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Proposed Targeted Amendments to the IFRS Foundation *Constitution* to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards

As noted in our response to the IFRS Foundation's (IFRSF) Consultation Paper on Sustainability Reporting¹, we are strongly supportive of the development of high-quality global standards for sustainability reporting and the IFRSF establishing an International Sustainability Standards Board (ISSB). The UK has been a beneficiary of global convergence in standard setting, and extending this to sustainability reporting is an important next step. We, therefore, also support the UK adoption of these standards as this will enhance the comparability and reliability of sustainability information across the capital markets.

We generally support the proposals in the Exposure Draft (ED). However, we believe that there are a number of broader matters that the IFRSF needs to consider as it develops sustainability reporting standards. These are outlined below with our detailed responses to the consultation questions included in the Appendix to this letter.

Replicating the processes and operations of the International Accounting Standards Board

We see that there is considerable merit in mirroring many of the processes that are in place at the IASB, utilising that experience to quickly operationalise the ISSB. That said, we believe that it is important for the IFRSF to recognise that sustainability reporting is different to financial reporting and therefore some different and innovative approaches may be required for the development of standards by the ISSB.

Points to consider are:

- The subjective, qualitative nature of some of the information resulting from the application of sustainability standards.

¹ The FRC's response is available at <https://www.frc.org.uk/getattachment/15d419a7-8254-4211-b188-1fd44db2c6f9/IFRS-response-to-IFRSF-Sustainability.pdf>

- The need for the Board and technical staff to have a broad skill set. For example, including those with experience of wider corporate reporting, ESG and environmental specialists.
- The need to move at pace with the development of these standards and considering how time taken to publish final standard can be reduced whilst balancing the need for a robust due process.
- The development of an agile process for standard-setting using evidence from the market, for example, by looking at examples of good practice by companies that currently use some of the voluntary frameworks for non-financial reporting. A mechanism within the ISSB, similar to the FRC's Financial Reporting Lab could facilitate this.
- Although highly effective, the IASB model is not low-cost, and in bringing the ISSB into existence, the IFRSF needs to consider how it can do this in a cost-effective way that is affordable to existing and future stakeholders and funders.

Consideration of these issues may lead to some differences between the IASB and the ISSB, for example we suggest the IFRSF considers whether more ISSB members might be part-time members.

Stakeholder involvement

We are pleased to note that the IFRSF is using some of the existing frameworks as building blocks for its sustainability reporting standards and leveraging the expertise in those organisations. However, we believe that the Foundation should work with a wider set of stakeholders as it develops its standards. We note that the Technical Readiness Working Group (TRWG) that has been set up does not include any representation from investors or companies.

We believe that it is essential that the IFRSF has a mechanism similar to the Accounting Standards Advisory Forum to engage with and seek input from National Standard Setters. Some national standard-setters have significant experience and access to networks which could add value to the ISSB. In the UK, we have a well-developed framework for non-financial reporting in the Strategic Report². In addition, the FRC has taken a number of steps to encourage good practice in non-financial reporting including our recently published climate thematic³. We would be very happy to share our experiences with you. Given the breadth of our regulatory activities, we can also provide relevant insights relating to emerging developments in audit and assurance as well as monitoring and enforcement.

Going forward, we also recommend that the ISSB uses forums such as the World Standard-Setters Conference to seek input on the development of sustainability standards.

² The FRC's 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>

³ A summary of the climate thematic is available at <https://www.frc.org.uk/getattachment/ab63c220-6e2b-47e6-924e-8f369512e0a6/Summary-FINAL.pdf>

Adoption and implementation of ISSB Standards

We recommend that the IFRSF engages with national standard-setters as soon as possible to discuss adoption of the ISSB standards within national frameworks. In the UK, the process may not be as straightforward as the adoption of IFRS as the narrative reporting requirements are set out in company law which would need to be amended, requiring legislation. In addition, the UK government will shortly be mandating the use of TCFD disclosures and we believe it is important that any national developments are capable of being aligned as far as possible with those internationally.

We believe that it is essential for the IFRSF, at an early stage in the process, to have buy-in from preparers. This will ensure that implementation of the ISSB standards is successful. To achieve this, we consider that there is a need for further communication with and understanding of the challenges that preparers might face.

We have heard that preparers would welcome:

- Early signalling of the ISSB's plans and expectations
- A definition of sustainability reporting
- Principles-based standards which are readily understandable
- Transparency around the timelines for implementation of the standards

In our experience, many preparers are keen to improve the quality of their reporting in this area but need time to prepare and ensure that they have the necessary systems and resources in place. We are currently looking at work we might do to help raise awareness of the need to enhance the maturity of data and data systems that will be needed to support sustainability reporting, which may not be as robust as those which underpin financial reporting. We also recommend that the ISSB field test its proposals.

Funding

The ED notes that if the changes to the *Constitution* are approved, 'it would allow the Foundation to secure the resources needed to create a new board'. We are unclear on the Foundation's plans for funding and it would be helpful for the Foundation to provide an indication of the stakeholders it intends to seek funding from, the contribution that will be required and how this will be sustained or evolve as the ISSB becomes more established. We believe that this is a particularly important issue to address, noting that securing a sustainable funding model for the IASB took significant time and effort.

We also recommend that the IFRSF ensures that its proposals for the ISSB are cost-effective. The costs of the IASB are high, as noted earlier in our response and we encourage the IFRSF to consider how the ISSB can be established with a limited expansion of the IFRSF's cost base (including the cost of an additional Board) and identifying potential synergies that can be achieved by leveraging from the existing structure.

Connectivity between financial and sustainability reporting

In parallel with establishing the ISSB, we recommend that the IFRSF considers how it can ensure that there is coherence between the activities of the IASB and ISSB. We see the IASB's Management Commentary Practice Statement as providing the overall framework for narrative reporting underpinned by detailed sustainability standards. However, sustainability matters can also have an impact on the financial statements. The educational material 'Effects of climate-related matters on the financial statements' is a good example of this. We consider that there is a need for formal and informal mechanisms within the IFRSF to ensure that, where relevant, there is joining up between the IASB and ISSB projects. We believe that establishing this connectivity will be a step towards ensuring that the annual report as a whole 'tells a

story'. This will also help to ensure that the ISSB is able to respond to the challenge set by IOSCO, that there should be a clear link with the conceptual framework used for financial reporting.

Process for establishing advisory groups

While we recognise the need for the IFRSF to move at pace with establishing the ISSB, we believe that it is essential that its process for appointing members of any groups to support the development of this work (for example, the multi-stakeholder consultative committee) is open and transparent. We believe that this is necessary to maintain the independence of that standard setting process and to establish a similar level of credibility that exists in the IASB in terms of a robust due process and transparency around its activities.

If you would like to discuss these comments, please contact Deepa Raval at d.raval@frc.org.uk. We are very keen to engage further with the IFRSF as it continues to develop its proposals, as we are very keen to see the ISSB concept succeed.

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Appendix

We use the following terminology in this response:

- *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)
- *Narrative reporting* – referring to information typically included in management commentary including non-financial reporting
- *Sustainability reporting* – as referred to by the IFRSF

We agree with many of the proposed amendments to the *Constitution* but believe that there are a number of specific areas which the IFRS Foundation needs to re-consider. These are set out in our responses to the questions below.

Proposal 1 – Expand the Foundation’s remit to create a new board that will set IFRS Sustainability Standards

Question 1

Do you agree that the amendments proportionately reflect the Trustees’ strategic direction, considering in particular:

(a) the proposed amendments to the objectives of the Foundation, outlined in the proposed new section 2b of the *Constitution*, as set out in Appendix A; and

(b) the proposed amendments to reflect the structure and function of the new board, outlined in the proposed new sections 43–56 of the *Constitution*, as set out in Appendix A?

(a) We broadly agree with the proposed amendments to section 2b of the *Constitution*.

We welcome the use of the term corporate reports in section 2b as it reflects that companies provide a range of information beyond financial reporting, incorporating non-financial reporting. At a later stage, as part of the development of the Conceptual Framework, we encourage the ISSB, to provide some clarity around its use of this term and also consider the placement of sustainability information that will be required as a result of the application of the standards.

Section 2b includes a reference to helping investors to ‘connect with multi-stakeholder sustainability reporting’. We are not convinced that this is appropriate to include as part of the objective as it could be conflating the information needs of investors, which the IFRSF has identified as the intended audience of the information arising from the application of sustainability standards, with the information needs of other stakeholders.

As part of our thought leadership work on the Future of Corporate Reporting⁴, we identified that the information needs of investors and other stakeholders can overlap. Non-financial

⁴ The FRC’s thought leadership paper is available at <https://www.frc.org.uk/getattachment/90cb0ae1-b7ac-4f1e-8de0-8e63deaa0089/-.aspx>

reporting is an area that is of ever-increasing interest to investors and other stakeholders and we believe that a future corporate reporting model should include information that meets the needs of both these groups. However, given the IFRSF's capital markets focus, we are unclear of what its plans are in respect of making connections with multi-stakeholder sustainability reporting.

If the IFRSF wishes to acknowledge that wider stakeholders may also have an interest in the information arising from the application of sustainability standards, we suggest including the following language below the objective which can also be included in the conceptual framework for sustainability reporting:

"Whilst information arising from the application of sustainability standards is designed to meet the needs of capital market participants, it may also be of interest to other stakeholders".

Outside the *Constitution*, we believe that there would be merit in the IFRSF via a mechanism such as a 'Corporate Reporting Lab' exploring how information that is relevant to value creation may also satisfy the information needs of other stakeholders; and how investor-focussed sustainability reporting can in practice be connected to reporting frameworks that provide information on a company's wider impacts without an investor-materiality lens (e.g., Global Reporting Initiative).

We highlight that reporting on value creation and reporting on impacts are not mutually exclusive. The FRC's Guidance on the Strategic Report encourages companies to consider the wider impacts of their activities and include them in the Strategic Report when the information is relevant to long-term value creation. In the UK, consideration of the broader matters that impact company performance in the long-term is part of the director's Section 172 legal duty (to promote the success of the company); and reporting on the 'impacts of a company's activities' also forms part of the UK implementation of the Non-Financial Reporting Directive. The audience of the Strategic Report, as set out in law, is the shareholders and therefore materiality is assessed through that lens.

(b) We broadly agree with the proposed amendments to reflect the structure and function of the new board as set out in sections 43-56 of the *Constitution*, subject to the points below.

Section 43 – We disagree with the proposal to only have a minority of part-time board members for the ISSB and suggest that part-time board members form the majority. In our view, finding candidates with relevant and current expertise in sustainability reporting is likely to be more challenging than recruiting members for the IASB as the pool is likely to be smaller. This will also help to deliver a more cost-effective proposal for stakeholders to fund. The IFRSF has indicated that an announcement in respect of the ISSB is likely to be made in November 2021. This is an ambitious timeline which may make it even more difficult to find suitable candidates to fill full time roles.

We also note that the proposed amendments refer to 'part-time' members as those who 'commit most of their time to paid employment by the Foundation'. In our view, this runs the risk of the IFRSF missing out on perspectives and independent challenge from those with significant experience in this area but prefer to be involved in a non-executive role (subject to being able to demonstrate that their independence is unaffected, and that they have no

conflicts of interest). In addition, this effectively prevents an IASB member from also being a member of the ISSB which may assist in enhancing connectivity between the boards.

Section 44 – We note that the groups of stakeholders that will form the composition of the ISSB does not include representatives from civil society. We believe that this stakeholder group will be in a good position to provide critical challenge. Furthermore, if the IFRSF maintains the objective of the ISSB as set out in section 2b, to ‘connect with multi-stakeholder sustainability reporting’, civil society representatives will be in a good position to advise on these matters.

Sustainability Standards Interpretations Committee – we disagree with the decision not to establish an Interpretations Committee at this time. One of the outcomes of international sustainability standards is to ensure that sustainability information is consistent and comparable. We believe that an interpretations committee will be necessary to ensure consistent application of the standards and to enable companies and their advisers to raise any practical challenges they face when implementing the standards for the first time.

Section 54 – We disagree with the proposal to only require a ‘simple majority’ for the approval of an ISSB Standard. We are unclear on the rationale behind departing from the approval process that is in place for IASB standards. If the standards the ISSB issues are to be widely used, with confidence, and in the public interest; then it is important for them to be able to demonstrate they command not only widespread stakeholder support but also the support of a large majority of board members.

Proposal 2 – Create the International Sustainability Standards Board under the Foundation’s governance structure to set IFRS sustainability standards

Question 2

On the potential naming of the new board and its associated standards, do you agree that ‘the International Sustainability Standards Board (ISSB)’ setting ‘IFRS sustainability standards’ accurately describes the function of the new board and its associated standards?

Names

We broadly agree with naming the new board the ISSB but encourage the IFRSF to consider whether it would be appropriate to incorporate the word ‘reporting’ into the nomenclature to distinguish from other sustainability standards.

We disagree with referring to the standards set by the ISSB as ‘IFRS sustainability standards’ as this has the potential to confuse with the objective and remit of the IASB. IFRS is also often used as shorthand to refer to International Accounting Standards. Instead, we suggest simply to refer to standards set by the ISSB as ‘International Sustainability Reporting Standards (ISRS).

Paragraph 18(b) of the ED discusses the option of re-naming the Foundation to the ‘International Corporate Reporting Foundation’ which we prefer to retaining the existing name. In our view, this provides the Foundation with an opportunity to refresh its brand and reflect its expanded remit.

We believe that it is important that sustainability standards are given equal status to accounting standards and consider that a change in the Foundation’s name will enable the necessary culture change.

Objectives

Section 2 of the *Constitution* identifies the objectives of the IFRSF that will be delivered by the IASB and ISSB respectively. We believe that there is an opportunity for the Foundation to more clearly define the boundaries of the work covered by each board.

We encourage the IFRSF to consider deleting the words ‘and other financial reporting’ from paragraph 2(a) (objectives delivered through IASB) as this could be seen as an overlap with the scope of the ISSB as ‘sustainability reporting’ could also be part of financial reporting as it could have an impact on financial performance over the longer term.

We recognise the historical reasons for using the term ‘financial reporting’ in relation to the IASB’s work as it is used in the IASB’s Conceptual Framework. Although, the IASB has not defined this term, in the context of its standards, it is mainly associated with information reported in the financial statements. We also note that use of this broad term in the IASB’s Conceptual Framework accommodates management commentary.

As part of this process, we also ask the IFRSF to consider whether it would be appropriate to transfer the project on Management Commentary to the ISSB given that the IASB has indicated that management commentary is the ‘docking station’ for reporting sustainability information. This will ensure that the narrative reporting standards and guidance published by the IFRSF remain coherent and provide the IASB with a clearer remit focussed on accounting standard setting.

Proposal 3 – Consequential amendment to the Foundation’s governance

Question 3

Do you agree with this proposed consequential amendment, outlined in proposed new sections 60 and 61 of the *Constitution*, as set out in Appendix A?

Yes. We agree with the proposed consequential amendment set out in sections 60 and 61 of the *Constitution*.

Other matters

Question 4

Are there any other matters you would like to raise in relation to the proposed targeted amendments to the *Constitution*?

Composition of Monitoring Board and Trustees

In light of the expanded roles of the IFRSF, we recommend that the composition of the Monitoring Board and Trustees is reviewed.

Currently, the Monitoring Board comprises a number of securities regulators. We do not consider that this group alone will adequately represent the broader grouping of public authorities that have responsibilities over the development of wider reporting standards and in particular those organisations with responsibility over narrative and non-financial reporting. Any changes to the composition of the Monitoring Board to reflect this, should support a review of the criteria used to determine the appointment of Trustees, to ensure that the Trustees comprise members with the appropriate skills and experience to oversee the expanded remit of the IFRSF.

Trustees' duties

The amendments to the text in the sections 4-17 refer to the distinct activities of the IASB and ISSB (accounting and sustainability standards). This is important for identifying the roles of the respective boards. However, as part of the additional duties of trustees set out in section 15 of the *Constitution*, we recommend that there is a specific duty of the trustees which includes ensuring, where appropriate that there is coherence between the standards to enable effective linkage between narrative reporting and the financial statements.

Development of sustainability standards

In parallel to the amendments to its *Constitution*, we believe that there is a need for the IFRSF to consider its approach for the development of sustainability standards, including the creation of a due process handbook. In our view, there are some key components relating to the development of an international infrastructure for narrative reporting that the IFRSF needs to consider. We set out below, a number of steps that the IFRSF needs to consider.

Overarching framework for narrative reporting

In our view, there is a need for the IFRSF to provide clarity on what it considers to be the overarching framework for narrative reporting in the context of its work. As noted above, the IASB refer to Management Commentary as the 'docking station' for reporting sustainability information which we support. However, we understand that the TRWG, which we understand is looking at convergence in sustainability reporting standards focussed on enterprise value, includes the International Integrated Reporting Framework (IR).

In our view, the Management Commentary Practice Statement, when finalised should achieve similar aims to the IR framework, bringing together financial and non-financial information into a coherent narrative. We believe it would be undesirable for the IFRSF to have two overarching frameworks for narrative reporting - an ISSB framework (IR) and an IASB framework (Management Commentary) that serve similar purposes.

Development of metrics

Sustainability reporting is often discussed in the context of providing management commentary. However, we have heard from investors that there is also a need for quantitative measures as sustainability issues give rise to financial risks. We therefore recommend that metrics are developed as part of the sustainability standards.

Audit and Assurance

We continue to hear calls for the development of audit and assurance models to support the sustainability standards. We believe that this is necessary to enhance the reliability of the information reported. We therefore encourage the ISSB to give consideration to the audit and assurance implications as it develops its standards, working with the IAASB and its associated national standard setters.