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Would ISSB & EFRAG solve The Heterogeneity Issue in ESG Reporting?

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The European Commission, European Financial Reporting Advisory Group (EFRAG), and the International Sustainability Standards Board (ISSB) have collaboratively endeavored to enhance the coherence of their respective climate-related disclosure mandates within the overlapping climate disclosure standards. This cooperative effort has yielded a notably strong level of congruence, resulting in reduced complexity and redundancy for entities seeking to implement both the ISSB Standards and The European Union Sustainability Reporting Standards (ESRS).

To support organizations that will be applying for both ESRS and the ISSB Standards, the European Commission, in conjunction with EFRAG and the ISSB, will develop guidance material on interoperability. This material aims to aid entities in navigating between the two sets of standards and understanding situations where additional disclosures are necessary according to only one of the standards.[1]

The World Business Council for Sustainable Development (WBCSD) has released an "Implementation Guidance for ISSB Standards and ESRS." This guidance offers a comprehensive comparison of the two groundbreaking sustainability disclosure standards that are establishing new benchmarks for worldwide sustainability reporting. Additionally, the guidance underscores key areas of focus for financial experts, as pinpointed by WBCSD's CFO Network.[2]

WHAT IS EFRAG?

The European Financial Reporting Advisory Group (EFRAG) was established in 2001 as a joint effort between the European Union (EU) and private sector entities. It serves as a platform for providing expert counsel and suggestions to the European Commission on matters related to accounting. The overarching goal of this partnership is to elevate the caliber and uniformity of financial reporting methodologies across the EU. Additionally, it was entrusted with contributing insights to the creation of sustainability standards within the framework of International Financial Reporting Standards (IFRS).

As a component of the European Green Deal, the EU embraced the preliminary The Corporate Sustainability

Reporting Directive (CSRD) proposition on April 21, 2021, with the intention of modifying the prevailing reporting mandates under the Non-Financial Reporting Directive (NFRD). Within this proposition, EFRAG was designated as the technical consultant tasked with formulating the European Sustainability Reporting Standards (ESRS) under the Commission's purview. The ESRS is intentionally designed to align seamlessly with various reporting frameworks, such as Global Reporting Initiative (GRI) and Task Force on Climate-Related Financial Disclosures (TCFD). Furthermore, it incorporates non-financial metrics that draw inspiration from the conventional framework established by GRI.[3]

On April 29, 2022, EFRAG introduced preliminary exposure drafts for the European Sustainability Reporting Standards (ESRS) and initiated a 100-day public review phase, which concluded on August 8, 2022. These drafts detailed reporting stipulations encompassing environmental, social, and governance (ESG) concerns. These concerns were grouped into four overarching categories:

- **Cross-cutting**:

ESRS 1 Includes in it the General principles;

ESRS 2 includes general, strategy, governance, and materiality assessment.

- **Environment**:

ESRS E1 deals with Climate change;

ESRS E2 deals with Pollution

ESRS E3 includes Water and marine resources

ESRS E4 deals with Biodiversity

ESRS E5 includes Resource use and circular economy.

- **Social**:

ESRS S1 includes Own workforce

ESRS S2 includes Workers in the value chain

ESRS S3 deals with affected communities

ESRS S4 deals with Consumers and end-users.

- **Governance**:

ESRS G1 includes Governance, risk management, and internal control

ESRS G2 contains Business conduct.

The European Commission has published an adopted Delegated Act (DA) based on the initial ESRS draft proposed by EFRAG in November 2022. The European Commission conducted a consultation on the draft DA for the first set of ESRS from June 9, 2023 to July 7, 2023, and subsequently ratified the DA on July 31, 2023. European Commission published final version which will come in force January 01, 2024 (subject to no objections being raised by EU Parliament and Council), but phase-in for reporting obligation under CSRD depending on size of company / group (for all large companies / groups reporting will start for FY2025).[4]

KEY CHANGES MADE BY THE COMMISSION:

The Commission has introduced specific modifications to the EFRAG draft with the goals of aligning more closely with ISSB standards, reducing reporting demands for smaller enterprises and newcomers to reporting, and implementing materiality considerations fully for Disclosure Requirements (DRs) in all standards except for general disclosures and data points in ESRS 2. In response to input gathered from EU Member States, EU agencies, industry representatives, and other involved parties, the Commission has introduced several significant revisions to the initial drafts proposed by EFRAG in November 2022. These adjustments are intended to facilitate the adoption process and provide additional time for organizations to prepare for reporting. This will be accomplished through the gradual integration of specific Disclosure Requirements (DRs), particularly for smaller businesses and those new to reporting contingent on the size of the company, while some obligatory DRs will transition into being optional. Additionally, there have been additional refinements made to improve compatibility with the International Sustainability Standards Board (ISSB) standards. Ensuring extensive interoperability with the International Sustainability Standards Board (ISSB)'s IFRS Sustainability Disclosure Standards S1 (pertaining to general requirements for disclosing sustainability-related financial information) and S2 (focusing on climate-related disclosures) is a primary objective.

WHAT IS THE INTERNATIONAL SUSTAINABILITY STANDARDS BOARD (ISSB)?

The Trustees of the IFRS Foundation officially introduced the International Sustainability Standards Board (ISSB) on November 3, 2021, during COP26 in Glasgow, in response to significant market demand for its establishment.

The ISSB's primary mission is to develop globally recognized standards that cater to the interests of investors and financial markets, resulting in a comprehensive and high-quality framework for sustainability disclosures. These disclosures are meant to be presented alongside financial statements within the same reporting package. The ISSB Standards are designed to be used alongside various accounting requirements and are aligned with the fundamental principles of the IFRS Accounting Standards, which are mandated by over 130 jurisdictions, supported by influential entities such as the G7, G20, International Organization of Securities Commissions (IOSCO), Financial Stability Board, and Finance Ministers and Central Bank Governors of more than 40 jurisdictions. This universal approach makes the ISSB Standards applicable across the globe.

The ISSB's key objectives encompass:

• Developing standards that create a universal foundation for sustainability disclosures.

• Addressing the information needs of investors.

• Enabling companies to offer comprehensive sustainability information to global capital markets.

• Ensuring compatibility with disclosures tailored to specific jurisdictions or broader stakeholder groups.

The ISSB draws inspiration from market-led initiatives centered on investor-focused reporting, including the Climate Disclosure Standards Board (CDSB), Task Force for Climate-related Financial Disclosures (TCFD), Value Reporting Foundation's Integrated Reporting Framework, industry-based The Sustainability Accounting Standards Board (SASB) Standards, and the Stakeholder Capitalism Metrics of the World Economic Forum.[5]

WHAT IS THE INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS S1 & IFRS S2)?

International Financial Reporting Standards - IFRS S1 and IFRS S2 were formulated by the ISSB after receiving substantial input from the market and in direct response to appeals from entities such as the G20, the Financial Stability Board, the International Organization of Securities Commissions (IOSCO), as well as prominent figures within the business and investment sectors. The ISSB Standards were officially issued on June 26, 2023 introduced by ISSB Chair Emmanuel Faber during the IFRS Foundation's annual conference. They were launched globally through a series of events organized by stock exchanges. The primary aim of the ISSB is to establish comprehensive global standards for sustainability-related financial disclosures that cater to capital markets.

The initial two IFRS Sustainability Disclosure Standards created by the ISSB are IFRS S1 and IFRS S2. IFRS S1 entails disclosure requirements that empower companies to convey sustainability-related risks and opportunities to investors over short, medium, and long-term horizons. IFRS S2, on the other hand, outlines distinct disclosures relating to climate matters and is intended to complement IFRS S1. It provides supplementary guidance derived from the climate-oriented themes and metrics found in the SASB Standards. Given that IFRS S2 draws on the TCFD Recommendations, the IFRS has released a comparative analysis between these two standards. Broadly, IFRS S2 mandates more detailed information compared to the TCFD recommendations, while maintaining alignment with the core TCFD recommendations and suggested disclosure subjects. The supplemental information requested by IFRS S2 encompasses industry-specific metrics, the intended utilization of carbon credits for attaining net emissions targets, and financed emissions disclosure. Businesses adhering to the ISSB Standards will inherently adhere to the TCFD recommendations, implying that enterprises already complying with TCFD recommendations are well-positioned to transition to the application of the ISSB Standards.[6]

Both IFRS S1 and IFRS S2 completely integrate the recommendations from the Task Force on Climate-related Financial Disclosures (TCFD). In line with this, the ISSB is committed to maintaining, enhancing, and progressing the Sustainability Accounting Standards Board (SASB) Standards while urging preparers and investors to continue utilizing them. The ISSB also issued updated SASB Standards to align climate-related topics and metrics with the sector-specific guidance outlined in IFRS S2. This focused update encompassed:

Introduction of new topics and metrics encompassing financed emissions in three industries:

• Asset Management & Custody Activities, Commercial Banks, and Insurance.

• Revision of 12 metrics to improve their international applicability.

• Removal of six metrics that lacked international relevance.[7]

The decision to require the application of the ISSB Standards lies within the authority of individual jurisdictions. The ISSB is actively engaged in collaborating with specific jurisdictions to facilitate the adoption of these standards and to guarantee that they align well with national regulations, ensuring seamless compatibility and interoperability.

EFFECT ON OTHER FRAMEWORKS LIKE GRI, TCFD, SASB:[8]

Although the ISSB Standards and ESRS are contemporary creations, they draw upon certain established frameworks. The ISSB's standards have not been created from the ground up; instead, they draw upon pre-existing frameworks and standards like TCFD and SASB. Similarly, the ESRS is structured to

align effectively with various reporting frameworks, such as GRI and TCFD. Notably, standards like GRI, TCFD, and SASB are highly valuable for revealing sustainability-related performance data. Thus, it is imperative to collaborate in order to enhance the compatibility and coordination among these standards.

Leveraging existing disclosures will aid companies in adopting the new standards. It is important to note that both ESRS and ISSB Standards incorporates numerous existing standards in terms of comprehensiveness, necessitating their complete implementation.

Various comparison drafts have been provided by EFRAG, GRI and ISSB which will help in proper implementation of these standards by the entities, they are:

- EFRAG's comparison of the general requirements of the IFRS S1 and ESRS 1 and 2.[9]

- GRI's Q&A on its alignment with the ESRS emphasizes the extent to which GRI reporting will prepare companies well for the ESRS.[10]

- The ISSB has published a comparison of its draft climate standard with the TCFD recommendations.[11]

- EFRAG's comparison of the ESRS and TCFD.[12]

Entities must incorporate pertinent elements from these standards into their reporting structure and also perform a gap assessment to recognize supplementary disclosure components necessary for adherence to the ESRS and ISSB Standards, and make arrangements to meet these requirements to present a holistic view of their performance.

Sonal Verma leads the ESG Practice in the firm as a Partner and Global Leader – Markets & Strategy. With his crossroad working with business & laws – he brings advice & technology for effective change management in the journey of ESG. Sonal is well acclaimed for his work in regulatory & compliance programs over the last decade. He had in the past worked with 1800 plus clients in India and 61 other countries globally. He has worked with the top 3 unicorns and many Fortune 500 companies. His clients have been across different industries, viz. Automotive and OEMs, Pharma and Life Sciences, Manufacturing, Chemical Industry, BFSI, Infrastructure and Utilities (including stateowned PSUs), e-Commerce and Fintech Companies, Diversified Conglomerates etc.

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[1]https://www.ifrs.org/news-and-events/news/2023/07/european-comission-efrag-issb-confirm-high-degree-of-climate-disclosure-alignment/
[2]https://www.wbcsd.org/Overview/CFO-Network/WBCSD-Implementation-Guidance-ISSB-Standards-and-ESRS
[3]https://www.onetrust.com/blog/efrag-eu-sustainability-reporting-standards/
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