KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

brian.odonovan@kpmgifrg.com

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

Our ref BOD/288

22 November 2024

Dear Dr Barckow

Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements – Proposed Illustrative Examples*

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB's) Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements – Proposed Illustrative Examples* (the ED). We have consulted with, and this letter represents the views of, the KPMG network.

Investors and regulators have been demanding clarity on climate-related matters in financial reporting. We support the IASB's efforts to address these long-standing concerns through a portfolio of measures, including the introduction of new illustrative examples. We are pleased that the IASB has prioritised this project and is allowing stakeholders to provide feedback on the examples although this was not a mandatory due process step. Considering the time and resource challenges, illustrative examples would be a useful tool for explaining how to apply the existing requirements in IFRS® Accounting Standards to drive clarity in financial reporting.

We have a number of comments on the examples and believe that further work is needed before they are finalised. Our key concerns relate to the following areas:

- performing materiality assessments, especially in scenarios in which a risk or uncertainty does not impact an entity's financial position, performance or cash flows;
- providing 'no impact' disclosures; and
- explaining the IASB's decisions.

Materiality assessments

- ***No impact on the entity's financial position, performance and cash flows*: We understand that the examples are not intended to introduce any new guidance but to illustrate how to apply existing guidance in IFRS Accounting Standards. However, we are concerned that some may interpret them – especially Examples 1, 2 and 5 – as introducing new guidance on how an entity performs an assessment of whether information is material when a risk or an uncertainty does not have an impact on the entity's financial position, performance or cash flows.

  - *Examples 1 and 2:* These examples contain only limited facts and discussion. We believe that there is a risk that they could be over-interpreted in practice, with some stakeholders seeking to reverse engineer them to discover new, unintended principles. We recommend enhancing the analysis within these examples (see our detailed comments in response to Question 2) and relocating it to *Practice Statement 2: Making Materiality Judgements* (Materiality Practice Statement).
  - *Example 5:* We are concerned that Example 5 introduces new guidance on how to consider 'an announced regulation' when applying IAS 12 *Income Taxes*, which extends beyond the scope of the current project and would require standard setting. We also believe that some of the technical analysis under IAS 12 is not accurate and may result in inappropriate application of the standard. We recommend replacing Example 5 with an alternative example which illustrates the requirements of paragraph 31 (or 17(c)) of IAS 1 *Presentation of Financial Statements* (see our detailed comments in in response to Question 2).

- ***Potential risks to consider***: Some may read the proposed illustrative examples as implying that an entity needs to perform a comprehensive analysis of all potential risks – not just the relevant risks that may impact it – when assessing whether information is material. We understand that the examples are intended to focus only on the risks that may impact the entity. However, we recommend explicitly explaining this point – e.g. in the basis for conclusions accompanying the illustrative examples.
- ***Connectivity with other publicly available information***: Some examples refer to an entity's climate-related transition plan. However, it is unclear if and how the existence of a transition plan, the level of detail it contains and the publicly available information about it would impact the materiality assessment. Similar questions arise for other publicly available information, including the front part of the entity's annual report, sustainability report and other similar information. We recommend explaining how the entity's publicly available information about risks and uncertainties would impact the assessment of whether information about a specific risk or uncertainty is material. Such explanations can be included in the basis for conclusions accompanying the illustrative examples.

'No impact' disclosures – when and where to provide

Some examples illustrate disclosures which an entity provides when it determines that climate-related risks or other uncertainties do not impact its financial position, performance and cash flows. We understand that the IASB aimed to illustrate the application of paragraph 31 (or 17(c)) of IAS 1. However, it is unclear from Example 1 why the transition plan having no impact is material information. We are concerned that this example could result in entities providing generic disclosures about information that is not material to the financial statements and potentially obscuring material information.

In addition, some may read this example alongside Example K in the Materiality Practice Statement as implying that such disclosures should always be provided in the financial statements. We believe that the appropriate location of 'no impact' disclosures – i.e. inside or outside the financial statements – may depend on the specific facts and circumstances and an entity's assessment of its users' needs.

Explaining the IASB's decisions – basis for conclusions

We acknowledge that illustrative examples are generally not accompanied by a basis for conclusions. However, we believe that the basis for conclusions to the ED provides useful background information which would be helpful in driving clarity and consistency in reporting the effects of climate-related and other uncertainties in the financial statements. Therefore, we recommend publishing the basis for conclusions when releasing the final illustrative examples.

Other significant comments

We also have some concerns and recommendations in relation to the following areas.

- ***Over-reliance on paragraphs 31 and 125 of IAS 1*:** Examples 1, 2, 4 and 5 aim to illustrate that paragraphs 31 and 125 of IAS 1 may require disclosure of information beyond what is required by other IFRS Accounting Standards. These examples may indicate that the disclosure requirements in other IFRS Accounting Standards are insufficient. A better longer-term solution may be to amend the respective IFRS Accounting Standards rather than use IAS 1 to fill disclosure gaps.
- ***Impairment – impact on the terminal value*:** For many entities, the major effects of climate-related and other uncertainties will have a more significant impact on the terminal value than the five-year forecast period. We note that none of the examples discuss the disclosure of the impact of climate-related and other uncertainties on the terminal value. We recommend amending Example 3 to address this.
- ***Location of examples and cross-references*:** Some examples illustrating overarching disclosures under IAS 1 (IFRS 18/IAS 8) involve underlying scenarios falling in the scope of other specific standards – e.g. Example 5 involves a recoverability assessment of deferred tax assets under IAS 12. There is a risk that some examples may be missed because they are only included in the illustrative examples accompanying IAS 1 (IFRS 18/IAS 8). If the examples are only included in IAS 1 (IFRS 18/IAS 8), then we recommend including cross-references to them from other relevant IFRS Accounting Standards.
- ***Connectivity*:** The proposed illustrative examples are a good start in strengthening connections. We recommend further collaboration between the IASB and the International Sustainability Standards Board (ISSB) through a future joint project to drive greater connectivity between financial reporting and sustainability reporting.

We understand that the IASB did not intend to limit the consideration of connected reporting to disclosures prepared under IFRS Sustainability Disclosure Standards; however, further guidance is required in this space.

Please contact Brian O'Donovan at brian.odonovan@kpmgifrg.com or Irina Ipatova at irina.ipatova@kpmgifrg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Appendix

KPMG's responses to the specific questions raised in the ED

Question 1— Providing illustrative examples
The IASB is proposing to provide eight examples illustrating how an entity applies the requirements in IFRS Accounting Standards to report the effects of climate-related and other uncertainties in its financial statements. The IASB expects the examples will help to improve the reporting of these effects in the financial statements, including by helping to strengthen connections between an entity's general purpose financial reports. Paragraphs BC1–BC9 of the Basis for Conclusions further explain the IASB's rationale for this proposal. (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. 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. Paragraphs BC43–BC45 of the Basis for Conclusions further explain the IASB's rationale for this proposal. (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.

(a) We agree, provided our key concerns and recommendations are addressed.

As mentioned in our cover letter, investors and regulators have been demanding clarity on climate-related matters in financial reporting. The impact of climate-related and other uncertainties is becoming more significant and its importance and relevance to the users of financial statements are increasing. Subject to our comments on Examples 1, 2 and 5 (see our response to Question 2), we agree that the proposed examples will help to improve the clarity of financial reporting and to drive the right behaviours when making judgements about the materiality of information – in particular, when an entity determines that there is no impact on its financial position, performance and cash flows. The examples also appropriately draw attention to the existing overarching requirements in IAS 1 (IFRS 18/IAS 8).

(b) Except for Examples 1, 2 and 5 (see our response to Question 2) and subject to our recommendation on cross-referencing (see below), we agree that including the examples as illustrative examples accompanying IFRS Accounting Standards addresses stakeholder concerns and will help drive clarity in financial reporting in a timely manner. The external due process applied to these examples, in comparison to educational material, gives an opportunity to all stakeholders to provide their input and is appropriate given their nature.

As mentioned in our cover letter and response to Question 2, we recommend that the IASB consider whether amendments to some disclosure requirements in IFRS Accounting Standards may be appropriate in the longer term.

Recommendations

Explaining the IASB's decisions – basis for conclusions

As explained in our cover letter, we believe that the basis for conclusions to the ED provides useful background information which would be helpful in driving clarity and consistency in reporting the effects of climate-related and other uncertainties in the financial statements. We recommend publishing the basis for conclusions when releasing the final illustrative examples – e.g. within the basis for conclusions of the relevant standards or as a separate section in the Bound Volume.

Location of examples and cross-references

As explained in our cover letter, we are concerned that some examples will be missed because they are only included in IAS 1 (IFRS 18/IAS 8). If some examples are only included in IAS 1 (IFRS 18/IAS 8), then we recommend including cross-references to them from other relevant IFRS Accounting Standards. For example, cross-refer from IAS 36 *Impairment of Assets* to Example 4 in the ED proposed to accompany IAS 1 (IAS 8).

Question 2— Approach to developing illustrative examples
Examples 1–8 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.

Paragraphs BC10–BC42 of the Basis for Conclusions further explain the IASB's overall considerations in developing the examples and the objective and rationale for each example.

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 and why.

Overall, we agree with the IASB's approach to developing examples. However, we have the following comments and recommendations.

Recommendations

Selection of requirements and fact patterns

Generally, we agree that the selection of examples showcases some of the most relevant issues and requirements of IFRS Accounting Standards in the context of climate-related and other uncertainties, subject to our comments on Examples 1, 2 and 5 outlined below.

We think that there are also other relevant issues and recommend that, in a future project, the IASB develop additional examples which illustrate the following.

- How to determine whether information about *physical* risks that affect an entity's financial position and performance is material. Examples 1 and 2 focus on transition risks. Some may interpret the examples as implying that climate-related physical risks do not affect financial statements. In line with our recommendation about Examples 1 and 2, we believe that these additional examples should be located in the Materiality Practice Statement.
- How to determine whether information about the *reasons* for a write-down of inventory to net realisable value (NRV) is material. IAS 2 *Inventory* does not require disclosure of the reason for writing down inventory to NRV. However, if this information is material, then the overarching requirements in paragraphs 31 (or 17(c)) of IAS 1 would require such disclosure. This is another potentially common impact of climate-related and other uncertainties on the financial statements. For example, a manufacturer commits to using recyclable materials in its production process. It has some non-recyclable raw materials on hand at year-end which it no longer expects to use and recognises a write-down to NRV. We suggest this example could replace Example 5 to illustrate the requirements of paragraph 31 (or 17(c)) of IAS 1.
- How an entity's transition plan may impact the useful economic life and residual values of property, plant and equipment, including how critical assumptions underlying the financial statements are consistent with or dissimilar to the critical

assumptions underlying the transition plan, and the disclosure thereof in other publicly available information.

Technical content

Overall, we support the IASB's initiative, but further work is required, potentially involving the ISSB, before the examples are finalised.

Materiality assessments

The IASB concluded that examples should, amongst other things, illustrate *how* an entity determined whether information about how climate-related and other uncertainties affects its financial position and performance is material – including considering connections to information provided in other general purpose financial reports.

- *No impact on the entity's financial position, performance and cash flows*: As explained in our cover letter, we are concerned that some may interpret Examples 1, 2 and 5 as providing new guidance.
  - *Examples 1 and 2*: We recommend relocating the analysis within these examples to the Materiality Practice Statement. We agree that such guidance is helpful to drive the right behaviours; however, the guidance in these examples needs to be enhanced such that it illustrates *how* an entity makes materiality judgements. Also, it needs to be considered in the context of the Materiality Practice Statement. These examples contain only limited facts and discussion. As drafted, we are concerned that they could be over-interpreted, with some stakeholders seeking to reverse engineer them to discover new, unintended principles – which may result in diversity in practice.
  - *Example 5*: We are concerned that this example introduces new guidance on how to consider 'an announced regulation' when applying IAS 12 *Income Taxes.* We also believe that some of the technical analysis under IAS 12 is not accurate and may result in inappropriate application of the standard. We recommend replacing this example with an alternative example which illustrates the requirements of paragraph 31 (or 17(c)) of IAS 1 – e.g. an example which illustrates how to determine whether information about the reasons for a write-down of inventory to NRV is material.
- *Potential risks to consider*: As explained in our cover letter, we are concerned that some may read the proposed illustrative examples as implying that an entity needs to perform a comprehensive analysis of all potential risks – not just the relevant risks that may impact it – when assessing whether information is material. We do not believe this is the intention of the examples. We recommend explicitly explaining that an entity only needs to consider information about relevant risks that may impact it when assessing whether information is material to disclose – e.g. in the basis for conclusions accompanying the illustrative examples.

- *Connectivity with other publicly available information*: As explained in our cover letter, we are concerned that it is unclear if and how a transition plan and other publicly available information impact the materiality assessment. We recommend explaining how the entity's publicly available information about risks and uncertainties would impact the assessment of whether information about a specific risk or uncertainty is material to the financial statements. Such explanations can be included in the basis for conclusions accompanying the illustrative examples.

No impact disclosure – when and where to provide

As explained in our cover letter, we are concerned that it is unclear from the examples when an entity is required to disclose that climate-related and other uncertainties do not impact its financial position, performance and cash flows. For example, in Example 1 it is unclear why the transition plan having 'no impact' on the entity's financial position and performance is material information in the context of the entity having assets which are nearly fully depreciated, with recoverable amounts exceeding their carrying amounts and no asset retirement obligations. Some could interpret Example 1 as providing guidance that information about climate-related and other uncertainties is material because it relates to an entity's prospects for the future, notwithstanding there is no impact on the financial position, performance and cash flows of the entity. However, we do not believe that this was the intention of the example. Consequently, we are concerned that this example could result in entities providing generic disclosures in the financial statements about information that is not material to the financial statements, which could potentially obscure material information.

We believe that for information to be material to the users of the financial statements, there needs to be the *potential* for the financial statements to be impacted by the climate-related and other uncertainties. Accordingly, we recommend amending the fact patterns in Examples 1 and 2 such that there is a significant goodwill balance. We believe that this change will make a clear link to the financial statements and reduce diversity in the application of the guidance in these examples.

We are also concerned that some may read Example 1 as implying that 'no impact' disclosures should always be provided in the financial statements. We believe that the appropriate location of 'no impact' disclosures – i.e. inside or outside the financial statements – may depend on the specific facts and circumstances and an entity's assessment of its users' needs. We also believe that further guidance is required in this area and recommend that the IASB address this matter as part of the Materiality Practice Statement.

Over-reliance on paragraphs 31 and 125 of IAS 1

As explained in our cover letter, we are concerned that Examples 1, 2, 4 and 5 may indicate that the disclosure requirements in other IFRS Accounting Standards are insufficient. For example, Example 4 results in the entity applying paragraph 125 of IAS 1 to provide additional disclosures about assumptions used to determine the recoverable amount for a cash-generating unit (CGU) which does not contain goodwill or intangible assets with indefinite useful lives, and no impairment loss is recognised.

These disclosures are not required by IAS 36, although encouraged. We recommend that the IASB consider whether amendments to other IFRS Accounting Standard disclosure requirements are appropriate in the longer term.

Impairment assessment – impact on the terminal value

For many entities, the major effects of climate-related and other uncertainties will be expected in the long-term – i.e. beyond what is typically a five-year maximum forecast period under IAS 36. The terminal value is generally significant to the recoverable amount of an asset or CGU and therefore the effects of climate-related and other uncertainties on the terminal value may be more significant than the effects on the forecast period.

The examples do not discuss the application of the disclosure requirements in IFRS Accounting Standards to the impact of climate-related and other uncertainties on the terminal value. For example, it is unclear from Example 3 whether an entity should disclose the future price of greenhouse gas emission allowances – e.g. in 2030, 2040, 2050 – used in estimating the cash flows and/or long-term growth rate in the terminal value formula. Reflecting the impact of climate-related and other uncertainties in the terminal value can be complex. We recommend adding to Example 3 disclosures about the impact of climate-related and other uncertainties on the terminal value, based on the requirements in paragraph 134 of IAS 36 or paragraph 31 (or 17(c)) of IAS 1.

Question 3— Other comments
Do you have any other comments on the Exposure Draft?

We agree that focussing the examples on inconsistencies in information about the effects of climate-related and other uncertainties that might appear to exist between financial statements and other general purpose financial reports would help to strengthen connectivity. We believe that examples are a good start in strengthening connections and will facilitate timely improvements in reporting.

We understand that when developing the examples the IASB did not intend to limit the consideration of connected reporting to disclosures prepared under IFRS Sustainability Disclosure Standards.

The reporting landscape continues to evolve and we believe that further guidance on connections between the financial statements and information outside of the financial statements is needed. The proposed examples focus on climate-related uncertainties. We recommend developing further guidance on connectivity of information about the effects of both climate-related and other uncertainties. We also recommend further collaboration between the IASB and the ISSB on climate-related uncertainties through a future joint project to drive greater connectivity between financial and sustainability reporting. For instance, examples with broad fact patterns illustrating several requirements in IFRS Accounting Standards (as considered in BC17(b)), and linking to the IFRS Sustainability Disclosure Standards (where appropriate), would be very helpful to further strengthen connections.