SUSTAINABILITY REPORTING

Key issues and implications for Australian entities and their boards

ESG Centre of Excellence

CPA AUSTRALIA

Key Points

The Standards

- The International Sustainability Standards Board (ISSB) issued its first two sustainability standards on Friday, 26 June 2023.
- The objective is to issue standards that provide a comprehensive global baseline for consistent, comparable sustainability reporting to meet investor needs.
- The ISSB Sustainability Standards, notably IFRS S1, aim to capture the environmental and social dimensions of business practices. Social considerations includes, but is not limited to, diversity and inclusion, modern slavery, worker safety, occupational health and safety issues and product safety.
- The standards adopt a four-pillar core content framework which requires an entity to provide disclosures about its approach to sustainability-related considerations through its governance, strategy, risk management and use of metrics and targets.
- IFRS S1 deals with general requirements for the disclosure of material information about significant sustainability-related risks and opportunities across an entity's value chain.
- IFRS S2 deals with climate-related disclosures and builds on the four content areas.
- IFRS S2 also sets out disclosure requirements about climate-related risks and opportunities, transition plans and scenario analysis that will facilitate users assessing the impact of these risks and opportunities on the entity's:
  - financial position, performance and cash flows and,
  - strategy and business model.
- IFRS S1 is designed to be applied alongside future industry or topic specific standards with IFRS S2 that deals with climate, being the first such topic.

Next steps

- The ISSB is currently consulting on its future agenda and considering future standards on human capital, human rights and biodiversity, environment and environmental systems (BEES).
- A concurrent consultation will seek public commentary on the internationalisation of the SASB standards with a view to providing industry-specific guidance.
- The Australian Treasury is currently consulting stakeholders on introducing climate reporting requirements that would align with the ISSB Standards. The current proposal would be for a phased approach that would intially to large companies and financial institutions and those companies already reporting under the NGER Act.
- The AASB will use the ISSB standards as a baseline to develop Australian-specific sustainability-related financial disclosure requirements.

Recommendations

- Boards and other bodies tasked with governance will play a key role and will typically need to significantly elevate their own understanding of sustainability-related standards and the implications on their respective organisations.
- This briefing sets out next steps for organisations and their boards. We recommend that entities review their governance structures, systems and reporting against the ISSB Standards' proposed disclosure requirements and address any resulting gaps.

Overview

The International Sustainability Standards aim to provide a comprehensive baseline and international language for sustainability-related considerations and disclosures.

As a result of increasing stakeholder concerns about environmental social and governance (ESG) issues many entities voluntarily provide additional disclosures about environmental and social issues over and above financial reporting requirements.

In November 2021 the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB). This is to address the urgent need for a single set of globally accepted sustainability reporting standards that are integrated, consistent and of a comparable standing with financial reporting standards. On 26 June 2023, the ISSB released two sustainability standards:

- IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information; and,
- IFRS S2 Climate-related Disclosures.

The aim is to create a single international language for reporting sustainability issues including opportunities and risks. The two standards are designed to be applied together and alongside future industry or topic specific standards. Importantly, these standards are focused on sustainability-related financial information.

This is a different focus from multi-stakeholder reporting, which is the focus of alternative sustainability frameworks like the GRI. The Australian Accounting Standards Board (AASB) will use the ISSB standards as a baseline to develop Australian-specific sustainability-related financial disclosure requirements.

In this briefing we provide a broad overview of the ISSB's first two standards, including what Australian entities should do now to prepare for their potential impact.

The ISSB Standards have been designed for for-profit entities but the applicability will be determined by the AASB and equivalent bodies at each jurisdiction.

Treasury has proposed for the standards to apply to large companies and financial institutions as well as those entities that are required to report under the NGER Act. However, a prior CPA briefing[1]outlined a range of reasons why smaller entities should consider voluntarily engaging with the requirements of the ISSB Standards and their reporting requirements.

For example, the finance industry as well as equity markets increasingly requires information about environmental and social issues. There is therefore an economic imperative, including the potential to reduce the cost of capital, about voluntarily and preparing such reports even when not mandated.

There are also likely to be increasing supply chain pressures, exacerbated by the broad definition of the “value chain” in the General Requirement Standard, that will generate a demand for such reporting[2].

Accordingly, the briefing is aimed at CPA Australia members who are directors or advisers to boards as well as other members seeking a summary of the requirements as a precursor to a deeper engagement with the standards.

---

[1] CPA Australia, (2023), “SME Governance: How ESG governance leads to better outcomes and why SMEs should act now”

[2] For example, BHP recently took a further step in the push to slash carbon emissions across its global supply chain, with a new goal for suppliers to be carbon-neutral by 2050.

General requirements (IFRS S1)

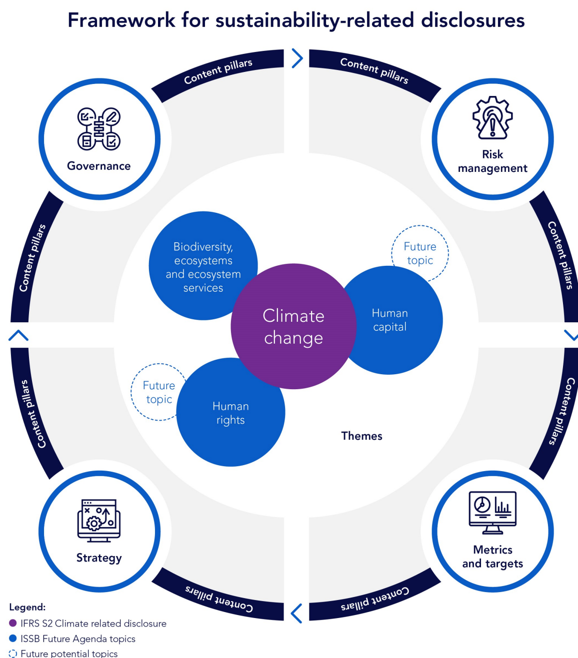
The objective of the General Requirements Standard is to require an entity to disclose information about its sustainability-related risks and opportunities that is useful to the primary users of general-purpose financial reporting (GPFR) when they make decisions about providing resources to the entity. The reporting entity is required to disclose material information about all sustainability-related risks and opportunities to which it is exposed.

The General Requirements Standard adopts a four-pillar core content framework which requires an entity to provide disclosures around governance, strategy, risk management as well as metrics and targets.

Content Pillar		Description
Governance		The governance processes, controls and procedures the entity uses to monitor and manage sustainability-related and climate-related risks and opportunities.
Strategy		The approach for addressing sustainability-related and climate-related risks and opportunities that could affect the entity's business model and strategy over the short, medium and long term.
Risk Management		The processes the entity uses to identify, assess and manage sustainability-related and climate-related risks.
Metrics and targets		The information the entity uses to assess, manage and monitor its performance in relation to sustainability-related and climate-related risks and opportunities over time.

The figure below illustrates the intersection between the four-pillar core content and the structure of disclosures in the Climate Standard and future topics.

Framework for sustainability-related disclosures



Some of the other general requirements are outlined below. It should be noted that the application of many of these requirements will vary by jurisdiction and should therefore be read in conjunction with the pronouncements of local standard setting bodies.

1) Who needs to report?

An entity's sustainability-related financial disclosures shall be for the same reporting entity as the related GPFR.

At the time of writing the Australian Federal Government was consulting stakeholders on introducing climate reporting requirements that aligns with IFRS S2, proposing that such reporting requirements apply to large companies and financial institutions and those entities already required to report under the NGER Act. with a phased approach to broaden the scope of entities that would be captured over the next several years.

IFRS S2 is discussed in more detail later in this briefing document.

2) What are "sustainability-related risks and opportunities"?

Entities are required to report all material information about "sustainability-related risks and opportunities", which arise from an entity's dependencies on resources and its impacts on resources.

They are required to describe where significant sustainability-related risks and opportunities are concentrated in their "value chain." The term "value chain" is defined broadly and encompasses the whole lifecycle of its products or services and the entity. Some examples include:

- the entity's 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 production facilities that rely on scarce resources;
- investments it controls, including its investments in associates and joint ventures, such as financing a greenhouse gas-emitting activity through a joint venture; and
- sources of finance.

3) How is materiality defined?

Sustainability-related financial information is material if omitting, misstating, or obscuring such information could be expected to influence decisions that the primary users of GPFRs make based on that reporting.

Making materiality judgements involves both qualitative and quantitative considerations. 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. IFRS Practice Statement 2 Making Materiality Judgements provides further guidance on this issue.

4.) Where should the information be disclosed?

The standard requires disclosures required by IFRS Sustainability Disclosure Standards as part of its general purpose financial reports but acknowledges that the location of such disclosures may differ depending on regulation and other jurisdictional requirements.

In common with the practice of many entities currently making voluntary disclosures, the disclosures may be included as part of the management discussion and analysis (MD&A) in the front part of the annual report or in a separate sustainability report that is cross referenced to the annual report.

5) How do you deal with estimation uncertainty?

The standard acknowledges that the use of reasonable estimates is integral to preparing sustainability-related disclosures and defining metrics. It is also recognised that this does not undermine the usefulness of the information providing that 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 should identify metrics that have significant estimation uncertainty and disclose the sources and nature of the estimation uncertainties and the factors affecting the uncertainties.

6) Is a statement of compliance required?

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

7) What if any assurance is required?

With a view towards the requirements for comparable and robust information, we would point to the role of audit and assurance to provide credence to the disclosures being put forward by entities.

There is work currently underway on formulating a global assurance standard for sustainability-related disclosures, with the International Accounting and Assurance Standards Board's continuing work on developing ISSA 5000 as the global baseline for obtaining assurance on sustainability-related disclosures.

We are also aware of Treasury's proposal to phase in assurance requirements, aiming to alleviate the resourcing burden that providers of assurance would need to navigate.

8) What is the relationship between the General Requirements Standard and the Climate as well as any future standards?

The General Requirements and the Climate Standards and are designed to be applied together and alongside future industry or topic specific standards.

The standards adopt the common four-pillar core content framework which requires an entity to provide disclosures about governance, strategy, risk management as well as metrics and targets.

Climate-related disclosures (IFRS 2)

The Climate Standard is the ISSB's first thematic IFRS Sustainability Disclosure Standard. The objective of this standard is to require an entity to disclose information about its exposure to significant climate-related risks and opportunities, facilitating users of GPFR to assess the impacts of these risks and opportunities on the entity's:

- financial position, performance and cash flows;
- enterprise value and;
- strategy and business model.

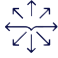
The climate-related risks the entity is exposed to include, but are not restricted to, the physical risks from climate change and transition risks associated with moving to a lower-carbon economy. The climate-related opportunities available to the entity are also in scope.

The Climate Standard is structured around the four content pillars of governance, strategy, risk management, and metrics and targets specified in the General Requirement Standard. Below we provide an overview of some of the key disclosures required under each pillar.

Governance

The objective of the disclosures on governance is to enable users of GPFR to understand the governance processes used to monitor and manage climate-related risks and opportunities. An entity is required to disclose information such as:

- the identity of the body or bodies that may include the board, a committee or equivalent charged with oversight of climate-related risks and opportunities;
- how the body ensures that the appropriate skills and competencies are available to oversee the strategies designed to respond to climate-related risks and opportunities; and
- information about how the dedicated controls and procedures are applied to the management of climate-related risks and opportunities and integration with other internal functions.

Strategy		The objective of climate-related disclosures on strategy is to enable users of GPFR to understand the entity's strategy for addressing climate-related risks and opportunities. An entity is required to disclose information such as: • the climate-related risks and opportunities that it could reasonably expect to affect its flows, its access to finance and its cost of capital (also referred to as the entity's prospects), over the short, medium or long term; • the current and anticipated effects of climate-related risks and opportunities on its business model and value chain; • the effects of climate-related risks and opportunities on the entity's strategy and decision-making including its climate-related transition plan; • The effects of climate-related risks and opportunities on the entity's financial position, financial performance and cash flows; and • the climate resilience of its strategy and its business model to significant physical and transition risks. This includes using climate-related scenario analysis to assess its climate resilience. The standard provides for an entity's approach to scenario analysis to be determined in terms of its own skills, capabilities and resource availability.
Risk management		The objective of climate-related financial disclosures on risk management is to enable users of GPFR to understand the process, or processes, by which climate-related risks and opportunities are identified, assessed, and managed. An entity would disclose the processes it uses such as: • to identify, assess and manage climate-related risks, and how the processes are integrated into the entity's risk management framework; • 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; • to identify, assess and prioritise climate-related opportunities; and • to monitor and manage the climate-related risks and opportunities, including related policies.
Metrics and targets		The objective of climate-related financial disclosures on metrics and targets is to enable users of GPFR to understand how an entity measures, monitors and manages its significant climate-related risks and opportunities. The expectation is that these disclosures will enable users to understand how the entity assesses its performance against targets. An entity would disclose: • metrics, including Scope 1, 2 and 3 emissions[1], and targets used to assess and manage climate-related risks and opportunities; • information relevant to cross-industry metric categories, industry base metrics and other metrics used by the board or management to measure progress towards targets; • targets set by the entity to mitigate or adapt to climate-related risks or maximise climate-related opportunities; • how the targets the entity has set to manage climate-related risks and opportunities compared with those created in the latest international agreement on climate change and whether it has been validated by a third party; and • whether the entity intends to use carbon offsets to achieve those targets.

1 Scope 1 emissions are direct greenhouse gas emissions that occur from sources that are owned or controlled by an entity. Scope 2 emissions are indirect greenhouse gas emissions that occur from the generation of purchased electricity, heat or steam consumed by an entity. Scope 3 emissions are indirect emissions, outside of Scope 2 emissions, that occur in the value chain of the reporting entity, including both upstream and downstream emissions.

What organisations need to do now

Considering growing regulatory and capital market interest in the ISSB Standards, entities should prepare for imminent implementation through the actions identified below. Boards will play a key role in governance around implementation and will typically need to significantly elevate contemporary practice.

Issue	Tasks
Identify the impact on the entity	• Conduct a gap analysis to determine any differences between the entities current reporting practices and the requirements of the ISSB Standards. • Pay particular attention to potential gaps around the broader disclosures relating to Scope 3 emissions and identifying material information across all 'E', 'S' and 'G' categories.
Educate key stakeholders	• Educate the board, management and all other internal stakeholders involved in sustainability reporting about the new requirements to disclose material information about significant sustainability-related risks and opportunities across the entity's value chain. • Ensure the strategy for identifying, disclosing and, where possible, addressing the aforementioned risks is disseminated and understood through the entity. • Monitor the development of the Australian-specific sustainability-related financial disclosure requirements as well as the Federal Government's proposed climate-related disclosure reforms and update internal stakeholders.
Develop a board-led governance structure	• Establish a board-led governance structure to oversee implementation and oversee the quality of sustainability reporting and impact of these reporting requirements. • Improve internal governance structures to minimise silos and better integrate the sustainability, legal and finance functions. • Consider using cross-functional expertise across legal, finance and sustainability teams, to ensure disclosures are accurate and reduce the risks of green and blue washing. • Think through increased risk of liabilities especially with forecasts and other forward-looking statements. • Consider the levels of assurance required prior to issuing a statement of compliance, over and above any regulatory requirement. • Assess internal as well as external capability needs and gaps.
Enhance existing systems and processes	• Engage with existing process owners to identify the expanded systems and processes required for capturing, measuring and analysing the information needed to meet the new sustainability reporting requirements. • Develop an internal control system around sustainability reporting that is designed to maintain the integrity of the significant volumes of data that will flow across a wide range of disclosure topics.

References

Allens Linklaters, (2022), "What you need to know to be prepared for the ISSB Standards"

CPA Australia, (2023), "SME Governance: How ESG governance leads to better outcomes and why SMEs should act now"

CPA Australia (2021), "Climate Change and Financial Reporting"

International Sustainability Standards Board, (2023), "General Requirements for Disclosure of Sustainability-related Financial Information", IFRS Foundation.

International Sustainability Standards Board, (2023), "Climate-related Disclosures", IFRS Foundation.

International Sustainability Standards Board, (2023), IFRS Practice Statement 2.

KPMG (2022), "Sustainability reporting: Proposals for general and climate-related requirements"

Toscano, N. (2021), "BHP sets 'net-zero' goal for suppliers as climate scrutiny grows", *Sydney Morning Herald,* 14 September