Preparing for the ISSB's sustainability disclosure standards

Getting started: Materiality

This series of guides covers key aspects of the IFRS Sustainability Standards[1] (the Standards) issued by the International Sustainability Standards Board (ISSB). It is aimed at assisting finance professionals and finance teams to prepare for the reporting and disclosure requirements aligned with the Standards.

The Standards IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures* catalyse the integration of sustainability with financial reporting. They respond to expectations from capital markets participants for more meaningful and comparable sustainability and climate change disclosures. They will enable investors and other stakeholders to understand an entity's sustainability-related risks and opportunities, the connection between them, and potential financial impacts now and into the future.

IFRS S1 and IFRS S2 were issued in June 2023 and are applicable for annual reporting periods beginning on or after 1 January 2024. There are provisions in place to help entities scale up their approach to disclosures over time[2]. New Zealand's eXternal Reporting Board (XRB) is closely following the ISSB developments and the Standards will pave the way for mandatory reporting in Australia. The Australian Treasury has signalled that mandatory climate disclosures, aligned with IFRS S2, will be phased in for large Australian companies from the 2024-2025 financial year.

1 This guide has been prepared based on IFRS S1 and S2 issued in June 2023.
2 Relief in IFRS S1 allows an entity to report only on climate-related risks and opportunities in the first year it applies IFRS S1 and IFRS S2.

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Getting started: Materiality

This first guide focuses on materiality, summarising the implications of the Standards and actions finance professionals and entities should take now, in preparation for reporting under the Standards.

How does the ISSB define materiality?

Under the Standards, an entity is required to disclose material sustainability-related information to enable primary users of general-purpose financial reporting to assess the effect of sustainability-related risks and opportunities on the entity's financial position, financial performance and cashflows over the short, medium and long-term.

The focus is on meeting the information needs of primary users of an entity's sustainability-related financial information i.e. existing and potential investors, lenders and other creditors. Therefore, the ISSB uses the same definition of 'material' that is used in IFRS Accounting Standards. In short, information is material if omitting, misstating or obscuring it could be reasonably expected to influence investor and creditor decisions.[3]

IFRS S1 clarifies that an entity's ability generate cashflows is inextricably linked to the entity's interactions with stakeholders it works with and serves, the society it operates in, the economy and the natural environment throughout its value chain.

Why is this relevant for financial reporting?

To align with the ISSB's disclosure expectations and definition of materiality, each entity will have to determine what information could be reasonably expected to influence decisions by potential investors, lenders, creditors and other such key stakeholders.

This means that an entity might have to provide additional disclosures in its financial statements. Entities will need to consider what information is required for users to assess the effects of sustainability risks and opportunities, such as the effect of climate change on their financial position, financial performance and cashflows.

Where can finance professionals and finance teams start?

Preparing to disclose against the Standards can be seen as an opportunity for entities to strengthen existing processes. Entities on the front foot have already undertaken a gap assessment against the Standards and developed a roadmap to their future sustainability reporting state. A comprehensive materiality assessment is seen as a key starting point on this roadmap.

Here are some tips for finance professionals and teams to start preparing:

- **Diagnose** – Review existing materiality assessment processes of sustainability risks and opportunities. Entities that already undertake such materiality assessments for sustainability reporting may find that using ISSB's definition could mean enhancing the current process to bring financial considerations more explicitly into the approach to determining materiality.
- **Assess** – Evaluate how best to expand the materiality assessment to include exploration of value trade off and interrelationship dynamics between risks and opportunities.
- **Communicate** – Socialise ISSB requirements with value chain partners and within the business and connect key business functions. Disclosing against the Standards requires a shift in mindset from financial reporting of transactions with the entity, to sustainability-related information encompassing the entire value chain. This will require increased collaboration in order to understand and respond to material risks and opportunities appropriately.
- **Plan** – Leverage materiality assessment results to enhance and challenge the business strategy, including validation of the appropriateness and defensibility of an entity's response to sustainability-related risks and opportunities.

3 The definition in the ISSB Standards is similar to Aotearoa New Zealand Climate Standard 3.

What does this mean for finance teams?

The Standards expect disclosure of impacts over short, medium, and long timeframes. Disclosing such forward looking information is new for many entities. It will require the preparation and maintenance of financial forecasts and scenario planning which consider strategic choices and trade-offs, specifically from a sustainability perspective.

It is important to recognise that with an emphasis on the future and material risks and opportunities, ISSB standards are fundamentally about strategy and strategic choices. They require the integration of sustainability-related risks and opportunities into the enterprise risk management framework, existing governance mechanisms and capital allocation decisions. As a first step, this means finding ways to improve sustainability risk and opportunity identification, understanding likelihood and severity of impacts and a prioritisation process that feeds directly into strategy.

To do so, these entities will need to deep dive into their business model to understand how their corporate strategy drives sustainability values and impacts, where conflicts and trade-offs are made, and how this understanding informs their sustainability vision.

Entities will need to ensure active engagement and buy-in exists across the Board, management, asset level, business partners and the value chain. This is necessary to effectively integrate sustainability-related risks, opportunities and business resilience assessments – quantifying risks and uncertainties the entity may face under different hypothetical futures with overall business strategy, financial planning, operations, governance, and disclosure.

Achieving all of this will take time and a continuous improvement mindset. Entities need to adopt an iterative approach that evolves by incorporating lessons learnt, and market and stakeholder feedback.

Other definitions of materiality

Under current sustainability reporting practices there are a number of materiality definitions, such as under the Global Reporting Initiative (GRI), and the European Sustainability Reporting Standards (ESRS). Other frameworks are being developed, including the U.S. Securities and Exchange Commission (SEC) proposed rule. As ISSB standards are implemented, entities should look to integrate their processes and approach to materiality, to consider the definition under ISSB and definitions under other relevant sustainability reporting frameworks and standards.

The ISSB has indicated that entities may **also** apply a multi-stakeholder lens when identifying disclosures. The Standards permit an entity to consider the GRI Standards and the ESRS in identifying disclosures about sustainability-related risks and opportunities. They adopt a broader impact approach to determining information, considering multiple stakeholders including investors, employees, customers, suppliers and communities.

What guidance is ISSB looking to provide on materiality?

To support entities in their capacity to report against its standards, the ISSB has provided additional guidance in IFRS S1 Appendix B.

In response to stakeholder concerns about the reporting of climate-related risks in the financial statements, the IASB has also decided to add to its maintenance project workplan a project on Climate-related Risks in the Financial Statements. The project aims to understand the cause of stakeholder concern, and whether the ISSB's guidance will address these concerns or if minor amendments to IASB Standards are needed.

To find out more

- Practical guidance on preparing for the ISSB's sustainability disclosure standards
- Making Sense of ISSB: A Guide for organisations on navigating climate regulation, compliance and reporting
- ISSB standards will change reporting: Practical insights for Audit & Risk committees
- Climate: climate resources and information on climate-related disclosures and action

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Our track record of helping our clients tackle climate transformation and our data-driven research, modelling assets and technology capabilities underpin our practical guidance to Executives, Non-Executive Directors, and Audit and Risk Committees – and their ability to prepare for the ISSB and this significant sustainability reporting change (whether that be strategic review, compliance advisory or assurance). We have been supporting clients over many years with the evolving sustainability reporting landscape from greenhouse gas reporting, GRI to TCFD and now the emerging TNFD framework. It's now time to get ISSB ready.

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