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PERSPECTIVES

Crosscurrents: Harmonizing Global Sustainability Reporting & IFRS and ESRS Interoperability Guide

Our perspectives feature the viewpoints of our subject matter experts on current topics and emerging trends.

INTRODUCTION: ADVANCING GLOBAL SUSTAINABILITY REPORTING STANDARDS

To improve the alignment of sustainability reporting standards globally, the International Financial Reporting Standards Foundation (IFRS) and European Financial Reporting Advisory Group (EFRAG) created an interoperability document. Published on May 2, 2024, it provides essential guidance and represents a pivotal step in harmonizing global sustainability reporting standards. The alignment aims to enhance the comparability, reliability, and transparency of sustainability disclosures, facilitating better decision-making for stakeholders and fostering a more sustainable global economy.

This interoperability document is especially relevant in jurisdictions where new climate impact laws are being enacted, as it offers a cohesive framework that ensures compliance with both international and regional standards. By integrating the concept of double materiality from the European Sustainability Reporting Standards (ESRS)—which includes both financial materiality and broader environmental and social impacts—into the IFRS framework, the interoperability document helps businesses streamline their reporting processes. This alignment not only aids in regulatory compliance but also dictates the methods for reporting transparency of disclosures, which is crucial for stakeholders and regulators focused on climate impacts. The guidance also offers practical support for companies to avoid duplicative efforts and improve the efficiency of their sustainability reporting.

The following information may be of particular interest to accountants and auditors, financial analysts, CFOs and financial controllers, sustainability officers, regulatory compliance professionals, investors and fund managers, consultants and advisors, and technology providers. Topics covered in this article may help address questions such as, but not limited to:

With which regulations do American corporations doing business in Europe need to comply?

- What is “double materiality”?
- Which sustainability requirements apply to international business?
- If a company/organization complies with ESRS, does it also comply with IFRS?
- What information should be tracked to prevent greenwashing claims on a company/organization’s sustainability strategy?
- How do companies/organizations know whether their climate strategies require third party verification?

EVOLUTION OF SUSTAINABILITY REPORTING STANDARDS

The growing emphasis on sustainability has led to the development of various reporting standards worldwide. The IFRS, known for its financial reporting standards, and EFRAG, responsible for the ESRS, have recognized the need for coherent and comparable sustainability reporting frameworks.

In 2020, IFRS formed the International Sustainability Standards Board (ISSB) to develop globally accepted sustainability disclosure standards. In 2022, they integrated the work of the Sustainability Accounting Standards Board (SASB), and in 2024, they assumed the monitoring of climate related disclosures from the Task Force on Climate-related Financial Disclosures (TCFD). IFRS S1 and IFRS S2 fully incorporate the TCFD recommendations.

Also, in 2020, The European Commission initiated the revision of the Non-Financial Reporting Directive (NFRD) to improve the quality and comparability of sustainability information disclosed by companies. As part of this initiative, EFRAG was tasked with developing the European Sustainability Reporting Standards (ESRS). In 2021, the Corporate Sustainability Reporting Directive was adopted, and a task force to develop ESRS was launched. In 2023, ESRS was finalized, including comprehensive standards on climate change, human rights, and governance May 2, 2024, IFRS and EFRAG publish the interoperability guidance.

IMPORTANCE OF IFRS AND ESRS ALIGNMENT FOR GLOBAL BUSINESSES

Navigating changing regulations across a multi-jurisdictional market is complex and can be costly and time consuming. What is collected, how it is collected, where it is stored, and to whom and when to report it to can be challenging to sort out, specifically for companies that are doing business in EMEA, in California, New York, or in other areas with emerging impact regulation. Simplification and clarification of requirements is critical. The alignment between IFRS and ESRS is crucial for businesses aiming to operate on a global scale as it ensures consistency and comparability in sustainability reporting. This harmonization allows multinational corporations to streamline their reporting processes, reducing the complexity and costs associated with meeting diverse regulatory requirements in different regions. By adopting these interoperable standards, businesses can enhance their transparency and credibility, building trust with global investors, customers, and other stakeholders. Moreover, this alignment supports better risk management and strategic decision-making by providing a comprehensive view of a company's sustainability performance.

COMPARING IFRS AND ESRS INTEROPERABILITY: KEY ALIGNMENTS AND DIFFERENCES

1. Scope and Focus Alignment

- **Environmental Sustainability**
    - **IFRS S1 and S2:** Focus on climate-related disclosures (S2) and broader sustainability issues (S1).
    - **ESRS:** Covers a wider range of environmental issues, including biodiversity, pollution, water and marine resources, and resource use.
    - **Interoperability Document:** Ensures that the broader environmental aspects covered by ESRS are integrated into the IFRS framework, allowing companies to report on comprehensive environmental factors using a unified approach. This includes aligning definitions, metrics, and disclosure requirements.
- **Social Sustainability**
    - **IFRS S1:** Provides a general framework for social issues but with less detail.
    - **ESRS:** Offers detailed standards on social sustainability, including labor practices, human rights, and community engagement.
    - **Interoperability Document:** Harmonizes the detailed social sustainability requirements of ESRS with the broader framework of IFRS S1. This includes specifying which social issues are material and ensuring consistency in reporting formats and metrics.

2. Materiality and Relevance

- **Materiality Assessment**
    - **IFRS S1 and S2:** Emphasize financial materiality—disclosures should focus on sustainability issues that could affect the financial performance and position of the company.
    - **ESRS:** Uses a double materiality perspective, considering both the financial impact and the wider environmental and social impacts of a company's activities.
    - **Interoperability Document:** Aligns the materiality concepts by incorporating double materiality into the IFRS framework where applicable. It provides guidance on how companies can assess and report both financial and wider impacts, ensuring that stakeholders receive a comprehensive view of sustainability issues.

3. Reporting Requirements and Format

- **Disclosure Requirements**
    - **IFRS S1 and S2:** Focus on high-level, globally applicable sustainability disclosures.
    - **ESRS:** Includes detailed and specific disclosure requirements tailored to the EU context.
    - **Interoperability Document:** Standardizes the reporting requirements and formats to ensure that companies can meet both IFRS and ESRS standards without duplicating efforts. It provides templates

and examples to help companies integrate detailed ESRS disclosures within the IFRS framework.

4. Assurance and Verification

- **Assurance**
  - o **IFRS S1 and S2:** Encourage third-party assurance to enhance the credibility of sustainability reports.
  - o **ESRS:** Mandates assurance for certain disclosures to ensure reliability and accountability.
  - o **Interoperability Document:** Aligns the assurance requirements by providing guidelines on obtaining third-party assurance for both IFRS and ESRS disclosures. It outlines the necessary steps and criteria for assurance, ensuring consistency and reliability across different regions.

5. Global Applicability

- **Applicability:**
  - o **IFRS S1 and S2:** Designed for global use, offering a standardized approach for sustainability reporting.
  - o **ESRS:** Primarily applicable within the EU but aims to align with global standards.
  - o **Interoperability Document:** Facilitates global applicability by aligning ESRS standards with IFRS, making it easier for multinational companies to comply with both sets of requirements. It ensures that EU-specific disclosures are relevant and comparable on a global scale, helping companies streamline their reporting processes.

INTEGRATION BENEFITS FOR NORTH AMERICAN CLIMATE REGULATIONS

The interoperability document can be particularly beneficial in states where climate impact laws are being enacted by providing a cohesive framework that aligns with both international financial reporting standards and specific regulatory requirements. As states increasingly mandate detailed disclosures on climate-related risks and impacts, this document helps businesses integrate these new requirements seamlessly into their existing reporting processes. Double materiality and impact assessment in the ESRS framework can provide helpful guidance while SEC climate impact rules and state level regulations are being reviewed and implemented.

HOW ESG CONSULTANTS CAN HELP

Experts can be invaluable in navigating the complexities of implementing these aligned standards. Experienced consultants can provide tailored guidance on integrating sustainability disclosures into existing reporting frameworks, ensuring compliance with both IFRS and ESRS requirements. Businesses should also consider enlisting experts to assist in developing robust data collection and assurance processes, enhancing the accuracy and reliability of sustainability reports. Leveraging consultant expertise can streamline the transition, mitigate potential challenges, and, ultimately, support businesses in achieving their sustainability objectives more effectively.

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Andrea Korney is a Vice President of Sustainability for J.S. Held's ESG & EHS Digital Solutions group, having joined the team in November of 2022 as part of J.S. Held's acquisition of Frostbyte Consulting. Throughout her career, Andrea has demonstrated her passion for inclusive stakeholder relations in the mining and energy sectors, focusing on reducing barriers and creating opportunities for diverse employees, business owners, and industry partners through policy and regulation influence, workforce development, and sustainability outreach. Andrea's 25+ years of experience in energy and metals extraction includes longstanding roles in oil and gas, power generation, and mining across North America and Russia. Her focus in these roles has included HR, corporate services, global supply chain and logistics, stakeholder relations, Native American relations, and government affairs.

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