CLIFFORD CHANCE

EXPLORING THE NEW ISSB SUSTAINABILITY DISCLOSURE STANDARDS

– THOUGHT LEADERSHIP

JULY 2023

EXPLORING THE NEW ISSB SUSTAINABILITY DISCLOSURE STANDARDS

The ISSB has published two new sustainability disclosure standards establishing a global baseline that is comprehensive and compatible with existing frameworks. The standards are expected to result in more consistent, reliable and comparable sustainability disclosures, which will aid investors in making better investment decisions and support the transition to a sustainable economy.

In this briefing, we outline the key requirements of the new ISSB standards, how they align with pre-existing sustainability disclosure frameworks and their expected impact on companies and investors.

Background

On 26 June 2023, the International Sustainability Standards Board (**ISSB**) issued the following International Financial Reporting Standards (**IFRS**):

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

(the **ISSB Standards)**.

The development of the ISSB Standards follows persistent calls from the investor community for high-quality, transparent, reliable and comparable ESG reporting on climate and other ESG matters.

The ISSB Standards are also aimed at reducing the reporting burden by building on and consolidating existing investor-focused reporting frameworks, including (for example): the Sustainability Accounting Standards Board (**SASB**) Standards, the Task Force for Climate-related Financial Disclosures (**TCFD**) Recommendations and the Climate Disclosure Standards Board (**CDSB**) Framework.

The ISSB has also collaborated with the Taskforce on Nature-related Financial Disclosures (**TNFD)** and the European Financial Reporting Advisory Group (**EFRAG**) in relation to their frameworks, which are addressed below.

The ISSB is continuing its work, and in May 2023 it launched a consultation suggesting that its next standards could be on biodiversity / ecosystems, human capital and human rights.

Overview

IFRS S1 outlines the general requirements for sustainability disclosure. It requires companies to disclose *material* information to their investors about their sustainability-related risks and opportunities, their governance structures, and their performance in relation to sustainability.

IFRS S2 outlines specific requirements for climate-related disclosure to meet investor needs. It requires companies to disclose information about their exposure to climate-related risks, their transition plans, climate-related metrics and targets and their climate-related financial impacts.

Alignment with IFRS Accounting Standards

The ISSB Standards have been designed to be used in conjunction with financial statements and have been built around the concepts underpinning the IFRS Accounting Standards, already required for use in more than 140 jurisdictions. Under the ISSB Standards, sustainability-related financial disclosures are to be published in conjunction with financial statements.

The ISSB Standards use the following definition of "material", based on the IFRS Accounting Standards and aimed at ensuring that investors understand sustainability risks and opportunities relevant to their investment decisions:

"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence investor decisions."

An earlier draft of the ISSB Standards had suggested requiring, as its key objective, disclosure of a company's *"significant sustainability-related risks and opportunities that [are] 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 shall disclose material information about all of the significant sustainability-related risks and opportunities to which it is exposed. The assessment of materiality shall be made in the context of the information necessary for users of general-purpose financial reporting to assess enterprise value*". However, in the final ISSB Standards, the ISSB opted to omit the terms "significant" and "enterprise value", and instead focus on disclosure of information about all *"sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects*".

"Enterprise value" was omitted following consultation feedback that highlighted inconsistencies with the International Accounting Standards Board's Conceptual Framework and that the use of "enterprise value" may unduly narrow the scope of sustainability-related financial disclosures, excluding information that may be useful to users in the decisions that they make. It was also noted that the term "enterprise value" has a particular and potentially conflicting definition in European legislation. Although the term "significant" is used in IFRS Accounting Standards, it was removed from the ISSB Standards on the basis that entities might identify information that is "material" but not "significant" and therefore the ISSB determined that it created more confusion than clarity around the scope of the disclosure requirements.

Key differences in the approach to materiality between the ISSB Standards and the ESRS are addressed below.

Commencement

The ISSB Standards are effective for reporting periods beginning on or after 1 January 2024. They will only become mandatory if and when adopted into regulatory frameworks by authorities in particular jurisdictions, although the ISSB has encouraged earlier voluntary application. In the meantime, companies are required to continue complying with mandatory sustainability disclosure standards currently in place in their relevant jurisdiction.

The ISSB is awaiting endorsement of the ISSB Standards by the International Organisation of Securities Commissions (**IOSCO**), which consists of 170 countries' market regulators, but certain jurisdictions have already announced plans in relation to their implementation.

Transitional relief

The ISSB has introduced transitional relief whereby, in the first year, companies will only need to disclose sustainability risks and opportunities in relation to climate, and even then will not have to provide information on Scope 3 greenhouse gas emissions and comparative information. The requirement to report sustainability information simultaneously with financial reports is also deferred.

Companies will then need to provide full reporting on sustainability-related risks and opportunities, beyond climate, from the second year alongside their financial reporting.

Key requirements of the ISSB Standards

The ISSB Standards require entities to disclose material information on four themes that represent core elements of how organisations operate which are outlined in the TCFD Recommendations (governance, strategy, risk management and metrics and targets). A summary of the key ISSB requirements in respect of each of these themes is outlined in the table below.

Disclosure theme	IFRS S1 disclosure requirements (General requirements)	IFRS S2 disclosure requirements (Climate disclosures)
Governance	Information about governance processes, controls and procedures for monitoring and managing sustainability-related risks and opportunities. This includes information about the oversight of sustainability-related information, as well as processes for ensuring the accuracy and completeness of disclosures.	Information about the governance body(ies) or individual(s) responsible for oversight of climate-related risks and opportunities. It also requires information about management's role in the governance processes, controls and procedures used to monitor, manage and oversee climate-related risks and opportunities.
Strategy	Information about approach to managing sustainability-related risks and opportunities, including information about the risks and opportunities that could affect their financial position, business model and value chain	Information about the climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects. This includes information about the current and anticipated effects of those climate-related risks and opportunities on their business models, value chains and financial position. It also requires information about the effects of those climate-related risks and opportunities on their strategy and decision-making, including information about their climate-related transition plan and the resilience of entities' strategy and business model in relation to climate-related changes, developments and uncertainties.
Risk Management	Information about processes for identifying, assessing, prioritising and monitoring sustainability-related risks and opportunities. This includes information about the extent to which these processes are integrated into and inform the entity's overall risk management process.	Information about the entity's processes and related policies for identifying, assessing, prioritising and monitoring climate-related risks and opportunities. Entities are required to use climate-related scenario analysis to assess their climate resilience and to identify climate-related risks and opportunities. IFRS S2 does not specify a particular methodology for conducting scenario analysis, but it specifies that it should be "commensurate with [the company's] circumstances" and also refers to the guidance on climate-related scenario analysis developed by the TCFD to assist companies in determining which methodology they ought to adopt. Notably, climate-related scenario analysis is encouraged, but not mandatory, under the TCFD Recommendations.
Metrics and targets	Information about performance in relation to sustainability-related risks and opportunities. This includes information about progress towards any targets they have set or are required to meet by law or regulation.	Information about metrics and targets relevant to seven cross-industry metric categories including, for example, information about absolute gross greenhouse gas emissions generated during the reporting period for Scope 1, Scope 2 and Scope 3 emissions measured in accordance with the GHG Protocol. The requirement to disclose Scope 3 emissions is notable, as the TCFD Recommendations do not mandate this. Information about industry-based metrics that are associated with particular business models, activities or other common features that characterise participation in an industry. In doing so, entities are required to refer to and consider the industry-based metrics outlined in the Industry-based Guidance on Implementing IFRS 2. For example, entities in the Electronic Manufacturing Services industry are required to disclose the weight and percentage of end-of-life material recovered and recycled, and entities in the Agricultural Products industry must disclose the percentage of agricultural products sourced from regions with High or Extremely High Baseline Water Stress. Entities participating in asset management activities are also required to disclose information about their financed emissions, including the absolute gross financed emissions (disaggregated by Scope 1, Scope 2 and Scope 3 emissions), the total amount of assets under management (AUM), the percentage of total AUM included in the financed emissions calculation and the methodology used.

Alignment with pre-existing sustainability disclosure frameworks

Sustainability Accounting Standards Board standards

While the ISSB Standards provide a general framework for disclosing sustainability-related information, the SASB Standards require disclosure of industry-specific sustainability information.

The ISSB Standards complement the SASB Standards, by encouraging companies to refer to and consider the applicability of the industry-specific disclosure topics, and the metrics associated with the disclosure topics, outlined therein. Both sets of standards are also aligned with the TCFD Recommendations.

TCFD Recommendations

The ISSB Standards are also designed to be compatible with the TCFD Recommendations, so that companies that are already complying with the TCFD Recommendations can easily transition to the ISSB Standards. As noted above, the ISSB Standards adopt the same four themes outlined in the TCFD Recommendations (governance, strategy, risk management and metrics and targets). Both sets of standards also require disclosures about climate-related risks and opportunities, including physical risks, transition risks and climate-related opportunities.

Notable differences include that the ISSB Standards are more comprehensive and prescriptive, requiring additional and more granular disclosure in relation to several matters, such as the identification and assessment of climate-related risks and opportunities, the management of climate-related risks and opportunities and the metrics and targets used to measure and manage climate-related performance.

The ISSB Standards also contain different requirements in relation to transition plans, the disclosure of emissions reduction targets and use of carbon offsets, and disclosure of industry-based metrics. Unlike the TCFD Recommendations, the ISSB Standards also mandate disclosure about financed emissions and Scope 3 GHG emissions.

The IFRS has published a table outlining how IFRS S2 and the TCFD Recommendations align and differ (see July 2023 – Comparison – IFRS S2 Climate-related Disclosures with the TCFD Recommendations, available at **www.ifrs.org**).

TNFD Recommendations

The Taskforce on Nature-related Financial Disclosures is developing a risk management and disclosure framework for organisations to report and act on evolving nature-related risks.

The TNFD is yet to finalise its framework; however, it has stated that its approach is to align to the ISSB Standards, and enable the reporting of those companies and financial institutions that may want, or need, to disclose in accordance with a different set of requirements.

European Sustainability Reporting Standards

On 5 January 2023, the EU Corporate Sustainability Reporting Directive (CSRD) entered into force, extending existing sustainability disclosures obligation for EU, and some non-EU-based, companies on a phased basis from 1 January 2024.

The CSRD obliges the European Commission to adopt so-called European Sustainability Reporting Standards (ESRS). Companies subject to the CSRD will be required to draw up their sustainability report in accordance with the ESRS. In June 2023, the Commission published draft ESRS and conducted a public consultation which closed on 7 July 2023. It is currently expected that the final ESRS will be officially adopted in Q3 2023. In December 2022, the ISSB, the Commission and the European Financial Reporting Advisory Group (EFRAG) announced that they are collaborating to achieve the shared objective of maximising the interoperability of their standards and aligning on key climate change disclosures. This collaboration is still ongoing.

A key difference between the ISSB Standards and the current draft ESRS is the extent of the reporting requirements. Both ESRS and ISSB contain general disclosure standards. The ESRS also contain a set of ten topical reporting standards on specific environmental, social and governance topics, while currently the ISSB Standards only feature one topic standard on climate disclosure. The ISSB Standards therefore only cover a fraction of the scope of the ESRS at this point in time.

Another key difference is the definition of "materiality". The ISSB Standards apply the concept of "*financial materiality*", i.e. they define materiality by reference to whether the information could reasonably be expected to influence investor decisions, whereas the draft ESRS apply the concept of "*double materiality*" meaning that sustainability matters are considered material if they are likely to have a significant impact on the company's financial performance (*financial materiality*) or on people or the environment (*impact materiality*).

While the ESRS and the ISSB Standards are both built on the foundation of the TCFD Recommendations and are largely compatible, the ESRS are designed to satisfy several EU legal requirements and therefore are more comprehensive and prescriptive. In particular, the ESRS require more granular disclosures and provide more detailed guidance on the topics that companies are required to report on. By contrast, the ISSB Standards encourage companies to refer to, and consider, the applicability of disclosure topics in other standards, such as the SASB Standards.

Implementation by jurisdictions

IOSCO, a body consisting of 170 countries' market regulators, has now endorsed the ISSB standards and published a note setting out a high-level overview of adoption considerations. This endorsement is expected to encourage widespread and prompt adoption of the ISSB Standards by individual jurisdictions.

Several jurisdictions have already announced plans in relation to the ISSB Standards, including:

- **United Kingdom:** Given that it was the first G20 country to codify the TCFD requirements for listed issuers, it is perhaps not surprising that the UK Government has announced that it will be establishing a mechanism for formal UK endorsement and adoption of the ISSB Standards and that it expects them to "*form a core component of the [Sustainability Disclosure Requirements (SDR)] framework, and the backbone of its corporate reporting element*". This work is co-ordinated by the Transition Plan Taskforce, which advises the UK Government and the FCA on the development of the UK's disclosure framework. Launch of the ISSB Standards is seen as a welcome development by the FCA, on the basis that the standards satisfy a clear market demand for consistent and comparable corporate sustainability disclosures that build upon the TCFD-aligned disclosure rules that have already been introduced for listed equity issuers, asset managers and FCA-regulated asset owners. In July 2023, the Financial Reporting Council began a formal consultation on the potential for adoption of the ISSB Standards in the UK.
- **European Union:** As above, the EU is currently developing its own standards in collaboration with the ISSB to determine the interoperability of EU standards and the ISSB Standards to maximise intersection, rather than adopting the ISSB Standards entirely.
- **Asia:** Both Japan and Singapore have declared intentions to align domestic sustainability reporting requirements with the ISSB Standards.
- **Australia:** The Australian government is planning to implement mandatory climate related financial disclosure requirements for companies and financial institutions, which are expected to be closely aligned with the ISSB Standards.
- **Africa:** The Financial Reporting Council of Nigeria announced Nigeria's

adoption of the ISSB Standards in their entirety on 26 June 2023.

Brazil, Canada and South Korea are also establishing, or have established, sustainability standards boards that will enable them to co-operate with the ISSB.

Impact on Industry Sectors

The current sustainability reporting landscape is confusing and fragmented, with many different frameworks and standards. By providing a common framework that is interoperable with existing sustainability reporting frameworks, the burden on large companies reporting across several jurisdictions is likely to be reduced and the quality and comparability of sustainability disclosures will be improved. This, in turn, is expected to drive investment in sustainability by making it easier for investors to identify companies that are committed to sustainability and to track their sustainability performance. Clearly, to be most effective from an investor's perspective, comparability of data across sustainability reporting frameworks is key. We therefore expect investors such as fund managers to be keeping a close eye on interoperability as they navigate the similarities and differences between frameworks and assess the usefulness of the resulting sustainability disclosures in informing investment decisions.

The ISSB Standards also have the potential to reduce greenwashing by requiring companies to provide more detailed disclosures and details of the methodology adopted, which, in turn, will likely make it easier for investors and other stakeholders to assess their sustainability claims.

Given that the ISSB Standards are likely to be adopted as the minimum benchmark across a number of jurisdictions, it would be prudent for companies to start planning for compliance, for example by:

- Assessing current sustainability reporting practices to identify areas where improvement is needed in order to meet the requirements of the ISSB Standards and making necessary changes to existing reporting systems and processes.
- Developing capacity to compile sustainability information efficiently by establishing an integrated governance and stakeholder engagement structure involving finance, sustainability and risk teams, to inform commitments, decisions and reporting on sustainability-related issues.
- Identifying which topics relevant to their business are "material".
- Starting to collect data about sustainability performance now, including in relation to Scope 3 GHG emissions, to ensure compliance of the information with the ISSB Standards.
- Keeping an eye on latest developments and announcements in your jurisdiction about adopting the ISSB Standards, to understand where and when your company may be subject to them.

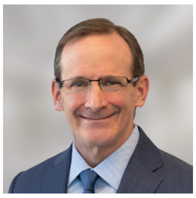
CONTACTS

Adam Hedley
Partner
London
T: +44 207006 3381
E: adam.hedley@
cliffordchance.com

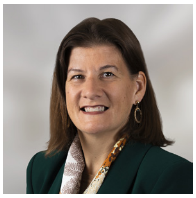
Kirsty Souter
Senior Associate
London
T: +44 207006 4178
E: kirsty.souter@
cliffordchance.com

Callum MacLeod
Lawyer
London
T: +44 207006 3300
E: callum.macleod@
cliffordchance.com

Clare Burgess
Partner
London
T: +44 207006 1727
E: clare.burgess@
cliffordchance.com



Steve Nickelsburg
Partner
Washington D.C.
T: +1 202 912 5108
E: steve.nickelsburg@
cliffordchance.com



Michelle Williams
Partner
Washington D.C.
T: +1 202 912 5011
E: michelle.williams@
cliffordchance.com

Dr. Mathias Elspaß
Partner
Düsseldorf
T: +49 211 4355 5260
E: mathias.elspass@
cliffordchance.com

Thomas Voland
Partner
Düsseldorf
T: +49 211 4355 5642
E: thomas.voland@
cliffordchance.com

Laura-Isabell Dietz
Associate
Düsseldorf
T: +49 211 4355 5017
E: lauraIsabell.dietz@
cliffordchance.com

Dr. Frederic Maximilian Mainka
Senior Associate
Düsseldorf
T: +49 211 4355 5355
E: frederic.mainka@
cliffordchance.com

Kate Norgett
Corporate Governance Director
London
T: +44 207006 2023
E: kate.norgett@
cliffordchance.com

James Koessler
Senior Associate
London
T: +44 207006 1375
E: james.koessler@
cliffordchance.com

Michael Coxall
Knowledge Director
London
T: +44 207006 4315
E: michael.coxall@
cliffordchance.com

Jacqueline Jones
Knowledge Director
London
T: +44 207006 2457
E: jacqueline.jones@
cliffordchance.com

CLIFFORD
CHANCE

2307-007178