Crowe

Ground-breaking event for Sustainability Reporting:

IFRS Standards S1 and S2

July 2023

Introduction

New standards

The International Sustainability Standards Board (ISSB) has issued the following first two new Sustainability Disclosure Standards in June 2023 for guidance on disclosures of sustainability related financial information:

a) **IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information** *(48 pages)*

b) **IFRS S2 Climate-related Disclosures** *(46 pages)*

These standards could be viewed as groundbreaking because they represent the first steps for a financial reporting body to take the lead in sustainable reporting. In doing so, ISSB may override the disparate standards of sustainability reporting currently issued by various bodies such as TCFD, GRI, SASB, etc.

Who is required to apply these standards?

No specific persons

IFRS S1 is not specific as to who should disclose sustainability related information. Logically, it should be those required by law or by regulators such as the stock exchange which require listed companies to disclose such information.

Requirements by regulators

At present, disclosures of sustainability information in Malaysia are only mandatory for companies which are listed on the Bursa Malaysia. Non-listed companies do not have such a requirement. Where sustainability information is disclosed, IFRS S1 requires the entity to disclose information about its sustainability-related risks and opportunities that are useful to primary users of general-purpose financial reports i.e. normal financial statements. The core of the disclosures are the "sustainability risks and opportunities".

Requirement by ISSB

IFRS S1 has stated that an entity whose sustainability-related financial disclosures comply with all the requirements of IFRS Sustainability Disclosure Standards shall make an explicit and unreserved statement of compliance. An entity shall not describe sustainability-related financial disclosures as complying with IFRS Sustainability Disclosure Standards unless they comply with all the requirements of IFRS Sustainability Disclosure Standards.

When are the standards applicable?

Reporting periods after 1 January 2024?

The standards shall apply for annual reporting periods beginning on or after 1 January 2024. Earlier application is permitted. For companies which had been reporting under GRI previously, they would need to transition to IFRS S1 and IFRS S2 for the reporting periods on or after 1 January 2024. However, the regulators in Malaysia have yet to make a decision whether to adopt IFRS S1 and S2 and when they shall be applicable.

Where to disclose the sustainability related information?

Several locations

According to IFRS S1, the sustainability related information may be disclosed in several locations such as:

a) An entity’s management commentary which forms part of the entity’s general purpose financial reports. This would certainly lengthen the already long annual reports of listed companies.

b) Same location as information disclosed to meet other requirements such as information required by regulators.

c) By way of cross-referencing to another report published by the entity.

How to disclose?

Form of disclosure

Disclosure will be in narrative form or quantitative form depending on the type of information. Due to the uniqueness of most companies' business models, value chains and internal management practices, these narratives may not lend itself to boilerplate descriptions and will require substantial effort especially in the first year of disclosure.

Narrative form

- Descriptive such as strategies, policies and procedures.

Quantitative form

- Financial effects

Difference between MFRS and IFRS S1 and S2

One of the major differences between MFRS and these two Sustainability Standards is that MFRS does not disclose much descriptive information other than policies. However, S1 and S2 requires narrative information that are not only historical but also forward looking or anticipated.

MFRS

Does not disclose much descriptive information other than financial information.

Major Difference

IFRS S1 & IFRS S2

Require narrative information that are not only historical but also forward looking or anticipated.

How to disclose? (cont.)

Disclosure of effects

Disclosure must also be made on the effect of sustainability related risks and opportunities on cash flows, the entity's access to finance or cost of capital over the short, medium or long term. IFRS S1 and IFRS S2 have made the observance of its standards as mandatory and shall override all other standards such as GRI, ESRS, SASB and GHG Protocol unless the disclosure is not covered by IFRS S1 and IFRS S2, in which event, guidance will be adopted from those other standards.

It would appear that with the issue of IFRS S1 and IFRS S2, disclosures of sustainability related information under other standards will be relegated in importance to IFRS S1 and IFRS S2.

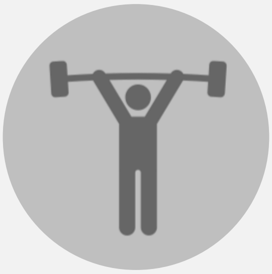
Sustainability risks and opportunities

↓

Cash flows, access to finance or cost of capital

↓

Over the short, medium or long term



Materiality

Materiality is still a valid concept in IFRS S1 and IFRS S2 as in the MFRS. Materiality should be judged from the perspective of the entity. According to IFRS S1, 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 reports make on the basis of those reports.

What information needs to be disclosed?

IFRS S1

Foundation for the future

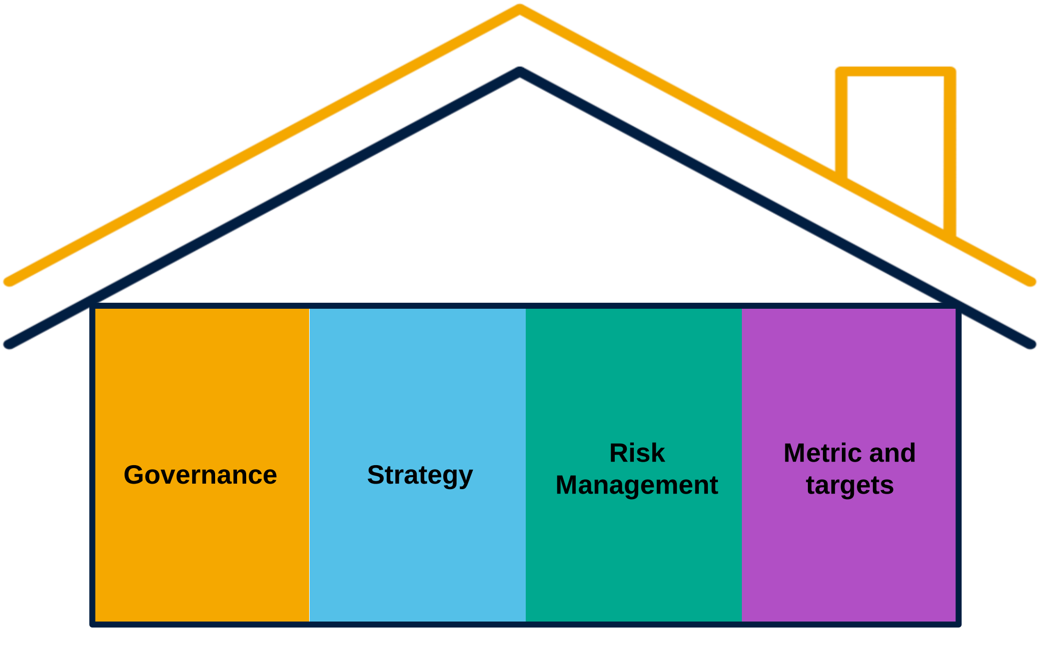
IFRS S1 lays the foundation for all future IFRS Sustainability Disclosure Standards. It provides for conceptual foundations (fair presentation, materiality, reporting entity and connected information) which underlie the disclosure of all sustainability information. IFRS S1 provides for disclosure of the following core content which closely mirror the topics in TCFD:

a) **Governance** - the governance processes, controls and procedures the entity uses to monitor and manage sustainability-related risks and opportunities;

b) **Strategy** - the approach the entity uses to manage sustainability related risks and opportunities;

c) **Risk management** - the processes the entity uses to identify, assess, prioritise and monitor sustainability-related risks and opportunities; and

d) **Metrics and targets** - the entity's performance in relation to sustainability-related risks and opportunities, including progress towards any targets the entity has set or is required to meet by law or regulation.



What information needs to be disclosed?

IFRS S1

The core content information required are both qualitative and quantitative in nature. Entities will therefore need to expend effort in preparing the necessary information. The section on Metrics and Targets will require a substantial amount of quantitative information to be disclosed.

Other than the core content information, IFRS S1 also provides guidance for general requirements such as sources of guidance, location of disclosures, timing of reporting, comparative information and statement of compliance. The section on Judgments, Uncertainties and Errors provide guidance on how an entity should disclose information on how they have handled judgments, uncertainties and errors in preparing the sustainability information.

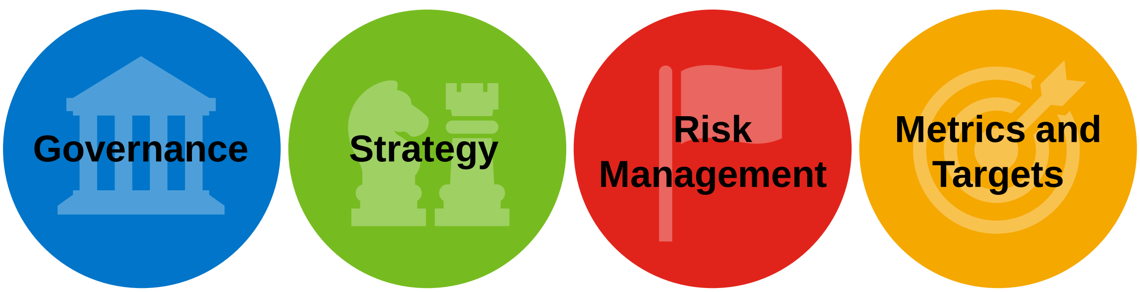
All in all, IFRS S1 requires a substantial amount of information to be disclosed and because entities vary from one another due to their unique business model, the possibility of using boilerplate descriptions and disclosures may be limited. The breadth of disclosures is indeed very extensive and requires one to comb through the IFRS S1 and IFRS S2 standards thoroughly.

What information need to be disclosed? (cont.)

IFRS S2

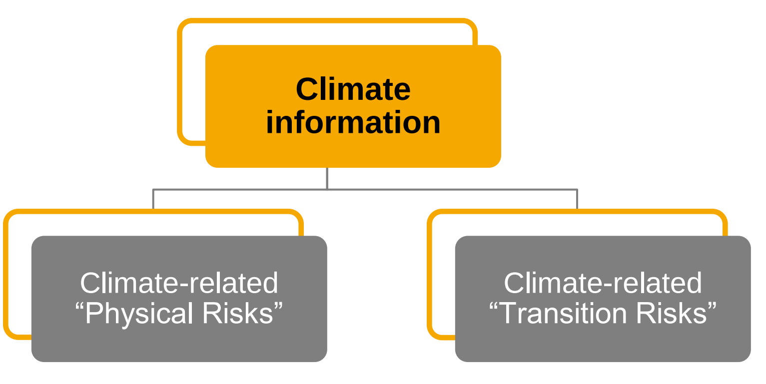
Disclosure of climate related risks

IFRS S2 is a specific standard for disclosure of climate-related risks and opportunities. The core content follows that in IFRS S1 which are Governance, Strategy, Risk Management and Metrics & Targets:



Physical risks and transition risks

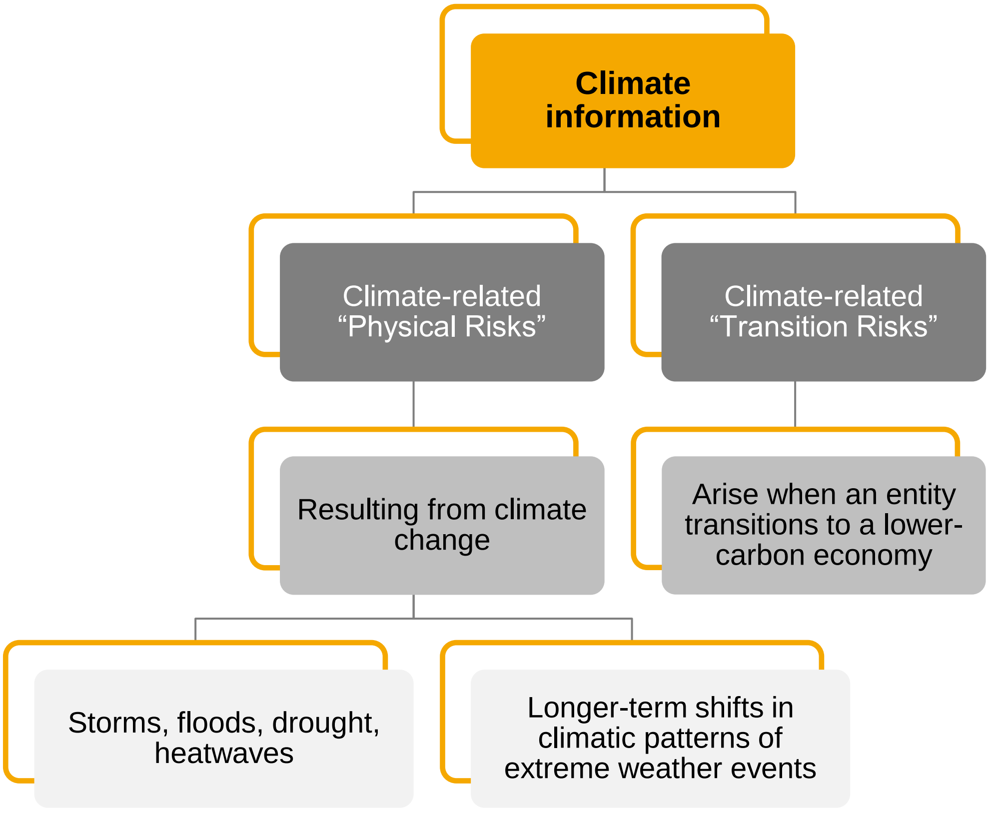
Climate information that has to be disclosed are divided into climate-related “Physical Risks” and climate-related “Transition Risks”. Climate-related Physical Risks are those resulting from climate change such as storms, floods, drought or heatwaves or from longer-term shifts in climatic patterns of extreme weather events, whilst Transition Risks are the risks that arise when an entity transitions to a lower-carbon economy



What information need to be disclosed? (cont.)

IFRS S2

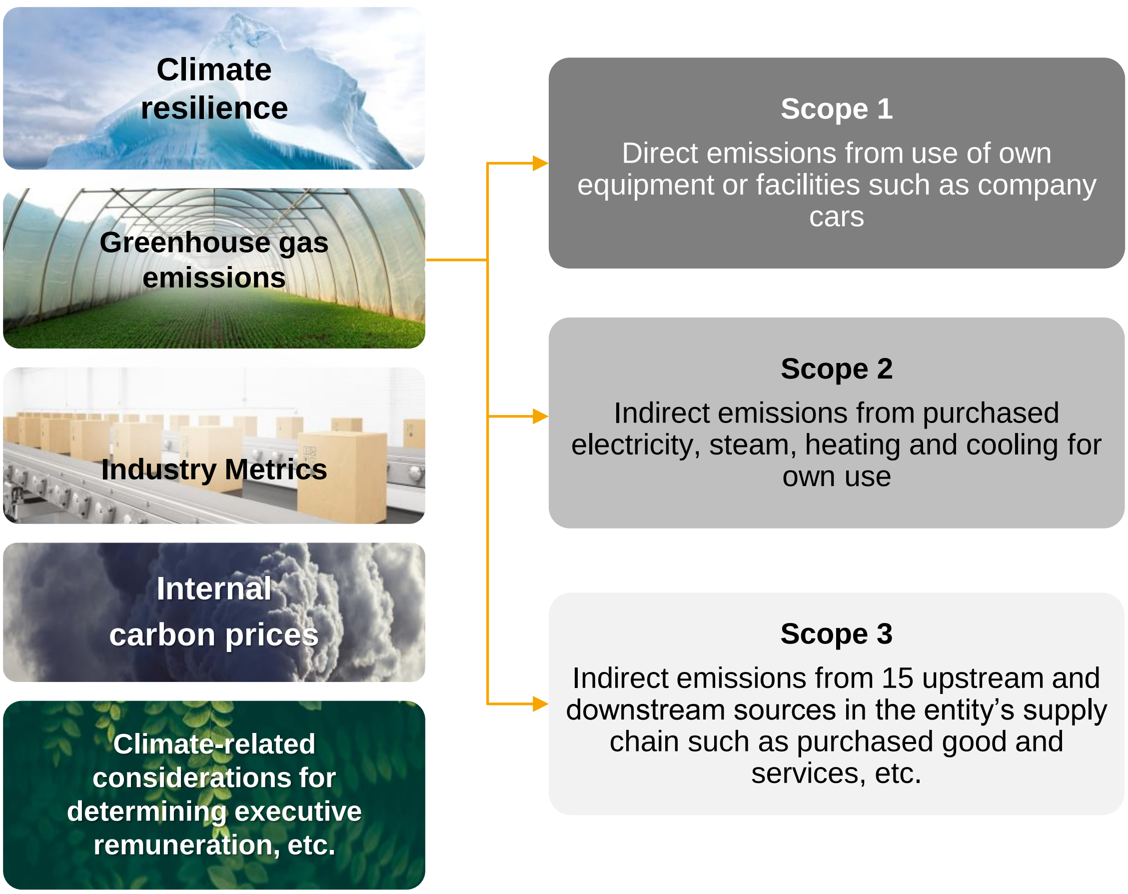
Physical risks and transition risks (cont.)



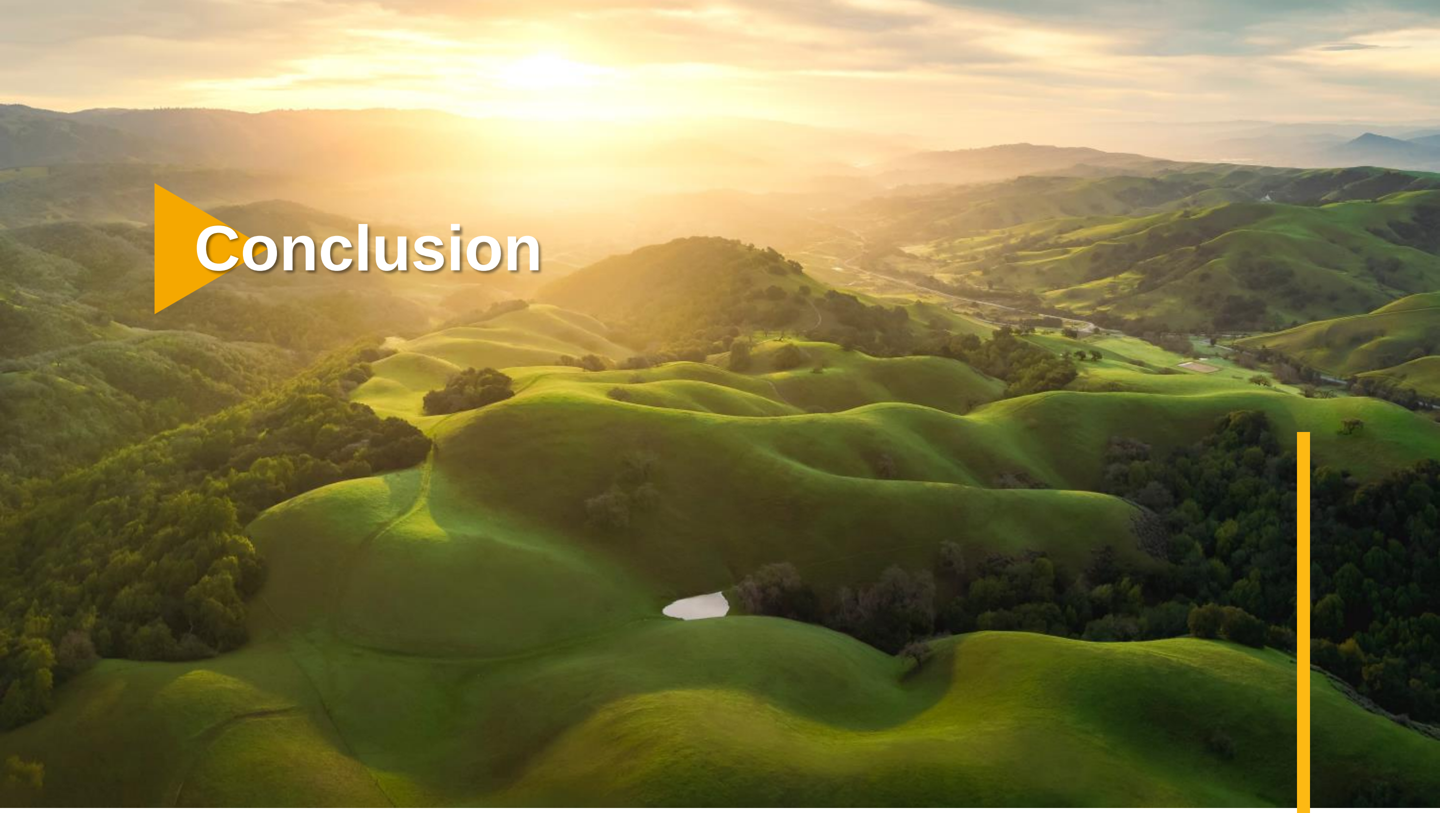
What information need to be disclosed? (cont.)

Additional climate related information required

In addition to these risks, an entity should report on their climate-related opportunities. As for IFRS S1, the information will be qualitative and quantitative in nature. The unique qualitative information would include information on the issues below:



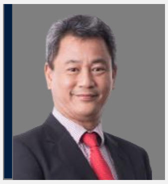
Much of the disclosures in IFRS S2 follow those in the TCFD and GHG Protocol. However, unlike GHG Protocol which made disclosure of Scope 3 emissions as voluntary, IFRS S2 has made the disclosure of Scope 3 emissions as mandatory. This has to be viewed however from the angle of materiality. Any Scope 3 emissions that are not material will not likely have to be disclosed even though disclosure is compulsory.



Conclusion

Due to these new sustainability disclosure standards, it is envisaged that preparers of financial statements and auditors would need to widen their knowledge to cover sustainability issues especially climate related matters such as greenhouse gas emissions.

Preparers would also need to be improve their story telling ability with regard to sustainability matters so as to present a complete and balanced picture of their company's sustainability performance. They will also need to work with designers to present information in a visually attractive format such as the use of tables, diagrams, flowcharts and infographics.



This article was written by **James Chan**, an Audit Partner at Crowe Malaysia. If you wish to seek clarification on any of these issues, please contact **james.chan@crowe.my**

Contact us

Crowe Malaysia PLT
Level 15, Tower C
Megan Avenue II
12, Jalan Yap Kwan Seng
50450 Kuala Lumpur
Malaysia

Tel. +603 2788 9898

About us

About Crowe Malaysia
Crowe Malaysia is the 5th largest accounting firm in Malaysia and an independent member of Crowe Global. The firm in Malaysia has 12 offices, employs over 1,200 staff, serves mid-to-large companies that are privately-owned, publicly-listed and multinational entities, and is registered with the Audit Oversight Board in Malaysia and the Public Company Accounting Oversight Board in the US.

About Crowe Global
Crowe Global is one of the top 10 accounting firms with over 200 independent accounting and advisory firms in more than 145 countries. For almost 100 years, Crowe has made smart decisions for multinational clients working across borders. Our leaders work with governments, regulatory bodies and industry groups to shape the future of the profession worldwide. Their exceptional knowledge of business, local laws and customs provide lasting value to clients undertaking international projects.

www.crowe.my