IESBA International Ethics Standards Board for Accountants®

529 Fifth Avenue, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.ethicsboard.org

Meeting:	IESBA
Meeting Location:	Virtual
Meeting Date:	September 13-17, 27 2021

Agenda Item 5

Emerging Issues and Outreach Committee (EIOC) Update

Objectives

1. To:

- Receive a presentation on the results of a global benchmarking study that captures and analyzes the extent to which companies are reporting and obtaining assurance over their sustainability disclosures.
- Consider and react to a presentation from a member of the EIOC on the topic of environmental, social and governance (ESG) and ethics.

EIOC Members

2. Members comprise:

- Winifred Kiryabwire, Chair
- Vania Borgerth, IESBA member
- Laurie Endsley, IESBA member
- Hironori Fukukawa, IESBA member
- Marta Kramerius, IESBA Technical Advisor
- Sundeep Takwani, IESBA Technical Advisor

Observer:

- Gaylen Hansen, Chair, IESBA Consultative Advisory Group (CAG)

Activities since March 2021 meeting

3. The EIOC met twice via video call in August 2021 to develop the agenda meeting materials.

External Presentation

4. During the session, IESBA members will receive a presentation from IFAC Public Policy & Regulation Directors, Mr. Scott Hanson and Mr. David Madon. They will provide an overview of the June 2021, IFAC and the Association of International Certified Professional Accountants (AICPA-CIMA) jointly issued report, titled the *State of Play on Sustainability Assurance* (see **Agenda Item 5-B**).

5. The presenters will highlight the key findings of the report and relevant insights about the global study. IESBA members will have an opportunity to comment and ask questions at the end of the presentation.

ESG and Ethics Presentation

6. During the meeting, EIOC member, Ms. Vania Borgerth will brief the IESBA and facilitate a discussion about:

   - The role of professional accountants in relation to ESG matters.
   - The applicability of the Code to ESG reporting and assurance.
   - Potential ethics and independence issues that have been identified by the EIOC.

7. The slide deck which Ms. Borgerth will present is provided at **Agenda Item 5-A**.

8. ESG is an evolving area. The **Appendix** to this document provides background information for IESBA's consideration in preparation for the upcoming discussion on ESG, especially regarding the potential next steps.

Materials Presented

Agenda Item 5-A	Slide Presentation: EIOC Update on Ethics and ESG
Agenda Item 5-B	June 2021 IFAC-AICPA CIMA Report, *The State of Play in Sustainability Assurance*

Action Requested

9. IESBA members are asked to consider and react to the presentations.

Appendix

Background Information – Supplement to Agenda Item 5-A

What is ESG?

1. The development of ESG reporting began decades ago when the demand for *sustainability* and *corporate and social responsibility* information arose. Despite the growing importance of ESG information to markets and companies, the term "ESG", "sustainability", and "corporate social responsibility" are often used interchangeably to describe reporting other than financial information. Furthermore, many narrowly associate ESG solely with climate change. Although climate change is part of the environmental component, ESG information includes broader qualitative and quantitative concepts and metrics to measure companies' performances that are not covered by financial reporting standards.[1]

2. The environmental element of ESG involves how a company manages the risks and opportunities associated with any environmental factor including, biodiversity, intelligent cities, transportation, greenhouse gas emissions, climate and pollution. The social element covers the company's values and business relationships like labour and supply-chain standards, diversity education, and inclusion. Lastly, the governance element covers the company's corporate governance, including the structure and diversity of the board, risks, business ethics, conflict of interest, independence and critical event responsiveness.

3. The following table developed by the Staff of the Financial Standards Accounting Board (FASB) includes examples from broad topics that are commonly considered as ESG matters (not intended to be all-inclusive).

Environmental	
• Climate change • Ecological impacts, such as pollution, deforestation, and loss of biodiversity • Energy management, such as energy-efficient buildings and production processes • Greenhouse gas emissions • Litigation risk, for example, related to environmental contamination • Policies and regulations • Raw material sourcing • Renewable energy • Sustainable products and packaging • Water and waste management	
Social	**Governance**
• Community relations • Diversity, equity, and inclusion • Employee health and safety • Human capital development • Labor management • Privacy and data security • Product quality and safety • Supply-chain standards	• Antibribery and anticorruption • Business ethics • Corporate resiliency • Diversity of leadership • Executive compensation • Lobbying and political contributions • Ownership structure • Tax transparency

Source: FASB Staff Educational Paper- Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards

[1] Center for Audit Quality (CAQ) - *The Basics on Today's ESG Reporting*

Why Focus on ESG Now?

4. ESG is growing increasingly important given the shift towards considerations of "non-financial" information in many fields of the global economy, such as in capital markets (e.g., Green bonds), in financial markets (e.g., greater financing for entities that practice sustainability), in consumer markets (e.g., consumer favoring entities that have minimal carbon footprint), in labor markets (e.g., potential candidate favoring employers that have a social responsibility or community engagement program). In addition, apart from its "non-financial" nature, ESG information also has "pre-financial" aspects which - if not well managed- could affect future cash flows in much the same way as financial information.

5. Investors are increasingly focused on ESG information as it provides better understanding of a company's long-term value creation and enables them to manage their investments based on ESG risks. Demand for sustainability information is driven by institutional investors, asset managers and other stakeholders (e.g., credit rating agencies) wanting better information about an entity's operations and the effect that it is having on the economy, environment and people/society at large.[2]

6. For example, "a 'meta' study by NYU Stern Center for Sustainable Business and Rockefeller Asset Management, aggregating findings from more than 1,000 research papers published between 2015-2020, finds a positive correlation between ESG and financial performance in the majority of both corporate studies focused on returns on equity, return or assets, or stock prices (58%), and investor studies focused on risk-adjusted attributes (59%)."[3]

7. Supporting that trend, leading asset managers have released statements expressing the importance of company-prepared ESG information and high-quality ESG disclosure (for example, see BlackRock's CEO 2021 statement directed to CEOs). Furthermore, credit-rating agencies are increasingly incorporating ESG factors into their credit worthiness calculations. For example, Fitch recently developed an ESG relevance scoring system to determine the impact of ESG factors on individual credit ratings.[4]

8. The wide range of users of ESG information demonstrates the growing importance of information that is "relevant, reliable, comparable, and assurable"[5]. Nevertheless, there is space and need to take steps in order assure that it will be less exposed to greenwashing risk.

Existing ESG Reporting Frameworks and Standards

9. There are many jurisdictional level frameworks and standards that guide ESG reporting and disclosure. A June 2021 IOSCO report noted that these frameworks and standards are typically applied on a voluntary basis, and the market has not converged on a single framework.[6] The IOSCO report noted the following as most referenced guidelines/ frameworks: Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Sustainable Development Goals (SDGs), and Taskforce on Climate-related Financial Disclosure (TCFD). The graphic below provides an overview of these organizations.

---

[2] IFAC Knowledge Gateway - *Professional Accountants Leading Reporting and Assurance on Sustainability* (Kevin Dancey)

[3] IOSCO - *Report on Sustainability-related Issuer Disclosures*, Section 2, page 8

[4] CAQ - *The Basics on Today's ESG Reporting*

[5] IFAC Knowledge Gateway - *Professional Accountants Leading Reporting and Assurance on Sustainability* (Kevin Dancey)

[6] IOSCO - *Report on Sustainability-related Issuer Disclosures*, Section 2.2

Global Reporting Initiative (GRI)	Sustainability Accounting Standards Board (SASB)	Taskforce on Climate-related Financial Disclosures (TCFD)	Sustainable Development Goals (SDGs)
• The GRI, established in 1997, was the first to promote a set of sustainability reporting standards. • The standards are directed at a broad scope of stakeholders. They comprise: ○ a set of universal standards, covering general disclosures and management approach ○ three sets of topic-specific standards, covering key metrics related respectively to economic, environmental and social matters.	• SASB was established in 2011. • The standards aim to serve the needs of the investor community. A key conceptual foundation for SASB's standards is the concept of financial materiality. • The standards cover 26 ESG topic areas and apply at the industry level. SASB identifies those metrics deemed to be financially material in each of 77 industries, across 11 sectors.	• The TCFD published its recommendations in 2017. • The recommendations provide a structure and framework for considering and reporting on climate-related risks and opportunities in four thematic areas: governance; strategy; risk management; and metrics and targets. • To allow for continued evolution in organisations' capabilities, the TCFD's recommended disclosures are largely principles-based.	• The SDGs form the core of the United Nations' 2030 Agenda for Sustainable Development, which was adopted in 2015. • They comprise 17 goals and a total of 169 targets, across five themes: people; planet; prosperity; peace; and partnership. Companies and financial services firms increasingly apply the SDGs to demonstrate that their decisions and actions are consistent with, or directed towards, helping to achieve particular goals or targets.

Source: IOSCO's Report on Sustainability-related Issuer Disclosures, Figure 2.

10. Additionally, International Integrated Reporting Council (IIRC) has developed Integrated Reporting (IR), a conceptual framework aimed at promoting a more cohesive and efficient approach to corporate reporting as it requires a cross-reference between financial and non-financial information, which will make assurance easier in the future. The IR framework does not have a "report" as the main target, but the process and culture of the company itself. It promotes integrated thinking and reporting, which includes disclosure of financial and non-financial performance in a manner that enables stakeholders to understand the business model and how the business strategy drives value for these stakeholders in the short, medium, and long term.[7]

11. Besides its framework, IIRC has been working to bring together standard setters and providers of sustainability frameworks in order to reduce inconsistences among such a variety of frameworks.

Global Regulatory Response

12. IOSCO's Sustainability Task Force (STF)[8] is currently focused on better understanding investors' needs with respect to sustainability. Among other matters, the IOSCO noted that:

- "Investor demand for sustainability-related information is currently not being properly met".[9]
- Engagement with stakeholders revealed that "many market participants, including issuers, are waiting for regulators to help to drive clarity, consistency, and quality of sustainability reporting across jurisdictions."[10]

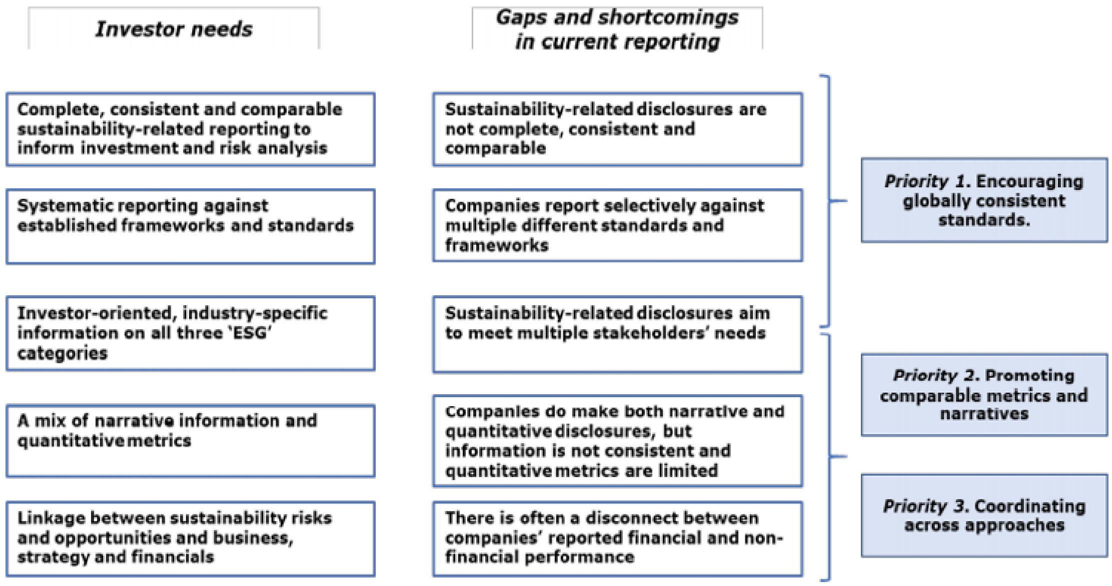
7 CAQ - *The Basics on Today's ESG Reporting*

8 See IOSCO's *Report on Sustainability-related Issuer Disclosures*, Section 3,

9 See IOSCO's *Report on Sustainability-related Issuer Disclosures*, Section 3, page 14

10 IOSCO - *Report on Sustainability-related Issuer Disclosures* Section 5, page 30

13. IOSCO has identified three priority areas for improvement which are noted in the diagram below. These priority areas were informed by investor sustainability-related reporting needs, and "gaps and shortcomings" with the status quo.



Source: IOSCO – Report on Sustainability-related Issuer Disclosures, Figure 6.

14. The IOSCO Report acknowledges the need for a "building blocks approach" in establishing a global comprehensive corporate reporting system for sustainability/ ESG. The concept of a "building blocks approach" is explained in a May 2021 IFAC publication. IFAC is of the view that its publication will help facilitate discussions about how its approach can deliver a global system for consistent, comparable, and assurable sustainability-related information that best meets the needs of investors and other stakeholders. IFAC has released a public statement to express its view that a new International Sustainability Standards Board (ISSB) under the auspices of the IFRS Foundation is critical to achieve globally consistent sustainability standards that lead to relevant, reliable, comparable, and assurable information.[11]

Other Relevant Developments

15. The following paragraphs highlight some of the more relevant ESG-related developments at the global and jurisdictional level that the EIOC considered during its August 2021 deliberations.

International Developments

16. IFRS Foundation Trustees (the Foundation) Consultation Paper on Sustainability Reporting (September 2020). The document sought public input on:

   - A proposal to establish a new global sustainability standards reporting board (ISSB) to sit alongside the IASB.

[11] This document includes references below to IFAC's continued engagement in this area that goes beyond this publication.

- o The role the Foundation could play in relation to sustainability disclosures.

17. There were 577 responses[12] to the Consultation from a variety of market participants around the world. Respondents expressed support for the Foundation to play a key role in global sustainability reporting, and for the establishment of the ISSB within the governance structure of the IFRS. A feedback statement summarizing the feedback on the consultation was published by the Foundation in April 2021. Also in April 2021, the Foundation issued an Exposure Draft (ED), *Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards.* The comment deadline for the ED closed on July 29, 2021, and 175 comments letters were received[13]. The Foundation also established a Working Group formed by Value Reporting Foundation (VRF), World Economic Forum, International Accounting Standards Board (IASB), TCFD and Climate Disclosure Standard Board (CDSB) in order to prepare the basis for ISSB operation. This development is expected to be formally announced during United Nations Climate Change Conference (CoP 26) in November 2021.

18. Statement of Intent to Work Together Towards Comprehensive Corporate Reporting (September 2020). The Statement of Intent was developed by internationally significant framework and standard-setting institutions[14] (the Alliance) and represents their vision for a comprehensive, globally accepted, corporate reporting system that integrates financial and non-financial information.

    - o This was followed by the publication titled, *Reporting on enterprise value Illustrated with a prototype climate-related financial disclosure standard* (the Prototype) in December 2020 which provided an update on the progress made towards a comprehensive corporate reporting system from leading sustainability and integrated reporting organizations CDP, CDSB, GRI, IIRC and SASB.

    - o The Prototype highlighted how certain components of the existing frameworks and standards issued by CDP, CDSB, GRI, IIRC and SASB can be used together to provide a starting point for the development of global standards for sustainability-related financial disclosure, and could serve as a useful input for the IFRS Foundation.

19. Creation of the Value Reporting Foundation (June 2021). The IIRC and the SASB merged to form a new international organization – Value Reporting Foundation (VRF) which will maintain the Integrated Reporting Framework, advocate integrated thinking, and establish sustainability disclosure standards for enterprise value creation. In addition, it will promote using SASB's proposed metrics for more than 70 sectors. The VRF's website includes additional information about the new organization, including a set of FAQs.

Jurisdictional Level Developments

European Union

20. The European Union's legislation on sustainability reporting has been in place since 2014 as part of the Non-financial Reporting Directive (NFRD). The NFRD already requires large companies to

---

[12] Please find *here* IFAC's response to IFRS Foundation Sustainability Reporting Consultation

[13] Please find *here* IFAC Comment Letter to the IFRS Foundation's ED on proposed Constitutional amendments that accommodate new ISSB

[14] *Global Reporting Initiative* (GRI), *Sustainability Accounting Standards Board* (SASB), *International Integrated Reporting Council* (IIRC) *Climate Disclosure Standard Board* (CDSB) *Disclosure Insight Action* (CDP)

disclose certain information on the way they operate and manage social and environmental challenges.

21. Recognizing the demand for enhanced non-financial disclosures, the European Commission reviewed the NFRD and in April 2021, published a *Proposal for a Corporate Sustainability Reporting Directive* (CSRD). Among others, this proposal:

    - Extends the scope to all large companies and all companies listed on regulated markets (except listed micro-enterprises),
    - Requires the statutory auditor to perform a 'limited' assurance engagement on a company's sustainability reporting,
    - Introduces more detailed reporting requirements, and a requirement to report according to mandatory EU sustainability reporting standards.

22. Under the CSRD proposals, it is envisioned that sustainability reporting standards will be developed by the European Financial Reporting Advisory Group (EFRAG). The CSRD proposal also notes[15] that in order to minimize disruption for companies already reporting sustainability information under the existing frameworks, the EU sustainability reporting standards should take account of those existing standards and frameworks for sustainability reporting and accounting where appropriate including those to be developed under the auspices of IFRS Foundation.

US Securities Exchange Commission (SEC)

23. In light of demand for climate change information and questions about whether current disclosures adequately inform investors, public input is requested from investors, registrants, and other market participants on climate change disclosure, the then Acting Chair of the SEC issued a public statement to request public input (the Request).

24. The Request included questions ranging from how the SEC could best regulate climate disclosures to whether the SEC should expand its focus from climate disclosures alone to a focus on ESG matters as part of a broader, comprehensive disclosure framework. The deadline for comments was June 13, 2021.

25. The Request attracted considerable attention and comment letters were submitted well past the June 2021 deadline. Around 600 comment letters have been received to-date.[16] Those letters and additional information about the SEC's activities is available at: SEC.gov | SEC Response to Climate and ESG Risks and Opportunities.

Other

26. Progress is also being made at the individual country-level to deepening corporate reporting on sustainability-related matters.

[15] CSRD - Recital 37

[16] Please find *here* IFAC's response to SEC's Request for Input