

Uncertainties in Financial Statements

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Background

IASB projects: *Climate-related and Other Uncertainties in the Financial Statements*



- explore whether to create illustrative examples
- explore clarifying or enhancing disclosure requirements for estimates
- consult with the IFRS Interpretations Committee

Climate-related risk disclosure in financial statement



Commentary: Climate-Related Risks Disclosures in the Notes to Financial Statements: Descriptive Evidence from Australia

Ao Li & Eric C.T. Lee, Australian Accounting Standards Board, Australia

This paper aims to provide background information about the International Accounting Standards Board's Climate-Related Risks in the Financial Statements project. Further, we provide some observations of related disclosures in the notes to the 2022 financial statements of the top 75 Australian Securities Exchange-listed entities. Overall, we find that there has been improvement in the disclosures and considerations of climate-related risks in the financial statements in recent years. However, the disclosures appear to be generic, which may not meet the needs of financial statement users. We suggest that further research is needed to provide evidence about how such risks are considered and disclosed in the financial statements and whether such information meets user needs. Evidence will help standard setters to consider appropriate action, such as providing educational material or amending the Accounting Standards, to enhance the quality of financial reporting.

- Top 75 ASX-listed entities
- Increasing disclosure, however generic

Examples of other risks in the annual report

Strategic risks

- Competition
- Strategy execution
- Business model disruption
- Digital disruption
- Changing customer expectations
- Portfolio management
- Climate-related risks

Regulatory risks

- Compliance with applicable laws, regulations and standards
- Regulatory or legislative change

Financial risks

- Currency and commodity price movements
- Liquidity and access to funding

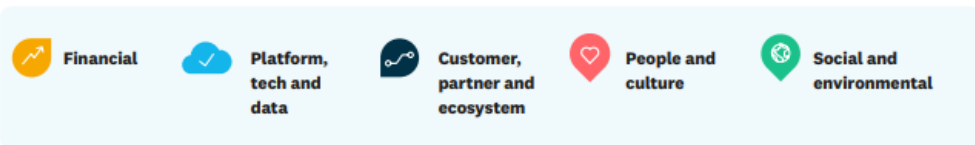
Operational risks

- Risks to the health, safety or wellbeing of team members and customers
- Technology, cyber-security and data-related risks, inclusive of privacy and data optimisation
- Business disruption, loss of major infrastructure and physical security
- Risks inherent in distribution and sale of products, including product safety
- Conduct risk
- Human rights risks, including modern slavery in own operations and supply chains
- Climate and nature-related risks, including emissions management
- Risks inherent in asset management, including process safety risk
- Talent attraction, retention and engagement
- Supply chain and inventory management
- Clinical governance risks in Health
- Geopolitical risks including potential impacts on global supply chains or input prices

Whether and how are these risks incorporated in the financial statements?

Source: Extract from the Operating and Financial Report from a large ASX-listed entity in the retail industry. Identity information was removed.

Examples of other risks in the annual report

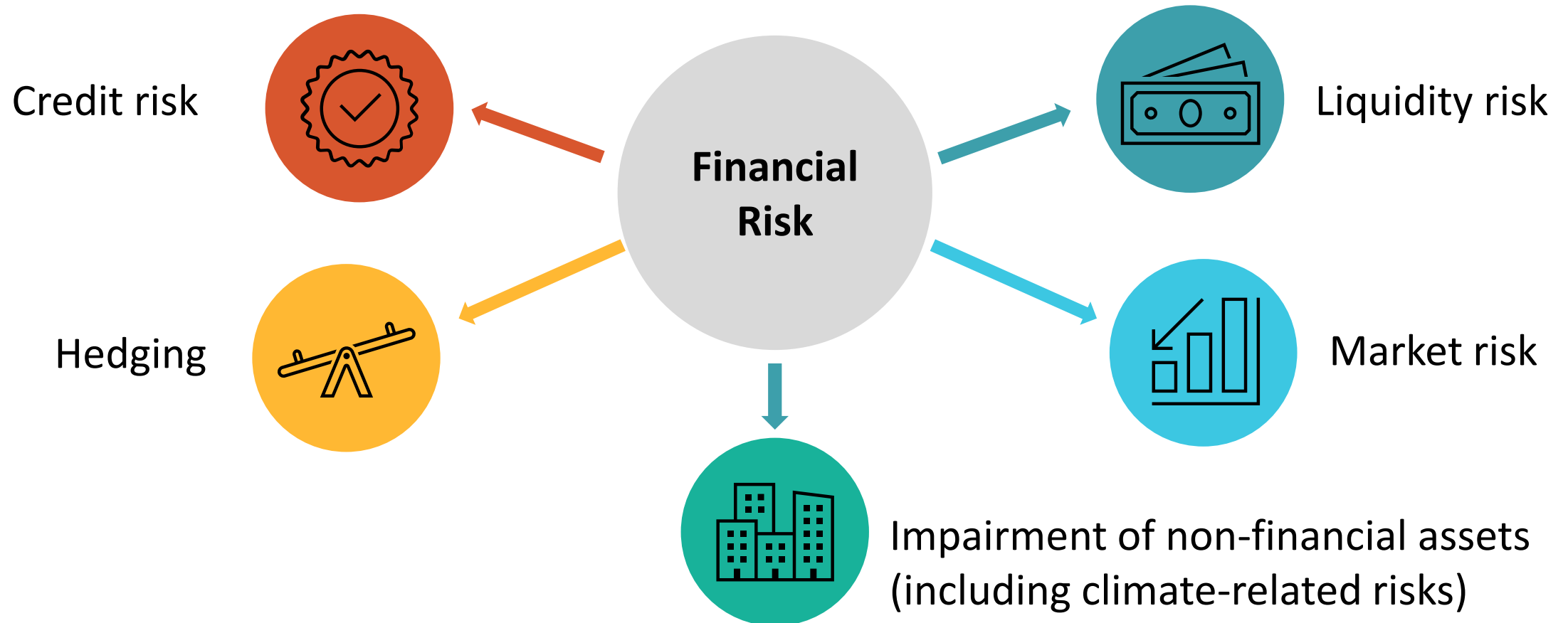


Key areas of potential risk	Mitigation strategies and activities	Inputs impacted
<p>Access to talent/workforce planning</p> <p>Ability to attract, develop and retain talent to deliver on strategy</p>	<ul style="list-style-type: none"> Attraction and retention strategies, including flexible work policies and career development opportunities Continually exploring new resourcing options to ensure we have the opportunity to access an expanded potential top talent pool Recruitment teams across all regions Succession-planning processes for key roles 	
<p>Product delivery execution</p> <p>Ability to deliver new products and innovations that meet our customers' needs</p>	<ul style="list-style-type: none"> Investment in engineering and product development capability Prioritisation of initiatives to focus available resources and talent on delivery of highest priority projects Investment in targeted customer and market research programs, which are used to inform future product development needs and priorities across 	
<p>Short-term performance (growth and cash) does not meet expectations</p> <p>The risk that our short-term performance falls short of our internal targets and external market expectations resulting in increased cost of capital, negative shareholder/market sentiment impacting future access to capital</p>	<ul style="list-style-type: none"> Monitoring of forecasts versus actual performance and market expectations Opportunity to continually improve market communication strategy to build understanding of Xero's strategy and focus on long-term performance Allocation of capital in a way that balances short-term performance and investment in long-term strategic objectives 	

Key areas of potential risk	Mitigation strategies and activities	Inputs impacted
<p>Data and cybersecurity breaches</p> <p>Security controls and processes are insufficient, leading to a breach and resulting in loss of data or system functionality, and disruption to customers' businesses, leading to customer churn and/or reputational damage</p>	<ul style="list-style-type: none"> Governance and oversight mechanisms such as the Security Governance Group, Data Use Governance Group, and Audit and Risk Management Committee risk updates Data security and awareness programs for all Xero employees and partner and customer education, providing an opportunity to empower users of the Xero platform with knowledge of how their actions can help keep their data safe and accounts secure Best practice tools and processes to provide multi-layer protection against unauthorised access, e.g. multi-factor authentication, security penetration testing SOC2 and ISO 27001 compliance and certification, including regular external audits Annual cybersecurity scenario exercise with Board 	
<p>Competitive intensity and disruption</p> <p>New technologies and/or competitors that impact Xero's ability to deliver on our strategic priorities and financial performance</p>	<ul style="list-style-type: none"> Systems in place for monitoring and responding to competitor and market activity, used to help inform business decision-making Development of strategic partnerships and pipeline of potential acquisitions Continual investment in product innovation and development to provide beautiful products that meet customer needs 	
<p>Strategic execution</p> <p>Ability to execute our strategic initiatives leading to reduced revenue growth and reputational impacts</p>	<ul style="list-style-type: none"> Program and project governance of strategic initiatives with regular review, oversight and reporting Continued focus on improving execution through alignment of strategic initiatives with annual operational plans, objectives and key results Executive sponsorship and accountability for each strategic initiative Board oversight from regular briefings on progress, challenges and outcomes 	

Source: Extract from the Operating and Financial Report from a large ASX-listed entity in the tech industry. Identity information was removed.

Risk-related disclosure in financial statements



Example of inputs to impairment calculation

Why so high-level?

Climate-related risks

The Group's assessment of the potential financial impacts of climate-related risks, including the associated costs of achieving net zero Scope 1 and Scope 2 emissions targets for [redacted] by 2030, Industrial and Safety (excluding [redacted]) by 2035 and [redacted] and [redacted] by 2050, continues to mature. The potential financial impacts of climate-related risks have been considered in the CGU's impairment tests through the inclusion of the impact of committed initiatives or through downside scenario analysis. As at 30 June 2023, this analysis did not indicate a climate-related risk of material impairment due to the current headroom in each of the Group's affected CGUs. The financial impact of this risk will continue to be assessed.

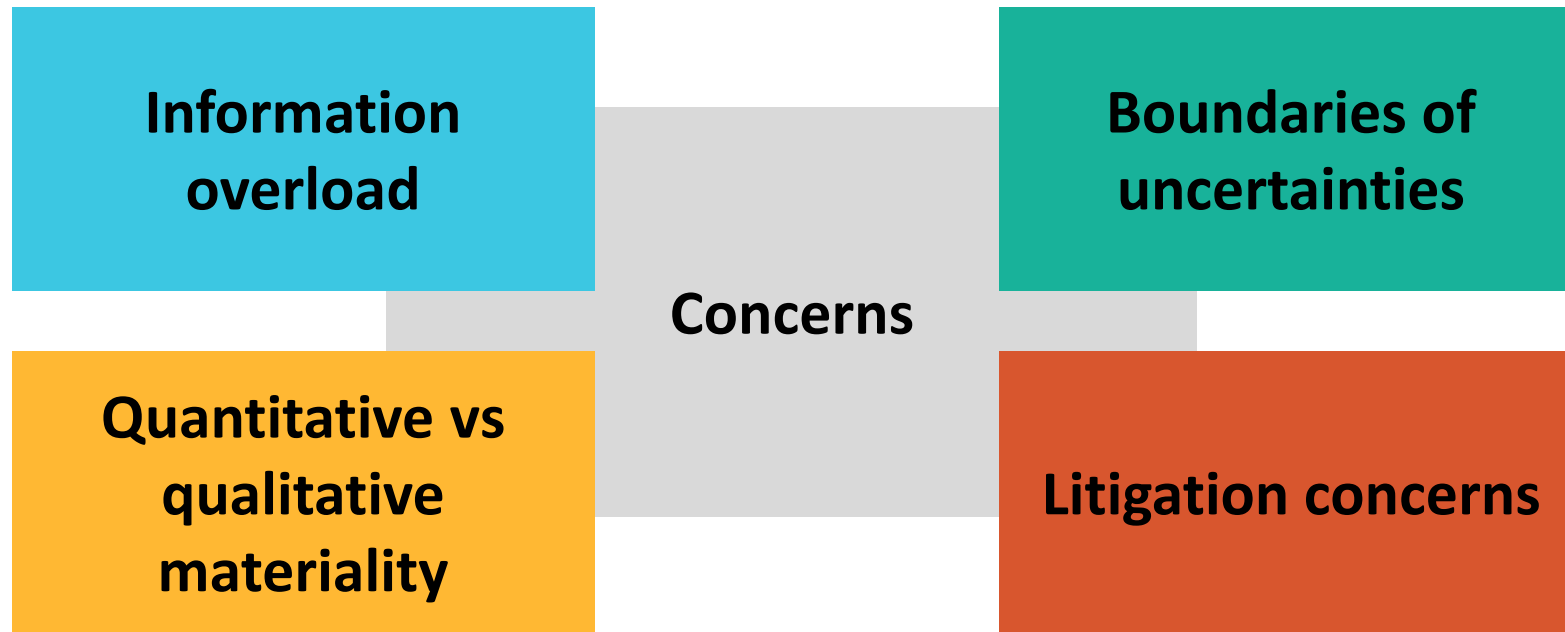
Inputs to impairment calculations

For VIU calculations and FVLCOD discounted cash flow models, cash flow projections are based on corporate plans and business forecasts prepared by management and approved by the Board.

In determining FVLCOD for CGUs, these projections are discounted using a risk-adjusted discount rate commensurate with a typical market participant's assessment of the risk associated with the projected cash flows. When calculating the FVLCOD of a CGU, forecast cash flows also incorporate reasonably available market participant assumptions.

Source: Extract from a large ASX-listed entity's 30 June 2023 financial statements. Identity information was removed.

Preparers' feedback



Discussion with AOSSG members

- Are there any suggestions or considerations for the IASB to develop illustrative examples, such as:
 - What risk(s)/uncertainties should be covered?
 - Any common fact pattern(s) should be considered?

More at the AASB Research Forum

Session 1: Forward- looking information

- *The use of forward-looking statements in management commentaries*
- *Australian listed companies' readiness for baseline and extended sustainability disclosures*

Session 2: Climate- related risks in financial statements

- *Climate in Accounting Standard*
- *Consequences of climate-related disclosures by Australian firms in the extractives sector*

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