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Dear Technical Advisory Committee

Call for evidence – UK endorsement of IFRS S1 & IFRS S2

Mazars is an internationally integrated partnership specialising in audit, accountancy, advisory, tax and legal services. Operating in over 90 countries and territories around the world, we draw on the expertise of 47,000 professionals – 30,000+ in the Mazars integrated partnership and 17,000+ via the Mazars North America Alliance.

In the UK, Mazars has approximately 160 partners and over 2,900 employees, and is ranked one of the top 10 firms nationally.

General comments

We are pleased to have the opportunity to contribute to the Technical Advisory Committee's Call for evidence on the potential UK endorsement of IFRS S1 & IFRS S2. We set out below some general comments on the endorsement of these important standards, followed by responses to the specific topics for consideration set out in the call for evidence.

Support for endorsement without amendment

Adoption of the ISSB's international sustainability disclosure standards is a jurisdictional decision. We believe that, in principle, it is important that jurisdictions adopting the standards should make minimal changes to ensure consistency and interoperability of the standards.

In our view the IFRS S1 and IFRS S2 standards are suitable for endorsement in the UK, and it is imperative that they be endorsed without amendment, other than in truly exceptional cases where this is required, for example to reflect UK legislative requirements. Endorsement and adoption of the international standards without amendment, in particular avoiding carve outs from the requirements, will help to:

- ensure international consistency of the application of the standards for the benefit of stakeholders,

- maximise interoperability with other international standards, most notably those issued under the European Commission's CSRD requirements,
- mitigate the impact on multinational entities reporting in different jurisdictions,
- support the UK's ambitions to be a green finance hub, and
- provide leadership for other jurisdictions considering adoption of the standards, given the UK's role as a major global finance centre and a global leader in corporate reporting.

Furthermore, future development of guidance, including sector specific guidance, should be carried out in collaboration with the ISSB and international partners wherever possible, to minimise the potential for local interpretation and inconsistency, other than where necessary to interpret UK regulatory or legislative requirements.

Consequences of the UK legislative framework

We understand that there are legal constraints on how the endorsement and adoption of these standards may be achieved in the UK, in particular that the standards may need to be written into UK Law to become effective. Notwithstanding these constraints, as noted above, we believe that the standards should be adopted as published by the ISSB and any amendments should only be considered where the issues may give rise to contradictions with existing UK Law or where there is a fundamental lack of clarity, specificity or reference to external sources which are outside the control of UK legislators (e.g. the SASB standards referred to in IFRS S1.55(a)).

With regards to writing the standards into UK Law, the form, structure and content of the standards as written may be in some cases unsuitable for direct transcription and the TAC should recommend to the Secretary of State that they consider alternative means of endorsing the standards, for example by referencing the standards in UK Law in a similar manner to the treatment of IASB financial reporting standards.

It will be important in endorsing and adopting the standards to ensure that there is consistency between other UK reporting requirements (e.g. TCFD, transition plans, investment labelling rules) and UK sustainability disclosure standards to minimise duplication and complexity in what is already a complex reporting framework.

Rapidly evolving reporting environment

Sustainability reporting is a rapidly evolving environment with a proliferation of disclosure reporting requirements, associated assurance requirements and entities developing processes, systems and controls to gather, process and report sustainability information while building the capacity, capability and experience of sustainability professionals. Many of the disclosures are particularly difficult to develop, especially where those disclosures are qualitative and for quantitative disclosures which are highly uncertain, relying on complex estimates, forward looking information and data from third parties which are difficult to validate.

Against this backdrop it is important that regulators, standard setters, investors, lenders and wider stakeholders recognise that it will take time to get to a position where there are robust systems for reporting and assurance of sustainability disclosures, and that Government, regulators and others manage the expectations of users.

Simplifying the reporting framework for sustainability requirements

The UK's corporate reporting framework requires a range of sustainability disclosures including Strategic Report requirements under s.172 and the inclusion of SECR disclosures, as well as TCFD disclosures under FCA Listing Rules and the upcoming requirements around transition plans. There is currently a lack of integration, leading to risk of duplication of information and a lack of clarity and ease of use for stakeholders. The introduction of the ISSB Standards provides an opportunity to streamline and simplify the reporting requirements around sustainability into a more coherent package.

Responses to topics for consideration

1: Overall views of the standards

We support the endorsement of the ISSB S1 and S2 standards and believe that they will provide users with decision useful information on sustainability related risks and opportunities. As noted in our general comments, we believe that the standards, as published by the ISSB, are suitable for endorsement in the UK and that it is imperative that they be endorsed without amendment, in particular without carve-outs, other than in truly exceptional cases where this is required, for example to reflect UK legislative requirements. (See our general comments above).

We note that the ISSB does not define the term sustainability in its standards. In transcribing the standards into UK Law, we believe that it may be beneficial to define sustainability to provide legal certainty for preparers.

2: Identifying sustainability-related risks and opportunities

We are pleased to note that the ISSB has issued application guidance to support entities adopting the standards. However, there will be areas where further guidance would be helpful to entities adopting IFRS S1 and S2 for the first time to identify risks and opportunities, for example materiality assessment, Scope 3 emissions, transition planning, identifying the reporting boundary/value chain and scenario analysis.

Whilst there is existing UK guidance in some of these areas (e.g. scenario analysis, transition planning), additional guidance in these, and other, areas would be best achieved through working with the ISSB and other international partners to ensure there is consistency in the interpretation and application of the ISSB standards, although there may be instances where additional guidance may be required to reflect UK regulatory and legislative circumstances. The same holds true for sector specific guidance which will be needed as additional sector specific reporting and disclosure requirements are developed in the coming years.

3: Application of materiality

Although the ISSB has linked the definition of materiality to that used in financial reporting standards, with a focus on the primary users of the general-purpose financial reports, the application of materiality to sustainability related topics will in itself be more complex than the well-established use of materiality in financial reporting given the nature of the disclosures, both quantitative and qualitative.

We note that there is an inconsistency in language in IFRS S1.3 and IFRS S1.17, with the former paragraph stating that entities should disclose information about "all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows etc…", while para. 17 applies to a materiality lens to the disclosures noting that "An entity shall disclose *material information* about sustainability-related risks and opportunities". While the intention of the ISSB appears clear, clarification of the application of materiality to disclosures would be beneficial.

4: Reporting approach

We support the requirement in IFRS S1 that the sustainability-related disclosures relate to the same reporting entity as the related financial statements which will enable users to consider the sustainability and financial information together, to highlight the interrelationships between the two and to enable proper consideration of the entire population of risks and opportunities the entity faces. Endorsement in the UK needs to take account of this requirement, and where consolidated financial statements are prepared there should be no further requirement for standalone reporting, to minimise the burden on reporting entities.

Entities will face challenges in determining their reporting boundaries and, in particular, identifying the value chain and further guidance would be helpful to support implementation.

5: Timing and location

We support the ISSB requirements for disclosure of sustainability-related information as part of general-purpose financial reporting, and that the disclosures should be published at the same time, for the same reasons set out in our response to question topic 4 above.

Entities should be given clarity on the timelines for implementation to enable them to meet this challenging timetable in the early years of sustainability reporting given the current relatively immature systems, processes and controls over sustainability disclosures.

Consideration will need to be given during the endorsement process as to the appropriate location within the wider general purpose financial reports, taking account of the already complex reporting regulations in place and of how the Government effects the required legislation to adopt sustainability disclosure standards. We believe that the most appropriate location for the disclosures would be in the Strategic Report. However, simplification of the overall reporting regulations would be beneficial given existing reporting requirements and upcoming disclosures around Transition Plans, to ensure reporting is easy to navigate for users and avoid the risk unnecessary duplication.

6: Judgements, uncertainties and errors

Refer to our general comments regarding the uncertainties inherent in some sustainability disclosures.

7: Financial impact and connectivity

As noted in our overall comments, sustainability reporting is a rapidly evolving environment and the links between financial and sustainability information are part of that evolution. As entities build their capacity, capability and experience, the quality and robustness of disclosures, connectivity and the linking of financial and sustainability impacts will increase over time. This is particular true of those sustainability topics which are reliant on complex estimates, forward looking information and data from third parties which are difficult to validate. We appreciate the ISSB's acknowledgement that more needs to be done to integrate sustainability reporting information into wider reporting and urge the FRC/TAC to engage with the ISSB in developing further guidance.

8: Industry-based requirements

There will undoubtedly be significant benefits in the introduction of industry or sector-based reporting requirements in due course to enable users to gain a view of an entity's performance, risks and opportunities relative to their peers in relevant sectors. Ultimately, therefore, the standards should specify industry-based topics and metrics for disclosures. However, these should be introduced only once sustainability reporting is well established and entities have developed robust systems, processes and controls for capturing and reporting sustainability information. As such, the development of industry-based requirements should be carried out in collaboration with the ISSB and international partners wherever possible, to minimise the potential for local interpretation and inconsistency, other than where absolutely necessary to interpret UK regulatory or legislative requirements. Such international sector-specific standards should be adopted at the same time as other major jurisdictions.

9: Cross industry metrics (IFRS S2)

Scope 3 emissions remain a considerable challenge across all entities, with particular challenges faced in certain sectors such as financial services where value chains can be extensive and particularly complex. There will be extensive use of estimates and reliance on third party data, particularly in the early years but even when systems, processes and controls are fully established Scope 3 emissions will likely remain subject to considerable uncertainty. Challenges in respect of Scope 3 include the availability of high quality, assured data across the value chain (especially as many smaller entities will not be required to disclose their own emissions) and a lack of consistent Scope 3 emissions calculation methodologies across all sectors. We note that the ISSB standards provide one year relief for disclosure of Scope 3 emissions, although an extended period may be appropriate either for all entities or for those sectors where methodologies have not been fully established. The UK should be mindful of developments in other major jurisdictions and align with those requirements where possible.

There needs to be recognition from regulators, primary users and wider stakeholders that some of the estimates and forward-looking information in sustainability may be highly uncertain for some time to come. Furthermore for some disclosures, such as Scope 3 emissions, where entities are reliant on third party data which may not be assured or otherwise validated, the Government should consider whether safe-harbour provision may be appropriate to protect entities making disclosures based on external data sources which cannot be validated.

10: Costs and benefits

There will undoubtedly be an additional cost to the implementation of sustainability reporting and entities will need to invest in the capacity and capability of the teams, as well as invest in enhanced systems, processes and controls for the gathering and reporting of sustainability information. Many larger companies have already made some investment and improvements in recent years, most notably to meet UK climate reporting requirements, but more will be required to meet the wider disclosure requirements in these standards. Smaller entities will find the implementation even more challenging and appropriate reliefs will be important to enable an effective transition. Endorsement of the international standards without amendment would assist multi-national companies in implementing the standards effectively and efficiently.

However, we believe that the benefits, to the entity, its investors, lenders and other users, of more transparent disclosure of sustainability-related risks and opportunities, as well as performance against targets and metrics, will outweigh the additional costs. Enhanced integration of sustainability and financial risks and opportunities will be a significant improvement in considering the overall sustainability of reporting entities.

11: Application of the requirements

We welcome the proportionality and relief provisions set out in the ISSB's standards. If, upon endorsement, the UK considers it necessary to grant further reliefs over and above those provided for by the ISSB, we believe that such relief should be granted by further extension to the implementation period rather than carving out requirements from the disclosure standards. Any extensions should be focussed only where they are needed for new reporting requirements; for example, many companies are already reporting on Scope 1 and Scope 2 emissions under SECR requirements and there should be no need for relief on these disclosures, whereas Scope 3 emissions are less well developed.

In endorsing the standards, consideration should be given to an appropriate timeline for implementation by different sizes and natures of entity. It is important that sustainability disclosure requirements are introduced as soon as practicable given the pace of adoption in other jurisdictions, in Europe and beyond. It would seem to be appropriate for smaller companies to have a longer implementation timeline. However, smaller companies will report data which impacts on larger entities in their own value chain, which would potentially delay the timely availability of appropriately high-quality sustainability information for larger companies, which may need to be reflected in implementation timelines for larger companies.

Further discussion

If you would find it helpful to discuss any issues in this letter, please contact Paul Winrow, Partner – Sustainability Reporting and Assurance (paul.winrow@mazars.co.uk).

Yours faithfully

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