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Disclosure: ISSB Makes Recommendations Regarding Scope 1, 2 and 3 Disclosures and Clarifies Materiality Standard

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Disclosure

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The International Sustainability Standards Board (ISSB), a standard-setting organization created by the International Financial Reporting Standards (IFRS) Foundation to promote consistent and reliable climate-related disclosures, has unanimously decided on a **recommendation** that companies disclose information on Scopes 1, 2 and 3 greenhouse gas emissions starting in early 2023. "Scope 1 covers direct emissions from a company; scope 2 covers indirect emissions from electricity purchased and used; and scope 3 covers all other indirect emissions from the value chain." The ISSB also intends to develop relief provisions to assist companies applying Scope 3 requirements, which may include additional time to make disclosures and safe-harbor provisions.

As part of its amendments, the ISSB revised the language of various proposals that were confusing. For instance, it clarified that "materiality" has the same definition for climate-related disclosures as it has in the IFRS International Accounting Standards, where materiality is defined as information that "could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements." The ISSB plans to provide additional guidance to assist issuers in making materiality assessments for climate disclosure purposes.

Taking the Temperature: The ISSB announcement is significant in a number of respects. First, there is a question about issuers' ability to accurately report information on Scope 3 emissions. Because these are value-chain emissions, by definition third parties, not the issuer itself, have the relevant GhG information. It is not clear that issuers will be able to obtain all such information in order to provide complete and accurate reporting, not to mention the potentially significant costs involved in doing so and the potential for double-counting given that one issuer's Scope 3 emissions are another company's direct emissions. The SEC's proposed climate-change disclosure regulation treats

Scope 3 emissions differently than Scope 1 and 2 emissions, with disclosure required only if such emissions are material or if the company has made a commitment regarding Scope 3, which also would be subject to safe harbor protections.

Second, the ISSB's materiality clarification also is important. Certain disclosure frameworks, including various EU climate-related standards such as the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Disclosure Regulation (SFRD), have adopted the concept of "double materiality," whereby information is material not only because of its potential impact on the issuer (the traditional assessment of materiality), but also because of the issuer's impact on climate. The ISSB's materiality articulation does not adopt the concept of double materiality. Nonetheless, despite the ISSB's clarification, issuers need to be careful to consider whether their climate-related impacts could have a material boomerang effect on their companies. For example, companies engaged in operations that entail significant GhG emissions (*i.e.*, their impact on the environment) could, at some point, anticipate significant legal or regulatory restrictions on those operations (*i.e.*, President Biden's August 5, 2021 Executive Order directing that 50% of all new passenger cars and light trucks sold in 2030 be zero-emission vehicles), which in turn will have a material impact on the nature of the issuer's business or financial performance.