Key contacts

Yemisi Awonuga
Partner and Co-Head,
Energy and Natural Resources
yemisi.awonuga@templars-law.com

Oyeyemi Aderibigbe
Senior Associate,
Corporate & Commercial
oyeyemi.immanuel@templars-law.com

Client Alert

Nigeria Pioneers the Adoption of a Global Baseline for Sustainability-Related Disclosures

Introduction

Sustainability factors are becoming a crucial part of investment decision-making. The increasing calls from investors that prioritise ESG stewardship for globally comparable information on sustainability-related risks and opportunities can no longer be ignored. In what constitutes a significant step forward and a first amongst its African peers, Nigeria, *through the trio of the NGX Regulation Limited, the Financial Reporting Council ("**FRC**") and the International Sustainability Standards Board ("**ISSB**"),* announced the adoption of a sustainability-related reporting framework. The announcement was made on the 26th of June 2023 at the Nigerian Exchange Group House through the launch of the International Financial Reporting Standards ("**IFRS**") Sustainability Disclosure Standards ("**IFRS S1 and IFRS S2**") (referred to as the "**Sustainability Disclosure Standards**" or "**SDS**").

With this singular historic step, Nigeria has become the first African country to adopt sustainability-related disclosure standards and integration of ESG verticals into the financial reporting obligations of companies regulated by the FRCN.[1] The adoption also signals the recognition of the intrinsic link between sustainability-related risks and opportunities and a business entity's prospect, access to finance, and the cost of capital over the short, medium, or long term.

[1] Section 7 of the Financial Reporting Council of Nigeria Act 2011 (FRCN Act) provides that the FRC is authorised to issue rules and guidelines for the purpose of implementing auditing and accounting standards for Public Interest Entities. and Section 77 of the FRCN Act provides that 'Public Interest Entities include

Evaluating the Sustainability Disclosure Standards

The SDS comprises the IFRS S1 and the IFRS S2.

IFRS S1 – General Sustainability related Disclosures

The IFRS S1 mandates the inclusion of sustainability[2] related disclosures in annual financial reports issued by companies. It prescribes how sustainability related financial disclosures are to be prepared and presented by companies in their financial reports to ensure that the information disclosed is useful to investment decision-makers who review such financial reports. Specific details required to be included are:

- The governance processes, indices and strategies adopted by the reporting entity to identify, assess, monitor, and manage sustainability risks and opportunities arising in the course of its business.
- The processes adopted by the reporting entity to prioritise these sustainability-related risks and opportunities.
- The reporting entity's performance and progress in relation to the sustainability-related targets set for itself or required by applicable law.

In plain terms, environmental, social and governance stewardship has become a core financial reporting index and a critical pathway to accessing capital and resources.

IFRS S2 – Climate-Related Disclosures

IFRS S2 requires companies to include information about climate-related financial risks and opportunities that could reasonably be expected to affect cash flows, access to finance or cost of capital over the short, medium, or long term. These climate-related financial risks could be:

- **Physical risks-** relating to actual physical damage from climatic hazards or disasters to which the reporting entity's business operations may be subject.
- **Transition risks-** these are risks and costs that may be attributed to the reporting entity's transition to low energy consumption and low carbon emission infrastructure.

The specific details to be included in the financial reports are:

- The governance processes, procedures and strategies adopted to monitor, manage, and oversee climate-related risks and opportunities.
- Processes used prioritise climate-related risks and opportunities and the integration of those processes into the reporting entity's overall risk management process.

governments, government organizations, quoted and unquoted companies and all other organizations which are required by law to file returns with regulatory authorities excluding private companies that routinely file returns only with the Corporate Affairs Commission and the Federal Inland Revenue Service'.

[2] Sustainability refers to the management of environmental, social, and financial concerns by a company to ensure responsible, ethical business. It is often measured by environmental, social, and governance (ESG) metrics.

- The reporting entity's performance and progress in relation to the climate-related targets set for itself or required by applicable law.

Applicability of the Sustainability Disclosure Standards

Reporting entities are entities which are required or choose to prepare general-purpose financial statements[3]. By implication, all entities required by law to file annual financial statements and the entities who opt to adopt the SDS must comply.

Commencement date for compliance with the Sustainability Disclosure Standards

Compliance with the Sustainability Disclosure Standards is expected to commence in January 2024.

Implications

Increased exposure to non-compliance and low-financial rating

The increased granularity prescribed by the SDS means that the compliance baseline for companies in Nigeria's corporate environment has changed. The inclusion of details on a company's assessment of a universe of material sustainability issues, risk management modalities, governance protocols and opportunities related to the SDS will bring these issues into regulatory or public scrutiny. Non-compliance will expose a company's portfolio to financial and non-financial consequences, especially if such companies are publicly traded.

Multi-disciplinary expertise required for financial reporting

The depth of analysis required by a reporting entity to assess and rank the sustainability-related risks and opportunities applicable to it will necessitate multi-sectoral experience and appreciation of the ESG verticals. Therefore, pragmatic companies are expected to rethink their approach to doing business, formulation of their priorities and the calibre of their leadership and management. Corporates who have hitherto not embraced environmental sustainability, social responsibility or governance stewardship may struggle to comply due to inadequacies in their strategy, processes and overall risk management protocols.

Reformulation of the investor's due diligence scorecard

ESG integration has evolved into a core business risk index, which is expected to drive regulatory reform, risk re-categorisation and shape investment priorities. Legal due diligence scorecards will be considered incomplete if they do not assess compliance with the SDS. Also, we expect the increasing availability of decision-useful information that investors can utilise in making investment decisions will set new benchmarks for assessment. Corporates will be compelled to integrate these benchmarks in profiling themselves for new business opportunities, acquisitions, and divestments.

[3] Appendix A IFRS S1

Increased costs of reporting

The cost of financial reporting compliance will increase significantly as a result of a multiplicity of factors, including the necessary upskilling of sustainability professionals.

NGX's Expected Outcome

According to the NGX, one of its aspirations is to assist corporates in harnessing c. US$2 trillion of ESG-based investor funds available globally. However, such corporates must be committed to tackling material sustainability issues, achieving specific environmental goals, and demonstrating transparent ESG reporting practices.

Expected outcome for corporates.

Corporate priorities have to change. More importantly, corporates who adopt and integrate these ESG metrics will earn a competitive advantage over their peers and improve their chances of accessing capital.

Conclusion

The NGX and the FRCN have taken a novel step that will engender a paradigm shift in the Nigerian corporate environment. And if properly harnessed, the implementation of the SDS will reposition Nigerian businesses and place them on the global sustainability map ultimately enhancing their access to capital and increasing their enterprise value.