CORPORATE REPORTING FACULTY

SHAPING SUSTAINABILITY STANDARD SETTING

What lessons can sustainability standard-setters learn from the experience of accounting standard-setters?

ICAEW

CONTENTS

FOREWORD

For the past 20 years, ICAEW has played a leading role in sustainability, working closely with governments, regulators, standard-setters and agencies such as the United Nations (UN). One of the key themes in ICAEW's current 10-year strategy is 'helping to achieve the UN's Sustainable Development Goals (SDGs)'. ICAEW is committed to making a leading contribution to the achievement of SDGs addressing poverty, protection of the planet and the promotion of peace and prosperity by 2030.

In this context, the fast-moving world of sustainability reporting is increasingly important. This is especially true of the progress made since 2021 by the International Sustainability Standards Board (ISSB), with its promise of a suite of international sustainability disclosure standards and a less fragmented global reporting landscape. With so much change happening at pace, many stakeholders we spoke to in late 2023 agreed that it was important to take a step back to reflect on what has been achieved in this area, and what might be done better.

The outcome of extensive discussions with stakeholders since then is this report on sustainability standard setting. It explores the lessons that sustainability standard-setters can learn from the experience of their accounting counterparts, drawing on ICAEW's considerable experience in international accounting standard setting. This dates back as far as 1973, when ICAEW hosted the inaugural meeting of the International Accounting Standards Committee (IASC), the International Accounting Standards Board's predecessor, in London.

This report is a considered contribution to the much wider debate about the challenges we all face around sustainability. I hope it will be of interest to a wide range of organisations and individuals with an interest in the development and future success of sustainability reporting.

Alan Vallance
ICAEW Chief Executive

1. SUMMARY OF KEY FINDINGS

This report analyses the key features of accounting standard setting and considers the challenges faced by sustainability standard-setters. Drawing on this analysis, it makes recommendations and observations, which are summarised below. These findings should be read in conjunction with the contextual information in section 2 of the report, and the detailed analysis in section 4. This section highlights 10 core standard-setting areas that we think should be given particular focus, together with our detailed recommendations.

1 CLARITY OF PURPOSE AND INTENDED AUDIENCE

Some of the debate around sustainability reporting stems from the lack of consensus about what sustainability reporting is and who it is for. While this may be inevitable to some extent, matters are not helped by sustainability standard-setters' contrasting approaches and views on some fundamental issues, such as the approach to materiality. This can be confusing for businesses and other stakeholders.

Clarity of purpose may have been achieved by individual standard-setters, but is lost when the broad sustainability standard-setting landscape is considered. We recommend that the role of ISSB standards is clearly articulated and agreed, relative to those of the Global Reporting Initiative (GRI), European Financial Reporting Advisory Group (EFRAG) and others, so as to define the relationship between the different sets of standards.

2 STRATEGIC PLAN AND DETAILED ROADMAP

While successful accounting standard-setters will always have a long-term plan, they must also be highly agile when unexpected or urgent issues arise. Long-term planning allows standard-setters to prioritise projects and allocate resources properly.

We strongly recommend that the ISSB publishes a clear and detailed roadmap setting out the steps that need to be taken for it to achieve its core objectives. This also includes how individual projects fit into its longer-term plan and the way in which the ISSB's work relates to the overall strategy, mission and objectives of the International Financial Reporting Standards (IFRS) Foundation. Presenting the bigger picture is essential, particularly for governments and regulators considering endorsement and adoption of the standards. They need to understand the bigger picture in the context of their own legislative priorities and opportunities.

3 CONCEPTUAL FRAMEWORK

To a considerable extent, the accounting standard-setting model provides a template for sustainability standard setting. One of the more significant features of the International Accounting Standards Board's (IASB's) standard setting is its Conceptual Framework – high-level, overarching principles covering key aspects of financial reporting.

The ISSB used the IASB's Conceptual Framework when it developed its first two standards, which we support as an interim step. However, this framework was created for a different purpose and contains relatively limited guidance on developing disclosure requirements, which makes it of limited use to sustainability standard-setters. While perhaps not an immediate priority, a conceptual framework designed for sustainability standard setting should feature prominently in the plans of the ISSB and other relevant standard-setters.

4 EFFECTIVE DUE PROCESS

Rigorous due process is a vital part of standard setting, and it is important that the ISSB and EFRAG followed specific and defined due process steps when producing their initial standards. Concerns have been raised with us about aspects of early due process, including communication and transparency around actions taken. These concerns have led to a perception of shortcomings in that due process among some stakeholders that, if repeated, could undermine confidence in the standard-setting process over time.

Quality is paramount. Established practices may need to be flexed in the face of time pressures, but sacrificing them without very careful consideration would be counterproductive. As time pressures abate, sustainability standard-setters should consider a steadier pace of activity. They should also consider whether existing due process steps, such as the post-implementation review (PIR) stage, need greater focus and enhancement given the relative youth of sustainability reporting standards generally.

5 INDEPENDENCE AND APPROPRIATE EXPERTISE

The main qualifications for IASB membership are professional competence and practical experience. It is also important that standard-setters are independent, unbiased and have no conflicts of interest. Even when supporting government policies, they should be free from political influence.

The ISSB's board includes people of high calibre, with a wide range of relevant skills and experience. Some flexibility in the selection criteria applied may be needed to ensure that this remains the case. This could be achieved, for example, by placing less emphasis on geographic coverage to ensure that there continues to be an appropriate level of subject matter expertise or stakeholder representation within the group, alongside sufficient diversity.

6 STAKEHOLDER ENGAGEMENT AND POLITICAL PRESSURES

Accounting standard-setters typically think of stakeholders as preparers, users and auditors of financial statements. These groups can encompass a wide range of individuals and organisations, including investors, regulators, governments, analysts and academics. However, there is an even wider range of stakeholders with an interest in sustainability reporting and, increasingly, it is also the subject of much political debate.

Arguably, stakeholder engagement should look rather different when comparing the ISSB's and EFRAG's outreach activities. Compared with EFRAG, the ISSB has a narrower primary user in mind. Nonetheless, effective engagement with this wider stakeholder group, to ensure adequate awareness of their views and concerns, is important if the ISSB's standards are to be regarded as truly legitimate.

7 AVOIDING DISCLOSURE OVERLOAD

Sustainability standards come with a significant volume of disclosure requirements. Inevitably, questions have been raised about whether this is just another example of overloading the annual report with information that will be costly to produce and of questionable benefit to most stakeholders. This is particularly relevant for sustainability standard-setters focused on the needs of a wide user group, such as EFRAG or GRI.

Cost-benefit considerations are a crucial element of developing reporting standards and should not be an afterthought. Sustainability reporting must not become just another box-ticking exercise where the focus is on compliance rather than communication. This would bring little benefit to investors and other stakeholders – or to the business itself – as it would result in boilerplate text that is of little or no interest to anyone. It is therefore important that any additional disclosure requirements adequately explain what information stakeholders need and how they will use it.

8 INTEROPERABILITY

Interoperability is arguably the biggest challenge for sustainability standard setting. While the ISSB has been working on its standards, the EU and the US have been developing their own requirements, making the pathway to a global baseline less clear. This creates challenges for companies with listings on different capital markets. It raises the prospect of individual companies having to report under two or more different frameworks.

EFRAG and the ISSB have been working together to improve the interoperability of their respective climate-related disclosure standards, resulting in some degree of alignment. However, not everyone is so optimistic about the interoperability of the two sets of standards. Interoperability is a worthy goal, but it should only be seen as a stepping stone towards greater convergence over time, alongside a suitable equivalence regime. A good foundation would be for major sustainability standard-setters to commit to minimising differences between their standards as a starting point when developing their own.

9 PRIORITISING IMPLEMENTATION

Like the IASB, the ISSB does not have the power to require jurisdictions to adopt its standards. For EFRAG, adoption is not an issue as its standards have been incorporated into EU legislation. However, EFRAG and the ISSB both face similar pressure from stakeholders to produce additional standards swiftly. Working on new standards inevitably takes precious resources away from implementation activities.

The ISSB should make the adoption and successful implementation of these standards its highest priority, as doing so is key to ensuring the whole project's continued success and credibility. Sustainability standard-setters should take care when producing implementation guidance that covers cross-cutting themes applicable in another body's standards to ensure such guidance does not conflict with others and create confusion rather than adding clarity.

10 ASSURANCE AND ENFORCEMENT

Like financial reporting, a critical aspect of good sustainability reporting is robust assurance and enforcement. Without these, there will be no certainty that information reported will be reliable or comparable. Similarly, like accounting standard-setters, sustainability standard-setters must produce standards that are of sufficient quality and clarity to allow for effective assurance and enforcement.

2. PURPOSE OF THIS REPORT

The creation of the ISSB within the IFRS Foundation in 2021 was one of the most significant developments in global corporate reporting in a generation. It laid the groundwork for the development of a suite of international sustainability disclosure standards and a less fragmented reporting landscape. It also provided opportunities for closer alignment of financial and non-financial reporting.

Developments elsewhere, in particular the European Commission's adoption of the European Sustainability Reporting Standards (ESRS), have also progressed quickly, especially when compared to the relatively sedate pace of accounting standard setting to which we had become accustomed in recent years.

With so much change happening at some pace – and with so much at stake – many stakeholders we spoke to agreed that it was important to take a step back to reflect on what has been achieved, and what might be done better.

This report is not an academic study and should not be interpreted as such. It reflects views we heard from stakeholders at a roundtable event held in London in September 2023 and a series of one-on-one interviews with standard-setters, policymakers, academics and others, conducted between September and November 2023. Naturally, the views noted in the report do not necessarily reflect the views of all of the project participants. Where appropriate, we have offered views of our own, which broadly align with positions we have taken in previous policy responses. Some references to relevant ICAEW policy responses are included.

THE AIM OF THIS REPORT IS:

- to reflect on the features of good accounting standard setting; and
- to discuss whether there are important lessons that sustainability standard-setters can learn from the experience of their accounting counterparts.

We refer frequently to the work of the IASB in the report. We do this because it is a body with over two decades of international standard-setting experience. It listened and learned and, over time, has become highly regarded on the global stage due to its reputation for governance, due process and quality. Its standards are widely applied around the world. We acknowledge that many – but not all – of the points we have highlighted in relation to IASB governance, oversight, processes and procedures apply to other accounting (and auditing) standard-setters, and that the IASB itself drew on earlier experience of standard setting in the US. We also acknowledge the GRI's contribution to sustainability standard setting, which has been considered during the development of this report.

Many of the suggestions we make are relevant to any standard-setting body. However, in many cases we have directed our suggestions towards potential improvements at the ISSB. We do this not because we think they are a poor standard-setter but because:

- we are a strong supporter of the ISSB's work and see the board as critical to the future of sustainability standard setting. We want to do all we can to ensure its success.
- many of the lessons we have identified are less applicable or relevant for standard-setters working under the restrictions of political remits.
- the report primarily takes an international/global perspective rather than a jurisdictional one.

The primary audience for this report is organisations or individuals directly or indirectly involved in the work of global standard-setting bodies. In particular, given the importance we attach to the success of the ISSB, we address the IFRS Foundation. The report should also be of interest to standard-setters generally, other policymakers, and those with an interest in the development and future success of sustainability reporting.

3. UNDERSTANDING THE CONTEXT FOR SUSTAINABILITY STANDARD SETTING

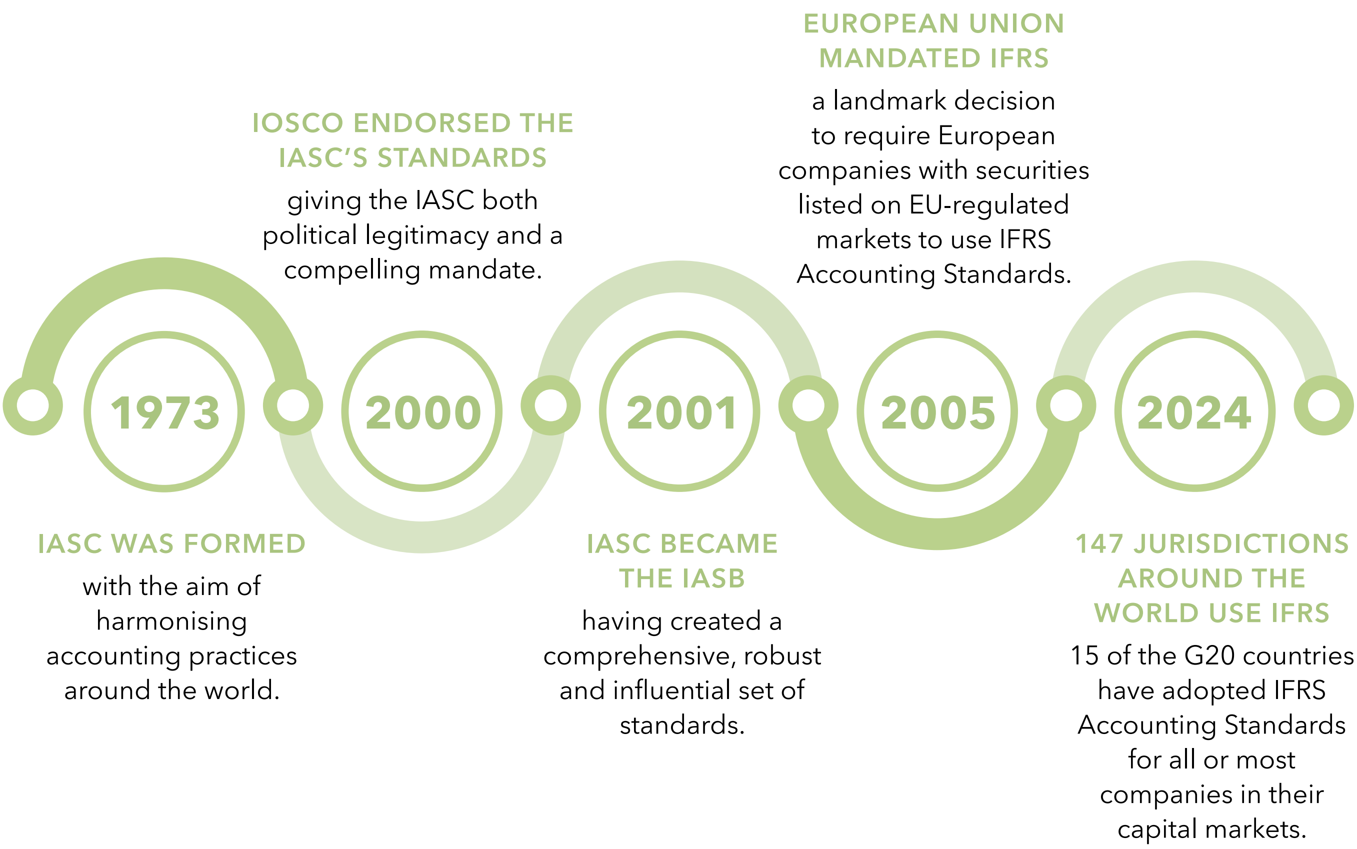
3.1 A HISTORICAL FOCUS ON FINANCIAL PERFORMANCE

The annual report has long been the cornerstone of corporate reporting. It is widely regarded as a key form of communication between businesses, investors and other capital market participants. However, corporate reporting is continually evolving in response to changing information needs and the demands of an ever-widening range of stakeholders and users. The dynamic nature of the modern business and regulatory environment means that the annual reports of today's large, listed companies are almost unrecognisable when compared to those of 20 years ago.

Historically, the annual report was focused on how a business was performing from a financial perspective. Accordingly, regulators and standard-setters directed their efforts to the creation of a framework of high-quality, widely accepted accounting standards.

For many years, each country had its own generally accepted accounting principles (GAAP). This made it difficult for users of financial statements to make comparisons between companies reporting under different regimes. Moreover, a company's performance when measured under one regime rather than another could be very different. This began to change with the formation of the International Accounting Standards Committee (IASC).

FIGURE 1: IFRS ACCOUNTING STANDARDS – A BRIEF HISTORY



3.2 AN INCREASED FOCUS ON NON-FINANCIAL INFORMATION

In recent years, there has been increasing investor demand for more information than that provided to meet the requirements of accounting standards. Other stakeholders, whose needs would not typically be met by traditional financial reporting, have also been seeking additional information. As a result, the annual report started to include more non-financial information. This information is sometimes referred to as narrative reporting.

Non-financial information is a broad term, which includes details of the company's approach to business risks and opportunities, and to broader societal and ethical issues. It also captures management discussion and analysis and corporate governance disclosures. The purpose of providing this information is not always clear and varies considerably depending on who you speak to – an issue we will return to later in this report.

One common aim is for non-financial information to increase transparency. This in turn should enable investors and other stakeholders to have a better understanding – and therefore more confidence – about an entity's risk management, governance, strategy, performance and prospects.

The approach to non-financial reporting varies, with governments and regulators introducing new local requirements in response to a variety of stakeholder demands and/or for political purposes. Each new requirement typically leads to an increase in the size and complexity of annual reports, resulting in concerns about clutter and information overload. A consequence of adding new requirements in such a piecemeal way is that annual reports can lack coherence and the connectivity that investors need.

3.3 SUSTAINABILITY REPORTING

Much of the discussion around non-financial information relates to sustainability risks and opportunities, especially climate-related issues. Sustainability reporting also covers wider environmental considerations such as biodiversity, as well as social responsibility and governance.

In recent years, a growing body of regulations, standards and guidance has emerged in relation to sustainability reporting, with an overall aim of helping companies to communicate pertinent information about sustainability matters in a coherent and meaningful way.

Created with the backing of the G7, the G20, the International Organisation of Securities Commissions (IOSCO), the Financial Stability Board and others, the ISSB is looking to build on the work of existing reporting initiatives to develop a high-quality, comprehensive global baseline of sustainability disclosures focused on the needs of investors and the financial markets.

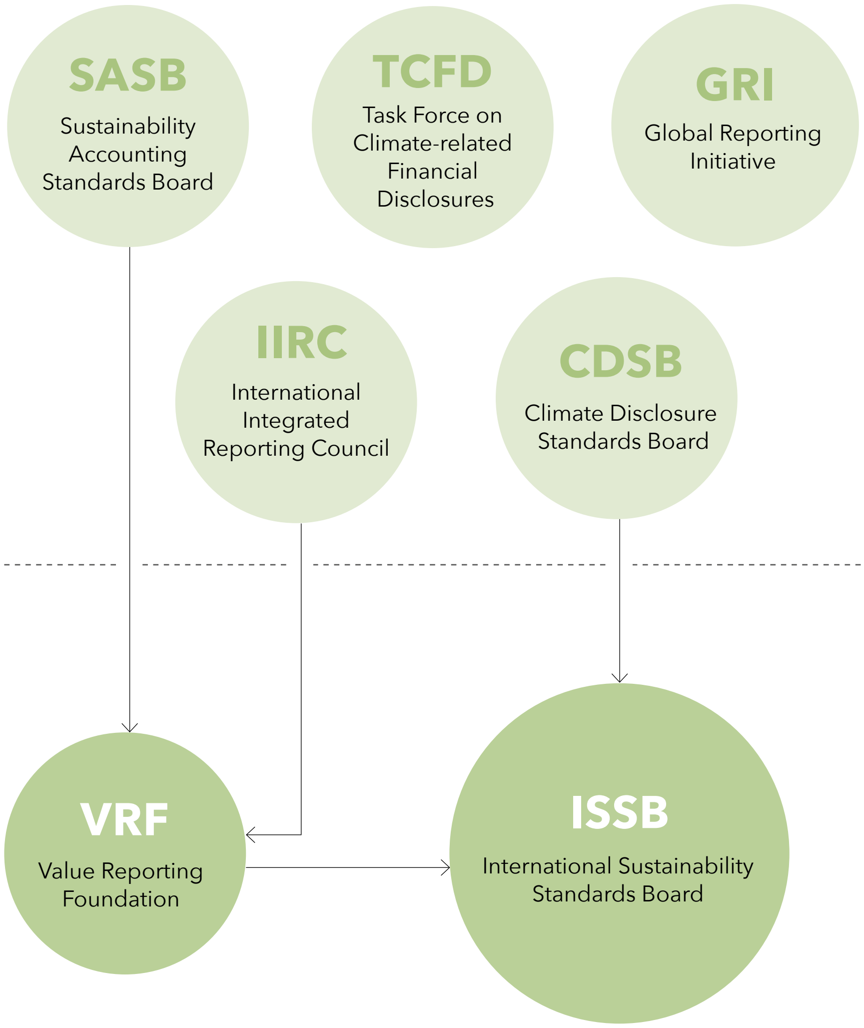
The first two IFRS Sustainability Disclosure Standards, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures,* incorporate and build on the work of the bodies depicted in figure 2. The ISSB is also working with the GRI, whose widely used standards are aimed at broader stakeholders, to ensure that the two sets of standards are compatible and interconnected.

Elsewhere, the EU's ESRS were adopted by the European Commission in July 2023. In the US, there have been some important initiatives at state level. In March 2024, the Securities and Exchange Commission (SEC) finalised its rules to enhance and standardise climate-related disclosures.

FIGURE 2: EVOLUTION OF THE INTERNATIONAL SUSTAINABILITY STANDARD-SETTING LANDSCAPE

PRE 2021

With sustainability factors becoming a mainstream part of investment decision-making, it became apparent that this fragmented landscape of largely voluntary requirements was not fit for purpose. A common global approach was needed if meaningful comparisons were to be made.

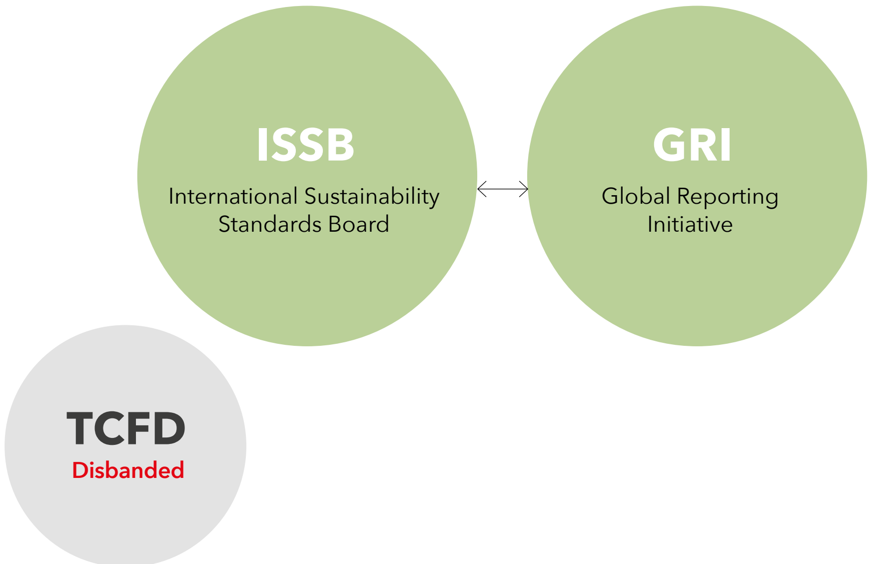


2021 TO 2022

In 2021, much progress was made, with the VRF formed as a merger of the IIRC and the SASB in June and the ISSB subsequently launched at the COP26 summit in Glasgow in November. During 2022, the CDSB, followed by the VRF, were both consolidated into the IFRS Foundation.

POST 2022

The ISSB standards are based on the recommendations of the TCFD, which was disbanded in 2023 following the finalisation of the first two ISSB standards. The ISSB works together with the GRI under a collaboration agreement.



4. KEY STANDARD-SETTING LESSONS

4.1 CLARITY OF PURPOSE AND INTENDED AUDIENCE

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

The IASB's Conceptual Framework explains that the objective of general purpose financial reporting is to "provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity". While other parties – including governments, regulators, rating agencies, customers, employees and members of the public – may find general purpose financial reports useful, they are not considered the primary users of such reports. Seeking to address the needs and interests of all the other users risks adding more and more information to the annual report to the point where it obscures what is important to its primary users.

The IASB's Conceptual Framework also clearly defines materiality, explaining that information is material if "omitting, misstating, or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports".

These IASB definitions are critical. They make it clear who financial reporting is for and how entities should assess what information should and should not be included in their financial statements. As such, they promote the objective that financial statements are focused on the primary users' decisions about providing resources to the entity and are not crowded with information not material to them in making those decisions.

Effective standard setting must seek a balance between relevance, comparability and enforceability. Balancing these competing objectives critically depends on what the reported information is to be used for. Clarity of purpose is paramount.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

The ISSB's sustainability disclosure standards have been designed specifically to provide reliable information to investors. They aim to help companies communicate how they identify and manage the sustainability-related risks and opportunities they face over the short, medium and longer term. The standards rely on the concept of financial materiality. As such, they share the same approach to materiality as the IASB's accounting standards, with disclosures only required if they are reasonably expected to influence decisions of the primary users (investors).

Despite this clearly articulated approach and intended audience, confusion remains about the purpose of sustainability reporting standards more generally. We have identified two issues that are contributing to this confusion.

Firstly, there is a lack of consensus among stakeholders about what sustainability reporting is and who it is for. Some agree with the ISSB's approach and see it as a way of helping businesses focus on creating long-term value for investors by encouraging them to behave in a more sustainable way. Others see it as a means of sharing information about how the business's activities impact on sustainable development so that stakeholders can make informed decisions about who they want to interact with, buy or sell to, work for and so on. There are also those who see it as a way to help countries and companies get to net zero more quickly. Perhaps it encompasses all these things. However, there seems to be little clarity about and agreement on the real purpose of sustainability reporting among businesses and other stakeholders.

In contrast to the ISSB's approach, the ESRS and GRI standards are aimed at meeting the needs of a broader group of stakeholders. This includes not only investors but also customers, suppliers, employees, local communities, regulators and others. Consequently, the ESRS rely on the concept of double materiality, which not only focuses on how sustainability issues affect the development, performance and position of the company (outside-in), but also on the company's impact on the economy, environment and people (inside-out). In other words, under the ESRS, materiality must be considered from both a financial and an impact perspective.

The fact that sustainability standard-setters have taken different approaches and have different target audiences is confusing. The different purposes overlap – they are neither entirely the same, nor entirely different. The ISSB has faced criticism that its approach is too narrow, whereas the European approach has been criticised for being over-ambitious.

Secondly, the ISSB's standards include a definition of sustainability-related disclosures, but do not define 'sustainability' or 'sustainability-related'. This is confusing for both businesses and stakeholders. The lack of a clear definition makes it hard to understand what activities will be captured by the standards and to envisage how wide-reaching their implications will be. It is possible for sustainability to be interpreted in different ways, which could lead to a lack of comparability and consistency when applying ISSB standards.

We acknowledge that there is no straight-forward or universally agreed definition of sustainability. We also recognise that there are potential drawbacks in including one. One potentially useful definition is provided by the United Nations (UN), which defines sustainability as "meeting the needs of the present without compromising the ability of future generations to meet their own needs".

It may also be useful if these standards and the disclosures they require were explicitly linked to the UN's SDGs. The UN's 17 interconnected goals are designed to provide a blueprint to achieve a better and more sustainable future and to address global challenges such as climate change and inequality. We note that the GRI integrates these SDGs into its sustainability reporting standards.

OUR RECOMMENDATIONS

The differences in the standard-setting approach between the ISSB and EFRAG – which develops the ESRS for the European Commission – reflects the different stakeholder expectations about core issues (who is being reported to, what is being reported, etc). These differences add to the difficulty of achieving a widely applied global baseline. Some steps have been taken to manage this difficulty, such as a common definition of financial materiality agreed by both organisations. However, we believe more action is needed.

Collaboration between the ISSB and GRI is likely to play an important role in bridging the gap between the ISSB's standards and the ESRS. As noted, GRI standards are aimed at a broader group of stakeholders (including investors). They focus on materiality from an impact perspective. This complements the ISSB's standards, which look at materiality from a financial perspective. Many of those we spoke to believe that a company that is simultaneously applying ISSB and GRI standards would broadly meet all the requirements of the ESRS. We recommend that the ISSB explore the possibility of shaping its standards in a way that provides a financial materiality lens to the subject matter addressed by the GRI's standards.

Clarity of purpose may have been achieved by each individual standard-setter, but that clarity is lost when considering the broad sustainability standard-setting landscape. We recommend that there is clear and agreed articulation of the role of the ISSB's standards relative to those of GRI, EFRAG and others, sufficient to define the relationship between the different sets of standards.

We also recommend that the ISSB reconsiders the benefits of including a definition of sustainability. Explanation of what the term is intended to capture would add crucial clarity around the limits of what is expected to be disclosed and help drive a universal understanding of purpose and scope.

4.2 STRATEGIC PLAN AND DETAILED ROADMAP

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

Successful accounting standard-setters need a long-term plan, but they also need to be agile enough to deviate from that plan and react quickly if an unexpected or urgent issue arises.

The IASB's technical work plan focuses on projects and activities that are steps towards the possible issuance of new or amended standards, or new interpretations. It is updated regularly, is available on the IFRS Foundation website, and includes estimates of project timelines reflecting recent board decisions. This long-term planning helps the IASB to prioritise its projects and allocate resources appropriately. It also enables interested parties to understand what is in the pipeline and identify opportunities to respond to discussion papers and exposure drafts.

Importantly, this work plan is shaped by agenda consultations held every five years, which seek formal public input on its balance and strategic direction. These agenda consultations also provide stakeholders with the opportunity to comment on which projects should be added to or withdrawn from the work plan. This approach means that, in a sense, it is stakeholders rather than standard-setters who set the agenda. Doing so ensures that projects are only added to the agenda where there is clear rationale for pursuing them – that is if there is a problem that stakeholders believe needs to be addressed. This is important as resources are limited.

The third agenda consultation was completed in July 2022. Previously, there was a tendency to overload the work plan with new projects following such consultations. However, the IASB appears to have taken a more conservative approach this time around, focusing much of its time and resources in the coming years on advancing projects that are already underway rather than starting new ones. This is in line with feedback received from stakeholders, many of whom advocated a period of calm. This more measured approach shows that the IASB is increasingly aware of its own capacity and that of its stakeholders.

While the consultations are the primary way to determine the IASB's work plan, the board can also add projects to it or change its priorities between consultations in response to changing circumstances. This is important, as sometimes the standard-setting process needs to be accelerated in response to urgent matters or unexpected developments.

This ability to be agile when necessary has enabled the IASB to respond rapidly and issue relatively minor amendments to its standards in response to emerging issues such as Interbank Offered Rate (IBOR) reform, Covid-related rent concessions and Pillar Two tax reform. However, there is a safety net in place that requires the IASB to consult with the Advisory Council and Accounting Standards Advisory Forum (ASAF) before it can add a major project that was not contemplated in the previous agenda consultation to its work plan.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

In recent years, the global economy has faced increasing uncertainty amid high levels of economic, social and geopolitical disruption. Against this backdrop, there has been much debate about whether the era of globalisation is coming to an end, with the world becoming more fragmented along geopolitical lines.

These economic and geopolitical challenges, coupled with many of the others we touch on in this report (such as competing stakeholder interests and ever-present time pressures), form a rather unstable and uncertain backdrop in which to set out a solid long-term plan.

There is a risk that the recent fast pace of sustainability standard setting may lead to a default position of agile rather than strategic, resulting in standard setting that is almost too reactive.

OUR RECOMMENDATIONS

The ISSB was formed with the aim of creating a high-quality, comprehensive global baseline of sustainability disclosures. While a clear long-term vision exists, more needs to be done to elaborate on this, such as through a coherent and detailed roadmap explaining to stakeholders more fully the desired destination and how the ISSB intends to reach it.

The roadmap should include how individual projects fit into its longer-term plan and the way in which the ISSB's work relates to the IFRS Foundation's overall strategy, mission and objectives. This is a gap that should now be addressed. Stakeholders both inside and outside of the IFRS Foundation need to know what success looks like.

The 2023 agenda consultation focused solely on what projects should be undertaken in the next two years rather than putting those projects into context by looking at how they fit into the bigger picture. However, looking at the bigger picture is essential, particularly for governments and regulators that need to understand this in the context of their own legislative priorities and opportunities when considering endorsement and adoption.

4.3 CONCEPTUAL FRAMEWORK

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

ICAEW has long argued that standards based firmly on principles result in a clearer and more understandable body of accounting literature. Such an approach is more likely to produce standards that are sufficiently flexible to accommodate complex and unforeseen eventualities and changes in the financial and economic environment. It also requires the application of judgement by companies and auditors.

Importantly, principles-based standards also reduce the opportunity to circumvent standard-setters' intentions. A more prescriptive, rules-based environment may invite reporting entities to structure transactions in a way that achieves a particular accounting outcome even if doing so does not reflect the substance of what is truly happening. This may result in unintended consequences.

However, if standards contain high-level principles alone, there are likely to be issues with comparability, as individual entities may interpret and apply those principles in different ways. The solution is to create standards that are based on principles but also provide clear and, where necessary, detailed guidance on how to apply those principles in practice.

The IASB is committed to writing principles-based standards and has largely avoided detailed rules-based solutions. Arguably, this is only possible because of the strength of its Conceptual Framework – high-level, overarching principles covering key aspects of financial reporting. The Conceptual Framework provides concise definitions of assets, liabilities, equity, income and expenses and provides guidance on how such elements should be recognised and measured in financial statements. This ensures that IFRS Accounting Standards are using the same principles and definitions and are interoperable with one another. The Conceptual Framework also provides guidance to help preparers and auditors deal with situations where standards-level guidance does not exist.

The IASB also provides a basis for conclusions with each of its standards, explaining how the board has applied the overarching principles set out in the Conceptual Framework and why the final standard says what it does. Several of the people we spoke to told us that this is generally helpful and enables them to understand the rationale behind the standard's requirements.

In contrast, US GAAP is generally thought of as being more rules-based, meaning that US standards tend to be more detailed than their IFRS counterparts. Moreover, US standards often include sector-specific material, application guidance and interpretations that are absent from IFRS Accounting Standards. But it is never going to be possible to create a rule for every situation or every individual sector. As such, standard-setters are not able to remove judgement – and therefore some degree of variability in how things are reported – from the equation.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

The IASB's Conceptual Framework is designed to assist the IASB in developing new or revised accounting standards and to help preparers applying those standards deal with issues that are not covered by them. By comparison, sustainability standard setting is a relatively new discipline. As we have noted, there is little agreement – even among sustainability standard-setters – about what sustainability information comprises, who sustainability information is for and what information is considered material. These questions, among others, could be addressed through the creation of a Conceptual Framework, specifically designed to guide future standard-setting activities by setting out the key concepts relevant to sustainability reporting standards. This is a matter that deserves more attention.

Close connectivity between financial reporting and sustainability reporting is essential if information produced for investors is to be high quality and compatible. Investors need general purpose financial reports to provide them with a holistic, comprehensive and coherent picture of a company. They want to understand how matters reported in financial statements and in sustainability-related financial disclosures are connected. A lack of connectivity may result in a misalignment between sustainability-related financial disclosures and financial statements, with disclosures potentially contradicting rather than complementing each other.

A few of those we spoke to are not convinced that it is possible for industry-based standards to also be principles-based because certain rules may be necessary for them to be industry specific. Inclusion of rules might be an acceptable compromise given the strong investor demand for industry-specific disclosures, but one that needs proper consideration.

OUR RECOMMENDATIONS

We acknowledge that some material from the IASB's Conceptual Framework has been brought into the ISSB's standard on general requirements for disclosure of sustainability-related financial information, along with elements drawn from certain other IFRS Accounting Standards. We applaud this as an interim step, but at the same time note that this material was created for a different purpose and much of it is consequently not ideal for creating sustainability reporting standards. Moreover, it contains relatively limited guidance on developing disclosure requirements, which makes it of limited use to sustainability standard-setters. Nonetheless, it could form the foundation for building a separate ISSB Conceptual Framework. This is something we encourage the board to focus on in the medium term.

In the longer term, we recommend that the ISSB and the IASB work together to produce a combined Conceptual Framework that addresses both financial reporting and sustainability-related matters. Doing so would ensure that companies' financial statements and their sustainability-related financial disclosures are more coherent and internally consistent.

4.4 EFFECTIVE DUE PROCESS

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

A key feature of successful accounting standard setting is rigorous and highly transparent due process which is consistently followed when developing new and amended standards. Due process is essential both for developing high-quality standards and for ensuring that stakeholders can be confident that all relevant views have been considered during their development. Good and open due process builds trust, legitimacy and acceptance of the standards.
The IASB's due process is now widely regarded as one of its key strengths (see figure 3). The requirements in the IFRS Foundation Due Process Handbook are built on the principles of transparency, full and fair consultation, and accountability. While the handbook sets out the minimum steps that must be taken, the IASB will often carry out steps and procedures over and above those required as it is continually striving to improve how it consults and operates.

Applying due process inevitably means that the development of new and amended standards takes time. While some may find this frustrating, we believe that it is the only way to ensure that stakeholders are fully engaged and that the final standards are evidence-based and of the highest possible quality. Several of those we spoke to about the relatively sedate pace of IASB standard setting welcomed the ample opportunity to share their feedback and identify possible implementation issues. Others, however, commented that it can at times take too long, with some projects remaining on the IASB's agenda for many years. However, some attribute this to a lack of rigour in project management of individual standards rather than due process per se. No matter the pace, it is important that the overall quality of the IASB's due process is very high, as this undoubtedly adds to its legitimacy as a global standard-setter.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

From the ISSB's launch at COP26 in November 2021, to the publication of its first exposure drafts in March 2022 and its first standards in June 2023, everything moved forward very quickly. This was in response to demands from the G20, the G7 and other international bodies. The ESRS have been developed and finalised over a similar timeframe, but have resulted in the simultaneous publication of an extraordinary 12 new standards. This pace reflects pressure from stakeholders and politicians to get things done in a short space of time, but it has inevitably had implications for due process.

Several of those we spoke to were of the view that this has meant that the ISSB – and more so EFRAG – have not listened closely enough to its stakeholders, shortcutting elements of proper due process and issued standards too soon.

There have certainly been some innovative aspects to the timeline that resulted in the publication of the ISSB's standards. Prototypes of its first two standards were developed ahead of the ISSB's creation and were published on the day it was launched. While these prototypes built on the established work of a number of organisations (such as the TCFD, the CDSB, the IIRC and the SASB), they were not subject to the due process of those organisations or the IFRS Foundation.

Responding to the urgent international demands meant that these prototypes were turned into exposure drafts in March 2022, without formal consultation on their contents. Moreover, at that stage the ISSB itself was still in the process of being established and was not quorate. This move was unprecedented and required special permission from the IFRS Foundation's Due Process Oversight Committee. This permission was granted on the condition that all subsequent due process steps are adhered to.

As part of our research, we heard concerns about the quality of this subsequent due process. Several people have told us that they feel that the whole process seemed rushed in the face of policy and stakeholder pressure. Further concerns were expressed about the depth and range of the ISSB's outreach activities.

FIGURE 3: IFRS FOUNDATION DUE PROCESS – KEY ELEMENTS

All board papers are available on the IASB's website and all standard-setting meetings are open to the public, who may attend as observers. Meetings are also webcast live, with recordings available on the IFRS Foundation's website.

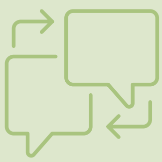
Each round of public consultation tends to be accompanied by an extensive outreach programme, including public round tables and online webcasts, as well as group and one-to-one visits. Interviews are also conducted with interested parties such as preparers, auditors, regulators or users of financial statements who are likely to be affected by the proposals.

Major projects will often begin with a discussion paper, which identifies the problem that needs to be addressed, outlines a range of alternative solutions and seeks stakeholder views. This is an important step in the process. It ensures that a wide range of views are sought at an early stage and that stakeholder input is considered before any major decisions on the project's direction are taken.

One or more exposure drafts will typically follow, setting out specific proposals and inviting comments on them. The IASB welcomes comment letters on its proposals from individuals as well as private and public bodies. Feedback is judged on the merit of the ideas presented, rather than the perceived importance of the commentator or the popularity of a given solution. All comment letters are posted with equal prominence on the IASB's website.

Each standard issued also includes an accompanying basis for conclusions, which provides added context and sets out the rationale for the IASB's decisions. Any dissenting opinions from board members are also published. This increases transparency and ensures that stakeholders can understand the thought process behind the standard.

The IASB is committed to assessing and explaining its views about the likely costs and benefits of implementing proposed new requirements. Proposals therefore include an effects analysis, which sets out how financial statements are likely to change because of the proposed new requirements, whether those changes will improve the quality of financial statements and whether those changes are justifiable considering the associated costs.



At the end of the project, the IASB publishes a feedback statement that explains how it responded to the broad themes it received comments on throughout the consultation. Each new standard or major amendment is also subject to a post-implementation review (PIR), which enables stakeholders to provide feedback on any areas where the standard is not working well in practice.

A few people suggested that the final standards should have been re-exposed before being issued as certain aspects were very different from what had originally been proposed. ICAEW (along with many of those we spoke to) accepts that compromises had to be made due to the urgency with which the ISSB was being asked to act. As part of its announcement to endorse the ISSB's standards, IOSCO commended both the pace and quality of the ISSB's work and recognised the robust process it followed.

Striking the right balance between urgency and due process is always very difficult but we think, overall, the ISSB has got this right so far.

Whether or not these concerns are valid, some stakeholders' perception of the due process could undermine confidence in the standard-setting process over time. This, in turn, could have wide-ranging impacts on its success in the longer term.

We have some more significant concerns about the due process applied by EFRAG to date, some of which ICAEW raised in its comment letter to EFRAG on the draft ESRSs. EFRAG has its own due process procedures for setting standards for sustainability reporting that are not dissimilar to the IASB's due process handbook. But again, we heard concerns about whether these procedures were applied rigorously, with the process rushed in the face of an inflexible – and tight – statutory deadline for completing the standards. Publishing 12 exposure drafts simultaneously for feedback is not explicitly in contradiction of the due process procedures, but few would say that such action is ideal in terms of good due process.

OUR RECOMMENDATIONS

Those we spoke to were keen for all parties involved to reflect on this feedback and determine what needs to be done in future to ensure that stakeholders can be confident that due process has been applied rigorously. We would also recommend that sustainability standard-setters continually re-assess the balance between urgency and due process as developments progress. Compromising due process in the face of time pressures will ultimately make it more difficult for sustainability standard-setters to obtain the global buy-in they need to succeed.

Much can be learned from the IASB experience, although it may not be necessary for sustainability standard-setters to replicate everything that the IASB does. For example, while discussion papers often form a very important step in the accounting standard-setting process, they may not be necessary in every case when it comes to setting sustainability standards, particularly if standards are being built on those already developed by others. For example, if the ISSB develops a new standard on nature-related matters based on the guidance issued by the Taskforce on Nature-related Financial Disclosures (TNFD), considerable outreach should have already been undertaken in developing the original framework.

However, care needs to be taken. The quality of due process undertaken by other bodies will not necessarily be considered equivalent to that undertaken by an organisation like the IFRS Foundation. Sustainability topics are not always well understood, so standard-setters should endeavour to raise awareness of them and educate stakeholders about them in order to fully engage them in the consultation process. This is an important issue. We recommend that the case for not issuing a discussion paper – and the potential downsides – are carefully considered on a case-by-case basis.

In some instances, elements of existing due process practices may need to be enhanced for sustainability standard setting. Given the relative youth of sustainability standards and their principles, we believe the PIR process should play a bigger role. Recent IASB PIRs tend to focus on whether the board's original objectives have been met rather than whether the objectives were right in the first place, which is perhaps a more critical question to consider.

In other instances, it may not be possible for sustainability standard-setters to follow established IASB steps. For example, it could be more challenging for them to produce meaningful effects analyses, when, in contrast to the world of accounting, there is less historical data or academic research into sustainability standard setting that standard-setters can use when attempting to quantify expected benefits.

4.5 INDEPENDENCE AND APPROPRIATE EXPERTISE

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

It is important that standard-setters are independent, unbiased and free from conflicts of interest. They should not be unduly influenced by any individual stakeholder or group of stakeholders. Similarly, they should not be unduly influenced by those with vested interests that conflict with the public interest. Even if supporting government policies, they should be free from political influence.

In the early days of international standard setting, the nascent IASC struggled to meet these ideals, but the IASB's governance and due process are designed to keep its standard-setting process free from vested interests. The IFRS Foundation trustees are responsible for the IASB's governance and oversight. The trustees, in turn, are overseen by a monitoring board of capital market authorities whose members include representatives of – among others – IOSCO, the European Commission, the US SEC, the Chinese Ministry of Finance and the UK Financial Conduct Authority. This three-tier structure is widely regarded as a best-in-class approach to both governance and oversight. As such, it adds legitimacy to the IASB's standard-setting activities.

Among other things, the trustees are responsible for appointing IASB members. The IFRS Foundation's constitution sets out the requirements for members, including qualifications, background, length of term and criteria for selection. The main qualifications for IASB membership are professional competence and practical experience. The board is required to represent the best available combination of technical expertise and diversity of international business and market experience. To ensure broad international diversity, the constitution requires four members from the Asia/Oceania region, four from Europe, four from the Americas, one from Africa and one appointed from any area, subject to maintaining overall geographical balance.

IASB members are mostly full-time employees, meaning they are not only independent but can also dedicate all their time to standard-setting activities. While having full-time board members is perhaps the ideal scenario, we acknowledge that this won't always be possible, or necessary. For example, the best way to get representation from certain stakeholder groups at board level may be to appoint someone on a part-time or volunteer basis. What is critical, however, is that board members are acting in the public interest and are publicly accountable.

Nonetheless, the IASB's independence has sometimes been called into question. For example, the EU gained a high degree of influence after its decision to require listed companies to use IFRS Accounting Standards from 2005 onwards made it the IASB's most important 'customer'. Further concerns arose in the wake of the 2008 global financial crisis when the IASB was put under pressure from the EU to make amendments to IAS 39 Financial Instruments: Recognition and Measurement without following its normal due process. Around this time, some also felt the US was gaining too much influence, as the IASB and the US Financial Accounting Standards Board (FASB) were working bilaterally to address some of the issues brought to the fore during the crisis and to achieve greater convergence between their respective sets of standards.

But the influence of both the EU and the US has arguably waned in recent years as the use of IFRS Accounting Standards has continued to spread, meaning that the IASB now has an increasing body of stakeholders to consider. Questions about the IASB's independence and legitimacy will, inevitably, continue to be raised from time to time. But, on the whole, the IASB's open, inclusive and transparent due process mean that it is widely considered to be an independent standard-setter that is not unduly influenced by political or other special interest groups. That said, independence is something that needs to be constantly worked on and demonstrated.

How standard-setters are funded is also key to their independence and people's perception thereof. Ideally, any over-reliance on political or corporate donations should be avoided. The IFRS Foundation is funded through a mix of contributed and earned revenue.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

Whether by design or not, sustainability reporting affects a wide range of stakeholders in addition to those typically affected by traditional corporate reporting. Among others, this includes non-governmental organisations, charities, voluntary and community organisations, and other civil society organisations. During our outreach, a few individuals we spoke to suggested that consideration should be given to whether representatives of these groups should be given a seat at the boardroom table.

We note that the Global Sustainability Standards Board – which oversees the development of GRI standards – is drawn from a wide range of stakeholder communities and is required to include not only members from the business community, but also from civil society, investment institutions, mediating institutions and labour constituencies. Given its focus on investors, this is not something that the ISSB seems likely to replicate.

The current geographic make-up of the ISSB's board mirrors that of the IASB. While this split makes sense for the IASB, it is worth considering whether this approach is entirely appropriate for the ISSB – something ICAEW commented on in response to the IFRS Foundation's consultation paper on sustainability reporting. The 14-person board currently includes four members from North America, three of whom worked for the SASB before taking up their current posts. Similarly, there are four board members from Europe including the chair. In both instances, these numbers seem excessive to a few we spoke to given that neither the US nor the EU is likely to adopt the ISSB's standards. The balance also seems to be tilted towards the global north with no current members from, for example, South America.

Of course, everyone we spoke to acknowledged that the world of sustainability reporting is relatively new and finding people with the right skills and experience will not always be easy. One additional challenge is that sustainability standard-setters will need to draw on a more diverse range of experience in terms of subject matter coverage given the nature of sustainability reporting.

OUR RECOMMENDATIONS

The ISSB's board includes people of high calibre, with a wide range of relevant skills and experience. Some flexibility in the selection criteria applied may be needed to ensure that this remains the case. This could be achieved, for example, by placing less emphasis on geographic coverage to ensure that there continues to be an appropriate level of subject matter expertise or stakeholder representation within the group, alongside sufficient diversity. However, it should be accepted that it is not necessary for the board – or staff – to have expertise in every subject and that it may be necessary from time to time to bring in subject matter experts or form expert groups to work with the board on developing standards on specialist topics.

The IASB's criteria for board membership makes it clear that, among other things, they should have good analytical, communication, negotiating and influencing skills. ISSB members, in particular, will also need the skills to support the process of adopting a brand new set of sustainability standards.

4.6 STAKEHOLDER ENGAGEMENT AND POLITICAL PRESSURES

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

When undertaking public consultations, accounting standard-setters should actively seek feedback from a wide range of stakeholders and be seen to listen to what they have to say. Again, this is something the IASB tends to do well.

The IASB tries to ensure that it gets balanced feedback from all relevant parties. Many of the comment letters it receives are from those with the technical expertise and resources to understand the proposals and respond fully to them. However, the IASB is responsible for developing standards that serve the needs of investors. Unfortunately, when it comes to comment letters, investors tend to be under-represented. The IASB therefore takes additional steps to try to ensure that investors can participate in the development of IFRS Accounting Standards.

Whenever major proposals are published, the IASB produces a high-level snapshot summary of the main requirements, which is written for a general business audience. This is accompanied by a comprehensive programme of outreach activities, all designed to allow investors and the public at large to better understand the IASB's work and comment on the general principles being proposed.

The IASB consults extensively with a broad range of other bodies and organisations (many of which are illustrated in figure 4). Partnering with these bodies enables the IASB to reach a wider range of stakeholders than would otherwise be possible. It also means those stakeholders are more willing to buy in to the whole standard-setting process, knowing that their voices are being heard.

Overall, the IASB has an impressive track record of listening to a wide range of stakeholders and responding to what those stakeholders see as important. This holds true throughout the entire standard-setting process, from the initial identification of potential issues to the issuance and implementation of its final standards. Nevertheless, some we spoke to raised concerns that the IASB has sometimes been too eager to find a compromise that pleases everyone. Listening to stakeholders is important, but effective standard-setters also need to provide leadership and shape opinion.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

There is no doubt that sustainability is of growing interest to investors. But it is also a topic of interest to a wide range of other stakeholders, such as customers, suppliers, employees, local communities and regulators. Increasingly, it is also becoming the subject of much political debate.

Many stakeholders are pushing for urgent and immediate action when it comes to sustainability reporting. Those who support its wider use see it as a way of helping businesses to be less myopic, encouraging them to look beyond short-term profits and focus on creating long-term value for investors. Others see it as an essential component of efforts to decarbonise the global economy and moving towards net zero. But support is not universal, with some insisting that sustainability issues simply don't affect them or arguing that the costs of making additional disclosures outweigh the benefits. Some have even suggested that the increased focus on sustainability reporting is anti-growth and anti-jobs.

Politicians in some countries have criticised the increase in sustainability reporting – this is sometimes referred to as an 'ESG backlash'. Much of the focus has been on the incorporation of climate change considerations into investment decisions.

The backlash is most evident in the US, with at least 165 anti-ESG bills introduced in 37 states during 2023 alone. These bills often seek to prohibit state agencies from doing business with certain firms or require asset managers for state funds to de-prioritise ESG criteria when making investment decisions. These bills were introduced by Republican lawmakers, showing just how polarising the issue has become.

We have highlighted the importance of standard-setters being independent, unbiased and free from conflicts of interest. However, there will always be special interest groups, lobbyists, politicians and governments who try to influence the standard-setting process.

The IASB's principles-based approach to standard setting and the largely sector-agnostic global standards that it produces means that the impact of such lobbying is diluted. For example, if a standard-setter is consulting on proposals that affect a wide range of businesses around the world, it will hopefully receive feedback from a wide range of stakeholders.

The voice of a lobbyist from a specific sector or political persuasion will be just one of many that they hear. In contrast, if a standard-setter is consulting on sector-specific proposals that affect a small number of businesses in a specific geographical location, the voice of that lobbyist and like-minded people will be amplified within a much smaller pool of respondents.

Standard setting on the global stage has always – and will always – involve negotiating a path through competing stakeholder and political pressures.

It is something that the IASB has had to deal with over the years. So, the situation the ISSB and other sustainability standard-setters are currently facing is not without precedent. While the political pressures are formidable, it should be possible to navigate a way forward. Many of the other issues we have mentioned in this report – such as good due process, transparency and independence – should help protect sustainability standard-setters from undue political interference.

FIGURE 4: THE IASB CONSULTS AND WORKS CLOSELY WITH A WIDE RANGE OF BODIES AND ORGANISATIONS

OUR RECOMMENDATIONS

It is important that standard-setters seek to obtain balanced feedback from all relevant parties whenever they undertake a public consultation. The IASB seeks to listen to a wide range of stakeholders and respond to what those stakeholders see as important. This is something that sustainability standard-setters are making every effort to replicate, and should continue to do so.

Accounting standard-setters typically think of stakeholders as preparers, users and auditors of financial statements. These groups can encompass a wide range of individuals and organisations, including investors, regulators, governments, analysts and academics. However, as already noted, there is an even wider range of stakeholders with an interest in sustainability reporting in the user category. In contrast to say EFRAG, these stakeholders do not represent the ISSB's primary user and therefore do not represent its target audience.

Many of these additional stakeholders have little or no interest in financial reporting and are likely to have little or no history of engagement with standard-setters. It is, nonetheless, very important that the ISSB and other sustainability standard-setters make every effort to engage with them to grow their knowledge and ensure that they can assess the importance of such stakeholders' views and concerns to their primary audience. Sustainability standard-setters must not assume that stakeholders have a full knowledge of their work.

Effective engagement with this wider stakeholder group is important if the ISSB's standards are to be regarded as truly legitimate. The mechanisms developed by the IASB for engaging with users may be a helpful starting point when it comes to reaching out to these additional stakeholders, but it is likely that the ISSB will also have to develop and continue to refine new and additional mechanisms for doing so, drawing on the long experience in this area of bodies like the GRI. Standards that include sector-specific requirements create additional pressures as the feedback received may be unbalanced if only stakeholders from that sector respond. Sustainability standard-setters need to be aware of this risk when assessing feedback and charting a way forward.

At first glance, it may seem that sustainability reporting requirements will only affect preparers of large company reports. However, the impact is likely to be much wider. For example, the requirements for a listed entity to report greenhouse gas emissions that occur throughout its value chain may mean that smaller entities will be required to have some understanding of these requirements so that they can provide information those larger entities need for their sustainability reports. Sustainability standard-setters need to find ways to engage effectively with these smaller entities to ensure that their views are heard, otherwise they may be affected disproportionately. This will again be challenging, especially as many value chains encompass entities in the global south and developing countries that would not typically engage with the standard-setting process.

4.7 AVOIDING DISCLOSURE OVERLOAD

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

Concerns have frequently been raised about the number of disclosures IFRS Accounting Standards require and how they add to what some see as the 'disclosure overload' in the annual report and accounts. Many of these concerns come from the preparer community, who often find it costly and burdensome to meet all the disclosure requirements. In our experience, investors typically want more disclosure, not less – although, of course, they do not directly experience the associated costs. Getting the balance right is an ever-present challenge.

The IASB has dedicated considerable time and resources to its disclosure initiative over the last decade, undertaking a series of projects designed to respond to calls to simplify and rationalise disclosure in financial reports. Progress has been made in a number of areas, including steps to ensure that new disclosure requirements are more objective driven in an attempt to move away from a checklist mentality.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

Adding to reporting requirements must not be taken lightly. It is crucial to undertake a comprehensive cost-benefit assessment when developing any new or additional reporting requirements that considers stakeholders beyond the reporting entity and throughout the value chain.

What is certain is that sustainability standards come with a high disclosure burden. Inevitably, questions have been raised about whether this is just another example of overloading the annual report with information that will be costly to produce and of questionable benefit to most stakeholders. This is particularly relevant for sustainability standard-setters, such as EFRAG or the GRI, focused on the needs of a user group beyond investors.

While these concerns may be valid to some extent, both ISSB standards, and to a large extent the ESRS, only require disclosures where matters are considered material. Perhaps more effort is needed to communicate this. Preparers need to be made aware that the first thing they need to do for each topic is apply a materiality filter and that disclosures are not required for matters that are not considered material. So, while there is a significant amount of information that entities could potentially be required to disclose, the average company will only need to disclose a fraction of it.

OUR RECOMMENDATIONS

Ultimately, sustainability reporting will not succeed if it is widely viewed as an exercise that brings little real benefit to investors. If that happens, it risks becoming just another box-ticking exercise where the focus is on compliance rather than communication. Doing so would only result in more boilerplate text that is of little or no interest to investors. It is therefore imperative that sustainability standard-setters work hard to really engage with companies at the most senior level to ensure that there is real and ongoing support from those at the top.

Although ICAEW advocates principles-based standards, we accept that standards sometimes need to be prescriptive, provided that the more detailed material is built on the foundation of a sound, up-to-date conceptual framework. This is particularly relevant when it comes to disclosure requirements, where too much focus on high-level principles and objectives, and not enough focus on specific disclosure requirements, may result in poor quality, inconsistent disclosures that are likely to impair comparability.

In our view, disclosure objectives should be provided to set out the high-level principles, but they should be supported by clear and granular explanations of what information users want and how and when that information is used. Preparers will then be better able to apply a materiality filter and assess whether a disclosure is needed and, if so, what information needs to be provided. In this respect, the ISSB should leverage the IASB's thinking as part of its disclosure initiative.

Requirements that are not prescriptive enough are likely to result in a lack of comparability and risk creating greenwashing opportunities. Conversely, disclosure requirements that are too detailed can lead to a compliance mindset and risks profuse information being disclosed that does not allow users to identify what is important to them. The standards should always encourage disclosure of information that is useful for decision-making, provided in a consistent and comparable way.

Many businesses have existing systems, processes and metrics relating to sustainability matters that work well in the context of their business models. It would be a standard-setting failure if these ended up being scrapped or neglected in response to requirements that were so rigid that businesses felt that they had to unnecessarily create entirely new processes solely to generate information mandated by the standard.

Sustainability standard-setters need to focus on raising awareness of how the materiality filter works as part of their stakeholder engagement activities. Educational guidance on how to prevent material information from being obscured by immaterial information would also be helpful. Guidance on fundamental matters such as the application of materiality should not be developed unilaterally though. Work on interoperability should extend to guidance as well as standard setting.

4.8 INTEROPERABILITY

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

Most practising accountants are too young to recall a time when financial reporting was not governed by accounting standards. We now take standards for granted. However, the UK's first authoritative accounting guidance did not begin to appear until the 1940s. The guidance was issued by ICAEW as *Recommendations on Accounting Principles*, but remained non-mandatory. It was not until the 1970s that the UK's first mandatory accounting standards were issued. Until then, best practice was largely a matter of judgement. A similar story applies throughout much of the world.

The primary aims of those early, rather succinct, recommendations and standards were to capture and codify best practice and to eliminate diversity in practice. Their contents largely reflected existing best practice.

Many codified national GAAPs existed when the IASC was launched in 1973, meaning the international standard-setting project had a myriad of existing widely applied laws and standards to build upon. The IASC's early standards were also quite brief, although for political reasons they typically included more accounting policy choices than national GAAPs.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

International standard setting for sustainability reporting has had a different starting point. There are many existing and largely voluntary frameworks, such as the GRI and SASB, but nothing comparable to the well-established best practice or national GAAPs that the IASC sought to harmonise during its early years. Some governments have incorporated a degree of sustainability reporting regulation in local laws, but on a global level much of what the ISSB and other sustainability standards-setters are looking to create is largely being developed from scratch. This is both an opportunity and a challenge.

As noted earlier, a number of different bodies have been consolidated into the IFRS Foundation. Indeed, many elements of the ISSB's inaugural standards draw on the standards of these organisations or refer to them. Moreover, they also reference other measures and metrics such as those of the Greenhouse Gas (GHG) Protocol. This contrasts with the approach adopted by the IASB, which has always tried to avoid mentioning standards and guidance created by other standard-setters, agencies or bodies. While there are clear reasons behind the ISSB's different approach, such as the political imperative and the need for speed, questions have nonetheless been raised about how heavily the ISSB is relying on the work of others. A number of those we spoke to are concerned about how some of the pre-existing frameworks being drawn on or referenced have been developed. Others have asked whether it is right to assume that what these bodies have produced has been subject to rigorous due process and stakeholder consultation. As part of our outreach, several people challenged whether some of what is being incorporated is fit for purpose.

While the ISSB has been working on its standards, EFRAG and the US SEC have continued to develop their own solutions. These requirements are designed for their specific jurisdictions and entities that have operations in those jurisdictions and are not intended to be used more widely. However, they make the pathway to a truly global baseline less clear. They also create challenges for companies with listings on different capital markets, as it raises the prospect of individual companies having to report under two or more different frameworks. For example, an SEC registrant that has a subsidiary listed in the EU and a subsidiary in a jurisdiction that requires ISSB reporting could potentially be required to report under all three regimes. This is clearly an unsatisfactory situation.

The European Commission, EFRAG and the ISSB have been working together to improve the interoperability of their respective climate-related disclosure standards. This work has resulted in a degree of alignment between the two sets of standards, which should reduce complexity and duplication to some extent for entities wishing to apply both the IFRS Sustainability Disclosure Standards and the EU's ESRS.

EFRAG's August 2023 paper on interoperability between the ESRS and the ISSB's standards concluded that "companies that are required to report in accordance with ESRS will to a very large extent report the same information as companies that use ISSB standards". It added that "the very high degree of interoperability between ESRS and the two ISSB standards significantly reduces the risk that companies required to report in accordance with ESRS will also be expected to report separately under ISSB standards".

However, several of those we spoke to are not so optimistic about the interoperability of the two sets of standards which, in their view, are more different than EFRAG suggests. They were particularly worried about the implications of double materiality and how the additional information that this will entail could obscure what is important to investors. They also questioned whether an auditor could sign off on a single set of disclosures having concluded that it complies with both sets of standards. We note that the ISSB is undertaking its own detailed assessment of interoperability.

The SEC's requirements were only finalised in March 2024, so to our knowledge little detailed work has been done on their interoperability with the other two climate-related standards at this stage. However, there was a lot of alignment between the ISSB's standard on climate-related disclosures and the SEC's proposed climate-related disclosure rule as both are based on the TCFD framework.

There was a time when US GAAP was being talked about as a potential global accounting language. Ultimately, this did not happen as jurisdictions did not want to commit to a set of standards that were created for a specific country and over which they had little or no influence, having had no representation on the relevant bodies. The same issues are likely to prevent the ESRS or equivalent US requirements from being adopted globally, as jurisdictions will again find it difficult to accept standards if they cannot fully participate in their development.

Ironically perhaps, it was the EU's backing that gave IFRS Accounting Standards the momentum that propelled them towards becoming a truly global set of standards. Clearly, the same dynamics do not apply when it comes to sustainability standards. But multinational companies do not wish to report under multiple reporting regimes, so there will be pressure for requirements to be brought ever closer together.

OUR RECOMMENDATIONS

We encourage the ISSB to finalise and publish its interoperability assessment at the earliest possible opportunity to inform the debate and improve stakeholders' understanding of just how interoperable the two sets of standards really are. The ideal solution here would be a jointly issued interoperability table.

Interoperability is a worthy goal, but it should only be seen as a stepping stone towards greater convergence over time, alongside a suitable equivalence regime. Ultimately, the ambition should be to emulate what the IASB has achieved to date in its mission to create a truly global set of standards that are widely used around the world. This will be no easy task, especially as both the EU and the US have taken their own separate paths. But if there is to be a global set of sustainability standards, those we spoke to tended to regard those issued by the ISSB – possibly in conjunction with those issued by the GRI – as the best option.

While local standards are likely to remain a feature of sustainability reporting in the EU, US and elsewhere, those we spoke to agreed that it was not unrealistic to expect all major players to work together to build a consensus that enables them to create a global baseline they can all agree on. A good foundation would be for them to commit to minimising differences between each other's standards as a starting point when developing their own.

So, for example, the ISSB should use the EU's standards on issues such as pollution, water and marine resources as a starting point when looking to develop its own standards on the same subjects. Likewise, the EU should look to the ISSB's sector-specific guidance when developing similar requirements of its own. In fact, the CSRD requires that the work of global standard-setting initiatives for sustainability reporting are taken account of "to the greatest extent possible". Where necessary, modifications should be made over time to existing standards to ensure that any remaining differences between the various sets of standards are kept to a minimum.

Beyond the ESRS, we feel that the ISSB should continue to leverage the work already done by others when developing additional standards. This will accelerate the process and increase the chances of global harmonisation. Partnerships with organisations such as the GRI and the TNFD are likely to be instrumental in moving things forward. However, the ISSB should exercise caution and only incorporate the work of bodies that have followed demonstrably rigorous due process when developing its standards. Even then, any proposals to include pre-existing materials into the ISSB's own standards should be subject to its own due process.

It may take time, but we believe that a truly global baseline is achievable in the medium term. Ultimately, we may end up with a bipolar world similar to that in accounting, with the US retaining its own reporting requirements and most others applying standards developed collaboratively by the ISSB, GRI and EFRAG. That, in itself, would be a great achievement.

4.9 PRIORITISING IMPLEMENTATION

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

The IASB seeks to improve understanding of its standards and equip preparers with the skills needed to implement them through educational initiatives. In recent years, it has also helped preparers to apply major new standards through the creation of Transition Resource Groups (TRGs). These groups are used to identify implementation issues and provide support in the form of webinars, case studies and other materials where needed. Preparers have welcomed the creation of and output from these TRGs.

Beyond the initial implementation phase, the IFRS Interpretations Committee plays a role in ensuring that IFRS Accounting Standards are applied consistently. It is responsible for responding to questions about application issues and providing timely guidance on matters not specifically addressed in the standards.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

Like the IASB, the ISSB does not have the power to require jurisdictions to adopt its standards. Work is progressing in several jurisdictions – including the UK, Canada, China, Japan and Singapore – that is expected to lead to their adoption or the creation of local requirements based closely on ISSB standards. These and other jurisdictions will typically need to follow an endorsement process before the standards are adopted. This will inevitably take time.

For EFRAG, adoption is not an issue as its standards have been incorporated into EU legislation. However, EFRAG and the ISSB both face similar pressure from stakeholders to swiftly produce additional standards. In the ISSB's case, the pressure is to produce further topical standards. For EFRAG, the focus is now on SME standards as well as sector-specific material. This presents a challenge for sustainability standard-setters, as working on new standards inevitably takes precious resources away from implementation activities.

Much has been achieved in a short time since the ISSB's formation in November 2021. While IFRS S2 focuses on climate-related disclosures, IFRS S1 provides a framework for and requires reporting on the full breadth of sustainability issues, not just climate, and so the reporting on other topics should be just as extensive. These two standards provide a good foundation for sustainability reporting, so we suggest that now is the time for the ISSB to allow some breathing space.

If the ISSB achieves widespread global adoption of the initial standards, this could form an excellent foundation for growth and expansion into new topic areas. But without securing this foundation, developing and producing new standards may not achieve the desired impact.

We are pleased to note the launch of the ISSB's Transition Implementation Group (TIG) in September 2023, established to support implementation of the ISSB's first two standards. The TIG will provide a public forum for stakeholders to share implementation questions with the ISSB and to follow the discussion of those questions. These discussions will help the ISSB determine what, if any, action will be needed to address the implementation questions. Possible actions include providing supporting resources such as webinars, case studies and other educational material. This approach echoes that of the IASB's TRGs and is likely to be of benefit to preparers.

OUR RECOMMENDATIONS

At this stage, rather than being drawn into competing with other standard-setting bodies and rushing to issue further topic-specific standards, the ISSB should focus on supporting the rollout of IFRS S1 and IFRS S2. As highlighted in ICAEW's response to the ISSB's consultation on agenda priorities, we agree with those we spoke to who thought that the ISSB should make the adoption and successful implementation of these standards its highest priority, as doing so is key to ensuring the whole project's continued success and credibility.

The endorsement of the ISSB's standards by IOSCO – which echoes its endorsement of IFRS Accounting Standards over 20 years ago – is likely to result in further jurisdictions exploring how they can incorporate the standards into their respective legislative frameworks. IOSCO's endorsement is just the beginning of global acceptance though and the ISSB must be careful not to rely too heavily on it. In our view, the ISSB should prioritise working with jurisdictions to understand the relative roles of governments and regulators and to encourage them to endorse, adopt and implement their standards as soon as possible. Doing so is essential if the ISSB is to build the critical mass that is needed to take the project forward.

If we are to have a truly global baseline, every effort should be made to convince jurisdictions that the full benefits of adopting the standards can only be reaped if they are adopted in their entirety and unchanged from their original form. ICAEW's response to the UK's call for evidence on UK endorsement of IFRS S1 and IFRS S2 highlighted the importance of this. Jurisdictions should therefore be encouraged to set a high threshold for amending the published standards or carving out elements of them. Anything else risks undermining consistency and comparability.

Some companies – including some larger listed companies – appear to be ill-prepared for the introduction of either the ISSB's or EFRAG's standards. It is therefore important that the sustainability standard-setters learn from the experience of the IASB, GRI and others and do all that they can to educate preparers and raise their awareness of what implementing these standards will involve. Education initiatives and capacity-building efforts should not only focus on accountants and finance professionals. They should also encompass other groups that form part of the preparer community, such as engineers and scientists, and their professional associations, who have a role to play in ensuring that sustainability reporting is of the right quality.

Another possible way of supporting implementation would be to seek out corporate champions of varying types and sizes who are willing to actively embrace the ISSB's standards and enthusiastically promote their use.

EFRAG has also taken steps to support implementation of its standards. Early in 2023 EFRAG took the sensible decision to delay the drafting of its sector-specific standards and focus on implementation activities. EFRAG has recently been working on non-authoritative implementation guidance covering what it deems to be the most challenging aspects of ESRS implementation: materiality assessment, value chain and ESRS datapoints. These steps are welcomed by many, but we have heard widespread concerns about the unilateral efforts in developing implementation guidance on core sustainability reporting concepts. We recommend that EFRAG engages with other sustainability standard-setters when working on implementation guidance to ensure such guidance does not conflict with others and create confusion rather than clarity.

4.10 ASSURANCE AND ENFORCEMENT

KEY FEATURES OF EFFECTIVE ACCOUNTING STANDARD SETTING

Once issued, not only do the standards need to be implemented, but they also need to be assured and enforced on a consistent basis. Robust assurance and enforcement are critical aspects of good financial reporting, helping to provide certainty that information reported is reliable and comparable.

Although the IASB is mindful that its standards need to be applied consistently, it is not responsible for ensuring consistent application of those standards around the world. Responsibility for enforcing its standards is – quite rightly – left to regulators. The IFRS Foundation therefore proactively engages with bodies such as IOSCO and the European Securities and Markets Authority (ESMA), which coordinate the enforcement of its standards internationally, throughout the standard-setting cycle and beyond.

Accounting standards are designed in such a way that they provide an effective basis to enable regulators and auditors to assess compliance.

CHALLENGES FACED BY SUSTAINABILITY STANDARD-SETTERS

Assurance over sustainability information plays a crucial role in the evolving corporate landscape and is increasingly becoming a prominent part of corporate reporting. High quality and independent assurance can provide trust and credibility to sustainability disclosures, support decision-making and help management with risk mitigation by identifying and assessing gaps and risks in sustainability reporting. This includes assessing the effectiveness of underlying internal processes and controls.

For the ISSB, the auditability and enforceability of its standards are likely to be key factors for adoption and endorsement. Lawmakers and regulators are less likely to adopt standards that cannot be enforced effectively. For EFRAG, the picture is somewhat different because its standards are already part of EU law. Adoption is not the challenge. However, assurance will still be required and will form a critical part of the reporting process. If the assurance process is ineffective, there is a risk that it could undermine the whole purpose of sustainability reporting.

Many of the challenges related to the assurance and enforcement of sustainability standards are not strictly challenges that sustainability standard-setters should or could seek to resolve. Nonetheless, without good quality assurance and consistent enforcement, the objective of sustainability standard setting will not be met. The fact that assurance and enforcement are not directly an issue for sustainability standard-setters is a challenge in itself. Sustainability standard-setters must be cognisant of the issues without necessarily having the means to resolve them.

As part of our outreach, we have heard a number of concerns about assurance services in relation to sustainability reporting. These include, but are not limited to:

- demand for assurance potentially outstripping the available supply of suitably skilled and experienced assurance practitioners in the short term;
- lack of understanding and associated expectation gaps about the different levels of assurance provided, with some engagements offering limited assurance and others offering reasonable assurance;
- inconsistent methodologies being used to provide such assurance potentially resulting in inconsistent outcomes.

OUR RECOMMENDATIONS

Both the ISSB and EFRAG will need to work closely with auditors and regulators to ensure that their standards can be audited and enforced appropriately. The IAASB's proposed International Standard on Sustainability Assurance (ISSA) 5000 General Requirements for Sustainability Assurance Engagements is designed to serve as a comprehensive, standalone standard suitable for any sustainability assurance engagement. The proposed standard will apply to sustainability information reported across any sustainability topic and prepared under multiple frameworks. It is profession agnostic, supporting its use by both professional accountants and non-accountant assurance practitioners. Once finalised, its adoption and application around the world should help to enhance confidence and trust in sustainability reporting.

As explained in ICAEW's response to the proposed International Standard on Sustainability Assurance 5000, we support and recognise the importance of a single, internationally recognised assurance standard and, in particular, the need for a global assurance baseline to be clearly established.

5. NEXT STEPS

Sustainability lies at the heart of ICAEW's Strategy, and sustainability reporting is highly relevant in this context. This report is presented as a contribution to its future development and success.

Our work in this area does not stop with the publication of this report. We are committed to contributing to the success of sustainability standard setting, reporting and assurance, as a leading voice where policy, sustainability and accountancy meet. We aim to encourage debate through wide dissemination of the report's findings, exploring some of its key themes and discussing these with key stakeholders in the UK and internationally.

We will continue to seek to influence the sustainability standard-setting and regulatory agenda through our policy work, responding to future exposure drafts, discussion papers and calls for evidence. We will also seek to help shape the standard-setting, reporting and assurance landscape through further thought leadership activity, dissemination of reporting best practice, and efforts to improve skills, knowledge and understanding among our members in business and practice, in the private and public sectors and beyond.

Should you have any comments on this report, or any ideas or views on ways in which ICAEW can usefully add to the debate, we would be delighted to hear from you. Please get in touch at crf@icaew.com.

APPENDIX: PROJECT PARTICIPANTS

STEERING GROUP

- Chris Nobes – Professor at Royal Holloway University of London and former IASC board member[1]
- Steve Cooper – independent analyst and former IASB board member[1]
- Michael Stewart – Senior Expert of Financial Reporting at Huawei and former technical director at the IASB[1]
- Nigel Sleigh-Johnson – Director, Audit and Corporate Reporting at ICAEW
- Laura Woods – Technical Manager, Corporate Reporting at ICAEW

INTERVIEWEES

- Nick Anderson – IASB board member[1]
- Richard Barker – ISSB board member
- Andy Kemp – Chair of the Audit Committee Chairs' Independent Forum
- Katherine Schipper – Professor at Duke University and former FASB board member
- Tom Seidenstein – Chair of the International Auditing and Assurance Standards Board
- Saskia Slomp – CEO at the European Financial Reporting Advisory Group[1]
- Ann Tarca – IASB board member
- Mark Vaessen – Partner at KPMG in the Netherlands and President of Accountancy Europe
- Wei Guo Zhang – Professor at Shanghai University of Finance and Economics and former IASB board member

We would also like to thank interviewees who participated in the research who prefer to remain anonymous.

ROUNDTABLE PARTICIPANTS

- Anthony Appleton – Partner at BDO and former Director of Accounting and Reporting at the Financial Reporting Council
- Mark Babington – Executive Director of Regulatory Standards at the Financial Reporting Council
- Yasmine Chahed – independent senior adviser and research consultant
- Matt Chapman – Director of Wider Corporate Reporting at KPMG
- Ciara Lynch – Head of External Reporting and Specialist Accounting at GSK
- Renata Padilla – VP of Global Financial Reporting at InterContinental Hotels Group

Drafts of the report were also discussed with, among others, Seema Jamil O'Neill (UK Endorsement Board Technical Director), Elizabeth Barber (Chair of ICAEW's Sustainability Committee), together with members of key ICAEW Corporate Reporting Faculty committees: the Financial Reporting Committee and the Non-Financial Reporting Committee.

The views noted in the report do not necessarily reflect the views of all of the project participants.

1 Also, a roundtable participant or observer.

ABOUT ICAEW

Chartered accountants are talented, ethical and committed professionals. ICAEW represents more than 208,000 members and students around the world. 99 of the top 100 global brands employ ICAEW Chartered Accountants.*

Founded in 1880, ICAEW has a long history of serving the public interest and we continue to work with governments, regulators and business leaders globally. And, as a world-leading improvement regulator, we supervise and monitor around 11,500 firms, holding them, and all ICAEW members and students, to the highest standards of professional competency and conduct.

We promote inclusivity, diversity and fairness and we give talented professionals the skills and values they need to build resilient businesses, economies and societies, while ensuring our planet's resources are managed sustainably.

ICAEW is the first major professional body to be carbon neutral, demonstrating our commitment to tackle climate change and supporting UN Sustainable Development Goal 13.

ICAEW is a founding member of Chartered Accountants Worldwide (CAW), a global family that connects over 1.8m chartered accountants and students in more than 190 countries.

Together, we support, develop and promote the role of chartered accountants as trusted business leaders, difference makers and advisers.

We believe that chartered accountancy can be a force for positive change. By sharing our insight, expertise and understanding we can help to create sustainable economies and a better future for all.

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* includes parent companies. Source: ICAEW member data February 2024, Interbrand, Best Global Brands 2023

ABOUT THE CORPORATE REPORTING FACULTY

ICAEW's Corporate Reporting Faculty helps guide members through current and emerging reporting requirements and provides them with world-class technical knowledge to ensure they continue to be experts in their roles in public practice or business. Recognised internationally as a leading authority on corporate reporting, the faculty is also responsible for formulating ICAEW policy on financial and non-financial reporting issues and makes submissions to standard-setters and other external bodies on behalf of ICAEW.

The faculty provides an extensive range of services to its members including:

- practical guidance on common corporate reporting matters;
- regular articles, news and opinion features as part of its online magazine By All Accounts; and
- an extensive programme of events and webinars on the latest developments in corporate reporting.

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