THE
INVESTMENT
ASSOCIATION

Response to consultation

IASB Exposure Draft: Climate-related and Other Uncertainties in the Financial Statements

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Consultation questions

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. 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.

The Investment Association (IA) and its members agree with the IASB's approach of providing examples to help improve the reporting of the effects of climate-related and other uncertainties in the financial statements.

The proposed examples will help entities better understand how to apply the existing IFRS Accounting Standards. We agree with the IASB's assessment that the standards already require disclosures of the kind described in the examples. The examples are well calibrated to show why this is the case and to redress any misunderstandings among issuers and their auditors.

This approach is consistent with IA members' support for connected disclosures, which enable users to assess the connections between sustainability disclosures and the general-purpose financial statements.

IA members are significant investors in companies around the world and aim to invest in companies that deliver long-term value for their shareholders. By integrating sustainability factors, including climate and other forward-looking uncertainties, into corporate and financial reporting, companies can better manage risks and opportunities. This underpins sustainable growth and long-term value creation.

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The internationalisation and harmonisation of accounting and financial reporting standards in the 20^{th} and 21^{st} centuries, led by the IASB, are among the principal successes underpinning modern global capital markets. This has enabled investors to match people's savings to productive uses with confidence across the globe. We have also increased our understanding of systemic risks facing global capital, companies, and society, especially climate change. Strengthening the connections between disclosures on climate and other forward-looking uncertainties is a necessary step to improve the confidence and decision-usefulness of sustainability information, by leveraging the familiarity and consistency of the financial information via pertinent descriptions of the connections between the two.

As we elucidate in answer to question 2, forward-looking sustainability disclosures, as distinct from backward-looking financial disclosures, require materiality-focused and comprehensive explanations of assumptions, tolerances and their potential impact so investors better understand how companies plan to manage and deploy capital to enhance their resilience and prospects in the face of uncertainties they anticipate today.

This is particularly important from a climate perspective, where investors continue to call for greater connectivity between narrative reporting and climate-related assumptions and estimates in financial statements, given the materiality of the issue for financial performance. Furthermore, investors recognise that the spread of strategic corporate commitments, e.g. to achieve net zero by 2050, will have impacts on a variety of company financial measures. These in turn will be contingent on assumptions and tolerances that, by the same token, investors seek to understand.

Integrating sustainability information with financial data thus provides a more holistic view of a company's performance. By improving the quality and consistency of disclosures, these illustrative examples enhance investors' understanding of the full spectrum of factors that can impact a company's long-term success, enable investors make better-informed decisions and provides greater confidence to invest in companies that produce them.

The quantitative and qualitative impacts of climate-related and other uncertainties on the issuer are material information for investors. It is right for these examples to demonstrate to issuers, how they should explain and quantify these effects. Issuer-centric quantitative impact thresholds are not the only determinant of materiality under the IASB's materiality definition. Issuers should be reminded of the IASB definition, that "information is material if omitting, misstating, or obscuring it could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make on the basis of those financial statements". This may encompass information on climate change that is both qualitative and quantitative.

The IASB notes that a commonly cited reason for the lack of consistency in the disclosure of quantitative information is commercial sensitivity. This is particularly true of forward-looking assumptions. Better reporting on these assumptions, the underlying decisions taken by the board and how these impact on a company's accounts are critical to investors in aiding their investment decisions. It would be helpful for the IASB to set out its expectations for issuers on what is deemed to be commercially sensitive information as part of these examples.

(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.

The IASB considered three options for the inclusion of the examples: as educational materials, as illustrative examples accompanying IFRS Accounting Standards, or as part of the Standards themselves. We agree with the IASB's conclusion that including the examples as illustrative examples accompanying IFRS Accounting Standards is the most appropriate approach.

Including the examples as illustrative examples ensures that they are more accessible and practical for entities to use. This approach allows entities to see how the requirements can be applied in real-world scenarios, thereby enhancing the clarity and consistency of disclosures. The illustrative examples are designed to help entities understand how to apply the existing IFRS Accounting Standards to report the effects of climate-related and other uncertainties, which is crucial for improving the quality of financial reporting.

Secondly, publishing the examples as educational materials might not provide the same level of authority and integration with the Standards. Educational materials are often seen as supplementary and may not be as widely referenced or adhered to by entities. Including the examples as part of the Standards themselves might require more onerous approval and implementation processes by applying jurisdictions. It could also be interpreted as reducing the flexibility needed for entities to apply the Standards in a manner that reflects their specific circumstances.

Question 2—Approach to developing illustrative examples

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.

We agree with the IASB's approach to developing illustrative examples in the Exposure Draft, which focuses on the most relevant requirements for reporting the effects of climate-related and other uncertainties in financial statements. The examples are a good reflection of the experiences of investors, through illustrations of fact patterns and requirements well calibrated to the areas corporate reporting can improve. This supports the aim to provide investors disclosures they need to effectively price climate and other uncertainties and integrate such material factors into the investment process.

Examples 1–8 cover a diverse range of scenarios and requirements, ensuring that various aspects of climate-related and other uncertainties are addressed. Specific focus areas, such as materiality judgments, disclosure of assumptions, and the disaggregation of information, are those that IA members and the wider investor community have highlighted as warranting improved corporate disclosures.

Members highlight the significance of Example 3, which illustrates the disclosure of assumptions about the costs of acquiring allowances for greenhouse gas emissions in measuring the recoverable amount of a cash-generating unit. This example, along with others that emphasise the importance of explaining a company's assumptions and sensitivities, is particularly vital. Forward-looking sustainability disclosures, as distinct from backward-looking financial disclosures, require comprehensive explanations of assumptions, tolerances and their potential impact.

The examples are well calibrated to help preparers understand the steps they should take to fully understand their own sensitivities and dependencies. The examples are well structured to show how one step – accounting for the impairment impact of needing to purchase GHG allowances – leads naturally to the next – considering the likely price and path of these allowances – which in turn elicits disclosures on how the company arrived at the likely and wider plausible set of scenarios for this dependency. Broad materiality provisions help preparers and investors focus on the disclosures that matter to the investment process. IA members give the example that they consider it material to know broadly how the issuer has approached the sensitivity analysis and its conclusions, without needing that analysis disclosed in full.

By including such examples, the IASB helps to bridge the gap between traditional financial reporting and sustainability-related information for preparers and users. Additionally, it is welcome that the IASB has devised these examples to assist auditor engagement. Auditors play a critical role in the verification of financial information, and their engagement is essential for maintaining investor confidence. The illustrative examples are designed to be practical and accessible, aiding auditors in their evaluations and thereby reinforcing the reliability of financial statements.

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

We believe that the IASB should consider addressing the lack of a common basis in financial accounting for regulated carbon market allowances and other regulated environmental certificates, such as those from renewables obligations, renewable transport fuel obligations, and EV credits. As carbon prices and the number of markets continue to grow, it is crucial to establish a standardised approach to financial accounting for these allowances. This will enhance the clarity and consistency of financial disclosures, enabling investors to better understand the financial implications of carbon pricing and related regulations. We understand that the IASB is considering a research project on polluter pay mechanisms and our members would support this work.

We agree with the IASB's emphasis on focusing initially on climate-related examples. This approach allows for a targeted and manageable introduction of new reporting standards that address the urgent and significant impact of climate-related risks. Should this initial focus not achieve the desired improvements in transparency in reporting for investors, we believe it may be appropriate for the IASB to consider broader standard-setting activities.