December 22, 2020

Mr. Erkki Liikanen
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Re: IFRS Foundation Consultation Paper on Sustainability Reporting

Dear Mr. Liikanen –

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs (AICPA). This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the IFRS Foundation's *Consultation Paper on Sustainability Reporting* (Consultation Paper). The CAQ is supportive of the IFRS Foundation's efforts to develop and seek comment on this consultation on sustainability reporting.

While the Consultation Paper does not define sustainability reporting, we consider sustainability reporting and Environmental, Social and Governance or "ESG" reporting to be synonymous terms, whereby both refer to reporting on three central risk dimensions that can influence long-term financial performance of companies: environmental, social, and governance. We recommend that the IFRS Foundation define sustainability within the conceptual framework if they move forward with the creation of a Sustainability Standards Board (SSB), as we believe a common set of definitions is a necessary foundation on which standard setting would build. In determining how to define sustainability, the SSB could look to how other standard setters have defined this term, such as SASB. We see this as being especially important as some may associate the term "sustainability" solely with climate change and may not appreciate that it encompasses other social and governance factors (our comments in response to questions 7 and 8 build on this recommendation).

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We have organized our views based on certain of the questions posed in the Consultation Paper:[1]

Question 1: Is there a need for a global set of internationally recognised sustainability reporting standards?

In the past year, the focus on ESG reporting as a way for U.S. public companies to communicate business risks and opportunities has rapidly translated into growing demand for this information from investors, policymakers, and regulators.[2] This has been driven by, among other things:

- The rise of corporate purpose[3] and a focus on long-term value, including intangible assets such as human capital and corporate brand and reputation, for all stakeholders, including investors, employees, customers and others;
- Investor demand to understand a company's ESG profile – from both an operational and strategic perspective – in making capital allocation decisions; and
- Board of Directors and company management interest in identifying strategies to drive differentiation, cost efficiencies, and resilience.

The global COVID-19 health pandemic and attention on social injustices, particularly here in the U.S., have only accelerated interest in ESG information, such as employee safety and diversity and inclusion policies. Despite this, one of the biggest challenges that we hear from investors, companies and Board members in assessing a company's ESG risks is the lack of broadly adopted ESG reporting standards. While the building blocks of reliable, comparable and relevant ESG information begin with a foundation of quality reporting by company management, the challenge for companies to determine what types of ESG information to report, and how to communicate relevant information to stakeholders in a landscape of multiple frameworks and standards, is real.

A globally accepted system built from existing standards and frameworks that can be adapted to the market needs in different jurisdictions would help support companies in presenting ESG information that is comparable.

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)?

The Consultation Paper identifies certain requirements that would be essential for success if the IFRS Foundation was to move forward with further developing the SSB. While we are in agreement with the requirements for success as outlined in the Consultation Paper, we believe the following requirements would be instrumental in enabling the establishment of a new SSB that does not distract from the current mission of the IFRS Foundation:

- Achieving a sufficient level of global support – Before the IFRS Foundation moves forward with forming the SSB, it is essential that all relevant stakeholders are committed to the mission and are willing to participate in the standard setting process as well as accept the

[1] Note: We have not responded to each question of the consultation.
[2] See announcement from the World Economic Forum.
[3] See announcement from the Business Roundtable.

outcomes. Multidisciplinary feedback from various stakeholders, such as investors, preparers, regulators and auditors will be an important part of this process. We encourage the new SSB to consider roundtables, surveys, and alternative methods for seeking input incremental to the standard setting process to ensure sufficient feedback is received from a wide array of stakeholders.

- Achieving global consistency and reducing complexity – It is important that these standards represent a globally consistent set of standards and do not become an additional framework or standard. We believe the IFRS Foundation, with the creation of an SSB, could achieve this objective by utilizing existing standards to inform the creation of the new global standards. The CDP, CDSB, GRI, IIRC and SASB *Statement of Intent to Work Together Towards Comprehensive Reporting* (Joint Position Paper) describes how these frameworks and standards can be interoperable to meet ESG reporting needs. A cohesive set of standards that incorporates the significant progress made by the aforementioned framework and standard setters would facilitate the timely establishment of the SSB in this rapidly evolving area of corporate reporting as well as reduce the complexity for preparers in disclosing this information and for investors in using this information to make economic decisions.

- Funding – We believe a model that achieves a broad base of funding from a diverse set of stakeholders in the financial reporting supply chain will be vital to the success of the SSB.

- Technical expertise – Achieving an appropriate level of technical expertise to set sustainability standards will be critical for the success of an SSB and will require the expertise of accountants and other specialties and disciplines. We recognize the IFRS Foundation has experience and knowledge setting standards that consider the input of many stakeholders, including the accounting profession. The current make up and technical expertise that existing ESG standard and framework setters (e.g., SASB, GRI, etc.) have could inform the understanding of relevant expertise needed on the SSB. This will help mitigate concerns that an SSB may distract from the IFRS Foundation's current mission.

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?

We acknowledge that climate-related information is top of mind for many investors. Many companies have made public commitments to carbon reduction strategies and as a result standards and frameworks have been established to enable measurement and reporting of progress relative to these commitments. As such, for practical purposes and the material impact of this topic to many companies, we support the notion of prioritizing climate-related information as described in the Consultation Paper.

While we believe it is logical to start with climate-related disclosures, it is important to note the growing importance of other interconnected environmental, social, and governance factors. Climate-related information intersects with various other E, S, and G factors, and as climate change progresses, these topics will only grow in materiality and in importance to investors. For example, climate change has an impact on "E" issues, such as rising sea levels and biodiversity, as well as "S" issues, such as workforce conditions, and "G" issues, such as transparency in communicating the strategy to reduce carbon emissions.

Further, recent events related to the global COVID-19 health pandemic and attention on social injustices, particularly here in the U.S., have heightened interest in other types of company-prepared information including employee safety and diversity and inclusion policies. As such, while we understand the need to escalate the development of a globally accepted framework for climate-related information, and agree that the SSB should initially develop climate-related disclosures, we encourage the IFRS Foundation to not lose sight of other ESG areas and make progress on these areas in parallel with climate-related disclosures.

Said another way, in order for the SSB to reduce complexity and achieve comparability in sustainability reporting, it is critical that the IFRS Foundation make it clear that the SSB would have a remit that is broader than only climate related disclosures and encompasses other ESG areas. The International Accounting Standards Board's (IASB) *Conceptual Framework for Financial Reporting* describes the objective of, and the concepts for, general purpose financial reporting and the overall purpose of the conceptual framework.[4] A conceptual framework designed by the SSB could describe the objective and purpose for sustainability reporting which would help to define the remit of the board as well as inform the scope and expansion of topics to be covered by the SSB, including how the SSB will be nimble enough to respond to evolving risks and topics related to ESG reporting. In order to assist with this progress, we encourage the IFRS Foundation to set the overall mandate and boundaries for ESG reporting but allow the SSB to set its own agenda and prioritization within the overall mandate.

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

As stated in the Consultation Paper, climate-related risk is a financial risk of growing importance to investors and prudential regulators. As such, in order to allow the SSB to issue sustainability standards as quickly as possible, we support an initial focus on climate-related risks. However, as explained above in our response to question 7, we believe that the SSB should plan to expand its scope to include other environmental, social and governance factors. Given the increasing importance of other material E, S, and G factors to investors, it will be critical to the global acceptance of these standards for the SSB to communicate the intention to expand the scope of the standards on a timely basis. This could be achieved through releasing research agenda topics or a work plan that encompasses the addition of broader factors beyond climate-related E, S, and G factors.

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

The approach to materiality will be an important driver to setting standards that support the disclosure of ESG information that meets the objectives of the intended users. As described in the Joint Position Paper, there are two materiality concepts used by companies for sustainability disclosure:

- A company determines the sustainability topics that are material for disclosure based on the organization's **significant impacts on the economy, environment and people**. This approach is targeted at stakeholders who want to understand the company's positive and negative contributions to sustainable development.

[4] See IASB's *Conceptual Framework for Financial Reporting*.

- When a company discloses information to a sub-set of the stakeholders indicated above - those users whose primary objective is economic decision-making (such as many institutional providers of financial capital) - the company delineates the sub-set of sustainability topics that are material for **enterprise value creation**, recognizing that some of that performance already may be reflected in the annual financial accounts.[5]

Information that is material to enterprise value creation is a materiality concept based on the ability to influence economic decisions which is similar to the materiality used in financial reporting.[6] As more and more investors are using ESG information to make capital allocation choices, it is critical that it is of high-quality and decision useful. We believe decision useful information is consistently prepared, comparable from company to company, and reliable.

ESG reporting standards designed through the lens of investors being the primary users of this information (i.e., materiality focused on enterprise value/financial materiality) will attract the broadest range of global support and promote the international use of consistent and comparable standards needed by global capital markets. The Consultation Paper states that the SSB would initially focus its efforts on the sustainability information most relevant to investors and other market participants. As a result, we support the SSB's materiality approach with an initial focus being on ESG information most relevant to investors. We think this aligns with the building blocks approach laid out in IFAC's Roadmap, *Enhancing Corporate Reporting: The Way Forward*, that starts with disclosures relevant to enterprise value creation.

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?

Because ESG information is increasingly used by the capital markets, the information needs to be credible and well supported, so that when questions are asked, there are good answers about the quality of the process for accumulating and reporting the information, the oversight of the reporting, and the ability of the information to withstand outside challenges. Put another way, the information needs to be reliable. Trust and confidence in the information companies disclose are essential to the efficient functioning of markets and an independent assessment of that information can contribute to its reliability.

Like the audits of financial statements and internal control over financial reporting, third-party assurance from a public company audit firm enhances the reliability of ESG information presented by companies to investors and other stakeholders.[7]

The accounting profession has made considerable progress on the role and value of assurance on ESG information—and the systems and processes used to generate it. Notably, the AICPA has convened the Sustainability Assurance and Advisory Task Force. In July 2017, the task force published *Attestation Engagements on Sustainability Information*, a guide to assist practitioners engaged to perform an examination or a review of an entity's sustainability information. An accountant's report is designed to assist intended users in evaluating the reliability of information disclosed by management by providing an objective and impartial assessment of the assertions, data, and other disclosures made by management.

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[5] See page 4 of the Joint Position Paper.

[6] Ibid.

[7] For more details see the CAQ's resource, *The Role the Auditor in Company Prepared ESG Information: Present and Future*.

Obtaining any level of assurance by a credentialed accountant, such as a certified public accountant or "CPA", involves the evaluation of processes, systems, and data, as appropriate, and then assessing the findings in order to support an opinion based on an examination or conclusion based on a review. Assurance over ESG reporting, specifically when performed by a credentialed accountant, can enhance its reliability because public company auditors:

- Consistently follow established attestation standards (e.g., U.S. Generally Accepted Auditing Standards or "U.S. GAAS" or International Standards of Auditing or "ISA") which define the performance and reporting requirements for the attest engagement.
- Are independent of their audit clients, in accordance with the applicable independence standards.
- Are required to maintain a system of quality control in accordance with various rigorous standards which are constantly evolving (e.g., International Standard on Quality Management and the Public Company Accounting Oversight Board Quality Control Standards).
- Have extensive experience in gaining an understanding of business processes and assessing and responding to risk.
- Are experienced in reporting on compliance with various established standards and frameworks.
- Routinely incorporate qualified specialists with deep subject matter experience into attestation procedures when needed. [8]
- Adhere to continuing professional education ethics and experience requirements, including attending specialized training.
- Have expertise in evaluating internal systems and processes for collecting, analyzing, and reporting information.
- Have a long history and experience of independently evaluating information that is then used in making capital allocation decisions

Assurance is an important step along the way to companies reporting comparable, reliable and consistent ESG information to investors. The importance of assurance is recognized by investors and standard-setters, such as SASB, who specifically designed their standards to serve as a basis for suitable criteria in independent, third-party assurance. Credentialed accountants have the relevant skillsets to provide trust and confidence in the reporting of relevant, reliable and consistent ESG information.

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[8] Of a sample of audits conducted by large, global network firms selected for inspection by the PCAOB, it was found that auditors used the work of at least one auditor-employed specialist in about 85 percent of those audits. See PCAOB Release No, 2018-006.

We appreciate the opportunity to comment on the Consultation Paper. We would be pleased to discuss our comments or answer any questions regarding the views expressed in this letter. Please address questions to Catherine Ide (cide@thecaq.org) or Dennis McGowan (dmcgowan@thecaq.org).

Sincerely,

Catherine Ide
Vice President, Professional Practice
Center for Audit Quality