IFRS Accounting

Staff paper

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Project	**Climate-related Risks in the Financial Statements**
Topic	**Project objective**
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Purpose and structure

1. This paper discusses whether any changes to the objective of the IASB's project on Climate-related Risks in the Financial Statements are needed.

2. The current objective of this project is to explore whether and how financial statements can better communicate information about climate-related risks.

3. The paper is set out as follows:

    (a) Summary of staff recommendation and question for the IASB (paragraph 4).

    (b) Background (paragraph 5).

    (c) Summary of feedback (paragraphs 6–12).

    (d) Staff analysis and recommendation (paragraphs 13–21).

Summary of staff recommendation

4. The staff recommends generalising the objective of this project to explore whether and how financial statements can better communicate information about climate-related and other uncertainties.

Question for the IASB

Question for the IASB
Does the IASB agree with the staff recommendation to generalise the objective of this project to explore whether and how financial statements can better communicate information about climate-related and other uncertainties?

Background

5. As part of our work, we asked stakeholders whether the IASB should generalise the objective of this project to include other risks in addition to those related to climate, and opportunities as well as risks. We explored this approach because:

   (a) it would align with the IASB's approach to developing principle-based accounting standards, which helps maintain the relevance of IFRS Accounting Standards as global conditions change;

   (b) it would be consistent with the International Sustainability Standards Board's (ISSB) approach in that the ISSB considers both risks and opportunities, and all sustainability-related risks and opportunities and not just climate-related risks and opportunities; and

   (c) the ISSB has concluded that it is not always possible for preparers to separate the financial effects of climate-related risks and opportunities from the financial effects of other sustainability-related risks and opportunities.[1]

[1] See paragraph 38 of IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*; paragraph 19 of IFRS S2 *Climate-related Disclosures*; and paragraphs 28–39 of ISSB Agenda Paper 3E for the January 2023 meeting.

Summary of feedback

Other risks

6. Many stakeholders said the IASB should generalise the objective of the project to include risks in addition to those related to climate because such an approach would be consistent with the principle-based nature of IFRS Accounting Standards. Some stakeholders also said that applying a principle-based approach to any targeted amendments to IFRS Accounting Standards would avoid further piecemeal changes to those Accounting Standards if another risk, for example biodiversity-related risk, becomes more prominent in the future.

7. A few stakeholders (mainly preparers and national standard-setters) expressed concerns about the challenges of separating the financial effects of climate-related risks from the financial effects of other risks. Consequently, they recommended generalising the objective of the project to cover risks in addition to those related to climate.

8. Other stakeholders disagreed because of concerns that generalising the objective would delay any potential actions the IASB might take to respond to concerns about the reporting of climate-related risks in the financial statements. Most stakeholders that disagreed with including other risks suggested that the IASB start with climate-related risks and possibly address other risks later.

9. A few stakeholders expressed the concern that generalising the objective might result in burdensome disclosures for preparers if they are required to disclose information about any risk that has the potential to affect information included in the financial statements. They noted that this could result in preparers providing voluminous, boilerplate disclosures about a wide variety of risks simply to avoid the risk of challenge by auditors and regulators.

Opportunities

10. We received limited feedback about whether to include opportunities in the objective of this project. Some stakeholders supported including opportunities to encourage entities to provide a balanced view of their financial position and financial performance.

11. However, many other stakeholders did not support including opportunities in the objective of this project. A few of these stakeholders expressed doubts that the financial effects of opportunities could be reflected in financial statements because, in their view, opportunities tend to relate to assets and liabilities that do not exist at the balance sheet date.

12. One stakeholder observed that IFRS Accounting Standards refer to risks in several places; however, 'opportunities' would be a novel concept in IFRS Accounting Standards and therefore, inclusion of this concept might go beyond the bounds of a narrow-scope project.

Staff analysis and recommendation

Other risks

13. IFRS Accounting Standards are principle-based, enabling them to stay relevant as global conditions change. We agree with stakeholders that said generalising the objective of this project to cover all types of risks would be consistent with the principle-based nature of IFRS Accounting Standards. Such an approach would help ensure that various types of risks are captured as they emerge and would result in treating similar items in the same way. The notion of treating similar items in the same way is a pervasive principle embedded in various concepts in the *Conceptual Framework for Financial Reporting*, including comparability, unit of account and classification and aggregation.

14. We also think that it may not always be possible to quantify the financial effects of climate-related risks separately from the financial effects of other risks. For example, in some instances it may not be possible to attribute a specific portion of an impairment loss to climate-related factors when other factors, such as macroeconomic factors, may also have contributed to the impairment of an asset or when there is an interdependency between various factors.

15. We note that, for this reason and as discussed in paragraph 5(c), the ISSB requires an entity to provide only qualitative—rather than both quantitative and qualitative—information about the financial effects of climate-related risks and opportunities when those effects are not separately identifiable. By generalising the objective of this project, we also help address the concern that it may not always be possible to quantify the financial effects of climate-related risks separately from the financial effects of other risks.

16. The most common reason stakeholders expressed for retaining a focus on climate-related risks was to avoid a delay in possible IASB actions that, in their view could happen, if the objective was generalised. However, we think many of the potential ways to improve the reporting of climate-related risks in the financial statements can be applied equally to other risks. For example, an approach that involves clarifying the application of the concept of materiality would apply not only to information about the effects of climate-related risks but to information about all risks that affect the financial statements.

17. As noted in the summary of feedback, a few stakeholders expressed the concern that generalising the objective might result in burdensome disclosures for preparers if the IASB requires additional disclosures about all risks. However, we note that IFRS Accounting Standards require entities to apply judgement in assessing whether information is material to the financial statements. In particular, paragraph 30A of IAS 1 *Presentation of Financial Statements* states that 'an entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information'. In our view, the application of the concept of materiality

and management judgement would mitigate the risk of entities providing unnecessary disclosures about all potential risks the entities might face. Nonetheless, as discussed in paragraph 15(f)(i) of Agenda Paper 14C *Potential actions*, in exploring possible new disclosure requirements, we will consider ways to establish boundaries on the required disclosures.

18. For these reasons, we think that responding to stakeholders' concerns about the reporting of climate-related risks in the financial statements might be best achieved if the IASB apply potential actions to all risks rather than to one specific risk. However, where possible, examples specific to climate-related risk could be provided as it is a topical risk that stakeholders are particularly interested in.

Opportunities

19. We think that, in the context of financial statements, 'opportunities' could relate to future events that might lead to assets or liabilities in future reporting periods, such as an acquisition to expand into a new geography. Opportunities could also relate to existing assets and liabilities and be reflected in positive assumptions affecting the reporting of those assets and liabilities in the financial statements. For example, expected higher growth rates for 'green' products may need to be reflected in the measurement of existing assets at the reporting date.

20. We note that financial statements provide information about the reporting entity's assets, liabilities, equity, income and expenses. Consequently, unless the information relates to assets and liabilities that exist at the end of the reporting period, financial statements do not typically provide information about possible future transactions and other possible future events. Accordingly, the effects of opportunities that might result in assets or liabilities in the future will generally not be reflected in the financial statements for the reporting period. Positive assumptions, however, should be reflected in the financial statements applying IFRS Accounting Standards.

21. As noted in paragraph 5(b), we considered aligning the objective of this project with the ISSB's approach of covering both risks and opportunities. However, the term

'opportunities' is not currently used in IFRS Accounting Standards. Therefore, to mitigate possible confusion that this term could introduce in the context of financial statements, we recommend that the objective of this project should focus on 'climate-related and other uncertainties' which captures both risks (climate and other) and those scenarios related to opportunities (eg, positive assumptions) that should be reflected in the financial statements. This language also helps ensure that while generalising the objective, the concerns initially raised by stakeholders about climate-related risks are acknowledged.