Appendix to the UK Endorsement of IFRS S1 & IFRS S2: Call for Evidence

The template below may be used to prepare and structure your response to <u>the call</u> <u>for evidence</u>.

Stakeholder type	□Individual	
	□Investor	
	□Shareholder	
	□Academic	
	□Business	
	☐Representative Body	
	⊠Other (please specify)	
	Professional institute	
Individual/Organisation name	The Institute of (ICAS)	Chartered Accountants of Scotland
Organisation size	170	
(number of employees)		
Contact email address		
Is this response confidential?	□Yes	⊠No

Views on the potential application of IFRS S1 and IFRS S2 in the UK

Please provide your views on whether the disclosures required by the IFRS Sustainability Disclosure Standards, in the context of the UK:

- will result in disclosures that are understandable, relevant, reliable and comparable for investors;
- are technically feasible to prepare;
- can be prepared on a timely basis and at the same time as general purpose financial reports; and
- are expected to generate benefits that are proportionate to the costs that are likely to be incurred.

Respondents are asked to provide opinions and evidence pertaining to specific topics in these two standards. In particular, respondents are asked to provide insight into any challenges and benefits that might arise when preparing and disclosing information in compliance with the two standards, including the scale of the challenge and any solutions you are able to propose.

In preparing your response, you may consider the topics outlined in the call for evidence. Please note, you are not required to limit your response to the suggested topics, nor are you expected to respond to all topics or questions. In your response, you are encouraged to comment on any aspect of the IFRS Sustainability Disclosure Standards. When providing your comments, please clearly state the requirement(s) that the comment relates to so that these can be effectively captured.

1. Overall views on the standards.

IFRS SDS include many terms that are open to interpretation hence facilitate ways for reporters to avoid making specific disclosures e.g. disclose a range (S1 para 36); undue cost or effort (S1 para 37a); don't have skills (S1 para 39). While such clauses enable the standards to be a one size fits all and afford reliefs, we are concerned that resulting disclosures will not be homogenous and reporters that do not want to disclose certain details have a ready means of achieving that goal while also being compliant with the SDS. These reliefs may also lead to issues for assurance providers.

In a similar vein, greater clarity is needed as to what is required of preparers in the first instance to help with the comparability of information being produced by different entities. Additionally, enhanced clarity will help to provide a suitable basis for assurers (where this is sought) and regulators to be able to assess whether or not reporting requirements have been met. These areas include the need for the inclusion of definitions e.g. what is deemed to be sustainability-related, and better guidance e.g. on materiality. Whilst accepting the need to exercise professional judgement, if there is a lack of clarity for preparers then assurers will face considerable challenges in providing assurance on the information to be reported.

We query the logic of including in general requirements the requirement to refer to any other standards like in S1 para 55(a) "an entity shall refer to and consider the applicability of the disclosure topics in the SASB standards". It seems inappropriate to refer to other standards particularly ones that are outside the control of UK SDS and are currently being refreshed i.e. their latest version is unknown.

Altogether we favour SDS that are more strongly aligned to financial reporting standards, so that there is better interconnectedness and users of the disclosures can glean a more comprehensive and rounded understanding of an entity's results and plans, from a financial and non-financial perspective. We believe that sustainability reporting should be deservedly on an equal footing with traditional financial reporting.

2. Identifying sustainability-related risks and opportunities

We believe following the tried and tested approach of the GRI would be one approach to identify sustainability-related risks and opportunities. This would also ensure interoperability of the SDS with GRI and therefore readily facilitate meaningful disclosure of both impacts as well as those matters that are financially material and thereby give more investors and other stakeholders a better and more rounded sense of the reporting entity's achievements and plans.

We believe investors might be interested in an organisation's significant impacts because:

- 1. An organisation's significant impacts should be managed and integrated into strategy, policies and the business model.
- 2. An organisation's significant impacts affect the availability of natural resources and the quality of relationships on which the organisation depends.
- An organisation's significant impacts and affected dependencies result in risks and opportunities for the organisation which, over time, affect returns to investors.
- 4. The cumulative impacts of many organisations over time result in non-remediable financial impacts on companies (such as is happening now with climate change).

5. Impacts that matter to stakeholders (other than investors) ultimately matters to investors too because the organisation depends on them for survival.

3. Application of materiality

We believe in the end goal of disclosing per double materiality, for the reasons explained in our answer to Q2.

We are concerned that investors seeking to achieve certain impacts in addition to financial returns will be challenged to assess a reporting entity on such impact matters based on disclosures prepared under these standards. This will inhibit their ability to assess an entity's progress to net zero, plans to transition, success in achieving SBT and similar.

We believe that board members will make better decisions if they consider the business on an integrated basis and understand the business case for addressing sustainability-related risks and opportunities as part of the commercial strategy.

4. Reporting approach

We are concerned that despite IFRS S1 stating in para 20 that "An entity's sustainability-related financial disclosures shall be for the same reporting entity as the related financial statements" there are three definitions of reporting boundaries or basis of preparation to the information in built in the standards so that compliance with the standards could be at odds with compliance with para 20 i.e. the standards have apparent contradictions.

- Financial statements are drafted per entities and influence
- Sustainability-related financial disclosures concern value chain being the full range of interactions, resources and relationships related to a reporting entity's business model and the external environment in which it operates (per Appendix A Defined terms). (On this particular point, we also query the viability of including the **full range** of the value chain across a reporting entity's business model, given the voluminous number of value chain partners and multi-layered nature of the value chain of some operators.)
- GHG per IFRS S2 para 29aii, the entity shall measure its greenhouse gas emissions in accordance with the Greenhouse Gas Protocol which allows different approaches to define the organisational boundary (per equity, financial control or operational control, per ghg-protocol-revised.pdf (ghgprotocol.org)). It is unclear what should apply when IFRS S2 para B23 GHG states: "an entity shall apply the requirements in the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004) only to the extent that they do not conflict with the requirements in this Standard" particularly given the requirements of the Standard (IFRS S2) are so open to interpretation.

5. Timing and location

With the proviso per answer to question 4, that the sustainability and financial information do in fact relate to the exact same reporting entity, the information should be disclosed in a way that makes it easy for report users to glean a true sense of the entity's activities and progress.

Consideration also needs to be given to being able to clearly demark what information has been covered by what assurance opinion (where provided).

Additionally, we are concerned that 'not obscured' is a contextual and relative term that is specific to different users/types of users. Even within the category of investors, being only one stakeholder group, there is likely to be a range of different disclosure needs, given the different types of investors including those seeking impact, those applying exclusions, tilts and ESG scores.

6. Judgements, uncertainties and errors

While the reporting entity preparing disclosures about the anticipated financial effects of a sustainability-related risk or opportunity does not need to do so if it would create "undue cost or effort" (S1 para 37a) its significant value chain partners will not have the same choice. The same comment applies to other reliefs concerning skills and resources (S2 para 20). This pull-through could potentially burden the value-chain operators that are least able to handle such requests. Which in turn could impact the quality of the data reported.

Overall, we are concerned about the availability of quality source data, on which these disclosure requirements depend.

7. Financial impact and connectivity

See answer to Q1

8. Industry-based requirements

Per IFRS S1 para 55a we note "an entity shall refer to and consider the applicability of the disclosure topics in the SASB Standards". We query the logic of mandating the application of another set of standards to fulfil compliance with IFRS SDS, particularly when those standards are evolving (re recent consultation to revise and in effect internationalise SASB) and would be outside the control of any UK authority and so could evolve in a way that did not serve UK standards. The SDS can be made more comprehensive through the inclusion of further definitions and explanations in the standards.

9. Costs and benefits

We favour a proportional approach to application of the standards, and believe that the UK government needs to make sustainability reporting mandatory for appropriate classes of entity which will help put it on a deservedly equal footing as traditional financial reporting. At the outset, an appropriate class of entity would be PIEs as defined by UK legislation. We don't believe that voluntary action in this area is appropriate on such a pressing issue. We consider that a proportionate and less onerous approach will be required for SMEs (Small and Medium sized Enterprises).

We are further concerned that the standards will be onerous to apply, particularly those affected by other new mandatory reporting standards. Due to the additional work required to appropriately meet the additional reporting requirements we believe that consideration will also need to be given to the potential need for transitional relief.

It is vital that we do not lose sight of the overall purpose of sustainability reporting and what SDS and more are to serve: urgent transition activities and positive progress in the real world. While reporting is an important element that facilitates this, it is a case of striking the right balance between allocating resources across reporting and strategically-aligned activities.

10. Application of the requirements

As explained above, we are concerned that the reliefs could be levered to serve an entity that did not want to disclose certain details. Such entities could technically be in compliance with the new standard i.e. the disclosures could "present fairly" all sustainability-related risks and opportunities, all be it at a high level i.e. low level of specificity.

We welcome the International Auditing and Assurance Standards Board' (IAASB)'s current consultation on its proposed international sustainability assurance standard. When finalised this will improve user confidence in such opinions where they are provided.