Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.ifrs.org)

27 November 2024

Dr Andreas Barckow
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Andreas,

IASB Exposure Draft
Climate-related and Other Uncertainties in the Financial Statements

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing, ethics and sustainability disclosures for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Exposure Draft (ED).

The HKICPA appreciates the IASB's endeavours to address stakeholders' concerns regarding insufficient disclosures of the effects of climate-related risks in the financial statements and inconsistencies between that information disclosed in the financial statements and the information provided in other general purpose financial reports. We agree that providing examples would generally help improve the reporting of the effects of climate-related and other uncertainties in the financial statements. We also support including them as illustrative examples accompanying IFRS Accounting Standards. However, we have significant concerns about certain aspects of the proposals. We provide detailed comments in the Appendix and summarise our primary concerns and recommendations below.

Connectivity

One of the objectives of the ED is to strengthen the connection between financial statements disclosures and sustainability disclosures. However, we believe this aim is challenging to achieve due to the lack of strong principles underlying how financial statements and sustainability reports should be connected. Also, the illustrative examples do not clearly demonstrate this connectivity.

To better achieve this objective, we strongly recommend that the IASB collaborate with the ISSB to develop a more comprehensive plan for their long-term strategy concerning the connectivity between financial statements disclosures and sustainability disclosures. This plan could include the development of a framework that sets out the principles of connectivity and how it can be achieved. Such a project could be conducted as a separate workstream to avoid delaying the publication of the illustrative examples.

As an interim measure, we recommend that the IASB enhance the illustrative examples to demonstrate how connectivity can be attained. We also recommend the IASB collaborate with the ISSB on developing the article as mentioned in the April 2024 IASB staff paper regarding the role of financial statements and the interaction between IFRS Accounting Standards and IFRS SDS. If feasible, this article should be published alongside the enhanced illustrative examples to promote clarity about connectivity.

Requirements in other IFRS Accounting Standards and non-climate related uncertainties

Understandably, the proposed examples illustrate only certain disclosure requirements in a few IFRS Accounting Standards regarding the effects of climate-related and other uncertainties in the financial statements. Furthermore, the ED focuses primarily on climate-related risks and uncertainties, with only one out of the eight examples illustrating other types of risks and uncertainties. We are concerned that this is insufficient to raise awareness and assist preparers in considering other applicable disclosure requirements in IFRS Accounting Standards and in reporting the effects of non-climate related uncertainties. Accordingly, we recommend the IASB enhance its existing educational material – *Effects of climate-related matters on financial statements* or publish similar guidance to cover other applicable IFRS Accounting Standards and other types of uncertainties that are contentious or prevalent among entities. If possible, this enhanced material should be published together with the illustrative examples and the article on the role of financial statements as a single package to provide comprehensive guidance.

Negative statement in Example 1

We have significant concerns that the disclosures stating that a specific risk had no impact on the financial statements, as illustrated in Example 1, could set a new precedent for mandating a negative statement in financial statements. We believe this is not the intended purpose of paragraph 31 of IAS 1 *Presentation of Financial Statements.* We are also concerned that such negative statements may extend beyond climate and sustainability risks and uncertainties to encompass a broader range of other risks and uncertainties, potentially creating a significant burden for preparers in conducting the assessments and leading to boilerplate disclosures or information overload, which would not be useful for users.

Accordingly, we strongly recommend the IASB clarify whether the 'no impact' disclosure signifies a new requirement. If it does, this new requirement should be considered through a separate standard-setting project. If it does not constitute a new requirement, the IASB should clearly explain its conclusion and rationale in the Basis for Conclusions. We also recommend the IASB enhance Examples 1 and 2 to illustrate the principles and thought process of when and how to apply paragraph 31 of IAS 1 and determining whether to disclose additional information based on user expectations for items that have no effect on the entities' financial position or financial performance.

If you have any questions regarding the matters raised in this letter, please contact Shiro Lam (shirolam@hkicpa.org.hk) or Kennis Lee (kennislee@hkicpa.org.hk), Associate Directors of the Standard Setting Department.

Sincerely,

Cecilia Kwei

Cecilia Kwei
Director of Standard Setting

<u>Work undertaken by the HKICPA in forming its views:</u>

The HKICPA:
(a) issued an Invitation to Comment on the ED on 1 August 2024 to its members and other stakeholders;
(b) sought input from its Task Force for the ED; and
(c) developed its views through its Financial Reporting Standards Committee, having reflected on its respondents' views. The Committee comprises preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

<u>Detailed comments on the IASB ED</u>

Question 1: Providing illustrative examples

1. We agree that providing examples would generally help improve the reporting of the effects of climate-related and other uncertainties in the financial statements. However, we question whether the proposed examples are sufficient to meet all the objectives of the ED and adequately address stakeholder needs. We provide our detailed comments below.

A. <u>Vehicles for the examples</u>

2. We agree with the IASB's proposal to include the examples as illustrative examples accompanying IFRS Accounting Standards. We believe that this approach strikes an appropriate balance between accessibility, enforceability and flexibility in the content and format of the examples.

3. Moreover, we support the IASB's intention to group the examples and publish them (together with the Basis for Conclusions (BC)) as a single document in addition to including the examples as illustrative examples accompanying IFRS Accounting Standards (BC 45 of the ED). We believe the package as a whole would improve the accessibility and understandability of the examples and offer a suitable platform to convey the following important messages, which are currently located in the BC:
   (a) the principles and requirements illustrated in the examples apply equally to non-climate related uncertainties;
   (b) the illustrative examples do not cover all requirements in IFRS Accounting Standards that might be applicable to a fact pattern; therefore, it is important to refer to all the relevant requirements in the Standards when preparing financial statements; and
   (c) the background of the examples is hypothetical and entities must address real-world complexities on a case-by-case basis.

4. However, if the IASB decides to include the examples solely under different Standards to which they relate (and not in a single document), we recommend the IASB carefully consider where the BC on the examples would be placed, and how the important messages as set out in paragraph 3(a) to 3(c) above would be effectively communicated to the preparers.

B. <u>Connectivity</u>

5. As stated in BC 21 of the ED, one of the objectives of the ED is to illustrate the provision of connected information in general purpose financial reports and to reinforce compatibility with IFRS Sustainability Disclosure Standards (IFRS SDS). Our respondents find this aim challenging to attain as there is currently no principle

about how financial statements and sustainability reports are expected to be connected and how they could be connected. In addition, the examples in the ED only illustrate the application of the existing disclosure requirements in IFRS Accounting Standards; they do not clearly demonstrate the connectivity between financial statements disclosures and sustainability disclosures.

6. In the absence of any principles about the connection between financial statements and sustainability reports, we believe the IASB's goal of strengthening connectivity could not be fully attained by merely providing preparers with illustrative examples of existing disclosure requirements in IFRS Accounting Standards. We consider it crucial for the IASB and the ISSB to explain the different parameters of financial statements and sustainability reports so that users know how to interpret the underlying meaning of the disclosures. For example, the basis for estimating the anticipated financial effects under IFRS SDS may differ from that used for estimating the future cash flows in impairment assessments under IAS 36 *Impairment of Assets* due to variations in the time horizons considered in sustainability reporting versus financial reporting. Financial statements may not reflect the risks that materialise beyond the time horizon or the future actions that an entity may be compelled to take to mitigate climate-related risks, which are essential for preparing sustainability-related financial disclosures. Such differences could affect the extent of financial impacts and related disclosures in the two reports.

7. To achieve the objective of enhancing connectivity, we recommend the IASB collaborate with the ISSB to develop a more comprehensive plan for their long-term strategy concerning the connectivity between financial statements disclosures and sustainability disclosures. This could include the development of a framework that sets out the principles of connectivity and how it can be achieved. Such a project could be conducted as a separate workstream to avoid delaying the publication of the illustrative examples.

8. As an interim measure, we recommend the IASB enhance the illustrative examples in the ED (see Question 2 for our detailed recommendations) and add cross-references to the relevant requirements in IFRS SDS in the illustrative examples to demonstrate how connectivity could be attained. We understand that some jurisdictions do not apply IFRS SDS; however, adding explicit references to the relevant requirements in IFRS SDS could clearly demonstrate how the accounting disclosures in the illustrative examples interact with sustainability disclosures.

9. Additionally, we understand from the April 2024 IASB staff paper that the IASB is exploring the development of an article about the objective of financial statements, their audience, their boundaries and how IFRS Accounting Standards and IFRS SDS interact and complement each other. We recommend that the IASB and the ISSB work together to develop this article and if feasible, publish it alongside the enhanced illustrative examples to promote clarity about connectivity.

C. <u>Requirements in other IFRS Accounting Standards and non-climate related uncertainties</u>

10. When developing the illustrative examples, the IASB focused on the requirements in IFRS Accounting Standards that are among the most relevant for disclosing the effects of climate-related and other uncertainties in financial statements. Therefore, the illustrative examples in the ED only demonstrate the application of certain specific disclosure requirements in a few IFRS Accounting Standards, such as IAS 1, IAS 36, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and

IFRS 7 *Financial Instruments: Disclosures*. Without illustrating all relevant disclosure requirements, some of our respondents are concerned that preparers may overlook other applicable disclosure requirements within the aforementioned Standards or in other Standards.

11. Similarly, some respondents noted that the examples in the ED heavily focus on reporting the effects of climate-related uncertainties, with only one out of the eight examples illustrating the effects of other types of uncertainties. These respondents considered this is insufficient to raise awareness and assist preparers in how to report the effects of non-climate related uncertainties in the financial statements.

12. In view of the above concerns, some of our respondents requested additional illustrative examples. However, we believe it is impracticable to produce additional examples that cover all applicable requirements in IFRS Accounting Standards or all non-climate related uncertainties. Doing so would not effectively address the respondents' concerns. To alleviate the above issues, we recommend the IASB:
    (a) Enhance the IASB's educational material – *Effects of climate-related matters on financial statements* or publish similar guidance to cover other applicable IFRS Accounting Standards and types of uncertainties that are contentious or prevalent among entities, such as regulatory changes (e.g. social media usage and carbon levies), nature-related issues (e.g. water stress), business sustainability, social issues, data security/cyber breaches and geopolitical instability. If possible, the enhanced material could be published at the same time as the illustrative examples and the article on the role of financial statements referred to in paragraph 9 above as a single package, to provide preparers with comprehensive guidance;
    (b) Enhance the examples to improve preparers' understanding of the thought process involved in assessing and reporting the impact of various types of uncertainties in financial statements (see Question 2 for our detailed recommendations for each example); and
    (c) Add a caveat in the illustrative examples to remind preparers that there may be other applicable disclosure requirements for them to consider beyond those illustrated.

Question 2: Approach to developing illustrative examples

13. We considered that the selection of requirements and fact patterns illustrated in most of the examples in the ED should be enhanced or clarified. Our detailed comments are as follows.

A. Examples 1 and 2 – Materiality judgements leading to/ not leading to additional disclosures (IAS 1/ IFRS 18)

(a) Negative statement and practical challenges

14. Example 1 illustrates that when making materiality judgements, an entity must assess both qualitative and quantitative factors that could reasonably be expected to influence the decisions of users of financial statements. In the illustrated scenario, the entity is required to disclose information about transition plans even if those plans have 'no effect' on the entity's financial position or financial performance. We have significant concerns that this could set a new precedent for disclosures stating that a specific risk had no impact on the financial statements, which we believe is not the intended purpose of paragraph 31 of IAS 1. Furthermore, we are concerned that such negative statements may extend beyond

climate and sustainability risks and uncertainties to encompass a broader range of other risks and uncertainties. This could create a significant burden for preparers in conducting assessments and preparing the disclosures, potentially leading to boilerplate disclosures or information overload, which would not be useful for users.

15. Even if the IASB does not consider this a new requirement, the current drafting of the examples, which require entities to rely on the expectations of *users* to determine whether additional disclosures are needed under paragraph 31 of IAS 1, still poses significant challenges for *preparers*. Preparers may find it unclear as to when they are 'expected' to disclose items which have no effect on the recognition or measurement of their assets and liabilities, as well as related income and expenses. In addition, we are concerned that simply referencing this 'catch all' paragraph as the justification for disclosures in the proposed examples, without a comprehensive illustration of the principles and thought process, may lead to confusion about the logic of applying paragraph 31 of IAS 1 in the examples. This could result in unintended consequences of over-interpretation and misapplication of the paragraph in other contexts. We consider that neither 1.8 of Example 1 nor 2.8 of Example 2 clearly illustrates the following thought process:
    (a) the types of uncertainties that entities disclose are those material uncertainties that affect judgement and estimates made as part of the preparation of financial statements;
    (b) the qualitative factors that the entity has considered in reaching the conclusion that the additional information that is material to financial statements and is likely to influence user's decision making; and
    (c) the judgement that the entity made regarding the extent of disclosures that need to be provided in the financial statements, if certain information has already been provided in a general purpose financial report outside the financial statements.

16. In light of the above concerns, we strongly recommend that the IASB thoroughly assess and clarify whether the 'no impact' disclosure signifies a new requirement. If it does, we believe that the new requirement should not be introduced through an illustrative example. Instead, it should be properly deliberated through a separate standard-setting project. On the other hand, if it does not constitute a new requirement, then the IASB should clearly explain its conclusion and rationale in the BC. We also recommend the IASB enhance Examples 1 and 2 to clearly illustrate the principles and thought process of when and how to apply paragraph 31 of IAS 1 in order to address the concerns stated in paragraph 15 above.

17. In addition, we note that the illustrative examples have been developed by the IASB to complement the 2019 IASB educational material. Accordingly, we recommend the IASB enhance the examples by illustrating how entities should apply the four-step process (i.e. identify, assess, organise and review) in IFRS Practice Statement 2 *Making Materiality Judgements*, when making materiality judgements relating to disclosures about climate-related and other emerging risks, as depicted in the 2019 IASB educational article.

(b) Connectivity

18. BC 32 of the ED states that Examples 1 and 2 assume that the entity does not apply IFRS SDS. If those Standards were applied, an entity would need to disclose further information in its sustainability-related financial disclosures. Our respondents found this paragraph confusing as they are uncertain about what additional information is expected to be disclosed if IFRS SDS is adopted, where this information should be located and how it should be connected with the financial

statements disclosures. As mentioned in paragraph 8 above, we consider it essential for the IASB to enhance the illustrative examples as an interim solution to achieve the objective of improving connectivity. We therefore recommend that the IASB demonstrate in these examples how financial and sustainability reports could be connected when entities adopt both IFRS Accounting Standards and IFRS SDS. For example, it should clarify whether and where the information about how the entity is funding the transition plan and how resilient the assets are under the plausible climate scenarios should be disclosed.

(c) Drafting comments

19. We have the following drafting comments to enhance the clarity of the examples:
- Given that the climate-related transition plan in Example 1 spans the next 10 years, we recommend that the IASB specify in 1.3 and 1.9 of the ED that the transition plan has no effect on assets and liabilities 'as at year end', and related income and expenses 'for the current year', to avoid any misinterpretation regarding the timing of the effects on financial statements.
- Add in 1.4 of the ED that the entity has determined there is no information to be disclosed in respect of paragraph 125 of IAS 1.
- Clarify in 2.2 of the ED that the entity itself (not only the industry) has limited exposure to climate-related transition risks and that the only impact of those risks is through the entity's greenhouse gas (GHG) emission policy.

B. *<u>Example 3 – Disclosure of assumptions: specific requirements (IAS 36)</u>*

20. Example 3 illustrates the impact of GHG regulation on impairment assessment and focuses on the *<u>costs</u>* of future emission allowance. We consider the example could be improved by clearly indicating that entities need to consider factors other than costs, such as revenue, when assessing the potential impact of GHG regulation on impairment assessment. This clarification is necessary to avoid the misleading impression that costs are the sole consideration or that they should outweigh other factors. For example, GHG regulation may adversely affect future revenue for certain industries, such as the manufacturing of plastic bags, resulting in a negative revenue growth rate and affecting the cash inflows in the cash flow projections.

C. *<u>Example 4 – Disclosure of assumptions: general requirements (IAS 1/ IAS 8)</u>*

21. We recommend the IASB enhance the clarity of this example in the following aspects:
(a) Explain the impact of climate-related transition risk on the useful lives of the entity's property, plant and equipment as it is one of the key considerations when evaluating the impact of climate risks on these assets;
(b) Specify in 4.3 of the ED the internal and/or external factors that indicate some of the entity's non-current assets might be impaired during the current reporting period; and
(c) Replace the terms 'CGU's carrying amount' and 'carrying amount of the CGU' in 4.6(d) of the ED with 'CGU's recoverable amount' and 'recoverable amount of the CGU', as the assumptions impact the calculation of recoverable amount of CGU but not the carrying amount.

D. *<u>Example 5 – Disclosure of assumptions: additional disclosures (IAS 1/ IFRS 18)</u>*

22. 5.4 of the ED states that the entity does not have a history of recent losses but possess unused tax losses. We recommend that the IASB clarify how the entity has arrived at this tax position to improve the understanding of the example.

E. *Example 6 – Disclosure about credit risk (IFRS 7)*

23. We have the following drafting recommendations to improve the clarity of this example:
    (a) Enhancing the background:
        (i) 6.1(a) of the ED: Clarify the specific paragraph in IFRS 7 that requires the disclosure of information about the effects of particular risks on an entity's credit risk exposures and credit risk management practices; and
        (ii) 6.2 of the ED: Delve into the financial institution's credit risk management practices and explain clearly how those practices help the entity identify two portfolios of loans for monitoring and taking action to mitigate credit risks arising from customers' exposure to climate-related risks.
    (b) More detailed illustrations:
        (i) 6.3(b) of the ED: Include mitigating factors as another factor that entities may need to consider when assessing the significance of the effects of climate-related risks on the entity's exposure to credit risk; and
        (ii) 6.4(b)(i) of the ED: Specify in the example that the focus of disclosures should be on key parameters that are particularly sensitive when disclosing how climate risks were incorporated in the inputs used to measure expected credit losses (ECL).

    (c) Adding additional relevant disclosure requirements:
        (i) 6.4(c) of the ED: Include an explanation of any significant changes in the quality of the collateral or credit enhancements as a result of climate-related risks, as required by paragraph 35K(b)(ii) of IFRS 7; and
        (ii) Illustrate the disclosures required under paragraphs 35F-35N of IFRS 7 if additional ECL is recognised on the loans to customers who are subject to climate risks like droughts and flood risk.

F. *Example 8 – Disclosure of disaggregated information (IFRS 18)*

24. Example 8 illustrates the application of the principles of aggregation and disaggregation in IFRS 18 *Presentation and Disclosure in Financial Statements*, resulting in the disclosure of two types of property, plant and equipment based on dissimilar climate-related risk characteristics. However, some respondents questioned whether this example could be viewed as an interpretation of a class of property, plant and equipment, defined as 'a grouping of assets of a similar nature and use in an entity's operations' under paragraph 37 of IAS 16 *Property, Plant and equipment*, rather than as an application of the aggregation and disaggregation principles in IFRS 18. We recommend the IASB clarify this point.

25. If the IASB clarifies that the disclosures illustrated result from the application of IFRS 18, we recommend that the IASB include a prominent box at the beginning of Example 8, akin to those in Examples 1, 2, 4 and 5, to prompt readers to consider similar principles in IAS 1 and assess whether the disaggregated information is material for disclosures in reporting periods before an entity applies IFRS 18, as stated in BC 42 of the ED.

Question 3: Other comments

A. *Application issues*

26. In addition to the effects of climate-related matters on the disclosure requirements, our respondents have raised several application issues pertaining to how climate-related matters would affect the application of measurement and recognition requirements. These issues include:
   (a) IAS 36: When should climate-related issues, as well as legal and regulatory changes (such as enactments/modifications in tax laws and imposition of carbon levies) be taken into account in the impairment assessment? Should they be considered when they are anticipated, upon their announcement or enactment, or upon their effective dates? When should the replacement of old operations by new operations (e.g. low carbon operation) impact impairment assessment of goodwill?

   (b) IFRS 9: Whether and, if so, how does an entity isolate climate-related risks as a separate driver for inputs used to measure ECL, such as probabilities of default and loss given default? How do climate-related risks translate into ECL to meet the 'reasonable and supportable information' in paragraph 5.5.4 of IFRS 9? How should an entity consider whether an estimation technique used in measuring ECL needs to be changed in response to climate-related risks as stated in 6.4(b)(iii) of the ED?

27. We recommend the IASB provide further guidance on the above application issues related to the measurement and recognition requirements in the context of climate-related and other uncertainties. We believe that guidance on these practical matters would not only enhance the consistent application of the measurement and recognition requirements but would also improve the clarity of disclosures and minimise the unintended consequence of having boilerplate disclosures.

28. Apart from the issues mentioned above, a few respondents requested guidance or an additional example illustrating how climate-related risks could affect the significant judgements made applying IFRS 17 *Insurance Contracts*. Specifically, they seek clarity on how entities consider climate change in estimating future cash flows, adjusting for non-financial risk and determining discount rate when measuring insurance contracts. We acknowledge that IFRS 17 is a relatively new standard and many preparers are still in the learning phase of its application, focusing on the fundamental principles and requirements of the new insurance accounting model and how to improve on application. Therefore, instead of providing additional guidance on climate-related considerations at this stage, we suggest that the IASB closely monitor the application of IFRS 17, assess any practical issues after entities have applied the Standard for some time (e.g. in the post-implementation review of IFRS 17) and consider whether any illustrative examples or other educational materials may be necessary.

B. *Estimation uncertainty disclosure requirements under IAS 1*

29. As investors are now placing greater emphasis on sustainability information which encompasses risks and opportunities that could impact an entity's financial performance over the medium to long term, some respondents expressed concern that the 12-month horizon in relation to estimation uncertainty disclosure requirements under paragraph 125 of IAS 1 is increasingly being perceived as artificial and a potential barrier to providing comprehensive information on

significant estimates made in the financial statements. Accordingly, they suggested that the IASB consider future standard-setting activities to address measurement changes likely to occur after 12 months from the reporting date.

30. While we acknowledge this development, we do not see an urgent need to expand the existing requirements in IFRS Accounting Standards at this stage. Instead, we recommend the IASB monitor the evolving needs of users regarding the potential extension of the time horizon beyond 12 months to better address measurement changes that may occur after 12 months from the reporting date. We also suggest the IASB engage with stakeholders to gather insights on this issue and consider it in future standard-setting discussions.

~ End ~