ISSB meeting

Date	**October 2022**
Project	**General Sustainability-related Disclosures**
Topic	**Fundamental concepts**
Contacts	**Jordan Knights** (jordan.knights@ifrs.org) **Sam Wallace** (sam.wallace@ifrs.org)

Objective

1. This paper discusses the use of fundamental concepts and terms within the Exposure Draft IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* ([draft] S1). These include the objective, definition and application of the concepts of materiality and enterprise value, the use of the term 'significant' and the breadth of reporting required.

2. The objective of this paper is to:

    (a) describe the matters raised in consultation period feedback related to the fundamental topics that the ISSB has agreed to redeliberate (see paragraphs 49–58 of Agenda Paper 3B & 4B General Sustainability-related Disclosures—Plan for redeliberation from the September 2022 ISSB meeting);

    (b) seek feedback on the staff's analysis and recommendations; and

    (c) seek decisions from the ISSB on select matters, which will provide further clarity on a path to more comprehensive decisions at a future ISSB meeting.

3. This paper addresses several fundamental concepts and terms and it is presented as a consolidated paper because these concepts and terms are highly interrelated. Therefore, considerations and decisions on the specific concepts and/or terms in this paper must be made with a broader understanding of the relationships and implications between them.

Summary of the staff's recommendations

4. Paragraph 4(a)–(f) summarises the staff's recommendations. The staff is seeking decisions from the ISSB to help clarify the path forward on more comprehensive decisions planned for the December meeting. For each recommendation, the staff has provided alternative options and analysis in the relevant sections of this paper. Additional matters are discussed in the paper below that are intended for feedback from the ISSB and to help establish a path forward, but not for decision making.

    Part 1: Materiality and enterprise value

    (a) confirm that information is being provided to meet the information needs of the primary users of general purpose financial reporting as proposed in [draft] S1

    (b) remove the definition of enterprise value that was included in [draft] S1 and remove the words 'assess enterprise value' from the [draft] S1 objective and definition of materiality

(c) draw on existing frameworks to more clearly articulate the notion of enterprise value and its link with sustainability

Part 2: Use of the term ‘significant’

(d) remove the term ‘significant’ and the phrase ‘all significant’ in relation to sustainability-related risks and opportunities

Part 3: Breadth of reporting

(e) confirm that the substance of the reporting requirements for the value chain and reporting entity will remain unchanged from [draft] S1

(f) consider providing guidance or further emphasising existing guidance on how entities should approach reporting on subsidiary and value chain activities.

5. This paper does not include specific recommendations on the process of identifying sustainability-related risks and opportunities (including using the materials of other standard setters) or on the application of materiality assessment.

Structure of the paper

6. This paper is structured:

(a) Background (paragraphs 7–11);

(b) Part 1: Materiality and enterprise value (paragraphs 12–72);

(i) Topics identified in plan for redeliberations;

(ii) Materiality and enterprise value in [draft] S1

(iii) Staff discussion;

(iv) Staff analysis;

(v) Questions for the ISSB;

(c) Part 2: Use of the term ‘significant’ and the phrase ‘all significant’ (paragraphs 73-92);

(i) Topics identified in plan for redeliberation;

(ii) Use of the term ‘significant’ in [draft] S1;

(iii) Staff discussion;

(iv) Staff analysis;

(v) Questions for the ISSB;

(d) Part 3: Breadth of reporting – subsidiaries and value chain (paragraphs 93-107);

(i) Topics identified in plan for redeliberation;

(ii) Breadth of reporting requirements in [draft] S1;

(iii) Staff analysis;

(iv) Questions for the ISSB;

(e) Next steps (paragraph 108).

Background

7. In March 2022, the Chair and Vice-Chair published [draft] S1, which sets out proposed requirements for disclosing sustainability-related financial information to provide users of general purpose financial reporting (users) with a complete set of sustainability-related financial disclosures. [Draft] S1 was developed in response to calls from users for more consistent, complete, comparable and verifiable sustainability-related financial information to enable them to inform investment decision-making and resource allocation.

8. [Draft] S1 included an Invitation to Comment, soliciting public feedback on the proposals in [draft] S1. Many respondents provided feedback on the use and meaning of the terms and fundamental concepts in this paper, including a range of feedback on whether these terms and concepts were clear and would enable consistent application.

9. In September 2022, the ISSB decided on the topics for redeliberation of [draft] S1:

   (a) enterprise value;

   (b) breadth of reporting required;

   (c) 'significant' sustainability-related risk or opportunity;

   (d) identifying significant sustainability-related risks and opportunities and disclosures (including using the materials of other standard-setters); and

   (e) application of the materiality assessment.

10. Each topic is fundamental and interconnected to the objective of the exposure draft, including understanding the requirements to identify sustainability-related risk and opportunities and to provide users of general purpose financial reporting with a complete set of sustainability-related financial disclosures.

11. The following sections address the fundamental concepts and terms for redeliberation. These sections include an explanation of the topic(s) identified by market feedback, background on the meaning and use of the term or fundamental concept, the staff analysis of the important issues, and suggested options and recommendations to improve the handling of these concepts in [draft] S1.

Part 1: Materiality and enterprise value

Topics identified in plan for redeliberations

12. Respondents provided mixed feedback on the application of the fundamental concepts in [draft] S1 that guide how preparers should identify and assess relevant information to be included in sustainability-related financial disclosures. This feedback centred around the concepts of 'materiality' and 'enterprise value' and how they should be applied to identify and assess decision useful information for disclosure.

13. Many respondents agreed with the proposals on materiality, but some respondents presented anticipated challenges associated with the focus on enterprise value, the adaptions made to the wording used from the IASB's *Conceptual Framework for Financial Reporting* (*Conceptual*

Framework) and expressed that there is a lack of clarity around the scope of sustainability-related risks and opportunities and sustainability-related financial information.

14. Some respondents are seeking more clarity on the concept of enterprise value, and the extent to which it includes the impact of an entity on people, planet and the economy, and how the focus on enterprise value would relate to other sustainability reporting frameworks.

15. Some respondents questioned whether enterprise value is an appropriate term to anchor material sustainability-related disclosures around, as they perceived enterprise value to be too narrow a scope to capture information that may be decision useful to users of general purpose financial reporting.

16. Some respondents suggested that defining 'sustainability' or providing further guidance as to what constitutes 'sustainability-related risks and opportunities', and 'sustainability-related financial information' would help clarify the requirements.

17. Many respondents also emphasised the importance for the ISSB to work with jurisdictions, including Europe and the United States (US), in developing a global baseline of sustainability-related financial disclosures. Specifically, respondents said that key differences in concepts, terminologies, and definitions remain between the ISSB's proposals and jurisdictional initiatives.

18. In the redeliberations of fundamental concepts of [draft] S1, the staff recommend that the ISSB address these issues:

    (a) consider whether the ISSB should revise [draft] S1 to maintain more consistent definition and language with the IASB *Conceptual Framework*;

    (b) consider whether the term enterprise value should continue to serve as a fundamental concept in [draft] S1; and

    (c) discuss whether further guidance and resources are needed to clarify the scope of sustainability-related risks and opportunities and the application of the materiality assessment.

Materiality and enterprise value in [draft] S1

19. Paragraphs 1–2 of [draft] S1 describe the overall requirements for identifying and assessing information to be included in sustainability disclosures:

> 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.
>
> 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.

20. Specifically, the requirements in paragraphs 1–2 of [draft] S1 identify:

    (a) the objective of disclosures – to assist users of general purpose financial reporting in assessments of enterprise value and in deciding whether to provide resources to the entity;

    (b) the information to disclose – material information about all significant sustainability-related risks and opportunities; and

(c) how the assessment of materiality (that is, determining what information to disclose) relates to the objective of disclosure (that is, the use of that information by users of general purpose financial reporting) – in other words, how (a) and (b) above relate to each other.

21. By establishing this overarching framework, [draft] S1 serves a similar role for sustainability-related financial disclosures as the IASB's *Conceptual Framework,* IAS 1 *Presentation of Financial Statem*ents and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* serve for general purpose financial statements prepared in accordance with IFRS Accounting Standards.

22. [Draft] S1 further discusses the meaning of enterprise value (paragraphs 5 and 17):

> Enterprise value reflects expectations of the amount, timing and certainty of future cash flows over the short, medium and long term and the value of those cash flows in the light of the entity's risk profile, and its access to finance and cost of capital. 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.
>
> …When such impacts, dependencies and relationships create risks or opportunities for an entity, they can affect the entity's performance or prospects, create or erode the value of the enterprise and the financial returns to providers of financial capital, and the assessment of enterprise value by the primary user.

23. [Draft] S1 also discusses how preparers are to understand materiality in the context of sustainability-related financial information (paragraphs 56–58):

> Sustainability-related financial information is material 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, which provides information about a specific reporting entity.
>
> Material sustainability-related financial information provides insights into factors that could reasonably be expected to influence primary users' assessments of an entity's enterprise value. The information relates to activities, interactions and relationships and to the use of resources along the entity's value chain if it could influence the assessment primary users make of its enterprise value. It can include information about sustainability-related risks and opportunities with low-probability and high-impact outcomes.
>
> Materiality is an entity-specific aspect of relevance 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 financial reporting. This [draft] Standard does not specify any thresholds for materiality or predetermine what would be material in a particular situation.

24. In summary, the concepts of materiality and enterprise value are relied on to establish the objective of [draft] S1, as well as how preparers should determine the information to provide to fulfil the objective.

Staff Discussion

ISSB materiality objective and definition

25. The ISSB does not have a separate conceptual framework that applies directly to sustainability-related financial information. Rather, the definition of ISSB materiality was developed based on the objective and definitions of 'material' and 'materiality' in the IASB's *Conceptual Framework* and IAS 1. This alignment aims to facilitate connectivity between sustainability-related financial information and information in the financial statements, as well as to improve stakeholders' understanding of the ISSB's work and to ease application of IFRS Sustainability Disclosure Standards by preparers, given the widespread use of IFRS Accounting Standards.

26. The IASB's *Conceptual Framework* describes materiality in paragraph 2.11:

> information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

27. This definition is also used in IAS 1 with a specific reference to the general purpose financial statements (as opposed to general purpose financial reports).

28. [Draft] S1 adapted this language to state that 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'.

29. Although the information captured in sustainability-related financial disclosures is intended to be broader than financial accounting and disclosures and will likely cover a longer time horizon, the primary users of IFRS Sustainability Disclosure Standards are consistent with those defined in the IASB's *Conceptual Framework*.

30. The objective and definition of materiality in the IASB's *Conceptual Framework* are not constrained to what is financially material in the financial statements. Rather, they identify information that is useful to primary users of general purpose financial reporting. This includes material financial information that helps existing and potential investors, lenders and other creditors to estimate the value of the reporting entity (IASB's *Conceptual Framework* paragraph 1.7). It is also important to note that primary users of financial reporting, particularly investors, are a diverse group with differing objectives and types of risk exposure, as well as a wide range of interests in relation to sustainability matters.

31. Given the level of judgement involved, some preparers may not have a strong understanding of what affects enterprise value, especially over the long term, and may revert to reporting a relatively narrow set of information. Users may find that information provided in order 'to assess enterprise value' may be too restrictive and less decision useful than information provided under the broader definition of materiality in the IASB's *Conceptual Framework*.

Enterprise value and the connection to sustainability-related financial disclosures

32. As stated in paragraph 2 of [draft] S1, the objective of the proposed disclosures is to allow 'users of general purpose financial reporting to assess enterprise value and determine whether to provide resources to the entity'. Enterprise value is defined in Appendix A of [draft] S1 as: 'The total value of an entity. It is the sum of the value of the entity's equity (market capitalisation) and the value of the entity's net debt'.

33. This language defines the objective of sustainability-related financial disclosures somewhat differently from the objective of financial reporting. Paragraph 1.2 of IASB's *Conceptual Framework* refers to 'providing resources to the entity' but not to enterprise value:

> The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about:
>
> a. buying, selling or holding equity and debt instruments;
>
> b. providing or settling loans and other forms of credit; or

c. exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.'

34. The inclusion of enterprise value in [draft] S1 was intended to broaden the scope of current IFRS financial accounting and disclosures to capture a broader set of information, including forward-looking and qualitative information.

35. [Draft] S1 uses enterprise value throughout the proposed standard to emphasise that information is to be provided about sustainability-related risks and opportunities that are relevant to an assessment of the total value of the enterprise including information about future cash flows, dependencies on resources, and other direct or indirect drivers of market returns and cost of capital over the short, medium and long term.

36. According to paragraph 1.7 of the IASB's *Conceptual Framework*, 'general purpose financial reports are not designed to show the value of a reporting entity; but instead they provide information to help existing and potential investors, lenders and other creditors estimate the value of the reporting entity'.

37. Sustainability-related financial disclosures aim to provide material information that is useful to primary users and thus complement the information provided by financial accounting and disclosure statements. While the intent of using enterprise value was to broaden the scope of information captured, the use of this term may have constrained the objective of [draft] S1 and created a disconnect with the various use cases of sustainability-related financial disclosures by primary users and the decisions that they make.

Use and description of the term 'sustainability'

38. Although the concept and definition of materiality align with the IASB's *Conceptual Framework*, the type and scope of sustainability-related risks and opportunities and sustainability-related financial information will differ from the resources reflected in general purpose financial statements.

39. Some respondents indicated that it may be difficult to understand sustainability-related financial information in the context of assessing materiality without a clearer understanding of sustainability. [Draft] S1 uses language throughout and within its Basis for Conclusions to describe sustainability-related financial information. For example, paragraph 6 of [draft] S1 explains that:

> Sustainability-related financial information is broader than information reported in the financial statements and could include information about:
>
> d. an entity's governance of sustainability-related risks and opportunities, and its strategy for addressing them;
>
> e. decisions made by the entity that could result in future inflows and outflows that have not yet met the criteria for recognition in the related financial statements;
>
> f. the entity's reputation, performance and prospects as a consequence of the actions it has undertaken, such as its relationships with people, the planet and the economy, and
>
> g. its impacts and dependencies on them;

40. [Draft] S1 and its Basis for Conclusions also state that sustainability-related risks and opportunities arising from activities along an entity's value chain that may significantly affect its business model should be included (for example, impacts of suppliers).

Application of materiality for sustainability-related financial disclosures

41. Although applying materiality to general purpose financial reporting is generally well understood, there is significantly less clarity and established practices in applying materiality judgements to sustainability-related financial disclosures.

42. To prepare sustainability-related financial disclosures, it is expected that preparers will have to consider financial implications over longer periods than those considered in preparing general purpose financial statements. Preparers may also need to consider financial implications of impacts and dependencies throughout their value chain to a greater degree (see paragraphs 92-96).

43. It is necessary to reassess materiality when preparing financial statements. However, given the dynamic nature of materiality (per BC76 of [draft] S1) and the evolving nature of primary users' use of the information, as a general proposition, it is expected that changes in assessments of materiality are likely to be more common for sustainability-related financial information.

44. Financial statement materiality is well established and customary practices have developed for determining materiality in general purpose financial reporting. For those using IFRS Accounting Standards, support is available through IFRS Practice Statement 2: *Making Materiality Judgements* .

45. [Draft] S1 aims to build upon this foundation of market knowledge and practice around materiality to enhance connectivity with the IASB and improve consistent application. However, given the relative lack of established practice in sustainability, the ISSB may consider that providing guidance to support the assessment of materiality would support higher quality, more consistent disclosures.

Materiality interoperability considerations

46. Differences in materiality definitions and concepts for the ISSB, Europe, GRI and the US SEC are creating some confusion in the market. Although each of the reporting frameworks describe material information differently, there is significant overlap in the language they use, particularly because they all refer to assessing material information in the context of the short, medium and long term effects of sustainability issues. However, it is important to note that what is 'material' depends on the issue, the context, the time frame and the stakeholder.

47. The key difference between GRI, Europe and ISSB is the audience. The ISSB is focused on potential investors, lenders and other creditors (primary users of general purpose financial reporting), whereas GRI and Europe have a broader set of 'users' of the information.

48. To address market confusion and to help enable interoperability, the ISSB may need to consider providing additional clarity on the relationship between ISSB's concepts, terminologies, and definitions compared to other jurisdictional initiatives and sustainability reporting frameworks.

Staff analysis and recommendations

49. The staff has presented this section to enable a logical discussion to help guide decision making and feedback that will help clarify the path forward on the comprehensive decisions that are planned for a future ISSB meeting. Some issues presented below are recommended for decision-making at present, while others are intended to help guide discussions about future decisions.

Matter to address 1—Confirm primary users

50. In approaching discussions and decisions related to the fundamental concepts in [draft] S1, it is helpful to begin by confirming the audience for the ISSB's information – the primary users of general purpose financial reporting. As described above, [draft] S1 defines primary users of general purpose

financial reporting as 'existing and potential investors, lenders and other creditors', in alignment with the IASB's *Conceptual Framework*. [Draft] S1 also discusses the types of decisions that these primary users make.

51. Although the ISSB did not include this topic in the plan for redeliberations, the staff brings this issue forward as the most logical starting point before advancing to the issues below. It is important that the ISSB confirm and remain grounded in the definition of primary users of general purpose financial reporting before advancing to materiality and enterprise value.

52. **Staff recommendation—maintain as proposed in [draft] S1**

    (a) The staff recommends that the ISSB confirm that information is being provided to meet the information needs of the primary users of general purpose financial reporting as proposed in [draft] S1.

Matter to address 2—Is 'enterprise value' a necessary and appropriate concept to help establish the objective of [draft] S1 and the definition of materiality?

53. This matter and decision for the ISSB to make refers to the use of enterprise value to help anchor the objective of [draft] S1 and the definition of materiality (or the basis for materiality assessments).

54. Although enterprise value was included to help explain the scope of sustainability-related financial disclosures (see paragraphs 34-35), the use and definition of enterprise value in [draft] S1 presents these challenges:

    (a) The term creates inconsistencies with the IASB's *Conceptual Framework*, which focuses on information that is useful for primary users in determining whether to provide resources to the entity.

    (b) Some respondents, including some users, expressed concerns that the use of enterprise value may unduly narrow the scope of sustainability-related financial disclosures, excluding information that may be useful to users in the decisions that they make.

    (c) Some respondents noted that in their view the definition of 'enterprise value' in Appendix A of [draft] S1 is not wholly consistent with the description in paragraph 5 and throughout the Basis for Conclusions, which includes greater focus on drivers of future cash flows and the intrinsic value of the reporting entity.

    (d) The Appendix A definition specifically references market capitalisation, which led some respondents to incorrectly assume that [draft] S1 was not intended for application to private companies.

    (e) It is also noted that debt investors may not be primarily concerned with assessments of enterprise value.

    (f) The term 'enterprise value' has a particular and potentially conflicting definition in European legislation.

55. The staff set out options below for how this could be addressed. These options refer specifically to the wording of the objective of [draft] S1, and not to whether the term 'enterprise value' may be used at all in [draft] S1.

56. **Option 1—Maintain existing approach and consider additional clarity and/or guidance**

(a) If the ISSB determines that enterprise value is the appropriate term to anchor sustainability-related financial disclosures around, then it may be appropriate to keep the existing language while providing guidance on how to interpret and apply this concept.

(b) The ISSB may consider expanding the definition of enterprise value to include some of the language from paragraph 5 and paragraph 17 of [draft] S1 and/or from the Basis for Conclusions (B35, BC38, BC39 of [draft] S1) on drivers of enterprise value and the effect on cash flows over the short, medium and long term. This expanded definition could help clarify how enterprise value applies to private companies, where the assessment of market/equity value is still generally informed by assessments of future cash flows and the cost of capital.

(c) The ISSB may also consider revising the definition of enterprise value to remove reference to market capitalisation to reduce the risk of confusion that enterprise value is only applicable to public companies.

(d) However, the ISSB should keep in mind that the term enterprise value may have an existing legal definition in some jurisdictions and is defined in European legislation. This risks creating confusion when the term used by the ISSB differs from such definitions.

57. **Option 2—Replace the term enterprise value with a different term or phrase**

(a) The ISSB may consider replacing the term enterprise value with a different phrase like 'capital allocation,' 'entity's future performance and future value' or 'the entity's ability to create, preserve or erode the value of the enterprise and the financial returns to providers of financial capital'.

(b) Using a different term may avoid some of the challenges with the term being seen as too prescriptive or narrow to capture decision-useful information. However, the staff anticipates that new terms will create new concerns including about how they are defined, and the effect they are intended to have on the disclosure requirements. This is an important consideration given the central role that the term plays in the draft requirements.

(c) If the ISSB chooses a different term, it may be useful to define how that term affects the materiality assessment and the breadth of reporting required.

58. **Option 3—Remove enterprise value from the objective and definition of materiality**

(a) The ISSB may consider removing the term 'enterprise value' from the objective in paragraph 1 of [draft] S1 and from the materiality definition in paragraph 2. The intention of doing this would not be to fundamentally change the focus of the required disclosures. Instead, it would be to acknowledge that disclosures are used in a variety of ways by users. This approach could also reduce concerns that the term 'enterprise value' and its possible interpretations exclude information that is decision useful for users. As a result, [draft] S1 would avoid prescribing the type of filter (enterprise value) needed to assess materiality

(b) This approach would create alignment with the IASB's *Conceptual Framework* in regards to the objective of reporting and the definition of materiality (noting a minor difference related to the IASB's use of 'general purpose financial statements' versus the ISSB's use of 'general purpose financial reporting').

(c) This option does not necessarily suggest that the term 'enterprise value' cannot be used anywhere in the disclosure requirements but rather that the term would not be used to anchor the objective of [draft] S1 and definition of materiality. In some cases discussing the concept of enterprise value may continue to be helpful, such as in articulating how some users may use the information (eg assessments of enterprise value) or in discussing future cash flows and cost of capital.

(d) The staff advises that paragraph 17 of [draft] S1 is critical to the broader understanding of value and the needs of primary users of general purpose financial reporting as they consider sustainability risks and opportunities. The ISSB should consider moving paragraph 17 of [draft] S1 to be adjacent to paragraph 1 or 2 of [draft] S1 and/or expanding the discussion contained in this paragraph.

59. **Staff recommendation**

(a) The staff recommends Option 3 where the definition of enterprise value that was included in [draft] S1 is removed and that the words 'assess enterprise value' are removed from the [draft] S1 objective and definition of materiality.

Matter to address 3 — Is there a better way to frame the notion of enterprise value by clarifying its meaning and connection to sustainability?

60. To address the challenges and feedback in paragraphs 16-18, the ISSB should consider whether the language throughout draft [S1] could be improved or reorganised to provide a clearer understanding of the notion of enterprise value and its connection to sustainability. Further clarity can help inform the process of identifying sustainability-related risks and opportunities and the assessment of material sustainability-related financial information.

61. **Staff recommendation—draw on existing frameworks to more clearly articulate the notion of enterprise value**

62. The ISSB may choose to include additional resources and language in the [draft] S1 or throughout the Basis for Conclusions to further clarify the concept of enterprise value and the scope of sustainability-related financial information required. The staff believes that this additional clarity is relevant irrespective of the decision the ISSB makes regarding the use of the term and concept of enterprise value in the preceding matter.

63. There may be opportunities to align and include concepts from the Integrated Reporting Framework (IR Framework) to better frame the notion of enterprise value and to better clarify its meaning and its relation to sustainability-related financial information.

64. For background, the IR Framework became part of the materials of the IFRS Foundation on consolidation of the Value Reporting Foundation by the IFRS Foundation in August 2022. The IFRS Foundation released a press release in May 2022 signalling the commitment of the Chair of the IASB and the Chair of the ISSB to building on the IR Framework and specifically noting that the IASB and ISSB will use principles and concepts from the IR Framework in their standard-setting work, subject to due process.

65. Fundamental Concepts of IR Framework include:

(a) the value created, preserved or eroded for an organisation ('entity') (and its providers of financial capital) is inextricably linked to the value created for other stakeholders, society and the natural environment;

(b) to create value, entities rely on critical resources and relationships, or 'capitals' - the IR Framework involves six categories of capitals (such as financial, human and natural capital) which are positively or negatively affected by the entities' activity, and on which they depend; and

(c) the process through which value is created, preserved or eroded is influenced by an entity's external environment, business model, performance and other factors.

66. The IR Framework describes the relationships between the external environment, the company's business model, and the capitals (resources and relationships) as inputs, outputs and outcomes in process through which value is created, preserved or eroded.

67. The ISSB may consider using the IR Framework to further describe the connection between sustainability and enterprise value, which may clarify the scope of sustainability-related risks and opportunities throughout the value-chain in the context of sustainability-related financial information.

Matter to address 4—Is additional disclosure needed for materiality assessment of sustainability-related financial disclosures?

68. Given the level of judgement needed to assess and disclose which sustainability-related financial disclosures are material, the ISSB may consider whether it would be useful to understand management's approach to the materiality assessment.

69. Within [draft] S1, there is no requirement for an entity to disclose how it decided what is, and what is not, material. The Risk Management disclosure requirements in [draft] S1 refer only to the process for identifying significant sustainability-related risk and opportunities but not the process for assessing and disclosing material sustainability-related financial information or materiality judgments.

70. The ISSB may consider introducing a disclosure requirement about the process of identifying and disclosing material information and/or materiality judgments. This may address concerns about the lack of disclosure about how entities decide what is, and what is not, material and provide greater transparency for users.

71. For reference, below are the proposed approaches to materiality for sustainability/climate-related disclosure requirements:

(a) the European Financial Reporting Advisory Group (EFRAG) materiality approach is under development, but exposure drafts included specific disclosure requirements on identifying and assessing impacts, risks and opportunities.

(b) the US SEC risk management section of the proposed climate disclosure rule states that when describing any processes for identifying and assessing climate-related risks, a registrant should disclose how it determines the materiality of climate-related risks, including how it assesses the potential scope and impact of an identified climate-related risk, such as the risks identified in response to § 229.1502.

Questions for the ISSB

72. The staff presents these questions for the ISSB.

Questions for the ISSB
1. Does the ISSB have any questions or comments about the matters described in this section of the paper? 2. Does the ISSB agree with the staff recommendations?

3. Does the ISSB have comments or questions that can help establish the path forward for more comprehensive decisions related to the concepts and terms discussed in this section of the paper?

Part 2: Use and definition of the term 'significant'

Topics identified in plan for redeliberations

73. Many respondents expressed concerns about the use of 'significant' before the phrase 'sustainability-related risks and opportunities' and its relationship with materiality (see paragraphs 32–33 of Agenda Paper 3A *General Sustainability-related Disclosures—Summary of comments* from the September 2022 ISSB meeting). Most respondents said that the term 'significant' lacked a clear definition and some noted that the distinction between the use of the terms 'significant' and 'material' is unclear throughout [draft] S1.

74. The ISSB will need to consider whether the term 'significant' is needed to achieve the objective of the [draft] S1, or if it would be appropriate to replace or remove the term. The ISSB will also need to consider whether greater clarity needs to be provided on the process for identifying sustainability-related risks and opportunities and on the relationship between materiality and the concept of significant.

Use of the term 'significant' in [draft] S1

75. The word 'significant' is used in [draft] S1 *only* as part of the phrase 'significant sustainability-related risks and opportunities', with these exceptions:

(a) Paragraph 31 (d) – Significant assumptions;

(b) Paragraph 32 – Significant changes in its performance;

(c) Paragraph 79 – Significant estimation uncertainty; and

(d) Paragraph 83 – Sources of significant uncertainty.

76. The term 'significant' in the context of 'significant sustainability-related risks and opportunities' was included to provide greater clarity on the broad requirement for a reporting entity to disclose material information about sustainability-related risks and opportunities to which it is exposed. This adjective was used to help preparers understand that the focus is on particular risks and opportunities that are decision useful, or would have a sufficient impact on an entity's business model and activities, and thus future performance and value. It also aims to provide practical comfort to preparers that they need not undertake an exhaustive search of all sustainability-related risks and opportunities.

77. This term was added to the prototype documents prepared by the Technical Readiness Working Group in response to concerns raised in targeted outreach that the reference to 'all significant sustainability related risks and opportunities' could imply an exhaustive search.

78. The key references to 'significant sustainability-related risks and opportunities' in [draft] S1 are:

(a) Paragraph 2: '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.'

(b) Paragraph 14: 'The objective of sustainability-related financial disclosures on strategy is to enable users of general purpose financial reporting to understand an entity's strategy for addressing significant sustainability-related risks and opportunities.'

Use of the term 'significant' in other frameworks and jurisdictions

79. The following paragraphs describe how certain jurisdictions and standard setters use the term 'significant'.

80. IASB

(a) The term 'significant' is used in IFRS Accounting Standards but is not directly defined.

(b) The IASB previously used the term 'significant' in IAS 1 *Presentation of Financial Statements* and IFRS Practice Statement 2 *Making Materiality Judgements* as part of a requirement for companies to disclose their 'significant accounting policies.' In February 2021 the IASB issued amendments that require companies to disclose their material accounting policy information rather than their significant accounting policies.

(c) As outlined earlier in this paper the term and concept of materiality are important in the IASB's literature and are founded in the IASB's *Conceptual Framework*. This concept is used in IFRS Accounting Standards to establish how those standards are applied and the information an entity is required to include in their financial reports. The IASB uses the term material to refer to information rather than describing the 'magnitude' or importance of risks or opportunities and it is not interchangeable with the term or meaning of the word significant.

81. GRI

(a) GRI standards and guidance use both 'significant' and 'material.' GRI applies the term 'significant' to an entity's impacts, and the term 'material' to the GRI topics on which an entity is required to report.

(b) GRI's *Materiality and Topic Boundary* guidance states:

> It has been clarified that an organization is required to identify material topics by considering the two dimensions of the principle: (1) the **significance** of the organization's economic, environmental, and social impacts – that is, their **significance** for the economy, environment or society, as per the definition of 'impact' – and (2) their substantive influence on the assessments and decisions of stakeholders. A topic can be material if it ranks highly for only one dimension of the Materiality principle.'

82. EFRAG

(a) ESRS 1 paragraph 48 specifically states that the terms 'significant' and 'material' have the same meaning when referring to impacts, risks and opportunities in ESRS and describe them as being interchangeable.

(b) [Draft] ESRS 2 Section 4 *Sustainability material impacts, risks and opportunities* also uses 'significant' as part of its definition of 'impact materiality':

> Impact materiality is a characteristic of a sustainability topic or information in relation to an undertaking, a particular sector or all sectors. A sustainability topic or information is material from an impact perspective if the undertaking is connected to actual or potential **significant** impacts on people or the environment related to the sustainability topic over the short, medium or long term. This includes impacts directly caused or contributed to by the undertaking and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain.

83. US SEC

(a) The US SEC rules define some terms that contain ‘significant’, such as ‘significant deficiency’ or ‘significant operations’ and use the term elsewhere as an undefined modifier.

(b) The SEC’s proposed climate disclosure rule uses the term ‘materiality’ in a manner consistent with its use in the context of the financial statements.

Staff analysis

84. The ISSB may consider several options to address feedback on the use of ‘significant’ sustainability-related risks and opportunities in [draft] S1. These options depend on the ISSB’s treatment of other fundamental concepts, such as materiality and enterprise value, and how these are incorporated into disclosure requirements.

Matter to address 5—Is the term ‘significant’ and phrase ‘all significant’ necessary and/or appropriate to define the objective of [draft] S1?

85. The ISSB will need to decide whether the use of the terms ‘significant’ and ‘all significant’ creates more confusion than clarity, and whether [draft] S1 only require material information to be reported. Specifically, [draft] S1 stipulates that a reporting entity is required to disclose material information useful to the primary users of general purpose financial reporting when they assess enterprise value and decide whether to provide resources to the entity.

86. Applied well, the concept of ‘materiality’ should be the key filter reporting entities would use to evaluate information. Relying only on this word may also improve understanding and translation especially in jurisdictions where translations of ‘significant’ and ‘material’ can be the same word.

87. An important question to consider is whether in practice preparers would be able to identify information that is ‘material’ but not ‘significant’ (or vice versa). The ISSB should consider whether insignificant sustainability-related risks and opportunities could result in material sustainability-related financial disclosures. If the ISSB cannot identify such instances, then removing the reference to ‘significant’ could reduce confusion without fundamentally altering the objective and scope of the disclosure requirements.

88. The ISSB will have to consider whether removing these terms affects the reporting burden (in reality or perception) or the scope of information to be reported noting that it was preparer feedback (albeit on a limited basis) that originally resulted in this word being added. Removing the term ‘significant’ without also removing the word ‘all’ in the requirement to report information about ‘all of the significant sustainability-related risks and opportunities’ to which an entity is exposed may risk an unintended increase in reporting. Removing both terms would likely not affect the reporting burden, as reporters are likely to refer primarily in either case to the concept of materiality in determining which information to disclose.

89. **Option 1—Remove the term ‘significant’ and ‘all significant’**

(a) This option entails removing the term ‘significant’ and ‘all significant’ without the replacement of an alternative term. These terms may be unnecessary, given the existing ‘materiality filter’ combined with the definition of primary users and an understanding of the types of decisions these users make.

(b) In the absence of the term significant, the ISSB may consider further reliance on the defined term, disclosure topics. This term is defined in [draft] S1 as: ‘a specific sustainability risk or opportunity based on the activities conducted by entities within a particular industry as set out in an IFRS Sustainability Disclosure Standard or an industry-based SASB Standard.’ The ISSB may also consider additional illustrative examples or other supporting materials to help clarify the types of sustainability-related risks and opportunities likely to result in material information.

90. **Option 2—Replace 'significant' with a different term**

(a) The ISSB may consider replacing the term 'significant' with a different qualifier like 'principal,' 'relevant' or 'key'. Using a different term may avoid the problem of conflicting use of the term 'significant' and 'material' between the ISSB and other standard setters or regulators. Some feedback suggests that the term significant has connotations of a quantitative assessment and that a term that is more clearly qualitative in nature may enable a better understand of the basic idea that was intended to be conveyed – that the focus is on sustainability-related risks and opportunities that are important. However, the staff anticipate that market participants will continue to raise concerns about these new terms, how they are defined, whether they conflict with existing laws or frameworks and the effect they are intended to have on disclosure requirements.

(b) If the ISSB chooses a different term, it may be useful to explain how that term relates to the materiality assessment. For example, to illustrate that an entity considers which sustainability-related risks and opportunities to consider using this first test, and then decides which information about those sustainability-related risks and opportunities is material to users' decision making.

(c) If there is no effect on the work that an entity is expected to undertake or the information provided by adding a term such as 'key' then the benefits of signalling the nature of the search to preparers relative to the potential risk of continued confusion needs to be considered. To deal with the practical issue of ensuring that preparers understand that an exhaustive search is not required, rather than using a qualifier explanatory material accompanying the standards may be provided.

91. **Option 3—Maintain the existing approach**

(a) If the ISSB determines that 'significant' and 'material' are truly different filters, then it may be appropriate to keep the existing language, while providing guidance for how those concepts should be interpreted and applied.

(b) The ISSB may consider defining 'significant'. Alternatively, reliance could be placed on the common, dictionary based definition of this term. However, it would seem difficult to define this term without referring to the additional concepts of materiality, enterprise value, and primary users. It should be noted that defining significant may have consequences for the IASB as well which would need to be evaluated.

(c) It should be noted that the IASB has sought to avoid using the term 'significant' due in part to the lack of clarity around that term. This was one reason that the IASB has moved to requiring material information about accounting policies in its recent amendments to IAS 1.

Questions for the ISSB

92. The staff presents these questions for the ISSB.

Questions for the ISSB
4. Does the ISSB have any questions or comments about the matters or options described in this section of the paper?
5. Does the ISSB have comments or questions that can help establish the path forward on this section?

Part 3: Breadth of reporting – subsidiaries and value chain

Topics identified in plan for redeliberations

93. Almost all respondents agreed with the proposals that sustainability-related financial information should be required for the same reporting entity as the related financial statements. However, many respondents raised questions about the breadth of reporting required, focused primarily on value chain reporting and reporting on subsidiaries, affiliates, and joint ventures.

94. Many respondents commented that the scope of reporting on value chains could be broad and subject to interpretation, especially in the absence of other IFRS Sustainability Disclosure Standards providing guidance on specific sustainability-related risks and opportunities. Some respondents said that they anticipated challenges with reporting on activities in their value chain that they do not control. Many respondents expressed confusion about the examples of value chain reporting listed in [draft] S1, and how these illuminated the breadth of reporting required. Many of these respondents suggested that [draft] S1 provide guidance on the scope of disclosures for value chain activities.

95. Some respondents raised the question of how to handle risks and opportunities that might be important at the level of a subsidiary, but not at the level of a financial reporting entity. This question would arise primarily with larger entities or conglomerates, such as general trading companies, where subsidiaries may operate in a range of industries and face very different sets of sustainability-related risks and opportunities. It may be unclear when such risks and opportunities from subsidiaries would alter the mix of information of interest to users evaluating the reporting entity.

Breadth of reporting requirements in [draft] S1

96. [Draft] S1 adopted similar fair presentation and reporting entity concepts to the IASB's *Conceptual Framework*. See paragraphs 37 and 48 of [draft] S1:

> An entity's sustainability-related financial disclosures shall be for the same reporting entity as the related general purpose financial statements. For example, if the reporting entity is a group, the consolidated financial statements will be for a parent and its subsidiaries; consequently, that entity's sustainability-related financial disclosures shall enable users of general purpose financial reporting to assess the enterprise value of the parent and its subsidiaries.
>
> When applying this [draft] Standard and other IFRS Sustainability Disclosure Standards, an entity, after it has considered all relevant facts and circumstances, shall decide how to aggregate the information in its sustainability-related financial disclosures. An entity shall not reduce the understandability of its sustainability-related financial disclosures by obscuring material information with immaterial information or by aggregating material items that are dissimilar.

97. Paragraph 40 of [draft] S1 provides additional details on the breadth of reporting requirements, as well as examples of the kinds of owned or value chain activities an entity might report on:

> Paragraph 2 requires an entity to disclose material information about all significant sustainability-related risks and opportunities to which it is exposed. These risks and opportunities relate to activities, interactions and relationships and to the use of resources along its value chain, such as:
>
> 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 (such as a production facility that relies on scarce water resources);
>
> c. investments it controls, including investments in associates and joint ventures (such as financing a greenhouse gas-emitting activity through a joint venture); and
>
> d. sources of finance.

Staff analysis

Matter to address 6—Are the breadth of reporting requirements across an entity's subsidiaries and value chain appropriate?

98. The connection to financial reporting is fundamental to the approach of [draft] S1, and respondents generally agreed with the requirement that the reporting entity be the same for both general purpose financial statements and sustainability-related financial disclosures. Therefore, the staff do not anticipate an option to alter the fundamental link between financial and sustainability reporting entities.

99. Although assessing important value chain risks and opportunities is a difficult exercise, it is not new or unique to the field of sustainability reporting. Entities regularly assess prominent value chain activities for the sake of general planning and risk management. This process is unique to each entity and cannot be specifically prescribed through a single set of guidance (or standards).

100. As part of general purpose financial reporting, companies already produce management commentary that provides insights into factors that have affected the entity's performance and financial position and factors that could affect the entity's ability to create value and generate cash flows in the future. These factors span across the value chain including the activities of diverse subsidiaries and dependencies. So, in the staff's analysis, [draft] S1 does not require a radically new approach to risk management or strategic business model analysis.

101. **Staff recommendation**

 (a) The staff does not recommend changing the substance of the [draft] S1 reporting requirements for value chain or reporting entity.

Matter to address 7—Does [draft] S1 require greater clarity on the breadth of reporting required across an entity's subsidiaries and value chain?

102. It is reasonable to expect that reporting on a broad spectrum of value chain activities, especially those outside the control of the entity, and activities of subsidiaries, especially those operating in different industries, will raise significant questions in the relatively new area of sustainability reporting.

103. In the future, the ISSB will continue to establish IFRS Sustainability Disclosure Standards where additional value chain requirements or guidance on specific sustainability-related risks and opportunities would be provided.

104. The language in the examples in paragraph 40 of [draft] S1, which aim to help clarify the breadth of reporting requirements, particularly confused respondents.

105. The staff notes these issues that the ISSB may seek to resolve:

 (a) The "control" language may incorrectly imply that an entity's control of activities is a threshold for whether or not an entity should report on those activities.

 (b) The section implies that an entity should report similarly on its own and its suppliers' employment practices, when in practice entities will likely assess and report very differently on their own versus on value chain activities.

 (c) The list seems arbitrary and does not seem to clarify any boundaries about either which owned or value chain activities an entity should disclose.

106. **Staff recommendations**

The staff recommends the following:

(a) Primarily to address greater clarity and guidance on value chain reporting requirements in other IFRS Sustainability Disclosure Standards, including IFRS [draft] S2 Climate-related disclosures.

(b) In the short term, the ISSB may consider improving the examples in paragraph 40 of [draft] S1.

(c) Otherwise, the staff does not anticipate that altering the text of [draft] S1 will improve these issues. Any attempt to clarify the breadth of reporting required for value chain activities or subsidiaries and associates in the text of the standard is unlikely to apply in the same way to all types of entities and may actually create more confusion.

(d) However, the staff believes there is an opportunity to provide greater clarity on these requirements outside of [draft] S1. Many respondents may be unaware that there is substantial market guidance and practice around reporting on a broad range of activities in the value chain and across subsidiaries.

(e) Specifically, many of the industry-based SASB Standards contain disclosure topics and metrics that demonstrate how an entity could report on value chain activities, and which activities may be relevant for a given industry. For example, the Hardware industry standard contains metrics on supply chain labour rights, product waste recovered, and the assessment of risks around acquiring critical raw materials. Even if an entity decides that these disclosure topics and their associated metrics are not relevant to its business, the SASB Standards illustrate how they might determine an appropriate scope and assess materiality for value chain activities.

(f) Regarding reporting on diverse activities, including across subsidiaries, the SASB Implementation Primer contains this guidance:

What to Do If Multiple Industries Apply

Some organizations are “pure play” companies focused on a single line of business that is neatly captured by SASB’s industry classification system. Others’ operations are integrated horizontally across industries or vertically through the value chain straddling multiple industries. For such companies, multiple industry standards may be required to address the full array of sustainability topics reasonably likely to impact a firm’s financial condition and/or operating performance. For example:

- If a company’s consolidated operations span multiple industries, SASB recommends reviewing multiple industry standards to identify topics beyond those defined in its primary industry standard that may warrant disclosure to investors.

- If a company has a unique business model that defies traditional industry classifications, it may wish to consider disclosure topics (and associated metrics) from an array of industries that have similar activities, choosing those disclosure topics most likely to communicate material information to investors. Some companies with very unique business models, such as emerging technology-based business models, may need to create a custom “SASB template” based on disclosure topics from multiple industries.

(g) Although this guidance applies specifically to industry-based standards, the ISSB may consider clarifying that entities with wide-ranging business activities should similarly assess materiality across their various lines of business, rather than aiming to report solely on their primary business.

(h) The ISSB could consider including similar guidance to support application of [draft] S1 or incorporating examples of how companies have reported to the SASB Standards or other frameworks or standards as part of its capacity building.

Questions for the ISSB

107. The staff presents these questions for the ISSB.

Questions for the ISSB	
6.	Does the ISSB have any questions or comments about the matters described in this section of the paper?
7.	Does the ISSB agree with the staff recommendations on the matters in this section?

Next steps

108. The staff plans to continue to analyse the feedback from comment letters, survey responses and market outreach related to the fundamental concepts and terms in [draft] S1. The staff plans to present further analysis along with recommendations (based on the outcomes of this meeting) on additional decisions and/or more comprehensive decisions related to the fundamental concepts and terms in [draft] S1 in the December meeting. Further research or outreach may be required for some of those matters.