BWD STRATEGIC PRESENTS

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SUSTAINABILITY INSIGHTS

A strategic review of the latest in sustainability policy and practice

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BWD Strategic is an advisory firm that specialises in sustainable business strategy. We view sustainability as an untapped opportunity to build organisational resilience and long-term financial value. Wherever you are in your sustainability journey, we can help with a solution tailored to your needs.

Dr. Alex Gold
CEO BWD North America
BWD North America
m +1 646 465 0967
e alex@bwdstrategic.com

Ben Kruse
Strategy Director
BWD North America
m +1 816 584 8468
e ben.kruse@bwdstrategic.com

Siobhan Lyons-Kramer
Strategy Manager
BWD North America
m +1 602 845 9587
e siobhan@bwdstrategi.com

Gabriela McCrossan
Senior Strategy Associate
BWD North America
m +1 623 826 5037
e gabriela@bwdstrategic.com

Welcome to Sustainability Insights, a biannual publication dedicated to providing a strategic overview of the latest developments in sustainability policy and practice.

At BWD Strategic, we view sustainability not just as an obligation but as a powerful opportunity to enhance organizational resilience and create long-term financial value. Whether you're just starting out on your sustainability journey or seeking to refine your existing strategies, our solutions are designed to meet your unique needs.

In each issue, we delve into emerging trends, regulatory updates, the role of nature in sustainability reporting, human rights, social considerations, and the challenges of greenwashing. You'll also find a calendar of upcoming sustainability events to keep you informed. To see past issues of the magazine, scan the QR code below.

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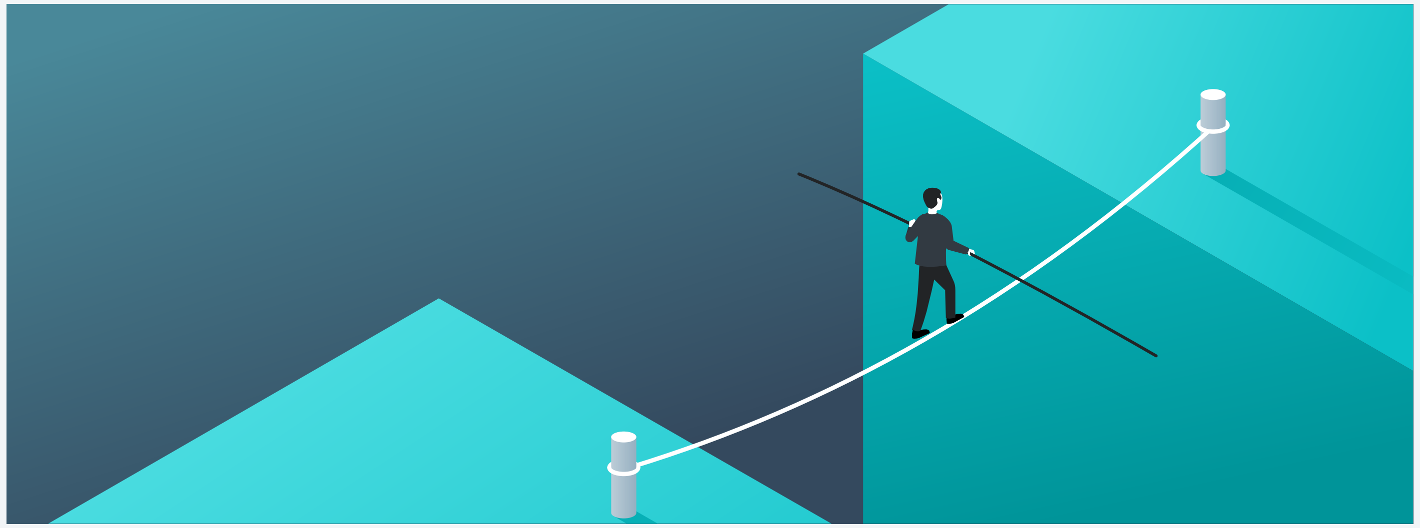


Getting it right on value chain impacts

AVOIDING MISTAKES IN MATERIALITY ASSESSMENT

/ WORDS BY

Dr. Alex Gold
CEO BWD North America

The mistake in many materiality assessments

If your business sources products that can ultimately be traced back to hundreds of children working in a mine in a faraway place, should child labor be considered a material impact in your materiality assessment? Would your assessment change if the child labor is occurring in your own operations?

Many businesses will rate child labor in their own operations as a more severe impact than child labor in their supply chain. This is a mistake because the standards require impacts to be assessed with reference to the stakeholders experiencing the impact. The company's "involvement" with the impact is not a factor. Put another way, just because child labor is in your supply chain doesn't make it any less severe than if it were occurring in your own operations.[1]

How to consider your involvement in negative impacts

Although impacts are meant to be assessed on the basis of severity, your "level of involvement" with the impact does affect what you're expected to do (and disclose) about the impact. Ensuring that your materiality assessment identifies your level of involvement in negative impacts will ensure your impact assessment is accurate, while allowing your business to explain why your approach to mitigating impacts varies depending on whether the impact occurs in your own operations or elsewhere in your value chain.

Due diligence standards define three levels of involvement:

- Directly caused the impact
- Contributed to the impact
- Linked to the impact through business relationships

THE TABLE BELOW USES THE EXAMPLE OF GROUNDWATER CONTAMINATION TO ILLUSTRATE HOW VARYING LEVELS OF INVOLVEMENT WITH THE IMPACT SHOULD BE ACCOUNTED FOR IN A MATERIALITY ASSESSMENT. KEY TAKEAWAYS:

- The impact on people/environment is the same across all three columns, and so the impact is rated the same across all three circumstances (i.e. the company's level of involvement does NOT influence the impact assessment, because impact is assessed according to its severity on people/environment).
- However the company's level of involvement is different, and the level of involvement informs what the company is expected to do about the impact.

ILLUSTRATING VARYING DEGREES OF COMPANY CONNECTION TO A SINGLE IMPACT (GROUNDWATER CONTAMINATION)

	Directly causing groundwater contamination	Contributing to groundwater contamination	Groundwater contamination through business relationships
Impact on people or the environment	A company truck spills contaminants and pollutes community groundwater with one million tonnes of petroleum.	A company's operations leach petroleum into the groundwater, which does not cause problems on its own, but in combination with other nearby companies results in one million tonnes of petroleum contaminants.	A company's supply chain involves the extraction of raw materials that have been associated with dumping one million tonnes of petroleum in groundwater.
Company involvement with the impact	The company has **directly caused** the contamination	The company has **contributed to** the contamination	The company is linked to the contamination **through business relationships**
Assessing impact significance (materiality) - for impacts this means assessing severity and likelihood	One million tonnes of petroleum is assessed as a significant (material) impact on the community and environment.	One million tonnes of petroleum is assessed as a significant (material) impact on the community and environment.	One million tonnes of petroleum is assessed as a significant (material) impact on the community and environment.
The conclusion for management, and the "material information" that may be expected for disclosure, differ according to the company involvement	The company would be expected to clean up the spill and remediate any negative impact on its own. The company is expected to disclose negative impacts and any financial consequences associated with the spill.	The company would be expected to report on its contribution, confirm it is operating within allowed limits, and how it may be partnering with others and authorities toward a long-term solution. The company would not be expected to remediate the whole thing on its own.	The company would be expected to report on due diligence activities being undertaken regarding dumping in its supply chain. It is expected to engage suppliers and offer grievance mechanisms. If dumping is discovered in its supply chain, the company is expected to use leverage to get its suppliers to remediate the issue and enhance practices moving forward, but the company is not expected to remediate it on its own.

IMPORTANT

The significance (materiality) of the impact is assessed independent of the company's involvement with it. Dampening the significance of a negative impact because a company did not directly cause it would not comply with requirements.

The company's involvement with the impact is factored into the management and reporting recommendations.

Using the example of groundwater contamination, the figure shows how the level of involvement with a negative impact does not affect the severity assessment of the impact, and instead affects the expectations on the company to manage the impact.

THE TABLE BELOW OFFERS SIMILAR GUIDANCE, THIS TIME USING SITUATIONS THAT ARE COMMON TO MANY COMPANIES:

- Employee injuries in own operations
- Company GHG emissions
- Child labor in the supply chain

ILLUSTRATING HOW COMMONLY-IDENTIFIED IMPACTS MAY VARY BY COMPANY CONNECTION

	Impact of employee injury	Impacts of climate change	Impacts of child labor in the supply chain
Identifying potential impacts from research, engagement, value chain analysis	An employee is severely injured from on-site manufacturing activity	GHG emissions from company operations (scope 1 and 2) contribute to climate change	The company is aware of the potential of child labor in its supply chain, as child labor has been linked to specific products or countries of origin
Determining company involvement with the impact	This impact - employee injury - is **directly caused** by the company	This impact - climate change - is not directly caused by the company. The company **contributes to** the impact because its actions, together with others, leads to the impact.	The company is **linked to the impact through its business relationships**. The impact is not a result of the company's action but rather caused by entities in its value chain.
Assessing impact significance (materiality) - for impacts this means assessing severity and likelihood	Because the injury is severe, it should be deemed significant (material)	The impacts on society/ environment from climate change would be deemed significant (material) over long-term timeframe (if not now).	The impact of child labor on the individual experiencing it is severe and so it should be deemed significant (material).
The conclusion for management, and the "material information" that may be expected for disclosure, differ according to the company involvement	The company is expected to remediate the injury entirely on its own, understand what went wrong, and improve practices to reduce the risk of it occurring into the future.	The company is expected to have a plan for reducing its own contribution to climate change - i.e. its own emissions - to below acceptable levels (e.g. 1.5C future). It is not expected to solve climate change on its own.	The company would be expected to report on due diligence activities being undertaken to understand whether child labor is occurring in its supply chain. It is expected to engage suppliers and offer grievance mechanisms. If child labor is discovered in its supply chain, the company is expected to use leverage to get its suppliers to remediate the issue and enhance practices moving forward, but the company is not expected to remediate it entirely on its own.

IMPORTANT

The significance (materiality) of the impact is assessed independent of the company's involvement with it. Dampening the impact assessment because of the company involvement would not comply with requirements. It may also lead to unsupportable conclusions such as:

- Climate change is not having a significant (material) impact on society and environment into the long term
- Child labor is not a significant (material) impact on the person experiencing it

The company's involvement with the impact is factored into the management and reporting recommendations.

Using examples of safety, GHG emissions, and child labor, the figure shows how the level of involvement with a negative impact does not affect the severity assessment of the impact, instead affecting expectations on the company to manage the impact.

How can I be expected to disclose value chain impact data? The impacts are out of my control!

The uncomfortable reality for many companies is that once they acknowledge the materiality of impacts in the supply chain, they would then need to disclose on the impacts.

Standards setters understand that getting data on supply chain impacts is difficult. This is why they allow for estimation using sector averages and proxies.[2] Take the example of supply chain GHG emissions – a major component of most companies' scope 3 emissions profile. Companies can estimate supply chain emissions using data already available to them – such as data on spend or amount of product sourced – combined with verifiable methods from the GHG Protocol.

Verifiable estimation methods are increasingly available for other environmental and social topics. Check out resources from CDP, WiFOR, or IFVI. There's also input-output databases such as EXIOBASE and Eora.

Standards setters understand that value chain information will not be perfect. They specify that accurate information need not be perfectly precise, and that useful information can still be provided even if it is uncertain.[3]

While using proxies is imperfect, it is an improvement of the current state of sustainability reporting – which often omits reporting on value chain impacts because it's too difficult to get the information. If companies omit reporting on value chain impacts because it's too difficult, an assurance provider may find this to be a material misstatement. Such a misstatement would be hard to correct on the spot – as it would require a new materiality assessment and impact estimation. So it pays to be up front about material impacts in the value chain and get a head start on estimating value chain impact data if necessary.

/ IN DEPTH

How to understand the difference between material matters and material information

/ WORDS BY

Dr. Alex Gold
CEO BWD North America

Material matters? Material information? Isn't it all the same? Isn't something just material or it's not? Not so fast. If 2024 was the year of the double materiality assessment, then 2025 will be the year that material information rises to prominence.

By articulating the difference between sustainability matters and sustainability information, this article will provide the guidance you need to stay across it as you seek to deliver sustainability reporting aligned with CSRD/ESRS and ISSB Standards.

Distinguishing sustainability matters and sustainability information

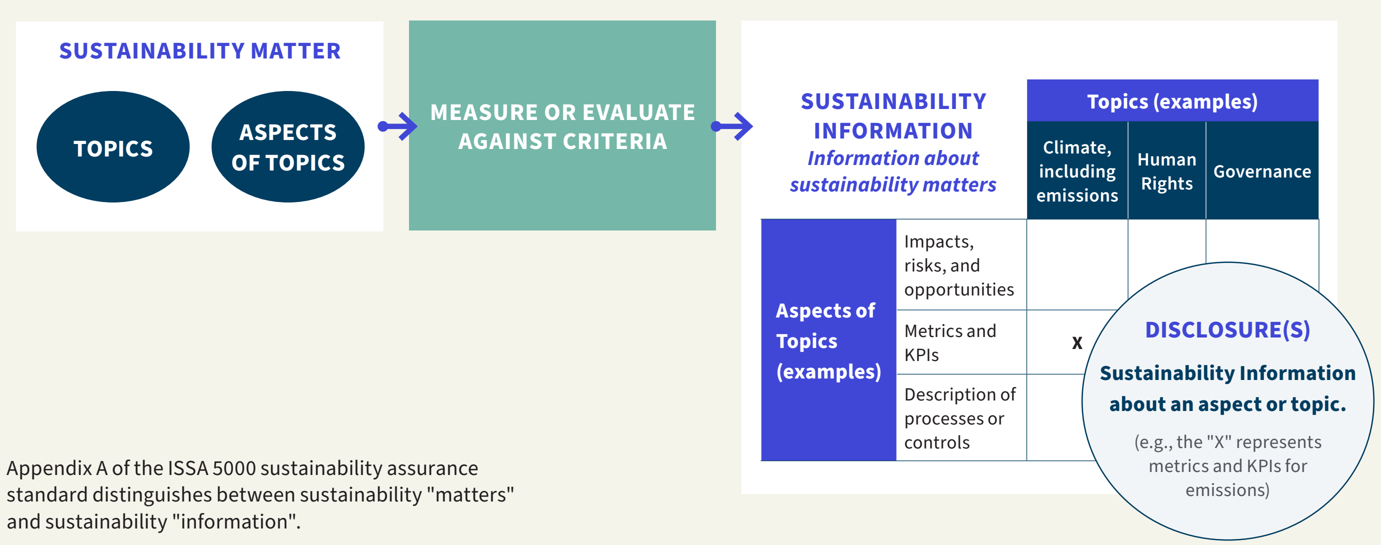
Identifying material *matters* is familiar to many sustainability reporters. Material *matters* are things like health and safety, GHG emissions, waste, supply chain management. When companies performed "materiality assessments", the focus was demonstrating that sustainability strategies were focused on the *matters* most relevant to the business and its key stakeholders.

Because reporting was voluntary, we paid less attention to how the material *matters* informed disclosure. If waste is a material *matter* for your business, what *information* about waste is material to people reading your report? This is what we mean by material *information* – and it's a poorly-developed muscle in the sustainability reporting world.

While frameworks like GRI and SASB suggested material *information* (e.g. indicators) to be disclosed, the voluntary nature of sustainability reporting meant that reporting frameworks were treated like menus to choose from as opposed to a list of required disclosures. No one was checking whether the *information* in the reports was *material* to report users. As a result, information was omitted not because it was immaterial, but because it was unfavorable or too difficult to obtain.

As we enter the era of mandatory sustainability reporting, this is a problem. The new assurance standard for sustainability reporting clearly distinguishes sustainability matters from sustainability information. Furthermore, omitting material information because it is unfavorable or difficult to obtain may be a "material misstatement due to fraud or management bias."

In an era where the legitimacy of sustainability is being challenged from many angles, the last thing a sustainability team wants is allegations of fraud or bias. It's clear that we need to get good at *material information*.



Appendix A of the ISSA 5000 sustainability assurance standard distinguishes between sustainability "matters" and sustainability "information".

So how can we build our material information muscle?

The first thing to acknowledge is that identifying your material matters is a different test to identifying the material information about such matters (see Note 1 at the end of this article for references from the standards setters).

Although both EFRAG (creator of the European Sustainability Reporting Standards (ESRS)) and ISSB (creator of the IFRS Sustainability Disclosure Standards) have specified how to identify material information, it is easier to explain the process through some examples. The examples seek to highlight the distinction between the process of identifying significant sustainability matters vs identifying material information about such matters. It does not attempt an exhaustive illustration of the processes described by EFRAG or ISSB (see the footnotes to this article for additional links).

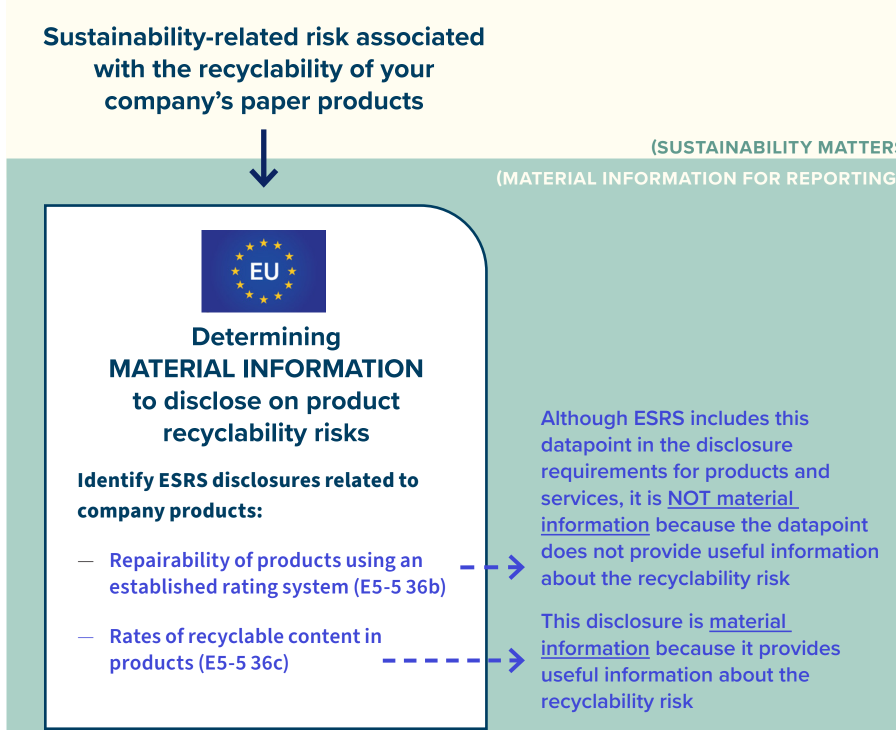


Diagram of the relationship between sustainability matters and sustainability information, and an example of how to determine material information about a sustainability matter

EXAMPLE OF IDENTIFYING MATERIAL INFORMATION FOR A SUSTAINABILITY-RELATED RISK

Perhaps you're a paper manufacturer and you've identified risks related to the recyclability of your paper products. In ESRS-speak, such a risk would relate to the matter of "resource outflows", and the ESRS specifies several disclosures for resource outflows. This is where the material information process comes in – which of the prescribed ESRS disclosures are relevant for your risk?

One of the disclosures asks for information on **recyclability** (E5-5 36c) – this disclosure would likely be considered material information because it is directly relevant to the risk that you identified.

Another one of the disclosures relates to product **repairability** (E5-5 36b) – this disclosure is unlikely to be considered material information because repairability is less relevant to the risk that you identified (for an electronics manufacturer, maybe a different story).

Make sure you document the logic behind why some disclosures are material information or not. An assurance provider may see that you've identified a material matter (resource outflows) and then question why you omitted one of the ESRS indicators related to the matter. You need to be able to say that the omission is valid because the indicator did not provide relevant and useful information about the underlying material risk. Developing fact patterns as part of your materiality assessment, as described later in this article, will help.

EXAMPLE OF IDENTIFYING MATERIAL INFORMATION EVEN IF YOU DON'T BELIEVE YOUR COMPANY IS EXPOSED TO A PARTICULAR SUSTAINABILITY-RELATED RISK

Material information may also relate to matters considered to be material by external parties but do not apply to your business. For example, you may be an apparel manufacturer that has made efforts to source supplies from jurisdictions known for their effective human rights protections. You are aware that your peers have disclosed histories of human rights violations in the supply chain and you're aware of several investor-focused frameworks that ask apparel companies to disclose information on human rights practices. So even though you've done well to mitigate human rights risk, external factors may mean that you're expected to disclose material information about human rights risk anyway. In this case, you may disclose that you're not exposed to human rights risk and explain why.

This example underscores the importance of not excluding material matters simply because your business is managing them well. If your business is managing an issue such as human rights through targeted sourcing, then the underlying matter is still material for your business. You've simply done well to manage the matter, and your management approach remains material information.

Ensuring your materiality assessment covers material information

Although determining material information is distinct from determining material matters, the concepts build off each other. When assessing material matters, the assessment should clearly set out the facts and circumstances underpinning the assessment. For example, each material risk should be accompanied with a description of the risk, how it relates to the business model, external factors influencing the risk, and so on. Such a description is referred to as a *fact pattern*.

EXAMPLE OF A FACT PATTERN FROM ISSB

The ISSB has published a few examples of fact patterns. One example is reproduced in italics below.

The entity operates in the agricultural products industry. It grows wheat itself in two regions: Region 1 and Region 2. The entity also buys wheat from a supplier who grows the crop in Region 1. The entity mills the wheat and sells it to customers.

The entity's business model depends on water because growing wheat relies on rainfall and on irrigation from other water sources. Region 1 currently has high baseline water stress and the entity expects the water stress to become worse over the medium term.

The entity identifies water scarcity as a climate-related risk to which it is exposed. Climate change drives water scarcity in Region 1 through increasing temperatures and changing precipitation patterns. As a result, there is likely to be a significant reduction in the water available in this region. Water scarcity can affect the entity's prospects because, for example, reduced water availability can disrupt its own wheat production and can increase the price it pays to purchase the crop from its supplier.

What's in a fact pattern?

Fact patterns should specify:

- Entity-specific qualitative factors, such as the connection between the company's business model and the sustainability matter
- External qualitative factors, such as industry practice or regulation regarding a sustainability matter
- Quantitative factors, such as amounts of resource consumption or percent of revenue tied to high risk activities

The fact pattern provides the objective evidence base for management to judge whether information is material or not. Relating back to the example of determining material information for product recyclability, if someone asks the company to disclose on repairability, they can point to the fact pattern to suggest indicator is not relevant to the risk. On the other hand, if someone asks the company to disclose on recyclability of their product, and the company still doesn't do so, then it is more likely that their judgement may be called into question.

Pro tip: Ensure your materiality assessment provides specific fact patterns about impacts, risks, or opportunities. The fact patterns are the objective evidence base that you will use to defend why you've included or excluded information in your reporting.

In the end, it's all about material information

When it comes time for assurance over your sustainability report, the assurance provider is going to be looking at why specific information is included or omitted from your reporting. Matters like emissions, diversity, and safety are just the starting point.

So if you have a handle on your material matters, make sure you have a process for determining material information as well.

Notes

Note 1. The ESRS distinguishes between material matters and material information. ESRS 1 section 3.2 distinguishes between "material matters and materiality of information" The flowchart in ESRS 1 Appendix E distinguishes between performing the impact and financial materiality assessment (material matters) and determining the materiality of individual disclosure requirements and datapoints (material information).

The ISSB considers the distinction to be so crucial that it reserves the word "material" to be used only in the context of material information. Important risks and opportunities are instead referred to as "sustainability-related risks and opportunities reasonably expected to affect the entity's prospects". (ISSB guidance will sometimes shortcut this cumbersome wording by referring to them as "significant risks and opportunities"). So for ISSB, it's about determining significant sustainability-related risks and opportunities, and then determining the material information to disclose about these risks and opportunities. See Section 2 of ISSB guidance Sustainability-related risks and opportunities and the disclosure of material information.

Finding footing with finance: "material information" in sustainability vs financial statements

/ WORDS BY

Dr. Alex Gold
CEO BWD North America

One of the biggest myths to be addressed in 2025 is the idea that "financially material information" must be the same in the financial statements and in sustainability reporting.

We regularly see companies seeking to apply the same "materiality threshold" that they use for financial statements to their mandatory sustainability reporting (per European Sustainability Reporting Standards (ESRS) or IFRS/ISSB Sustainability Disclosure Standards). This is usually a quantitative threshold, such as 1% effect on a financial line item, above which the matter may be considered material for reporting.

While using a familiar quantitative threshold might be expedient, its legitimacy for sustainability reporting is questionable. The ISSB states:

"IT WOULD BE INAPPROPRIATE FOR THE ENTITY TO RELY ON PURELY NUMERICAL GUIDELINES OR TO APPLY A UNIFORM QUANTITATIVE THRESHOLD FOR ALL MATERIALITY JUDGEMENTS".[4]

EFRAG (the authority that created the ESRS) has also stated that financially material information in sustainability reporting will differ from financially material information in the financial statements.[5]

Why "financially material" varies across sustainability and financial statements

So why can't we use the same threshold? More importantly, how is it possible that "financially material" information can be different across the disclosures?

Sustainability statements (or sustainability-related financial disclosure per the ISSB) aims to provide information about sustainability matters that is useful to financial markets. Although the intent is to place these disclosures within a company's general purpose financial reports, they remain distinct from the financial statements. The financial statements continue to serve their specified objectives and provide their own set of information.

These different objectives means that the reports provide distinct information about the company, such that "information that is material for sustainability-related financial disclosures might not be material for financial statements, or the other way around."[6]

A key difference is that sustainability-related financial disclosure provides information about sustainability-related risks and opportunities whereas financial statements provide information about an entity's assets, liabilities, equity, income and expenses. Sustainability-related financial disclosure recognizes that investors may seek information on matters that are financially important, but excluded from financial statements, such as:

- Sustainability-related risks and opportunities may affect assets and liabilities in the financial statements, but the effects may not meet financial accounting recognition criteria
- Sustainability-related risks and opportunities may affect assets, liabilities, income and expenses at a future date, and would need to be recognized in the financial statements in the future
- Sustainability-related risks and opportunities may affect natural capital, social capital, and other factors of value creation outside the scope of assets and liabilities in conventional financial statements

This means that judgements on material information for sustainability-related financial disclosures will be distinct from materiality judgements for the financial statements. Trying to use a materiality threshold from the financial statements would be inappropriate for determining material information for sustainability-related financial disclosure.

How sustainability and finance teams can collaborate on financial statements: examples

It's best to explain how to put this into practice using a few examples. In the examples, we will assume that a sustainability committee has responsibility for the sustainability reporting, and that a corporate finance team has responsibility for the financial statements. In each of the examples:

- The sustainability committee leads the determination of material matters and material information for sustainability-related financial disclosure
- The corporate finance team leads the determination of material information for the financial statements

Consider the following examples of sustainability-related risks, and how information on the risk differs in sustainability reporting vs financial statements.

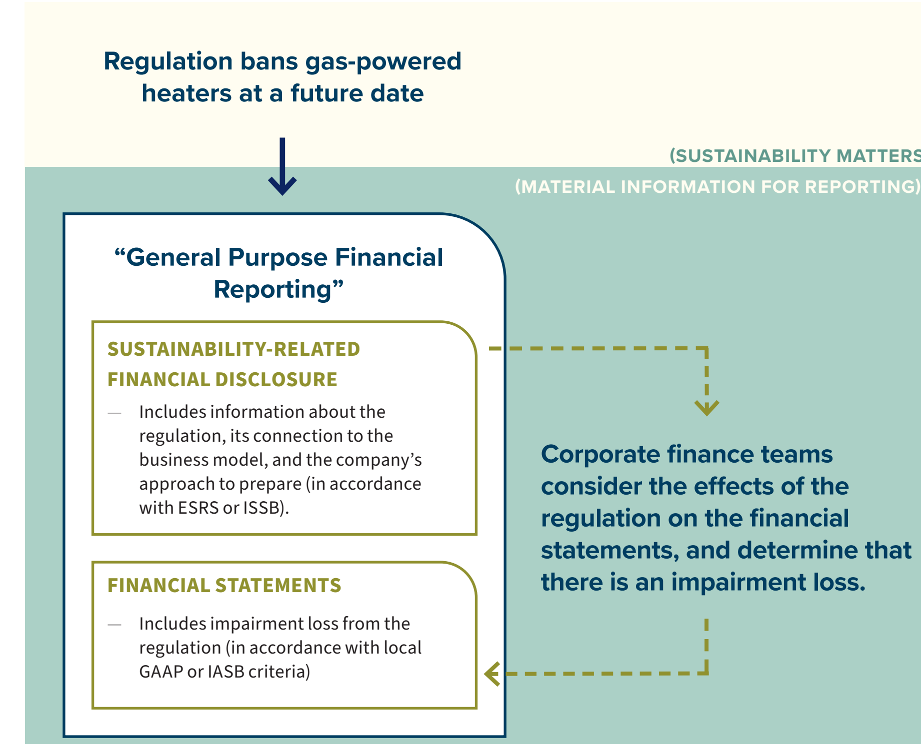
Sustainability standards like ESRS and ISSB inform financial disclosure that is separate to the financial statements, but provided alongside financial statements as part of "general purpose financial reporting" (or the "management report").

EXAMPLE: FINANCIAL EFFECTS FROM SUSTAINABILITY REGULATION

The company identifies a sustainability-related regulation - bans on gas-powered heaters at a future date - as a risk that it should disclose in its sustainability statement. Standards like ESRS and ISSB ask companies to also consider whether the risk has an effect on the financial statements - a job for the corporate finance team.

The corporate finance team considers the effects of the regulation on the financial statements, and determines that there is an impairment loss to be recorded.

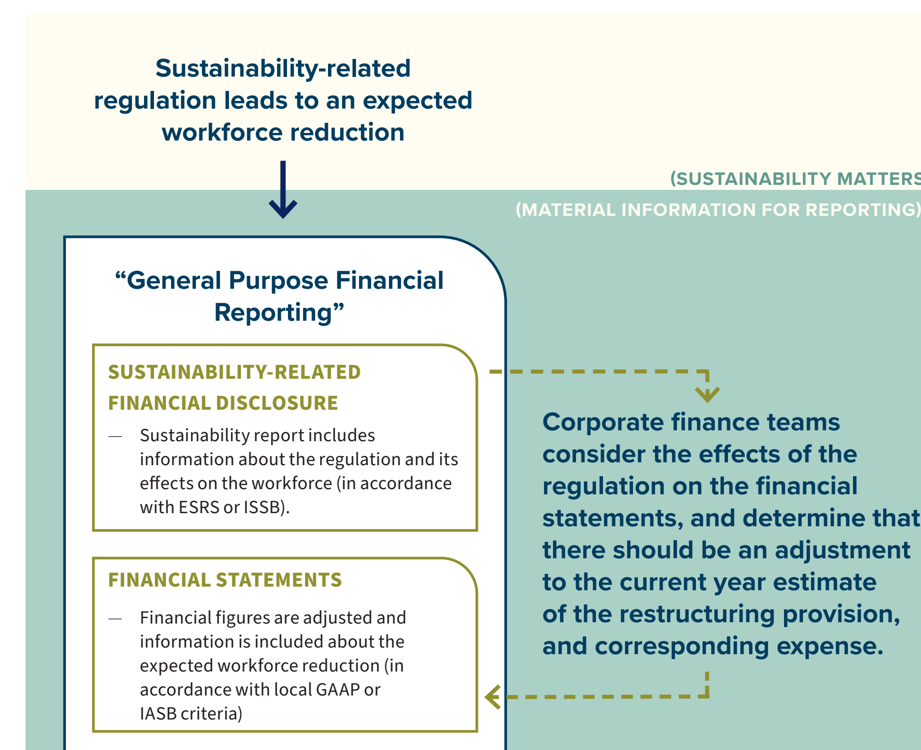
The sustainability statement would include a crossreference to the financial statements.



Example of recognizing an impairment loss in the financial statements due to sustainability-related regulation.

The corporate finance team also considers whether there is a risk of material adjustment to future assets and liabilities, and determines that there should be an adjustment to the restructuring provision because of an expected workforce reduction.

The sustainability statement would include a crossreference to the financial statements.



Example of recognizing the risk of material adjustment to assets and liabilities into the future, within the financial statements.

EXAMPLE: FINANCIAL EFFECTS FROM FOREST FIRES

Just because you disclose a financial risk in the sustainability statement doesn't mean that it **must** also be recorded in the financial statements.

Consider the example of disclosing forest fire risk in your sustainability statement, which is considered a material climate risk into the long-term - although the frequency and severity is uncertain.

Corporate finance teams consider the forest fire risk and determine that its effects for not meet the accounting criteria to recognize an impairment loss. So there is no effect on the financial statements.

The sustainability statement would disclose that the forest fire risk has no effect on the financial statements and describe why.

Forest fires may affect asset values next year, however fire frequency and severity is uncertain

(SUSTAINABILITY MATTERS)

(MATERIAL INFORMATION FOR REPORTING)

"General Purpose Financial Reporting"

SUSTAINABILITY-RELATED FINANCIAL DISCLOSURE

- Includes information about the forest fire risk and potentially affected assets (in accordance with ESRS or ISSB).
- May include risk of adjustment in future years.

FINANCIAL STATEMENTS

- Does not affect the figures in the financial statements (in accordance with local GAAP or IASB criteria)

Corporate finance teams consider the forest fire risk in their impairment analysis and determine that it does not meet criteria to recognize an impairment loss.

Some sustainability-related risks will not result in effects that are recognized in the financial statements. This is to be expected, and simply needs to be disclosed as such.

EXAMPLE: FINANCIAL EFFECTS FROM EMISSIONS TARGETS

Consider the example of disclosing an emissions reduction target, and expected expenditure, in the sustainability statement.

Corporate finance teams consider the effects of the target and determine that the expense has not affected financial performance according to the financial statements. Information about the target may not be included in the financial statements.

The sustainability statement would disclose that the target has not affected the financial performance according to the financial statements.

Company publishes and is working toward an emissions reduction target

(SUSTAINABILITY MATTERS)

(MATERIAL INFORMATION FOR REPORTING)

"General Purpose Financial Reporting"

SUSTAINABILITY-RELATED FINANCIAL DISCLOSURE

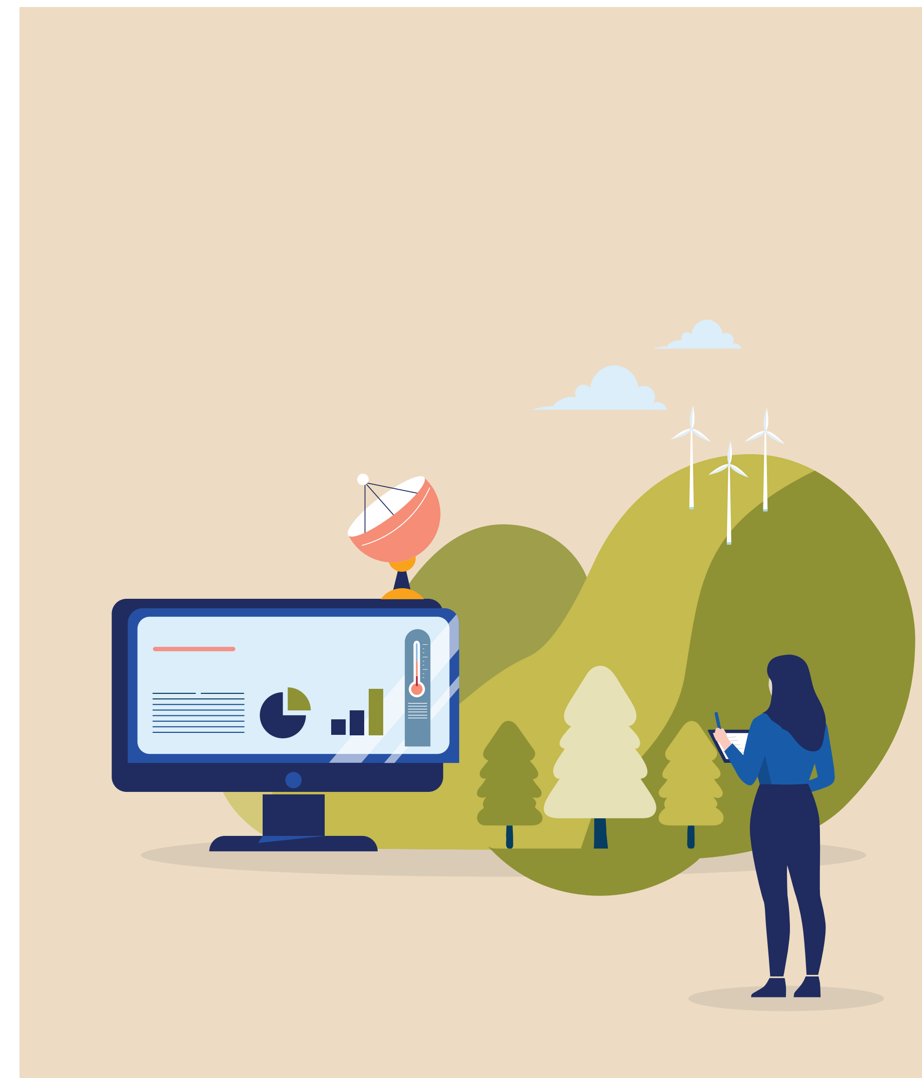
- Includes information about the target, expected capex/opex, etc. (in accordance with ESRS or ISSB).

FINANCIAL STATEMENTS

- Information on the target is not included in the financial statements (in accordance with local GAAP or IASB criteria)

Corporate finance teams consider the effects of the target on the financial statements, and determine the expense is not sufficient to merit recognition.

Although sustainability reporting standards may require disclosing information on expenditures, the corporate finance team may determine that the expenditures do not meet criteria for recognition in the financial statements.



It shouldn't be the same: coherent reporting requires the content to be different

The ESRS and ISSB Standards seek to take a longer-term view, consider the whole value chain, and better account for things like resource dependencies and external impacts. If we try to use the materiality threshold from the financial statements for our sustainability reporting, we risk failing to deliver against the requirements of sustainability reporting standards. It is perfectly acceptable for a risk to be acknowledged in the sustainability-related financial disclosure and then for it to be deemed to have no effect on the financial statements. Companies simply need to demonstrate that they've analyzed the consequences and explain the result.

Sustainability standards setters such as EFRAG and IFRS (which is the home of the ISSB) also have financial reporting mandates, and are clear that their objective is not to try to make the sustainability reporting and the financial statements identical. Instead, it is to create a transparent assessment of how sustainability matters affect the business and value chain into the long-term, and how these same matters may affect the assets and liabilities as recognized in the financial statements.

Mandatory sustainability reporting

CLIMATE DISCLOSURE IN AUSTRALIA

/ WORDS BY

Luke Heilbuth
CEO, BWD Strategic

It's an interesting time in sustainability.

On one hand, we're seeing an increase in politicisation, with US Republicans influencing a growing global movement that equates ESG with woke capitalism.

On the other, mandatory climate reporting in many jurisdictions is compelling organisations to place climate at the heart of their strategy and business models.

What happens when the immovable object of American political influence meets the irresistible force of the law?

We'll need to navigate political blowback, heightening investor and regulatory expectations, and the implementation challenges that come with taking climate change seriously.

This guide will get you started. It steps through the latest regulatory developments, explains the key risks you should be considering, and provides some guidance on what to do next.

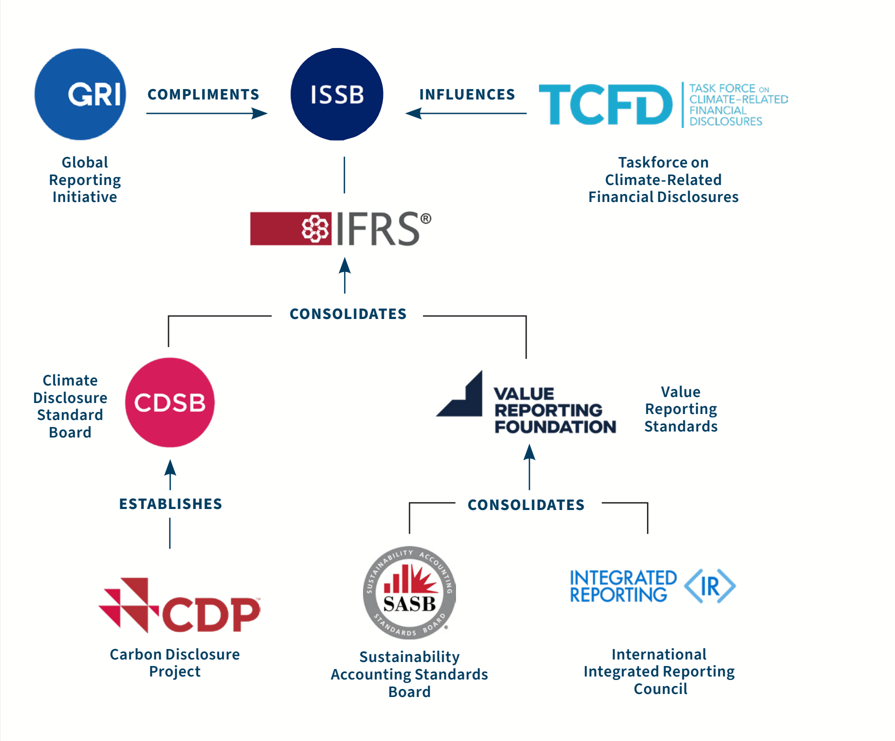
PART ONE

What are the latest regulatory developments?

No more alphabet soup

Australian businesses now have certainty on where to find best practice guidance for sustainability reporting: The International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI).

The ISSB is the most important. It has ushered in a new era of reporting by creating two new sustainability standards called IFRS S1 and S2. We won't focus on GRI in this paper because it does not underpin mandatory Australian legislation like the ISSB does.



What are the new IFRS Sustainability Standards?

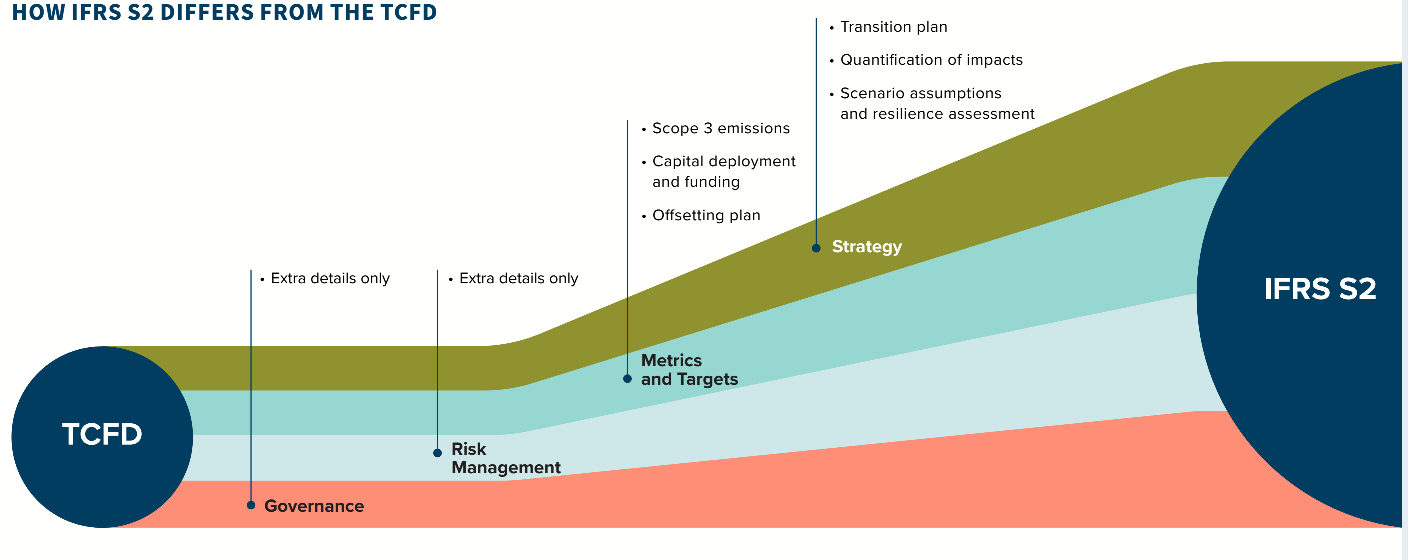
IFRS S1 sets the stage for disclosures related to *general* sustainability risks and opportunities. It aims to help investors make better investment decisions. IFRS S2 dives into *climate*-related disclosures, offering guidance to align a company's strategy and reporting with the urgent need for climate action.

The TCFD voluntarily disbanded in October 2023, but its intellectual property is contained within IFRS S2.

Both Standards require a company to report on four pillars in their sustainability disclosure: Governance, Strategy, Risk Management and Metrics and Targets.

In April 2024, the ISSB voted to add biodiversity and human capital to its two-year work plan. Any new standards won't be finalised until at least 2026. For now, the organisation is focused on implementing IFRS S1 and S2.

HOW IFRS S2 DIFFERS FROM THE TCFD



How does the ISSB influence Australian legislation?

Australia is finalising the implementation of the ISSB guidance in policy and practice through new legislation and the introduction of the Australian equivalents of IFRS S1 and S2 – ASRS S1 and S2 – which passed through the Senate in August 2024.

The Australian Standards will align with IFRS S1 and S2 to ensure consistency with global sustainability disclosures. The mandatory component of the Australian Standards (ASRS S2) only focuses on climate-related disclosure. Entities can choose to report against the non-mandatory ASRS S1, which covers sustainability issues beyond climate (ASRS S1), but must disclose them in a separate document. Major uplifts for companies include the need to disclose a transition plan, the current and anticipated financial impacts of climate risks, and the need to conduct a climate resilience assessment against at least two scenarios; one of which must be consistent with 1.5°C.

The legislation takes a phased approach to implementation. 'Group 1' entities must prepare disclosures for financial years that commence from 1 January 2025; 'Group 2' entities from 1 July 2026; and 'Group 3' entities from 1 July 2027.

Given more than 6,000 Australian entities must report under these new climate-related disclosure requirements (and more than 20,000 by FY2028), you should prepare now to ensure your organisation is ready for what ASIC calls a once-in-a-generation change.

SUMMARY OF REGULATORY DEVELOPMENTS

- **ISSB, GRI are most relevant for Australian reporters.**
- **IFRS S1 and S2 designed to help investors make better decisions.**
- **New legislation requires a major uplift in climate strategy and reporting.**

ENTITY	Entity and their controlled entities meet at least two of the three thresholds			Report from first financial year commencing on or after
	Consolidated revenue for the financial year	Consolidated gross assets at EOFY	Full-time equivalent employees at EOFY*	
GROUP 1				
Large entities and their controlled entities	$500 million or more	$1 billion or more	500 employees or more	1 January 2025
NGER reporting entities**	Above the publication threshold in s 13(1) of the NGER Act. The main thresholds are: 1: 50 kt of greenhouse gas emissions; 2: 200 TJ of energy produced; or 3: 200TJ of energy consumed.			1 January 2025
GROUP 2				
Large entities and their controlled entities	$200 million or more	$500 million or more	250 employees or more	1 July 2026
NGER reporting entities	NGER reporting entities that do not meet the above NGER publications thresholds.			1 July 2026
Asset owners	N/A	$5 billion or more	N/A	1 July 2026
GROUP 3				
All other in-scope entities	$50 million or more	$25 million or more	100 employees or more	1 July 2027

* Part-time employees are to be included as an appropriate fraction of a full-time equivalent employee.

** NGER reporting entities are corporations registered under the *National Greenhouse and Energy Reporting Act 2007* (Cth) (**NGER Act**) at the end of the financial year, or corporations required to make an application to be registered under subs 12(1) of the NGER Act for the financial year.

Climate-related financial disclosures will sit within a sustainability report, which will form the fourth report required as part of annual financial reporting obligations and be contained in an entity's annual report.

Treasury's Policy Position Statement

PART TWO

What are the related business risks?

This legislation is transformational for climate action. Until recently, it was unthinkable that the law would compel every major company to assess, manage and report on the implications of climate change. As ASIC Chair Joe Longo says, action must also be taken now.

"You have to do this now. It's simply not an option to put this off until after legislation has passed, and then scramble to comply. You have to figure out how you're going to marshal data, support and capabilities and start keeping the necessary records now – today."

Given the scale, pace and complexity of the change, corporate boards and executive teams are rightly apprehensive about the risks of this new regime. There are at least three to consider:

1. Implementation risk
2. Integration risk
3. Data risk

1. Implementation risk

The risk of failing to meet new legislative requirements

The principal risk facing your company is failing to meet the new legislative requirements, which are expected to be legislated by August 2024.

Report preparation and lodgement

Companies must disclose their climate-related financial disclosures in a new 'sustainability report', not in their financial and/or directors' report.

It *must* be called a 'sustainability report', even though only climate disclosure is currently required. The Government did not listen to industry feedback calling for flexibility in naming (you cannot, for example, call it a 'climate report').

Our view is that this sustainability report can either be housed as a discreet 'chapter' within a consolidated annual reporting document (clearly labelled as such) or as a standalone document lodged at the same time as the rest of the annual reporting suite.

The sustainability report must also be publicly available on the company website on lodgement day. For publicly listed companies, it must be available for shareholder scrutiny ahead of the Annual General Meeting.

Report content and record keeping

You *can* include non-mandatory sustainability information – such as content on nature or diversity – in your sustainability report, provided it is clearly distinguished from the mandatory requirements of the ASRS S2 Standard as a 'separate voluntary statement'.

The ASRS has advised us that cross-referencing is permitted under the ASRS Standards, which means you don't have to replicate numbers from the financial statements into the sustainability report. But make sure you provide clear links to ensure readers can easily find the financial information they need.

You *do not* need to disclose information that is commercially sensitive or requires 'undue cost or effort' to disclose. The latter is intended to relieve the reporting burden on smaller organisations. It is unlikely to be relevant for larger businesses, which are expected to have the resources for meaningful compliance.

For Group 1 entities, limited assurance is required for scope 1 and 2 GhG emissions from 1 January 2025. Disclosing scope 3 emissions is required from the entity's second reporting period (but limited assurance is only required from 2030). The assurer should be the same as the one used for your financials. An audit of *all* climate disclosures in the sustainability report will be required from 1 July 2030.

Finally, you must keep records that reflect how you prepared your sustainability report for potential regulatory review for seven years, and notify ASIC (only required in the first year) where the records are kept. Failure to maintain sustainability reporting records carries a maximum penalty of two years' imprisonment, so adherence is critical.

KEY TAKEOUTS

- **Disclosures must be made in a sustainability report.**
- **The same auditor of your annual report must provide limited assurance of your scope 1 and 2 emissions (scope 3 from 2030).**
- **You must keep records of report preparation for regulators.**

Penalties for non-compliance

The Corporations Act will be amended to include civil penalties and fines for non-compliance, enforced by ASIC. That said, the regulator has said it will take a pragmatic approach to supervision and enforcement of the regime. It will also issue future guidance to help you meet your obligations.

In the first instance, if ASIC considers a statement in your sustainability report to be incorrect, incomplete or misleading, it may direct you to correct, complete or provide further information. Not complying with an ASIC direction attracts a maximum penalty of 60 penalty units ($18,780 as of July 2023).

Companies will be exempt from *private* lawsuits for misleading or deceptive reporting claims in relation to scope 3 emissions or scenario analysis until 30 June 2027. But enforcement action can still be taken by ASIC on these areas.

Be aware, too, that activists may seek to lobby ASIC directly, presenting a detailed case for non-compliance with the aim of initiating enforcement action. Australia is potentially the world's most litigious jurisdiction for climate action on a per capita basis. In 2023, there were at least 127 judicial proceedings involving climate change.

KEY TAKEOUTS

- **ASIC will take a 'pragmatic' approach to enforcement.**
- **Companies are immune from private lawsuits on scope 3 and scenario analysis until 2027.**
- **No immunity for other topics, or statements made outside the sustainability report.**

2. Integration risk

The risk of ineffective collaboration between sustainability and other functions

Sustainability strategy was once viewed by many as a subset of marketing; the chance to build a brand-bolstering narrative around a company's commitment to stakeholders. Mandatory reporting creates a new imperative for companies to place climate change at the core of strategy, closing gaps in implementation, integration, data and capital allocation in the process.

The days of the siloed sustainability function working in isolation to produce a good news report full of tree-planting and charity handshakes are over. Sustainability is reaching its full potential as a core driver of value creation, with companies needing to deploy multiple functions and skillsets to explain how climate and other key sustainability themes create or erode financial value.

The sustainability report is simply the output of the internal work required to ready a corporate strategy and business model for a more sustainable future; a case of the tail wagging the dog. We shouldn't underestimate the difficulty of this internal transformation, which requires sustainability, finance, legal, technology, strategy, risk, and investor relations teams – as well as the C-suite and board – to work as one.

Things can go easily go wrong. Examples of ineffective collaboration include:

- **Inaccurate financial data: Finance does not review the numbers in claims made within the sustainability report.**
- **Inadvertent greenwashing: Legal does not evaluate net zero or similar environmental claims, which are inadvertently deceptive or misleading.**
- **Misaligned technology investment: IT makes a large technology investment which fails to collect the right sustainability data.**
- **Misaligned strategic execution: Sustainability and corporate strategy pursue separate agendas, meaning sustainability goals are not integrated into enterprise strategy.**
- **Insufficient visibility of ESG risks: The risk team fails to incorporate emerging ESG risks into the risk register because they weren't involved in the materiality assessment.**

These common mistakes can lead to regulatory sanction, a lawsuit and/or the loss of investor confidence. Your company should regularly review each of these integration risks to make sure they don't become major issues.

KEY TAKEOUTS

- **Legislation makes climate change a strategic imperative for every business.**
- **Compliance will require extensive cross-functional collaboration.**
- **Report is only the output; real work is in transformation of strategy and business model.**

3. Data risk

The risk of collecting data without follow-up action

Companies need timely, verifiable data at the right level of precision to mitigate the risk of reporting non-compliance *and* to seize opportunities associated with deploying sustainability in the pursuit of long-term value creation.

Examples of sustainability initiatives requiring high-quality data include gender pay gap reviews, modern slavery risk assessments, climate scenario analyses, decarbonisation roadmaps and LEAP assessments under the Taskforce for Nature-related Financial Disclosures.

Data collection without follow-up action is pointless. As US thought leaders Alison Taylor and Bob Eccles argue, collecting and reporting on data can create a false impression that senior teams are focusing on the strategic value of sustainability when they are not.

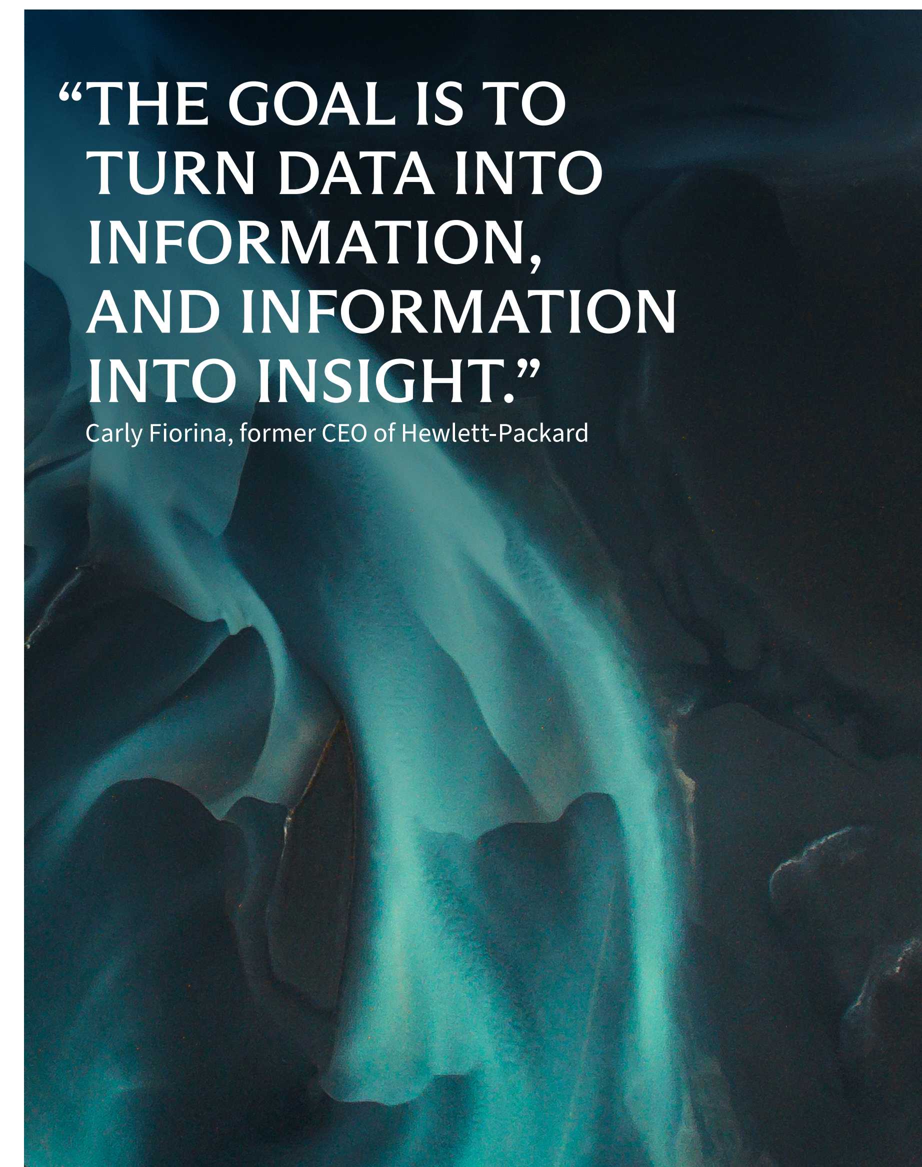
Instead, teams need sufficient resources and upskilling on how to feed sustainability data into board and other decision making processes to drive better decision making, especially in relation to capital allocation.

KEY TAKEOUTS

- **Companies need verifiable data to mitigate sustainability risks and seize opportunities.**
- **Data collection without follow-up action is pointless.**
- **Data must be converted into insights that support better decision making.**

SUMMARY OF KEY RISKS

- **Implementation: Legislative and ASRS guidance is onerous but clear.**
- **Integration: Sustainability is a strategic imperative; requires cross-functional collaboration.**
- **Data: Collection is only a starting point; the goal is better strategic decision making.**



"THE GOAL IS TO TURN DATA INTO INFORMATION, AND INFORMATION INTO INSIGHT."

Carly Fiorina, former CEO of Hewlett-Packard

PART THREE

What should companies do next?

Applying the new legislation and accompanying ASRS guidance in practice will take a lot of work, even for companies long used to climate strategy and disclosure. Regardless of your level of climate maturity, BWD suggests a four-step process to set you up for success.

Step 1. Prepare

- **Gap analysis**
- **Double materiality assessment**

Start by conducting a gap analysis comparing your current reporting practices against the informational, presentation and procedural needs of ASRS S1 and S2. The review should cover annual and sustainability reports, TCFD statements and internal policies. Gaps, once identified, should then inform an ASRS compliance roadmap.

Second, we strongly recommend commissioning a double materiality assessment. The approach should align with IFRS/ASRS guidance on identifying sustainability-related risks and opportunities, as well as the GRI, which provides the best methodology for identifying stakeholder impacts.

While the IFRS Chair has advocated for a single (financial) materiality approach, ISSB guidance is consistent with double materiality, and it remains the foundational strategy of choice among most sustainability leaders, including because double materiality is mandatory under European law.

Step 2. Educate

- **Board, senior management and all other internal stakeholders**
- **Directors' declaration**

The board, management and all internal stakeholders should be briefed early on how and when the mandatory reporting obligations will apply. Board members should be clear on the responsibility they will assume when providing a directors' declaration on the accuracy of the climate-related financial disclosures in the sustainability report.

For the first three years, directors can simply declare that the entity has taken reasonable steps to ensure that the sustainability report has been prepared in accordance with the Corporations Act.

After three years, though, directors must declare that the report complies with the ASRS *and* discloses all material climate-related financial risks and opportunities relevant to their organization.

DIRECTORS' DECLARATION

1.52 The directors' declaration is a declaration by the directors of their opinion on whether the statements are in accordance with the Corporations Act, including in compliance with the relevant sustainability standards (i.e. whether the climate statement is in compliance with the sustainability standards that relate to climate). These declarations must be made with a resolution of the directors, dated and signed.

From the Treasury Laws Amendment Bill 2024: Climate-related Financial Disclosure, Exposure Draft Explanatory Materials

Step 3. Embed

- **Governance processes**
- **Data systems**

New governance arrangements are likely needed to oversee reporting implementation, integration and quality control. Arrangements should focus on creating a cross-functional delivery team with expertise from sustainability, finance, legal and technology.

Sustainability professionals are good at explaining the strategic value of sustainability, while finance, legal and IT colleagues will help ensure disclosures are accurate and avoid inadvertent greenwashing, especially where forecasts and forward-looking statements are made.

Data is crucial. The reporting delivery team should help develop systems capable of maintaining timely and precise data flows to support a wide array of disclosures. Examples include aligning physical and transition risks and opportunities with cash flow, access to finance and cost of capital projections, and scope 3 emissions monitoring and reporting, which require a reliance on third-party data. Access to scope 3 data should be secured up front, as part of contractual arrangements with supply chain partners where possible.

Step 4. Enact

- **Start early, get resources**
- **Stay on top of developments**

Ideally, the above steps should be enacted nine months before the lodgement date of the mandatory sustainability report. Make sure senior decision makers understand they will need to allocate more resources to the reporting effort, especially in the first year.

For many companies, this will include a need for external advisory support to feel confident about meeting their legislative obligations.

We strongly recommend drafting a communications strategy post the report's release, as the enhanced detail and comparability of this new regime will expose companies to even greater climate scrutiny from investors, regulators and activists.

Finally, staying on top of developments is key, given the draft legislation anticipates the expansion of reporting requirements beyond climate disclosures to broader environmental matters, such as nature-related financial disclosures. The ongoing evolution of the ASRS has been referred to as 'climate first, but not only'.

SUMMARY

PART ONE

What are the latest regulatory developments?

Only ISSB (IFRS S1 and S2), GRI especially relevant for Australian reporters.

IFRS S1 and S2 designed to help investors make better decisions.

Australian law and Standards broadly reflect the ISSB, close to finalisation.

PART TWO

What are the related business risks?

Implementation

Integration

Data

PART THREE

What should companies do next?

Prepare

Educate

Embed

Enact

WANT TO KNOW MORE ABOUT SUSTAINABILITY IN YOUR INDUSTRY?

Get in touch:

/ ENDNOTES

1 From EFRAG Implementation Guidance on Materiality Assessment p38 (paragraph 160): "The type of involvement (i.e. caused, contribute or directly linked) is important given that it could lead to a different approach when addressing the negative impacts. However, this does not imply that impacts that are directly linked [i.e. deep in the supply chain] are necessarily less material than those caused or contributed to, as the basis of the materiality assessment is severity."

2 See ESRS 1 section 5.2 "Estimation using sector averages and proxies".

3 ISSB Sustainability-related risks and opportunities and the disclosure of material information p18: "Accurate information does not have to be perfectly precise." ESRS 1 section 7.2 (paragraph 89): "Even a high level of measurement uncertainty would not necessarily prevent such an assumption or estimate from providing useful information."

4 ISSB Sustainability-related risks and opportunities and the disclosure of material information p47.

5 In response to the FAQ of "Is the material information for financial statements the same as for the sustainability statement?" EFRAG responded "No, it is not the same." See EFRAG Implementation Guidance 1: Materiality Assessment.

6 ISSB "Sustainability-related risks and opportunities and the disclosure of material information" p16.

BWD Strategic

BWD is an advisory firm that specialises in sustainable business strategy. By combining best practice sustainability strategy with original design and data visualisation, we cut through the complexity of sustainability to create a lasting competitive advantage for our clients.

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