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Andreas Barckow
Chair
International Accounting Standards Board
Columbus Building
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Dear Dr Barckow

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

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements (Proposed illustrative examples).*

We welcome the IASB's project on climate-related and other uncertainties in the financial statements. The Educational material published in 2023 and the April 2024 IFRS Interpretation Committee agenda decision *Climate-related Commitments* have helped explain how entities should apply the existing requirements in IFRS Accounting Standards to reflect the effects of climate-related matters in their financial statements. We fully support the IASB taking further actions to enhance the existing disclosure requirements on such matters and to help improve connectivity between the entity's non-financial reporting on sustainability risks and opportunities (whether applying IFRS Sustainability Disclosure Standards or not) and information disclosed in its financial statements.

Whilst we agree that providing illustrative examples accompanying IFRS Accounting Standards is useful and more effective than publishing educational material, we do not believe that this is sufficient to address the demands of investors for additional information in the financial statements.

We agree with the IASB's decision to address broadly the disclosure of the effect of uncertainties on an entity's financial statements, and not only climate-related uncertainties. We regret, however, that only one of the examples proposed illustrates the disclosure of non-climate-related uncertainties.

As detailed in our response to Question 1, to ensure that appropriate and consistent information is provided in respect of climate-related and other uncertainties, we believe that it is necessary to establish clear principles an entity should apply in determining the appropriate disclosures to meet fully the requirements of IFRS Accounting Standards. In our view, these principles should address the scope of uncertainties for which information should be disclosed, the time horizon to consider and the effect of information provided elsewhere in general purpose financial reports.

We believe that the examples proposed are generally appropriate. However, we raise concerns in our response to Question 2 in respect of the proposed examples 1 and 2. We agree that there are situations where it may be relevant for an entity to disclose that its financial statements are not affected by a specific risk or uncertainty. However, we are concerned that insufficient facts are provided in example 1 to explain why this is one of these situations. To provide an appropriate context to the conclusion reached, it would be useful to specify that:

1. In the example described, an entity's transition plan and its effect on that entity is a key topic on which investors have been asking for information from those charged with governance.
2. Those charged with governance have, however, determined that the transition plan does not currently have a material effect on the financial statements.
3. However, given the investor interest those charged with governance should also consider whether the *absence* of effect of the transition plan on the entity's financial statements is material to investors. If so, that fact should be disclosed.

In addition, we believe that examples 1 and 2 should be included as part of IFRS Practice Statement 2 *Making Materiality Judgements* since their main purpose is to illustrate the application of materiality judgement.

If you have any questions concerning our response, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely

Veronica Poole
Deloitte Global IFRS and Corporate Reporting Leader

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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.

Subject to our comments in response to Question 2, we agree that providing illustrative examples accompanying IFRS Accounting Standards is useful and is more effective than publishing educational material. This ensures that the guidance is subject to a more thorough due process review. It also gives more prominence to the guidance. In practice, we note a great degree of adherence to guidance provided through illustrative examples.

However, we do not believe that adding illustrative examples is sufficient to address the demands of investors for additional information in an entity's financial statements about the effect of climate-related risks and other uncertainties as noted in BC1.

We believe that financial statements generally provide information that reflects the current requirements and principles set out in the IFRS Accounting Standards. We believe that amendments to the applicable standards are required to ensure meaningful changes to the disclosures provided on uncertainties. For example, we note that some of the proposed examples are described as illustrating the application of IAS 1:31 (or IFRS 18:20). We do not believe that this paragraph (even when accompanied by illustrative examples) is clear and specific enough to explain to preparers the circumstances requiring additional disclosures beyond those specifically required in a standard. In particular, we believe that it would be useful to provide guidance on the judgement framework to be applied when deciding whether additional information should be disclosed.

To ensure that appropriate and consistent information is provided in respect of climate-related and other uncertainties, we believe that it is necessary to establish the principles an entity should apply to determine the disclosures required. In our view, these principles should address the following elements:

- *Scope of uncertainties for which information should be disclosed*: We believe that it is important to distinguish the type of uncertainties that an entity may be required to disclose in its financial statements from the uncertainties disclosed elsewhere, for example as part of sustainability-related financial disclosures. Accordingly, we believe that the principles should establish that an entity should provide information in respect of material uncertainties that affect material judgements and estimates made as part of the preparation of the financial statements.

- *Time horizon to consider*: We note that IAS 1:125 (or amended IAS 8:31A) requires information about major sources of uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Whilst it is useful to clarify, as explained in BC37, that this is not limited to uncertainties that will be resolved within the next financial year, we do not believe this is sufficient. Indeed, we believe that it would be useful to establish as a principle that an entity may be required to disclose information about uncertainties that will affect the carrying amounts of assets and liabilities only over a longer period. We do not suggest that the time horizon to consider should be specified. Instead, we believe that it should be explained that the period to consider depends on the circumstances applicable to the entity (for example, the industry in which it operates, the nature of the uncertainties, the useful life of its assets).
- *Effect of information provided elsewhere in general purpose financial reports*: Some of the proposed examples (in particular examples 1 and 2) and the additional explanation provided in the basis for conclusions appear to link the need for information in the financial statements with whether an entity prepares sustainability reporting and, if so, the standards applied when preparing this reporting (potentially implying that the provision of material information within sustainability reporting could, particularly if that reporting is prepared under IFRS Sustainability Disclosure Standards, negate the need for that information to be included in the financial statements). We do not believe that such an implication is appropriate as financial statements should include all information required to enable the primary users of the financial statements to understand the impact of particular transactions, events and conditions on the entity's financial position and financial performance. If the intention of this material is, instead, to allow for the inclusion of information via cross-reference to sustainability reporting, this together with the criteria for such a practice (including any relevance of the framework under which sustainability reporting is prepared) should be set out in IFRS Accounting Standards (most likely, in IFRS 18 or, for entities that have not yet applied that Standard, IAS 1).

Whilst not directly related to the disclosure of the effect of uncertainties on the financial statements, we also believe that it is important to set out clearly the principle of consistency in assumptions and estimates used throughout the financial statements (e.g. cash flows used to assess impairment losses in IAS 36, recoverability of deferred tax assets in IAS 12, performance under long-term contracts in IFRS 15, etc). Evaluating the consistency of assumptions is a key aspect of the work we perform as auditors. Investors and regulators have also repeatedly called for consistency between assumptions within and outside of the financial statements. Setting out that this important principle applies to the preparation of financial statements would contribute to improving quality and connectivity.

We suggest these principles would be well suited to be added to IAS 8 (as amended for IFRS 18). Having established these principles, each of the proposed examples could then explain how the conclusion presented reflects the application of the principles.

If the IASB believes that this cannot be achieved within the scope of this project, alternative means should be sought to explain more clearly the basis for the conclusions reached in the illustrative examples. This may include additional wording in the objective or disclosure sections of each of the standards in which examples are added. Indeed, consistent with our response to the *Request for Information – Third agenda consultation*, we believe that the disclosure of the impact of sustainability-related uncertainties on the financial statements should be the subject of targeted standard-setting actions.

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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.

As indicated in our response to Question 1, we agree that examples would provide helpful guidance if accompanied by amendments to the applicable standards to set out the principles that are illustrated.

We support the IASB's decision to develop examples based on narrow fact patterns. However, to reflect this decision, we suggest that each of the examples should include a statement indicating that the example does not illustrate the application of all requirements of IFRS Accounting Standards that may be relevant to the fact pattern and that it only focuses on a specific aspect.

In addition, we believe that it may be helpful to provide an example illustrating the application of the disclosure requirement IFRS 15:114 to disaggregate revenue depicting how its nature, amount, timing and uncertainty is affected by economic factors.

Our detailed comments in respect of the examples proposed are outlined below.

Example 1

We agree that there are situations where it may be relevant for an entity to disclose that its financial statements are not affected by a specific risk or uncertainty.

However, we are concerned that insufficient facts are provided in example 1 to explain why this is one of these situations. In particular, the example does not explain why the fact that the transition plan does not have an effect on the financial statements is material information to the users despite the fact that the assets of the affected manufacturing facilities are nearly fully depreciated and there is significant headroom in the affected cash generating units. To provide an appropriate context, it would be useful to specify that an entity's transition plan and its effect on the entity is a key topic on which investors have been asking for information from those charged with governance and that accordingly those charged with governance should also consider whether the absence of effect of the transition plan on its financial statements is material to investors and, if so, that fact should be disclosed.

We believe that this example should be included as part of IFRS Practice Statement 2 *Making Materiality Judgements* since its main purpose is to illustrate the application of materiality judgement.

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It may also be appropriate to add IAS 1:125 (or amended IAS 8:31A) to the specific requirements listed in paragraph 1.4 that the entity considered in assessing whether IFRS Accounting Standards require the disclosure of certain information.

Finally, as noted in our response to Question 1, we are concerned that it may be inferred from BC30 and BC32, that the information disclosed elsewhere may affect an entity assessment of the information required in the financial statements:

- BC30 indicates that "the entity considers whether the disclosures it makes in a general purpose financial report outside its financial statements affect its determination of which information is material in the context of its financial statements". We do not believe that this statement is correct. Whether an entity prepares sustainability information should not affect whether information is *material* in the context of the financial statements. We believe that BC30 is misleading and should not be retained;
- BC32 indicates that examples 1 and 2 assume that the entity does not apply IFRS Sustainability Disclosures Standards and that if the entity had applied those standards it would have disclosed in its sustainability-related financial disclosures information about the effect of climate-related risks and opportunities on its financial position, financial performance and cash flows for the reporting period. This statement can read to imply that an entity may exclude information from its financial statements on the basis that it is included elsewhere in the general purpose financial report. We do not believe that this is appropriate. Currently, IFRS Accounting Standards only address the possibility of incorporating information in the financial statements by explicit cross-reference to other information disclosed elsewhere in limited circumstances (notably, in context of specific disclosure requirements in IFRS 7). If the intention of BC32 is to allow for such a practice in respect of sustainability information, we believe that the criteria supporting the use of cross referencing in the financial statements should be set out in the main body of IFRS Accounting Standards themselves.

Example 2

Whilst the conclusion reached in example 2 is different, we believe the example presents the same shortcomings as example 1. Namely, the fact pattern is not sufficiently detailed to explain the basis for the conclusion reached by the entity that no additional information is required to be included in the financial statements. Also, consistent with our comment on example 1, we believe that the example 2 should be added to IFRS Practice Statement 2 *Making Materiality Judgements*.

We believe it would also be useful to clarify the background provided in paragraph 2.2 to specify why the entity itself (not only the industry) has limited exposure to climate-related transition risks.

Example 3

We support the finalisation of example 3, but note the following suggestions.

In our response to the IASB's Exposure Draft *Business Combinations – Disclosures, Goodwill and Impairment* we noted the importance of "enhancing disclosure in respect of key assumptions used to estimate the recoverable amount. For example, clarifying that the key assumptions that may need to be disclosed are not limited to the growth rate and discount rate, but may include other performance metrics. It may also be useful to illustrate the application of the sensitivity analysis in IAS 36:135(e), and include in this illustration the disclosure of the impact of changes in key assumptions other than growth rate and discount rate."

We believe that example 3 provides the opportunity to illustrate the application of the disclosure requirements on key assumptions.

For example, it may be appropriate to explain how the entity has determined its key assumptions. Also, in addition to information about the future price of greenhouse gas emission allowances and the future scope of emissions, paragraph 3.5(a) could refer to level of expected emissions. It may also be appropriate to refer to the sensitivity analysis required by IAS 36:135(e).

Example 4

Whilst the example appropriately reflects the existing requirements in IFRS Accounting Standards, we note that it highlights a deficiency in IAS 36. Indeed, whilst IAS 36:134(f) requires additional information to be disclosed when a reasonably possible change in a key assumption would result in an impairment loss in respect of a cash-generating unit to which goodwill (or an intangible asset with indefinite useful live) is allocated, no similar requirement exists in respect of other cash-generating units (CGUs) for which an impairment test has been conducted. Instead of relying on the existing requirements in IAS 1:125 (or amended IAS 8:31A), we suggest that the IASB may consider amending IAS 36, for example to require a broader application of IAS 36:134(f) including when an entity estimates the recoverable amount of an asset or a CGU (to which neither goodwill nor intangible assets with indefinite live have been allocated) because there is an indication that the asset or CGU may be impaired.

If the IASB decides not to amend the disclosure requirements in IAS 36, we believe that it would be appropriate to finalise example 4 but note the following suggestion.

The example explains that the entity is required to disclose the information specified in IAS 1:125 (or amended IAS 8:31A) because there is a significant risk of an adjustment to the carrying amount of the assets if the entity revises those assumptions in the next year. We agree with this conclusion. However, as explained in our response to Question 1, it may be useful to expand this fact pattern and illustrate the disclosure that would be required if instead the entity expected a significant risk of an adjustment to the carrying amount of the assets in more than 12 months.

Example 5

We support the finalisation of example 5 but suggest the following clarifications.

The background refers to a regulation “that would restrict the entity’s ability to operate and generate profits in the future.” In such a scenario, in addition to the recoverability of its deferred tax asset, the entity may be concerned about the impact of the regulation on other areas such as impairment of assets or going concern. Consistent with our earlier comment, we believe that it would be important to specify that the example is only meant to illustrate uncertainties related to recoverability of deferred tax assets.

Paragraph 5.4 indicates that the entity has unused tax losses but no history of recent losses. It may be useful to explain the situation further, for example, by indicating that the tax losses arose in the first years of the entity’s operations and since then the entity has been profitable but continues to have unused tax losses.

Paragraph 5.5 indicates that the entity’s assumption is that “the regulation will become effective only after the entity has been able to utilise these losses”. It is unclear whether the entity assumes that all tax losses will be utilised in the next two years (i.e. before the date the government has announced it will consider the changes in the legislation) or over a longer period (i.e. the entity expects that it will take longer for the legislation to be enacted and become effective). We believe that the example should be clarified in this respect, because it seems important in order to explain the conclusion in paragraph 5.10 that the decisions of the users could reasonably be expected to be influenced by the lack of information. If the entity assumed that it will utilise all tax losses in the next two years and if a reasonably informed user would also assume that the legislation would not be enacted for the next two years, there seems to be no need for the disclosure of additional information.

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Example 6

We support the finalisation of example 6.

Example 7

We support the finalisation of example 7 but note the following suggestions.

Whilst we agree with the outcome of the example (i.e. the need for disclosure of information due to qualitative materiality factors even though the amount of the provision is immaterial), we note that the example may not be realistic. In our experience, even on a discounted basis, decommissioning provisions in the petrochemical (or similar) industry are generally material. We suggest the IASB to consider an alternative way to illustrate the outcome achieved, for example, by not specifying the industry in which the entity operates. This would also make the example more explicitly relevant to a broader group of entities.

Example 8

We support the inclusion of an example illustrating that information may need to be disaggregated when it relates to items with dissimilar risk characteristics. However, we have concerns about the example suggested. This example could be seen as an interpretation of what is a class of property, plant and equipment ('PPE') in IAS 16:37 which is defined as "a grouping of assets of a similar nature or use". The example suggests that PPE items with different levels of greenhouse gas emissions necessarily belong to the different PPE classes. We do not believe that this generalisation is appropriate and we suggest that the IASB explains why this is the case in the example or simply states as part of the fact pattern that the entity has determined that the PPE items belong to different classes of assets.

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

Status of the illustrative examples

We agree with the statement in BC49 that it is appropriate to allow entities sufficient time to implement any changes to the information disclosed in their financial statements as a result of the issuance of the illustrative examples.

We note that the IFRS Foundation Due Process Handbook addresses the authority of explanatory material only in the context of IFRS Interpretation Committee agenda decisions. We suggest that the IFRS Foundation considers amending its Due Process Handbook to clarify the authority of explanatory material included in the illustrative examples accompanying IFRS Accounting Standards and whether the practical allowance for sufficient time to implement applies to any change in practice driven by illustrative examples.

Other comments

We note the addition into the IASB's work plan of a project on intangible assets and bring to the IASB's attention the suggestion we made in our response to the *Request for Information – Third agenda consultation* that pollutant pricing mechanisms should be considered, along with cryptocurrencies and commodities lending transactions, as part of a project on new forms of 'intangible assets'. We suggested that this project could:

- First consider if and when these new intangible assets are in the scope of an existing IFRS Accounting Standard (e.g. IAS 38 or IFRS 9). If not in the scope of an existing IFRS Accounting Standard, the characteristics of the items that belong to a different class of assets could be identified.
- For those items identified as belonging to a new class of assets, the IASB could in turn address (i) recognition, (ii) initial and subsequent measurement, (iii) derecognition and (iv) lending transactions.

We also draw attention to our response to the IASB's Exposure Draft *Business Combinations – Disclosures, Goodwill and Impairment* in which, as noted in our response to Question 2, we suggested potential improvements to the disclosure requirements in IAS 36.