Understanding the new ISSB Standards

July 2023

The International Sustainability Standards Board (ISSB), which was established in November 2021 at the UN Climate Change Conference (COP26), has launched its inaugural Standards on the 26th of June 2023. The new IFRS S1 and IFRS S2 Standards marks a significant step towards achieving a global baseline of sustainability reporting that looks to improve trust and confidence in company disclosures about sustainability in capital markets to inform investment decisions.

Why new standards?

Several ESG/sustainability standards, benchmarks, frameworks, and principles already exist which companies have adopted globally, mostly on a voluntary basis. However, over the years, it became clear that there was a lack of cohesion and consistency in how sustainability information is reported, what sustainability information and data is required, and the language being used, making accurate comparisons nearly impossible for the global market. Therefore, in response to calls from the G20, the Financial Stability Board and the International Organization of Securities Commissions (IOSCO), as well as leaders in the business and investor community, the ISSB was created by the International Financial Reporting Standards (IFRS) Foundation.

Historically, the IFRS is known for establishing globally accepted accounting standards through the International Accounting Standards Board (IASB). However, the link between IASB and the ISSB standards is not a coincidence as they are intrinsically linked. Adequate systems and strategies are required to ensure that organisations can manage sustainability risk and/or catalyse on opportunities that may impact the financial health of the company. Therefore, the ISSB Standards are designed to ensure that companies provide sustainability-related information alongside financial statements and in the same reporting package which have been built on the concepts that underpin the IFRS Accounting Standards.

What do the IFRS S1 and IFRS S2 standards cover?

The ISSB released two sustainability standards in July 2023. Both Standards require an entity to disclose all material sustainability-related and climate-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, access to financing, or cost of capital over the short, medium, or long term.

Sustainability-related information is considered *material* if omitting, misstating, or obscuring it could be reasonably expected to influence decisions that primary users make on the basis of that reporting, which is aligned with the IASB's definition in the accounting standards. However, the Standards provide an exemption to the materiality ruling where information can only be omitted under certain conditions if it is commercially sensitive information.

It is important to note that an entity is required to provide disclosures required by IFRS Sustainability Disclosure Standards as part of its general purpose financial reports, at the same time and cover the same reporting period as the related financial statements.

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

IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors the sustainability-related risks and opportunities they face over the short, medium, and long term.

Specifically, IFRS S1 states that an entity shall provide disclosures about:

- **Governance:** the governance processes, controls and procedures the entity uses to monitor and manage sustainability-related risks and opportunities;
- **Strategy:** the approach the entity uses to manage sustainability-related risks and opportunities;
- **Risk management:** the processes the entity uses to identify, assess, prioritise, and monitor sustainability-related risks and opportunities; and
- **Metrics and targets:** the entity's performance in relation to sustainability-related risks and opportunities, including progress towards any targets the entity has set or is required to meet by law or regulation.

IFRS S1 also states that an entity shall refer to and consider the applicability of the disclosure topics in the Sustainability Accounting Standards Board (SASB) Standards which provides industry-based disclosures on sustainability-related issues most relevant to investor decision-making in 77 industries, unless it is concluded that these are not applicable to the reporting entity.

Additionally, IFRS S1 states that an entity may refer to and consider the applicability of the Climate Disclosure Standards Board (CDSB) Framework Application Guidance (specifically for water-related disclosures and biodiversity-related disclosures), other sustainability-related standards, requirements set out by regulatory bodies or industry practice. Essentially, this clause provides flexibility to provide sustainability-related information in addition to the core content requirements that simply makes sense for the reporting entity to ensure it meet its various stakeholder expectations.

IFRS S2 Climate-related Disclosures

IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1.

This Standard applies to climate-related risks to which the entity is exposed, including climate-related physical risks and transition risks, and climate-related opportunities. Climate-related risks and opportunities that could not reasonably be expected to affect an entity's prospects are outside the scope of the IFRS S2 Standard.

Specifically, IFRS S2 states that an entity shall provide disclosures about:

- **Governance:** the governance processes, controls and procedures an entity uses to monitor, manage and oversee climate-related risks and opportunities;
- **Strategy:** an entity's strategy for managing climate-related risks and opportunities;
- **Risk management:** an entity's processes to identify, assess, prioritise and monitor climate-related risks and opportunities, including whether and how those processes are integrated into and inform the entity's overall risk management process; and
- **Metrics and targets:** an entity's performance in relation to its climate-related risks and opportunities, including progress towards any climate-related targets it has set, and any targets it is required to meet by law or regulation.

It's noticeable that the specific requirements for IFRS S1 look almost identical to those of IFRS S2. The reason for this is that the IFRS S2 Standard is a thematic standard that builds on IFRS S1 and follows a similar structure and approach, except it focuses on climate-related disclosures instead of the broader sustainability-related disclosures.

The above core requirements set out in IFRS S2 is aligned with the recommendations of the TCFD. It is important to note that companies applying ISSB standards will be fully compliant with the TCFD recommendations.

Similar to IFRS S1, under IFRS S2, entities are required to consider the applicability of the industry based (SASB) guidance but are not required to apply the particular metrics included in the guidance. IFRS S2 also requires specific metric category disclosures, including Scope 1, Scope 2, and Scope 3 greenhouse gas (GHG) emissions generated during the reporting period and should be calculated and reported in accordance with the Greenhouse Gas Protocol. While there is a grace year for disclosing Scope 3 GHG emissions in the first year of reporting, it will be critical for companies to better understand its value chain and Scope 3 emissions footprint as soon as possible.

When do the Standards apply?

The effective date for the application of IFRS S1 and IFRS S2 is for annual reporting periods on or after the 1st of January 2024. However, early adoption is permitted and in fact encouraged by the ISSB to provide adequate time and resources to improve sustainability-related disclosure.

Why should the ISSB Standards be adopted?

As mentioned above, the ISSB Standards are not the only ESG/sustainability standards out there. However, the main objective of the ISSB in its creation is to create a global baseline with a common language for disclosing sustainability-related information. The IFRS has now taken over the oversight and monitoring responsibilities of leading sustainability standards, including SASB (previously held by the Value Reporting Foundation [VRF]) and the TCFD (previously held by the Financial Stability Board [FSB]), as well as aligning with other standards, such as the Corporate Sustainability Reporting Directive's (CSRD), which provides further evidence of streamlining sustainability reporting through a single standard. The CDP (formerly the Carbon Disclosure Project) has also stated that it would incorporate IFRS S2 into its framework.

In addition to aligning with a comprehensive, global standard, several jurisdictions have expressed significant interest in adopting or aligning with the ISSB Standards, including Australia, Canada, Japan, Hong Kong, Malaysia, New Zealand, Nigeria, Singapore, EU, and the UK. Therefore, while currently voluntary, the ISSB Standards is likely to be made mandatory for many companies within the next few years, especially given regulatory sustainability-related disclosures already exist or are in the process of being implemented globally.

What next for the ISSB?

In a major step towards consistent, comparable and reliable sustainability information, IOSCO recently announced that it has decided to endorse the sustainability-related financial disclosures standards, recently issued by the ISSB, IFRS S1 and IFRS S2. IOSCO has now called on its 130 member jurisdictions, regulating more than 95% of the world's financial markets, to consider ways in which they might adopt, apply or otherwise be informed by the ISSB Standards within the context of their jurisdictional arrangements. To facilitate this process, the IFRS Foundation will publish its Adoption Guide to support jurisdictions in their adoption of IFRS S1 and IFRS S2.

Based on research into the information needs of investors, the ISSB has identified four potential projects, of which three are sustainability-related research projects, including (1) biodiversity, ecosystems and ecosystem services; (2) human capital; (3) human rights; and (4) a project researching integration in reporting.

How can ITPEnergised help?

At ITPEnergised our trusted advisors in the ESG and Carbon Services teams work closely to support clients as they navigate their way through ESG reporting and aligning with ESG/sustainability standards. Please contact us at info@itpenergised.com if you would like to understand more on ISSB Standards and how they may integrate or influence your ESG commitments and disclosures, or if you wish to discuss your ESG journey.