What CFO's Need to Know About Future ESG Reporting Standards

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In recent years, there has been a societal shift resulting in clear sustainability reporting and disclosures which has placed the topic high up on an organisation's priority list.

The close linkage between sustainability disclosures and general-purpose financial statements (FS) mean it is logical for CFOs to take ownership of creating greater transparency in reporting.

Increased stakeholder awareness of the impact corporations have on the environment means investors are increasingly making decisions based on non-financial data, and supporting practices that result in long-term value creation.

Better MI and reporting around ESG can also help manage downside risk. Alongside regulators, private initiatives such as the Principles for Responsible Investment (the PRI, a network of financial institutions working to implement six aspirational principles), and Climate Action 100+ (an investor-led initiative trying to ensure the world's largest GHG emitters take action on climate change) prove there is a growing demand for change and sustainability information.

In order to develop a more consistent set of requirements, the ESG reporting landscape is consolidating, and there are three key frameworks emerging:

- **The European Sustainability Reporting Standards (ESRS)**
- **The Securities & Exchange Commission (SEC)'s 'Climate Disclosure Rule'**
- **The International Sustainability Standards Board's (ISSB) Sustainability Standards**

The three reporting frameworks

Standards overview

Below is a snapshot of each standard:

EFRAG ESRS's: The European Financial Reporting Advisory Group (EFRAG) is a private association established in 2001 with the approval and support of the European Commission to serve the public interest.

They provide advice to the Commission on whether newly issued or revised IFRS standards meet the criteria of the IAS regulation for endorsement for use in the EU.

Their current ESRS draft standards have three central concepts; Governance (topics include risk management and internal controls); Social (covering workforce, value chain, communities and consumers); and Environmental (covering climate change, pollution, biodiversity and resource use).

In addition, there are industry/sector specific standards in development. In terms of breadth of reporting topics, EFRAG originally proposed reporting under a series of themes (strategy and business models, governance, materiality assessment, policies, targets, action plans and resources, and metrics), however following consultations, they have decided to adopt the four-pillar approach of the TCFD, to improve interoperability with the ISSB (who have also adopted the four pillars).

SEC's Climate Disclosure Rule: The SEC is a US government oversight agency responsible for regulating the securities markets and protecting investors.

From 2023 onwards, they will require the publication of climate-related financial statement metrics and related disclosures in a note attached to a firm's audited FS.

Disclosures will cover GHG emissions (scope 1, 2 and 3), and other climate reporting (governance, physical risks, targets, scenario analysis). They have also broadly adopted the four-pillar approach of the TCFD.

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ISSB Sustainability Standards: The ISSB was formed by the IFRS foundation as the sustainability counterpart to the International Accounting Standards Board (IASB), who write accounting standards, to satisfy the need for companies to provide high-quality, transparent, trustworthy, and comparable reporting on climate change and other ESG issues.

Their disclosure topics are themed around the TCFD's four pillars:

- **Governance**
- **Strategy**
- **Risk Management**
- **Metrics/Targets**

On June 26th, 2023, ISSB issued their final reporting requirements, in the form of 2 foundational standards: IFRS S1: General Requirements and IFRS S2: Climate specific requirements.

There are plans for further topic-specific standards to be issued in the future (e.g., Biodiversity).

In a recent announcement, the Financial Stability Board (FSB) announced the culmination of their role and that the ISSB is set to take over the responsibility of monitoring the progress of climate-related disclosures from the TCFD, in 2024.

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How are firms impacted?

1 Uncertainty over coverage and timing

All firms are likely to be impacted by one or more of the above regulatory standards, although the timelines for each differ in immediacy.

The European Parliament is negotiating the final terms of the EFRAG's suggested reporting directive, which if they proceed as planned will mean all large or listed EU companies will have to apply the ESRS standards to their 2024 published sustainability reports.

For the SEC, they have indicated all 'large, accelerated filers' will have to implement the required disclosures by the fiscal year 2023, with smaller companies following in 2024 and 2025.

However, this indicative timeline was based on the assumption that the new 'Climate Rule' would be finalised by then, which given the SEC recently missed two self-imposed deadlines of mid-October 2022, and end of March 2023, means this may be unlikely.

The finalisation date has been pushed back due to thousands of public comments, a Supreme Court ruling, and the complexity and novelty of the climate requirements to the SEC.

Meanwhile, the ISSB has confirmed an effective date of 1st January 2024 for its two standards, and if adopted by individual countries, could affect all firms within each jurisdiction.

However, different jurisdictions can set local effective dates that could be before or after the ISSB effective date in line with their own timelines for adoption.

If a firm does decide to adopt early application of the standards, then they must report under both S1 and S2 at the same time and disclose their early adoption in their reporting.

In addition, for the first annual reporting period that a firm starts reporting under, for just that period they will have relief from:

- Reporting sustainability-related financial disclosures at the same time as the related FS
- Having to report on all sustainability-related risks and opportunities, and instead only having to report on climate-related ones
- Measuring scope 1,2 and 3 GHG emissions in accordance with the Greenhouse Gas Protocol if they use a different measurement basis in their annual reporting
- Disclosing scope 3 GHG emissions at all
- Disclosing comparative information related to other sustainability-related financial information

Generally, the ISSB have stated that requirements in S1 would only apply if they relate to the disclosure of climate-related financial information for a firm's first year. If transition relief is used, a firm would need to disclose this.

A firm applying transitional relief can also delay reporting its sustainability-related financial disclosures until up to nine months after the end of its annual reporting period, or in its next interim report, rather than at the same time as the annual report.

This is in order to give firms time to get up to speed with the reporting requirements in the first effective year.

Firms with operations or listings in both the EU and the US will likely need to comply with more than one standard, and potentially all three.

2 Lack of data & knowledgeable resources

Data availability has the potential to be the biggest challenge for a company wanting to improve ESG disclosures. As discussed later in this article, regulatory requirements involve dozens of separate indicators to be reported on, with firms needing to have accurate, up-to-date data streams to track progress.

This is complicated further as certain sustainability indicators are inherently qualitative and difficult to track and report on in a consistent manner, as well as see the effect of any gains.

Additionally, a firm may find it expensive to put in place the data infrastructure or dedicated resources to allow it to meet ESG reporting requirements.

Larger firms have the luxury of potentially buying carbon credits (which can have limited real-life benefits on improving environment impact), investing in technology and offering higher salaries to attract talent.

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Many firms also struggle to recruit or retain talented and knowledgeable people 'on the ground' who understand ESG risk and can lead compliance and disclosure programmes or departments.

This can lead to delays in setting up disclosure programmes, and also result in processes not following best practice due to originating from inexperienced staff. There is an overall lack of SME's in the ESG space, with very few candidates that straddle both the environmental and finance elements, usually specialising in one area or the other.

3 Assurability

The assurability requirements of each standard also differ slightly.

The ESRS's will initially require limited assurance (i.e. a statement that no matter has been identified by the auditor suggesting material misstatement) over all sustainability information, before moving to reasonable assurance (i.e. a higher level of assurance, where sufficient audit evidence is obtained to indicate there is a remote likelihood of material misstatements) at an unspecified future date.

The SEC will require scope 1 and 2 GHG emission reporting to be subject to limited assurance in year two and three after adoption, moving to reasonable assurance in year four (although there has been push back on this from firms worried about the cost burden of reasonable assurance).

For scope 3 and non GHG sustainability reporting, the SEC is not proposing any assurance to be required 'at this time' due to the more challenging aspects of collecting data (such as obtaining accurate figures from suppliers, customers and other third parties).

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The SEC have proposed a requirement that will allow specialists other than auditors (such as engineering firms) to perform assurance and haven't prescribed a particular standard (although PCAOB and IAASB standards would meet process requirements).

The SEC will also require disclosure of financial statement (FS) metrics for any FS caption where the climate impact causes the total line item to be impacted by more than 1%, with this metric being reported in a FS footnote. Disclosure will also be required for severe weather / transition related activities and due to their location will be in scope of the audit of the FS themselves.

Assurability requirements under the ISSB will be dependent on the individual jurisdictions that adopt the framework. However, the ISSB is working with the IAASB and the International Organisation of Securities Commissions (IOSCO) to enhance and develop general standards for assurance on sustainability reporting, building on existing concepts.

4 Building on existing IFRS financial reporting requirements

Cost vs benefit

In an attempt to respond to concerns around the cost of complying with new sustainability disclosure requirements, the ISSB have built on current IFRS standards and introduced to their framework the concept of "reasonable and supportable information that is available at the reporting date without undue cost or effort".

This is aimed at reducing the burden on smaller firms where disclosures would require a high level of measurement or outcome uncertainty.

Commercially sensitive information

The ISSB also confirmed an exemption that would, in certain circumstances, permit a firm to exclude information from its sustainability opportunity related disclosures if that information was commercially sensitive.

Reasons for doing so included where keeping information from being publicly available would provide a firm with an economic benefit and competitive advantage, and whereby disclosing the information, a firm would be 'seriously prejudicing' the benefits from the underlying opportunity.

A firm would have to disclose the fact it has used the exemption and reassess each year whether it still qualifies.

The ESRS framework also contains guidance on when firms are able to omit information from their sustainability reporting regarding their own know-how, intellectual property, or the results of innovation, namely when such information may risk disclosure of trade secrets.

It was noted in January 2023 by the ESMA that this risks opening a loophole for firms to withhold excessive information and using this blanket requirement to reduce transparency of reporting.

The SEC Climate Rule does not address this point directly; however concerns were raised by the Business Roundtable (a group representing CEOs of large companies in the US) about requirements for businesses to disclose information relating to analytical tools, scenario analysis, transition plans and processes for identifying, assessing and managing climate-related risks.

The nature of this information often requires the use of proprietary comparative data that may conflict with current legal protection offered to companies around disclosure of intellectual property and sensitive information.

5 Connectivity to financial statements

The IFRS S1 standard as a part of its conceptual foundations requires companies to provide information to enable users to understand the connectivity between sustainability-related risks and opportunities and a company's financial statements.

Whereas the IFRS S2 standard requires companies to disclose both qualitative and quantitative information on the effects of current and anticipated climate-related risks and opportunities on the entity's financial position, financial performance, and cash flows over the short, medium, and long term.

This means that companies shall have to move on from narrative reporting in the front half of the annual report to including material climate-related information within financial reporting in the back-half as well.

For example, companies can mention how the climate-related risks and opportunities affecting the company have been factored into the entity's financial planning.

Transition to disclosure under the three standards

The effort required by a company to achieve compliance with one or more of the three main frameworks depends on the current standard of reporting.

The differences between frameworks can be outlined over two key axis – **breadth**, meaning the number of different topics a standard requires firms to disclosure under, and **granularity**, or the number of required disclosure points under each topic.

If a firm has no sustainability reporting at all, then there is an inherent level of difficulty in bringing disclosures in-line with regulatory requirements, as this will require investment in data, infrastructure and resources.

However, as a counter to this, it will be much clearer than a company transitioning that has some level of reporting, as there will be no need to augment existing processes, and instead they have the freedom to create a process from scratch that is fit for purpose.

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If a company is a multinational and falls under several jurisdictions, then it will also need to consider an integrated disclosure solution to avoid duplicated effort or reporting in one region not meeting the requirements of another.

However, if a firm is reporting under any of the current voluntary sustainability frameworks already, then the level of difficulty will be determined by the alignment of breadth and granularity of the current framework against the regulatory one.

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Framework comparisons

Transition to disclosure under the three standards

Taking a deeper dive into the differentiation between the three standards, we can look at the differences across their structural makeup below:

Category	ISSB	ESRS	SEC
Breadth of Disclosure (Reporting Topics)	Split into S1 (general requirements) and S2 (climate requirements). S1 has 23 distinct disclosures, whilst S2 has a further 22-35 requirements depending on the firm. S1 asks a firm to report on all material sustainability risks and opportunities, with S2 only requiring climate-related disclosures.	EFRAG requires disclosure across a wide range of ESG risks and opportunities, including governance, internal controls, workforce and the value chain, communities and end users, climate change, pollution, biodiversity and resource use (11 standards in total).	Disclosures focus on climate-related risks (excluding other sustainability topics), and their material impact on a firm's business, strategy and outlook. They also cover the governance of climate-related risks and relevant risk management processes, as well as GHG emissions. The disclosure of climate-related opportunities is optional.
Materiality	Materiality will be assessed on whether a factor will influence the assessment of a firm's financial value - i.e., it will apply a financial focus and the effect of sustainability on a firm's total value. There is an overall investor focus.	A 'double materiality' lens will be applied, which consists of 'financial materiality' (i.e. an outside perspective, the effect on a firm's economic and financial activities throughout the value chain) and 'impact materiality' (i.e. a company's impact on ESG factors that can affect the return on business activity).	Materiality is assessed in-line with the current Securities Law definition, i.e. if a FS caption is impacted by more than 1%, there must be footnote quantitative disclosures. As with the ISSB, there is a financial focus.
Sector Specifics	Industry-based disclosure requirements will apply and have been derived from existing SASB standards.	Sector specific standards are in development but have not yet been published.	NA, not required.

Category	ISSB	ESRS	SEC
Location in FS	Disclosure is not required in the audited FS, but can be included as part of general reporting, such as in management commentary. A firm can also cross-reference a separate sustainability report in the FS. No footnote disclosure is currently required.	Disclosure would be within a specific section of a firm's annual management report and is not required in the audited FS. No footnote disclosure is currently required. Cross-referencing is permitted.	For financial impact and metrics (as well as estimates and assumptions), disclosure would be within the audited FS. Information is also required in a separate specific section of a firm's annual management report. A FS footnote would be required for the disclosure of severe weather / transition related activities.
Timing	**When to Report:** Disclosure is required at the same time as the FS. **Horizons:** Time horizons for disclosure over the short, medium, and long term are not defined, but should be used instead of the term 'over time'.	**When to Report:** Disclosure is required at the same time as the FS. **Horizons:** Time horizons are defined for several elements, but may vary (e.g. general requirements may define 'short term' as one year, but specifically for transition risks, this would be defined as five years).	**When to Report:** Disclosure is required at the same time as the FS. **Horizons:** Time horizons for disclosure over the short, medium, and long term are not defined.

In addition to the above, the reporting boundary across the three standards is also different, with variation in value chain definitions.

The SEC focuses on direct supplier or customer relationships, whereas the ISSB and ESRS rules mean firms will have to consider relationships across multiple tiers.

The TCFD defines the value chain as all upstream and downstream processes or services, and recommends that companies disclose their scope 1, 2 and 3 GHG emissions as well as total GHG emissions.

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Final thoughts and next steps

In conclusion, although there has been good progress to consolidate standards (mainly using the TCFD requirements as a baseline), there is still differentiation in both structural terms and disclosure requirements.

Under current proposals, CFOs leading companies operating in multiple jurisdictions will need to design an integrated reporting strategy to meet all the requirements of the different standards affecting them, to avoid duplication of effort and messaging.

There would ideally be a 'one report to rule them all' capturing all disclosure requirements.

All CFOs need to have at least started their journey of understanding the requirements of each of the reporting frameworks, including which ones apply to their business, and building their disclosure processes.

Where there are multijurisdictional requirements, they should aim to understand the implications of falling under more than one regulatory framework and consider creating a baseline of sustainability reporting disclosures that are consistent across all geographical locations and cover the requirements of all frameworks. This will increase transparency and allow for easier comparison across a firm's business units and with other firms.

It is likely that improving these processes will require engagement with various stakeholders to determine which ESG topics or risk types there is exposure to. Further challenges include difficulties in compiling accurate MI and data and employing people with the knowledge and experience to manage compliant disclosures.

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About us

Be | Shaping the Future UK (Be UK) are the UK arm of a leading pan-European financial services management consultancy (Be | Shaping the Future), with over 1,900 consultants located across 13 European countries.

We are one of the fastest growing consultancies in the UK with dedicated specialist teams in:
• Finance & CFO advisory
• Cards and payments
• Retail and commercial banking
• ESG and sustainability
• Risk and regulation

We work in partnership with our clients to deliver transformational change and strategic advice, powered by a unique culture, attaining a new quality and price standard.

The ESG team at Be UK is composed of specialists from a variety of backgrounds, including banking, accounting, financial services consulting and financial and non-financial risk management.

The team's key service areas include:
• ESG reporting and risk management diagnostic assessments
• ESG target operating model design and delivery
• ESG and sustainability risk and reporting framework development and implementation
• Training (e.g., ISSB, EFRAG and SEC requirements and gap assessment, introduction to ESG metrics and, carbon accounting)

Contact

For more information on how we can help with your finance, ESG and sustainability initiatives, please get in touch.

Bash Govender
Partner - ESG & sustainability

Bash drives change and innovation on behalf of CFOs and senior management across the financial services industry.
As a qualified chartered accountant, he has spent half of his career within leadership positions in the finance (CFO) and Operations (COO) departments of global multinational banks. The other half of Bash's career has been as a management consultant delivering large-scale strategic, regulatory and transformation programmes for multinational investment banks and emerging FinTech companies. Bash specialises in supporting CFOs, CRO's and CSO's to design and build ESG/sustainability disclosures that are compliant with regulations and enriching to users of the financial statements.

E: b.govender@beshapingthefuture.co.uk
T: +44(0) 7545 223 529
W: www.beshapingthefuture.co.uk

Matt Singleton
Senior Manager - ESG & sustainability

Matt joined Be UK in 2022 to help develop their ESG proposition. He is a chartered accountant and in 2022 he completed the sustainability and climate risk certification with the Global Association of Risk Professionals.
Matt and his team work with clients to help them identify and solve their sustainability reporting needs. He specialises in the upcoming TCFD, ISSB, EFRAG and SEC reporting regimes.

E: m.singleton@beshapingthefuture.co.uk
W: www.beshapingthefuture.co.uk