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ALERTS

ISSB Takes The Lead On Global Sustainability Disclosure Standards – Will The U.S. Follow?

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Highlights

• In response to stakeholder demands for more consistent, comparable, and reliable information, the ISSB has issued a comprehensive set of sustainability-related financial and climate disclosure requirements

• The ISSB standards have substantial international support, and are widely viewed as paving the way for convergence on a single global sustainability disclosure standard

• The close collaboration between the ISSB and the EU to maximize the interoperability of their respective standards exemplifies how far the world has come in such a short time; and provides a roadmap for others, including the U.S., to adapt and adopt uniform disclosure requirements

One of the more vexing issues limiting the adoption of and reliance on mandatory environmental, social and governance (ESG) disclosures has been the lack of common standards or consistent methodologies for collecting and reporting verifiable and reliable data, measuring performance, or comparing performance within or across sectors. The absence of such a consistent framework – indeed the proliferation of

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literally hundreds of widely varying approaches – has led to widespread confusion with companies gravitating toward the framework that puts them in the best light.

The International Sustainability Standards Board (ISSB) was established in November 2021 by the trustees of the IFRS Foundation at the United Nations Climate Change Conference (COP26). The ISSB's purpose is to establish a comprehensive global baseline of sustainability-related financial disclosures to meet the needs of capital markets. After an 18-month herculean effort that involved extensive consultation with stakeholders, the ISSB issued its inaugural global sustainability disclosure standards on June 26.

Some of the primary benefits expected from adoption of the new ISSB standards – IFRS S1 and IFRS S2 – include uniform requirements that will help boost investors' confidence when making investment decisions. These new standards will help investors understand and compare how companies identify and manage sustainability-related risks and opportunities over the short, medium and longer term. Over time, duplicative reporting and overall reporting costs should be reduced. It is also anticipated that leveling the playing field by using common standards will lead to better internal controls that should reduce the risk of greenwashing claims.

There is already widespread global support for the G7- and G20-endorsed ISSB standards, with a number of countries having signaled their intent to incorporate or account for them, including the United Kingdom, Canada, Hong Kong, Singapore, Nigeria, Japan, New Zealand, and Australia. There will be challenges to adoption by the EU and U.S., both of which are currently contemplating their own climate-based sustainability disclosure requirements that differ from the ISSB standards. The EU proposal requires more disclosure than the ISSB, while the U.S. Securities and Exchange Commission (SEC) proposal calls for a bit less. The SEC proposal has also given rise to unique intramural political considerations.

There is also support from the global business community, including collaborative initiatives with the ISSB to facilitate adoption of the standards as a comprehensive global baseline for sustainability reporting. In early June, the World Economic Forum entered into a memorandum of understanding with the ISSB. That group will share insights and best practices from corporations reporting on the ISSB standards with a focus on building capacity among companies. The efforts of that group should augment those of the Transition Implementation Group on IFRS S1 and IFRS S2 that ISSB is forming to solicit and address stakeholder questions about the standards and provide a public forum for stakeholders to learn about the experiences of others involved with implementation of the standards.

The outcome of the upcoming review of the ISSB standards by the International Organization of Securities Commissions (IOSCO) will likely have substantial bearing on global adoption. IOSCO includes securities regulators from 170 jurisdictions (including the U.S.) responsible for more than 95 percent of the world's securities markets. During the launch event for the ISSB standards in London on June 26, after commending the pace and quality of the ISSB's work, Jean-Paul Servais, chair of IOSCO, reaffirmed that, "IOSCO is conducting an independent assessment of the

ISSB Standards, with a view to completing this review promptly."

Overview

As the ISSB explains, IFRS S1 and IFRS S2 were developed to facilitate investors' efforts to obtain useful, reliable and comparable sustainability-related information to assist them in understanding sustainability-related risks and opportunities when making investment decisions. The standards are based on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, Sustainability Accounting Standards Board (SASB) Standards, Climate Disclosure Standards Board (CDSB) Framework, Integrated Reporting Framework, and World Economic Forum metrics to streamline sustainability disclosures.

IFRS S1 prescribes overall requirements for providing users of general purpose financial reports a complete set of sustainability-related financial disclosures. According to the supporting IFRS S1 Basis for Conclusions, these disclosure requirements were "designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium and long term and inform their decisions relating to providing resources to an entity." As further explained in the IFRS Project Summary, IFRS S1 "requires a company to disclose information about its governance, strategy and risk management, as well as metrics and targets, in relation to its sustainability related risks and opportunities."

IFRS S2 sets out specific climate-related disclosures, which were developed to provide users "more consistent, complete, comparable and verifiable information about an entity's climate-related risks and opportunities." IFRS S2 integrates recommendations by the Task Force on Climate-related Financial Disclosures (TCFD). It requires the disclosure of information about both cross-industry and industry specific climate-related risks and opportunities. IFRS S2 requires a company to disclose information about the same four content areas as IFRS S1, but in relation to its climate related risks and opportunities.

Of particular note, IFRS S2 requires a company to disclose its Scope 1, Scope 2 and Scope 3 greenhouse gas emissions (GHG). With respect to Scope 3 emissions – a particularly controversial issue in the U.S. – the ISSB explained its rationale for requiring disclosures in its project summary:

"The requirement to disclose Scope 3 GHG emissions reflects the importance of providing information related to a company's value chain, to more fully inform investors' understanding of a company's exposure to transition risk. A company must consider the 15 categories of Scope 3 GHG emissions set out in the GHG Protocol Corporate Value Chain (Scope 3) Standard, with information being disclosed when material, and provide disaggregated information about its Scope 3 GHG emissions when material."

The ISSB recognizes that measurement of Scope 3 GHG emissions, which account for two-thirds of many companies' carbon footprint, will include estimation and has developed a Scope 3 measurement framework to provide additional guidance about how to measure Scope 3 GHG emissions. In its last round of revisions before going final (in which the ISSB provided transition relief for several IFRS S1 and S2 requirements), the ISSB extended by one year the time for disclosure of Scope 3 GHG emissions information and the use of the Greenhouse Gas Protocol to measure Scope 1, 2 and 3 GHG emissions in specific circumstances.

IFRS S2 is also accompanied by Industry-Based Guidance that "suggests ways to identify and disclose information about climate-related risks and opportunities associated with particular business models, activities or other common features that characterize participation in an industry." This non-exhaustive guidance has been derived from SASB standards, which were recently taken over and are now maintained by the ISSB.

The IFRS S1 and S2 standards are designed to be used together and are both effective beginning on or after Jan. 1, 2024, for annual reporting periods (i.e., investors will begin to see information in 2025 for companies that apply the standards during their 2024 reporting cycle). As a mitigating measure, the ISSB included the concept of "reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort" for key areas of both IFRS S1 and S2. The standards also allow for temporary or permanent relief from some requirements.

Proportionality

After taking into account comments received during consultation, the ISSB clarified in the final standards that many of the requirements of IFRS S1 and S2 are to be applied in a manner "proportionate" to a company's circumstances to account for the practical reality that some companies have more limited resources and capabilities. The ISSB explained that it expects companies to use "all reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort."

The ISSB applied proportionality mechanisms to the requirements associated with identification of risks and opportunities, determination of the scope of the value chain, disclosure of current and anticipated financial effects, and other areas such as timing of reporting and providing comparative information in the first year of application. Proportionality mechanisms were also applied by the ISSB to specific S2 requirements associated with climate-related scenario analysis, measurement of Scope 1, Scope 2 and Scope 3 greenhouse gas emissions, and calculation of metrics in particular cross-industry metric categories.

Interoperability

After receiving comments on IFRS S2, the ISSB recognized the need to pursue and facilitate interoperability with specific jurisdictional disclosure requirements and informational needs that go beyond the ISSB baseline. The ISSB carefully weighed and incorporated interoperability considerations throughout its final decision-making on IFRS S1 and S2 to achieve greater interoperability between the standards and jurisdictional requirements.

During consultation, stakeholders highlighted the need to coordinate the ISSB disclosure requirements with the European Sustainability Reporting Standards (ESRS) proposed by the EC through the European Financial

Reporting Advisory Group (EFRAG) and with the SEC's climate-related disclosure rules in the U.S. At a higher level, such interoperability is needed to achieve true global convergence of sustainability related disclosure requirements. More granularly, such coordination is needed to minimize duplicative reporting, complexity, potential inconsistencies and costs.

The ISSB, EC, and EFRAG have worked closely to facilitate interoperability. The ISSB made revisions while developing its proposed and final standards to accommodate and account for the EU's Corporate Sustainability Reporting Directive (CSRD) and proposed ESRS. After ISSB issued its final draft standards in February 2023, the parties continued to work on an interoperability table between IFRS S1 and S2 and the ESRS. Most recently, just before issuance of the final ISSB standards this past June, the EC issued revised the updated draft ESRS for consultation, which focus on improving their interoperability with the ISSB standards.

Nonetheless, some key differences remain that will need to be monitored and addressed after the ESRS are finalized in July. The CSRD required climate-related disclosures to be implemented through the ESRS are still more detailed than those required by IFRS S2. Additionally, while the differences over the ISSB and CSRD materiality assessment requirements have been narrowed, significant issues remain. Originally, double materiality applied to all disclosures required by ESRS (i.e., both impact materiality and financial materiality), while just financial materiality applies to the ISSB standards. The proposed revised draft ESRS no longer requires materiality assessments for "general disclosures." These changes are intended to ensure proportionality and a high degree of interoperability, and are expected to reduce costs. However, double materiality still applies to most other ESRS disclosure requirements, so continued close management of interoperability with the ISSB single materiality assessment standard will be needed.

The SEC's proposed climate-related disclosure rule, proposed in April 2022 and due to be issued in October 2023, is more closely aligned with the ISSB standards than ENSR, as both were developed based on the disclosure requirements recommended by the TCFD. While the U.S. has indirectly supported the development of the ISSB standards through G7 and G20, and will likely continue to do so through its role as an IOSCO Board member, there are some important degrees of separation.

The U.S. has not adopted the IFRS general accounting standards (used by more than 140 other jurisdictions), which the ISSB standards are designed to complement. Additionally, the anti-ESG movement in the U.S. has pushed back hard on the SEC's authority to regulate climate-related disclosures in general and has singled out for opposition the Scope 3 GHG emission disclosure requirements sought globally by most investors and required by both the ISSB standards and ENSR. Notably, unlike the collaboration of the EC and ISSB, there has been virtually no reported U.S. involvement with either the EC or ISSB on maximizing interoperability.

What's Next for the ISSB?

The ISSB standards are voluntary and will only become binding legal requirements in those jurisdictions that adopt them. A favorable review from IOSCO is expected to provide substantial support for widespread adoption. As Servais, IOSCO chair, noted at the launch event for the standards June 26, “Endorsement shall be a real game changer for regulators around the world in considering the use of the ISSB framework.”

Now that the standards have been issued, the ISSB will focus on supporting adoption by market participants and jurisdictions. The ISSB is continuing to work with jurisdictional representatives through its Jurisdictional Working Group (which includes the EC and U.S. SEC) and Sustainability Standards Advisory Forum to align the ISSB standards with jurisdictional specific disclosure requirements and help local regulators develop disclosures that will supplement and work alongside IFRS S1 and S2.

In addition to the Transition Implementation Group, the ISSB will also assist companies and others by working on capacity-building. The ISSB has established a partnership framework to support the introduction of IFRS Sustainability Disclosure Standards across all economic settings, including the “phasing and scaling” of requirements in consideration of smaller companies and of companies operating in developing and emerging economies.

Takeaways

From a standing start, in less than 18 months after it was launched, the ISSB has accomplished the implausible, if not impossible. In response to widespread stakeholder demands for more consistent, comparable, and reliable information, the ISSB has developed a comprehensive global baseline of sustainability-related financial and climate disclosures. Along the way, as a result of extensive outreach and consultation, the ISSB has garnered substantial international support for its standards.

The ISSB has also implemented programs and working groups to educate business and jurisdictions, adapt the standards to account for various jurisdictions’ unique disclosure requirements, and ultimately secure those jurisdictions’ adoption of the standards. IOSCO’s anticipated endorsement of the IFRS S1 and S2 standards is likely to drive adoption by the many jurisdictions worldwide that have already adopted IFRS accounting standards.

It appears that the ISSB is well on its way toward meeting its promise to chart a path for convergence on a single, albeit flexible, global sustainability disclosure standard. The close collaboration between the ISSB and the EU/EFRAG to maximize the interoperability of the IFRS S1 and S2 and ENSR disclosure requirements exemplifies how far the world has come in such a short time. It also provides a roadmap for other jurisdictions, including the U.S., to adapt and adopt uniform sustainability related disclosure requirements.

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