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Preparing for additional mandatory climate-related disclosures under the new ISSB global standards

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In this briefing, we look at how the new ISSB Standard for climate-related disclosures – currently being implemented by 20+ governments around the world – expands on previous best practice and how companies can prepare to upgrade.

In 2017, the Task Force for Climate-related Financial Disclosures ("TCFD") (an initiative of the Financial Stability Board) published recommendations to companies for identifying and disclosing to the market their risks and opportunities relating to climate change. The TCFD recommendations generated significant buy-in from companies, governments and financial regulators. By October 2020, nearly 60% of the world's 100 largest public companies supported the TCFD, reported in line with the TCFD recommendations, or both.

Corporate ESG reporting took another significant step forward in 2021 with the creation of the International Standards Stability Board ("ISSB"), a body charged with developing the first global baseline standards for disclosure of sustainability-related financial information – the ambition being to enhance consistency and comparability. In 2023, the ISSB finalised its first two standards (we previously wrote about them here): IFRS S1 (general requirements) and IFRS S2 (climate-related disclosures). The ISSB standards are based heavily on the structure and substance of the TCFD recommendations, and a growing number of countries have endorsed them – as of May 2024 more than 20 jurisdictions accounting for nearly 55% of global GDP have decided to use, or are taking steps to introduce, the ISSB standards in their legal or regulatory frameworks.

In the UK, the TCFD recommendations currently form the basis of mandatory corporate climate disclosures: in 2022, the Companies Act was amended to require that UK companies within scope disclose climate-related information based on the TCFD recommendations in their annual reports. However, as the UK has been a strong supporter of the ISSB, in May 2024 the (previous) UK government announced its intention to transpose IFRS S1 and IFRS S2 into new UK Sustainability Reporting Standards in early 2025, likely replacing the current climate-reporting requirements of the Companies Act.

Assuming the new UK Labour government follows the same path, companies that already make climate-related disclosures in line with the TCFD recommendations (under the Companies Act or voluntarily) may therefore ask how onerous the transition will be to report in line with IFRS S2. In short, the answer is that, while the requirements of IFRS S2 are based on and are consistent in many respects with the TCFD recommendations, IFRS S2 raises the bar.

High level gap analysis

The TCFD recommendations are organised around four thematic pillars of Governance, Strategy, Risk Management and Metrics and Targets. The recommended disclosures are summarised as follows:

- **Governance:** describe the board's oversight of, and management's role in assessing and managing, climate-related risks and opportunities;
- **Strategy:** describe the entity's climate-related risks and opportunities and their impact on its businesses, strategy and financial planning, and the resilience of its strategy;
- **Risk Management:** describe the entity's processes for identifying, assessing and managing climate-related risks and how they are integrated into its overall risk management; and
- **Metrics and Targets:** disclose the metrics used to assess climate-related risks and opportunities and Scope 1, 2 and (if appropriate) 3 greenhouse gas ("GHG") emissions and related risks; and describe the targets used to manage climate-related risks and opportunities and performance against targets.

The TCFD recommendations focus on disclosure of information that is financially material – i.e., information that could have an impact on a company's financial performance and that is therefore of interest to investors.

The requirements in IFRS S2 are organised under the same four pillars and are similarly focussed on disclosure of financially material information. IFRS S2, however, goes further than the TCFD recommendations. One analysis found more than 50% of the (roughly 100) IFRS S2 disclosure requirements are additional to the TCFD recommendations, and another 26% are substantial advancements to the TCFD recommendations.

As reflected in a comparison document published by the ISSB, the differences between the TCFD recommendations and IFRS S2 fall into three main categories: (i) different wording but *broadly consistent* in substance; (ii) *more detailed information* is required to be disclosed under IFRS S2 on a topic that is covered by the TCFD recommendations; and (iii) IFRS S2 has *additional requirements*.

Below we take each of the four thematic pillars in turn, giving examples of where IFRS S2 requires more detailed information or imposes additional requirements.[1] As a rule of thumb however, much of the extra detail and additional datapoints are focused on Strategy and Metrics and Targets.

Governance

For Governance, much is *broadly consistent* and there are *no additional requirements*. Upgrading to IFRS S2 will however require *more detailed information* to be disclosed about the governance of climate-related risks and opportunities within a business. For example, whereas both the TCFD recommendations and IFRS S2 require a description of the governance body's oversight of climate-related risks and opportunities, IFRS S2 requires more specific disclosures about how that body's responsibilities for climate-related risks and opportunities are reflected in relevant Terms of Reference, mandates, role descriptions and other related policies applicable to that body.

Relatedly, IFRS S2 requires disclosure of *more detailed information* about how the governance body determines whether appropriate skills and competences are available or will be developed to oversee strategies designed to respond to climate-related risks and opportunities, and whether, in overseeing the entity's strategy and risk management processes, the body has considered trade-offs between climate-related risks and opportunities.

Strategy

Within the Strategy pillar, upgrading to IFRS S2 means both *more detailed information* as well as *additional requirements.*

Examples of *more detailed information* needed under IFRS S2 are as follows:

- Whereas the TCFD recommendations require a description of the impact of climate-related risks and opportunities on the business, IFRS S2 requires disclosure of where in the company's business model and value chain climate-related risks and opportunities are concentrated—for example, geographical areas, facilities and types of assets.
- Whereas the TCFD recommendations require disclosure of the resilience of a company's strategy taking into account different climate-related scenarios, IFRS S2 requires additional specificity around climate resilience—for example, the company's capacity to adjust and adapt its strategy and business model over the short-, medium- and long-term, and significant areas of uncertainty considered by the company in its assessment.
- Whereas both the TCFD recommendations and IFRS S2 require disclosure of any climate transition plan a company has, IFRS S2 goes a step further, requiring information about key assumptions used and dependencies on which the plan relies.

Examples of the *additional requirements* under IFRS S2 for Strategy are as follows:

- In identifying climate-related risks and opportunities, a company must refer to and consider the applicability of the industry-based disclosure topics in the ISSB's industry-based guidance on implementing IFRS S2. Each volume of the industry-based guidance suggests possible ways to identify, measure and disclose information about climate-related risks and opportunities tailored to particular sectors, business models and economic activities.
- Whereas the TCFD recommendations require disclosures about how climate-related issues have affected the entity's businesses, strategy and financial planning, IFRS S2 also requires disclosure that looks ahead to anticipated effects of climate-related risks and opportunities.

Risk Management

Under the Risk Management pillar, upgrading to IFRS S2 means *more detailed information* as well as *additional requirements*. One example of more detailed information needed is that in describing a company's processes for identifying and assessing climate-related risks, IFRS S2 also requires disclosure of the input parameters a company uses to identify risks—for example, information about data sources, the scope of operations covered and the detail used in assumptions.

In terms of *additional requirements* for Risk Management, whereas both the TCFD recommendations and IFRS S2 require disclosure about the processes used to identify and assess potential climate-related *risks*, IFRS S2 goes a step further to require disclosure of the processes a company uses to identify, assess, prioritise and monitor climate-related *opportunities*.

Metrics and Targets

Within the Metrics and Targets pillar, upgrading to IFRS S2 means primarily *additional requirements*, with some more *detailed information*. One example of more *detailed information* needed is around greenhouse gas ("GHG") emissions targets, including more specificity on which GHG emissions are covered by the target and whether the target is gross or net.

Examples of the *additional requirements* for Metrics and Targets under IFRS S2 are as follows:

- IFRS S2 requires disclosure of information about a company's planned use of carbon credits to achieve its net GHG emissions targets, including disclosure of the type of carbon credit (e.g., whether the underlying offset will be nature-based or based on technological carbon removals).
- IFRS S2 requires additional disclosures about how the latest international agreement on climate change has informed the company's targets and whether the targets have been validated by a third party.
- IFRS S2 requires additional disclosures about a company's GHG emissions. The table below provides some examples:

1. The TCFD recommendations require disclosure of Scope 1 and 2 emissions, but they require disclosure of Scope 3 emissions only "if appropriate". By contrast, IFRS S2 requires disclosure of Scope 3 emissions plus certain information about them—for example, Scope 3 GHG emissions categories and information on financed emissions (i.e., GHG emissions associated with an entity's investments) if the entity has activities in asset management, commercial banking or insurance. IFRS S2 also sets out a Scope 3 measurement framework for preparing such disclosures.
2. For Scope 1 and 2 GHG emissions disclosed, IFRS S2 requires that the company disaggregate emissions between the consolidated accounting group and other entities not in the consolidated accounting group (e.g., JVs).
3. For Scope 2 GHG emissions disclosed, IFRS S2 requires that the company disclose its location-based Scope 2 GHG emissions, as well as information about any contractual instruments necessary to inform an understanding of the Scope 2 GHG emissions.

Further thoughts and practical guidance

Larger companies that already report in line with the TCFD recommendations – whether required to do so or voluntarily – have a very good head start toward compliance with IFRS S2. Some further work will be needed, however.

The following recommendations are also relevant also to smaller companies who (while unlikely to be within the direct scope of new ISSB-aligned reporting requirements in the UK and elsewhere) will very likely be asked by their key corporate stakeholders – institutional investors, lenders and customers – to collect and disclose more climate-related data in line with ISSB standards.

- Undertake a gap analysis between the company's current climate-related data collection and disclosures (TCFD-aligned or otherwise) and the data points required to be disclosed by IFRS S2.
- Communicate the new requirements and results of the gap analysis to the Board and to relevant internal operational teams, which will likely include finance, strategy, risk management, information technology, investor relations, legal, internal audit and human resources.
- Identify and plug any gaps in internal and external resources.
- Create a strategy and action plan for data gathering to close any gaps identified, including providing training to key stakeholders.

Companies should also bear in mind that adoption of the ISSB standards in the UK and around the world will likely include the more general sustainability disclosure requirements of IFRS S1 (as well as the climate-focused requirements of IFRS S2). This will mean required disclosures of the company's material sustainability-related risks and opportunities, organised in the same four-pillar structure of IFRS S2 (e.g., for Metrics and Targets, disclosure around an entity's performance in respect of its sustainability-related risks and opportunities, including targets and progress in relation thereto). Under IFRS S1, companies must also refer to and consider the applicability of the disclosure topics in the SASB Standards to help identify their material sustainability-related risks and opportunities.

For more information and tailored advice as needed on upgrading TCFD disclosure to IFRS S2, or on these frameworks/standards in general, please email your Charles Russell Speechlys contact.

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[1] How the ISSB distinguishes more detail from additional requirements is not always clear from the analysis in its comparison document, but we adopt its classification for ease of cross-reference.