Navigating sustainability reporting

The thickening alphabet soup of sustainability reporting standards: Who are the standard setters and what are some key recent developments in standards for reporting sustainability practices? An analysis by Hessam Kalantar of KBLG.

It has become increasingly difficult to stay abreast of efforts to agree and promulgate standards for reporting and disclosing sustainability practices. This is largely because there has been a lot of activity on this front in recent months, with initiatives by organisations affiliated with, or originating from, the International Financial Reporting Standards (IFRS) leading the charge. IFRS of course needs no introduction, having begun as an attempt to harmonise accounting across the European Union. The value of this standardisation quickly became attractive the world over, with the first set of International Accounting Standards (IAS) being issued by what was then the International Accounting Standards Committee (IASC). In 2001, the new International Accounting Standards Board (IASB) took over the responsibility for setting IACs from the IASC and has since continued to develop standards that have been embraced worldwide (reportedly, as of 2018, 27,000 domestically listed companies on 88 major stock exchanges in the world use IFRS standards).

The International Auditing and Assurance Standards Board (IAASB) was founded in 1978 as the International Auditing Practices Committee (IAPC) under the auspices of the International Federation of Accountants (IFA). Whereas IAPC originally focused on general auditing guidelines, a comprehensive review in 2001 reconstituted IAPC as the IAASB. IAASB describes itself as "an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards."

IFRS, IAS, IASC, IASB, IAPC and IAASB are together only the first few spoonfuls of alphabet soup that one must digest by way of background, because there are many other initialisms[1] to know and understand if you want to monitor standards pertinent to sustainability reporting. Enter, for example, the International Sustainability Standards Board (ISSB), that was formed in 2021 at COP 26. The ISSB was the product of consolidating the Climate Disclosure Standards Board (CDSB) established by what was formerly the Carbon Disclosure Project (CDP), and the Value Reporting Framework, formed by the consolidation of the Sustainability Accounting Standards Board (SASB) and Integrated Reporting, itself part of the IFRS Foundation.

The ISSB is strongly informed by the Task Force on Climate-Related Financial Disclosures (TCFD), itself a product of the Switzerland headquartered Financial Stability Board (FSB). ISSB is also harmonised with the Global Reporting Initiative (GRI). GRI, based in the Netherlands, says of itself that it "exists to help organisations be transparent and take responsibility for their impacts so that we can create a sustainable future". And how does it do this? By creating "the global common language for organisations to report their impacts - which enables informed dialogue and decision making around those impacts". GRI has in fact been busy supporting the European Commission with development of the draft European Sustainability Reporting Standards (ESRS), for which consultation closed only in July of this year. This expectation is that the ESRS will become available for use by companies from 2024, as contemplated by the EU's Corporate Sustainability Reporting Directive (CSRD), which came into effect in January. The CSRD required all large companies and all

listed companies, with limited exceptions, to disclose information on what they see as the risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and the environment. Under the CSRD, companies will have to apply the ESRS rules for the first time in the 2024 financial year for reports published in 2025.

But we digress somewhat and must return to the ISSB whose new standards have the blessing of, among others, the International Organization of Securities Commissions (IOSCO), the FSB (of course), and the G20 and G7 member states. For this reason much hope rests on its success. Released only in June of this year, the ISSB sustainability standards are as follows:

(i) IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1)—which sets out the overall requirements for an entity to disclose sustainability-related financial information about all its sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects, and to provide the market with a complete set of sustainability-related financial disclosures; and

(ii) IFRS S2 Climate-related Disclosures (IFRS S2)—which sets out the overall requirements for climate-related financial information.

In short, IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium and long term. IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1.

To comply with IFRS S1, an entity must disclose material information on all its significant sustainability-related risks and opportunities. IFRS S1 also sets out what other existing sustainability standards should be considered as part of compliance with IFRS S1 and which standards may be considered for specific topics. To comply with IFRS S2, an entity would disclose material information on its significant climate-related risks and opportunities. Entities also have to provide both quantitative data-based and qualitative narrative- driven disclosures.

The ISSB's disclosure regime is based on an assessment of financial materiality. 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".

The ISSB standards will be effective for annual reporting periods beginning on or after January 1, 2024, although it will be up to individual countries and industries to decide whether the application of IFRS S1 and IFRS S2 will be made mandatory. Far more likely is gradual, organic adoption across first public companies and thereafter smaller ones. As far as the Middle East is concerned, adoption by Governments such as that of the UAE, which has been vocal about sustainability measures generally, particularly in the prelude to Dubai hosting COP28, will be interesting to watch. Will local regulators impose or encourage adoption of IFRS S1 and IFRS S2, draw inspiration from it, or leave it to corporate boards to decide? All eyes will be on what the publicly-listed giants of industry do with the ISSB Standards, if anything at all.

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Given the ever-rising popularity of stock exchange listings in the UAE and Saudi Arabia, including those of recently floated Government held companies that are part of the so-called "energy transition", the expectation is that some formulation of these standards will be made to apply first and foremost on reporting by these entities.

Standard setting is moving quickly across a multitude of regulators and intergovernmental organisations, and ever more intialisms and acronyms abound. We make only passing mention here of other significant standard setters, among them the UN Forum on Sustainability Standards (UNFSS), which released its 5th flagship report "Voluntary Sustainability Standards, Sustainability Agenda and Developing Countries: Opportunities and Challenges" late last year, or CDP (mentioned above) that, in its own words, "runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts". Best of all, CDP publishes the scores of reporting companies on its website, thereby promoting transparency and encouraging companies to outdo their peers on sustainability metrics. Nor can a proper round-up of where we are with sustainability disclosure standards omit mention of the SEC and the rule it published in 2022 requiring publicly traded companies to step up their reporting on climate-related risks. The proposed rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors, was expected to be finalised earlier this year but must now contend with further politicisation as the US braces itself for an election year come 2024. News reports suggest the SEC is considering scaling back the scope of the rule, particularly the inclusion of scope 3 (supply chain) emissions in reporting requirements. The SEC is reportedly also considering easing the threshold for financial reporting on climate risks; as originally proposed, the rule would have companies analyse climate-related costs and risks for each line item of their financial statements and report any climate costs that are 1 per cent or higher on a line item basis.

Finally, the IAASB has acted on the heels of the ISSB's IFRS S1 and IFRS S2 by putting out exposure drafts and consultation papers last month on a *Proposed International Standard on Sustainability Assurance 5000, General Requirements for Sustainability Assurance Engagements*. The goal of this set of standards is to "enhance the trust and confidence investors, regulators and other stakeholders have in sustainability information" by having the standards "serve as a comprehensive, stand-alone standard suitable for any sustainability assurance engagements."

The direction of travel of these standards is achieving consensus at an international level following concerted efforts to gather and reflect stakeholder input. Much progress has been made, but confusion remains until one single set of rules become authoritative and sufficiently user-friendly. Having standards that tease out verifiable facts as to what companies are and are not doing to mitigate the adverse impact of climate change is vital to investors, consumers and governments when making choices on who to lend to, buy from or tax. With the firepower and credibility of the IFRS Foundation behind it, the ISSB's new standards are likely to eventually spread far and wide. In the meantime, it is hoped, good ESG citizenship will entice companies to embrace accountability voluntarily and as matter of corporate culture. Anything less would just not be **SMART** (and here we mean the acronym that stands for **S**pecific, **M**easurable, **A**chievable, **R**elevant, and **T**imely)!

1. These are technically not acronyms since, unlike 'Laser' and 'Nasa', none of these are pronounceable as words, and probably just as well!

Text by:
HESSAM KALANTAR, *managing partner, Kalantar Business Law Group (KBLG)*