29 December 2020

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London, E14 4HD
United Kingdom

Re: Carbon Tracker Initiative's response to the IFRS Foundation Consultation Paper on Sustainability Reporting

Dear Mr. Liikanen & the IFRS Foundation Trustees,

Carbon Tracker Initiative (Carbon Tracker) would like to thank the International Financial Reporting Standards (IFRS) Foundation (the Foundation) for the opportunity to provide comments on its Consultation Paper on Sustainability Reporting.

Carbon Tracker is an independent, London-based financial think tank. We carry out in-depth analyses to help investors understand the financial impacts of the energy transition on capital markets and investments in high-cost, carbon-intensive fossil fuels. Our research makes clear that the transition to a low-carbon world will require a substantial reallocation of capital to low-carbon business and investments. This makes the issue highly relevant to investors.[1]

In order to make informed judgements about a company's value, its use of capital, and the validity and viability of its future climate strategy (including its ability to continue as a going concern), investors need timely, transparent, reliable and comparable information. Despite this, there is still a significant lack of information about the financial effects of material climate-related risks on companies' current financial statements[2]. In fact, a recent UK Financial Reporting Council (FRC) review suggests that the 'consideration of climate information in financial statements lags behind narrative reporting.'[3] This is of great concern to Carbon Tracker and to the investment community[4]; the lack of pertinent information means that capital cannot be appropriately allocated.

The formation of a Sustainability Standards Board (SSB) under the same umbrella as the International Accounting Standards Board (IASB) would help promote the connection between sustainability concerns and financial reporting and thereby improve the quality of information provided to investors.

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[1] *Accordingly, our response focuses on investors as the primary users of such sustainability standards. This includes '…existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.' IFRS (International Financial Reporting Standards) [Conceptual Framework for Financial Reporting (2018) – Unaccompanied Standards (2020) (ifrs.org)], paragraph 1.5 footnote 4.*

[2] *For example, see work being performed in this area by the NGFS (Network for Greening the Financial System): [Workstream on bridging the data gaps | Banque de France (ngfs.net)]*

[3] *FRC (Financial Reporting Council) (November 2020), FRC Climate Thematic – Reporting – How are companies developing their reporting on climate-related challenges?, p. 53.*

[4] *See open letter from global investor organisations representing over US$100 trillion in assets under management requesting better climate-risk related information in financial statements: [Accounting for climate change | Sustainability issues | PRI (unpri.org)].*

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We appreciate that through addressing sustainability reporting[5] an SSB would not set financial accounting standards. However, the financial statements are complementary to the information that sustainability standards would provide in the 'front-half' of an annual report. Indeed, some stakeholders 'have argued that using the knowledge base of the accountancy profession is a vital component in developing high-quality and consistent measurement and disclosure requirements in sustainability reporting.'[6] Carbon Tracker agrees. An SSB could look to work with and leverage the technical accounting expertise of the IASB as part of its standard-setting process.

Along with greater transparency about the effects of material climate-related risks in financial reporting, we must focus on consistency of the climate-related information provided by a company. The most efficient and effective way of facilitating this is again via collaboration between accounting standard-setters and sustainability standard-setters. This requires that the SSB 'operate alongside' the IASB in order to '…benefit from the increasing interconnectedness between financial reporting and sustainability reporting'[7], and for each body to share their relevant knowledge and experience.

We would therefore urge the Foundation, as part of the formation of an SSB, to develop a clear plan of collaboration with the IASB. This will help to ensure that companies provide investors with the complete set of information necessary to make capital allocation decisions that markets (and society) so desperately need.

It is in this context that we respond to your consultation paper as provided below. Please do not hesitate to contact me directly (rschuwerk@carbontracker.org) or Barbara Davidson, Senior Analyst in Climate Disclosure and Accountancy (bdavidson@carbontracker.org), if you have any questions. We remain at your disposal for further discussions on this important matter.

Rob Schuwerk

Executive Director, Carbon Tracker Initiative

[5] *Used interchangeably herein with 'narrative-reporting' and 'front-end reporting', even if a company's climate-related or sustainability reports are separate from the company's annual report.*
[6] *IFRS Foundation (September 2020), Consultation Paper on Sustainability Reporting, p. 9.*
[7] *Ibid.*

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Carbon Tracker's responses to consultation questions

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?

Yes. A global set of standards would provide consistent, comparable and reliable sustainability information and address the confusion caused by the fragmented approach today. The Foundation should play a role in setting those standards given its 'existing standard-setting expertise and due process procedures focused on transparency, broad consultation and accountability that … could be deployed to reduce complexity and achieve greater consistency in global sustainability reporting.'[8]

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?

Yes. Subjecting the SSB to the Foundation's three-tier governance structure and well-tested due process procedures would be an indication of the quality of the sustainability standards. Relying on the Foundation's existing governance would reduce the time it could take to form a global SSB and develop international standards.

However, a single set of global sustainability standards are only one part of achieving consistency and global comparability—arguably more important are the linkages between these sustainability risks and financial results. Despite the importance of consistency between sustainability and financial reporting, much less time and effort appear to be spent on addressing the need for disclosure of the financial effects of material climate-related risks in financial statements.

The IASB has made it clear that material climate-related risks are covered by International Financial Reporting Standards (IFRS)[9]. Accordingly, investors expect consideration of the material financial risks from climate change, including the related effects on a company's current financial position and performance, to be part of a company's overall sustainability story. While investors do not expect that the same climate-related assumptions and judgements will apply to both a company's narrative reporting and its financial statements, they do expect the assumptions to trend in the same direction. For example, investors need to understand how the assumptions that are used to prepare a company's sustainability-related information, such as the scenarios recommended by the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures (TCFD), tie back to the information that is used to prepare the company's audited financial statements (or indeed, if the information differs, why it differs).

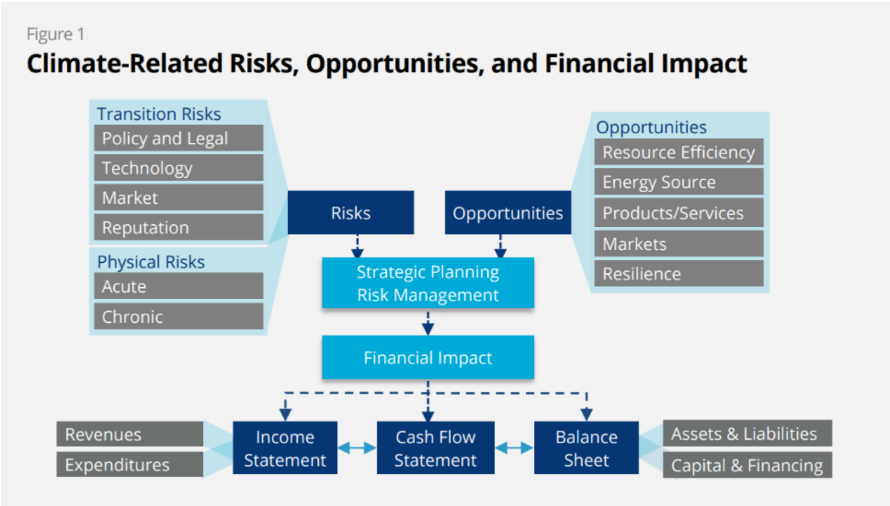
Investors also need to gauge the extent to which a company's capital is tied up in long-term assets or other investments which cannot or will not be used in a transition to a low-carbon economy. If sustainability disclosures highlight management's goal to achieve net-zero emissions by 2050, what assumptions are management making regarding the valuation and useful lives of relevant assets? Without the full picture, an investor cannot reasonably assess the financial effects of a company's efforts to align with a low-carbon economy.

Inconsistency between sustainability disclosures and financial reporting might also be a signal that management are ignoring the effects of changes to regulations, policies, and behaviours, to name a few, on their current and future business plans. For example, a company's sustainability disclosures might identify material transition risks to its current business activities, such as the electrification of vehicles, polices governing the phase-out of coal or changes in consumer

[8] *IFRS Foundation (September 2020), Consultation Paper on Sustainability Reporting, p. 7.*
[9] *See IFRS (International Financial Reporting Standards) (November 2019), IFRS Standards and climate-related disclosures, In Brief, and IFRS (November 2020), Effects of climate-related matters on financial statements.*

demand for plastic. If management do not adjust the financial statements, or, at a minimum, include disclosures about the potential financial effects of these risks, then the sustainability information would not be decision-useful. This could also increase the risk of 'greenwashing' in company reports.

Our views on the interaction between sustainability disclosures and financial reporting are aligned with those of other bodies in this space. The FRC's thematic review on climate highlights the importance of consistency between the 'front and back half' of reports[10]. In its original 2017 publication, the TCFD highlighted the interaction between its recommended disclosures and the financial reporting impacts (below). The key linkage is between strategic planning/risk management and financial impact—this through-line to the statements of income, financial position and cash flows is driven by changes to the estimates and assumptions that underpin the financial statements.



Source: Task Force on Climate-related Financial Disclosures (June 2017), Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures, p 8.

In a more recent report targeted at non-financial companies the TCFD further emphasises the connection between front-end reporting and financial statements, highlighting that '[m]aterial financial implications related to company's strategy should be disclosed in the appropriate financial statements or notes to the financial statements.'[11] This includes whether, and how, issues addressed in TCFD disclosures affect[12]:

- asset impairment;
- the useful lives of assets;
- the fair value of assets;
- various provisions and liabilities;
- expected credit losses; and
- disclosures of other climate-related risks.

Collaboration with accounting standard-setters such as the IASB is the most efficient way in which to develop effective, relevant and comparable sustainability standards while ensuring consistency with a company's financial reporting. The formation of an SSB under the umbrella of the

[10] *FRC (Financial Reporting Council) (November 2020), FRC Climate Thematic: Reporting – How are companies developing their reporting on climate-related challenges? and FRC Climate Thematic: Investors – What do investors want to see?.*
[11] *TCFD (Task Force on Climate-related Financial Disclosures) (October 2020), Task Force on Climate-related Financial Disclosures-Guidance on Scenario Analysis for Non-Financial Companies, p 51.*
[12] *This list is not exhaustive.*

Foundation would thus facilitate collaboration between the SSB and the IASB. For example, similar to the prior convergence work programme between the IASB and the US Financial Accounting Standards Board, the SSB and the IASB could develop a joint work programme. This could cover topics with both financial and non-financial reporting elements, such as reducing company emissions and the effects on the value of assets used in operations[13].

It is likely that both boards would target the same stakeholders on many projects, and so the formation of joint working groups and outreach where the SSB staff address sustainability issues while the IASB staff cover financial reporting concerns would make the best use of relationships, time and technical staff. The SSB could also leverage from the IASB's relevant projects in this area, such as changes to the management commentary practice statement, while the IASB could consider topics that link to sustainability reporting in developing its future work plans. Appointment of common board members may be another way in which the two boards could collaborate.

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)?

Yes. We agree that all the requirements set out in paragraph 31 are important, and would highlight the following:

- (b): working with regional initiatives. Due to the urgency of the subject matter and the Foundation's lack of experience in sustainability standard-setting, the Foundation needs to ensure that it draws from and builds upon the relevant knowledge, research and experience of existing sustainability initiatives. This will both help to maintain and consolidate the wealth of information that these bodies have accumulated over time and help further develop the SSB's relationships in the sustainability space. However, in doing so, an SSB would need to apply a financial overlay to help show the connection between climate-related risks and financial information;
- (c): ensuring the adequacy of the governance structure. Much of the support for the Foundation's formation of an SSB is grounded in the understanding that the Foundation's three-tier governance structure will also apply to an SSB;
- (f): developing and building synergies with financial reporting. We would like to reiterate that collaboration between the IASB and the SSB are a key part of success; and
- (g): ensuring that the Foundation's current mission is not compromised. An SSB that creates standards which are 'coherent with and connected to financial reporting and the IASB's own mission to serve investors and other primary users of financial statements'[14] would provide decision-useful information for investors and so align with the Foundation's current mission[15]. Accordingly, we ask that, in the formation of an SSB, the Foundation does not lose sight of the need for material climate-related risk information in financial statements today.

Carbon Tracker believes that two additional factors are necessary for success. These will be informed by the objectives of a global sustainability standards board—which we believe should be focused on providing investors with decision-useful information. These factors are:

- a focus on investors, lenders and other creditors as the primary users of such information, at least until there is evidence that key assumptions are available to allow markets to adequately price this risk. Identifying investors as the primary user group does not mean

[13] *Such as work previously performed on Pollutant Pricing Mechanisms (formerly referred to as Emissions Trading Schemes), IFRS - Pollutant Pricing Mechanisms.*

[14] *IFRS Foundation (September 2020), Consultation Paper on Sustainability Reporting, p. 8.*

[15] *Which is 'to develop standards that bring transparency, accountability and efficiency to financial markets around the world' and to serve '…the public interest by fostering trust, growth and long-term financial stability in the global economy.', IFRS - About Us.*

that other stakeholders, such as preparers, governments and advocacy groups, as well as the general public, would not find this information useful; and

- using a financial concept of materiality, as discussed on page 13 of the consultation paper. This would facilitate a timely provision of focused and effective sustainability standards.

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?

Yes. The Foundation could and should use its extensive network in over 140 jurisdictions to determine the mechanisms by which such standards could be adopted into the various jurisdictions, thus facilitating consistent global application of the standards. The Foundation's global reputation, consultative process, and extensive outreach will greatly contribute to the market's uptake of such standards.

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

There is no need to 'recreate the wheel'. The existing initiatives in this space have laid much of the groundwork that would be required for producing a timely set of global sustainability standards. As noted in our response to Question 3, the Foundation could leverage the results of collaboration between current key voluntary sustainability standard-setters and frameworks (e.g., CDP, CDSB, GRI, IIRC and SASB) and draw from their existing knowledge base and labour pool.

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?

The SSB should build a consideration of jurisdictional initiatives into its work programme and outreach activities in order to:

- learn from and potentially incorporate the climate-related work of these jurisdictions;
- ensure alignment between sustainability standards and local initiatives (e.g., that they do not undermine or contradict each other); and
- discuss ways in which the jurisdictions could add local requirements without sacrificing comparability, consistency or quality of global standards.

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?

Yes. As highlighted in our cover note, the initial focus of the SSB should be to provide investors with the information they need to understand the effects of material climate-related risks on companies. We do note the Foundation's (and the TCFD's) comments about a possible need to also consider the 'connection between a company's impact on the environment and the risks and opportunities for that company.'[16] While this is true, providing investors with the information they need to price these risks accordingly can provide the ancillary benefit of addressing companies' impacts on the environment.

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

In the beginning, the SSB should have a focused definition of climate-related risks, for the reasons outlined in our response to Question 7.

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[16] *IFRS Foundation (September 2020), Consultation Paper on Sustainability Reporting, p.14.*

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

Yes. As noted in our response to Question 3, a financial concept of materiality would facilitate a more efficient standard-setting process with a better connection to financial reporting. Additionally, as we have seen with the IASB, standard-setting is a dynamic process. What is material to investors changes over time. Introducing a 'double materiality' lens would, in our view, add an extra layer of unnecessary complexity today. However, the SSB could consult over time to gauge the need to expand the definition.

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?

Overall, Carbon Tracker believes that external assurance is required. In the near term, a review-level of assurance may be sufficient, with the view of eventually evolving to audit-level assurance. The ability of companies to provide assurance-ready disclosures will depend on the speed at which they can integrate climate-related sustainability information into their risk and control systems. However, providing an option for companies to obtain audit-level assurance from the beginning may be a consideration; this could give investors an indication of which companies are leading (and which are lagging) in incorporating these issues into their business planning, and so their internal governance processes, today.

The SSB and Foundation should coordinate the implementation of the timing of any assurance requirements with the relevant securities regulators, oversight bodies, auditors and audit standard-setters. Of course, if material climate-risk information is included in a company's financial statements today, it would already be subject to assurance[17]. Regulators should therefore also ensure that auditors apply the requisite scrutiny to sustainability information that they have for the financial statements today.

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

We would like to reiterate that understanding the effects of material climate-related risks on a company's financial statements is a key part of financial analysis. The measurement of information in a company's financial statements (and so its profits) can be significantly affected by such risks, which include, but are not limited to, declining commodity prices, increasing costs of carbon emissions, new technologies, low-carbon regulations and policies, and changing consumer preferences.

Investors also need to determine if a company has or will generate sufficient cash flows to meet any climate-related strategies as outlined in its sustainability narrative, while addressing the financial effects of climate-related risks on its current financial position and performance.

Finally, it is important that investors are able to identify whether management's stewardship of assets is aligned with the investor's and/or the company's sustainability policies.

[17] *For further information see IASB (International Auditing and Assurance Standards Board) (October 2020), The Consideration of Climate-Related Risks in an Audit of Financial Statement | IFAC (iaasb.org).*