Beyond the GAAP

Mazars’ monthly newsletter on financial and sustainability reporting

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Editorial

On 31 July, only three weeks after the end of the public consultation on the draft delegated act, but a month behind the schedule set by the Corporate Sustainability Reporting Directive (CSRD), the European Commission adopted the final regulation on the first set of European Sustainability Reporting Standards (ESRS), after making a few last-minute changes based on the responses (more than 600!) received.

The final text of the ESRS is expected to be published in the Official Journal of the European Union by the end of this year (provided the European Parliament and the Council do not raise any objection), for entry into force from 1 January 2024 for the first companies concerned by the CSRD.

At international level but also as regards sustainability reporting, this issue of Beyond the GAAP features a detailed summary of the content of the first two standards that were released by the International Sustainability Standards Board (ISSB) at the end of June, IFRS S1 – *General Requirements for Disclosure of Sustainability-related Financial Information*, and IFRS S2 – *Climate-related Disclosures*.

IFRS Highlights

Amendments to IAS 21 – *Lack of Exchangeability*

In mid-August, the International Accounting Standards Board (IASB) published its amendments to IAS 21 entitled *Lack of Exchangeability.*

These amendments were the subject of an Exposure Draft in April 2021 (see Beyond the GAAP no.154 of April 2021).

They clarify when a currency is exchangeable into another currency and how to determine the exchange rate when it is not.

When is a currency exchangeable into another currency and when is it not?

At the measurement date, a currency is exchangeable into another currency when an entity is able to obtain the other currency within a time frame that allows for a normal administrative delay and through a market or exchange mechanism in which an exchange transaction would create enforceable rights and obligations and for a specified purpose.

Conversely, a currency is not exchangeable if an entity is able to obtain no more than an insignificant amount of the other currency at the measurement date.

How should an entity determine the exchange rate to be applied when a currency is not exchangeable?

If a currency cannot be exchanged for the other currency at the measurement date, the entity must estimate the spot exchange rate at that date. This is the rate at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions.

What additional disclosures should be presented if a currency is not exchangeable?

When a currency is not exchangeable into another currency, an entity should disclose information that enables users of its financial statements to understand how the lack of exchangeability affects or is expected to affect its financial performance, financial position and cash flows.

To achieve this objective, an entity shall disclose information about:

- the nature and financial effects of the lack of exchangeability;
- the spot exchange rate(s) used;
- the estimation process; and
- the risks to which the entity is exposed because of the lack of exchangeability.

Application date and arrangements for first application?

These amendments will come into effect for reporting periods beginning on or after 1 January 2025, subject to endorsement by the European Union. Early application is permitted.

Application of these amendments will not be retrospective. Any effect of initially applying the amendments will be recognised as an adjustment to:

- the opening balance of retained earnings when the entity reports foreign currency transactions;
- the cumulative amount of translation differences in equity when the entity uses a presentation currency other than its functional currency, or translates the results and financial position of a foreign operation.

PIR IFRS 9 – Phase 2 - Impairment

In the course of its post-implementation review of IFRS 9, Phase 2 - Impairment, the IASB published a Request for Information on 30 May to gather feedback from stakeholders on a number of aspects.

The Request for Information sets out questions in 10 sections addressing the topics previously identified by the Board in February 2023 (see Beyond the GAAP no.174 of February 2023):

- Question 1 looks at the general impacts (advantages and disadvantages) of the changes introduced by IFRS 9 on impairment from the point of view of preparers, users, auditors and regulators;
- Questions 2 to 8 deal with specific aspects of the impairment model introduced by IFRS 9. These questions are designed to gather information on any difficulties encountered in interpreting the provisions of IFRS 9, its cost/benefit ratio, the relevance of the information provided to users and the diversity of practices observed.
- Question 9 asks about the credit risk disclosure requirements in IFRS 7.
- Question 10 addresses any other matters not identified by the Board that could be relevant to the PiR.

The comment period for the Request for Information runs until 27 September 2023.

Renewable power purchase agreements: draft narrow-scope amendments to IFRS 9

At its July 2023 meeting the IASB tentatively decided to add a project to the work plan regarding the treatment of renewable ("green") power purchase agreements.

This issue was initially submitted to the IFRS Interpretations Committee (IFRS IC) in June 2023, but the committee did not wish to give an opinion and opted to refer the matter to the IASB.

This project reflects the growing use of these contracts by entities consuming electricity, not least with a view to reducing their carbon footprint. The aim is to clarify the feasibility of narrow-scope amendments to IFRS 9 concerning the transactions qualified as own-use as well as hedge accounting requirements. These amendments would bring consistency in the treatment of these transactions between the entities concerned, while improving the relevance of the disclosures to users of the financial statements.

In the case of transactions qualified as own-use, the project addresses contracts for the physical purchase of electricity that cannot be stored by the purchaser and thus must either be consumed or sold at its market price. The aim is to clarify the standard by recognising the purchase cost of these agreements over their term, as opposed to treating them as derivative financial instruments that must be remeasured at fair value through profit or loss.

As regards hedge accounting, the project addresses virtual power purchase agreements, or VPPA. A VPPA meets the definition given by the standard of a derivative instrument (swap) enabling the buyer and seller of renewable power to transform a variable market price into a fixed price. The aim is to facilitate the application of hedge accounting to these agreements, whose nominal value is variable because it depends on the quantity of electricity actually produced. Documenting these derivatives in a hedging relationship would prevent the effective portion of the derivative from being remeasured at fair value through profit or loss.

Standards on the presentation of financial statements and on disclosures by subsidiaries not subject to public disclosure requirements announced for the first half of 2024

The IASB's July meeting was an opportunity for the Board to observe that it had reached the end of the decision-making process on its *Primary Financial Statements* (PFS) project and on the prospective standard *Subsidiaries without Public Accountability: Disclosures.*

Readers will recall that the PFS project was intended to replace IAS 1 – *Presentation of Financial Statements* with a new standard.

The objective of the project *Subsidiaries without Public Accountability: Disclosures* was much more narrowly focused, authorising a subsidiary to prepare full IFRS financial statements locally with reduced disclosure requirements, provided that:

- the subsidiary is not subject to public disclosure requirements;
- its ultimate or any intermediate parent publishes consolidated financial statements that are available for public use and comply with IFRSs.

The IASB therefore decided to launch the finalisation phase for these two standards, with a view to publishing them in the first half of 2024 and applying them to financial years beginning on or after 1 January 2027.

Taking climate-related matters into account in IFRS financial statements

In November 2020 (see Beyond the GAAP no.149 of November 2020), the IFRS Foundation published educational material illustrating the circumstances under which the application of IFRSs might require entities to take account of climate issues.

In July the IFRS Foundation published an update to this document (available here), in particular in order to include an example relating to the new IFRS 17 on insurance contracts.

In parallel, the IASB will pursue its project to examine whether and how to provide better disclosures about climate risks in financial statements (see Beyond the GAAP no.175 of March 2023). The technical team is currently continuing to gather feedback from stakeholders, with the aim of presenting the evidence to the IASB by the end of the year to decide on the direction of the project.

IPTF publishes working document on hyperinflationary economies

On 7 January, the International Practices Task Force (IPTF) at the Center for Audit Quality's SEC Regulations Committee updated its discussion document identifying countries that are considered to have hyperinflationary economies.

The countries with a three-year cumulative inflation rate exceeding 100% are Argentina, Ethiopia, Haiti, Iran, Lebanon, South Sudan, Sudan, Suriname, Turkey, Venezuela and Zimbabwe.

As in previous editions, the IPTF notes that the list is based on available data and does not claim to be exhaustive (e.g. Syria and Afghanistan are both omitted).

For more details, the IPTF working document is available here.

European Highlights

Sébastien Harushimana appointed as EFRAG FR TEG Chair

The Administrative Board of the European Financial Reporting Advisory Group (EFRAG) has announced the appointment of Sébastien Harushimana as full-time chair of the EFRAG Financial Reporting Technical Expert Group (EFRAG FR TEG) with effect from September 2023 (the press release can be consulted here). During his term of office, he will be responsible for leading EFRAG's financial reporting technical activities.

The European Commission adopts the final delegated regulation on the first set of ESRS

On 31 July 2023, the European Commission (EC) published its final delegated regulation[1] on the first set of European sustainability reporting standards or ESRS[2]. On the same day, the EC also published questions and answers on the adoption of ESRS. Mazars has subsequently issued a guide to the first set of ESRS, that is currently available in French here and will be published in English in the near future.

The final adoption follows a four-week public consultation launched on 9 June 2023 by the EC in order to gather stakeholders' views of the draft delegated act (see Beyond the GAAP no.178 of June 2023). More than 600 responses[3] were received and led to some last-minute amendments. These final changes mainly concern:

- the addition of a requirement to justify (where appropriate) the fact that a company concludes that climate change is not a material topic[4] and therefore none of the information listed in ESRS E1 has been reported. In this case, the company should publish a detailed explanation of the conclusions of its materiality assessment with regard to climate change, including a forward-looking analysis of the conditions that could lead it to conclude that climate change is an important issue in the

[1] Go to "Commission adoption" on this web page to access the delegated regulation in all EU languages.

[2] Included in Annex I of the delegated regulation Annex II contains the list of acronyms and the glossary of all terms defined in the ESRS.

[3] Including Mazars' opinion, accessible from the Commission's web site.

[4] Justification for other topics that may have been disregarded by the entity as deemed not material remains optional.

future. The EC thus recognises that climate change has widespread and systemic effects on the economy as a whole;

- the addition of a disclosure requirement (where applicable) for datapoints relating to information required under other European regulations[5] such as the Sustainable Finance Disclosure Regulation (SFDR), which was deemed "not material" and therefore omitted. In practice, each company will have to publish a table listing all the datapoints arising from these other regulations and indicate where they appear in its sustainability statements. Where appropriate, datapoints deemed not material by the company should be marked "not material";
- modification of the definition of financial materiality to align with IFRS S1 (see the study on the ISSB's standards in this issue). The assessment of this materiality is now focused on identifying the disclosures considered material for the main users of general purpose financial reports (investors in particular). It was therefore considered that the information needs of other stakeholders are met either through the information provided on the impact materiality, or through the information needed by investors.

The adoption of the first set of ESRS was welcomed by EFRAG (press release available here), which has actively contributed to the development of these standards in its role as technical advisor to the EC. EFRAG has also reaffirmed its commitment to the implementation of a support mechanism toward the effective implementation of ESRS (see 'European Highlights' in this issue).

The ISSB also issued a statement to mark this event (accessible here) emphasising the very high degree of alignment that has been achieved between ESRS and IFRS Sustainability Disclosure Standards as part of joint work carried out in recent months with both the EC and EFRAG (see the study of ISSB standards in this issue).

The interoperability of ESRS with the Global Reporting Initiative (GRI) standards is also endorsed, bearing in mind that GRI standards have served as a basis for EFRAG's work on impact materiality. In practice, companies that will publish sustainability information in accordance with the ESRS will be considered to have prepared this information "with reference to the GRI standards". It will also be possible, under certain conditions, to supplement the disclosures required by the ESRS with information stemming from the GRI standards.

The final text of the ESRS will be published in the Official Journal of the European Union by the end of the year (assuming there are no objections from the European Parliament and the Council during their scrutiny period[6]), coming into force on 1 January 2024 for the first companies[7] falling into the scope of the Corporate Sustainability Reporting Directive (CSRD).

EFRAG continues its work to support the implementation of Set 1 and the development of the ESRS framework

On 6 July 2023, the European Commissioner for Financial Services Mairead McGuinness addressed EFRAG's Sustainability Reporting Board (SRB) and

[5] These datapoints are listed in Annex B of ESRS 2.
[6] The latter began on 21 August and will run for two months (with a possible two-month extension).
[7] Large undertakings with more than 500 employees that are public-interest entities as per the directive 2013/34/EU.

stressed the importance of the work of the EC's technical advisor in (i) supporting the implementation of ESRS Set 1 and (ii) preparing the ESRS standard applicable to listed SMEs and the voluntary standard for unlisted SMEs. It was also announced that the timetable for the endorsement of sector-specific standards by the EC would be determined at a later date, following the adoption of the final delegated regulation relating to ESRS Set 1, which took place at the end of July (see 'European Highlights' in this issue).

A summary of the key messages of this speech has been prepared by EFRAG and can be consulted here. A recording of the public session is available here.

This speech is a follow up to:

- the statements made mid-March 2023 by the EC's President Ursula von der Leyen and Commissioner McGuinness respectively on (i) setting a target of reducing the reporting burden on companies by around 25% and (ii) prioritising the introduction of a support framework for implementation of the first set of ESRS (see Beyond the GAAP no. 175 of March 2023);
- the address delivered by Sven Gentner, Head of unit for corporate reporting, audit and credit rating agencies in the directorate-general for financial stability, financial services and capital markets union (DG FISMA) on 12 April during a meeting of EFRAG SRB in order to present the progress of the EC's ongoing work on Set 1. At this meeting, SRB Chairman, Patrick de Cambourg, also presented the measures that EFRAG was considering to support the application of ESRS (see Beyond the GAAP no.176 of April 2023).

It is against this background that EFRAG has refined its roadmap and continued its work in recent weeks, while taking account of the final versions of the Set 1 standards adopted by the EC on 31 July.

Working papers on draft implementation guidance on the value chain (available here) and the materiality assessment (available here) were released during the SRB's meeting on 23 August.

These drafts will be approved in September prior to a four-week public consultation period to gather stakeholders' feedback. This guidance will therefore not be finalised until EFRAG's due process is complete.

It is important to note that this guidance will not form part of the ESRS (which represent a regulatory text) and that it will not therefore be binding. The aim here is to present the principles laid down by the ESRS in an educational way, to provide illustrative examples and to answer frequently asked questions that may arise in connection with the application of these principles. This guidance should therefore be particularly useful for companies that have not previously published sustainability information but are within the scope of the CSRD.

On the basis of the drafts now available, we can assume that this guidance will present:

- with regard to value chain:
    - illustrative examples for a better understanding of this key concept of the ESRS;
    - the scope of the information to be "extended" to the company's value chain;
    - the role of the value chain in the materiality assessment;
    - the factors to be taken into account in determining and, where appropriate, estimating data relating to the value chain;

- with regard to double materiality assessment:
  - the issues relating to materiality assessment and how this assessment is key to the implementation of ESRS;
  - the interactions between impact materiality and financial materiality;
  - the role of stakeholders in the materiality assessment process;
  - the practical implementation of this assessment, with illustrations of the steps that a company might choose to follow (as the method to implement remains a free choice for each company).

The details (in Excel) of the various datapoints to help companies perform their gap analysis have not yet been made public, even in draft form.

In the near future, EFRAG will also host a portal where companies and other stakeholders can ask technical questions on the application of ESRS. Where appropriate, the EC may publish guidance on issues relating to the legal interpretation of standards.

With regard to forthcoming public consultations to complement the ESRS framework, EFRAG announced at the SRB meeting on 12 July that they would cover, by the end of the year, (i) exposure drafts on ESRS for SMEs and (ii) the XBRL Digital Taxonomy relating to ESRS Set 1.

With regard to sector-specific standards, EFRAG has confirmed that the first set of exposure drafts will include the standard relating to the classification of ESRS sectors (known as "SEC 1") as well as the draft standards relating to (i) Oil and Gas and (ii) Mining, Quarrying and Coal. The publication dates for these drafts have yet to be clarified (this is expected to be later than envisaged by the CSRD, in particular because of the European elections in 2024).

ISSB Sustainability Disclosure Standards: final versions of IFRS S1 and IFRS S2 issued

On 26 June 2023, the International Sustainability Standards Board (ISSB) issued its first two Sustainability Disclosure Standards, **IFRS S1 – *General Requirements for Disclosure of Sustainability-related Financial Information***, **and IFRS S2 – *Climate-related Disclosures***.

The two standards (available here) lay the foundation of the ISSB's global baseline of sustainability-related disclosures. A guide has been prepared by Mazars on these new standards.

Further IFRS Sustainability Disclosure Standards are to be issued over the coming years, expanding the framework to include other ESG (Environment, Social and Governance) topics.

The publication of IFRS S1 and IFRS S2 marks the end of a due process that lasted several months, even though the standard-setting process has progressed quickly, thanks to the ISSB's decision to build on existing globally recognised frameworks and standards. In the most recent phase of the work, the ISSB made final amendments to the standards in light of the many comment letters it received in response to the two exposure drafts published in March 2022 (cf. Beyond the GAAP no. 164, March 2022 and Beyond the GAAP no. 169, September 2022).

Today's special feature includes (i) background information relating to the creation of the ISSB and the development of IFRS S1 and IFRS S2; (ii) key points of the content of the two standards; (iii) the timetable for application and the issues relating to interoperability with other frameworks; and lastly (iv) next steps.

Background

Creation and objectives of the ISSB

Readers will remember that the creation of the ISSB was announced by the IFRS Foundation in **November 2021 at COP26 in Glasgow**, in order to address the increasing and urgent needs for transparency in sustainability reporting.

The ISSB's objective was to provide a globally recognised framework on which jurisdictions could build to ensure high-quality, comparable and relevant sustainability information that would meet investors' needs. With this in mind, the ISSB's remit was to work alongside the International Accounting Standards Board (IASB) to **publish IFRS Sustainability Disclosure Standards**, ensuring **connectivity** and **compatibility** with **IFRS Accounting Standards**.

The scope of the ISSB's responsibilities and available resources was expanded through the consolidation of the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation[8] (VRF) into the IFRS Foundation, in January 2022 and August 2022 respectively. This means that the ISSB now governs the SASB standards, and intends to improve their international applicability.

The ISSB also signed an agreement with the Global Reporting Initiative (GRI) in March 2022, with a view to ensuring that IFRS Sustainability Disclosure Standards, which are focused on investors' information needs, are **complementary to and compatible with GRI standards**, which

[8] Which was itself formed from the consolidation of (i) the Sustainability Accounting Standards Board (SASB) Foundation and (ii) the International Integrated Reporting Council (IIRC).

are intended to meet the needs of a wider range of stakeholders.

Furthermore, the Financial Stability Board (FSB) recently gave the ISSB responsibility for monitoring companies' climate-related disclosures under the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), as these recommendations have been incorporated into IFRS S1 and IFRS S2.

Finally, it should be noted that the ISSB does not have responsibility for deciding on (i) whether an assurance should be provided on sustainability information or (ii) the appropriate assurance standards to apply in that case. This is the remit of local jurisdictions and regulators.

Other frameworks and standards used in the development of IFRS S1 and IFRS S2

The ISSB built on several widely used and globally accepted frameworks when developing its first two IFRS Sustainability Disclosure standards. These included:

- **the Integrated Reporting Framework**, to define the objectives and underlying concepts of IFRS S1;
- **the TCFD's recommendations**, with the standards structured around the following four reporting areas: (1) Governance; (2) Strategy; (3) Risk management; and (4) Metrics and targets;
- the topics and metrics included in **the SASB standards**, to develop the approach used for identifying (i) sustainability-related risks and opportunities and (ii) the related information that should be reported. IFRS S2 includes industry-specific guidance that preparers shall consider, derived from the SASB standards;
- **some of the IASB's concepts**, notably materiality, which is defined as follows for both sustainability reporting and financial reporting: "Information is material if omitting, misstating or obscuring it could reasonably be expected to influence investors' decisions."

Key points of IFRS S1

The needs of primary users (notably investors) are paramount

IFRS S1 requires preparers to disclose material information on sustainability-related risks and opportunities to meet **the needs of primary users** (i.e. investors, lenders and other creditors) **of general purpose financial reports** (which include both financial statements and sustainability-related financial disclosures).

The ISSB's standards are based on the principle that sustainability information is useful to primary users because a company's ability to create value is inextricably linked to **its interactions with its stakeholders, society, the economy and the natural environment** in which it operates, throughout its entire **value chain**. The company's dependencies and impacts on these resources and relationships are likely to give rise to sustainability-related risks and opportunities.

IFRS S1 requires preparers to disclose information on these risks and opportunities if they could **reasonably be expected to affect the company's prospects**, i.e. its cash flows, access to finance, or the cost of capital over the short, medium or long term.

IFRS Sustainability Disclosure Standards thus have a different conceptual approach to materiality from that followed by the European Sustainability Reporting Standards (ESRS), which use a double materiality approach (i.e. a sustainability issue is material if it meets the criteria for impact materiality or financial materiality or both, considering the needs of users of sustainability information in a broader sense). However, the ISSB believes that its concept of materiality for investors **implicitly includes some level of impact materiality**, as many impacts are financially material.

General requirements that form a "conceptual framework"

IFRS S1 sets out the general requirements that must be met for a preparer to be compliant with IFRS Sustainability Disclosure Standards. IFRS S1 is **similar to a "conceptual framework"**, as it identifies the elements that are essential to a complete set of sustainability-related financial disclosures, and specifies the qualitative characteristics of this information. This standard must be applied in conjunction with the other IFRS Sustainability Disclosure Standards.

Guidance to complement the standards

IFRS S1 lists the sources of guidance that preparers may consult to identify (i) **risks and opportunities** arising from sustainability issues other than climate (as this topic is covered by IFRS S2) and (ii) **the information to disclose** about them.

In both cases, preparers shall consider the **applicability of the SASB standards** to the industries in which they operate (as these standards are industry-based). Additional optional sources of guidance are also listed, such as the CDSB Framework Application Guidance and industry practices.

If there is no IFRS Sustainability Disclosure Standard that specifically applies to a given risk or opportunity, IFRS S1 requires the company to apply its judgement to determine what information is relevant to disclose. In this situation, a preparer may also (provided certain conditions are met) consider the **applicability of the GRI Standards and the ESRS**, in addition to the guidance mentioned above.

Proportionality provisions to support application of the standards

The ISSB has introduced **proportionality provisions** to ease the reporting burden on preparers and to support application of IFRS Sustainability Disclosure Standards.

For example, 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" for some requirements, e.g. when identifying sustainability-related risks and opportunities or determining the scope of the entity's value chain.

General principles for connectivity and presentation of information

IFRS S1 also includes general requirements on **connectivity of information**, to give users of general purpose financial reports a better understanding of the connections between:

- an entity's sustainability-related risks and opportunities;
- the various disclosures provided by the entity:
  - within its sustainability-related financial disclosures; and
  - between sustainability-related financial disclosures and other information disclosed by the entity, such as its financial statements.

Although IFRS sustainability information prepared under IFRS related standards shall be included as part of an entity's general purpose financial reports, **IFRS S1 does not specify the exact location of these disclosures**, which could, for example, be presented in a specific section of the management commentary. The ISSB also permits entities to use an integrated approach to sustainability reporting.

However, preparers must report their sustainability-related financial disclosures at the same time as they publish their financial statements.

Finally, it should be noted that IFRS S1 permits all entities to apply IFRS Sustainability Disclosure Standards, regardless of which framework they use to prepare their financial statements (i.e. IFRS Accounting Standards or other generally accepted accounting principles or practices). In practice, this means that any entity may elect to prepare its sustainability information in accordance with the ISSB's standards.

Key points of IFRS S2

Climate change: the first topical standard covered by the ISSB

IFRS S2 can be viewed as the **first topical standard** issued by the ISSB, with further topics to be covered in the coming years. The ISSB decided to focus first on climate change, which it believes will present risks for all entities and economic sectors.

The climate-related risks covered by IFRS S2 include **physical risks** (i.e. those resulting from events or long-term trends) and **transition risks** (i.e. those resulting from the transition to a low-carbon economy).

A structure aligned with TCFD recommendations and application in conjunction with IFRS S1

IFRS S2 (like IFRS S1) fully incorporates the TCFD's recommendations. On 24 July 2023, the IFRS Foundation published a comparison (available here) between the requirements of IFRS S2 and the TCFD's recommendations, showing that companies which apply the ISSB standards will also comply with these recommendations.

IFRS S2 requires entities to publish industry-specific information, but does not impose particular metrics. The standard provides industry-based guidance which is derived from the SASB standards. Preparers must consider the applicability of this guidance, but are not required to publish the specific metrics included in this guidance.

Climate-related disclosures published in accordance with IFRS S2 must take account of the **general requirements set out in IFRS S1**, even if the entity applies the transition provision permitted by IFRS S1, which allows entities to only publish climate-related disclosures in the first year of IFRS sustainability reporting.

Key disclosures required on an entity's response to climate-related risks and opportunities

The disclosures required under IFRS S2 cover the key elements of:

- the company's **strategy** for managing climate-related risks and opportunities;
- the company's **performance** in relation to these climate-related risks and opportunities, including progress made towards targets that it has set itself or that it is required to meet.

As regards strategy, IFRS S2 specifically requires entities to publish disclosures on:

- their **climate-related transition plan**;
- the **current and anticipated financial effects** of climate-related risks and opportunities on the company's performance, financial position and cash flows. These disclosures are subject to specific proportionality measures, in accordance with IFRS S1;

- their **resilience to climate change**, i.e. their ability to adapt to climate-related impacts or events (such as pervasive wildfires), changes (such as regulatory limits on the use of particular fossil fuels) and uncertainties (such as assumptions about the pervasiveness of wildfires or the stringency of regulation), using **climate-related scenario analysis**. Appendix B of IFRS S2 provides application guidance based on the TCFD's framework to help companies tackle this complex issue and implement a suitable approach that fits their specific circumstances.

As regards performance, IFRS S2 specifies various groups of metrics that entities shall disclose:

- **greenhouse gas (GHG) emissions for Scopes 1, 2 and 3**, measured in accordance with the GHG Protocol guidance unless local regulations require the use of a different method. Companies that have Scope 3 emissions associated with investments or other forms of financing (i.e. companies with activities in asset management, commercial banking or insurance) shall also disclose information on **financed emissions**;
- **financial metrics** related to climate-related risks and opportunities, such as the amount of investment or financing devoted to these risks and opportunities;
- **internal carbon prices**, i.e. whether and to what extent these prices are taken into account by the entity when making decisions, and the price used to measure the cost of GHG emissions;
- **disclosures on executive remuneration policies**, i.e. whether and to what extent these policies include climate-related considerations, and the portion of remuneration affected over the financial period.

An entity shall also disclose **any climate-related targets it has set itself**, including the base period used for reference, any interim targets or milestones, and whether and how the targets take account of the most recent international climate change agreements (currently the 2015 Paris Agreement), including any jurisdictional commitments. For each GHG emissions reduction target, the entity shall also disclose whether the target is calculated on a gross or net basis. If the latter, it is also required to disclose (i) the associated gross emissions reduction target and (ii) the carbon credits that it plans to use to offset its GHG emissions in order to meet each of the net targets.

Timetable for application and interoperability with other frameworks

Effective date and transition provisions

IFRS S1 and IFRS S2 come into effect for financial periods commencing **on or after 1 January 2024** (early application is permitted if both standards are adopted simultaneously). In practice, the effective date will depend on either the endorsement by local jurisdictions or the company's decision to voluntarily apply the standards.

The ISSB has **provided transition reliefs** in order to facilitate application of the two standards. Thus, in the first year of application of IFRS S1, an entity is permitted:

- **not to disclose comparative information** (i.e. sustainability-related financial information in accordance with the ISSB's standards for a period prior to the date of initial application);
- to report sustainability-related financial disclosures **after the publication of its**

financial statements (subject to certain conditions);

- **to only report on climate-related risks and opportunities** in accordance with IFRS S2, therefore only applying the requirements of IFRS S1 that relate to this topic. In this case, the entity is not required to disclose the associated comparative information in the first year. Moreover, it is not required to disclose comparative information on risks and opportunities arising from sustainability-related issues other than climate in the second year.

In the first year of application of IFRS S2, an entity may apply one or both of the following provisions:

- it may **continue to use a method other than the GHG Protocol** to measure its GHG emissions, if that method was used in the year immediately preceding initial application of IFRS S2;
- it is **not required to disclose its Scope 3 GHG emissions**, including, where relevant, the additional information on its financed emissions.

The entity may continue to apply these reliefs when presenting the related information as comparative information in subsequent reporting periods.

Interoperability of IFRS Sustainability Disclosure Standards with other standards

When developing the IFRS Sustainability Disclosure Standards, the ISSB **took account of interoperability considerations**, so that entities would not need to provide multiple sets of sustainability-related disclosures.

To achieve this, the ISSB has been working with (i) representatives of various jurisdictions through its Jurisdictional Working Group and Sustainability Standards Advisory Forum (SSAF) and (ii) national standard-setters who oversee mandatory reporting standards and frameworks, such as the European Commission (EC) and EFRAG (European Financial Reporting Advisory Group) for the EU, the FCA (Financial Conduct Authority) and FRC (Financial Reporting Council) for the UK, and the SEC (Securities and Exchange Commission) for the US.

Interoperability between IFRS Sustainability Disclosure Standards and ESRS is a key issue for European companies with international activities that fall within the scope of the CSRD (Corporate Sustainability Reporting Directive). The EC has thus worked closely with the ISSB to maximise interoperability of the final ESRS published on 31 July 2023 (see ‘European Highlights’ in this issue), revising the draft standards submitted to it by EFRAG, its technical adviser, in November 2022. The EC and ISSB believe that this work has enabled them to (i) achieve a very high degree of alignment between the two frameworks and (ii) avoid a situation where entities that are required to disclose sustainability information in accordance with the ESRS, but that also wish to comply with the ISSB’s standards, have to publish a separate set of disclosures. The EC, EFRAG and ISSB will shortly be publishing interoperability guidance that will help companies to navigate between the two sets of standards and understand the additional information that is required under ESRS on the one hand, and IFRS on the other (expected to be very limited).

Finally, it should be noted that the CDP[9] (formerly the Carbon Disclosure Project)

[9] The CDP is a non-profit organisation that provides a global disclosure system for management of environmental impacts, aimed at investors, companies, cities, states and regions.

announced in late 2022 that it would incorporate the requirements of IFRS S2 into its questionnaires in order to provide investors with a consistent framework of climate-related information and to reduce the burden on preparers by aligning the reporting frameworks.

Next steps

Some announcements already made by jurisdictions with regard to early application of IFRS S1 and IFRS S2

The IFRS Sustainability Disclosure Standards have been developed to complement the IFRS Accounting Standards, which are applied by more than 140 jurisdictions worldwide. In light of this, the ISSB has established a support framework to assist with the application of the new standards across all types of economic environment.

It is now up to individual jurisdictions to decide whether or not they will make the standards mandatory; the ISSB is not able to impose this. Individual companies can also **choose** to adopt IFRS S1 and IFRS S2.

In July 2023, these standards were **endorsed by IOSCO (the International Organization of Securities Commissions)**, which called on its 130 member jurisdictions, which between them regulate over 95% of financial markets worldwide, to consider how they might adopt, apply or otherwise take account of the ISSB's standards in their respective jurisdictional frameworks (cf. press release dated 25 July 2023, available here).

Some jurisdictions have already announced their intention to be early adopters, notably among emerging and developing markets (such as Mexico, Nigeria and Zimbabwe).

In March 2023, the UK government set out a plan to adopt the ISSB's standards. The process is under way and a decision is expected within 12 months. The SSBJ (Sustainability Standards Board of Japan) announced its plan to incorporate the standards into the new Japanese regulations at around the same time.

Finally, the United States has indirectly supported the development of the IFRS Sustainability Disclosure Standards via the G7 and G20, and will continue to do so as a member of the IOSCO Board. In March 2022, the SEC proposed a set of rules (available here) to improve and standardise climate-related information provided to investors, which are scheduled for publication in October 2023. These rules should be aligned to the greatest extent possible with IFRS S2, as both are based on the TCFD's recommendations.

Further sustainability-related development of the IFRS framework

A consultation has been launched to help the ISSB to prioritise its work plan over the next two years (from 2024), notably considering potential research and standard-setting projects on (i) biodiversity, ecosystems and ecosystem services; (ii) human capital; and (iii) human rights (see Beyond the GAAP no. 177, May 2023).

A separate public consultation was also launched on 27 July on a digital Taxonomy project (Proposed IFRS Sustainability Disclosure Taxonomy), with a view to publishing the final version in the first half of 2024. This initiative aims to support the preparation of digital reporting of sustainability-related financial information from 1 January 2025.

Publications

Guide to the first set of ESRS

Further to our brief article in the 'European Highlights' section above, Mazars' Corporate Reporting Advisory department has released a guide to the first set of European Sustainability Reporting Standards. This guide is currently available in French here and will be published in English in the near future.

The guide provides an overview of the ESRS in the form of an FAQ, covering topics such as: identifying the required sustainability disclosures, presenting sustainability disclosures, consistency between ESRS and the European regulatory framework, and more.

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About Mazars

Mazars is an international, integrated and independent firm, specialising in audit, advisory, accountancy, tax and legal services [1]. With a presence in 95 countries and territories across the world, Mazars brings together the expertise of 47,000 professionals – 30,000 in our integrated partnership and 17,000 in the United States and Canada via the Mazars North America Alliance – to serve clients of all sizes at every stage of their development.

[1] Where permitted under applicable country laws

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