OPINION

IFRS S1 and S2: Game changers in global sustainability reporting

The International Sustainability Standards Board (ISSB) published on June 26 its first two global sustainability reporting standards — IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosure.

These standards can be game changers by helping companies identify material sustainability risks and opportunities that will help investors, lenders, and creditors assess the company's resilience against changes and uncertainties driven by sustainability-related issues. Through sustainability reporting, business leaders can future-proof their organizations and solidify their positions in the global market.

IFRS S1

IFRS S1 requires businesses to disclose information about their sustainability-related risks and opportunities to investors, lenders, and other users of general-purpose financial statements. This standard covers information about an organization's governance, strategy, risk management, and the applicable metrics and targets for its identified material sustainability-related risks and opportunities. While the standard is supposed to become effective for annual reporting periods starting on or after Jan. 1, 2024, this will vary based on local legislation.

Given how close this is, higher management may wish to consider the different variables when implementing IFRS S1, such as the breadth of information they will have to share with clients and investors.

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STRENGTHENING GOVERNANCE

Organizations operating in industries or areas vulnerable to climate-related risks may already be disclosing information about their board and management's oversight responsibilities and risk assessment processes. However, it is important to consider that IFRS S1 covers many sustainability topics besides climate change. The standard underscores how boards oversee target setting and progress monitoring, whether sustainability-related risk protocols exist, and if these policies synergize with other internal functions.

Businesses must bolster their governance and streamline processes to capitalize on IFRS S1's potential. Additionally, organizations must install aptly skilled professionals to meet the standard's sustainability-related requirements and realize their strategic vision.

SUSTAINABILITY-RELATED RISKS AND OPPORTUNITIES

Companies are expected to report only material sustainability-related risks and opportunities in the first year of applying IFRS S1. Nevertheless, management may already wish to delineate a comprehensive set of risks and opportunities, as this will help organizations identify crucial metrics and targets. This also means that businesses should sufficiently plan and allocate resources, as the identification phase is imperative for sustainability reporting.

When identifying sustainability-related risks and opportunities, IFRS S1 compels organizations to consider the IFRS Sustainability Disclosure Standards (IFRS S1, IFRS S2) and the industry-based Sustainability Accounting Standards Board (SASB). Companies can also analyze their competitors in the same industry or region to diversify their findings.

Under IFRS S1, companies must share details about how sustainability-related risks and opportunities could affect their business model, cash flows, and strategic plans. This rigorous process demonstrates the relationship between sustainability issues and a company's financial performance, giving investors a clear understanding of how environmental and societal factors could affect organizations.

IFRS S1 uses the same concepts as the IFRS Accounting Standards, making it easier to integrate into future IFRS reporting. However, the scope for IFRS S1 differs from other sustainability reporting frameworks, so companies will have to first identify differences before applying the standard.

HISTORICAL INFORMATION AND SUSTAINABILITY METRICS

In financial reporting, organizations generally utilize historical cost and fair value to measure the effect of events, transactions, and conditions in the financial statements. While accounting standards traditionally provide direct measurement guidance, the IFRS S1 does not. Instead, businesses must consider metrics from the SASB Standards and GRI Standards.

IFRS S2

On the other hand, IFRS S2 requires companies to disclose information specifically about climate-related risks and opportunities. IFRS S1 and IFRS S2 share the same content elements: governance, strategy, risk management, and metrics and targets. Similarly, the ISSB has set IFRS S2's implementation date for annual reporting periods starting on or after Jan. 1, 2024, but, again, the effectivity date will depend on local legislation. Furthermore, the ISSB declared that organizations could utilize the standard earlier, but they must report their early adopter status and apply IFRS S1 at the same time.

COMPREHENSIVE TRANSITION PLANS

IFRS S2 categorizes climate-related risks as either physical or transitional. Physical risks are event-driven and longer-term such as extreme flooding and sea level rise, while transition risks are associated with moving to a lower-carbon economy such as higher operating costs as well as regulatory and reputational risks that will be faced by the company. Integrating transition plans into organizational strategies is becoming more important as the world continues to reduce carbon emissions. In line with this, IFRS S2 incorporates specific disclosure requirements about transition plans to help users understand the relationship between climate-related risks and opportunities and organizational strategy and decision-making.

In addition, companies must declare the percentage of their assets and operations that are vulnerable to transition risks. Transition plans differ from long-term goals because the former is more comprehensive and detailed, such as articulating concrete plans like reducing greenhouse gas emissions. Organizations that already have transition plans must disclose critical assumptions, key activities, and resource plans.

SCENARIO ANALYSES TO ENHANCE RESILIENCE

Investors will have access to more information given the requirements of IFRS S2, which could help them understand how companies adapt to disruptions related to climate change. Specifically, IFRS S2 requires organizations to articulate the durability of their business models to physical and transition risks. Hence, the standard mandates companies to perform climate-related scenario analyses and evaluations. Organizations should use suitable analysis methods based on their capabilities and resources.

Conducting scenario analyses can help companies understand the resilience of their overall strategy to climate-related disruptions and uncertainties. Upper management will consequently gain salient insights to enhance their risk management procedures but should note that this is an iterative process that will require collaboration among the different business functions.

REDUCE GREENHOUSE GAS EMISSIONS

Reducing greenhouse gas (GHG) emissions is crucial to climate change mitigation efforts. As such, IFRS S2 specifically requires organizations to disclose their absolute gross GHG emissions for the reporting period. GHG emissions are usually measured according to the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004). Given the undertaking's complexity, IFRS S2 allows some flexibility with the organization's measurement approach.

If local jurisdictions demand that companies use a different measurement method, IFRS S2 will permit it. During the first annual reporting period, organizations will also be allowed to use another methodology besides the GHG Protocol if they already had an alternative approach for the period immediately preceding the standard's application date.

Organizations must engage their stakeholders to ensure proper systems and controls are in place to support their disclosures.

AVAILABLE RELIEFS

Companies may take advantage of the available transition reliefs that the ISSB has offered to report preparers. This helps them apply the standards during the first year of reporting and facilitates the "climate-first" approach in its disclosures. Included in the set of reliefs is prioritizing and reporting only on climate-related information and publishing the disclosures together with the company's half-year report. Issuers also need not disclose their Scope 3 GHG emissions, adopt the GHG Protocol, and provide comparative information to comply with the ISSB standards in its inaugural year of application.

FULL STORY
Read the full story by scanning the QR code with your smartphone or by typing the link <rebrand.ly/Suits072423>

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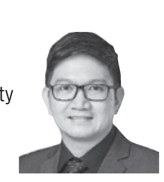

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