IFRS Consultation on Sustainability Reporting

Providing guidance on the road to a decarbonised global economy

---

Respondents: Christian Dreyer CFA & Dr. Kate Sikavica

Question 1: Is there a need for a global set of internationally recognised sustainability reporting standards?

(a) If yes, should the IFRS Foundation play a role in setting these standards and expand its standard-setting activities into this area?
(b) If not, what approach should be adopted?

Answer: Yes, the paradigm of a single set of high-quality, understandable, enforceable and globally accepted accounting standards should be extended to apply to sustainability standards.

Rationale: As current IFRSs satisfy the need of financial market participants for decision-useful financial information to improve their capital allocation decisions, there is an as yet unmet need for comparable, high-quality, therefore standardised information about a reporting entity's sustainability performance in order to supply guidance on the path to decarbonising the global economy.
a) We believe that the IFRS Foundation is in a unique position to facilitate the setting of Sustainability Reporting Standards (SRS) because the decarbonisation of the global economy will require structural changes in the global economy. The decisions to effectuate these changes efficiently and effectively will have to be made based on financial performance as well as on sustainability information. It is essential that this information is created and presented following a coherent conceptual framework that articulates the interconnectedness (including the definition of segment reporting, for instance) and dual materiality of IFRSs and SRSs. Failure to create coherent, interconnected IFRSs and SRSs will result in an unnecessarily inefficient path to a decarbonised economy. It follows therefore that the IFRS Foundation is in the best position to deploy its credibility, track record and governance in the creation of SRSs.

Question 2: Is the development of a sustainability standards board (SSB) to operate under the governance structure of the IFRS Foundation an appropriate approach to achieving further consistency and global comparability in sustainability reporting?

Answer: Yes, provided that the SSB is given adequate discretion for developing a standard appropriate for reporting on sustainability matters. Reporting on sustainability differs from financial reporting in terms of focus and dimensionality: Sustainability reporting requires a stronger focus on processes and practices rather than on contractual / financial transactions; it is multidimensional in nature in that several metrics may apply to the same phenomenon (in lieu of units of account). Because interaction effects between sustainability and financial performance are highly likely (in the sense that sustainability performance will have an impact on financial performance and vice versa), it seems worthwhile to include provisions on the treatment and transparency of these interactions in the SRSs (and possibly also the IFRSs). Accordingly, the interplay between the two boards should be made transparent, too. The governance structure that the IFRS Foundation has developed over the years to serve multiple stakeholder communities would have to be used as a template even if the Foundation decided not to engage in SRS.

Question 3: Do you have any comment or suggested additions on the requirements for success as listed in paragraph 31 (including on the requirements for achieving a sufficient level of funding and achieving the appropriate level of technical expertise)?

Answer: Even though the accounting profession should be in a position to provide relevant input when it comes to the conceptual framework and matters of presentation, we believe that a significant amount of complementary cross-disciplinary and technical expertise will have to be added in addition to accounting knowledge, mostly at staff level (assuming staff will be a shared resource for both boards). However, an in-depth analysis of common concepts and tools (such as digital delivery of SRS reports via XBRL instances) should be performed very early in the process in order to inform the standard-setting process.

Question 4: Could the IFRS Foundation use its relationships with stakeholders to aid the adoption and consistent application of SSB standards globally? If so, under what conditions?

Answer: As this is one of the requirements for success according to para. 31 mentioned above, the answer clearly is yes. It is important however to consider the positioning of SRS vis-à-vis IFRS, especially keeping in mind the IFRS for SME example: We understand SRS as a complement to either set of standards that will share a number of concepts and tools. The key initial relationship will be with *regulators*, especially at the EU level. If the EU were to consider adopting an SRS mandate similar to its IFRS mandate, this would pre-determine a major characteristic of the SRS, namely whether it would be designed with mandatory application and audit in mind. This will immediately relate back to the Foundation's engagement with the next two stakeholder groups, namely *issuers / preparers* and *auditors*. The IFRS Foundation's excellent relationships with *local standard setters*, most importantly FASB, may become a valuable lever, as they will be exposed to very similar challenges in their respective jurisdictions.

Question 5: How could the IFRS Foundation best build upon and work with the existing initiatives in sustainability reporting to achieve further global consistency?

Answer: We believe that an SRS drafted with mandatory application and auditability in mind differs significantly from existing frameworks that do not have these attributes. Mandatory application and auditability to ensure consistency require a more stringent specification of reporting principles (such as type and amount of information provided, treatment of underlying assumptions), including qualitative and enhancing characteristics. Hence existing frameworks cannot be transposed to SRS directly. Nevertheless, there is no doubt that existing frameworks have unearthed numerous useful concepts pertaining to sustainability. The IFRS Foundation should first evaluate from the perspective of decision-usefulness for decarbonisation existing sustainability reports which have been prepared following existing frameworks across different industries. This will enable the Foundation to identify decision-useful sustainability reporting concepts and metrics (which - as we believe - should be operationalizable / quantifiable in nature).

Global consistency can be achieved with a dual focus on decision-usefulness for capital market participants and a narrow interpretation of sustainability (SDG 13 climate change) while making sure that SRS and IFRS are interconnected and interoperable.

Question 6: How could the IFRS Foundation best build upon and work with the existing jurisdictional initiatives to find a global solution for consistent sustainability reporting?

Answer: As described in the answer to Q4, we think that the EU is the most advanced jurisdictional initiative with global relevance, and therefore the most important for the IFRS Foundation to engage with at this point. The IFRS Foundation could provide a forum for exchange among jurisdictional initiatives, just like it hosts the World Standardsetters Conference.

Question 7: If the IFRS Foundation were to establish an SSB, should it initially develop climate-related financial disclosures before potentially broadening its remit into other areas of sustainability reporting?

Answer: Yes - we believe that the SRS should not aim to become a generic ESG disclosure standard, being all things to all people. There is value in focusing on the one specifically global sustainability dimension that is represented by SDG13. As the **S**ocial and **G**overnance dimensions of ESG will typically be immediately financially material through their business model relevance, they should be covered under the general IFRS where relevant. The rationale for a separate SRS focusing on climate change is twofold: 1) Climate change is the canonical example of an externality that needs to be internalised by establishing suitable price mechanisms or other incentives, and 2) as long as there are no effective carbon pricing schemes in place, the economic impact of decarbonisation cannot be captured in financial accounts, as the noise of generic price fluctuations will likely drown out specific decarbonisation effects. SRS should therefore be drafted to complement existing IFRSs in regards to decarbonising the global economy, leveraging the global consensus that has emerged to support this goal.

Question 8: Should an SSB have a focused definition of climate-related risks or consider broader environmental factors?

Answer: As outlined above, the SSB should have a narrow focus on climate change. However, we believe that climate change and the associated decarbonisation of the global economy must not be understood in terms of risk only, as it offers a generational opportunity for structural change. In that respect, the SSB should take a balanced view.

Question 9: Do you agree with the proposed approach to materiality in paragraph 50 that could be taken by the SSB?

Answer: While we understand where the IFRS Foundation is coming from in its proposed approach to materiality, we believe that this approach could potentially compromise the achievability of the goal that it is setting for the SSB. This assessment is based on the assumption that GHG Protocol Scope 3 information could not be captured by the proposed single materiality approach. Yet, this category of information is of utmost importance when it comes to understanding the materiality of the reporting entity's output in regards to its carbon footprint. If that assumption is correct, the approach needs to be revised.

Question 10: Should the sustainability information to be disclosed be auditable or subject to external assurance? If not, what different types of assurance would be acceptable for the information disclosed to be reliable and decision-useful?

Answer: We believe that external assurance is the minimal level of assurance required by the standard. We would prefer it to be audited, if possible, as the quality of sustainability reporting is still very heterogeneous, both horizontally (over time) and vertically (across entities). Similar to the levels of fair value disclosure (IFRS 13), insights into the nature and source of information presented along with information that allows for the verifiability of processes used in determining sustainability performance (risk / impact, opportunity, if any) would be essential in assessing its reliability.

Question 11: Stakeholders are welcome to raise any other comment or relevant matters for our consideration.

Answer: When drafting an SRS today, the reporting value chain from the report's creation, distribution, analysis and archival needs to be conceived as fully digital without media breaks. Current IFRS' deep XBRL taxonomy integration into the standard setting and reporting workflow may serve as a template, even though the SRS taxonomy is likely to encounter some original architectural challenges.

Respondents’ backgrounds:

Christian Dreyer CFA is an independent analyst and investor, interested in the epistemology of markets. His volunteering activities include being the first Chair of the Capital Markets Advisory Committee to the IFRS Board, and member of the XBRL Advisory Council to the IFRS Foundation.

Dr. Kate Sikavica is an independent governance expert and an affiliate researcher at the University of Zurich, Switzerland.

Basel / Zürich, 18 December 2020