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

Comments on the Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements*

To the IASB Board Members:

The Japanese Institute of Certified Public Accountants (JICPA) appreciates the continued efforts of the International Accounting Standards Board (IASB) to develop high quality accounting standards and welcomes the opportunity to comment on the Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements* (Exposure Draft).

We, as auditors, acknowledge that the topic of climate-related risks is significant. As such, we support the IASB's purpose of the project, which is to respond to stakeholders who are concerned that information about the effects of climate-related risks in the financial statements is insufficient or appeared to be inconsistent with information entities provide outside the financial statements. In addition, we acknowledge that inclusion of the examples as illustrative examples accompanying IFRS Accounting Standards may make it easier for entities and auditors to find them than publishing them as educational materials available on the IASB's website, and, therefore, it would provide a greater opportunity for entities and auditors to consider the effects of climate change in practice.

The ED's proposal to provide illustrative examples can be a useful way to solve practical issues as mentioned above. However, we are concerned that providing illustrative examples alone as currently proposed in the ED would not be sufficient to fully comprehend the IASB's intent, and therefore, limited improvement would be seen in practice under the proposal. In other words, in order to improve information disclosures as intended by the IASB, we suggest the IASB provide prescriptive concepts behind the illustrative examples and explanations as to how to apply general disclosure requirements. At the same time, we recommend the Board to consider amending IFRS Accounting Standards, including guidance about materiality judgements on information to be disclosed in the financial statements in terms of the relationship with sustainability and other disclosures made in the general purpose financial reports. Also, because the potential widespread impact would go beyond the scope of the ED, the effect should be additionally considered, when considering amendments to IFRS Accounting Standards. Due to the above reasons, we do not agree with the current ED, proposing to solve the situation by simply providing illustrative examples.

Please see our comments to each Question in the following pages.

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.

Comment:

JICPA does not fully agree with the IASB's proposal because we believe providing illustrative examples alone as currently proposed in the ED would not be sufficient to fully comprehend the IASB's intent, and therefore, only limited improvement would be expected in practice under the proposal.

As described in paragraph BC6 of the ED, the reporting landscape is evolving, particularly with developments in sustainability reporting. We are aware of the needs of stakeholders, especially investors, who are seeking consistency between information about the effects of climate-related risks in the financial statements and information entities provide outside the financial statements, particularly information on climate-related risks reported in other general purpose financial reports. But before discussing consistency between the information, it is important that we all have a clear understanding that there is a difference between the objective and scope of general purpose financial reports, which include financial statements and sustainability-related financial disclosures, and the objective and scope of financial statements.

Given that stakeholders are requiring timely actions to improve the reporting of the effects of climate-related risks in the financial statements, we believe providing examples about how to apply the current IFRS Accounting Standards can be useful in a way for stakeholders for the purpose of facilitating stronger connections with the information in general purpose financial reports, but the improvement would be limited and tentative.

We say this because illustrative examples themselves are not prescriptive, in general. Unless the IASB provides prescriptive concepts behind illustrative examples, entities dealing with all kinds of issues (i.e. facts and circumstances) may overlook materiality judgements illustrated in the ED, referring to them as just one example. Accordingly, the IASB might not be able to sufficiently respond to the needs of stakeholders to improve disclosures.

Also, based on the IASB's understanding that IFRS Accounting Standards are generally sufficient in requiring an entity to disclose information about the effects of climate-related risks in the financial statements, the Board is presenting a sample of disclosures in illustrative examples by referring to general disclosure requirements, including paragraph 31 of IAS 1 *Presentation of Financial Statements* (paragraph 20 of IFRS 18 *Presentation and Disclosure in Financial Statements*). As explicitly stated in paragraph 31 of IAS 1 (paragraph 20 of IFRS 18), there are situations where 'compliance with the specific requirements in IFRS Accounting Standards is insufficient to enable users of financial statements to understand the effect of transactions and other events and conditions on the entity's financial position and financial performance.' The illustrative examples heavily reliant on such overarching requirement in itself indicate that the IASB is required to consider reviewing IFRS Accounting Standards. Also, from the perspective of stakeholders, including preparers and auditors of financial statements, it is not necessarily clear as to how to apply the general disclosure requirements. For example, although the examples in the ED illustrate application methods based on current IFRS Accounting Standards to a certain extent, the required thought processes are not clear enough to have all stakeholders be on the same page with respect to how far and what exactly needs to be considered under the requirements or the IASB's expectation on applying the requirements. Unless the IASB finds a way to create a common understanding among stakeholders, it may only cause confusion in practice without making significant disclosure improvements.

In addition to that, we suggest the IASB consider expanding illustrative examples as follows so that consistent disclosures amid different business circumstances will be appropriately achieved between information on climate-related risks reported in general purpose financial reports and information about the effects of climate-related risks in the financial statements: clarify the IASB's intent and expected thought processes in the illustrative examples; and provide prescriptive concepts behind those illustrative examples and explanations as to how to apply general disclosure requirements. We believe consistency can be achieved only when this is considered together with amendments to IFRS Accounting Standards, including guidance about materiality judgements on information to be disclosed in the financial statements in terms of the relationship with sustainability and other disclosures made in the general purpose financial reports. Amendments to IFRS Accounting Standards should be separately considered because of the expected widespread impact that would go beyond the scope of the ED.

In summary, we believe providing illustrative examples alone as currently proposed in the ED could be useful only to a certain extent but would not contribute to a significant improvement as expected by the IASB. For improvement purposes, we suggest the IASB provide prescriptive concepts behind the illustrative examples and explanations as to how to apply general disclosure requirements. At the same time, we recommend the Board to amend IFRS Accounting Standards, including guidance about materiality judgements on information to be disclosed in the financial statements in terms of the relationship with sustainability and other disclosures made in the general purpose financial reports. Also, amendments to IFRS Accounting Standards should be separately considered because of the expected widespread impact that would go beyond the scope of the ED. Due to the above reasons, we do not agree with the current ED, proposing to solve the situation by simply providing illustrative examples.

Please see further detail of our concerns and possible solutions for individual examples in our comment to Question 2.

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.

Comment:

We do not necessarily disagree with the IASB's approach to improve disclosures through developing illustrative examples, and we even think some of the examples can be useful. For instance, there is already an explicit requirement in IAS 36 *Impairment of Assets* about disclosing information on key assumptions, but we think preparers can disclose information more appropriately by referring to Example 3 because it is possible that the current requirement in IAS 36 is causing some misunderstanding in practice.

However, we are afraid the IASB's approach is not working as intended for certain illustrative examples proposed in the ED. As already commented in Question 1, in order to achieve improvement as expected by the IASB, we strongly recommend the Board to provide prescriptive concepts behind the proposed illustrative examples and explanations as to how to apply general disclosure requirements. At the same time, we recommend the Board to consider amending IFRS Accounting Standards, including guidance about materiality judgements on information to be disclosed in the financial statements in terms of the relationship with sustainability and other disclosures made in the general purpose financial reports. It is also imperative to appropriately address concerns raised for each illustrative example. Unless the above issues are resolved, JICPA would not support the finalisation of the ED.

Please see our comment on individual examples.

(1) Example 1 and Example 2

Example 1 illustrates how an entity makes materiality judgements in accordance with the requirement in paragraph 31 of IAS 1 (paragraph 20 of IFRS 18).

However, we are concerned that referring to paragraph 31 of IAS 1 (paragraph 20 of IFRS 18) may only cause confusion in practice in determining whether it is required or not to disclose the effect of climate-related matters as well as the reason for that assertion, even under circumstances when it is concluded it is not material to the financial statements, unless all the stakeholders, including preparers and auditors, clearly understand the basic concept of the requirement. In Example 1, for instance, entities working on various transition plans and facing different circumstances in the real world may end up providing boilerplate, standardised disclosures, concluding their transition plans and/or circumstances have no effect on the financial statements, by simply covering checkpoints in paragraphs 1.3, 1.4 and 1.9. Reading Example 1 and Example 2 together, we understand the IASB's intent as follows:

- Example 1 is based on an assumption that the entity is in manufacturing business that is exposed to climate-related risks and is disclosing the transition plans in its non-financial statements to address associated potential risks and, accordingly, the fact and the reason that the impact is immaterial to the financial statements should be disclosed as the fact itself influences the decision-making of users of the financial statements.
- Example 2 appears to be illustrated using a different assumption and Example 2 is to illustrate a situation where no additional disclosure is required because doing so would not affect the decision-making of users of the financial statements.

However, we are afraid the IASB's intent above is not clear enough to stakeholders without describing prescriptive concepts in the ED.

Furthermore, connections between disclosure information on sustainability-related risks over the medium or long term and the information provided in the financial statements are covered in the proposed illustrative examples, in which related information is assessed for its materiality to the financial statements using a wider time span. Again, without describing prescriptive concepts, we do not expect to see such positive changes to happen in practice just by providing the illustrative examples proposed in the ED.

We also suggest the IASB provide sufficient support to entities, for developing their thought processes in identifying, determining and providing information more likely to influence users' decision-making considering their business environment, risks and various information in their financial and non-financial statements. In particular, Example 1 can be interpreted that the IASB is requiring entities to address not just climate-related risks but also a variety of other risks that might impact the financial statements by asking entities to understand on how users of financial statements are utilising information for their decision-making purposes and to expand the search for potential risks. We highly recommend the IASB to provide sufficient and appropriate explanation about its expectation on thought processes to be followed by entities in the illustrative examples. Otherwise, we are afraid it may only cause confusion in practice without making significant disclosure improvements.

In conclusion, as commented in Question 1, we recommend the IASB consider clarifying its intent and expected thought processes in the illustrative examples and providing prescriptive concepts. At the same time, we recommend the IASB to consider amending IFRS Accounting Standards, including guidance about materiality judgements on information to be disclosed in the financial statements in terms of the relationship with sustainability and other disclosures made in the general purpose financial reports.

In case of amending IFRS Accounting Standards through the incorporation of guidance and revised illustrative examples into IAS 1/ IFRS 18, instead of developing accompanying documents, a careful consideration should be given to include IFRS Practice Statement 2 *Making Materiality Judgements*. As illustrated in Example 1 in the ED, entities may be required to disclose information on climate-related risks and the likes due to its materiality from a qualitative perspective, even though such information does not have a material effect on their financial position and financial performance at the moment. We note that IFRS Practice Statement 2 *Making Materiality Judgements*, a non-mandatory guidance, already explains that information can be material due to qualitative factors, despite the absence of materiality based on quantitative factors but it is not clear in the definition of 'materiality' in IAS 1/ IFRS 18.

(2) Example 5

Example 5 illustrates the possibility of an entity to disclose information in accordance with paragraph 31 of IAS 1 (paragraph 20 of IFRS 18) even if specific IFRS Accounting Standards do not require such disclosure.

Given that a requirement already exists in paragraph 125 of IAS 1 (Paragraph 31A of IAS 8), paragraphs 5.8–5.11 in the ED do not seem to provide a clear-cut explanation to entities about the detailed steps and the scope of risk search to be considered with respect to how far, in practice, they would need to assess risks related to periods after the end of the next fiscal year in accordance with paragraph 31 of IAS 1 (paragraph 20 of IFRS 18). As we are not even sure whether the example and assumptions used in

Example 5 are realistic and common, we are concerned Example 5 might only create confusion in practice.

Therefore, if the IASB were to finalise the ED without deleting Example 5, we highly recommend the IASB to clarify its intent and expected thought processes and to provide prescriptive concepts in the ED, which should be aligned with our suggestion for other illustrative examples.

(3) Example 6

Example 6 illustrates how an entity can disclose risks related to climate change from the perspective of IFRS 7 *Financial Instruments: Disclosures*.

As the maximum period over which expected credit losses shall be measured by financial institutions for general loans is limited to the contractual period, we argue that financial institutions are exposed to only part of the risks related to climate change that generally persist over a long term. In that sense, we request the Board to further consider whether picking the theme 'climate-related risks' is truly useful as a general example for disclosures related to 'the effects of particular risks' under IFRS 7.

That said, we may suggest adding a sentence as assumptions, mentioning the financial institution in Example 6 is significantly exposed to climate change-related risks. Or alternatively, when a financial institution not subject to any significant exposure is required to disclose such fact according to its credit risk management, we suggest the financial institution describe the basis for the disclosure, while the IASB should consider providing guidance about materiality judgements, as we commented in Question 1.

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

Comment:

No comments from JICPA.

Yours faithfully,

Eriko Otokozawa
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The Japanese Institute of Certified Public Accountants