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ED - IFRS S1 General Requirements for Disclosure of Sustainability-Related Financial Information

I welcome this opportunity to make a submission and would like to comment both generally as well as for specific questions.

General Comment

The development of general purpose financial reporting has been guided for the last 60 years by what we now refer to as conceptual frameworks. This is currently provided by the Conceptual Framework for Financial Reporting, and the concepts underpinning this can be traced to Accounting Research Study No.1, The Basic Postulates of Accounting by Moonitz published in 1961, and Accounting Research Study No. 3, A Tentative Set of Broad Accounting Principles for Business Enterprises by Sprouse and Moonitz published in 1962 by the AICPA. These frameworks identify the objective(s) of financial reporting, the user(s) of financial reports and how the information in financial reports is used. Importantly, this provides fundamental guidance on the scope and content of financial reports. It also provides a discipling mechanism on standard setters and it has contributed to the quality of general purpose financial reports.

Unfortunately, it does not seem that this has been properly considered in the context of what I interpret as an attempt to develop a framework for sustainability reporting. Perhaps the most obvious evidence of this is the emphasis given to the determination of 'enterprise value' in the objective of sustainability reporting (para 1). I believe this is a legacy of strategies to legitimize sustainability reporting and identifying its significance (which we are beyond). Problematically it identifies one specific use of sustainability information, and scant consideration is given to whether this is appropriate for users of information more generally, or how it might be used more generally (i.e., too restrictive).

Furthermore when read in conjunction with S2 it suggests the adoption of a 'stakeholder view' of the firm, where the purpose of reporting is less well developed. This leads to an unfocused consideration of reporting on 'sustainability' generally / widely. Hence the reference to 'enterprise value'. The relevance of this to users generally is not well established. This contrasts with the Conceptual Framework for Financial Reporting which arguably adopts are ‘shareholder view’ and identifies the provision of information for decision making as central to the objective of financial reporting.[1] Critically, this provides a broad understanding of the objective of financial reporting, and this could overflow into sustainability reporting. Most problematically, if financial and sustainability reports are prepared on different bases it makes it difficult to envisage how there can be articulation / connectivity.

There are other consequences arising from not understanding who the users of the information are and how the information is used, including:

1. What ‘sustainability reporting’ should include and the extent to which this can / should be addressed by Sustainability Standards. For example, financial reporting has generally emphasized outcomes from business operations (e.g., sales and earnings and information relevant to assessing future outcomes for earnings) that are (obviously) relevant for decision making. How governance mechanisms are relevant for decision making is less obvious and are not addressed in financial reporting standards. Furthermore, extending sustainability reporting to include governance mechanisms requires assumptions about whether they are necessary and sufficient. A concerning feature of the exposure draft is that it places considerable emphasis on inputs and controls (e.g., governance mechanisms) and there is little rigorous empirical evidence of a causal relation with sustainability outcomes. Most of the governance and management issues addressed in the exposure draft would be more appropriately addressed in domestic legislation, or bodies providing guidance to directors, which would recognize idiosyncrasies in domestic legal and economic environments.
2. How sustainability reporting should address the complication of corporations operating in multiple jurisdictions (industries) with differing legislative requirements (e.g., targets)?
3. How sustainability reporting should address the issue of comparability when corporations adopt different business structures (e.g., leading to differences in Scope 1/2/3 emissions). This might also contribute to corporations adopting different business structures to achieve reporting outcomes (i.e., regulatory arbitrage). There is also the challenge of firms being able to determine volumes of scope 1/2/3 emissions reliably and for this to be verifiable.
4. Finally, the approach seems more consistent with reporting to government, and facilitating aggregation across firms within an economy. This is inconsistent with users and uses more generally and is arguably beyond the scope of general purpose reporting as governments can legislate for the provision of this information. Furthermore, there will be different concerns across jurisdictions. These may be reflective of differences in economic factors but may also be opportunistic as countries endeavor to attracting business (in the same fashion as income tax determination differs and this creates benefits for tax haven).

For these reasons I would recommend that emphasis be given in the objective of sustainability reporting as the ‘provision of information for decision making’. This will allow proper consideration of ‘users’ and ‘uses’, and allow co-existence of the financial and

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[1] This might be argued, but when the Conceptual Framework is considered in conjunction with a range of accounting standards (including but not limited to IFRS 3 Business Combinations, IFRS 9 Financial Instruments, IFRS 11 Joint Arrangements and IFRS 16 Leases) this is more apparent.

sustainability reporting frameworks. It will also provide clearly defined limits on sustainability reporting (not management).

Specific Comments

1. As discussed above I think the focus on 'enterprise value' is problematic, and it would be more appropriate to focus on the 'provision of information for decision making'. This would still lead to consideration of the provision of information about the timing and uncertainty of future cash flows, and this would align well with financial report information. Para 6(b) is consistent with this. Whether this should extend as broadly as suggested other parts of para 6 is doubtful. For example, matters addressed in para 6(a), (c) and (d) most probably belong in the management discussion and analysis rather than the financial report. I am doubtful that this information can be standardized sufficiently for it to addressed with comparability in sustainability standards / reports. This identifies a major constraint in standard setting that seems to have been ignored. The outcome must be the provision of information that is consistent in nature and comparable across firms (not subject to interpretation and variable across firms).
2. The objective is clear, albeit problematic for the development of sustainability standards (as discussed above) and for this reason I would argue for the 'provision of information for decision making as the objective of financial reporting.
3. The issue of scope is highly problematic due to the broadness of the objective of sustainability reporting. Hence it is unlikely to guide standard setting in a meaningful manner.
4. The core content is too broad and unfocused and whether this can be addressed appropriately (i.e., standarized) is highly doubtful. Para 22 is appropriate and consistent with an objective of providing information for decision making.
5. If there is to be connectivity / articulation between financial reports and sustainability reports there must be consistency. Whether or how this extends to sustainability across the supply chain is not addressed. Nor are potential issues arising from firms operating in different jurisdictions.
6. Connectivity is critical. Whether this is possible with differing objectives is doubtful.
7. I am unsure how the determination of fair presentation can be outsourced (i.e., SASB), as this creates potential problems with inconsistency.
8. Materiality is important if reporting is restricted to physical / virtual reporting occurs. If digital financial reporting is prescribed this becomes irrelevant.
9. Agreed, if there is to be connectivity / articulation.
10. If sustainability reporting was to be addressed entirely in the general purpose financial report it would significantly increase complexity, and undermine readability. For this reason any development of sustainability reporting should be done in conjunction with development of digital financial reporting.
11. Agreed.
12. Agreed.
13. No comment
14. If jurisdictions go beyond the requirements of ISSB standards that is not an issue. In this regard it is worth remembering that standards should focus on matters where a consensus exists, and should not seek to be exhaustive which appears to be feature of both the current exposure drafts (i.e., S1and S2).

15. Sustainability reporting and digital financial reporting must be addressed concurrently to avoid complexity and ensure understandability of general purpose financial reports.

I would like to conclude by saying that I believe that it is appropriate that the boundaries of reporting be extended, and this is potentially disclosing information relevant for determining the future prospects of firms. However, if this is to be realized it must be developed on a solid foundation.

Yours faithfully

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ED - IFRS S2 Climate-related disclosures

I welcome this opportunity to make a submission and would like to comment both generally as well as for specific questions.

General Comment

A feature of the reporting framework and financial reporting standards generally is that they have systematically addressed diverse issues, and this has been achieved through a broad range of standards. For example, in relation to assets there are standards including IAS 2 Inventories, IAS 16 Property Plant and Equipment, IAS 38 Intangible Assets and IAS 40 Investment Property. This has allowed a systematic and focused consideration of the issues arising in relation to each asset type.

This approach seems to have been ignored with the development of this exposure draft, that seeks to address the issue of climate change generally, with a standard that focuses specifically on carbon emissions. Consequences of this are that:

1. It dictates how carbon emission information should be used. If there are changes in our understanding of the impact of carbon emissions this will dictate changes to the standard (hence why standards should not dictate the use of information).
2. Notwithstanding the concern with climate disclosures generally, reference is only made to carbon emissions. No consideration is given to non carbon emissions that may have climate impacts. Alternatively, if emissions are standardized as carbon emissions is this the appropriate measurement mechanism (i.e., currency). Is this to be addressed by constant amendment of the standard to broaden its scope which will be challenging for users and preparers. Does this imply processes for recognition and measurement are beyond the scope of the standard and how will these be determined.
3. More generally, why should environmental impacts be limited to consideration of climate change. Maybe, pollution by heavy metals or other pollutants that contribute to ‘acid rain’ is a more immediate issue.
4. Perhaps most critically there is insufficient consideration of issues associated with the recognition and measurement carbon emissions and this is most obvious in relation to the consideration of scope 1/2/3 emissions. Does this imply processes for recognition

and measurement are beyond the scope of the standard, and if so how will these be determined.

A more appropriate strategy would have been to develop a standard limited to the 'reporting of carbon emissions'. This would be less subject to value judgements, and allow a clearer focus on what needs to be addressed if information is to be provided for decision making. Furthermore, this would eliminate the need for much of the content in S2 which is better addressed in S1 and contributes to S2 being highly repetitive and unnecessarily complex. Bearing in mind that there should be connectivity between financial and sustainability reporting the focus should be on para 14.

Specific Comments

1. As discussed in relation to the exposure draft for IFRS S1 I believe the focus on 'enterprise value' is problematic, and it would be more appropriate to focus on the 'provision of information for decision making'. This would still lead to consideration of the provision of information about the timing and uncertainty of future cash flows, and this would align well with financial report information. Whether this should extend as broadly as suggested in para 5 is doubtful. Most of the issues addressed in para 5 probably belong in the management discussion and analysis rather than the financial report. I am doubtful that this information can be standardized sufficiently for it to addressed with comparability in sustainability standards. This identifies a major constraint in standard setting that seems to have been ignored. The outcome of standards must be the provision of information that is consistent in nature and comparable across firms (not subject to interpretation and variable across firms) and is useful to users and does not pre-empt decisions.
2. Reporting, both financial and sustainability, should give prominence to reporting actions and outcomes. I struggle to understand how governance information is appropriately addressed in reporting standards and an implicit assumption is that the governance mechanisms are appropriate, necessary and suffucent.
3. By considering climate risks generally and then focusing on carbon emissions this is too open ended and vague.
4. Consideration of the value chain and emissions beyond Scope 1 is problematic. How can this be addressed in a reliable and verifiable means is not considered and I doubt that it can be addressed successfully. For example, it is not possible to determine standards for carbon emissions used in the construction of an aircraft for an airline as there may be significant differences across manufacturers both in products and processes. There may also be significant differences in the carbon emissions in the manufacturing process that are impacted by whether electricity used is from coal, nuclear, wind or solar sources. Put simply, firms can only report what they do.
5. It is not appropriate to address this is a reporting standard.
6. It is not appropriate to address this is a reporting standard.
7. It is not appropriate to address this is a reporting standard.
8. It is not appropriate to address this is a reporting standard.
9. Standards should be applied across firms equally, and be self sufficient. Furthermore, reporting elements should not be delegated. Many of these issues are already being addressed / considered in relation to digital financial reporting (i.e., extensions) and

the critical question is whether they should be addressed in reporting standards or addressed by firm voluntary disclosures, for which there will be economic incentives.

10. It is not appropriate to address this is a reporting standard.
11. See 9 above.
12. Compliance costs with the requirements of IFRS S1 and S2 would be significant and there is no rigorous empirical evidence suggesting any benefits.
13. Extending reporting beyond the entity (i.e., value chain and Scope 2/3) means that verifiability in impossible.
14. No Comment
15. The best manner for providing information on sustainability which is diverse and not capable of aggregation is digitally.

I would like to conclude by saying that I believe that it is appropriate that the boundaries of reporting be extended, and this is potentially disclosing information relevant for determining the future prospects of firms. However, it should focus on outcomes (not inputs) of firm activities (not others) and address in detail issues associated with recognition and measurement. A standard which focuses more specifically on measuring and reporting carbon emissions while more modest in intent would have been more appropriate.

Yours faithfully

Peter Wells