Submission to the International Accounting Standards Board on the Exposure Draft Climate-related and Other Uncertainties in the Financial Statements, Proposed illustrative examples

Canada Climate Law Initiative
University of British Columbia
Vancouver, BC

Sonia li Trottier,
Director, Canada Climate Law Initiative
trottier@allard.ubc.ca

November 26th, 2024

The Canada Climate Law Initiative (CCLI) appreciates the opportunity to comment on the International Accounting Standards Board (IASB)'s Exposure Draft Climate-related and Other Uncertainties in the Financial Statements, with respect to the proposed illustrative examples. The CCLI applauds the work of the IASB. Illustrative examples will contribute to mainstream climate-related disclosures in financial statements, which are essential to enable users to access an entity's exposure to and management of climate-related risks and opportunities.

CCLI examines the legal basis for corporate directors, officers, pension fiduciaries, and asset managers to manage and report climate-related financial risks and opportunities, publishing guidance on effective climate governance.[1] The views here represent CCLI only and not necessarily the views of our stakeholders and the wider community.

Summary

CCLI supports the IASB's commitment to ensure connectivity and interoperability in financial reporting to meet users' (primarily investors', creditors', and lenders') needs. As IASB has determined, investors are increasingly interested in assessing the climate resilience of their investee firms and overall portfolio. Often, investors seek climate and sustainability-related information that does not exist in financial statements and must instead be gleaned from other reports, such as a corporation's Task Force on Climate-

[1] See for example, Helen Tooze, *Canadian Credit Unions and Effective Climate Governance Cooperating for a Sustainable Future* (CCLI and Canadian Credit Union Association, 2023); Janis Sarra and Norie Campbell, *Banking on a Net-Zero Future: Effective Climate Governance for Canadian Banks* (CCLI, 2022); Janis Sarra, *Life, Health, Property, Casualty: Canadian Insurance Company Directors and Effective Climate Governance* (CCLI, 2021); and Janis Sarra, Roopa Davé, Meghan Harris-Ngae, and Ravipal Bains, *Audit Committees and Effective Climate Governance, A Guide for Boards of Directors* (CCLI, 2020).

related Financial Disclosures (TCFD) report, sustainability report, website, or investor initiatives like Climate Engagement Canada and Climate Action 100+.

The IASB initiative aims to offer further guidance to preparers by using examples regarding what may constitute decision-useful information in climate and sustainability reporting. This initiative aligns with the work of the International Sustainability Standards Board (ISSB) and the development of the International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 C*limate-related Disclosures*. CCLI fully supports the IFRS S1 and S2 global sustainability standards, and we look forward to the issuance of the Canadian Sustainability Disclosure Standards (CSSB) S1 and S2.

In order to promote consistency of the placement of climate-related disclosures, whether in the financial statements, and accompanying MD&A, or in annual information forms and sustainability reports, CCLI suggests clearly stating the IASB's objectives and disclosure expectations for both users and preparers. Otherwise, actual reporting protocols may differ vastly, leading to an increasingly dispersed and incomparable climate reporting landscape. To the extent that investors must seek material climate-related information elsewhere, the utility of the financial statements may be viewed as increasingly incomplete or even compromised.

We note that the IASB is deliberately including the term "other uncertainties" in its reporting guidance. This inclusion could be beneficial in offering clearer financial reporting guidance for uncertainties in general, improving the application of the IFRS Accounting Standards, raising awareness of those standards, and strengthening connections between the information provided in financial statements and sustainability-related disclosures. However, except for example 5, it is not apparent whether uncertainties apart from climate-related uncertainties are considered in the exposure draft.

Question 1 – Providing illustrative examples

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.**

CCLI finds the IASB's proposal to provide examples regarding how entities can report the effects of climate-related uncertainties in their financial statements, in accordance with IFRS Accounting Standards, to be largely useful. However, CCLI cautions that the examples chosen are insufficient considering the vast complexity of climate risk measurement across sectors, geographies, jurisdictions, and various types of climate physical and transition risk. In addition, with the exception of example 5, it is not apparent whether uncertainties apart from climate uncertainties are considered in the exposure draft.

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.**

CCLI understands that the illustrative examples are not intended to add to or change the requirements in the IFRS Accounting Standards. Rather, we understand that they are intended to provide guidance regarding how the current IFRS Accounting Standards should be applied with respect to disclosure of climate-related risks and uncertainties in the financial statements. However, we caution that users of financial statements may seek more information than would otherwise be disclosed under current IFRS

Accounting Standards, even with these illustrative examples. In other words, the examples do not necessarily close the gap between information provided elsewhere and the financial statements.

It may be time to revisit the financial reporting frameworks that the financial statements are based upon. An entity's climate-related targets should be materially consistent with its financial statements, with asset values and associated financial disclosures appropriately reflecting any impacts, such as the timing and nature of liabilities or the potential impacts of carbon pricing on profits to shareholders. In promoting alignment between disclosures made in the financial statements and other sustainability reporting and public announcements, the IASB may wish to provide real-world examples of reporting and/or guidance that goes beyond the one-year time horizon, encompassing two-, three-, five-, and 10-year or more horizons, in line with an entity's external (to the financial statements) climate commitments. Many companies have made public net-zero emissions pledges, yet no clear financial implications related to these pledges are provided within the financial statements. This dissonance and potential misalignment between sustainability reporting, pledges and financial statement disclosures may potentially be alleviated with appropriate guidance and examples.

Preparers may also be unwilling or uncertain about whether to disclose certain forward-looking information in financial statements. Whereas the results of climate stress tests based on theoretical assumptions stretching out to 2030 may rightly be relegated to a sustainability report, the impact of anticipated, imminent carbon pricing hikes on future costs or the potential for asset impairment for assets located in climate-vulnerable areas should feature in the financial statements. Examples could include reference to the appropriate taxonomy, carbon accounting, or climate disclosure framework. They could also encourage specific disclosures, such as the percentage of firm assets located in highly climate-vulnerable areas, impacting credit risk; or the portion of revenues subject to future carbon border adjustments; or the percentage of capital expenditure allocated to clean energy or eco-efficiencies. Consideration of how an entity account for its commitments to reduce or offset greenhouse gas (GHG) emissions could well influence its asset or liability profile.

Reporting of asset impairment due to a natural disaster may seem straightforward in the case of damaged inventories, buildings, or receivables; whereas reporting on the impacts of anticipated weather-related disruptions in a supply chain or changes in customer demand may seem less clear. We recommend that the IASB offer clear guidance to meet the needs of both user and preparer groups with respect to the disclosure of potentially sensitive and complex information as well as where this information should be disclosed, such as in the body of the financial statements, the MD&A section of the annual report, and/or in collaborating with regulators to have the information presented in the annual information form (AIF). Investors interested in assessing the company's resilience to climate risk relative to the portfolio or other benchmarks are impeded by the potential for incomplete and irregular disclosures.

Question 2 – Approach to developing illustrative examples

Examples 1 to 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.[2]

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.

<u>Example 1 – Materiality judgements leading to additional disclosures (IAS 1/IFRS 18)</u>

<u>Example 2 – Materiality judgements not leading to additional disclosures (IAS 1/IFRS 18)</u>

Both examples appear to reflect a qualitative opinion narrowly focused, in one instance, on the firm's transition plan and, in the other instance, on its GHG policy rather than on a fulsome assessment of potential climate-related impacts, including physical and transition risk, on the firm's assets and liabilities.

With respect to the principle of transparency, the key message here should be that, when in doubt regarding the materiality or impending materiality of a factor, the entity should err on the side of caution and disclose. In example 1, the entity discloses its rationale for why its transition plan is deemed to have no effect on the financial statements, but this rationale appears incomplete. Ideally, the rationale should reflect alignment between traditional accounting and the best global sustainability and climate reporting standards and practices, but no such alignment is reflected, here. In example 1, while the facilities may be depreciated, transition risks such as insurance costs and the cost of changing raw materials or manufacturing methods can be quite substantial. In both examples, more explanation is warranted as to why the entity does not disclose additional information about climate-related transition risks in its financial statements and reports.

It is also somewhat concerning that in example 1 the company's additional disclosure is simply to disclose that its transition plan is immaterial without further explanation for how this determination was made. Investors may find the same information material, but without requisite disclosure may not even know that concerns or issues exist. Transition plan components that are likely to show up in the financial statements would relate to items such as executive remuneration, skills training, insurance costs, and transition-related capital expenditure (CapEx), as well as the cost of data collection and third-party verification and assurance.

The ISSB requires that companies with transition plans disclose information about them when applying IFRS S2. Similarly, the UK's Transition Plan Taskforce states that an entity's climate transition plan is integral to a company's overall business strategy and should be informed by both national commitments and the latest international agreement on climate change.[3] CCLI recommends that, where an entity has a transition plan, the entity provide a link in the financial statements to that plan, so that investors can easily access it and assess it themselves.

The Office of the Superintendent of Financial Institutions (OSFI) in its B-15 Guideline states that federally regulated financial entities should develop and implement a transition plan in line with its business plan

---

[2] International Accounting Standards Board, "Exposure Draft Climate-related and Other Uncertainties in the Financial Statements" (July 2024) at 6, online: <https://www.ifrs.org/content/dam/ifrs/project/climate-related-other-uncertainties-fs/iasb-ed-2024-6-climate-uncertainties-fs.pdf>.

[3] Transition Plan Taskforce, "Disclosure Framework" (October 2023) at 2, online: <https://transitiontaskforce.net/wp-content/uploads/2023/10/TPT_Disclosure-framework-2023.pdf>.

and strategy and should disclose "the current and potential impact of climate related risks and opportunities on the FRFI's business, strategy and financial statements and reports and future cash flows."[3] CCLI has formally proposed an amendment to the *Canada Business Corporations Act* (CBCA) to require companies regulated by the CBCA to disclose their transition plans within their financial statements, including targets for emissions reductions; disclosure of scope 1, 2 and 3 emissions; and annual reporting of progress to meet those targets.[4]

In example 2, the main consideration for disclosure of climate-related risks is the entity's sector, as well as that sector's presumed low level of emissions and low exposure to climate transition risks. The entity finds, given its sector, that its GHG emissions policy has no impact on its balance sheet. However, this example may be misleading: we cannot conclude that all firms in the service sector have low climate risks. For example, service providers dependent on technology and artificial intelligence generally have higher levels of scope 3 emissions, depending on the energy source, resulting in higher transition risk.

Also in example 2, there is no consideration of other potential liabilities and revenue impacts, such as their direct or indirect exposure to physical climate risk or the geolocation of their core assets and supply chain. CCLI recommends that IASB provide a non-exhaustive list of climate-related impacts for companies to consider in preparing their financial statements, in alignment with best sustainability reporting practices.

Example 3 – Disclosure of assumptions: specific requirements (IAS 36)

This example does appear to be in line with best practice reporting on emissions allowances. In the example, the entity discloses whether its key assumptions regarding the future price of GHG emission allowances and the future scope of emissions regulations are consistent with external information. Additionally, it would be important for the entity to ensure that all jurisdictions it operates in or does business with are considered.

A review of Shell PLC's Annual Report and Accounts for 2023 reveals the complexity of reporting in schemes where a cap is set for emissions.[5] For Shell PLC, an emission liability is recognized under other liabilities when emissions give rise to an obligation. To the extent that the liability is covered by emission certificates held for compliance purposes, the liability is measured with reference to the value of these held emission certificates and of the remaining uncovered portion at market value. For Shell PLC, the associated expense is presented under "production and manufacturing expenses". Both the emission certificates and the emission liability are "derecognized" upon settling the liability with the respective regulator. This example demonstrates the utility of using real-world examples to inform reporting practices with respect to emissions allowances

CCLI recommends that Example 3 be expanded because, in the transition to the low carbon economy, carbon-intense companies will be increasingly subject to emissions caps and, where feasible, trading mechanisms.

Under the *Canadian Environmental Protection Act*, Canada intends to cap emissions from the oil and gas sector by 2030 at levels 20% – 23% below 2019 levels (with the use of offsets) and 35% – 38% below 2019 levels (without the use of offsets).[6] The European Union (EU) Emissions Trading System (ETS) is based on

---

[4] Canada Climate Law Initiative, "Submission to federal Ministers Champagne and Guilbeault on Amendments to CBCA Regulation" (February 2023) at 2, online: <https://ccli.ubc.ca/resource/submission-to-the-canada-business-corporations-act-cbca/>.
[5] Shell PLC, "Annual Report and Accounts 2023" (December 2023), online: <https://reports.shell.com/annual-report/2023/>.
[6] Government of Canada, "Regulatory Framework for an Oil and Gas Sector Greenhouse Gas Emissions Cap", online: <https://www.canada.ca/en/services/environment/weather/climatechange/climate-plan/oil-gas-emissions-cap/regulatory-framework.html>.

a cap that reduces annually in line with the EU climate target, expressed in emission allowances with one allowance giving the right to emit one ton of CO_2e. The China ETS is the world's largest, covering only the power sector. 46 countries are pricing emissions through carbon taxes or emissions trading schemes (ETS) to date[7], and that number is rising, while several sub-national schemes are also in place.

Example 4 – Disclosure of assumptions: general requirements (IAS 1/IAS 8)

Example 4 seems most relevant for firms in CO_2-intense industries that are highly exposed to climate transition risks and are subject to assumptions that may carry well into the future, especially across the medium (3-5 years) and long term (5-10 years plus). However, dynamic regulatory developments in the current or coming financial year could materially impact a firm and change the assumptions it is currently subject to. Because IAS 1, paragraph 129 requires a firm to disclose in a manner to help users understand the judgments management makes about the future, the firm may choose to disclose qualitative and quantitative information about its assumptions, in this way meeting the requirements of paragraph 129.

CCLI suggests that the entity also be encouraged to determine to which assumptions it is also currently subject, based on to what data it subscribes and what economic modelling services it purchases.

Example 5 – Disclosure of assumptions: additional disclosures (IAS 1/IFRS 18)

Example 5 is of a firm that will become subject to government's regulation to restrict the firm's ability to operate and generate profits in the future. The firm may need to disclose assumptions it makes about the future, despite IFRS Accounting Standards otherwise not requiring this forward-looking disclosure. The firm discloses its assumption that the announced regulation will only become effective after the firm has utilized unused tax losses, while also disclosing how this assumption impacts the carrying amount of the firm's deferred tax asset.

However, example 5 appears to be not necessarily climate-related. For example, it could easily reflect practices in emerging markets where a firm is put on notice that its operations in a particular jurisdiction are about to be nationalized. It is unclear how this example relates to climate uncertainty, unless the IASB expects countries to actively restrict the ability of CO_2-intensive operations to operate within their jurisdiction. Barring this expectation, the example as described appears to lack specificity and real-world application.

Example 6 – Disclosure about credit risk (IFRS 7)

Example 6 relates to credit risk for real assets and is well placed, with some differentiation between climate-related risks and opportunities for agricultural versus real estate assets.

Preparers should understand that tracking the impact of historical physical climate risk on credit risk is insufficient to the task of determining how climate risk will factor into future default and loss probabilities. Instead, preparers should understand how assumptions for probability of natural catastrophic events across geographies are changing, and how forward-looking climate information factors into expected credit losses. While insurance may be viewed as a credit enhancement, assets that are subject to repeat events may become under-insured or uninsured, factoring into the assessment of expected credit losses

[7] United Nations Climate Change, "About Carbon Pricing", online: <https://unfccc.int/about-us/regional-collaboration-centres/the-ciaca/about-carbon-pricing#What-is-the-current-status-of-carbon-pricing-in-th>.

and asset stranding. Investors in real assets are interested in understanding the overall exposure of the portfolio to physical climate risk and their geolocation.

While the example is useful, we also point out that there may be some climate-related opportunities that can positively impact the balance sheet. For example, Bonnefield, a farm investor and provider of land lease financing for farmers, describes technological opportunities that can help to lower operating costs, advance carbon markets, and maintain or increase crop yields, while also discussing how a longer growing season in certain locations improves the farmer's ability to grow higher value crops.[8] This potential for positive impacts may be useful to include in the IASB's examples.

Example 7 – Disclosure about decommissioning and restoration provisions (IAS 37)

Considering the reasonable likelihood of an event like the one demonstrated here for certain carbon intense assets, such as we saw with coal phase-outs, example 7 is particularly useful. In this example, owing to lower demand or regulatory changes, asset impairment or asset stranding occurs, demonstrating the concept of dynamic materiality, as a situation that was previously deemed financially immaterial becomes or may become material. In this case, the entity may be required to close its facility earlier than expected, changing the net present value calculations of decommissioning and site restoration. The entity also discloses major assumptions such as the expected future use case of each of the firm's petrochemical facilities and the expected date of closing the facilities, making this a comprehensive example of disclosure.

Example 8 – Disclosure of disaggregated information (IFRS 18)

Example 8 is important because it recognizes that material information regarding assets such as plant, property and equipment (PP&E) could be obscured if it is aggregated with PP&E with dissimilar risk and value characteristics.

The example could benefit from increased specificity regarding how to dis-aggregate a feature that was previously reported as aggregated. For example, a question that arises is whether or not prior years' disclosures need to be restated.

Question 3 – Other Comments

Do you have any other comments on the exposure draft?

In Canada, corporate board members are legally obligated to address climate change risks and opportunities as part of their oversight of the companies they serve: they may not demure to management or simply wait for management to identify and bring the issue forward.[9] Because corporate board members oversee the financial statement disclosures of the firm, the issue of potential director liability for poor quality climate-related disclosures exists.

As a result, these examples would benefit from providing additional disclosure guidance for both physical risks and opportunities as well as transition risks, including liabilities and opportunities. Considering the

---

[8] Bonnefield, "TCFD Report 2024" (February 2023) at 11, online: <https://bonnefield.com/wp-content/uploads/2023/08/Bonnefield-TCFD-Report-2023.pdf>.

[9] Carol Hansell, "Putting Climate Change Risk on the Board Room Table" (June 2020) at 1, online: <https://ccli.ubc.ca/resource/putting-climate-change-risk-on-the-board-room-table/>.

urgency of the climate crisis and the volatility and impact of physical climate risks on markets and society at large, we urge the IASB to include specific consideration of how and where to disclose information regarding future focused physical climate risk and opportunity in financial statements. Clearer and more uniform disclosure of physical climate risks may lead to enhanced investment in climate resilience as well as to decreased loss and damages from severe climate events. It should be noted that, while data comparability is important, it stands to reason that materiality is a more relevant concern in the sustainability space.

These examples could also benefit from more explanation of the rationale underpinning how firms deem a climate-related factor meets or does not meet the threshold for materiality. The IASB can help entities better understand what is more appropriate to include in general sustainability reporting. In doing so, the IASB can reduce the risk of greenwashing by bringing clarity on what is appropriate and expected to be included in the financial statements and related notes. Further discussion of what assumptions and conclusions are at play, to inform how these determinations of materiality were reached, would provide just as valuable information as the examples themselves.

Many of the inconsistencies and misalignments between the financial statements and other sustainability disclosures arise due to a timing mismatch: companies are making long-term promises (e.g., net-zero) but many are not disclosing the financial implications in the financial statements. Key to decision-useful climate reporting is to be relevant, comparable, verifiable, and timely, which are all core accounting principles.

In summary, CCLI strongly supports the Exposure Draft Climate-related and Other Uncertainties in the Financial Statements, Proposed illustrative examples. In our view, they will contribute to advancing clear, consistent accounting standards that will protect the financial system, its users, and the public interest more generally. We look forward to supporting your efforts and we welcome the opportunity to discuss our recommendations.

Sincerely,

On behalf of the Canada Climate Law Initiative,

Alison Schneider
Climate Governance Expert, Canada Climate Law Initiative

Sonia li Trottier
Director, Canada Climate Law Initiative