CHAPTER 3

ISSB introduces the proposals on global baselines standards for sustainability disclosures

This article aims to:

Provide an overview of the proposals introduced by the International Sustainability Standards Board (ISSB) on general requirements for disclosure of sustainability-related financial information and climate-related disclosures.

Overview

In recent years, momentum has grown from primary users of general purpose financial reporting for more consistent, complete, comparable and verifiable sustainability-related financial information to enable them to assess an entity's enterprise value. Further, investors and other stakeholders have joined the discussion over lack of harmonised standards for non-financial reporting. Increasing global focus towards climate change, inclusion of social and governance parameters and COVID-19 pandemic crisis have contributed in accelerating this momentum.

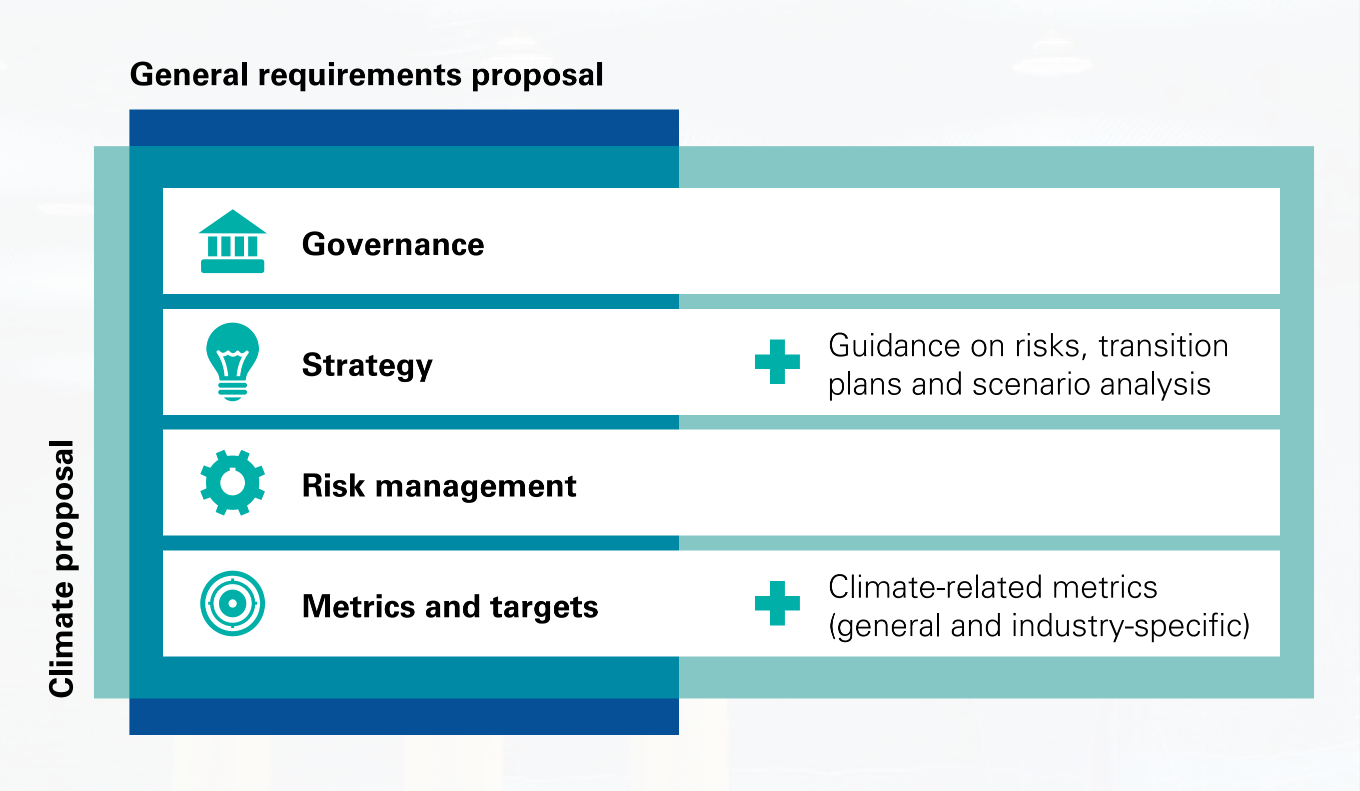
In this regard, in November 2021, the IFRS Foundation announced the creation of the ISSB. ISSB has been formed with an objective to build on the work of investor-focused reporting initiatives to become the global standard setters for sustainability disclosures for the financial markets. As a stepping stone, in November 2021, the IFRS Foundation created the Technical Readiness Working Group (TRWG) which published two protypes namely – the general requirements for disclosure of sustainability-related financial information prototype (general requirements prototype) and the climate-related disclosures prototype for consideration of the ISSB. The prototypes evolved from the work published in December 2020 by a group of five standard-setters and frameworks[1] providers focussed on corporate sustainability and integrated reporting.

Building on these prototypes released by the TRWG, the ISSB, on 31 March 2022 has released the Exposure Draft (ED) of its first two proposed standards. The comment period of both EDs ends on 29 July 2022.

- IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (ED on IFRS S1)
- IFRS S2 *Climate-related Disclosures* (ED on IFRS S2)

The proposals in the two EDs are structured to be applied together and alongside future topic-or industry-specific standards. They propose reporting across four content areas – governance, strategy, risk management, and metrics and targets – which are consistent with the TCFD framework.

The diagram below demonstrates the relationship between the proposals. Climate-related content is indicated in green box while General requirements are in blue box.



(Source: Sustainability reporting-New on the Horizon by KPMG International Standards Group; April 2022)

In this article, we aim to provide an overview of the proposals introduced by the ISSB in its ED on IFRS S1 and IFRS S2.

1. The Climate Disclosure Standards Board (CDSB); the International Accounting Standards Board (IASB); the Task Force on Climate-related Financial Disclosures (TCFD); the Value Reporting Foundation, which represents: the Sustainability Accounting Standards Board (SASB); the International Integrated Reporting Council (IIRC); and the World Economic Forum and its Measuring Stakeholder Capitalism Initiative. The International Organisation of Securities Commissions (IOSCO) and the International Public Sector Accounting Standards Board participated as official observers.

IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*

ED on IFRS S1 is based on the general requirements prototype. This ED sets out the proposed overall requirements for disclosing sustainability-related financial information It is intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs. Some of the key elements on the ED are as following:

- It is designed to require information that would complement the information contained in an entity's financial statements, regardless of which GAAP the entity has used when preparing those financial statements.
- It lays down proposals for general requirements that apply to the disclosure of sustainability-related financial information and would form the basis on which complementary standards that set out more specific disclosure requirements will be developed.
- It sets out proposed general requirements that must be applied for an entity to be able to state compliance with IFRS Sustainability Disclosure Standards.
- It identifies the core content of a complete set of sustainability-related financial disclosures and sets out the qualitative characteristics of useful sustainability-related financial information.

Key aspects of the ED on IFRS S1 are as below:

Sustainability-related financial information

Entities should disclose a complete set of sustainability-related financial information. Sustainability-related financial information is defined as 'information that gives insight into sustainability-related risks and opportunities that affect enterprise value, providing a sufficient basis for users of general purpose financial reporting to assess the resources and relationships on which an entity's business model and strategy for sustaining and developing that model depend.' The definition is broad based to reflect that the information relevant to assessing enterprise value will change over time. The information should take into account of the interconnectedness of risks as well as interactions between the entity's resources and relationships. This includes the way in which sustainability related risks and opportunities link and overlap and by doing so influence and amplify each other. Sustainability-related financial information is required only to the extent that it is material to an assessment of enterprise value.

Enterprise value

Enterprise value is defined as 'the total value of an entity' and is 'the sum of the value of the entity's equity (market capitalisation) and the value of the entity's net debt.' ED on IFRS S1 suggests that an enterprise value reflects users' assessments of future cash flows, including the value they attribute to those cash flows, reflecting the cost of capital. Enterprise value, therefore, reflects current market expectations about future cash flows.

The ED states that the information required to be provided by an entity must be sufficient to enable an assessment of enterprise value as at the reporting date taking into consideration information about sustainability-related risks and opportunities over the short, medium and long term. Sustainability-related financial information must, therefore, explain decisions and strategies made as at the reporting date that could reasonably be expected to affect future outcomes.

Core content

The ED proposes disclosure of sustainability-related financial information centered on the following four primary topics, aligned with those in the TCFD recommendations:

Governance

The governance processes, controls, and procedures used to monitor sustainability-related risks and opportunities

Strategy

The approach for addressing sustainability-related risks and opportunities that may affect an entity's business model and strategy over short, medium and long term

Risk management

The processes an entity uses to identify, assess, and manage sustainability-related risks

Metrics and targets

Information to assess, manage and monitor entity's performance w.r.t sustainability-related risks and opportunities over time

General features

This section sets out proposed requirements relating to the reporting entity, connected information, fair presentation, materiality, comparative information, frequency of reporting, location of information, sources of estimation and outcome uncertainty, errors and statement of compliance. These sections of the proposal were adapted from IAS 1, *Presentation of Financial Statements and IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors*. These are as follows:

- **Reporting entity:** An entity is required to disclose sustainability-related financial information for the same reporting entity for which it prepares its general purpose financial statements. For example, a parent that prepares consolidated financial statements would define the reporting entity as itself and its subsidiaries. This is proposed so that users of general purpose financial reporting can assess the enterprise value of the defined parent and subsidiaries.
- **Connected information:** Sustainability- related risks and opportunities are related. An entity is required to provide disclosures that show the relationships between sustainability-related risks and opportunities, on the one hand, and financial position and financial performance, on the other. An entity should highlight or explain connections between:
  - Separate sustainability-related risks and opportunities,
  - The pieces of information disclosed including between:
    1. Information to respond to separate disclosure requirements about the same risk or opportunity that affects more than one core content,
    2. Disclosures about different risks and opportunities, both within and across core content and
    3. Sustainability-related financial disclosures and information in the financial statements.
- **Fair presentation:** The ED requires that 'a complete set of financial disclosures shall present fairly the sustainability-related risks and opportunities to which an entity is exposed.' Fair presentation requires an entity 'to disclose information that is relevant, representationally faithful comparable, verifiable, timely and understandable' and 'to provide additional disclosures when compliance with the specific requirements in IFRS Sustainability Disclosure Standards is insufficient' for the needs of users of general purpose financial reporting. An entity should consider all relevant facts and circumstances when deciding how to aggregate information in sustainability related financial disclosures, but the understandability of disclosures shall not be reduced 'by obscuring material information with immaterial information or by aggregating material items that are dissimilar'.

  It is also proposed that an entity is required to disclose the industry or industries specified for the disclosures that it has provided. Entities should consider the SASB Standards as a means both of identifying sustainability-related risks and opportunities and to develop disclosures in the absence of specific requirements in IFRS Sustainability Disclosure Standards.
- **Materiality and comparatives:** The proposals require that a complete depiction of sustainability-related financial information include material information about all significant sustainability-related risks and opportunities. This definition of materiality was developed based on the definitions of 'material' and 'materiality' in the Conceptual Framework and IAS 1. The ED is supplemented with Illustrative Guidance. It illustrates how to think about materiality matters, but is not considered to be mandatory in applying the proposals. The proposals, if approved would ensure that all entities applying the proposed requirements will use the same definition of material information. Also, an entity would be required to reassess its materiality judgements at each reporting date to take into account of changed circumstances and assumptions.

  An entity should disclose comparative information in respect of the previous period for all metrics disclosed in the current period. When such information would be relevant to an understanding of the current period's sustainability-related financial disclosures, the entity should also disclose comparative information for narrative and descriptive sustainability related financial disclosures.
- **Frequency of reporting and location of information:** The proposal lays down that sustainability-related financial disclosures be disclosed as part of a reporting entity's general purpose financial reporting. A consequence is that an entity would be required to report its sustainability-related financial disclosures at the same time it publishes its related financial statements. This requirement would be a change for entities that disclose sustainability-related financial information separately from and later than their financial statements.
- **Sources of estimation and outcome uncertainty:** Entities are required to disclose information about any material changes in estimates or material errors. An entity should identify metrics that have significant estimation uncertainty and disclose the sources, nature and factors affecting the uncertainties. Also, when sustainability-related financial disclosures include financial data and assumptions, they should be consistent with the corresponding financial data and assumptions in the entity's financial statements, to the extent possible. The ED proposes that all changes in estimate and corrections of errors in previously reported metrics and targets would be corrected by restating any comparative information presented.

- **Statement of compliance:** An entity whose sustainability-related financial disclosures comply with all the relevant requirements of IFRS Sustainability Disclosure Standards, should include an explicit and unqualified statement of compliance. The ED proposes issuing disclosure-only standards and if an entity meets these disclosure requirements, it can assert compliance with IFRS Sustainability Disclosure Standard.

IFRS S2 *Climate-related Disclosures*

Exposure Draft *Climate-related Disclosures* (ED to IFRS S2) has been developed in response to the demand for globally consistent climate-related disclosures that meet the needs of users of general purpose financial reporting. Information about the climate related matters that are relevant to assessments of enterprise value over the short, medium and long term is increasingly important for decisions made by investors and other stakeholders. This ED builds on the prototype developed by the TRWG and the proposals in ED to IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information.*

The ED requires an entity to disclose information about its exposure to significant climate-related risks and opportunities, enabling users of an entity's general purpose financial reporting:

(a) to assess the effects of climate-related risks and opportunities on the entity's enterprise value

(b) to understand how the entity's use of resources, and corresponding inputs, activities, outputs and outcomes support the entity's response to and strategy for managing its significant climate-related risks and opportunities; and

(c) to evaluate the entity's ability to adapt its planning, business model and operations to significant climate-related risks and opportunities.

The proposals of this ED replicate the core content requirements of the general requirements proposal ED which are structured around governance, risk management, strategy and associated metrics and targets. These are discussed in detail below:

Governance

An entity is required to disclose information that enables users of general purpose financial reporting to understand the governance processes, controls and procedures used to monitor and manage climate related risks and opportunities. To achieve this objective, the ED proposes that an entity be required to disclose information about the governance body or bodies (which can include a board, committee or equivalent body charged with governance) with oversight of climate-related risks and opportunities, and a description of management's role regarding climate-related risks and opportunities. The ED expects detailed disclosures and includes requirements such as how the governance body's responsibilities for climate-related risks and opportunities are reflected in the entity's terms of reference, board mandates and other related policies, etc.

Strategy and resilience

The objective of climate-related financial disclosures on strategy is to enable users to understand an entity's strategy for addressing significant climate-related risks and opportunities that could reasonably be expected to affect the entity's business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term. In preparing such disclosures, an entity should refer to the industry disclosure requirements, consider the applicability of cross-industry metric categories and the industry-based metrics associated with disclosure topics.

While providing disclosures on its strategy, it should provide information about decision-making, including transition plans, information about current and anticipated changes to its business model, information regarding climate-related targets of these plans and qualitative and quantitative information about the progress of such plans disclosed in prior periods.

The ED proposes that an entity be required to also disclose the effects of significant climate-related risks and opportunities on its financial position, financial performance and cash flows for the reporting period, and the anticipated effects over the short, medium and long term - including how climate-related risks and opportunities are included in the entity's financial planning. The requirements also seek to address potential measurement challenges by requiring disclosure of quantitative information unless an entity is unable to provide the information quantitatively, in which case it shall be provided qualitatively.

An entity shall also disclose information that enables users of general purpose financial reporting to understand the resilience of the entity's strategy (including its business model) to climate-related changes, developments or uncertainties—taking into consideration an entity's identified significant climate-related risks and opportunities and related uncertainties. An entity be required to use climate-related scenario analysis to assess its climate resilience unless it is unable to do so. If an entity is unable to use climate-related scenario analysis, it shall use an alternative method or technique to assess its climate resilience.

Risk management

An entity would provide disclosures to understand the process, or processes, that an entity uses to identify, assess and manage not only climate-related risks, but also climate-related opportunities. An entity would need to describe climate-related risks for risk management purposes, the extent to which and how the climate-related risk identification, assessment and management process, or processes, are integrated into the entity's overall risk management process and the extent to which and how the climate-related opportunity identification, assessment and management process, or processes, are integrated into the entity's overall management process.

Metrics and targets

The ED proposes incorporating the TCFD's concept of cross-industry metrics and metric categories with the aim of improving the comparability of disclosures across reporting entities regardless of industry. The proposals require an entity to disclose these metrics and metric categories irrespective of its particular industry or sector (subject to materiality). The ED proposes seven cross-industry metric categories that all entities would be required to disclose: greenhouse gas (GHG) emissions on an absolute basis and on an intensity basis; transition risks; physical risks; climate-related opportunities; capital deployment towards climate-related risks and opportunities; internal carbon prices; and the percentage of executive management remuneration that is linked to climate-related considerations. The GHG Protocol be applied to measure GHG emissions.

Further, an entity be required to disclose information about its emission-reduction targets, including the objective of the target (for example, mitigation, adaptation or conformance with sector or science-based initiatives), as well as information about how the entity's targets compare with those prescribed in the latest international agreement on climate change.

Industry based disclosures

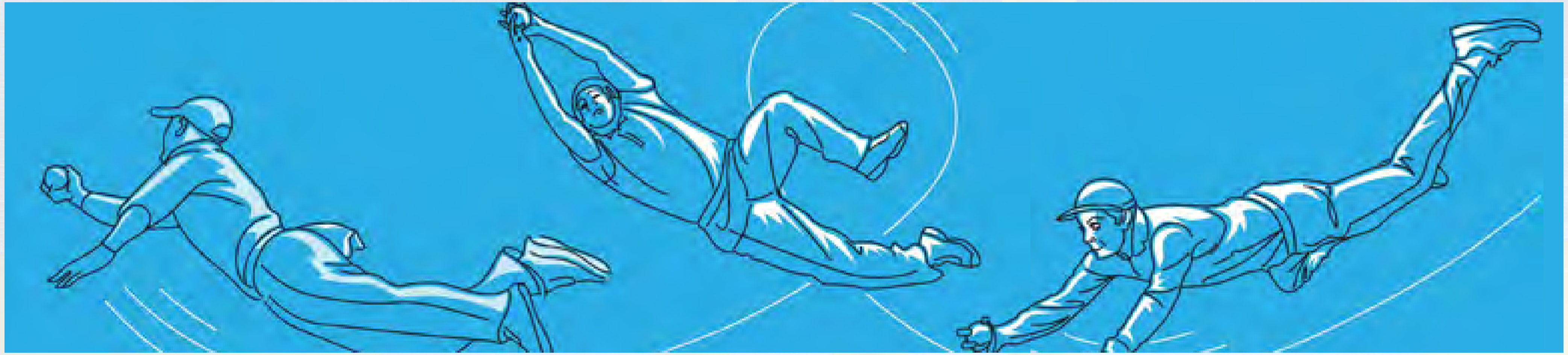
The ED proposes industry-based disclosure requirements in Appendix B that address significant sustainability-related risks and opportunities related to climate change. These requirements have been derived from the SASB Standards.

Next steps

The IFRS Sustainability Disclosure Standards will provide a global baseline of requirements – a building blocks approach. Having a global baseline of ISSB standards will enhance global comparability. Although the proposals do not specify an effective date, the ISSB has stated that it aims to issue the final standards before the end of 2022. Early application could be useful for entities already providing disclosures about sustainability-related risks and opportunities.

For many entities, these requirements may be new. Therefore, entities should act now and understand their sustainability-related risks and opportunities, establish a board-led governance structure that brings both financial and sustainability report to the boardroom table for making informed commitments and reporting on sustainability matters, create or adjust their internal systems and controls to meet the requirements of the sustainability standards.

As sustainability reporting evolves, independent assurance by auditors on non-financial information is also evolving. The IAASB[2], SEC[3] and other regulators are making significant steps in supporting this area and further developments are expected in this area.



2. IAASB – International Auditing and Assurance Standards Board
3. SEC – U.S. Securities and Exchange Commission