CLA Global TS
The Growth Strategist For Asia

Overview of the new IFRS Sustainability Disclosure Standards (IFRS SDS)

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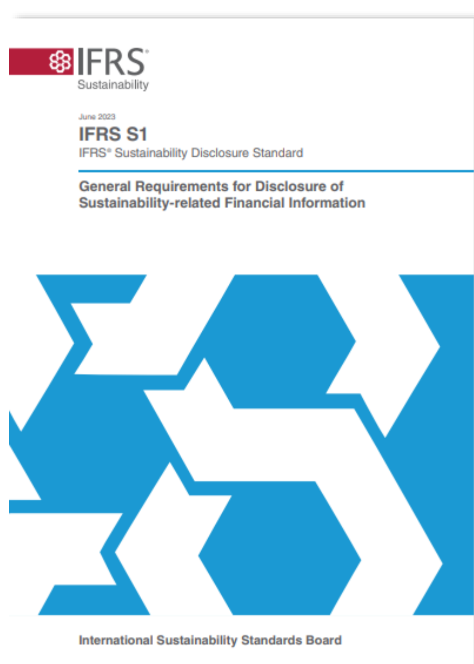
Introduction

The demand and urgency for credible and standardized sustainability data and transparency is surging in the face of the climate crisis, green financing and regulatory movements. In November 2021, as a result of the Conference of the Parties (COP 26) and the UN Climate Change Conference in Glasgow, the IFRS Foundation Trustees announced the creation of the International Sustainability Standards Board (ISSB).

The main purpose of the ISSB was to develop a "comprehensive global baseline of high-quality sustainability disclosure standards to meet investors' information needs" while also consolidating the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (VRF—which oversees the Integrated Reporting Framework and the SASB Standards) under one organization.

The ISSB has responded to the call to action by publishing two standards, known as the IFRS Sustainability Disclosure Standards (IFRS SDS)[1], on the 26 June 2023:



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

- **IFRS S2**: Climate-related Disclosures

[1] IFRS - IFRS Sustainability Standards Navigator

The new Standards provide a common language for disclosing the effect of sustainability and climate-related risks and opportunities on a company's prospects.

As the first effective date of the IFRS SDS are for financial periods beginning on and after 1 January 2024, we can expect to see adoption and implementation of these standards very soon.

It is important to note that adoption of IFRS SDS is not linked to the adoption of IFRS Accounting Standards by any entity for its financial reporting needs.

An entity may apply IFRS SDS irrespective of whether the entity's related general purpose financial statements are prepared in accordance with IFRS Accounting Standards or other generally accepted accounting principles or practices (GAAP).

Introduction to IFRS S1

IFRS S1 lays the foundation for any organization reporting their sustainability data in line with the IFRS SDS. In particular, the sustainability information disclosed is to be included in and published together with the general purpose financial statements. The intended audience are the primary users of general purpose financial statements, which indicates that sustainability data reported is intended to add value and context to the financial performance of a company. The basic reporting principles for all reporters are:

- **Fair presentation**, or disclosing all relevant information which may reasonably affect the entity's prospects and representing this information in line with the principles of the IFRS SDS. Companies must also ensure the data is comparable, verifiable, timely and understandable;
- **Materiality**, where material information shall be disclosed. As a rule of thumb, any information which could be expected to influence the decisions of the users of the general purpose financial statements, will be deemed material;
- **Reporting entity**, where the related financial statements and the sustainability report shall cover the same reporting entity; and
- **Connected information**, to link items such as risks and opportunities and also highlight the connections between the sustainability data, strategic direction, and financial performance of the organization.

S1 also illustrates the pillars under which sustainability information should be categorized, namely into the Governance, Strategy, Risk Management and Metrics and Targets pillars. For reporters familiar with the Taskforce for Climate-related Financial Disclosures (TCFD), this mirrors the framework laid out for climate reporting under the TCFD. In short, reporters would be employing a structured top-down approach to firstly ensure that the Board of Directors and management are suitably tasked with sustainability governance and that the organization performs an impact assessment and revising business strategy, before leading on to measuring performance and setting targets for the entity.

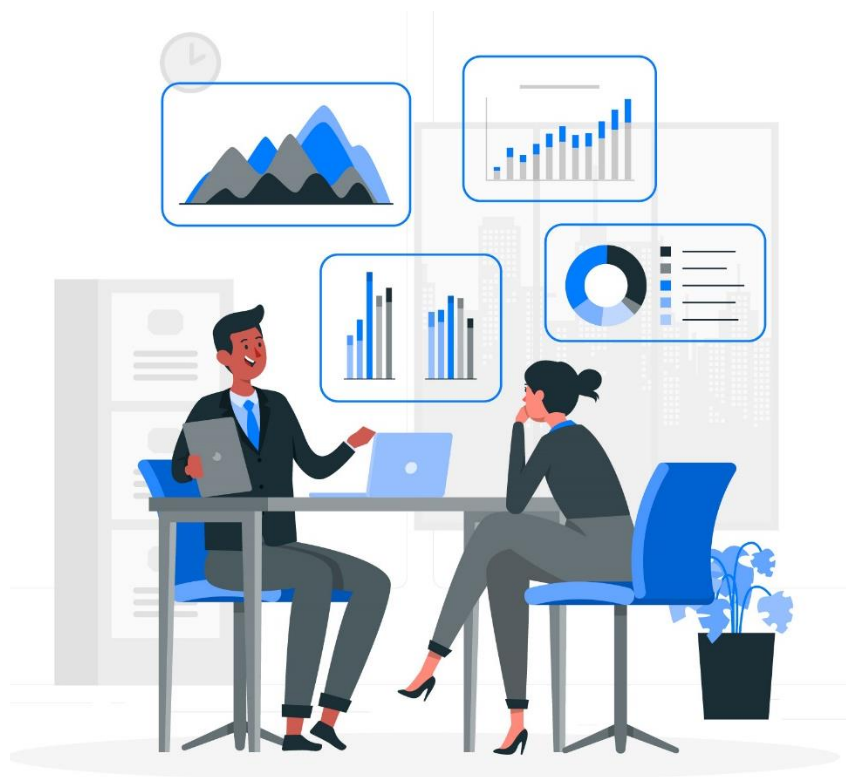
S1 also allows that there are areas of estimation and uncertainty within sustainability, and provides guidance on incorporating, then disclosing, the items where significant assumptions may have been made in order to gather the disclosure data.

Introduction to IFRS S2

Leading from the guidance in the IFRS S1, S2 focuses on climate-related disclosures that organisations are required to disclose, to provide primary users of general purpose financial statements with insights into their climate-related risks and opportunities.

The key focus is on climate-related risks (either physical or transition), as well as opportunities, to present a balanced view of the relationship between climate change, and business strategies and risk management. While other frameworks such as TCFD and the Greenhouse Gas Protocol (GHG Protocol) do not mandate the disclosure of Scope 3 emissions, S2 has included this within the metrics required. The inclusion of Scope 3 emissions reinforces the importance of evaluating the value chain, rather than isolated entities, to determine the carbon footprint of an organization.

S2 also highlights that there should not be unnecessary duplication of disclosures with S1. Hence, synergies in the area of governance and risk assessment, as well as strategy development, can be leveraged for a more comprehensive overview of the steps entities are taking to measure, monitor and disclose sustainability data.



Under S2, the disclosure requirements mirror S1 and TCFD:

Governance

Covering the Board and Management's roles in the sustainability programme of a company.

Risk Assessment

Where businesses are required to disclose its processes and policies in relation to identifying, assessing, prioritizing, and monitoring climate-related risks and opportunities. Further, these processes and policies should be integrated into and inform the overall risk management process.

Strategy

Requiring entities to assess climate-related risks and opportunities within its business model as well as along its value chain, and to elaborate on how its assessment has impacted its strategy and financial position, performance, and cash flows (both current and anticipated effects). In addition, to illustrate climate resilience, entities will also need to perform scenario analysis to allow readers to understand whether the entity's strategy and business model is resilient to climate-related changes.

Metrics and Targets

For entities to provide readers with understanding of their performance with regards to climate-related risks and opportunities. Scopes 1, 2 and 3 greenhouse gas emissions are included under this category and are to be measured in accordance with the GHG Protocol. Beyond the calculation of emissions, the amounts, and percentages of assets vulnerable to climate-related risks or aligned to climate-related opportunities are also disclosure requirements under S2. To illustrate the importance of climate-related objectives, entities shall also disclose the linkage between executive remuneration and climate-related considerations. A process for setting and disclosing quantitative and qualitative targets will also need to be disclosed, and organizations will also be reporting on progress vis-à-vis these targets as time passes.

Impact on Companies

Undeniably, incorporating the IFRS SDS into general purpose financial statements is a monumental task, especially for reporters new to sustainability and climate change impact reporting. Due to the requirements to set up processes and policies, and for the Board and Management to exercise due care over the programme, it will be deeply entwined with the strategic direction and operations of an organization – in fact, it will be a foregone conclusion that any business decision will require consideration of its corresponding sustainability and climate change impact.

The IFRS recognises that adoption of the IFRS SDS requires time, and has allowed the following transitional arrangements for the first annual reporting period in which the IFRS SDS are applied:

- Comparative figures and information relating to past financial periods are not required for the first annual reporting period;
- If greenhouse gas emissions were measured with a standard other than the GHG Protocol in the previous reporting period, it is permitted to continue with the other method;
- Scope 3 is not required, including financed emissions for companies in asset management and related industries.

The reliefs adopted above extend to the purpose of presenting that information as comparative information in the next year as well.

Conclusion

In summary, the ISSB is ushering in a new era of sustainability-related disclosures in capital markets worldwide by way of recently releasing the IFRS SDS which comprises:

- IFRS S1 which sets out the overall requirements with the objective to require an entity to disclose information about its **sustainability -related risks and opportunities** that is useful to the primary users of general purpose financial reports in making decisions relating to providing resources to the entity. [IFRS S1:1]
- IFRS S2 which requires an entity to disclose information about its **climate-related risks and opportunities** that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity. [IFRS S2:1] These are climate-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term. [IFRS S2:2]

While Singapore considers the inclusion of the IFRS SDS as part of our financial reporting process, organizations would benefit from performing a preliminary assessment of whether they are ready to start on their sustainability journey. Small and medium enterprises may not be directly affected for the immediate future, but when large organizations require their supply chains to comply with sustainability requirements as part of their partner onboarding processes, we will indubitably see a trickle-down effect for smaller operations to also be on top of their sustainability initiatives. While setting up such processes will result in additional costs at the onset, companies who embed sustainability into the cornerstones of their business may eventually be able to realize a competitive advantage.

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