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The Secretariat to the UK Sustainability Disclosure TAC Financial Reporting Council 8th Floor 125 London Wall London, EC2Y 5AS

Sent by email only to: UKSustainabilityTAC@frc.org.uk

11 October 2023

Dear Sir/Madam

UK endorsement of IFRS S1 - General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 - Climate-related Disclosures: Call for evidence

EY UK welcomes the opportunity to respond to the UK Sustainability Disclosure Technical Advisory Committee's (TAC) call for evidence on the UK's endorsement of IFRS S1 and IFRS S2, issued by the International Sustainability Standards Board (ISSB). This is an important step in promoting international consistency and comparability for sustainability reporting and incorporating them into the UK regulatory reporting framework (as UK Sustainability Disclosure Standards (SDS)).

We have set out our detailed responses to the TAC's call for evidence in the appendix to this letter. We support the incorporation of IFRS S1 and IFRS S2 (the 'ISSB standards') into the UK regulatory framework and consider that these will improve existing reporting in the UK by providing more decision-useful information, especially in respect of broader sustainability topics beyond climate.

We consider that the application of these standards will be technically feasible, however we believe that entities will face implementation challenges, including some issues of interpretation, as set out in our responses in the appendix. We acknowledge that guidance around materiality assessments within the ISSB standards would benefit from being expanded, particularly to address interoperability with the European Sustainability Reporting Standards (ESRSs), given the requirements for a double-materiality assessment under ESRSs.

By using the ISSB standards as a baseline, the aim is for the information disclosed by entities under UK SDS to be globally comparable and decision-useful for investors. To help with the implementation, there are areas where further guidance and implementation support would be needed, and we have highlighted where this would be welcomed and useful in our responses to the questions. In many cases, the ISSB would be best placed to provide interpretational guidance. There are also areas where the UK could support with non-mandatory guidance that does not add new requirements but will instead ease implementation and promote consistency or that addresses UK-specific regulatory requirements. We would also encourage the Financial Reporting Council (FRC) and/or the UK government's Department for Business and Trade (DBT) to engage with the ISSB to issue additional guidance and support in areas of implementation difficulty.

Ideally, the ISSB standards should be implemented into UK legislation unamended in order to preserve the benefit of a global baseline and efficiency within groups. This may also improve the likelihood of 'equivalence' decisions being granted by other jurisdictions. We note that the call for evidence highlights that the endorsement process will consider amendments where necessary for effective application in a UK context. In our view, any such modifications should be limited so the wording is as close as possible to the original ISSB standards. We would support a change to permit rather than require entities to consider the Sustainability Accounting Standards Board (SASB) standards, if this is needed, to avoid possible conflicts with existing company law (we understand there may be issues arising from referencing an external framework). In any case, the implications of any modifications made in implementing the ISSB standards in the UK need to be carefully



considered. For the purposes of this call for evidence, we have focused on the merits of IFRS S1 and IFRS S2 as published by the ISSB.

While this call for evidence focuses on whether the ISSB standards are fit for endorsement, it will be important that the UK government considers the following in order to implement the ISSB standards successfully:

Scope and timing of implementation

It is important that there is adequate time for implementation, given the fact that significant new UK regulatory requirements will be effective in 2025 and 2026 (see below), the necessary learning curve and the need for a lead-time to allow entities to put in place processes for reliable data collection. Any entities falling in scope that have not yet reported under the Taskforce on Climate-related Financial Disclosures (TCFD) or under the Climate-related Financial Disclosure Regulations, may be reliant on access to advice and external support when implementing the ISSB standards in relation to Climate-Related Risks and Opportunities (CRROs). Many entities will need to extend their existing reporting to cover Sustainability-Related Risks and Opportunities (SRROs) and may likewise need implementation support.

If entities are late in implementing the ISSB standards (which is an issue we have encountered with the Climate-related Financial Disclosure Regulations), this may impact the availability of sufficient advisory support. The Financial Conduct Authority (FCA) has recently announced that it is aiming to introduce requirements for listed entities to report under the ISSB standards effective for accounting periods beginning on or after 1 January 2025. We are unclear whether the implementation in UK company law is intended to be aligned with the same proposed date.

Given the above considerations, it would be helpful to consider a phased implementation of IFRS S1 and IFRS S2, starting with requirements in the FCA's Listing Rules and then at a later date in the Companies Act 2006.

A timetable with different implementation dates for different scopes of entities (for example, listed entities implementing before unlisted entities or size-based phasing of implementation) would aid smaller entities with 'learning' from prior implementations by larger or listed entities and allow easier access to advisers to support implementation. However, we acknowledge that a lengthy lead time would lessen the benefits of sustainability reporting, both for investors and entities themselves and encourage some entities to delay their efforts to implement the ISSB standards (as we have found with the Climate-related Financial Disclosure Regulations).

As explained in our response to question 4, we believe that there should be careful consideration of the availability of exemptions for subsidiaries within a group which are included in a consolidated sustainability report complying with IFRS S1 and IFRS S2 (or potentially equivalent frameworks). This might help reduce the cost and time burden while allowing entities to focus on providing the most material and relevant information for users.

Corporate Sustainability Reporting Directive (CSRD)

A number of UK-listed and unlisted entities are also in scope of the CSRD and have already commenced the work needed to implement ESRSs. In that context, the interoperability of IFRS S1 and IFRS S2 with ESRSs becomes a key consideration where clarity is needed. One area of concern relates to the differences in the definitions of 'materiality' which we have set out in more detail in our response to questions 1 and 3 below.

UK audit and corporate governance reform and other regulatory developments

Future reforms to the UK's non-financial reporting framework, arising from the UK's Non-Financial Reporting Review, the implementation of a revised UK Corporate Governance Code and the

 $^{^1\} https://www.fca.org.uk/publications/newsletters/primary-market-bulletin-45$



interaction with existing disclosures, need to be properly considered. We strongly advocate for using this as an opportunity to remove any existing requirements that have accumulated over the years (and overlap with the ISSB standards), for example, the UK government's Streamlined Energy and Carbon Reporting (SECR).

Entities also need to understand how the UK Green Taxonomy (including the proposed reporting requirements under the Taxonomy) and the proposed transition plan disclosure requirements for larger entities will be integrated into the UK reporting framework and whether implementation dates will be aligned to avoid multiple changes at different times.

We recognise that some of our comments are beyond the remit of the TAC's call for evidence, but we consider that these are important points concerning the implementation of the ISSB standards, which we support for endorsement. In particular, to avoid unnecessary burden on entities, we believe that the timing of implementation needs to dovetail with developments in the wider UK regulatory landscape and we would recommend a phased implementation that also allows for subsidiary exemptions.

We hope you find our comments useful, and if you have any questions or would like to discuss any of our views, please contact me using the details provided.

Yours sincerely,



Rob Doepel Partner Ernst & Young LLP United Kingdom



Appendix

Topic 1: Overall views on the standards

This topic specifically refers to IFRS S1 and IFRS S2 as a whole.

Specific matters to consider in your response:

- How easy or difficult is it to interpret the requirements described in IFRS S1 and IFRS S2?
- To what extent will the requirements in the standards improve upon existing reporting in the context of the UK?
- To what extent do you think that application of the standards in the UK is technically feasible?
- How, if at all, might the information disclosed in accordance with IFRS S1 and IFRS S2 be used by investors for their decision-making, and companies for the management of the business?

Our response:

In general, we support the incorporation of IFRS S1 and IFRS S2 into the UK regulatory framework and consider that these will improve existing reporting in the UK, especially in respect of broader sustainability topics beyond climate, therefore providing more decision-useful information. We consider that the application of these standards will be technically feasible, although we acknowledge that guidance around materiality assessments within the standards would benefit from being expanded, especially to address interoperability with ESRSs, given the requirements for a double-materiality assessment under ESRSs.

We have highlighted a number of areas of interpretation or implementation difficulty in our later responses, where guidance over particular aspects of the ISSB standards would be welcomed. In many cases, the ISSB would be best placed to provide interpretational guidance. However, there are areas where support from the UK in the form of non-mandatory guidance, rather than new requirements, would ease implementation, promote consistency and address UK-specific regulatory requirements. We would also encourage the FRC/DBT to engage with the ISSB to encourage additional guidance and support in areas of implementation difficulty.

Benefits of high-quality sustainability financial disclosures

A key benefit would be better quality of sustainability reporting, based on a rigorous principles-based framework. At present, much sustainability reporting is limited to climate-related financial disclosures, although there is limited narrative reporting in other areas. A wider focus is welcomed.

This would not only provide information that investors value, as it gives better insight into an entity's long-term value and strategy to address SRROs, but would also provide a spur to entities to ensure that sustainability considerations are part of 'business as usual' when making their strategic and risk management decisions. With increased information on sustainability matters, management can make better informed decisions to help their business address the impacts and possibilities arising from SRROs, and to manage regulatory deadlines for certain industries, associated with the UK's net zero commitments.

While the ISSB standards do not prescribe how governance should be conducted, the implementation of IFRS S1 and IFRS S2 is likely to encourage the embedding of sustainability considerations into risk management, business strategy and decision-making. However, we consider that investors and entities are best placed to comment more fully on how information disclosed in accordance with IFRS S1 and IFRS S2 would be used.

Technical feasibility of implementation

IFRS S1 and IFRS S2 employ many concepts familiar from IFRS Accounting Standards. They are also principles-based, rather than prescriptive. We believe that the ISSB standards are written in plain language, allowing entities to interpret them in a way that supports meaningful and relevant disclosure. Supporting documentation, such as the Basis for Conclusions, accompanying guidance,



Board meeting summaries and the work of the Transition Implementation Group on IFRS S1 and IFRS S2, which is in the course of being set up, will support consistency of application. It is helpful that there is an overlap with other frameworks such as the Carbon Disclosure Project (CDP), TCFD and ESRSs. Listed entities already reporting under TCFD should find the structure of the ISSB standards familiar.

The ISSB standards require disclosure of what an entity is doing, rather than prescribing how an entity governs, manages risks and opportunities, and sets its strategy in managing the business [IFRS S1.BC93]. Therefore, the focus is on transparency and in many cases, there remains an option to disclose that there is no relevant information. The exception to this is metrics, where specific metrics need to be disclosed regardless of whether these are currently calculated or used as Key Performance Indicators (KPIs).

We consider that certain specified climate-related metrics will be technically difficult to comply with as there may be no prevailing methodologies available for that metric; for example, the amounts and percentages of assets/activities vulnerable to physical and transition risks [IFRS S2.29(b), (c)]. Requirements for industry-based metrics in climate-related and other sustainability topics (including the requirement to consider SASB standards) will require additional effort for many entities. As with the implementation of any new reporting standard, the collection of new data poses a challenge, particularly where the methodologies and processes to obtain the data are still developing (see further comments below).

A key area in the implementation of IFRS S1 and IFRS S2 is the materiality assessment. There are some concerns as to whether there is sufficient guidance in IFRS S1 on this topic, specifically, whether it is sufficiently clear how to determine what is material information, including what timeframe investors are interested in, not least as it might differ to the timeframe that matters to other stakeholders. Differences in the materiality assessment between other regulations, such as under ESRSs (which some UK reporters will also need to apply), may make the materiality determination when applying the ISSB standards harder.

A recent draft implementation guidance from the European Financial Reporting Advisory Group (EFRAG)² explicitly acknowledges that 'Reflecting the equivalence of the scope of financial materiality in ISSB standards and ESRS, an undertaking that applies ESRS is expected to be able to comply with the identification of the risks and opportunities to be disclosed under IFRS'. While there are caveats and qualifications, this would be a crucial clarification (if finalised and accepted by ISSB). It will be important that there is an explicit acknowledgement and/or guidance on the alignment of the materiality assessments under both the ISSB and ESRS frameworks to ensure feasibility of implementation.

Even with additional context on the materiality assessment, there will still be a need to interpret concepts familiar from financial reporting in the context of sustainability reporting. For instance, even though the definitions of materiality, primary users, concept of an error, etc., are very similar to those found in IFRS Accounting Standards, there will be new challenges in putting these into practice in the context of ISSB standards (see our response to questions 2 to 9). It is therefore inevitable that there will be a 'learning curve' and many questions of interpretation will arise as entities begin to implement these standards. We have already identified areas which are difficult to interpret in practice. For example, the difference between IFRS S1.29(e)/41-42 (describing the resilience of the entity's strategy and business model) and IFRS S1.29(b)/34(b) (the anticipated effects on financial position/performance/cash flow). Even though this has been discussed by the ISSB and is addressed in the Basis for Conclusions, it is an area about which we still receive questions from preparers.

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² EFRAG Implementation guidance for the materiality assessment



Notwithstanding these challenges, we believe that the application of the ISSB standards in the UK is technically feasible. This assumes, of course, that these standards are implemented in law as close as possible to the standards as issued by the ISSB. This is because those standards have gone through extensive due process including consideration of interoperability with other frameworks (which may be relevant for ease of application within groups and potentially for 'equivalence' determinations under regulatory frameworks).

We note that the call for evidence states that "this endorsement process will assess the suitability of the IFRS Sustainability Disclosure Standards and will consider amendments where necessary for effective application in a UK context." We would support a change to permit rather than require entities to consider the SASB standards, if this is needed to avoid possible conflicts with existing company law (as we understand there may be issues referencing an external framework). However, if there are any departures from the wording of the standards 'where necessary for effective application in a UK context', the implications need to be carefully considered.

Implementation challenges

We believe there will be significant operational challenges in implementing the ISSB standards. These include:

- Uncertainty over how the ISSB standards will be implemented into UK regulation. For example, whether the requirements will be written directly into legislation or referenced, in the same manner as UK-adopted international accounting standards or incorporated in a simplified form (as was the case with the Climate-related Financial Disclosure Regulations). The scope of entities within any requirements and the availability of any group exemptions will also be key. We would presume that, at least initially, the requirements will not be extended to smaller private entities that are out of scope of the Climate-related Financial Disclosure Regulations. In addition, it would be relevant to have a more granular understanding of how existing regulations will be amended, if at all.
- Data collection, and how to ensure the reliability of data, in particular with respect to any data sourced from the value chain. The main challenges here include:
 - Data provided by suppliers/customers etc., for periods that differ to the reporting period;
 - o The possibility of errors being later identified in such data; and
 - The need for estimation procedures and the fact that in some cases consensus over appropriate methodologies will develop over time. There are methodologies developing in the area of Scope 3 emissions (including estimating data), but data collection is likely to be less mature in other sustainability areas. The cost burden of estimating data may be reduced if there were more efficient ways of obtaining it, for example, it is understood that the UK government may consult on Greenhouse Gas (GHG) Scope 3 emissions later this year with the aim of exploring how it can support Scope 3 reporting.
- Upskilling of capabilities. Even if the requirements are understood, it is likely that many entities
 may need advisory help in new areas, such as navigating materiality (for sustainability reporting),
 transition plans, scenario analysis and data collection from their value chain. This is particularly
 relevant for smaller entities who would need also to upskill staff and increase resourcing for
 corporate reporting.
- Interoperability with ESRSs. Since many UK entities may be in scope of both ESRSs and IFRS S1 and IFRS S2 (if UK endorsed), interoperability will be a key concern. Some UK entities have already started the work needed to implement ESRSs so further clarity on interoperability would be opportune. One key area of concern is differences in the definitions of 'materiality' (as noted above).
- It will not be possible to effectively implement IFRS S1 and IFRS S2 without close interaction of
 sustainability, financial and business management. This is required in order to determine and
 monitor SRROs; understand the impacts on strategies, transition plans and resilience; and
 develop and monitor metrics and targets. Determining what is material information to report will
 also require input from all these functions. Currently we understand that ESG functions are not



always embedded within business risk management, strategy and decision-making, consequently this is an area where we expect change to occur.

Topic 2: Identifying sustainability-related risks and opportunities

This topic specifically refers to the requirements in IFRS S1 (paragraphs 54-55, B6-B7, B11-B12 and C1-C3) and IFRS S2 (paragraphs 10-12).

Specific matters to consider in your response:

- What challenges, if any, are there for UK companies in identifying and disclosing all sustainabilityrelated risks and opportunities based upon the requirements? Please explain your response.
- Have you used, or do you plan to use, the sources of guidance in IFRS S1 paragraph 54-55 and the disclosure topics in IFRS S2 paragraph 12 to identify sustainability-related and climate-related risks and opportunities? Do you have any comments on their use?

Our response:

IFRS S1.3 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". IFRS S1.17 requires that material information is disclosed about such SRROs. We believe that entities may find it challenging to identify the pool of SRROs that are relevant to their business and then to further determine the level at which they should perform the 'materiality assessment' to identify the SRROs to be disclosed.

We consider that the process of identifying SRROs should be integrated into the current risk management process. However, we note that in many organisations, the two functions (sustainability and risk) often have different perspectives and priorities. Whilst mature organisations should already be incorporating these considerations, experience of TCFD disclosures suggests that some are not yet considering these topics in a sufficiently comprehensive manner across the value chain when assessing risks, and this is an area where more guidance would be well received. For example, the FRC when updating its *Guidance on Risk Management*, *Internal Control and Related Financial and Business Reporting*, could emphasise the need for a comprehensive integrated approach to sustainability matters across business functions.

Topic 3: Application of materiality

This topic specifically refers to the requirements in IFRS S1 (paragraphs 17-19 and B13-B28).

Specific matters to consider in your response:

- Is it clear how the concept of materiality (IFRS S1 paragraphs 17-19) applies to the identification and disclosure of sustainability-related risks and opportunities? Please explain your response.
- How do investors identify sustainability-related information that is material in a company's annual report?

Our response:

We generally support the definition of materiality proposed in IFRS S1, primarily for its consistency with financial reporting and therefore alignment with the objectives and focus of the ISSB in developing these standards. However, we do have some concerns about how it would be applied in practice.

Interoperability

Our primary concern with regards to the application of the materiality definition is interoperability. For reporting entities in scope of other sustainability-related regulations and disclosure frameworks, it would be challenging and time consuming to have to repeat a materiality assessment process with multiple different parameters, and would make the resulting disclosures confusing and onerous.



Ideally, we would call for as much alignment as possible between different disclosure frameworks affecting UK entities, to avoid duplication of effort and to enable reporting entities to leverage synergies. Recognising however that each framework and regulation has its own objective to fulfil and therefore understanding total alignment may not be feasible, we would need explicit and formal acknowledgement of any differences, and guidance on how to navigate them.

To use the ESRSs as an example (as a number of UK entities will be required to report either directly or indirectly under the CSRD), we welcome the preliminary announcement from the EFRAG Sustainability Reporting Board (SRB) that the definitions of financial materiality under both the ISSB and ESRS requirements are expected to be consistent and aligned. Whilst this appears to be true at a conceptual level, some practical questions remain.

The CSRD prescribes a topic-based approach to materiality, providing specific topics that all entities must consider when assessing materiality, in the form of the 10 topic-based standards. ISSB on the other hand, requires consideration of the SASB standards to identify potentially material SRROs. Though the output of the assessment – i.e., the list of identified material sustainability matters – may be the same or at least similar, the process to determine those matters are different. Acknowledgement of such differences and practical guidance on how to address them in both process and disclosure would be welcome. We encourage the FRC/DBT to engage with the ISSB on this matter.

To give another example of interoperability with ESRSs, we may consider the treatment of sustainability-related impacts and dependencies under IFRS S1 and IFRS S2. In theory, we understand that for the purpose of these standards, sustainability-related impacts and dependencies are only relevant and potentially material in so far as they give rise to SRROs that could reasonably be expected to affect the entity's prospects (as explained in IFRS S1.2-3). We welcome the contextualisation of this 'inextricable link' in terms of established and familiar concepts (particularly the IRC 'capitals'), and likewise recognise the consistency with the CSRD, which also specifically highlights the interconnectedness and chain reactions between impacts and dependencies and opportunities and risks.

Entity-level materiality

As per our response to question 4, we would strongly favour scope of application in the UK of the ISSB standards at group-level over entity-level, on the basis of practicality and feasibility.

However, where group entities are required to, or choose to report, under the ISSB standards, there may be challenges in determining what is material to a primary user concerned with the prospects of a given group entity (or subsidiary). This is particularly the case if external investors or creditors provide resources at the entity level.

For example, where an investor or creditor is providing resources at an entity-level, there could conceivably be a mismatch between the information that may affect decision-making – i.e., what may be considered material – and the information presented, where a materiality assessment has been carried out at a parent– or group-level. This would be especially pertinent in situations where a subsidiary is operating in a different sector or geography to the rest of its group.

Breadth of considerations

The question of whether or not a given SRRO would likely influence decision-making is highly dependent on the investor, firm, fund and strategy in question, far more so than with financial information. Each investor has different investment objectives, risk appetites and time horizons, and will take a different approach to the consideration and integration of sustainability-related information. It follows that this definition of materiality in practice could become extremely broad, and highly subjective/judgement based.



As such, for the resulting disclosures to be useful, we believe transparency around the approach, and any assumptions made about investor preferences or requirements, when considering the potential materiality of SRROs, is of the utmost importance, to explain the rationale behind where and why a reporting entity has drawn the line. Moreover, clarifying examples and practical guidance would offer significant help.

Topic 4: Reporting approach

This topic specifically refers to the requirements in IFRS S1 (paragraphs 20, B38, and B11-B12) and IFRS S2 (paragraphs B32-B54).

Specific matters to consider in your response:

- What, if any, are the challenges in preparing sustainability-related disclosures at the same entity level used in the preparation of financial statements (e.g., consolidated reporting or entity-level reporting)? Please explain your response.
- Is there sufficient guidance on how to identify the value chain and on how to prepare and present information about sustainability-related risks and opportunities in the value chain? If not, what would you need to be able to comply with this requirement?

Our response:

Reporting entity boundaries

IFRS S1 is clear that sustainability-related financial disclosures are prepared for the same reporting entity boundary as the financial statements. Consequently, if consolidated financial statements are prepared, the sustainability-related financial disclosures will also be provided on a consolidated basis. The corollary is that if individual entity financial statements are prepared, the sustainability-related financial disclosures are provided for the individual entity.

While this may not be in remit of this call for evidence, we believe there should be careful consideration of the availability of exemptions for subsidiaries within a group that provides consolidated sustainability-related financial disclosures complying with IFRS S1 and IFRS S2 (or potentially equivalent frameworks). This might help reduce the cost and time burden while allowing entities to focus on providing the most material and relevant information for users. These challenges are further explained below.

Challenges for group entities (below ultimate parent)

In general, reporting on a consolidated basis provides good connectivity between the sustainability-related financial disclosures and the financial statements. However, challenges can still arise for entities (for example, a sub-group) that are part of a wider reporting group as the SRROs may cut across different group entities, and the governance/strategy/risk management may well be directed by the ultimate parent. Consequently, in many cases, the most meaningful and relevant reporting may be at the level of the ultimate parent's consolidated financial statements.

Nevertheless, in some cases, for example, where there are subgroups comprising divisions with distinct SRROs, information at the subgroup level could provide more granularity which might be obscured at the ultimate parent consolidated reporting, due to differences in materiality at group and sub-group levels (see for example, comments in our response to question 3). However, it is the ultimate parent's consolidated position that tends to be the level that users of financial statements are most interested in.

Alignment of reporting boundaries across multiple reporting frameworks

We note that challenges arise in SECR as the reporting of greenhouse gas emissions may not align with the financial reporting boundary (for example, the treatment of subsidiaries, joint ventures, associates, other equity investments, joint operations and franchises) due to the three possible methods of reporting: financial control, operational control and equity share. With that in mind,



guidance will be needed around greenhouse gas emissions reporting under IFRS S2, as this may differ from existing reporting under SECR.

Challenges in collecting data

Even in consolidated financial statements, there can be challenges in obtaining the data needed to report on a consolidated basis on an accurate and timely basis as the information may be retained by different departments and on different systems throughout the group.

Connectivity between intermediate parent individual sustainability-related financial disclosures and the financial statements

Intermediate parent individual financial statements will present the entity as a holding company, and report investments in subsidiaries rather than the subsidiaries' underlying activities. However, the definition of SRROs has the effect that the investments in subsidiaries form part of the 'value chain' and impact the intermediate parent's sustainability-related financial disclosures. There is, therefore, inherently less connection between the intermediate parent individual sustainability-related financial disclosures and the financial statements.

A further complication is that the nature of the parent's relationship with the subsidiaries may differ. IFRS S1 identifies the primary users as investors, potential investors and creditors. In some cases, the intermediate parent may hold the investments for legal/tax/regulatory purposes and the ultimate parent makes business decisions and determines the strategy of the subsidiaries. If the reporting entity has no real involvement in the strategy and business of the subsidiaries, it may be unclear what is material information in the context of the individual parent financial statements, sustainability-related financial information may not be monitored at that level and there will be no external stakeholders. However, there might be public policy or regulatory expectations as to what such reports should include.

Similar issues might arise in connection with parents that are investment entities. Reporting by intermediate parents preparing individual financial statements is an area where there may be difficulties of interpretation and further (non-mandatory) guidance or support might help consistency.

Value chain, including specific challenges for financial institutions

The concept of the 'value chain' under IFRS S1 is broad, which presents challenges in the identification of sustainability-related financial disclosures. Across all sectors, clarification on where disclosure requirements apply to own operations, rather than value chain, would be helpful.

For financial institutions, almost any sustainability-related financial disclosure topic might impact the value chain (depending on how widely this is assessed). For climate, with regard to scope 3 financed activities emissions, there is now reasonable understanding but for other disclosure topics, this is not the case. A lack of prevailing guidance/standards/methodology makes it difficult to understand what disclosures would look like, if applied to all financed activities. Specific guidance for financial institutions as to how and when disclosures apply to financed activities would be welcome.



Topic 5: Timing and location

This topic specifically refers to the requirements in IFRS S1 (paragraphs 60-63, B27, B45-48, 64-69) and IFRS S2 (paragraphs B19).

Specific matters to consider in your response:

- What are your estimates of the benefits or costs in relation to reporting sustainability-related information at the same time and in the same location as general purpose financial reports for companies in the UK?
- If UK companies were to include this information in the Strategic Report, how will they be able to ensure that this information is presented in a manner such that it is clearly identifiable and is not obscured by other information (IFRS S1 paragraph 62)?

Our response:

Timing and alignment with financial statements

We support requiring sustainability-related information to be reported at the same time as the financial statements. There are clear benefits to reporting sustainability-related disclosures at the same time as financial reports including:

- Ease of demonstrating the connectivity between the two disclosures and information for investors and stakeholders, and this approach encourages alignment of disclosures; and
- Embedding sustainability reporting as business as usual, as this approach is aligned to the broader reporting timetable and incorporates the subject matter into this area.

We realise that successful alignment will take time, as this is not current practice for all reporting entities, so implementation timelines need to be realistic to allow time for transition.

Location

IFRS S1 requires the sustainability-related financial disclosures to be presented as part of general-purpose financial reports [IFRS S1.60]. While IFRS S1 gives flexibility over the location of information (subject to any other regulatory requirements), it requires that the sustainability-related financial disclosures are clearly identifiable and not obscured by additional information [IFRS S1.62].

Possible models include: (i) a separate sustainability report or (ii) integration of the requirements within the strategic report. The first approach has some benefits – most notably the information will be easily identifiable and not obscured. It may also make it easier for entities that have to report under various similar standards (for example, ESRSs) or complementary requirements (for example, transition plans) to present all of the required and related sustainability information together in one place without significantly increasing the length of the annual report.

Nonetheless, it is our opinion that reporting under the standards should follow the second approach (similar to the Climate-related Financial Disclosure Regulations) and be integrated within the strategic report, for the following reasons. The second approach will:

- Drive connectivity between sustainability disclosures and financial statements which is a fundamental 'ask' from investors including by aligning the cut-off date of the disclosures;
- Utilise existing (and proposed) director accountability measures over narrative reporting within the annual report and financial statements;
- Ensure that an investor materiality lens is applied to information being disclosed (since there is a danger that standalone sustainability reports might be broad in scope and lose the discipline of an investor focus); and
- Allow entities to demonstrate the extent to which sustainability considerations form part of the overall business model and strategy or remain siloed.

This would not preclude additional information being included outside the annual report, for example in a standalone sustainability report.



Including disclosures under UK SDS within the strategic report does come with its own set of challenges depending on how this is implemented. The two common practices that have developed for TCFD reporting are:

- A fully integrated approach with an index setting out where the disclosures have been included
 in the strategic report. The shortcoming of this approach is that whilst in theory the index helps
 direct the users to the specific disclosures, the references are seldom precise. The index can
 create the illusion of a 'proof of completeness', when in fact the specific required information is
 not included or is only obliquely referred to. If material sustainability-related information is
 included, it does risk being obscured by surrounding narrative.
- A standalone 'sustainability section' within the strategic report. A separate section will help determine the boundary of disclosures made under the standards (as this information should be clearly identifiable [IFRS S1.62]) and this is already a common approach used by many listed entities. However, in practice this leads to a loss of balance in the front half, with significantly more pages dedicated to sustainability than to core strategy and risk considerations. This can create duplication; for example, the role of board committees may be discussed once for the purpose of discussing climate change accountabilities and a second time as part of the broader governance discussion. It also perpetuates the siloed presentation of sustainability topics, with a lack of clarity about how delivering sustainability commitments will influence the business model or how they interact with core strategic objectives. It can also lead to material sustainability-related financial disclosures being obscured by the inclusion of immaterial initiatives and data points that have little impact, either on the entity or its operating environment.

In light of the above, we advocate a hybrid approach that encourages an integrated presentation of sustainability-related financial disclosures (whilst discouraging the presentation of immaterial data) and also ensures that such information is easily identifiable through clear annotations. The FRC/DBT would need to issue clear practical guidance on how to approach UK SDS within the strategic report covering matters such as:

- Which aspects of the standards are best integrated with the broader requirements of existing reporting requirements that will be maintained (for example, explanation of governance arrangements) and how to annotate this information so that it is easily identifiable;
- Which aspects of the standards should be presented separately in a prominent disclosure (for example, metrics and targets); and
- Best practice for cross referencing and avoiding duplicating of disclosure.

<u>Additional considerations</u>

- Transition reliefs: If the disclosures required by IFRS S1 and IFRS S2 are required as part of the strategic report, then would that override the transition relief to report after the related financial statements in year one, unless there was a similar/equivalent provision? See our response to question 11 concerning the transition reliefs.
- Third-party data: The relief to still allow for use of supplier/third-party data where the reporting cycle is not aligned is crucial, especially for emissions data.



Topic 6: Judgments, uncertainties and errors

This topic specifically refers to the requirements in IFRS S1 (paragraphs 70-71, 74-86 and B49-B59).

Specific matters to consider in your response:

- How clear, if at all, are the requirements in IFRS S1 paragraphs 74-86 regarding judgements, uncertainties and errors? How easy or difficult is it to distinguish between a change of estimate and an error? Please explain your response.
- What, if any, further considerations are there in respect of disclosing revised comparative information when there are changes in estimates?

Our response:

It is helpful that the concepts of judgements, uncertainties and errors are framed in a similar way to IFRS Accounting Standards and therefore will be understood. However, their application to sustainability-related financial disclosures will be less clear-cut and involve significant judgement. This is likely to reduce over time as practice and consensus develops. Given this, high quality narrative disclosures will be critical to ensure that relevant and understandable information is disclosed. Dissemination of good practice examples would assist in good quality disclosure of judgements and estimates. This is an approach that is already followed in the UK in respect of implementation of IFRS Accounting Standards (or narrative reporting), with the FRC Lab publicising good practice. A similar approach in respect of implementation of UK SDS would be welcomed.

Wider scope of judgements

With regards to judgements and estimation uncertainty, clear and informative disclosure of judgements and estimation uncertainty is likely to be critical to the understandability of sustainability-related financial disclosures. Given the subject matter, judgements on sustainability-related financial disclosures are likely to cover different areas to those traditionally seen under financial reporting, including the determination of the SRROs and of material information (including how sources of information were used).

Methodologies for estimates

Similarly, transparent disclosure of estimation uncertainty will be important. This includes the methodologies applied, where there are a range of acceptable methodologies and the impact (even if qualitative) of selecting a particular methodology. IFRS Accounting Standards disclosures focus on estimates where there is a risk of material change in the next financial year. However, in IFRS S1, the requirement is to disclose estimates with a high level of measurement uncertainty which is not restricted to the risk of material change in the next financial year. Measurement uncertainty could arise from the difficulties of making assumptions over a longer time horizon (as well as difficulties over data collection), resulting in more extensive disclosure of measurement uncertainty in respect of sustainability-related financial disclosures.

Retrospective restatement for revisions to estimates

Although the distinction between an error and change of estimate is aligned with financial reporting, the treatment is not. Particularly in the early years of implementation, it is likely that data revisions will be much more frequent than for financial reporting. This might be due to refinements in methodology (perhaps due to a consensus developing over appropriate methodologies) or improvements in the scope of what data can be collected (i.e., a material change in estimate). It could be due to misapplication of methodologies or data errors in information supplied from the value chain (which is not under the entity's control) or identified as a consequence of an assurance engagement.

Unlike financial reporting, both material changes in estimates and corrections of errors are retrospectively applied unless this is impracticable. We agree that this helps in establishing a more relevant trend on a comparable basis. However, there is a concern that some entities may not adjust (on grounds that impracticable) even if the effect would be material.



Guidance is needed on how to treat acquisitions and disposals (i.e., changes to the structure for the group) under the ISSB standards for metrics in the baseline year and for general comparatives for emissions and other sustainability-related information (this is an area dealt with in the Greenhouse Gas Protocol). This would be a useful area for the FRC/DBT to engage with the ISSB to issue practical guidance.

Distinction of error versus revision in estimate

Despite having the same effect on the comparatives, it is likely that attention is placed on whether an adjustment is determined as a material change in estimate or an error. Highlighting an error (even if an honest mistake) could lead to allegations of greenwashing or regulatory scrutiny, which could encourage disclosure of changes in comparatives as a material change in estimate rather than an error. In any case, this is likely to be a difficult distinction to make (and audit) and this would be another useful area for the FRC/DBT to engage with the ISSB to issue practical guidance to assist a consistent understanding of the distinction.

It is possible over time that the bar for what information is reasonably expected to be obtained may rise, meaning that in the near term after implementation more adjustments might be regarded as new information in relation to estimates provided, rather than errors. A similar situation arose with determination of IFRS 9 expected credit losses in early years of implementation, as models became more sophisticated and methodologies more established. Given this, latitude from regulators in the early years of implementation, focusing on high quality narrative disclosures concerning the restatement would be welcomed.

Restatements could arise from so many different causes that it may be relevant for the primary users to understand the source of the restatement. Guidance on broad categories that could be disclosed would be useful (such as adjustment to value chain data, refinement of methodology, extension of scope of data collected etc.).

Topic 7: Financial impact and connectivity

This topic specifically refers to the requirements in IFRS S1 (paragraphs 21-24, 34-40 and B39-B44) and IFRS S2 (paragraphs 15-21 and B65).

Specific matters to consider in your response:

- How easy or difficult is it to interpret the requirements for preparing and disclosing information about the current and anticipated effects of sustainability-related information on the financial position, financial performance and cash flows? Please explain your response.
- What, if any, are the challenges in preparing disclosures that connect sustainability-related information to the financial statements?

Our response:

With regards to anticipated financial effects, the existing guidance is insufficient. There is scope for different entities to disclose similar things in different ways, which undermines the overarching objective of achieving consistency.

Requiring entities to quantify the financial impact of climate change across multiple time horizons could lead to confusion and questions from investors, especially if the impacts seem disproportionately different. Entities are already struggling to develop financial models for TCFD climate risk, and without explaining and qualifying every assumption, it is difficult to accurately and reasonably draw the link between climate risk and financial impact.

If required to provide figures, entities would likely need to provide explanation of baseline projections. Entities might be able to better quantify in terms of percentages of current activities or expected revenue, without going into specific projections. This could be done by using ranges (low, medium, high), with the thresholds for each range being disclosed. This would provide investors with



enough information to understand the potential financial impact of climate change, without requiring entities to make overly complex or inaccurate estimates.

Financial assessment should be made where possible or appropriate, but it is important to recognise that not all sustainability risks can be readily quantified in financial terms. The assumptions required for other topics, such as human rights and biodiversity, would be more complicated and may require an annex. In these cases, it is more important to demonstrate the linkage between sustainability risks and strategic value and metrics.

We understand that there is no requirement in the ISSB standards to use scenario analysis to calculate anticipated financial effects; it is only required to inform the resilience assessment. However, we consider that scenario analysis can inform anticipated financial effects. ESG scenario analysis is new for most entities and therefore guidance in this area would be helpful.

Topic 8: Industry-based requirements

This topic specifically refers to the requirements in IFRS S1 (paragraphs 54-59) and IFRS S2 (paragraphs 12 and 32).

Specific matters to consider in your response:

- What, if any, are your estimates of the benefits and/or costs in preparing industry-based disclosures?
- Should the standards stipulate which guidance and industry-based topics and metrics a company should disclose, and why? What, if any, are the other sources of guidance that are currently used by UK companies?

Our response:

We believe that the availability of industry-specific topics, metrics and guidance is useful for entities to consider in drafting their disclosures. The suggested frameworks containing industry-based topics and metrics should be a tool for entities to use in making their disclosures fair, balanced, understandable and comparable. However, we would support a change to permit, rather than require, entities to consider the SASB standards if this is needed to avoid possible conflicts with existing company law. The implications of any modifications made in implementing the ISSB standards in the UK should be carefully considered.

From the perspective of users and stakeholders, comparability of sustainability and annual reports, within and across industries, is key to effective decision making. Without this comparability, it is challenging for participants to find meaning in the disclosures and to differentiate between entities.

From the perspective of entities (as preparers), it can be difficult to apply generic metrics that broadly pertain to a number of industries. This is particularly challenging for industries with large value chains with many different products or service offerings. We note that there are already industry-specific metrics that are being used based on industry consensus (for example, retailers and consumer product goods disclosing 'packaging'). Permitting but not requiring entities to consider SASB would allow entities to consider additional frameworks and metrics that may be more suitable and are applied across their industries as the regulations are adopted and mature.



Topic 9: Cross-industry metrics (IFRS S2 only)

This topic specifically refers to the requirements in IFRS S2 (paragraphs 29, B19-B65).

Specific matters to consider in your response:

- Are the requirements for greenhouse gas reporting, including on financed emissions, technically and practically feasible? If not, please explain the reasons for this. You might want to consider resource, infrastructure, measurement methods (including the GHG Protocol Corporate Standard) or other challenges.
- What, if any, are the challenges in preparing and disclosing information about the cross-industry metrics other than greenhouse gas emissions (IFRS S2 paragraph 29(b)-(g))?

Our response:

Greenhouse gas emissions

In relation to greenhouse gas emissions, we recognise that few entities currently have the capabilities to report on all 15 categories of Scope 3 emissions. We nonetheless support encouraging or requiring reporting entities to do so to eliminate or reduce the risk that entities choose to focus on easier, less significant emissions sources over those which may be harder to calculate but are ultimately more material/significant.

Updates to the Greenhouse Gas Protocol (GHGP) may address some of the concerns around emissions reporting and therefore it may be helpful to align any endorsement of the ISSB standards (as UK SDS) around the planned relaunch of the GHGP in 2025, as this will provide updated guidance on how to report on CRROs.

There is a notable absence of reference to the Partnership for Carbon Accounting Financial (PCAF) in IFRS S2 in relation to disclosing financed emissions. We assume this is on the basis that it may change and that standards may evolve, but by the same token, if the industry does advance, this omission would mean IFRS S2 would be at risk of being left behind and becoming outdated. In light of this, it would be helpful for the UK implementation guidance for the standards to reference PCAF (similar to the approach taken by TCFD).

Assets/activities at risk

Disclosing the amount of assets affected by climate change transition can be very complex and subjective and as such we would stress the need for clarity on the definition of climate-aligned opportunities, such as a taxonomy for identifying what would be considered 'at risk' to ensure consistent interpretation and disclosure.

For industries or activities where the majority of assets are at risk, information about assets and activities at risk after mitigation and/or adaptation activities would be potentially more insightful and helpful to investors. This may be the case for power and energy entities and entities active in other carbon intensive industries, where the scope for transition activities is large and could be a major point of differentiation between entities.

Internal carbon pricing

We question whether internal carbon pricing is truly a cross-industry metric. For many sectors, primarily outside of extractive industries, it is not widely used as a mechanism for climate risk management, therefore it is not clear that the corresponding disclosures would be useful for decision-makers. With that in mind, should it remain classified as a cross-industry metric, it would be beneficial to develop implementation guidance on how to disclose carbon prices, particularly for industries in which it is not as established.



Topic 10: Costs and benefits

Specific matters to consider in your response:

- What are the anticipated benefits of preparing and disclosing information required by IFRS S1 and IFRS S2 (for both companies and investors), and which elements of the standards will provide the greatest benefits?
- What are the anticipated drivers of costs when preparing and disclosing information required by IFRS S1 and IFRS S2?
- What is the current process used by preparers to gather the relevant sustainability related information required for reporting purposes? Please include information on the sources (where data is gathered), the frequency and associated costs.
- Please outline the additional steps your company would need to undergo to comply with the requirements of IFRS S1 and IFRS S2? Please consider staff, time, production, IT and any other costs associated with compliance. Which of these steps is the most costly/challenging steps, and why?
- How far do you agree or disagree that the benefits of disclosure will outweigh the costs of reporting over time?

Our response:

We have no comments on this topic. We believe that companies/preparers and investors are best placed to respond to this topic.

Topic 11: Application of the requirements

This topic specifically refers to the requirements in IFRS S1 (paragraphs E3-E6) and IFRS S2 (paragraphs C3-C5).

Specific matters to consider in your response:

- How might the proportionality provisions* ease reporting burdens or reduce challenges within reporting, if at all?
- Do the reliefs provided in IFRS S1 and IFRS S2 give appropriate transitional relief as preparers develop their reporting in this area? Please explain your answer.
- Are there any further anticipated challenges in the application of IFRS S1 and IFRS S2 that are not considered or addressed in the standards and guidance?

Our response:

Transitional reliefs

We believe that the transitional reliefs included in IFRS S1.E3, E5 and E6 and IFRS S2.C3-C5 will ease implementation of the reporting standards.

However, we do not support the relief in IFRS S1.E4 of separating the sustainability and other corporate and financial reporting in the first year of implementation. This seems counter to the objective of achieving connectivity between financial and sustainability-related disclosures and the consequent benefit of embedding sustainability matters within core business processes and practices. We believe that it would be better to delay implementation than to have reporting out of cycle. Moreover, if the disclosures were to be required in, for example, the strategic report as part of the annual report (as is the case with much narrative reporting), it is difficult to see how this relief could be implemented.

We welcome the 'climate-first approach' in IFRS S1.E5. This would ease reporting burdens with a focus on a topic that is regarded as critical and is more established and familiar to many entities. There is a question over the interaction of climate with other social and environmental topics (for

^{*}refer to the summary of proportionality mechanisms and temporary reliefs in the ISSB's Feedback Statement on IFRS S1 and IFRS S2.



example, climate change as a driver for biodiversity risks or the social risks of an unjust transition). This is an area that is being considered by the ISSB as part of its work supporting implementation of the standards. However, there may be uncertainty as to the boundaries of CRROs, which could cause difficulties in interpretation and inconsistent practice, especially as this is not explained in IFRS S2.

We have considered whether the one-year relief before reporting on the full range of SRROs is sufficient. On balance, a longer period would reduce the overall benefits of requiring sustainability-related reporting. However, given the expected learning curve, we would call for a lighter regulatory approach in the early years of adoption.

To avoid low quality disclosure, we would encourage (non-mandatory) implementation support on less familiar areas as well as publicising examples of good practice (as the FRC Lab often do, in relation to emerging areas). For example, TCFD published additional technical and topic-specific guidance (on scenario analysis, transition planning, metrics and targets, etc.) on a semi-regular basis following launch of the core framework. It is important that any implementation support provided in the UK (for example, Transition Plan Taskforce guidance) is fully aligned with IFRS S1 and IFRS S2 and is non-mandatory guidance rather than adding to the requirements of the existing standards or being a parallel source of interpretation of IFRS S1 and IFRS S2, which must rest with the ISSB. It would be helpful to entities to provide a clear roadmap for implementation of the ISSB standards in the UK, and for when any further implementation support in a UK context will be available.

We support the one-year relief for Scope 3 emissions to allow the feasibility of collecting or estimating the data, but given the materiality of this information, would not support a longer period of relief.

Other challenges

There may be other challenges regarding the use of the SASB standards, as a source that must be considered for determining SRROs and material information to disclose. These include, for example, situations where an entity's activities could fall within several industry classifications or where its business does not neatly fit in with a particular industry. Also, the ISSB has consulted on an approach to internationalising the SASB standards (expected before the end of 2023), and there is therefore limited experience on how straightforward and relevant these will be. In practice, the use of industry metrics is likely to be more consistent where industry participants have a similar business model as practice is likely to develop where similar metrics become the norm.

Topic 12: Any further comments

Please provide any other comments on the requirements in IFRS S1 and IFRS S2 and their potential application in the UK.

Our response:

We have set out additional comments in our cover letter and appreciate that some of these comments are outside of the TAC's remit in this call for evidence.