Dean&Francis
ISSN 2959-6130

The Impact of IFRS S1 on Corporate ESG Disclosure: A Comparative Analysis of SMIC and MTR Corporation

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Abstract:

Environmental, social, and governance (ESG) issues are becoming increasingly important in corporate investment and financing as the global economy and society evolve. This study focuses on the impact of the IFRS S1 standard issued by the International Sustainability Standards Board (ISSB) in 2023 on corporate disclosure and the standard's role in improving corporate information's comparability. By comparing the 2022 and 2023 ESG reports of Semiconductor Manufacturing International and MTR Corporation, this study finds that implementing IFRS S1 promotes a more comprehensive integration of sustainability information in corporate financial reporting. The study notes that the harmonization of international standards, such as the concept of dual materiality proposed by ISSB and the United Nations' Sustainable Development Goals (SDGs), is influencing ESG disclosure practices globally. The difference in focus between the two companies in ESG reporting reflects their different strategies to address the ESG risks and opportunities. The introduction of the IFRS S1 standard will promote standardization of corporate disclosure, optimize the investor decision-making process, and contribute to the achievement of the broader SDGs.

Keywords: ESG Reporting, IFRS S1 Compliance; Information Disclosure Transparency.

1. Introduction

With the continuous development of the economy and society, human beings are facing more and more global problems, such as the stock market meltdown in Japan, the "Black Monday" in the Asia-Pacific market, the nuclear-contaminated water in the UK, and the illegal employment of child labor in garment factories in Vietnam for the production of Adidas and Nike, etc. ESG (Environment, Social, and Governance) has become a global concern, especially in the investment and financing of companies. ESG has become a global concern, especially in corporate investment and financing. Since James S. Coleman published an article entitled *The Role of Social Capital in Human Capital Creation* in the American Journal of Sociology in 1988, which challenged the dominance of the concept of self-interest in economics and introduced social capital as a measure of ESG, there has been a growing interest in corporate ESG [1]. Measurement and attention to the disclosure of information on corporate ESG has been increasing yearly.

IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information issued in 2023 and effective on the annual reporting period on and after 1 January 2024. IFRS accounting standards are required for use by more than 140 jurisdictions. An entity can apply IFRS Sustainability Disclosure Standards regardless of whether its related general-purpose financial statements are prepared by IFRS Accounting Standards or other generally accepted accounting principles (GAAP). To meet the growing need for reliable and uniform sustainability data crucial for economic and investment choices, the IFRS Foundation set up the International Sustainability Standards Board (ISSB) in 2021. Working in conjunction with the IASB (International Accounting Standards Board), the ISSB is tasked with formulating IFRS Sustainability Disclosure Standards. These standards are designed to lay down a universal foundation for sustainability reporting, thereby equipping capital markets with the necessary information to make informed decisions [2]. The IFRS S1 framework for sustainability reporting comprises several key components that work together to ensure consistency and reliability. It includes clear objectives for enhancing transparency and accountability, guidelines for governance to manage sustainability risks, and a focus on materiality to highlight significant issues for stakeholders. Additionally, the framework encourages stakeholder engagement to address their concerns, recommends standardized metrics and measurable targets for tracking performance, outlines a defined structure for presenting information, and provides guidance on obtaining third-party assurance to bolster report credibility. These elements create a comprehensive approach to sustainability reporting [3].

This study will mainly discuss the impact of the IFRS S1 standard on corporate disclosure and further analyze the role of the new standard's development in improving companies' comparability.

2. Core Content of IFRS S1

ESG investing represents an approach that integrates environmental, social, and governance factors into the fundamental analysis and decision-making processes of investing [4]. It goes beyond the traditional method of evaluating companies based solely on financial indicators such as revenue and profit margins. ESG investing encourages businesses to take on social responsibilities while seeking commercial interests and enables investors to assess a company's long-term value and risks more comprehensively. In short, ESG investing provides investors with an enriched and in-depth analytical framework to identify enterprises that excel in sustainability [5].

The risks and opportunities enterprises may face in terms of ESG are multifaceted, involving various areas, from climate change to social responsibility and corporate governance. This study will analyze the opportunities and challenges companies may face in the environment, society, and governance aspects.

In terms of the environment, companies may face risks that can be divided into two categories: natural and policy-related. Risks oriented towards the natural environment include typhoons and tsunamis that may be encountered in coastal areas, rising sea levels due to global warming, and increasing extreme weather conditions. These risks are not controllable by a single company, and when they occur, the destruction is not limited to just one company. To effectively mitigate such risks, raising global awareness of climate and environmental issues is necessary, such as establishing disclosure standards like IFRS S1 and the UN's SDG goals.

Policy-related risks accompany natural risks, with environmental policies being the government's legislative and regulatory measures concerning the environment. For instance, the "Law of the People's Republic of China on the Prevention and Control of Atmospheric Pollution" mandates that enterprises, centralized heating facilities, coal-fired heat source production and operation units, and other polluting entities emitting industrial exhaust gases and toxic and harmful atmospheric pollutants are required to secure a pollution discharge permit [6]. The risks associated with such policy restrictions and the introduction of new policies may be detrimental to a company's profitability, but the sacrifice of immediate benefits can lead to more sustainable development.

Social risks primarily refer to the impact of different social and cultural environments on a company. Potential issues may arise, including labor issues, which correspond to varying legal regulations across various regions. For example, different legal standards exist for severance pay or employee redundancy compensation between Mainland China and Hong Kong [7]. This can affect companies, especially multinational corporations, in terms of personnel and supply chain management.

In corporate governance, companies should consider board structure, executive compensation, and shareholder rights issues. In addition, they should address potential operational problems, such as employee demographics (by gender, age, education, etc.). A diverse workforce can enhance companies' ability to adapt to diversified markets. Companies should also focus on increasing investment in R&D, as more R&D spending can help reduce costs and drive innovation through new technologies. Corporate governance is a key concept for any company; therefore, ESG governance is closely related to the environmental and social aspects. For example, within the framework of legality and compliance, companies should establish environmental and social requirements according to their development needs. In this way, adopting multiple strategies can enable the company to achieve long-term and stable growth.

As mentioned earlier, governance is closely connected to environmental and social aspects, so the risks associated with governance are numerous. For example, a lack of transparency in information disclosure (such as pollutant emission data) could lead to penalties from financial regulatory agencies or law enforcement, negatively impacting the company's reputation. This, in turn, could cause shareholders to lose trust in the company's executives or the company itself, severely undermining shareholder interest and trust, which may lead to a funding crisis. Although this is an exaggerated scenario, it is indeed a possibility. Therefore, companies should prioritize information disclosure, reputation management, and maintaining relationships with shareholders and other investors in their governance practices.

Opportunities arise when companies emphasize ESG, enabling them to achieve long-term growth. For example, companies can effectively manage risk during pollution discharges. They consider current environmental and labor policies when developing short-term and long-term goals, ensuring that their strategies and goals are more practical and feasible. In addition, companies with strong ESG performance have more opportunities to attract investment, enhance brand awareness, and meet market demand, thus creating a virtuous circle that ensures long-term business growth.

IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information requires companies to include sustainability information in their financial reports to help investors and stakeholders gain a comprehensive understanding of the company's finances and the ESG factors that may affect performance. Companies are required to disclose sustainability risks, opportunities, governance, strategy, risk management and key performance indicators, which should be published at the same time as the financial report to ensure consistency of information and transparency. This helps to improve the decision usefulness of financial reporting and promotes responsible and transparent business operations.

Compared to other ESG standards and financial regulatory bodies, the U.S. Securities and Exchange Commission (SEC) is the first one. Currently, the SEC does not have a static ESG disclosure checklist, as the goals and purposes for investors to obtain ESG information are different. Therefore, the ESG checklists disclosed by different organizations are also different [8]. The SEC's process of setting standards could be faster. Before proposing new standard proposals, the SEC should conduct more long-term and in-depth research on companies, investors, and the market rather than simply copying international standards.

The International Sustainability Standards Board (ISSB) has set forth comprehensive ESG reporting standards for businesses, which will be in effect starting January 1, 2024. These standards adopt a "dual materiality" framework, necessitating that companies disclose information that substantially affects both their financial outcomes and sustainability efforts. It is required for companies to detail their Scope 1 and 2 GHG emissions, either by adhering to the GHG Protocol or other recognized methods. Additionally, they must conduct scenario analyses to evaluate their ability to withstand climate-related challenges and the potential financial repercussions. The standards advocate for the inclusion of these disclosures within financial reporting documents or through cross-referencing to ensure ease of access. Although the ISSB does not require external verification, it underscores the significance of sector-specific indicators and the financial ramifications of climate risks and opportunities. These guidelines are designed to boost transparency and support the achievement of worldwide sustainability objectives [9].

United Nations Sustainable Development Goals (SDGs) encourage businesses to embrace sustainable practices and transparency. SDGs, such as Responsible Consumption and Production (Goal 12) and Climate Action (Goal 13), implicitly call for corporate accountability and environmental stewardship. The overarching aim of the SDGs is to foster a sustainable and inclusive global economy, which inherently requires companies to consider their environmental and social impacts. As a response, many organizations voluntarily align their ESG reporting with the SDGs, demonstrating their commitment to contributing to a better future. Investors and consumers increasingly value such disclosures, pressuring companies to be more transparent about their ESG performance. Although the SDGs offer a voluntary framework, they effectively shape the corporate disclosure landscape towards a more sustainable model [10].

ESG investments take into account environmental, social and corporate governance factors to contribute to a comprehensive assessment of the long-term value and risks of a business. Corporations are exposed to a variety of risks and opportunities in these areas, such as the environmental challenges posed by climate change and the potential business and reputational impacts of differing social and governance standards. The IFRS S1 standard proposed by the International Council for Sustainability Standards (ICSS), which requires companies to disclose sustainability information in their financial reports, promotes the practice of integrating ESG considerations into a company's core strategy. This helps to create a more transparent and responsible business environment, in line with the global trend towards sustainability, and the ISSB's concept of 'double materiality' and specific disclosure requirements provide a systematic way for companies to assess the financial impacts of sustainability issues in comparison to those of organizations such as the SEC and SDGs. It helps companies deal more effectively with the complexities of ESG investing and identify growth opportunities while better managing potential risks. Such a strategy not only meets investor expectations, but also helps to advance the broader sustainability goals of responsible consumption, production and climate action emphasized by the SDGs.

3. Adaptability Analysis of A-Shares and Hong Kong Stocks

In response to the issuance of IFRS S1 and IFRS S2 (Climate-related Disclosures) by the ISSB in June 2023, the Hong Kong Exchanges and Clearing Limited (HKEX) released the "Implementation Guidelines for Climate-related Disclosures under the HKEX Environmental, Social, and Governance Framework" in April 2024. As a member of the Green and Sustainable Finance Cross-Agency Steering Group, HKEX is committed to strengthening the climate-related information disclosure of listed companies by IFRS S2, which serves as the global benchmark for sustainable disclosure [11]. In the A-share market, according to the China Listed Companies Association, in 2023, more than 2,100 companies independently compiled and published their 2023 Sustainable Development Reports (including Corporate Social Responsibility (CSR), sustainable development, and ESG reports that listed companies publish separately from their regular reports), accounting for 39.7%, an increase of nearly 300 companies compared to the previous year. An increasing number of companies are beginning to disclose detailed data on climate management targets, carbon dioxide emission reductions, and the use of renewable energy [12].

On February 8, 2024, the Shanghai, Shenzhen, and Beijing stock exchanges respectively sought public comments on the "Shanghai Stock Exchange Listed Company Self-Regulatory Guidance No. 14 - Sustainable Development Report (Trial) (Draft for Comments)", "Shenzhen Stock Exchange Listed Company Self-Regulator Guidance No. 17 - Sustainable Development Report (Trial) (Draft for Comments)", and "Beijing Stock Exchange Listed Company Continuous Supervision Guidance No. 11 - Sustainable Development Report (Trial) (Draft for Comments)" (collectively referred to as the "Draft for Comments"), and the public comment period ended on February 29, 2024 [13]. Given the similar context between the Hong Kong Stock Exchange and the mainland, it is highly likely that the ESG requirements of the Hong Kong Stock Exchange could serve as a model for the A-share exchanges in Shanghai, Shenzhen, and Beijing. Therefore, conducting comparative research between the A-share and Hong Kong markets immediately after the release of the new implementation guidelines in the Hong Kong stock market is meaningful. This could provide valuable insights into the alignment and potential convergence of ESG reporting standards and practices across these markets.

This study will take Semiconductor Manufacturing International Corporation (SMIC) and MTR Corporation as examples to analyze the different focuses of the two companies' 2023 ESG reports and compare the ESG reports before and after the issuance of IFRS S1 (which will be implemented from 2024). Therefore, this study will compare the 2022 ESG reports with the 2023 ESG reports of these two companies.

SMIC was established in 2000 and is one of the world's leading integrated circuit foundry companies and a leader in mainland China's integrated circuit manufacturing industry. It has advanced manufacturing processes, production capacity advantages, and service support, providing global customers with 8-inch and 12-inch wafer foundry and technical services. The company was listed on the Hong Kong Exchange (stock code: 00981. HK) in 2004 and on the Shanghai Exchange (stock code: 688981. SH) in 2020 [14].

The MTR Corporation was founded in 1975 and was listed on the Hong Kong Stock Exchange in 2005 (stock code: 00066.HK). The company manages a network of nine rail lines and airport express across Hong Kong Island, Kowloon and the New Territories. In addition, the company provides light rail and bus shuttle services in the Yuen Long and Tuen Mun districts. The company also offers intercity travel services for passengers from Hong Kong to places such as Guangdong province, Beijing and Shanghai. In addition to the rail business, the company is involved in many other businesses, such as the development of residential and commercial property, property leasing and management, advertising, telecommunications, and the provision of international consulting services. The company also expands its business worldwide, participating in the management of several subway lines in Beijing, Shenzhen, Hangzhou and Macao, and conducting international operations in urban rail transit systems in the UK, Australia, Sweden and elsewhere, with consulting departments across a wide range of cities in Asia and Australia [15].

Overall, both MTR Corporation and SMIC are listed on the Hong Kong stock market, and the ESG reports of both companies comply with the current ESG disclosure guidelines of the Hong Kong Exchange, the “Environmental, Social, and Governance Reporting Guide.” Since IFRS S1 is also one of the international standards referenced in the formulation of these guidelines, both companies have combined ESG investment with financial reporting in their 2023 ESG reports. Additionally, both companies have listed a materiality matrix in their ESG reports; in MTR’s 2023 ESG report, there are seven high-quality issues all related to customer rights. SMIC’s materiality matrix reflects that the company pays more attention to its development in society. As a transportation company, MTR’s three goals in the 2023 ESG report are social inclusion, development and opportunity, and reducing greenhouse gas emissions. SMIC mainly introduced compliance operations, sustainable development, product quality, employee sustainability, and giving back to society in its 2023 ESG report. As companies of different types, it can see that SMIC values company and product-related issues more than MTR; in contrast, MTR focuses more on social inclusion than SMIC.

Comparing the ESG reports of MTR and SMIC before and after the issuance of IFRS S1, that is, the comparison between 2022 and 2023, it can find the following: MTR newly added references to the ISSB and the latest IFRS disclosure standards in the “Reporting Framework” section in 2023. Moreover, when analyzing MTR’s three social objectives in 2023, annotations indicate which items under the ISSB framework have been disclosed. In addition to the ISSB system, MTR marked the SDGs, GRI, and HKEX frameworks in the ESG report. MTR’s ESG report 2022 only marked the frameworks of GRI and HKEX. SMIC’s ESG reports in both 2022 and 2023 have disclosed information based on the ESG indicators of the Hong Kong Exchange and GRI indicators. This can illustrate that with the gradual improvement and standardization of ESG disclosure requirements by international organizations (such as ISSB) and financial institutions (such as HKEX), and more importantly, as society places greater value on corporate ESG information, companies will provide more comprehensive disclosures on ESG information.

4. Conclusion

The implementation of IFRS S1 is a significant development in the area of corporate ESG reporting, which promotes more standardised and transparent disclosure of financial information related to sustainability. By comparing the ESG reports of SMIC and MTR, we can see that both companies are endeavouring to integrate ESG elements into their financial reports, demonstrating their commitment to enhancing transparency and accountability. The study emphasises the importance of following international standards, such as the concept of double materiality proposed by the International Social Responsibility Standards Board (ISRSB) and the United Nations’ Sustainable Development Goals (SDGs), which are key influences on global ESG disclosure practices.

Comparing the two companies’ reports for 2022 and 2023, we find that their disclosures are becoming more comprehensive and detailed, indicating that both companies are actively responding to the requirements of the new IFRS S1. MTRC’s focus on promoting social inclusion and reducing GHG emissions, while SMIC is more focused on compliance, promoting sustainable development and ensuring product quality, reflects how both companies are identifying and responding to the complex risks and opportunities presented by ESG elements. The materiality assessment matrices provided by both companies further highlight how they prioritise ESG issues based on the expectations of various stakeholders and regulatory requirements.

As corporate ESG reporting standards continue to be refined and promoted by international organisations and financial institutions, companies are expected to further enhance the consistency and credibility of their ESG disclosures. We believe that the standardisation of corporate ESG reporting, guided by IFRS S1, will optimise the decision-making process for investors and contribute to the wider SDGs, while emphasising the central role of corporate transparency in building a responsible and inclusive business environment.

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