To: **IFRS Foundation**

From: ***Accountability Sustainability and Governance* Research Group Members at the School of Accounting and Finance of the University of Bristol**

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Re: IFRS Consultation Paper on Sustainability Reporting

We write as accounting scholars with significant research experience in, and understanding of, how accountability and governance in the public and private sectors contribute (or not) to the betterment and sustainability of our planet and society. Our research has extensively investigated sustainability disclosures in corporate reports, how accounting is implicated in societal issues and, the role of governance and accounting in defining organisational practices with regard to sustainability. While we have prepared individual responses to each of the questions raised, we present here a summary of our major comments in response to the Consultation Paper.

1. The Consultation Paper narrows what we would understand as *stakeholders* under sustainability reporting. It consistently emphasises sustainability reporting as being 'helpful', 'important' and 'relevant' to investors and although we do not deny the importance of sustainability information for investors, we question whether the scope of sustainability reporting is to address investors' information needs or rather serve a wider, public interest in the sustainable development of our planet and society.

2. There is a continual assertion that the Foundation's stepping into this space will reduce complexity and increase comparability. We believe this is flawed. Sustainability issues are complex, interconnected and uncertain, "wicked" problems. Attempts to reduce complexity (to increase consistency / comparability) will provide partial and potentially flawed information.

3. We question how the institution of another (Sustainability Standards) Board would not (logically) add more complexity. Surely, this creates a greater risk of fragmentation, or

else reflects an assumption that that all other standards and guidelines will lessen in importance if the IFRS steps into the standards arena. And we see this as a real danger that broader stakeholder sustainability reporting will be marginalised given the power of investors. Further, investor focus and single materiality already underpin existing IFRS and so where jurisdictions adopt IFRS investors should already be getting "material information". If they do not, perhaps the IASB should continue in its endeavour of issuing clarifications of which information is material and should be disclosed (under existing IFRS). As these would be issued as clarifications of disclosure requirements, they would be mandatory wherever IFRS are already adopted. The Consultation Paper is silent on the issue that any new standards issued by a new "board" would likely be voluntary, unless individual States mandate them. Given the current state of art in sustainable reporting practices, mandatory adoption and enforcement would be the game changer, not so much a new set of standards.

4. The only sustainability reporting standards that clearly aim at addressing a stakeholder audience, the GRI standards, are conceived to report on corporate (positive and negative) impacts on stakeholders, society and the environment. This is the most widely adopted set of standards and it is not clear why reports prepared according to the GRI would not be providing material information to investors unless, as noted in the point above, the problem is not the lack, or fragmentation, of standards, but rather mandatory adoption and enforcement. While surely the IFRS Foundation has established processes and expertise in standard setting, this does not imply that other bodies do not have this already. Given the urgency of a broad set of sustainability issues, we question how the IFRS Foundation would have a well-established and inclusive process with expertise in *sustainability* above and beyond that of organisations that have been doing this for years. Finally, quite concerningly and disappointingly, we note that the requirements for success fail to mention sustainability and sustainable development at all.

5. We view the climate first approach as much as the approach to (financial) materiality as a backward step. The desire to prioritise investors and to reduce complexity may lead to a weaker form of accountability where organisations are not held to account for their long-term social and environmental impacts. It is key to understand that social and environmental materiality and financial materiality are not always aligned.

6. Although we do not deny that investors' information needs are important, we do not see the establishment of a new Sustainability Standard Board as necessary or the best

solution for the reasons stated in the five points above. Our recommendation is therefore to facilitate existing initiatives as the best way forward (to avoid the risk that sustainability reporting deviates from its original purpose), and to bring under the remit of the IASB the clarifications needed to satisfy investor information needs, as discussed in point 3.

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?

We do not think this is the fundamental question the IFRS Foundation (hereafter the Foundation) should ask. The key question should rather be: ***what is the purpose of sustainability reporting?***

In our opinion, **the purpose of sustainability reporting is to address societal concerns over corporate externalities, whether positive or negative, i.e., the social and environmental impacts of corporate activities that go unaccounted for in traditional corporate (financial) reporting**. Or else, notwithstanding the fact that certain social and environmental issues have financial implications or bear financial risks for companies, these are only one side of the coin, and without proper accounting for and reporting for impacts, we do not see how sustainability reporting can inform our progress towards the achievement of the SDGs. Further, in order to obtain significant advances in sustainability reporting, given current practices, the game changer would not be another standard setter entering the arena, but rather mandating (and enforcing) the adoption of already existing standards.

We recognise that the Foundation has expertise in setting standards, but we are not convinced that they are best placed to provide sustainability reporting standards. We argue that the GRI have developed and made available a global set of standards for sustainability reporting. Founded in 1997, the GRI launched its first set of guidance in the early 2000s, and these have now gone through several rounds of revisions, consultations and improvements. The GRI has a well-established and inclusive process through which it has developed and revised its guidelines and standards and is well placed to continue to do so. It represents the longest and most fruitful process that has led to wide adoption and affirmation of globally recognised standards for sustainability reporting (Etzion and Ferraro, 2010; KPMG, 2020). Not without

criticism about its effectiveness (Milne and Gray, 2013), the GRI Standards now entail a set of four key principles that guide the definition of content of a sustainability report: *stakeholder inclusiveness, sustainability context, materiality and completeness*. All of these principles are pillars for sustainability reporting as they set the foundations for reporting to take on multiple stakeholders concerns and define sustainability (and performance toward it) in the context of ecological, social and economic thresholds.

Whether these principles are being applied and followed in an effective way is questionable (Boiral, 2013; Levy et al, 2010) but surely these principles are consistent and fundamental for reporting on the social and environmental impacts of corporate activities. We further note that the GRI also proposes several principles defining the quality of sustainability reporting, and comparability is one of them. Perhaps there are several other standards, and one could question why the GRI is better or not than others, but it is the only standard (with the ISO standard) that entails a vision for sustainability reporting that provides accountability to stakeholders and serves the wider public interest.[1]

In addressing the issue of what is the purpose of sustainability reporting, we question whether the traditional investor-focus that the Consultation Paper adopts is the most appropriate for the future of sustainability reporting. This focus ultimately implies that what should be reported is only related to risks and opportunities that may have financial implications for companies in the short-term. This is at the expense of transparency over externalities and impacts that may have long-term consequences, on the firm's financial performance but also on society overall (Unerman et al., 2018; Michelon et al., 2020). While one could potentially agree that socially and environmentally material issues may – in the long term - become also financially material for the reporting entities, any reporting for sustainability needs to embrace that long term view. As an example, the fact that the proposed starting point would be only climate change is illustrative of the fact that an investors' focus and financial materiality are not necessarily aligned with the most pressing issues when it comes to sustainability (e.g., biodiversity loss, water depletion, among others; see also Bebbington et al., 2020). Not only would a narrow focus on investors' needs not allow firms to account for sustainability, but further represents a step-backwards with respect to the current state of art. If satisfying investors' information needs is the purpose the Foundation wishes to achieve, we believe the IASB would be most suited to address it.

[1] Corporate Reporting Dialogue Statement of Common Principles of Materiality.

Ultimately, we argue that what is at stake when it comes to sustainability reporting is not just limited to the efficient functioning of capital markets. It is a lot more and all of our efforts should be concentrating on the bigger picture. The risk is that we will have the impression of having addressed the problem while we have not. Possibly, we believe that to call the Foundation proposal a proposal on "sustainability reporting" is misleading, given current literature and practice on the topic refers to sustainability reporting as an account addressing all stakeholders. It seems that what the Foundation is proposing is to provide a set of non-financial information whose scope may be broader than financial statements, but for which the key user does not change.

In our opinion, the Consultation Paper fails to acknowledge that mandatory adoption of any standards is a necessary (yet insufficient) condition for successful implementation and does not address or discuss issues of regulation and enforcement (e.g., Christensen et al, 2013; Leuz and Wysocki, 2016) or the importance of comprehensive institutional reforms and changes for the production of normativity (Cooper and Owen, 2007; Bebbington et al. 2012).

It is also undeniable that the Foundation can play a role in this debate, but it is questionable whether it is the right institution to lead such an endeavour, given its focus on capital markets and investors' needs. We are not convinced that the Foundation's proposal to produce another set of standards will reduce complexity and fragmentation in this field. There appears to be a presumption that other, existing standards will be subsumed or become less relevant and so fragmentation will lessen, but if this is the case then we are even more concerned that broader stakeholder, sustainability reporting standards will lose traction. A more sensible approach would be to facilitate, endorse and collaborate with other standard setters such as the GRI. Or else, continue with the work that the IASB has already been doing on the effects of climate change on financial statements.[2]

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?

We note that the Consultation Paper refers to a lack of consistency and comparability in sustainability reporting and fails to see that the problem is not the lack of standards, but the

[2] https://www.ifrs.org/-/media/feature/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements

lack of proper regulation and institutional arrangements around sustainability reporting. Again, we question whether investors should be the primary addressers of such type of reporting, or whether accountability for the wide array of social and environmental externalities is due to stakeholders and society at large. Further the document already acknowledges that there is a plethora of standards and guidance, and it is not clear why a new player would necessarily do better than what has already been tried in setting some harmonization in this arena.

Consistency is granted by a set of common principles that guide the definition of the content, but comparability when it comes to sustainability reporting is less of a straightforward issue. In financial reporting comparability implies that similar underlying economic activities would generate similar accounting outcomes, measured in monetary amounts. It is not clear whether comparability in sustainability reporting is desirable or achievable, as often externalities are not quantifiable, or hard to quantify, and the risk of error in measuring these quantitatively and/or monetarily is not insignificant (Unerman et al., 2018). Each business contributes to and detracts from the environment and society in a unique way and reporting of such broad value creation or destruction should be transparent to stakeholders (Adams, 2017; O'Dwyer and Humphrey, 2020). A set of comparable non-financial indicators may resolve in a tick-the-box mentality, as often is with compliance, without really creating an incentive for firms to change their actions or provide a transparent account of their social and environmental impacts (Vigneau et al. 2015; Clementino and Perkins, 2020; Wijen, 2020).

We are concerned by the desire for, and emphasis upon, comparability. Sustainability issues are complex and interconnected and there are high levels of uncertainty in capturing these issues quantitatively. Through emphasising comparability there is a danger that sustainability reporting will be overly simplified to enable investors (who may have varying levels of sustainability literacy) to evaluate sustainability on the basis of an indicator or set of indicators. Such simplistic sustainability reporting would he 'helpful' in enabling investors to compare organisations to inform their investment decision, but such information will be partial and so may result in investors taking flawed information into their evaluations / models as if meaningful and so actually further misallocate resources. A simple example is how an organisation that makes greater use of outsourcing will have lower Scope 1 and Scope 2 greenhouse gas emissions than an equivalent organisation that does not. A non-expert user may be led to believe the first organisation is more efficient and better at managing emissions, but in reality, the two organisations Scope 1 and Scope 2 emissions are not comparable.

In the Consultation Paper, it is not clear how a newly formed SSB would build on existing guidance, nor how it would contribute to the adoption (or dismissal) of other existing reporting frameworks. The greatest unintended consequence we foresee is that should the newly SSB enter the field, companies may be encouraged to report "sustainability" information for investors and leave aside proper stakeholder engagement and at least some accountability over externalities, bringing us back to the late 1990s, when the first stand-alone sustainability reports were released in accordance with the GRI (at the time called) guidelines (Archel et al., 2011; Malsch, 2013). Alternatively, should the Foundation decide to entail a wider purpose to sustainability information, then we would need another consultation to discuss and understand why the Foundation would be better suited to come up with new reporting standards for stakeholders than an already existing standard setters that has worked on these issues for many years.

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)?

It is not clear whether the requirements listed in para 31 would constitute success. In our view, success should be defined by whether the initiative proposed by the Foundation allows us to work towards the achievement of sustainability through, for instance, progress towards the SDGs. The absence of any reference to supporting progress towards a less unsustainable future is concerning as it is indicative of the Foundation losing sight of the aim of sustainability reporting.

With respect to requirement for success (a) "achieving a sufficient level of global support from public authorities, global regulators and market stakeholders, including investors and preparers, in key markets": we believe it would not be enough to achieve "global support". Without adequate regulation and enforcement, reporting practices are not likely to drive changes in practices that affect sustainable development.

With respect to requirement for success (b) "working with regional initiatives to achieve global consistency and reduce complexity in sustainability reporting": It is important to achieve consistency as discussed above but reducing complexity in sustainability reporting may not be practical. Sustainability information are complex and diversified in nature. The disclosure is affected by various factors including region, culture, industry, type of organisation,

products/services the organisation is offering etc. Reducing the complexity may undermine the richness of sustainability information, and lead to the issue of selectivity.

With respect to requirement for success (f) “developing a structure and culture that seeks to build effective synergies with financial reporting”: we need investors and companies on our side, but more fundamentally we need a real cultural shift if we want to move away from a reporting that only relates to risks and opportunities that may have financial implications for companies in the short-term (e.g., dependencies). Instead, sustainability reporting should put sustainability and the planetary boundaries at its core, and thereby steer the decisions of investors and organisations towards tackling the socially and ecologically most material and pressing sustainability questions. In other words, we advocate for reporting where public interest considerations become the primary information needs we aim at fulfilling. Paradoxically to this requirement, the IFRS Foundation and the IASB could consider how to make financial reporting more aligned with sustainability considerations.

With respect to requirement for success (g) “ensuring the current mission and resources of the IFRS Foundation are not compromised”: it is understandable from the Foundation’s perspective, but furthering progress towards sustainability through sustainability reporting is again absent. The Foundation’s mission emphasises serving the public interest and refers to bringing “transparency, accountability and efficiency to financial markets” and “long-term financial stability”. The “Working in the Public Interest: The IFRS Foundation and the IASB” document further clarifies that this is conceived as achieved through “enabling investors and other market participants” and “providers of capital” to “make informed decisions” and we are particularly concerned (as explained in more detail elsewhere in our response) by the narrow focus of the initiative on investors information needs. We would like to reiterate that for us successful sustainability reporting would not just inform investors, but would be felt by broader non-financial stakeholders, society and the natural environment. The Foundation’s mission would effectively require a narrowing of sustainability reporting that is also reflected in the proposed choice of adopting a similar narrow conceptualisation of materiality.

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

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?

We recognise that the Foundation has influence and strong relationships with investors and market participants, which could aid the adoption of consistent sustainability reporting standards globally. As previously indicated, however, we think the best way to promote global adoption of sustainability standards would be to facilitate existing initiatives and endorse standards that encourage proper stakeholder engagement and push companies to account for their externalities. The Foundation could consider whether current IFRS are appropriate in light of climate change and other pressing sustainability issues such as biodiversity loss and water depletion and could consider issuing additional guidance on appropriate disclosures.

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?

While it seems clear that climate change has become the most pressing financial (regulatory?) risk, by initially focusing on only climate change, any sustainability reporting standards would neglect the highly interconnectedness of sustainability matters (Bebbington and Larrinaga, 2014). Sustainability reporting by definition is concerned with more than climate change. This is clearly reflected within all definitions of sustainability and the GRI's sustainability reporting standards provide guidance on a much broader range of sustainability concerns. By focusing only upon climate, the SSB would be taking a backward step from our existing understanding of sustainability and existing sustainability reporting practice. There is a real danger that such a focus will distract organisational attention away from other pressing sustainability concerns – for instance biodiversity to name just one. We are also mindful of the interconnectedness of sustainability issues. A focus upon climate-related risks understates the complexity of sustainability. Given current evidence of the extent to which current practices are unsustainable within our planetary boundaries and the potential for tipping points to be reached, we do not think it possible to address sustainability one issue at a time.

On one side, one could argue that the TCFD already represents a good set of standards for climate-related financial disclosures and wonders why can't the Foundation (and/or the IASB) endorse/incorporate such guidance? On the other side, the initial focus on climate change is clearly just a reflection of the focus on investors' needs. In essence, by such simplification,

sustainability is reduced to those aspects which may have material financial impacts on the reporting entity. At the same time, the reporting entity and its activities can have substantial impacts on communities and ecosystems. These impacts are ultimately negative externalities that economists for decades have identified as problematic if not internalized. Such impacts may result in, say, biodiversity loss, water scarcity and depleted ecosystem services, which might have no relevance at all for the reporting entity. Further, all of these issues represent another set of "Tragedies of the Horizon", as Mark Carney defined climate change in September 2015 during his speech at Lloyd's of London, imposing a cost for future generations that the current generation may have no direct incentive to fix. While reducing complexity keeps such impacts (that are not directly related to climate change) invisible in the accounting and reporting, the real physical impacts remain and affect others. It may well be that reducing complexity makes the world of investors and standard setters easier, but it is hardly the best way to address the inevitably complex and interrelated problems that deal with the interconnectedness of our eco-systems.

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

As stated above, the focus upon climate related risks level continues to exclude, and hence leave invisible, the impacts and externalities created by organisations both individually and in combination. Sustainability reporting should not just be about risks and dependencies, but also impacts and externalities (Unerman et al., 2018). We note that corporate social and environmental externalities are by definition not financially material – if they were, we think that the Consultation Paper would not have posed the question of whether an initial focus on climate change would be adequate.

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

Our response is that the proposed approach to materiality is narrow and problematic in many ways (e.g., Rodrigue, 2014). First, the IASB has already provided some guidance on the effects of climate-related matters on financial statements. In this context disclosure is required to make sense of how financial statements may change due to climate change risk. Further IAS1 already dictates what information is material. The Consultation Paper states that the SSB should focus

on producing information about the effects of relevant events (e.g., climate change) on the reporting entity, as this would support the decision of investors and other market participants (the prime audience for financial reporting). But again, we believe this should fall within the existing remit of the IASB.

Second, the Consultation Paper states that *investors information needs to understand a company's long-term value creation as well as its impact on the climate*. We argue that these can only be fulfilled if reporting was prepared using a double-materiality perspective, which requires companies to engage with stakeholders to assess how corporate activities are creating externalities, which may not (yet?) have created a financial obligation or financial implications for the company.

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?

Assurance of sustainability reporting is argued to enhance the credibility of disclosures (Simnett et al., 2009) yet the evidence is mixed (Owen et al, 2000; O'Dwyer et al., 2011; Michelon et al., 2019). Current practice is voluntary and variable, but most commonly limited in both scope and level of engagement. Research suggests that such limited levels of assurance do not provide credibility (Boiral, et al. 2019). Moreover, higher levels of assurance of (as noted above complex) sustainability information would prove significant and costly such that voluntary adoption of high levels of engagement and broad scope appears unlikely (Cooper and Owen, 2014). There are also different types of sustainability assurors and difference standards of assurance (see Edgley et al., 2015). AA1000AS emphasises stakeholder inclusivity and is more consistent with a broader audience for sustainability reporting advocated in our response. In contrast ISAE3000 is most often adopted by big 4 accounting firms and has a narrower focus. We suggest that key to the assurance of sustainability reporting being acceptable is for assurors to be literate and experts in sustainability. Given the complexity of this it is important to recognise that such assurance will be costly, but this is a price that is necessary for the benefits of assurance to be meaningful.

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

We recognise that the Foundation has influence and strong relationships with investors and market participants, which could aid the adoption of consistent sustainability reporting standards globally. As previously indicated, however, we think the best way to promote global adoption of sustainability standards would be to endorse standards that encourage proper stakeholder engagement and push companies to account for their externalities. Our recommendation is therefore to facilitate existing initiatives as the best way forward (to avoid the risk that sustainability reporting deviates from its original purpose), and to bring under the remit of the IASB the clarifications needed to satisfy investor information needs, as discussed throughout this response.

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