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Comments on the Exposure Draft (ED/2024/6)
Climate-related and Other Uncertainties in the Financial Statements

1. The Accounting Standards Board of Japan ("we") welcome the opportunity to provide our comments on the International Accounting Standards Board ("the IASB")'s Exposure Draft (ED/2024/6) *Climate-related and Other Uncertainties in the Financial Statements* ("the ED"), issued in July 2024.

(Including the examples as illustrative examples accompanying IFRS Accounting Standards)

2. As discussed in detail in the Appendix of this letter, we are of the view that many of the examples proposed in the ED should be deleted, and even if some examples were to be retained, we think they should not be treated as illustrative examples accompanying IFRS Accounting Standards. If the examples were to be published in some form, we think it would be more useful for stakeholders to understand how entities should disclose information regarding the effects of climate-related risks in the financial statements, for example, by supplementing the explanations for each IFRS Accounting Standard in the IASB's Educational material "Effects of climate-related matters on financial statements" republished in July 2023. We think that the IASB should separately address how to improve the accessibility issues of the Educational material and to enhance its awareness.

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(The relationship between financial statements and sustainability-related financial disclosures)

3. We support the IASB's initiative that aims to promote the connectivity between information an entity provides in its financial statements and information it provides in other parts of its general purpose financial reports, to address the concerns of stakeholders that the information about the effects of climate-related risks in an entity's financial statements apparently is inconsistent with the information it provides outside its financial statements.

4. However, while this is not unique to this project but also relates to other projects (including the Power Purchase Agreements project and the Business Combinations – Disclosures, Goodwill and Impairment project), we do not agree with the IASB's direction that may lead to the conclusion that any information that users find useful should be provided in the financial statements.

5. Considering that many of the risks associated with climate-related and other uncertainties relate to future uncertainties, it is also important for the IASB to make efforts to deepen the understanding of users of financial statements that some information about such risks may not be included in financial statements.

6. We think that the IASB needs to consider what information should be disclosed in financial statements and what not in order to promote connectivity within the general purpose financial reports.

7. As the IASB's *Conceptual Framework for Financial Reporting* states, we are of the view that the objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources. Moreover, noting that the IASB's *Conceptual Framework for Financial Reporting* refers to the result of past events in both the definition of an asset and the definition of a liability, we are of the view that the information to be provided in the financial statements mainly relates to the information regarding past and present events and that if information regarding future uncertainties were to be provided, such information should be limited to the measurement of assets and liabilities that refer to future cash flows.

(Paragraph 31 of IAS 1 *Presentation of Financial Statements*)

8. We note that Example 1 and Example 5 in the ED refer to the overarching disclosure requirement in paragraph 31 of IAS 1 *Presentation of Financial Statements.* Our understanding is that practice has developed based on the understanding that this requirement would require an entity to disclose additional information when it determines, in relation to the financial statements as a whole, that such information is so important that the lack of disclosure of such information would mislead users of financial statements. The proposed examples imply that an entity can conclude whether additional information should be disclosed, based merely on the background information in the Examples, which we think is inappropriate and thus should be deleted.

9. We agree with the IASB's observation that IFRS Accounting Standards are generally sufficient in requiring an entity to disclose information about the effects of climate-related risk in the financial statements. However, if the IASB's intention is to change the interpretation of existing standards, we are of the view that such change should not be made using illustrative examples.

10. For our comments on the specific questions in the ED, please see the Appendix of this letter.

11. We hope our comments are helpful for the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

Y. Kawanishi

Yasunobu Kawanishi
Chair
Accounting Standards Board of Japan

Appendix

<u>Comments on Specific Questions in the ED</u>

Our comments on the specific questions sought in the ED are as follows.

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.

(Question 1 (a) — Whether providing examples would help improve the reporting of the effects of climate-related and other financial statements)

1. Our view is provided in our response to Question 1(b).

(Question 1 (b) — Whether including the examples as illustrative examples

accompanying IFRS Accounting Standards)

2. The examples in the ED were made based on the assumption that IFRS Accounting Standards are generally sufficient in requiring an entity to disclose information about the effects of climate-related risk in the financial statements. However, as described in paragraph 12, paragraph 17 and paragraph 18 of this Appendix, we are of the view that certain examples should be deleted because they seem to provide interpretations of IFRS Accounting Standards that are different from existing practice.

3. In addition, as described in paragraph 21 of this Appendix, some of the examples are based on the extremely rare fact patterns. Accordingly, if these examples were to be included as illustrative examples accompanying IFRS Accounting Standards, we are concerned that only those disclosures that relate to climate-related uncertainties would be overemphasised. Therefore, we consider that neither Example 3 nor Example 6 should be included as illustrative examples accompanying IFRS Accounting Standards.

4. If the IASB were to publish the examples in some form, we think it would be more useful for stakeholders to understand how entities should disclose information regarding the effects of climate-related risks in the financial statements, for example, by supplementing the explanations for each IFRS Accounting Standard in the IASB's Educational material "*Effects of climate-related matters on financial statements*" republished in July 2023. We think that the IASB should separately address how to improve the accessibility issues of the Educational material and to enhance its awareness.

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.

(Question 2 — Our comments on the IASB's approach to developing examples)

<u>The relationship between financial statements and sustainability-related financial disclosures</u>

5. We support the IASB's initiative that aims to promote the connectivity between information an entity provides in its financial statements and information it provides in other parts of its general purpose financial reports, to address the concerns of stakeholders that the information about the effects of climate-related risks in an entity's financial statements apparently is inconsistent with the information it provides outside its financial statements.

6. However, while this is not unique to this project but also relates to other projects (including the Power Purchase Agreements project and the Business Combinations – Disclosures, Goodwill and Impairment project), we do not agree with the IASB's direction that may lead to the conclusion that any information that users find useful should be provided in the financial statements.

7. Considering that many of the risks associated with climate-related and other uncertainties relate to future uncertainties, it is also important for the IASB to make efforts to deepen the understanding of users of financial statements that some information about such risks may not be included in financial statements.

8. We think that the IASB needs to consider what information should be disclosed in financial statements and what not in order to promote connectivity within the general purpose financial reports.

9. As the IASB's *Conceptual Framework for Financial Reporting* states, we are of the view that the objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources. Moreover, noting that the IASB's *Conceptual Framework for Financial Reporting* refers to the result of past events in both the definition of an asset and the definition of a liability, we are of the view that the information to be provided in the financial statements mainly relates to the information regarding past and present events and that if the information regarding future uncertainties were to be provided, such information should be limited to the measurement of assets and liabilities that refer to future cash flows.

<u>Uncertainties other than climate-related uncertainties</u>

10. Despite the fact that this project's objective includes not only climate-related uncertainties but also other uncertainties, the examples focuses too heavily on climate-related issues. This seems to be inconsistent with the project's objective.

11. In addition, if examples that focus too heavily on climate-related uncertainties are included as examples accompanying IFRS Accounting Standards, it may cause the misunderstanding that climate-related uncertainties are more important than other uncertainties in the context of each disclosure requirement. For this reason, if the IASB were to publish the examples in some form, we think that the IASB should add examples that cover other uncertainties.

(Question 2 — Our comments on the selection of requirements and fact patterns in the examples and technical content of the examples)

<u>Paragraph 31 of IAS 1 -Example 1, Example 2 and Example 5</u>

12. We note that Example 1 and Example 5 in the ED refer to the overarching disclosure requirement in paragraph 31 of IAS 1 *Presentation of Financial Statements.* Our understanding is that practice has developed based on the understanding that this requirement would require an entity to disclose additional information when it determines, in relation to the financial statements as a whole, that such information is so important that the lack of disclosure of such information would mislead users of financial statements. The proposed examples imply that an entity can conclude

whether additional information should be disclosed, based merely on the background information in the Examples, which we think is inappropriate and thus should be deleted.

13. We agree with the IASB's observation that IFRS Accounting Standards are generally sufficient in requiring an entity to disclose information about the effects of climate-related risk in the financial statements. However, if the IASB's intention is to change the interpretation of existing standards, we are of the view that such change should not be made using illustrative examples.

14. Furthermore, Example 5 provides an example based on a fact pattern that assumes that government regulations that have yet to be enacted will come into effect earlier than expected. However, we are of the view that such disclosures should be included in the general purpose financial report outside the financial statements, as they represent the effects of uncertainties on the financial statements that arise from future regulations. We do not think it is appropriate to illustrate such disclosures as an example that would be subject to paragraph 31 of IAS 1, which requires an entity to determine whether disclosures about such risks are important in relation to the financial statements as a whole.

15. For the reasons mentioned above, we think that both Example 1 and Example 5 should be deleted.

16. In addition, because Example 2 in the ED is developed to contrast Example 1, we think Example 2 would be unnecessary if Example 1 were deleted.

<u>Paragraph 125 of IAS 1 -Example 4</u>

17. Example 4 in the ED provides an example related to the assumptions about uncertainties that will not be resolved within the next financial year, although the IASB is aware that there are different interpretations whether paragraph 125 of IAS1 applies not only to the assumptions about uncertainties that will be resolved within the next financial year but also to the assumptions about uncertainties that will be resolved only after the end of the next financial year. Because this example effectively provides an interpretation of IAS 1, we think this example should be deleted.

<u>Paragraph 85 of IAS 37 - Example 7</u>

18. Paragraph 85 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires an entity to provide, among other information, a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits for each class of provisions. Our understanding is that, in this case, if the carrying amount of the provision is immaterial, it is generally understood that disclosures would not be required and that disclosures would not be provided until the outflow period actually becomes shorter. Accordingly, Example 7, which proposes disclosures applying paragraph 85 of IAS 37, taking into account the possibility that an entity may use different assumptions from those currently used. We are concerned that this interpretation is different from how the requirements are currently understood.

19. We think Example 7 should be deleted because it may cause the misunderstanding that, even when the carrying amount of a provision is immaterial, disclosures for each class of provisions would be required under paragraph 85 of IAS 37.

<u>Disclosure of disaggregated information -Example 8</u>

20. Example 8 proposes that disaggregated information should be provided in the notes because the vulnerability of the two types of Property, Plant and Equipment (PP&E) to climate-related transition risks is very different. However, considering that an entity usually analyses and examines their assets and liabilities by taking into account multiple factors, we do not think there is sufficient reason to justify that an entity will need to disaggregate PP&E based solely on climate-related risks when it discloses disaggregated information based on IFRS 18 *Presentation and Disclosure in Financial Statements*. For this reason, we think this example should be deleted.

<u>Background information - Example 3 and Example 6</u>

21. Because the examples in the ED assume extremely rare situations, we think that the benefit of including them in the examples accompanying the IFRS Accounting Standards would be limited.

    (a) Example 3 assumes that an entity allocates a significant amount of goodwill to one of its cash-generating units (CGUs) and that the entity determines that its assumptions about future emission allowance costs are key assumptions in calculating the value in use of the CGU as the recoverable amount. However, considering that it is extremely rare for an entity to have similar situations as Example 3, the benefit of Example 3 would be limited.

(b) Regarding the disclosure of credit risks in Example 6, the disclosure of credit risks should cover risks that exist within the contract periods of the loans. We are of the view that it would be rare that risks exceeding the contract periods, such as climate-related risks, would become important risks to the entity, and thus that the benefit of Example 6 would be limited.

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

22. As we note in paragraph 3 of this Appendix, we do not support the IASB in providing the examples as illustrative examples accompanying IFRS Accounting Standards. Nevertheless, the following paragraphs note our concerns if the IASB were to publish the example in the ED as examples accompanying IFRS Accounting Standards.

23. As mentioned in paragraph 12 of this Appendix, we think that some of the examples in the ED provide interpretations that are different from existing practice. Accordingly, if these examples are published as illustrative examples accompanying IFRS Accounting Standards, entities may need to change their existing practice.

24. If that were to be the case, we think the IASB should at least set an effective date and, if necessary, establish transition requirements to ensure that entities have sufficient time to respond to the change.

25. Depending on the timing of publishing the examples, certain entities may not have sufficient time to respond to the change. We note that many entities in our jurisdiction have fiscal years ending in March. The IASB should keep in mind that entities may have different year-ends and that the effective date and transition requirements should be established to ensure that entities with specific year-end dates are not significantly disadvantaged.

[EOD]