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JOINT COMMENTS ON THE CONSULTATION PAPER ON SUSTAINABILITY REPORTING

of the

Working Group "Integrated Reporting and Sustainable Management" and the Working Group "Financial Reporting" of the Schmalenbach Association, Germany

Dear Mr. Liikanen,

We welcome the opportunity to provide comments on the Consultation Paper on Sustainability Reporting and the possible creation of a Sustainability Standards Board (SSB). We believe this is a debate which is more important than ever before. The results of this consultation carry the potential to significantly shape corporate reporting in the future. The direction outlined gives a strong impulse to standardize corporate, especially non-financial reporting in terms of content as well as in an institutional perspective.

We both are working groups of the Schmalenbach Association, with members from academia, industry and accounting firms that have a long-standing experience in financial and non-financial reporting and/or sustainability management. The Schmalenbach Association is a German registered non-profit association that aims to exchange knowledge and experience between academia and practice in business and to provide viable answers to current questions of business practice and legislation. For more than 85 years, the Schmalenbach Association has initiated and coordinated the dialog between business research, teaching and practice.

Our detailed comments on the Consultation Paper's proposals are noted below.

If you have any questions regarding these comments, please feel free to contact us directly.

Yours sincerely

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Question 1:

Is there a need for a global set of internationally recognised sustainability reporting standards?

(a) If yes, should the IFRS Foundation play a role in setting these standards and expand its standard-setting activities into this area?

(b) If not, what approach should be adopted?

Yes

Currently, there is a high variety of institutions that deal with sustainability issues and promulgate norms, rules and even standards. These have different agendas and different focuses. Consolidation of these activities, engagements and/or standard settings would be highly desirable and beneficial for the sake of clarity, comparability, and reliability of sustainability related information provided by companies. This would help the reporting companies as well as the different users of such information. It would increase considerably the usefulness of sustainability related information and would underline its relevance.

There are already actors with a quite long experience for both perspectives of sustainability management and reporting, the so-called “outside-in perspective” (e.g., TCFD, SASB) and the “inside-out perspective” (e.g., GRI). These have already produced reporting norms, principles or standards that have been increasingly applied over the last years. Not only the standards but also the standard setting institutions have gained global acceptance and recognition.

Therefore, it is our conviction that the major task of a new sustainability reporting standard setter (at least initially) will not primarily be to create new standards – but to consolidate, converge, and/or select particular solutions from among the existing material. So far, the different normative promulgations (frameworks, guidelines, rules, standards, etc.) have been existing in parallel, and they have been competing with each other. For the near future, there is a strong need to bring these different solutions together and forge one set of global standards. Although the Corporate Reporting Dialogue has precisely this aim of global convergence, so far it has not been successful in reaching this aim. Therefore, as the urgent societal developments and challenges require fast solutions in this respect, we are convinced that a standard setting body with global recognition for and long-standing experience in high-quality standard setting such as the IFRS Foundation is absolutely necessary.

However, it would be very important and absolutely necessary for the success of such a global sustainability reporting standard setter to include and integrate at least the above mentioned other major actors in this field – to benefit from their experience, to reduce the “time-to-market” of the standards, and to bundle resources and efforts.

Against this backdrop, another prerequisite for the success of this endeavor is to emphasize that the primary users of such reporting standards are all stakeholders and not just investors.

Question 2:

Is the development of a sustainability standards board (SSB) to operate under the governance structure of the IFRS Foundation an appropriate approach to achieving further consistency and global comparability in sustainability reporting?

Yes

The answers to Question 1 already outline one of the fundamental challenges that an SSB is likely to face. This is because the relationship between high quality reporting standards and the rapid development of such reporting standards is inversely proportional, such that a goal-oriented trade-off of the criteria quality and time-to-market is unavoidable. Without timely development of such standards, the SSB could become irrelevant in the medium term, which could also have spill-over effects on the IASB. On the other hand, the issue is pressing against the background of global sustainability challenges (like increasing global warming or social disparities), such that even high quality reporting standards as products of a protracted development process could then be meaningless for the capital market and global society as a whole. Consequently, a clear specification and rapid implementation of work and time schedules is needed.

The tight time frame relates also to the established IFRS due process and governance structure. On the one hand it could provide significant added value in the area of non-financial standard setting, but on the other hand, it will most likely slow down the progress. Therefore, it really would be very favorable (as mentioned above) that the new standard setting body draws on the pronouncements already made by other actors to get an efficient start.

Regarding the timeframe, the political agendas on the global, national and regional levels must clearly be considered when developing standards. For example, the implementation of the UN Sustainable Development Goals (SDGs) and the global targets for achieving CO₂ neutrality (mainly the Paris Agreement's 2°C goal) must be taken into consideration. Companies as well as jurisdictions have already started to incorporate the SDGs in their decision-making processes, therefore any sustainability reporting standard setter needs to closely take these goals into consideration. As these goals are widely accepted, referencing them will lend added legitimacy to the new standard setter.

In addition, as non-financial aspects (can) have a considerable financial impact (and are therefore often referred to as “pre-financials”), it would be important that the IASB and the SSB work closely together to improve corporate reporting in total by developing standards that lead to decision useful corporate information for capital providers as well as other stakeholders. As a consequence, the resulting standards would reveal that sustainability is not just an additional field of relevance, but a subject that infuses the business model, strategy, operational processes and the stakeholder relationships of an entity. It would also reflect the fact that business entities deal with various types of scarce resources and that management has the obligation to consider scarcity in its decisions. Therefore, it should also report about it.

Given these considerations, one might also consider it consequent to create only *one* board – an International Corporate Reporting Standards Board (ICRSB) that comprises experts from all relevant areas and institutions of corporate reporting, and to have special working groups underneath this board that deal with particular challenges of this broader field of standard setting.

With regard to the envisaged objective to obtain consistency and comparability in sustainability reporting, it is our opinion that an important differentiation needs to be made. As each company has its specific sustainability impact (i.e., effect on different resources and different related sustainability risks and opportunities) and each corporate management uses different concepts and means to take this impact into consideration, it is very important that sustainability reporting reveals this fact. Therefore, requiring a limited set of standardized metrics would fail to capture these company-specific underlying circumstances. Rather, it is necessary that it is up to the management to make the decision what to report and in which scale (“management approach”). These decisions need to be consistent over time. But it is up to the standard setter to give clear guidance about the definition and the calculation (for quantitative indicators) of the measures used to measure “sustainability performance”, i.e., the impacts, the risks, etc. Thus, the measures reported by the entities need to be consistent and comparable between entities to allow users to make comparisons.

It should be prevented that sustainability reporting degenerates into a matter of pure compliance. The set of reporting standards should safeguard a clear representation of how management has handled sustainability issues during the reporting period in reflection of its strategy and business model – otherwise non-financial information will prove to be irrelevant to users.

Finally, if the IFRS Foundation decides to establish the standard setter for non-financial reporting, the designation as a “Sustainability Standards Board” is unfortunate, since the new board’s remit is “reporting standards”. It would be more appropriate to call the board “International Sustainability *Reporting* Standards Board” (ISRSB). As a consequence of the broader standard setting under the auspice of the IFRS Foundation, it might (then) also be appropriate to rename the IFRS Foundation into something like “International Corporate Reporting Foundation (ICRF)”.

Question 3:

Do you have any comment or suggested additions on the requirements for success as listed in paragraph 31 (including on the requirements for achieving a sufficient level of funding and achieving the appropriate level of technical expertise)?

We do fully agree with the list of para. 31. However, we would like to add a few more requirements. We think that the aspect of independence of the SSB is crucial and should therefore be included in the list. The IASB has an internationally highly recognized position and reputation, which is largely due to its high degree of independence from political agendas and other initiatives. It would not be conducive to the SSB and the IFRS Foundation as a whole if a different approach were taken with regard to the SSB.

Furthermore, high expertise in non-financial issues (coming from different angles such as corporations, academia, and science, etc.) should be established and maintained on the board of the SSB and in all other bodies to be established, in particular (also) expertise that is capable to converge the perspectives of financial and sustainability reporting. This could be done by incorporating the numerous initiatives in the field of non-financial reporting as soon as they join, partner with or subordinate themselves to the IFRS Foundation. The incorporation of relevant expertise is a particularly important prerequisite for the acceptance and goal-oriented work of an sustainability reporting standard setter, as the scope of its work is much broader than the one

of financial reporting due to different fields/resources/capitals (like natural capital, human capital and social capital, etc.) that need to be considered. Therefore, also the scope of addressees/users is much broader than primarily investors.

As stressed above, due to the pressing societal challenges, important prerequisites are speedy actions and timely standard setting without compromising too much on the quality of the standards. Therefore, it might be worthwhile to consider that some of the requirements mentioned in para. 31 are less (timely) important at the beginning of the SSB's standard setting activities than others. However, this assessment of the time preference needs careful consideration, because in a medium- and long-term perspective all mentioned (and by us additionally proposed) requirements are equally relevant.

One of the mentioned goals focuses on the reduction of complexity in non-financial reporting (para. 31b). Since this complexity is inherent in the sustainability context (e.g., due to different capitals and a much longer time horizon), it is debatable to what extent it can be reduced. In our opinion, this targeted reduction gains traction precisely when financial and non-financial topics are integrated into corporate management and decision making following the concept of "integrated thinking". Still, common standardized definitions of particular measures or even adequate monetization can help to make impacts of non-financial issues more "tangible", transparent, easier to understand and even more comparable.

Question 4:

Could the IFRS Foundation use its relationships with stakeholders to aid the adoption and consistent application of SSB standards globally? If so, under what conditions?

Yes

Due to the importance of sustainability issues for society as a whole, it would be absolutely necessary to involve all stakeholders in the standard-setting process in this area of reporting. However, with regard to sustainability, stakeholders' views are likely to be more diverse and (often) conflicting than in the area of financial reporting. In order to keep up its authority, it would be necessary that the SSB keeps the balance between the various stakeholders' expectations. Against this background, it would be most likely that the IFRS Foundation, having a sample of stakeholders primarily oriented towards capital providers, needs to broaden its stakeholder relationships to include a wider variety of users of the reports beyond the scope of its current constituencies.

Question 5:

How could the IFRS Foundation best build upon and work with the existing initiatives in sustainability reporting to achieve further global consistency?

With reference to the comments on Question 2, cooperation depends on the political objective pursued. If the key actors in the area of standard-setting for non-financial reporting join the IFRS Foundation and if the goal is to develop such reporting standards quickly, it would make sense to adopt already established reporting practices (e.g., those promulgated by the TCFD, the SASB and/or the GRI) to a large extent and then adapt and supplement them accordingly. Here, the IFRS Foundation could work jointly with the organizations that join the IASB in the

Corporate Reporting Dialogue, which have signed a statement of intent to work together to aim for comprehensive corporate reporting. Finally, it would be worthwhile that their representatives became SSB members.

Furthermore, it should be noted that a consolidation of the actors in the field of non-financial reporting standard-setting could also take place through joint arrangements or even mergers of these institutions (e.g., as recently announced by SASB and IIRC). This could as well be a strategy for the IFRS Foundation to initiate or support such arrangements or actions.

In addition, in the mid-term the IFRS Foundation and the IASB should also consider whether IFRS themselves need to be amended in order to fully open corporate reporting for non-financial aspects and items (as already described in answering Question 2).

Question 6:

How could the IFRS Foundation best build upon and work with the existing jurisdictional initiatives to find a global solution for consistent sustainability reporting?

The EU Commission is a current driving force with regard to the regulation of non-financial reporting. Therefore, it would be wise for the SSB to start the dialogue with the relevant bodies at the EU and strive for common or at least mutually accepted solutions or cooperation in particular areas. It should be avoided that the SSB standards might be in contrast to regulations of the EU or other major jurisdictions.

In order to be legally accepted at the EU level, SSB standards would need to pass through a democratic legitimization process (analogous to the IFRS). Although such a process has the risk of carve-ins and carve-outs due to political objectives, this procedure would ensure EU-wide acceptance of the standards and could motivate other jurisdictions to adopt them as well.

It could also be conceivable to establish a kind of cooperation or separation of duties between the private standard setter and public ones (like the EU, UN, etc.), with the SSB addressing issues concerning the outside-in perspective of sustainability and the inside-out perspective being the remit of public regulators, naturally with effective cooperation with each other.

However, due to the tight time frame of global sustainability challenges, the EU and other jurisdictions might not want to or cannot wait until the global endeavors to create a SSB lead to success and it starts to develop standards. The jurisdictions need to fulfill their obligations according to international treaties, like the 2015 Paris Agreement. And this implies a high time pressure.

Question 7:

If the IFRS Foundation were to establish an SSB, should it initially develop climate-related financial disclosures before potentially broadening its remit into other areas of sustainability reporting?

Yes, it depends:

We understand that this proposed agenda is one that will first address an already more extensively standardized area of non-financial reporting and will be the first – albeit less ambitious – point of departure for gaining experience and achieving rapid results in establishing the SSB internationally. In addition, the focus on climate change is likely to address the most pressing global and socially relevant issue at present. However, conceptually, it would be worthwhile to

first develop a conceptual framework and after that the reporting standards based on it. However, the above-mentioned time pressure might not leave enough time for this quality-oriented approach.

As also mentioned above, sustainability is a complex issue with lots of interactions and spill-over-effects. This needs to be kept in mind. Thus, climate change has a lot of social and macro-economic implications and interdependencies. Therefore, the SSB would need to expand its scope of concern to all aspects of sustainability, covered by notions such as “ESG”, “triple bottom line” or, most comprehensively, the 17 UN SDGs. The SDGs in particular could serve as a framework for structuring the areas that need to be covered by a comprehensive concept of sustainability and/or corporate reporting.

In addition, an SSB should bear in mind that standards on non-financial issues are closely and consistently related to financial ones. Accordingly, a requirement or commitment to integrated management and an integrated approach to reporting would be required to fully address the issues and their implementation within the company. The concern about the complex web of interdependencies between financial and non-financial issues has already established itself in science and business practice under the term “integrated thinking” (see also the answers to Question 3). Accordingly, the SSB could consider the major principles of the IIRC’s Integrated Reporting Framework as a premise or a kind of preamble for its own reporting standards, which could generate significant synergetic effects between financial and non-financial corporate reporting.

Question 8:

Should an SSB have a focused definition of climate-related risks or consider broader environmental factors?

Broader environmental factors should be considered, because there are clear interdependencies between different environmental factors and climate change. In addition, the standards should not only cover risks but opportunities and the incorporation of such issues in corporate strategy and governance of the reporting company.

As mentioned above regarding Question 7, the SSB should expand its scope of concern to all aspects of sustainability, covered by notions such as “ESG”, “triple bottom line” or, most comprehensively, the 17 UN SDGs.

Question 9:

Do you agree with the proposed approach to materiality in paragraph 50 that could be taken by the SSB?

No, because:

A perspective limited to financial materiality does not really provide the entirety of decision-relevant (sustainability) information. Materiality should be assessed both from the outside-in (financial materiality) and the inside-out (ESG materiality) perspective, because inside-out impacts should be included in the corporate strategy development process to the same extent as outside-in impacts. Both perspectives can lead to the detection of opportunities and risks that

might influence future corporate success. Both perspectives are interconnected. For this reason, both materiality perspectives have relevance for investors as well as other stakeholders.

Furthermore, the focus on “outside-in materiality” could contradict the view of corporate value creation in a multidimensional perspective that is at the core of the concept of integrated thinking and reporting.

Finally, the two-sided perspective of the materiality concept is incorporated in the EU’s Non-Financial Reporting Directive and clearly represents the expectations of society with regard to corporate responsibility. It is an important aspect for a company to justify its “license to operate” and it is therefore politically and societally expected to be included in corporate governance and management.

Question 10:

Should the sustainability information to be disclosed be auditable or subject to external assurance? If not, what different types of assurance would be acceptable for the information disclosed to be reliable and decision-useful?

While external auditability is a desirable characteristic of disclosures in reporting (see this as an approval of para. 52), auditability is not a quality criterion for the setting of reporting standards that needs to be considered in the standard setting process. As such, verifiability is a more appropriate term, which may be particularly appropriate in the area of non-financial factors.

External auditing of non-financial reporting should be made mandatory to some extent, but the SSB is not to be seen responsible for establishing such a requirement. This responsibility is borne to national or international jurisdictions or oversight bodies, like the European Commission or the SEC.

In addition, the question may arise whether reasonable assurance is a desirable goal in light of the lacking “auditability/external verifiability” of – at least – some non-financial issues such as human rights violations, etc. If necessary, a new hybrid level of assurance could be developed in this field, so that the limited auditability of such facts would be expressed accordingly. However, as already said, this is not the duty of the reporting standard setter, but the international auditing profession and jurisdictions. The auditing profession is called upon to develop adequate processes, principles and standards on how to adequately audit non-financial information and its interdependencies with financial data.

Question 11:

Stakeholders are welcome to raise any other comment or relevant matters for our consideration.

In order to help all related parties and stakeholders, it is necessary that the IFRS Foundation – after its consultation process – makes rapid decisions and develops a clear agenda in terms of objectives, processes and timeline. The IFRS Foundation should be transparent about the next steps that will be taken.

Due to the fast developments in the field of digitalization it would be sensible for the IFRS Foundation to consider electronic data processing issues, such as an XBRL taxonomic approach (perhaps related to the European Single Electronic Format, which is currently limited to financial reporting) when setting the sustainability reporting standards. As the EU requires to provide financial information applying XBRL according to ESEF and prepares a (at least until now not XBRL-related) taxonomy for sustainability issues, it might not take long for non-financial data also being provided through a standardized electronic regime. While synergetic effects for standard setting have been shown in the area of financial reporting procedure, it might be advisable to implement a taxonomy approach – as laid down in the Due Process Handbook for IFRS standard setting – also in the standard setting process of the SSB.

Finally we would like to motivate all relevant constituencies to meet the huge challenge of forging a comprehensive set of corporate reporting standards on the basis of what has been developed so far, to work together constructively on a step by step basis, to find the appropriate balance between quality and speed of standard setting and finally to aim in finding standards that lead to a faithful representation of the corporate value creation for the providers of financial capital and the providers of other capitals.

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