
Transition Implementation Group on IFRS S1 and IFRS S2

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Topic **Identification of sustainability-related risks and consideration of risk mitigation activities**

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This paper has been prepared for discussion at a public meeting of the Transition Implementation Group on IFRS S1 and IFRS S2. It does not purport to represent the views of any individual member of the International Sustainability Standards Board or staff. Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards.

Introduction

1. We have received a submission about whether and how an entity considers its risk mitigation activities when identifying sustainability-related risks that could reasonably be expected to affect its prospects in applying IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*.^{1,2}
2. The objective of this paper is to provide background and analysis to support the discussion by the Transition Implementation Group on IFRS S1 and IFRS S2 (the TIG).
3. The purpose of the TIG is to provide a public forum for the discussion of implementation questions related to application of IFRS Sustainability Disclosure Standards, and to provide information for the ISSB to determine what, if any, action will be needed to address those questions.³

¹ This paper uses the term 'risk mitigation activities' - this is intended to be used in the generic sense of actions taken to address risks. These actions may include, for example, in the case of climate-related risks both mitigation and adaptation efforts.

² IFRS S1 requires an entity to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term. In the Standard, and in this paper, these risks and opportunities are collectively referred to as 'sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects'.

³ The TIG Terms of Reference can be found on the IFRS Foundation website: <https://www.ifrs.org/content/dam/ifrs/groups/tig-s1-s2/terms-of-reference.pdf>

4. This paper:
 - (a) sets out the relevant requirements in IFRS S1 and IFRS S2 *Climate-related Disclosures*;
 - (b) summarises the implementation question raised in the submission;
 - (c) outlines the staff's analysis related to the implementation question; and
 - (d) asks the members of the TIG for their views on the question raised.

Relevant requirements

5. The following paragraphs set out the main requirements in IFRS S1 related to the implementation question. **Appendix A** of this paper includes relevant excerpts from IFRS S1 and IFRS S2 that have been referenced in this paper.
6. Paragraph 1 of IFRS S1 sets out the objective of IFRS S1:
 - 1 The objective of IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information is to require an entity to disclose information about its 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.
7. Paragraph 17 of IFRS S1 states that an entity is required to disclose material information about sustainability-related risks (and opportunities) that could reasonably be expected to affect the entity's prospects:
 - 17 An entity shall disclose material information about the sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects.

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8. The Basis for Conclusions accompany but are not part of IFRS Sustainability Disclosure Standards. The Basis for Conclusions summarise the considerations of the ISSB in developing Standards and thus provide useful context to understand the requirements in Standards, but do not in themselves establish requirements.
 9. Paragraph BC1 of the Basis for Conclusions on IFRS S1 explains the ISSB's intention to require entities to provide users of general purpose financial reports with information to enable them to assess an entity's exposure to and management of sustainability-related risks:⁴

BC1 ... Users told the ISSB that this information would enable them to assess an entity's exposure to and management of sustainability-related risks and opportunities over the short, medium and long term, and would inform their decisions relating to providing resources to an entity. Such information supplements and complements the information in the entity's general purpose financial statements (referred to as 'financial statements').

Implementation question received

10. The implementation question asked whether or not an entity considers its risk mitigation activities—either risk mitigation activities that have been put in place or risk mitigation activities that are planned—when applying the requirements in IFRS S1 related to the identification of sustainability-related risks that could reasonably be expected to affect its prospects. In simple terms, the submission asked, if an entity has taken actions to mitigate a sustainability-related risk or plans to take such actions, are such risks identified:
 - (a) after taking into consideration those mitigants, that is, on a 'net' basis; or

⁴ Throughout this paper, the terms 'primary users' and 'users' are used interchangeably, with the same meaning.

- (b) ignoring those mitigants, that is, on a ‘gross’ basis?

Staff analysis

Identification of sustainability-related risks that could reasonably be expected to affect the entity’s prospects

11. The objective of IFRS S1 is for an entity to provide material information to users of general purpose financial reports about its sustainability-related risks (and opportunities) that could reasonably be expected to affect its prospects. The information provided is that which is useful to those users in making decisions about providing resources to the entity. An entity’s process to identify sustainability-related risks is therefore an important consideration in meeting this objective and is necessary to enable the disclosure of material information about such sustainability-related risks.
12. IFRS S1 requires disclosure of information about all sustainability-related risks that *could reasonably be expected* to affect the entity’s prospects. This means, when identifying sustainability-related risks that could reasonably be expected to affect an entity’s prospects, the entity considers an external perspective in addition to its own. In particular, the entity needs to consider matters about which information, if misstated, omitted or obscured, could reasonably be expected to influence a decision by primary users. Thus, the perspective of primary users is a particular consideration for the entity.

Consideration of risk mitigation activities when identifying sustainability-related risks that could reasonably be expected to affect an entity’s prospects

13. IFRS S1 does not prescribe whether or how an entity is required to consider risk mitigation activities when identifying sustainability-related risks. Further, IFRS S1

does not explicitly state that an entity considers risk exposure taking into consideration its risk mitigation activities, nor that it should disregard them.

14. The staff think an entity might consider—among other things—how its risk mitigation activities affect whether a sustainability-related risk could reasonably be expected to affect its prospects. A risk mitigation activity could affect *the extent to which an entity is exposed* to a risk, for example if the risk mitigation activity reduces the entity's exposure to the risk⁵ or eliminates the risk entirely. Risk mitigation activities could also *change the expectation of the effect of the risk* on an entity or change the extent to which the entity's prospects are affected. Therefore, risk mitigation activities could affect the expectation of whether and how a sustainability-related risk might affect an entity and how it might affect an entity's prospects.
15. The staff consider some of the ways risk mitigation activities could affect the identification of a sustainability-related risk that could reasonably be expected to affect an entity's prospects, and in particular the circumstances in which an entity:
- (a) has risk mitigation activities in place; and
 - (b) does not have risk mitigation activities in place but has planned risk mitigation activities.⁶

Risk mitigation activities are in place

16. The staff consider the following examples in which an entity has risk mitigation activities in place, and how these risk mitigation activities could affect whether and how an entity identifies a sustainability-related risk that could reasonably be expected to affect its prospects:

⁵ Either for example, by changing the extent to which the entity can be affected by the risk or by protecting the entity if they are affected by the risk, such as by obtaining third party protection such as insurance.

⁶ The staff note that if an entity has plans to mitigate a sustainability-related risk, but the risk is not yet mitigated, it is more likely that there is a sustainability-related risk for which to disclose material information about.

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- (a) *despite having risk mitigation activities in place, a sustainability-related risk is identified:* an entity operates in an industry that is known for its supply chain activities being concentrated in jurisdictions with high incidences of human rights violations. Therefore, it is reasonably expected that entities in this industry are exposed to sustainability-related risks related to human rights violations. However, the entity has implemented risk mitigation activities, to ensure its suppliers operate entirely in one jurisdiction that is known for its effective policies to prevent human rights violations. Thus, due to its mitigation activities the entity determines this risk is not expected to affect its prospects. However, when considering whether it *could reasonably be expected to affect its prospects*, the entity notes that despite its risk mitigation activities, this risk is so pervasive in its industry, it is a risk that could be reasonably be expected to affect the entity's prospects. The entity therefore identifies this as a sustainability-related risk that could reasonably be expected to affect its prospects, effectively identifying the risk 'before' or despite the effect of its mitigation activities.⁷
- (b) *due to its risk mitigation activities, a sustainability related risk is not identified:* an entity operates in an industry that is subject to stringent regulations regarding its wastewater treatment. Ten years ago, the entity implemented risk mitigation activities including the introduction of 'best-in-class' equipment to facilitate wastewater treatment. This equipment undergoes mandatory routine maintenance, and the entity conducts daily random tests of water quality. The entity has never experienced any challenges associated with its water quality, and never failed to meet its regulatory obligations related to water quality. The entity considers whether exposure to a risk associated with its wastewater treatment would be one that is reasonably expected to affect its prospects, given the entity has effectively managed this risk for ten years, and

⁷ The staff note that, in such circumstances, the entity might identify such sustainability-related risk but disclose information about its risk mitigation activities that explains that the entity is not exposed to this risk.

that its primary users are aware of the stringent regulatory requirements for wastewater treatment and its approach to mitigate this risk. The entity does not identify this as a sustainability-related risk that could reasonably be expected to affect its prospects due to the effect of the risk mitigation.

- (c) *due to risk mitigation activities in place, a sustainability related risk is not identified:* an entity operates in the automobile industry and in 2024 20% of its manufactured vehicles were gasoline-powered. The entity operates in only one jurisdiction which has introduced a regulation that will tax the production of gasoline-powered vehicles produced after 2028. Therefore, the entity is, in 2024, exposed to a sustainability-related transition risk. However, by 2025, as part of its risk mitigation strategy, the entity has ended production of gasoline-powered vehicles. Therefore, when considering the sustainability-related risks that the entity is exposed to in 2025, the entity does not identify this as a sustainability-related risk that could reasonably be expected to affect its prospects.

Risk mitigation activities are not in place but are planned

17. The staff also consider the following example in which an entity has risk mitigation activities that are not in place, but are planned, and how these risk mitigation activities could affect whether and how an entity identifies a sustainability-related risk that could reasonably be expected to affect its prospects:
- (a) *despite planned risk mitigation activities, a sustainability-related risk is identified:* an entity's assets are at risk of damage due to increasing severe weather events that it considers to be attributable to climate-related risks, and therefore identifies a sustainability-related risk. The entity plans to mitigate this risk by selling these assets. However, as this risk mitigation activity is only planned and the entity still owns these assets, the entity remains exposed to this sustainability-related risk. The entity therefore identifies this as a sustainability-related risk that could reasonably be expected to affect its

prospects. That is, despite planned mitigation activities, the entity identifies a sustainability-related risk.

Staff view

18. The staff reiterate that IFRS S1 does not prescribe whether or how an entity is required to consider risk mitigation activities when identifying sustainability-related risks. The staff have analysed relevant considerations in response to the submission that questions whether an entity is *required* to consider its risk mitigation activities when identifying sustainability-related risks that could reasonably be expected to affect its prospects.
19. In the staff's view the answer is that it depends. Judgement must be applied in determining whether a sustainability-related risk could reasonably be expected to affect an entity's prospects, including judgement about how risk mitigation activities that are planned or already in place, inform the identification of sustainability-related risks. In some circumstances, an entity's mitigation activities might inform the entity that it is *not* exposed to a sustainability-related risk that could reasonably be expected to affect its prospects. In other cases, despite an entity's mitigation activities, the entity might determine it is exposed to a sustainability-related risk that could reasonably be expected to affect its prospects.
20. In applying this judgement, the staff note that it is useful to consider the relevance, and materiality, of the information that would be provided given the sustainability-related risks that are identified. For example, in the example set out in paragraph 16(a), in determining whether, despite the mitigation activities and their anticipated effectiveness, the human rights-related risk represents a sustainability-related risk that could reasonably be expected to affect the entity's prospects, consideration is given to whether information about the risk mitigation activities are material for primary users when making investment decisions. By identifying this as a risk despite the risk mitigation, such information would be provided.

21. The staff notes that IFRS S1 requires information to be provided about judgements made in preparing sustainability-related financial disclosures. In particular, paragraph 74 of IFRS S1 requires that an entity disclose information to enable users of general purpose financial reports to understand the judgements that the entity has made in the process of preparing its sustainability-related financial disclosures *that have the most significant effect on the information included in those disclosures*. In providing examples of such judgements, paragraph 75 of IFRS S1 includes the identification of sustainability-related risks (and opportunities) that could be reasonably be expected to affect the entity's prospects. As a result, to the extent a judgement about how risk mitigation activities were considered when identifying sustainability-related risks represents one of the judgements that most significantly affected the information included in the disclosures, it may be necessary to disclose such information.

Staff note

22. An entity identifies sustainability-related risks that could reasonably be expected to affect its prospects in order to apply the requirement in paragraph 17 of IFRS S1, to *disclose material information about* such sustainability-related risks.
23. IFRS S1 requires that material information is disclosed about identified sustainability-related risks, and as a result, in the following paragraphs, the staff have considered how risk mitigation activities might also inform the disclosure of information about sustainability-related risks.

Consideration of risk mitigation activities when disclosing information about sustainability-related risks that could reasonably be expected to affect an entity's prospects

24. ISSB Standards do not always prescribe whether or how an entity is required to consider or disclose information about risk mitigation activities when disclosing

information about sustainability-related risks. For example, a disclosure requirement might:

- (a) **explicitly require disclosure of information about a sustainability-related risk that *includes* the effect of risk mitigation activities.** In such circumstances, when preparing sustainability-related financial disclosures, an entity considers the effect of its risk mitigation activities on the information it provides about a sustainability-related risk. For example, paragraph 35(c) and 35(d) of IFRS S1 requires disclosure of quantitative and qualitative information about how the entity expects its financial position to change over the short, medium and long term (anticipated financial effects) given its strategy to manage sustainability-related risks (and opportunities), and how the entity expects its financial performance and cash flows to change over the short, medium and long term, given its strategy to manage sustainability-related risks (and opportunities). That is, an entity is required to disclose anticipated effects *after* consideration of an entity's planned response.
- (b) **explicitly require disclosure of information about a sustainability-related risk *without* considering risk mitigation activities.** In such circumstances, when preparing sustainability-related financial disclosures, an entity does *not* consider the effect of its risk mitigation activities on the information it provides about its sustainability-related risks. For example, paragraph B62(c)(ii) of IFRS S2 requires entities that participate in commercial banking activities to disclose information about their gross exposure included in the financed emissions calculation and in doing so for funded amounts, entities are required to 'exclude from gross exposure all impacts of risk mitigants'.
- (c) **explicitly require disclosure of information about risk mitigation activities.** In such circumstances, when preparing sustainability-related financial disclosures, an entity is required to disclose information about its risk mitigation activities. For example:

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- (i) paragraph 33(a) of IFRS S1 requires an entity to disclose information about how the entity has responded to, and plans to respond to, sustainability-related risks in its strategy and decision-making.
 - (ii) paragraph 14(a) of IFRS S2 requires an entity to disclose information about how the entity has responded to, and plans to respond to, climate-related risks in its strategy and decision-making, and includes explicit disclosure requirements related to information about the entity's mitigation and adaptation efforts.
- (d) **not explicitly require disclosure of information about risk mitigation activities or their effect on a sustainability-related risk.** In such circumstances, when preparing sustainability-related financial disclosures, an entity considers whether information about its risk mitigation activities—or the effect of those activities on the risk—would provide material information to primary users as it relates to fulfilling the specific disclosure requirement. For example:
- (i) paragraph 41 of IFRS S1 requires disclosure of information that enables users of general purpose financial reports to understand the entity's capacity to adjust to the uncertainties arising from sustainability-related risks. An entity might consider that its risk mitigation activities, and the effectiveness of such risk mitigation activities, could inform its disclosures about its capacity to adjust to the uncertainties arising from sustainability-related risks. Therefore, the entity discloses the relevant material information.
 - (ii) paragraph 34(a) of IFRS S1 requires disclosure of information that enables users of general purpose financial reports to understand the effects of sustainability-related risks (and opportunities) on the entity's financial position, financial performance and cash flows for the reporting period (current financial effects). An entity might consider that its risk mitigation activities could have affected the sustainability-related risk,

such that it also affected the amounts recognised as current financial effects. Information about these risk mitigation activities, or their effect on the sustainability-related risk, might be material information about the current financial effect.

Staff view

25. An entity is required to apply the specific disclosure requirements as set out by ISSB Standards. In some circumstances, these requirements explicitly require disclosure of information about an entity's risk mitigation activities. In other circumstances, such requirements are not explicitly set out, and an entity will need to apply judgement to determine the material information to disclose to meet the disclosure requirement and its related disclosure objectives.
26. IFRS S1 requires entities to disclose information that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity. Therefore, in considering whether to disclose information about risk mitigation activities, an entity is required to consider whether omitting, misstating or obscuring information about its risk mitigation activities could reasonably be expected to influence the decisions of primary users.

Questions for the TIG members

27. The staff present the following questions for the TIG members.

Questions for TIG members

1. What are your views on the question and analysis related to whether and how an entity would consider risk mitigation activities when *identifying* sustainability-related risks that could reasonably be expected to affect prospects?
2. What are your views on the staff note related to considering risk mitigation activities when *disclosing* information about sustainability-related risks that could reasonably be expected to affect an entity's prospects?

Appendix A – Relevant extracts

A1. This paragraph includes excerpts from IFRS S1 that have been referenced in this paper.

Materiality

18 In the context of sustainability-related financial disclosures, information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity.

Strategy and decision-making

33 An entity shall disclose information that enables users of general purpose financial reports to understand the effects of sustainability-related risks and opportunities on its strategy and decision-making. Specifically, the entity shall disclose information about:

- (a) how the entity has responded to, and plans to respond to, sustainability-related risks and opportunities in its strategy and decision-making;
- (b) ...
- (c) ...

Financial position, financial performance and cash flows

34 An entity shall disclose information that enables users of general purpose financial reports to understand:

- (a) the effects of sustainability-related risks and opportunities on the entity's financial position, financial performance

and cash flows for the reporting period (current financial effects)...

35 Specifically, an entity shall disclose quantitative and qualitative information about:

(a)...

(b)...

(c) how the entity expects its financial position to change over the short, medium and long term, given its strategy to manage sustainability-related risks and opportunities, taking into consideration:

(i) its investment and disposal plans (for example, plans for capital expenditure, major acquisitions and divestments, joint ventures, business transformation, innovation, new business areas, and asset retirements), including plans the entity is not contractually committed to; and

(ii) its planned sources of funding to implement its strategy; and

(d) how the entity expects its financial performance and cash flows to change over the short, medium and long term, given its strategy to manage sustainability-related risks and opportunities.

Resilience

41 An entity shall disclose information that enables users of general purpose financial reports to understand its capacity to adjust to the uncertainties arising from sustainability-related risks. An entity shall disclose a qualitative and, if applicable,

quantitative assessment of the resilience of its strategy and business model in relation to its sustainability-related risks, including information about how the assessment was carried out and its time horizon. When providing quantitative information, an entity may disclose a single amount or a range.

Judgements

74 An entity shall disclose information to enable users of general purpose financial reports to understand the judgements, apart from those involving estimations of amounts (see paragraph 77), that the entity has made in the process of preparing its sustainability-related financial disclosures and that have the most significant effect on the information included in those disclosures.

75 In the process of preparing sustainability-related financial disclosures, an entity makes various judgements, apart from those involving estimations, that can significantly affect the information reported in the entity's sustainability-related financial disclosures. For example, an entity makes judgements in:

- (a) identifying sustainability-related risks and opportunities that could be reasonably expected to affect the entity's prospects...

A2. This paragraph includes excerpts from IFRS S2 that have been referenced in this paper.

Strategy and decision-making

14 An entity shall disclose information that enables users of general purpose financial reports to understand the effects of climate-related risks and opportunities on its strategy and decision-making. Specifically, the entity shall disclose:

- (a) information about how the entity has responded to, and plans to respond to, climate-related risks and opportunities in its strategy and decision-making, including how the entity plans to achieve any climate-related targets it has set and any targets it is required to meet by law or regulation. Specifically, the entity shall disclose information about:
- (i) ...
 - (ii) current and anticipated direct mitigation and adaptation efforts (for example, through changes in production processes or equipment, relocation of facilities, workforce adjustments, and changes in product specifications);
 - (iii) current and anticipated indirect mitigation and adaptation efforts (for example, through working with customers and supply chains);
 - (iv) ...
 - (v) ...

Financed emissions

Commercial banking

B62 An entity that participates in commercial banking activities shall disclose:

- (a) ...
- (b) ...
- (c) the percentage of the entity's gross exposure included in the financed emissions calculation. The entity shall:

- (i) if the percentage of the entity's gross exposure included in the financed emissions calculation is less than 100%, disclose information that explains the exclusions, including the type of assets excluded.
- (ii) for funded amounts, exclude from gross exposure all impacts of risk mitigants, if applicable.
- (iii) disclose separately the percentage of its undrawn loan commitments included in the financed emissions calculation.
- (d) ...

A3. This paragraph includes an excerpt from the Basis for Conclusions on IFRS S1 that has been considered in this paper.

BC1 IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) was developed in response to calls from users of general purpose financial reports (users) for more consistent, complete, comparable and verifiable sustainability-related financial information. Users told the ISSB that this information would enable them to assess an entity's exposure to and management of sustainability-related risks and opportunities over the short, medium and long term, and would inform their decisions relating to providing resources to an entity. Such information supplements and complements the information in the entity's general purpose financial statements (referred to as 'financial statements').

A4. This paragraph includes an excerpt from the Basis for Conclusions on IFRS S2 that has been considered in this paper.

BC127 The ISSB decided to confirm and clarify the proposed requirements for an entity engaged in financial activities associated with commercial banking or insurance to disclose information about its undrawn loan commitments. That is, the entity would be required to disclose separately its financial exposures and its emissions related to those undrawn loan commitments. The ISSB also decided to confirm and clarify the proposed requirement for an entity engaged in financial activities associated with commercial banking to provide disclosures on a gross basis. That is, the entity would be required to provide these disclosures without considering risk mitigation, which the ISSB noted would not affect the greenhouse gas emissions associated with a loan. Additionally, for all financial activities, the ISSB decided to remove the proposal for an entity to include derivatives when calculating its financed emissions, citing the lack of an established methodology for the asset class.