

Mr Erkki Liikanen
Chair
Trustees of the IFRS Foundation
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Canary Wharf, London E14 4HD
UNITED KINGDOM

29 July 2021

Dear Mr Liikanen,

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

The Australian Financial Reporting Council (FRC), Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board (AUASB) are pleased to provide our joint comments on the IFRS Foundation's *Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards*.

While we commend the initiative of the IFRS Foundation (the Foundation) and its recognition of the need to move with pace in this area, until it is resolved, the ability of the Foundation to establish new funding streams for the proposed standard-setting board to carry out its work remains of significant concern as a key barrier to success of the Foundation's sustainability reporting initiative. In addition, at this time we have several other broad concerns about the Foundation's initiative which we think may also hinder its long-term success prospects. In general, as described below, our concerns stem from lack of clarity about the proposed standard-setter's remit, agenda and its interaction with the work of the International Accounting Standards Board.

We consider that, before creating a global sustainability reporting standard-setting board, there is a need for the Foundation to:

- better articulate and communicate the sustainability reporting standard-setting board's envisaged achievements, beyond climate-related reporting; and
- clearly establish and communicate the relationship and interaction between the efforts of the IASB and the proposed new board, including in which 'corporate report' the work of each body will be presented.

Without some charting of the new board's plan beyond climate, we think it remains unclear how successful the new board will be in the longer term, and whether there is likely to be adoption and use of the international standards as a package, or whether standard use will be fragmented. We think that it must be clear how the new board will address and gain support for development of global baseline requirements on sustainability reporting topics other than climate and for which there may be less global consensus and momentum for action. We are concerned that a lack of transparency or effort in this regard may result in some loss of the current support for the Foundation's initiatives when its roadmap is revealed in the future.

The above actions will go some way to managing this concern.

Proposed strategy of the new standard-setting board

We concur the proposed strategy of the new standard-setting board recognises the immediate capacity of the new board and its likely resources, and agree it focuses on an appropriate initial area of interest. However, we think that, as broadly reflected by the expression of paragraph 2(b) of the IFRS Foundation *Constitution (Constitution)*, the stated strategy should provide only the first step in meeting more visionary goals. We would encourage the Foundation not to unnecessarily rigidly restrict itself to having an investor focus on enterprise value as in our outreach to Australian stakeholders on the Foundation's initiative, we often heard support for a new sustainability reporting standard-setter couched in "only if it does not add to the existing noise" terms. Existing reporting practice reflects that users of sustainability information – including investors – are interested in more than just information that directly impacts an entity's enterprise value. We would not like to see the new board's efforts fail to meet the needs of market participants in the longer term, and the produced standards ending up as further 'noise'.

The *Constitution* suggests that the adoption of sustainability reporting standards will be promoted and facilitated through convergence with national or regional standards. We note that in its 7 July 2021 webinar discussing the Trustees' work on creating a proposed new standard-setting board, the Trustees spoke of their intent as being not to compete with existing sustainability initiatives, but to harmonise, streamline and consolidate their work. We note that this is not necessarily the same as a convergence strategy. We also query whether convergence is consistent with the strategy of adopting a 'building blocks approach'.

Further, we think that a convergence strategy for sustainability reporting standards may not be appropriate as, unlike financial reporting, national or regional sustainability reporting standards do not necessarily already exist in this regard. We encourage the Foundation to reconsider whether the convergence reference in the *Constitution* aligns to its stated strategies for the new board.

The remit of the new standard-setting board and its potential work programme

Because of the different terminology employed in various forums, we are concerned that there is lack of clarity whether the new board's intended work is to address 'sustainability', 'sustainability-related disclosures' or 'sustainability reporting'. While we observe that the Foundation generally has described the work of the proposed board as to address sustainability reporting or sustainability-related disclosures, rather than sustainable development or sustainability more generally, we think its inconsistent messaging has the potential to foster lack of clarity amongst those who might use these standards; for example, through the proposed naming of the board as the International Sustainability Standards Board. In addition, from our outreach activity we understand there to be an expectation that the Foundation's sustainability reporting standards will establish and require consistent measurement metrics for reporting – which we think may not necessarily be the case should the intended content be more akin to that of the narrative reporting specified by IFRS 7 *Financial Instruments: Disclosures* – and that reported information will be auditable.

Consequently, we encourage the Foundation to take more care to use language consistent with the new board's standard-setting scope, at least until such time as that scope is more globally understood, and to take other actions as considered necessary to manage stakeholder expectations of the product. We think this is crucial to avoid both accidental stakeholder disappointment caused by a mismatch to stakeholder expectations, and possible deliberate misconstrue of the proposed board's intended work by parties who might not support this Foundation initiative. Consistent with our above comment, we do not support naming the proposed new board as the International Sustainability Standards Board as we think this is mischaracterises its planned remit. Our preference is for that new board to be called the International Sustainability *Reporting* Standards Board as this

avoids giving the impression that the standards will also address developing sustainability goals or measures, and consequently appears to be a name better reflective of the board's intended work.

In addition, we note that 'sustainability' remains undefined beyond the indication that ESG topics will be within the proposed new board's remit. We urge the Foundation to provide better clarity in this regard. We would also ask the Foundation to consider whether there is an exploitable gap between its proposed sustainability reporting scope and other extended external reporting areas that may be relevant also to the Foundation servicing, in general, 'corporate reporting'. If so, we would encourage the Foundation to consider acting to fill the apparent gap – this could potentially be as simple as addressing sustainability reporting under the auspices of a board with a broader remit.

As the new board will be a sustainability standard-setter, we encourage the Foundation to give substantive consideration in its communications to other aspects of sustainability in addition to climate, so as to avoid giving the impression that its decision-making in establishing the new board and efforts in gaining stakeholder acceptance are limited to only its climate related endeavours. In this regard, we encourage upfront publishing of a potential initial suite of topics the new board might address. This may aid jurisdictions, and companies, in their planning as to whether and how to incorporate the work of a global sustainability reporting standard-setting board into local sustainability reporting practices, especially in jurisdictions like Australia where no specific mandatory sustainability reporting directives presently exist.

Relationship and interaction with the IASB and other sustainability reporting initiatives

We support the establishment of the sustainability reporting standard-setter as a separate board to the IASB. However, we think it is imperative the Foundation provides clarity on how the intended work of the sustainability reporting standard-setter differs from that of the IASB, and clarity on how the two boards will work together or otherwise in areas of apparent technical overlap, including addressing the potential for joint projects and cross-staffing.

For example, as suggested by its identification in the IASB Third Agenda Consultation as a potential project, it appears to us that developing requirements for reporting of climate-related information about an entity's sustainability practices that impact (or has the potential to impact) financial reporting, and consequently its enterprise value, would already be within the IASB's remit, but yet appears to also be part of the remit of the new board. Another example is the IASB's efforts to improve management commentary reporting – a management commentary could reasonably be expected to include discussion of topics for which a sustainability reporting standard-setter might develop requirements; placing outputs of both boards into the same document and introducing complexity into the reporting process, especially if the requirements are not aligned. We observe our outreach activity indicated that stakeholders were concerned about duplication of efforts by the boards, and more significantly, concerned that the dissimilar project outcomes would unnecessarily introduce complexity into their external reporting. Given the overlaps, we think the Foundation must give due regard to how it envisages the boards will work to develop a coherent external reporting product.

We think it is necessary for the sustainability reporting standard-setter to be engaged as part of the IASB's project planning and in its deliberations on the Foundation's cross-cutting Third Agenda Consultation and Management Commentary projects. Similarly, we think the IASB should be engaged on the sustainability reporting standard-setter's projects that impact financial reporting.

Where appropriate, such interaction should be formalised as part of the *Constitution*. In addition, we would encourage the Foundation to prioritise developing a conceptual framework for corporate reporting that informs the work of its two standard-setting boards. We think that it would be helpful if that conceptual framework included explaining whether the Foundation has a vision for presenting

the work of its two standard-setting bodies as part of a single report, or whether its intention is for sustainability information to be reported separately from the financial statements; and if so, how the Foundation will address duplication concerns and avoid the financial report becoming unwieldy to prepare and understand. Such conceptual framework could also set out how the Foundation sees its sustainability reporting standards as integrating with the work of other sustainability reporting initiatives including the Value Reporting Foundation and the Task Force on Climate-related Financial Disclosures.

Leveraging the IFRS branding to sustainability reporting

Our comments above reflect our view that the Foundation's initiative has value beyond as an 'add-on' to financial reporting. Consistent with this, we do not support styling the standards produced by the proposed new board as 'IFRS' sustainability standards. We are strongly of the view that the 'IFRS' acronym origins should not be disregarded, and that it should be retained for use only in the financial reporting space. Likewise, we consider this to be an opportunity for the IFRS Foundation to be renamed and repositioned to reflect its broader area of oversight.

While we understand the reasoning for the proposed styling of the standards, rather than deploying 'IFRS' as a general brand, we consider that the Foundation developing a separate new brand for sustainability reporting standards is consistent with placing value and giving respect to sustainability reporting in its own right, and in keeping with it developing a long-term vision for the proposed standard-setter. We are concerned the unnecessary emphasis on financial reporting could imply that the Foundation considers the value of sustainability reporting is only as a complement to the financial statements. This may have the unfortunate unintended consequence of providing a flashpoint for user groups with different sustainability objectives to claim that the sustainability agenda is being inappropriately claimed by an industry whose interest is in generating a return to shareholders rather than creating a sustainable future for the next generations. We also think that the divorce from 'IFRS' may help drive acceptance of the initiative to the broader sustainability reporting stakeholder group, who do not necessarily operate in the financial reporting space.

Our specific comments on the proposed amendments to the *Constitution* are detailed in Appendix A to this letter. These comments were informed by the views of Australian stakeholders, through discussions with approximately 20 stakeholders across a range of organisations and including users, large corporate entities (both finance-focus and sustainability-focus staff), auditors and professional accounting bodies, and academic staff. We recognise that due to the need to move quickly, some compromise may be necessary on less-crucial aspects of the current public consultation on the proposed amendments to the *Constitution*. We caution however, that such compromise must not be seen as impinging the credibility of the standard-setter or its standards.

In closing, we wish to note that we are supportive of the Foundation taking a leadership role to address sustainability reporting, but stress that it must be a considered endeavour with a plan for long-term success. If you have any questions regarding this letter, please contact any of the signatories or Nikole Gyles, AASB Technical Director (ngyles@aab.gov.au).

Yours sincerely,



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FRC



Keith Kendall
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William Edge
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APPENDIX A – Responses to questions raised in the Exposure Draft *Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards*

Question 1 — Expand the Foundation’s remit to create a new board that will set IFRS sustainability standards

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?

Our comments below are additional to, and should be considered in context of our comments detailed as part of our cover letter. Overall, we agree that the amendments proportionately reflect the Trustees’ strategic direction. In general, we support the proposed amendments to:

- (a) the objectives of the Foundation, outlined in the proposed new section 2b of the *Constitution*; and
- (b) reflect the structure and function of the new board, outlined in the proposed new sections 43–56 of the *Constitution*.

However, we have a few specific comments. With regards to the proposed amendments, we are concerned about the proposed simple majority (plus extra Chair vote in the event of a tie) required to approve issue of a sustainability reporting-related exposure draft or standard. While this may mean that pronouncements might be issued more speedily, such voting threshold suggests that the process given to these pronouncements is less rigorous, and as such, inconsistent with stakeholder rationale for why the Foundation should develop sustainability reporting standards. We think only requiring a simple majority for approval of a final standard has the potential to impinge on the credibility accorded to these pronouncements, and could possibly hinder global take-up of those standards approved only by a simple, rather than a super, majority. We recommend the *Constitution* mirror instead the supermajority approval required by the IASB for approval of its exposure drafts and standards.

In addition to the proposed amendments, we think the *Constitution* should further be amended to:

- (a) provide clarity about the relationship between the proposed new board and the IASB, and address potential overlapping work and set out how the boards might work together or otherwise set the boundary on areas of reporting overlap – refer our comments in our cover letter;
- (b) reflect that Trustees should be financially knowledgeable about sustainable dollars. We think this better links the financial reporting and sustainability reporting scopes of the Foundation’s two standard-setting bodies;
- (c) if the IFRS-styling is finalised in the manner proposed, rename the IFRS Interpretations Committee. This will provide the necessary clarity that its scope is limited to addressing the interpretation of Standards produced by the IASB; and
- (d) if the IFRS-styling is finalised in the manner proposed, give further consideration to the suggested styling of the IASB’s standards as ‘IFRS accounting standards’. We think due regard should be given to the IASB’s management commentary efforts, for which an ‘accounting standard’ label may not be appropriate.

As noted in our cover letter, we sought feedback from Australian stakeholders about the proposed amendments to the *Constitution*. For your information, we report the following:

- stakeholders supported development, in the first instance, of principles-based standards. However, some cautioned that such approach may need to be revisited if it was found after implementation, not to result in improved sustainability-related disclosures overall. Several stakeholders stressed that the principles-based standards would need to be realistic, as otherwise an entity might not be able to report in accordance with the principle or the resultant information might not be auditable, consequently detracting use of the standards;
- stakeholders had mixed views about the Foundation’s proposal for the *Constitution* to not cater for a sustainability standards interpretations committee at this time. Many considered that there will be a need for further guidance and assistance to facilitate and promote consistent application of the standards at an industry level. In keeping with this, some stakeholders thought catering for such a committee now would be consistent with future proofing the *Constitution*, even if that committee is not established until a future point in time. (We support the non-creation of a sustainability standards interpretations committee at this time as we think such action creates a negative perception and expectation that the produced standards will not be able to be applied by entities without further guidance and interpretation);
- some stakeholders observed that the terms of board members should consider whether there is a need for the continual renewal and refresh of board perspectives given infancy in the area of sustainability reporting. Stakeholders supported pragmatism in selecting board members, prioritising expertise over geographical representation. Some stakeholders considered the *Constitution* should contemplate that an IASB board member should be included on the new board (and vice versa); and
- several stakeholders judged it important for the Trustees to not just be financially knowledgeable but that at least some members should also be knowledgeable about sustainability reporting. Reasons given for this view included that such representation speaks to the veracity of the sustainability standards and sets up sustainability reporting as being of equal significance to financial reporting – and as such, may assist in gaining support for the initiative from the sustainability community consistent with the expressed objective of connecting with multi-sustainability reporting stakeholders.

Question 2 — Create the International Sustainability Standards Board under the Foundation’s governance structure to set IFRS sustainability standards
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?

For the reasons given in our cover letter, we do not support the proposed naming of the new board and its associated standards. We support instead the ‘International Sustainability Reporting Standards Board’ setting ‘International Sustainability Reporting Standards’ as we think it is important to divorce IFRS from sustainability reporting and reflect the intended limits of the new board’s activity. In addition, we think the IFRS Foundation should be renamed to reflect the extended scope of its activities.

We note that Australian stakeholders provided us mixed feedback on the potential IFRS-styling of the new standards. Some stakeholders considered the explicit association with ‘IFRS’ to be positive as it conveys officiality and the expectation that the product would be of high-quality and auditable, or as an explicit link of the pronouncements to financial reporting. These stakeholders were not

concerned of the origins of 'IFRS' in accounting and financial reporting, as they prioritised it as a general brand name. Other stakeholders considered the association with 'IFRS' to be negative for the exact same reasons, noting that the objectives and outcomes of financial reporting and sustainability reporting could be quite different and querying the relevance of an IFRS-badge to the sustainability reporting community. These stakeholders also questioned the future proofing of the labels should the Foundation's strategy eventually extend to beyond an investor focus on enterprise value.

Generally however, the stakeholders we spoke to considered content of the standards to be of more import than the actual styling of the pronouncement.

Question 3 — Consequential amendment to the Foundation's governance
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?

We have no specific comment to make on the Executive Director's reporting line, as we think this is a matter of organisational structure for the Trustees to determine. However, we note the following:

- section 60 proposes updating the existing text to reference the appointment of the Executive Director by the Trustees after consultation with the chairs of the two standard-setting boards. We think the insertion of the text "and after consultation with the chairs of the IASB and the ISSB" is unnecessary, as section 15(b) already establishes that the appointment is made in consultation with the chairs of the two standard-setting boards;
- section 60 proposes updating the existing text to require the Executive Director to engage with (rather than the present "report to") the chairs of the two standard-setting boards. We think it should be clarified that engagement with one or both chairs is only as pertains to matters of relevance to that chair's standard-setting activities; and
- the wording of section 61 is of concern, as it suggests that the two standard-setting boards will share a combined senior technical team. This reinforces the concern that accountants might be inappropriately extending their work into areas for which they are seen as having little expertise. Because the two standard-setting boards are separate, we think that this section should similarly envisage that each board will be supported by its own staff resources and own senior technical team. We think this is important because the objective and purpose of each of the standard-setting boards is different, and consequently we do not think it would be appropriate for senior technical team members to have cross-board roles.

Question 4 — Other matters
Are there any other matters you would like to raise in relation to the proposed targeted amendments to the <i>Constitution</i> ?

Our overarching concerns were detailed as part of our cover letter. We have no other matters to raise in relation to the proposed targeted amendments to the *Constitution*.