, are an example of this approach.”</td> </tr> </table>	Metals and mining industry	“Collaborating across industry to decarbonise our value chain: “As part of the Group’s ambition to reduce our Scope 3 emissions by 50% by 2040, we are focusing on hard-to-abate sectors such as steel – from which most of our value chain emissions derive. We are working with steelmakers in Europe and Asia to research efficient feed materials – capitalising on the premium physical and chemical qualities of our minerals, including iron ore pellets and lump iron ore. These premium products are suited for use in the direct reduced iron (DRI) process, a technically proven and significantly less carbon intensive steel production method . The collaboration agreements ...signed in 2022, are an example of this approach.”
Metals and mining industry	“Collaborating across industry to decarbonise our value chain: “As part of the Group’s ambition to reduce our Scope 3 emissions by 50% by 2040, we are focusing on hard-to-abate sectors such as steel – from which most of our value chain emissions derive. We are working with steelmakers in Europe and Asia to research efficient feed materials – capitalising on the premium physical and chemical qualities of our minerals, including iron ore pellets and lump iron ore. These premium products are suited for use in the direct reduced iron (DRI) process, a technically proven and significantly less carbon intensive steel production method . The collaboration agreements ...signed in 2022, are an example of this approach.”		
Users’ expectation of connectivity	Users’ may expect to see visibility in the financial statements of the related expenses and any newly capitalised assets suggested by the sustainability disclosures. If such amounts are very small, these may still be material to users in terms of progress toward and likelihood of achieving the company’s emissions targets.		

Example 8: Research and development (R&D) costs incurred on customer decarbonisation	
Financial statement disclosure	There does not appear to be any disclosure on this area in the financial statements.

Example 9: Research and development (R&D) for regulatory risk mitigation			
Context	A company disclosed its programme to develop a new delivery system for a product that, when used, would substantially reduce the Greenhouse Gas emissions (GHG) produced, specifically (emphasis added):		
Sustainability disclosures	<table border="1"> <tr> <td>Pharmaceutical industry</td> <td> “Risk Management – Potential financial impact/timeframe: High (> £250m)/ medium (3-10 years): Regulations governing the use of high global warming potential (GWP) substances are being updated in the EU and UK and were updated recently in the US. This could lead to increasing costs and restrict the ability to manufacture our products that use a high GWP propellant. We are investing in an R&D programme to reduce greenhouse gas emissions ...and have made good progress towards reformulating an alternative gas that could potentially reduce the climate impact by up to 90%, if the clinical trials are successful.” </td> </tr> </table>	Pharmaceutical industry	“Risk Management – Potential financial impact/timeframe: High (> £250m)/ medium (3-10 years): Regulations governing the use of high global warming potential (GWP) substances are being updated in the EU and UK and were updated recently in the US. This could lead to increasing costs and restrict the ability to manufacture our products that use a high GWP propellant . We are investing in an R&D programme to reduce greenhouse gas emissions ...and have made good progress towards reformulating an alternative gas that could potentially reduce the climate impact by up to 90%, if the clinical trials are successful.”
Pharmaceutical industry	“Risk Management – Potential financial impact/timeframe: High (> £250m)/ medium (3-10 years): Regulations governing the use of high global warming potential (GWP) substances are being updated in the EU and UK and were updated recently in the US. This could lead to increasing costs and restrict the ability to manufacture our products that use a high GWP propellant . We are investing in an R&D programme to reduce greenhouse gas emissions ...and have made good progress towards reformulating an alternative gas that could potentially reduce the climate impact by up to 90%, if the clinical trials are successful.”		
Users’ expectation of connectivity	Users’ may expect to see visibility in the financial statements of the related expenses and any newly capitalised assets suggested by the sustainability disclosures. If such amounts are very small, this may still be material to users in terms of progress toward and likelihood of achieving, emissions targets.		
Financial statement disclosure	There does not appear to be any disclosure related to this in the financial statements. The company does however confirm consideration of climate, but this appears to only be in relation to impairment of intangible assets.		

Example 10: Research and development (R&D) Investment in new technologies	
Context	A company made numerous references to new technologies and partnerships established to pursue R&D. Specifically (emphasis added):
Sustainability disclosures	<p style="text-align: center;">Travel and leisure industry</p> <p>a) “A partnership that will pioneer the development of hydrogen combustion engine technology capable of powering a range of aircraft...</p> <p>b) A programme dedicated to developing hydrogen-powered zero emissions aircraft.</p> <p>c) The development of hydrogen ecosystems to support the introduction of aircraft,</p> <p>d) A consortium led by Airbus that is investing in Direct Air Carbon Capture and Sequestration (DACCS), a form of technical carbon removal.</p> <p>e) A multi-million-pound fleet-wide investment into the latest technology from Airbus to achieve further carbon emission reduction through Descent Profile Optimisation.</p> <p>e) Harnessing the power of AI and big data through initiatives such as the deployment of a fuel management tool.”</p> <p>It was also disclosed that the company had announced its pathway to net zero. This roadmap referenced several partnerships with other commercial companies to explore certain technologies which may assist with the overall goal to decarbonise the aviation industry. Most of these partnerships appeared to be agreements to work together on the areas identified but did not involve a financial commitment from the company other than the time and effort involved in the collaboration over an agreed period.</p> <p>The company also indicated that where there may be areas requiring a financial commitment from the company in the future, these are still subject to negotiation and there is no binding commitment on at the date of publication of the financial statements.</p>
Users’ expectation of connectivity	The comments appear to suggest that the costs associated with these will be the company’s own costs (not via investee entities), so the expectation may be for visibility in the accounts of the related expenses and any newly capitalised assets suggested by the sustainability disclosures. If such amounts are very small, this too may be material to users in terms of progress toward and likelihood of achieving the company’s emissions targets.
Financial statement disclosure	There does not appear to be any reference to development assets or research expenses. The value of software has increased, but there is no accompanying disclosure.

Appendix B: Aspects of draft IFRS Sustainability Disclosure Standards

B1. This appendix sets out the key areas of draft [IFRS S1](#) and [IFRS S2](#) that relate to connectivity matters with accounting requirements. The information below summarises the requirements rather than reproducing the actual paragraphs from the standards.

IFRS Sustainability Disclosure Standards

Structure and core content

B2. Both S1 and S2 propose requiring the disclosure of information about significant sustainability-related (climate-related) risks and opportunities to be centred on a company's consideration of its governance, strategy and risk management and the metrics and targets it uses to measure, monitor and manage significant sustainability-related risks and opportunities.

B3. While the sustainability disclosures and accounting standards are both branded as IFRS Standards they have different structures. The table below compares the structures for reference.

IFRS Sustainability Disclosure Standards
Comparative information
Frequency of reporting
Location of information
Specifying the reporting entity and the related financial statements
Use of financial data and assumptions
Sources of estimation and outcome uncertainty
Errors
Statement of compliance

IFRS Accounting Standards
Objective
Scope
Definitions
Recognition
Measurement at initial recognition
Measurement after initial recognition
Derecognition
Presentation and Disclosure

[draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

Connected Information

- B4. S1 contains a section regarding ‘connected information’¹ which proposes that an entity will be required to provide users of general-purpose financial reporting with information that enables them to assess the connections between:
- a) various sustainability-related risks and opportunities;
 - b) the governance, strategy and risk management related to those risks and opportunities, along with metrics and targets; and
 - c) sustainability-related risks and opportunities and other information in general purpose financial reporting, including the financial statements.

Understandability

- B5. Paragraph C26 of the S1 requires the entity should ensure that the financial disclosures are clear and concise, that the use of generic information, that is not specific to the entity should be avoided and that duplication of information in the general-purpose financial reporting, including unnecessary duplication of information also provided in the related financial statements.

[draft] IFRS S2 *Climate-related disclosures*

Connected Information

- B6. The Metrics and Targets section of S2, paragraph 22(b) requires that consideration is given to the relationship with the amounts recognised and disclosed in the accompanying financial statements (for example, the carrying amount of assets used should be consistent with amounts included in the financial statements and when possible, the connections between information in these disclosures and amounts in the financial statements should be explained).

Strategy

- B7. Paragraph 8(d) requires (“the entity shall disclose”) the disclosure of the effects of significant climate-related risks and opportunities on the entity’s financial position, financial performance and cash flows:
- a) For the reporting period.
 - b) The anticipated effects over the short, medium and long term.

¹ Draft [IFRS S1](#) Paragraph 42.

- c) How these risks and opportunities are included in the entity's financial planning.

Climate-related risks and opportunities

- B8. Paragraph 9(a) requires ("the entity shall disclose") a description of significant climate-related risks (physical and transition risks) and opportunities and the time horizon over which each could reasonably be expected to affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium and long term.
- B9. Paragraph 9(b) requires the entity to disclose how it defines short, medium and long term and how these definitions are linked to the entity's strategic planning horizons and capital allocation plans.

Quantitative disclosure

- B10. If the entity can provide quantitative information, paragraph 14(a) stipulates that the entity will be required to disclose the impact on its most recently reported financial position, financial performance and cash flows. And for these risks and opportunities identified, paragraph 14(b) requires information where there is a significant risk of material adjustment to the carrying amounts of assets and liabilities reported in the financial statements within the next financial year.

Financial position

- B11. Paragraph 14(c) goes on to stipulate that the entity is required to disclose how it expects its financial position to change over time (considering its definition of the short, medium and long term as required by paragraph 9(b)) when considering its strategy to address the significant climate-related risks and opportunities it has identified.
- B12. This includes its current and committed investment plans and their anticipated financial effects on the financial position. Examples may include capital expenditure, major acquisitions and divestments, joint ventures, business transformation, innovation, new business areas and asset retirements.

Financial performance

- B13. Paragraph 14(d) requires the entity to disclose how it expects its financial performance to change over time ((considering its definition of the short, medium and long term as required by paragraph 9(b)) when considering its strategy to address the significant risks and opportunities. Examples may include increases or decreases in revenue or costs of products and services aligned or not aligned with a lower-carbon economy; consistent with the latest international agreement on climate change; physical damage to assets from climate events; and the cost of climate adaptation or mitigation.

Appendix C: Consideration of IFRS Accounting Standards

- C1. This appendix sets out the key areas of the Accounting Standards relating to connectivity matters with sustainability reporting. The information below summarises the requirements rather than reproducing the actual paragraphs from the standards.

Conceptual Framework

Objective of general purpose financial reporting

- C2. Paragraph 1.2 of the Conceptual Framework (CF) stipulates that the objective of general purpose financial reporting (hereafter referred to as “financial reports”) is provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about buying, selling or holding equity and debt instruments, providing or settling loans and other forms of credit, or exercising rights to vote on, or otherwise influence, management’s actions that affect the use of the entity’s economic resources.
- C3. The decisions made by existing and potential investors, lenders and other creditors relating to providing resources to the entity will depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and on their assessment of management’s stewardship of the entity’s economic resources. To be able to make these decisions, the existing and potential investors, lenders and other creditors need information (CF paragraph 1.3).
- C4. Paragraph 1.4 states that these information needs encompass information about the economic resources of the entity, claims against the entity and changes in those resources and claims and how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s economic resources.
- C5. Paragraph 1.22 sets out that the purpose of the information about how efficiently and effectively the reporting entity’s management has discharged its responsibilities to use the entity’s economic resources helps users to assess management’s stewardship of those resources. Having such information available is also useful for predicting how efficiently and effectively management will use the entity’s economic resources in future periods. Hence, it can be useful for assessing the entity’s prospects for future net cash inflows.
- C6. Paragraph 1.23 states that examples of management’s responsibilities include using the entity’s economic resources including protecting those resources from

unfavourable effects of economic factors, such as price and technological changes, and ensuring that the entity complies with applicable laws, regulations and contractual provisions.

Link to sustainability-related risks and opportunities

- C7. The actions taken by management to address the potential impact of sustainability-related risks and opportunities in future periods would naturally be part of the assessment of management's stewardship.

Objective of financial statements

- C8. Paragraph 3.2 of the CF sets out the objective of financial statements specifically as providing financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources.
- C9. According to paragraph 3.3, information about possible future transactions and other possible future events (forward-looking information) is included in financial statements if it relates to the entity's assets or liabilities, including unrecognised assets or liabilities, or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period and is useful to users of financial statements. Paragraph 3.4 states that, for example, if an asset or liability is measured by estimating future cash flows, information about those estimated future cash flows may help users of financial statements to understand the reported measures. It also states that financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and strategies for the reporting entity.

Link to sustainability-related risks and opportunities

- C10. It is very likely that the greater focus on sustainability-related risks and opportunities especially from existing and potential investors, would be likely to increase the need to disclose forward-looking information in the financial statements. This is because of its usefulness to these user groups in seeking to understand a range of assets and liabilities (recognised or not) expected to reflect climate-related estimates.

IAS 1 Presentation of Financial Statements

Objective of IAS 1

- C11. The objective of IAS 1 (as set out in paragraph 1) is to prescribe the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of

financial statements, guidelines for their structure and minimum requirements for their content.

Purpose of financial statements

- C12. IAS 1 paragraph 9, which sets out the purpose of financial statements, states that financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it.

Reports presented outside the financial statements

- C13. Paragraph 14 of IAS recognises that many entities present, outside the financial statements, reports and statements such as environmental reports and value-added statements, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group. This paragraph goes on to specify that reports and statements presented outside financial statements are outside the scope of the International Financial Reporting Standards (IFRSs).

Sources of estimation uncertainty, fair presentation

- C14. Paragraph 125 of IAS 1 requires that an entity disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. For each of those assets and liabilities considered to be subject to this significant risk of material adjustment, the entity is required to disclose the nature and carrying amount at the end of the reporting period.
- C15. Paragraph 126 sets out that estimation is likely to be involved in determining the effects of uncertain future events on those assets and liabilities. It also recognises that the estimates would be likely to involve assumptions about such items as the risk adjustment to cash flows or discount rates and future changes in prices affecting costs.
- C16. In addition, IAS 1 contains several overarching disclosure requirements on fair presentation and materiality and aggregation (Paragraphs 17 and 31), accounting policy information (Paragraph 117), and judgements (Paragraph 122), as well as a requirement that the notes provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them (Paragraph 112c).

Link to sustainability-related risks and opportunities

- C17. Even if sustainability reporting outside the financial statements discloses sufficient information to understand the lack of financial statement impact, sufficient information should be disclosed in the financial statements to meet the

requirements of IAS 1 paragraph 125. This will allow the financial statement reporting to “stand on its own” which would allow for greater understandability and auditability.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Disclosure

- C18. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (paragraph 39) requires disclosures with respect to the nature and amount of changes in accounting estimates that has an effect in the current period or is expected to have an effect in a future period. An example of this is estimating a provision for warranty obligations, applying IAS 37.