DILIGENTIA

DILIGENTIA ETS

COMMENT LETTER

IFRS ED Sustainability Disclosure Standards

July 29th, 2022

To the Review Teams of the:

- *Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information*

- *Exposure Draft IFRS S2 Climate-related Disclosures:*

Introduction

Diligentia appreciates this opportunity to respond to the ISSB Exposure Drafts "*IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information*" and "*IFRS S2 Climate-related Disclosures"*.

Diligentia ETS (**https://diligentia.it/en/**) is a global community of Associations, Companies and professionals sharing the need of changing the economic development pattern and promoting responsible business conduct, more attentive to the balance between profit and the protection of environment and the well-being of local communities, business partners and customers.

On the issue of Corporate Sustainability Reporting, Diligentia has set up a specific research center ("Osservatorio"), composed of associates, academics, individual members of other professional associations, such as the association of Chief Financial Officer (ANDAF), Association of Internal Auditor (AIIA), Association for quality (APQI, Conforma), as well as member of accreditation body for certification (Accredia).

The first goal of the Observatory is to provide a commentary contribution to the draft sustainability standards issued by ISSB and EFRAG which are in public consultation. The Observatory is going continue its activity to follow the development and evolution of sustainability standards and their application.

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Exposure Draft ED/2022/S1 - General Requirements for Disclosure of Sustainability-related Financial Information

Comments to questions included in ED IFRS 1

Please, note that questions from ED IFRS 1 are in bold, while comments from Diligentia ETS are written in italics.

Question 1 – Overall approach

a) Does the Exposure Draft state clearly that an entity would be required to identify and disclose material information about all of the sustainability-related risks and opportunities to which the entity is exposed, even if such risks and opportunities are not addressed by a specific IFRS Sustainability Disclosure Standard? Why or why not? If not, how could such a requirement be made clearer?
The ED clarifies that The assessment of materiality shall be made in the context of the information necessary for users of general purpose financial reporting to assess enterprise value. The perspective is clear, but Diligentia favors a multi-stakeholder and a double-materiality approach.

b) Do you agree that the proposed requirements set out in the Exposure Draft meet its proposed objective (paragraph 1)? Why or why not?
Diligentia thinks that IFRS S1 should provide a definition for the meaning of 'significant' in relation to risks, impacts, *and opportunities*

c) Is it clear how the proposed requirements in the Exposure Draft would be applied together with other IFRS Sustainability Disclosure Standards, including the [draft] IFRS S2 Climate-related Disclosures? Why or why not? If not, what aspects of the proposals are unclear?

d) Do you agree that the requirements proposed in the Exposure Draft would provide a suitable basis for auditors and regulators to determine whether an entity has complied with the proposals? If not, what approach do you suggest and why?
Disclosure requirements have a forward-looking perspective and a long-term nature. Some specific guidance about the disclosure of assumptions, forecasts and projections would be helpful. We raise the following areas of concern:

a) defining methods to distinguish risks and impacts in short, medium and long term
b) defining methods to link the looking forward information regarding non-financial issues with financial information

Question 2 - Objective

a) Is the proposed objective of disclosing sustainability-related financial information clear? Why or why not?

(b) Is the definition of 'sustainability-related financial information' clear (see Appendix A)? Why or why not? If not, do you have any suggestions for improving the definition to make it clearer?
In the Appendix A, the ED provides this definition for sustainability-related financial disclosures: "Disclosures about sustainability-related risks and opportunities that are useful to users of general purpose financial reporting when they assess an entity's enterprise value, including information about its governance, strategy and risk management, and related metrics and targets".
In the same Appendix, there is a definition for "Sustainability-related financial information": "Information that gives insight into sustainability-related risks and opportunities that affect enterprise value, providing a sufficient basis for users of general purpose financial reporting to assess the resources and relationships on which an entity's business model and strategy for sustaining and developing that model depend".
The differences between "Sustainability-related financial disclosures" and "Sustainability-related financial information" should be explained, since they are not so intuitive.

Question 3 – Scope

Do you agree that the proposals in the Exposure Draft could be used by entities that prepare their general purpose financial statements in accordance with any jurisdiction's GAAP (rather than only those prepared in accordance with IFRS Accounting Standards)? If not, why not?
Diligentia agrees 100% with this approach. Disclosures about sustainability are helpful irrespective of the accounting standard applied.

Question 4 – Core Content

a) Are the disclosure objectives for governance, strategy, risk management and metrics and targets clear and appropriately defined? Why or why not?
(b) Are the disclosure requirements for governance, strategy, risk management and metrics and targets appropriate to their stated disclosure objective? Why or why not?
Yes, on Diligentia's view the disclosure objectives and requirements seem clear appropriate.
Diligentia agrees with the requirement for entities to disclose information about the effects of sustainability-related risks and opportunities on financial position, performance and cash flows. However, some guidance and instructions would be needed on this issue.

Question 5—Reporting entity

a) Do you agree that the sustainability-related financial information should be required to be provided for the same reporting entity as the related financial statements? If not, why?
Diligentia agrees. In the case of groups, sustainability disclosure should be provided both in the consolidated management report and in the parent company separate one. Disclosures on sustainability at the operating segment level (as defined by IFRS 8) is needed.

(b) Is the requirement to disclose information about sustainability-related risks and opportunities related to activities, interactions and relationships, and to the use of resources along its value chain, clear and capable of consistent application? Why or why not? If not, what further requirements or guidance would be necessary and why?

Sustainability related risks and opportunities could arise in any point of the value chain. Thus, the reference to the value chain is fair, on Diligentia's view. Collecting information and disclosing facts which arise out of the company boundaries creates some difficulties; thus, further guidance is needed.

(c) Do you agree with the proposed requirement for identifying the related financial statements? Why or why not?
Diligentia agrees. However, if sustainability disclosures are presented in the management report it should be clear and obvious which are the related financial statements.

Question 6 —Connected information

a) Is the requirement clear on the need for connectivity between various sustainability-related risks and opportunities? Why or why not?
(b) Do you agree with the proposed requirements to identify and explain the connections between sustainability-related risks and opportunities and information in general purpose financial reporting, including the financial statements? Why or why not? If not, what do you propose and why?
Diligentia absolutely agrees with the concept of connectivity. However, further guidance is needed for its practical implementation.

Question 7 —Fairly presentation

Is the proposal to present fairly the sustainability-related risks and opportunities to which the entity is exposed, including the aggregation of information, clear?
Why or why not?
(b) Do you agree with the sources of guidance to identify sustainability-related risks and opportunities and related disclosures? If not, what sources should the entity be required to consider and why? Please explain how any alternative sources are consistent with the proposed objective of disclosing sustainability-related financial information in the Exposure Draft.

Question 8—Materiality

Is the definition and application of materiality clear in the context of sustainability-related financial information? Why or why not?
(b) Do you consider that the proposed definition and application of materiality will capture the breadth of sustainability-related risks and opportunities relevant to the enterprise value of a specific entity, including over time? Why or why not?
(c) Is the Exposure Draft and related Illustrative Guidance useful for identifying material sustainability-related financial information? Why or why not? If not, what additional guidance is needed and why?
(d) Do you agree with the proposal to relieve an entity from disclosing information otherwise required by the Exposure Draft if local laws or regulations prohibit the entity from disclosing that information? Why or why not? If not, why?
Diligentia favors a multi-stakeholder and a double-materiality approach, as the EFRAG one in ESRS.

Question 9—Frequency of reporting

Do you agree with the proposal that the sustainability-related financial disclosures would be required to be provided at the same time as the financial statements to which they relate? Why or why not?
Yes, this is absolutely consistent with the concept of connectivity.

Question 10 —Location of information

Do you agree with the proposals about the location of sustainability-related financial disclosures? Why or why not?
(b) Are you aware of any jurisdiction-specific requirements that would make it difficult for an entity to provide the information required by the Exposure Draft despite the proposals on location?
(c) Do you agree with the proposal that information required by IFRS Sustainability Disclosure Standards can be included by cross-reference provided that the information is available to users of general purpose financial reporting on the same terms and at the same time as the information to which it is cross referenced? Why or why not?
(d) Is it clear that entities are not required to make separate disclosures on each aspect of governance, strategy and risk management for individual sustainability-related risks and opportunities, but are encouraged to make integrated disclosures, especially where the relevant sustainability issues are managed through the same approach and/or in an integrated way? Why or why not?
Diligentia suggests that IFRS S1 should require sustainability-related financial disclosures to be provided in the management report. In the notes to the accounts, there could be some cross-reference to the management report to avoid overlapping.

Question 11—Comparative information, sources of estimation and outcome uncertainty, and errors

a) Have these general features been adapted appropriately into the proposals? If not, what should be changed?
(b) Do you agree that if an entity has a better measure of a metric reported in the prior year that it should disclose the revised metric in its comparatives?
(c) Do you agree with the proposal that financial data and assumptions within sustainability-related financial disclosures be consistent with corresponding financial data and assumptions used in the entity's financial statements to the extent possible? Are you aware of any circumstances for which this requirement will not be able to be applied?
Diligentia agrees with the use of concepts stated by IAS 1 and IAS 8. Diligentia also recommends to apply the same principles of disclosure for events occurred after the reporting date, distinguishing between "adjusting" and "non-adjusting events" similarly to IAS 10.

Question 12—Statement of compliance
Do you agree with this proposal? Why or why not? If not, what would you suggest and why?

*Diligentia agrees. However, there is a contradiction between Paragraph 91 that requires entities to comply with <u>all the relevant</u> requirements, and the statement which states that "to be able to assert compliance with IFRS Sustainability Disclosure Standards, an entity must meet **all** the requirements of these Standards".*
Diligentia also suggests the accreditation system to guarantee compliance with the standards of the declarations/claims, not a simple self-declaration. There are some example of Certification under accreditation: for example Get It Fair "GIF ESG Rating scheme" that aims to grant the "GIF Responsible Organization" validated claim to distinguish companies that have successfully completed a Due Diligence on ESG (Environment, Social, Governance) risks.

Question 13—Effective date

a) When the ISSB sets the effective date, how long does this need to be after a final Standard is issued? Please explain the reason for your answer, including specific information about the preparation that will be required by entities applying the proposals, those using the sustainability-related financial disclosures and others.
(b) Do you agree with the ISSB providing the proposed relief from disclosing comparatives in the first year of application? If not, why not?
In relation to question b) Diligentia recommends that companies should always provide comparative information, even in the first year of application.

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Other Comments

Diligentia also suggest a revision in paragraph 30. The proposed changes are reported in italics and in red colour.

- **Metrics and targets**

30. An entity shall disclose the metrics it uses to manage and monitor sustainability-related risks and opportunities; and the metrics it uses to measure performance, including progress towards the targets it has set. *The metric shall be developed under accredited certification scheme.*
31. When a metric has been developed by an entity, it shall disclose:
(a) how the metric is defined, including whether it is an absolute measure or expressed in relation to another metric (such as revenue or floor space) and any sources that have been used to construct the metric;
(b) ~~whether measurement of the metric~~ *the demonstration that the metric* is validated by an external body and, ~~if so~~, which body; and
(c) explanations of the methods used to calculate the targets and the inputs to the calculation, including the significant assumptions made and the limitations of those methods.

- **Statement of compliance**

91. An entity whose sustainability-related financial disclosures comply with all of the relevant requirements of IFRS Sustainability Disclosure Standards shall include an explicit and unqualified statement of compliance, *that shall be certified by an accredited Certification Body for ESG Rating Scheme (e.g. Get It Fair).*

- **Verifiability**

C23: Sustainability-related financial disclosures shall be provided in a way that enhances their verifiability *by an accredited Certification Body for ESG Rating Scheme. […]*

Basis for Conclusions on [Draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

Statement of compliance

BC 84: The Exposure Draft proposes requiring an entity to include an explicit and unqualified statement of compliance only if its sustainability-related financial disclosure complies with all requirements of the IFRS Sustainability Disclosure Standards. *This statement shall be verified by an accredited Certification Body for ESG Rating Scheme*. This proposed requirement reflects that it is important that users of the information understand whether the entity has been selective in its approach to reporting sustainability-related financial information or whether the entity has applied all of the requirements. Stating whether the entity has complied with all the disclosure requirements is considered particularly important to the establishment of the ISSB because its primary objective is to improve the comparability of information provided. […]

Exposure Draft ED/2022/S2 - Climate-related Disclosures

The proposed changes are reported in italics and in red colour.

Question 9 — Cross-industry metric categories and greenhouse gas emissions

[…] 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. The GHG Protocol allows varied approaches to be taken to determine which emissions an entity includes in the calculation of Scope 1, 2 and 3 — including for example, how the emissions of unconsolidated entities such as associates are included. […]

Do you agree that entities should be required to use the GHG Protocol to define and measure Scope 1, Scope 2 and Scope 3 emissions? ***No, Diligentia does not agree***

Why or why not? ***Because the GHG Protocol is not an accredited certification system***

Should other methodologies be allowed? ***We propose to adopt the ISO 1406x Certification System:***

- *ISO 14064-1 GREENHOUSE GASES — part 1: specification with guidance at the organization level for quantification and reporting of greenhouse gas emissions and removals*
- *ISO 14064-2 GREENHOUSE GASES — part 2: specification with guidance at the project level for quantification, monitoring and reporting of greenhouse gas emission reductions or removal enhancements*
- *ISO 14064-3 GREENHOUSE GASES — part 3: specification with guidance for the verification and validation of greenhouse gas statements*
- *ISO 14067 GREENHOUSE GASES — Carbon footprint of products — requirements and guidelines for quantification*

Why or why not? ***The ISO 1406x Certifications is under accreditation, so there is guarantee of competence, independence and impartiality of the Certification Bodies to give value and reliability to the measurements of GHG.***

Question 11—Industry-based requirements

[…] Do you agree that an entity be required to use the GHG Protocol Corporate value Chain (Scope 3) Accounting and Reporting Standard to provide the proposed disclosures on financed emissions without the ISSB prescribing a more specific methodology (such as that of the Partnership for Carbon Accounting Financials (PCAF) Global GHG Accounting & Reporting Standard for the Financial Industry)? If you don't agree, what methodology would you suggest and why? ***See Comment on question no. 9***

Comments on IFRS S2 Climate-related Disclosures

Premise: The Envision Protocol, a rating system for the measurement of the sustainability of the infrastructure, has a specific credit for the "climate risk" topic:

The scope of the Climate and Resilience category is two-fold: minimizing emissions that may contribute to climate change and other short- and long-term risks, and ensuring that infrastructure projects are resilient. In order to be resilient, infrastructure must be informed, resourceful, robust, redundant, flexible, integrated, and inclusive […].

In order to link the aims of the IFRS Standard to disclose information about climate risks and the already measurement system of Envision Protocol, we suggest to quote the Envision Protocol.

- **Climate-related risks and opportunities**

An entity shall disclose information that enables users of general purpose financial reporting to understand the significant climate-related risks and opportunities that could reasonably be expected to affect the entity's business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term. *These information could be derived from Certification (e.g. Envision for the infrastructure).*

Specifically, the entity shall disclose:

(a) a description of significant climate-related risks and opportunities and the time horizon over which each could reasonably be expected to affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term.

(b) how it defines short, medium and long term and how these definitions are linked to the entity's strategic planning horizons and capital allocation plans.

(c) whether the risks identified are physical risks or transition risks. For example, acute physical risks could include the increased severity of extreme weather events such as cyclones and floods, and examples of chronic physical risks include rising sea levels or rising mean temperatures. Transition risks could include regulatory, technological, market, legal or reputational risks.

Climate resilience

An entity shall disclose information that enables users of general purpose financial reporting to understand the resilience of the entity's strategy (including its business model) to climate-related changes, developments or uncertainties — taking into consideration an entity's identified significant
climate-related risks and opportunities and related uncertainties. The entity shall 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 use an alternative method or technique to assess its climate resilience *(e.g. Envision Protocol for the sustainability of the infrastructure).*

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

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 *or other accredited Certification Schemes [See Comment N. 1]*

BC 112: 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.

BC 113: The Exposure Draft's proposed disclosure requirements about GHG emissions are based on the GHG Protocol *or other accredited Certification Schemes based on Standard 1406x* because:

(a) the Protocol *and the Standards* 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 *and the Standards* aligns with the predominant corporate practices for compiling a GHG inventory; and

(c) ~~its~~ *their* 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).