Global Sustainability Standards

Background

The IFRS Foundation, established in 2001 by a coalition of international accounting organisations, including the World Bank, was tasked with developing high-quality, understandable, and globally accepted accounting standards. To fulfil this mandate, the foundation created an independent standard-setting body, the International Accounting Standards Board (IASB).

The IFRS Foundation acts as an oversight body, providing governance and strategic direction, while the IASB focuses on the technical work of drafting and issuing International Financial Reporting Standards (IFRS).

Development of Global Sustainability Standards

As a result of increasing stakeholder concerns about Environmental, Social and Governance (ESG) issues, many entities voluntarily provide additional disclosures about ESG issues over and above their financial reporting requirements.

In November 2021, the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB) to address the need for a single set of globally accepted sustainability reporting standards that are integrated, consistent and on par with financial reporting standards.

In June 2023, the ISSB issued its first two IFRS sustainability disclosure standards, IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures.

IFRS S1 sets out general requirements for the disclosure of material information about sustainability-related financial risks and opportunities. IFRS S2 sets out supplementary requirements specific to climate-related matters. Together, the standards require an entity to disclose information about its impacts and dependencies on people, the planet and the economy to meet the needs of primary users of general-purpose financial information.

IFRS S1 and S2 came into effect for annual periods beginning on or after 1 January 2024, but implementation depends on adoption or enacting them into law.

Key features:

Purpose: IFRS S1 and S2 are intended to enhance transparency and comparability of sustainability-related information for stakeholders. They aim to bridge the gap between sustainability and financial reporting.

Content: IFRS S1 establishes a baseline for sustainability-related financial disclosures. IFRS S2 builds on this by requiring companies to disclose information about climate-related risks and opportunities.

Guidance: IFRS S1 requires companies to consider the SASB Standards for topics beyond climate. IFRS S2 provides guidance from the Task Force on Climate-related Financial Disclosures (TCFD).

IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information

The primary objective of this Standard is to ensure entities disclose material information about sustainability-related risks and opportunities that could significantly affect their financial performance, position, or cash flows.

IFRS S1 provides the basic requirements for sustainability disclosures, which should be used with IFRS S2 as well as any future standards the ISSB releases.

Key features include:

<u>Requires disclosure of material information:</u> Mandates the disclosure of material information about sustainability-related risks and opportunities with the financial statements.

<u>Industry-specific guidance:</u> Encourages using industry-specific guidance (including industry-based SASB standards) to identify and disclose relevant sustainability-related risks and opportunities.

<u>Broader sources:</u> Refers to various sources to assist companies in identifying sustainability-related risks and opportunities.

<u>Connecting sustainability and finance:</u> Requires disclosures that demonstrate the connections between sustainability-related risks and opportunities and their

potential impact on the entity's financial statements. For example, a company should disclose how climate change-related risks, such as increased insurance costs due to extreme weather events, could impact its financial performance (e.g., increased expenses and reduced profitability).

GAAP agnostic: Applies regardless of the underlying Generally Accepted Accounting Principles (GAAP) used by the entity.

IFRS S2: Climate-related Disclosures

IFRS S1 and S2 are designed to be applied together. However, IFRS S2 has been developed to capture climate-specific requirements, including:

Strategy disclosures: Distinguishing between physical (e.g. extreme weather events) and transition (e.g. policy changes, technological changes) risks.

Climate-related action plans: Disclosures of how companies plan to address climate change, including managing risks and capitalising on opportunities.

Scenario analysis: Requires scenario analysis of climate-related impacts.

Metrics and target disclosures:

Cross-industry metrics: Including key metrics relevant to all companies, such as greenhouse gas emissions.

Industry-specific metrics: Incorporating metrics relevant to specific industries (for example, carbon intensity of loan portfolios for banking institutions).

Company-specific metrics: Requiring disclosure of company-specific metrics used by the board or management to measure progress towards climate-related targets.

Disbandment of the Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD was established in 2015 by the Financial Stability Board (FSB) to develop voluntary and consistent climate-related financial risk disclosures for use by companies, investors and other stakeholders.

In 2017, the TCFD published its final recommendations across four core areas for climate-related disclosures: Governance, Strategy, Risk Management, and Metrics & Targets. Following publication, the recommendations have achieved widespread global recognition and have been embraced by numerous companies and jurisdictions.

The ISSB now oversees climate-related financial disclosures, building its IFRS S2 standard on the TCFD's recommendations. In late 2023, the FSB announced the TCFD was disbanded, as its work was considered complete.

Australian Sustainability Reporting Framework

Australia's sustainability reporting framework was established in September 2024, following the Climate-related financial disclosure reporting legislation being passed through Parliament. The Act requires relevant entities to disclose climate-related plans, financial risks and opportunities in line with the Australian Sustainability Reporting Standards (ASRS) issued by the Australian Accounting Standards Board (AASB).

The ASRS include two standards: AASB S1 General Requirements for Disclosure of Sustainability-related Financial Information and AASB S2 Climate-related Disclosures.

Both standards closely align with IFRS S1 and S2, with only minor modifications to suit the Australian context. The key difference is that AASB S2 is mandatory for reporting entities, while AASB S1 remains voluntary.

Australia is implementing a three-phased approach (see **Figure 1**), with the first group required to report for annual periods beginning on or after 1 January 2025. Sustainability reports must be lodged in line with current financial reporting requirements. Since most Australian companies have a 30 June year-end, the first mandatory reports for Group 1 entities will be for the year ended 30 June 2026.

Figure 1: Phased Implementation Approach

	Required to lodge financial reports under Chapter 2M of the *Corporations Act 2001* <u>and</u> falls within one (or more) of the following three categories (sustainability reporting thresholds)				
	Meet two of three reporting thresholds:			National Greenhouse and Energy Reporting (NGER) Reporters	Asset Owners (Registered schemes, Registrable superannuation entities and retail CCIVs)
	Consolidated gross revenue (For the financial year)	Consolidated assets (At the end of the financial year)	Employees		
Group 1 First annual reporting periods beginning on or after 1 January 2025	$500 million or more	$1 billion or more	> 500	Above NGER publication Threshold [2]	Scoped out of Group 1
Group 2 First annual reporting periods beginning on or after 1 July 2026	$200 million or more	$500 million or more	> 250	All other NGER reporters	$5 billion or more assets under management
Group 3[1] First annual reporting periods beginning on or after 1 July 2027	$50 million or more	$25 million or more	> 100	N/A	Refer to Group 3 reporting thresholds (see left)

[1] Limited disclosure for Group 3 entities if they have no material financial risks or opportunities relating to climate – see next page
[2] NGER reporters meeting Group 1 thresholds will be in Group 1 even if emission is below NGER publication threshold

Source: KPMG Australian Sustainability Reporting Legislation and Standards Guide, September 2024

Comment

While these new sustainability standards aim to enhance transparency and accountability, they also present challenges for businesses. Companies will need to invest in data collection, develop robust reporting systems, and potentially adjust their business strategies to address the disclosed information. Some companies already have established sustainability reporting practices, others will need to significantly enhance their capabilities to comply with the new requirements.

Ultimately, the successful implementation of these standards will depend on a collaborative effort between businesses, regulators and investors to ensure a balanced approach that supports both sustainability goals and business needs. ***SFM***