

Lee White
IFRS Foundation
Columbus Building, 7 Westferry Circus
Canary Wharf
London, E14 4HD

15 December 2020

Dear Lee,

Consultation Paper on Sustainability Reporting

We welcome this important step taken by the IFRS Foundation (IFRSF) and support the proposal in the Consultation Paper (CP) to establish a Sustainability Standards Board (SSB). You will already be aware that the FRC joined with a number of other UK regulatory authorities and government departments to welcome the consultation. We are strongly supportive of a single set of global standards for sustainability reporting as we consider that these will improve the quality and quantity of sustainability information in a consistent way that meets the needs of users.

Our main comments are outlined below with detailed responses to the questions in the CP included in the Appendix.

Governance structure

We believe that setting up a new SSB using the existing IFRSF architecture is appropriate for the development of international sustainability reporting standards. We see the benefits of this approach as being:

- an established governance structure and due process;
- established credibility in international standard setting;
- most likely to ensure connectivity between financial and non-financial reporting; and
- building on an existing structure could enable standards to be developed more quickly.

However, we consider that securing the necessary funding will be a challenge for the IFRSF and note that it took quite some time for the Foundation itself to develop and agree its funding model. We also note that reform of international audit related standard setting, under the auspices of the Monitoring Group has struggled to propose a funding model that will strengthen the independence of those standard setting boards, and this challenge should not be underestimated. As a matter of urgency, we recommend that the Trustees consult with those it intends to seek funding from, including national regulators, and set out a budget to enable them to make an assessment of their ability to provide secure and reliable financial support over the short, medium and longer-term. The Trustees should also set out, where possible, the synergies that it might deliver by using the Foundation as a vehicle for an expanded range of standard setting responsibilities. We understand that the funding for the SSB would be separate from the contributions for the IASB. In our view, it is imperative that the SSB is independent so would encourage the IFRSF to consider potential sources of funding widely.

8th Floor, 125 London Wall, London EC2Y 5AS Tel: +44 (0)20 7492 2300 Fax: +44 (0)20 7492 2301 www.frc.org.uk

The Financial Reporting Council Limited is a company limited by guarantee. Registered in England number 2486368. Registered office: as above.

Please see our privacy page at <https://www.frc.org.uk/about-the-frc/procedures-and-policies/privacy-the-frc> if you would like to know more about how the FRC processes personal data or if you would like to stop receiving FRC news, events, outreach or research related communications.

Scope

In our view, there are three elements that the IFRSF needs to consider in relation to the scope of the activities of the SSB:

(i) Audience of Sustainability Standards – investors or wider stakeholders

In line with its mission, we support the IFRSF focusing initially on the information needs of investors. However, sustainability reporting is an area which is of interest to other stakeholders as well as investors and, over the longer term, the IFRSF could consider expanding its scope to accommodate the information needs of other stakeholders. In our recent discussion paper on the Future of Corporate Reporting¹, the FRC has set out a blueprint for a corporate reporting framework over the long-term which accommodates the interests of investors as well as wider stakeholders. From the perspective of the IFRSF, we consider that if the SSB starts with a broad remit initially it may take longer to reach agreement to establish the Board and be challenging for the SSB to develop standards that cover all aspects of sustainability reporting. This could delay progress on urgently needed standards.

(ii) Topics on which standards will be developed e.g. climate

We agree that climate should be the first standard that is developed but the SSB should cover the full breadth of sustainability matters and care should be taken that it does not become a purely environmental standards board. We recommend that the SSB sets out and consults on a preliminary work plan to determine the key standard setting topics for the first 5 years alongside starting its work on climate. It should also articulate its proposals for developing and consulting on an appropriate conceptual framework to develop the necessary framework of standards.

(iii) Definition of sustainability reporting

The CP does not define or set the boundaries for sustainability reporting for the purposes of the SSB's work. We recommend that the IFRSF defines 'sustainability reporting' so that it is clear to stakeholders the activities that fall within the scope of the SSB and those that are excluded. This will partly depend on (i). In addition, we consider that there is a need for clarity on the breadth of narrative reporting that will fall within the SSB's remit. For example, the term non-financial reporting, as used in the EU Non-Financial Reporting Directive (NFRD) includes disclosures that would be included in management commentary. ESG is another term that is used in this space and the SSB will need to consider whether the 'governance' aspects will be covered as part of its work. Either way, there is an important piece of co-ordination to ensure that any wider suite of standards which might be developed to support broader ESG reporting are conceptually logical and consistently aligned. This is also important to ensure that the standards are proportionate to meet the needs of stakeholders without creating an onerous regulatory burden. Some further thoughts are included in our response to question 11.

Building on existing work

We believe it is critical for the IFRSF to build on the work done by existing framework providers including taking account the work by some of these organisations to merge or align existing guidance through initiatives such as the Value Reporting Foundation and Impact Management Project. This will enable the SSB to develop its standards more quickly, and more cost

¹ The discussion paper is available at <https://www.frc.org.uk/getattachment/cf85af97-4bd2-4780-a1ec-dc03b6b91fbf/Future-of-Corporate-Reporting-FINAL.pdf>

effectively using the existing expertise and examples of good practice by those already reporting in this area.

We consider that elements of the existing frameworks could be used as 'building blocks' for the SSB standards. Some of these may need to be adapted for use in a global market. We recommend that the SSB conducts research on assessing the suitability of existing frameworks as part of the early stage of its development of a set of global standards.

Timing

If there is broad support for the proposals in the CP, we encourage the IFRSF to move at pace to establish an SSB and develop its standard on climate. There are urgent calls for consistent and comparable sustainability information and any delay by the SSB developing its standards runs the risk of different regional solutions being developed which could de-rail efforts for global convergence, which we believe to be important.

If you would like to discuss these comments, please contact Deepa Raval at d.raval@frc.org.uk.

Yours sincerely

Mark Babington
Executive Director, Regulatory Standards
DDI: 020 7492 2323
Email: m.babington@frc.org.uk

Appendix Questions for consultation

We use the following terminology in this response:

- *Existing frameworks – the range of voluntary initiatives that include frameworks, standards and metrics*
- *Financial reporting – referring to the scope of the work of the IASB*
- *Non-financial reporting – information on broader matters that could impact company performance over the longer term (for example information on environmental, employee, social, and human rights matters)*
- *Strategic Report – UK equivalent of management commentary or MD&A*
- *Sustainability reporting – as referred to in the IFRSF paper (see our response to Q11 below)*

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. We believe there is a need for a single set of global standards for sustainability reporting to provide consistent and comparable information for users. In the UK, we have heard that the multiple voluntary frameworks that exist in this space creates a confusing landscape for companies. In our view, the introduction of mandatory international sustainability reporting standards would address the current challenges faced by preparers and users of corporate reports.

(a) As noted in our cover letter, we believe that the IFRS Foundation is the appropriate organisation to develop these standards and should expand its remit to achieve this.

The IFRSF's mission is "is to develop standards that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy."

We note that non-financial information is of increasing importance to the global capital markets and therefore consider that developing standards to meet the information needs of investors is consistent with the IFRSF's current mission.

We also highlight that the notion of public interest is evolving and is interpreted more broadly than may previously have been the case. In recent years there has been an increasing focus on the wider impacts of business which has often been a catalyst for new corporate reporting initiatives and other regulatory developments.

We have seen this trend in the UK for some time with the inclusion of non-financial information as part of the Strategic Report; and the introduction of new reporting requirements by government to meet public policy aims. The government has also introduced a reporting requirement, which became effective on 1 January 2019, on the director's section 172 duty which requires director's to explain, amongst other matters,

how they have had regard to the interests of other stakeholders and in fulfilling their duty to promote the success of the company for the benefit of shareholders.

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. We support the establishment of a separate SSB under the existing IFRSF governance structure for the reasons set out in our covering letter.

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)?

We broadly support the requirements for success set out in paragraph 31. We believe that some of these will have greater level of immediacy than others. We consider that (a) and (e) are high hurdles that need to be overcome for the proposals to progress.

We encourage the IFRSF to have discussions with public authorities globally and national regulators at an early stage on their appetite for adoption of SSB standards. The IASB has been successful with the adoption of IFRS across the world and this should be the ultimate aim for SSB standards.

On (d), we agree that the appropriate level of technical expertise is needed for Trustees, SSB members and staff. However, we believe that some of this expertise can be drawn from the existing frameworks providers who have extensive knowledge in sustainability reporting. We believe that this together with recruitment should not be a barrier to success.

Whilst we agree with the view expressed in paragraph 27 of the CP, that the knowledge base of the accountancy profession can contribute to the development of high quality sustainability reporting standards, the IFRSF should recognise that different skills and expertise may be required to that for accounting standard setting. We therefore recommend that the IFRSF is open to recruiting board members and staff from a range of disciplines e.g. environmental specialists.

On Board membership, we encourage the SSB to consider appointing part-time non-executive Board members. This would provide a IFRSF with a wider pool of candidates with the relevant and current expertise.

(f) recognises the importance of synergies with financial reporting. However, we suggest that this is expanded to include 'cohesiveness between sustainability reporting and financial reporting'. In our response to question 11, we set out some ideas for a coherent corporate reporting system.

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. In our view the IFRSF has an established stakeholder base, which it should build on to aid the adoption and consistent application of SSB standards globally. In particular, we

encourage the SSB to work with national standard setters to understand how SSB standards could be incorporated within their local reporting frameworks.

Once the standards are issued and adopted, the SSB could consider setting up a group similar to the IFRS Interpretations Committee to help promote consistency of application. In addition, it could also consider producing educational material to supplement its standards.

In addition, the IFRSF should also build relationships with new stakeholders for the development of Sustainability Standards. Those that are involved in discussions in this space may be different to the IFRSF's existing stakeholder base. For example, the ESG investment community, preparers responsible for sustainability reports, civil society groups; and providers of existing frameworks. Whilst we support the SSB focussing initially on the information needs of investors, we recommend that the IFRSF engage with a wider group of stakeholders and have representation from these groups on the SSB and as part of any advisory groups. We believe that this would provide the IFRSF with different perspectives and critical challenge.

Question 5

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

We believe that the IFRSF first needs to establish its strategy and work plan in respect of SSB standards and then determine which elements of existing frameworks would best fit within that.

This should be supplemented by research on the extent of voluntary adoption of these frameworks and the quality of the resulting information for users.

As noted in the CP, the existing frameworks serve different purposes. We believe that when making an assessment of the suitability of the existing frameworks, the IFRSF should consider a number of dimensions:

- Audience – investors vs wider stakeholders
- Breadth – sustainability information in general or specific single issue
- Global reach – demand for and use of initiatives internationally or nationally
- High-level principles vs detailed measures – overarching framework or metrics

In our view, some of the commonly used frameworks could be mapped along these dimensions.

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 see jurisdictional initiatives as steps towards a global solution. As such, we encourage the IFRSF to engage with those jurisdictions that are leading the way in this area and build on those.

in the UK, the FRC's Guidance on the Strategic Report² provides an overarching framework for reporting financial and non-financial information for investors. This requires a company to

² The Guidance on the Strategic Report is available at <https://www.frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf>

provide information on a broader range of risks and the wider impacts of its activities when it is relevant to the long-term value creation. In addition to local requirements, the framework incorporates the requirements of the EU Non-Financial Reporting Directive (NFRD).

As noted above, we support global standards for reporting non-financial information as the long-term vision. To address urgent calls from investors for comparable and consistent non-financial information, the FRC recently published a statement³ encouraging companies to provide TCFD disclosures and use the SASB metrics as applicable to their sector.

The Financial Conduct Authority in the UK will also be introducing a requirement for premium listed companies to provide TCFD disclosures on a 'comply or explain' basis and the UK government has recently announced that it will mandate TCFD disclosures by 2025.

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?

As noted in our cover letter, we agree that climate should be the first standard that is developed but recommend that the SSB sets out and consults on a preliminary work plan to determine the key standard setting topics for the first 5 years alongside starting its work on climate.

With that in mind, we recommend revising the proposed objective of the SSB set out in Paragraph 24 of the CP "to develop and maintain a global set of sustainability reporting standards initially focussed on climate-related risks". In our view, the objective should be sufficiently broad to ensure it covers a range of topics. We suggest the objective is modified as follows:

"To develop and maintain a global set of standards for high quality sustainability reporting"

Question 8

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

We consider that it is useful to have a definition of climate-related risks so that there is a common understanding of this term which will form the basis of a climate standard. That said, climate-related risks are a sub-set of environmental matters which should be considered as part of any framework for sustainability reporting.

In the Strategic Report and NFRD, there are some broad topics for companies to consider and report on when material. These include:

- Environment
- Employees
- Social matters
- Human rights

In addition, we note that reporting on climate-related risks should also be picked up as part of the principles for risk reporting in the Management Commentary, Management Report (EU) or Strategic Report.

³ The statement is available at <https://www.frc.org.uk/news/november-2020/frc-nfr-statement>

As a general point, we recommend that the Sustainability Standards are accompanied by a glossary and as part of the development of those standards it will be necessary to develop a common understanding of the terminology, which can otherwise be subject to interpretation.

Question 9

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

No. We are unclear on the articulation of materiality that is proposed by the SSB.

We recognise that there are two elements of materiality presented in paragraphs 46-51.

- Materiality as applied to the financial statements with the primary users of financial reporting in mind.
- Materiality assessed in the context of the impact of a company's activities on a range of stakeholders as set out in the NFRD.

We believe that there is a third element which has been alluded to in that section 'material to long-term value creation'.

The FRC's Guidance on the Strategic Report reconciles the two elements above. The primary users of that report remains the investors. However, companies are required to provide information on the impacts of a company's activities on stakeholders and the environment to the extent that they could impact the long-term value of the company.

As we have set out in our recent thought leadership paper on the future of corporate reporting, we can see that there are three levels of materiality emerging:

- Applicable to the financial statements – as defined by the IASB;
- Applicable to the Strategic Report – long-term value creation; and
- Assessed with reference to an organisation's wider impacts – similar to the concept in the NFRD.

A similar idea 'dynamic materiality' has been included by the Impact Management Project as part of its *Statement of Intent*.

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?

In our view, sustainability information that is disclosed in annual reports should be capable of being audited or subject to external assurance. Independent assurance increases the confidence of users in the non-financial information that companies disclose.

Currently, the audit procedures over non-financial information provided in the annual report (ISA 720) are limited. For example, for the Strategic Report in the UK, these procedures include, checking the report for consistency with the financial statements, checking that the report has been prepared in accordance with applicable legal requirements and identifying whether the report contains any material misstatements.

The International Audit and Assurance Standards Board (IAASB) is in the concluding phases of a project to develop non-authoritative guidance on the application of assurance standards in respect of Extended External Reporting (EER) in response to the increasingly growing

demand for assurance engagements in relation to EER. EER encapsulates many different forms of reporting, including, but not limited to, sustainability reporting. Assurance engagements on EER are similar in concept to an audit (a specific type of assurance engagement) but they are performed on EER reports rather than on financial statements.

Accordingly, we encourage the SSB to work closely with the IAASB as it develops its thinking in this area, including to increase transparency about the type of external assurance that sustainability information has been subject to.

In addition, in the UK, matters relating to the audit or assurance of a wider set of information, including ESG, are currently being considered as part of Sir Donald Brydon's recommendations⁴ arising from an independent review of the quality and effectiveness of audit. These recommendations include, amongst other areas, the development of a principles-based framework for corporate auditing; and the development of the audit profession with different audit and assurance providers providing audit and assurance over different areas of reporting.

Question 11

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

Definition of sustainability reporting

We believe that as a starting point, the IFRSF needs to clearly define what it means by sustainability reporting as this will determine the boundaries of the activities of the SSB.

The term non-financial information is often used in this space. However, there is no commonly agreed definition of that term which is capable of being interpreted broadly or narrowly. For example, the NFRD uses the term broadly to include a range of information that would typically be included in Management Commentary. Alternatively, non-financial reporting could be narrowly defined covering environmental, employee, social and human rights matters.

In our view, we believe that the IFRSF should adopt a narrower definition of sustainability for its activities to distinguish those standards from Management Commentary.

We also highlight that the term 'sustainability reporting' is often referred to by companies in the context of the separate sustainability report that they produce with a non-investor stakeholder in mind.

Interaction with Management Commentary

We are not convinced that the IFRSF has sufficiently considered how sustainability standards will fit with the forthcoming Management Commentary Practice Statement and we have a concern that these two work streams will be treated independently, as they will be developed by separate Boards, without interdependencies being identified.

We see the Management Commentary Practice Statement as providing the overarching framework for reporting financial and non-financial information, including sustainability information, similar to the Strategic Report in the UK.

⁴ The report is available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf

In our response to the Accountancy Europe Paper ‘Interconnected Standard Setting for Corporate Reporting’⁵, we put forward the idea of the IASB’s Management Commentary project being transferred to the SSB so that narrative reporting standards fall within the work of the same Board. This would provide a clearer focus for the IASB’s work on setting accounting standards for the financial statements.

That said, we consider that there should still be a formal mechanism in place to ensure that there is linkage between sustainability reporting and the financial statements. In our recent Climatic Thematic⁶ review, we found that whilst companies were reporting on climate related risks as part of their narrative reporting, more consideration needed to be given to the financial statement impacts.

Placement of information

One important area that has not been covered in the IFRSF CP in respect of sustainability reporting is the placement of information resulting from application of the SSB standards.

We often hear that the annual report is trying to serve too many purposes and audiences and believe that including all information in the annual report is no longer a tenable position. We recommend that the IFRSF develop some placement principles to provide flexibility for companies on where this information is reported. In practice, there are a few locations where companies may be including this information – in the annual report, as part of a separate sustainability report or in another separate report. For example, some of the TCFD recommended disclosures are very granular such as those for scenario analysis. Some companies are reporting this detailed information in a separate TCFD report with the key information included in the Strategic Report.

Taxonomy

It is clear that the primary consumption of any disclosure that results from this work will be digital. We therefore encourage the IFRSF to consider the development of a taxonomy alongside the sustainability standards to enable sustainability information to be tagged on a consistent basis. This could be achieved by integrating current data and taxonomy programs where appropriate rather than developing something new.

Conceptual Framework

We agree that there is a need for the development of a conceptual framework for sustainability reporting that starts with a clear objective for this information.

As noted in paragraph 44 of the CP, we are not convinced that an entirely new set of qualitative characteristics (QCs) needs to be developed for sustainability reporting. In our view, the QCs that exist in the IASB Conceptual Framework could be adapted for application to other types of information. For example, the CP notes that verifiability of information is important, which is a QC that already exists in the IASB CF. For example, the QCs have been modified for

⁵ The FRC response is available at <https://www.frc.org.uk/getattachment/b50ff52a-4b66-435c-b67d-ee9ba0e6232/FRC-Submission-of-response-to-Accountancy-Europe-paper-290420.pdf>

⁶ The review is available at <https://www.frc.org.uk/investors/climate-thematic-review-2020#:~:text=Climate%20Thematic%20Review%202020%20Throughout%202020%2C%20the%20FRC,associations%20and%20investors%20play%20in%20considering%20climate-related%20issues.>

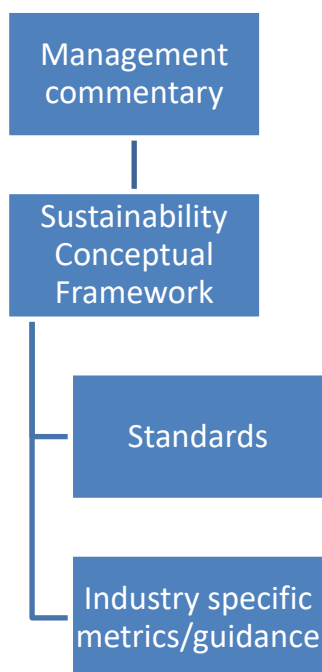
application to Management Commentary and a similar approach could be taken for sustainability information.

It can be confusing if different terms are used to describe similar QCs across different types of reporting. Our preference would be for there to be a set of QCs that can be applied across IFRSF financial and sustainability reporting. The QCs in other frameworks could be used to identify any gaps.

Industry specific standards

When considering the development of an overall framework for sustainability reporting, the SSB could consider whether there is a role for industry specific metrics or guidance. At a high level, we believe that it would be appropriate for the SSB to set principles-based standards that are industry-agnostic to fit in with existing global reporting frameworks. However, at a more detailed level, we consider that it may be helpful to provide industry specific guidance. For example, the Sustainability Accounting Standards Board has industry specific metrics which we encourage the SSB to include as part of its framework. In the UK, we also have Statements of Recommended Practice that support the UK GAAP standards, many of these provide guidance for specific industries.

One approach to draw the elements of the framework discussed above together may be as follows:



Transparency

From the public discussions by the IFRSF Trustees to date, we note that a significant amount of thought and engagement has been carried out prior to issuing the CP. However, ahead of

the publication of the CP, there was little information in the public domain on progress on this agenda. For example, there were no papers on this topic at Trustee meetings.

Going forward, we urge the IFRSF Trustees to be more transparent with their activities in relation to the sustainability reporting agenda and provide a similar level of transparency around the activities of the SSB as for IASB meetings.

Long-term vision

The FRC has recently published a thought leadership paper on the Future of Corporate Reporting which sets out a vision for a coherent system for corporate reporting. In that paper, we set out proposals for a principles based framework for corporate reporting that includes:

- accommodating the information needs of investors and other stakeholders;
- including ideas for qualitative characteristics that could apply across corporate reporting;
- considering the placement of information across a reporting network; and
- considering how non-financial reporting should evolve.

Some of these ideas may be relevant as the IFRSF develops its thinking on strengthening the connectivity between financial and sustainability reporting, determines the scope of its work and develops a conceptual framework for sustainability reporting.

Further information on the FRC's initiative is available at <https://www.frc.org.uk/accountants/accounting-and-reporting-policy/clear-and-concise-and-wider-corporate-reporting/frc-future-of-corporate-reporting-project>