July 29, 2022

International Sustainability Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD, UK

Re: IFRS Exposure Drafts IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures

Dear Mr. Faber,

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs. This letter represents the observations of the CAQ based upon feedback and discussions with certain of our member firms, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views related to the International Sustainability Standards Board (ISSB), *Exposure Draft: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information* (General Requirements ED) and *Exposure Draft: IFRS S2 Climate-related Disclosures* (Climate ED) (collectively, the exposure drafts). The key points of our letter, include expressing support for the ISSB's important efforts to develop a globally accepted baseline for ESG reporting, highlighting a few key areas of the exposure drafts that we believe may slow down widespread adoption and affect the goal of achieving a global baseline of sustainability information, and highlighting areas where greater clarity could be provided to indicate whether and how concepts in the ISSB's exposure drafts relate to similar concepts in the IFRS accounting standards and vice versa.

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Support for ISSB proposals

We welcome the ISSB's exposure drafts. We believe that a globally accepted system for ESG reporting that is developed from existing standards and frameworks that can be built upon to meet the market needs in different jurisdictions would help support companies in presenting ESG information that is consistent and comparable. Accordingly, we strongly support the efforts of the ISSB which are built upon recommendations by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) and components of the frameworks and standards of leading international sustainability bodies, like the Value Reporting Foundation and the Climate Disclosure Standards Board. Preparers and users are familiar with these approaches (to varying degrees) and we believe this will help facilitate adoption and market acceptance of ISSB standards which will also help drive consistency between jurisdictional requirements.

We believe that it is essential for investors to understand the relationships and connectivity between sustainability risks and opportunities and the financial disclosures in general-purpose financial reporting. Accordingly, we support the proposal in the General Requirements ED to require an entity to explain the connections between different pieces of information, including between various sustainability-related risks and opportunities and information in the entity's financial statements. Additionally, the General Requirements ED also strengthens the link between management commentary and sustainability-related risks and opportunities in the financial disclosures.

Further, we support the focus on enterprise value which responds to calls from primary users of general-purpose financial reporting for more consistent, complete, comparable, and verifiable sustainability-related financial information to help them assess an entity's enterprise value. This focus recognizes that, among other things, sustainability-related risks and opportunities arise from an entity's dependencies on resources and its impacts on resources, and the relationships the entity maintains that may be positively or negatively affected by those impacts and dependencies.

Jurisdictional adoption considerations

We are encouraged by the G7's endorsement of the ISSB and the ISSB's progress on the global baseline of sustainability reporting standards.[1] Achieving a sufficient level of global support and acceptance from public authorities, global regulators, and market stakeholders will play a pivotal role in the ultimate success of the IFRS Sustainability Disclosure Standards serving as a global baseline. Given this, we highlight a few key areas of the exposure drafts that we believe may slow down widespread adoption and the ultimate success of the proposed standards serving as a global baseline.

[1] IFRS - G7 welcomes ISSB's work to deliver global baseline of sustainability disclosures and https://www.consilium.europa.eu/media/57555/2022-06-28-leaders-communique-data.pdf - p4.

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Requirements for identifying sustainability-related risks and opportunities and disclosures
The General Requirements ED would require an entity to disclose material information about all of the significant sustainability-related risks and opportunities to which it is exposed. It goes on to explain that in addition to using IFRS Sustainability Disclosure Standards to identify sustainability-related risks and opportunities, an entity shall consider:

> “(a) the disclosure topics in the industry based SASB Standards;
> (b) the ISSB’s non-mandatory guidance (such as the CDSB Framework application guidance for water- and biodiversity-related disclosures);
> (c) the most recent pronouncements of other standard-setting bodies whose requirements are designed to meet the needs of users of general-purpose financial reporting; and
> (d) the sustainability-related risks and opportunities identified by entities that operate in the same industries or geographies.”

The General Requirements ED as drafted appears similar to the hierarchy prescribed in *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors* which indicates that in the absence of an IFRS Standard that specifically applies, management uses its judgement in developing and applying an accounting policy that results in information that is relevant and reliable and indicates that in making that judgement management refers to the following sources in descending order:

- the requirements and guidance in IFRS Standards dealing with similar and related issues; and
- the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework.

The above-mentioned text in the General Requirements ED dramatically increases the breadth of considerations and reporting requirements for entities beyond climate with no related guidance. It would further create challenges from a completeness perspective; bringing in unspecified or all other standard setters creates a maze of complexity that will be difficult to follow and could pose challenges for report users and auditors to understand whether all relevant frameworks have been applied to report the sustainability disclosures. Companies are at very different places in terms of reporting readiness, particularly across the full spectrum of sustainability-related risks and opportunities. By starting with such a broad base, we believe this would increase the upfront costs and time required for companies to adopt the General Requirements. This could place additional pressure on the cost-benefit analysis of standard-setters and regulators in jurisdictions looking to use the IFRS Sustainability Disclosure Standards as a baseline for sustainability-related disclosures.

We believe that considering the other standards, frameworks and pronouncements listed in paragraph 51 (b) – (d) of the General Requirements ED should not be a requirement. Instead, we recommend that other standards, frameworks, and pronouncements in paragraphs (b) – (d) should be listed as optional.

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We believe the same approach should be applied to paragraph 54. [2] The optional resources could serve as guidance for entities on where to look to identify other relevant, material disclosures and provide them with pointers on how to disclose material information about all relevant sustainability matters in the absence of an IFRS Sustainability Disclosure Standard. Later, as the concepts related to the topics in paragraphs 51 (b) - (d) of the General Requirements ED become more established as sustainability reporting matures, they can then be incorporated into the relevant IFRS Sustainability Disclosure Standards.[3] Such an approach is likely to result in a global baseline with a greater chance of widespread adoption.

Effective dates

We believe the effective dates selected will also play a role in whether the exposure drafts gain widespread adoption. We acknowledge the urgent investor need for this information and thus believe that early adoption should be permitted for those companies that are ready to adopt the standards earlier. Further, effective dates which allow other companies sufficient time to prepare will be important to ensure high-quality reporting of sustainability information alongside financial information. While we recognize that most jurisdictions may make their own decisions about timing for implementation, for jurisdictions that wish to require reporting in accordance with the IFRS Sustainability Disclosure Standards, as written, we believe the effective dates should be carefully considered, particularly in light of the following proposed requirements:

- The requirement in the General Requirements ED for an entity to disclose information required by IFRS Sustainability Disclosure Standards as part of its general-purpose financial reporting. [4]
- The requirement in the General Requirements ED for an entity to report at the same time as its related financial statements and for the same reporting period as the financial statements and
- The requirement in the Climate ED to report Scope 3 greenhouse gas (GHG) emissions.

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[2] We recommend doing this by striking "the most recent pronouncements of other standard-setting bodies whose requirements are designed to meet the needs of users of general-purpose financial reporting, and the metrics used by entities in the same industries or geographies." from paragraph 54.

[3] As part of this, the ISSB could consider reviewing other standard setting guidance/rules (e.g., the U.S. Securities and Exchange Commission guidance/rules) and incorporate the relevant guidance/rules into the standard.

[4] The State of Play in Sustainability Assurance (June 2021), an AICPA and IFAC global benchmarking study of 1,400 companies across twenty-two jurisdictions, found that while 91 percent of companies reviewed report some level of sustainability information, only 34 percent report this information as part of their general-purpose financial reporting. The study also found that only 15 percent reference the SASB Standards and 24 percent reference the TCFD recommendations, respectively, when doing so. This indicates that most entities across those twenty-two jurisdictions have yet to start disclosing sustainability information in their general-purpose financial reporting and have yet to start reporting in accordance with the SASB Standards or TCFD framework upon which the exposure drafts are heavily based.

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Each of the above currently occur only to a very limited extent and will require significant effort by entities to develop high quality reporting.[5] We believe the quality of the ESG information could be negatively impacted by accelerated timelines for reporting this information. This information often resides outside the organization (such as Scope 3 emissions data) and it requires time for companies to receive and aggregate the information from third parties, who have their own processes for accumulating the information. With accelerated timelines, there may not be sufficient time for the operation of the companies' and the third parties' processes and controls over the ESG information. As a result, accelerated timelines may require companies to include more estimates within this information, that may ultimately be revised in future periods. In addition, there may be strains on resources at companies to finalize the ESG information at the same time as the general-purpose financial statements, which could impact the quality of the general-purpose financial statements.

Given the above-mentioned, as well as the fact that entities will need sufficient time to develop an understanding of the final standards and up-skill to be able to implement the standards appropriately, we recommend that the effective dates allow sufficient time for companies to prepare. We believe that a phased in approach by both disclosure area/topic and entity size would provide companies more time to prepare for the more challenging disclosures (e.g., GHG emissions) and support companies in providing high quality disclosure.

Overall, we strongly support the efforts of the ISSB and believe it will be essential for the standards to appeal to and be adopted by multiple jurisdictions to support the goal of achieving a global baseline of standards for reporting sustainability information. For this to occur, we believe it will be important for the ISSB to gain a greater understanding of whether and how the above-mentioned factors could serve as impediments to the adoption of the IFRS Sustainability Disclosure Standards and take relevant steps to address them. Multidisciplinary feedback from various stakeholders, such as regulators, investors, preparers, and auditors will be an important part of such a process. We encourage the ISSB to consider roundtables, surveys, and alternative methods for seeking input as part of, and incremental to, the standard setting process to ensure sufficient feedback is received from a wide array of stakeholders across key jurisdictions.

GHG Protocol considerations

Of those companies that voluntarily report GHG emissions, many companies apply the GHG Protocol and thus have practices in place to accumulate and report emissions information consistent with the

[5] According to an analysis conducted by the CAQ, approximately 91% of S&P 500 companies mentioned climate-change in their 2021 form 10-K, compared to approximately 76% of S&P 500 companies in their 2020 form 10-Ks. Further, we observed roughly 102 of S&P 500 companies mention scope 1, scope 2, and/or scope 3 GHG emissions status, objectives and/or targets in their 2021 form 10-K.

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GHG Protocol.[6] Given this, we believe requiring use of a widely known and accepted framework, such as the GHG Protocol for determining GHG emissions, is a pragmatic approach which could help limit the reporting burden on entities that already disclose their GHG emissions data and will help facilitate a shorter transition period than requiring a different approach. We note that the GHG Protocol is in the process of assessing the need for additional guidance and encourage the ISSB (which we believe is well equipped) to work with the GHG Protocol to update the GHG Protocol standards/guidance, as necessary. To the extent the ISSB is unable to work with the GHG Protocol, we believe specifying that a known framework that meets specified minimum criteria be used could establish a baseline for determining entities GHG emissions while still allowing for flexibility that will enable entities to adapt to new approaches as they emerge.

Interplay between IFRS accounting standards and IFRS sustainability disclosure standards
We believe that consideration should be given to areas where sustainability disclosures and financial reporting intersect, and that greater clarity be provided to indicate whether and how concepts in the ISSB's exposure drafts relate to similar concepts in the IFRS accounting standards and vice versa. Recognizing the urgency with which global sustainability disclosure standards are required, we are not suggesting that all of these areas need to be addressed prior to finalization of these exposure drafts. However, over time, greater clarity on the interplay between IFRS accounting standards and ISSB IFRS sustainability disclosure standards should be provided. Examples of areas that could benefit from greater clarity include the following:

- The General Requirements ED uses the phrase enterprise value many times. It is however unclear whether this means an IFRS 13 market participant lens should be applied or if it is more of an IAS 36 value in use perspective or whether both apply depending on the circumstances (e.g., a management lens when considering scenarios). It is particularly unclear given that Appendix A[7] and paragraph 5[8] of the General Requirements ED appear to define enterprise value differently.
- It seems that companies may elect to present sustainability information on a segment basis. It is also possible that due to the importance of local laws and regulations as well as differences in for example what constitutes 'diverse' in different countries, that segments will be geographically based. This is different from how most companies report segments under IFRS accounting standards. Do investors have a preference for whether sustainability reporting is

[6] A CAQ analysis of the 2020 CDP submissions of S&P 500 companies, indicated that 87% of the companies that submitted GHG emissions data to the CDP reported their GHG emissions using the GHG Protocol. While the GHG Protocol was the most commonly used standard for reporting GHG emissions data, companies often used it and made reference to multiple other methodologies.

[7] Appendix A in the General Requirements ED defines enterprise value as "The total value of an entity. It is the sum of the value of the entity's equity (market capitalization) and the value of the entity's net debt."

[8] Paragraph 5 of the General Requirements ED indicates that enterprise value reflects expectations of the amount, timing and certainty of future cash flows over the short, medium and long term and the value of those cash flows in the light of the entity's risk profile, and its access to finance and cost of capital.

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presented by geography while other segment reporting is on a different basis? And does reporting different segments for ESG purposes factor into the IFRS segment analysis? Greater clarity on such matters would be helpful.

- Many other technical questions will arise, for example, how are business combinations reflected in sustainability disclosures (prospectively or retrospectively), how are divestitures handled (e.g., should there be a discontinued operations equivalent)? How should changes in estimates or subsequently identified errors be dealt with? Clarity on whether entities should apply the principles in the IFRS accounting standards which deal with such matters to answer those questions would be helpful.
- Materiality-related questions that may arise include: whether, and if so, how, financial statement materiality comes into play with sustainability disclosures or whether there is a separate implicit or explicit materiality for sustainability disclosures; whether financial statement materiality overrides in the financial disclosures that intersect with the sustainability disclosures; and whether the word “significant” used in the exposure drafts is the same as materiality or different.

Robust reporting standards would facilitate high-quality audits

We agree that the usefulness of sustainability-related financial information is enhanced if it is comparable, verifiable, timely and understandable, as indicated in paragraph C16 of the General Requirements ED.

Investors continue to demand high-quality, accurate, reliable information on climate and other ESG matters, and various jurisdictions are responding to those demands by requiring, among other things, assurance. Examples include the Corporate Sustainability Reporting Directive Proposal (CSRD) in Europe and the U.S. Securities and Exchange Commission’s (SEC) proposed rules to enhance and standardize climate-related disclosures for investors. Reporting standards play an essential role in enabling high quality reporting that then enables high quality assurance to promote trust and confidence in the reported information. Accordingly, we believe it is essential that the ISSB Standards have a set of clear and robust measurement and reporting criteria that are widely accepted by stakeholders. We believe the exposure drafts serve as a good starting point. Further consideration may need to be given to how auditors get comfortable with completeness, particularly if the frameworks/standards incorporated into the IFRS sustainability disclosure standards are not limited to the SASB Standards. We understand that the IAASB is undertaking a project to develop a new sustainability assurance standard and believe it will be important for the ISSB to work with the IAASB to coordinate the work streams, and to consider whether any auditing guidance is necessary.[9]

Like the audits of financial statements, we believe that third-party assurance from an independent accountant enhances the reliability of ESG information, including climate-related disclosures, presented

[9] Balancing Urgency and Effectiveness in International Sustainability Assurance Standards | IFAC (iaasb.org)

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by companies to investors and other stakeholders. The accounting profession has acknowledged the value of ESG information to investors and others, and in their public interest role play a part in the flow of reliable information for decision making.

Obtaining any level of assurance by an independent accountant 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. We believe that assurance from an independent accountant is one element of a high-quality financial statement reporting system and that it will form an important element of high-quality ESG disclosures.

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The CAQ appreciates the opportunity to comment on the exposure drafts and would be pleased to discuss our comments or answer any questions regarding the views expressed in this letter. Please address questions to Dennis McGowan (dmgowan@thecaq.org) or Desiré Carroll (dcarroll@thecaq.org).

Sincerely,

Dennis J. McGowan

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