Exposure Draft

IFRS® Accounting Standard (Climate-related and Other Uncertainties in the Financial Statements)
Proposed illustrative examples

Comments Submitted by Bhopal Branch (CIRC) of ICAI (21ST September 2024)

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

The IASB's proposal to provide illustrative examples for reporting the effects of climate-related and other uncertainties in financial statements offers targeted support to address practical challenges faced by entities. To understand why this proposal is beneficial, it's helpful to explore the specific concerns that the IASB aims to address and how the examples can make a meaningful difference.

Key Concerns Driving the Proposal:

1. **Insufficient or Inconsistent Climate-Related Disclosures**:
   Stakeholders have raised concerns that financial statements do not adequately reflect the risks posed by climate-related uncertainties. Often, the climate risks presented in other parts of an entity's reporting (such as sustainability disclosures) do not align with the financial statements. For example, a company might discuss its exposure to environmental risks in sustainability reports but fail to reflect the potential financial impacts of those risks in its balance sheet or income statement. This inconsistency reduces the credibility and usefulness of financial reporting for investors and other users.

2. **Application Challenges of IFRS Accounting Standards**:
   While IFRS Accounting Standards are generally principle-based and flexible, the application of these standards to complex and emerging issues like climate-related risks has posed challenges. Entities are required to disclose uncertainties under existing standards, but it's not always clear how to apply these requirements to specific climate-related situations. The uncertainty around long-term climate impacts, for instance, might complicate how entities estimate liabilities or impairment of assets. This has led to inconsistencies in how climate risks are recognized or measured.

3. **Evolving Reporting Landscape**:
   With the rise of sustainability-related financial disclosures, there is a growing body of information that goes beyond the traditional financial statements. Sustainability disclosures prepared under frameworks like the IFRS Sustainability Disclosure Standards (by the ISSB) might include qualitative and quantitative information about environmental risks. The financial statement preparers face a challenge in aligning this broader sustainability reporting with IFRS financial reporting requirements, creating potential gaps in user understanding.

The Role of Illustrative Examples:

1. Clarifying the Application of IFRS Standards:

- **How Examples Will Help**: The illustrative examples will provide practical, scenario-based guidance on how entities can apply existing IFRS standards, such as IAS 1 (Presentation of Financial Statements) or IAS 37 (Provisions, Contingent Liabilities, and Contingent Assets), in the context of climate-related risks. For example, how should an entity recognize a provision related to future climate regulation, or how should an entity assess the impairment of assets affected by long-term climate risks? By showing how to apply the principles already embedded in IFRS, the examples will remove ambiguity, helping preparers confidently disclose the financial effects of these risks.
- Entities will gain clearer insights on how to reflect uncertainties like the potential costs of carbon emissions, regulatory changes, or the physical impact of climate change. This is especially important for sectors highly exposed to environmental risks (e.g., energy, mining, transportation).

2. Consistency in Reporting:

- **How Examples Will Help**: By providing examples on how to disclose and measure climate-related uncertainties, the IASB will help create more consistent practices across different companies and sectors. For instance, illustrative examples could show how companies should incorporate climate-related information into their accounting estimates, such as provisions for environmental liabilities or impairment tests for long-lived assets.
- Consistency is crucial for investors and other users of financial statements to make comparisons between companies and to understand the financial impact of climate risks more reliably. Clear examples reduce the risk of subjective interpretations of accounting rules that may vary between entities, ensuring uniform application of IFRS standards.

3. Addressing Stakeholders' Demand for More Information:

- **How Examples Will Help**: Investors, regulators, and other stakeholders are increasingly interested in the financial impacts of climate change. By offering concrete guidance on how to report climate-related uncertainties in financial statements, the IASB's illustrative examples can bridge the gap between traditional financial statements and the broader information available in sustainability-related reports. For example, the examples may demonstrate how climate-related information from an entity's sustainability disclosures can be connected to key line items in financial statements.
- Users of financial statements often need more detailed and transparent information about how climate risks affect a company's financial performance and position. Illustrative examples will ensure that entities disclose these uncertainties comprehensively, making financial statements more relevant and useful to their primary users, particularly in industries where climate risk is material.

The IASB's decision to include these examples alongside IFRS standards, rather than as separate educational materials, is significant:

- **Elevates the Importance of Climate-Related Disclosures**: By attaching these examples directly to the standards, the IASB signals the importance of climate-related disclosures as integral to the financial reporting process, not an optional or supplementary exercise.

- **More Widely Accessible**: When included within the standards, these examples will be more visible to financial statement preparers, auditors, and regulators, ensuring they are considered as part of compliance with IFRS, as opposed to educational materials that may be overlooked.
- **Timely and Consistent Response**: Educational materials are often seen as informal guidance, while incorporating examples within the standards ensures that all entities have clear, consistent instructions to follow, addressing the issues raised by stakeholders in a timely manner.

Some may argue that providing examples could reduce the flexibility of IFRS standards, potentially encouraging entities to focus on specific scenarios rather than considering the full range of their climate-related risks. However, illustrative examples are typically designed to show how to apply principles in a variety of contexts, not to dictate a one-size-fits-all approach. They can provide clarity without undermining the flexibility and principles-based nature of IFRS.

Conclusion:

In conclusion, the IASB's proposal to include illustrative examples alongside IFRS Accounting Standards is a practical and necessary step to improve the reporting of climate-related and other uncertainties in financial statements. The examples will clarify the application of existing standards, promote consistency across entities, and respond to stakeholders' demands for more detailed and reliable information on how climate risks impact financial statements. Given the growing importance of sustainability and climate-related risks, this initiative aligns IFRS reporting with the evolving needs of users, while still preserving the flexibility of the standards.