Approaching the IFRS Sustainability Disclosure Standards

What companies can learn from IFRS S1 and IFRS S2

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Introduction

On 26 June 2023, the International Sustainability Standards Board (ISSB) published the first two IFRS Sustainability Disclosure Standards namely **IFRS S1 – General Requirements for Disclosure of Sustainability-related Financial Information** and **IFRS S2 – Climate-related Disclosures** laying the foundation of a global baseline of sustainability-related disclosures. Additional standards are expected to be issued in the coming years to complement this baseline and address a wider range of environmental, social and governance topics.

The publication of IFRS S1 and IFRS S2 is the outcome of a due process that lasted several months even if the ISSB has been fast in its standard-setting work, **building upon several widely used frameworks and standards**. In making its final decisions, the ISSB notably considered the numerous responses received following the publication in March 2022 of two Exposure Drafts.

It is now up to local jurisdictions **to decide whether to make these standards mandatory**. Companies may choose to adopt IFRS S1 and IFRS S2 on a voluntary basis. **Interoperability of IFRS Sustainability Disclosure Standards with other frameworks and standards**, including the European Sustainability Reporting Standards (ESRS), will be key to avoid multiple reporting for companies.

Chris Fuggle
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What is the ISSB and what is its ambition?

Given the accelerated focus on sustainability matters and the growing and urgent demand for transparent financial-related sustainability disclosures by companies, the IFRS Foundation announced the formation of the ISSB in November 2021 at COP26 in Glasgow.

The ISSB's key objective is to develop a **comprehensive global baseline** of high-quality sustainability disclosure standards to meet investors' needs across global capital markets and on which local jurisdictions could build on. This global baseline is intended to ensure **consistency in reporting and comparability of sustainability information** around the world. It will be possible to add incremental targeted disclosures to meet broader multi-stakeholder needs ("building blocks approach").

The remit of the ISSB is to issue standards working alongside the well-established International Accounting Standards Board (IASB), ensuring **connectivity and compatibility** between IFRS Sustainability Disclosure Standards and IFRS Accounting Standards.

In response to a demand for **consolidation in sustainability reporting** given the current fragmented landscape, the Climate Disclosure Standards Board (CDSB) was consolidated into the IFRS Foundation in January 2022. It has been followed in August 2022 by the consolidation of the Value Reporting Foundation (VRF) which is itself a consolidation of the Sustainability Accounting Standards Board (SASB) Foundation and the International Integrated Reporting Council (IIRC), enabling the ISSB to build on the VRF resources. Besides, since the ISSB now governs the SASB Standards, it seeks to internationalise their applicability to make SASB industry-based metrics applicable in a global context.

Under a collaboration agreement signed in March 2022, the ISSB is also committed to working with the Global Reporting Initiative (GRI) to ensure its investor focused standards are complementary to and compatible with existing GRI standards which have an objective of meeting wider stakeholders' information needs.

Very recently, the Financial Stability Board (FSB) recognised that IFRS S1 and IFRS S2 fully incorporate the Task Force on Climate-related Financial Disclosures (TCFD) work and therefore handed over to the ISSB their responsibility for monitoring the progress on companies' climate-related disclosures from the TCFD effective from 1 January 2024.

Lastly, **assurance requirements are not within the remit of the ISSB**. It will therefore be up to local jurisdictions and regulators to decide whether sustainability-related financial information should be externally verified and the appropriate assurance standards to apply.

Upon which standards and frameworks has the ISSB built IFRS S1 and IFRS S2?

The first IFRS Sustainability Disclosure Standards build upon the following widely accepted frameworks and standards.

The objective of IFRS S1 and the concepts that underlie sustainability-related risks and opportunities build on the Integrated Reporting Framework.

The core content of the IFRS Standards builds on the TCFD recommendations, with four reporting areas covering a company's:

- **Governance**: i.e. the governance processes, controls and procedures the company uses to monitor and manage sustainability-related risks and opportunities.
- **Strategy**: i.e. the approach the company uses to manage sustainability-related risks and opportunities.
- **Risk management**: i.e. the processes the company uses to identify, assess, prioritise and monitor sustainability-related risks and opportunities.
- **Metrics and targets**: i.e. the company's performance in relation to sustainability-related risks and opportunities, including progress towards any targets the company has set or is required to meet by law or regulation. The metrics to be disclosed shall include industry-specific metrics.

In identifying and disclosing information about sustainability-related risks and opportunities in accordance with IFRS S1, a company must consider the applicability of the **disclosure topics and of the metrics specified in the SASB Standards**. IFRS S2 includes **industry-based guidance** on implementing the standard that companies must consider and which has been derived from the SASB Standards.

The ISSB also built upon IASB's concepts and definitions. The definition of material sustainability-related information is based on the **definition of "material" in IFRS Accounting Standards** i.e. information is material if omitting, misstating or obscuring it could reasonably be expected to influence investors' decisions.

What are the key aspects of IFRS S1 and IFRS S2?
Focusing on IFRS S1

IFRS S1 requires the disclosure of material information about sustainability-related risks and opportunities to meet the needs of primary users (i.e. investors, lenders, and other creditors) of general purpose financial reports (these include financial statements and sustainability-related financial disclosures).

The ISSB Standards are premised on the principle that sustainability information is useful to primary users because a company's ability to create value is inextricably linked to the interactions between **the company and its stakeholders, society, the economy and the natural environment** throughout the **company's value chain**. A company's dependencies and impacts on those resources and relationships give rise to sustainability-related risks and opportunities.

IFRS S1 therefore requires companies to provide information about sustainability-related risks and opportunities that **could reasonably be expected to affect the company's prospects** i.e. its cash flows, its access to finance or cost of capital over the short, medium or long term.

The conceptual foundation of IFRS Sustainability Disclosure Standards as regards materiality is therefore different from ESRS which take a double materiality perspective (i.e. a sustainability matter is material when it meets the criteria for impact materiality or financial materiality or both, considering the needs of users of sustainability statements in a broader sense). However, the ISSB considers that **some level of impact materiality is implicit** in its view of materiality to investors given that many impacts are financially material.

IFRS S1 sets out the **overall requirements** that a company is required to apply to assert compliance with IFRS Sustainability Disclosure Standards. This Standard is similar to a "conceptual framework" and identifies the essential elements of a complete set of sustainability-related financial disclosures. It also sets out the qualitative characteristics of useful sustainability-related financial information. A company applying IFRS Sustainability Disclosure Standards would **apply the requirements in IFRS S1 in conjunction with other Standards**.

IFRS S1 lists **practical sources of guidance** which play an important role in supporting (1) the identification of sustainability-related risks and opportunities other than climate (this topic being supported by IFRS S2) and (2) the information to disclose about those risks and opportunities.

In both cases, a company **must consider the applicability of the SASB Standards** for the industries the company operates in. IFRS S1 also specifies sources of guidance a company may consider, i.e. the CDSB Framework Application Guidance, the most recent materials of investor-focused standard-setters and industry practice.

In the absence of an IFRS Sustainability Disclosure Standard that specifically applies to a sustainability-related risk or opportunity, IFRS S1 requires a company to apply judgement to identify the relevant information. Subject to conditions (including not obscuring material information required by IFRS Sustainability Disclosure Standards), and in addition to the sources of guidance listed above, a company **may also consider the applicability of the GRI Standards and the ESRS**.

The ISSB made several **proportionality-related decisions** in order to ease the burden of disclosure and assist entities in applying IFRS Sustainability Disclosure Standards. For instance, the ISSB has introduced the concept of "all reasonable and supportable information that is available to the entity

at the reporting date without undue cost or effort" with respect to various requirements, including when identifying sustainability-related risks and opportunities or when determining the scope of a company's value chain.

IFRS S1 also includes requirements on **connected information** which are meant to provide users of general purpose financial reports with a better understanding of the connections across a company's sustainability-related risks and opportunities, and the connections between the various disclosures a company has provided, both within its sustainability-related financial disclosures and across these disclosures and other disclosures such as the company's financial statements.

Sustainability disclosures under IFRS should be provided **as part of a company's general purpose financial reports**. IFRS S1 does not prescribe the exact location of such information; for instance, this could be located in the management commentary section. The ISSB also allows companies to have an integrated approach to reporting on sustainability-related matters.

A company is required to report its sustainability-related financial disclosures **at the same time as it issues its related financial statements**.

Lastly, it can be noted that IFRS S1 enables entities to apply IFRS Sustainability Disclosure Standards **regardless of whether the financial statements are prepared in accordance with IFRS** Accounting Standards or other generally accepted accounting principles or practices (GAAP). This allows any organisation to voluntarily prepare its sustainability disclosures in line with the requirements of ISSB Standards.

What are the key aspects of IFRS S1 and IFRS S2?
Focusing on IFRS S2

IFRS S2 can be viewed as the first ISSB topical standard, having in mind that the ISSB aims at covering additional topics in the coming years. According to the ISSB, climate change is likely to present risks for nearly all entities and economic sectors.

In July 2023, the ISSB already decided to develop educational material to explain and illustrate how an entity might apply some requirements in IFRS S2 to disclose information about some nature and social aspects of climate-related risks and opportunities.

Climate-related risks under IFRS S2 include **physical risks and climate-related transition risks**. Physical risks that result from climate change are risks that can be event-driven (acute) or from long-term shifts (chronic). Transition risks are the risks associated with the transition to a lower-carbon economy such as policy, legal, technological, market and reputational risks.

Like IFRS S1, IFRS S2 **fully incorporates the TCFD's recommendations**. On 24 July 2023, the IFRS Foundation published a comparison of the requirements in IFRS S2 and the TCFD recommendations which shows that companies that apply the ISSB Standards will meet the TCFD recommendations and so do not need to apply the TCFD recommendations in addition to the ISSB Standards.

IFRS S2 requires companies to provide **industry-specific disclosures** without imposing industry-based metrics. The industry-based guidance on implementing IFRS S2 which accompanies the Standard derives from the SASB Standards. A company is not required to apply the particular metrics included in the guidance. However, a company must consider the applicability of these industry-based materials.

Providing climate-related disclosures under IFRS S2 needs to be made **in conjunction with the general requirements** under IFRS S1 even if a company adopts the "climate-first" approach in the first year of reporting under IFRS Sustainability Disclosure Standards, as permitted by IFRS S1 transitional measures.

Some **key disclosures** of IFRS S2 deal with the understanding of:

1. The company's strategy for managing climate-related risks and opportunities.
2. The company's performance in relation to these risks and opportunities, including progress towards any targets it has set and/or which it is required to meet.

With respect to strategy, IFRS S2 notably requires companies to disclose information about their **climate-related transition plan**. It is important to note that the ISSB does not require companies to have a transition plan nor does it describe what a "good" transition plan is, consistently with the fact that IFRS are disclosure standards only.

Current and anticipated financial effects of climate-related risks and opportunities on a company's financial performance, financial position and cash flows are also key disclosures under IFRS S2. These requirements are closely aligned with those in IFRS S1 including as regards proportionality measures. In practice, the ISSB has identified specific situations where a company does not need to provide quantitative information on anticipated financial effects notably if it lacks the skills, capabilities or resources to do so. In such situations, only qualitative information will be provided.

Another important disclosure to understand a company's strategy relates to the assessment of the company's **climate resilience**, i.e. its capacity to adjust to climate-related changes (for example, pervasive wildfires), developments (for example, regulatory limits on the use of particular fossil fuels) and uncertainties (for example, assumptions about the pervasiveness of wildfires or the stringency of regulation), **using climate-related scenario analysis**. Appendix B of IFRS S2 provides application guidance on how companies should approach this complex matter, building on TCFD materials. It aims at supporting a company in determining an approach to climate-related scenario analysis that is commensurate with its circumstances.

As regard the company's performance, IFRS S2 requires the disclosure of information in relation to the following metric categories:

- **Greenhouse gas (GHG) emissions for Scope 1, Scope 2 and Scope 3** measured in accordance with the GHG Protocol guidance unless required notably by a jurisdiction authority to use a different method. For Scope 3 GHG emissions, companies with emissions associated with investments (or other forms of financing) – i.e. companies with activities in asset management, commercial banking and insurance – must disclose additional information on **financed emissions**.
- **Financial metrics** related to climate-related risks and opportunities, including the amount of capital expenditure, financing or investment deployed towards those risks and opportunities.
- **Internal carbon prices** i.e. whether and how these prices are applied in decision-making and the prices used to assess the cost of the GHG emissions.
- **Executive remuneration** i.e. whether and how climate-related considerations are factored into executive remuneration and the percentage of executive management remuneration concerned for the current period.

If a company has set **climate-related targets** to monitor progress towards achieving its strategic goals, it shall disclose information in this regard. This information notably includes the base period from which progress is measured, any milestones or interim targets, and how the latest international agreement on climate change (which currently means the 2015 Paris Agreement), including jurisdictional commitments that arise from that agreement, has informed the target. For each GHG emissions target, a company shall notably disclose whether the target is a gross emissions target or net one. In the latter case, the company is also required to separately disclose its associated gross emissions target. The company shall also disclose its planned use of carbon credits to offset GHG emissions to achieve any net GHG emissions target.

When to apply IFRS S1 and IFRS S2 for the first time and what are the transitional provisions?

IFRS S1 and IFRS S2 are effective for annual reporting periods beginning on or after 1 January 2024 (earlier application is permitted if both Standards are adopted early). In practice, the first-time application date will depend on the endorsement by local jurisdictions or on whether a company decides to voluntarily apply the Standards.

The ISSB has set some **transitional reliefs** to support companies applying IFRS S1 and IFRS S2. In the first year of application of IFRS S1:

- A company is **not required to disclose comparative information** (i.e. it is not required to provide IFRS disclosures for any period before the date of initial application).
- A company is permitted to report its sustainability-related financial disclosures **after it publishes its related financial statements** (subject to conditions).
- A company is permitted to disclose information **only on climate-related risks and opportunities** (in accordance with IFRS S2), therefore applying IFRS S1 only for the requirements that relate to the disclosure of such information. In such case, this company is not required to provide comparative information for climate-related information in the first year of application. Besides, it is not required to disclose comparative information about its sustainability-related risks and opportunities other than climate-related risks and opportunities in the second year of application.

In the first year of application of IFRS S2, a company can use one or both of these reliefs:

- If, in the annual reporting period immediately preceding the date of initial application of IFRS S2, the company used a method for measuring its GHG emissions other than the GHG Protocol, **the company is permitted to continue using that other method.**
- A company is **not required to disclose its Scope 3 GHG emissions** which includes, where relevant, the additional information about its financed emissions.

Such reliefs can continue to be used when presenting that information as comparative information in subsequent reporting periods.

Are IFRS Sustainability Disclosure Standards interoperable with other standards?

The ISSB has incorporated interoperability considerations in its decision-making process prior to publishing its first two Standards.

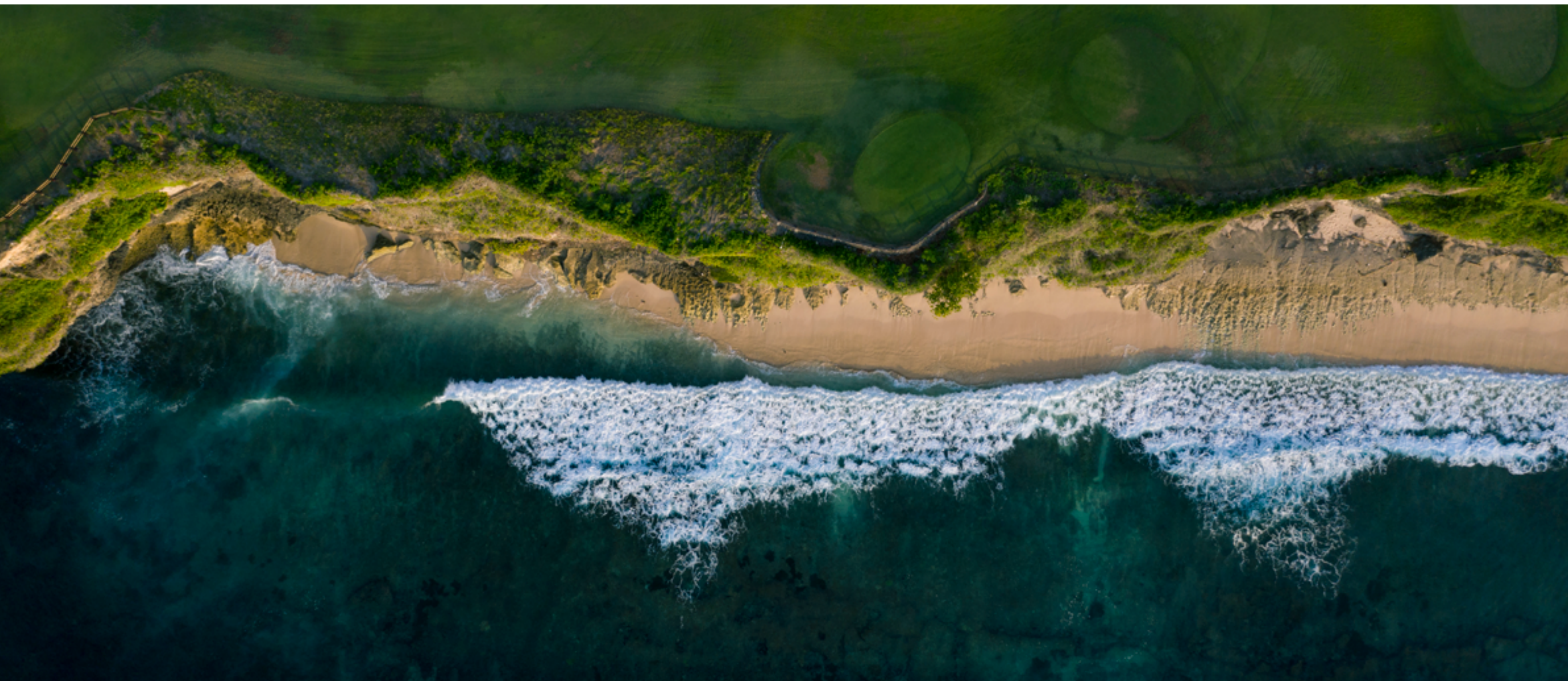
The ISSB is also working with jurisdictional representatives through its **Jurisdictional Working Group and Sustainability Standards Advisory Forum** (SSAF) to enhance interoperability of the ISSB Standards with jurisdictional specific disclosure requirements or initiatives. This collaboration helps local jurisdictions develop disclosures that will supplement and work alongside IFRS S1 and IFRS S2.

The ISSB is also directly working with jurisdictional standard-setters to maximise interoperability of standards and mandatory reporting frameworks, for example the European Commission (EC) and the European Financial Reporting Advisory Group (EFRAG) in the EU, the Financial Conduct Authority (FCA) and the Financial Reporting Council (FRC) in the UK, and the Securities and Exchange Commission (SEC) in the US.

For EU companies in the scope of the Corporate Sustainability Reporting Directive (CSRD) with international reach, **interoperability of IFRS Sustainability Disclosure Standards with ESRS will be key** (see Mazars Guide on the ESRS). The EC revised the draft ESRS prepared by EFRAG – the EC's technical advisor – in November 2022, with a focus on improving their interoperability notably with the ISSB Standards in order to avoid dual reporting.

On 31 July 2023, the EC has adopted the Delegated Regulation as regards the ESRS. The EC and the ISSB consider that their joint work on improving interoperability of their respective climate-related disclosure requirements in the overlapping climate disclosure standards has successfully led to a very high degree of alignment, reduced complexity and duplication for entities wishing to apply both the ISSB Standards and the ESRS. To assist entities who will apply both ESRS and the ISSB Standards, the EC together with EFRAG and the ISSB will work on interoperability guidance material that could assist entities in navigating between the standards and to understand where there are incremental disclosures required by only one set of standards.

It can also be noted that CDP (initially known as Carbon Disclosure Project), a not-for-profit charity that runs a global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts, announced at the end of 2022 that it will incorporate IFRS S2 into its existing questionnaires, thereby providing investors with consistent climate-related information and reducing the reporting burden on companies through an alignment of requirements.



What support has already been expressed by the different jurisdictions in view of the adoption of IFRS S1 and IFRS S2?

The Standards issued by the ISSB are designed to complement the IFRS Accounting Standards which are used by over 140 jurisdictions worldwide.

The ISSB has established a partnership framework to support the introduction of IFRS Sustainability Disclosure Standards across all economic settings, including the "phasing and scaling" of requirements in consideration of smaller companies and of companies operating in developing and emerging economies.

The ISSB does not have the right to mandate application of the Standards. However, companies can voluntarily apply these Standards and jurisdictional authorities can decide whether companies should apply them.

The response to adoption of IFRS Sustainability Disclosure Standards has varied globally. On 25 July 2023, **IOSCO (the International Organization of Securities Commissions) has decided to endorse these Standards** and has called on its 130 member jurisdictions, regulating more than 95% of the world's financial markets, to consider ways in which they might adopt, apply or otherwise be informed by the ISSB Standards within the context of their jurisdictional arrangements, in a way that promotes consistent and comparable sustainability-related disclosures for investors.

Some jurisdictions have already announced their intentions to be early adopters, notably among the emerging and developing markets (e.g., Mexico, Nigeria and Zimbabwe), while others are yet to decide.

In March 2023, the UK Government set out its plans on adopting the ISSB Standards as part of its revised Green Finance Strategy, and it is now in the process of setting up an appropriate endorsement mechanism. An endorsement decision is now expected to take place within 12 months.

Also in March 2023, the newly formed Sustainability Standards Board of Japan (SSBJ) announced its plan to incorporate ISSB Standards into the upcoming Japanese requirements.

Lastly, the United States has indirectly supported the development of the ISSB Standards through G7 and G20 and will likely continue to do so through its role as a Board member of IOSCO. In March 2022, the SEC proposed climate-related disclosure rules, which are due to be issued in October 2023. They should be aligned with IFRS S2 as both were developed based on the disclosure requirements recommended by the TCFD.

What's next?

Coverage of sustainability-related risks and opportunities goes beyond climate-related matters and therefore the ISSB seeks to **publish additional Standards in the future**. A consultation was launched to assist the ISSB in prioritizing its work for the next two years (starting in 2024) notably considering new research and standard-setting projects on (i) biodiversity, ecosystems, and ecosystem services, (ii) human capital and (iii) human rights.

To facilitate **digital reporting** of IFRS S1 and IFRS S2, a public consultation on the Proposed IFRS Sustainability Disclosure Taxonomy was launched on 27 July 2023, with the anticipation of publishing the final Taxonomy by H1 2024. This initiative aims to support digital reporting for the first published reports which are expected from 1 January 2025.

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