18 December 2020

Mr Erkki Liikanen, Chair IFRS Foundation
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Dear Mr Liikanen

IFRS Foundation Trustees' Consultation Paper on Sustainability Reporting

Climate change is a global emergency. To achieve the goal of limiting global average temperature increases to 1.5°C above pre-industrial levels and achieve net-zero carbon emissions by 2050[1], the members of the G20 which between them make up 78 percent of global GHG emissions will need to increase their ambitions and investments by factors of five to 100-fold, depending on the types of technology needed. This places an unprecedented responsibility onto the shoulders of business decision-makers, including the non-executive board directors whose oversight processes and decisions ultimately shape business strategy.

In support of those responsible for governance on corporate boards in the G20 and beyond, the Climate Governance Initiative (CGI or the Initiative), a global project launched in collaboration with the World Economic Forum, has been established with the aim of mobilising non-executive directors to put climate change at the heart of their companies' business strategies. The Initiative has been expanding internationally by creating local CGI forums or "Chapters" for non-executive directors (NEDs), often known under the name of Chapter Zero[2].

THE CLIMATE GOVERNANCE INITIATIVE

The Climate Governance Initiative (CGI) was formally launched in January 2019 by the World Economic Forum. Its aim is to mobilise non-executive directors to place climate change at the heart of board decision-making processes and business strategy, by giving directors opportunities to engage with each other and with independent experts in order to gain skills and perspectives, and serve as advocates within their boards for the adoption of effective climate transition strategies.

[1] The target identified by the Intergovernmental Panel on Climate Change as critical to averting the most extreme forms of damaging climate change.
[2] The CGI Chapters in Malaysia and Russia are known as Climate Governance Malaysia and the Russian Chapter, respectively.

The core mission of the Initiative is to promote the implementation of the Climate Governance Principles, a set of comprehensive and ambitious best practice standards developed to guide board behaviour, by providing a range of engagement opportunities aimed at enhancing their skills in this area. Each national Chapter works within its respective country as well as across borders to share knowledge and promote climate action, both at company-specific and systems level.

The member Chapters of the Initiative have collectively responded to this consultation, giving our strong support to the IFRS Foundation taking the lead in setting an international standard on sustainability.

Our detailed responses to the Consultation Paper's questions and proposals are below.

If you have any questions concerning our comments, please contact Karina Litvack at karina.litvack@gmail.com or +39 340 826 3790.

To date, the CGI has established fully operational local Chapters in the following countries:

- France
- Italy
- Malaysia
- Russia
- Switzerland
- United Kingdom

Additional Chapters are currently in formation, and will be formally launched in 2021. They include:

- Brazil
- Central America Hub
- Central Asia Hub
- Central/Eastern Europe Hub
- Chile
- Colombia
- EU Hub
- Hong Kong
- Ireland
- Mexico
- Netherlands
- Nordic Hub
- Poland
- Singapore
- South Africa
- Ukraine
- United States of America

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, there is a need, and this has been consistently expressed by our members. Our forums collaborate with experts and leaders in the business, academic and sustainability communities to host webinars and workshops for the education of our NED members. The curriculum reinforces the implications of climate-related issues on business and governance. The topics include: 'Setting ambitious strategies and targets', 'Scenario-planning', 'Risk management', 'Audit', 'Executive Compensation', 'Reporting', amongst others. The feedback provided by our members frequently cites the unnecessary confusion created by numerous reporting frameworks and the need to incorporate impact-linked metrics in accounting standards. Having a multiplicity of competing frameworks makes target-setting more challenging and is more vulnerable to gaming at a time when a common, robust reporting framework is crucial to enable systemic change.

Sustainability reporting was long seen as marginal, but now its time has come. It has reached the stage in its evolution where it is regarded as necessary by a critical mass of both users and reporters, but its processes still lack the maturity and robustness necessary to bridge the disconnect between long term-value creation and sustainability performance. Sustainability reporting today reflects its origins as a voluntary movement that gathered pace in different parts of the markets, with different priorities and orientations. As such, it is marked by a multiplicity of competing frameworks that make comparability, both for reporters and users, a major challenge. As with financial reporting, we recognise perfect comparability between different reporting entities in sustainability reporting is not a realistic standard. However, as with financial reporting, our members have highlighted a need for greater methodological standardisation across national boundaries to build objectivity and credibility, as well as to overcome resistance on the part of many companies to embracing sustainability reporting in the first place.

Accurate reporting underpins performance measurement, which in turn enables action. Our members find this lack of comparability to be a key limiting factor when determining the metrics and Key Performance Indicators (KPIs) to assess performance that, by extension, drive the behaviours that promote strong climate action.

The IFRS Foundation is the right home for this endeavour. It has the proximity to the accounting profession to enable possible future convergence of financial and sustainability performance, and in the interim, it has the existing infrastructure to develop and monitor the new framework as it matures and adapts to new developments. Its international stature and reputation as a strong standard-setter will facilitate awareness-raising, because business leaders and investors trust the organisation. Further, the strong international network and existing relationships of the Foundation will promote rapid adoption, as channels exist to facilitate the permeation of the message to the broadest possible audience. We therefore give our strong support to the IFRS Foundation taking the lead in setting an international standard on sustainability.

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?

At this early stage in its evolution, a dedicated SSB would give the process the robustness it needs and allow the various parties already involved in standard-setting to be brought together with an aligned purpose. At present, interest in sustainability reporting is high and rising, but the process is neither fully established nor integrated within the existing financial reporting standards. Yet the paramount concern of stakeholders is whether the process will be widely accepted as the *de facto* global standard, and thus enjoy the same degree of respect and recognition as the International Financial Reporting Standards (IFRS) themselves. Establishing a dedicated SSB that sits alongside the IFRS Foundation's existing standard-setting structure will enable the unique features of sustainability standards to be given the attention they need at this relatively early stage in their development, while benefiting from the expertise, rigour and strong governance of the IFRS Foundation.

Rapid strategic integration of sustainability into business strategies must be the goal as it is critical to long-term value creation. Sustainability reporting must, similarly to the intention of financial reporting, inform strategic decision-making, rather than only present a view of the results of decisions taken. The Task Force on Climate-related Financial Disclosure, which the IFRS Foundation supports, features four pillars that provide a natural means for integration, so that boards are enabled through the forward-looking aspects to drive value and resilience over the medium and longer term. Climate change in particular presents significant challenges as well as opportunities for strategic planning, risk management and other key processes, and the reporting framework must therefore ensure boards have the information they need to deliver effective climate governance.

Sustainability reporting requires a dedicated structure to enable its rapid and robust development, but should over time be folded into the main infrastructure for overseeing and maintaining accounting standards. It is our view that over time, as sustainability and 'dynamic materiality' are integrated into the strategy of each business and become a larger factor of the monetisation of sustainability within the business and its revenue streams, the line between sustainability reporting and financial reporting will become increasingly blurred, and the need for a dedicated SSB will lessen, thereby allowing for the two structures to be merged.

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)?

A clearly-defined vision that acknowledges the needs of, and benefits for, each stakeholder is essential for success. A standard written for the benefit of investors and business leaders will not suffice. Good business requires balancing of all stakeholders. As the voice of consumers and customers continues to grow, the need will likewise grow for a standard that enables better-informed purchasing decisions, in turn driving companies to build resilience through their product offerings.

The Just Transition has also been noted by the non-executive director community as a key consideration for the successful transformation of boards and companies. Not only do our members have a responsibility to all stakeholders of the business, and as such must have regard for their interests during decision-making; but a failure to address the transition in a holistic manner that takes account of the socioeconomic fallout for the employees, suppliers and communities that face disruption and potentially severe economic loss risks provoking a backlash that risks impeding a successful and smooth transition. Therefore, in order to achieve success in enabling an effective transition to a net-zero economic system, the adoption and implementation of the standardised sustainability reporting framework is contingent on how well it incorporates consideration of the implications of the transition for all of those impacted by the transition.

Reporting must cover the entire value chain. It is necessary to recognise that the overall footprint of reporting companies typically extends considerably beyond their immediate operations, which can be dwarfed by the activities of suppliers and customers. A recognised framework for capturing these would add a great deal of value, particularly in establishing common KPIs related to Scope 3 carbon emissions. Further, the broader impact of product or service usage is not fully considered within Scope 3 and must become a requirement in order to achieve a true account of the business' environmental footprint.

The SSB must engage proactively in the COP process, and be prepared to develop reporting standards that reflect newly-agreed terms as they emerge. The SSB should opine on, and seek actively to influence, the COP decision-making process on all issues relevant to corporate reporting as they evolve over time. One such example concerns Article 6, which is the only part of the Paris rulebook that could not be agreed at COP24 in Dec 2018, and includes essential clauses that, unless decided upon and clarified, will undermine the ability of corporates to recognise, trade and value carbon offsets as a critical part of their climate mitigation strategies. The issues include Article 6.2 "internationally-traded mitigation outcomes (ITMOs)" and the accounting rules to avoid double- counting, with the associated valuation implications for corporates; and Article 6.4, the establishment of an international carbon market.

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 IFRS Foundation is uniquely suited with its international reach and reputation to act as a catalyst for rapid adoption of SSB standards.

A key stakeholder that the IFRS Foundation should seek to influence is the auditing profession. While the procedures of an external assurance plan will not be determined by the SSB, there is opportunity to engage with the International Standards on Auditing to develop procedures to enforce the framework of the SSB.

Without adequate accountability and policing, the sustainability information is at risk of being deficient and of not enjoying the same rigour that companies apply to financial reporting. Due to the pervasive nature of climate change on the business and its financial statements, a mechanism is required to help evaluate the linkage between the two, and ensure sustainability is seen as being as relevant to the credibility of the accounts as revenue, operating income, and cash flows. There is a need for an analogous mechanism to that of the auditing standard embodied in International Standard on Auditing 240, which presumes there to be an increased level of risk associated with Revenue. Classification of climate change in this manner will also ensure that the necessary internal controls are designed and implemented to protect the integrity of the information on a proactive basis.

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

Corporates need the guidance of an expert, independent, consultative body to determine which of the plethora of existing standards best meets their needs. Under the status quo, they are uncertain about which stakeholders benefit from the disclosures required by each framework, and the level of assurance available for each. As certain investors express favour for one particular standard over alternative ones, there is a risk that choices will be made for expedient reasons (e.g. pressure from a large investor), rather than because a standard is judged as superior through the usual collaborative and consultative process that is the hallmark of the IFRS process. Collaboration is essential to identify the most effective elements of the many existing initiatives in sustainability reporting and form a single coherent standard.

Valuable work has been done already by the World Economic Forum's International Business Council in collaboration with the Big Four Accounting Firms, see *Towards Common Metrics and Consistent Reporting of Sustainable Value Creation*. This is a good example of competitors collaborating on a common issue (e.g. too many KPIs reconciled differently) and is one that can be replicated and driven by other stakeholder groups with similar interests and challenges. Another example is the joint statement of Intent, by CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB), to work together to achieve comprehensive corporate reporting.

To ensure success, the SSB should also engage with forward- looking initiatives such as the Task Force for the Development of Voluntary carbon markets to ensure rapid establishment of externally- validated transparent benchmarks and market data. For example, reporting on sufficient levels of funding will require the IFRS Foundation also to set standards on acceptable pricing benchmarks e.g. for future offsetting obligations.

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 Foundation will need to strike an appropriate balance between a common core of key principles and a reasonable degree of local flexibility. Consistent with IFRS, messaging positioned appropriately for dissimilar jurisdictions is vital. A one-size-fits-all approach cannot be taken. The CGI has seen success where individuals who align with the mission have taken the responsibility of engaging with networks in their respective localities to spread the common key messages adapted for the region. Receiving the key messages that are true to the spirit of the standard from a recognisable local individual is invaluable. There should be one version of the core principles delivered by all but adapted to local specificities. Similarly, a core set of metrics applicable globally that could be supplemented regionally and by jurisdictional requirements would be valuable for comparability and therefore better at achieving inclusive decision-making and adoption.

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?

A robust framework for climate change reporting should be prioritised, followed by a broadening of the standard once this phase has been completed. We are in the midst of a climate emergency the likes of which are completely unprecedented in the history of humanity's life on this planet. This dictates that the topic be given utmost priority, to enable immediate action on a scale and at a pace of acceleration never before seen. For this reason, we advocate prioritising the development of reporting standards that address all aspects of climate change, including those areas that are inherently related, such as water and biodiversity.

In so doing, it is important that the standard devised by the SSB avoid imperilling the progress achieved to date through the adoption of the TCFD, which has received the backing of more than 1,000 corporations around the world. The adoption of TCFD represents a major milestone in the process of integrating the reporting of climate governance, risk, metrics, targets and capital allocation within corporate decision-making. It is therefore important to ensure the new sustainability standard build on and complement the TCFD recommendations. There is a valuable opportunity to leverage the specific expertise on the TCFD that is beginning to develop within corporations and among consultants to strengthen the process of embedding the new standard within companies' internal and external reporting.

The IFRS Foundation's experience in rolling out globally-accepted standards will be invaluable in embedding climate-related disclosures, likely based on TCFD, at faster pace, moving them rapidly from a largely voluntary submission to one automatically embedded within a company's reporting framework.

Once this all-important phase of developing a standard on climate change has been completed, the Foundation should turn its attention to broader sustainability issues. When boards and other users of the information endeavour to make decisions, information that provides only a single focused perspective is not adequate. Further, if sustainability in its entirety is not considered, there is the potential to make decisions that have negative impacts to other parts of the planet, its people and/or profit. For this reason, once a robust climate reporting standard has been established, we would favour progressing to a comprehensive approach that substitutes a holistic, strategic consideration of sustainability matters and considers the full impact of business on the planet and its inhabitants in the medium to long term.

A longer-term view is necessary, and as noted above, we anticipate that as sustainability becomes a factor of the monetisation of the business, it will become an integral part of the business and therefore corporate reporting. The current system of financial reporting will ultimately require supplementing to expand its remit.

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

Per our response to Question 7 above, the urgent existential threat posed by climate change requires priority treatment, provided this initial phase includes the closely-related areas of water and biodiversity. Cessation of the degradation of the environment in its totality is required and the definition of climate-related risks should therefore consider broader environmental factors.

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

It is imperative for materiality to be considered as the foundation for an effective reporting system, and ultimately more complete strategic risk management process. We recognise that the traditional concept of materiality has often proved to be of limited effectiveness in identifying and reporting on those climate-related issues that can, when incorporated into stress-testing that reflects robust climate scenarios, prove devastating to business. We therefore support a broader and more prescriptive definition of materiality that explicitly recognises the extraordinary degree of uncertainty associated with climate change. The system is changing rapidly, risks that are not currently perceived as material are likely to become so at a future date, and therefore a need exists for a sophisticated and transparent view on assumptions about how the future unfolds through scenario analysis. To be effective at considering the ever-evolving and interconnected implications of climate change, scenario analysis must be undertaken to horizon-scan and to protect the value of the business.

We also support an approach that enshrines double materiality in the reporting process as early as possible, on the grounds this will create the conditions for companies to report transparently both on their resilience to the physical effects of climate change, and on the steps they are taking to reposition the company for commercial resilience in a world where market, regulatory, technological, capital markets and competitive drivers will force them to craft and execute on a robust climate transition strategy.

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?

We support applying the same standard of audit to the sustainability report as is employed for the financial statements. The sustainability information must reflect the true, fair and balanced state of the business, by considering both the impacts of the company on stakeholders and the environment, and the impacts on the company from its exposure to external factors such extreme weather events, such that they can be evaluated with the same rigour as that applied to financial statements. Therefore, sustainability information is as relevant as the financial information to stakeholders, and should be subject to the same challenge and given the same level of priority to ensure its integrity.

In the earlier stages, sustainability reporting will inform many inputs in the financial statement balances and accounts, and the long-term performance and viability of the business. As it matures into an integral part of the business' strategy, it will become impossible to separate it from financial reporting. Therefore, both should be subject to the same level of assurance from the earliest opportunity.

The many business leaders within our forum who rely on the assurance provided by external auditors to make informed decisions agree that a multi-faceted opinion that evaluates and, if necessary, incorporates climate change as a key audit risk is essential for the audit opinion to be valid. A lesser level of assurance may result in insufficiently challenged inputs, thereby misstating the financials.

A siloed approach involving two separate assurance exercises in sustainability on the one hand and financial reporting on the other cannot result in comprehensive consideration of these ubiquitous and often interdependent sets of risk. Alternatively, they could result in duplication of efforts, where external auditors re-evaluate the sustainability information to understand the implications for their engagement, potentially reaching inconsistent conclusions.

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

The new sustainability standards should feature as a required component of continuing education for the profession. The basic requirement for change is education. Like many other professionals, accountants and external auditors have demonstrated an uneven level of awareness of the climate emergency. The preparers of financial information and external auditors are rightly expected to undertake ongoing training throughout their careers to keep abreast of new developments in accounting practice. The IFRS Foundation's education infrastructure and the panoply of tools at its disposal enable it to bring this new set of skills to accounting practitioners, and need to be updated as a matter of urgency.

The IFRS Foundation already has excellent tools that could enable effective climate accounting, but generally remain underutilised. These include:

1. **International Accounting Standard 1 paragraph 125**, which requires disclosure of the assumptions the business makes about the future, and other sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities.
2. **IFRS 7 on financial instruments**, which requires qualitative and quantitative information about the risks associated with these instruments, among which climate risks are increasingly seen as potential drivers of change in valuations.
3. **IAS 36 on Impairment of Assets**, insofar as the implications of climate-related risks for the critical assumptions that underly impairment calculations, such as commodities prices or asset longevity in a carbon-constrained world, have the potential to weigh on the future cash flows that feed into valuations of assets and liabilities. Effective use of scenarios and stress-testing (as called for by the TCFD Recommendations) is critical to informing the decision as to whether, and if so, how much assets should be written down.
4. **IAS 37 on Provisions, Contingent Liabilities and Contingent Assets**, which is directly applicable when dealing with uncertain conditions that could include, as result of scenario analyses, future risks and opportunities created by climate change.

As these examples illustrate, even under current rules, climate-related risks and opportunities can and should be incorporated within annual financial reporting. However, the incomplete application of the rules suggests additional guidance is necessary to facilitate better application of forward-looking scenario information in the annual report. Overall, there has been limited adoption of these requirements where climate change is concerned, a fact that demonstrates the lack of proper consideration, knowledge and understanding of this topic. Efforts must now be made as a matter of utmost urgency to develop a separate standard that is taken up and enforced systematically across all audited entities, so as fully to leverage the already strong components of the IFRS Foundation. Thereafter, the need arises to ensure the new standard adapts continually to new climate-related developments, such as clarity on standards to capitalise carbon credit investments prior to retirement or capitalisation of carbon sequestration project costs prior to issuance.