Need to know

ISSB proposes global baseline of sustainability disclosure standards for capital markets

Contents

This *Need to know* outlines the proposals for IFRS Sustainability Disclosure Standards IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures* published for public consultation on 31 March 2022 by the International Sustainability Standards Board.

- The International Sustainability Standards Board (ISSB), established at COP26 to develop a comprehensive global baseline of sustainability disclosures for the capital markets, has launched a consultation on its first two proposed standards:

  – IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*
  – IFRS S2 *Climate-related Disclosures*

- The proposed IFRS S1 sets out overall requirements with the objective of disclosing sustainability-related financial information that is useful to the primary users of the entity's general purpose financial reporting when they assess the entity's enterprise value and decide whether to provide resources to it.
- The proposed IFRS S2 sets out the requirements for identifying, measuring and disclosing climate-related risks and opportunities
- The EDs are based on the prototypes developed by the Technical Readiness Working Group (TRWG), which built on the recommendations of the Financial Stability Board's (FSB) Task Force on Climate-Related Financial Disclosures (TCFD)
- The design of the proposed standards is intended to allow for supplementation and interoperability with jurisdictional requirements
- Both standards would be applied prospectively, with no requirement for comparative information in the period of initial application. The EDs do not propose an effective date
- The comment period for both EDs ends on 29 July 2022
- The UK government has confirmed it intends to incorporate ISSB standards into the UK corporate reporting framework

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

What does this mean for UK companies?

In October 2021, the UK government published a policy paper, ***Greening Finance: A Roadmap to Sustainable Investing*** ("the roadmap"), setting out how it intends to 'green' the financial system and align it with the UK's commitment to reach net zero greenhouse gas (GHG) emissions by 2050.

The roadmap sets out the current requirement for premium listed companies to report against the TCFD recommendations and further requirements which are set to take effect for standard listed companies, public interest entities, high turnover companies and LLPs, AIM companies, the financial sector, and investment products this year. The FCA has emphasised that while the TCFD recommendations promote transparency and can drive organisational change, they are not a corporate reporting standard and that a common international standard, building on the TCFD recommendations, would be needed to deliver the consistency and comparability of corporate reporting that the market needs.

One part of the government's strategy is to bring together new and existing UK sustainability reporting requirements under a single framework of new economy-wide Sustainability Disclosure Requirements ("the SDR") for companies, asset managers and owners, and investment products. The roadmap states that the government "expects that ISSB standards will form a core component of the SDR framework, and the backbone of its corporate reporting element" and confirms that the government intends to develop a mechanism by which the standards may be endorsed for use in the UK.

Importantly, it also confirms that regulatory changes will ensure that UK reporting under ISSB standards is consistent with existing and forthcoming disclosure requirements so that companies do not have to report the same information twice.

See our ***Need to know*** for more detail on the roadmap and this ***Need to know*** which discusses the recently published UK government legislation on climate-related financial disclosures for certain UK companies and LLPs.

Background

As set out in our ***Purpose-driven Business Reporting in Focus***, the IFRS Foundation (IFRSF) announced the creation of its new International Sustainability Standards Board (ISSB) in November 2021. The ISSB was established to develop a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors' information needs.

At the same time, the IFRSF announced commitments with the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (VRF) (previously the Sustainability Accounting Standards Board (SASB) Foundation and the International Integrated Reporting Council (IIRC)) to consolidate their technical expertise, content, staff and other resources with the ISSB. The consolidation of CDSB has been completed and it is expected that VRF will be finalised by June 2022.

The IFRSF Trustees published a revised constitution, which provides for the ISSB to sit alongside the International Accounting Standards Board (IASB) and follow the same robust due process as the IASB. The intent is that the new ISSB would address the breadth of sustainability topics that are critical to business, although they would prioritise climate initially given its urgency. The ISSB will have two key advisory bodies, which are in the process of being established: the Sustainability Consultative Committee and the Sustainability Standards Advisory Forum.

When the Trustees announced the creation of the ISSB, they published two prototypes that were developed by the Technical Readiness Working Group (TRWG):

- General Requirements for Disclosure of Sustainability-related Financial Information Prototype
- Climate-related Disclosures Prototype

The TRWG was created in March 2021 to give the ISSB a running start. It was designed to integrate and build on the work of relevant organisations focused on meeting investors' information needs, with the purpose of providing technical recommendations for consideration by the ISSB.

Since the initial announcement, the Trustees have appointed a Chair (Emmanuel Faber) and a Vice-Chair (Sue Lloyd) to the ISSB. To balance the need to advance the work of the ISSB on a timely basis while obtaining input from interested parties, the Trustees decided to grant special powers to the Chair and Vice-Chair to enable timely publication of initial exposure drafts (EDs) for stakeholder input.

A quorum of eight ISSB members will be required to deliberate the feedback received on the EDs and to finalise the requirements. To achieve a quorate Board in a timely manner, the IFRSF will prioritise appointing a further six ISSB members in addition to the already appointed Chair and Vice-Chair. Once a quorum is in place, the IFRSF will complete the remaining appointments that will provide the full Board of 14 members. The Trustees expect the ISSB recruitment process to be completed by the third quarter of 2022.

The EDs introduce limited changes to the TRWG prototypes and therefore include the recommendations by the TCFD and components of the frameworks and standards of international sustainability bodies, which had been subject to extensive public consultation and achieved significant market uptake.

The consultation period on the EDs closes on 29 July 2022.

Observation

Later this year, the ISSB will consult on its standard-setting priorities. This consultation will include seeking feedback on the sustainability-related information needs of investors when assessing enterprise value and on further development of industry-based requirements, building on SASB Standards, which address a broad range of sustainability matters.

Jurisdictional efforts towards sustainability reporting requirements

The EDs are published at a time of significant policy and regulatory response. The ISSB's standards are intended to create a global baseline, which can be supplemented (and therefore interoperate) with jurisdictional requirements. The most important jurisdictional developments include the following:

In the EU, the European Commission (EC) published in April 2021 its proposed Corporate Sustainability Reporting Directive (CSRD) that includes a provision for mandatory European Sustainability Reporting Standards (ESRS) to be developed by the European Financial Reporting Advisory Group (EFRAG). The final CSRD is expected mid-2022. EFRAG's Project Task Force on ESRS has published working papers and the newly-established EFRAG Sustainability Reporting Board is expected to release a first set of exposure drafts in April 2022.

In the US, the Securities and Exchange Commission (SEC) issued a proposed rule on 21 March 2022 titled *The Enhancement and Standardization of Climate-related Disclosures for Investors*. The proposed rule is open for public consultation.

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

The IFRS S1 ED is inspired by IAS 1 *Presentation of Financial Statements* and sets out the overall requirements for an entity to disclose sustainability-related financial information about all its significant sustainability-related risks and opportunities, to provide the market with a complete set of sustainability-related financial disclosures. Guidance is provided on the qualitative characteristics of useful sustainability-related financial information.

Objective

The proposed objective of IFRS S1 is to require an entity to disclose information about its significant sustainability-related risks and opportunities that is useful to the primary users of general purpose financial reporting when they assess enterprise value and decide whether to provide resources to the entity.

A reporting entity would disclose material information about all significant sustainability-related risks and opportunities to which it is exposed. The assessment of materiality would be made in the context of the information necessary for users of general purpose financial reporting to assess enterprise value. An entity's general purpose financial reporting would be required to include a complete, neutral and accurate depiction of its sustainability-related financial information.

The ED proposes to define enterprise value as the total value of an entity, which is the sum of the value of the entity's equity (market capitalisation) and the value of the entity's net debt.

Enterprise value reflects expectations of the amount, timing and certainty of future cash flows over the short, medium and long term and the value of those cash flows in the light of the entity's risk profile, and its access to finance and cost of capital.

The ED states that sustainability-related financial information is broader than information reported in the financial statements and could include information about:

- an entity's governance of sustainability-related risks and opportunities, and its strategy for addressing them;
- decisions made by the entity that could result in future inflows and outflows that have not yet met the criteria for recognition in the related financial statements;
- the entity's reputation, performance and prospects as a consequence of the actions it has undertaken, such as its relationships with people, the planet and the economy, and its impacts and dependencies on them; and
- the entity's development of knowledge-based assets.

IFRS S1 would also prescribe the basis for disclosing sustainability-related financial information that:

- is comparable both with the entity's sustainability-related financial information of previous periods and with the sustainability-related financial information from other entities; and
- is connected to the other information in the entity's general purpose financial reporting.

Observation

The proposed definition and explanation of enterprise value recognise that the impacts an entity has on people, the planet and the economy through its direct activities and its value chain affect the entity's performance, prospects and cash flows over time. The intent of the proposal therefore is to capture the breadth of sustainability-related risks and opportunities that could affect enterprise value. In 2020, the 'Group of 5' leading international sustainability standard-setters and frameworks positioned the issues relevant to enterprise value as a subset of an entity's wider impacts in relation to sustainable development. This subset forms the basis of the assessment of materiality for disclosure in mainstream corporate reporting, which is consistent with the approach set out in the ED. The 'Group of 5' further highlighted that some of these effects on enterprise value have already taken place at the reporting date (or are included in the projections of the cash flows that support valuations and estimates of future cash flows), and are therefore already represented as monetary amounts recognised in the financial statements.

Scope

An entity would apply IFRS S1 in preparing and disclosing sustainability-related financial information in accordance with IFRS Sustainability Disclosure Standards. An entity may apply IFRS Sustainability Disclosure Standards whether the entity's related financial statements are prepared in accordance with IFRS Accounting Standards or another accounting framework.

Core content

Unless another IFRS Sustainability Disclosure Standard permits or requires otherwise, an entity would 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 for addressing sustainability-related risks and opportunities that could affect the entity's business model and strategy over the short, medium and long term, including:
  - Identifying sustainability-related risks and opportunities
  - Strategy and decision-making
  - Financial position, financial performance and cash flows
  - Resilience

- Risk management—the processes the entity uses to identify, assess and manage sustainability-related risks

- Metrics and targets—information used to assess, manage and monitor the entity's performance in relation to sustainability-related risks and opportunities over time. Metrics should enable users to understand how the entity assesses its performance, including progress towards the targets it has set. An entity would identify metrics that apply to its activities in line with its business model and in relation to specific sustainability-related risks or opportunities. Some entities have a range of activities and, therefore, may need to apply metrics that are applicable to more than one industry.

The ED sets out objectives for each of these aspects, and disclosure requirements to achieve those objectives.

General features

The ED states that sustainability-related financial information is useful when it is relevant and faithfully represents what it purports to represent. The ED describes these as fundamental qualitative characteristics. Usefulness is enhanced if the information is comparable, verifiable, timely and understandable.

Sustainability-related financial information forms part of general purpose financial reporting and accordingly the qualitative characteristics in the IASB's *Conceptual Framework for Financial Reporting (Conceptual Framework)* also apply to sustainability-related financial information. However, the nature of some of the information required to meet the objectives of the proposed IFRS S1 differs from the information provided in general purpose financial statements. The ED therefore sets out the qualitative characteristics of useful sustainability-related financial information.

Observation

The ISSB's approach is rooted in the key concepts of the IASB *Conceptual Framework*. The consistency of the expected attributes of the reported information with the IASB's approach is intended to facilitate greater connectivity and consistency between the sustainability disclosures and the financial statements.

Reporting entity

The sustainability-related financial disclosures should provide information on the same reporting entity as the related general purpose financial statements. For example, if the reporting entity is a group, the consolidated financial statements are those of a parent and its subsidiaries; consequently, that reporting entity's sustainability-related financial disclosures are meant to enable users of general purpose financial reporting to assess the enterprise value of the parent and its subsidiaries.

An entity would disclose the financial statements to which the sustainability-related financial disclosures relate. When currency is specified as the unit of measure, the entity would use the presentation currency of its financial statements.

To achieve the objective of IFRS S1, an entity would be required to disclose material information about all significant sustainability-related risks and opportunities to which it is exposed. These risks and opportunities relate to activities, interactions and relationships and to the use of resources along its value chain, such as:

- its employment practices and those of its suppliers, wastage related to the packaging of the products it sells, or events that could disrupt its supply chain;

- the assets it controls (such as a production facility that relies on scarce water resources);

- investments it controls, including its net investments in associates and joint ventures (such as financing a greenhouse gas-emitting activity through a joint venture); and

- sources of finance.

The value chain is proposed to be defined as the full range of activities, resources and relationships related to a reporting entity's business model and the external environment in which it operates, including the activities, resources and relationships the entity uses and relies on to create its products or services from conception to delivery, consumption and end-of-life.

Connected information

Under the proposals, an entity would provide information that enables users of general purpose financial reporting to assess the connections between various sustainability-related risks and opportunities, and to assess how information about these risks and opportunities is linked to information in the general purpose financial statements.

The ED proposes that when IFRS Sustainability Disclosure Standards require the disclosure of common items of information, an entity shall avoid unnecessary duplication. For example, when an entity integrates its oversight of sustainability-related risks and opportunities, the disclosures on governance shall also be integrated rather than provided in the form of separate governance disclosures for each significant sustainability-related risk and opportunity.

Observation

It is envisaged that disclosures on sustainability-related risks and opportunities should be integrated as a whole, rather than be presented as disconnected statements, topic by topic, which could undermine the understandability of reporting, and increase the length of reports.

Connectivity between sustainability-related information and financial information is an important consideration and has been repeatedly demanded by investor groups. The ED therefore emphasises that an entity may need to disclose the effects of sustainability-related risks and opportunities on its financial position, financial performance and cash flows over the short, medium and long term. This information may also need to be linked to information in the financial statements and to specific metrics and targets.

Fair presentation

It is proposed that a complete set of sustainability-related financial disclosures should present fairly the sustainability-related risks and opportunities to which an entity is exposed. Fair presentation requires the faithful representation of sustainability-related risks and opportunities in accordance with the principles set out in the proposed Standard.

The ED presumes that applying IFRS Sustainability Disclosure Standards, with additional disclosure when necessary, results in sustainability-related financial disclosures that achieve a fair presentation.

To identify significant sustainability-related risks and opportunities—and their related metrics and targets—an entity would apply IFRS Sustainability Disclosure Standards. An entity would also be required to consider the disclosure topics in the industry-based SASB Standards, the ISSB's non-mandatory guidance (such as the CDSB Framework application guidance for water- and biodiversity-related disclosures) and the most recent pronouncements of other standard-setters whose requirements are designed to meet investors' information needs. An entity would also be required to consider the sustainability-related risks and opportunities identified by companies that operate in the same industries or geographical areas.

An entity would use the same sources set out in the previous paragraph to identify disclosures, including metrics, that are likely to be helpful in assessing how sustainability-related risks and opportunities to which it is exposed could affect its enterprise value, with the additional requirements that the disclosures must:

- be relevant to the decision-making needs of users of general purpose financial reporting;
- faithfully represent the entity's risks and opportunities in relation to the specific sustainability-related risk or opportunity; and
- be neutral.

Observation

The approach proposed in the ED is similar to IAS 8:10, where, in the absence of an IFRS Accounting Standard that specifically applies to a transaction, other event or condition, management should use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. This approach ensures that an entity can provide relevant information on all significant sustainability-related issues, including those not addressed in an IFRS Sustainability Disclosure Standard.

Guidance from other standard-setting bodies that management could use in applying its judgement in identifying disclosures about a significant sustainability-related risk or opportunity includes the TCFD's latest guidance on metrics, targets and transition planning, the VRF's International <IR> Framework and/or the World Economic Forum (WEF) International Business Council's (IBC) Stakeholder Capitalism Metrics. It follows that if no IFRS Sustainability Disclosure Standard exists for a certain topic, an entity may continue to provide disclosures that it may already make in line with another framework, if that framework meets the requirements set out above.

Materiality

Sustainability-related financial 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 reporting make on the basis of that reporting, which provides information about a specific reporting entity.

The ED proposes that sustainability-related financial information is material when it provides insights into factors that could reasonably be expected to influence primary users' assessments of an entity's enterprise value. The information relates to activities, interactions and relationships and to the use of resources along the entity's value chain if that could influence the assessment primary users make of its enterprise value. It can include information about sustainability-related risks and opportunities with low-probability but high-impact outcomes.

Proposed illustrative guidance provides further information on implementing materiality judgements. It illustrates that when assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial reporting, the entity considers the characteristics of those users and its own circumstances.

To meet the common information needs of its primary users, an entity first separately identifies the information needs shared by one of the three types of primary users defined in the proposed Standard—for example, investors (existing and potential)—then repeats the assessment for the two remaining types—namely lenders (existing and potential) and other creditors (existing and potential). The combined information needs identified is the set of common information needs the entity aims to meet.

An entity would only be required to provide disclosure specified in an IFRS Sustainability Disclosure Standard if the entity determines that the information is material. Making materiality judgements involves both qualitative and quantitative considerations. For example, IFRS Practice Statement 2 *Making Materiality Judgements* states that such qualitative considerations may include 'characteristics of an entity's transaction, other events or conditions or of their context, that, if present, make(s) information more likely to influence the decisions of the primary users of the entity's financial statements.' As a result, by its nature, some information required by IFRS Sustainability Disclosure Standards is likely to be material because of the presence of a qualitative factor. For example, it is likely that all entities exposed to significant climate-related risk would assess information about the governance of that risk to be material.

Because materiality judgements are entity-specific, it is expected that an entity's disclosures would provide:

- information specific to the practices and circumstances of the entity, rather than a generic disclosure; and
- material information necessary for an assessment of how the entity contributes to and is affected by sustainability-related risks and opportunities.

Comparative information

An entity would be required to disclose comparative information in respect of the previous period for all metrics disclosed in the current period. When such information is relevant to an understanding of the current period's sustainability-related financial disclosures, the entity would also disclose comparative information for narrative and descriptive sustainability-related financial disclosures.

Frequency of reporting and location of information

An entity would be required to report its sustainability-related financial disclosures **at the same time** as its related financial statements and the sustainability-related financial disclosures would be for the same reporting period as the financial statements.

An entity would also be required to disclose information required by IFRS Sustainability Disclosure Standards **as part of its general purpose financial reporting**.

Subject to any regulation or other requirements that apply to an entity, the ED acknowledges that there are various possible locations in an entity's general purpose financial reporting in which sustainability-related financial information could be disclosed. For example, sustainability-related financial disclosures could be included in an entity's management commentary when management commentary forms part of an entity's general purpose financial reporting.

Management commentary complements an entity's financial statements. It provides insights into the factors that have affected the entity's financial performance and financial position and the factors that could affect the entity's ability to create value and generate cash flows. Management commentary can be known by or incorporated in reports with various names, including management's discussion and analysis, operating and financial review, integrated report and strategic report.

The ED allows information required by an IFRS Sustainability Disclosure Standard to be included by cross-reference, provided that the information is available to users of general purpose financial reporting on the same terms and at the same time as the information to which it is cross-referenced.

Observation

Reporting sustainability-related financial disclosures at the same time as the related financial statements could mean a significant change for entities that currently publish a separate sustainability report at a different time to their financial statements.

Sources of estimation uncertainty

When metrics cannot be measured directly and can only be estimated, measurement uncertainty arises. The ED acknowledges that the use of reasonable estimates is an essential part of preparing sustainability-related metrics and that this does not undermine the usefulness of the information if the estimates are accurately described and explained. Even a high level of measurement uncertainty would not necessarily prevent such an estimate from providing useful information. An entity would identify metrics that have significant estimation uncertainty and disclose the sources and nature of the estimation uncertainties and the factors affecting the uncertainties.

When sustainability-related financial disclosures include financial data and assumptions, the ED proposes that such financial data and assumptions should be consistent with the corresponding financial data and assumptions in the entity's financial statements, to the extent possible.

An entity would also disclose information about the assumptions it makes about the future, and other sources of significant uncertainty, related to the information it discloses about the possible effects of sustainability-related risks or opportunities, when there is significant outcome uncertainty.

Statement of compliance and errors

An entity whose sustainability-related financial disclosures comply with all of the relevant requirements of IFRS Sustainability Disclosure Standards would be required to include an explicit and unqualified statement of compliance.

The ED proposes that an entity would correct material prior period errors by restating the comparative amounts for the prior period(s) disclosed unless it is impracticable to do so.

Key changes from the Prototype

Compared to the General Requirements for Disclosure of Sustainability-related Financial Information Prototype, the following key changes have been made in the ED:

- The definition of enterprise value in the ED is more precise and aspects of the definition are now included in the objective of the proposed Standard, which is generally strengthened in the ED

- The "reporting boundary" is renamed "reporting entity" in the ED and its definition aligned with the IASB definition. It is further clarified that the reporting entity would be required to disclose sustainability related risks and opportunities (including in the value chain) that affect primary users' assessment of enterprise value

- In the ED, more clarity is given to the requirements and guidance on how to identify relevant sustainability-related risks and opportunities in addition to those addressed by IFRS Sustainability Disclosure Standards

- "Connectivity" is changed to "connected information" in the ED, reinforcing the objective for preparers to present clear and understandable decision-useful sustainability-related information and to enhance connectivity with financial information

- "Reporting channel" is changed to "location of information" in the ED to remove ambiguity

Proposed IFRS S2 *Climate-related Disclosures*

The ED on IFRS S2 is the ISSB's proposal for the first thematic IFRS Sustainability Disclosure Standard and is structured around the TCFD four core elements of governance, strategy, risk management, and metrics and targets.

Objective

The proposed objective of IFRS S2 is to require 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 to:

- assess the effects of significant climate-related risks and opportunities on the entity's enterprise value;

- 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

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

Scope

IFRS S2 would apply to:

- climate-related risks the entity is exposed to, including but not restricted to:
  - physical risks from climate change (physical risks); and
  - risks associated with the transition to a lower-carbon economy (transition risks); and
- climate-related opportunities available to the entity.

Governance

The proposed objective of climate-related financial disclosures on governance is to enable 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, an entity would 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 information about management's role in those processes.

Strategy

The proposed objective of climate-related financial disclosures on strategy is to enable users of general purpose financial reporting to understand an entity's strategy for addressing significant climate-related risks and opportunities.

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

- the significant climate-related risks and opportunities that it reasonably expects could affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term;
- the effects of significant climate-related risks and opportunities on its business model and value chain;
- the effects of significant climate-related risks and opportunities on its strategy and decision-making, including its transition plans;
- 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; and
- the climate resilience of its strategy (including its business model) to significant physical risks and significant transition risks. It is proposed that 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 should use an alternative method or technique to assess its climate resilience. Such alternative methods or techniques could include qualitative analysis, single point forecasts, sensitivity analysis and stress tests

Observation

Scenario analysis is becoming increasingly well established as a tool to help entities and investors understand the potential effects of climate change on business models, strategies, financial performance and financial position. Many entities use scenario analysis in risk management for other purposes. However, since the application of climate-related scenario analysis is still being developed by many entities, the proposed requirements are designed to accommodate alternative approaches to resilience assessment. It is, however, recommended that scenario analysis for significant climate-related risks and opportunities should become the preferred option to meet the information needs of users to understand the resilience of an entity's strategy to significant climate-related risks.

Risk management

The proposed objective of climate-related financial disclosures on risk management is to enable users of general purpose financial reporting to understand the process, or processes, by which climate-related risks and opportunities are identified, assessed and managed.

To achieve this objective, an entity would disclose the process, or processes, it uses to:

- identify climate-related risks and opportunities;
- identify climate-related risks for risk management purposes, including when applicable:
  - how it assesses the likelihood and effects associated with such risks (such as the qualitative factors, quantitative thresholds and other criteria used);
  - how it prioritises climate-related risks relative to other types of risks, including its use of risk assessment tools (for example, science-based risk assessment tools);
  - the input parameters it uses (for example, data sources, the scope of operations covered and the detail used in assumptions); and
  - whether it has changed the processes used compared to the prior reporting period;
- identify, assess and prioritise climate-related opportunities; and
- monitor and manage the climate-related risks and opportunities, including related policies.

An entity would also disclose:

- 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 proposed objective of climate-related financial disclosures on metrics and targets is to enable users of general purpose financial reporting to understand how an entity measures, monitors and manages its significant climate-related risks and opportunities. The ED proposes that these disclosures should enable users to understand how the entity assesses its performance, including progress towards the targets it has set.

To achieve this objective, an entity would disclose:

- information relevant to the cross-industry metric categories, which are relevant to entities regardless of industry and business model;

- industry-based metrics (as set out in an appendix to the ED) which are associated with disclosure topics and relevant to entities that participate within an industry, or whose business models and underlying activities share common features with those of the industry;

- other metrics used by the board or management to measure progress towards the targets; and

- targets set by the entity to mitigate or adapt to climate-related risks or maximise climate-related opportunities.

More detail on cross-industry metrics and industry-based metrics is given below.

Cross-industry metrics
IFRS S2 would require disclosure of information relevant to the cross-industry metric categories of:

- Greenhouse gas (GHG) emissions:

  - The entity's absolute gross greenhouse gas emissions generated during the reporting period, measured in accordance with the Greenhouse Gas Protocol Corporate Standard, expressed as metric tonnes of CO_2 equivalent, classified as Scope 1, Scope 2 and Scope 3 emissions

  - For Scope 1 and Scope 2 emissions, the entity would disclose emissions separately for the consolidated accounting group (the parent and its subsidiaries); and associates, joint ventures, unconsolidated subsidiaries or affiliates not included in the consolidated accounting group

- Transition risks—the amount and percentage of assets or business activities vulnerable to transition risks

- Physical risks—the amount and percentage of assets or business activities vulnerable to physical risks

- Climate-related opportunities—the amount and percentage of assets or business activities aligned with climate-related opportunities

- Capital deployment—the amount of capital expenditure, financing or investment deployed towards climate-related risks and opportunities

- Internal carbon prices:

  - The price for each metric tonne of greenhouse gas emissions that the entity uses to assess the costs of its emissions

  - An explanation of how the entity is applying the carbon price in decision-making (for example, investment decisions, transfer pricing and scenario analysis)

- Remuneration:
  - The percentage of executive management remuneration recognised in the current period that is linked to climate-related considerations
  - A description of how climate-related considerations are factored into executive remuneration

Industry-based metrics

The proposed Standard sets out the requirements for identifying, measuring and disclosing information related to an entity's significant climate-related risks and opportunities that are associated with specific business models, economic activities and other common features characterised by participation in an industry. In applying the proposed Standard, an entity that participates in a particular industry would be required to provide the information set out in these requirements.

The industry-based disclosure requirements have been derived from SASB Standards and are set out in an appendix to the ED. They are organised by industry, enabling an entity to identify the requirements that are applicable to its business model and associated activities. The proposed Standard includes 77 industry classifications across 11 sectors. There are 68 industry-based sets of disclosure requirements in separate volumes. The remaining nine industry classifications do not have climate-related disclosure requirements beyond the cross-industry requirements.

For each industry, disclosure topic(s) related to climate-related risks or opportunities are identified. A set of metrics is associated with each disclosure topic. The disclosure topics represent those climate-related risks and opportunities that have been identified as those that are most likely to be significant to entities in that industry, and the associated metrics are those that have been identified as being most likely to result in the disclosure of information that is relevant to an assessment of enterprise value.

Some entities participate in a broad range of activities that are likely to span more than one industry. For entities whose operations are integrated horizontally across industries (such as conglomerates) or vertically through the value chain, more than one set of industry-based requirements may be required to be applied to meet the objective of completeness and address the full range of climate-related disclosure topics reasonably likely to make an impact on an entity's ability to create enterprise value.

The industry-based requirements are organised according to the Sustainable Industry Classification System (SICS). In preparing disclosures in accordance with the industry-based requirements, an entity would identify the industry or industries it has selected. As a starting point, an entity can identify its primary industry classification on the SASB Standards website.

Observation

The proposed requirements are largely unchanged from the equivalent requirements in the SASB Standards. However, the requirements included in the ED include some targeted amendments compared to the existing SASB Standards.

The first set of proposed changes addresses the international applicability of a subset of metrics for which the SASB Standards cited jurisdiction-specific regulations or standards. In this case, the ED proposes amendments to include references to international standards and definitions or, where appropriate, jurisdictional equivalents.

The second set of proposed changes relative to the existing SASB Standards addresses the emerging consensus on the measurement and disclosure of financed or facilitated emissions in the financial sector. To address this, the ED proposes adding disclosure topics and associated metrics in four industries: commercial banks, investment banks, insurance and asset management. The proposed requirements relate to the lending, underwriting and/or investment activities that finance or facilitate emissions. The proposal builds on the GHG Protocol Corporate Value Chain (Scope 3) Standard which includes guidance on calculating indirect emissions resulting from Category 15 (investments).

Key changes from the Prototype

Compared to the Climate-related Disclosures Prototype, the following key changes have been made in the ED:

- For transition plans and carbon offsetting, requirements are added to improve specificity and clarity of information needed to meet the disclosure objective
- Disclosure requirements are added for alternative methods or techniques that may be used by the entity to assess its climate resilience, when it is unable to do scenario analysis
- Requirements on disclosure of GHG emissions are expanded. For example, an entity would disclose Scope 1 and Scope 2 emissions separately for the consolidated accounting group and for associates, joint ventures, unconsolidated subsidiaries or affiliates not included in the consolidated accounting group
- Jurisdiction-specific metrics are internationalised
- Metrics on financed emissions are added

Transition, effective date and comment period

The standards, if finalised, would be applied prospectively. An entity would not be required to provide comparative information in the first period in which an entity applies the proposed standards.

The ED does not propose an effective date. The effective date will be set when the standards are finalised.

The comment period for the EDs ends on 29 July 2022.

Further information

If you have any questions about the contents of this newsletter, please speak to your usual Deloitte contact.

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