Comments on IFRS Foundation Consultation Paper on Sustainability Reporting

JUST SHARE

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IFRS Foundation
By email: commentletters@ifrs.org

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Dear Sir / Madam

COMMENTS ON CONSULTATION PAPER ON SUSTAINABILITY REPORTING

Introduction

1. Just Share welcomes the publication of the Consultation Paper on Sustainability Reporting ("Consultation Paper"), and the recognition in the Consultation Paper of the "urgent need to improve the consistency and comparability in sustainability reporting".

2. Just Share is a South African non-profit shareholder activism organisation. We believe that responsible investment is required to create a more just and inclusive economy. We use advocacy, engagement and activism to drive good corporate citizenship by South African-listed companies and institutional investors. Our work focuses on three key inter-related environmental, social and governance (ESG) issues: corporate governance, climate change and inequality.

3. Comparable sustainability reporting is necessary because social and environmental issues span countries and continents, and questions about the use of global common resources, international equity and collective contributions to climate change (and climate action) are being asked with increasing urgency. Addressing the challenges of inequality, biodiversity loss, ecosystem collapse and climate change requires a coordinated, concerted effort from the entire global community: financial, political and social.

4. Comparable financial reporting as an analogy is useful but limited. While it has been highly successful in integrating global economies, facilitating cross-border capital investment and enabling the internationalisation of capital markets, financial reporting has intentionally not considered the interests of broader stakeholders. This has made the project of standardisation easier, but the economic focus on financial materiality to the exclusion of all else has, to a large extent, contributed to the crises we face today. Sustainability reporting must by definition take account of a wide group of interests, and is far more complex. The challenge for a global standard of sustainability reporting will be to make reporting coherent and comparable, without trivialising or ignoring real-life impacts.

5. Just Share's comments on the Consultation Paper are set out below. We have focused on the key issues that we believe must be dealt with before significant progress can be made towards the achievement of consistent, comparable and decision-useful sustainability reporting. Our comments are divided into two parts. In Part I we provide general comments in relation to the Consultation Paper as a whole. In Part II we provide our responses to some of the questions asked by the IFRS Foundation in the Consultation Paper.

Part I. General Comments

6. The IFRS Foundation is right to note that having comparable and consistent standards will "allow business to build public trust through greater transparency of their sustainability initiatives, which will be helpful to investors and to an even broader audience in a context in which society is demanding initiatives to combat climate change."

7. The current situation, in which there are a number of different sustainability reporting standards and frameworks, means that reporting on sustainability is fragmented. At best the information is incomplete, at worst it is greenwashing and/or a deliberate manipulation or cherry-picking of information to portray the reporting entity in a favourable light.

8. Furthermore, the existing standards and frameworks, despite having obtained significant global reach, remain voluntary and without strong enforcement mechanisms or external verification. They are also applied inconsistently across jurisdictions and industries. The convergence and harmonisation of these standards on a global scale is an important tool in addressing the challenges related to climate change, the destruction of natural resources, and growing global inequality.

9. We recognise the advantages that the IFRS Foundation brings to the area of reporting, including its experience and track-record in setting reporting standards, institutional knowledge, and its global reach and relationships with key entities including governments, regulators and standard-setters. Such attributes are invaluable in creating a global, cohesive and widely-used framework for sustainability reporting.

10. However, we are concerned about a number of aspects of the IFRS Foundation's potential approach to sustainability reporting.

Limited scope of stakeholders

11. In the Consultation Paper, the IFRS Foundation lists relevant stakeholders as investors, the corporate sector, central banks, market regulators, public policy makers and auditing firms and other service providers. This list leaves out important stakeholders in the area of sustainability including, but certainly not limited to civil society, labour and affected communities.

12. Sustainability fundamentally encompasses challenges of such global importance and urgency that the inclusion of all interested and impacted stakeholders is essential if solutions to these challenges are to be just and equitable. This is also particularly important because civil society has played such a key role in putting sustainability issues, and particularly climate change, onto the agenda of the global financial sector.

13. In 1987, the Brundtland Commission defined sustainability as “development that meets the needs of the present without compromising the ability of future generations to meet their needs”.[1] Today, we understand that achieving this goal requires a radical transformation of the global economy, in particular in order to achieve a just transition away from fossil fuels. Sustainability is no longer understood as being confined to environmental issues: it encompasses social, economic, and environmental issues, all of which are interconnected.

14. A broad stakeholder base creates complexity but is also an advantage, and is essential if sustainability reporting is to achieve what IFRS asserts it should achieve. If the development of a global standard in sustainability reporting is limited to the stakeholders listed by IFRS, it will fail to achieve the kind of “social licence to operate” that such an initiative will need, in order to have real-world impact.

15. Across the globe, civil society activism has been a key driver of progress on ESG integration, sustainability reporting, climate risk disclosure and climate action. It is indisputable that civil society has played, and continues to play, a major role in shaping and driving the just transition to a low carbon economy, and sustainability reporting is a crucial source of the information that underpins strategic engagement and advocacy. Civil society and community activists are important consumers of both financial and sustainability reporting.

16. It is crucial, therefore, that the process of establishing a framework for sustainability reporting includes participation by civil society, labour, and affected communities who are important users of the information and are very often the subject of such reporting.

Climate first approach

17. Just Share understands the Task Force’s rationale for an initial focus on climate-related information. However, there appears to be a misperception reflected in the Consultation Paper relating to what ‘climate-related information’ entails. For example, the Consultation Paper refers to its proposed definition of climate-related information, which it says “could focus specifically on climate change and greenhouse gas emissions, or take into consideration wider environmental factors and the associated risks”. The Consultation Paper goes on to say that the “SSB could broaden its work over time to focus on other priorities beyond a specifically climate or environmental focus (for example into social and other related matters) as demands change.”

18. It is essential that the language of sustainability reporting acknowledges that climate change is a human rights issue which will profoundly affect every person on earth, and that the effects of climate change are already impacting the lives and livelihoods of many vulnerable communities across the world. Furthermore, climate change is intrinsically linked to biodiversity destruction and ecosystem collapse, and cannot be viewed in isolation from these severe environmental threats.

[1] Brundtland Commission (1987) “Our Common Future”, *Oxford University Press.*

19. We acknowledge the importance of getting started as soon as possible and starting with the most urgent risks. Unfortunately, however, precisely because of the urgency of tackling climate change, there is no time to take an incremental approach to sustainability reporting. The standards of sustainability reporting will inevitably develop and expand and a flexible structure that allows for this is crucial. However, the need for urgency must not lead the IFRS Foundation to compromise on the qualitative value of the standards it sets from the outset. Instead, it must begin as boldly and robustly as possible. In respect of climate change, the interrelationship between ESG factors is already clear and so should not be left for a later stage, as the Consultation Paper suggests.

Double-materiality

20. The Consultation Paper identifies the multidimensional character of sustainability reporting to include (a) the financial effects of relevant factors on the reporting entity – information relevant to investors and market participants and (b) the impact of reporting entities on their environment and communities – information relevant to broader set of stakeholders. However, these elements are increasingly interconnected and indistinguishable. The impact of companies on the environment is increasingly a financial consideration, rendering the distinction between the two less and less significant. The Recommendations of the Task Force on Climate-Related Financial Disclosures are a recognition of, and response to, the **financial materiality of climate change,** both because of the impacts of climate change on companies, and because of the impacts of their activities on global climate action goals**.** By the time the IFRS standards on sustainability reporting will be put into practice this distinction will be even less useful.

21. The purpose of sustainability reporting is surely (a) to provide a broad range of stakeholders with information that transparently and honestly reflects the impacts of companies on people and the environment, and (b) to allow those making financial decisions to integrate ESG impacts and risks into that financial decision-making. We therefore do not understand what is meant by the Consultation Paper's statement that "if established, the SSB would initially focus its efforts on the sustainability information most relevant to investors and other market participants". If this means that the focus will be only on information related to the effects of relevant sustainability issues **on the reporting entity**, then this appears to miss the point of ESG integration.

22. Limiting the scope of the sustainability standards may have the unintended effect of delaying the process of providing decision-useful reporting. If the IFRS Foundation does pursue this approach, then the full intended scope or set of standards must be included in the initial frameworks and in the SSB's foundation documents, accompanied by a timeframe for expansion of the standards.

Relationship between the International Accounting Standards Board (IASB) and the Sustainability Standards Board (SSB)

23. One of the 'requirements for success' suggested in the Consultation Paper entails "ensuring the current mission and resources of the IFRS Foundation are not compromised." The current mission of the IFRS Foundation is "to deliver robust, reliable and transparent information as input for the decisions of the ***primary users of general-purpose financial statements***. IFRS Standards are based on the concept of ***financial materiality*** [our emphasis]".

24. Financial reporting and sustainability reporting have fundamentally different rationales, as discussed above. The former involves the reporting entity providing "a compelling business case for the practice" while the other means "highlighting a broader contribution to society and its long-term interests".[2]

25. It is important that the IASB and SSB are able to share skills and learning but are kept appropriately independent.

Approach to fragmentation

26. The Consultation Paper notes that the diverse approaches of the various existing sustainability standards have resulted in an increasing global fragmentation in this area. Each framework or set of standards differs in scope, content, target audience and in the way that they are applied.

27. The Consultation Paper implies that an IFRS sustainability standard will be able to unify these, but does not provide any detail about how it will do so. Does the IFRS Foundation intend that the existing frameworks and standards are subsumed into one global set of standards? In that case, how does it intend to ensure that they do not become a matter of minimum compliance? It is crucial that the IFRS standards on sustainability reporting do not compromise on important areas of reporting covered by the existing initiatives.

28. Fragmentation also concerns the variable application of the standards across regions, jurisdictions and industries. Given the diverse approaches and levels of progress towards sustainability that exist between them, a sustainability framework needs to be broad enough to take into account the goals of the Paris Agreement, while allowing for some localised nuance and complexity. It must do this without creating a set of lowest common denominator standards. Most crucially, it must avoid the potential for reporting entities to use the reporting frameworks "opportunistically for the misrepresentation of facts".[3]

[2] Etzion, D., & Ferraro, F. (2010) "The Role of Analogy in the Institutionalization of Sustainability Reporting", *Organization Science, 21(5)* 1092-1107.

[3] Cherepanova V. (2017) "A Case for International Financial Reporting Standard on Sustainability: A Critical Perspective", *Journal of Management and Sustainability 7(2)* 79.

PART II. ANSWERS TO QUESTIONS FOR CONSULTATION

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?

29. Yes, there is a need for sustainability reporting that is globally comparable and consistent. The IFRS Foundation is well positioned to play a role in this regard. However, it is essential that it does so in full recognition of the fact that the focus purely on financial materiality has played a significant role in contributing to the current crises faced by humanity and the planet. It is not clear from the consultation paper that the Foundation is fully cognisant of the interconnectedness of financial and sustainability factors in determining materiality.

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?

30. The appropriateness of the SSB will depend on its mandate and its relationship to the IASB and the IFRS Foundation. It is important that it is treated separately and equally to the IASB in order to maintain the quality and legitimacy of the sustainability standards. It will also depend significantly on the expertise included on the SSB, which must include representatives of the wide group of stakeholders who are users of sustainability reporting.

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)?

31. The willingness and role of existing sustainability reporting initiatives is crucial and we support the inclusion of this as a requirement for success of this project. It is critical not to lose any of the momentum gained by the wide recognition of some of the existing initiatives, such as the Recommendations of the Task Force on Climate-related Disclosures (TCFD).

32. The requirement that the establishment of the SSB does not compromise the current mission of the IFRS Foundation must be removed as it implies a hierarchy or preference for the existing framework. The rationale of sustainability reporting is fundamentally different to that of financial reporting. They do not serve precisely the same function. If that were the case, there would be no need for sustainability reporting.

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

33. The core principle that must underlie the IFRS Foundation's work with existing initiatives is to ensure that it establishes the highest possible set of standards that harmonises the best of

existing standards. It is counter to the idea of sustainability to produce a culture of minimum-compliance or a “race to the bottom".

34. The IFRS Foundation must commit to a process of harmonisation, which means capturing the best of different standards and producing the highest common denominator, while eliminating differences to increase comparability. It raises the overall level of reporting. This is as opposed to standardisation, which involves creating a uniform system that constitutes the lowest common denominator, or results in regression.[4] The latter is incompatible with sustainability reporting in a time of a global sustainability crisis**.**

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?

35. Just Share understands the Task Force’s rationale for an initial focus on climate-related information. However, there appears to be a misperception reflected in the consultation paper relating to what ‘climate-related information’ entails. For example, the Consultation Paper refers to its proposed definition of climate-related information, which it says “could focus specifically on climate change and greenhouse gas emissions, or take into consideration wider environmental factors and the associated risks”. The Consultation Paper goes on to say that the “SSB could broaden its work over time to focus on other priorities beyond a specifically climate or environmental focus (for example into social and other related matters) as demands change.”

36. It is essential that the language of sustainability reporting acknowledges that climate change is a human rights issue which will profoundly affect every single person on earth, and that the effects of climate change are already impacting the lives and livelihoods of many vulnerable communities across the world. Furthermore, climate change is intrinsically linked to biodiversity destruction and ecosystem collapse, and cannot be viewed in isolation from these severe environmental threats.

37. We acknowledge the importance of getting started as soon as possible and starting with the most urgent risks. Unfortunately, however, precisely because of the urgency of tackling climate change, there is no time to take an incremental approach to sustainability reporting. The standards of sustainability reporting will inevitably develop and expand and a flexible structure that allows for this is crucial. However, the need for urgency must not lead the IFRS Foundation to compromise on the qualitative value of the standards it sets from the outset. Instead, it must begin as boldly and robustly as possible. In respect of climate change, the interrelationship between environmental, social and governance factors is already clear and so should not be left for a later stage, as the Consultation Paper suggests.

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

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[4] Cherepanova V. (2017) “A Case for International Financial Reporting Standard on Sustainability: A Critical Perspective”, *Journal of Management and Sustainability 7(2)* 80

38. See above.

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

39. The Consultation Paper identifies the multidimensional character of sustainability reporting to include (a) the financial effects of relevant factors on the reporting entity – information relevant to investors and market participants and (b) the impact of reporting entities on their environment and communities – information relevant to broader set of stakeholders. However, these elements are increasingly interconnected and indistinguishable. The impact of companies on the environment is increasingly a financial consideration, rendering the distinction between the two less and less significant. The Recommendations of the Task Force on Climate-Related Financial Disclosures are a recognition of, and response to, the **financial materiality of climate change,** both because of the impacts of climate change on companies, and because of the impacts of their activities on global climate action goals**.** By the time the IFRS standards on sustainability reporting will be put into practice this distinction will be even less useful.

40. The purpose of sustainability reporting is surely (a) to provide a broad range of stakeholders with information that transparently and honestly reflects the impacts of companies on people and the environment, and (b) to allow those making financial decisions to integrate ESG impacts and risks into that financial decision-making. We therefore do not understand what is meant by the Consultation Paper's statement that "if established, the SSB would initially focus its efforts on the sustainability information most relevant to investors and other market participants". If this means that the focus will be only on information related to the effects of relevant sustainability issues **on the reporting entity**, then this appears to miss the point of ESG integration.

41. Limiting the scope of the sustainability standards may have the unintended effect of delaying the process of providing decision-useful reporting. If the IFRS Foundation does pursue this approach, then the full intended scope or set of standards must be included in the initial frameworks and in the SSB's foundation documents, accompanied by a timeframe for expansion of the standards.

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?

42. Yes – the biggest problem with existing sustainability reporting initiatives is that they do not provide for any external verification. However, the accounting and auditing professions are not trained to verify sustainability information. External assurance is only reassuring if users of the information trust that those doing the assurance are experts in the area that they are verifying.

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

43. See Part I of our submission and the conclusion below.

Conclusion

44. The Consultation Paper emphasises the "urgent need to improve the consistency and comparability in sustainability reporting". The key aspect of this is **urgency**. The world needs to act fast to address climate change and the many other social and environmental challenges which climate change will exacerbate. Sustainability reporting is a crucial tool in determining who is doing what needs to be done, and who is not. The IFRS Foundation occupies a unique position in which it can leverage its institutional knowledge and experience, and its extensive relationships to ensure broad acceptance of a global framework that is coherent and cohesive.

45. However, such a framework must be aimed at the full range of users of such reports including the investors and market participants, civil society, labour and affected communities. A global framework on sustainability reporting must reach for the highest possible standard of reporting, allowing for the complexity of regional and sectoral characteristics. It is only by taking a bold approach to sustainability reporting – introducing a framework that is comparable, auditable, and reliable, that the global community will be in a position to plan and implement a just transition to a low carbon economy, with the urgency it requires.

46. We thank the IFRS Foundation for the opportunity to comment on this Consultation Paper. Kindly keep us updated as this process progresses.

Yours faithfully
JUST SHARE

per:

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