Council of Institutional Investors®
The voice of corporate governance

Via Email

July 15, 2021

Erkki Liikanen
Chairman
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Re: Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards[1]

Dear Mr. Liikanen & the IFRS Trustees:

The Council of Institutional Investors (CII) appreciates the opportunity to comment on the *IFRS Foundation's Exposure Draft, Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards* (Exposure Draft).[2]

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[3]

CII applauds the efforts of the IFRS Foundation to explore the development of a global architecture for sustainability reporting in the form of on International Sustainability Standards Board (ISSB) to establish a baseline for environmental, social, and governance disclosure. CII

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[1] IFRS Foundation, Exposure Draft, Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards (Apr. 2021), https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/ed-2021-5-proposed-constitution-amendments-to-accommodate-sustainability-board.pdf.
[2] *Id.*
[3] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.

generally believes that a single set of global sustainability standards applicable to companies around the world, including registrants under the U.S. Securities and Exchange Commission's (SEC) rules, would be the ideal solution to addressing investor needs for that information.[4]

As we indicated in our letter to you last December (December Letter), CII has several membership-approved policies that we believe are relevant to the issues raised by the Exposure Draft.[5] Those policies include the following:

> **<u>Statement on Corporate Disclosure of Sustainability Performance</u>**
>
> Investors increasingly seek decision-useful, comparable and reliable information about sustainability performance in corporate disclosures in order to better understand how nonfinancial metrics can impact business and profitability. CII believes that independent, private sector standard setters should have the central role in helping companies fill that need. Market participants, non-governmental organizations and governments can aid the success of these standard setters by supporting their independence and long-term viability, attributes of which include: stable and secure funding; deep technical expertise at both the staff and board levels; accountability to investors; open and rigorous due process for the development of new standards; and adequate protection from external interference.
>
> CII encourages companies to disclose standardized metrics established by independent, private sector standard setters along with reporting mandated by applicable securities regulations to better ensure investors have the information they need to make informed investment and proxy voting decisions. CII believes those standards that focus on materiality, and take into account appropriate sector and industry considerations, are more likely to meet investors' needs for useful and comparable information about sustainability performance. CII also believes that over time, companies should obtain external assurance of the sustainability performance information they provide.[6]

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[4] *See, e.g.*, Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to the Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission 13 (June 11, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/June%2011%202021%20CII%20Comment%20Letter%20on%20Climate%20Disclosure%20for%20SEC%20(final)%20LN.pdf.

[5] *See* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Erkki Liikanen, Chairman, IFRS Foundation 1 (Dec. 17, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/December%2017%202020%20comment%20letter%20(final)-AB%20LNF.pdf (CII has several membership-approved policies that we believe are relevant to the issues raised by the Paper.").

[6] CII Policies, Statement on Corporate Disclosure of Sustainability Performance (adopted Sept. 22, 2020), https://www.cii.org/sustainability_performance_disclosure.

Statement on Company Disclosure

In evaluating proposals to expand company disclosure, CII considers the following factors:

- Materiality to investment and voting decisions
- Depth, consistency and reliability of empirical evidence supporting the connection between the disclosure and long-term shareowner value
- Anticipated benefit to investors, net of the cost of collection and reporting
- Prospect of substantially improving transparency, comparability, reliability and accuracy[7]

Independence of Accounting and Auditing Standard Setters

Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the financial reporting standards that: (1) enterprises use to recognize, measure and report their economic activities and events; and (2) auditors use in providing assurance that the preparers' recognition, measurement and disclosures are free of material misstatements or omissions. The result should be timely, transparent and understandable financial reports.

The Council of Institutional Investors has consistently supported the view that the responsibility to promulgate accounting and auditing standards should reside with independent organizations.

CII supports U.S. accounting and auditing standard setters cooperatively working with their international counterparts toward a common goal of high quality standards. This means maintaining a high degree of on-going communication among domestic and international standard setters to produce standards that first and foremost result in high quality financial reports, and secondarily result in consistent financial reporting outcomes. CII continues to be open to a transition to a single global set of high quality standards designed to produce comparable, reliable, timely, transparent and understandable financial information that will meet the needs of institutional investors and other consumers of audited financial reports. However, at this time CII does not support replacing U.S. accounting or auditing standards or standard setters with international standards or standard setters. Notwithstanding CII's current opposition to replacing U.S. standards or standard

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[7] CII, Policies on Other Issues, Statement on Company Disclosure (adopted Mar. 10, 2020), https://www.cii.org/policies_other_issues#Company_disclosure.

setters, in light of the globalization of the financial markets and the fact that U.S investors invest trillions of dollars in securities of enterprises that report their financial results in some form of international standards, we generally support high quality international accounting and auditing standards.

In order to be high quality, accounting and auditing standards must be seen as meeting the needs of the investing public, and the standard setting process must be independent and free from undue influence. Attributes that underpin an effective accounting or auditing standard setter include:

- **Recognition of the Role of Reporting** – A recognition that financial accounting and reporting and the quality of auditing thereof is a public good, necessary to investor confidence in individual enterprises and the global capital markets as a whole;
- **Sufficient Funding** – Resources sufficient to support the standard setting process, including a secure, stable, source of funding that is not dependent on voluntary contributions of those subject to the standards (for international standard setters, such funding may depend on governmental and stakeholder cooperation from multiple jurisdictions, including the United States);
- **Independence and Technical Expertise** – A full-time standard-setting board and staff that are independent from prior employers or similar conflicts and possess the technical expertise necessary to fulfill their important roles;
- **Accountability to Investors** – A clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors' information needs (this includes having significant, prominent and adequately balanced representation from qualified investors on the standard setter's staff, standard-setting board, oversight board and outside monitoring or advisory groups);
- **Due Process** – A thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards;
- **Adequate Protections** – A structure and process that adequately protects the standard setter's technical decisions and judgments (including the timing of the implementation of standards) from being overridden by government officials or bodies; and
- **Enforcement** – A clear, rigorous and consistent mechanism for enforcement by regulators of the accounting and auditing standards.[8]

In the remainder of this letter, we describe the application of the above referenced policies to select questions contained in the Exposure Draft.

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[8] CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), https://www.cii.org/policies_other_issues#indep_acct_audit_standards.

Question 1

Do you agree that the amendments proportionately reflect the Trustees' strategic direction, considering in particular:

. . . .

(b) the proposed amendments to reflect the structure and function of the new board, outlined in the proposed new sections 43–56 of the Constitution, as set out in Appendix A?[9]

CII generally agrees that the proposed amendments proportionately reflect the trustees' strategic direction. However, in the December Letter we conditioned our support for the ISSB on the adoption of a few modest but vital improvements to the IFRS Foundation's "own governance structure and [the] . . . governance structure for an [I]SSB that are more aligned with our policies for an effective, independent standard setter."[10] We, therefore, respectfully request, that at a minimum, the issues raised by the following sections of the IFRS Foundation Constitution be promptly resolved:

Sections 6 & 7 (Trustee Composition)

The Exposure Draft states that the "Trustees do not propose that the requirements in relation to the size or specific expertise of the Trustee body [Sections 6 & 7] should be amended."[11] The Exposure Draft explains that "Trustees expect that its membership and its expertise can be sufficiently adjusted where necessary in the coming years as the regular rotation of its membership takes place."[12] We respectfully disagree.

We assume the IFRS Foundation Trustees will continue to make critical decisions in the coming weeks and months in connection with the formation and initial operation of the ISSB. In our view, those decisions will more likely be of higher quality and more consistent with the IFRS Foundation objective of developing sustainability standards designed to "help investors"[13] if composition of the Trustees includes adequately "balanced representation from qualified investors, including that at least half of the investor Trustees possess significant knowledge of, or have experience with, financial and investment analysis incorporating sustainability issues."[14]

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[9] IFRS Foundation, Exposure Draft, Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards at 9 (emphasis added).
[10] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Erkki Liikanen, Chairman, IFRS Foundation 2 (attachment Dec. 17, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/Attachment-ABedits.docx%20(Final)%20LN.pdf.
[11] IFRS Foundation, Exposure Draft, Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards at 6.
[12] *Id.*
[13] *Id.* at 16.
[14] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Erkki Liikanen, Chairman, IFRS Foundation at 5; *see* Letter from Elizabeth Mooney, CFA CPA, Partner, Capital Strategy Research & Dane Mott, Accounting Analyst, Capital Research Strategy to Kathleen L. Casey, Chair, Financial Accounting Foundation 3 (app. Apr. 9, 2021), https://www.dropbox.com/s/h67pwz3vkhmsvc0/CapGroupFASB04092021.pdf?dl=0 ("A

We believe knowledge and experience in financial accounting and knowledge and expertise in sustainability are two distinct albeit overlapping skill sets.[15] And per our review of the online biographies of the 21 current Trustees of the IFRS Foundation, it does not appear that the current composition of the IFRS Foundation Trustees includes adequately balanced representation from qualified investors. Moreover, only one Trustee biography references "sustainability."[16] We believe these deficiencies must be addressed as soon as possible.

Section 43 (ISSB Members)

The Exposure Draft provides for the "possibility for a minority of part-time members (see Section 43) . . . to allow flexibility when establishing the new board to attract appropriate talent while ensuring independence in the new board's technical deliberations."[17] The Exposure Draft, however, does not fully explain how the IFRS Foundation intends to ensure the independence of part-time ISSB board members, other than a general reference to meeting "appropriate guidelines."[18] Moreover, the Exposure Draft does not fully explain why the ISSB would be permitted to have a higher number of part-time members than is currently permitted on the International Accounting Standards Board (IASB), namely up to 6 of 14 for the ISSB compared to only 3 of 14 for the IASB.[19]

As long-time observers of accounting and auditing standard setting in the United States and internationally, we are aware of persistent rumors that part-time standard setters have been pressured by their employers on certain high-profile technical matters. We are confident that similar rumors would arise and persist if the IFRS Foundation Trustees appoints part-time ISSB members.

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structural problem we perceive in the current standard setting process is that investor users are under-represented in the composition of the FAF, FASB, IFRS Foundation, and IASB."); *cf.* Letter from Jane B. Adams et al. to The Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission 4 (June 7, 2021), https://www.dropbox.com/s/o5z86fdac0iw43h/Repair%20the%20Financial%20Reporting%20Infrastructure%20Sign-on%20Letter%206.7.21%20UPDATED.pdf?dl=0 ("Only if FASB and FAF are reformed to include more robust investor representation can we reasonably expect these boards to reflect investors' perspectives."); Letter from Jane B. Adams et. al. to Chairman Jay Clayton, U.S. Securities and Exchange Commission et al. 2 (Oct. 26, 2020) https://www.dropbox.com/s/77lilnerw2qt9wq/AOCI%20SEC%20Letter%2010_26_2020.pdf?dl=0 (describing concerns about the lack of investor representation on the U.S. Financial Accounting Foundation and the Financial Accounting Standards Board).

[15] *See* Commissioner Hester M. Peirce, Public Statement, Statement on the IFRS Foundation's Proposed Constitutional Amendments Relating to Sustainability Standards (app. July 1, 2021), https://www.sec.gov/news/public-statement/peirce-ifrs-2021-07-01 (commenting on the composition of the IFRS Foundation Trustees and the IFRS Advisory Council noting that "[e]xpertise in financial accounting and expertise in sustainability are two distinct skill sets . . . .").

[16] *See* IFRS, The Trustees of the IFRS Foundation, Members (last visited July 9, 2021), https://www.ifrs.org/groups/trustees-of-the-ifrs-foundation/#members (of the 21 current trustees of the IFRS Foundation, only three appear to have professional experience as investors).

[17] IFRS Foundation, Exposure Draft, Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards at 8.

[18] *Id.* at 27, §43.

[19] *Compare id.* at 22, §24 *with id.* at 26-27, §43; *see* Commissioner Hester M. Peirce, Public Statement, Statement on the IFRS Foundation's Proposed Constitutional Amendments Relating to Sustainability Standards (app.). (commenting that the "proposal, . . . would permit the ISSB to have a higher number of part-time members than is currently permitted on the IASB (up to 6 of 14 compared to only 3 of 14 for the IASB), which heightens conflict of interest concerns as outside employment may impair part-time members' objectivity").

As we explained in the December Letter:

> We believe having full-time board members is absolutely essential to ensuring the independence of the [I]SSB. Part-time board members are more likely to be conflicted by positions taken by their employer and could face difficult decisions as to which constituency they owe their allegiance.
>
> Those potential conflicts are not hypothetical. As one example, the creation of the U.S. Financial Accounting Standards Board (FASB) . . . with full-time members was largely in response to concerns that the decisions of the part-time members of the prior accounting standard setting organization—the Accounting Principles Board—were influenced by 'conflict[s], real or apparent, between the member's private interest and the public interest.' We believe part-time members of an [I]SSB would likely be subject to similar and perhaps more frequent conflicts of interest.[20]

Finally, we note that our views on part-time board members are generally aligned with prior views of the SEC staff.[21] In commenting in 2012 on part-time board members on the IASB, the SEC staff observed:

> Unlike the FASB, the IASB is permitted to include up to three part-time members who would not be required to sever their existing employment arrangements. Although this is limited to a small minority of members and does not appear to have resulted in an actual issue in the past, *the presence of such relationships does pose the possibility of including board representation of individuals who are not viewed as objective*.[22]

Question 4

Are there any other matters you would like to raise in relation to the proposed targeted amendments to the Constitution?[23]

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[20] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Erkki Liikanen, Chairman, IFRS Foundation at 3-4 (attachment) (footnotes omitted).

[21] *See* Office of the Chief Accountant, United States Securities and Exchange Commission, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers, Final Staff Report 50 (July 13, 2012), https://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-final-report.pdf.

[22] *Id.* (emphasis added & footnote omitted); *see* Commissioner Hester M. Peirce, Public Statement, Statement on the IFRS Foundation's Proposed Constitutional Amendments Relating to Sustainability Standards (app. July 1, 2021), https://www.sec.gov/news/public-statement/peirce-ifrs-2021-07-01 (commenting that "[g]overnance measures that protect the integrity of the standard-setting process are a crucial prerequisite for effective standard-setting [and] [s]everal governance issues embedded in the proposed amendments to the Foundation's Constitution [including part-time board members] raise concerns.").

[23] IFRS Foundation, Exposure Draft, Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards at 21 (emphasis added).

The Exposure Draft describes "[p]arallel work streams that the Trustees are [undertaking] . . . to ensure that the key requirements for success [of the ISSB] can be satisfied."[24] Perhaps the most important work stream outlined is to "[a]chieve the level of separate funding required and the capacity to obtain financial support" for the ISSB.[25] On this issue, the Exposure Draft states:

> The Trustees are working towards a funding arrangement to obtain the seed capital that would, in the short term, allow a new board to commence its standard-setting activities quickly. And, for the longer term, the Trustees are seeking funding from a diverse range of sources to secure the board's future and independence. The Trustees recognise the importance of ensuring that the funding for the IASB and the new board is kept separate.[26]

It is our understanding that the IFRS Foundation Trustees have not yet successfully obtained seed capital or long-term funding to support the ISSB. As we stated in the December Letter:

> We believe economic independence is an important guiding principle in institutionalizing a standard setting body that is responsive to the needs of investors. In 2010, then U.S. Securities and Exchange Commission (SEC) Chair Mary Schapiro warned, with reference to IASB, that the funding mechanism should not be such that funders could say, "[w]e do not like this, so we will reduce our contribution."[27]

In addition, we note that in 2012 the SEC staff raised serious concerns about the IFRS Foundation's funding structure and its potential impact on the independence of the IASB. More specifically, the SEC staff stated:

> The Commission previously has noted that the IASB may be subject to a perceived, or potentially an actual, connection between the availability of funding and the outcome of the IASB's standard-setting process.
>
> . . . .
>
> In its 2012 budget, the IFRS Foundation continues to rely significantly on voluntary contributions from the large accounting firms. Contributions from the largest accounting firms were expected to be *approximately 25%* of the 2012 collections. . . . . [*T*]*he continued reliance by the IFRS Foundation on funding from the largest accounting firms will continue to cause concerns as to the adequacy and independence of the IASB's funding model*.[28]

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[24] *Id.* at 36.
[25] *Id.* at 39 (emphasis omitted).
[26] *Id.*
[27] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Erkki Liikanen, Chairman, IFRS Foundation at 4 (attachment & footnotes omitted).
[28] Office of the Chief Accountant, United States Securities and Exchange Commission, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers, Final Staff Report at 50, 57-8 (emphasis added & footnotes omitted).

Almost 10 years later, it is our understanding that the largest accounting firms now contribute approximately 27% of the IFRS Foundation's funding. Thus, the most daunting challenge to achieving near and long-term success for the ISSB may be the ability of the Trustees to secure adequate and independent funding for the ISSB *and* the IASB.[29]

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We appreciate the opportunity to provide feedback on the Exposure Draft. If you have any questions, please feel contact me at jeff@cii.org.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

[29] *See, e.g.,* Commissioner Hester M. Peirce, Public Statement, Statement on the IFRS Foundation's Proposed Constitutional Amendments Relating to Sustainability Standards (app.) ("The questions around ISSB's funding also raise concerns [and] . . . [t]he Foundation should resolve the funding issues before forming the ISSB.").