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Australian Accounting Standards Board (AASB)

Via email: hsimova@aasb.gov.au
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Dear AASB

AASB Exposure Draft ED 331 – Climate-related and Other Uncertainties in the Financial Statements – proposed illustrative examples

Thank you for the opportunity to provide a submission on the draft IFRS Exposure Draft – Climate-related and Other Uncertainties in the Financial Statements – Proposed illustrative examples (**Exposure Draft**).

The AICD's mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of more than 52,000 reflects the diversity of Australia's director community, comprised of directors and leaders of not-for-profits, large and small businesses and the government sector.

This submission is informed by consultation with members, including the AICD Reporting Committee comprising Audit Committee Chairs and members, audit firm partners and Chief Financial Officers (CFOs).

1. Executive Summary

The AICD welcomes the guidance as an important initial step in clarifying how financial statements should incorporate the impact of climate change.

In summary, our key points are as follows:

- Climate disclosure within the financial statements should not be viewed in isolation from other relevant disclosures, particularly mandatory climate disclosures required under the domestic climate reporting standard (AASB S2). Some of the mandated disclosures under AASB S2 require quantitative disclosures (albeit subject to a number of carve-outs[1]) that may lead to financial statement adjustments. We would encourage the issue of guidance or educational material which addresses how AASB S2 may intersect with financial statement disclosures.
- More broadly, organisations need to be aware of the interconnectedness between the various reports, how disclosures in one report may impact another, and how inconsistencies may give rise to greenwashing allegations and/or risk.

[1] Including that an entity need not provide quantitative information about the current or anticipated financial effects of a climate-related risk or opportunity if the entity determines that: (a) those effects are not separately identifiable; or (b) the level of measurement uncertainty involved in estimating those effects is so high that the resulting quantitative information would not be useful.

- To improve the accessibility and usability of the Exposure Draft for directors, standard-setters could consider supplementing the illustrative examples with broader, more accessible guidance, providing more detail on how key threshold judgments within the illustrative examples are exercised, and ensuring that the illustrative examples cover a broad range of sectors.
- Given the current focus on climate disclosures (particularly in light of mandatory climate reporting), the Exposure Draft should be confined to that topic.
- Directors recognise the need for education and training for boards, finance teams, and internal control and audit staff on integrating climate considerations into financial statements. We would encourage the AASB to issue further accessible guidance and educational material tailored to the individual needs of the various roles involved in the financial reporting process, including directors.

2. The director role

Directors are acutely aware of, and focused on, discharging their non-delegable financial reporting duties. This includes issuing directors' declarations confirming that the financial statements and notes comply with the accounting standards and give a "true and fair view" of the company's financial position and performance. In doing so, directors consider whether the financial statements incorporate all information that has a material impact on the organisation's financial position, performance and prospects. This can include climate-related impacts.

As part of their oversight role, directors need to satisfy themselves that the underlying assumptions, judgements and assessments applied in the financial statements (such as those applicable to revenue, liability and asset valuations), including as they apply to climate, have reasonable grounds.

It is important to build awareness, understanding and capacity on the impact of climate on the financial statements across the spectrum of actors involved in the financial reporting process. This includes those charged with oversight and governance (including directors), as well as the finance, risk management, and internal audit teams.

We would encourage the AASB to consider issuing accessible guidance and educational material tailored to the individual needs of the various roles involved in the financial reporting process, including directors.

3. Aligning financial statement disclosures with other climate disclosures

To mitigate greenwashing risk, disclosures of climate-related effects in the financial statements must be consistent with climate disclosures in other public or investor-facing reports. This includes the Directors' Report and the mandatory Sustainability Report (for those covered by Australia's mandatory climate reporting regime).

While we appreciate that the Exposure Draft is limited in scope to the financial statements, it is important that organisations are made aware of the interconnectedness between the various reports, how disclosures in one report may impact another report, and how inconsistencies may give rise to greenwashing allegations and/or risk.

This is particularly the case given AASB S2 requires the provision of quantitative information in relation to (focusing on disclosure of *current*, as opposed to anticipated, financial effects):

- how climate-related risks and opportunities have affected the entity's financial position, financial performance and cash flows for the reporting period;

- significant risk of a material adjustment within the next annual reporting period to the carrying amounts of assets and liabilities reported in the related financial statements;
- current changes to the entity's business model, including its resource allocation e.g. resource allocations resulting from demand or supply chain changes or from business development through capital expenditure, additional expenditure on research and development, or acquisitions and divestments;
- the amount and percentage of assets or business activities vulnerable to climate-related physical and transition risks, and climate-related opportunities; and
- the amount of capital expenditure, financing or investment deployed towards climate-related risks and opportunities.

We appreciate that AASB S2 has a number of qualifications for the provision of quantitative information, including, relevantly, where the level of measurement uncertainty is so high that the resulting quantitative information would not be useful. To date, the majority of climate disclosures have been qualitative, with limited financial report disclosures, although references to climate in financial statement notes have been increasing in recent years. [2] Under the mandatory climate reporting regime, it is likely that most organisations will begin with qualitative disclosures and may progress to quantitative disclosures as the quality and availability of data and methodologies improve.

Given the interconnectedness between mandatory climate reporting and financial statement disclosures, it would be useful for the AASB to provide supplementary guidance or educational material on how the AASB S2 requirements may intersect with financial statement disclosures.

We also note that some of the assumed facts within the examples will also be impacted by the introduction of mandatory climate reporting. For instance, statements such as "the entity discloses no other information about climate-related transition risks in its general-purpose financial statements" (in Examples 1 and 2) may need to be revisited to consider whether the entities are captured within the mandatory climate reporting regime.

4. Other implementation considerations

Feedback from members is that the Exposure Draft provides helpful insight into how climate-related considerations may be disclosed in the financial statements.

In particular, directors found it useful that the examples included instances where climate did *not* require additional disclosures, as well as examples where additional disclosures or adjustments *were* necessary. This supported the message that not every climate consideration will have a quantifiable financial impact that needs to be recorded in the financial statements (as distinct from narrative disclosure in other reports).

To improve the accessibility and usability of the Exposure Draft for directors, we offer the following suggestions:

- **Supplement the illustrative examples with broader, more accessible guidance:** While we appreciate the Exposure Draft is a technical accounting document, this may hinder its accessibility and usability by other stakeholders involved in the financial reporting process, including directors. Supplementing the Exposure Draft with broader, narrative-

[2] Only 14.9% of ASX-listed entities made climate disclosures in the notes of their financial statements in their 2022 Annual Reports, albeit this was an increase from 10.5% in 2021. The ASX100 are leading the pack - just over half (50.5%) of ASX100 entities made references to climate in their financial statements notes in 2022. See AASB – AUASB Research Report (Nov 2023) Trends in climate-related disclosures and assurance in the Annual Reports of ASX-listed entities at pages 14 and 15.

style guidance could bridge this accessibility gap. To reduce the burden on the AASB, this could take the form of updating existing guidance, such as the April 2019 AASB and AUASB's Climate-related and other emerging risks disclosures: assessment of financial statement materiality using AASB/ IASB Practice Statement 2 or adapting IFRS's Effects of climate-related matters on financial statements to the Australian context.

- **Providing more detail on how key threshold judgments are exercised**: Some of the illustrative examples deem certain threshold information as fact. For instance, Example 1 states as part of the 'background' that the entity is exposed to climate-related transition risks, while Example 2 states that the entity 'has limited exposure to climate-related transition risks.' These conclusions are stated without explaining the rationale for the entity coming to this view, or the likely nature and extent of these risks. Such assessments are not merely background information but are critical to the entity's assessment of the financial impact of climate. As such, we would encourage the examples to provide more fulsome explanations of how entities have exercised these key threshold judgments to avoid confusing report preparers and users.
- **Limit the guidance to climate only**: Given the current focus on climate disclosures (particularly in light of mandatory climate reporting) and the particularities of accounting for climate's financial effect, the Exposure Draft should be limited to that topic area.
- **Potential future topics to address in any future guidance** could include accounting for carbon credits and the impact of pollution.
- **Ensuring examples across a broader range of sectors:** While some of the examples consider the sectoral impact of climate change, others are relatively broad. For instance, Example 2 only states that the entity is a 'service provider' (which is extremely broad) while Example 4 merely states that the entity is in a 'capital-intensive industry.' Ensuring the examples incorporate more detailed facts about the impact and role of sectoral factors may aid their use.

5. Next steps

If you would like to discuss any aspects further, please contact Anna Gudkov, Senior Policy Adviser at agudkov@aicd.com.au.

Yours sincerely,

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