Issue 5 /June 2023

IFRS Sustainability Developments

ISSB issues inaugural IFRS Sustainability Disclosure Standards

What you need to know

- On 26 June 2023, the ISSB issued two inaugural IFRS Sustainability Disclosure Standards, which are effective for annual reporting periods beginning on or after 1 January 2024: IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*.
- Mandatory application depends on each jurisdiction's endorsement or regulatory processes.
- IFRS S1 and IFRS S2 target the information needs of existing and potential investors, lenders and other creditors, who are the primary users of an entity's sustainability-related financial disclosures.

Introduction

On 26 June 2023, the International Sustainability Standards Board (the ISSB or the Board) issued its first two IFRS Sustainability Disclosure Standards, ushering in a new era in international corporate reporting:

- IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1) sets out the core content requirements for a complete set of sustainability-related financial disclosures and requires an entity to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects. The effect on the entity's prospects refers to the effect on the entity's cash flows, its access to finance or cost of capital over the short, medium or long term
- IFRS S2 *Climate-related Disclosures* (IFRS S2), which is the ISSB's first topic-based Standard, requires an entity to provide information about its exposure to climate-related risks and opportunities

The ISSB was established by the IFRS Foundation in November 2021 in response to demands from global capital markets for the development of standards to provide a comprehensive global baseline of sustainability disclosures.

Both IFRS S1 and IFRS S2 are effective for annual reporting periods beginning on or after 1 January 2024. A 'climate first' transition option is available, which allows an entity to provide only climate-related disclosures in its first year of applying IFRS S1 and IFRS S2.

Mandatory application of IFRS Sustainability Disclosure Standards depends on each jurisdiction's endorsement or regulatory processes. The application of IFRS Sustainability Disclosure Standards is not linked to the application of IFRS Accounting Standards. Therefore, an entity applying IFRS Accounting Standards for financial reporting purposes is currently not required to also apply IFRS Sustainability Disclosure Standards, and vice versa.

General requirements for sustainability-related disclosures

IFRS S1 sets out general requirements for the content and presentation of an entity's sustainability-related financial disclosures. These are disclosures that provide information about all sustainability-related risks and opportunities that could reasonably be expected to affect an entity's cash flows, access to finance or cost of capital over the short, medium or long term (i.e., to affect an entity's prospects). In order to provide a complete set of sustainability-related financial disclosures, an entity must present fairly those sustainability-related risks and opportunities by providing a complete, neutral and accurate depiction of them.

Identifying sustainability-related risks and opportunities

An entity's ability to generate cash flows over the short, medium and long term is inextricably linked to interactions between an entity and its stakeholders, society, the economy and the natural environment throughout an entity's value chain. As a result, an entity and the resources and relationships throughout its value chain form an interdependent system in which an entity operates. Accordingly, sustainability-related risks and opportunities arise from an entity's dependencies on those resources and relationships, as well as an entity's impacts on those resources and relationships. Resources and relationships may include: those in the entity's operations, such as human resources; those along its supply, marketing and distribution channels; and the financing, geographical, geopolitical and regulatory environments in which the entity operates. The sustainability-related financial information that is relevant to an entity would depend on many factors, such as the entity's activities or the industry to which it belongs, the locations in which it operates, its products and manufacturing processes and the nature of its reliance on employees and supply chains.

As such, sustainability-related risks and opportunities may arise from, for example, climate change, water use, land use, workplace health and safety, labour conditions in the value chain, and data security. Climate-related risks and opportunities are within the scope of IFRS S2, which is the ISSB's first topic-based standard. The ISSB is currently consulting on which other topics should be included on its standard-setting agenda.

In identifying sustainability-related risks and opportunities that could reasonably be expected to affect its prospects, an entity:

- Must refer to any applicable IFRS Sustainability Disclosure Standard (currently only IFRS S2)
- Must consider the applicability of the disclosure topics in the industry-based Sustainability Accounting Standards Board (SASB) Standards, noting that an entity might conclude that those disclosure topics do not apply to its circumstances
- May consider: the Climate Disclosure Standards Board (CDSB) Framework Application Guidance for water-related disclosures and biodiversity-related disclosures; the most recent pronouncements of other standard-setting bodies whose requirements are designed to meet the information needs of users of general purpose financial reports; and the sustainability-related risks and opportunities identified by entities that operate in the same industry(s) or geographical region(s)

An entity must reassess the scope of the sustainability-related risks and opportunities throughout its value chain if a significant event or a significant change in circumstances occurs (e.g., this may arise from a supplier making a change that significantly alters its greenhouse gas emissions; an entity buys a business and thereby expands its value chain; or a significant change in an entity's exposure to sustainability-related risks or opportunities).

Sustainability-related risks and opportunities that could not reasonably be expected to affect an entity's prospects over the short, medium or long term are outside the scope of IFRS Sustainability Disclosure Standards.

Materiality

IFRS S1 requires an entity to disclose material information about the sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects. The definition of 'material information' is consistent with the definition of 'material' that applies for IFRS Accounting Standards.

Extract from IFRS S1

Information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity.

A consequence of the ISSB setting the scope of its Standards based on what is material to the investor is that some information that is considered material under other disclosure frameworks, that are designed to meet broader multi-stakeholder needs, might not be material under IFRS Sustainability Disclosure Standards.

Types of information to be disclosed

IFRS S1 sets the general requirements for the types of information about sustainability-related risks and opportunities that an entity must disclose. Those requirements are derived from the four pillars of the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations, as summarised in the graphic below.

Governance

Information about the governance processes, controls and procedures a reporting entity uses to monitor and manage sustainability-related risks and opportunities.

Strategy

Information about an entity's strategy for managing sustainability-related risks and opportunities.

Risk management

Information about how sustainability-related risks and opportunities are identified, assessed, and managed and whether and how those processes are integrated into its overall risk management framework.

Metrics and targets

Information about how an entity measures, monitors and manages sustainability-related risks and opportunities and assesses its performance, including progress towards the targets it has set.

To the extent that there is a specific topic-based standard (which currently only exists for climate-related risks and opportunities (IFRS S2)), an entity must also apply the specific disclosure requirements of that standard. Consequently, until such time as the ISSB issues further standards on sustainability matters other than climate, an entity's disclosure of sustainability-related risks and opportunities will be subject to the general disclosure requirements in IFRS S1 (i.e., by applying a hierachy of pronouncements similar to that which IFRS S1 applies to the identification of sustainability-related risks and opportunities).

A 'proportionality' principle has been incorporated into IFRS Sustainability Disclosure Standards with IFRS S1 and IFRS S2 both specifying that, in preparing certain sustainability-related financial disclosures, an entity should:

- Use reasonable and supportable information that is available without undue cost or effort; and
- Consider whether it has the skills, capabilities and resources to provide particular disclosures (e.g., quantitative information about anticipated financial effects of a sustainability-related risk or opportunity)

The table below summarises the main types of information that IFRS S1 requires an entity to disclose:

Governance

- The governance body (e.g., a board or committee charged with governance) or individual responsible for oversight of sustainability-related risks and opportunities
- Management's role in those processes

Strategy

- The sustainability-related risks and opportunities that could reasonably be expected to affect an entity's prospects
- The current and anticipated effects of those sustainability-related risks and opportunities on an entity's business model and value chain
- The effects of those sustainability-related risks and opportunities on an entity's strategy and decision-making
- The current and anticipated financial effects of those sustainability-related risks and opportunities
- The resilience of an entity's strategy and business model to those sustainability-related risks

Risk management

- The processes that an entity uses to identify, assess, prioritise and monitor sustainability-related risks for risk management purposes
- The extent to which and how those processes are integrated into an entity's overall risk management process

Similar disclosures are required for the management of sustainability-related opportunities.

Metrics and targets

- Metrics required by an applicable IFRS Sustainability Disclosure Standard
- Metrics developed by an entity itself and used to measure and monitor its sustainability-related risks and opportunities and performance in relation to those risks and opportunities, including progress towards any targets an entity has set, or is required to meet by regulation or legislation

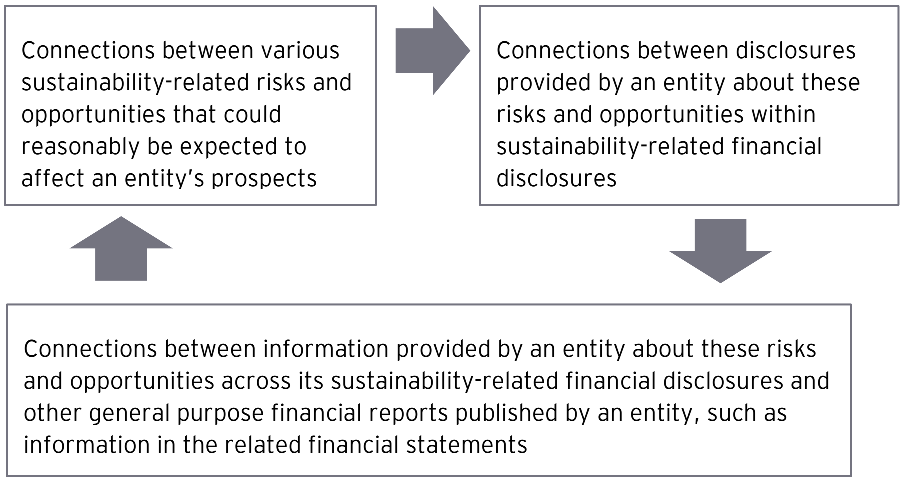
The metrics disclosed must include metrics that are associated with specific business models, activities and other common features that characterise participation in an industry.

General features

Sustainability-related financial disclosures must be:

- Prepared and reported for the same reporting entity as the related general purpose financial statements, which may be prepared in accordance with IFRS Accounting Standards or other generally accepted accounting principles or practices
- Reported at the same time and cover the same reporting period as the entity's related financial statements. Comparative information for the previous period must also be disclosed

Together, an entity's general purpose financial statements and its sustainability-related financial disclosures form part of the entity's general purpose financial reporting. The primary users of general purpose financial reports (being existing and potential investors, lenders and creditors) use this information to make decisions about providing resources to an entity. For this reason, IFRS S1 also requires an entity to draw connections between the following items of information to enable users to understand the connections between them:

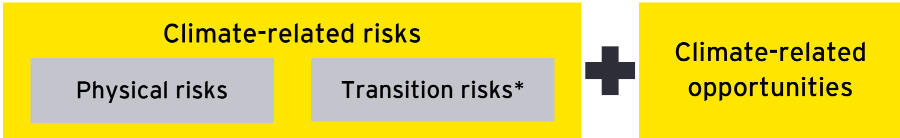


Other general requirements from IFRS S1 include:

Matter	IFRS S1 requirement
Statement of compliance	An explicit and unreserved statement of compliance is made if an entity's sustainability-related financial disclosures comply with all the requirements of IFRS Sustainability Disclosure Standards.
Cross references	Information required to be disclosed by IFRS Sustainability Disclosure Standards can be included in an entity's sustainability-related financial disclosures by cross-reference, provided that the cross-referenced information is available on the same terms and at the same time as those disclosures and the complete set of sustainability-related financial disclosures is not made less understandable by including information by cross-reference.
Location of information	Information required to be disclosed by IFRS Sustainability Disclosure Standards also can be disclosed in the same location as information disclosed to meet other requirements (e.g., other regulatory or voluntary disclosures), provided that the sustainability-related financial disclosures are clearly identifiable and not obscured by that additional information.
Judgements and uncertainties	An entity must disclose information about both: ▶ The various judgements made that have the most significant effect on the information included in its sustainability-related financial disclosures; and ▶ The most significant uncertainties affecting the amounts reported in those disclosures.
Prior period errors	Material prior period errors must be corrected by restating the comparative amounts for the prior period(s) disclosed unless it is impracticable to do so.
Consistent data and assumptions	To the extent possible, considering the requirements of the relevant accounting standards, the data and assumptions used in preparing the sustainability-related financial disclosures must be consistent with the corresponding data and assumptions used in preparing the entity's financial statements.
Sensitive information	Disclosure of information about sustainability-related opportunities that is either prohibited by local laws or regulations or is commercially sensitive (provided that specific criteria in IFRS S1 are met and the information relates to an opportunity) may not need to be disclosed, but the entity will need to disclose the nature of the restriction that prevented the disclosure.

Climate-related disclosures

- IFRS S2 requires an entity to provide information about its exposure to climate-related risks and opportunities, as illustrated below:



* *Defined as risks that arise from efforts to transition to a lower-carbon economy.*

Identifying climate-related risks and opportunities

In identifying climate-related risks and opportunities, IFRS S2 requires an entity to refer to and consider the applicability of the industry-based disclosure topics defined in the *Industry-based Guidance on Implementing IFRS S2*.

Types of information to be disclosed

Similar to the general requirements in IFRS S1, IFRS S2 specifies that, for climate-related risks and opportunities, an entity is required to disclose information about:

- The governance, strategy and risk management of its business
- The metrics and targets it uses to measure, monitor and manage its climate-related risks and opportunities

Some of the disclosure requirements in IFRS S2 in relation to the governance and risk management of climate-related risks and opportunities are similar to the disclosure requirements in IFRS S1 for sustainability-related risks and opportunities more generally. Those disclosure requirements are not repeated below. However, some of the specific or incremental disclosure requirements in IFRS S2 for climate-related risks and opportunities are presented below:

Strategy

Examples of some of the specific climate-related financial disclosures on strategy required by IFRS S2 include:

- An explanation of whether the climate-related risks that an entity has identified are physical risks or transition risks
- How an entity plans to achieve any climate-related targets that it has set
- Information about current and anticipated changes to an entity's business model, including changes to its strategy and resource allocation to address the climate-related risks and opportunities that it has identified, and its current and anticipated direct and indirect mitigation and adaptation efforts
- Information about plans that an entity may have to transition to a lower-carbon economy
- An entity's assessment of its climate resilience (see section on Climate resilience below)

Climate resilience

An entity must use climate-related scenario analysis to assess its climate resilience. IFRS S2 provides guidance on how to conduct the analysis, along with other considerations that are outlined below:

Approach

Use an approach to climate-related scenario analysis that is commensurate with an entity's circumstances.

Exposure

Consider the degree of an entity's exposure to climate-related risks and opportunities.

Reasonable and supportable information

Consider all reasonable and supportable information that is available at the reporting date without undue cost or effort.

Other considerations

Consider the skills, resources and capabilities available to an entity when determining its approach to scenario analysis.

An entity may also consider publicly available, off-the-shelf scenarios from authoritative sources that are most relevant to its circumstances and most likely to support disclosure.

Metrics and targets

There are three main categories of metrics and targets:

1. Cross-industry metric categories, which relate to: (1) Greenhouse gas emissions; (2) transition risks; (3) physical risks; (4) climate-related opportunities; (5) capital deployment; (6) internal carbon prices; and (7) remuneration
2. Industry-based metrics
3. Climate-related targets

Examples of some of the specific disclosures required by IFRS S2 as part of the cross-industry metric categories listed above include:

- An entity's greenhouse gas (GHG) emissions (see further explanation below)
- The amount and percentage of assets or business activities that are:
  - vulnerable to climate-related transition risks
  - vulnerable to climate-related physical risks
  - aligned with climate-related opportunities
- The amount of capital expenditure, financing or investment deployed towards climate-related risks and opportunities

- The price for each metric tonne of GHG emissions that an entity uses to assess the costs of its GHG emissions (i.e., its internal carbon price) and how an entity is applying a carbon price in its decision making

- The percentage of executive management remuneration recognised in the current period that is linked to climate-related considerations and how those considerations are factored into executive remuneration

Comprehensive disclosures are also required for an entity's climate-related targets, including the targets that an entity has set, the targets that an entity is required to meet by law or regulation and any GHG emissions targets.

Greenhouse gas (GHG) emissions

IFRS S2 requires an entity to make various disclosures about its GHG emissions generated during the reporting period, as set out in the diagram below:

An entity must disclose its absolute gross Scope 1, Scope 2 and Scope 3 GHG emissions

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Scope 1	Scope 2	Scope 3
For Scope 1 and Scope 2 GHG emissions, a **consolidated group** must disclose emissions by **associates and joint ventures separately** from those by the consolidated accounting group	For Scope 1 and Scope 2 GHG emissions, a **consolidated group** must disclose emissions by **associates and joint ventures separately** from those by the consolidated accounting group	An entity must disclose the categories included within its measurement of Scope 3 GHG emissions, such that users can understand which emissions have been included in, or excluded from, the reported Scope 3 GHG emissions
	An entity must disclose its **location-based** Scope 2 GHG emissions and provide information about any contractual instruments relating to the source of those emissions	

The GHG emissions disclosures must be expressed in metric tonnes of CO_2 equivalent and measured in accordance with the *Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004)* unless a jurisdictional authority or an exchange on which an entity is listed requires the use of a different method for measuring GHG emissions.

As part of its GHG disclosures, IFRS S2 also requires an entity to disclose:

- The approach used to measure its GHG emissions (e.g., the equity share or control approach must be used if GHG emissions are measured in accordance with the Greenhouse Gas Protocol 2004) and the inputs and assumptions used in that measurement (including the emissions factors used)

- Its 'financed emissions' if it is an entity that has activities in asset management, commercial banking or insurance

Effective dates

IFRS S1 and IFRS S2 are effective for annual reporting periods beginning on or after 1 January 2024. Mandatory application of IFRS Sustainability Disclosure Standards will however depend on each jurisdiction's endorsement or regulatory processes. Earlier application of the Standards is permitted provided an entity applies both Standards at the same time and an entity discloses that it has applied the Standard early.

Transition relief for IFRS S1

The ISSB has provided the following transition reliefs when an entity first applies IFRS S1:

- An entity is not required to disclose comparative sustainability-related financial information in the first annual reporting period in which the entity applies IFRS S1 and IFRS S2
- The 'climate first' transition relief allows an entity to report on only climate-related risks and opportunities (as set out in IFRS S2) in the first year it applies IFRS S1 and IFRS S2. If the entity elects this relief, it must disclose that fact and the transition relief for comparatives described above will apply here too, such that an entity would not be required to disclose comparative information for climate-related (or other sustainability-related financial information) in the first year it applies IFRS S1 and IFRS S2. In its second year of application, comparative information would be required only for climate-related financial information
- In the first annual reporting period in which an entity applies IFRS S1, it is permitted to report its sustainability-related financial disclosures after it has published its related general purpose financial statements (with IFRS S1 specifying the time frames when those disclosures must be published)

Transition relief for IFRS S2

In the first annual reporting period in which an entity applies IFRS S2, an entity is permitted to use one or both of the following transition reliefs:

- Continue to use a measurement method other than the GHG Protocol 2004 to measure its Scope 1, Scope 2 and Scope 3 GHG emissions if an entity has been using that other measurement method to measure its GHG emissions in the annual reporting period immediately preceding the date of initial application of IFRS S2
- Not disclose its Scope 3 GHG emissions, including financed emissions (if an entity participates in asset management, commercial banking or insurance activities)

Supporting implementation

The ISSB will form a Transition Implementation Group (TIG) to support the implementation of IFRS S1 and IFRS S2. The TIG will:

- Provide a public forum for the discussion of implementation questions submitted by stakeholders on the requirements in IFRS S1 and IFRS S2
- Inform the ISSB to determine what, if any, action will be needed to address those questions. Possible actions include providing supporting materials such as webinars, case studies and/or referral to the ISSB

The TIG is expected to comprise 15 members and three observers. Membership of the TIG will include members from the preparer community who are engaged in sustainability reporting as well as assurance providers who are also engaged in the implementation of IFRS S1 and IFRS S2.

How we see it

EY congratulates the ISSB on issuing its first two IFRS Sustainability Disclosure Standards. By issuing IFRS S1 and IFRS S2, and with consultations on its future standard setting agenda underway, the ISSB has taken significant steps towards meeting the needs of global capital markets for a comprehensive global baseline of sustainability disclosure requirements.

With globally applicable IFRS Sustainability Disclosure Standards available for application, it is now time for entities to prepare for the implementation of these Standards and the disclosure of the sustainability-related financial information that investors and other capital market participants have been calling for.

As many entities discovered when implementing new IFRS Accounting Standards in recent years, the successful implementation of new Standards often requires early and full engagement from internal stakeholders to develop or upgrade their data, systems and process capabilities in order to comply with the new requirements. Regular communication with external stakeholders is also key and will assist entities to better understand and assess the new information that will be reported.

Implementation of new requirements may bring short-term challenges, but it can also deliver long-term benefits for the entity and the users of its financial reports, such as a better understanding of an entity's rights and obligations and its risks and opportunities. Similarly, although we expect that the implementation of IFRS Sustainability Disclosure Standards will be a significant undertaking for many entities, entities should consider the benefits that the capital markets will obtain from sustainability-related financial information that is disclosed in accordance with a global baseline and, which accordingly, should lower their costs of capital.

EYG No. 006361-23Gbl

ED None