Comments on the ISSB Exposure Drafts S1 and S2

The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) and its secretariat in the United Nations Conference on Trade and Development (UNCTAD) welcome this opportunity to comment on the International Sustainability Standards Board (ISSB) Exposure Drafts S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and *S2 Climate-related Disclosures* and commend the publication of these documents.

ISAR notes the importance of the work of the ISSB for the promotion of sustainable business and investment and looks forward to supporting the Board in its global standard setting efforts. The comments in this document are offered as an initial step in building a productive and enduring relationship with the ISSB.

Background

The comments in this document have been compiled by UNCTAD on behalf of ISAR. ISAR is a subsidiary body of the Economic and Social Committee (ECOSOC) that engages all UN member States. The week-long annual ISAR meetings are attended on average by 300-400 delegates – accounting and reporting experts officially designated by their country. In addition, ISAR has a rotating membership of 34 countries in 5 groups – Africa, Asia, Eastern Europe, Latin America, European and other States.

ISAR has developed a wealth of material on a broad range of financial and sustainability reporting topics. It is focused on promoting dialogue, the exchange of views, and peer-to-peer learning to strengthen the infrastructure for and quality of corporate reporting globally. ISAR pays specific (but not exclusive) attention to the needs of developing countries and provides technical assistance to countries and regions with weaker accounting and reporting infrastructures.

The thirty-eighth annual session of ISAR held in November 2021 requested the UNCTAD secretariat to synthesize the views of ISAR on the development of sustainability reporting standards and to act as a channel to communicate those views to the ISSB. This decision was grounded in ISAR's long-standing collaborative relationship with the IFRS Foundation and the IASB, and its efforts to support the implementation of IFRS in developing countries. As part of technical sessions to advance corporate reporting organized throughout 2022, a consultative meeting was held on 1 and 2 June to review and discuss the ISSB Exposure Drafts. There was broad representation at the meeting from jurisdictions at different levels of maturity in sustainability reporting – including a total of 40 experts from 25 countries. The discussions at the meeting were based on broader consultations at national and regional levels. The outcome of the overall process forms the basis of this document.

Particularly relevant as a basis for the comments in this document is ISAR's experience in promoting SDG impact reporting. Following the adoption of the 2030 agenda for sustainable development, ISAR developed a set of core indicators covering economic, environmental, social and governance aspects. The indicators were based on extensive deliberations involving member States, corporate reporting experts, investors, leading organizations in the sustainability reporting field and other stakeholders. The indicators were specifically geared towards measuring the contribution of reporting entities to the SDGs. They were accompanied by *Guidance on the Core Indicators* (GCI) and extensive training material to support their practical application. To validate the GCI, the indicators were piloted in more than 35 entities in 19 countries across all continents, with the sample including MSMEs and large firms in a range of industries.

More generally, ISAR has undertaken extensive work on the Monitoring of Compliance and Enforcement for High-quality Corporate Reporting and has provided support in many jurisdictions for the implementation of various reporting frameworks, such as IFRS for SMEs. A key instrument in this work is ISAR's Accounting

Development Tool (ADT), which provides a framework for capacity building and enables developing countries to assess their regulatory, institutional, and human capacity for high-quality corporate reporting. The ADT – also a product of intergovernmental consensus – was expanded in 2018 to incorporate sustainability reporting aspects. It can be augmented further to aid the implementation of the ISSB standards.

Critical Issues for ISAR

As an overarching observation, ISAR supports the view that the connectivity principle is crucial to developing a coherent corporate reporting standard that clearly links sustainability-related disclosures to the financial statements. However, the singular focus on financial aspects is a concern. ISAR suggests that the ISSB seek further avenues towards a better balance between how the standards treat the impact of sustainability issues on business on the one hand, and how business affects the economy, society, and the environment on the other.

The following specific points emerged as critical for ISAR member States during the consultation process.

Approach

- **Building blocks.** ISAR agrees on the need for a global baseline for sustainability reporting, to which jurisdictions can add additional requirements to satisfy their policy objectives. Going forward it will be important for the global baseline focused on value to business to be extended to cover the impact of business on the economy, society, and the environment. Further extensions to account for the needs of SMEs will also be necessary. Interoperability with other major reporting standards is fundamental.

- **Due process.** To ensure the credibility and adoption of the standards, the ISSB will need to reach parity with the IASB's extensive due process. It should engage a diverse set of stakeholders globally to take into account the needs of jurisdictions that are still transitioning to a more comprehensive approach to reporting. It is important for the ISSB to acknowledge that sustainability reporting engages a highly diverse and broad set of stakeholders. More time is needed for constituents to review and provide comments on the SASB standards as these comprise an extensive body of knowledge developed outside the IFRS Foundation. It will also be important for the ISSB to reconcile the SASB industry approach with the ISSB theme-based approach and to address the disparity with the IASB industry-agnostic approach.

- **Implementation**. Sustainability reporting, to date, has been largely voluntary in most countries. Many jurisdictions consider the timeline for introduction of both IFRS S1 and S2 of less than two years too ambitious. This is due to the potentially high costs of compliance, varying degrees of familiarity with sustainability reporting concepts and lack of capacity, particularly in jurisdictions with weaker corporate reporting infrastructures.

Specific considerations for developing countries

- **Scope 3 emissions.** ISAR members recognize the importance of accounting for scope 3 emissions. However, reporting requirements need to consider the challenges of implementation and the potential burden on SMEs, which form the greatest part of the business sector in developing countries. Addressing climate risks in developing countries may require longer implementation lead times to allow for the formulation of transition plans that address economy-specific challenges.

  In addition, because there is a lack of international agreement on measuring scope 3, a supplement to the GHG Protocol Standard may be required. Such a supplement should be sector-specific and accommodate the circumstances faced by SMEs in developing countries. Without this, the use of estimations, which may contain material inaccuracies, could lead companies to misattribute the main sources of emissions in their value chains. An alternative that could be considered would be to provide details on suppliers, assuming that, over time, these should publish emissions data themselves. Consideration could also be given to the contextualisation of emissions and targets by local economic conditions and energy sources available in a given jurisdiction.

- **Spillover effects**. The requirement to disclose information on the reporting entity's value chain means that the implementation of sustainability reporting standards by listed firms in more advanced markets will affect suppliers elsewhere, including firms in jurisdictions that need more time to prepare, and including SMEs. It is unlikely that these entities will be able to supply high-quality information to larger entities covered by the ISSB's requirements. There is the risk of inaccurate emissions statements due to inadequate reporting infrastructures, which could have the unintended consequences of driving capital flows away from the countries that need them most.

- **Inclusivity**. There is a clear need for a differential approach for smaller and evolving capital markets as well as for markets dominated by SMEs. Developing the equivalent of IFRS for SMEs and other mechanisms to engage with developing countries will be crucial. Otherwise, overly rigid ESG financing requirements by banks and bondholders could impede economic growth and undermine progress towards the SDGs.

Need for more guidance on the application of concepts

- **Materiality.** Clarity is needed on extending the well-established concept of materiality under IFRS Accounting Standards to information that is, in substance, non-financial in nature. Considerable debate remains about how the concept of materiality should be applied to information that is not derived directly from the transaction-based accounting system. Also, considering the trend in many jurisdictions towards double materiality – also the preferred direction for most ISAR members – it will be complex in practice to apply one of the two materiality perspectives in isolation. Reporting challenges, especially in developing countries, will be exacerbated if businesses are faced with the need to reconcile various mandatory and voluntary reporting requirements.

- **Reporting entity.** Further explanation is needed on the use of 'entity', 'reporting entity' and the 'consolidated accounting group', which appear to be used interchangeably. If the same principles apply as under IFRS accounting standards – including, e.g., for the treatment of discontinued operations – it would be helpful to make this clear.

- **Enterprise value.** Further clarification is also needed on 'enterprise value'. The term is not used in the IFRS conceptual framework for financial reporting, which makes clear that financial reporting is not intended to represent the value of the business *per se*. Importantly, 'enterprise value' appears to refer to public listed entities only, excluding other entities – the vast majority of businesses around the world – from the scope of the new standards.

Broader implementation issues

- **IFRS 1 equivalent.** It will be important to ease the transition for entities that have historically used other reporting standards for measuring and disclosing sustainability related metrics. A standard similar to IFRS 1 *First-time adoption of International Financial Reporting* would help entities determine an appropriate baseline for prior years and limit the need to apply the new standards retrospectively. This will be particularly relevant where an entity discloses trends in emissions over several years.

- **Preconditions for reliable reporting.** There is a need for the ISSB to make clear what preconditions are necessary for entities to produce high-quality information. This issue is unique to sustainability reporting where the notion of controls, unlike with the financial statements, is not well-established and typically outside the scope of the work of audit and risk committees. The application of criteria and assurance varies significantly around the world and the quality of data reported can be poor. This is a key area for the ISSB to address as it remains unclear to what extent entities must have developed effective internal controls and appropriate governance mechanisms to oversee the production of sustainability information for inclusion in financial filings. Currently, only a few jurisdictions require assurance of sustainability information.

- **Interoperability with non-IFRS financial reporting standards.** Where national standards are used for financial reporting the introduction of ISSB standards could be complex. Sustainability-related information will be comingled with financial information prepared under a different basis of accounting. The ISSB standards also presume a knowledge of fundamental concepts under IFRS – for example, determining the consolidation boundary of the entity. If a national GAAP permits non-consolidation of certain entities, it could give rise to misstatements of information.

- **Segmentation of disclosures.** At a minimum, segmentation should follow the disaggregation required under IFRS 8 financial statements, separating operating segments when they are exposed to different risks and segmenting disclosures by region or country. ISAR members have expressed concerns about concentrated sustainability risks in developing countries not being brought to light in global disclosures. Where applicable, the standards could indicate when operating segments are different from those used to disclose financial information, and why.

Other practical considerations

- **Monetization of risks.** In the absence of further guidance, it is not clear how entities should proceed in assigning a monetary value to specific sustainability-related risks. This is typically not required under IFRS accounting standards, apart from some specific applications to financial institutions. The IASB in the past has been critical of the term ‘contingent’ liabilities as it may conceal items that are in fact in substance present obligations. The concern is that attempting to value risks so precisely could be misleading to users of financial reports, particularly where the basis of measurement and assumptions made are not transparent. It is likely to also create assurance issues.

- **Risks and strategy.** Detailed disclosures related to risks and strategies may have important implications for the stakeholders of an entity, who may act on the basis of the information disclosed. The ISSB will need to balance transparency to capital providers against the impact that disclosures could have on an entity’s relationships with other stakeholders, including suppliers, organized labour, and customers. Accordingly, guidance will be needed on how an entity should present forward looking information in a manner that is not prejudicial to its future financial performance where it has acted in good faith.

Next Steps

Implementation of sustainability reporting standards will be a critical area of focus for ISAR in the coming years. Particularly important will be capacity building in developing countries and the facilitation of inclusive debate for the further development of the standards. To that end, we will make available our stakeholder infrastructure, including the Regional Partnerships for the Promotion of Sustainability Reporting in Africa and Latin America, and the consultative groups ISAR convenes to address corporate reporting and governance issues. We will welcome close engagement with the ISSB’s advisory bodies.

We look forward to our continued collaboration in promoting reliable and comparable sustainability reporting by entities around the world.