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Mr Emmanuel Faber
Chair
International Sustainability Standards Board

28 July 2022

Dear Mr Faber,

Rolls-Royce plc thanks you for the opportunity to respond to the ISSB's Exposure Drafts, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, and *IFRS S2 Climate related Disclosures* (the 'EDs'). We are pleased to provide you with the following comments that we hope will contribute to the development of a high-quality set of international standards for corporate reporting on Environmental, Social and Governance (ESG) matters.

We welcome the aggregation of reporting requirements into a consistent set of high-quality international requirements to meet user needs while avoiding the unnecessary costs and risks to preparers that would result from continued fragmentation. From assessing the proposals in the EDs, we wish to highlight the following key areas where we suggest the Board gives further thought to the proposed requirements prior to finalisation of the standards.

- **We recommend defining what is meant by 'sustainability' in S1,** ensuring consistency with other major standard-setting initiatives and being as explicit as possible on the areas that are within its scope.

- **The use of terminology such as 'significant' and 'material' relating to the identification of risks and opportunities in S1 should be clarified and made consistent across the standard.**

- While we recognise that implementation will be a matter for individual jurisdictions, **we believe that a successful proposal would facilitate a staggered implementation, through the use of a comply or explain approach**.

- Our understanding is that a proposed timeline for the preliminary set of standards will be announced later this summer which we welcome. **It would be of great value to us, as we plan for developing the capabilities needed to deliver this reporting transformation, to have as much clarity as possible over the scope, timing and requirements for each new requirement.** We have some concerns over making investment to collate data and communicate risks and opportunities under S1 that might then require significant change as new standards are issued.

- **We have some reservations over the introduction of enterprise value as a measure of materiality**, although we understand the need to identify a suitable measure. Some of our concerns may be alleviated through enhanced definitions and the provision of further guidance or illustrative examples. We can see merits in alternative measures, such as a multiple of financial statement materiality, which would have the benefit of being more clearly aligned to existing financial reporting.

- We agree that in principle sustainability-related financial information should be provided for the same reporting entity as the related financial statements i.e. at consolidated Group level in the Rolls-Royce Holdings plc Annual Report. However, we would also highlight certain practical considerations that we think should be factored into the proposal. **In some cases, it may not be possible to gather the required sustainability information for all entities within the Group (i.e. where access to information is restricted by contracting or local legal restrictions), or it may be possible but extremely difficult in the desired timeframes. A comply or explain approach would be preferable.**

- We are very pleased to see that the existing TCFD framework has been leveraged for use as the foundation of the S2 proposal. While we support the intention to create uniformity, we have **some concern that requiring alignment to other external data sources provides a complex inter-relationship of documents and a risk that as other bodies issue amendments we will not be able to reflect them quickly enough to meet our external reporting deadlines**. Once again, a comply or explain method would ensure that meaningful disclosure could take place without undue negative connotations.

- We feel that there is an expectation of more forward-looking information being disclosed in S2 than is currently the case under TCFD. While we appreciate the merits of quantitative disclosures, **we have some concerns around lack of clarity of expectations in relation to disclosures of the forecast impact of climate-related risks and opportunities over the short, medium and long term that will cause uncertainty where assurance is required.** Medium and long-term forecast information is not generally provided (and would likely constitute the provision of forward guidance), hence, there is no clear baseline for disclosing the impact of climate quantitatively.

- It would be advantageous if the approach to **medium and long-term forecast information was consistent with new requirements emerging from the Department for Business, Energy & Industrial Strategy "Restoring trust in audit and corporate governance" consultation, specifically in relation to Resilience Statements.**

- **We recognise the appetite for understanding the current and anticipated effects of significant climate-related risks and opportunities in the value chain, and are of the view that these should be permitted to be qualitative rather than quantitative.** The lack of commercial entitlement to all the required data; the difficulty of making estimates; and the complexity of collating full year data in line with our normal reporting requirements, mean that in our view providing quantitative information may be impracticable.

- Whilst we recognise the need for improved disclosure and coverage of additional material areas to meet user's needs, we do note that our 2021 sustainability disclosures extend to 18 pages and, given S1 is much broader and S2 contains additional requirements, we would therefore expect our reports to become significantly longer even before further standards are released. On this basis we feel it is **extremely important that the standards avoid the need to report immaterial information.**

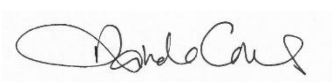
- **We recommend that further thought is given on how to introduce industry-based guidance in S2 and would prefer (i) making such disclosures optional (rather than mandatory) to enable Groups with activities crossing different sectors to focus on the data that is most meaningful to users, and (ii) a phased application of such requirements.** We believe that we should be able to apply judgement to disclose information in what we consider the most appropriate way to reflect the risks and opportunities. We may choose to include disclosure of the information in Appendix B, but for a Group such as ourselves that operates in multiple markets, we believe that concentrating disclosure on our primary areas of operation provides better and more focused reporting. We note that paragraph B 1 currently states that "in applying this [draft] Standard, an entity that participates in a particular industry would be required to provide the information set out in these requirements."

- **We also question whether the development of thinking across all reporters for all of the metrics covered by Appendix B is sufficiently mature to support mandatory disclosure at this time**, for example, in relation to disclosures around the use of internal carbon prices.

We also include some more detailed comments in relation to the questions outlined in ED S1 within the Appendix this letter. We have sought to be clear and constructive in our feedback which we hope helps to provide you with useful insight as you move to the next stage of the project.

In case you have any questions or comments, please do not hesitate to contact me.

Yours sincerely,



Pamela Coles
Chief Governance Officer

Appendix 1: Additional comments in relation to IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*

Question 1 Overall approach

(a) Does the Exposure Draft state clearly that an entity would be required to identify and disclose material information about all of the sustainability-related risks and opportunities to which the entity is exposed, even if such risks and opportunities are not addressed by a specific IFRS Sustainability Disclosure Standard? Why or why not? If not, how could such a requirement be made clearer?

(b) Do you agree that the proposed requirements set out in the Exposure Draft meet its proposed objective (paragraph 1)? Why or why not?

(c) Is it clear how the proposed requirements in the Exposure Draft would be applied together with other IFRS Sustainability Disclosure Standards, including the [draft] IFRS S2 Climate-related Disclosures? Why or why not? If not, what aspects of the proposals are unclear?

(d) Do you agree that the requirements proposed in the Exposure Draft would provide a suitable basis for auditors and regulators to determine whether an entity has complied with the proposals? If not, what approach do you suggest and why?

Our response

We think the requirements covered by the questions above have been met, however, we believe the following points are worthy of further consideration:

- There is some circular drafting and cross referencing which does not make the standard as user friendly as it could be. For example: paragraph 19 only refers to paragraphs 16 and 51.
- We would welcome a definition of what is meant by, and covered by, the term sustainability.
- We believe that enterprise value, as the basis for sustainability reporting materiality, should be defined and addressed much earlier within the standard. This concept has never been defined in the context of International Financial Reporting Standards and we believe that establishing it up front will help users. The inclusion of more illustrative examples in this area would also be beneficial.

Question 2 Objective (paragraphs 1–7)

The Exposure Draft focuses on information about significant sustainability-related risks and opportunities that can reasonably be expected to have an effect on an entity's enterprise value.

(a) Is the proposed objective of disclosing sustainability-related financial information clear? Why or why not?

(b) Is the definition of 'sustainability-related financial information' clear (see Appendix A)? Why or why not? If not, do you have any suggestions for improving the definition to make it clearer?

Our response

The objective is clear. However, we do believe that the addition of a definition of 'sustainability' would have value.

We also note that paragraph 3 (and repeated in paragraph 53) requires reporting entities to prepare 'neutral' sustainability-related financial information. We consider use of "fair presentation" as used in paragraphs 45 to 49 to be a more appropriate terminology and avoids the use of multiple terms in the same context. In the UK under the Corporate Governance Code, we are required to confirm that our annual report and accounts, taken as a whole, are fair, balanced and understandable to enable users to assess an entity's performance, strategy and business model. We believe that a similar approach in the sustainability-related disclosures would provide more consistency.

Question 3 Scope (paragraphs 8–10)

Do you agree that the proposals in the Exposure Draft could be used by entities that prepare their general-purpose financial statements in accordance with any jurisdiction's GAAP (rather than only those prepared in accordance with IFRS Accounting Standards)? If not, why not?

Our response

We believe that the proposals are suitably drafted to meet this ambition, however, we are IFRS preparers and our experience of other GAAPs is mainly restricted to local entity statutory reporting.

Question 4 Core content (paragraphs 11–35)

The Exposure Draft includes proposals that entities disclose information that enables primary users to assess enterprise value. The information required would represent core aspects of the way in which an entity operates.

- **(a) Are the disclosure objectives for governance, strategy, risk management and metrics and targets clear and appropriately defined? Why or why not?**
- **(b) Are the disclosure requirements for governance, strategy, risk management and metrics and targets appropriate to their stated disclosure objective? Why or why not?**

Our response

We believe that the objectives are clear and appropriate, however, without specific examples they are open to interpretation.

We understand the need to provide the financial impact of sustainability-related risks and opportunities on the financial statements, however, it would be helpful to incorporate specific illustrative examples of the requirements of paragraph 22 to ensure consistent application. We feel that there is an expectation of more forward-looking information being disclosed in S2 than is currently the case under TCFD. While we appreciate the merits of quantitative disclosures, we have some concerns around lack of clarity of expectations in relation to disclosures of the forecast impact of climate-related risks and opportunities over the short, medium and long term that will cause uncertainty where assurance is required. Medium and long-term forecast information is not generally provided (and would likely constitute the provision of forward guidance), hence, there is no clear baseline for disclosing the impact of climate quantitatively. It would be advantageous if the approach to medium and long-term forecast information was consistent with new requirements emerging from the BEIS "Restoring trust in audit and corporate governance" consultation, specifically in relation to Resilience Statements.

In principle we agree with the proposed requirement to include metrics and report performance against those metrics. However, the disclosure requirements included in paragraphs 27 through 35 are extensive and we would challenge how this aligns with paragraph 48 regarding not disclosing immaterial information to the extent it obscures material information. While in isolation each disclosure requirement is not unreasonable, when considered in totality and scaled up across multiple sustainability-related risks, it will represent a significant level of disclosure. While understanding the basis of each metric being reported, there has to be a balance of providing clear and concise information and meeting the material needs of users.

Question 5 Reporting entity (paragraphs 37–41)

The Exposure Draft also proposes that an entity disclose the financial statements to which sustainability-related financial disclosures relate.

- **(a) Do you agree that the sustainability-related financial information should be required to be provided for the same reporting entity as the related financial statements? If not, why?**
- **(b) Is the requirement to disclose information about sustainability-related risks and opportunities related to activities, interactions and relationships, and to the use of resources along its value chain, clear and capable of consistent application? Why or why not? If not, what further requirements or guidance would be necessary and why?**
- **(c) Do you agree with the proposed requirement for identifying the related financial statements? Why or why not?**

Our response

We agree that sustainability related information should be provided for the same entity as covered by the related financial statements. However, we have a number of concerns around the proposed disclosure requirements for subsidiaries and joint arrangements where we are unclear how sustainability data would be incorporated under different levels of ownership interest. Paragraph 40(c) requires disclosure relating to investments that the reporting entity controls, including associates and joint ventures. Under IFRS Accounting Standards, associates and joint ventures are not controlled undertakings and we therefore recommend such reference is clarified.

We would also flag the practical considerations to be factored into the proposal. In some cases it may not be possible to gather the required information where access is restricted by contract or local legal restrictions. In other cases, it may be possible but difficult to collect and obtain assurance in the desired timeframes.

Question 6 Connected information (paragraphs 42–44)

(a) Is the requirement clear on the need for connectivity between various sustainability-related risks and opportunities? Why or why not?

(b) Do you agree with the proposed requirements to identify and explain the connections between sustainability-related risks and opportunities and information in general purpose financial reporting, including the financial statements? Why or why not? If not, what do you propose and why?

Our response

We believe that the requirement is clear on the need for connectivity and with the proposed requirements. However, we request that further guidance, including illustrative examples, be given.

Question 7 Fair presentation (paragraphs 45–55)

(a) Is the proposal to present fairly the sustainability-related risks and opportunities to which the entity is exposed, including the aggregation of information, clear? Why or why not?

(b) Do you agree with the sources of guidance to identify sustainability-related risks and opportunities and related disclosures? If not, what sources should the entity be required to consider and why? Please explain how any alternative sources are consistent with the proposed objective of disclosing sustainability-related financial information in the Exposure Draft.

Our response

The proposal is clear and we agree with the sources of guidance. However, we do have concerns regarding the ability to comply if we need to consider all pronouncements and peer reporting up until the date of reporting. By its nature, a risk assessment is a time intensive task and it would not be possible in all circumstances to re-perform to reflect changes in source data whilst still meeting our reporting timetable.

Question 8 Materiality (paragraphs 56–62)

(a) Is the definition and application of materiality clear in the context of sustainability-related financial information? Why or why not?

(b) **Do you consider that the proposed definition and application of materiality will capture the breadth of sustainability-related risks and opportunities relevant to the enterprise value of a specific entity, including over time? Why or why not?**

(c) **Is the Exposure Draft and related Illustrative Guidance useful for identifying material sustainability-related financial information? Why or why not? If not, what additional guidance is needed and why?**

(d) **Do you agree with the proposal to relieve an entity from disclosing information otherwise required by the Exposure Draft if local laws or regulations prohibit the entity from disclosing that information? Why or why not? If not, why?**

Our response

We do not consider that the definition of materiality is sufficiently clear to be sure that it would be applied as intended. Paragraph 2 states that materiality shall be made in the context of enterprise value, defined as the sum of the value of the entity's equity (market capitalisation) and the value of the entity's net debt. We believe further guidance is required to understand the use of enterprise value in this context.

Questions raised internally that would require guidance, include does this make sense when market capitalisation can be influenced by short to medium term factors where volatility in share price could lead to possibly frequent changes in what are considered material risks and opportunities. The Exposure Draft is silent on how to calculate net debt for the purpose of determining the enterprise value.

Alternative measures of materiality, such as a multiple of financial statement level materiality would have the benefit of being clearly aligned to existing financial reporting.

Question 9 Frequency of reporting (paragraphs 66–71)

Do you agree with the proposal that the sustainability-related financial disclosures would be required to be provided at the same time as the financial statements to which they relate? Why or why not?

Our response

We are supportive of the intent but note the significant burden on resources in an already time intensive reporting period. The breadth of topics that may fall under the scope of S1, the requirement to obtain data from joint arrangements and to reflect changes in underlying data could make it impossible to meet reporting deadlines. An annual reporting timescale will not always fit with an assessment of long-term sustainability risks. The use of a comply or explain mechanism has merit in such cases.

We believe that interim reporting should only be required by exception, where there has been a material change to the previously reported full year position. We seek further clarification on paragraph 71 which we think tries to address post balance sheet events, but we would find some examples helpful.

Question 10 Location of information (paragraphs 72–78)

The Exposure Draft proposes that an entity be required to disclose information required by the IFRS Sustainability Disclosure Standards as part of its general-purpose financial reporting i.e. as part of the same package of reporting that is targeted at investors and other providers of financial capital. However, the Exposure Draft deliberately avoids requiring the information to be provided in a particular location within the general-purpose financial reporting. Information could also be included by cross-reference, provided that the information is available to users Do you agree with the proposals about the location of sustainability-related financial disclosures? Why or why not?

(a) Are you aware of any jurisdiction-specific requirements that would make it difficult for an entity to provide the information required by the Exposure Draft despite the proposals on location?

(b) Do you agree with the proposal that information required by IFRS Sustainability Disclosure Standards can be included by cross-reference provided that the information is available to users of general-purpose financial reporting on the same terms and at the same time as the information to which it is cross referenced? Why or why not?

(c) Is it clear that entities are not required to make separate disclosures on each aspect of governance, strategy and risk management for individual sustainability-related risks and opportunities, but are encouraged to make integrated disclosures, especially where the relevant sustainability issues are managed through the same approach and/or in an integrated way? Why or why not?

Our response

We believe that the required information can be provided and we support integrated disclosures. We see the ability to cross-reference as important, especially with Annual Reports becoming longer due to new requirements.

Question 11 Comparative information, sources of estimation and outcome uncertainty, and errors (paragraphs 63–65, 79–83 and 84–90)

The Exposure Draft also includes a proposed requirement that financial data and assumptions within sustainability-related financial disclosures be consistent with corresponding financial data and assumptions used in the entity's financial statements, to the extent possible.

(a) Have these general features been adapted appropriately into the proposals? If not, what should be changed?

(b) Do you agree that if an entity has a better measure of a metric reported in the prior year that it should disclose the revised metric in its comparatives?

(c) Do you agree with the proposal that financial data and assumptions within sustainability-related financial disclosures be consistent with corresponding financial data and assumptions used in the entity's financial statements to the extent possible? Are you aware of any circumstances for which this requirement will not be able to be applied?

Our response

We recognise that this is an area where improvement in metrics will be a feature as time passes. We agree that where practical, prior year disclosures should be restated to reflect the better measures, however there are likely to be practical considerations to consider. We believe comparative information should only be amended if there is a change in policy or the identification of an error (rather than a change in estimate)

Until the full breadth of reporting across a range of sustainability risks and opportunities are understood there may be cases where retrospective remeasurement might not be possible (or the where the cost / benefit does not support the change). In these cases moving to a new more informative metric without restating comparatives is better than delaying change simply to have restated comparatives. We would propose a comply or explain structure.

Question 12 Statement of compliance (paragraphs 91-92)

The Exposure Draft proposes a relief for an entity. It would not be required to disclose information otherwise required by an IFRS Sustainability Disclosure Standard if local laws or regulations prohibit the entity from disclosing that information. An entity using that relief is not prevented from asserting compliance with IFRS Sustainability Disclosure Standards.

Do you agree with this proposal? Why or why not? If not, what would you suggest and why?

Our response

We agree with this proposal.

Question 13 Effective date (Appendix B)

- **(a) When the ISSB sets the effective date, how long does this need to be after a final Standard is issued? Please explain the reason for your answer, including specific information about the preparation that will be required by entities applying the proposals, those using the sustainability-related financial disclosures and others.**
- **(b) Do you agree with the ISSB providing the proposed relief from disclosing comparatives in the first year of application? If not, why not?**

Our response

A sufficiently long implementation timeframe will be required to obtain clear, concise and relevant information. This is a journey where fast action is essential but it is also key to develop a robust base for future reporting.

The availability of resources and trained employees will be key. Other new requirements such as the UK Green Taxonomy will utilise many of the same employees who will be most critical to the successful roll out of these standards. We would request that, at an absolute minimum, there be twelve months after the final standard is issued before the effective date. As mentioned previously, a comply or explain approach, at least in the early years, would be welcomed.

We agree with the proposed relief from disclosing comparatives in the first year of application

Question 14 Global baseline

Other stakeholders are also interested in the effects of sustainability-related risks and opportunities. Those needs may be met by requirements set by others, including regulators and jurisdictions. The ISSB intends that such requirements by others could build on the comprehensive global baseline established by the IFRS Sustainability Disclosure Standards. Are there any particular aspects of the proposals in the Exposure Draft that you believe would limit the ability of IFRS Sustainability Disclosure Standards to be used in this manner? If so, what aspects and why? What would you suggest instead and why?

Our response

No comment.

Question 15 Digital reporting

Do you have any comments or suggestions relating to the drafting of the Exposure Draft that would facilitate the development of a Taxonomy and digital reporting (for example, any particular disclosure requirements that could be difficult to tag digitally)?

Our response

No specific points although tagging is complex and time-consuming. We would expect that tagging service providers may be able to add more insights to this part of the proposal.

Question 16 Costs, benefits and likely effects

The ISSB is committed to ensuring that implementing the Exposure Draft proposals appropriately balances costs and benefits.

- **(a) Do you have any comments on the likely benefits of implementing the proposals and the likely costs of implementing them that the ISSB should consider in analysing the likely effects of these proposals?**
- **(b) Do you have any comments on the costs of ongoing application of the proposals that the ISSB should consider?**

Our response

There are significant costs associated with the proposed reporting requirements, but given the appetite from key stakeholders we see that this investment is required. We are pleased that the principles have built upon the TCFD, enabling the investments we have made towards compliance with those requirements to be utilised in the future.

Any assurance requirements will form part of the application costs. We suggest a framework which requires all reporters to disclose what type of assurance they are receiving, if any, in lieu of requiring assurance. This would not necessarily be from our statutory auditors. In our view, any mandatory assurance should be required no earlier than 12 months after first implementation to allow for initial benchmarks and peer practices to be established.

Question 17 Other comments

Do you have any other comments on the proposals set out in the Exposure Draft?

Our response

No further comments