The Association of Accountants and Financial Professionals in Business

via email
To: commentletters@ifrs.org

July 29, 2022

Mr. Emmanuel Faber, Chair
International Sustainability Standards Board
IFRS Foundation
Columbus Building, 7 Westferry Circus
Canary Wharf
London E14 4HD, UK

Re: Exposure Draft (ED/2022/S1): *General Requirements for Disclosure of Sustainability-related Financial Information*
Exposure Draft (ED/2022/S2): *Climate-related Disclosures*

Dear Chair Faber:

IMA® (Institute of Management Accountants) writes to share its views on Exposure Draft (ED/2022/S1): *General Requirements for Disclosure of Sustainability-related Financial Information* (ED-S1) and Exposure Draft (ED/2022/S2): *Climate-related Disclosures* (ED-S2) (collectively EDs or Proposals).

IMA is a global association representing about 140,000 accountants and finance team professionals. Our members work inside organizations of diverse sizes, industries, and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations.

IMA is a member of the International Federation of Accountants (IFAC). IMA was a founding member of the International Integrated Reporting Council (IIRC) and under formal arrangement to work cooperatively with the Sustainability Accounting Standards Board (SASB). IMA is also a founding member of the Committee of Sponsoring Organizations of the Treadway Commission (COSO), which delivers generally accepted frameworks and guidelines for internal control and enterprise risk management.

Financial reporting/preparer perspective: IMA is uniquely qualified to provide careful and reasoned insight into the EDs. First, IMA's Financial Reporting Committee (FRC) represents highly experienced financial reporting professionals, including senior-level accounting officers from some of the largest companies in the world. The FRC also includes representatives from each of the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC, as a group, has significant and recognized expertise in reviewing and responding to proposed regulations, standards, and research projects in financial reporting. Importantly, the FRC generally provides preparers' perspectives, and these preparers are the corporate professionals who will be instrumental in implementing the EDs and connecting reported sustainability information to financial statements issued in accordance with applicable national laws and authoritative accounting principles.

Trust

In September 2021, led by our Sustainable Business Management Global Task Force, IMA issued a Statement of Position (IMA-SoP) containing nine fundamental principles that we believe must be incorporated into any newly issued sustainability reporting standards. As we emphasize in IMA-SoP Principle 1, trust, accountability, and transparency are the cornerstones of professional accountancy. Our work must build the public's trust. Expectations are for businesses to deliver on sustainability reporting with the same rigor, thoughtfulness, and energy used to deliver on mainstream financial reporting. Sustainability information must be high-quality and reliable; it must be produced through standards and processes that instill this trust.

The business community and market stakeholders have been supportive of the IFRS Foundation's amalgamation of sustainability standard setting largely because of trust. They expect that the IFRS Foundation, already experts in standard setting, will deliver high-quality and operational standards for sustainability that harmonize with existing, authoritative standards. Mindful that stakeholders are seeking an accelerated timeline, we nevertheless urge the International Sustainability Standards Board (ISSB) to proceed with thoughtful consideration in issuing standards that meet this expectation and that will continue to build trust in our profession.

We applaud the dedication and timeliness of the Foundation's establishment of the new ISSB and releasing the Proposals. As we note in the IMA-SoP, sustainability is largely a consideration of how we consider entities' use of precious resources and responsiveness to contributing stakeholders over the long term. We are currently experiencing unprecedented weather patterns across the globe, a demonstration of reality: What were once considered long-term financial risks are happening *now*. The accounting profession must respond accordingly.

Management's ability to take action on sustainability goals

IMA's Sustainable Business Management Global Task Force members emphasize that building sustainable businesses and economies cannot rely on external reporting alone. Accounting resources are limited, and accounting itself must be sustainable. That is, we believe that meaningful change will require accounting and finance information to be *actionable* by management (IMA-SoP Principle 2). As a result, as the ISSB moves forward, we urge that standard setters remain mindful that management is a user and stakeholder of sustainable business information. While we understand that the role of the ISSB is standard setting for external reporting, we do not want to see sustainability accounting become merely a compliance exercise. Producing high-quality information is a costly process. Therefore, the results of this process must be useful for decision making, or it is unsustainably wasteful. We emphasize that external reporting is only a small part of the overall transition that is needed for the business community to act responsibly.

Relevance to small and medium-size entities (SMEs)

Among IMA's membership is a large constituency of CFOs and controllers of SMEs. We observe that the work of the ISSB's predecessor organizations, in building voluntary standards, largely utilized the input of global organizations with significant resources to innovate and experiment around sustainability reporting. The SME community, however, has been largely absent from the building of these voluntary standards. Meaningful standard setting for sustainability must prioritize the needs of this constituency more effectively than the predecessor organizations during initial development (see IMA-SoP Principle 6).

As we have heard from our members, many of these constituents feel completely excluded from an active role in developing accounting for sustainability, and they view implementation of new reporting mandates as bewildering and costly. As a general proposition, we are observing that many SMEs find existing financial reporting standards increasingly less relevant to how they actually manage their businesses. With respect to sustainability, many small business professionals are telling us that they lack both understanding and requisite tools, such as benchmarking data, systems, and personnel.

We note that the EDs make reporting entities responsible for obtaining information from the "value chain," and our research shows that the adoption and implementation of sustainability standards as articulated in these EDs will require SMEs to deliver information, but not necessarily to the securities markets. Instead, external stakeholders, primarily large customers who will report on sustainable business issues, will require sustainability data as part of procurement stipulations and contract terms. The practicalities of this data delivery process and the potential, unspecified burdens and potential liabilities on SMEs appear to be absent from consideration in the EDs. Moreover, this data sharing along the value chain raises significant concerns around data quality and internal controls, which represents additional, unaddressed challenges.

Global alignment: authoritative vs. nonauthoritative guidance

We support the ISSB's effort to develop a single and comprehensive set of baseline global standards for disclosure of sustainability information aimed at primary users of financial reporting. A set of globally accepted standards that can be widely used will allow for consistent, comparable, and high-quality sustainable business reporting designed to meet the information needs of these users and the capital markets as a whole.

IMA strongly encourages the ISSB to work with other regulators and standard setters to consider the reporting responsibilities of corporate reporting teams in responding to the variety of new mandates around sustainability and climate accounting and disclosures. IMA observes that fragmentation has generally been detrimental to the development, implementation, and usefulness of reported sustainable business information (IMA-SoP Principle 7). Concurrently with the release of the EDs, the U.S. Securities & Exchange Commission (SEC) has released proposed rules on climate risk, and the European Commission, through its European Financial Reporting Advisory Group, is proposing new disclosure standards to support the implementation of its Corporate Sustainability Reporting Directive. Collaboration and harmonization are essential for corporate entities to comply through the delivery of meaningful information and for building reporting systems that engender trust.

Referencing existing guidelines, authoritative IFRS standards, and cohesive drafting

We welcome the incorporation of the Task Force on Climate-Related Financial Disclosures (TCFD), the Greenhouse Gas (GHG) Protocol, and the SASB standard into the EDs. These voluntary guidelines have served as a benchmark for sustainable business and climate-related disclosures. They have been widely recognized as useful, and many entities, securities markets, and governments have moved toward adoption.

However, a great many reporting entities have selected only portions of these sets of guidelines and adapted them for their own reporting agendas. The movement from voluntary reporting guidelines to authoritative standards must adhere to the rigors of IFRS standard setting. To some extent, the current EDs simply echo or read as a cut-and-paste exercise to satisfy the passionate perspectives of the predecessor organizations rather than create a cohesive standard with adequate connectivity to existing financial reporting concepts and standards that have been developed over decades through careful drafting and robust due diligence processes. With additional specificity, we note that the industry standards in ED-S2 address more topics than just climate, and the proposed guidance should explain how these requirements interact so that stakeholders can reconcile the requirements.

We believe that ISSB standards, to the extent possible, should refer to the concepts, definitions, and standards that are generally accepted in financial reporting. We urge the ISSB to ensure that the drafting of subsequent EDs and final standards use definitions consistently throughout a document without paraphrasing, eliminating, or changing wording.

We observe that ED-S1, in certain places, repeats or references language from IFRS standards, which we endorse. For example, the definition of “materiality” and “primary users of financial reporting” are taken word for word from authoritative IFRS standards. ED-S1 also incorporates, for example, existing IFRS standards on fair presentation, errors, frequency of reporting, and statement of compliance. Yet ED-S1 also introduces new language on estimation and outcome uncertainty that lacks harmonization with existing authoritative guidance, such as International Accounting Standard (IAS) 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* as we note in “Estimates and IAS 8.”

Importantly, the EDs do not make clear the aspects of the proposed standards that are mandated under IFRS and those that are supplemental and would be presented as management commentary. Today, management commentary under IFRS is driven either by jurisdictional regulation or voluntary reporting to meet stakeholder demand. In practice, the EDs would require many new subsections to management commentary, such as governance, strategy, risk management, and resilience that have not been part of IFRS mandates. Because preparers are responsible for implementation and reporting, they would require additional commentary on which aspects of the proposed disclosures are authoritative, which are part of mandatory IFRS compliance, and which are nonauthoritative or supplemental.

Clarity with respect to enterprise value (vs. impact accounting)

While we understand that there are passionate advocates for impact accounting, we urge the ISSB to be absolutely clear that it is using an enterprise value (or going concern value approach) in its incorporation of language from other frameworks. In this respect, references to “impacts and dependencies” appear to be an indirect path to satisfy proponents of impact accounting. It is likely to create confusion and add complexities to the goal of connectivity (see IMA-SoP Principle 9).

Enterprise value is a balance sheet-related concept in that it speaks to available resources (including expected resources) and corresponding claims to the entity's resources at *a point in time*. Critically, an explanation of how "sustainability information" *reconciles* to existing financial statements, particularly the balance sheet and statement of cash flows, is absent from the EDs. Instead of clarifying how this connects cohesively to the basic financial statements and accepted structures of financial reporting, it leaves labor-intensive, subjective interpretation to preparers and auditors. While we observe that large and well-funded organizations have engaged in the experimentation to report under vaguely written standards, workable guidance for connectivity needs to be considered and explicitly provided.

Under current financial reporting standards, a substantial portion of enterprise value remains unrecognized in financial statements because it is based on expectations of the future, and timing and measurement of ultimate realization is speculative. This value is subject to subjective judgment and multiple factors outside an entity's control. Rather than speak of impacts and dependencies, an elegant solution is to consider, conceptually, a "hidden balance sheet," which considers this unrecognized value as resources (assets) provided to the entity from multiple external stakeholders (resource providers), such as employees, vendors, customers, and governments (representing the community, taxpayers, and natural resources). These resource contributors allow the entity to *commingle* these assets in its operations with an expectation that the entity will use these resources wisely and not wastefully to generate benefits. In this way, standards for sustainability adhere to the existing concepts around basic financial statements and supplemental information.

Mainstream financial reporting standards use the terms "user" or "investor" to represent the market, but investors are not all the same. Some investors indeed aim to identify short-term market inefficiencies or buy securities to hold only for one to three years. However, there is a class of investors—long-term, passive, even generational investors—and their asset managers whose interests are not satisfied by financial reporting and its short-term focus. Over the decades, financial reporting has responded to the loudest voices in the room, which are often the shortest-term investors. For example, we can also look to the recent debate over the subsequent measurement of goodwill after an acquisition and whether impairment represents mispriced transactions. By definition, the goal of sustainability accounting is to provide more data for these investors about an entity's access and use of resources on behalf of its stakeholders over the long term. This is why among the strongest advocates for the development of sustainability accounting and reporting are long-term asset managers who are responsible for larger swaths of the economy such as BlackRock, the Bank of England, and the largest government employee pension funds.

Rather than enterprise value or market value, we note that perhaps the ISSB's ultimate objective is to provide information that supports long-term investors' estimation of *going concern value*, which is a well-understood, fundamental term in financial reporting. Although auditors formally evaluate going concern by looking ahead over a short-term period of one year, the term "going concern value" speaks to an entity's ability to survive and deliver benefits for its stakeholders as a whole, ongoing enterprise, which is the heart of sustainability.

In addition, while we agree with the cash flow approach to support enterprise value, we note that in some cases, transactions are not liquidated through cash, and reference (connectivity) to existing guidance and definitions would be beneficial (see IAS 7, *Statement of Cash Flows*). In addition, we note that in the sustainability arena, some stakeholders are satisfied with intangible, noncash benefits. For example, employees contribute human resources to an entity with the expectation of cash flows in the form of salary and benefits as well as intangible benefits of satisfaction. Nevertheless, although this intangible satisfaction component may be relevant to debt and equity investors, as a practical matter, our current economic and measurement tools are inadequate to capture these intangible returns.

<u>Estimates and IAS 8</u>

A key operational difference between estimation under mainstream financial accounting vs. sustainability accounting is time horizon: Sustainability reporting incorporates a long-term perspective that considers an entity's expected use of available resources and how it will satisfy the expectations of resource contributors. This necessarily requires preparers to gather data and develop additional assumptions for a longer term. This estimation necessarily becomes more qualitative, subjective, and variable for changing conditions. However, the nature of a reporting entity's estimation process is not different. We urge the ISSB to follow existing guidance in IAS 8, which addresses how an entity reports on changes in estimates.

We believe that use of estimation will be pervasive in the collation and analysis of sustainability data. However, as written, ED-S1 would require an entity to restate comparative information for changes in estimates, unless impracticable. We agree that restating previously issued estimates could impose a significant burden not only on preparers but also on their auditors. As a practical matter, retrospective restatement of previously issued estimates and reconsideration of assumptions require a reconsideration of the availability of information in the past. It also introduces liability to enterprises that in good faith relied upon information that was contemporaneously available. Restatements also jeopardize the full faith and trust in the sustainability reporting process. We note, however, that there is concern that in response to this risk, entities could use this as a means to issue generalized boilerplate disclosures that would evade meaningful updates.

In addition, with respect to disclosures regarding long-term expectations, it may be beneficial for reporting entities to provide a range of outcomes, such as best-case and worst-case scenarios.

<u>ED-S1 on connected information</u>

We believe that the section labeled "Connected Information," in the current draft of ED-S1, is too vague. For example, ¶43 requires an entity to "describe the relationships between different pieces of information."

In proposing disclosure of management's assessments, we suggest that the ISSB look to the current IFRS 8, *Operating Segments*, to understand the practicalities and challenges around the Chief Operating Decision Maker standards. Moreover, as noted previously, it would be beneficial for the ISSB to look to existing IFRS standards, to the extent possible, for guidance regarding the development and disclosure of forward-looking estimates (IAS 8).

Definition of “sustainability-related” or “climate-related”

In its comments to the SEC’s proposed rules on climate (Release 33-11042, *The Enhancement and Standardization of Climate-Related Disclosures for Investors; IMA-FRC response dated June 21, 2022*), the FRC raised the practical challenges of interpreting “climate-related” information, and this observation is equally applicable to the interpretation of the term “sustainability-related” and “significant.” From management’s perspective, the ultimate goal is to align and integrate sustainable business activities throughout organizational initiatives, programs, and activities to achieve climate targets. Therefore, interpretation and application of these terms may produce broad inconsistencies in practice, as some organizations classify certain activities as “sustainability-related” or “climate-related.” An unintended consequence of this inconsistency may be an invitation for the greenwashing that global stakeholders seek to avoid, as reporting entities designate information that does not reflect actual sustainable practices. Similarly, the FRC raised the challenges and potential inconsistencies in practice in how reporting entities characterize short-, medium-, and long-term risks and opportunities.

It is recommended that the ISSB provide clarification on the definition of “sustainability-related” to help preparers. Providing a clear definition of sustainability-related activities as well as illustrative guidance to highlight examples of these types of activities will help financial statement preparers focus on the appropriate risks and opportunities to assess for disclosure and improve comparability of the disclosures, which will benefit users who are seeking this information.

In addition, following from concerns regarding the interpretation of “sustainability-related,” for the proposed disclosure requirements to be operable, we recommend that the ISSB provide additional guidance on how to characterize or classify the purpose of an expenditure, which is rarely for a discrete, single purpose. For example, in relation to capital deployment toward climate-related risks and opportunities, an entity replacing a factory at the end of its life might take the opportunity to invest in innovative technology, which is both more efficient and reduces carbon emissions. Without additional guidance, we will likely see inconsistencies in how entities characterize and disclose expenditures.

Definition of “value chain” vs. “business model”

We note that the disclosure requirements outlined in ¶12 of ED-S2 may need additional clarification on the distinction between “value chain” and “business model.” While the two are related, the scope of risks and opportunities within the value chain and the business model are not the same. Therefore, in issuing high-quality, operable standards, it is important to ensure that the final guidance is clear and avoids using such terms interchangeably.

Technology

In IMA-SoP Principle 5, we emphasize the critical importance of utilizing technology in setting new standards at their inception. However, we note that consideration of synchronizing technology capabilities to minimize the burden of adoption appears to be absent from the EDs.

First, in aiming to minimize fragmentation, we encourage the ISSB/IFRS Foundation to continue to work with regulators and other standard setters on the global stage to issue standards that are interoperable. As noted previously, in building sustainable businesses and economies, use of accounting resources must be sustainable. In 2018, for example, the IFAC estimated that fragmented accounting regulations cost the financial sector alone $780 billion annually. There are enormous gains for the profession to produce interoperable reporting standards, and we can demonstrate sustainability by not wasting resources at the individual entity level and system-wide.

Second, when drafting and exposing standards, it is important for the ISSB to consider not only how professional humans will interpret the language but also how it will be translated into machine language. As noted herein, some of the phrasing in the reporting standards in the EDs is vague. The lack of precision may be acceptable if sustainability standards are voluntary. When moving to issue them authoritatively, precision and the use of technology must be considered so that preparers' technology solutions can deliver responsive data (and auditors can provide attestation). Our FRC preparers, for example, noted the significant and costly challenges of implementing new financial reporting standards (such as leases) when software providers were not ready to provide effective and functional solutions on time.

Adoption of TCFD recommendations

We observe that much of the proposed disclosures are based on the recommendations of the TCFD. As these reporting guidelines have been generally accepted by the market regarding climate-related disclosures, we agree that using these recommendations as a basis for standards is positive. We note that the SEC is also proposing new regulations for climate disclosures and has also largely looked to the TCFD guidelines.

While the TCFD guidelines have been widely considered thoughtfully developed and well drafted, we also note that many reporting entities are not yet providing disclosure around many categories called for under the TCFD recommendations, including governance, risk management, and strategy. Providing scenario analyses (as would be required under the Proposals) is virtually nonexistent. We observe that the key reason for this is the lack of reliable systems subject to robust internal control (IMA-SoP Principle 3) to produce compliant information. Without such systems, corporate preparers are reluctant to provide disclosures that may prove unreliable to the market. Moreover, many of the disclosures required in the EDs necessitate sourcing third-party data, including Scope 2 and Scope 3 emissions data, from an entity's value chain, but these entities (many of which may be SMEs) may lack reliable reporting systems.

To promote the disclosure of high-quality, reliable information in accordance with the value of trust, the hallmark of our profession, new climate change and other sustainable business disclosures that are not currently included in annual or quarterly processes require new financial reporting systems of oversight. Financial reporting professionals must be allowed the time and space to develop and implement effective systems to ensure the quality of material environmental, social, and governance (ESG) disclosures. Moreover, in the United States, public entities must adhere to rigorous internal control processes in compliance with the Sarbanes-Oxley Act (SOX).

Adoption of the GHG Protocol

We agree that the Greenhouse Gas (GHG) Protocol has become generally accepted with respect to the measurement and reporting of GHG emissions.

With respect to ED-S2, we appreciate the provision regarding Scope 3 emissions reporting at ¶21(a)(vi)(4), which permits an entity to exclude Scope 3 emissions if, for example, it is unable to obtain a faithful measure. As noted previously, reporting Scope 3 emissions requires the sourcing of data from third parties that may lack reliable information. We further believe that sourcing Scope 2 information from some suppliers may also raise certain concerns about reliance on third-party data.

Reporting entity, boundaries

The FRC agrees that, for large entities, an entity's sustainability and climate-related financial disclosures should reflect the same reporting entity as the related financial statements. Reiterating their comments to the SEC proposal, the FRC further believes that the ISSB should consider the cost benefit of providing sustainability and climate information for certain subsidiaries and provide exemptions.

We note, however, that many companies are using different boundaries (control-based) in their application of the GHG Protocol. The ISSB may need to address these differences in future standard setting.

Regardless of how an entity defines its reporting entity for sustainability reporting purposes, we recommend that the standard incorporate a requirement for a basis of preparation disclosure to make clearer to users what is and is not included in sustainability reporting, as well as the methodology or assumptions used, estimates made, and judgments taken.

Governance

The proposal to report an entity's processes, controls, and procedures is unprecedented in the corporate reporting arena. Even in the U.S., where public companies are subject to SOX, reporting entities do not describe their systems to the level of detail contemplated by the EDs. Instead, responsible directors and officers of entities with securities on public markets attest that the systems that are producing external reports are functioning as designed, and independent auditors issue further attestation as to the accuracy of these statements. Nowhere, however, are the actual detailed processes described. This requirement is entirely novel.

Therefore, the proposed governance disclosures are likely to be inconsistent with current regulatory requirements regarding director and officer responsibilities and disclosure schemes. Nevertheless, we note that the SEC, in its proposal, has exposed a similar requirement. We assume that regulators and standard setters will consider harmonizing legal obligations in moving forward toward implementation.

Moreover, the identification or designation of certain individuals as experts with responsibilities or oversight for a reporting entity's sustainability could raise individual liability risk. At the moment, reporting entities are experiencing challenges to identify and onboard professionals with adequate climate and sustainable business expertise, and this requirement could make the hiring of new corporate leaders in the sustainability arena even more difficult than it is today.

Effective dates and transition

We agree with the EDs' requirement for prospective implementation. A retrospective transition approach would make reporting much more burdensome to financial statement preparers.

We also agree that the guidance should not require the disclosure of comparative information in the first period of application.

We believe it would be beneficial to implement both ED-S1 and ED-S2 concurrently with the same effective date. However, given the complexity and scope of work involved, a phased effective date is recommended. For example, disclosure of metrics in the first year would be a major step forward. The ISSB can then require disclosures about governance and risk management in the second year, after the entity has had time to develop appropriate responses and consider first-year results and processes.

We anticipate that entities will need to make significant updates to their existing technology and financial reporting systems and controls, and invest in additional resources with requisite knowledge about sustainability and climate reporting to be able to produce reliable and verifiable disclosures. We recommend an effective date of one to two years after the final standard is issued to provide entities with the time to sufficiently prepare for the disclosures. The requirements that the disclosure of ED-S1 and ED-S2 be made available at the same time as existing financial reporting will take time for entities to achieve, particularly given the reliance on third-party information that is not available as timely as existing financial information. Without enough time to achieve this, some entities may delay the release of existing financial reporting, which would be detrimental to financial statement users.

We would be pleased to discuss our comments at your convenience.

Sincerely,

Jeffrey C. Thomson, CMA, CSCA, CAE
President and CEO
IMA® (Institute of Management Accountants)