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UK Sustainability Disclosure Technical Advisory Committee
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Dear FRC colleagues,

UK Endorsement of IFRS S1 & IFRS S2: Call for Evidence

We welcome the opportunity to respond to your consultation on UK Endorsement of IFRS S1 & IFRS S2.

The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-sized quoted companies. A list of Expert Group members can be found in Appendix A.

Overall, we welcome the FRC's objective of endorsing IFRS S1 and IFRS S2 and its commitment to assessing their feasibility and appropriateness for the UK context. The QCA is broadly in favour of reporting against these standards as we believe that they will help in simplifying sustainability-related disclosures for companies.

As you will see below, we have produced a shorter response. Instead of responding to each question in turn, we have provided more general observations on the two standards and their adoption in the UK. Specifically, we focus on the extent to which IFRS S1 and IFRS S2 can be effectively interpreted, their role in supporting connectivity across financial reporting, and the technical feasibility of the standards' application in the UK.

Interpretation of IFRS S1 and IFRS S2

Regarding the degree to which the requirements in IFRS S1 and IFRS S2 can be effectively interpreted, we have the following, brief observations on materiality contained in IFRS S1 and transitions plans in IFRS S2:

- **Materiality (IFRS S1) -** Overall, we believe the definition and application of materiality as stated in paragraphs 17-19 is clear. However, we do think it might be challenging for entities to apply such a definition in the context of sustainability-related disclosures. While the ISSB's Illustrative Guidance is useful for entities, the FRC should explore ways to offer entities more support in the form of educational materials, illustrative examples or information such as that provided in the IFRS Practice Statement 2.

- **Transition plans (IFRS S2) -** We believe that disclosure about transition plans as contained in paragraph 14 of IFRS S2 is useful for investors and other users of this information. However, the proposed disclosures are extensive, and more guidance, illustrative examples and clearer definitions may be required. For example, the terms 'resource allocation', and 'indirect and direct mitigation efforts' may not be clearly understood or consistently interpreted.

  Many companies, including smaller companies, are not at a very advanced stage in producing their transition plans, and they are unlikely to be in the position to provide much disclosure in this area about changes and actions. For these entities, the focus should be on describing their progress in their transition planning journey, including disclosure of any key developments or changes in plans during the period.

Connectivity across the financial report

To improve consistency and connectivity with reporting, we suggest the FRC indicate a preference for including sustainability-related financial disclosures within annual reports/general purpose financial reporting in order to encourage entities to limit disclosures to material and significant content. The majority of UK statutory disclosures are contained in the entities' annual reports.

Regarding entities being allowed to make integrated disclosures, we believe the FRC should enable entities to adopt this approach. We also think that moving it to the section on connected information (paragraph 21 – 24) would clarify the suggested approach to a greater extent. This is because entities should be integrating both sustainability matters and sustainability disclosures with the rest of their reporting on governance, strategy and risk management.

Technical feasibility of the standards in the UK context

Below we provide some general observations on the technical feasibility of the adoption of both IFRS S1 and IFRS S2 in the UK. We also offer more specific comments on the challenges smaller entities may face when reporting on the business model and value chain section of IFRS S2.

<u>General observations</u>

Many entities, especially smaller entities, will struggle with the requirement to report under IFRS S1 and IFRS S2 standards on all significant sustainability-related risks and opportunities and it is important that the FRC takes the capacity of smaller entities into consideration. Entities will require sufficient time to be able to adhere to the requirements and the extensive number of new disclosures included in the standards. The workload will include addressing data collection, systems, processes and controls, and we believe entities will require a number of years to be fully compliant with this new type of reporting.

Some of the more challenging disclosure requirements, such as those in relation to Scope 3 emissions, current and anticipated financial impacts, scenario analysis, and metrics and targets, should be phased in. Governance, risk management, disclosure of identified risks and opportunities under strategy and disclosure of some initial metrics, including Scope 1 and 2 GHG emissions, would be more feasible for a greater number of entities to apply initially. Generally, it may be possible to provide qualitative disclosures first, followed by quantitative disclosures at a later stage.

Overall, we believe a solution to the above issues would be for the FRC to adopt a phased-in approach to the implementation process. In their June 2023 feedback statement on IFRS S1 and IFRS S2, the ISSB committed to allowing companies temporary relief to choose to report on only climate-related risks and opportunities in line with IFRS S2 in the first year of the standards' implementation, with companies required to report in full on their sustainability-related risks and opportunities from the second year. While we welcome the inclusion of temporary reliefs for companies, we recommend the FRC extend the period to two reporting years, instead of the one-year temporary relief proposed by the ISSB, to give entities sufficient time to fully adapt to the new requirements.

In addition, while there are inherent issues with the 'comply or explain' model in relation to how it is interpreted in practice by certain market participants, we welcome that compliance is not mandatory. We believe that this approach, alongside an extended phasing-in period, will encourage wider adoption of the standards at the beginning of the adoption process.

<u>Business model and value chains (IFRS S2)</u>

While we consider that disclosures about the effects of significant climate-related risks and opportunities should include information about the effects on an entity's business model and value chain, assessing effects on the value chain will be particularly difficult for smaller entities. In particular, they may struggle to produce the necessary quantitative information. As such, we recommend that qualitative information be allowed, with entities explaining the process applied to determine and assess their value chain (including any limitations/restrictions) and any concentrations.

The disclosure requirement in paragraph 13(b) about concentrations in the value chain lacks clarity regarding the types of concentration or nature of information an entity should disclose. Some application guidance and/or illustrative examples from the FRC would be very helpful in this area.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours sincerely,

James Ashton.

James Ashton
Chief Executive

Appendix A

The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group*

Rochelle Duffy (Chair)	PKF Littlejohn LLP
Tom Stock (Deputy Chair)	Haysmacintyre
Richard Amos	Skillcast Group PLC
Edward Beale	Western Selection PLC
Matthew Brazier	Invesco Asset Management Limited
Simon Cooper	KPMG LLP
Anna Hicks	Saffery Champness LLP
Mark Hodgkins	Trackwise Designs PLC
Michael Hunt	ReNeuron Group PLC
Clive Lovett	Kinovo PLC
Sandra McGowan	BDO LLP
Giles Mullins	Grant Thornton UK LLP
James Naylor	Mazars LLP
Emily Rees	Quartix Technologies PLC
Mathew Stallabrass	Crowe UK LLP