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ESRS Mining, quarrying and coal: information about environmental liabilities - Issues Paper

Objective

- 1 The objective of this paper is to provide EFRAG SR TEG with further information about the IFRS requirements related to rehabilitation or environmental liability provisions, to support the discussion on the additional requirements to be included in the Mining sector ESRS.

Background information - provisions

- 2 At its meeting on 3 February 2023, EFRAG SR TEG discussed the draft working paper on ESRS Mining, Quarrying and Coal and the EFRAG Secretariat also received feedback on the working paper by 10 February 2023.
- 3 The following comments on DR MIN X-G1 *Closure and post-closure*¹ are relevant for the discussion. The draft required *'to disclose, per operational site [TO BE DISCUSSED], the financial provisions available and ultimately necessary, for closure and rehabilitation of the operational sites'*.
 - (a) This is an important example of connectivity between financial and sustainability reporting;
 - (b) Being the closure and rehabilitation of a site a material event, the information per operational site is important, to allow society at large to judge the adequacy of provisions for rehabilitation and aftercare, despite the fact that financial reporting normally focuses on obligations at undertaking's level (however in case of big litigations good practice is that under IAS 37 the specific provisions are disclosed);
 - (c) For financial reporting, a legal obligation needs to exist before a provision can be created, i.e., voluntary actions may not be sufficient for a provision under financial reporting frameworks but could be captured as potential financial effects under sustainability reporting; and
 - (d) New terms for 'financial provision' should be avoided.

Position under IFRS

- 4 IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is the relevant standard related to the recognition, measurement and disclosures on financial provisions for rehabilitation. The required information about the relevant property, plant and equipment for the operating site falls under IAS 16 *Property, Plant and Equipment*.

¹ Please note that the DR number and name have been changed since the discussion.

- 5 IAS 37 requires the existence of a present obligation for the recognition of a provision. Such obligation may be triggered by legislation or contracts. In the case of constructive obligations, an obligation may be derived from an undertaking's actions that created a valid expectation that it will discharge such responsibilities. (Please refer to Appendix 1 for some extracts from IAS 37).
- 6 There is no requirement in IFRS to disclose provisions by operational site as the standard only requires disclosures by class of provisions. IAS 1 *Presentation of Financial Statements* also requires information about sources of estimation uncertainty.

Concerns about the current requirements

Academic research: globally

- 7 Academic research² has found substantial variations exist in companies' choice to disclose the discount rate when accounting for decommissioning and environmental liabilities. This was based on a large international sample across the mining, utilities, and oil and gas sectors.
- 8 Furthermore, the research notes that when a company with a decommissioning liability becomes insolvent the clean-up liability remains attached to the asset, which may therefore become less attractive to a potential buyer. Therefore, if eventually the asset remains unsold, the taxpayer ends up picking up the decommissioning tab. ICAS points out that this scenario is likely to be more frequent in a post-COVID world.
- 9 The report recommends that:
 - (a) Standard setters should require disclosing the discount rates applied to facilitate comparability and thus allow for users of financial statements and other key stakeholders to see inside the 'black box' of accounting for decommissioning liabilities; and
 - (b) Preparers should include, and auditors demand, enhanced disclosures, to include not only the discount rate but also undiscounted future estimated cash flows and timing of decommissioning activities, augmented by a comprehensive narrative on the major uncertainties surrounding these items.

Academic research: Companies in the EU

- 10 Focusing on European-listed firms with environmental liabilities reporting under IFRS from 2005 to 2015, academic research³ found similar diversity in disclosure practices.
- 11 The authors note: "We study a particular type of liability that has no direct claimants and is difficult to measure mainly due to its longevity. This means that, although there is a public interest in environmental liabilities, few capital market actors (such as investors and creditors) actively demand disclosure on how they are estimated (Michelon et al., 2020). Further, due to their inherent uncertainty, companies are reluctant to provide information about these liabilities. These factors taken together creates an information vacuum related to environmental liabilities, increasing the risk of the public having to take responsibility for clean-up costs in case of company failure."

² Giovanna Michelon, Mari Paananen and Thomas Schneider (2020) [Black box accounting: Discounting and disclosure practices of decommissioning liabilities](#).

³ Mari Paananen, Emmeli Runesson & Niuosha Samani (2021) [Time to clean up environmental liabilities reporting: disclosures, media exposure and market implications](#), Accounting Forum, 45:1, 85-116, DOI: 10.1080/01559982.2021.1872909

- 12 While they find that disclosures about environmental liabilities have increased over time, only 35% of the companies with a material environmental liability disclose both discount rates and time horizons and 19% report neither key input. Disclosures of discount rates and time horizons are 40% and 53%, respectively (material environmental liabilities: 53% and 63%). In 2016, the corresponding figures for discount rates and horizons are 53% and 59%, respectively (material environmental liabilities: 58% and 64%).
- 13 However, external pressure in the form of media exposure remediates this situation and has a positive impact on firms' disclosure practices, and improved information content. The authors conclude that more explicit disclosure guidelines from the IASB, such as requiring disclosure on key inputs used to estimate the environmental liabilities, would contribute to companies being more forthcoming with information. Further, such guidelines would empower auditors and other enforcers to demand more detailed disclosure.

IASB workplan

- 14 In January 2020 the IASB added a project to its workplan to:
- (a) align the IAS 37 liability definition and recognition requirements with its Conceptual Framework;
 - (b) clarify which costs to include in the measure of a provision; and
 - (c) specify whether the discount rate used to reflect time value of money includes non-performance risk.
- 15 This project is likely to result in changes to the disclosure requirements but usually disclosures are considered only towards the end of such a project.

GRI Mining Exposure Draft

- 16 The following is the correspondent requirement in the mining GRI Exposure Draft:
- For financial provisions made by the organization for closure and rehabilitation, including environmental and socioeconomic post-closure monitoring and aftercare for mine sites, report:*
- the total undiscounted monetary value, and a breakdown of this total by mine site;
 - the methodology used to calculate the undiscounted financial provisions for closure and rehabilitation.

EFRAG Secretariat analysis

- 17 The EFRAG Secretariat notes that requiring disclosures around financial provisions goes beyond the topic of connectivity between financial and sustainability statements and therefore does not consider such additions lightly.
- 18 However, given that IFRS⁴ does not require information about discount rate, time buckets or undiscounted cash flows used for these liabilities, and the deficiencies in current practice, adding requirements in this area is important. As mentioned above, these liabilities have no claimants or claimants who would struggle to enforce such obligations if the financial provisions are insufficient to rehabilitate operational sites post-closure.
- 19 The EFRAG Secretariat notes that rehabilitation liabilities are in scope of financial reporting, nevertheless considers that this information is particularly relevant also to the users of sustainability statements. To avoid duplication, incorporation by

⁴ The EFRAG Secretariat assumes the same is true for local gaap but have not had time to research this.

reference will always be possible. What is in particular important, is the information of the undiscounted amount of expected cash outflows, as the focus of financial reporting is the recognised discounted amount.

- 20 In addition, the information mentioned above should be required by operational site to allow for the evaluation of the adequacy of such provisions. IFRS may ask for such information for material sites, but due to financial materiality considerations in IFRS will not require such information for all operational sites. Therefore, if this is considered to be necessary given the broader stakeholders under ESRS compared to IFRS⁵, it would need to be included under ESRS.
- 21 In addition, the EFRAG Secretariat considers appropriate to include a question to constituents in the consultation to assess whether the cost to be reported should be limited to the outflows or resources that meet the accounting recognition criteria (more likely than not) or if for sustainability reporting the threshold for reporting should be lower.

Proposed disclosure in V3

- 22 **The undertaking shall disclose the costs the undertaking expects to incur due to closure and rehabilitation of operational sites.**
- 23 The objective of this Disclosure Requirement is to allow an understanding of the financial effects of closure and rehabilitation of operational sites and how they relate to the amounts reflected in the financial statements.
- 24 The undertaking shall disclose:
- (a) the cost it expects to incur for closure and rehabilitation, per operational site, including environmental and socioeconomic post-closure monitoring and aftercare for mine sites, measured as undiscounted monetary value;
 - (b) the methodology used to calculate such cost;
 - (c) an illustration of how the expected cost relates to amounts recognised or disclosed in its financial statements; and
 - (d) the discount rate applied to measure the liabilities recognised in the financial statements.

Questions for EFRAG SR TEG

- 25 Does EFRAG SR TEG agree with the EFRAG Secretariat proposed redrafting?

⁵ Per the IFRS Conceptual Framework: The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

Appendix 1: Extracts from IFRS

26 The following are extracts from IAS 37 pertaining to the required information around provisions for rehabilitation etc.

Definitions

10 A constructive obligation is an obligation that derives from an entity's actions where:

- (a) *by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and*
- (b) *as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.*

Future events

48 Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

49 Expected future events may be particularly important in measuring provisions. For example, an entity may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an entity does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

50 The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Disclosure

84 For each class of provision, an entity shall disclose:

- (c) *the carrying amount at the beginning and end of the period;*
- (d) *additional provisions made in the period, including increases to existing provisions;*
- (e) *amounts used (ie incurred and charged against the provision) during the period;*
- (f) *unused amounts reversed during the period; and*
- (g) *the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.*

Comparative information is not required.

85 An entity shall disclose the following for each class of provision:

- (a) *a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;*
- (b) *an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the*

major assumptions made concerning future events, as addressed in paragraph 48; and

- (c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

27 The following are extracts from IAS 1.

Sources of estimation uncertainty

125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period.

126 Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. For example, in the absence of recently observed market prices, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the effect of technological obsolescence on inventories, provisions subject to the future outcome of litigation in progress, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about such items as the risk adjustment to cash flows or discount rates, future changes in salaries and future changes in prices affecting other costs.

127 The assumptions and other sources of estimation uncertainty disclosed in accordance with paragraph 125 relate to the estimates that require management's most difficult, subjective or complex judgements. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgements become more subjective and complex, and the potential for a consequential material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.

128 The disclosures in paragraph 125 are not required for assets and liabilities with a significant risk that their carrying amounts might change materially within the next financial year if, at the end of the reporting period, they are measured at fair value based on a quoted price in an active market for an identical asset or liability. Such fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period.

129 An entity presents the disclosures in paragraph 125 in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other sources of estimation uncertainty. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures an entity makes are:

(a) the nature of the assumption or other estimation uncertainty;

(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and

(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

130 This Standard does not require an entity to disclose budget information or forecasts in making the disclosures in paragraph 125.

131 Sometimes it is impracticable to disclose the extent of the possible effects of an assumption or another source of estimation uncertainty at the end of the reporting period. In such cases, the entity discloses that it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from the assumption could require a material adjustment to the carrying amount of the asset or liability affected. In all cases, the entity discloses the nature and carrying amount of the specific asset or liability (or class of assets or liabilities) affected by the assumption.

132 The disclosures in paragraph 122 of particular judgements that management made in the process of applying the entity's accounting policies do not relate to the disclosures of sources of estimation uncertainty in paragraph 125.

133 Other IFRSs require the disclosure of some of the assumptions that would otherwise be required in accordance with paragraph 125. For example, IAS 37 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. IFRS 13 Fair Value Measurement requires disclosure of significant assumptions (including the valuation technique(s) and inputs) the entity uses when measuring the fair values of assets and liabilities that are carried at fair value.