CLIENT ALERT

IFRS Foundation Introduces New Sustainability and Climate Disclosure Requirements

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On June 26, 2023, the IFRS Foundation's[1] International Sustainability Standards Board ("ISSB") announced the launch of new standards for global sustainability and climate disclosures. These standards are intended to serve as guidance for reporting entities regardless of whether they apply IFRS accounting standards or other generally accepted accounting principles, and they will become applicable for reporting periods as of January 2024. The standards are emblematic of the growing prominence of environmental, social, and governance ("ESG") transparency concerns, will inform the state of the art in this milieu, and may even serve as an additional incentive for companies to prioritize performance and reporting around such matters.

The Required Disclosures

The first of the two new ISSB standards, entitled "General Requirements for Disclosure of Sustainability-related Financial Information" ("IFRS S1"), seeks to spur disclosure of information about "sustainability-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity."[2] Under IFRS S1, an entity must disclose information about, among other things, governance structure and allocation of management responsibility concerning sustainability factors, the effect of sustainability-related risks and opportunities on the entity's business model and financial prospects (both for the reporting period and over the anticipated short, medium,

1 The IFRS Foundation is a not-for-profit, public interest organization established to develop high-quality, understandable, enforceable and globally accepted accounting and sustainability disclosure standards. See https://www.ifrs.org.

2 IFRS S1 ¶ 1.

and long term), and the entity's policies and procedures for managing sustainability-related risks and opportunities. IFRS S1 also provides that an entity must disclose "metrics the entity uses to measure" sustainability-related risks and opportunities, as well as the entity's "performance" according to these benchmarks.[3]

The other new ISSB standard, entitled "Climate-related Disclosures" ("IFRS S2"), seeks to require a reporting entity "to disclose information about its climate-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity."[4] IFRS S2 largely mirrors IFRS S1, as it includes required disclosures of governance, strategy, risk management, and performance metrics for climate-related risks and opportunities.

These new requirements reflect the increased relevance of ESG performance in investment decision-making, and they seek to advance better, broader, and more consistent disclosure for such purposes. In particular, the requirements reflect the view of many investors, regulators, and other stakeholders that ESG factors are relevant not only to the public interest but to a company's financial performance over various time horizons. For example, IFRS S1 states that "[i]nformation about sustainability-related risks and opportunities is useful to primary users because an entity's ability to generate cash flows over the short, medium and long term is inextricably linked to the interactions between the entity and its stakeholders, society, the economy and the natural environment throughout the entity's value chain."[5] This view that ESG issues are intrinsically related to long- and short-term value is commonly expressed by investors, regulators, and commentators advocating for a greater focus on ESG issues in business.[6] The ISSB's acknowledgement that "primary users" of financial statements find this information useful serves as a meaningful imprimatur on the still-growing ESG movement.

Significantly, the ISSB's new requirements also highlight specific disclosures of ESG "metrics and targets." Noting the need for users of financial reports "to understand an entity's performance in relation to its sustainability related risks and opportunities," both IFRS S1 and IFRS S2 provide that an entity must disclose not only the metrics it uses to assess its performance with respect to these issues, but also the method for developing and calculating these metrics, whether the metrics are validated by third parties, the targets the entity sets with respect to the metrics, and the entity's performance in relation to those targets.[7]

3 *Id.* ¶¶ 45-51.

4 IFRS S2 ¶ 1.

5 IFRS S1 ¶ 2.

6 *See, e.g.*, George Serafeim, *Social-Impact Efforts That Create Real Value*, Harvard Business Review (Sept.—Oct. 2020), https://hbr.org/2020/09/social-impact-efforts-that-create-real-value; Jon Raphael, *Driving Value Through ESG Integration*, Forbes (Jan. 17, 2023), https://www.forbes.com/sites/deloitte/2023/01/17/driving-value-through-esg-integration/?sh=7adfad635393.

7 IFRS S1 ¶¶ 45-53; IFRS S2 ¶¶ 29-37.

These required disclosures also take into account growing concerns regarding "greenwashing"—an oft-scrutinized "marketing tactic that companies use to lure in environmentally conscious customers, despite their products or services being anything but."[8] The ISSB appears to be attempting to mitigate this problem by requiring companies to provide detailed data regarding sustainability and climate issues, rather than relying on vague pronouncements. The U.S. Securities and Exchange Commission ("SEC") likewise has attempted to snuff out greenwashing through a proposal to require additional, data-based disclosures from "certain investment advisers and funds that purport to take [ESG] factors into consideration when making investing decisions."[9] In announcing this proposal, SEC Chair Gary Gensler noted that disclosures about ESG are often difficult for investors to understand, and explained, "I think investors should be able to drill down to see what's under the hood of these funds."[10]

Global Standards?

The ISSB consulted widely among international regulators (via the International Organization of Securities Commissions ("IOSCO")), and a range of stakeholders such as large companies and financial institutions, in preparing IFRS S1 and IFRS S2. As ISSB Chair Emmanuel Faber recently stated in an interview, "a critical next step" will be IOSCO's expected endorsement of the requirements and jurisdictions' adoption and implementation of them.[11] The U.K. government and the U.K. Financial Conduct Authority ("FCA") are supportive of these international standards and will consult on a mechanism for the U.K.'s adoption of them. The FCA has stated its intention that its climate-disclosure rules for U.K.-listed companies and relevant regulated firms will reference ISSB standards. Other nations which have indicated they will adopt S1 and S2 include Singapore, Australia, Brazil, Canada, Japan and South Korea.[12]

It is unlikely that complete global harmony of sustainability reporting standards will be achieved yet, as for example, the ISSB and the EU have taken a different approach. The EU's Corporate Sustainability Reporting Directive ("CSRD") will require disclosure on the basis of "double materiality," meaning disclosures must show not just how sustainability issues affect a Company's business but the impact of the business's activities on people and the environment.[13] CSRD disclosures

8 Kelly Anne Smith, *Greenwashing And ESG: What You Need to Know*, Forbes (Aug. 25, 2022), https://www.forbes.com/advisor/investing/greenwashing-esg/.

9 Gary Gensler, U.S. Securities and Exchange Commission, Statement of ESG Disclosures Proposal (May 25, 2022), https://www.sec.gov/news/statement/gensler-statement-esg-disclosures-proposal-052522.

10 *Id.*

11 PracticalESG.com, *ISSB Chair Discusses New Standards* (July 5, 2023), https://practicalesg.com/2023/07/issb-chair-discusses-new-standards/.

12 ISSB: Frequently Asked Questions, https://www.ifrs.org/groups/international-sustainability-standards-board/issb-frequently-asked-questions/.

13 Directive (EU) 2022/2464 of the European Parliament And of the Council of 14 Dec. 2022 amending Regulation (EU) 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting ¶ 29, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022L2464.

cover a wider range of sustainability topics including climate change, biodiversity and ecosystems, working conditions, human rights and business ethics.

Impact of the Disclosures

Ultimately, the ISSB's new requirements should hasten what the SEC and many investors and commentators have already begun to encourage, namely, routine, detailed disclosures from entities regarding ESG performance. These requirements also should help to ensure that entities rein in broad, unsupported disclosures; a company cannot describe itself as "sustainable" or "green" while also disclosing that it failed to achieve key targets according to its own sustainability metrics. In particular, companies should take care in setting and reporting regarding "net zero" commitments, which are sure to come under increasing scrutiny in the future.[14] With or without such requirements, companies should ground ESG disclosure practices in a sound process that ensures consistency across messaging platforms, accuracy, and verifiability, and which addresses the needs and interests of financial and other key stakeholders. Adherence to and transparency regarding a company's internal performance metrics can also mitigate the risk of liability under securities laws, as well as investor scrutiny or charges of "greenwashing."

[14] *See* ZeroTracker.net,, *Net Zero Targets Among World's Largest Companies Double, But Credibility Gaps Undermine Progress* (June 12, 2023), https://zerotracker.net/insights/net-zero-targets-among-worlds-largest-companies-double-but-credibility-gaps-undermine-progress.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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