A GAME CHANGER FOR SUSTAINABILITY REPORTING?

BY **TAN ZHAI YUN**

The "alphabet soup" of sustainability reporting standards and frameworks is a common source of frustration for corporations. To outsiders, the slew of acronyms representing the different frameworks and standards is confusing and almost comical.

But global regulators and industry players came together in 2021 during the United Nations Conference of Parties in Glasgow, the UK, to launch the International Sustainability Standards Board (ISSB) and create a global baseline for sustainability reporting.

With a standardised method of reporting, sustainability data from companies can be compared more easily, which then enables investors and other stakeholders to do their evaluations more effectively. Consequently, industry leaders can be acknowledged and laggards engaged to improve their performance.

The standards were finally released in June after consultation with industry players. Two standards — one covering sustainability risks and opportunities and the other, climate-related issues — were published (see "What is the ISSB?").

Industry observers are now watching which countries will begin mandating their corporates to report according to the ISSB standards. Additionally, there are concerns about the added burden of reporting on corporates, and if this activity can actually be impactful.

"The good thing about the ISSB is that it came out of a desire to harmonise the many existing sustainability standards. They worked with existing standard setters and brought the best of it to develop the ISSB standards," says Manohar Johnson, southern region assurance partner at PwC Malaysia.

"In that sense, it becomes somewhat easier for global corporates to accept it, because whatever they are currently doing might not be 100% compliant with the ISSB but it's not 0%. So, it won't be too difficult to fully transition into the ISSB. At least, that is for the major corporates."

Since the ISSB is championed by the International Financial Reporting Standards (IFRS) Foundation, which successfully streamlined financial reporting standards in the past, the ISSB standards are expected to gain the confidence of global stakeholders.

The content is also not entirely new because it combines what was already required under two popular sustainability reporting frameworks: The Task Force on Climate-related Financial Disclosures (TCFD), which was founded by the Financial Stability Board under former Bank of England governor Mark Carney, and the Sustainability Accounting Standards Board (SASB), which is primarily used in the US.

What is new is the ISSB's requirement of Scope 3 emissions disclosure, which typically measures emissions from companies' value chains.

"I think the goal [of the ISSB] is commendable but it still has a long way to go in terms of launching thematic areas that go beyond climate. But they need to start somewhere ... and the proof will always be on the implementation side of things," says Inna Amesheva, director of ESG Regulatory Research at data provider ESG Book.

ESG REGULATORY RESEARCH

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STANDARD SETTERS IN CONVERSATION

There has already been a flurry of announcements about the compatibility between the ISSB and other frameworks and standards. Obviously, the TCFD is largely similar to the ISSB.

The Global Reporting Initiative (GRI) announced a collaboration with the IFRS Foundation to coordinate their work (see "GRI making its mark in impact reporting"), while European authorities developing the European Sustainability Reporting Standards (ESRS) are working on an interoperability guidance material with the ISSB. The ESRS will be required of companies that generate revenues from the European Union and will come into effect in 2024.

Global corporations will be keeping a close eye on these developments. Otherwise, corporates might have to prepare multiple reports according to different frameworks, which strains their resources and reduces comparability of data.

"Compared with previous regimes, this time, policymakers, at least on the face of it, are speaking to each other more. The ISSB has already mapped [its standards] with the TCFD. The ESRS also has some mapping tables to translate one standard into another. It's not going to be the same, but at least if you are reporting according to one, you can also fulfil some of the requirements of the other," says Amesheva.

A key difference between the ISSB and the ESRS is that the ISSB is meant for financial investors, so it only focuses on financial materiality. This means that reporting entities look at the risks and opportunities imposed by climate-related events, for instance, on the company.

On the other hand, the ESRS focuses on double materiality. Other than just looking at the impacts on the company, this standard requires companies to look at their impact on the wider environment and society.

ADDING A BURDEN FOR MALAYSIAN CORPORATES?

In Malaysia, the Securities Commission Malaysia announced in May that it has set up a national-level advisory committee on sustainability reporting (ACSR) to support the implementation of the ISSB standards in Malaysia.

Currently, Malaysian public-listed companies (PLCs) have to abide by Bursa Malaysia's sustainability reporting guidelines, which mandate climate change-related disclosures aligned with the TCFD by 2025 (Main Market PLCs) and reporting of a common set of indicators alongside at least three years of data for each reported indicator by 2023.

Bursa Malaysia has yet to announce if it will be adopting the ISSB instead of the TCFD framework.

However, PLCs could already be burdened by the resources needed to meet Bursa Malaysia's enhanced reporting guidelines and prepare a TCFD-aligned report. At the same time, PLCs are answering many sustainability surveys sent by their investors, banks, stakeholders and ratings agencies, which takes up time and resources.

"It will be interesting to see whether Bursa will mandate ISSB [aligned reporting] from 2025 in place of the TCFD, or still require the TCFD and introduce the ISSB some years later," says Manohar.

Countries like the UK, Singapore, Japan and Australia have moved forward in implementing the ISSB standards. Does it matter whether Malaysia adopts the ISSB, and when?

"I guess the main thing is about 'investability' and showing Malaysia's commitment to global standards. It's the same reason why Malaysia made the decision to converge with IFRS on accounting standards

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to enable comparability [of data] across companies," says Manohar.

If Malaysian companies are the only ones that are not complying with the ISSB standards, it might put them at a disadvantage with foreign investors. "It's likely that going forward you might have bottom-up pressure to report the data even if it's not regulated by the policymakers. It might just be market reality," says Amesheva.

One advantage for Malaysian PLCs is, if they are already following the TCFD recommendations, they are halfway to complying with the ISSB standards, she adds.

Regardless, the increasing scrutiny on sustainability reporting by local and foreign stakeholders means that companies must invest more resources into this area.

"Definitely, there will be a lot of compliance, consulting, legal and probably assurance costs as well. The ESRS requires at least a limited level of assurance. Also, [there is a demand for] digital reporting. Companies would have to gear up and basically hire sustainability reporting professionals or combine it with the financial reporting function," says Amesheva.

To make the process more seamless, Manohar notes that it is important to set an implementation date for the ISSB as soon as possible, so that companies have enough time to prepare.

SCENARIO ANALYSIS AND DOUBLE MATERIALITY MAY BE CHALLENGING TO DO

One of the more challenging aspects of TCFD reporting is the need to perform climate scenario analysis, which looks at how a company will be impacted by climate change going forward. This is also required under ISSB.

"They'll have to do modelling [to do that analysis]. That's not easy. Otherwise, they have to hire someone with the expertise to do it," says Manohar.

The second toughest part for companies to comply under the ISSB, Manohar believes, is in reporting their sustainability strategies.

PWC MALAYSIA

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Many companies currently might only be focused on collecting data points to include in their sustainability statements because it is required by regulators, but the ISSB and TCFD require companies to describe how they are integrating sustainability matters into their operational and business strategy, he says.

A property company, for instance, will have to explain how their investment decisions take into consideration their land bank located in flood-prone areas or places at high risk of flooding in the next 10 years.

Amesheva, meanwhile, thinks that companies may struggle with figuring out what is material to be reported. Materiality is an accounting term that refers to information that will impact an investor's decision-making. Double materiality expands the impact to stakeholders such as employees, customers and the environment.

"You could think that you are impacting local ecosystems, your workers and communities in a certain way, but the assessment [of materiality] could still vary from company to company," she says.

WHAT IS THE ISSB?

Why: The International Sustainability Standards Board (ISSB) was formed by the IFRS Foundation in 2021 to create a global baseline of sustainability disclosures, based on the needs of investors and the financial market.

Who: It is supported by the G7, G20, the Financial Stability Board, the International Organization of Securities Commissions and central bank governors from over 40 jurisdictions.

How: The ISSB builds on the work of existing players, such as the Climate Disclosure Standards Board, Task Force on Climate-related Financial Disclosures, the Value Reporting Foundation's Integrated Reporting Framework, the SASB Standards and the World Economic Forum's Stakeholder Capitalism Metrics.

- Intended scope is global and voluntary.
- Focuses on financial materiality.
- First two standards were released in July: IFRS S1 requires disclosures about sustainability-related risks and opportunities, while IFRS S2 focuses on climate-related risks and opportunities.

When: Annual reporting periods beginning on or after Jan 1, 2024.

What: Entities have to disclose the following information for sustainability-related (IFRS S1) and climate-related (IFRS S2) risks and opportunities:

- Governance processes, controls and procedures to manage, monitor and oversee
- Management strategy
- Processes used to identify, assess, prioritise and monitor
- Performance and progress towards targets the entity has set

DOES MORE REPORTING MAKE ANY DIFFERENCE?

Critics often describe corporate sustainability reports as documents filled with marketing jargon, much of which are not externally assured nor comparable with other peers due to the different reporting formats. On the flip side, companies could be struggling to find resources — and hire consultants — to prepare these reports and meet the varying requirements.

Could there be any real impact from encouraging more reporting? "It is hard to say right now, but the intention is that when more information is available, the financial community can make better-informed decisions. When you look at the green transition and want to invest in companies that are doing better, without that information, it is very difficult to do," says Amesheva.

Increased transparency from the reporting is therefore important. Companies will also have to really consider how the items they are reporting — such as the scenario analysis on the impact of climate change — will affect them going forward.

"That's the intention. In an ideal world, that would work. Of course, there will also be companies that are just checking the box and will hire 10 people to do the report without taking any further action," she says.

"But the powerful element would be when that data is out in the market and investors or banks make decisions based on it. Then the company has to realise [maybe that's why] it didn't get that loan because it has a terrible human rights record or environmental footprint. The intention is for it to go up to the C-level, so it can re-orient the way the company operates in a more resilient direction."

To counter greenwashing in sustainability reports, Manohar suggests that the public analyse where the narrative in the reports do not match with the actual strategy or investments of the company, and check what type of assurance has been done on the report. E

GRI MAKING ITS MARK ON IMPACT REPORTING

There has been much chatter on whether the Global Reporting Initiative (GRI), which according to PwC is currently the most widely used standard for sustainability reporting globally, will be replaced by the International Sustainability Standards Board (ISSB).

GRI CEO Eelco van der Enden rejects that possibility. The GRI complements the ISSB and the European Sustainability Reporting Standards (ESRS), which are the two influential sustainability reporting standards that global corporates must acknowledge in the next few years.

Van der Enden says the ISSB fills an important gap in creating a global comprehensive baseline for sustainability reporting, much like the International Accounting Standards does for financial reporting.

But the ISSB focuses on providing information for investors, while the GRI serves a multi-stakeholder audience. "We look at what the business' impact is on sustainability issues like human rights, climate change, clean water and anti-bribery. The ISSB looks at what influence climate change or labour laws have on the reporting entity," says Van der Enden.

"The ISSB is about the 'outside in' and the GRI is about the 'inside out'. Over time, they all come together and that is why the ISSB and GRI are complementary."

Both organisations have frequent discussions on how they can cooperate, support capacity building and create an interoperability scheme, he says.

"Within a couple of weeks, we will come up with a joint statement on what the way forward will be. We will not at this moment start to set joint standards. That has to do with governance and mandate, but also resources."

The GRI has also announced that it aims for interoperability with the ESRS and provides a mapping exercise on how the GRI is linked to the ESRS. "If you comply with the GRI, you semi-automatically comply with the impact side of the ESRS, so that's good news for GRI reporters in Europe," he says.

GRI

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Meanwhile, the GRI standards are already used by corporates that are following the Task Force on Climate-related Financial Disclosures (TCFD) reporting framework. "I dare say that the burden of reporting when you use the GRI and then the TCFD and ISSB is minimal. But we will come out with a guidance for this," says Van der Enden.

The organisation is currently offering courses to educate corporates on the latest sustainability reporting framework and the role of the GRI.

Like many others, he believes sustainability reporting will go the way of financial accounting standards. "With the introduction of new legislation or new things, you will always hear people pushing back, which is fair. You will hear [complaints about] the cost of compliance, business secrets and that the information is difficult to understand," he says.

Can there be real impact by promoting more reporting? Van der Enden is optimistic. "We see that our standards are not only being used for reporting. They are being used more and more as guidance for risk management and internal audits. [The standards highlight] the topics companies should look at to mitigate risks around topics that they never before thought were real issues."