



March 2022

# Exposure Draft

IFRS<sup>®</sup> Sustainability Disclosure Standard

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## Basis for Conclusions on [Draft] IFRS S2 Climate-related Disclosures

Comments to be received by 29 July 2022



**Basis for Conclusions on**  
Exposure Draft  
*Climate-related Disclosures*

*Comments to be received by 29 July 2022*

This Basis for Conclusions accompanies the Exposure Draft ED/2022/S2 *Climate-related Disclosures* (published March 2022; see separate booklet). Comments need to be received by 29 July 2022 and should be submitted by email to [commentletters@ifrs.org](mailto:commentletters@ifrs.org) or online at <https://www.ifrs.org/projects/open-for-comment/>.

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## **Basis for Conclusions on [draft] IFRS S2 *Climate-related Disclosures***

*This Basis for Conclusions accompanies, but is not part of, [draft] IFRS S2 Climate-related Disclosures.*

### **Introduction**

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#### **The need for the project**

- BC1 Climate change creates both business risks and business opportunities: all entities and economic sectors face significant risks directly from physical climate changes, and risks arising from the transition to a lower-carbon economy, including those associated with greenhouse gases (GHG) associated with business activities. At the same time, climate change and related economic changes can also create opportunities for entities. For example, an entity can enhance its enterprise value by reducing its contributions to climate change (mitigation) or by adjusting its business model to compete more effectively in an evolving market (adaptation). The effect a company's activities have on climate change may also give rise to risks and opportunities for entities by, for example, prompting regulatory intervention or reputational effects. Entities can be exposed to these risks and opportunities directly and through counterparties beyond their direct operations, including because global supply chains and distribution channels are interconnected.
- BC2 Exposure Draft *Climate-related Disclosures* was developed in response to the demand for globally consistent climate-related disclosures that meet the needs of users of general purpose financial reporting. Information about the climate-related matters that are relevant to assessments of enterprise value over the short, medium and long term is increasingly important for decisions made by users.
- BC3 Specifically, users<sup>1</sup> have repeatedly called for more consistent, complete, comparable and verifiable information, including consistent metrics and decision-useful standardised qualitative disclosures, to help them assess how climate-related matters and the associated risks and opportunities affect:
- (a) an entity's financial position and financial performance;
  - (b) the value, timing and certainty of the entity's future cash flows over the short, medium and long term (and, therefore, an assessment of enterprise value by users of general purpose financial reporting); and
  - (c) the entity's response to climate-related risks and opportunities through its strategy and business model.
- BC4 Asset managers and institutional investors face new expectations from their customers, clients and beneficiaries in understanding sustainability-related risks and opportunities, while also contending with underdeveloped data and analytics on investable assets and significant cost pressures related to data

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<sup>1</sup> Throughout the Basis for Conclusions, the terms 'primary users' and 'users' are used with the same meaning and refer to existing and potential investors, lenders and other creditors.

gathering and analysis. Meanwhile, preparers who face rising demand from investors, lenders and other creditors for consistent, comparable climate-related financial disclosure are also confronted with fragmented sets of both mandatory and voluntary reporting standards, frameworks and guidance that may in some cases create disparate competitive challenges in various jurisdictions.

- BC5 This urgent need for high-quality, consistent and comparable information regarding climate-related matters was recognised by the Trustees of the IFRS Foundation (Foundation) in March 2021, in announcing its efforts to accelerate convergence among global sustainability reporting standards focused on enterprise value. In further announcing the strategic direction for a future International Sustainability Standards Board (ISSB), the creation of which was formally announced on 3 November 2021, the Trustees emphasised a commitment that the ISSB would focus its initial efforts on climate-related disclosures, while separately advancing progress towards meeting the information needs of users of general purpose financial reporting on other priority matters related to sustainability.

## Background

- BC6 In announcing the creation of the ISSB, the IFRS Foundation Trustees (Trustees) emphasised that they would build on the work of investor-focused reporting initiatives to become the global standard-setter for sustainability disclosures for financial markets, as some respondents suggested during the Trustees' 2020 consultation on sustainability reporting (the Trustees' 2020 consultation). Acknowledging respondents' statements about the urgent need for such standard-setting, the Trustees sought to provide the ISSB with a solid foundation on which to start work. In March 2021, the Trustees recruited members of some reporting initiatives to create the Technical Readiness Working Group (TRWG), chaired by the Foundation, to provide recommendations to the ISSB. The TRWG comprised representatives from the Climate Disclosure Standards Board (CDSB), the International Accounting Standards Board, the Task Force on Climate-related Financial Disclosures (TCFD), the Value Reporting Foundation (representing SASB Standards and the International Integrated Reporting Framework) and the World Economic Forum. The International Organization of Securities Commissions (IOSCO) and the International Public Sector Accounting Standards Board participated as official observers.
- BC7 The Exposure Draft builds on a prototype developed by the TRWG, which in turn evolved from work published in December 2020 by a group of five standard-setters and framework-providers focused on corporate sustainability and integrated reporting. This 'group of five' standard-setters and framework-providers—CDP (formerly the Carbon Disclosure Project), CDSB, the Global Reporting Initiative, the International Integrated Reporting Council and the Sustainability Accounting Standards Board (SASB)—co-authored a paper illustrating how their complementary frameworks, standards and platforms could be consolidated to focus on the aspects set out by the TCFD to provide a running start for the development of a single set of global standards that

enable disclosure of how sustainability-related risks and opportunities create, preserve or erode an entity's enterprise value. The 'group of five' effort was, in large part, a direct response to an increasingly fragmented approach to sustainability reporting and calls for the creation of a coherent and comprehensive system of corporate disclosure.

- BC8 The TRWG took up the 'group of five' prototype as its starting point. From March to November 2021, the TRWG refined the prototype through technical collaboration which included seeking input from some preparers and investors. The TRWG also identified market feedback and technical issues that had yet to be addressed or that warranted further consideration to enable these matters to be raised with the ISSB. The TRWG's refinements also reflected input from a Technical Experts Group created by IOSCO to help, in part, ensure that a standard based on the prototype would facilitate disclosure that could meet the needs of global capital markets. A high-level overview of the latter group's assessment was published in June 2021 in IOSCO's *Report on Sustainability-related Issuer Disclosures*.
- BC9 The TRWG's work on climate-related disclosure resulted in the November 2021 publication of a prototype standard on the Foundation's website. However, the prototype was not subject to the Foundation's formal due process or that of any members of the TRWG.
- BC10 Since the publication of the TRWG prototype, the ISSB Chair and Vice-Chair have sought to address matters raised by the TRWG based on their technical collaboration and external consultations. The Exposure Draft is mainly based on the evolution of the TRWG's prototype; it is underpinned by the work of standard-setters and framework-providers that has been subject to extensive public consultation and redeliberation and has achieved significant market uptake. Proposals in the Exposure Draft that are substantive changes from the TRWG prototype, rather than changes to improve clarity, are highlighted in the Basis for Conclusions. They include:
- (a) greater specificity and detail around the use of carbon offsets in the context of an entity's transition plan (see paragraphs BC71–BC85);
  - (b) clearer guidelines on resilience assessments, including whether and when an entity must use multi-scenario analysis and what the resulting disclosure should enable users of general purpose financial reporting to understand (see paragraphs BC86–BC95);
  - (c) a requirement to disclose quantitative information about the current and anticipated effects of significant climate-related risks unless an entity is unable to do so, in which case the information should be disclosed qualitatively. This change was intended to address questions about the clarity of 'feasibility' in the context of IFRS Standards (see paragraphs BC96–BC100);
  - (d) explicit inclusion of climate-related opportunities in the scope of requirements related to an entity's risk management process (BC101–BC104);

## BASIS FOR CONCLUSIONS ON CLIMATE-RELATED DISCLOSURES

- (e) the addition of TCFD-developed Illustrative Guidance to support the application by preparers of cross-industry metric categories (see paragraphs BC105–BC109);
- (f) separate GHG emissions disclosures for the consolidated accounting group and others, such as associates and joint ventures, and a more detailed explanation of the entity’s approach (see paragraphs BC110–BC118);
- (g) reference to scenarios and targets aligned with ‘the latest international agreement on climate change’, recognising that political and scientific consensus is likely to evolve (see paragraphs BC119–BC122); and
- (h) enhancements to the industry-based materials in Appendix B of [draft] IFRS S2 *Climate-related Disclosures*, including those intended to facilitate international applicability (see paragraphs BC130–BC142) and disclosure of financed emissions (see paragraphs BC149–BC172), and the addition of signposting and illustrative examples to assist preparers in providing connected information (see paragraphs BC143–BC148).

### Context for the project

#### The decision to prioritise climate-related disclosures

- BC11 In September 2020, a Task Force comprising and formed by the Trustees initiated a public consultation to assess the demand from stakeholders for global standards for sustainability-related financial disclosure and to understand what the Foundation could do in response to that demand. Although a range of views was expressed, stakeholders shared a common message: there is an urgent need to improve the consistency and comparability of sustainability-related financial disclosures – particularly disclosures related to climate change.
- BC12 Climate-related risk is of growing importance to users of general purpose financial reporting, as well as to a range of other stakeholders, including corporations, market regulators, public policy makers and central banks. In recent years, the World Economic Forum’s annual *Global Risks Report* has consistently ranked ‘climate action failure’ and related risks among the world’s most pressing challenges in terms of both likelihood and severity. Already, the impacts of climate change are increasingly apparent in droughts, fires, floods, resource scarcity and species loss. These impacts have also begun to disrupt and reshape markets, from automobiles and agriculture to infrastructure and insurance. In this context, both entities and their investors increasingly recognise that pursuing ‘business as usual’ – particularly in carbon-intensive sectors – risks experiencing business disruptions or losing competitive advantage due to growing regulatory pressures and through higher costs, reduced resilience, competitive market dynamics and failure to keep pace with technological innovation, alongside reputational damage.



- BC13 Yet, even as a growing number of entities are compelled to rethink their business models and strategies, explore alternative inputs, invest in new processes and technologies, reskill workforces or reconfigure or replace product lines, investors, lenders and other creditors have repeatedly emphasised they are often left without the information they need to assess performance in response to climate change in this dynamic competitive landscape. Increasingly, users of general purpose financial reporting are seeking consistent, comparable information to help them better understand how entities are managing climate-related risks and opportunities, how they intend to achieve their climate-related performance targets, what progress they have made against those targets, and how resilient their business models and strategies are in the face of a global transition towards a lower-carbon economy. Just as entities in many industries have recognised that the costs of inaction may outweigh those of acting on climate-related risk, investors face a choice between facilitating a more immediate and orderly economic transition or accepting a more abrupt and potentially turbulent one.
- BC14 Although climate-related financial disclosure has been prioritised due to the urgency of climate change and the related market demand for this information, the ISSB will address other sustainability-related risks and opportunities. Although responses to the Trustees' 2020 consultation identified climate-related financial disclosure as a top priority, they also indicated that users of general purpose financial reporting have a clear and pressing need for material information on the full range of sustainability-related risks and opportunities they consider in their assessments of an entity's enterprise value. The ISSB will develop its forward-looking priorities and associated work plan through broad consultation with preparers and users of general purpose financial reporting and other stakeholders interested in or affected by sustainability-related financial disclosure, including through consultation on the ISSB's future work plan.

### **Relationship to other IFRS Sustainability Disclosure Standards**

- BC15 The ISSB aims to develop standards that will provide a comprehensive global baseline of high-quality sustainability-related disclosures to meet the information needs of users of general purpose financial reporting. It is proposed that these IFRS Sustainability Disclosure Standards will include general, thematic and industry-based requirements. In addition to its release of the Exposure Draft, which the Basis for Conclusions accompanies, the ISSB has also issued an Exposure Draft of [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* at the same time. As one of a broader set of envisioned standards, the Exposure Draft is intended to complement other (future) IFRS Sustainability Disclosure Standards and complement [draft] IFRS S1.
- BC16 [Draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* proposes requiring an entity to provide material information about all significant sustainability-related risks and opportunities that affect enterprise value. It is, therefore, intended that the disclosures proposed to be required by the Exposure Draft would enable an entity to meet the requirements in [draft] IFRS S1 to provide material information about risks

and opportunities related to climate change. For example, when an entity determines that information about a climate-related risk or opportunity is material, it would be required to apply the cross-industry requirements described in the Exposure Draft together with the applicable industry-based climate-related requirements included in Appendix B *Industry-based disclosure requirements*.

BC17 Thus, the climate-related disclosure requirements in the Exposure Draft build on the proposals in [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*. The provisions in the Exposure Draft are consistent with and complement those in [draft] IFRS S1, including those related to these elements:

- (a) the Exposure Draft, like [draft] IFRS S1, includes disclosure requirements in the core content areas of governance, strategy, risk management and metrics and targets (see paragraphs BC28–BC30).
- (b) in applying the requirements proposed in the Exposure Draft, entities are intended to prepare disclosures in accordance with the conceptual elements and general features set out in [draft] IFRS S1, including those related to material information, reporting entity, connected information and location of information, among others. With respect to material information, for example, an entity is required to disclose information in accordance with the Exposure Draft—including industry-based requirements—when such information is determined to be material to the entity, in accordance with [draft] IFRS S1 (see paragraphs BC182–BC186).

#### **Due process provisions applicable to the Exposure Draft**

BC18 The urgent need for the ISSB to deliver its initial Standards has been repeatedly highlighted, including in feedback to the September 2020 consultation on sustainability reporting held by the Trustees and to the April 2021 Exposure Draft of proposed amendments to the IFRS Foundation *Constitution*. IOSCO has also emphasised the urgent need for disclosure standards on climate change. Such urgency can pose significant challenges to standard-setting, which aims to achieve effective outcomes by balancing timely responsiveness to market needs with the rigour of formal due process.

BC19 The Trustees recognised the opportunity to use and build upon existing sustainability standards and frameworks, including those developed in accordance with prior due process by the organisations that developed them and that enjoy broad user and preparer support. The main components of the Exposure Draft are based on work that has been subject to extensive public consultation and redeliberation and have since garnered significant market uptake (see paragraphs B6–B10). The Trustees viewed this as a signal these foundational standards and frameworks help to address the information needs of investors and other capital market participants.

- BC20 The Trustees noted the need for prompt action. However, they also noted that this does not negate the need for formal due process and exposure by the ISSB. It is important that the ISSB's stakeholders are given the opportunity to provide feedback on the proposals consistent with the IFRS Foundation's inclusive and thorough due process. To balance the need to advance the work of the ISSB on a timely basis while obtaining input from interested parties, the Trustees decided to grant special powers to the Chair and Vice-Chair of the ISSB to enable timely publication of initial exposure drafts for stakeholder input. The Trustees agreed it would be appropriate that as the ISSB is being established (that is, as a transitional measure) the ISSB Chair and Vice-Chair be provided with the ability to publish exposure drafts of a climate-related disclosure standard and/or a general requirements disclosure standard. This decision is reflected in paragraph 56 of the IFRS Foundation's *Constitution* published in November 2021. The effect of this provision in the *Constitution* is only to enable the exposure drafts to be published prior to the ISSB being quorate. The exposure drafts are subject to public consultation and will be redeliberated by a quorate ISSB. The ISSB Chair and Vice-Chair's right was made subject to oversight by the Due Process Oversight Committee of the Trustees who were consulted at a meeting convened on 21 March 2022 at which they confirmed that they did not object to the ISSB Chair and Vice-Chair publishing these exposure drafts.

## Overview of the approach taken in the Exposure Draft

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### Objective and requirements

- BC21 The Exposure Draft has as its objective to require an entity to disclose information about its exposure to significant climate-related risks and opportunities, enabling users of an entity's general purpose financial reporting:
- (a) to assess the effects of climate-related risks and opportunities on the entity's enterprise value;
  - (b) to understand how the entity's use of resources, and corresponding inputs, activities, outputs and outcomes support the entity's response to and strategy for managing its significant climate-related risks and opportunities; and
  - (c) to evaluate the entity's ability to adapt its planning, business model and operations to significant climate-related risks and opportunities.
- BC22 The approach taken in the Exposure Draft to achieve these objectives reflects the view that developing a complete understanding of an entity's climate-related risks and opportunities requires a mix of information related to governance, strategy, risk management and metrics and targets. Proposed requirements related to governance and risk management primarily provide users of general purpose financial reporting with an understanding of the entity's internal structures and processes for the identification, assessment and oversight of climate-related risks and opportunities. Proposed requirements related to strategy and metrics and targets primarily provide

users with an understanding of the entity's strategic responses to specific climate-related risks and opportunities, including information about its resilience, outlook and key performance indicators.

### **Climate-related risks and opportunities**

- BC23 The proposed requirements are intended to elicit decision-useful information regarding both climate-related risks and climate-related opportunities. The Exposure Draft applies to climate-related risks that an entity may be exposed to, including both physical risks from climate change (physical risks) and risks associated with the transition to a lower-carbon economy (transition risks). The uncertainty related to these risks can be a source of loss or gain for an entity, and in the latter case may also create opportunities.
- BC24 Physical risks resulting from climate change can be event-driven (acute) or result from longer-term shifts (chronic) in climate patterns. Physical risks may materialise over the short, medium or long term. Acute physical climate-related risks could include events such as extreme storms, extreme precipitation or extreme temperatures. For example, extreme temperatures or storm damage may affect entities' financial performance through effects on entities' premises, operations, supply chain, transportation needs and employee safety. Chronic physical risks include increases over the longer term in mean temperatures, shifts in precipitation patterns or rising sea levels. Chronic risks also may lead to significant financial implications for entities over time, such as those associated with changes in water availability, sourcing and quality; sea level inundation affecting entities' premises or operations; or chronic drought affecting supply chains.
- BC25 Transition risks may entail extensive policy, legal, technology and market changes from society's move to a lower-carbon economy. To manage such risks, an entity may choose to undertake a range of mitigation and adaptation responses to climate change. Mitigation responses are those activities undertaken by an entity using technologies and services that reduce the risks associated with its potential contributions to climate change, such as through increased energy efficiency, water-use efficiency, renewable energy uptake and the capture or sequestration of carbon dioxide. Adaptation responses involve taking action to prepare for and adjust to both the current effects of climate change and the predicted impacts in the future, including infrastructure resiliency efforts and business model shifts (for example, the introduction of new products and services, and aligning business models with new environmental conditions). Depending on the nature, speed and focus of these changes, transition risks may pose varying levels of financial and reputational risk to entities.
- BC26 An entity may also take advantage of opportunities to enhance its financial position, performance and prospects in the face of climate change. Efforts to mitigate and adapt to climate change can produce opportunities for entities, such as through developing new products and services that capitalise on shifting consumer needs or preferences and enhance brand reputation. Climate-related opportunities will vary depending on the region, market and industry in which an entity operates.

BC27 In developing the Exposure Draft, the importance of recognising the overlaps in these categories of risk and opportunity became clear. For example, mitigation and adaptation to climate-related impacts may be influenced by the geographic location of an entity as physical risks may vary by location and transition risks by jurisdiction. Efforts to move to a lower-carbon economy may also reduce physical risks in the long run. Therefore, transition risk is often connected to physical risk. Such connections might be part of an entity's direct operations or arise from downstream or upstream relationships in the value chain. For example, climate-related resource constraints may prompt an entity in the processed foods industry to reformulate important products, which can in turn shift demand among suppliers towards crops that optimise resource efficiency, enhance soil quality and increase its capacity to store carbon. Similarly, climate-related opportunities are often the converse of risks (that is, a favourable outcome related to a given uncertainty), for instance, when mitigation technologies enable entry into new markets or confer competitive advantage. The Exposure Draft aims to reflect this relationship between risks and opportunities in its proposed requirements, such as those related to risk management and strategy, particularly in the areas of capital allocation planning and scenario analysis, which reflects a range of potential outcomes (see paragraphs BC86–BC95).

### **Core content**

BC28 Consistent with the structure set out in [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, the Exposure Draft is structured around core content related to governance, risk management, strategy and associated metrics and targets. This core content is aligned with the structure of the widely accepted TCFD Recommendations and reflects broadly how entities manage sustainability-related risks and opportunities.

BC29 This structure reflects the view that disclosure requirements related to each aspect of the core content provide information relevant to the assessment of enterprise value. The proposed requirements associated with governance, strategy, risk management and metrics and targets are intended to result in a complete and integrated set of information being provided on an entity's exposure to climate-related risks and opportunities; the current and anticipated impacts on its business model, financial statements and cash flows; its strategy for addressing these risks and opportunities; the measurement and monitoring of its strategy execution, performance and relevant uncertainties; and the governance structures and processes in place to oversee and manage the entity's strategy and approach to climate-related risks and opportunities.

BC30 While the proposed disclosure requirements are structured according to the core content areas, information proposed to be required by the Exposure Draft shall be disclosed by entities so that, along with an entity's other general purpose reporting, it facilitates an overall assessment of the entity's enterprise value. It was stressed that it may be appropriate to integrate this disclosure across the four areas of core content rather than strictly compartmentalising them, in accordance with the proposed requirements on connected

information in [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*.

### **Comparability**

- BC31 To provide climate-related information that enables users of general purpose financial reporting to assess an entity's enterprise value, the Exposure Draft proposes both cross-industry and industry-based disclosure requirements. Cross-industry disclosures enable comparison on aspects of climate-related risks and opportunities—or their implications for financial position, financial performance and future cash flows—applicable to the assessment of enterprise value for entities, regardless of their industry, business model or economic activities. Industry-based disclosure topics and metrics enable comparisons on key competitive issues by providing insight into performance on the particular drivers of climate-related risk and opportunity related to specific industries, business models or economic activities.

### **Cross-industry components**

- BC32 To enhance comparability of key information, the Exposure Draft proposes that all entities disclose the same information regarding governance, risk management and key aspects of strategy. In addition, the Exposure Draft proposes that all entities disclose metrics related to seven fundamental categories of climate-related information that are aligned with TCFD guidance. Taken together, it is intended that these disclosure requirements will provide common information for users of general purpose financial reporting to use when assessing the implications of climate-related risks and opportunities on the enterprise value of entities in various industries with various activities. The cross-industry, climate-related metric categories are not meant to supplant or replace other information that entities use as part of their business planning or that industries use to monitor or measure climate-related risks or opportunities specific to their industry or entity. Rather, they are intended to provide a base of comparability between and within industries and to form a framework for the types of climate-related metrics that all entities should disclose when material. Key considerations related to each of the cross-industry metric categories are discussed in detail in paragraphs BC105–BC118.

### **Industry-based components**

- BC33 To complement the cross-industry components applicable to all entities discussed in paragraph BC32, industry-based components are also included in the Exposure Draft. Responses to the Trustees' 2020 consultation showed strong demand among the investor community for information that would enhance its ability to compare the climate-related performance of entities with similar business models, as well as to quantify relevant benchmarks for the assessment of entity performance related to industry-specific (or activity-specific) drivers and consequences of climate-related risks and opportunities. In setting out its expectations for the ISSB, IOSCO echoed the need for industry-based disclosure.

- BC34 This industry-based approach acknowledges that climate-related risks and opportunities tend to manifest differently in relation to an entity's business model, the underlying economic activities in which it is engaged and the resources upon which its business depends or which its activities affect. Accordingly, users of general purpose financial reporting have stressed the usefulness of tailored information to assess and manage exposures to climate-related risks and opportunities. For example, real-estate investors have said they need information on the energy efficiency of buildings and the vulnerability of building stock due to geographic location. In the car industry, investors have indicated a need to be able to track progress on the development of zero-emission or hybrid vehicles that curb use-phase emissions and help entities stay ahead of regulations and benefit from changing consumer preferences. Similarly, investors in commercial banks have signalled a need to understand the degree to which financed emissions – those embedded in the lending portfolio – may create risks to the value of the assets recognised in the lender's own statement of financial position.
- BC35 The Exposure Draft thus includes industry-based elements largely based on the SASB Standards. The SASB Standards were developed by an independent standard-setting board through a rigorous and open due process over nearly 10 years with the aim of enabling entities to communicate sustainability information relevant to assessments of enterprise value to users of general purpose financial reporting. The outcomes of that process identify and define the sustainability factors most likely to have a significant effect on the enterprise value of an entity that operates in a given industry (that is 'disclosure topics'). Further, they set out standardised measures to help users assess an entity's performance on the topic, including by understanding the direct levers of influence available to the entity, and how the entity is using them. Accordingly, the industry-based proposals in the Exposure Draft (see paragraphs BC123–BC129) are based on the climate-related materials in the SASB Standards. This is also consistent with feedback from the Trustees' 2020 consultation – that the ISSB build on established frameworks and standards focused on enterprise value.
- BC36 Appendix B *Industry-based disclosure requirements* of the Exposure Draft refers to associated volumes of industry-based requirements, which are published separately and contain detailed technical protocols. However, these and other industry-based requirements across a range of sustainability-related risks and opportunities could be grouped together within IFRS Sustainability Disclosure Standards as industry materials addressing a range of sustainability-related risks and opportunities, rather than being linked to a climate or other thematic standard. While these proposed industry requirements are being issued along with the Exposure Draft for ease of reference, the ultimate location of these requirements within IFRS Sustainability Disclosure Standards could change. Such a change in how the requirements are published would not change the status or applicability of the requirements.

## Industry classification

- BC37 The industry-based components of the Exposure Draft draw from the SASB Standards, which are in turn based on the Value Reporting Foundation's Sustainable Industry Classification System (SICS<sup>®</sup>). Although other classification systems are in use, it was observed that SICS categorises corporate securities into homogeneous groups based on the sustainability-related risks and opportunities they face, providing an appropriate basis for establishing disclosures relevant to users of general purpose financial reporting. It was, therefore, agreed that SICS is well suited for sustainability-related standard-setting.
- BC38 SICS was specifically designed to account for the fact that, whereas all entities are similarly dependent on financial capital, their relationships with other forms of capital—such as natural, human or social capital—tend to vary based on their business models and the associated economic activities they undertake. SICS was designed to serve as a proxy for these considerations by establishing 11 thematic sectors comprising 77 industry groupings, each of which is characterised by similar impacts and dependencies on the non-financial capitals that serve as sources of value. This includes climate-related impacts and dependencies, as reflected in the industry-based requirements in the Exposure Draft.
- BC39 Other industry classification schemes (for example, the Global Industry Classification Standard, or GICS, and the Industry Classification Benchmark, or ICB) are deeply embedded in market infrastructure. Meanwhile, other sustainability reporting frameworks and standards, focused on the needs of multiple stakeholders, have proposed additional classifications. For example, the Global Reporting Initiative has prioritised establishing standards for 40 sectors linked to GICS, ICB and the International Standard Industrial Classification (ISIC). Meanwhile, in the European Union, mandatory sustainability reporting may be linked to the Statistical Classification of Economic Activities in the European Community (NACE), which is derived from ISIC.
- BC40 Entities are expected to use SICS to identify their appropriate industry-based disclosure requirements in IFRS Sustainability Disclosure Standards, but it is recognised that they are likely to use other systems for other purposes. Although each system is useful for specific purposes, none is well suited to serve every user or objective. For example, for the purpose of standardising sustainability-related financial disclosure, the view was that the system would need to:
- (a) achieve a balance between granularity and practicality—in other words, it needs to reflect the important nuances of economic activity without undermining the system's usefulness as a device for comparing a sufficiently large group of entities. The more narrowly defined the industries (or activities), the fewer entities will be included in each one and, in turn, comparability would decrease among potential competitors.



- (b) address the right mix of key industries at a comparable level in its hierarchy. For example, in the context of sustainability impacts and dependencies, the ISSB's work will apply to industries focused on the generation of alternative energy (for example, solar and wind energy), many of which are nested within other largely dissimilar industries in a traditional classification system and thus may be 'overlooked' in standard-setting.
- (c) be based on a framework that facilitates the grouping of entities and industries with reasonably similar sustainability impacts and dependencies. Most conventional classification systems take either a supply-side or production-orientated approach (grouping entities according to the inputs and production processes they use), or a demand-side or commodity-orientated approach (grouping entities according to the product or service they provide). Sustainability impacts and dependencies may be related to inputs, processes or products.

BC41 It was further acknowledged that there is a practical benefit for proposed industry requirements built on the SASB Standards to use the associated classification system, which would enable a smoother transition to IFRS Sustainability Disclosure Standards for those already preparing or consuming information using the SASB Standards.

BC42 The cruise line industry was cited as an example of how such a system can benefit standard-setting. In conventional systems, operators of cruise lines are often included in a single industry category alongside hotels and resorts. However, each of these business models is characterised by a different set of sustainability impacts and dependencies, despite their economic similarities. Even when broad aspects of sustainability such as ecological impacts or labour practices may apply to both hotels and cruise lines, the specific sustainability-related risks and opportunities faced by an entity in one or the other business may vary. For users of general purpose financial reporting, the information that is most decision-useful will likely reflect that divergence. For instance, users can more readily assess risks related to a hotel's ecological impact by understanding the number of facilities it operates near protected areas or endangered species' habitat. On the other hand, for a cruise line, it will more likely benefit from measures related to discharge management. By segregating these industries to capture more appropriately their fundamental relationships to non-financial resources, it is envisioned that SICS can help enable suitably tailored standard-setting focused on the assessment of enterprise value.

BC43 As an example of how individual industries are further organised into sectors, SICS establishes a thematic sector that groups nine transport industries with similar sustainability profiles: 'Air Freight & Logistics', 'Airlines', 'Auto Parts', 'Automobiles', 'Car Rental & Leasing', 'Cruise Lines', 'Marine Transportation', 'Rail Transportation' and 'Road Transportation'. These industries could face similar sustainability-related risks and opportunities, such as those related to GHG emissions, fuel management, air quality and passenger safety. Traditional classification systems categorise these industries under different

sectors. For example, GICS groups manufacturers of cars and their components under the 'Consumer Discretionary' sector alongside 'specialty retailers', 'hotels' and 'restaurants'. Meanwhile, airlines, railway operators, car rental companies, logistics, haulage and shipping companies are grouped under the 'Industrials' sector, alongside professional services and construction and engineering companies. From a demand-side standpoint, this makes sense because the financial performance of carmakers and their suppliers relies heavily on levels of disposable income, while industrial activity influences the demand for services provided by industries involved in the transportation of goods. However, it was recognised that this purely economic breakdown does not allow investors to easily identify the non-conventional factors that could also affect the performance of these entities from a sustainability standpoint.

BC44 The Exposure Draft reflects the view that what is most important is not that all preparers and users of general purpose financial reporting apply the same industry classification system for every purpose, but that the systems they use are sufficiently linked and interoperable. To help users and preparers of sustainability-related financial disclosure, the Value Reporting Foundation has mapped SICS to a number of other commonly used classification systems including GICS, NACE, the North American Industry Classification System (NAICS) and the Standard Industrial Classification (SIC) system used by the US Securities and Exchange Commission, as well as with the International Securities Identification Numbering (ISIN) system. The utility of these mappings, and of SICS more broadly, is evidenced by the fact that entities in nearly 60 countries across six continents—including more than half of the S&P Global 1200—currently use the SASB Standards to disclose sustainability-related information to investors; and approximately 200 investors in 30 countries, representing more than US\$50 trillion in assets under management, have licensed SICS-based tools and resources.

BC45 Despite these advantages, to maintain its relevance, SICS will require upkeep. As entities transform their business models to adapt to a changing competitive landscape—or help create those changes through innovation—the composition of sectors and industries, as well as their interrelationships, will continue to evolve. To date, the SICS system has undergone a relatively small number of significant revisions, most notably in 2016 when four industries and one sub-industry were recategorised, two industries were merged, one sector was split and several industries and sectors were renamed. These changes came about as evidence surfaced through market-driven standard-setting to allow for more accurate assessment of these industries' sustainability profiles.

### **Costs, benefits and likely effects**

BC46 The ISSB is committed to ensuring that the application of its proposals, as set out in the Exposure Draft, appropriately balances costs and benefits. That is, the ISSB aims to develop standards that, when applied, result in benefits that justify the cost of implementation and ongoing application.

- BC47 It is recognised that entities may incur costs related to the implementation and ongoing application of a standard based on the Exposure Draft, such as the costs associated with gathering information, designing controls to achieve high-quality disclosures and obtaining third-party assurance of that information. By incorporating and building upon the core elements of widely used sustainability frameworks and standards, the proposals set out in the Exposure Draft are designed to minimise such costs. Additionally, these and other costs were weighed against anticipated benefits, including those confirmed by extensive academic and market research and by the standard-setters whose materials form the basis for the Exposure Draft, such as positive impacts on operational efficiency, access to capital, cost of capital, reputation and employee engagement. Preparers may also benefit from more streamlined sustainability reporting for users of general purpose financial reporting through the application of the proposals in the Exposure Draft when used to meet the needs of investors, lenders and other creditors in international capital markets. The potential for relevant avoided costs, such as those frequently cited by investors related to the inefficiencies of manual data collection, translation and analysis was also considered.
- BC48 In striving to produce cost-effective standards, the ISSB is committed to gathering, assessing and sharing knowledge about the likely costs of implementing proposed new requirements and the likely ongoing application costs and benefits of the proposals. The Exposure Draft asks for respondents to provide information about the likely costs and benefits of the proposals to inform the ISSB's decision making. The ISSB is particularly interested in obtaining feedback about the proposed requirements in the Exposure Draft that, in comparison to others, have been less widely implemented and applied by entities, such as those related to scenario analysis or other assessments of an entity's resilience to plausible future climate trajectories and the proposals to introduce new industry-specific requirements about financed and facilitated emissions. The ISSB will gain insight into the likely effects of its proposed new requirements through its formal consultation processes—such as publishing the Exposure Draft—and through less formal consultations.

### **Climate scope**

- BC49 As the Intergovernmental Panel on Climate Change (IPCC) has noted, the physical and economic impacts of climate change are wide ranging, affecting sea level rise, ice coverage, frequency of extreme rainfall, changes in wildfire events, human health, land use and availability, water quality and availability, biodiversity, food supply and gross domestic product. Against this background, and because many of these impacts are related, it is not possible to precisely define the full scope of climate-related risks and opportunities that are likely to affect entities or the assessment of their enterprise value. The proposed requirements do not, therefore, explicitly prescribe what is 'climate-related'. The Exposure Draft does, however, align with the TCFD Recommendations and with the industry-based requirements in the SASB Standards that the TRWG identified as being climate-related in order to provide a sense of the parameters of 'climate-related risks and opportunities'. Those parameters are deliberately wide and are not intended to be interpreted

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as comprehensive. This approach is intended to facilitate and encourage disclosure of all climate-related risks and opportunities that could affect the assessment of enterprise value.

- BC50 Although the proposed requirements do not explicitly reference related issues such as water availability, preserving biodiversity, deforestation and climate-related social impacts, they may result in disclosures about those and other issues when a preparer determines that such information is material to users of its general purpose financial reporting in assessing the impact of climate-related risks and opportunities on its enterprise value. An entity's performance in relation to many of these risks and opportunities is likely to be captured by the industry-based disclosure topics and associated metrics included in Appendix B to the Exposure Draft, which are expressly intended to supplement and complement the general and cross-industry requirements. However, the industry-based requirements are not intended to be comprehensive, and an entity may identify additional climate-related risks or opportunities – and associated performance metrics – relevant to its particular facts and circumstances.
- BC51 For example, it is expected that a beverage manufacturer would be likely to address the short-, medium- and long-term impacts of climate change on water availability – especially in particular regions. The implications for that entity's strategy, operations, capital planning, asset values and the cost-stability of water would be relevant in assessing climate-related risk as it is reasonably likely to have a significant effect on the enterprise value of entities in this industry. The industry-based requirements referenced in Appendix B include water-management metrics for beverage manufacturers, including total water withdrawn, total water consumed and the percentage of each in regions with high or extremely high baseline water stress. Industry-relevant metrics such as these are intended to build upon the cross-industry disclosure requirements, resulting in a more complete picture of climate-related risk being provided and enhancing comparability.
- BC52 The inclusion of these disclosure topics and associated metrics in the Exposure Draft is not, however, an indication that the broader sustainability-related risks and opportunities to which they relate – including the availability, sourcing and quality of water, preserving biodiversity and deforestation – have been sufficiently addressed by the Exposure Draft for the purposes of sustainability-related financial disclosure. In effect, under the ISSB's proposals, disclosures would only be required on the aspects of these matters that were identified as being most closely related to climate change. Subject to further consultation on its agenda priorities, the ISSB intends to consider more fully these and other sustainability-related risks and opportunities in its future standard-setting, consistent with its objective of addressing sustainability-related financial disclosures relevant to enterprise value assessment more broadly (that is, beyond climate change).

**Impacts and dependencies**

- BC53 Climate-related risks and opportunities arise from an entity's impacts and dependencies on natural resources, and from the key relationships it maintains that may be positively or negatively affected by those impacts and dependencies.
- BC54 It is noted that 'impacts' have often been the primary focus of corporate efforts to address climate change. These include, for example, the economic externalities that entities generate—such as pollution—which impose costs on third parties and often invite regulatory intervention. Climate-related externalities, such as greenhouse gas emissions, represent significant financial risks in this way. However, impacts can also be 'internalised' through other channels, including through evolving social norms and expectations or more directly through market forces, such as shifting consumer preferences or disruptive technological responses.
- BC55 It is also recognised that another market-based mechanism that can lead to significant climate-related risk is changes in the availability, quality or cost-stability of key inputs. This is an example of a 'dependency'. Depending on their business models and the economic activities in which they are engaged, entities' climate-related dependencies can, of course, vary significantly. A beverage manufacturer may depend on the availability and quality of local water resources, which can be affected by physical climate change, whereas an entity in the technology sector is more likely to depend on energy produced from fossil fuels, which could present an important energy transition risk.
- BC56 Thus, the Exposure Draft reflects the view that, depending on the specific facts and circumstances of an entity, both impacts and dependencies can be highly relevant to enterprise value-focused investment analysis and decision-making. In particular, measures of impact tend to be most closely linked to enterprise value when impacts are—or are likely to become—subject to regulation or otherwise 'internalised', which makes the information more directly relevant to the risk facing the entity. For example, in addition to regulatory and policy channels, impacts may be internalised through market forces (for example, supply, demand and pricing dynamics, such as those related to increasingly constrained resources) or social pressures (for instance, reputational impacts and investor expectations). The potential for such internalisation can be particularly relevant to assessments of enterprise value as entities and investors consider impacts in relation to longer periods of time (see paragraphs BC69–BC70). Where direct measures of impact are less useful but the impacts themselves are still relevant to assessments of enterprise value, the Exposure Draft has proposed disclosures related to the underlying drivers of impact and an entity's strategic and operational responses to the associated risk. For example, a home builder's environmental impacts stem largely from the resource efficiency of its residential buildings over their full lifecycle, so the Exposure Draft proposes metrics related to design practices, choice of materials and associated certifications, which can both mitigate impact and drive revenue and market share by satisfying consumer preferences. Such disclosure not only provides users of general purpose financial reporting with useful information about how an entity is managing

significant climate-related risks and opportunities, it may also provide actionable business intelligence to drive performance.

## Disclosure requirements

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### Governance (paragraphs 4–6 of [draft] IFRS S2)

- BC57 Users of general purpose financial reporting have expressed interest in understanding the role an entity's governance body or bodies play in overseeing climate-related risks and opportunities. They are also interested in understanding management's role in assessing and managing climate-related risks and opportunities. Such information can support evaluations of whether significant climate-related risks and opportunities receive appropriate board and management attention.
- BC58 Paragraphs 4 and 5 of the Exposure Draft propose that an entity be required to disclose information that enables users of general purpose financial reporting to understand the governance processes, controls and procedures used to monitor and manage climate-related risks and opportunities. To achieve this objective, the Exposure Draft proposes that an entity be required to disclose information about the governance body or bodies (which can include a board, committee or equivalent body charged with governance) with oversight of climate-related risks and opportunities, and a description of management's role regarding climate-related risks and opportunities.
- BC59 The Exposure Draft's proposed governance disclosure requirements are based on the recommendations of the TCFD, which are to describe the board's oversight of climate-related risks and opportunities and management's role in assessing and managing climate-related risks and opportunities. However, the Exposure Draft proposes more detailed disclosure on some aspects of climate-related governance and management in order to meet the information needs of users of general purpose financial reporting. For example, the Exposure Draft proposes a requirement for preparers to disclose how the governance body's responsibilities for climate-related risks and opportunities are reflected in the entity's terms of reference, board mandates and other related policies.
- BC60 The proposed disclosure requirements cover not only the structures, processes and capabilities that are in place for the oversight of climate-related risks and opportunities, but also how climate-related risks and opportunities are integrated into other aspects of the entity's governance. For example, the proposed requirements include disclosure about the governance body's involvement in overseeing the establishment of climate-related performance targets and monitoring the entity's progress against those targets, and its oversight of management's role in assessing and managing climate-related risks and opportunities.
- BC61 Some consider that information about the governance body or bodies responsible for the oversight of climate-related risks and opportunities may be enhanced if information is also provided regarding the specific expertise these bodies or their members possess on climate-related matters. As a result, the Exposure Draft's proposals would require the disclosure of information about

how the body ensures that the appropriate skills and competencies are available to oversee strategies designed to respond to climate-related risks and opportunities. This level of specificity in skills and competencies may be challenging for some preparers to put in place—especially smaller corporate boards that already have to include a range of skills including audit, technology and industry experience. However, for many corporate governance bodies, the expertise that is needed is on a specific aspect of climate change (for example, expertise on physical risks for an entity with operations in particularly flood-prone regions) rather than climate science more broadly. In such cases, industry experience is often more relevant. The proposals reflect the view that it is useful for preparers to explain the approach it has taken and why.

- BC62 Regarding management’s role in assessing and managing climate-related risks and opportunities, there is a need for these disclosure requirements to be capable of capturing the particular context of an entity. As a result, the Exposure Draft includes a proposed disclosure requirement for a description of management’s role in assessing and managing climate-related risks and opportunities, including whether that role is delegated to a specific management-level position or committee and how oversight is exercised over that position or committee.
- BC63 The Exposure Draft includes a proposal that an entity avoid unnecessary duplication in its disclosure on governance associated with climate-related risks and opportunities. It was noted that many entities integrate governance and management of sustainability-related risks and opportunities (including climate-related risks and opportunities). As a result, the Exposure Draft states that when an entity’s oversight of sustainability-related risks and opportunities is managed on an integrated basis, providing integrated governance disclosures rather than separate disclosures for each significant sustainability-related risk and opportunity would reduce duplication.

## **Strategy (paragraphs 7–15 of [draft] IFRS S2)**

### **Physical and transition risks**

- BC64 The ISSB’s proposals set out in the Exposure Draft distinguish two essential categories of climate-related risk—transition risk and physical risk (see paragraphs BC23–BC27). The proposed requirements for these risks are based on an integrated set of disclosures about the significant transition and physical risks to which an entity is exposed, comprising qualitative and quantitative information on risk identification, assessment and management; an entity’s response to and strategy for managing risks; current and anticipated implications of risks on financial performance and position; and metrics and targets used to monitor and manage these risks. The specific transition and physical risks—when they have significant implications for the entity’s objectives—are expected to vary depending on the entity’s business model, sector, location and other circumstances; hence the specific information disclosed in accordance with the Exposure Draft would vary by entity. It was proposed that the disclosure topics identified in the industry-based requirements (see paragraphs BC123–BC129) can serve as a useful

starting point for an entity to consider the specific risks and opportunities it may need to address.

- BC65 The use of ‘transition risk’ and ‘physical risk’ as broad categories is expected to be uncontentious as these categories are widely recognised and used. However, climate-related risk identification, assessment and management is an evolving field. Key challenges include data availability, methodologies and models applicable at a business level, especially regarding assessing physical risks, as well as the financial implications of climate-related risks. Hence, the Exposure Draft includes requirements, such as those about the resilience of an entity’s strategy to physical and transition risks, that allow various analyses to form the basis for the disclosures provided, thus accommodating a range of current practices as well as evolving practices.

**Concentrations of climate-related risks and opportunities in an entity’s value chain**

- BC66 The Exposure Draft includes proposed disclosure requirements that are designed to enable users of general purpose financial reporting to understand the impact of climate-related risks and opportunities on an entity’s business model, including in its value chain. [Draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* proposes a definition of value chain which is applicable to the Exposure Draft: ‘the full range of activities, resources and relationships related to a reporting entity’s business model and the external environment in which it operates’. The definition further clarifies that a value chain encompasses the activities, resources and relationships an entity uses and relies on to create its products or services from conception to delivery, consumption and end-of-life. This definition is intentionally broad. However, that does not mean an entity has to provide information about all of the climate-related risks and opportunities affecting the entity’s value chain. The information that the Exposure Draft would require an entity to provide is limited to that which enables users of general purpose financial reporting to assess an entity’s enterprise value—so the impact arising from the value chain needs to be relevant to this assessment—and the information provided is that which is material.
- BC67 The disclosure requirements seek to balance measurement challenges with the information that users of general purpose financial reporting need to understand where in an entity’s value chain climate-related risks and opportunities are concentrated. For example, users have emphasised the value of reliable geographically-specific information in assessing the resilience of an entity’s supply chain to physical climate-related risk. However, relevant quantitative disclosures may create measurement challenges for preparers. As a result, the Exposure Draft includes proposals for qualitative disclosures about the current and anticipated effects of significant climate-related risks and opportunities on an entity’s value chain. The proposals would also require an entity to disclose where in an entity’s value chain significant climate-related risks and opportunities are concentrated.



- BC68 This approach is designed to achieve an appropriate balance, facilitating decision-useful information to users of general purpose financial reporting without imposing excessive costs on preparers or requiring them to make undue efforts.

**Time horizons**

- BC69 The relevant time horizons vary for climate-related risks and opportunities and their associated effects over the short, medium and long term, depending on an entity’s business model, strategy and cash flows. For example, factors such as these may be relevant in determining how a particular entity defines ‘short’, ‘medium’ and ‘long’ term: its investment cycle; the industry of which it is a part; the profile of the climate-related risks it faces; the useful life of its assets; its strategic objectives; and the sectors and jurisdictions in which it operates. Mining projects, for instance—which include exploration, feasibility, approval, construction, production and reclamation activities—can span decades. By contrast, knowledge-intensive industries, such as the development of telecommunications and software, generally have much shorter planning and investment cycles. Some effects are relatively immediate. The enhancement of a particular workforce skill through focused training is one example. Others, such as the reversal of impacts on ecosystems, might take generations to accomplish.

- BC70 As a result, and rather than prescribing specific time frames across industries, the Exposure Draft includes a proposal that would require an entity to determine what it considers the ‘short’, ‘medium’ and ‘long’ term; and to disclose how those definitions are linked to its strategic planning horizons, particularly its plans to allocate capital. This is due to the importance of the individual entity’s context in determining the appropriate time horizons. Similarly, the users of general purpose financial reporting, who are the intended beneficiaries of this information, are not a homogeneous group with a common understanding of ‘short’, ‘medium’ and ‘long’ term.

**Transition plans**

- BC71 The disclosure of an entity’s transition plan towards a lower-carbon economy is important for enabling users of general purpose financial reporting to assess the entity’s current and planned responses to the decarbonisation-related risks and opportunities that can reasonably be expected to affect its enterprise value.

- BC72 Transition plans form part of an entity’s overall business strategy towards a lower-carbon economy. Such plans are typically aligned with an entity’s broader activities for addressing climate-related risks and opportunities as well as its overall business strategy, and reflect the entity’s individual circumstances while including relevant, industry-specific information.

- BC73 Although transition plans may include a wide range of information, market perspectives vary on what information is most useful for climate-related financial disclosure. At a minimum, the TCFD has recommended that disclosure about a transition plan should include an entity’s current GHG emissions and the related strategic implications for its business, strategic and

financial planning. Users of general purpose financial reporting increasingly emphasise that such plans should explain the specific actions and activities that a particular entity plans to undertake to support the transition. These actions or plans can include targets to reduce its GHG emissions, current or anticipated changes to business and strategy, and periodic milestones or key performance indicators to measure progress. Users have further suggested that target dates, scope and coverage should also be provided to monitor progress, while underlying assumptions and uncertainties should be included to facilitate transparency.

- BC74 The Exposure Draft provides a range of proposed requirements related to transition plans. Although transition plans are most explicitly related to the proposed strategy requirements (paragraph 13 of the Exposure Draft), it is proposed that disclosures about an entity's transition plan also include related disclosures made in accordance with the Exposure Draft's metrics and targets requirements. For example, in disclosing information about their transition plans, many entities will include or make explicit connections to their disclosure of GHG emissions (paragraph 21) and their targets to reduce emissions (paragraph 23). To show current-period progress against the plan, many entities also incorporate or make explicit connections to their disclosure of quantitative measures of performance on specific mitigation or adaptation activities using industry-based metrics (Appendix B), which may also serve as metrics of progress related to targets (paragraph 23). An entity may also include elements of scenario analysis or other assessments of its resilience (disclosed in accordance with paragraph 15) into its transition plan disclosure to show how it has tested the achievability of the plan and its associated targets under multiple plausible climate-related scenarios.
- BC75 Most specifically, paragraph 13 of the Exposure Draft proposes a range of disclosures about an entity's transition plans. The Exposure Draft proposes requiring disclosure of information to enable users of general purpose financial reporting to understand the effects of climate-related risks and opportunities on an entity's strategy and decision-making, including its transition plans. This includes information about how it plans to achieve any climate-related targets that it has set (including information about the use of carbon offsets), its plans and critical assumptions for legacy assets and quantitative and qualitative information about the progress of plans previously disclosed by the entity.

#### *Carbon offsets*

- BC76 The Exposure Draft's proposals reflect the need for users of general purpose financial reporting to gain insight into an entity's approach to reducing emissions, including the role played by carbon offsets and the quality of those offsets.
- BC77 An entity seeking to meet climate-related targets may consider reducing emissions from its own value chain (reductions), obtaining carbon offsets to neutralise or compensate for its value chain emissions (removals), or both. Carbon reduction within an entity's value chain typically occurs through changes to processes, technologies or business models made, directed or

influenced by the entity. For example, an entity may increase the energy efficiency of its operations resulting in lower Scope 2 emissions or implement carbon capture technology into its processes resulting in decreased Scope 1 emissions. Carbon reductions result in an entity emitting fewer absolute greenhouse gases into the atmosphere.

- BC78 Carbon removals involve extracting (already-emitted) GHG emissions from the atmosphere, either through nature-based or technological means. Removals outside an entity's value chain are often represented by carbon offsets. Offsets are typically generated by and obtained from third parties to neutralise or compensate for a portion of an entity's value chain emissions on a net basis. A class of carbon offsets, known as carbon credits, are offsets that take the form of transferable or tradable instruments, certified by governments or independent certification bodies, representing a removal of emissions of one metric tonne of CO<sub>2</sub> or an equivalent amount of other GHGs. Entities may generate credits, for example, through cap-and-trade schemes that they can sell, or they may buy carbon offset credits for their own use in offsetting some of their emissions.
- BC79 Jurisdictions have varied views about the extent to which carbon removal—and thus offsetting—should be used and whether it can reliably be used alongside or instead of carbon-reduction programmes to achieve climate-related emission targets. These disparate views are exemplified by the varying regional approaches to gross and net-zero emission-reduction targets. For example, of 74 countries with net-zero targets, five have communicated separate gross emissions-reduction targets to achieve alongside their net-zero targets and 10 have committed to meeting their net-zero targets without purchasing international offsets. Even so, because of technical or economic constraints, many entities will find it difficult to reduce all their emissions so carbon offsets can play an important role in the transition plans of entities.
- BC80 An entity's reliance on carbon offsets, how the offsets it uses are generated, and the credibility and integrity of the scheme from which the entity obtains the offsets have implications for an entity's enterprise value over the short, medium and long term. For example, the carbon capture and storage technology may prove ineffective, or changing regulations may discourage or ban the use of specified carbon offsets after abrupt leakages, food shortages, regime changes or advocacy efforts. Significant uncertainty about future prices for carbon offsets implies additional climate-related (pricing) risks and opportunities. Accordingly, the Exposure Draft's proposals include disclosure requirements regarding the use of carbon offsets in achieving an entity's emission targets. The proposal reflects the need for users of general purpose financial reporting to understand an entity's plan for reducing emissions, the role played by carbon offsets and the quality of those offsets.
- BC81 When providing information about carbon offsets used, the Exposure Draft proposes that an entity is required to disclose whether its offsets are based on natural or technological carbon removals. Each of these methods results in a different risk profile for investors. For example, many technological solutions are not presently economical at commercial scales and will require significant investment and have significant energy requirements, creating a drag on their

net contributions; the solutions may also pose challenges regarding long-term storage of captured carbon. Natural-based approaches, on the other hand, involve the enhancement of natural carbon sinks, such as through afforestation, soil-based carbon sequestration and the use of other biomass stores. While often a more cost-effective solution at the present time compared to technology solutions, nature-based approaches may prompt concerns about leakage, ‘permanence’ and ‘additionality’, as well as about secondary effects on other social and environmental issues such as food production.

- BC82 In evaluating offset projects, ‘additionality’ and ‘permanence’ have been highlighted as two essential features for assessing the quality of carbon offsets. Permanence refers to how long the carbon will be safely removed from the atmosphere, and additionality refers to whether an investment causes new climate benefits or whether the benefits would have happened irrespective of the investment. While these metrics can be useful, assessing additionality and permanence is complex.
- BC83 Instead of requiring entities to disclose their assessment of additionality and permanence, the Exposure Draft proposes requirements to disclose the basis of the offsets’ carbon removal (nature- or technology-based) and the third-party verification or certification scheme for the offsets. The Exposure Draft also proposes that an entity disclose any other significant factors necessary for users of general purpose financial reporting to understand the credibility and integrity of the offsets used by the entity. For example, in order to meet these requirements, an entity in the technology sector may disclose that after assessing multiple schemes, it has offset residual emissions within its value chain via afforestation programmes to meet its strategic commitment to mitigate climate-related risk. The entity could further explain how many offset programmes it selected and that the basis of selection led to (semi)-permanent and additional outcomes, and met an accredited verification standard. The entity could also describe each project, where the projects operate, the number of metric tonnes of offsets, the cost per metric tonne, the year in which the emission reduction occurred and the verification standard applied to the scheme.
- BC84 Carbon offsets can be based on avoided emissions. Avoided emissions are the potential lower future emissions of a product, service or project when compared to a situation where the product, service or project did not exist, or when compared to a baseline. Emission avoidance has been criticised by some as being inherently problematic because it is challenging for investors to determine whether such projects meet the additionality tests. Avoided-emission approaches in an entity’s climate-related strategy are complementary to and fundamentally different from the entity’s emission-inventory accounting and emission-reduction transition targets. The Exposure Draft, therefore, proposes to include a requirement for entities to disclose whether the carbon offset amounts achieved are through carbon removal or emission avoidance.

BC85 The Exposure Draft aims to balance the cost for preparers with the need to disclose enough information to enable users of general purpose financial reporting to gain insight into the entity’s approach to reducing emissions, the role played by carbon offsets and the soundness or credibility of those carbon offsets.

**Climate resilience**

BC86 The likelihood, magnitude and timing of climate-related risks affecting an entity are often complex and uncertain. As a result, users of general purpose financial reporting need to understand the resilience of an entity’s strategy (including its business model) to climate change, factoring in the associated uncertainties. Paragraph 15 of the Exposure Draft, therefore, includes requirements related to an entity’s analysis of the resilience of its strategy to climate-related risks. These requirements focus on:

- (a) what the results of the analysis, such as effects on the entity’s decisions and performance, should enable users to understand; and
- (b) whether the analysis has been conducted using:
  - (i) climate-related scenario analysis; or
  - (ii) an alternative technique.

BC87 For the proposed disclosure requirements in the Exposure Draft, the starting point was to set out what the entity’s analysis of climate resilience should enable users of general purpose financial reporting to understand—including areas of significant uncertainty considered in that analysis. Stating the aims up front is intended to help an entity provide information that meets the needs of users when preparing disclosures in accordance with the subsequent requirements in paragraph 15(b).

BC88 Scenario analysis in the context of climate-related risk is used to evaluate a range of hypothetical outcomes associated with climate-related risks and opportunities by considering a variety of alternative plausible future states (scenarios) under a given set of assumptions and constraints. A critical aspect of scenario analysis is the selection of a set of scenarios that covers a range of future outcomes, both favourable and unfavourable. Scenario analysis is becoming increasingly well established as a tool to help entities and investors understand the potential effects of climate change on business models, strategies, financial performance and financial position. The work of the TCFD showed that investors have sought to understand the assumptions used in scenario analysis and how an entity’s findings from the analysis inform its strategy and risk-management decisions and plans. The TCFD also found that investors want to understand what the outcomes show about the resilience of the entity’s strategy, business model and future cash flows to a range of future climate scenarios (including whether the entity has used a scenario aligned with the latest international agreement on climate change). Corporate board committees (notably audit and risk) are also increasingly requesting entity-specific climate-related risks to be included in risk mapping with scenarios reflecting different climate outcomes and the severity of their effects.

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- BC89 Although scenario analysis is a widely accepted approach, its application to climate-related matters in business, particularly at an entity level, and its application across sectors is still evolving. Some sectors, such as extractives and minerals processing, have used climate-related scenario analysis for many years; others, such as consumer goods or technology and communications, are just beginning to explore applying climate-related scenario analysis to their businesses.
- BC90 Many entities use scenario analysis in risk management for other purposes, where robust data and practices have been developed. Most entities thus have the analytical capacity to undertake scenario analysis. However, at this time the application of climate-related scenario analysis for entities is still developing.
- BC91 Preparers raised other challenges and concerns associated with climate-related scenario analysis, including: the speculative nature of the information that scenario analysis generates, the potential legal liability associated with disclosure (or miscommunication) of such information, limited data availability and the potential disclosure of confidential information about an entity's strategy. Nonetheless, by prompting the consideration of a range of possible outcomes and explicitly incorporating multiple variables, scenario analysis provides valuable information and perspectives as inputs to an entity's strategic decision-making and risk-management processes. Accordingly, information about an entity's climate-related scenario analysis is important for users in assessing enterprise value.
- BC92 Given the differing effects of climate-related risks for entities in various sectors and circumstances, the Exposure Draft does not prescribe particular scenarios that an entity should use nor propose that standard or specific reference scenarios be applied. This is because this approach is not considered practical (particularly for an international standard-setter) and would risk entities being required to apply scenarios that may not result in useful information in their circumstances. Consequently, the Exposure Draft's proposed disclosure requirements seek to balance the need for comparable disclosure with the need to allow entities to select scenarios appropriate for their facts and circumstances and to require disclosure about those scenarios including the time horizons used, inputs and assumptions. The provision of information about the assumptions used is intended to facilitate comparisons by users of general purpose financial reporting. As mentioned in paragraph BC88 and further discussed in paragraph BC122, the Exposure Draft requires disclosure of whether the entity has used a scenario aligned with the latest international agreement on climate change, and it further requires the entity to explain why it selected the scenarios it used. It is envisaged that over time industries and/or jurisdictions might work together to develop scenarios that would improve comparability in practice.
- BC93 The Exposure Draft proposes that an entity be required to use climate-related scenario analysis to assess its climate resilience unless it is unable to do so. If an entity is unable to use climate-related scenario analysis it shall explain why and use an alternative method or technique to assess its climate resilience.

- BC94 Conducting and disclosing information about climate-related scenario analysis may be considered challenging by a number of preparers at this time—particularly in some sectors. Therefore, the proposed requirements are designed to accommodate alternative approaches to resilience assessment, such as qualitative analysis, single-point forecasts, sensitivity analysis and stress tests. This approach would provide preparers, including those in smaller entities, with relief, recognising that formal scenario analysis and related disclosure can be resource intensive, represents an iterative learning process, and may take multiple planning cycles to achieve. It is noted that by making climate-related scenario analysis a requirement subject only to whether an entity is able to conduct it, over time an increasing number of entities would be expected to apply this form of analysis. The Exposure Draft proposes that when an entity uses an approach other than scenario analysis, it disclose similar information to that generated by scenario analysis to provide users of general purpose financial reporting with the information they need to understand the approach used and the key underlying assumptions and parameters associated with the approach and associated implications for the entity's resilience over the short, medium and long term. These proposed requirements are designed to help users understand what the TCFD has described as the entity's adaptive capacity to respond to climate change to better manage the associated risks and seize opportunities, including the ability to respond to transition risks and physical risks.
- BC95 It is recommended that scenario analysis should become the preferred option to meet the information needs of users to understand the resilience of an entity's strategy to significant climate-related risks. As a result, the Exposure Draft proposes that entities that are unable to conduct climate-related scenario analysis provide an explanation of why this analysis was not conducted. Consideration was also given to whether climate-related scenario analysis should be required by all entities with a later effective date than other proposals in the Exposure Draft to provide more time for entities to prepare. However, on balance, the Chair and Vice-Chair decided that at this time it was more appropriate to limit climate-related scenario analysis to those able to do it.

#### **Current and anticipated effects**

- BC96 Users of general purpose financial reporting need to understand the effects of significant climate-related risks and opportunities on an entity's financial position, financial performance and cash flows for the reporting period, and the anticipated effects over the short, medium and long term. Financial effects arise, of course, from the specific climate-related risks and opportunities to which that entity is exposed, and its strategic and risk-management decisions on seizing those opportunities and managing those risks. Disclosure of actual and anticipated financial effects associated with climate change enables more effective pricing of climate-related risks and opportunities, more informed assessments of enterprise value and facilitates the efficient allocation of capital.

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- BC97 The Exposure Draft proposes requirements for an entity to disclose information about the anticipated future effects of significant climate-related risks and opportunities. The Exposure Draft proposes that, if such information is provided quantitatively, it can be expressed as a single amount or as a range. Disclosing a range enables an entity to communicate the significant variance of potential outcomes associated with the monetised effect for an entity; whereas if the outcome is more certain, a single value may be more appropriate.
- BC98 The TCFD's 2021 status report identified the disclosure of anticipated financial effects of climate-related risks and opportunities using the TCFD Recommendations as an area with little disclosure. Challenges include: difficulties of organisational alignment, data, risk evaluation and the attribution of effects in financial accounts; longer time horizons associated with climate-related risks and opportunities compared with business horizons; and securing approval to disclose the results publicly. Disclosing the financial effects of climate-related risks and opportunities is further complicated when an entity provides specific information about the effects of climate-related risks and opportunities on the entity. The financial effects could be due to a combination of other sustainability-related risks and opportunities and not separable for the purposes of climate-related disclosure (for example, if the value of an asset is considered to be at risk it may be difficult to separately identify the effect of climate on the value of the asset in isolation from other risks).
- BC99 Similar concerns were raised by members of the TRWG in the development of the prototype climate-related disclosure standard following conversations with some preparers. The difficulty of providing single-point estimates due to the level of uncertainty regarding both climate outcomes and the effect of those outcomes on a particular entity was also emphasised. As a result, the proposals in the Exposure Draft seek to balance these challenges with the provision of information for users of general purpose financial reporting about how climate-related issues affect an entity's financial position and financial performance currently and over the short, medium and long term by allowing anticipated monetary effects to be disclosed as a range or a point estimate.
- BC100 The Exposure Draft proposes that an entity be required to disclose the effects of significant climate-related risks and opportunities on its financial position, financial performance and cash flows for the reporting period, and the anticipated effects over the short, medium and long term—including how climate-related risks and opportunities are included in the entity's financial planning (paragraph 14). The requirements also seek to address potential measurement challenges by requiring disclosure of quantitative information unless an entity is unable to provide the information quantitatively, in which case it shall be provided qualitatively.



**Risk management (paragraphs 16–18 of [draft] IFRS S2)**

- BC101 An objective of the Exposure Draft is to require an entity to provide information about its exposure to climate-related risks and opportunities, to enable users of general purpose financial reporting to assess the effects of climate-related risks and opportunities on the entity's enterprise value. Such disclosures include information for users to understand the process, or processes, that an entity uses to identify, assess and manage not only climate-related risks, but also opportunities. Paragraphs 16 and 17 of the Exposure Draft propose to extend the remit of disclosures about risk management beyond the TCFD Recommendations, which currently only focus on climate-related risks, to also include climate-related opportunities. This proposal reflects both the view that risks and opportunities can relate to or result from the same source of uncertainty (see paragraphs BC23–BC27), as well as the evolution of common practice in risk management, which increasingly includes opportunities in processes for identification, assessment, prioritisation and response.
- BC102 While the proposed disclosure requirements include climate-related opportunities, the Exposure Draft proposes more detailed disclosure requirements for climate-related risks, reflecting the relative maturity of entities' risk management processes and the needs of users of general purpose financial reporting to be assured that entities have adequate risk identification, assessment and management processes.
- BC103 Avoiding unnecessary duplication is critical to improving the understandability of the proposed climate-related disclosures. The core content areas of IFRS Sustainability Disclosure Standards are interrelated. For example, risk (and opportunity) identification and assessment inform the entity's strategy formulation and planning, and its establishment of performance targets. The proposals in the Exposure Draft seek to capture this interrelatedness without unnecessarily duplicating the disclosure requirements. Therefore, the Exposure Draft proposes disclosures on both:
- (a) the process, or processes the entity uses to identify, assess and manage climate-related risks and opportunities (Risk Management); and
  - (b) what these climate-related risks and opportunities are, including the entity's strategies for addressing them, the entity's assessment of their impact on its business model, management's strategy and decision-making, as well as its financial position, financial performance and cash flows, and how these inform the climate resilience of the entity's strategy (Strategy).
- BC104 By design, the risk management requirements in the Exposure Draft are closely aligned with those in [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*. This follows the recommendations of the TRWG who intended that specific disclosure requirements always follow the core content areas set out in [draft] IFRS S1 with tailoring to suit the particular sustainability matter being addressed. In finalising the Exposure Draft, consideration was given to whether this could give rise to unnecessary duplication in disclosures and thus whether it was appropriate to include the

disclosure requirements listed under risk management in the Exposure Draft (paragraphs 16–18), or whether instead the objective should simply be listed with a cross-reference to [draft] IFRS S1. This is because these two sets of disclosure requirements are nearly identical, with the Exposure Draft specifying the need to provide these disclosures for climate-related risks and opportunities. However, to ensure consistent and comparable disclosures, and to facilitate ease of application of the Exposure Draft, the requirements are laid out in both exposure drafts in full. To avoid unnecessary duplication in disclosures, the Exposure Draft states that an entity shall avoid unnecessary duplication. For example, it may be most appropriate for an entity to describe its overall risk management for sustainability-related matters and to include additional content specifically about climate-related risks and opportunities; co-locating information about overall risk management for sustainability-related matters and climate-related risks and opportunities, thus complying with both the Exposure Draft and [draft] IFRS S1.

## **Metrics and targets (paragraphs 19–24 of [draft] IFRS S2)**

### **Cross-industry metric categories**

- BC105 The Exposure Draft proposes incorporating the TCFD’s concept of cross-industry metrics and metric categories with the aim of improving the comparability of disclosures across reporting entities regardless of industry. The proposals in the Exposure Draft would require an entity to disclose the metric categories irrespective of its particular industry or sector (subject to materiality). In proposing these requirements, the TCFD’s criteria were considered. These criteria were designed to identify metric categories that are:
- (a) indicative of basic aspects and drivers of climate-related risks and opportunities;
  - (b) useful for understanding how an entity is managing its climate-related risks and opportunities;
  - (c) widely requested by climate reporting frameworks, lenders, investors, insurance underwriters and regional and national disclosure requirements; and
  - (d) important for estimating the financial effects of climate change on entities.
- BC106 The Exposure Draft thus proposes seven cross-industry metric categories that all entities would be required to disclose – greenhouse gas (GHG) emissions on an absolute basis and on an intensity basis; transition risks; physical risks; climate-related opportunities; capital deployment towards climate-related risks and opportunities; internal carbon prices; and the percentage of executive management remuneration that is linked to climate-related considerations. The Exposure Draft proposes that the GHG Protocol be applied to measure GHG emissions (see paragraphs BC112–BC114).

- BC107 The TCFD found, in its public consultation in June 2021, that most respondents (over 75%) agreed that the cross-industry metric categories had the potential to improve comparability. The TCFD’s consultation also showed that investors overwhelmingly (71–91%) viewed cross-industry metrics for GHG emissions, physical or transition risk, climate-related opportunities and capital deployment to be very useful, while internal carbon price and remuneration metrics were viewed as relatively less useful (42% viewed them as very useful). The same consultation showed that the extent of disclosure of these metric categories by entities varied. GHG emissions were currently disclosed or planned to be disclosed by 64% of respondents; for the rest of the cross-industry metric categories, between 25–47% of reporting entities were already disclosing or planning to disclose them.
- BC108 Aside from the GHG emissions category, the other cross-industry metric categories are defined broadly in the Exposure Draft. It is noted that this may reduce the comparability of the information provided. In order to improve understandability and to guide application, the Exposure Draft proposes implementation guidance that provides non-mandatory illustrative examples of the information that could be used to meet the cross-industry metric categories. These materials were not in the TRWC’s climate-related disclosure prototype and are based on the TCFD’s *Guidance on Metrics, Targets and Transition Plans*.
- BC109 Despite these comparability challenges, it was considered important to include information to facilitate cross-industry comparisons while seeking to address identified challenges including those discussed here. One reason for the broad descriptions of required disclosure is a consequence of the state of development in this area of measurement. The ability of entities and industries to identify appropriate metrics will vary, and the state of methodologies and data may need to evolve further in some areas. For instance, the required information for transition and physical risks is the ‘amount and extent of assets or business activities vulnerable to’ the risk. The requirements also allow for some information that is less specific because it is expected that many entities may find it difficult to disaggregate their capital expenditures and attribute a specific portion to climate-related risks and opportunities, particularly for projects with multiple goals. Finally, it was acknowledged that, although GHG emissions are well defined under the GHG Protocol Standard, calculation of Scope 3 emissions under the Protocol is still being refined and involves a number of data and methodology challenges for preparers. However, despite the challenges with Scope 3 emissions, such data are commonly used as an important foundational input to the calculation of risk exposure throughout the value chain, including the financed emissions of financial institutions.

### **Scope 1, 2 and 3 emissions**

- BC110 Climate change is driven by imbalances in atmospheric GHG concentrations. A basic climate-related risk metric, therefore, is an entity’s carbon footprint, that is, its contribution to GHG emissions. For a disclosure about such emissions to be meaningful to users of general purpose financial reporting, an entity would have to disclose its gross GHG emissions—that is, its emissions

before accounting for any removal efforts (offsets and credits). Disclosure of gross GHG emissions helps users of general purpose financial reporting to determine to what extent an entity is mitigating its own emissions. Users also need to understand the various approaches an entity may take to reduce its net GHG emissions and the associated risks. As a result, the Exposure Draft proposes that an entity separately disclose its removal efforts (offsets and credits) to arrive at its net GHG emissions (paragraph 13 of the Exposure Draft, and paragraphs BC76–BC85). This enables users to understand how much an entity is relying on other parties to offset emissions, including the variety and quality of other approaches used by the entity to reduce its net GHG emissions.

- BC111 Reporting of emissions on a gross basis is foundational data from which several other climate-related risk and opportunities metrics, including scaled emission intensity metrics and indices, are determined and monitored. Emissions data can be used to compare facilities or industries, track emissions from one year to the next, help a particular industry to identify opportunities for reduction, provide important information to the finance and investment communities and calibrate emission trading schemes. As an indicator of transition risk, this information is, of course, important for the assessment of an entity's enterprise value by users of general purpose financial reporting.
- BC112 The Organisation for Economic Co-operation and Development has reported that, although a wide range of standards, protocols, codes, principles and guidance on GHG-emission measurement, reporting and verification have been developed by private- and public-sector initiatives around the world, the most widely used methodologies are the GHG Protocol and the International Organization for Standardization standard 14064 (which is compatible with the GHG Protocol), on which many of the other schemes rely. The GHG Protocol Corporate Standard was first published in 2001 and has been periodically updated to clarify how an entity can measure and account for emissions throughout its value chain. The GHG Protocol Corporate Standard, defines three scopes of GHG emissions from the perspective of the reporting entity:
- (a) Scope 1 – GHG emissions are direct emissions from owned or controlled sources.
  - (b) Scope 2 – GHG emissions are indirect emissions from the generation of purchased energy.
  - (c) Scope 3 – GHG emissions are all indirect emissions (not included in Scope 2) that occur in the value chain of the reporting entity, including both upstream and downstream emissions. Scope 3 emissions are further divided into 15 categories, eight of which are upstream, and seven of which are downstream from the reporting entity. Scope 3 Category 15 is 'investments' – those GHGs emitted by a third-party to which the reporting entity provides financing. The investment category, sometimes referred to as 'financed emissions', is a particularly important reporting category for financial institutions

because it is often the most significant part of their GHG emissions inventory (see paragraphs BC149–BC172).

BC113 The Exposure Draft’s proposed disclosure requirements about GHG emissions are based on the GHG Protocol because:

- (a) the Protocol provides standardised approaches and principles for an entity to prepare a GHG inventory that represents a true and fair account of its emissions;
- (b) use of the Protocol aligns with the predominant corporate practices for compiling a GHG inventory; and
- (c) its use will promote consistency and transparency in GHG accounting and disclosure among various entities and GHG programmes (including the TCFD Recommendations and the SASB Standards, which the Exposure Draft builds upon).

BC114 The Exposure Draft proposes that an entity shall measure its GHG emissions in accordance with the GHG Protocol Corporate Standard. The collection and reporting of GHG emissions data is not a precise and exact science. For instance, the GHG Protocol allows various approaches to be taken to determine which emissions are included in the calculation of Scope 1, 2 and 3 by an entity—including, for example, how the emissions of unconsolidated entities such as associates are included. This means that the way information is provided about an entity’s investments in other entities in their financial statements may not align with how its GHG emissions are calculated. It also means that two entities with identical investments in other entities could report different GHG emissions in relation to those investments by virtue of choices made in applying the GHG Protocol. To facilitate comparability despite the varied approaches allowed in the GHG Protocol, the Exposure Draft proposes that an entity shall disclose:

- (a) separately the Scope 1 and Scope 2 emissions, for:
  - (i) the consolidated accounting group (the parent and its subsidiaries); and
  - (ii) associates, joint ventures, unconsolidated subsidiaries or affiliates not included in the consolidated accounting group; and
- (b) the approach it used to include emissions for associates, joint ventures, unconsolidated subsidiaries or affiliates not included in the consolidated accounting group (for example, the equity share or operational control method in the GHG Protocol Corporate Standard).

BC115 For entities in some industries, the industry-based requirements (see paragraphs BC123–BC172) propose the disclosure of further information related to Scope 1 emissions. For entities in others, the industry-based requirements propose the disclosure of information about the entity’s energy management practices, an important driver of its Scope 2 emissions.

BC116 For Scope 3, the Exposure Draft proposes that:

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- (a) an entity shall include upstream and downstream emissions in its measure of Scope 3 emissions.
- (b) an entity shall disclose an explanation of the activities included within its measure of Scope 3 emissions to enable users of general purpose financial reporting to understand which Scope 3 emissions have been included in, or excluded from, those reported. For example, an entity might be exposed to risks or opportunities related to the GHG emissions arising out of third-party transportation and distribution services it buys for outbound logistics of products sold to customers. The entity would include that information about such emissions if material to the users of its general purpose financial reporting in their assessment of its enterprise value.
- (c) when the entity's measure of Scope 3 emissions includes information provided by entities in its value chain, it shall explain the basis for that measurement.
- (d) if the entity excludes those GHG emissions, it shall state the reason for omitting them, for example, because it is unable to obtain a faithful measure.

BC117 The disclosure of Scope 3 GHG emissions, in particular, faces a number of challenges, including those related to data availability, use of estimates, calculation methodologies and other sources of uncertainty. However, despite these challenges, the disclosure of GHG emissions, including Scope 3 emissions, is rapidly increasing both in the number of entities providing disclosures and the quality of the information across all sectors and jurisdictions. This development reflects an increasing recognition that Scope 3 emissions are an important component of investment-risk analysis because, for most entities, they represent by far the largest portion of an entity's carbon footprint. Entities in many industries face risks and opportunities related to activities that drive Scope 3 emissions both up and down the value chain. For example, they may need to address evolving and increasingly stringent energy efficiency standards through product design (a transition risk) or seek to capture growing demand for energy-efficient products or to enable or incentivise upstream emissions reduction (climate opportunities). In combination with industry metrics related to these specific drivers of risk and opportunity, Scope 3 data can help users of general purpose financial reporting evaluate the degree to which an entity is adapting to the lower-carbon transition. Thus, their evaluation enables an entity and its investors to identify the most significant GHG reduction opportunities across the entire value chain, thereby informing strategic and operational decisions regarding relevant inputs, activities and outputs.

BC118 These considerations are reflected in the increasing number of entities making public commitments to reduce their direct and indirect GHG emissions to net zero and also in the increasing market, societal and regulatory expectations placed on financial institutions to report GHG emissions—including Scope 3 emissions—in meeting their disclosure obligations.

**Targets aligned with the scientific and political consensus**

- BC119 The proposals related to emissions reduction require information to be provided by an entity about how its climate-related targets compare with scientific and political consensus, while allowing for the fact that such consensus could evolve. Consequently, the Exposure Draft proposes that information be provided about the targets the entity has set and does not define ‘science-based’ targets in a manner that locks in current agreed norms.
- BC120 Paragraph 23 of the Exposure Draft proposes that an entity be required to disclose information about its emission-reduction targets, including the objective of the target (for example, mitigation, adaptation or conformance with sector or science-based initiatives), as well as information about how the entity’s targets compare with those created in the latest international agreement on climate change.
- BC121 The ‘latest international agreement on climate change’ is defined as the latest agreement between members of the United Nations Framework Convention on Climate Change (UNFCCC). The agreements made under the UNFCCC set norms and targets for a reduction in greenhouse gases. At the time of publication of the Exposure Draft, the latest such agreement is the Paris Agreement (April 2016); its signatories agreed to limit global warming to well below 2 degrees Celsius above pre-industrial levels, and to pursue efforts to limit warming to 1.5 degrees Celsius above pre-industrial levels. Until the Paris Agreement is replaced, the effect of the proposals in the Exposure Draft are that an entity is required to reference the targets set out in the Paris Agreement when disclosing whether or to what extent its own targets compare to the targets in the Paris Agreement.
- BC122 Paragraph 15 of the Exposure Draft would also require an entity to disclose whether the entity has used among its scenarios, a scenario aligned with the ‘latest international agreement on climate change’ (see paragraph BC121). As with the targets, this requirement is designed to enable users to understand if the entity has used a scenario consistent with those created in the latest international agreement (that is, currently well below 2 degrees Celsius, and pursuing efforts to 1.5 degrees above industrial levels).

**Industry-based metrics**

- BC123 In addition to the cross-industry metric categories discussed in paragraphs BC105–BC118, the Exposure Draft also proposes that an entity would be required to disclose industry-based metrics. In many cases, industry-based metrics will be closely related to cross-industry metrics categories, as illustrated in the Illustrative Guidance that accompanies the Exposure Draft. A non-comprehensive selection of industry-based metrics is associated with the disclosure topics contained in Appendix B *Industry-based disclosure requirements*.
- BC124 Climate change will affect an entity differently depending on its business model and associated economic activities, so to support the provision of information that is useful to users of general purpose financial reporting in assessing enterprise value, the Exposure Draft includes a significant industry-

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tailored component. When the SASB Standards were being developed, users said they needed metrics linked to key drivers of enterprise value, which tend to vary from one industry to another, in order to meaningfully assess climate-related risks and opportunities, as well as associated exposures and vulnerabilities. In addition, responses to the Trustees' 2020 consultation and the statements issued by IOSCO about the work of the ISSB have emphasised the importance of the ISSB developing industry-based requirements.

- BC125 To address this market need, the starting point for the Exposure Draft was the SASB Standards. It was decided that these materials would provide a robust basis for the industry-based requirements included in the Exposure Draft (see paragraphs BC33–BC36). This also enables the ISSB to benefit from the input that the SASB has received in the past. Furthermore, by basing the proposals on these requirements, the Exposure Draft enables those entities already applying the SASB Standards or those consuming the information resulting from those standards to have a simpler transition to IFRS Sustainability Disclosure Standards.
- BC126 However, several potential challenges in taking this approach were identified. These challenges, and a summary of the approach taken to address each, included:
- (a) international applicability (many sectors)—to address industry metrics that cited jurisdiction-specific regulations or standards, the Exposure Draft includes proposed revisions to some SASB requirements to update references to international standards and definitions or, where appropriate, jurisdictional equivalents;
  - (b) real or perceived duplication (certain sectors)—to address industry metrics that duplicated—or may be interpreted as duplicating—disclosures required in the core content of the Exposure Draft, such as measures of GHG emissions, the Exposure Draft proposes appropriate signposting and application guidance to clarify interrelationships; and
  - (c) emerging consensus on financed emissions (financial sector)—to address emerging consensus on the disclosure of financed emissions in the financial sector, the Exposure Draft proposed new industry-based metrics aligned with current norms and practices.
- BC127 Each of these work streams is detailed in paragraphs BC130–BC172. This work has been carried out since the November 2021 publication of the TRWG prototypes by the technical staff of the ISSB (including those who have joined from the CDSB) and the technical staff of the Value Reporting Foundation, building on prior work of the SASB and others.
- BC128 Most of the industry-based requirements included in the Exposure Draft are unchanged from those in the SASB Standards and thus the ISSB benefits from the prior experience of those using the SASB Standards and using the information resulting from their application. The ISSB is particularly interested in feedback from market participants on the revisions proposed to these requirements through these recent work streams.



BC129 Because the other industry-based requirements have been in wide use since the SASB Standards were issued in 2018, it was noted that the Value Reporting Foundation has had the opportunity to gather input and identify potential revisions, and that this information will inform the ISSB’s work, including its consultation on its agenda. It was further stressed that—given the dynamic nature of climate change, related business risks and opportunities, and market understanding and practices—ongoing maintenance will be required to ensure that climate-related information meets the needs of users of general purpose financial reporting. The proposals in the Exposure Draft provide a strong foundation for climate-related disclosures for the ISSB.

**International applicability (multiple sectors)**

BC130 The ISSB’s remit is to set out a global baseline of sustainability-related disclosures for users of general purpose financial reporting. As the proposed standards become more detailed and specific, there are inherent trade-offs between facilitating comparability and avoiding complexity. Key differences in regulatory environments, voluntary standards, industry structures and business models across geographic regions can exacerbate the difficulty of developing sustainability-related disclosure standards that are readily applicable across jurisdictions.

BC131 It was noted that the overwhelming majority of the industry-based metrics related to the Exposure Draft are suitable to be applied internationally. For example, the Exposure Draft includes 350 industry-based metrics across 68 industries. Of these, 36 metrics (approximately 10%) were identified as requiring additional technical refinement to enhance their international applicability. Consideration was given to whether this issue could be addressed by developing interim guidance for preparers in targeted jurisdictions. However, it was determined that the 36 metrics could be addressed through just 12 focused technical amendments.

BC132 A cascading set of questions was considered to evaluate each metric and arrive at proposed revisions. The questions sought to determine:

- (a) whether an international standard, definition or calculation methodology applied;
- (b) if so, whether it was applicable to most or all jurisdictions;
- (c) if not, whether a widely understood general definition or calculation methodology could be derived from jurisdictional standards; and
- (d) if a general definition or calculation methodology cannot be derived, whether there were jurisdictional requirements with which an entity would have to comply.

BC133 Three proposed approaches were developed based on the answers to these questions:

- (a) Revision Approach 1—to revise by referring to an internationally applicable standard, definition or calculation method in relation to which:

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- (i) most jurisdictions abide;
  - (ii) jurisdictional equivalents are generally not meaningfully different from the prevalent international standard, definition or calculation methodology;
  - (iii) examples of jurisdictional equivalents are provided when relevant to enhance understandability;
- (b) Revision Approach 2—to revise otherwise by providing a general definition:
- (i) in the absence of an internationally applicable standard, definition or calculation methodology;
  - (ii) when the underlying concept is widely understood such that a general definition or calculation methodology would be broadly acceptable;
  - (iii) when a definition, standard or calculation methodology could enhance comparability;
- (c) Revision Approach 3—to revise otherwise by referring to jurisdictional requirements:
- (i) in the absence of an internationally applicable standard, definition or calculation methodology; and
  - (ii) when jurisdictional level standards, definitions or calculation methodologies apply.

*Example of Revision Approach 1: revised with reference to an internationally applicable standard, definition or calculation method*

- BC134 The SASB metric IF-EU-420a.2 measures the percentage of the electric load of electric utilities served by ‘smart grid’ technology. The technical protocol for this metric refers to ‘smart grid technology characteristics’ in accordance with Title XIII of the United States Energy Independence Act of 2007.
- BC135 Because the International Energy Agency (IEA), an internationally relevant organisation, defines those characteristics in its report, *Technology Roadmap: Smart Grids* (2011), the metric was revised to include the IEA’s smart grid characteristics.

**Table 1—Revision Approach 1 to adapting the SASB Standards**

SASB Standards	Proposed Revision
<i>IF-EU-420a.2. Percentage of electric load served by smart grid technology</i>	<i>IF-EU-420a.2. Percentage of electric load served by smart grid technology</i>

*continued...*

...continued

**SASB Standards**

An electric load is considered to be served by smart grid technology when the technology enables one or more of the distinguishing characteristics set forth in Title XIII of the U.S. Energy Independence Act of 2007.

- (i) Examples of smart grid technologies include, but are not limited to, demand-response systems, distribution automation, smart inverters, advanced metering equipment and other smart home and intelligent building control products.

**Proposed Revision**

An electric load is considered to be served by smart grid technology when the technology enables one or more of the distinguishing characteristics defined by the International Energy Agency (IEA).

- (i) Examples of smart grid technologies include, but are not limited to, energy storage, demand-response systems, distribution automation, smart inverters, advanced metering equipment, and other smart home and intelligent building control products.

*Example of Revision Approach 2: revised by providing a general definition*

- BC136 The SASB Standards include a metric that measures renewable fuel consumption in nine industry standards. The definition of renewable fuel used in the metrics is based on the US Renewable Fuel Standard.
- BC137 While there does not appear to be one definition of renewable fuel used internationally and in more than a single industry, there are many jurisdiction-level renewable fuel regulations which define renewable fuel, and definitions of renewable fuel used internationally for specific industries. The various jurisdictional and industry definitions all reflect a consistent set of general principles around renewable fuels. Thus, a general definition was derived and is given in the revised metric to reflect the core principles in the jurisdictional and industry-specific definitions.

**Table 2—Revision Approach 2 to adapting the SASB Standards**

<b>SASB Standards</b>	<b>Proposed Revision</b>
Renewable fuel is defined by the U.S. Renewable Fuel Standard (U.S. 40 CFR 80.1401), as fuel that meets all of the following requirements:	Renewable fuel is generally defined as fuel that meets all of the following requirements:
(i) produced from renewable biomass;	(i) produced from renewable biomass/feedstock;
(ii) used to replace or reduce the quantity of fossil fuel present in a transportation fuel, heating oil, or jet fuel; and	(ii) used to replace or reduce the quantity of fossil fuel present in a transportation fuel, heating oil, or jet fuel; and
(iii) has lifecycle greenhouse gas (GHG) emissions that are at least 20 percent less than baseline lifecycle GHG emissions, unless the fuel is exempt from this requirement pursuant to U.S. 40 CFR 80.1403.	(iii) achieved net greenhouse gas (GHG) emissions reduction on a life cycle basis.

*Example of Approach 3: revised with reference to jurisdictional requirements*

BC138	Three industry standards within the SASB Standards include as a metric the percentage of eligible products by revenue that are certified in accordance with the ENERGY STAR® programme.
BC139	The ENERGY STAR® programme is an initiative of the U.S. Environmental Protection Agency to identify and promote energy-efficient products. Other jurisdiction-level programmes, certifications and methodologies – such as the China Energy Label Program and the European Database of Energy Labelling – also promote the manufacture and use of energy-efficient products. No single classification system is accepted internationally, and the definitions, methodologies and thresholds used to determine the meaning of ‘energy-efficient’ differ between jurisdictions such that the proposal set out in the Exposure Draft does not include a general definition.
BC140	Given the lack of an internationally accepted approach and general definition, by following Revision Approach 3, the proposal set out in the Exposure Draft would require an entity to make the required disclosure on the basis of jurisdictional programmes and methodologies. The revision is intended to enable an entity to provide data on the energy efficiency of its products by using the most applicable methodology. (What would be ‘most applicable’ is based on where those products are sold to highlight the inherent risks and opportunities to which an entity is exposed.)

**Table 3—Approach 3 to adapting the SASB Standards**

<b>SASB Standards</b>	<b>Proposed Revision</b>
<i>Percentage of eligible products by revenue certified to the ENERGY STAR® program</i>	<i>Percentage of eligible products by revenue certified to an energy efficiency standard</i>
The entity shall disclose the percentage of its revenue from eligible products certified to the U.S. Environmental Protection Agency (EPA) ENERGY STAR® program.	The entity shall disclose the percentage of its revenue from eligible products certified to an energy efficiency standard.
(i) Eligible products are those in a product category for which ENERGY STAR® certification exists, including the following appliance and heating and cooling product categories: air purifiers, clothes dryers, clothes washers, dehumidifiers, dishwashers, freezers, refrigerators, air conditioning, boilers, ductless heating and cooling, furnaces, heat pumps and ventilation fans.	(i) The entity shall calculate the percentage as the revenue from products meeting the requirements for the applicable certification divided by total revenue from products eligible for certification.
(ii) The entity shall calculate the percentage as the revenue from products meeting the requirements for ENERGY STAR® certification divided by total revenue from products eligible for ENERGY STAR® certification.	(ii) Eligible products are those in a product category for which certification exists, including but not limited to: heating and cooling product categories: air purifiers, clothes dryers, clothes washers, dehumidifiers, dishwashers, freezers, refrigerators, air conditioning, boilers, ductless heating and cooling, furnaces, heat pumps and ventilation fans.

BC141 Tables 1–3 provide examples of proposed revisions using each of the three criteria-based approaches developed to address the 36 metrics identified as exhibiting regional bias. In some other instances, when a lone country-specific example was referenced in the protocols underlying an industry-based metric for illustrative or other non-essential purposes, such references were removed. All the metrics that were revised are marked up in the industry-based requirements for ease of reference, with additions underscored and deletions struck through, reflecting changes from the current SASB Standards.

BC142 These revisions were informed by targeted stakeholder outreach intended to enhance the international applicability of the metrics. Some respondents also suggested how a number of the metrics could more effectively measure performance. However, making such improvements is outside the scope of the proposed requirements set out in the Exposure Draft that were focused only

on addressing internationalisation to facilitate timely incorporation of the SASB climate-related industry-based requirements in the Exposure Draft. All additional feedback has been documented for further consideration by the ISSB when it deliberates future revisions.

### **Real or perceived duplication (some sectors)**

- BC143 Some industry-based metrics included in the Exposure Draft may duplicate—or may be perceived as duplicating—the cross-industry metrics included in the Exposure Draft. In particular, a metric related to Scope 1 GHG emissions is identified as an industry-based metric for entities in 22 industries; that metric may sometimes duplicate the proposal that would require all entities to disclose their absolute Scope 1, Scope 2 and Scope 3 emissions, and the intensity of those emissions.
- BC144 However, it was acknowledged that some industry-based metrics for GHG emissions necessitate the disclosure of additional, industry-specific performance data or analysis associated with these emissions. For example:
- (a) the disclosure of the percentage of Scope 1 emissions emitted in areas that are subject to emissions-limiting or emissions-reporting regulation (for example, in relation to entities in the Coal Operations industry);
  - (b) the percentage of Scope 1 emissions associated with the emission of methane (for example, for entities in the Oil & Gas—Exploration & Production industry); and
  - (c) the percentage of Scope 1 emissions associated with perfluorinated compounds (for example, for entities in the Semiconductors industry).
- BC145 It was acknowledged that these additional industry-specific measures were included in the SASB Standards because significant evidence and market feedback suggested that such information would enable users of general purpose financial reporting to better understand and assess how effectively an entity is managing the risks and financial impacts associated with direct GHG emissions and that this would facilitate assessments of enterprise value. For example, in the Oil & Gas—Exploration & Production industry, methane emissions typically have a different risk/opportunity profile to that of CO<sub>2</sub> emissions due to unique characteristics such as implications for lost revenue.
- BC146 It was further noted that the detailed technical protocols accompanying the industry-based metrics provide significant additional guidance to entities in understanding the proposed requirements set out in the Exposure Draft. In contrast, the cross-industry metrics, including those related to GHG emissions, are more broadly defined (see paragraphs BC105–BC118). In order to preserve this benefit—without creating confusion by proposing actual or apparently duplicated requirements—a range of approaches was considered to ensure that associated requirements—including cross-industry and industry-based metrics—can readily be distinguished. References were included in the Exposure Draft, including illustrative examples in Appendix B, to emphasise the interrelationships between the proposed requirements and thus to reduce the risk of duplication.

- BC147 Furthermore, it was agreed that the Exposure Draft should include Illustrative Guidance that shows the relationships between cross-industry and industry-based requirements. Examples were, therefore, added to illustrate the kinds of metrics—such as those specified in the industry requirements—that provide relevant information for each cross-industry metric category. For instance, the Illustrative Guidance notes that a carmaker might fulfil the cross-industry requirement for quantitative information on climate-related opportunities by disclosing the number of zero-emissions vehicles, hybrid vehicles and plug-in hybrid vehicles it has sold, which is one of the industry-based metrics identified in the Appendix B *Industry-based disclosure requirements* to the Exposure Draft.
- BC148 Thus, while some proposed industry metrics may partly or ostensibly duplicate other proposed cross-industry requirements—including those related to GHG emissions—they were included in the Exposure Draft by design.

#### **Emerging consensus on financed emissions (financial sector)**

- BC149 Financial organisations, including commercial banks, investment banks, asset managers and insurance companies, are increasingly being asked to disclose the extent of their investment, lending and underwriting activity associated with sustainability-related matters. In relation to the climate, this involves the disclosure of emissions-financing activities. The absolute GHG emissions that banks and investors finance through their loans and investments are often referred to as financed emissions. More recently, an additional classification known as ‘facilitated emissions’ has been applied to other, off-balance-sheet activities performed by financial institutions, such as underwriting, securitisation and advisory services. The measurement of financed and facilitated emissions generally builds on the GHG Protocol Corporate Value Chain (Scope 3) Standard which includes guidance on calculating indirect emissions resulting from Category 15 (investments). Indirect GHG emissions are those emitted from sources not owned or controlled by an entity, but that are emitted due to the activities of the reporting entity.
- BC150 Financed emissions can show a financial institution’s exposure to significant climate-related risks, and how it may need to adapt its lending or financing activities over time. Specifically, such entities could face transition risks in the form of credit risk, market risk, counterparty risk and other financial and operational risks. For example, credit risk may arise in relation to financing and investment clients affected by increasingly stringent carbon taxes, fuel efficiency regulations or other policies; credit risk may also arise through related technological shifts. Operational risk may arise through reputational damage from financing fossil-fuel projects.
- BC151 A financial institution’s specific climate-related risk profile is likely to depend to a large extent on the industry or industries in which it operates, and the associated economic activities in which it participates. This is due to key differences among industries in terms of organisational structures and business models, including their associated on- and off-balance-sheet investment activities and asset classes, which result in different

decarbonisation pathways. Despite these different industry profiles, it was recognised that because the disclosure of financed and facilitated emissions is still a fairly novel practice, the SASB Standards do not contain requirements for financed emissions in the relevant industries. The SASB Standards, which for most financial industries were last updated in 2018, address climate-related risks through disclosure topics that cover how entities in each industry account for environmental and social factors in their financing activities more generally. The metrics associated with these topics facilitate high-level, qualitative and quantitative disclosure of exposure to risks associated with these factors and management strategies to address those risks. None of the metrics explicitly addresses the concept of financed or facilitated emissions.

- BC152 The absence of requirements in these industry standards to specifically measure financed emissions reflects the fact that, until recently, a corresponding lack of useful data and methodological clarity made the disclosure by financial institutions of relevant information a challenging undertaking. However, it was acknowledged that the situation is changing. Specifically:
- (a) an increasing number of entities across all sectors are disclosing Scope 1, Scope 2 and Scope 3 GHG emissions—a critical foundational input for financial institutions—suggesting that entities are less challenged by making such a disclosure; and
  - (b) the Partnership for Carbon Accounting Financials (PCAF) has done significant work to advance the understanding and calculation of GHG emissions for financial organisations under the GHG Protocol, allowing financial preparers to disclose their Scope 3 GHG emissions in a more comparable and complete manner.
- BC153 For financial organisations, Scope 3 GHG emissions, especially those in Category 15, are by far the largest component of their total GHG emissions. However, assessing and pricing exposure to climate-related risks within the financial system depends on the effectiveness of the climate-related disclosures of the entities financed by banks and asset managers and underwritten by insurers. Until very recently, the entities with significant direct and indirect GHG emissions have not disclosed sufficient information on Scope 1, Scope 2 and Scope 3 GHG emissions, to enable banks to understand the concentration of carbon-related assets on their balance sheets, and asset owners' ability to identify risks associated with carbon-intensive issuers. However, it was further observed that disclosure of GHG emissions is rapidly increasing both in terms of the number of entities providing this information and its quality across all sectors and jurisdictions. This trend is likely to continue—or accelerate—with the issue of a standard based on the Exposure Draft.
- BC154 Furthermore, financial sector entities increasingly agree on methods of measuring and disclosing financed and facilitated emissions. In November 2020, PCAF issued the first edition of the Global GHG Accounting and Reporting Standard for the Financial Industry (the PCAF Standard). The PCAF



Standard builds on the GHG Protocol Scope 3 rules, providing methodological guidance to assist in the measurement and disclosure of GHG emissions associated with six asset classes: (1) listed equity and corporate bonds, (2) business loans and unlisted equity, (3) project finance, (4) commercial real estate, (5) mortgages and (6) motor vehicle loans. PCAF has further committed to consider and publish explicit guidance on calculating GHG emissions for some financial products not currently addressed by the PCAF Standard, including private equity, investment funds, green bonds, sovereign bonds, loans for securitisation, exchange traded funds, derivatives and initial public offering (IPO) underwriting.

BC155 Due to the increasing availability of underlying emissions data and growing consensus on financial sector measurement methods, the Exposure Draft has sought to strike a balance between potentially competing forces. Given the increasing attention being paid to financed emissions—particularly in the wake of the decarbonisation commitment made by hundreds of the world’s largest financial institutions at the UN Climate Change Conference (COP 26) in November 2021—its omission from the Exposure Draft could be a significant barrier to fulfilling the objective of [draft] IFRS S2 *Climate-related Disclosures* in the near term. It could also result in the proposals failing to meet a significant information need of users of general purpose financial reporting that is increasingly relevant to enterprise value. Its inclusion could risk standardising disclosure that may become outdated or considered less useful over the medium to long term given the rapid evolution of related practice through an array of market-led initiatives and regulatory efforts.

BC156 Measuring the impact of climate on a financial portfolio is a well-established concept, which the GHG Protocol sought to advance in 2011 when it issued its Scope 3 Standard. Category 15 of that standard refers to financing of entities that have emissions. Furthermore, it was agreed that a judicious approach could capture prevailing industry practices—which have begun to reflect common principles and techniques—while stopping short of impeding innovation. Thus, the expedience of developing effective requirements for financial institutions to measure and disclose financed and facilitated emissions was considered by:

- (a) evaluating the positive and negative effects on enterprise value;
- (b) evaluating the feasibility and cost effectiveness of methods and practices in place;
- (c) reviewing the prevalence of financed and facilitated emissions disclosures in each financial industry;
- (d) reviewing TCFD, the Value Reporting Foundation and PCAF and research by other organisations to consider how such work might be used; and
- (e) doing technical and market research and consultation to inform and validate potential approaches.

BC157 As an outcome of this process, financed emissions-related disclosure requirements for four industries—commercial banks, investment banks, insurance and asset management, and custody activities entities—have been added to the Exposure Draft. These proposals were not included in the TRWG prototype. In designing these proposals, it was considered that each industry has unique business models, risk profiles, asset classes, time horizons –and momentum and consensus– to measure financed emissions. Each proposal is detailed in paragraphs BC158–BC172. In taking this measured approach, the Exposure Draft attempts to reflect significant, generally accepted aspects of current practice while also allowing for the development and refinement of technical measurement methods. The difficulties inherent in the comparability, coverage, transparency and reliability of Scope 3 GHG emissions data is recognised. Nevertheless, it is believed that the proposals in the Exposure Draft can help improve Scope 3 GHG emissions data availability and quality over time. However, the proposals for all four industries allow entities to design or choose a calculation method, provided the entity discloses information to ensure its methodology is clear.

*Commercial banks*

BC158 Commercial banks' loans to and investments in carbon-intensive industries are becoming inherently and increasingly risky due to evolving regulation and rapid technological change related to the transition to a lower-carbon and climate-resilient global economy. Heightened risk may emerge from the premature write-downs, or potential 'stranding' of long-lived assets. Borrowers or investees may also face further financial pressure from increased costs of operations and compliance. Calculating and disclosing financed emissions can, therefore, help users of general purpose financial reporting better understand their exposure to such risks. Commercial banks that fail to manage these transition risks and associated opportunities through their lending and investment management could face diminished returns and reduced enterprise value. Thus, it is proposed that entities participating in this industry should disclose their:

- (a) gross exposure to carbon-related industries, including as a percentage of total gross exposure;
- (b) percentage of total gross exposure for which financed emissions are calculated; and
- (c) gross absolute GHG emissions by industry and asset class (that is financed emissions) and associated emissions intensity.

BC159 Key considerations included nuances of measurement and scope. For example, it was observed that in their public disclosures, many commercial banks measure exposure by entities in their lending portfolios at current drawn amounts; others measure using committed amounts. The PCAF Standard calls for the current drawn amount. However, it was decided that committed amounts—including undrawn loan commitments—will often be likely to provide a more accurate forward-looking indicator of risk exposure by more fully capturing the emission-generating activity that the entity has agreed to finance. Therefore, the Exposure Draft proposes that both sets of figures be

disclosed to help users to compare entities, including those following the PCAF Standard.

- BC160 The scope of the disclosure was also determined to ensure it effectively captured significant exposure to high-emission industries and activities. The Exposure Draft proposes that, at a minimum, financial institutions disclose their exposure to financed emissions via loans and advances, project finance, debt securities and equity instruments.

*Investment banking and brokerage*

- BC161 Risks and opportunities relating to the transition to a lower-carbon economy can have significant implications for the entities, assets and projects that investment banks service either through the provision of capital (on-balance sheet) or other capital market activities and financial advisory services (off-balance sheet). As for commercial banks and investment banks, climate-related risk is a transverse risk that can manifest via a variety of traditional channels, including market risk (through impairment of asset valuations), credit risk (through reduced counterparty performance or collateral values), liquidity risk (particularly in carbon-intensive sectors) and reputational risk (through changing stakeholder expectations).

- BC162 Because many investment banks also participate in commercial banking activities, such as lending, the requirements proposed for financed emissions in the commercial banks industry could be applicable to entities in this industry. Investment banks could also be exposed to facilitated emissions through the provision of products and services such as underwriting, advisory and securitisation. Such emissions can present significant reputational risks, potentially affecting revenue generated by capital markets activity. Thus, it is proposed that entities in this industry should additionally disclose:

- (a) absolute gross GHG emissions for each business line by industry; and
- (b) revenue generated from capital market activities and financial advisory services.

- BC163 Facilitated emissions is a relatively new concept. Although lending and facilitation are both fee-generating activities for a bank, they are different in important ways. Whereas loans are held—often for years—on a bank's statement of financial position, facilitation involves point-in-time transactions, thus creating significant challenges in measuring the facilitated emissions that banks with capital market activities should account for. Despite this and other challenges associated with an emerging activity, a growing number of investment banks, including many of the world's largest, have provided public disclosures on facilitated emissions. Furthermore, the additional guidance being developed by PCAF is likely to accelerate this trend by enhancing clarity and consensus on methodologies.

**Insurance**

- BC164 Insurance companies invest premium revenue to meet insurance claim payouts and maintain asset-liability parity over the long term. In managing these investments, insurance entities increasingly need to consider climate-related factors, including transition risks and opportunities associated with technical innovations and increasing pressure to comply with emerging policy and regulation. Failure to address these issues could lead to diminished risk-adjusted returns on insurance portfolios and limit an entity's ability to issue claim payments.
- BC165 Measuring GHG emissions associated with underlying investments can enhance understanding of exposure to such risks and opportunities, and inform their management in the transition to a lower-carbon economy. Thus, it is proposed that entities participating in this industry should additionally disclose their:
- (a) gross exposure to carbon-related industries, including as a percentage of total gross exposure;
  - (b) percentage of total gross exposure for which financed emissions are calculated; and
  - (c) gross absolute GHG emissions by industry and asset class (that is financed emissions) and associated emissions intensity.
- BC166 Insurers also may face transition risks resulting from a reduction in insurable interest due to declines in value, changing energy costs or changing carbon regulation. Failure to appropriately understand these risks and opportunities and price them into the underwritten insurance products may result in higher-than-expected claims on policies. Such considerations would likely be addressed in the disclosure that is proposed to be required regarding an entity's resilience analysis. However, measurements and disclosures of emissions associated with the entities that insurance entities underwrite are considerably more nascent than those for assets. Efforts are under way to develop more robust methods, including those of PCAF and the Net-Zero Insurance Alliance. It was agreed this proposal related to financed emissions would focus solely on invested assets to allow important development in the measurement and disclosure of emissions related to underwriting to continue without distraction. In the meantime, if an entity concludes that information on emissions associated with underwriting is material, the entity should prepare such disclosure in accordance with the cross-industry requirement to disclose Scope 3 emissions.
- BC167 The physical risks that entities in the insurance industry are exposed to, either through investments or underwriting, are covered by other disclosure topics in the industry-based requirements.

**Asset management and custody activities**

- BC168 Asset managers and custodians maintain a fiduciary responsibility to their clients and, therefore, consider and include analyses of all material information in investment decisions. Climate-related transition risks and opportunities stemming from, for example, policy change and technological

innovation, are becoming more prevalent, and asset managers are increasingly incorporating these factors into investment decision making. The ability to measure exposure to GHG emissions of investment portfolios—in other words, financed emissions—is a core component of managing these risk and opportunities.

- BC169 Such activities are similar to those of other financial sector entities—such as those in investment banking and insurance—but it was acknowledged that these activities carry a different risk profile in asset management. Notably, assets under management (AUM) do not sit on an asset manager’s statement of financial position and such entities do not extend or risk their own capital in making investments on a client’s behalf.
- BC170 Despite this difference, asset managers—and their shareholders—may nevertheless face risks associated with financed emissions. Diminished investment returns in their portfolios could lead to reduced performance fees, for example. Over the long term, asset managers could precipitate an outflow of assets under management resulting in the loss of market share and lower revenue from management fees.
- BC171 Current disclosure practices in the industry were considered, and it was found that reporting of financed emissions is relatively uncommon. A number of industry participants disclosed a related metric, the weighted average carbon intensity (WACI) of their portfolios, as recommended by the TCFD. However, it was agreed that this data point is unlikely to provide decision-useful information to users of general purpose financial reporting when an asset manager holds a diversified portfolio broadly representative of the entire market. Among the handful of entities reporting Scope 3 emissions, the most common approach was to disclose emissions associated with a percentage of portfolio holdings (for example, where data was available) as a single figure for the entity’s total AUM. Although a more detailed breakdown might be helpful, it was agreed that the costs of such disaggregation could outweigh the benefits. Meanwhile, it was noted that a ‘total AUM’ approach to disclosure provides a useful indicator of the emissions—and thus the environmental impact—associated with client portfolios, and thus may also serve as a broad indicator of potential risks to the asset manager. Therefore, it is proposed that entities participating in this industry should additionally disclose their:
- (a) gross absolute GHG emissions by assets under management (that is financed emissions) and associated emissions intensity; and
  - (b) percentage of assets under management for which financed emissions are calculated.
- BC172 Several initiatives are under way to facilitate, encourage or mandate both entity and product disclosures by asset managers related to climate change and other sustainability-related risks. As those initiatives continue to develop and perhaps spark consensus on an approach to financed emissions in the industry, the ISSB can monitor the evolution of industry practice and consider whether updates to the requirements are warranted.

**Activity metrics**

- BC173 In addition to industry-based sustainability metrics, the Exposure Draft includes activity metrics among its industry requirements. Activity metrics are intended to produce contextual information to help facilitate comparative analysis of normalised sustainability performance data, for example, across peer firms of different sizes and scales. Contextual information is important when a comparison of absolute data could otherwise mislead.
- BC174 These activity metrics typically capture general business data or industry-specific data to supplement that which is already publicly available (for example, data about revenue and number of stores). For example:
- (a) general business data, such as the:
    - (i) number of employees;
    - (ii) amount of product sold;
    - (iii) asset use/asset size or capacity of asset; and
    - (iv) assets owned compared to those leased or outsourced; and
  - (b) industry-specific data, such as:
    - (i) network traffic, percentage on cellular network and percentage on fixed network (telecommunications);
    - (ii) data processing capacity, percentage outsourced (internet media and services);
    - (iii) available-seat kilometres (airlines); and
    - (iv) total area of retail space and total area of distribution centres (food retailers).
- BC175 As an example, for a grocer, disclosing absolute Scope 1 emissions from refrigerants (in CO<sub>2</sub>-e) might be useful in providing information to meet a regulatory cap. However, when comparing entities with similar business models, it may be helpful for users of general purpose financial reporting to be able to 'normalise' the data by square metres to account for differences in scale of operations. Many climate-related (and other sustainability) metrics can be appropriately normalised using common financial measures, and thus such measures should be readily available in an entity's financial statements; however, where specialised activity metrics have been identified as being necessary through work on SASB Standards, these are included in the Exposure Draft for normalisation.

**Disclosures considered but not included****Forward-looking portfolio alignment metrics**

- BC176 It was considered to propose industry-based requirements to disclose forward-looking portfolio 'alignment' metrics for financial institutions. A few entities within the financial sector disclose such metrics, indicating the alignment of their business activities with the UNFCCC requirements of restricting

temperature rises to well below 2 degrees Celsius above pre-industrial levels (portfolio alignment) and to pursue efforts to limit warming to 1.5 degrees Celsius above pre-industrial levels. However, as many more entities are waiting for additional clarity on methods and standardisation, the Exposure Draft does not include these requirements.

BC177 Many financial entities have worked to assess the options available to measure portfolio alignment, including methods for implementing implied temperature rise metrics and to identify areas of further consideration. This work has focused on measuring the extent to which portfolios are aligned with a net-zero GHG emissions-reduction ambition that would limit average temperature rise to 1.5 degrees Celsius by 2050. Such efforts show that to achieve the goals of the Paris Agreement, financial institutions would have to decrease the total GHG emissions financed by their lending and investment portfolios to within a defined amount or budget. The budget allocated to a financial portfolio depends on the composition of that portfolio because sectors and jurisdictions will decarbonise at different rates. Portfolio alignment tools could then inform appropriate target setting for a portfolio. Such tools would enable financial organisations to achieve their own GHG emissions-reduction targets and facilitate GHG emissions reductions in the real economy through engagement rather than through divestment.

BC178 Forward-looking portfolio alignment is an area of rapid development, particularly with the Glasgow Financial Alliance for Net Zero (GFANZ) now working to advance portfolio alignment by developing further guidance, facilitating tool construction and promoting the adoption of consistent, robust and decision-useful approaches. Rather than proposing additional disclosures at this time, the efforts to develop common practice will be monitored. Common practice would facilitate comparability and transparency among financial organisations, and provide clarity to non-financial preparers on how their transition plans may affect their interactions with investors, lenders and other creditors.

#### **‘Avoided’ emissions capacity**

BC179 The Exposure Draft does not propose disclosure of an entity’s capacity to ‘avoid’ emissions. A growing number of investors have suggested such information enables them to assess the ability and willingness of entities to remove or ‘abate’ their GHG emissions. ‘Avoided’ emissions refer to the emission reductions that occur when an entity is able to improve the efficiency of its product(s) or service(s), indirectly affecting its overall emissions. The metric, therefore, would serve as an indicator of how high an entity’s emissions would have been had its entity’s management failed to take strategic actions.

BC180 Such a disclosure requirement would be premised on the conclusion that an entity’s capacity to effectively navigate the global transition to a lower-carbon economy will depend on its ability to abate GHG emissions. In this context, there are a range of potential disclosures relating to an entity’s:

- (a) *current (proven) projected abatement capacity*—or an assessment of its current emissions and an estimate of the proportion of these emissions that would be economic to abate using currently available, proven technologies;
- (b) *long-term (probable) projected abatement capacity*—or future projections of abatement capacity using a range of standardised carbon price assumptions; and
- (c) *uneconomic projected abatement capacity*—or the residual sources of emissions from all of an entity’s carbon emission sources that remain uneconomic to abate after significant opportunities to cut emissions have been identified.

BC181 This area remains important, particularly as investors increasingly scrutinise entities’ transition plans to understand the specific efforts they are undertaking—or plan to undertake—to meet their goals. However, additional research and development is likely needed before such disclosure can be effectively standardised. For example, accurately measuring a new product or service’s potential to abate emissions is highly challenging and subject to manipulation. Additionally, in the context of residual emissions, considerable debate remains over how to define an objective method for calculating what is, or is not, ‘economic’ to abate. Significant market-led efforts are under way to address these and other challenges and it is proposed that continuing engagement should occur regarding ‘avoided’ emissions.

## Applying the Standard

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### Material information

BC182 The objective of the Exposure Draft is to propose that entities be required to provide material information about the entity’s exposure to climate-related risks and opportunities that is useful to users of general purpose financial reporting in assessing enterprise value and deciding whether to provide economic resources to the entity. When preparing and disclosing climate-related information, an entity shall do so in a manner consistent with the requirements proposed in [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*. [Draft] IFRS S1 notes that ‘sustainability-related financial information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reporting make on the basis of that reporting, which provides information about a specific reporting entity’. It is proposed that this definition would apply across all IFRS Sustainability Disclosure Standards. [Draft] IFRS S1 provides additional information about the application of materiality in the context of IFRS Sustainability Disclosure Standards.

BC183 As explained in [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, a uniform quantitative threshold is not specified for material information; nor is what would be material in a particular situation predetermined. Rather, IFRS Sustainability Disclosure Standards



require management to apply judgement to identify the information about climate-related risks and opportunities, including associated metrics, that is material to the entity's circumstances in the context of the entity's general purpose financial reporting. Entities have significant experience and expertise in making such judgements, with respect to both financial and non-financial information.

- BC184 It is noted that the disclosures proposed in the Exposure Draft, including the disclosure topics and associated metrics included in the industry-based requirements, are required to be provided by an entity when material. The proposed requirements set out in the disclosure topics and associated metrics included in the industry-based requirements address those climate-related risks and opportunities that are considered most likely to result in the disclosure of material information by entities participating in a given industry. However, ultimately the responsibility for making materiality assessments rests with the reporting entity for all requirements in IFRS Sustainability Disclosure Standards, including industry-based requirements. An entity need not provide a specific disclosure required by the Exposure Draft, including disclosures identified in the relevant industry-based requirements, if in the judgement of the entity the information resulting from that disclosure would not be material.
- BC185 This includes instances in which an industry-based metric requires an entity to disaggregate reported information—for example, the disaggregation of expected losses by geographic region (in mortgage finance) or of invested assets by industry and asset class (commercial banks). In such cases, items shall be disaggregated if the resulting disaggregated information is material. For example, if information related to a particular region or industry is not, in the view of management, material to assessments of its enterprise value, the information would not need to be disaggregated. In making its choices about what information to aggregate or disaggregate, an entity should ensure material information is not obscured and the understandability of the information disclosed is not reduced.
- BC186 Furthermore, it is noted that the list of disclosure topics included in the industry-based requirements is not exhaustive. Where material, an entity may need to provide further industry-based disclosures, including metrics, to meet the requirements proposed in the Exposure Draft in relation to climate-related risks or opportunities applicable to its business model or circumstances.

#### **Industry classification**

- BC187 The proposed industry-based disclosure requirements that accompany the Exposure Draft are organised by sector and industry. For each industry, disclosure topic(s) related to climate risks or opportunities are identified. A set of accounting metrics is associated with each disclosure topic. The full set of proposed requirements can be found in the industry-based requirements referenced in Appendix B to the Exposure Draft, which are published separately and contain industry descriptions, disclosure topic descriptions, metrics with technical protocols (which provide guidance on definitions, scope, implementation, compilation and presentation) and activity metrics

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(which quantify the scale of an entity's activities and are intended for use in conjunction with accounting metrics to normalise data and facilitate comparison).

- BC188 The disclosure topics and associated metrics are listed by reference to industry-based activities. Where material, an entity shall disclose metrics relevant to its activities in line with its business model and in relation to the specific climate-related risks or opportunities it faces. Some entities will have a range of activities that span across more than one industry. For entities whose operations are integrated horizontally across industries (for example, conglomerates) or vertically through the value chain, multiple industry standards may be required to address the full array of sustainability topics reasonably likely to affect an entity's ability to create enterprise value.
- BC189 While a lot of material is included in the full set of industry-based requirements, only a subset would apply to a reporting entity, and it is expected that these requirements will simplify rather than complicate the preparation of disclosures by an entity, with clearly defined requirements tailored to meet the needs of an entity's users.

### **Effective date**

- BC190 The Exposure Draft requires disclosure of information comparable with climate-related information in previous periods to provide insight into the entity's climate-related performance over time. Comparability is considered important for providing information that could be useful to existing and potential users of general purpose financial reporting.
- BC191 It is recognised that on initial application of a new IFRS Sustainability Disclosure Standard about climate-related risks and opportunities, it would be useful for users of general purpose financial reporting if comparative information were provided for the prior reporting period. As the Exposure Draft is building upon sustainability-related and integrated reporting frameworks used by reporting entities in the market today, entities may be able to apply a retrospective approach to provide such comparative information in the first year of application. However, it is acknowledged that entities will vary in their ability to use a retrospective approach.
- BC192 Acknowledging this situation, and to facilitate timely application of the Exposure Draft, it is proposed that an entity is not required to disclose comparative information in the first period in which an entity applies the Exposure Draft.
- BC193 [Draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* would require entities to disclose material information about all sustainability-related risks and opportunities. It is intended that [draft] IFRS S1 be applied in conjunction with the Exposure Draft. This could pose challenges for preparers, given the Exposure Draft proposes disclosure requirements for climate-related risks and opportunities, which are a subset of those sustainability-related risks and opportunities. Therefore, the requirements included in [draft] IFRS S1 could take longer to implement.

- BC194 The ISSB will set the effective date for the proposed requirements when it approves the final Standard. The ISSB recognises that many countries require time for translation and that jurisdictions may need to allow time for approval and administrative processes when the Standard is incorporated into legal or regulatory requirements. In addition, entities will require time to implement new standards. The information provided by stakeholders responding to the Exposure Draft about the time required to implement the proposals will be considered by the ISSB in determining the appropriate effective date.

### **Complementary relationship with IFRS Accounting Standards**

- BC195 As stated in the IFRS Foundation's *Constitution*, a key objective of the IFRS Foundation is for the International Accounting Standards Board (IASB) and the ISSB to develop, in the public interest, high-quality, understandable, enforceable and globally accepted standards for general purpose financial reporting. The IASB is responsible for developing a set of accounting standards and the ISSB is responsible for developing a set of sustainability disclosure standards. These complementary sets of IFRS (Accounting and Sustainability) Standards are intended to result in the provision of high-quality, transparent and comparable information in financial statements and in sustainability disclosures that is useful to investors and other participants in the world's capital markets in making economic decisions.
- BC196 The Exposure Draft is intended to result in an improvement in the quality and comparability of information about an entity's exposure to climate-related risks and opportunities. However, it does not negate requirements to consider the effects of climate, when material, in applying IFRS Accounting Standards. Applying the Exposure Draft does not substitute for applying the requirements of IFRS Accounting Standards.

### **Maintaining the requirements**

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- BC197 The ISSB is expected to engage in ongoing technical research and market consultation to ensure the maintenance of decision-useful, cost-effective climate-related disclosure requirements. This approach – bolstered by rigorous analysis and bottom-up, market-driven input – is essential to maintaining a set of standards that respond to the evolving needs of participants in global capital markets.
- BC198 Although the Exposure Draft presents a comprehensive set of requirements intended to create a global baseline of climate-related financial disclosure, it is a baseline that the ISSB will need to refine and build upon over time. Future climate-related projects will be added to the ISSB's work plan and carried out following the ISSB's thorough, inclusive and transparent due process requirements.



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