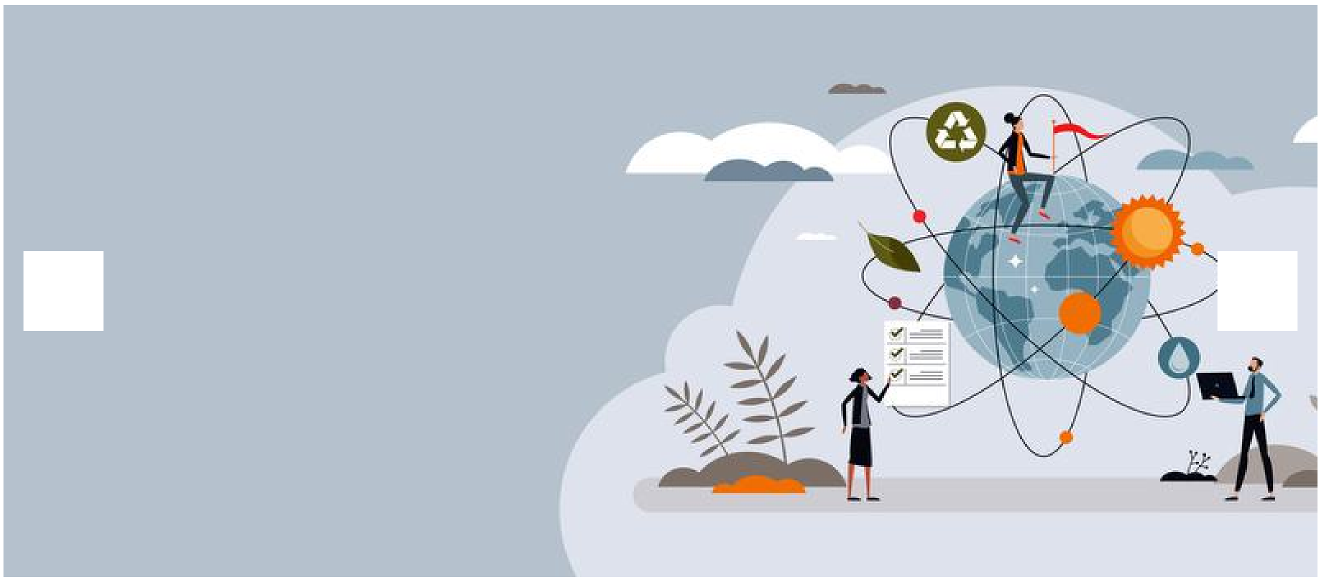
Unpacking IFRS S2 climate disclosures

Green reporting. It is the thematic standard for disclosures of climate related risks and opportunities faced by companies



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IFRS S1 ‘General Requirements for Disclosure of Sustainability-related Financial Information’, issued by the ISSB (International Sustainability Standards Board, a part of the IFRS Foundation) is the core framework for disclosure of material information about sustainability-related risks and opportunities across an entity’s value chain.

IFRS S2 is a thematic standard for disclosure of climate-related risks and opportunities. The standard draws heavily from the TCFD (Taskforce on Climate-related Financial Disclosures) and the GHG Protocol both of which have done pioneering work making them indispensable works of reference.

Climate-related risks are of two types — physical risks and transition risks. Physical risks can be event-driven (acute physical risks) such as caused by storms, floods, heatwaves etc., or from longer-term shifts in climatic patterns (chronic physical risks) including shifts in weather patterns which could lead to sea level rise, bio-diversity loss etc., resulting in impairment of assets.

Transition risks include policy, legal, technological, market and reputational risks. The effects could be, increased cost of operations due to disturbances in supply-chain, or the banning of materials which could lead to having to reinvent production processes (IFRS S2, Appendix A).

It is generally agreed among the scientific community that climate changes are caused by emissions of greenhouse gases caused by anthropogenic activities such as burning fossil fuels. These gases have no way of escaping the atmosphere and hang heavily (when did we last see a star-lit sky?) resulting in rise in global temperatures and climate-changes.

The objective of IFRS S2 is to require an entity to disclose information about climate-related risks and opportunities that could reasonably be expected to (those not expected to affect are scoped out) affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term since this information is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity. IFRS S2 is a highly detail oriented standard and will test an entity for its readiness to cope with it.

Core Content

At the heart of the Standard sits the Core Content which is Governance, Strategy, Risk Management and Metrics & Targets.

Disclosures of Governance is to enable the primary users of General Purpose Financial Statements understand how an entity manages its climate-related risks and opportunities.

Disclosures on Strategy is to enable the users to understand the strategy that an entity has adopted. The disclosures required are of the nature of climate-related risks and opportunities and how they will affect an entity's prospects. Disclosures are required for the effects of climate-related risks and opportunities on the entity's business model, the value chain, and plans for transition to net-zero.

One of the most important aspects under this heading is the effects on financial performance for the year under report, and the future and how they have been factored into future financial planning. This will put the statutory auditor on notice to take note of matters that should be brought into the financial statements (paragraph 9d). Also, the entity's resilience of the strategy and business model in dealing with these effects is required to be disclosed.

Risk management disclosures will enable the users of general purpose financial statements to understand how the entity is managing the risks and also whether these strategies have been integrated into the entity's overall risk management process.

Metrics and Targets are about enabling the users to understand the performance and progress towards any targets the entity has set. An important source of how to go about it is contained in the TCFD's Guidance on Metrics, Targets and Transition Plans per which climate-related metrics are those that apply to all organisations (cross industry) or those that are specific to an industry.

For the latter, one should refer to the 'Industry-based Guidance on Implementing IFRS S2'. These industry-specific disclosures numbering 77 were developed by Sustainability Accounting Standards Board (SASB) now subsumed in ISSB.

Greenhouse Gases Emissions

Metrics and Targets deal with greenhouse gases numbering seven as listed in Kyoto Protocol in a very detailed manner. The GHG Protocol had done pioneering work in coming to grips with the difficult task of defining, measuring and reporting of greenhouse gases. The protocol measures the greenhouse gases in terms of tonnes of carbon dioxide with a conversion factor across seven gases.

Per the GHG Protocol, emissions are classified into three categories — Scope 1, Scope 2 and Scope 3. Scope 1 are own-generated, Scope 2 refers to purchased fuels generating at a site other than the entity's own and Scope 3 are by the supply-chain. Scope 3 is further classified into eight upstream activities and seven downstream activities.

Of the three, Scope 3 is the most difficult to deal with since it requires an entity to gather information from these 15 sources that includes vendors, customers and service providers. While the corporate sector has now begun to address the issue of computing emissions for the Business Sustainability and Reporting Statement, there is some way to go before we can see accurate figures.

A downstream activity in Scope 3 is 'investments' which can also take the form of loans granted by banks, NBFCs etc., also referred to as 'financed emissions'.

The RBI (as part of Network for Greening the Financial System (NGFS), a coalition of central banks) in the 'Draft Disclosure Framework on Climate-related Financial Risks, 2024' dated February 28, 2024 had endorsed its agreement with the TCFD and the need to evaluate the climate-related risks in loans given by the Regulated Entities.

Following this, banks now are scrutinising funding proposals for climate-related risks. For those who would like to study this subject further, the publications of PCAF (Partnership for Carbon Accounting Financials) are highly recommended.

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Risk management disclosures will enable users of general financial statements to understand how an entity's

climate risk management has been integrated

into its overall risk management process