IFRS S2 Deep-dive webinar—Transcript from 18 July 2023

Rebecca Bar:

Good morning, good afternoon, good evening everyone. Thanks for joining us for our webinar today.

On 26 June, the International Sustainability Standards Board (ISSB) published IFRS S1 and IFRS S2, the first two ISSB Standards. Welcome to the second of this two-part webinar series, introducing and explaining these inaugural IFRS Sustainability Disclosure Standards.

These Standards advance the ISSB's goal of delivering a high-quality global baseline of sustainability-related disclosures to inform investment decisions and contribute to efficient and resilient global capital markets.

I am Rebecca Bar, Director of Membership, and I'll be your MC for today's webinar. I manage the IFRS Sustainability Alliance, a global membership programme with over 370 organisations that really share the belief in the power of building a global baseline.

I would like to introduce my colleagues who will be speaking today and then we will jump into content.

Sue Lloyd is Vice-Chair of the ISSB. Previously, she served as Vice-Chair of the International Accounting Standards Board and played a leading role in the establishment of the ISSB, beginning in 2020.

We are also joined by Caroline Clark-Maxwell, the Project Lead for the Climate Standard at the ISSB. Previous to that, Caroline worked on the Exposure Draft for the Climate Standard and she was part of the Technical Readiness Working Group that provided recommendations to the Trustees when they were considering setting up the ISSB. So she has been working on these Standards for quite some time.

Sue Lloyd:

Hello everybody, it is great that you are joining us today. Caroline and I will now provide an overview of our climate-related disclosure Standard, IFRS S2.

If you weren't able to join us for the first webinar covering IFRS S1, I encourage you to go back and listen to that recording, because a lot of the foundations for the requirements for disclosures set out by the ISSB are established in S1.

The first thing to say about IFRS S2, our climate-related disclosure Standard, is that it fully incorporates the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. So if you use the TCFD recommendations now, going forward you use the ISSB Standards—you don't need to use both. By using IFRS S2, you will meet the TCFD recommendations plus more. This is part of reducing the 'alphabet soup' that is sometimes talked about in sustainability reporting.

We were delighted last week that the Financial Stability Board announced they would be disbanding the TFCD following the inclusion of the recommendations in IFRS S1 and IFRS S2. And they have asked the IFRS Foundation to take on the monitoring of the adoption of the TCFD recommendations going forward. That really signifies how closely we've built on those recommendations.

So, looking at a high level, what does IFRS S2 ask of companies? It asks companies to set out disclosures about climate-related disclosures applying IFRS S1. I'll come back to that later on.

In terms of content, we ask for material information about the climate-related risks and opportunities a company is exposed to. So physical risks like the risk of flooding, or transition risks—how they might need to change their business model due to climate change—and also climate-related opportunities.

Another important part of this is that we ask for industry-specific information as well as cross-industry information. That is because investors tell us that understanding the effects from an activity and industry perspective really helps them to understand how climate-related risks and opportunities can affect a company.

Overall, the ISSB is asking a company, in applying IFRS S2, to identify and provide information about climate-related risks and opportunities that are really important to understanding the prospects of that company's business in the future, how it is going to perform from a business perspective. Investors need this information to understand how a company might need to transition its business, how it might be affected by physical risks, or how it might need to change its business model as a result of regulation, changes due to climate change or changes in consumer preferences.

We are also really interested in how climate risk might manifest in a company's value chain. That's something that is common to S1 and S2.

One of the important things about the ISSB Standards is that we are not just thinking about disclosures as an isolated exercise. We are thinking about the provision of information on sustainability risks and opportunities in combination with financial statements, as part of the general purpose financial report. This helps investors really understand what is said about sustainability risks and opportunities in the context of the financial statements of a company.

One of the reasons we say S2, our climate Standard, must be applied with S1, our general requirements Standard, is because S1 talks about who the reporting entity is, the fact that the information has to be provided with the financial statements and at the same time, and things like what to do with comparative information, what to do if you make an error, what to do if you need to change an estimate. A lot of that reporting housekeeping, if you like, is housed in S1 and you need to use it to apply S2.

There are also some important concepts in S1 that you need to understand to apply S2 well. The first is that we always ask for information that is material. That is defined in S1 and how to assess it is set out in S1. The information you provide needs to be so important that a particular disclosure, if it was missing or misstated or obscured, could be reasonably expected to influence the decision that an investor might make. So it needs to be important piece of information.

Another thing you will find in S1 that is important for your climate reporting is what we mean by the value chain. The value chain definition and the way to think about the value chain is all contained in S1.

Being someone who came from the accounting world to the sustainability world, it's taken me a while to get used to the idea that information about a company's value chain, which could be many steps removed from the company's direct activities and could come from the end users of its products or any part of the supply chain, is really important to understanding risks, including climate risks.

Let me give you one example that the ISSB's Chair, Emmanuel Faber, used in a recent speech. If you are reliant on supplies and imports from suppliers who send their products to you along the Rhine River, then you need to think about the risk of disruption to those supplies due to temperature rises that affect the river. If those sorts of risks in your value chain are at the level that is material information for your investors, that is important and needs to be included in climate information. So that's a good example of why you need to use S1.

Also, there are reliefs for the provision of climate-related information for opportunities when it is commercially sensitive. That relief is defined in S1.

S2, like S1, fully incorporates the TCFD concepts. We ask in S2 for information to be provided about governance, strategy and risk management, as well as metrics and targets. If you use the TCFD recommendations, you will be very familiar with those concepts, because we have taken them and incorporated them into S2. The great news is if you have used the TCFD recommendations, you are well prepared to use S2.

The strategy and metrics and target sections of S2 form a large part of the S2 disclosure requirements. We'll go through this in some detail in the rest of the presentation. But notice it's not just about greenhouse gas emissions. I'm saying that half-jokingly but also importantly, because a lot of what you hear about S2 is that you have to provide information about greenhouse gas emissions. And you do, but there are a lot of different aspects and other things to consider too: how climate-related risks and opportunities might impact the business, how you are managing that, how you are assessing that, how you are responding to that. So S2 goes well over and above just providing information for greenhouse gas emissions.

I'm going to set the scene by talking about the section in S2 on strategy and decision-making. The first thing to say is that the role of the ISSB is to ask companies to provide information to investors to enable them to understand how a company is running its business, how it is undertaking its planning. We don't tell a company how it should run its business, nor do we do things like require a company to have a transition plan.

The ISSB's role is about providing information to the market on what a company is doing, how it is thinking about these risks, how it is responding to risks, what plans it has in place—not telling you how to run your business.

We want companies to tell their investors whether and how they have addressed climate-related risks and opportunities in their strategic planning and decision-making. That is what S2 is asking for information about: a company's plans to respond to climate-related risks and opportunities, how it is resourcing its plans, and how it is progressing against the plans that it has in place.

An example of the sort of disclosure we mean here is providing information about any transition plans that a company has in place, such as for its greenhouse gas emissions targets—what those targets are, how it plans to achieve them, and what progress it is making over time.

This is also to point out that we are part of a bigger ecosystem. The ISSB doesn't set out requirements for what a good transition plan looks like, or how to form a transition plan.

But others, such as the UK Transition Plan Taskforce do, and when a company uses a set of guidance, they have to report on the plans in place. So that’s exactly what S2 is all about.

Now we are going to move on to another really important part of S2: current and anticipated financial effects. This is a good example of the point I made earlier: we are not interested in sustainability disclosures that are completely disconnected from the financial statements and the financial information a company is providing. Investors have told us consistently over the years that they want to understand how the information in sustainability reporting relates to the information in financial statements. And S2, like S1, tries to improve this understanding by requiring information about the effects on financial performance, financial positioning and cash flows of climate-related risks and opportunities, and the anticipated future effects.

For example, a company might disclose how the impairment of an asset was affected by its strategy to manage its transition risk; or if a company is changing how it uses its factories or machinery because of its emissions targets, how that is reflected in impairment of its assets; or if it has not impacted those assets, then why.

We also ask for information about the anticipated financial effects in the future. Do you expect the sale of particular products to be reduced because of consumer preferences? Do you expect to sell less diesel cars or more electric cars, for example?

In our Standard, we very much encourage and point towards the provision of quantitative information about the effects and anticipated future effects on financial statements of climate-related risks and opportunities. That is what is required. However, we know that is not always possible. So in the Standard there are some specific examples of when, instead of quantitative information, qualitative information is permissible. That is where quantitative information is not possible because you cannot separately identify the effect of climate from other risks and opportunities, or when there is a very high level of measurement uncertainty that would affect the robustness of information.

In the case of anticipated effects, there is another test as well: whether the skills, resources and capabilities of a company to quantify the anticipated future effects on financial statements is not something that is possible for the company. This is a good example of where the ISSB has tried to be proportionate in what a company is asked to do. So if you don’t have the skills, resources and capabilities to provide information about the anticipate financial effects in a quantitative way, qualitative information is available.

For all companies, we have a really important provision. When it comes to anticipated financial effects, you are not required to do an exhaustive search for every piece of information that might be relevant. You are required to use reasonable and supported information. You have to have a good basis for what you are disclosing. You have to make use of information that is readily available, but it does not have to be an exhaustive search. The amount of effort for information that we anticipate a company to make depends on a company’s circumstances.

That is reflected in an additional message in S2 about using ‘all reasonable and supportable information that is available without undue cost or effort’.

This is designed to make sure that the ask we have of companies is not that you do nothing, but that you make a good effort that is grounded in something that is realistic given the particular circumstances of a company. That is a really important part of S1. It was developed in response to feedback to the exposure draft: stakeholders said the previous wording in the Standard, where we talked about whether a company was able to do these things, was a bit vague. People wanted us to be more specific on the circumstances of when they could provide qualitative rather than quantitative information.

And with that I'm going to hand over to Caroline to take you through the next areas of S2.

Caroline Clark-Maxwell:

It is always a pleasure to talk about these Standards. And the first thing I’ll speak to you about today is climate resilience.

Climate change, and the uncertainties associated with that, can affect the resilience of a company’s strategy and business model. IFRS S2 therefore requires a company to assess its climate resilience and to disclose information about:

- the implications of climate change for its strategy and business model; and
- its financial and operational capacity to adjust or adapt over the short, medium and long term.

IFRS S2 requires all companies to use climate-related scenario analysis to inform their disclosures about their resilience to climate change. However, IFRS S2 does not specify which scenarios a company should use in its analysis, but requires the company to use relevant scenarios and provide information about the scenarios it has selected. In other words, a company is required to disclose inputs and assumptions it has used in its climate-related scenario analysis, in addition to the information about its climate resilience.

S2 contains guidance to ensure the requirement to undertake scenario analysis is proportionate. This includes guidance on how a company is required to determine its approach to scenario analysis versus the analysis used to assess its climate resilience.

Climate-related scenario analysis encompasses a range of practice, from qualitative scenario narratives to complex statistical modelling. Considering this, the ISSB decided to require a company:

- to use an approach that is commensurate with the company’s circumstances; and
- to use all reasonable and supportable information that is available to the company at the reporting date without undue cost or effort.

To determine what approach is commensurate with the company’s circumstances, the company is required to consider both:

- its exposure to climate-related risks and opportunities—the greater the exposure to climate-related risks and opportunities, the greater the need for a sophisticated scenario analysis; and
- its skills, capabilities and resources available for the climate-related scenario analysis.

The application guidance to S2 builds on the range of practices outlined in documents published by the TCFD. For example, the application guidance builds on the TCFD’s stages of progression to help guide companies on how to select an approach to climate-related scenario analysis that is commensurate with their circumstances.

The ISSB expects this guidance will enable companies to develop their skills and capabilities and therefore strengthen company disclosures over time, through a process of learning and iteration.

The next area we are going to talk about is greenhouse gas emissions, which often get a lot of interest. IFRS S2 requires a company to disclose its absolute Scope 1, Scope 2 and Scope 3 greenhouse gas emissions: in other words, the Standard requires companies to disclose their direct and indirect emissions.

Some people are surprised that the ISSB is asking for this information to be provided, because some consider this to be information about impacts, which they didn't necessarily expect to be an area of focus for the ISSB. If you listened to the S1 webinar, you will have heard some discussion around this already, but just to reiterate that the ISSB asks for information that is reasonably expected to affect a company's future cash flows, its cost of capital and its access to finance.

When the ISSB consulted on these requirements on greenhouse gas emissions, there was broad agreement amongst stakeholders, in particular investors, that greenhouse gas emissions information is necessary to understand the climate-related transition risks a company is exposed to, such as the risks associated with changing consumer preferences from high-emission products and the risk of new or strengthening regulation around greenhouse gas emissions in certain markets that means it may be necessary for a company to adjust the way the business is run to address these risks. And that means investors need information to assess a company's prospects.

The emissions must be measured in accordance with the GHG Protocol Corporate Standard, but there is a relief. A company is not required to use the GHG Protocol Corporate Standard if a jurisdiction requires a company to use a different approach to measurement.

Not all companies currently measure their emissions using the GHG Protocol Corporate Standard. If a company is using a different measurement method, it is permitted to continue to use that method in its first year of applying IFRS S2. This is intended to assist companies when they start using the ISSB Standards.

In response to the ISSB's public consultation, investors communicated that Scope 3 emissions disclosure is important in understanding climate-related risks and opportunities in company value chains, particularly because this usually represents a majority of a company's emissions.

Without information on these emissions, investors would not be able to fully assess the transition risk that companies are exposed to, and the extent to which a reporting company might have transferred such risk to its value chain partners and other participants.

Consider two consumer electronics companies that offer very similar, competing products. One of these companies does all of its own manufacturing, while the other outsources nearly all of its manufacturing. In such a scenario, for the first company, the greenhouse gas emissions associated with manufacturing activities would fall under Scope 1 and Scope 2, but for the latter company, it would fall under Scope 3.

Therefore, based solely on Scope 1 and Scope 2 greenhouse gas emissions information, an investor might assess the latter company as being more carbon-efficient and, thus, consider that company to have significantly lower transition risks. However, just because the emissions associated with manufacturing have been shifted from the company to its value chain, the company's prospects can still be affected by transition risks that are still present to companies in its value chain. For example, if emissions-limiting regulations on the manufacturing process are being introduced, such as a carbon pricing mechanism, that would affect both companies: they would both face increasing costs, whether that was internally or through higher prices being passed on from the value chain.

In short, the requirement to disclose Scope 3 emissions reflects the importance of providing information related to a company's value chain to more fully inform investors' understanding of a company's exposure to transition risks.

As part of IFRS S2, a company must consider the 15 categories of Scope 3 greenhouse gas emissions set out in the GHG Protocol Corporate Value Chain Standard, with information being disclosed when material. The 15 categories are intended to provide companies with a systematic framework to organise, understand and report on the diversity of Scope 3 activities within their value chain. The categories include purchased goods and services, use of products sold, and investments.

I want to touch on this a bit more. IFRS S2 requires companies with activities in asset management, commercial banking or insurance to disclose information about their 'financed emissions'—that is, the emissions that banks and investors finance through their loans and investments. This includes information about a company's absolute gross financed emissions disaggregated by Scope 1, Scope 2 and Scope 3 greenhouse gas emissions and information about the industries finance is provided to.

While measuring Scope 3 greenhouse gas emissions will often require the use of estimation, feedback to the ISSB showed that, despite the measurement uncertainty, it is useful to have those estimates about a company's Scope 3 emissions. So IFRS S1 and IFRS S2 introduce a number of reliefs to support companies that are starting to evaluate and disclose emissions. For example, a company is not required to disclose its Scope 3 emissions in the first year of applying IFRS S2.

The ISSB also developed a Scope 3 measurement framework to provide additional guidance about the relevant information to use in measuring Scope 3 emissions, which will often include the use of estimation. This framework does not specify the inputs a company is required to use to measure its Scope 3 emissions. Instead, it requires a company to prioritise inputs that are most likely to enable a representative measurement of the company's Scope 3 emissions. For example, whilst data from specific activities within the value chain (often referred to as 'primary data') is what a company is required to prioritise, the framework also acknowledges and helps companies consider the secondary data it could use if the primary data is not available. This could include use of industry-based averages.

IFRS S2 also clarifies that a company is required to use all reasonable and supportable information that is available without undue cost or effort. In other words, in prioritising information, a company is not required to use undue cost or effort in obtaining that information.

Prioritisation also implies trade-offs: it might, for example, be possible to get more granular data based on research that is less recent, and more recent data that lacks the same level of granularity. The framework helps lay out some of these considerations.

In developing this framework, the ISSB built on concepts and considerations set out in Chapter 7 of the GHG Protocol Corporate Value Chain Standard. So those familiar with the GHG Protocol Value Chain Standard will find a lot of that material here.

Moving on to industry-specific requirements, S2 requires a company to disclose industry-based metrics that are associated with common business models and activities in a particular industry. Because the effects of climate-related risks and opportunities vary significantly by activity or industry, such metrics are important for investor understanding.

To provide these disclosures, companies are required to refer to and consider disclosure topics and associated industry-based metrics in the Industry-based Guidance on IFRS S2. This guidance is based on the SASB Standards, with some modifications to enhance their international applicability.

The industry-based guidance can be very helpful for companies to identify climate-related risks and opportunities: disclosure topics identified in this guidance represent the climate-related risks and opportunities most likely to affect companies in a particular industry, and the associated metrics most likely to result in the disclosure of material information. So this can be a helpful starting point for companies to identify climate-related risks and opportunities relevant to investors in a way that is comparable to companies in a given industry.

We finally get to the climate-related targets. IFRS S2 requires a company to disclose the climate-related targets it has set, as well as those it is required to meet by law or regulation, including any greenhouse gas emissions targets. A company is required to disclose information about the characteristics of each target, how it sets and reviews each target, and its performance against each target.

In disclosing this information, a company is required to disclose how the latest international agreement on climate change (currently the Paris Agreement), including jurisdictional commitments that arise from that agreement, has informed the target.

IFRS S2 does not require a company to have climate-related targets. It does not require a company to have a greenhouse gas emissions target.

But if a company does have a greenhouse gas emissions target, the company is required to specify whether the target is a gross emissions target or a net emissions target. If a company discloses a net emissions target, it is also required to separately disclose its associated gross emissions target. When a company discloses a net emissions target, it is required to include information about any carbon credits it plans to use to achieve that target.

I will now briefly touch on some of the guidance. We have developed application guidance that companies must use to apply IFRS S2. There is also Accompanying Guidance to S2, comprising Illustrative Guidance, Illustrative Examples and the Industry-based Guidance mentioned earlier. And we have published the Basis for Conclusions on IFRS S2, which summarises the ISSB's considerations in developing the requirements in the Standard.

Other documents that might be worth looking at include:

- the Effects Analysis on IFRS S1 and IFRS S2, which describes the likely benefits and costs of both Standards.
- the Project Summary of IFRS S1 and IFRS S2, which is a great starting point for those who want a higher-level summary before diving into the Standards. It is an overview of the project to develop IFRS S1 and IFRS S2.
- the Feedback Statement for IFRS S1 and IFRS S2, which summarises feedback on the proposals that preceded IFRS S1 and IFRS S2 and the ISSB's response. If you have

been following the process and want to remind yourself of what the ISSB heard or the decision that made the base of that feedback, this is a really good document to refer to.

I hope we have provided a helpful overview of S2.

The Standards, guidance and other supporting materials can be found at: ifrs.org. *We also encourage you to register for IFRS Sustainability Updates, so you can keep informed as our team prepares more educational materials and guidance in the coming months.*