

## IFRS Developments

# IFRS Foundation Trustees publish Consultation Paper on Sustainability Reporting

### What you need to know

- ▶ On 30 September 2020, the Trustees of the IFRS Foundation published a Consultation Paper on the need for global sustainability standards and the Foundation's role in their development.
- ▶ The Consultation Paper is part of the Trustees' consultation process on the Foundation's strategy.
- ▶ The Consultation Paper seeks feedback on three main areas: the need for sustainability reporting, the role the Foundation would play in developing sustainability standards, and the potential to form a Sustainability Standards Board (SSB).
- ▶ Comments on the Consultation Paper are due by 31 December 2020.

### Introduction

On 30 September 2020, the Trustees of the IFRS Foundation (the Foundation) published a Consultation Paper to assess demand for sustainability reporting at a global level and to explore the Foundation's role in the development of global sustainability standards. The Trustees prepared this Consultation Paper through a Task Force. The Consultation Paper is part of the Trustees' consultation process on the Foundation's strategy that is required to be conducted every five years.

The purpose of the Consultation Paper is to seek stakeholder feedback on three main areas. The first is the assessment of the current need for sustainability reporting, in order to understand the necessity in developing global sustainability standards. The second is the potential role that the Foundation may have in developing such standards and the third is the role of a Sustainability Standards Board (SSB) proposed by the Trustees.

We discuss these areas in more detail below. Comments on the Consultation Paper are due by 31 December 2020.

### Assessing demand for global sustainability standards

#### *Current use of sustainability reporting by stakeholders*

The Task Force worked closely with stakeholders such as investors, regulators, central banks and audit firms, to explore the importance of sustainability reporting. Some of the Task Force's findings are, as follows:

- ▶ Large institutional investors and asset managers need better disclosure of climate risks and sustainability indicators to improve their analytics and to better inform their investment decisions.
- ▶ Entities commit to regulators, consumers and investors to improve their sustainability reporting. However, in the absence of commonly accepted and applied standards, there is concern that the current reporting is inefficient and ineffective.
- ▶ Climate-related risks and broader sustainability are areas of focus for central banks as important drivers of their financial stability. These areas have become even more prominent after prudential regulators started incorporating climate analyses into their stress testing models.

Diverse initiatives underline the need for a global framework to enhance comparability and reduce the complexity of sustainability reporting.

- ▶ Regulator involvement in sustainability reporting is notable in some regions, depending on the local government public policy positions, such as requiring companies to work towards net zero carbon emission targets.
- ▶ Audit firms and other service providers have started developing reporting frameworks in advance of their potential role in providing assurance, in the event that sustainability standard-setting goes ahead.

Currently, there are several sustainability reporting requirements, each with a different focus. For example, some focus on non-financial standard setting, some on frameworks for non-financial information, and others on frameworks for climate-related disclosures. Also, they vary in focus between the impact of risks on an entity itself, and/or on an entity's impact on the environment. In this regard, the Task Force noted that "... diverse approaches and objectives pose the threat of increasing fragmentation globally. The potential of fragmentation and the growing demands from stakeholders demonstrate the need for a global framework to provide greater comparability and reduce the complexity of approaches and objectives."

Therefore, based on the findings of the Task Force's outreach to stakeholders and its own research, the Consultation Paper concludes that there is an urgent need to improve the sustainability information provided by entities, stating that "... a set of comparable and consistent standards will allow businesses to build public trust through greater transparency of their sustainability initiatives, which will be helpful to investors and an even broader audience in a context in which society is demanding initiatives to combat climate change". It also states that many stakeholders acknowledge the fact that further delays to a common global initiative may have a negative impact on the transition to a low-carbon economy.

## **Identifying the role of the Foundation**

### *Reasons for the Foundation to be involved*

Several bodies and organisations have recommended the Foundation as a natural choice for the potential setting of sustainability reporting standards, for the following reasons:

- ▶ Its existing standard-setting expertise and due process procedures are focused on transparency, broad consultation and accountability.
- ▶ The Foundation maintains strong and collaborative international relationships with governments, regulators and national standard-setters.
- ▶ It works closely with stakeholders in connection with its standard-setting, implementation support and maintenance activities.

Nonetheless, the paper highlights that if the Foundation is to be involved in sustainability reporting, it would need to be supported by and work closely with governments, regulators and national standard-setters.

### *Options considered by the Trustees for the Foundation's role*

In response to the widely acknowledged and urgent demand for consistent sustainability reporting, and the fact that the Foundation was being suggested as the most obvious organisation to fulfil the role, the Trustees considered the options for the Foundation to take such a strategic role. The main options that were considered are:

- ▶ *Maintain the status quo*: the Trustees noted that keeping the status quo implies low risk for the Foundation. However, they felt that the status quo is not beneficial to the Foundation's stakeholders, nor to other various stakeholders, who expect the Foundation to take a leading role in global sustainability reporting.
- ▶ *Facilitate existing initiatives*: the Foundation could take a coordinating role, aiming to facilitate and harmonise the sustainability reporting initiatives that already exist. The Trustees considered that this option brings with it the risk of further fragmenting and complicating the process instead of contributing to the creation of a global framework for consistent standard-setting.
- ▶ *Create a Sustainability Standards Board (SSB)*: the Foundation could perform a standard-setting role, working with existing initiatives and building upon the work that has already been done. This option is considered by the Trustees as being more advantageous than the other options discussed and one that will potentially

contribute the most in terms of reducing complexity and achieving comparability in sustainability reporting.

## The role of the SSB

### *Objective of the SSB*

If the Trustees decide to proceed with an SSB, its objective would be to develop and maintain a global set of sustainability reporting standards, utilising any existing sustainability frameworks and standards. The SSB's initial focus will be on climate change risk, as this is a key financial risk on which investors and prudential regulators have increased their focus, following public policy initiatives in several jurisdictions. However, the Consultation Paper acknowledges that terms such as 'climate-related information' are open to interpretation and should be properly defined.

The Trustees would also be open to the potential of broadening the SSB's scope in the future to address other upcoming priorities beyond a climate and environmental focus, subject to the Foundation's due process requirements.

### *Governance structure of the SSB*

The Trustees proposed to include the SSB under the Foundation's current governance structure. This way, the SSB will be able to make use of the existing standard-setting process, due process procedures and the Foundation's network.

The Consultation Paper includes some specific requirements that the Trustees consider essential for the SSB's success:

- ▶ Achieve a sufficient level of global support from public authorities, global regulators and market stakeholders, including investors and preparers, in key markets
- ▶ Work with regional initiatives to achieve global consistency and reduce complexity in sustainability reporting
- ▶ Ensure the adequacy of the governance structure
- ▶ Achieve appropriate technical expertise for the Trustees, SSB members and staff
- ▶ Achieve the level of separate funding required and the capacity to obtain financial support
- ▶ Develop a structure and culture that seeks to build effective synergies with financial reporting
- ▶ Ensure the current mission and resources of the Foundation are not compromised

### *Collaboration between the SSB and other organisations and regional initiatives*

The Consultation Paper highlights the importance of collaborating with existing organisations involved in sustainability reporting. If the creation of the SSB proceeds, the Trustees will work on finding the best way to engage with these organisations, which will in turn help the SSB to build its expertise in sustainability reporting and ensure that it has sufficient resources to achieve its mission. Moreover, the Trustees noted that the success of a global initiative on sustainability reporting will not be feasible without the collaboration of the national and regional existing initiatives.

The Trustees support a 'single materiality' approach instead of a 'double materiality' approach, i.e., to report on information that is most relevant to investors and other market participants.

### *Objective of sustainability reporting and considerations of single vs double materiality*

The Trustees appreciate the concept of 'materiality' and its importance in sustainability reporting. However, stakeholders' views on the 'materiality' concept are divided. Some stakeholders believe that the SSB should work towards supporting investors and other market participants, by focusing on producing relevant information insofar as it affects the entity. Other stakeholders believe that SSB should develop standards based on the principle of 'double materiality'. That is, the reporting entity will additionally need to disclose its impact on the wider environment, as this would also be material to stakeholders.

The Trustees believe that the 'double materiality' approach would cause complexities and, effectively, lead to delays in standard-setting. Therefore, they suggest that sustainability reporting should initially be focused on information that is most relevant to investors and other market participants, which is also the IASB's current approach. In the long run, and to the extent that the various jurisdictions will prefer the 'double materiality' approach, the SSB could consider broadening its scope.

## **Assurance on sustainability reporting**

In the Consultation Paper it is acknowledged that consistency in sustainability reporting can be achieved more robustly at a global level if the sustainability information reported by entities is externally assured. No matter how standardised the information may be through the development of global sustainability reporting standards, the variability in disclosures is inevitable. Therefore, developing an assurance framework for sustainability information that is similar to that for financial reporting, should be considered.

### **How we see it**

The Foundation could play a significant role in global sustainability reporting via the creation of the SSB. By drawing on the IASB's existing structures and processes in global standard-setting, the SSB will leverage that expertise to develop the new sustainability standards. Nevertheless, the Foundation will only be successful in this role if the SSB works closely with the other organisations involved in sustainability reporting. This would be the case, in particular, if the 'double materiality' approach is to be followed in the long run.

## **About EY's International Financial Reporting Standards Group**

A global set of accounting standards provides the global economy with one measure to assess and compare the performance of companies. For companies applying or transitioning to International Financial Reporting Standards (IFRS), authoritative and timely guidance is essential as the standards continue to change. The impact stretches beyond accounting and reporting, to key business decisions you make. We have developed extensive global resources – people and knowledge – to support our clients applying IFRS and to help our client teams. Because we understand that you need a tailored service as much as consistent methodologies, we work to give you the benefit of our deep subject matter knowledge, our broad sector experience and the latest insights from our work worldwide.

© 2020 EYGM Limited.  
All Rights Reserved.

This publication contains copyright material of the IFRS® Foundation in respect of which all rights are reserved. Reproduced by EY with the permission of the IFRS Foundation. No permission granted to third parties to reproduce or distribute. For full access to IFRS Standards and the work of the IFRS Foundation please visit <http://eifrs.ifrs.org>

EYG No. 006890-20GbI

ED None

In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

**ey.com**