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Interconnected Standard Setting for Corporate Reporting

Dear Olivier,

Thank you for the opportunity to respond to your consultation, *Interconnected Standard Setting for Corporate Reporting*. As the consultation paper mentions, in 2019, IFAC set out its position on Enhancing Corporate Reporting, responding to a prevailing view that when it comes to corporate reporting, business as usual is not an option. IFAC believes that the reporting ecosystem, consisting of multiple and competing reporting workstreams, does not best serve the interests of capital markets, companies or their stakeholders. The options set out in Accountancy Europe's consultation for changing the corporate reporting system are useful for furthering the dialogue and work amongst relevant stakeholders toward a global and coherent solution.

Corporate reporting should capture all relevant information about organizations required by investors and capital markets to make decisions on allocating their capital. Information should be relevant, reliable, and comparable for which suitable criteria can be developed to facilitate assurance conclusions.

The challenge is that companies are disclosing many different things often on an inconsistent and unreliable basis. This is caused by both a myriad of different jurisdictional requirements and the absence of widely agreed standards in various areas beyond financial reporting. The result is variable quality and lack of comparability, leading to greater cost and inefficiency of capital allocation for both companies and investors. Alignment, harmonization, convergence—not fragmentation (regulatory-driven or otherwise)—is the ultimate goal.

We support the proposal for a global reporting structure based on an integrated and connected approach that prevails at every level through the structure. Although we prefer Approach 4 for a global reporting structure, it is not necessarily a complete solution. A single international non-financial reporting standards board would face many challenges in establishing standards in all relevant areas.

To facilitate an integrated approach, a common language and nomenclature are urgently needed. The use of the terms "financial" and "non-financial" reporting is an artificial segregation of information that is not always helpful in understanding potential pathways forward to enhancing the corporate reporting system.[1]

[1] IFAC interprets the use of these terms in the consultation to refer to i) traditional financial reporting (under IFRS Standards or US GAAP) and ii) all other forms of metric or narrative disclosures under GRI, SASB, CDSB, WICI, or other bodies of standards or frameworks for corporate reporting.

Reporting and disclosure for investors and capital providers need to provide financially material information covering three linked value creation perspectives: traditional financial reporting, drivers of value creation (informing market and intrinsic value), and wider impacts that represent societal value. Such factors and information include those that both the company and investors currently consider, and anticipate, to be material to financial performance and risk, and impacts that are likely to be relevant to value creation over time.

The concept of connectivity in reporting should be founded on integrating these value creation perspectives rather than viewing “non-financial” information in siloes, hence IFAC’s preference for Approach 4 versus Approach 3. The focus of efforts toward global oversight and standards should be on value creation and financial materiality – where external factors and business activities have current or potential financial and risk implications. Consequently, all information related to financial materiality should have a high level of rigor on a par with financial reporting information.

Our recommendations for taking forward the discussion on standard setting in the corporate reporting system are set out below. Going forward, we look forward to continuing the dialogue with you and other key stakeholders.

Sincerely,

Kevin Dancey
Chief Executive Officer

Recommendations

Recommendation 1: A global approach to international standard-setting is an optimal solution.

IFAC strongly supports a global, versus regional or local, approach to “non-financial” standard setting, including the process of establishing a conceptual framework and standards, for the same reasons international standards were critical for the maturity of financial reporting. A regional or local approach ultimately leads to inefficiency and increased costs — for both companies and investors and might be challenging to retrofit at an international level.

We agree that global oversight in the form of a “corporate reporting foundation” is needed for reporting related to the capital markets and financial materiality so to better enable resource allocation decisions in financial markets towards sustainable value creation[2].

A broadly supported, funded, legitimate and public interest international oversight body should have responsibility for both a conceptual framework and standard-setting activities. This body should get its mandate from, have its governance approved by, and be overseen by relevant multilateral institutions. For example, the composition of the Monitoring Board, which oversees the IFRS Foundation, includes representation from securities regulators as well as the European Commission. The Basel Committee acts as an observer. Additional types of public interest bodies could enhance oversight related to the reporting of “non-financial” information.

[2] In advocating for a global solution, it also needs to be acknowledged that financial reporting is subject to widely accepted international standards (IFRS) and US GAAP. These standards have led to a higher level of comparability of financial information but have not been entirely reconciled—requiring ongoing efforts by two “modules” (IFRS Standards and US GAAP) to prevent regional divergence in financial reporting.

Importantly, regulators will need to enforce a global approach and standards to ensure they are consistently adopted and applied across jurisdictions.

Recommendation 2: We need a conceptual framework for corporate reporting covering all information related to value creation and impact that enables connectivity to financial reporting.

A widely agreed conceptual reporting framework supported by a standard classification and taxonomy of information is needed. This would provide a standardized nomenclature helping to coordinate and direct standard setting and the development of national and international regulation and requirements. It will also provide a useful foundation for the digitalization of reporting and disclosure.

This conceptual framework would provide the principles and key concepts around "'how to report" with respect to scope, content and presentation. This is the foundation for "what to report" provided by standards. Standardized metrics and measurements in themselves are inadequate, especially if there are competing, narrow-scope conceptual frameworks supporting different bodies of metrics.

A conceptually robust and coherent approach to corporate reporting would help inform discussions on appropriate and workable standard setting arrangements and activities. A widely agreed conceptual framework clarifies language and key reporting concepts, information requirements, materiality, and reporting principles.

The conceptual framework should ideally bring together and harmonize the key concepts and principles of other voluntary standards, frameworks and recommendations, including the TCFD Recommendations on Climate-related financial disclosures, and also take into account and complement existing conceptual frameworks for financial reporting under IFRS Standards or US GAAP.

Recommendation 3: The International Integrated Reporting Framework is the starting point for such a conceptual framework given it is the only comprehensive reporting framework.

IFAC supported and assisted with the establishment of the IIRC to develop a comprehensive, umbrella framework to provide a basis for narrative information and metrics that enable organizations to more effectively communicate their ability to create value over time across all relevant capitals. Over the past decade, integrated reporting has been a successful, preparer-focused initiative for facilitating a comprehensive corporate reporting approach that connects reporting to corporate governance and management. Its focus on multiple capitals (covering all aspects of value creation), connectivity of information, and value creation related to governance, strategy and business model are important concepts that should be incorporated into any future, comprehensive corporate reporting conceptual framework.

The International Integrated Reporting Framework needs to be seen to incorporate all aspects of value creation representing factors that materially affect future cash flows and therefore market and intrinsic value. It should also more clearly incorporate positive and negative impacts on society and the environment that are not expected to impact financial performance in the short term but are relevant to a broader corporate purpose, reputation and license to operate, with a view that these broader impacts can ultimately have material financial impacts.

The current public review of the International Integrated Reporting Framework is an opportunity to provide input to the IIRC on what needs to be changed to the Framework to serve this purpose. We encourage the IIRC to specifically address how the Framework needs to change to be considered an all-encompassing connected conceptual framework.

Recommendation 4: Agreement is needed on the best approach to achieve global oversight

Without additional multilateral dialogue, it is currently unclear which is the best solution to establishing a global oversight body of international standard-setting. There are various options including:

1. Broadening the IFRS Foundation scope to expand its oversight over other aspects of reporting relevant to capital markets: Given the Foundation is currently established and has broad support, this might be seen as a relatively quick route to establishing standards on broader areas of reporting related to value creation. However, the considerable effort, funding and engagement that will be needed to make this happen should not be underestimated. Any expansion in its mandate should not distract efforts to enhance financial reporting.

   In terms of financial reporting, the IASB is an established and legitimate standard setter. Information on the potential future financial performance not yet captured in the financial statements is already within the IASB's current scope of interest and requirements within IFRS Standards may already capture some ESG and wider sustainability factors[3].

   Relevant aspects of wider financial reporting that relate to value creation are also captured through the management commentary project - a part of the IASB's work program. In conjunction with developments with the International Integrated Reporting Framework, these efforts might be escalated to enhance how this information is reported in management reports such as the Management Discussion and Analysis. The connection between the financial statements and the management report is important and there should be greater focus on integrating accounting and financial information with more forward-looking information in management reporting. In addition, the management commentary should provide another important input into the development of a connected conceptual framework.

2. An existing or entirely new body and set of structures are established under the sponsorship of multilateral institutions: For example, the International Integrated Reporting Council could expand its role to establish structures to provide oversight and coordination to the corporate reporting system. The IIRC would need to develop legitimate structures, processes and funding for international standard setting in various non-financial capitals. This option would require broad and committed support.

IFAC would be willing to participate in discussions to further explore viable solutions. Three key considerations on the best roadmap going forward will be:

- Ensuring public interest is a core part of a global oversight body's mandate
- Acting quickly to avoid further fragmentation
- Achieving widely- agreed and supported arrangements for governance and funding.

Recommendation 5: An international non-financial reporting standards board will require the engagement and support of others

We are not convinced that one standard setter can achieve standards in all areas required, at least not in the short-term. There are gaps in standards for various categories of information routinely used by investors

[3] For example, see IASB member Nick Anderson's article on how the principle-based approach of IFRS Standards means that climate change and other emerging risks are addressed by existing requirements, even though such risks are not explicitly referenced.

and other stakeholders, including sustainability reporting, ESG, quantifying and valuing impacts, and intangibles and intellectual assets.

The current attention on sustainability, ESG and climate is prevalent because many of the risks to long-term value creation relate to these factors. In these areas there is currently no single body of work covering all the relevant information, and voluntary frameworks and standards differ with regards to defining the principles, topics and scope for reporting. To make matters more complex, mandatory reporting requirements vary enormously across national and regional regulators, and stock exchanges.

Consequently, as we identified in our Point of View on Enhancing Corporate Reporting, there is a real sense of urgency for relevant, reliable, and comparable information based on a common set of standards which provide confidence in information and provide a stronger basis for audit and assurance[4].

While we prefer Approach 4 set out in the consultation, a modular approach to establishing standards and standardized metrics in specific issue areas and sectors[5] might be needed and undertaken through bilateral and other partnerships and agreements involving relevant investor and stakeholder input—with a renewed focus and openminded approach to collaboration, harmonization, and consolidation on the part of all engaged parties so as to best serve the public interest.

The Global Reporting Initiative, and Sustainability Accounting Standards Board, among others within and outside the Corporate Reporting Dialogue, have extensive experience in developing standards for sustainability and ESG information through a due process involving key stakeholders and are among various established organizations that can support efforts to develop globally accepted standards in these areas. The expertise and resources of these various organizations can be leveraged to ensure that, in various topic areas, it is possible to build from existing bodies of work.

Any efforts to develop standards in various topic areas should be under the oversight of a global body to ensure coordination and connectivity to the conceptual framework. Over time, it might be then possible to move to a single non-financial reporting standards board.

Recommendation 6: Innovation in reporting needs to flourish to ensure its future relevance

Innovation in reporting will continue to be important and should be supported by thought leadership and research from various communities including corporate and investor. For example, several different initiatives focus on advancing the thinking on impact measurement and valuation including the Value Balancing Alliance and the Impact Management Project.

Innovation activity needs to flourish within and outside of a standard-setting structure. Various organizations can provide advice and expertise to a global oversight body and related standard-setting activities, as well engage and support constituencies such as directors, CEOs, CFOs, investors and sustainability professionals. Of importance is also input from investors on what information is most important from a materiality perspective. Continued research around sustainability, ESG and impact can improve understanding and education particularly between companies, investors, regulators and others.

Digitization is also radically evolving reporting for companies and users. Data standards such as the European Single Electronic Format allows the reporting of annual reports in machine-readable formats. The development of data standards and taxonomies in various topic areas will continue to enable data

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4 IAASB's public Consultation on Proposed Guidance, Extended External Reporting Assurance promotes consistent high-quality application of ISAE 3000 (Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

5 The Sustainability Accounting Standards Board (SASB) defines industry specific metrics to account for financially material risks and opportunities. Their approach suggests that it is challenging to define one set of standardized metrics at a pan-market cross-industry level.

centralization in open data formats to enhance comparability. This benefits companies and investors in terms of cost saving, greater speed, reliability and accuracy. The process of standard-setting can help ensure that quantitative indicators and metrics are consistently defined within a structured classification system.