Freshfields Bruckhaus Deringer

A comparison of global sustainability disclosure standards: ISSB, ESRS and draft SEC

The IFRS Foundation's International Sustainability Standards Board (ISSB) was formed at COP26 in November 2021. On 26 June 2023, the ISSB published its inaugural set of global sustainability disclosure standards, S1 and S2 (the ***ISSB Standards***) which were subsequently endorsed by the International Organisation of Securities Committees (IOSCO) on 25 July 2023. Freshfields partner Teresa Ko is co-vice-chair and trustee of the IFRS Foundation and was a member of its Sustainability Steering Committee, which was involved in the establishment of the ISSB. Jurisdictions and companies now need to consider how they will apply these standards, as the IOSCO endorsement signifies to its membership of 130 securities regulators (regulating more than 95% of the world's securities markets) that the ISSB Standards are fit for capital market use at a global level.

Given the impact across our global footprint, we maintain an ongoing comparison between the ISSB standards and other sustainability reporting developments, including jurisdiction-specific frameworks and established industry standards like those from the Carbon Disclosure Project (CDP) and the Global Reporting Initiative (GRI). This briefing provides an update on requirements of the ISSB Standards, the newly adopted European Sustainability Reporting Standards (ESRS) required under the EU's Corporate Sustainability Reporting Directive (CSRD) and the US SEC's proposed rules on climate-related disclosures. Pages 6-10 also provide a comparison table showing differences in key elements between the three standards.

Next steps for businesses

- Consider how to adopt or align with the ISSB Standards:
  - Get familiar with the fundamental concepts in IFRS S1 and IFRS S2, identifying gaps in your own reporting
  - Consider the sustainability-related risks and opportunities that affect your business
  - Evaluate your internal systems and processes for collecting, aggregating and validating sustainability-related information across your business and its value chain
- Identify which mandatory standards will apply, from when and to whom (in the EU these obligations may commence from next year) and which voluntary standards you might consider applying
- Actively engage in ongoing consultations, especially the ISSB's Consultation on Agenda Priorities to provide feedback on future sustainability-related matters to pursue - whether it be biodiversity, human capital, human rights or integration in reporting across sectors
- Ensure relevant personnel are up to date on the sustainability reporting processes that may affect your business

IFRS Foundation's ISSB Sustainability Standards

On 26 June 2023, the ISSB published a set of two sustainability standards (together, the ***ISSB Standards***):

- IFRS S1, titled "*General Requirements for Disclosure of Sustainability-related Financial Information*" with the aim of requiring entities to disclose information about their sustainability-related risks and opportunities so that their reports are useful for capital providers making decisions relating to providing resources to the entity
- IFRS S2, titled "*Climate-related Disclosures*" with the objective of requiring entities to disclose information about their climate-related risks and opportunities so that their reports are useful for making decisions relating to providing resources to the entity

The overall aim of the ISSB Standards is to create a global baseline for sustainability reporting to allow companies to disclose useful, comparable, and consistent information to investors. The standards themselves are not mandatory - it is expected that they will be adopted into mandatory reporting frameworks by jurisdictions. The ISSB Standards will be effective for annual reporting periods beginning on or after 1 January 2024.

The ISSB Standards build on existing reporting frameworks including the Task Force on Climate-Related Financial Disclosures (***TCFD***), Sustainability Accounting Standards Board (***SASB***) and Climate Disclosure Standards Board (***CDSB***). The TCFD, SASB and CDSB previously produced recommendations and frameworks to help companies better understand what sustainability disclosures are needed in order to measure and manage climate risks. The creation of the ISSB Standards involved the consolidation of CDSB and SASB.

IFRS S1 requires disclosure of material information about all sustainability-related risks and opportunities in the short, medium or long term, that could be reasonably expected to affect the company's cash flow, access to finance, cost of capital or company's prospects. When considering which sustainability risks and opportunities to report on, IFRS S1 says that consideration must be given to the SASB Standards and CDSB framework application guidance. Building on IFRS S1, IFRS S2 fully incorporates the recommendations of the TCFD and requires disclosure of material information about climate-related risks and opportunities, including physical and transition risks.

As IFRS S2 is based on the TCFD Recommendations, the IFRS has published a comparison between these two standards. In general, IFRS S2 requires more detailed information than the TCFD recommendations but doesn't deviate from the TCFD core recommendations or recommended disclosure topics. The additional information required by IFRS S2 includes disclosure on industry-based metrics, planned use of carbon credits to achieve net emissions targets and financed emissions. Companies that comply with the ISSB Standards will meet the TCFD recommendations, and so companies that are already reporting against the TCFD recommendations are well positioned to start applying the ISSB Standards.

IOSCO announced its endorsement of the ISSB Standards on 25 July 2023 and is now calling on its 130 member jurisdictions to consider ways in which they can adopt and apply the ISSB Standards. To coincide with the endorsement, the IFRS Foundation published an adoption guide to support jurisdictional adoption.

The UK Financial Conduct Authority and UK Government have signalled support for the ISSB Standards and announced they would be establishing formal mechanisms for UK endorsement and adoption. The Department of Business and Trade ***(DBT)*** has announced that it is developing UK Sustainability Disclosure Standards due by July 2024, which will be based on the ISSB Standards. The DBT has noted that it will only divert from the ISSB Standards if it is 'absolutely necessary' for UK specific matters. A UK Sustainability Disclosure Technical Advisory Committee has been established to assess the ISSB Standards from a technical point of view and is calling for evidence until October 2023. Other jurisdictions considering adoption and/or alignment include Australia, Canada, China, Japan, Hong Kong, Malaysia, New Zealand, Nigeria, and Singapore. Further, the European Commission stated that it has aligned ESRS with the ISSB standards where possible.

Various industry bodies and governments are already encouraging companies to start voluntarily complying with IFRS S1 and IFRS S2 as a basis for reporting. The IFRS hopes that, similar to the IFRS Accounting Standards, the ISSB Sustainability Reporting Standards will become the de facto global standards for sustainability reporting.

EU's CSRD and ESRS

Sustainability reporting is becoming mandatory in the EU under the Corporate Sustainability Reporting Directive (***CSRD***) which came into force on 5 January 2023 amending the EU's existing framework. The CSRD is a very important cornerstone of the EU's sustainable finance agenda, aiming to support companies and the financial sector in the transition to a climate-neutral and sustainable economy.

Under the CSRD, the European Commission is required to develop and publish the European Sustainability Reporting Standards (***ESRS***). Together the CRSD and ESRS establish comprehensive mandatory disclosure requirements and data reporting obligations on sustainability matters for a wide range of companies.

The obligations to report against the ESRS commence as follows:

- Financial year starting in 2024 – groups and companies which are already subject to the Non-Financial Reporting Directive (***NFRD***)
- Financial year starting in 2025 – all "large companies" / "large groups" which (i) are incorporated in the EU or (ii) have listed debt in the EU
- Financial year starting in 2026 – listed medium and small EU companies / groups (***SMEs***) (with a voluntary opt-out for further two years)
- Financial year starting in 2028 – EU subsidiaries or branches reporting for their large non-EU parents under certain conditions

The European Commission published their final version of the ESRS on 31 July 2023 and will formally transmit it to the Parliament and Council in the second half of August for scrutiny. Unless the European Parliament or Council object, which is unlikely, the ESRS will come into force shortly and it is now clear what information must be gathered and disclosed.

With the ESRS, the EU aims to create a gold standard wider than the ISSB Standards. In its latest Q&A, the European Commission stated that it has aligned ESRS with the ISSB Standards where possible allowing companies / groups to use the same climate-related information for both. However, the European Commission has not yet issued a formal declaration of equivalency which would have allowed companies to report against the ISSB Standards rather than against ESRS in the EU.

The ESRS consists of twelve standards (two general standards which apply to all sustainability matters and ten topical standards addressing specific sustainability matters) containing 84 disclosure requirements and over 1000 datapoints. In addition, the ESRS will be expanded by 40+ sector-specific standards and SME-proportionate standards, which are expected to be published sometime in 2024. Generally, companies will have to provide information on sustainability matters within their (group) management report, rather than in a separate sustainability report.

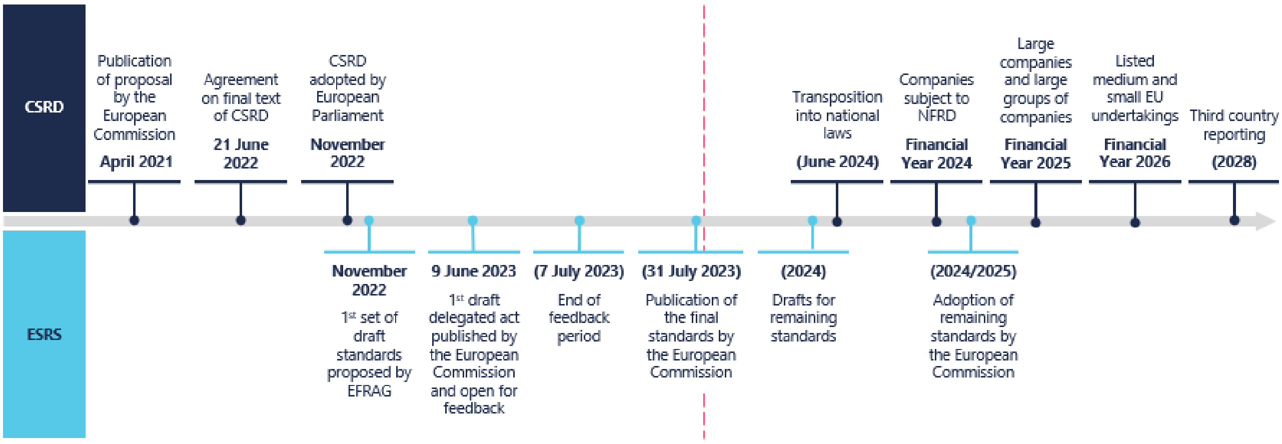
One of the biggest differences compared to other standards such as the ISSB Standards is the requirement that reporting must be done from a 'double materiality' perspective. This means that both of the following need to be assessed:

- **Impact materiality**: companies' / groups' impact on the people and the environment (including an analysis of the whole value chain)
- **Financial materiality**: how sustainability matters impact companies' / groups' business

In order to provide this information, an extensive due diligence process will be required and a large number of datapoints collected.

In the final version of the ESRS, the European Commission has responded to stakeholder feedback with the following changes:

- Other than for the two general standards, the materiality requirement has been extended to all other standards, meaning that companies only have to report on those sustainability matters that are material for their business
- The reporting requirements have been reduced compared to the previous draft and, for certain data points, phase-in provisions have been introduced for companies with fewer than 750 employees
- A limited number of reporting requirements and datapoints are now voluntary rather than mandatory.


CSRD
Publication of proposal by the European Commission
April 2021
Agreement on final text of CSRD
21 June 2022
CSRD adopted by European Parliament
November 2022
Transposition into national laws
(June 2024)
Companies subject to NFRD
Financial Year 2024
Large companies and large groups of companies
Financial Year 2025
Listed medium and small EU undertakings
Financial Year 2026
Third country reporting
(2028)
ESRS
November 2022
1st set of draft standards proposed by EFRAG
9 June 2023
1st draft delegated act published by the European Commission and open for feedback
(7 July 2023)
End of feedback period
(31 July 2023)
Publication of the final standards by the European Commission
(2024)
Drafts for remaining standards
(2024/2025)
Adoption of remaining standards by the European Commission

Climate-related disclosure in the US

The current disclosure regime in the US is largely principles-based with very few US Securities and Exchange Commission (***SEC***) line-item disclosure requirements. As a result, the current standard applied is a materiality standard, understood to be whether a reasonable investor would have viewed the undisclosed information as having significantly altered the total mix of information available as set out in *Basic v Levinson*. However, in March 2022 the SEC released proposed rules on climate-related disclosures in an effort to enhance and standardise disclosure and provide investors with consistent and comparable information across issuers. These proposed rules include:

- Narrative and quantitative disclosure across a company's business and oversight framework to be included in a company's annual report, on a Form 10-K or registration statement
- Disclosure regarding certain climate-related financial metrics, which would be required in the audited financial statements
- For accelerated filers or large accelerated filers, inclusion of an attestation report covering GHG emissions disclosures, provided by an independent attestation provider

Voluntary sustainability reports are becoming more prevalent as a result of increasing demands from a wide variety of stakeholders. In 2022, the Governance & Accountability Institute published a report on trends in sustainability reporting practices. It found that 81% of the Russell 1000 Index companies and 96% of S&P 500 companies published sustainability reports in 2021, an all-time high.

Following the publication of the proposed climate disclosure rules and three consultation periods, the SEC has received nearly 16,000 comments from individuals and organisations on the proposed rules. The SEC has pushed back finalisation and has included release of final rules in its Reg Flex Agenda for Fall 2023, although there remains uncertainty about whether the timing will continue to be delayed.

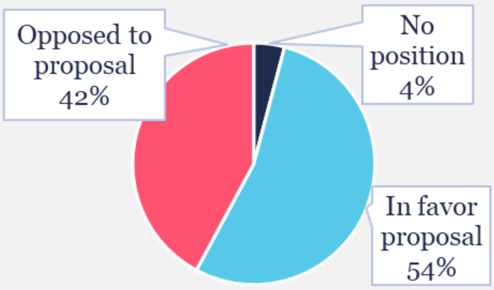
Given this uncertainty and investors' need to understand sustainability risks in their investments, we expect U.S. investors to continue to expect alignment with standards published by (private) foundations, including the SASB standards, which focus on materiality. It remains to be seen whether a dominant standard in the US will be the ISSB Standards, given some of the significant differences including relating to Scope 3 emissions.

Comments

Nearly 16,000 comments have been submitted.

84% were form letters and 16% were individualized comment letters.

Of the individualized letters:



Source: SEC.gov

Comparison of the published ISSB Standards against the proposed EU and US standards

	ISSB Standards	EU ESRS	Proposed SEC
Status and effective date	• Two Standards (S1 & S2) issued by ISSB • Applies to annual reporting periods beginning on or after 1 January 2024	European Commission published final version which will come in force 1 January 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)	Initial envisaged start was pushed back - start date not foreseeable currently
Jurisdiction	Countries to consider ways to adopt, apply or otherwise be informed by the standards	European Union (and non-EU companies with EU nexus)	All publicly reporting companies under SEC's jurisdiction in the US
Acceptance of other standards	'Building blocks approach' adding other standards to the baseline ISSB Standards	Yes, but only if deemed "equivalent" by decision of the European Commission. While not 'equivalent', the European Commission has stated that "Companies that are required to report in accordance with ESRS on climate change will to a very large extent report the same information as companies that will use the ISSB standard on climate-related disclosures"	Proposed rules would not permit reporting under any other standard - however, one of the questions for comment included reference to alternative reporting for foreign companies that report in accordance with ISSB (or other frameworks)
Location of Disclosure	Sustainability-related disclosures made at the same time and covering the same reporting period as financial performance, but not mandatory to appear within the same report as the company's financial statements	Sustainability information (including climate disclosures) to be included in the company's management report, preferably as a single separately identifiable section of the management report	Climate disclosures located in the company's registration statements and annual reports: • GHG emissions information presented in Regulation S-K portion of 10-K (unaudited) • Disclosure of financial impact (by line item) presented in Regulation S-X portion of 10-K (audited)
Scope of sustainability-related disclosures			
General sustainability disclosure required?	Disclosure of "All sustainability-related risks and opportunities that could reasonably be expected to affect an entity's prospects"	Comprehensive disclosure of material sustainability matters	N/A
ESG coverage	Climate-related risks and opportunities	Environmental, Social and Governance disclosure requirements	Climate-related risks

	ISSB Standards	EU ESRS	Proposed SEC
Investor Focus	Primary users are "existing and potential investors, lenders and other creditors"	• "Users of sustainability statements" are primarily "existing and potential investors, lenders and other creditors" • "Users" also includes undertaking's business partners, trade unions and social partners, civil society and non-governmental organisations, governments, analysts and academics	Climate-related disclosure should enable investors to make informed judgments about the impact of climate-related risks on current and potential investment
Materiality perspective	Single materiality Materiality of information is judged in relation to whether omitting, misstating or obscuring that information could reasonably be expected to influence decisions of primary users of general-purpose financial reports, which provide information about a specific reporting entity	Double materiality Materiality definition includes both of the following: • Impact materiality: companies' / groups' impact on the people and the environment (including an analysis of the whole value chain) and • Financial materiality: how sustainability matters impact companies' / groups' business	Single materiality • A matter is material if there is substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote • Disclosure of climate-related events and transition activities is not required if there is a less than 1% impact on the line item for the particular year
Climate-related targets			
Goals and Objectives	Disclosure of an entity's quantitative and qualitative climate-related targets it has set to monitor progress towards achieving its strategic goals, and any targets it is required to meet by law or regulation, including any greenhouse gas emissions targets	Disclosure of climate-related targets, including: • Relationship of target and policy objectives • Defined level of ambition and (where applicable) whether target is absolute or relative • Scope of the target • Methodologies and significant assumptions	Disclosure of climate-related targets if registrant has set such goals, to help investors better understand: • The scope of climate-related targets, including those relating to GHG emissions • Progress towards achieving climate-related targets
Measurement and Timeframe	• Original metric and objective to assess progress • Period over which the target applies and base period for measuring progress • For quantitative targets, whether it is absolute or intensity	• Baseline value and base year for measuring progress • Timeframe to achieve the target, including milestones or interim targets • GHG emission reduction targets in five-year rolling periods (at least up to 2030) for Scope 1, Scope 2, and Scope 3 emissions in absolute value	• Unit of measurement, including whether target is absolute or intensity based • Defined time horizon to achieve the target • Defined baseline time period and baseline emissions for tracking progress • Interim target (if any)

<table>
<tr><th></th><th>ISSB Standards</th><th>EU ESRS</th><th>Proposed SEC</th></tr>
<tr><td>Effect of Climate-related Risks and Opportunities on the business</td><td>Current and anticipated effects on business model and value chain
Effect on and climate resilience of strategy and decision making, including its climate-related transition plan
Effect on financial position, financial performance and cash flows over short, medium and long term</td><td>Disclosure of potential financial effects from climate-related physical and transition risks over short, medium and long-term, including:
Assets (monetary amounts and %) at risk
Share of net revenue at risk
Liabilities (monetary amounts and percentage) relating to transition risks that may have to be recognised
Mandatory disclosure of assessment of potential financial effects from climate related opportunities</td><td>Actual or potential negative impacts of climate-related conditions and events on consolidated financial statements, business operations, or value chains, as a whole.
Optional: impact of climate-related opportunities</td></tr>
<tr><td>Alignment with International Agreements on Climate Change</td><td>How international agreements on climate change have informed each climate-related target and whether the target and methodology has been validated by a third party
Whether a GHG target was derived using sectoral decarbonization approach</td><td>Whether GHG emission reduction targets are in line with limiting global warming to 1.5°C (Paris Agreement or an updated international agreement on climate change)</td><td>Whether time horizon for climate-related targets is consistent with goals established by climate-related treaty, law, regulation, policy or organisation</td></tr>
<tr><td colspan="4">Greenhouse gas (GHG) emission disclosures</td></tr>
<tr><td>Scope</td><td>Disclosure of:
absolute gross GHGs classified as Scope 1, Scope 2 and Scope 3
measurement approach and rationale</td><td>Mandatory disclosure of
Scope 1, Scope 2 and Scope 3 emission metrics (one year phase-in for Scope 3 emission for certain undertakings and groups)
total GHG emissions
GHG removals and storage / emission reductions (inside and outside its value chain)</td><td>Mandatory disclosure of gross Scope 1 and Scope 2 emissions
Disclosure of gross Scope 3 emissions if material or company has set an emissions reduction target including Scope 3 emissions</td></tr>
<tr><td>Assurance Required</td><td>Not specified</td><td>Assurance by auditor/service provider required for the sustainability report (subject to a phase in requiring only limited assurance at the beginning)</td><td>Attestation report by qualified service provider covering Scope 1 and Scope 2 emissions for accelerated filers and large accelerated filers</td></tr>
<tr><td>Breakdown of GHG emissions</td><td>Disclosure of absolute gross GHG emissions classified by scope and whether an absolute target or intensity target</td><td>Gross emissions in absolute terms and intensity terms (per net revenue)
Emissions by scope in absolute terms</td><td>Disclosure in absolute and intensity terms by each type of GHG and on an aggregated basis
Separate disclosure of Scope 1, Scope 2 and Scope 3 (if applicable) gross emissions</td></tr>
</table>

	ISSB Standards	EU ESRS	Proposed SEC
Reporting Boundary	Disclosure of Scope 1 and Scope 2 emissions separated into: • Consolidated accounting group (company and its subsidiaries) • Associates, joint ventures and unconsolidated subsidiaries and affiliates not included in consolidated group	• Reporting boundary is the one retained for financial statements complemented by information about upstream and downstream value chain • Companies should use best efforts to report on their upstream and downstream value chain beyond the consolidated group	• Reporting boundary for emissions should be consistent with accounting principles applicable to consolidated financial statements • Disclosure of emissions by entities that are consolidated in the financial statements
Calculation Methodology	Greenhouse Gas Protocol (GHG Protocol) applied to measure GHG emissions (unless listed company required to use other method)	Companies required to consider the principles, requirements and guidance in the GHG Protocol in compiling information for GHG emissions	Calculation methodology based on GHG Protocol
Governance			
Governance Disclosures	Disclosure about: • the governance bodies with oversight of sustainability-related and climate-related risks and opportunities, including how the governance body's responsibilities for climate-related risks and opportunities are reflected in the terms of reference, board mandates and other related policies • management's role regarding climate-related risks and opportunities	Disclosure of roles and responsibilities of governance bodies and management level, including: • Mandate, roles and responsibilities of governance bodies regarding strategy of sustainability matters • List and composition (including diversity) of the committees involved in definition of sustainability strategy • Description of sustainability-related expertise of individual members and relevant bodies and how availability of the appropriate skills and expertise to oversee sustainability matters is ensured • Process and frequency for informing governance bodies about sustainability matters	Disclosure of oversight and governance of climate related risks by board and management, including: • Board members' expertise in climate-related risks • Processes and frequency of discussion by board or board committee • How the board sets targets and oversees progress • Frequency that responsible persons or committee(s) report to the board or board committee
Executive Remuneration	Disclosure of: • whether and how climate-related considerations are factored into executive remuneration • percentage of executive management remuneration linked to climate-related considerations • whether and how performance metrics for sustainability-related risks and opportunities are included in remuneration policies	Companies required to provide description of integration of sustainability strategies and performance in incentive schemes	Not specified. Existing rules requiring compensation discussion and analysis already provides framework for disclosure of connection between remuneration and progress in addressing climate-related risks

	ISSB Standards	EU ESRS	Proposed SEC
Other key disclosure requirements			
Internal Carbon Price	Disclosure of: • whether and how a carbon price is applied in decision making • price of each metric tonne of GHG emissions the entity uses to assess the costs of its GHG emissions	Disclosure of • whether internal carbon pricing schemes are applied • type of internal carbon pricing schemes • how they support decision making and incentivise the implementation of climate-related policies and targets	Disclosure required for companies that use an internal carbon price • details, boundary and rationale of the internal carbon price • how it uses the internal carbon price to evaluate and manage climate-related risks

For further detail or if you would like more information, please see our webinars, blogs and briefings relating to sustainability reporting or reach out to those listed below:

Webinar 6 July 2023 **Global sustainability standards and reporting**	**Webinar** 22 June 2022 **Hope for a new paradigm? Global sustainability standards and reporting webinar**	**Briefing** 5 January 2023 **ESG Reporting for EU and non-EU companies: Entry into force of the Corporate Sustainability Reporting Directive**	**Blog** 27 June 2023 **ISSB: A new era for global sustainability disclosure**
Blog 3 January 2023 **The International Sustainability Standards Board – global update**	**Blog** 12 July 2022 **ESG disclosure requirements - are you ready for the EU corporate sustainability reporting directive?**	**Blog** 29 June 2022 **Hope for a new paradigm? Progress towards a global baseline of sustainability disclosure standards**	**Blog** 2 June 2021 **Sustainability disclosure: roundtable on standardised international reporting**

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