ASCG • Joachimsthaler Str. 34 • 10719 Berlin

Chairperson
Transition Implementation Group
on IFRS S1 and IFRS S2
c/o IFRS Foundation
Opernplatz 14
D-60313 Frankfurt am Main

Sustainability Reporting Technical Committee
Phone: +49 (0)30 206412-12
E-Mail: lanfermann@drsc.de

Berlin, ***DATE***

Submission to the TIG: Disclosure requirement on anticipated financial effects

Dear Madam or Sir

On behalf of the Deutsches Rechnungslegungs Standards Committee (DRSC) I am writing to submit an issue for consideration by the Transition Implementation Group on IFRS S1 and IFRS S2.

The DRSC's Sustainability Reporting Technical Committee strongly supports the ISSB's work in developing sustainability reporting standards designed to provide a global baseline, helping individual jurisdictions/regions to build their reporting requirements on them. In our comment letter as of 19 June 2025 on the Exposure Draft *Amendments to Greenhouse Gas Emissions Disclosures* we addressed an additional comment on IFRS S2 even though it concerns an issue that is not addressed in the ED. Since we believe that this topic should be addressed via the TIG, we would like to do so here and provide a little more detail at the same time.

We would like to refer you to the appendix. If you would like to discuss our submission further, please do not hesitate to contact me.

Yours sincerely

Georg Lanfermann

Appendix

Submission to the Transition Implementation Group on IFRS S1 and IFRS S2: Anticipated effects

1 Background

1 The IFRS Sustainability Disclosure Standards (IFRS SDS) are developed by the International Sustainability Standards Board (ISSB). They aim to provide investors with decision-useful, globally comparable sustainability-related information. They further aim to set a global baseline for reporting on sustainability issues that jurisdictions can use as a guide or as a basis for their own regulations. In June 2023 the ISSB issued its first two IFRS Sustainability Disclosure Standards, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*.

2 On the legal basis of the Accounting Directive governing corporate reporting in European Union (EU) the European Commission (COM) has adopted a delegated act in Juli 2023 containing the European Sustainability Reporting Standards (ESRS). As the ESRS were adopted as a regulation they automatically form part of the national laws of the EU Member States. According to the Accounting Directive the COM has mandated EFRAG to provide technical advice in preparing the ESRS. The ESRS are two general and ten topical sector-agnostic standards addressing Environmental aspects: Climate change (ESRS E1), Pollution (ESRS E2), Water and marine resources (ESRS E3), Biodiversity and ecosystems (ESRS E4), Resource use and circular economy (ESRS E5), social aspects: Own workforce (ESRS S1), Workers in the value chain (ESRS S2), Affected communities (ESRS S3), Consumers and end users (ESRS S4) as well as governance aspects: Business conduct (ESRS G1).

3 The ISSB and EFRAG have conducted joint efforts to examine the similarities between the ESRS and IFRS SDS. This project culminated in the “ESRS-ISSB Standards Interoperability Guidance” published in May 2024 by both bodies. The guidance, also referred to as “educational material”, illustrates the high level of alignment achieved between IFRS SDS and ESRS. It further outlines how companies can apply both sets of standards, including a detailed analysis of the alignment in terms of climate-related disclosures.

4 In February, the COM published its first omnibus proposal on reducing red tape for undertakings. The proposal further contained the announcement to revise the first set of ESRS. This revision aims to substantially simplify ESRS application and involves a reduction of the number of ESRS datapoints, clarifying provisions that are deemed unclear, providing clearer instructions on how to apply the materiality principle, etc. End of March 2025 the COM has mandated EFRAG to

develop the technical advice, and EFRAG has been working on the ESRS revision with a high intensity.

5 The Accounting Standards Committee of Germany (Deutsches Rechnungslegungsstandards Committee, DRSC) is actively involved in shaping this process at EFRAG. The DRSC's technical committees regularly discuss the technical status of EFRAG's work, which we also help to shape through our membership in the EFRAG committees. The work of our technical committees is informed through a wide range of outreach activities including the DRSC preparer forum on ESRS implementation and additional working groups on the ESRS revision. All discussions in our technical committees and the supporting outreaches on the ESRS revision we have been touching on the ISSB-ESRS interoperability as well.

6 During our technical work over the past few weeks, which included both the ESRS revision and the ISSB consultation on the revision of IFRS S2, we identified a pressing issue that we would like to bring to the attention of both EFRAG and the ISSB as it is a matter of interoperability: reporting on anticipated financial effects.

2 Current reporting requirements on anticipated financial effects

<u>IFRS SDS</u>

7 IFRS S1 requires an entity to disclose information to enable users of the reports to understand current and anticipated effects of sustainability-related risks and opportunities in the context of the entity’s strategy (IFRS S1.29), the entity's business model and value chain (IFRS S1.32) and the entity’s financial position, financial performance and cash flows (IFRS S1.34). Furthermore, the standards requires the entity to disclose quantitative and qualitative information on these effects (IFRS S1.35) and further contains a requirement on how to determine these disclosures using use all reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort and using an approach that is commensurate with the skills, capabilities and resources that are available to the entity (IFRS S1.37).

8 Paragraphs 38 and 39 of IFRS S1 further address a relief from the requirement to provide quantitative information on current and anticipated financial effects based on the identifiability of those effects, their measurement uncertainty and the skills, capabilities or resources of the entity to provide quantitative information.

9 IFRS S2 specifies the aforementioned disclosure requirements for the aspect climate change but does not contain further additional requirements as per our understanding. Paragraph 17 of IFRS S2 permits an entity to provide either a single amount or a range when disclosing quantitative financial information about current and anticipated financial effects.

10 IFRS SDSs do not contain an explicit definition of “anticipated financial effects”, however, paragraph 34 of IFRS S1 suggests that the term is meant to capture effects on an entity’s future financial position, financial performance and cash flows that have not been recognised in actual financial statements but are anticipated to do so in future periods.

ESRS

11 ESRS 2.48 point (e) (SBM-3) requires an undertaking to disclose the anticipated financial effects of the undertaking’s material risks and opportunities on its financial position, financial performance and cash flows over the short-, medium- and long-term, including the reasonably expected time horizons for those effects. This requirement is further specified in ESRS E1, E2, E3, E4, E5 for the respective environmental matters. These specifications include a requirement for quantification in monetary terms.

12 In contrast to IFRS SDS, ESRS do not contain a relief from disclosing quantified anticipated financial effects. ESRS E1 only permits disclosure of anticipated financial effects as a range in specific circumstances (AR70(a), AR73(a), AR74(a) of ESRS E1). ESRS 1 provides for a transitional relief from quantifying anticipated effects for the first three years of ESRS reporting.

13 The Annex II of the ESRS (Table 2) contains a definition of the term “anticipated financial effects”. According to this definition anticipated financial effects are “financial effects that do not meet the recognition criteria for inclusion in the financial statement line items in the reporting period and that are not captured by the current financial effects.”

3 Application challenges

14 Feedback received in our outreach activities from entities’ representatives continues to address the requirement to disclose anticipated financial effects. First, it has to be noted that financial effects associated with sustainability aspects require projections that are much more forward-looking than other issues. As all estimates on a mid-to-long-term time horizon such projections usually come with a high degree of uncertainty by nature in terms of their substance and amount. For this reason, such effects are considered in entities’ internal financial planning mainly in narrative/qualitative terms.

15 Further feedback received from our constituents included the question on the underlying concept of anticipated financial effects associated with sustainability aspects in the context of forecast disclosures made in management commentary and management reports. Although IFRS Practice Statement 1 does not require management commentary to include forecasts or targets, it contains a number of requirements in case the management commentary does contain forecasts, or target amounts for a metric of the entity’s future financial or non-financial performance or position. As an example for the management report, GAS 20 *Group management reporting* requires a parent

entity to provide disclosures in the group management report to ensure a suitable understanding of the expected development of the undertaking and of the material opportunities and risks associated with this development. These disclosures already provide information on financial effects that can be considered “expected” as they primarily relate to risks that are not already recognised in the financial statements or other capital market communication based on the entities’ financial planning.

16 Second, this problem is further intensified because the underlying methods required for quantitative projections of financial effects from sustainability aspects are missing or are available but not yet fully developed. As part of their ESRS implementation projects many entities have tested the practical functionality of the requirement to quantify anticipated financial and found that the tools currently available did not result in meaningful and decision useful information. For this reason, entities’ representatives indicated they will continue to take advantage of the reliefs granted in ESRS and IFRS (see above).

17 As a consequence, we believe that any requirement to disclose quantified anticipated financial effects beyond today’s risk reporting results in lack of comparability (not even year over year for one entity), high uncertainty for both preparers and users, and highly questionable decision usefulness of information. In other words, the level of maturity of the exercise to quantify anticipated financial effects is still a long way off.

4 Proposal for IFRS SDS and for ESRS and request for consideration

18 For the reasons mentioned above, the DRSC thinks that the requirement to quantify the anticipated financial effects should at least be specified as a decision to be made by the entity based on its accounting and reporting policies. Instead of a quantitative disclosure, entities could state how (narrative description) they have incorporated sustainability-related financial effects in their results, risk reporting and their planning.

19 The DRSC has also made the position clear to EFRAG that quantification of these effects should not be required. EFRAG is currently discussing a corresponding simplification in the ESRS. In order to maintain a high level of interoperability in this area, we strongly believe the TIG as well as the ISSB should also discuss this issue.