Navigating the new frontier of sustainability standards

ISSB Matters: Preparing for the IFRS Sustainability Disclosure Standards

EY

Building a better working world

The International Financial Reporting Standard (IFRS) Sustainability Disclosure Standards developed by the International Sustainability Standards Board (ISSB) present one of the most significant shifts in reporting that businesses in Oceania have ever seen. While the practical reality of the standards and how they will transition to legislation in Australia and New Zealand is still underway, we already know much of what the standards will mean, where the key gaps might be for companies in this region and what leading practice integration looks like.

This paper, the first of our *ISSB Matters* series, offers practical guidance to assist companies across the region prepare for future ISSB-aligned disclosure.

There's no doubt that the change being brought by the ISSB will be a net good. However, getting ready for the proposed disclosure requirements will be a testing time for many organisations.

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What do we know?

In late 2021, the IFRS Foundation launched the ISSB to develop a comprehensive global baseline of sustainability standards. This development represents a substantial step towards sharpening the focus on sustainability-related risks and opportunities and standardising the basis for reporting on sustainability matters. It also provides a pathway towards greater integration with financial disclosure requirements – providing much-needed guidance to investors and other stakeholders who are wanting to better understand the financial impact of sustainability-related risks and opportunities on organisations.

The goal of ISSB is to have a "complete suite" of sustainability standards. The standards leverage the architecture of the Taskforce on Climate-related Financial Disclosure (TCFD) framework, which consists of four pillars covering governance, strategy, risk management, and metrics and targets. IFRS Sustainability Disclosure Standards also include general features setting the expectation for what constitutes high-quality disclosure, such as considering alignment with financial statements, materiality and comparative information.

However, even companies that are already meeting the TCFD recommendations are likely not prepared for the IFRS Sustainability Disclosure Standards. The ISSB is setting what will become mandatory reporting requirements and comes with a heightened focus on integration, requiring all companies to apply the equivalent of financial reporting processes and rigour to sustainability disclosure.

The IFRS Sustainability Disclosure Standards consist of:

A general standard

Specifically, proposed base standard *IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1), which covers general requirements for disclosing sustainability-related financial information

Topic-based standards

Starting with *IFRS S2 Climate-related Disclosures* (IFRS S2), which focuses on climate-related disclosure (with potential future standards on human capital, biodiversity and other sustainability topics to come)

IFRS Sustainability Disclosure Standards architecture

Based on the four core elements of the recommendations of the TCFD

Governance
The governance processes, controls and procedures a reporting entity uses to monitor sustainability-related risks and opportunities.

Strategy
How an entity's strategy addresses significant sustainability-related risks and opportunities.

Risk management
How sustainability-related risks are identified, assessed, managed and mitigated.

Metrics and targets
Information used to manage and monitor the entity's performance in relation to sustainability-related risks and opportunities over time.

IFRS S1

IFRS S2

Thematic/cross-industry requirements | Industry-based requirements

Core content used across IFRS Sustainability Disclosure Standards

General features

Reporting entity
Align with the reporting entity for general purpose financial statements (NB: value chain disclosures are encouraged throughout).

Materiality
If omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reporting make on the basis of that reporting. This is generally consistent with the materiality concept in IFRS accounting standards.

Fair presentation
A complete set of sustainability-related financial disclosures shall present fairly the sustainability-related risks and opportunities to which an entity is exposed.

Comparative information
Disclose comparative information in respect of the previous period for all metrics disclosed in the current period (with some transition relief available).

Connected information
Information should be provided to enable users to assess the connections between various sustainability-related risks and opportunities, and to assess how information about these are linked to the general purpose financial statements.

Frequency of reporting
Report at the same time for the same reporting period (as the financial statements).

Location of information
Disclose information as part of its general-purpose financial reporting.

Disclosure of requirements
In the absence of a specific IFRS Sustainability Disclosure Standard that applies to a sustainability-related risk or opportunity, a company must consider the applicability of the disclosure topics in the industry-based Sustainability Accounting Standards Board (SASB) Standards as a basis for reporting.

Fundamental qualitative characteristics		
Relevance	Materiality	Faithful representation

Enhancing qualitative characteristics			
Comparability	Verifiability	Timeliness	Understandability

The IFRS S1 and S2 standards are expected to be finalised in June 2023, with adoption by jurisdictions likely to follow quickly. In Australia, Treasury has already consulted on a proposed FY25 implementation time frame. In New Zealand, the External Reporting Board (XRB) is closely following the ISSB developments to uplift the country's current climate disclosure requirements, which require certain entities to report against a localised version of the TCFD. This is the fastest emergence of new IFRS standards in many years, reflecting the urgency and demand to provide stakeholders (particularly investors) with clear, consistent and comparable sustainability information.

Development of final IFRS S1 S2 standards

Q2 2023

April, May, June

The ISSB confirmed the IFRS S1 and S2 will be released toward the end of Q2 2023. We expect this will be in June 2023.

Release of topic-based standards

From Q4 2023

December

The ISSB will be releasing further topic based standards (relating to potential topics such as human rights, human capital, and biodiversity) over the coming years.

Adoption by jurisdiction

Q1 2024

January

Adoption in Australia is expected to commence after 1 January 2024 (mandated date in local jurisdictions yet to be confirmed). This is expected to be a phase in approach.

How are the IFRS Sustainability Disclosure Standards being adopted locally? What are our regulators saying?

In Australia ...

Indications point to Australia introducing an Australian equivalent to the IFRS S2 standard with mandated reporting likely for FY25. The Federal Treasurer's address to the Australian Sustainable Finance Institute in December 2022 made it clear that the standards will:

1. Be mandatory for large firms.
2. Be aligned as far as possible with global standards.
3. Apply not just to firms, but to financial institutions and other comparable Commonwealth entities.

Whilst starting with climate-based reporting, the Treasurer also foreshadowed stronger reporting of other sustainability-related risks over time, in particular nature-related reporting – consistent with the staged approach envisaged by the ISSB.

Regulators and industry bodies are visibly supportive. The IFRS Sustainability Disclosure Standards have been endorsed by the Australian Securities & Investments Commission (ASIC) and has been welcomed by the Australian Banking Association (ABA), the Financial Services Council (FSC), CPA Australia, the Australian Institute of Company Directors (AICD) and the Australian Council of Superannuation Investors (ACSI). Amendments to the ASIC Act are currently being legislated to provide explicit responsibility to the FRC.

The Australian Accounting Standards Board (AASB) will write and release its own standard based on the ISSB, which will then be mandated to certain businesses, and it could require updates to the Corporations Act. According to the February 2023 Action Alert, the AASB project will initially relate to the for-profit sectors, looking to:

- Develop a separate suite of reporting standards that will sit alongside the existing Australian Accounting Standards.
- Address climate as its first sustainability reporting topic.
- Use the work of the ISSB as a foundation with modifications for Australian matters and requirements.

In New Zealand ...

New Zealand's mandatory climate risk reporting regime came into effect in 2023, requiring climate-based reporting, aligned with the TCFD framework, for certain large organisations and financial institutions in New Zealand. These requirements are encouraging a faster uptake of TCFD-related quality enhancement activities, such as deeper and more quantitative scenario analysis as well as assurance readiness. All these activities will be helpful for those caught in the IFRS Sustainability Disclosure Standards reporting requirements.

The current New Zealand regime is limited to climate-related disclosures only. It's unclear whether the XRB will adapt the New Zealand climate risk reporting regime to better align with the requirements of the IFRS Sustainability Disclosure Standards or continue with the existing national standards. However, the XRB has stated that "We are paying close attention to the ISSB's work and are acutely aware of the need to enable New Zealand entities to report in a globally consistent manner".[1]

Either way, for New Zealand entities with global investors, companies will be required to develop ISSB disclosure capabilities in the future. If the national regime continues as is, some companies may end up reporting to two (or more) different standards.

Thus, eventually, we can expect New Zealand to align with IFRS Sustainability Disclosure Standards reporting, at least outside of climate disclosures.

1 https://www.xrb.govt.nz/dmsdocument/4569

What are the challenges?

Elevating sustainability data to the quality required for financial reporting in the short time frame between now and adoption will be a massive challenge.

The challenges include:

- Integrating sustainability and financial data
- Accelerating reporting timelines
- Meeting the needs of all stakeholders

Integrating sustainability and financial data

The level of subject matter and organisational knowledge required to interpret and assess the financial impacts of material sustainability risks and opportunities over the short, medium and long term is significant. Often, financial and sustainability teams do not speak the same language, with terms like "materiality" traditionally having had different definitions in the accounting and sustainability worlds. Breaking down these barriers is key. As a starting point, teams need to understand what the other does, how they can leverage each other's strengths and to ensure they have a shared understanding of what key terms mean when applying IFRS Sustainability Disclosure Standards. For example, IFRS Sustainability Disclosure Standards will use the same definition of "materiality" that is used in IFRS Accounting Standards.

While a challenging task, deepening the connections between the historically distinct disciplines of sustainability reporting and financial reporting is also the greatest upside from the emergence of the ISSB. By requiring connections to be made between sustainability data and financial data, companies will need to enhance the systems and controls used to gather and report sustainability data. Once sustainability data is subject to robust systems and processes like those that currently apply to financial data, sustainability teams will be able to confidently produce accurate information for the market and, depending on the nature of investment in systems, the administrative burden of manual sustainability reporting may be significantly reduced.

Accelerating reporting timelines

The ISSB requires material sustainability disclosures to be reported alongside financial reporting. This will be a challenge for many companies, as the systems and processes and availability of sustainability data are not aligned with interim and year-end financial reporting in many cases. While we see a trend towards realignment in many organisations, many organisations will need to improve data availability using automation and controls and enhance governance to meet the requirements of IFRS Sustainability Disclosure Standards.

Meeting the needs of all stakeholders

As companies develop their IFRS Sustainability Disclosure Standards reporting capabilities in the context of broader disclosure, companies need to be mindful that the traditional audience for annual sustainability reporting goes beyond the investor-based focus of the ISSB. Companies should consider what other information may be useful to broader stakeholder groups, including customers, employees and community groups, and to consider the best way to communicate that information to them.

Some sustainability topics might not be considered material to investors but will be of ongoing interest to other stakeholders. Additional disclosures to meet the information needs of other stakeholders can be disclosed provided it does not obscure the information required by the IFRS Sustainability Disclosure Standards. Building the bridge between existing sustainability reporting, the disclosure of sustainability-related financial information required by the IFRS Sustainability Disclosure Standards and existing financial reporting is an important opportunity to automate the collection and quality control of all relevant sustainability data that may need to be reported to any stakeholder group.

IFRS S2 challenge: Turning climate impacts into meaningful business data

Quantifying climate impacts is not simple. Entities will be required to disclose the anticipated short-, medium- and long-term effects of climate-related risks and opportunities on an entity's financial position, financial performance and cashflows, and on its climate-related scenario analysis.

Disclosures of this calibre will require a mature understanding within the business of how climate-related risk and opportunity is linked to financial performance. Getting them right will require both conceptual conversations between finance, risk, strategy, and sustainability teams to make sure financial outcomes link to climate impact analysis.

What will integration look like?

Incorporating sustainability data into the tried and trusted environment of financial reporting is the obvious next step for building the connection between sustainability and financial reporting. However, this is not as simple as it sounds. Without great examples of "what good systems, processes and controls looks like", we are stepping into the unknown.

Companies can learn from mature reporters who have been voluntarily aligning to the standards that are now being absorbed into or working with the ISSB, including the TCFD, Global Reporting Initiative (GRI) standards, <Integrated Reporting> and the SASB. This is not to suggest that such companies' disclosures are ISSB aligned as the ISSB goes beyond the requirements of pre-existing voluntary frameworks. There's a difference in the quality of disclosure required by voluntary and mandatory regimes. As such, data associated to the same reporting entity and its value chain will require more robust internal systems and controls to meet the requirements of the IFRS Sustainability Disclosure Standards, as outlined on the following pages.

How to approach integration:

Align governance associated with financial and sustainability reporting

Overall groupwide responsibility for ISSB-related sustainability reporting should be the same calibre as for financial reporting, using the same oversight, governance framework and quality assurance processes. This has the dual advantage of elevating ISSB-related sustainability disclosures to the appropriate level of governance within the business whilst also managing business risk. For this to happen, the sustainability capability of finance teams will need to be rapidly uplifted. Training the finance team on, not just the standards, but also generally on sustainability topics relevant to the organisation, and the organisation's own sustainability strategy, is a critical first step.

That said, it is critical that sustainability functions remain instrumental in identifying what is important to the business, deciding what should be reported and the mechanisms of getting the associated information.

Align resources and approach

The goal is to bring the strengths of financial reporting and the innovation of sustainability reporting together. This requires both functions to have similar levels of authority when it comes to material sustainability disclosure. Sustainability teams have the context and in-depth knowledge of the ISSB intent. They also understand an organisation's sustainability and climate impacts and how to collect accurate and meaningful sustainability and climate-related data. Finance teams can collaborate with sustainability teams to leverage their experience in adopting the TCFD recommendations. In contrast, financial teams are the experts in collecting true and fair information. Finance has already developed the mature reporting processes that sustainability teams will need in the future. Both teams will need to work closely together on integration. Other functions, like strategy, investor relations and operations, also have important roles to play in the integration process, requiring capacity building across the business. When considering the resources required to make these changes, CFOs should be mindful that better quality sustainability reporting leads to more well-rounded and sophisticated financial reporting – and better visibility of risk.

> “… it is critical that sustainability functions remain instrumental in identifying what is important to the business, deciding what should be reported and the mechanisms of getting the associated information.

Leverage existing processes and systems

Organisations already have strong data management systems and processes for reporting on financial data. With suitable investment and cross-enterprise collaboration, these can be expanded to include sustainability information. We acknowledge there will be challenges with availability and suitability of some underlying sustainability data, particularly from the value chain. However, there is no need to build a parallel set of systems, controls and frameworks. Existing assurance processes can also be built on and extended.

Invest in automated workflows

Reporting under IFRS Sustainability Disclosure Standards will place greater focus on the processes by which data is gathered, analysed and checked, including internal audit reviews and external assurance. IFRS Sustainability Disclosure Standards also require granular, company-wide information to be available earlier than traditional sustainability data. This is simply not possible if sustainability teams are still relying on spreadsheets. Companies should be investing immediately in process automation and data systems.

Focus on impact

As sustainability reporting moves under the finance umbrella, it's important to remember its purpose. Reporting isn't for organisations to get better at producing data or telling a story. First and foremost, sustainability reporting must help entities to manage and respond to risk and grow sustainably as a business. Sustainability performance data must also be used to drive decisions that maximise positive and minimise negative sustainability impacts. Entities need to stay true to the intent of sustainability first principles and ensure impact is front and centre.

Apply a double materiality approach to assess financial materiality in a more meaningful way

ISSB applies the same lens to determine materiality as applies for IFRS accounting standards.[2] This can be a difficult concept in the context of sustainability-related information because of the greater potential for sustainability-related financial information to be qualitatively material even though it is not material from a quantitative perspective. Materiality judgements are entity-specific and need to consider whether the disclosure of that information could reasonably be expected to influence investors' decisions about providing resources to the entity.

In practice determining materiality for sustainability-related financial information must first consider the potential universe of sustainability issues that are important to the company and its stakeholders. As a consequence, assessing impact materiality will likely be a useful input to assessing materiality under IFRS Sustainability Disclosure Standards. This will enable companies to determine which sustainability-related risks and opportunities could have a financial consequence on the company's prospects.

For broader sustainability reporting of disclosures that lie beyond the remit of the ISSB, companies can look to existing frameworks for impact-based reporting, such as the Global Reporting Initiative. An impact-based reporting lens allows companies to articulate more holistic impact that is of interest to a broader range of stakeholders, which can augment and complement the identification and disclosure of qualitatively material information required by the IFRS Sustainability Disclosure Standards.

2 The current ISSB definition for materiality is: Disclosures must include all information that could reasonably be expected to influence decisions made by the primary users of financial reporting

Start preparing now

There is no time to waste. Incorporating sustainability information in general purpose financial reporting takes time. Companies need many months to establish, embed and fine-tune new systems and processes, which may require whole-of-enterprise changes.

Take action to integrate sustainability and financial understanding, capability and reporting:

1	**Establish accountability and a cross-functional working group**	Once clear governance and accountability are established, build out a cross-functional team, including representatives from sustainability, finance, strategy, governance, investor relations and operations. All parties must be rapidly educated about sustainability principles and financially-linked disclosure requirements, and the team should work together to uplift capability more broadly across the business.
2	**Conduct an ISSB gap analysis and determine course of action**	Understand future state reporting requirements, including IFRS Sustainability Disclosure Standards and other standards and frameworks to meet regulatory and stakeholder expectations. Remember to look out for opportunities to improve other management processes during the implementation stage. What other sustainability data are stakeholders asking for?
3	**Agree approach to materiality**	Consider whether the information needs of other stakeholders might also help to identify what information is material from the perspective of investors. Making a connection between the information needs of investors and other stakeholders may help in outlining how sustainability topics that are important to a wider stakeholder group may in time also become important to investors. This must however be done in a way that the disclosure of sustainability-related financial information is not obscured by additional information that is provided for stakeholders other than investors. To achieve this connection, companies could run impact and dependency pathways based on how sustainability topics map to financial impacts. For example, poorly managed human capital might lead to disengagement, higher attrition, lower attraction or greater training spend. The company would then need to assess whether this represents material information to the investor.
4	**Get assurance ready**	If a reporting entity is not already obtaining assurance in relation to its sustainability disclosures, enhancing data processes and systems should be a focus, including leaning heavily on existing financial controls. Consider pre-assurance over ISSB-related information and processes. This is where independent assurers look at existing or planned data controls, processes, and disclosures, and recommend an action plan to get ready for information to be both disclosed and assured in the future.

Preparing for IFRS Sustainability Disclosure Standards is challenging and requires hard work and immense collaboration across business functions. But it is also enormously important. Integrating sustainability and financial information should lead to more nuanced and sophisticated financial reporting. In this sense, the historical changes we are about to make to business and accounting may be the most important of our lifetimes.

We look forward to working with you to get them right.

About the Sustainability Disclosure Hub

The Sustainability Disclosure Hub is designed to help businesses navigate the IFRS Sustainability Disclosure Standards and transition to the next era of reporting. Taking an integrated approach, the Hub supports companies to prepare, and offers insights and resources to assist business to transition to a combined financial and non-financial reporting environment.

Headed by Oceania-leading non-financial and financial reporting specialists the Sustainability Disclosure Hub brings together EY capability locally and across the globe – coupling non-financial and financial reporting strategy, and readiness and assurance capabilities that have intimate knowledge of the ISSB and jurisdictional insights, including the AASB.

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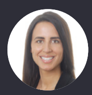

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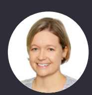

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