

**ICGN**

International Corporate Governance Network

Mr. Andreas Barckow
International Accounting Standards Board
IFRS Foundation
Columbus Building,
7 Westferry Circus,
Canary Wharf,
London, E14 4HD

27 September 2021

Via email: commentletters@ifrs.org**Subject:** Request for Information – Third Agenda Consultation

Dear Mr. Barckow,

The International Corporate Governance Network (ICGN) is pleased to respond to the International Accounting Standards Board's ("IASB" or "the Board") Request for Information – Third Agenda Consultation (the Consultation).

Led by investors responsible for assets under management in excess of \$59 trillion, ICGN advances the highest standards of corporate governance and investor stewardship in pursuit of long-term value creation, contributing to healthy and sustainable economies, societies, and the environment. Our membership is based in more than 40 countries, with a large number of investors, companies, advisors and other stakeholders, primarily based in North America and Europe, with growing representation in Asia.

ICGN offers an important investor perspective on corporate governance and stewardship to help inform public policy development and to encourage good practices by capital market participants as expressed through the the ICGN Global Governance Principles (ICGN GGP) and other related policy documents.

Transparent financial reporting is fundamental to good governance and investor protection and represents an ICGN policy priority. Reflecting this importance, recent revisions to Principle 7 on Corporate Reporting in the ICGN GGP, focus on corporate board responsibility for overseeing timely and relevant company disclosure for shareholders and relevant stakeholders relating to the company's financial position, approach to sustainability, performance, business model, strategy and long-term prospects.¹

ICGN appreciates this opportunity for investors to share our views on the priorities of the IASB's activities and new projects for 2022 to 2026. In response to this consultation, we would like to first emphasise the importance of sustainability reporting to investors. Companies have been transforming to adopt sustainable strategies and practices. It is essential that financial reporting address not only a company's financial factors but also its human capital, natural capital, including environmental, social and governance (ESG) or sustainability matters.

¹ ICGN Global Governance Principles.

https://www.icgn.org/sites/default/files/ICGN%20Global%20Governance%20Principles2021_0.pdf

ICGN notes that this consultation focuses on the current scope of the Board's work— financial statements and management commentary for profit-oriented companies. However, given the review being undertaken by the IFRS Foundation's Trustees on the potential establishment of a new board to set sustainability reporting standards (the proposed International Sustainability Standards Board), we believe it is essential at this important stage of development, for the IFRS Foundation to anticipate and articulate how the future ISSB might impact the IASB's activities and agenda.

ICGN expressed support for the establishment of the ISSB in a recent letter² and commented that the relationship between the ISSB and the IASB under the IFRS Foundation, and their agendas should be well planned to optimise the use of resources and avoid overlap. ICGN recognises the need for the pro-active consideration of the connectivity between the IFRS Conceptual Framework for IFRS Standards and a future framework for the development of standards by the ISSB as well as the connectivity between IFRS financial accounting standards and ISSB sustainability standards. ICGN encourages interconnectivity between IASB and ISSB agendas, meetings, staff knowledge and work projects. It is important to note that the Consultation itself did not allocate time to these activities, and we believe that it is necessary to do so.

In this regard, the remaining issues that will guide our response to the consultation questions are as follows.

Strategic direction and balance of the Board's activities

The Board has provided a good level of detail on the overall balance of its activities. In our view, the balance of items in the agenda seems reasonable, except for the timing as stated above that will be necessary to support work of the proposed ISSB, noting that the current level of resources will remain substantially unchanged from 2022 to 2026. Specifically, we appreciate that the Board plans to allocate substantial resources to research issues and develop major new financial reporting requirements and amendments to IFRS Standards. With standards that are near to completion, it is important to complete them and ensure early post-implementation reviews for efficacy. The Board should also enhance its focus on monitoring and enforcement of IFRS application.

Supporting Adoption and Capacity Building

We would also like to see the Board, as a standard-setter, to work more with investors, companies, auditors, regulators and others to identify challenges in applying the Standards and address those application challenges. This may involve, for example, additional resources to increase capacity building efforts to support emerging economies, jurisdictions that have recently adopted IFRS Standards, or future adopters of the Standards. As ICGN's members are investors who invest globally, we believe that the consistent application of IFRS Standards across jurisdictions is critical to investors' ability to have an accurate and comparable evaluation of company performance and risks.

² ICGN Comment Letter to IFRS on Proposed Establishment of an International Sustainability Standards Board, September 2021: https://www.icgn.org/sites/default/files/19.%20ICGN%20Letter%20to%20IFRS%2C%20%20Proposed%20Establishment%20of%20an%20International%20Sustainability%20Standards%20Board%2C%2014%20Sept%202021_0.pdf

Supporting Digitalisation

Digital reporting remains very limited, and we believe that this is an area where more resources are needed for the IASB to shape the impact of technology on corporate reporting and IASB's standard-setting. The Board's outreach to investors, companies, regulators, auditors, data aggregators and other interested parties, should provide an important understanding of how new technologies are changing the way investors consume information. This outreach should also address the extent to which improvements are needed for the IFRS Taxonomy and how the Board writes the Standards. As the primary users of financial statements, investors would greatly benefit from improved quality of electronic data and consistency in the application of the IFRS Taxonomy.

Supporting Stakeholder Engagement

In terms of the time and attention relating to the Board's overall activities, we believe that the Board must create "room" for meaningful stakeholder engagement on the agenda. We think that the current level of roughly 20% - 25% of board activity is an appropriate target to ensure stakeholder relations are given appropriate attention, we would expect to see more concrete initiatives to increase investor engagement across the Board's activities. More disclosure guidance from the IASB on this aspect could also encourage more companies to participate in such engagements.

Criteria for assessing the priority of financial reporting issues that could be added to the Board's work plan

ICGN appreciates that the importance of financial reporting to investors is the first on the list of the seven criteria considered by the IASB to decide whether to add a potential project to its work plan.

We agree that the criteria for establishing the IASB's project priority should be the relative urgency and importance of the issue for preparers and investors. In our view, staff resources, including the capacity of the Board and its stakeholders to make timely progress on the potential project, should not influence the prioritisation process.

The review should include past projects that have been proposed but have not commenced, as these projects should not be assumed to continue in the light of other priorities. ICGN would encourage the IASB to have clear criteria that consider investor needs and solutions addressing those needs in setting priorities. We note, however, that not all criteria are listed in the Due Process Handbook.

Finally, as global investors, we must note the importance of comparable information across jurisdictions. As US GAAP and IFRS Standards are the two primary financial reporting frameworks, we urge the Board to consider how best to maintain the benefits of alignment achieved during the convergence work between the IASB and FASB.

Financial reporting issues that could be added to the Board's work plan

Most fundamentally, ICGN's response to this question of the consultation is grounded on our viewpoint that the IASB's consideration for the priorities of projects should be focused on the benefit to investors, who are the primary users of financial reporting. The IASB should reconsider the priorities of those projects that are primarily focused on the requests of preparers and auditors, and offer only a limited corresponding benefit to investors. Concerning the specific comments on each recommended project, instead of the technical

aspect of the issue, we elaborate below on what investors need and how new projects could address those needs.

We respectfully encourage the Board to prioritise its work on eight topics identified in Appendix B of the consultation as follows:

- Climate-related risks
- Commodity transactions
- Cryptocurrencies and related transactions
- Government grants
- Intangible assets
- Negative interest rates
- Pollutant pricing mechanisms*
- Statement of cash flows and related matters

Climate-related risks

Investors have long been focused on sustainability issues relating to governance and environmental factors, especially climate risks. ICGN has advocated through public consultations for better accounting for climate risk and human capital in financial reporting.³ We encourage ongoing efforts to link climate reporting to financial reporting through the profit and loss statement and the balance sheet. Investors need better qualitative and quantitative information about the effect of material climate-related risks on the carrying amounts of assets and liabilities reported in the financial statements.

We appreciate the initial efforts of the IASB to educate companies and other stakeholders on the effects of climate-related matters on financial statements.⁴ However, we believe that further guidance from the IASB is needed to ensure the comparability and consistency of information disclosures and consistency between narrative information and impacts reflected in the financial statements, especially with respect to climate-related scenario analysis.⁵ Effective projects would ensure that estimations, assumptions, judgments, and measurements are standardised in a way that climate risk is a consideration.

Commodity transactions

Although the proposed project seems to focus on some of the most common types of transactions involving commodities—for example, commodity loans, there has been a range of non-financial tangible or intangible assets classified as commodities that call for more reporting guidance. Among them are cryptocurrencies, commodities and emission allowances that are typically held for investment purposes. We will elaborate further on cryptocurrencies and emission allowances below.

³ ICGN Comment Letter on IFRS Foundation's Consultation Paper on Sustainability Reporting, 21 December 2020: <https://www.icgn.org/sites/default/files/27.%20ICGN%20Letter%20to%20IFRS%20Foundation's%20Consultation%20Paper%20on%20Sustainability%20Reporting.pdf>

⁴ IFRS (2020) Effects of climate-related matters on financial statements prepared applying IFRS Standards: <https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf> and IFRS (2019) <https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climatechange-nick-anderson.pdf?la=en>

⁵ See International Federation of Accounts statement on climate-related information (2021): <https://www.ifac.org/knowledge-gateway/contributing-global-economy/discussion/corporate-reporting-climate-change-information-and-2021-reporting-cycle>

Cryptocurrencies and related transactions

Cryptocurrencies, or crypto assets, are becoming more prevalent in many markets. Currently, cryptocurrencies and other crypto-based digital assets are covered by the IAS 38 Intangible Assets. However, we believe that the features of these assets have evolved significantly in the last decade, such that they are more similar to financial instruments than to intangible assets.

The IASB should consider whether it should develop additional disclosure requirements in IAS 38 about the fair value of crypto assets or a whole new standard for this new category. Considerations should be given to requirements for direct holdings of cryptocurrencies for investment purposes as well as other related transactions, such as the adoption of cryptocurrencies in payments and capital raising using initial coin offerings.

Furthermore, the threat of ransomware and data breaches faced by companies has soared over the past few years. Companies are often required to make their payments in cryptocurrencies to help the hackers hide their illegal activities. Thus, more disclosure requirements on cryptocurrency transactions are needed to alert investors of such risk.

Government grants

Investors would have benefited from standards regarding government grants or assistance received or obtained by companies during the pandemic. The need remains. The IASB should initiate a project that would provide investors with the best information on the prospects of the company as a going concern. Specifically, the IASB could provide further guidance on the recognition criteria for government grants or assistance in the statement of profit or loss, including the timing of recognition of income from government grants, given the different types of government grants and assistance that businesses in various jurisdictions have received and the potential for some businesses to return government support when the impact of the pandemic is not as severe as originally expected.

Intangible assets

As discussed above, the IAS 38 should be reviewed in terms of its coverage of new types of transactions and assets such as crypto assets. There should be enhancements to capture more of a firm's value, often represented by intangibles, to facilitate better asset allocation.

Negative interest rates

The recent movement of interest rates into the negative zone has created practical valuation challenges for both companies and investors. Negative interest rates distort the value of assets or liabilities, as well as the presentation of income and expenses as the concepts of inflow and outflow of economic benefits, are reversed. As we expect the interest rates to remain lower for a longer time, more reporting guidance is needed now.

Pollutant pricing mechanisms

Pollutant pricing mechanisms, such as carbon taxes and emissions trading schemes (ETS), are effective ways of holding companies, especially heavy emitters, accountable for their emissions of greenhouse gases (GHGs). In an increasing number of jurisdictions, emission allowances are initially granted by the scheme administrator to companies and subsequently can be traded via market-based trading schemes. Through the COVID-19 pandemic, production levels decreased for many companies—resulting in correspondingly reduced

emission levels. As a result, companies may have benefited from positive cash flows and incomes from the trading of emission allowances. However, without specific accounting requirements in IFRS Standards for these mechanisms, there has been a great diversity in the way companies report and value these tradeable emission allowances.

There is an urgent need for the IASB to provide clear guidance on recognising and measuring emission allowances received and valuing the allowances held subsequently. The Board should clarify if different requirements apply to those held to cover past or future emissions of pollutants versus those held for investment purposes. The guidance should consider the diverse nature of pricing mechanisms (including spot price, futures price vs auction price), frequency of prices (daily or quarterly auction-based) and liquidity in different markets. It should also be noted that carbon prices are far from converged, ranging from a few US dollars to more than US\$100.

The current proposed topic in the document does not address carbon offset credits, which are transferrable instruments certified by governments or independent certification bodies to represent an emission reduction of one metric tonne of CO₂ or an equivalent amount of other GHGs. Companies use carbon offset credits, including those generated from internal projects or acquired externally, to reduce their carbon footprints. Given the fact that the quality of these credits is questionable in many cases, the IFRS standards should be clear on how companies should value these credits and disclose information about their quality.

Investors need to understand how the present assets, liabilities, income and expenses are affected by these pollutant pricing mechanisms.

Statement of cash flows and related matters

While we appreciate the items that the IASB lists under the proposed project for the statement of cash flows and related matters in the consultation, we would like to see more emphasis on the direct method being the primary method as it would reduce the difficulty of reconciling the statement of cash flows to the other financial statements for companies. For investors, the direct method is also more beneficial as it provides more insight into company operations.

We hope that our comments are helpful, and we look forward to engaging with you in this or other matters where we could provide meaningful input. Should you wish to discuss our comments further, please contact me or George Dallas, ICGN's Policy Director, by email at george.dallas@icgn.org.

Yours faithfully,



Kerrie Waring,
Chief Executive Officer, ICGN

Copy:

James Andrus, Co-Chair, ICGN Financial Capital Committee:

James.Andrus@calpers.ca.gov

Nga Pham, Co-Chair, ICGN Financial Capital Committee:

Nga.Pham@monash.edu