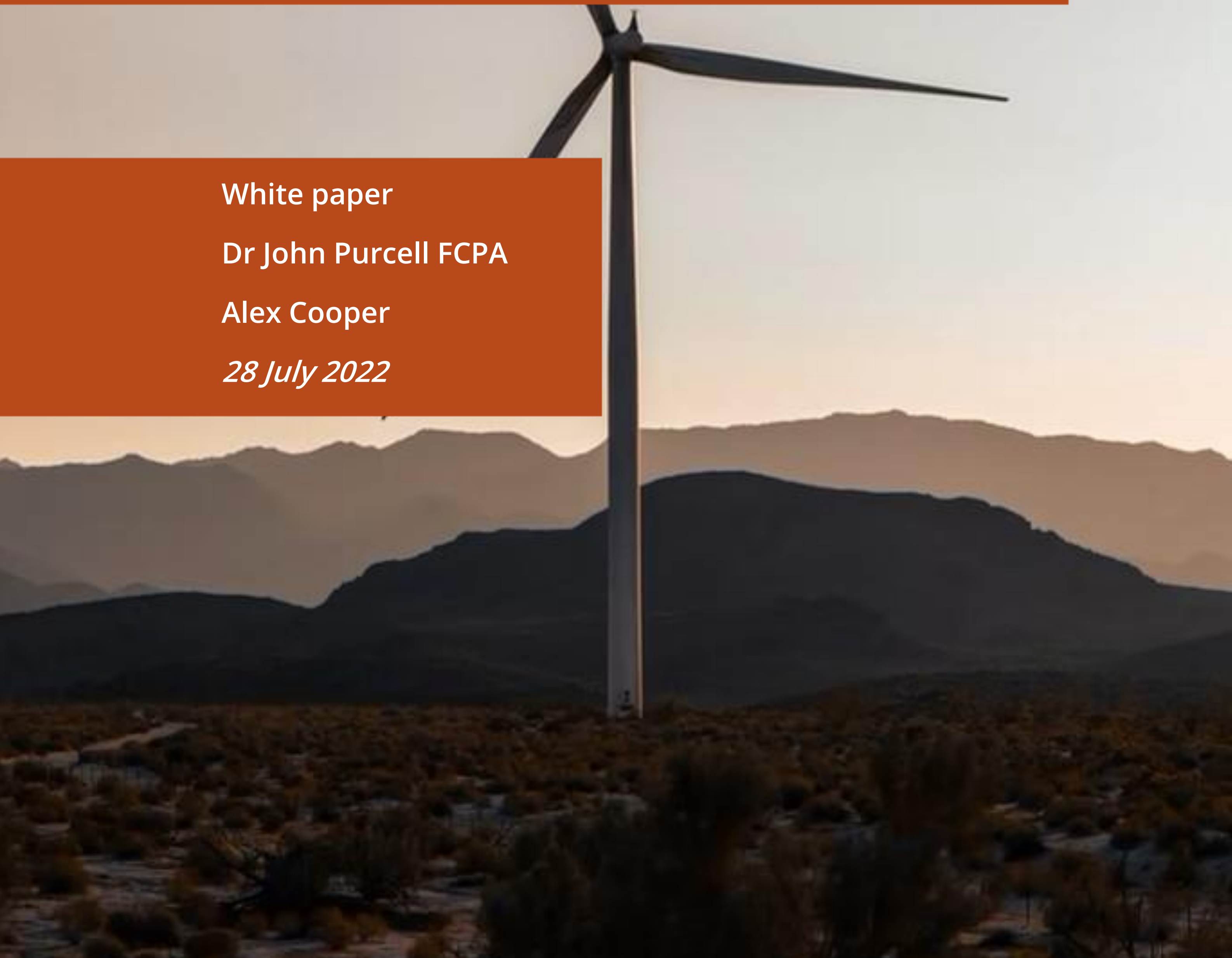
Commonwealth Climate and Law Initiative

The development of the ISSB sustainability standards: What does it mean for directors' legal duties?



White paper

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EXECUTIVE SUMMARY

Background and context

On 31 March 2022, the IFRS Foundation released two Exposure Draft Sustainability Disclosure Standards for public comment. These are designed to meet investors' information needs in assessing an issuer's enterprise value, enabling efficient allocation of resources through the capital market.

The two Exposure Drafts published to date are IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information, and IFRS S2 Climate-related Disclosures, and which are largely based on existing IFRS. They include several notable elements which may affect the governance of reporting entities, and therefore affect the consideration of how boards should act in order to best fulfil their legal duties to the company.

IFRS S1 and IFRS S2 require disclosures which are generally aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD), including narrative disclosures on governance, strategy, risk management, and metrics and targets. The Exposure Drafts set out requirements for reporting entities to disclose material information (i.e. information which could be reasonably expected to influence the decisions of the primary users of financial statements) about significant sustainability risks and opportunities across their entire value chain.

The Exposure Drafts propose that the disclosures should be made as part of the entity's general purpose financial reporting and that the information in the sustainability disclosures be connected to other information in the general purpose financial reporting. Directors' central role and responsibility to oversee the preparation of, and ultimately approve, the general purpose financial reporting brings these sustainability disclosures within the scope of the exercise of their powers and fulfilment of their duties. In exercising due care, skill and diligence in approving the disclosures, directors will therefore be required to robustly consider, understand and ask questions about the sustainability information disclosed.

While not explicitly requiring governance of or the development of a strategy to minimise sustainability risks and consider sustainability opportunities, the Exposure Drafts clearly envisage a reporting system through which entities disclose information regarding these aspects. If the ISSB standards become mandatory, as stated by the G7 nations, disclosing on these aspects will effectively require reporting entities to put in place governance systems to identify and manage sustainability risks and opportunities generally, and in particular, climate change-related risks and opportunities, which are the focus of IFRS S2. By bringing sustainability matters within the governance processes that apply to issues of risk management, strategy and disclosure, this is likely to elevate the standard of care and competence on sustainability issues which directors are required to meet in order to fulfil their legal duties.

Key takeaways and findings

- The Exposure Drafts set out requirements for entities to disclose, with their annual report, sustainability information which is useful to investors when assessing the entity's enterprise value, as part of the entity's general purpose financial reporting (see paras. 3.1, 3.4.6 and 3.4.7).
- Sustainability-related information is noted as being broader than information contained solely in financial statements, but should, to the extent possible, be reflected in financial statements (see paras. 3.1, 3.4.2 and 3.4.5).
- Sustainability-related information includes material information about all significant sustainability-related risks and opportunities to which an entity is exposed along its value chain. (see para. 3.4.1).
- It is proposed that entities be required to disclose their strategy for addressing significant climate-related risks and opportunities, including the impacts of climate on the entity's business model, its

access to finance, and its costs of capital, over short, medium and long-term time horizons (see paras. 4.5, 4.5.1, 4.5.2).

- Entities are also required to disclose their governance measures in relation to sustainability risks, which is likely to include the measures taken by the board (see para. 3.3).
- While the exact nature and substance of directors' legal duties differs across jurisdictions, these commonly reflect the general principles that directors are required to act in good faith for the benefit of their company, and with due care, skill and diligence (see para. 5.1).
- While deference is given to the directors' expertise and knowledge in decision-making for the company, if directors fail to ensure systems are in place to integrate those material sustainability risks which have been identified and disclosed by the company into risk management processes, this may breach the requirement to act in 'good faith' in the best interests of the company (see para. 5.4).
- The duty to act with due care, skill and diligence is measured to both and objective and subjective standard. The objective standard – that of the reasonable director - is considered to vary depending on the context in which the directors' behaviour is judged (see para. 5.1). If companies are required to disclose their measures for identifying, monitoring and managing sustainability-related risks and opportunities, it follows that directors should consider and act on such risks and opportunities when exercising their powers in order to meet their duty to act with due care, skill and diligence.
- Directors are required to sign-off on company accounts, certifying that these provide a 'true and fair' view of the company's financial position (see para. 5.2). Since the Exposure Drafts propose sustainability-related information as being part of an entity's general purpose financial reporting and potentially impacting on the entity's financial statements, directors could breach their obligations in this respect by signing-off on accounts which did not reflect disclosures on sustainability-related information.
- Directors could also be found liable for material omissions or misleading statements in the company's disclosures (see para. 5.3). Directors should ensure that there is a reasonable basis for any forward-looking statements which they make (such as sustainability targets), there is reasonable grounds on which to make those statements at the time they are made, and that identified sustainability risks are transparently disclosed in compliance with national requirements.

This White Paper has been prepared by the CCLI to provide guidance on the key features of the Exposure Drafts, and the implications of the consultation questions, in particular as they pertain to governance, strategy and management in respect of climate-related risks. It sets out the key provisions of the Exposure Drafts in this respect, and analyses, at a high level, the relevant legal duties to which boards are subject. Since the Exposure Drafts have yet to be finalised, and it remains to be seen which jurisdictions will adopt them, the legal analysis examines general principles rather than detailed legal provisions.

This White Paper continues as follows:

- Section 1 contains a brief introduction to the Exposure Drafts and the public consultation;
- Section 2 sets out the background to the ISSB and the purpose of the Exposure Drafts;
- Section 3 and Section 4 discuss the key features of the Exposure Drafts of IFRS S1 and IFRS S2 respectively, in particular those which pertain to the reporting entity's strategy and governance; and
- Section 5 discusses, at a high level, the effect of the Exposure Drafts (if finalised and made mandatory) on directors' duties.

About the Commonwealth Climate and Law Initiative (CCLI)

The CCLI is a legal research and stakeholder engagement initiative founded by the University of Oxford's Smith School of Enterprise and the Environment, ClientEarth and Accounting for Sustainability (A4S). We are a UK non-profit organisation funded by environmental philanthropy and research grants.

We examine the legal basis for directors and trustees to consider, manage, and report on climate change and broader environmental risks, opportunities and impacts, and the circumstances in which there may be liability for failing to do so. We also work to advance knowledge on effective sustainable governance practice.

We commission legal opinions from independent experts within a jurisdiction to build an authoritative evidence base on the requirements of company and trust law as it relates to the nature crises. We also work with leading academics, law firms and civil society entities to carry out our own legal research and disseminate our findings. Our Canadian partner, the Canada Climate Law Initiative, convenes experts to educate Canadian boards on climate change under the Canadian Climate Governance Experts project. They also provide an online knowledge hub for climate risk and sustainable finance resources.

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Disclaimer

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List of Abbreviations

BC	Basis for Conclusions
COP 26	Twenty-Sixth Conference of Parties to the UNFCCC, which took place in November 2021
ED	Exposure Draft
ESG	Environmental, social and governance
G7	'Group of Seven' Forum, consisting of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.
GAAP	Generally Accepted Accounting Principles
GHG	Greenhouse gases
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IPCC	Intergovernmental Panel on Climate Change
ISSB	International Sustainability Standards Board
SASB	Sustainability Accounting Standards Board
TCFD	Task Force on Climate-related Financial Disclosures
UNFCCC	United Nations Framework Convention on Climate Change

Contents

1. INTRODUCTION

The International Sustainability Standards Board (ISSB), part of the IFRS Foundation (formerly named the International Accounting Standards Committee), on 31 March 2022 released for public comment two draft (Exposure Daft) Sustainability Disclosure Standards:

- IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information
- IFRS S2 Climate-related Disclosures

The IFRS Foundation has allowed for a 120-day consultation period closing on 29 July and, dependent on the feedback, expects to release finalised standards by year's end.

In parallel with these deliberations by the International Sustainability Standards Board, steps will be taken towards public consultation on its future work agenda to determine further sustainability-related risk and opportunities to be prioritised as part of a comprehensive baseline of sustainability-related financial disclosures that will sit alongside financial statements as part of general purpose financial reporting.

2. BACKGROUND

The formation of the ISSB was announced at the UN Framework Convention on Climate Change (UNFCCC) 26th Conference of Parties (COP 26) co-hosted by the United Kingdom and Italian governments in Glasgow in November 2021. The impetus for formation of the ISSB can in large part be traced to the establishment by the International Organization of Securities Commissions (IOSCO) in 2020 of a Board-level Sustainability Finance Taskforce (STF) which would carry out work in three key areas:

- corporate issuers' sustainability-related disclosures;
- asset managers' disclosures and investor protection; and
- the role of Environmental, Social and Governance (ESG) data and ratings providers.

The first of IOSCO's key areas of focus culminated in the June 2021 *Report on Sustainability-related Issuer Disclosures* in which the following five **Investors' needs** are presented against corresponding **Gaps and shortcomings in current reporting**:

NEEDS	***GAPS***
Complete, consistent and comparable sustainability-related reporting to inform investment and risk management	Sustainability-related disclosures are not complete, consistent and comparable
Systematic reporting against established frameworks and standards	Companies report selectively against multiple different standards and frameworks
Investor-oriented, industry specific information on all three 'ESG' categories	Sustainability-related disclosures aim to meet multiple stakeholders' needs
A mix of narrative information and quantitative metrics	Companies do make both narrative and quantitative disclosures, but information is not consistent and quantitative metrics are limited
Linkage between sustainability risks and opportunities and business, strategy and financials	There is often a disconnect between companies' reporting financial and non-financial performance

These insights provide the basis of IOSCO's formulation of three **priorities** in advancing a disclosure regime for sustainability-related reporting:

> ***Priority 1.*** **Encouraging Globally Consistent Standards.** Encourage progress towards globally consistent application of a common set of international standards for sustainability-related disclosure across jurisdictions, covering the breadth of sustainability topics and leveraging existing principles, frameworks and guidance.
>
> ***Priority 2.*** **Promoting Comparable Metrics and Narratives.** To promote greater emphasis on industry-specific, quantitative metrics in companies' sustainability-related disclosures and standardisation of narrative information.
>
> ***Priority 3.*** **Coordinating Across Approaches*.*** To drive international consistency of sustainability-related disclosures with an emphasis on enterprise value, while also supporting mechanisms to coordinate investors' information needs on wider sustainability impacts – and (i) to promote closer integration of those two aspects with reporting under current accounting standards frameworks and (ii) facilitate independent assurance of companies' disclosures.

The delivery of outcomes against these priorities complements IOSCO's further identification of **elements** that would deliver substantially improved sustainability-related disclosures in a manner consistent with IOSCO's formal objectives of protecting investors, maintaining fair, efficient and transparent markets, and in reducing systemic risk. The character and details of these three elements both underpin the significant institutional developments that have been undertaken and explain the priorities given in each of the exposure draft IFRS Sustainability Disclosure Standards. The three elements are discussed at length in the June 2021 report from IOSCO[1], selected aspects of which are highlighted here on the basis for informing CCLI's constituencies of interest and their likely priorities and concerns.

Element 1. Establish an ISSB with a strong governance foundation. In its April 2020 report (Sustainable Finance and the Role of Securities Regulators and IOSCO), IOSCO had concluded that with regards existing development of frameworks and standards for sustainability, there lacked sufficient robust governance structures and processes of public interest oversight. In contrast, the processes which had emerged over time in relation to both financial accounting and audit standards had achieved very high levels of international legitimacy centred on attributes including:

- public accountability and independence,
- rigorous, transparent and participatory dues process, and
- a clear mission statement and a defined target audience.

In addition, the existing three-tier governance structure of the IFRS Foundation consisting of the Monitoring Board[2], Trustees and the International Accounting Standards Board (IASB), was seen as readily adaptable to accommodating a parallel board vested with powers and expertise specific to sustainability matters. Coinciding with its five-yearly cycle of strategic review, the IFRS Foundation in April 2021 embarked on consultations in relation to targeted amendments to its Constitution leading to the above referenced announcement at COP 26. Accordingly, the key objective of the IFRS Foundation now states:

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1 5.2 Key elements of IOSCO's vision to deliver the priorities for improvement pp 33 – 41.

2 The function of the Monitoring Board is set out in clause 19 of the IFRS Constitution and in essence provides a formal link between the Trustees and public authorities in a manner which seeks to replicate internationally the 'historical' relationship between corporate reporting standard-setters and public authority oversight of those powers. Membership of the Monitoring Board is dealt with in clause 21 and includes substantial representation from IOSCO.

> 2(a) through the IASB and the ISSB, to develop, in the public interest, high-quality, understandable, enforceable and globally acceptable standards (referred as 'IFRS Standard') for general purpose financial reporting based on clearly articulated principles. The IASB is responsible for developing a set of accounting standards (referred to as 'IFRS Accounting Standards') and the ISSB is responsible for developing a set of sustainability disclosure standards referred to as 'IFRS Sustainability Disclosure Standards'). These complementary sets of IFRS Standards are intended to result in the provision of high-quality, transparent and comparable information in financial statements and in sustainability disclosures that is useful to investors and other participants in the world's capital markets in making economic decisions.

Taken out of order, **Element 3 (Encouraging a 'Building Blocks' Approach)** is also reflected in amendment to the IFRS Foundation Constitution, here around coordination and interoperability with complementary disclosure requirements:

> 3. Information arising from the application of IFRS Standards is designed to meet the needs of investors and other capital market participants; however, other parties may also find the information useful. The ISSB develops IFRS Sustainability Disclosure Standards acknowledging the importance of their interoperability with other reporting initiatives that address broader information needs of other parties.

These passages from the revised IFRS Foundation Constitution are highly pertinent in their informing conclusion as to the anticipated information utility of IFRS-based sustainability disclosures along with what might be expected around institutional responses towards driving uptake.

Essential to the notions of 'interoperability' and a 'Building Blocks' approach is the intent that future ISSB standards will serve as a baseline of consistent and comparable sustainability information that, whilst investor focused, is also complementary:

- firstly, to wider multi-stakeholder information needs around disclosures, indicators and contextual information addressing sustainability developments, impacts or public policy objectives, and
- secondly, with jurisdiction-specific initiatives which extend beyond ISSB's particular orientation through a focus on comparable metrics and methodologies.

The use in Clause 2(a) of the term 'enforceable' in the context of both IFRS Accounting Standards and IFRS Sustainability Disclosure Standards points to the reality that in both instances the degree and method of enforcement are a function of jurisdictional policy choice and regulatory powers. As such, the 31 March release of the Exposure Drafts is accompanied by a statement from the ISSB Chair that "the ISSB is working closely with other international organisations and jurisdictions to support the inclusion of the global baseline into jurisdictional requirements." Where there is clear action being taken within the notion of a global baseline is in the realm of response to both national and regional measures specifically directed towards formalising sustainability disclosures within their areas regulatory remit. Hence, the further announcement from the IFRS Foundation on 27 April of the establishment of a working group made up predominantly of financial market regulator[3] aimed at examining compatibility of respective initiatives with the view to "optimising reporting efficiency for companies in those jurisdictions and how those jurisdictions can build

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[3] Members of the working group are the Chinese Ministry of Finance, the European Commission, the European Financial Reporting Advisory Group (EFRAG), the Japanese Financial Services Authority, the Sustainability Standards Board of Japan Preparation Committee, the UK Financial Authority and the US Securities and Exchange Committee. Prominent examples of relevant jurisdictional initiatives include in the EU, ongoing developments under the umbrella of the Corporate Sustainability Reporting Directive, EFRAG has released thirteen draft standards covering a range of sustainability subject matter which include reference to 'double materiality' (comment period closing 8 August) and in the USA open consultation from the SEC on rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reporting (comment period closing 17 June).

upon the global baseline according to their needs." Elsewhere, what is apparent is a growing appetite for substantially more forthright action around the regulation of climate-related disclosures, this captured in the Executive Summary of the IOSCO June 2021 Report:

> The G7 Finance Ministers and Central Bank Governors Communique of 5 June 2021 emphasized investors' need for "high quality, comparable and reliable information on climate risks." The Communique announced G7 support to move towards "mandatory climate-related financial disclosures that provide consistent and decision-useful information for market participants and that are based on the Task Force on Climate-related Disclosures (TCFD) framework, in line with domestic regulatory frameworks".

It is difficult to conjecture as to the degree to which high level sentiments such as these will hasten broad national-level adoption of IFRS S2, assuming satisfactory conclusion of the current consultation processes. Nevertheless, the momentum for providing regulatory underpinning to climate-related disclosures is evident across an increasing number of jurisdictions, identification and analysis for which can be found in the TCFD's October 2021 Status Report.[4]

Element 2. Building on Existing Efforts

IOSCO has expressed its emphatic view that the ISSB in developing a common set of disclosure standards should leverage existing sustainability-related reporting frameworks, such as the TCFD, in order to provide a 'running start'. Five themes or streams of existing developed are identified and which are reflected in the development of IFRS S1 and IFRS S2:

- 'Climate first', expanding to other ESG matters
- Investor focus for enterprise value
- Build from Prototype climate-related financial disclosure standard
- Integration with financial reporting
- Sound basis for audit and assurance

The manner in which each of these themes is addressed in the development of the first tranche of IFRS Sustainability Disclosure Standards is outlined in the following discussion. Each Exposure Draft (ED) is relatively lengthy, respectively 49 and 58 pages, including specific sections setting out consultation questions for respondents, and are accompanied by supporting materials, primarily Basis for Conclusions (BC).[5] The following therefore is centred on awareness raising in the context of how these shifts in the formalising and regulation of sustainability disclosures may shape or influence directors' duties. Key parts of the EDs are highlighted, though readers are urged to reviews the full texts, and, where appropriated, short 'CCLI White Paper Commentary' are provided as pointers of potential significance (these are by way of assistance to readers rather than authoritative conclusions).

[4] Please see TCFD Report 2021, Executive Summary page 4 and *Initiatives Supporting TCFD* pp. 15 -21 in which TCFD-aligned official reporting requirements are outlined for Brazil, European Union, Hong Kong, Japan, New Zealand, Singapore, Switzerland and United Kingdom.

[5] IFRS, Exposure Draft IFRS Sustainability Disclosure Standard: Basis for Conclusions on [Draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (March 2022); IFRS, Exposure Draft IFRS Sustainability Disclosure Standard: Basis for Conclusions on [Draft] IFRS S2 Climate-related Disclosures (March 2022).

3. [DRAFT] IFRS S1 GENERAL REQUIREMENTS FOR DISCLOSURE OF SUSTAINABILITY-RELATED FINANCIAL INFORMATION (ED IFRS S1)[6]

ED IFRS S1 is structured into four major parts – **Objective**, **Scope**, **Core Content** and **General Features** – and concludes with a series of appendices, most significant of which are *Defined terms* and *Qualitative characteristics of useful sustainability-related financial information.* The more significant features from each of these parts are outlined below, as well as some of the more pertinent questions raised for respondents.

Although not addressing specific parts of the proposed text of the standard, ED IFRS S1 is prefaced by a limited number of consultation questions around overall approach (Question 1(a) – (d)).

Aspects of overall approach are briefly discussed here as they point to key features of the intended breath of sustainability-related information that should be disclosed and the relationship between overarching general requirements and sustainability-topic specific standards.

ED IFRS S1 is to some extent modelled on IAS 1 *Presentation of Financial Statements*, particularly those parts dealing with objective, scope and general features, though does contain corresponding specification of structure and content. This, in part, reflects the highly evolved nature of financial statements and underlying classification of components. ED IFRS S1 also draws on IAS 8 *Accounting policies, changes in accounting estimates and errors* along with some aspects of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*). The *Conceptual Framework,* in describing the objectives of, and concepts for, general purpose financial reporting, has the purposes of guiding consistency in the developing financial accounting standards against which preparers are able to develop consistent accounting policies along with assisting relevant parties in their interpretation of these standards. With regards the *Conceptual Framework*, it is unclear if, and when, the ISSB may develop a separate conceptual framework dealing either discretely with sustainability-related information/ statements or addressing aspects of the overall 'architecture' of general purpose financial reporting.

Question 1 contains the following statement:

> Proposals in the Exposure Draft would require an entity to 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.

The intended breadth of disclosure is reflected in Question 1(a) whereby views are sought as to it being clear that the identification and disclosure applies to all material sustainability-related risks and opportunities regardless of a specific IFRS Sustainability Disclosure Standard dealing with the matter. Additionally, Question 1(c) which references ED IFRS S2 *Climate-related disclosures,* makes clear the intention that thematic standards are to be applied with reference to the principles and general requirements set out in ED IFRS S1. Relevant also under Question 1 is (d), seeking views on the ED providing a suitable basis for both auditors and regulators to determine compliance.

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[6] As with the text of IFRS Accounting Standards developed by the IASB, all paragraphs have equal authority with those in **bold type** stating the main principles.

3.1 Objective[7] (para. 1)

This is set out in para 1:

> **The objective of [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* is to require an entity to disclose information about its significant sustainability-related risks and opportunities that is useful to the *primary users of general purpose financial reporting* when they assess *enterprise value* and decide whether to provide resources to the entity.**

The primary focus here centres on the notion of *enterprise value* which is defined in Appendix A as:

> The total value of an entity. It is the value of the entity's equity (market capitalisation) and the value of the entity's net debt.

The information utility of sustainability-related financial given to enterprise value is identified in BC8 and extensively elaborated on at BC 33-41. Critical within these explanations is the reference to capital markets participants' expectations and estimations of the amount, timing and uncertainty of future cash flows over the short, medium and long term. Further, linkage is drawn with the interaction between an entity's risk profile and cost of capital against which an assumption is made (see BC 36) that, amongst other matters, disclosure of sustainability-related financial information reveals whether, and to what extent, the entity's activities increase or mitigate significant sustainability-related risk and opportunities along with the manner of management's response through its governance arrangements.

BC 38 provides some further useful elaboration on these relationships:

> Sustainability-related risks and opportunities are drivers of enterprise value when they result in, for example, direct or indirect changes to the market, legislation, and the relationship with the physical environment – such as caused by climate change – in which the entity operates, such as its ability to execute its strategy and progress its business model is affected.

Turning to para. 1's reference to users and their decisions, these mirror wording presented in para. 1.2 of the *Conceptual Framework* addressing existing and potential investors, lenders and creditors, though the *Conceptual Framework's* description of the resource provision decisions is more expansive generally addressing the exercise of rights.[8] The identification of audience is consistent with the above-described notion of interoperability with multi-stakeholder focused sustainability reporting. A further discernible difference is that the focus on the exercise of rights in para. 1.3 of the *Conceptual Framework* – for example, decisions to buy, sell or hold equity instruments – references actual or expected returns, whereas the decisions relating to the assessment of significant sustainability risk and opportunities are broader, pertaining to collective market assessments determining security pricing.

Pertinent also under **Objective** is para 3:

> **An entity's *general purpose financial reporting* shall include a complete, neutral and accurate depiction of its *sustainability-related financial information*.**

Each of the italicised phases is a term defined in Appendix A and the three characteristics of depiction (complete, neutral and accurate) are discussed in Appendix C. Each of these is discussed in further detail below.

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7 Paragraphs 1 and 3 are dealt with in this section of the White Paper and para. 2 considered in 3.4.1 under **Reporting entity.**

8 The types of decision identified in *Conceptual Framework* para 1.2(a)-(c) is mirrored in ED IFRS S1 in Appendix A where *General purpose financial reporting* is defined.

General purpose financial reporting

Dealing firstly with *general purpose financial reporting,* this is defined in Appendix A in terms that "General purpose reporting encompasses – but is not restricted to - an entity's general purpose financial statements[9] and **sustainability-related financial disclosures.**"

CCLI COMMENTARY

This wording is deliberately and necessarily broad and is distinguishable from **general purpose financial report**[1](emphasis added), the need for which is described below with reference to the **general features** of *location of information* and *statement of compliance*. 'necessity' aside, questions potentially arise as to whether such indeterminacy may impede both preparer uptake and national regulatory support.

Sustainability-related Financial Information

Turning to *sustainability-related financial information*[10], Appendix A defines this as:

> Information that gives insights into sustainability-related risk and opportunities that affect **enterprise value,** providing a sufficient basis for **users of general purpose financial reporting** to assess the resources and relationships on which an entity's **business model[11]** and strategy for sustaining and developing that model depend.

BC 25-31 explain that this description is intentionally broad, nevertheless narrow in its application to the scope of intended audience and possible range of sustainability issues. [12] It is broad insomuch as it recognises the presence of a potential multiplicity and interaction of sustainability-related risk and opportunities which may over time evolve to affect assessment of enterprise value. In these terms, the expectation is that disclosures will be dynamic, evolving in recognition that in the preparation of this information regard will need to be given to the "way in which [an entity's] activities increase or mitigate sustainability risks [and that] impacts and dependencies on resources and from the relationship it maintains - - - may be positively and negatively affected by those impacts and dependencies" (BC28). Similarly, it is highlighted in BC28 that "sustainability-related risks and opportunities link and overlap and by doing so influence and amplify each other."

9 **General purpose financial statements** is a term defined in the *Conceptual Framework* as "A particular form of general purpose financial reports that provide information about the reporting entity's assets, liabilities, equity, income and expenses." (ref. CF.3.2)

10 *Sustainability-related financial **disclosures*** is separately defined as "Disclosures about sustainability-related risks and opportunities that are useful to **users of general purpose financial reporting** when they assess an entity's **enterprise value**, including information about its governance, strategy and management, and related metrics and targets."

11 **Business model** is also a define term: "An entity's system of transforming inputs through its business activities into outputs and outcomes that aims to fulfil the entity's strategic purposes and create value over the short, medium and long term."

12 In this latter regard BC31 reiterates the point that the ISSB is confining itself to material investor focused sustainability information. Some reference is nevertheless made in BC30 to the concept of sustainable development noting also a number of the international public policy instruments which have emerged, not least of which is the UNFCCC.

CCLI COMMENTARY

The above elaboration in the Basis for Conclusions appears a clear acknowledgement of the complexity of sustainability-related subject matter particularly in translating environmental, social and economic phenomena into firm-specific impact and response. No doubt greater clarity will emerge as the ISSB evolves and releases, as is expected, further standards covering additional dimensions, themes and topics in both the environmental and social domains. Nevertheless, there is a significant degree of uncertainty regarding the scope and interdependencies of sustainability-related risks and opportunities. As such, there may be some risk of an 'expectations gap' emerging between the hoped-for transformational impact of sustainability-related financial information and what the standards themselves can achieve particularly over medium- and long-term time horizons.

Apart from reiterating the obvious that sustainability-related financial information is 'financial information', para. 6 emphasises that it is broader than information in financial statements, particularly as regards its communicating interaction with the entity's risk, opportunity and strategy, its future orientation and its dealing with such matters as the implications for reputation, performance and prospects which are not captured in accounting numbers. Paragraph 7 complements these distinctions with reference to the intention of sustainability-related financial information being disclosed in a manner facilitating comparison both across reporting periods and with other entities. Addressing perceptions that such breadth in potential disclosure may lead to indeterminacy, BC40 provides the important qualifier that the expectation is identification of significant risks and opportunities that would potentially disrupt or otherwise impact the entity's business model, stating in conclusion:

> Focusing on significant sustainability-related risks and opportunities rather than on all sustainability-related risk and opportunities is intended to ease application for preparers while not reducing the usefulness of information provided to users as the disclosure is already subject to materiality.

ED IFRS S1 para. 5 elaborates further on enterprise value in terms of it reflecting expectations of the amount, timing and uncertainty of cashflows over various time horizons. Paragraph 5 contains the statement that:

> Information that is essential for assessing the enterprise value of an entity includes information that is provided by the entity in its financial statements and sustainability-related financial information.

Without in any way being critical of the importance placed on enterprise value, it is noteworthy that it is not a concept directly referenced in either IAS 1 or the *Conceptual Framework,* the latter adopting the following cautious language:

> General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.[13]

The complexity of estimating the value of a reporting entity, particularly when dealing with factors at the threshold between financial statements and what might otherwise be conveyed in sustainability-related financial information, is elaborated on in a useful discussion in BC39 where it is stated:

> Some effects of significant sustainability-related risk and opportunities are reflected in the financial statements.[14]

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[13] (ref.CF.1.7)

[14] The IFRS has prepared a highly useful commentary in this regard: *IFRS Standards and climate-related disclosure* November 2019 https://www.ifrs.org/content/dam/ifrs/news/2019/november/in-brief-climate-change-nick-anderson.pdf

Yet against this,

> However, sustainability-related information also includes details of risks and opportunities related to unrecognised items.

Developing these two points further, BC39 explains that there may nevertheless exist items which would continue to be recognised in financial statements in that measurement consequences are such that their carrying amounts may still be recoverable notwithstanding the realistic assessment of reduced value creating capacity.

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The nature of both sustainability-related information and its interaction with financial statement recognition and measurement are complex and caution should be applied to expectations of their predictive power. The application of both requires a high degree of management judgment against which collective market assessment of value should likewise be treated with caution.

Complete, neutral and accurate

Turning now to the characteristics of *complete, neutral* and *accurate.* Each is elaborated on Appendix C *Qualitative characteristics of useful sustainability-related financial information* under the heading **Faithful presentation**, which is discussed further in this White Paper under the categories of **General features**. The first two have relatively uncontroversial 'plain language' meanings and are expressed in manner similar to that found in the *Conceptual Framework,* there also under the heading of *Faithful presentation*, as one of the fundamental qualitative characteristics of useful financial information.[15] C11 and C12 respectively state in part:

> A complete depiction of a sustainability-related risk or opportunity includes all material information necessary for the primary users to understand that risk or opportunity, including how the entity has adapted - - - as well as the metrics identified to set targets and measure performance.
>
> A neutral depiction is one without bias in the selection or disclosure of information. Information is neutral if it is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to make it more likely that the primary users will receive that information favourably or unfavourably.

Where there is some departure in language, and with potential practical implications, is the treatment of *accurate.* Both the *Conceptual Framework* and Appendix C of ED IFRS S1 includes "free from error", along with *complete* and *neutral*, as one of the depictions of faithful presentation. The *Conceptual Framework* states in relation to this matter that "(f)aithful presentation does not mean accurate in all respects" and that "free from error does not mean perfectly accurate in all respects."[16] C15 echoes the qualifications on what might be regarded as a quest for exactitude and goes further to provide the following (selected) elaborations:

Accuracy requires that:

- Estimates, approximations and forecasts are clearly identified as such;

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15 The other fundamental qualitative characteristics are *relevance* and *materiality,* which complemented by Enhancing qualitative characteristics; *Comparability, Verifiability, Timelines* and *Understandability*. These in turn are pick up in C16 to C33 of ED IFRS S1 Appendix C.

16 (ref. CF.2.18)

- No material errors have been made in selecting and applying an appropriate process for developing an estimate, approximation or forecast, and the inputs to that process are reasonable and supportable:
- Assertions are reasonable and based on information of sufficient quality and quantity; and
- Information about judgements about the future faithfully reflects those judgements and the information on which they are based.

CCLI COMMENTARY

The more detailed explanation of expected precision in sustainability-related financial information is welcome, yet it remains to be seen whether it is sufficient to assuage concern about measurement uncertainty, interaction/ interdependence of sustainability dimension, along with broader economic, regulatory and political uncertainties which may impinge, particularly in the longer term.

Finally, under **Objective** of ED IFRS S1, reference is made to paras. 5, 6 and 7, and the corresponding elaborations in BC 39 and 40 dealing with the interaction with financial position, financial performance or risk profile. This provides some pointers for interaction and development in financial statement disclosure. This issue is also dealt with in the White Paper under **General Features** *Connected information.* Paragraphs 6 and 7 are dealt with first in the immediately following discussion as they are more general in nature, whereas para. 5 points to more specific complexity.

3.2 Scope (para. 8)

Paragraph 8 as the key operative provision under **Scope** of ED IFRS S1 states:

> **An entity shall apply this [draft] Standard in preparing and disclosing sustainability-related financial information in accordance with *IFRS Sustainability Disclosure Standards.* An entity may apply IFRS Sustainability Disclosure Standards when the entity's related financial statements are prepared in accordance with IFRS Accounting Standards or other GAAP.**[17]

The key issue of contention underlying para. 8 is captured is the accompanying consultation question:

> Do you agree that the proposals in the Exposure Draft could be used by entities that prepare their general purpose financial statements with any jurisdiction's GAAP (**rather than only those prepared in accordance with IFRS Accounting Standards**)? If not, why not? [*emphasis added*]

Aside from addressing the reality of the absence of convergence between IFRS and financial accounting standards developed by the US Financial Accounting Standards Board (US GAAP), the proposed wider reach might be encouraging of greater global adoption. Nevertheless, a narrower approach which emphasises adoption of comprehensive rules, processes and oversight of corporate financial disclosure, might be more conducive to the development of high-quality sustainability-related financial disclosures and aid application of those principles and specific parts of IFRS Sustainability Disclosure Standards which stress the critical aspects of connectivity. Again, without suggesting a determined view, the final position adopted by IFRS may have implications for both audit practice and regulatory response at national jurisdiction levels.

[17] Generally Accepted Accounting Principles.

3.3 Core content (para. 11)

Those readers familiar with the TCFD 2017 Final Report Recommendations will recognise the four-tier structure adapted into ED IFRS S1. The main principles set out in para. 11 are:

> **Unless another IFRS Sustainability Disclosure Standard permits or requires otherwise, an entity shall provide disclosures about:**
>
> **(a) governance – the governance processes, controls and procedures the entity uses to monitor and manage sustainability-related risks and opportunities;**
>
> **(b) strategy – the approach for addressing sustainability-related risks and opportunities that could affect the entity's *business model* and strategy over the short, medium and long term;**
>
> **(c) risk management – the processes the entity uses to identify, assess and manage sustainability-related risks; and**
>
> **(d) metrics and targets – information used to assess, manage and monitor the entity's performance in relation to sustainability-related risks and opportunities over time.**

Both the accompanying Basis for Conclusions (BC42-45) and *Questions for respondents* are relatively brief in relation to this part of the Exposure Draft and perhaps belie a degree of potential complexity and uncertainty in application. Part of the challenge here may centre on understanding the interactions and boundaries between IFRS S1 and the topic-specific IFRS Sustainability Disclosure Standards which will emerge over time, aside of course from ED IFRS S2, it being apparent that this TCFD-style four-tier approach to structure of disclosures will be applied with a degree of universality. Nevertheless, as matters are currently presented, confusion may arise around matters such as the expected degrees of comprehensiveness between the *General Requirements* and the topic-specific standards, along with the degree to which compliance with one might satisfy requirements of the other.[18] This notwithstanding earlier observations in this White Paper in relation to respondent question Q1(c) that thematic standards are to be read and applied with reference to general disclosure requirements laid-out in ED IFRS S1.

Some of the more salient aspects[19] of the proposed **Core content** and accompanying elaborations are briefly discussed here:

Under the elaboration on the core content of **Governance**, para. 13 requires "disclosure of information about the governance body or bodies - - - with oversight of sustainability-related risks and opportunities, and information about management's role in those processes." Though not stated, it is probably fair to assume that in the majority of cases this is the same 'instrument' of corporate governance vested with powers of management of the entity (in most cases, the board of directors), particularly given the degree to which sustainability-related risk and opportunities are set in the context of the entity's *enterprise value*.[20]

18 ED IFRS S2 at para. 18 provides worthwhile clarification: "In preparing disclosures to fulfil requirements [on risk management] an entity shall avoid unnecessary duplication with [draft] IFRS S1 - - - For example, - - - when its oversight of sustainability-related risks and opportunities is managed on an integrated basis, providing integrated risk management disclosures rather than separate disclosures for each significant sustainability-related risk and opportunity would reduce duplication."

19 This is not intended as an exhaustive 'list' and interested readers are encouraged to review the full texts of ED IFRS S1 paras. 12 – 35 along with the accompanying BC42 – 45.

20 Elsewhere in frameworks such as Integrated Report (<IR>) the term 'Those charged with governance' (derived to a large degree from audit standards) is used, and to avoid any ambiguity or uncertainty is defined as "person(s) with responsibility for overseeing the strategic direction - - - and its **obligations with respect to accountability and stewardship**." (Emphasis added).

Paragraph 13 contains a list, ((a) – (f)), of descriptors of how the governance body is structured though its oversight and committee arrangements to address the monitoring and management of sustainability-related risks and opportunities.

CCLI COMMENTARY

As to whether this constitutes a 'tick-the box' or 'set-and-forget' disclosure, such temptation would seem both risky and contrary to broader direction of developments in sustainability-related disclosures. In this regard, it is worth pointing to the earlier-referenced TCFD 2021 Status Report, in which one of the key headline conclusions was that "[a]though the Task Force recommends disclosure on governance regardless of materiality, the Governance recommendation remains the least disclosed recommendation with the two Governance recommended disclosures[1] the second and third least disclosed."

Paragraph 13 concludes in a manner again broadly reflective of the TCFD recommendations with (g) requiring description of management's role including "information about whether dedicated controls and procedures are applied to the management of sustainability-related risks and opportunities and - - - how they are integrated with other internal functions."

CCLI COMMENTARY

As regards the interaction between the intent of para. 13(a) – (e) (governance bodies) and para. 13(f) (management), the ED is silent on well-understood themes of reliance on information or advice provided by other and responsibility for actions of delegates. No firm view is presented here on whether this level of specificity ought to be presented in a IFRS Sustainability Disclosure Standard, though it may ameliorate against the tendency to treat sustainability-related governance disclosures as a bland compliance exercise.

Under the elaboration on the core content of **Strategy** four components of disclosure are identified and elaborated on: Sustainability-related risks and opportunities; Strategy and decision making; Financial position, financial performance and cash flows; and Resilience.

It is not practical here to draw-out the full range of specifics either directly referred to or which can be reasonably deduced from the elaborations on **Strategy** provided in paras. 15 – 24. Full and effective application of the IFRS Sustainability Disclosure Standards will be transformational on how an entity prepares its disclosures regardless of the further depth and complexity of strategy-related sustainability disclosures which can be expected to flow from topic-specific standards as they are developed.[21] The implications for market assimilation of information, preparer capacity, the gaining of effective audit opinion and regulatory oversight are all significant. With these perspectives in mind, the following elements of the **Strategy** components are highlighted:

- *Time horizons.* The **Strategy** category of disclosures about sustainability-related risk and opportunities most directly articulates the requirements around time horizons. Specifically, para.

[21] This is directly alluded to in para. 24 dealing with Resilience and the use of scenario analysis in dealing with specific sustainability-related risks.

16(b) requires the entity to disclose "how it defines short, medium and long term and how these definitions are linked to the entity's strategic planning horizons and capital allocation plans." Elsewhere in para. 16, and the related paragraphs, this notion of time horizons is applied to such matters as the description of sustainability-related risks and opportunity addressed in the context of effect on the entity's business model, strategy and cash flows. Para. 18 goes further in emphasising the variability of time horizons based on such factors as industry-specific characteristics and business cycles, with para. 20 introducing a further element of future oriented disclosure around anticipated impacts within the entity's value chain. Preparers of general purpose financial reports and their directors will be familiar with presenting future-oriented disclosures either by way of management commentary or where assessments of prospective cash flows are such as to affect current period accounting numbers. Both the breadth and dynamism of sustainability-related subject matter are such that the formalisation of disclosures brought about by IFRS Sustainability Disclosure Standards has the clear potential to bring about a significant deepening of information made available to investors and capital markets. Entities that currently adopt and have independently assured sustainability disclosures with reference to leading voluntary frameworks and standards should be well positioned, others however will need to embark 'on the journey' of a deep analysis multiple timeframes to which they are subject.

- *Decision-making and judgments.* Paragraph 21 dealing with **Strategy** and decision-making introduces a further disclosure requirement associated with management-type judgments, in this case description of trade-offs between sustainability risk and opportunities. The example provided suggests a clear expectation of a degree of 'granularity' around operational decisions and integration across environmental and social dimensions of sustainability. Again, this promises the potential to reshape reporting practices by providing to investors a 'window' on how management seeks to maintain strategic agility and manage sustainability as a 'whole of business' issue.
- *Cash flows.* Turning to the Financial position, financial performance and cash flows component of **Strategy**, the principle(s) expanded upon in para. 22 provides important pointers to both the expected depth of disclosure and connectivity[22] with other elements of an entity's general purpose financial reporting. In these regards the choice of reference to "cash flows" is highly significant and may provide an interesting contrast to the emphasis elsewhere in the ED, and more broadly, on *enterprise value*. Significantly, "cash flow" along with each of "financial position" and "financial performance", are set with reference to "reporting period"[23] against which users are then able to understand the effects of significant sustainability-related risks and opportunities.[24] The degree of expected precision in reporting is further reinforced by the reference in para. 22 that "[a]n entity shall disclose quantitative information unless it is unable to do so." From the standpoint of report preparation, there can be observed in practice a tendency to treat financial and sustainability as discrete streams of disclosure. Such distinction will clearly collapse with the application of IFRS Sustainability Disclosure Standards.
- The nature of both **Risk management** and **Metrics and targets** are such that it is reasonable to anticipate that the primary disclosure rules and reference points will come from topic-specific IFRS Sustainability Disclosure Standards. Core content **Metrics and targets** nevertheless has amongst its main principles para. 28:

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22 Discussed further in relation to the *Connected information* General feature (3.4.2)

23 Discussed further in relation to the *Frequency of reporting* General feature (3.4.6)

24 Elsewhere para. 22 makes reference to the entity's "financial planning". This term is used in Recommended Disclosure 2(b) of the TCFD Recommendation. The ED however has not 'picked up' the further elaboration provided under *Guidance for All Sectors* (page 22).

> **Metrics shall include those defined in any other applicable IFRS Sustainability Disclosure Standard, metrics identified from other sources identified in paragraph 54 and metrics developed by an entity itself.**
>
> Paragraph 54, in turn, provides a list including industry-based SASB[25] Standards and the CDSB[26] Framework application for water and biodiversity-related disclosures. Elsewhere, para. 19 under **Strategy** makes similar reference to external sustainability frameworks and standards. Without suggesting a firm position on the matter, questions are potentially raised around indeterminacy through the references to materials that lie outside the standards themselves, particularly given the use in para. 28 of the word "shall" in the context of materials which have not been subject to the due process applied by the ISSB to the development and approval of an IFRS Sustainability Disclosure Standard.

As already noted, the *Basis for Conclusions* in relation to **Core content** are brief. BC43 does however contain a statement of note (and perhaps potential controversy):

> The core content provide structure for the requirements, and are not intended to indicate that information must be reporting in any specific order or prescribed format.

Again, without suggesting a firm position, this otherwise commendable striving for flexibility may sit in contrast with what are clearly very specific disclosure requirements and presenting also some friction with the desired enhanced qualitative characteristic of comparability,[27] particularly when considered in the context of previously discussed para. 17's reference to the nature of sustainability-related financial information lending itself to the assessment of comparison with other entities.

CCLI COMMENTARY

The foregoing discussion indicates that the expected character of sustainability-related financial disclosures will have a degree of dynamism which will go a significant way towards redressing the five areas of **Gaps and shortcomings** in current reporting identified by IOSCO. The transformation and transition challenges should not be underestimated. Further, what is apparent is that an assumed clear dichotomy between sustainability-related financial information and 'accounting numbers' financial information is to a large degree illusory.

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[25] USA-based Sustainability Accounting Standards Board which in 2021 merged with the International Integrated Reporting Council to form the Value Reporting Foundation which, in turn, will later in 2022 be merged into the ISSB governance and operating structure.

[26] Climate Disclosure Standards Board which in early 2022 ceased operations to form the preliminary operating structure of the ISSB.

[27] ED IFRS S1 Appendix C para. C17.

3.4 General features

3.4.1 Reporting entity (paras. 38 and 38)

The main principles set out under this component of **General features** are, at first glance, uncontroversial:

> Para. 37 **An entity's sustainability-related financial disclosures shall be for the same reporting entity as the related general purpose financial statements.**[28]

And:

> Para. 38 **An entity shall disclose the financial statements to which the sustainability-related financial disclosures relate.**

Significantly though, para. 40 goes on to provide the elaboration that the overarching requirement is that of disclosing material information about all significant sustainability-related risks and opportunities, and in doing so cross-references to para. 2 under **Objective**, the full text of which states:

> **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.**

Moreover, para. 40 expands upon the text of para. 2, by stating that the risk and opportunities to be considered by the reporting entity relate to activities, interactions and relationships and use of resources along its **value chain**, and provides the following four illustrations:

(a) its 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;

(b) the assets it controls;

(c) investments it controls, including investments in associates and joint ventures; and

(d) sources of finance.

Value chain in the realm of sustainability disclosures is, of course, a well understood and frequently applied concept. ED IFRS 1 in Appendix A adopts the following definition:

> The full range of activities, resources and relationships related to a **reporting entity's business model** and the external environment in which it operates.

BC50 notes that ED IFRS S1 adopts the definition of *reporting entity* which is "An entity that is required, or chooses, to prepare general purpose financial statements." It is explained that this definition, drawn from IFRS Accounting Standards, is used to avoid confusion apparent in earlier versions which referenced 'reporting boundaries'. BC50 does go on to state that, regardless, "in the case of sustainability-related financial information, the focus is on the effects - - - on the reporting entity's enterprise value." As such, application of ED IFRS S1 would compel deep and thorough review of, and reporting on, factors within the external environment with the determined reporting entity being the reference point to which the sustainability-related financial disclosures pertain. Aside from aligning with primary user needs, this approach, as noted in BC49, also "enables entities to link financial statements with sustainability-related financial information." The degree to which ED IFRS S1 may been seen to drive this 'linkage' is explored further in this White Paper under **Core content** *Connected information* (3.4.2) and *Sources of estimates and outcome uncertainty* (3.4.8).

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[28] The full text of para. 37 goes on by way of example to explains the treatment of parent and subsidiary entities and their collective reporting entity treatment as a group.

This more expansive approach to contemplated disclosures is further reinforced in BC52's addressing the treatment of joint ventures, affiliates and investments, which, though not part of the reporting entity, are subject to specific disclosures treatment in financial statements. As such, assessments will need to be applied to the facts and circumstances of each from the standpoint of their sustainability risk and opportunity impact on the reporting entity's enterprise value. In this regard ED IFRS S1 para. 41 foreshadows future IFRS Sustainability Disclosures Standards addressing specific guidance for these types of investment arrangement.

CCLI COMMENTARY

Many of the sustainability disclosure topics that could be contemplated as coming within the expectations of ED IFRS S1 para. 1, and reinforced by proper application of the *Reporting entity* **General feature**, would currently be addressed to same degree in existing sustainability frameworks and standards. Nevertheless, within the drive for complete, consistent and comparable sustainability-related disclosure, the ensuing degree of expected formality that could be anticipated to develop over time should not be underestimated. Each of the four supply chain illustrations ((a) – (d), set out above) present distinctly different aspects of control and source of relevant data. As such, the challenges of market-wide capacity building should likewise not be underestimated.

3.4.2 Connected information (para. 42)

The main principle here is set out in para. 42:

> **An entity shall provide information that enables the users of general purpose financial reporting to assess the connections between various sustainability risk and opportunities, and to assess how information about these risks and opportunities is linked to information in the general purpose financial statements.**

Both the following paragraph and the accompanying *Basis for Conclusions* (in particular BC56) emphasise the intended narrative character of these disclosures and that such disclosures should draw out interconnection (relationships, interdependencies, trade-offs and so forth) across each of the four elements of core content and across the various types of information presented in general purpose financial reporting. The potential 'dimensions' of information that ought to be addressed are set out in BC54:

> The Exposure draft would require entities to highlight or explain connections between:
>
> (a) separate sustainability-related risks and opportunities;
>
> (b) the pieces of information disclosed, including between:
>
> (i) information to respond to separate disclosure requirements about the same risk or opportunity that affect more than one element of core content;
>
> (ii) disclosures about different risks and opportunities, both within and across core content; and
>
> (iii) sustainability-related financial disclosures and information in the financial statements.

CCLI COMMENTARY

The latter of these identified forms of connection ((b)(iii) above) is one of a number of principles within ED IFRS S1 which should draw the attention of preparers and auditors to alignment and consistency with accounting numbers, note disclosures and any accompanying commentary and/ or attestations. Similarly, there is an expressed intention (again in BC56) that the discourse should address the anticipated impact on financial performance and position over the short, medium and long term. Moreover, the comprehensive character of these intended disclosures will heighten sensitivities around potential making of misleading or deceptive forward-looking statements.

3.4.3 Fair presentation (paras. 45 and 46)

The two main principles presented under this *General feature* are, on their face, relatively straightforward. Complexities are nevertheless likely to ensue particularly around the processes to be applied in identifying the particular sustainability-related risks and opportunities warranting disclosure. Respective paras. 45 and 46 are as follows:

> **A complete set of sustainability-related financial disclosures shall present fairly the sustainability-related risk and opportunities to which an entity is exposed. Fair presentation requires the faithful presentation of sustainability-related risk and opportunities in accordance with the principles set out in this [draft] Standard.**
>
> **Applying IFRS Sustainability Disclosure Standards, with additional disclosure when necessary, is presumed to result in sustainability-related financial disclosures that achieve a fair presentation.**[29]

The subsequent paras. 47-49 supplement these principles through adapting qualitative characteristics and the treatment of aggregation/disaggregation of information, drawn respectively from the *Conceptual Framework* and IAS 1, into the sustainability disclosure context. With regards aggregation of information, BC59 reiterates and adds emphasis to the requirement set out in para. 48 stating that "understandability of disclosures shall not be reduced 'by obscuring material information with immaterial information or by aggregating material items that are dissimilar'". Whilst the rules associated with aggregation in financial statements and that proposed for sustainability disclosures are driven by considerations of overarching materiality from the standpoint of user expectations, the subject matter being dealt with is distinctively different and, it is urged in this White Paper, brings to bear significantly contrasting issues of management judgment. Aggregation in financial statements is, in some regards, a more numeric 'mechanical' process,[30] whereas aggregation of sustainability-related information may bring to bear potentially subjective assessment of what users would regard as material.

This potential for complexity is further elevated through those parts of the ED and accompanying *Basis for Conclusions* which seek to give guidance around the identification of material *disclosure topics.*[31] Over time there should emerge, as is intended, topic-specific standards additional to ED IFRS S2 thus resolving some of the uncertainty around application of ED IFRS S1 and more generally as to achieving the qualitative characteristics identified as part of the **Fair Presentation** that will support satisfying the decision-making

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[29] This form of presumption is a fundamental driver of adherence to IFRS Accounting Standards and is closely linked to the idea (and some jurisdictions, the obligation) of presenting a 'true and fair view' of financial position and performance.

[30] The relevant text from IAS 1 states: "Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statement. If a line item is not individually material, it is aggregated with other items in those statements or in the notes." (para. 30)

[31] *Disclosure topic* is a defined term in Appendix A: "A specific sustainability-related risk or opportunity based on the activities of the entities within a particular industry as set out in an **IFRS Sustainability Disclosure Standard** or an industry-based SASB Standard."

needs of users. That said, the type of cohesion that exists between IAS 1 and the numerous IFRS Accounting Standards is unlikely to emerge given the diverse and evolving sustainability subject matter. As currently presented, para. 51, through the use of the word "shall", does compel consideration of materials outside of the IFRS Sustainability Disclosure Standards in determining material topics against which information about risks and opportunities will be disclosed. Foremost amongst these is the disclosure topics in the industry-based SASB Standards[32]. Similarly, para. 55 requires:

> [Disclosure of] the industry or industries specified in the relevant IFRS Sustainability Disclosure Standard or industry-based SASB Standards[33] that it has used when identifying disclosures about significant sustainability-related risk or opportunity.

CCLI COMMENTARY

Irrespective of the early stage of development, it is probably unreasonable to expect that a unified body of rules determining sustainability-related disclosures is achievable within the near terms, indeed if at all. Nevertheless, as indicated elsewhere in this White Paper, the breadth of material and resources that can be referred to in determining what is to be included or excluded may present issues of indeterminacy and excessive subjectivity. Similarly, the identification of *disclosure topics* does not in and of itself clarify fundamental issues of the actual information to be furnished within the four areas of **Core content.**

Achieving fair presentation in financial statements, though complex, is well understood through established processes and formal alignment with definitions and recognition criteria for assets, liabilities, income and expenses, supported by well understood qualitative characteristics. Potentially then, there is some risk in assuming that 'fair presentation' as between financial statements and sustainability-related financial disclosures is one and the same.

3.4.4 Materiality (para. 56)

Consistent with the objective set out in para. 1 of requiring the disclosure of information useful to the *primary users of general purpose financial reporting*, ED IFRS S1 adopts in para. 56 a definition of materiality closely aligned with the *Conceptual Framework*:

> **Sustainability-related financial information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reporting make on the basis of that reporting, which provides information about a specific reporting entity.**

As with financial statement materiality, the assessment is entity-specific "based on the nature or magnitude, or both, of the items to which the information relates in the context of the entity's general purpose reporting."[34] A number of important distinctions are nevertheless drawn out. BC71 notes that information on sustainability-related risk and opportunities is not constrained by definitions of assets and liabilities, and associated recognition criteria, and is thus broader in terms of both time horizons and organisational boundary. Moreover, attention is directed in both para. 57 and BC72 to sustainability-related risks and

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32 The most convenient way to navigate the SASB Standards is my reference to their Materiality Map which is matrix of five sustainability dimensions and twenty-six general issue categories matched against eleven industrial sectors https://www.sasb.org/standards/materiality-map/.

33 Seventy-seven within the eleven SICS sectors.

34 Para. 58, wording similar to para. 2.11 of the *Conceptual Framework.*

opportunities with low-probability and high impact outcomes, with the latter specifically mentioning the "relationship between the impacts of the entity's activities on the environment and society and the impact of the latter on enterprise value." (BC72 (a))

Paragraph 59 and BC76 both clarify that the materiality assessments are to be applied at each reporting date, in so doing the latter references as part of taking account of changed circumstances and assumptions the notion of *dynamic materiality*.[35]

The Materiality section of ED IFRS S1 *General features* concludes with the following (para. 62):

> An entity need not disclose information otherwise required by an IFRS Sustainability Disclosure Standard if local laws or regulations prohibit the entity from disclosing that information. If an entity omits material information for that reason, it shall identify the type of information not disclosed and explain the source of the restriction.

This concession is highlighted in this White Paper in the context of querying whether such relief should also extend to disclosure of sensitive commercial information about business strategies and prospects for future years if such disclosure could result in unreasonable prejudice.

3.4.5 Comparative information (para. 63)

The requirements here are to an extent structural and instrumental, para. 63 stating:

> **An entity shall disclose comparative information in respect of the previous period for all metrics disclosed in the current period. When such information would be relevant to an understanding of the current period's sustainability-related financial disclosures, the entity shall also disclose comparative information for narrative and descriptive sustainability-related financial disclosures.**

CCLI COMMENTARY

Drawn heavily from the corresponding wording in IAS 1 (para. 38), this requirement is uncontroversial, though it is remarked that ensuing topic specific IFRS Sustainability Disclosure Standards might present particular approaches to classification, changing treatment of which could create complexity in presenting meaningful comparative information.

3.4.6 Frequency of reporting (para. 66)

This is addressed in para. 66

> **An entity shall report its sustainability-related financial disclosures at the same time as its related financial statements and sustainability-related financial disclosures shall be for the same reporting period as the financial statements.**

The expectations about respective disclosures and timing alignment are both logical and uncontroversial. It will of course remain to be seen how national governments and regulatory bodies respond in relation to the mandating of IFRS Sustainability Disclosure Standards and the mechanisms they apply to any associated lodgement/filing requirements.

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35 The June 2021 IOSCO Final Report provides at page 60 a useful description of dynamic materiality whereby, in summary, an ESG matter, not being static, can over time be presented (i) as part of wider stakeholder sustainability reporting, (ii) impacting enterprise value and thus a basis for more formalised/ targeted disclosure, and (iii) capable of more direct monetisation reflected in accounting numbers.

CCLI COMMENTARY

As has been noted, ED IFRS S1 in its general requirements is adapted from IAS 1 and IAS 8. The nature of sustainability-related financial disclosures is such that those parts of IAS 1 dealing with the structure and content of financial statements cannot, of course, be adapted across to somehow set the structure and parameters of a 'sustainability-related financial report.' Development of these structural considerations will no doubt evolve over time with the embedding of practice. Nevertheless, investor needs for comparable and systematic reporting, as identified by IOSCO, points to an imperative for deeper consideration being given to possible optimum mediums of disclosure of sustainability-related financial information.

3.4.7 Location of information (para. 72)

This is covered in the following relatively concise main principle (para. 72):

> **An entity is required to disclose information required by IFRS Sustainability Disclosure Standards as part of its general purpose financial reporting.**

The subsequent elaborations and associated explanations in the *Basis for Conclusions* are noteworthy. The evident flexibility achieved through use of the term "reporting", rather than, for example, "report", recognises the variation in corporate reporting across jurisdiction and the current range in practice of reporting channel[36] for non-financial and sustainability disclosures. Para.73 expands on the potential accommodation of sustainability-related financial disclosures within an entity's management commentary, recognising also alternative terminology such as operating and financial review, integrated report and strategic report. Further paragraphs address the potential for information required by IFRS Sustainability Disclosure Standards being embedded in other disclosures such as financial statements and specific national regulated disclosure regimes.[37] The opportunity for rationalisation of reporting through clear cross-referencing is also recognised.

Aspects of disclosure rationalisation are further identified in para. 78 dealing with avoiding of unnecessary duplication where IFRS Sustainability Disclosure Standards require the disclosure of common information. The presented example recognising the potential for individual sustainability-related risk and opportunities being managed through a common or integrated approach.

3.4.8 Sources of estimates and outcome uncertainty (para. 79)

Noted in the above discussion on the **Strategy** element of *Core content* and the strong preference for presentation of quantitative information where available, this *General feature* provides further important insights into the expected veracity of disclosures.

Paragraph 79 introduces the circumstance of measurement uncertainty and the need for reasonable estimates in the preparation of metrics. It notes the "**[e]ven a high level of measurement uncertainty would not necessarily prevent such an estimate from providing useful information.**" As such, considerations of usefulness from the standpoint of primary user need, override issues of uncertainty. Users' needs are further safeguarded through the requirement that the "**entity shall identify metrics that it has**

36 The earlier iteration of ED IFRS S1 adopted the term 'reporting channel', subsequently replaced on the basis of potential ambiguity.

37 Though not stated, a fair assumption here would be statutory-based reporting of GHG emissions.

disclosed that have significant estimation uncertainty, disclosing the source and nature of the estimation uncertainties and the factors affecting the uncertainties."

Paragraph 80, in turn, states:

> **When sustainability related financial disclosures include financial data and assumptions, such financial data and assumptions shall be consistent with the corresponding financial data and assumptions in the entity's financial statements, to the extent possible.**

As with the previous discuss of both the *Core content* element of **Strategy** and the *General featured* of **Connected information**, this requirement within the overall scheme of ED IFRS S1 could drive further alignment with financial statements through providing a basis for 'probing' by auditors and concerned investors.

This *General feature* concludes with the following main principle (para. 83):

> **An entity shall disclose information about the assumptions it makes about the future, and other sources of significant uncertainty, related to the information it discloses about the possible effects of sustainability-related risks or opportunities, when there is significant outcome uncertainty.**

This principle is not accompanied by any further 'grey letter' elaborating paragraphs nor materially expanded upon in the *Basis for Conclusions.* Without suggesting a concluded position, it may be that preparers would regard para. 83 as lacking a sufficient level of comfort in the making of such disclosures. BC61 which accompanies the *General feature* of **Fair presentation** might fulfil this need, though it may indeed be preferrable for this type of clarification to more directly align the actual principles upon which the sustainability-related financial disclosures are based with a clearer intent of clarify the expected scope of disclosure. BC61 is as follows:

> The Exposure Draft explains how those concepts [the fundamental and enhanced qualitative characteristics] related to sustainability-related financial information. For example, because some sustainability-related financial disclosures will be in the form of explanations or **forward-looking information**, the proposals explain that this information can still be verifiable if it is supported by **faithfully presenting factually-based strategies, plans and risk analysis**. (Emphasis added)

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Disclosures in this area will be heavily based on management judgment against which users will likely apply notions of reasonable expectations and reliance. Developments around such interaction will likely be determined by jurisdictional application and broader prevailing legal rules in such areas as investor protection. Nevertheless, outcomes may well be influenced by the way in which the ISSB in its standards seeks to strike a balance between precision and universality.

3.4.9 Errors (para. 84)

This *General feature* is addressed through the prima facie simple main principle (para. 84):

> **An entity shall correct material prior period errors by restating the comparative amounts for the prior period(s) disclosed unless it is impractical to do so.**

Errors, be they omissions or misstatements, are distinguishable from changes in estimates and can arise through mistake, oversight, misrepresentation of facts and fraud. Estimates, notwithstanding the immediately preceding discussion, are approximations and thus can be treated through revision as additional information comes to hand. Where the error pertains to a prior year estimate, such change should be reflected in the estimate that relate to prior periods through comparatives. This treatment is seen to minimise the risk of knowing misstatement of current period information and contrasts with the treatment of changes in estimates in financial statements which are treated in the current period to preserve, through double entry processes, the integrity of profit and loss numbers.

3.4.10 Statement of compliance (para. 91)

Containing only two paragraphs (the latter, for consistency, dealing with a matter of disclosure relief[38]) this *General feature* is addressed through the main principle (para. 91):

> **An entity whose sustainability-related financial disclosures comply with all of the relevant requirements of IFRS Sustainability Disclosure Standards shall include an explicit and unqualified statement of compliance.**

Based on corresponding wording in IAS 1 (para. 16) there are nevertheless apparent material differences. IAS 1 para. 16 is expressed as "all the requirements of the IFRSs" where ED IFRS S1 introduces "relevant" as a qualification. A further difference is that of IAS 1 requiring the statement of compliance to be "unreserved" whilst ED IFRS S1 uses "unqualified", both however referring to the statement being "explicit".

Explanation for these differences can be found in the elaboration provided in BC85. There it is emphasised that the Exposure Draft points to the ISSB issuing disclosure-only Standards.[39] On this basis, it is further explained that the meeting disclosure is 'binary' in nature - the entity either meets or doesn't meet the required disclosure – thus rendering a qualified statement as inappropriate. Moreover, it is emphasised that ED IFRS S1, whilst requiring disclosure of information about strategic goals, does not give rise to an inference that they are being managed as such, therefore not precluding assertion of compliance with the IFRS Sustainability Disclosure Standard, so long as such fact is explained. BC85 nevertheless goes further to suggest that this latitude needs to be considered in the contexts of both user expectations of material information and the nature of specific disclosures requirements; Scope 1 GHG emissions under ED IFRS S2 mentioned specifically.

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Statements of compliance are, to say the least, significant in communicating to users the veracity of disclosures and the reliance that can be placed thereon. As presented and explained, this aspect of ED IFRS S1 may pose problems of indeterminacy around what is truly being communicated. This may potentially be further complicated by the possible overlaying of jurisdiction-based measures that may develop to give mandatory weight to some, or all, of the IFRS Sustainability Disclosure Standards which would likely be accompanied by some form of formal declaration of compliance.

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38 The reference in para. 92 is to local legal and regulatory prohibitions on information disclosures that would otherwise be required by IFRS Sustainability Disclosure Standards (cross-referenced to para. 62 – refer to the White Paper discussion of the **Materiality** *General feature*).

39 In contrast IFRS Accounting Standards are significantly wider addressing aside from disclosure, critical matters such as recognition and measurement.

4. [DRAFT] IFRS S2 CLIMATE-RELATED DISCLOSURES (ED IFRS S2)

As indicated above in section 3.3 of the White Paper, the ISSB's intention is to structure its Sustainability Disclosure Standards around four core content relating to governance, risk management, strategy and associated metrics and targets. This is seen as particularly pertinent in the development of ED IFRS S2 as the appropriate structure for communicating an understanding of the entity's internal structures and processes for the identification, assessment and oversight of climate-related risks and opportunities (BC22), with overarching emphasis on exposures and response to physical risks from climate change and risks associated with transitioning to a low carbon economy (BC23).

In comparison with ED IFRS S1, ED IFRS S2 is, of course, more technical and prescriptive in character. Particularly significant in this context is the structure of Appendix B to ED IFRS S2. The initial text of Appendix B is presented at pages 49 to 56 of the Exposure Draft. This, in turn, is accompanied by a separate booklet of 642 pages which set out industry-based disclosures. Based on SASB Standards, these materials provide for each of the seventy-seven industries across eleven sectors[40], a consistent basis for disclosure topics, metrics and technical protocols, and activity metrics (refer B10 – B12). In both instances, it is stated that Appendix B "has the same authority as the other parts of the [draft] Standard."

As an indicative guide, the following table, adapted from the introduction and overview passages from the accompanying Basis for Conclusions, sets out some of the more salient proposed disclosures cross-referenced to associated core content and BC paragraph references.

DISCLOSURE	CORE CONTENT	BASIS FOR CONCLUSIONS
Comparability: cross-industry components	Metrics and targets para. 21	BC32 BC105 - 118
Comparability: Industry-based components	Metrics and targets para. 20(b) and Appendix B	BC33 BC123 - 129
Carbon offsets in the context of an entity's transition plan	Strategy - Strategy and decision-making para. 13(b)(iii)	BC71 - 85
Resilience assessments	Strategy – Resilience para. 15 (in full)	BC85 - 95
Quantitative information on current and anticipated of climate-related risks	Strategy – Financial position, financial performance and cash flows para. 14	BC96 - 100
Explicit disclosure of climate-related opportunities	Risk management para. 17(a)(ii) & (f)	BC101 - 104
Consolidated accounting group treatment of GHG emissions disclosures	Metrics and targets para. 21(a)(iii)	BC110 – 118 generally dealing with Scope 1, 2 & 3 emissions under the GHG Protocol and BC114 specifically
Alignment of scenarios and targets with 'the international agreement on climate change'	Strategy – Climate resilience para. 15(b)(4) Metrics and targets para. 23(e)	BC119 - 122
Financed emissions (finance sector)	Appendix B	BC149-172

The above indicates that the key areas of development are in relation to the *Strategy* and *Metrics and targets* core elements. The below analysis nevertheless follows the broad structure of the ED.

40 For ease of access, the IFRS websites separates the eleven sector materials into discrete pdf. files. The text is 'marked up' to illustrate the internationalisation changes from the original SASB versions.

4.4 Governance (para. 4)

The main principle (para. 4) states:

> **The objective of climate-related financial disclosures on governance is to enable users of general purpose financial reporting to understand the governance processes, controls and procedures used to monitor and manage climate-related risks and opportunities.**

The elaborations in para. 5(a)-(g) mirror those in ED IFRS S1 para. 13. However the principle on Governance concludes with para. 6, with the important qualification that an entity should avoid unnecessary duplication and that disclosures should reflect the circumstance of oversight of sustainability-related risks and opportunities being managed on an integrated basis. Readers' attention is nevertheless drawn to the interesting commentary in BC61 concerning the specificity of skills and competencies when dealing with matters informed by climate science.

4.5 Strategy (para. 8)

This part of ED IFRS S2 commences with the main principle (para.8):

> **The objective of climate-related financial disclosures on strategy is to enable users of general purpose financial reporting to understand an entity's strategy for addressing significant climate-related risks and opportunities.**

The subsequent paragraph briefly introduces five disclosure themes addressed in detail under the four below headings, the first including also disclosure expectations in relation to the effect of significant climate-related risk and opportunities on the entity's business model and *value chain.* The definition of *value chain*[41] repeats that in ED IFRS S1 and Appendix A introduces definitions for *transition plans*[42] and *climate resilience.*[43]

4.5.1 Climate-related risks and opportunities (para. 9 ff.)

Paragraph 9 introduces a number of critical features of expected climate-related disclosures on strategy. Firstly, paras. 9(a) and (b) address risk and opportunities, their expected impacts on the entity's business model, strategy and cash flows, its access to finance and its cost of capital, in terms of short, medium and long term time horizons, the thresholds for which the entity itself must define. BC69 emphasises that the thresholds of 'short', 'medium' and 'long' term will depend on characteristics associated with the entity's business model, strategy and cash flows against which relevant factors will be "its investment cycle; the industry of which it is part, the useful life of its assets; its strategic objectives; and the sectors and jurisdictions in which it operates." BC70 goes on to explain the deliberate choice in drafting this part of ED IFRS S2 not to have prescribed specific time frames across industries, emphasising instead the importance of the individual entity determining appropriate timed horizons in terms of both its own operating characteristics and the potentially disparate understanding of 'short', medium' and 'long' term amongst the users of the entity's general purpose financial reporting.

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41 Refer above at 3.4.1 discussion of the *Reporting entity* **General feature.**

42 An aspect of an entity's overall strategy that lays out the entity's targets and actions for its transition towards a lower-carbon economy, including actions such as reducing its **greenhouse gas** emissions.

43 The capacity of the entity to adjust to uncertainty related to climate change. This involves the capacity to manage **climate-related risks** and benefits from **climate-related opportunities** including the ability to adapt to **transition risks** and **physical risks**.

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Noting the earlier discussion in this White Paper (at para. 3.3) in relation to the strategy component of *Core content* in sustainability-related financial disclosures, it is apparent that in moving from more general principle to thematic standards, there is revealed the degree of potential complexity in relation to disclosures choices and the need amongst many reporters, to build, over time, data capture, assimilation and analysis processes.

The second feature is that of compelling in the climate-related disclosures on strategy the addressing of the distinction between physical risk and transition risk (para. 9(c)). BC64 references back to BC24 and BC25 in which these respective forms of climate-related risk are explained in some detail and are thus seen as sufficiently distinct and well understood to warrant separate quantitative and qualitative disclosure, though within an integrated framing.

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BC65 develops the discussion further, providing acknowledgement of identification, assessment and management challenges including "data availability, methodologies and models applicable at a business level, especially regarding assessing physical risk, as well as the financial implications of climate-related risks." This important concession may nevertheless underestimate the challenges (and risks) in disaggregating climatic and other scientific models to national, industry sectors, firm and asset specific levels, along perhaps also with an undue inference that the regulatory and economic environments can be predicted with sufficient certainty.

Paragraph 12 introduces strategy-related disclosure requirements in relation to risks and opportunities within the entity's value chain. Specifically:

(a) a description of the current and anticipated effects of significant climate-related risks and opportunities on its value chain; and

(b) a description of where in its value chain significant climate-related risks and opportunities are concentrated (for example, geographical areas, facilities or types of assets, inputs, outputs or distribution channel).

Relating back to the definition of *value chain,* BC66 emphasises the scope of coverage in terms that "value chain encompasses the activities, resources and relationships an entity uses and relies on to create its products and services from **conception, to delivery, consumption and end-of-life**." (Emphasis added). More than merely descriptive, BC67 goes on to stress that the purpose of the disclosures is to enable report users to understand where in an entity's value chain climate-related risks and opportunities are concentrated. Measurement challenges for preparers is acknowledged with recognition of the appropriateness of a combination of quantitative and qualitative disclosures.

Two further paragraphs (respectively 10 and 11) pertaining to climate-related financial disclosures on strategy around risks and opportunities are included in the Exposure Draft. Neither is specifically expanded upon in the Basis for Conclusions. They are nevertheless repeated here as they are seen as significant as they relate to a wide range of reference points outside of the immediately surrounding paragraphs and are indicative of an assumed path towards relative maturity in climate-related financial disclosures.

> In identifying the significant climate-related risk and opportunities described in paragraph 9(a), an entity shall refer to the *disclosure topics* defined in the industry disclosure requirements (Appendix B).
>
> In preparing disclosures to fulfil the requirements of paragraphs 12 -15, an entity shall refer to and consider the application of cross-industry metric categories and industry-based metrics associated with disclosure topics, as described in paragraph 20.

Paragraph 20 is dealt with in detail in this White Paper in the section on ED IFRS S2 **Metrics and targets**. Suffice to say, it introduces, with subsequent paras. 21 – 23, the key disclosure requirements on CO_2 equivalent emissions levels along with associated metrics around emissions trajectories, impacts and aspects of management's response. Of particular relevance to the current discussion of effects within value chains is the direct reference in para. 21 to **Scope 3 emissions**.[44] Both paras. 10 and 11 mention disclosure topics[45] and their industry-based specificity. Industry classification is addressed in BC187 – 189 and, as with para. 10, necessitates reference to the separate booklet covering each of the seventy-seven industries within the eleven sectors. For illustrative purposes, the follow extract (Table 1: Sustainability Disclosure Topics & Metrics) for Health Care Delivery[46] provides the following:

TOPIC	METRIC	CATEGORY
Energy Management	(1) Total energy consumed, (2) Percentage grid electricity, (3) Percentage renewables	Quantitative
Waste Management	Total amount of medical waste, percentage (a) incinerated, (b) recycled or treated, and (c) landfilled	Quantitative
	Total amount of: (1) hazardous and (2) non-hazardous pharmaceutical waste, percentage (a) incinerated, (b) recycled or treated, and (c) landfilled	Quantitative
Climate Change Impacts on Human Health & Infrastructure	Description of policies and practices to address: (1) the physical risks due to an increased frequency and intensity of extreme weather events and (2) changes in the morbidity and mortality rates of illnesses and diseases, associated with climate change	Discussion and Analysis

BC189 concludes with what can be regarded as a somewhat comforting remark that in relation to the significant volume of industry-based materials in the Appendix B booklet "only a subset would apply to a reporting entity, and it is expected that these requirements will simplify rather than complicate the preparation of disclosures by an entity."[47]

44 Appendix A: "Indirect emissions outside of **Scope 2 emissions** that occur in the **value chain** of the reporting entity, including both upstream and downstream emissions."

45 *Disclosure topics* is a defined term in both ED IFRS S1 and S2 – refer footnote 33 above.

46 One of the five industries with the Health Care Sector, the other four being; Drug retailers; Health care distributors; Managed care; and Medical equipment and supplies.

47 Expansion into these mentioned areas of ESG development is of course subject to the ISSB's consultation and deliberations on its future work plan. Nevertheless, influential documents such as the WEF's *Measuring Stakeholder Capitalism* mentions each of these as core metrics and disclosures, respectively under Principles of Governance and People. It all the more noteworthy given the role played by the WEF and its stakeholder capitalism metrics in shaping the preliminary work of the ISSB (refer footnote 1 of ED IFRS S1).

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The foregoing discussion illustrates the clear intention of building into ED IFRS S2 a high degree of comprehensiveness, which whilst entailing substantial complexity, provides a definitive articulation of the expectations as to the degree and basis upon which climate-related risk and opportunities are embedded within an entity's value chain and thus brought to the fore in disclosures. Having a substantial foundation in metrics that are relatively mature, the value chain aspects of climate-related disclosures may, in some regards, attract less controversy around application when compared with possible future IFRS Sustainability Disclosure Standards which may emerge covering, for example, governance matters such as anti-corruption and social matters including the addressing and combatting the risk of child and other forms of modern slavery.

4.5.2 Strategy and decision-making (para. 13)

Two key areas of disclosure are introduced in para. 13: transition plans; and, as a sub-set, the use of carbon offsets, with each respectively elaborated on in BC71 – 75 and BC76 – 85.

Transition plan is a defined term with Appendix A providing:

> An aspect of an entity's overall strategy that lays out the entity's targets and actions for its transition towards a lower-carbon economy, including actions such as reducing its **greenhouse gas** emissions.

Paragraph 13 is composed of two main parts – (a) largely narrative in nature requiring disclosure as to "how [the entity] is responding to significant climate-related risks and opportunities including how it plans to achieve any related-climate targets it has set" and (b), in turn, requiring three forms of information regarding climate-related targets:

(i) the processes in place for reviewing targets;

(ii) the amount of the entity's emission target to be achieved through emissions reductions within the entity's value chain;

(iii) the intended use of carbon offsets in achieving emissions targets.

Consistent with the language used throughout both ED IFRS S1 and ED IFRS S2, disclosures about an entity's transition plans are couched in terms of current and anticipated changes to its business model communicating the underlying effects of climate-related risks and opportunities, with reference made back to para. 12 of ED IFRS S2.

In providing elaboration, BC73 makes reference to the TCFD. The most authoritative TCFD resource and that which seems to be of direct influence is the October 2021 Guidance on Metrics, Targets and Transition Plans, in particular section E (pp. 38 - 43). ED IFRS S2 and the TCFD Guidance broadly align in terms of expected disclosure of key climate-related financial information pertaining to transition plans[48], yet naturally differ because of their different scope and structure. Some of these differences are insightful.

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48 This is succinctly stated by the TCFD as (1) current GHG emissions performance, (2) impact on businesses, strategy, and financial planning from a low-carbon transition, and (3) actions and activities to support transition, including GHG emissions reduction targets and planned changes to business and strategy. Each is broadly covered in BC73 with slightly different language and emphasis.

One useful clarification of potential comfort to preparers provided by the TCFD is the statement:

> The Task Force recognizes that organizations' transition plans include a wide range of information, all of which may not be appropriate to include in financial filings or other annual corporate reports.[49]

Though possibly inferred in ED IFRS S1's definition of *general purpose of financial reporting* and what is deducible from language around such key matters as materiality and sources of estimates, there may be benefit of more direct articulation of this point within proposed para. 13, or similarly addressed elsewhere in the strategy component of ED IFRS S2.

Again, recognising different emphasis, the TCFD Guidance does make a distinction in an organisation's strategy for addressing climate-related risks and opportunities between a transition plan and an adaption plan with each together forming a climate strategy as a subset of overall business strategy (refer Figure E1). ED IFRS S2 paragraphs 13(a)(i)(2) and (3) respectively require information about direct and indirect "adaptation and mitigation efforts in its undertaking." 'Adaptation and/ or mitigation' is then specifically mentioned in each of:

- para. 14(d) under financial performance, financial position and cash flows;
- para. 15(a)(iii)(a) under climate resilience; and
- para. 23(d) dealing with industry-based climate-related targets.

Neither 'adaptation' nor 'mitigation' are separately defined but are included within the Appendix A definition of **transition risks**[50] and their respective nature discussed at various points in the Basis for Conclusions.[51] In its distinguishing between transition and adaption, the TCFD Guide states[52] in relation to the latter that "an adaption plan lays out how an organization minimize risks and capture opportunities associated with physical climate change."

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The above is not intended to draw out whose definitions and distinctions are 'correct', rather to emphasise the challenges with terminology which is perhaps more readily understandable in either national or sectorial policy contexts and which, when applied at an entity level, may not form a clear dichotomy in how strategies are developed and applied. As such, consideration might be given within the Climate-related Disclosure Standard to encouraging preparers to disclosure their interpretation applicable to the entity's particular strategic context. Again, without suggesting a firm determined position, it may be that paras. 13(b) and (c) sit more comfortably within either para. 15 dealing with climate resilience or paras. 19 – 24 dealing with metrics and targets.

Though not necessarily determinative of the veracity of the wording and approach adopted in ED IFRS S2, two further matters presented in the TCFD Guidance are mentioned here as likely pointers to effective

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49 TCFD Report 2021, page 43.

50 Moving to a lower-carbon economy may entail extensive policy, legal, technological and market changes to address **mitigation** and **adaption** requirements relating to climate change. Depending on the nature, speed and focus of these changes, transition risks may pose varying levels of financial and reputational risk to entities. (Emphasis added)

51 See BC1, 25, 27, 74 and 120.

52 Page 38 footnote 77.

application of a transition plan. These include a list of key characteristics of effective transition plans[53] and identification of transition plan elements.[54]

Turning now to carbon offsets.[55] The relevant ED provisions come within para. 13(b) and, as such, are a subset of disclosures relating to emissions targets within transition plans. In brief, para. 13(b)(iii) requires disclosure of the extent to which the targets set out in the entity's transition plan reliant on carbon offsets, whether the offset is subject to third-party verification and the type of offset – nature-based or dependent on technological carbon removal, and broadly whether the offset is achieved through carbon removal or emissions avoidance. The further aim is to enable users to assess the credibility and integrity of the carbon offset along with the assumptions as to permanence.

The rationale for inclusion of this reference to carbon offsets is covered extensively in the Basis for Conclusions with a focus on their growing use as part of corporate emissions reduction strategies, however accompanied by relative novelty and complex interaction with underlying science. Set in the context of differing jurisdictional approaches to the degree to which carbon removal, and thus offsetting, should be allowed to form part of national-based measurement of progress towards net-zero targets (BC79), the ED adopts a matching focus on recognition and adjustment for risk centred on such factors as uncertainty about future carbon offset pricing (BC80), and contrasting natural and technological approaches, the latter particularly with regards the cost effectiveness of nascent carbon capture and storage (BC81).

The presence of uncertainty is further emphasised with the overlaying of time factors in which nature-based approaches may be prone to leakage and uncertainty in permanence, and whether it is fair and reasonable to include the quantum of emission reduction which would have occurred regardless of the character of a technology-based investment - the challenge of 'additionality' (BC82).

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BC78 notes that, as a type of carbon offset, carbon credits "take the form of transferable or tradable instruments, certified by governments or independent bodies, which represent a removal of emissions of one metric tonne of CO_2 or an equivalent amount of other GHGs." BC78 goes on to briefly describe the generating of carbon credits through, for example, cap-and-trade schemes, which can be sold or bought for offsetting of emissions.

A preliminary review undertaken as part of developing the White Paper shows differing jurisdictional approaches to the recognition and treatment of carbon credits as financial instruments and thus whether or not they come within the financial accounting requirements of IFRS 7 *Financial Instrument Disclosures* and IFRS 9 *Financial Instruments.* It is apparent that as of 14 July 2021 the European Union regards them as such, whereas in Australia under Regulatory Guide 236 issued by the Australian Securities and Investments Commission, this is not the case, with carbon market participants not required to hold an Australian financial services licence under the Corporations Act 2001. RG 236 nevertheless dates back to 2015 at the time transitioning in Australia's national emissions reduction mechanisms. It is noted also that the commentary which does exist from IFRS on the effect of climate-related matters on financial statements, does not mention carbon credits in the context of potential application of IFRS 7 and IFRS 9.

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53 (1) Aligned with strategy. (2) Anchored in quantitative elements, Including climate-related metrics and targets. (3) Subject to effective governance processes. (4) Actionable, specific initiatives. (5) Credible. (6) Periodically reviewed and updated. (7) Reported annually to stakeholders.

54 Refer Table E1 which spans elements in each of Governance, Risk management and Metrics and targets, along with that of Strategy.

55 *Carbon offset* is a defined term in Appendix B: an emissions unit issued by a carbon crediting programme that represents an emission reduction or removal of a greenhouse gas emission. Carbon offsets are uniquely serialised, issued, tracked and cancelled by means of a registry.

4.5.3 Financial position, financial performance and cash flows (para. 14(d))

Except for two key differences, para. 14 largely mirrors para. 22 of ED IFRS S1 with the terminology 'sustainability-related' substituted with 'climate-related'. Paragraph 22 is discussed in this White Paper in section 3.3 in that part dealing with the Core content area of Strategy. The two additional requirements in para. 14 are respectively (d) and (e) which are as follows:

> How it [the entity] expects its financial performance to change over time, given its strategy to address significant climate-related risks and opportunities (for example, increased revenue from or cost of products and services aligned with a lower-carbon economy, consistent with the *latest international agreement on climate change*;[56] physical damage to assets from climate events; and the cost of climate adaptation or mitigation), and
>
> if the entity is unable to disclose quantitative information for paragraphs 14(a)-(d), an explanation of why that is the case.

From the standpoint of connection with financial reporting, it is noteworthy that ED IFRS S1 para. 22(b) and ED IFRS S2 para. 14(b) both state "information about - - - risk and opportunities - - - for which there is a significant risk that there will be a material adjustment to the carrying amount of assets and liabilities in the financial statements **within the next financial year**." (Emphasis added) Common also as between the two draft standards is the statement:

> An entity shall disclose quantitative information unless it is unable to do so. If an entity is unable to provide quantitative information, it shall provide qualitative information. When providing quantitative information, an entity can disclose single amounts or a range.[57]

The recognition given here to the practicalities and challenges for disclosure choices is particularly apparent in the climate-related context and is supported by a number of statements in the related Basis for Conclusions. Notably, reference is given in BC98 to the previously-referenced 2021 TCFD Status report where the challenges in disclosure of anticipated financial effects included such matters as data availability, differing business and climate-related time horizons, and uncertainty in attributing the effects of risk evaluation to financial accounts. Perhaps most germane for what is sought to be achieved through para. 14 generally and para. 14(d) more specifically, is the inability to disaggregated combinations of climate and other sustainability-related risk and opportunities to specific financial effects, along with applying, with confidence, unclear or indeterminate climate outcome at an entity-particular level (refer BC99).

As to whether wide adherence to the 'spirit' of this concession promotes good disclosure will be determined over time and in the contexts of preparer confidence and the potential weight brought to bear by investors, auditors and regulators. Similarly, a practical matter which may arises is that of friction with the more specific requirements of para. 14(b).

4.5.4 Climate resilience (para. 15)

Climate resilience and *climate-related scenario analysis* are both defined terms and are respectively as follows:

> The capacity of an entity to adjust to uncertainty related to climate change. This involves the capacity to manage **climate-related risks** and benefits from **climate-related opportunities**, including the ability to respond and adapt to **transition risks** and **physical risks**.
>
> Scenario analysis is a process for identifying and assessing a potential range of outcomes of future events under conditions of uncertainty. In the case of climate change, climate-relate scenario analysis allows an entity to

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56 Defined in Appendix A, reference being to the United Nations Framework Convention on Climate Change.

57 This recognition of the value and practicalities of presenting quantitative information within a range also applies in relation to climate resilience disclosures (see para. 15 and the following section of the White Paper) though apparently not for metrics and targets disclosures.

explore and develop an understanding of how the **physical risks** and **transition risks** of climate change may affect its business, strategies and financial performance over time.

The latter is pivotal to the operation of para. 15 being the default methodology applicable unless the entity is unable to do so.[58]

Paragraph 15 is structured in two parts. The first, para. 15(a), lays out the objectives sought to be achieved by resilience disclosures, the second, para. 15(b), addresses the alternative methods of analysis to be communicated in the disclosures. These being, as indicated, climate-related scenario analysis (para. 15(b)(i)) and alternative approaches applied when the former is deemed by the entity as impractical (para. 15(b)(ii), refer to footnote 60 below).

Falling as it does within the strategy core component, disclosure requirements as to the results of climate-related resilience analysis are directed at enabling users to understand assumptions about the way the transition to a lower-carbon economy will affect the entity, including policy assumptions for the jurisdictions in which the entity operates along with assumptions as to macroeconomic trends, energy mix and technology (refer paras. 15(b)(i)(8) and 15(b)(ii)(6)).

Importantly, preparers are required to indicate significant areas of uncertainty (para. 15(a)(ii)) along with communicating the entity's capacity to adjust or adapt its strategy and business model over the short, medium and long term (para. 15(a)(iii)). In these latter regards, a high degree of granularity is sought in the disclosures addressing such matters as implications for existing financial resources, impacts on the entity's stock of assets, along with the anticipated effects on current and planned investments in climate-related mitigation and adaptation (refer para. 15(a)(iii)(1)-(3)).

Concerning disclosures as to the methodological approach to climate-related scenario analysis covered in para. 15(b)(i), the pivotal elaboration is probably that provided in BC92 which both clarifies aspects of general approach and expands on the intent behind the requirement to explain "whether the entity has used, among its scenarios, a scenario aligned with the latest international agreement on climate change" (para. 15(b)(i)(4)).

BC92 explains that in the development of the ED the deliberate approach has been not to prescribe a particular scenario that an entity should use. This is said to reflect the differing nature of climate-related risks for entities in various sectors and circumstances giving rise to a range of possible future outcomes, both favourable and unfavourable. The accompanying disclosures on assumptions are therefore seen as the basis for facilitating the making of comparisons by users. The reference in BC92 to the latest international agreement on climate change is made, in part, to reflect an expectation that over time industries and/or jurisdictions will work towards comparability in practice centred on the Paris Agreement goal to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels. It is nevertheless further recognised in BC88 that there is a strong investor preference for climate resilience information across a range of potential scenarios, not only that based on the UNFCCC.

58 The concession is nevertheless significant recognising the seminal development of scenario analysis in some sectors, broader 'learnings' associated with progressive embedding of practice and resource challenges for smaller preparers. Refer BC94 which also provides an indicative list including single-point forecasting, sensitivity analysis and stress testing.

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The effects are such that both the formality sought to be established through ED IFRS S2 and the potential more generally for the IFRS Sustainability Disclosure Standards to gain regulatory traction, will likely create a strong compulsion for disclosure of climate scenario information, possibly developed for internal strategic and risk assessment purposes, being put forthrightly into the investor and wider public domains.

The sufficiency however of the ISSB's efforts in this direction may, over time, be challenged around such factors as accompanying pressure from investors for 'Paris aligned' accounts, preference for alternative or complementary bases of climate scenario assessments such as the IPCC global warming and related assessments, and successive updates of emissions reduction trajectories under the UNFCCC cycle of NDC updating.

4.6 Risk management (para. 16 ff.)

The main principle (para. 16) states:

> **The objective of climate-related financial disclosures on risk management is to enable users of general purpose financial reporting to understand the process, or processes, by which climate-related risks and opportunities are identified, assessed and managed.**

As with the ED's treatment of core element of *Governance,* the accompanying elaborations in para. 17 are almost word-for-word the same as those correspondingly presented in ED IFRS S1 (para. 26) and is likewise immediately followed a paragraph addressing unnecessary duplication. BC104 does explain the intention behind what might otherwise be regarded as undue repetitiveness in terms of promoting consistent and comparable disclosures. Relevant also is BC102 which explains that although ED IFRS S2 contains enhanced reference to 'opportunities' when compared with earlier iterations[59], the balance of disclosure requirements is weighted towards climate-related risks largely to reflects understanding of user needs and the relative maturity of entities' risk management processes.

4.7 Metrics and targets (para. 19 ff.)

The 'preamble' main principle (para. 19) to the metrics and targets core component of ED IFRS S2 mirrors that presented in para. 27 of ED IFRS S1. As already indicated, the required disclosures are divided between cross-industry metrics applicable to all disclosing entities (paras. 20(a) and 21(a)) and industry-based metrics (para. 20(b) which directly references Appendix B and para. 22). Paragraph 21(a) sets out disclosure categories for greenhouse gas emissions, followed by paras. 21(b)-(g) covering:

- the amount and percentage of assets or business activities vulnerable separately to transition risk and physical risk;
- the amount and percentage of assets or business activities aligned with climate-related opportunities;
- the amount of capital expenditure, financing or investment deployed towards climate-related risks and opportunities;

59 Principally that prepared by the Technical Readiness Working Group (TRWG)

- *internal carbon prices*[60] in terms of how the entity costs its emissions and applies to related decision-making; and
- the manner and metrics of linking executive remuneration to climate-related considerations.

Paragraph 22 references back to para. 21(b)-(g) indicating that these categories are to be industry-based per para. 20(b). Paragraph 23, in turn, sets out requirements in relation to climate-related targets with para. 24 indicating that identifying, selecting and disclosing the 'headline' targets in para. 23(a) – metrics used to assess progress towards reaching the target and achieving its strategic goals – reference and consideration shall be given to industry-based metrics, cross-referenced again to para. 20(b) and Appendix B.

Noteworthy also for addressing matters at the threshold between sustainability-related disclosures and financial statements is para. 22(b) requiring consideration of the amounts presented against para. 21(b)-(g) in terms of relationship with amounts recognised and disclosed in the accompanying financial statements. It further indicated that, where possible, connections between the information should be explained, and in particular, by way of example, the carrying amount of assets should be consistent.

4.7.1 Cross-industry metrics and targets

Readers will likely have observed that the requirements here are based on the TCFD *Guidance on Metrics, Targets and Transition Plans* mention above in this White Paper at 4.2.2. It is noted in BC108 that the emissions categories (para. 21(a)(i)-(vi)) are relatively precise in nature based as they are on the GHG Protocol Corporate Standard (refer further to BC112). In contrast, the further categories (para. 21(b)-(g)) are broader in nature, it explained in BC109 that whilst this may to some degree impede entity-to-entity comparability, this approach is taken in recognition of the current developing state of measurement, along with matters such as the difficulty many entities may have in "disaggregating their capital expenditures and attributing a specific portion to climate-related risks and opportunities, particularly for projects with multiple goals."

The establishing of GHG emissions disclosures in ED IFRS S2 on the GHG Protocol is explained in BC113:

a) the Protocol provides standardised approaches and principles for an entity to prepare a GHG inventory that represents a true and fair account of emissions;

b) use of the Protocol aligns with the prominent corporate practices for compiling a GHG inventory; and

c) its use will promote consistency and transparency in GHG accounting and disclosure among various entities and GHG programmes (including the TCFD Recommendations and the SASB Standards, which the Exposure draft builds on).

Nevertheless, it is recognised in BC114 that the "collection of GHG emissions data is not a precise and exact science." Less to do with the 'scientific' challenges, BC114 goes on to address a complexity or 'mismatch' associated with the accounting treatment of parent company and subsidiaries (IFRS 10 Consolidated Financial Statements) by ensuring that Scope 1 and 2 emissions are shown separately for:

a) the consolidated accounting group (the parent and its subsidiaries); and

b) associates, joint ventures, unconsolidated subsidiaries or affiliates not included in the consolidated accounting group.

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60 Defined in Appendix A: Price used by entities to assess the financial implications of changes to investment, production and consumption patterns, as well as potential technological progress and future emissions-abatement costs.

This important clarification aside, in may be unclear as to how ED IFRS S2, as currently presented, communicates in disclosures some of the inexactitude in the science and engineering of emissions measurement. Similarly, again without suggesting a determined position in this White Paper, how, in a practical sense, entities currently undertaking their emissions reporting on an operated or controlled facilities basis under national regulation, transition or dovetail their disclosures to the draft Standard requirements.

Noteworthy of course is the inclusion of Scope 3 emissions. The challenges here are well recognised in BC117, however the justification for inclusion aptly addressed stating:

> This development reflects an increasing recognition that Scope 3 emissions are an important component of investment-risk analysis because, for most entities, they represent by far the largest portion of an entity's carbon footprint.

And further,

> These considerations are reflected in the increasing number of entities making public commitments to reduce their direct and indirect GHG emissions to net zero and also in the increasing market, societal and regulatory expectations placed on financial institutions to report GHG emissions - including Scope 3 emissions – in meeting their disclosure obligations (BC118).

CCLI COMMENTARY

As will be apparent from previous comments, the finalisation of both ED IFRS S1 and ED IFRS S2, though of course potentially in modified forms, will go a substantial way towards addressing the concerns raised by IOSCO summarised in the Background section of this White Paper. The basing of ED IFRS S2 in its treatment of metrics and targets on those developed by the TCFD, and further underpinned by the GHG Protocol, is highly consistent with the intention that the Sustainability Disclosure Standards would build on existing efforts. As such, the disclosure proposals therein present a likelihood of at least a reasonable level of compatibility with a number of national government, and local market and securities regulator, initiatives compelling high quality emissions and related climate risk disclosures.

4.7.2 Industry-based metrics

As indicated the above discussion of the Strategy core content, the requirements here are heavily embedded in Appendix B, both the introductory/ explanatory text attached to the ED itself (pp. 49 – 56) and the extensive volume on specific industry materials.

As regards interactions between cross-sector metrics and industry-based metrics, B15 provides some guidance as to how a general requirement in para. 20(a) disclosures can be augmented for a specific entity within an industry by a more granular related metric. One of the examples given being that of a Scope 1 GHG emissions disclosure for an entity in the semiconductor industry (part of the Technology & Communications Sector), further showing Scop1 emissions specifically associated with perfluorinated compounds.

Turning to the structure of the industry-based materials, these present for each seventy-seven industries, an **industry description, disclosure topics, metrics, technical protocols** and **activity metrics**. By way of example, for the above referred Health Care Delivery industry, the metric for total energy consumed under the energy management topic, is accompanied by a unit of measure (Gigajoules (GJ), Percentage (%)) which, in turn, is elaborated as follows (with an identifier code of HC-DY-130a.1):

> 1.1 The scope of energy consumption includes energy from all sources, including energy purchased from sources external to the entity and energy produced by the entity itself (self-generating). For

example, direct fuel usage, purchased electricity and heating, cooling, and steam energy are all included within the scope of energy consumption.

1.2 The scope of energy consumption includes only energy directly consumed by the reporting entity during the reporting period.

1.3 In calculating energy consumption from fuels and biofuels, the entity shall use higher heating values (HHV), also known as gross calorific values (GCV), which are directly measured or taken from the Intergovernmental Panel on Climate Change (IPCC).

The range of sustainability topics and number of metrics will of course vary between industries. Again, by way of example, Water Utilities (part of the infrastructure Sector) has ten sustainability topics accompanied by seventeen metrics, whereas Health Care Delivery have respectively five and six.

A substantial part of the accompanying Basis for Conclusions (BC130 – 148) is devoted to a detailed explanation of the methods applied to achieve internationalisation of the SASB standards necessary for achieving a global baseline of disclosure. In essence, either of three approaches is adopted in cascading order:

(a) Revise by referring to an internationally applicable standard, definition or calculation method in relation to which most jurisdictions abide or where jurisdictional equivalents are note meaningfully different.

(b) revise otherwise by providing a general definition, and

(c) revise otherwise by referring to jurisdictional requirements.

As a brief example, within Health Care Delivery, the metric for hazardous pharmaceutical waste has the following amended definition:

Hazardous pharmaceutical waste is defined per the legal or regulatory framework(s) applicable with the jurisdiction(s) where the waste is generated ~~waste includes listed Resource Conservation and Recovery Act (RCRA) waste and non-listed characteristic waste~~.

5. EFFECTS ON GOVERNANCE AND DIRECTORS' DUTIES

As disclosure standards, rather than legislation or case law, IFRS S1 and IFRS S2 (once published) will not have a direct legal effect on the governance or strategy of reporting entities. However, if IFRS S1 and IFRS S2 become mandatory (or as TCFD-aligned reporting becomes increasingly common practice, and/or if TCFD-aligned reporting becomes mandatory in more jurisdictions[61]), it is likely that this will increase the extent to which directors should consider sustainability, in particular climate, risks in order to best fulfil their legal duties.

The analysis below is not specific to any particular jurisdiction, but identifies key relevant themes from jurisdictions in which issuers are required to use IFRS, with relevant examples, and considers the potential legal implications of the introductions of ISSB standards in respect of those themes.

5.1 Directors' duties

It is common across many, if not all, jurisdictions for directors to be subject to a fiduciary duty to act in the best interests of the company, and to act with due care, skill and diligence.[62]

Generally, a director must act in good faith in the best interests of their company. In the UK, this is expressed in statute as requiring directors to act in the way which they consider "in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole [...]".[63] In Canada, directors are required to "act honestly and in good faith with a view to the best interests of the corporation".[64]

Courts tend to defer to the judgment of the directors when assessing whether they have acted in the best interests of the company. This is reflected in the 'business judgment rule' under the law of many common law jurisdictions: Australian law sets a presumption that directors acting in accordance with their duty of loyalty to the company where they have done so with good faith, in an informed manner and with a rational belief; Canadian courts will defer to a business decision of directors which is within the range of reasonableness.[65] Courts in other jurisdictions generally adopt a similar stance, although the term 'business judgment rule' is less frequently seen in other jurisprudence.[66]

However, a director will generally be held to have not met this standard where they have failed to consider the best interests of the company when making a decision; i.e., when there has been no good faith effort to act in the best interests of the company. In that case, directors are judged on whether the decision they have made could have been made in good faith in the best interests of the company by a person in the position of company director.[67] A director will not meet this standard if they make a decision which no reasonable director could have made.

The requirement to act in the best interests of their company has historically been assessed on the basis of short-term financial benefit to the company or to its shareholders. However, this understanding may be

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61 To date, initiatives requiring, or moving towards mandating, reporting in line with the TCFD recommendations have been undertaken in Brazil, the EU, Hong Kong, Japan, New Zealand, Singapore, Switzerland and the UK.

62 For more detail on how this duty applies across various jurisdictions in a climate context, please refer to CCLI, CGI, Primer on Climate Change: Directors' Duties and Disclosure Obligations (June 2021).

63 Section 172, UK Companies Act 2006.

64 Section 122(1) Canada Business Corporations Act.

65 Section 180(2) Australian Corporations Act 2001; in Canada, see *Maple Leaf Foods Inc. v. Schneider Corp.* (1998) 42 O.R. (3d) 177 at [65].

66 In the UK, for example, the courts will not hold directors liable for mere lapses of judgment; see *In Re. City Equitable Fire Insurance Company, Limited* [1925] Ch. 407.

67 The position in UK law is expressed in *Charterbridge Corporation Ltd. v Lloyds Bank Ltd.* [1970] Ch. 62; in Australian law in section 180(1) Australian Corporations Act 2001.

outdated, and a number of legislative and regulatory statements have emphasised that good governance requires consideration of the long-term consequences of decisions made by the board, as well as a number of external stakeholders (including, in some jurisdictions, employees, wider society and the environment).[68] In addition, an increasing number of institutional investors have stated that they expect their investee companies to consider stakeholders and adopt a long-term view.[69] Directors seeking to raise capital or maintain shareholder support may therefore need to be particularly aware of ESG factors in governance.

Directors are also required to exercise their powers with due care, skill and diligence. Whether a director has acted with due care, skill and diligence is generally judged to both an objective and a subjective standard; a director is assessed on whether they have acted to the standard of a "reasonable" board member, and whether they have acted to a standard commensurate with the knowledge, skill and expertise which they actually have.[70] What the standard of a "reasonable" board member entails varies over time, as the social, economic and commercial contexts in which the company operates changes.[71] Lack of knowledge, skills or experience on the part of the director will generally not serve as a defence where they fail to meet the objective standard.[72]

As the commercial world increases its focus on sustainability matters through, for example, the wide update of voluntary disclosure frameworks requiring disclosures on sustainability-risk management, and certainly as directors become subject to regulations requiring such disclosures, it follows that the objective standard of care to which directors are held is likely to include consideration of these factors.

5.2 Directors' obligations to approve the annual report and accounts

Directors (and in some cases, officers of the company such as CEOs and CFOs) are required to sign-off on their company's annual accounts, stating that the accounts comply with relevant accounting standards and represent a 'true and fair' view of the view of the assets, liabilities, financial position and profit or loss of the company (or group of companies, in the case of company group accounts, which parent companies are required to produce).[73] Since the reporting of sustainability information is designed to form part of a company's general purpose financial reporting, as set out in para. 3 of the Objective to ED IFRS S1,[74] the provision of such information is incorporated into directors' duty to approve the annual report and financial information about the company.

Generally, it is considered that adherence to accounting standards will produce a 'true and fair' view, although directors are cautioned against absolute reliance on the accounting standards as fulfilling

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68 See, for example, s. 172 of the UK Companies Act 2006; the decision of the Canadian Supreme Court in *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69; section 166 of the Indian Companies Act 2013; statements of the Tokyo Stock Exchange in the Japanese Corporate Governance Code.

69 See, for example, Larry Fink, CEO of BlackRock, 2022 Letter to CEOs (January 2022); IIGCC, IIGCC response to TCFD public consultation on metrics, targets and transition plans (July 2021); IIGCC, Net Zero Stewardship Toolkit (April 2022).

70 See, for example, section 174 UK Companies Act 2006; section 180(1) Australian Corporations Act 2001; in Canadian law in *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68, [2004] 3 SCR 461.

71 See the discussion in Andrew Keay, *Directors' Duties*, 4th ed. (June 2020) at [8.18]-[8.31], which covers the development of English law from a position in which directors were regarded as "amateurs" and held to a low standard, to the current position where directors are held to a standard of reasonable care, skill and diligence, judged on a subjective and objective basis. See also *AWA Ltd v Daniels* (1992) 10 ACLC 933, an Australian case in which the judge stated: "Of necessity, as the complexities of commercial life have intensified the community has come to expect more than formerly from directors whose task is to govern the affairs of companies to which large amounts of money are committed by way of equity capital or loan." (emphasis added).

72 See, for example, *Re. DKG Contractors Ltd* [1990] BCC 903, in which an inexperienced director was held to have breached their duty under section 174 of the UK Companies Act 2006.

73 See, for example, sections 393, 394, 399 of UK Companies Act 2006; US Regulation S-X, Rule 4-01(a)(1); section 295 of Australia Corporations Act 2001; section158 Canada Business Corporations Act 1985.

74 Please see para. 3.1 above.

disclosure obligations, and should make departures or separate and reconciled disclosures to the extent necessary to produce a 'true and fair' view. As discussed above, the ED IFRS S1 proposes broadly similar approaches, stating that "**Applying IFRS Sustainability Disclosure Standards, with additional disclosure when necessary, is presumed to result in sustainability-related financial disclosures that achieve a fair presentation**" of the sustainability-related risk and opportunities to which the company is exposed.[75] The concept of 'true and fair' in both financial accounting and external audit is nevertheless, to say the least, contentious and on occasions problematic.[76] Both the *Conceptual Framework* and IAS 1 avoid use of the term 'true and fair' opting instead for 'fair presentation'. As such, 'true and fair' derives from overarching or complementary jurisdiction-based regulation of corporate disclosure, thus generating consideration of such matters as what will trigger, and what are the legal consequences, a 'true and fair' override in disclosures. Pertaining then to IFRS Sustainability Disclosure Standards, the matter of 'true and fair' in contrast to 'fair presentation' will seem likely a matter for national regulation to which there will no doubt be a range of views.[77]

Whilst the production of the annual report and accounts may be delegated, the responsibility and liability for approval ultimately remains with boards. This has been affirmed in the *ASIC v Healey* case in Australia, and in *Autonomy v Lynch* in the UK.[78] Where boards approve accounts which do not provide a fair and true view of the financial position of the company, they may be exposed to regulatory criminal fines.[79] In addition, directors may be liable for misleading disclosures (on which, see below).

Information about sustainability issues should be reflected in a company's financial statements. This is set out in the introduction to ED IFRS S1, which states "[t]he proposals would require an entity to explain the connections between different pieces of information, including between various sustainability-related risks and opportunities and information in the entity's financial statements," and in para. 42 of ED IFRS S1 (on which, see para. 3.4.2 above).

It consequently follows that because climate risks and opportunities must be disclosed in the narrative disclosures under the ISSB's proposals, their impact or potential impact on the company's financial statements should also be indicated in the financial statements or in the accompanying notes. Where directors have disclosed sustainability information, but have failed to reflect the effects of this information in company accounts, they may be found to have breached their duty to produce accounts which show a true and fair view of the company.

In addition, in such circumstances, courts have found that this has caused the directors to breach their duty to act with due care, skill and diligence; in *ASIC v Healey*, the Federal Court of Australia found that directors had breached their objective duty of skill, competence and diligence by approving accounts which did not comply with accounting standards.[80] Therefore, if a director were to approve annual reports and accounts

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75 See the discussion in this White Paper at **General Features**, *Fair presentation* (3.4.2).

76 A short but highly useful analysis and discussion can be found in the UK Report of the Independent Review into the Quality and Effectiveness of Audit (Sir Donald Brydon Review, December 2019) Chapter 11 True and fair?

77 Some of these issues are canvassed in A. Garvey, L. Parte, B. McNally and J. Gonzalo-Angulo "True and Fair Override: Accounting Expert Opinions, Explanations from Behavioural Theories, and Discussions for Sustainability Accounting ", *Sustainability* 2021, 13, 1928. https://doi.org/10.3390/su13041927

78 *ASIC v Healey and others* [2011] FCA 717; *Autonomy Corporation Limited and others v Lynch and another* [2022] EWHC 1178 (Ch).

79 See, for example, section 414 UK Companies Act 2006.

80 "What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her. Such a responsibility arises in this proceeding in adopting and approving the financial statements. Because of their nature and importance, the directors must understand and focus upon the content of financial statements, and if necessary, make further enquiries if matters revealed in these financial statements call for such enquiries. No less is required by the objective duty of skill, competence and diligence in the understanding of the financial statements that are to be disclosed to the public as adopted and approved by the directors." *ASIC v Healey* [2011] FCA 717 at [20]-[21].

with incorrect sustainability information, they could be in breach of their duty to act with due care, skill and diligence, in addition to their duty to produce accounts giving a true and fair view of the company's financial position.

5.3 Disclosure obligations

In addition, many jurisdictions have developed regimes in which directors of companies with publicly traded shares are responsible for the disclosure of material information to the market. Directors (and in some jurisdictions, officers) can be held liable for misleading disclosures or omissions in respect of material information, including both narrative disclosures and disclosures in financial statements.[81]

The direct responsibility of directors for misstatements or omissions made in financial reports was recently reaffirmed in the UK case *Autonomy v Lynch*:

> "As a theoretical matter, the purpose and objective of these 'front-end' reports are to reflect the directors' view of the business rather than the auditors', and to require directors to provide an accurate account according to their own conscience and understanding, neither of which can properly be delegated. As a practical matter, directors are likely to be, and should be, in a better position than an auditor to assess the likely impact on their shareholders of what is reported, and (for example) to assess what shareholders will make of possibly ambiguous statements. In short, on matters within the directors' proper province, the view of the company's auditors cannot be regarded as a litmus test nor a 'safe harbour': auditors may prompt but they cannot keep the directors' conscience."[82]

Directors should be aware that disclosure requirements may not be subject to the business judgment rule, given that disclosure constitutes legal compliance rather than a business decision.[83] The director is generally required to know that a statement or omission is misleading, or be reckless as to such, in order to be found liable.[84] Additionally, safeguards for disclosures are embedded in legislation, such as the provision of 'safe harbours' in respect of forward-looking statements or future matters. For example, section 769C Australian Corporations Act 2001 provides that a representation on a future matter will not be misleading where the person making the representation has "reasonable grounds" for making the representation.[85]

Additionally, the provision of IFRS accounts requires the exercise of judgment, and courts have recognised that this can give rise to a range of outputs; where an output can be justified as falling within the range of permissible views on the application of a particular IFRS standard, it will not give rise to liability.[86]

Directors should therefore be careful to ensure that misstatements and omissions in sustainability disclosures are avoided. Directors should check that sustainability disclosures are made on a reasonable basis and relate transparently to the underlying financial statements, should seek advice on the preparation of these disclosures and should scrutinise and question such disclosures adequately before they are issued.

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81 See, for example, sections 90, 90A and Schedule 10A of the UK Financial Services and Markets Act 2000 (which provide that persons discharging managerial responsibilities may be liable to a company which has made misleading disclosures); section 674 of the Australian Corporations Act 2001 (as discussed in Noel Hutley SC and Sebastian Hartford Davis, Further Supplementary Memorandum of Opinion (23 April 2021)); section 18(a) of the US Securities Exchange Act of 1934.

82 *Autonomy v Lynch* [2022] EWHC 1178 (Ch) at [476].

83 In *Kerr v Danier Leather Inc.*, 2007 SCC 44, the Supreme Court of Canada held that "while forecasting is a matter of business judgment, disclosure is a matter of legal obligation. The Business Judgment Rule is a concept well-developed in the context of business decisions but should not be used to qualify or undermine the duty of disclosure." See Hansell LLP, Legal Opinion: Putting Climate Change Risk on the Boardroom Table (June 2020).

84 See, for example, paragraph 3, Schedule 10A of UK Financial Services and Markets Act 2000.

85 See the discussion in Noel Hutley SC and Sebastian Hartford Davis, Further Supplementary Memorandum of Opinion (23 April 2021).

86 See, for example, the discussion in *Autonomy v Lynch* [2022] EWHC 1178 (Ch) at [463].

Any board subject to the ISSB standards which omitted to disclose identified sustainability information may be exposed to liability for making a material omission, given the strong connection between sustainability information and a company's enterprise value.[87]

5.4 Effect of increased sustainability-related disclosures on directors' duties

Legal analysis by the CCLI and other entities has demonstrated that, in many jurisdictions and to varying extents, directors should put in place systems to manage, monitor and mitigate climate-related risks in order to ensure they are fulfilling their fiduciary duties.[88] While boards are given a significant degree of discretion to exercise their decision-making powers, the objective assessment of whether they have exercised their powers in the best interests of the company and with due care, skill and diligence means that the standards to which directors are held varies as the context in which they make their decisions varies. As climate and wider sustainability issues become part of the corporate disclosure landscape, boards should consider these issues in order to ensure that they are meeting their duties to the company.

By requiring disclosure of climate-related (and other sustainability) risks and opportunities, the disclosures proposed in ED IFRS S1 and ED IFRS S2 are likely to affect the context in which directors fulfil their legal duties.

If a company is required to make disclosures on such risks and opportunities, as well as the processes by which those risks are identified and managed,[89] it is strongly arguable that directors would be expected to make decisions so as to mitigate those risks and take advantage of those opportunities. This is all the more likely given the links drawn between the sustainability disclosures and the broader financial disclosures of the company.[90] If a sustainability risk is determined to be a risk to a company's financial position, then it is more likely that a director would be expected to attempt to mitigate that risk even in a jurisdiction with a narrow focus on to whom the director owes duties (i.e. even in a jurisdiction which solely focuses on financial benefits to the company and shareholders as opposed to wider benefits to stakeholders). This is particularly the case given that ED IFRS S2 proposes disclosure of the strategy and decision-making processes in respect of those risks.[91]

While there may be reasons why it would be in the best interests of the company for directors to decide not to mitigate risks or pursue opportunities, it is likely, at the least, that they would be expected to consider those risks and opportunities. If a director were not to do so, but were to continue to make decisions for the company without in any way taking sustainability factors disclosed by the company into account, a court may find that such conduct did not meet the standard of good faith required of directors.

Further, it is likely that the adoption of ISSB sustainability standards will raise the standard of what is expected of a reasonable director, and therefore affect the standard of due care, skill and diligence with which directors are required to act. In Australian case law (in cases often referred to in other common law

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87 Please see para. 3.1 above.

88 See in Sarah Barker, CCLI, Directors' Liability and Climate Risk: Australia – Country Paper (April 2018); Cynthia Williams and Janis Sarra, CCLI, Directors' Liability and Climate Risk: Canada – Country Paper (April 2018); Christine Reddell, CCLI, Directors' Liability and Climate Risk: South Africa – Country Paper (April 2018); Alexia Staker and Alice Garton, CCLI, Directors' Liability and Climate Risk: United Kingdom – Country Paper (April 2018); Sarah Barker and Ellie Mulholland, CCLI, Directors' Liability and Climate Risk: Comparative Paper – Australia, Canada, South Africa, and the United Kingdom (October 2019); Ernest Lim, Directors Liability and Climate Risk: White Paper on Singapore (April 2021); CCLI and Climate Governance Initiative, Primer on Climate Change: Directors' Duties and Disclosure Obligations (June 2021); Governance Umakanth Varotil, Directors' Liability and Climate Risk: White Paper on India (October 2021); Sarah Barker, Cynthia Williams and Alex Cooper, CCLI, Fiduciary Duties and Climate Change in the United States (October 2021); Ernest Lim, Directors' Liability and Climate Risk: White Paper on Hong Kong (December 2021).

89 See the discussion in this White Paper at **General Features**, *Core Content* (3.3), **Strategy** (4.2), and **Risk management** (4.3).

90 See the discussion in this White Paper at **General Features**, *Connected information* (3.4.2).

91 See the discussion in this White Paper at **Strategy**, *Strategy and decision making* (4.2.2).

jurisdictions), directors have been held to be required to maintain familiarity with the financial status of the company through making enquiries and regularly reviewing the company's financial statements.[92]

It is notable that the definition of sustainability-related information includes sustainability-related risks and opportunities along an entity's value chain.[93] By extension, the preparation of disclosures sustainability information should involve enquiries of a company's suppliers and customers, as to any significant sustainability-related risks to which they are exposed. While not as extensive in terms of the duties to which companies and their directors are subject, this is similar to the proposed development under EU law for companies to put in place policies to identify, monitor and manage sustainability impacts.[94] The proposed scope of sustainability information under the EDs may therefore require directors to make enquiries of delegated functions to ensure the consideration of significant sustainability risks in supply chains.

It is likely, particularly given the requirements for directors in respect of a company's disclosures and annual accounts (on which, see above), that a reasonable director would be considered to be familiar with the sustainability risks and opportunities which the company discloses, and to consider them when making decisions. Directors would also be likely to be expected to have systems in place to identify those risks and opportunities, and to manage and monitor them (or at the least, good reasons for not having such systems in place), since disclosures on these factors are also proposed under the EDs.

6. Conclusion

The proposed disclosures in ED IFRS S1 and ED IFRS S2 denote an increasing focus on sustainability risks and opportunities in the corporate sphere. By requiring disclosures on these factors and the systems for identifying, monitoring and managing them, the proposed disclosure standards would be likely to raise the bar of what courts, shareholders and stakeholders would expect of directors.

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92 *ASIC v Healey* [2011] FCA 717.

93 See para. 3.4.1 above.

94 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937.

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