Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Mr Erkki Liikanen
Chair of the Trustees of the
International Financial Reporting Standards Foundation
Columbus Building
7 Westferry Circus / Canary Wharf
London E14 4HD

Berlin, 29 December 2020

Dear Mr Liikanen,

RE: IFRSF Consultation Paper on Sustainability Reporting

On behalf of the Accounting Standards Committee of Germany (ASCG), we are writing to comment on the Consultation Paper on Sustainability Reporting issued by the IFRS Foundation on 30 September 2020. We welcome the opportunity to comment on the proposals.

We commend the Trustees for taking up the initiative in this important field. This move comes at the right point in time and by the right organisation. The Foundation has a proven track record of being the only organisation in the world that has developed high-quality reporting standards in an independent due process that are accepted in more than 140 jurisdictions around the globe. We truly believe that this places the Foundation in a prime position vis-à-vis other initiatives. Further, we think that the fact that the Foundation has so far not dealt with sustainability issues should be seen an advantage: The Foundation can rightly claim not to have any vested interest as regards a preference for one framework or set of standards over others but is looking at the issue from a neutral position that would allow for interested parties coming together and jointly striving for the best answer.

We are, of course, aware of the many initiatives that are underway by industry groups, standard setters, and jurisdictions. We completely acknowledge the differences in speed, proficiency and approach that do exist, and commend those parties that have already performed work in that area for the work done. Yet, sustainability is a global topic with global challenges. And global challenges are best addressed through global initiatives and standards. It is for this reason that we wish flag our full support for the Foundation's initiative and offer any assistance we could provide in order to make the initiative a success.

Our responses to the questions of the consultation paper is laid out in the Appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Andreas Barckow (barckow@drsc.de) or Sven Morich (morich@drsc.de) on our behalf.

Yours sincerely,

Dr Nicolas Peter	*Prof Dr Dieter Truxius*
Chair	Vice Chair

Appendix – Answers to the questions in the Consultation Paper

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 to both the general and sub-question (a).

The Administrative Board of the Accounting Standards Committee of Germany (ASCG) firmly believes that there is an evident need for consolidation in the area of sustainability reporting standards. The several hundred existing initiatives with their different approaches, frameworks, standards and datasets make it difficult, if not impossible, for users of such information to reconcile and compare it across companies, industries and jurisdictions. This situation is simply untenable and cannot persist into perpetuity. Even though we acknowledge that some frameworks and standards are more widely used and adhered to than others, no organisation currently can claim to have produced *the* globally accepted set of standards. To foster comparability and consistency in the area of sustainability reporting, a global set should be a shared objective of all participants in this space. We realise that this may be easier said than done, but we also recognise the huge developments that have taken place in recent months, such as (and not limited to) the statement of intent by the group of five sustainability organisations to work together towards a common set, the announced intent by the IIRC and SASB to merge their organisations, etc.

On sub-question (a), we note that some may question why the IFRS Foundation would position itself in this space, as it does not have a noticeable track record in the area of sustainability reporting. Whilst it is correct that neither the Foundation nor the IASB has dealt with sustainability reporting issues in any great detail (notwithstanding the latter's noticeable work in the area of management commentary, which we do see as catering for at least some of the matters concerned), we believe that the Foundation has something to offer hardly anyone else can: its credibility and trust that come with a robust governance structure and accompanying processes. The IFRS Foundation has a proven track record with its private and independent Board developing standards that are regarded as being of high quality and useful to providers of capital when making economic decisions. Even more, we think the Foundation is the only private body in the world that can claim to have produced a global set of standards that is adhered to in more than 140 jurisdictions around the globe. We therefore strongly believe that the IFRS Foundation should not only become involved in this area, but take the lead.

(b) not applicable.

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?

Generally yes. As already said in our response to the previous question, we believe that the Foundation's track record in having a Board under its auspices that was able to successfully develop and deliver a set of high-quality financial reporting standards is proof that the organisation has a structure and due process that is tried, tested and trusted. To us, this is the key asset of the Foundation that it can duly bring to the discussion.

Our caveated answer relates to the following issues that we suggest the Trustees consider further:

- *On developing a Board:* Whilst we completely agree that establishing a Board has to be the ultimate goal, it may be sensible to foresee an interim step in order to leverage the existing guidance, get the necessary traction and buy-in by those organisations that already operate in the space of sustainability reporting. Furthermore, setting up a new Board from scratch and have it operate under the same or a similar governance structure that applies to the IASB may simply take too long to accomplish tangible results quickly.
  Both reasons lead us to think that it may be more appropriate to establish a platform/a Council/a Committee in the first place before having it developed further and converted into a full Board. In this regard, we believe that the course that has led the IASC to develop into the IASB can be seen as a role model: It brought together organisations that had been active in the area of standard setting, that shared a common thinking and mission in developing high-quality standards that were to be applied on a global basis, and that facilitated each organisation so contributing to maintain its independence – with a view to build trust and get the work started. We believe that something similar can be established rather quickly, e.g., with those globally active organisations whose products are already considered mature.
- *On the mission of achieving further consistency and comparability:* Whilst we agree that the ultimate goal of the new body should be to develop standards in the area of sustainability reporting to achieve further consistency and global comparability in that space, we believe that this mission needs refinement. Consistency and comparability are already challenging to fully achieve in financial reporting, as is regularly evidenced by the IFRS Interpretations Committee when trying to resolve diversity in practice. Yet, here a common basis exists, as bookkeeping, accounting and financial reporting follow conventions that have been in existence for many decades (if not centuries).
  Conversely, such consensus about key concepts does not seem to exist to date, and not all existing conventions are unanimously shared by everyone, when it comes to sustainability reporting. Fundamental concepts as to the intended recipient/audience of the information, as to the basis on which to report, on concepts such as materiality, etc. are heavy points where agreement needs time to develop. Hence, whilst we fully agree that consistency and comparability in sustainability reporting are of equal importance to consistency and comparability in financial reporting, it may be far more difficult to achieve. Therefore, interim steps should be formulated and serve as milestones on the journey towards consistency and comparability. Such a steppingstone may be formulated as

"adding to further comparability and consistency, *e.g., by fostering consolidation of existing frameworks, standards, data requirements etc.*"

- *On the name of the new body:* We suggest reconsideration of the name envisaged for the body, as we do not think the Trustees foresee the Board developing sustainability standards but rather sustainability *reporting* standards: As we have understood the CP, the purpose of the organisation would not be to come forward with proposals on how to reduce carbon emissions, enhance diversity on Boards, or foster good governance principles for sound management behaviour. Whilst these are no doubt important, we believe the Board's objective should be to develop standards that enable companies to *report* on the issues mentioned and to provide transparency to market participants, whoever they may be. We therefore think that the Board be more appropriately labelled 'Sustainability *Reporting* Standards Board' (SRSB).

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 agree that all the factors mentioned in paragraph 31 are important and need to be considered and addressed appropriately. However, we believe that some factors may require being addressed sooner than others.

For instance, 'achieving a sufficient level of support' is clearly a must-have. Without support from key players, including public authorities, global regulators, market stakeholders (criterion (a)) and regional initiatives (criterion (b)), it would be hard if not impossible to deliver truly global standards. Conversely, 'ensuring the adequacy of the governance structure' (criterion (c)) – whilst no doubt important – would only come into play, were the IFRS Foundation to start its work with the creation of a fully-fledged Board. As said in our response to the previous question, we are not sure whether that would be our preferred route to pursue. If the Foundation were to set up a Council or Committee solution with a smaller Secretariat and staff as a starter, the governance question would be one that could be duly considered with more time and after the body has started operations.

The same would be true for 'achieving an appropriate level of technical expertise for the Trustees, SSB members and staff' (criterion (d)) as well as for 'achieving the level of separate funding' (criterion (e)). Clearly, a technical Board cannot do without technical expertise; however, we would question whether it would not be (more) appropriate to build on and bring in expertise that already exists in the field – why re-invent the wheel? It goes without saying that everyone in the organisation needs to develop – we would even go as far and say that also the IASB members and staff need to develop their skills in that area, as, otherwise, interconnected standard-setting will never be fully achieved (and this addresses our position regarding criterion (f)). This is not to say that everyone in the organisation needs to be an expert in everything, but a minimum understanding for key concepts and principles should be assumed a must to address stakeholders' expectations. The organisation cannot and should not work in silos divided by Chinese walls.

As regards possible additions, we believe that two points should be added (at least for consideration, but probably also to the list): independence and timeliness. Independence is probably the key reason why the IASB's work is so highly respected by market participants. Clearly, the SSB should not operate in a bubble and completely detached from its environment. Yet, it is of the essence that its members and staff are not unduly influenced by any outside parties either. Only standards that can rightly claim to have been developed by an independent body in an open and robust due process will meet the expectations of stakeholders and give the new body similar credibility as is the case for the IASB. If independence was what the Trustees foresaw with criterion (g), then our point would be addressed.

The area of timeliness is tricky but important: Market participants have long asked for comparable metrics in the area of sustainability. To date, various global and regional initiatives are underway to develop more coherent sustainability information and reporting. If the IFRS Foundation wants to set its mark in the field, it has to produce tangible results quickly in order to become recognised as a relevant player. Timeliness needs to be balanced carefully with quality though, as delivering a product that is not well thought through has the potential of creating enormous reputational damage, not only to the SSB, but also to the IASB – which must be avoided at all cost (which also talks to criterion (g)). Conversely, a well-thought product is of little usefulness to market participants if it comes to the market too late. The issue of timeliness and its balancing with quality is but one reason that makes us believe that setting up a full-grown Board may better be considered as a second step. There are solutions out there in the market already, and if those solutions are appreciated by a large majority of stakeholders, it would be more than reasonable to consider ways of bringing them under the roof of the IFRS Foundation.

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?

We see no obstacle or conditions for the IFRS Foundation to use its relationships – on the contrary: We believe that the Foundation would be well-advised to build on its established relationships and seek the widest support possible for the adoption of its standards. That would particularly be the case for established relationships with public authorities and global regulators, as it would be up to them to mandate (or at least allow) companies in their jurisdictions to use the standards of the SSB and to enforce their application.

On the other hand, the IFRS Foundation should not lose sight of market stakeholders, in particular preparers and users of sustainability information. In order to remain relevant, it would be of utmost importance to follow closely where market demand exists, where diversity in practice hinders decision-making, and in which areas standards should therefore be developed or existing standards be consolidated and merged into a single solution.

We further believe that, if the Foundation successfully reaches out to those sustainability organisations that it already has worked with in the Corporate Reporting Dialogue, these could potentially be used as ambassadors for the standards to be developed. Such ambassadorial work might prove even more effective, were these organisations involved in the development of the sustainability reporting standards.

Question 5

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

Building on and from our responses to the previous and the second question, we believe that the IFRS Foundation should not endeavour creating yet another set of sustainability standards. There are already too many approaches in the market, so the objective should be to streamline the sustainability reporting landscape by consolidating, merging, amending, and improving rather than re-inventing what others have already produced.

As said before, we believe that a pragmatic and rather quick solution could be to set up a platform that allows the existing key players in the area to come together under the auspices of the Foundation and its Secretariat, to agree a mutually accepted set of core concepts and principles and to start from there. If some or most of the existing organisations would be willing to move under the roof of the Foundation and become part of the organisation – by sharing their resources and bringing in their people, the Foundation might even consider a bulk grandfathering of those organisations' standards and frameworks – as had been the case when the IASB had formally taken over from the IASC: One of the first moves of the newly created Board was to provide for continuity by first endorsing the entire existing literature, no matter when and how it had been developed, and to then look at each pronouncement one by one and consider improvements, amendments or withdrawals. We believe that it would be at least worth considering whether a similar approach could not be employed by the SSB. This would clearly accomplish the objective of building on existing and established initiatives and provide for timely results; whether doing so would stand the test of time and quality should be left to those charged with governance oversight, the independent Board and its constituents when responding to due process documents.

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?

As we see it, building upon the work of regional initiatives to find a global solution for sustainability reporting might prove challenging, if jurisdictions in other regions do not agree with the principles developed by the ones the SSB might consider using as a basis.

In any case, the IFRS Foundation needs to remain cognisant of noting and duly considering what others are doing in the area of sustainability reporting. We believe that no-one, be it an organisation or jurisdiction, would want to duplicate work that others have already considered and developed solutions for. Taking into account that there are different degrees of readiness and proficiency as well as different speeds, with some being ahead of others, it would be prudent and appropriate for the IFRS Foundation to take account of existing and emerging solutions. Cooperation, not confrontation should be the motto of any initiative to the mutual benefit of everyone.

Clearly, if the Foundation/the SSB could bring about a global solution that is perceived good for all or at least a vast majority of its stakeholders, then jurisdictional initiatives could consider whether they really need to develop anything in that space, too, or whether they could and should concentrate on areas where there is less appetite by a global constituency instead. In that sense, the work of the Foundation/the SSB would be complimentary to that of regional initiatives: It would form a basis from which jurisdictions could borrow, on which they could build on or amend, should they feel the necessity to go further to meet their specific public policy goals. That said, many of the public policy goals in the area of sustainability are global goals addressing global problems; and global problems are best addressed by global solutions.

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?

We understand this question such that the work of the SSB must start somewhere, so why not with climate-related subjects, which seem to be the focus of so many jurisdictions and stakeholders.

We believe that climate-related subjects are no doubt important, especially when considering whether a jurisdiction is on track in delivering on its global commitments made. The drastic impacts brought about by climate change have already surfaced in many regions and industries, so there is little argument that climate-related subjects are not important.

Yet, we believe that climate-related issues cannot be looked at in isolation: Many of the ‘E’ issues considered in ESG are intertwined with ‘S’ and ‘G’. For instance, if an entity that is trying to reduce its carbon footprint by shutting down factories and setting free workers, a focus merely on the (positive) impact this has on ‘E’ would not tell the complete story. We believe that most of the ESG topics cannot be addressed in a silo-based way, where one would first consider ‘E’, then ‘S’, and ultimately ‘G’. Stakeholders want to know how entities are addressing the issue of climate-change; but they would not only want to know how entities cope with the impact they are having on their environment, but equally what other consequences in that area exist.

Further, we believe that a focus on climate-related financial disclosures may run the risk of being duplicative to work already done. Especially in the area of *financial* disclosures, the IASB has already considered potential impacts brought about by climate change as well as their reflection in the financial statements and the notes. And even if one broadens the horizon to climate-related disclosures more generally, one may hold the view that the TCFD guidelines already provide a reasonably good basis that can be used – so what precisely would the SSB asked to look at or develop that is not already there?

We therefore believe that the remit of the SSB should be broad from the start: If it wants to put a stick to the ground and claim to be *the* global standard setter in the area of sustainability reporting, it cannot limit its remit to just one area. It must assume responsibility for all ESG areas, at least in principle. That broad remit, however, should not be confused with how the SSB should start building a work programme (which, logically, has to start somewhere) with defined timelines and deliverables. All other factors being equal, our preference, conceptually speaking, would be to start from first principles by developing a conceptual framework. However, we acknowledge that the timeliness aspect cited before may not allow for such effort.

A reasonable avenue might therefore be pursuing a pragmatic and multi-faceted approach consisting of: (a) seeking where a broad consensus exists already and start standard-setting in that space in order to deliver quick results; (b) seeking views of stakeholders by means of carrying out an agenda consultation to get a better feel for where stakeholders' pressure points are; and (c) agreeing on first high-level principles to be adhered to when setting standards.

Question 8

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

Similar to our answer on the previous question, we do not think that climate-related issues can be looked at in isolation – and certainly not detached from broader environmental factors. Such an approach may run the risk that a focused definition of climate-related risks was perceived arbitrary. On the other hand, we do not deny that it would be important to provide clarity to the discussion and define as clearly as is possible what is being considered part of climate-related issues and what is not.

Question 9

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

Putting aside the fight around terminology, we agree, in substance, with the view of the Foundation in that we would advise keeping the focus on providers of capital initially and considering a gradual expansion over time.

We admit having difficulty in responding to this question as we believe that there is a high degree of confusion as to what precisely is meant by single or double materiality. These terms are being used by different people to mean different things – some merely want to express a certain degree of importance/relevance/significance to one or several stakeholder groups; others believe that single materiality means financial materiality and double material means also taking into account societal impacts; and yet others use terms such as 'inside-out' and 'outside-in'. If the discussion continues in that way, we fear that it will be a fight over jargon from which little is to be gained.

As we see it, users of sustainability information expect a complete picture that is not one-sided but multi-faceted; whether one calls this double materiality or not, is of lesser importance to us. In a nutshell, it is about providing relevant and decision-useful information. Such information should focus on (a) potential impacts ESG factors could have on the way how an entity creates value, and (b) how an entity impacts its environment, i.e., information about an entity's ESG footprint. In the past, a majority of users of financial statements was more interested in the former, but that has changed significantly over recent years: The creation of externalities and their potential neglect may fire back at the entity over time and may, therefore, have a significant impact on its potential to create value longer-term. Reputational damage might translate into hard financial losses, evidenced by customers turning away, potential staff no longer applying for a job, neighbouring citizens filing legal claims, etc. The value creation of an entity becomes more and more interconnected with the way how (i.e., at what price) it creates value and presents itself to society – which is sometimes referred to as its 'licence to operate'.

Whether we would have related the view presented in the previous paragraph to the concept of materiality, we are not sure. In financial reporting, materiality is an established and pervasive concept. It is a subjective filter that is applied by the entity to all potentially relevant information in order to keep the reporting focussed. The tipping point between material and immaterial information is where decisions of the recipients of such information could be influenced, were the information not provided or provided in a different and potentially misleading way. Hence, to judge whether a piece of information may be material to the recipient of the information requires deep knowledge about the preferences and the decision-making mechanism of these individuals. That is difficult already if the focus was solely on recipients that are providers of capital (as they may have different priorities and preferences, e.g., when providing money in the form of equity or debt instruments). Broadening that concept to all potential stakeholders might render impossible, since an entity would have to know the preferences of all those stakeholders in order to decide which information to report. A so-called stakeholder dialogue can certainly facilitate providing clarity about stakeholders' preferences and priorities and be helpful in that regard. Medium- to longer-term, we believe that the pronounced distinction between a somewhat preferential view to providers of capital and society at-large will become blurred and potentially irrelevant.

We therefore agree to starting with a modest approach for the SSB regarding materiality, yet keeping an open eye on developments and gradually broadening scope should that become necessary and feasible.

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?

We admit that we are surprised by this question as we would not have associated a question about external assurance to be one that was for a *reporting* standard setter to answer. Whether or not sustainability information should be audited or be subject to external assurance is for jurisdictions to decide, not for a standard setter (and certainly not for the SSB).

Generally speaking, all information provided to outside parties should have the qualitative characteristic of being *verifiable* by third parties (which may be what the Trustees had in mind when using the term *auditable*) in order for it to be decision-useful. Given that financial information is subject to an external audit, and given that non-/extra-/broader financial or sustainability information is more and more becoming mainstream and a basis for decision-making by external parties, we see no valid reason, conceptually speaking, why an audit requirement should be in place for only part of the information provided to outsiders. We reiterate, though, that such decision is for jurisdictions to make.

More to our remit, the Administrative Board of the ASCG resembles a broad spectrum of entities, small and large, domestic and multinational, and of different industries. We believe that any consideration of introducing an audit requirement should take carefully into account the fact that a large part of the sustainability information is unstructured and not (yet) processed with the same degree of robustness that pertains to financial information. This is not to say that auditors cannot audit narrative or unstructured information; we mean this to say that the level of uncertainty that comes with that sort of information is naturally higher than for information that is structured, and for which robust processes and controls exist. Hence, even though it may be desirable to have financial and sustainability information being audited, and ideally with the same level of assurance, we would express our reservation about introducing a high level of assurance too quickly so as to not create any expectation gaps: As long as the audit regime against which an auditor performs his/her assurance does not cover every aspect of sustainability (and/or not to the same degree of robustness as is the case for financial information), it may be too early to require an audit with reasonable assurance, even though this would clearly be the preferred level.

In any case, and notwithstanding our preceding note of caution, the standards to be developed by the SSB should be of such quality that they contribute to collecting, processing and providing sustainability information that is capable of being verified and audited.

Question 11

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

We understand that this consultation is but the first step in a series of steps to follow. It is evident that if the Foundation were to respond positively to calls for it to become involved in sustainability reporting, changes to the Constitution of the organisation are necessary. It would be extremely helpful, if the Foundation provided clarity around the timeline of any such next steps, so that constituents and stakeholders can prepare themselves and get ready.

Further, we believe that the Foundation/the SSB should have digital reporting on their radar screen when venturing into the area of sustainability reporting. This should not be viewed as a nice-to-have but a must-have in order to get things right from the start. Information, whether financial or non-financial, is increasingly being processed in electronic format. Hence, any standards to be developed should already take a digital proliferation and consumption and their respective impacts into account.