THOMAS & McELROY LLC
Advisors in Organizational Sustainability

P.O. Box 766, Woodstock, VT 05091 I 802.457.4222

Emmanuel Faber, Chair of IFRS June 15, 2022
Suzanne Lloyd, Vice-Chair, IFRS
International Sustainability Standards Board
Columbus Building
7 Westferry Circus, Canary Wharf
London E14 4HD
UK

Dear Chair and Vice-Chair,

<u>Sustainability Disclosure Standard, IFRS S1 Exposure Draft</u>

We appreciate the opportunity you have afforded to comment on IFRS S1 while a draft.
The attached responses follow Questions 1 – 17, adding comments on Appendices A & C.

Thomas & McElroy LLC was formed to develop and publish principles and a methodology for corporate and other entities to set sustainability standards and measure performance. Our book, *The MultiCapital Scorecard,* was published in 2016 after 5 years of collaborative work. It encapsulates our combined 70 years of experience, research and practice. Martin Thomas worked 34 years for Unilever including heading global corporate planning and reporting. Dr. Mark McElroy's research was published in 2008 & 2012 on non-financial, context-based performance measurement.

Together we have incorporated our thinking into the MultiCapital Scorecard, which includes economic performance and triple bottom line progression designed for managing multinational and multi-divisional entities. We have therefore confronted many of the issues now facing the ISSB and published it all in a book that is free to users to implement. In our view, context is key and entities cannot seriously be expected to publish information that they do not both understand and find meaningful.

In summary, our findings on the IFRS's ED S1 are as follows:

- Integrated Reporting (per IIRC) requires multiple capital impacts to be combined.
- Focusing on Investors and creditors alone fails to address other valid stakeholder needs.
- As it stands, S1 has nothing that counts as accounting for Sustainability.
- Sustainability performance measurement requires standard setting; not incrementalism.
- Presenting sustainability information as a coherent whole requires a conceptual framework with an integrative component. Both are missing from S1. The world is awaiting these as part of the implementation of Integrated Reporting, but IFRS's ED S1 appears to be failing to deliver either.

In our view, our most useful contribution is to be candid. We stand prepared to explain or expand upon our concerns or indeed to help remedy the shortcomings if the ISSB wishes to do so.

With kindest regards,

Martin P. Thomas
m.thomas@call4change.com

Mark W. McElroy
mmcelroy@vermontel.net

IFRS S1 Exposure Draft Narrative Responses by Thomas & McElroy 15 June 2022

Answering the Questions for respondents from p9. *Italics show text from S1*

Question 1 - Overall Approach

" … the objective of disclosing sustainability-related financial information …"

Financial information is only a part of what we consider the objective ought to be.
Integrated reporting requires triple bottom line: economic, social & environmental information.
Sustainability, however, is undefined in your Draft. This is a fundamental flaw; allowing debilitating ambiguity.

Furthermore, there is no mention of the principle of capital maintenance nor a concept of how to integrate the various strands of impact on multiple capitals. This is also a fundamental flaw.

"…when they assess the entity's enterprise value and decide whether to provide resources to it."

This is an unambitious and limited purpose. It precludes any performance criteria other than economic enterprise value creation. This negates the longstanding recognition by King and the IIRC of considering impacts on multiple capitals (i.e., not just economic value).

"… the information …. necessary to assess enterprise value."

Enterprise value (EV) is a status at a point in time. Users need measurements of performance between points in time. This S1 exposure draft ignores performance information entirely.
However, there is an underlying suggestion that general purpose financial accounting information in some way supports enterprise value assessments. Evidence over many decades suggests that financial accounting information has become decreasingly related to EV.

(a) The S1 words do assert that ALL risks and opportunities should be disclosed, but only those with financial materiality to assessing EV. Disclosure is not subject to any set of principles (such as capital maintenance). Neither does S1 suggest that any sustainability norms apply.
Simply disclosing risks and opportunities falls short of integrating externalities into the entity's reporting processes, and it certainly does not result in the disclosure of sustainability performance.

Impacts on third parties are specifically excluded from S1. Economic, social and environmental impacts on others by the reporting entity (all of which may have deleterious effects on others) are completely ignored. This is the very antithesis of Sustainability Accounting.

We, Thomas & McElroy, wrote *The MultiCapital Scorecard* book, published in 2016 by Chelsea Green Publishing of Vermont USA. It provides principles and a methodology for triple bottom line performance management and measurement. It built on the nonfinancial work of McElroy and van Engelen, published by Routledge, London in 2012: *Corporate Sustainability Management*. Both set out better ways of reporting than the S1 would allow.

(b) The proposed requirements fail to meet even the inadequate *"proposed objective of paragraph 1"* for the reasons set out above. Sustainability accounting cannot be determined in a meaningful way without establishing performance norms for multiple capital impacts in which levels of sustainable performance are first determined and the metrics for monitoring performance against them are set out for impacts on each vital capital in the entity's own context(s).

(c) It is not *clear how S1 would be able to be applied to other IFRS disclosure standards*.

Why not?

It lacks a conceptual framework such as capital maintenance and the measurement of progression towards a desired future state. It fails to offer an integrative concept to allow impacts on multiple capitals to be brought into a single meaningful framework for each context. *The MultiCapital Scorecard* and Context-Based Sustainability (https://en.wikipedia.org/wiki/Context-Based_Sustainability) set out ways to do this.

Moreover, the S1's insistence upon only financial stakeholders being Users ignores the other valid stakeholders on whom impacts are vital considerations in sustainability performance measurement.

(d) Without a conceptual framework and in the absence of any context-based sustainability performance norms, how can any report preparers, auditors or regulators ensure that the reporting is meaningful in the context of the entity? Compliance with proposals that lack meaning cannot result in meaningful compliance. Pretending that this represents *"sustainability-related financial information that is useful"* is a gross misrepresentation.

Consequently, we conclude that this S1 *"Overall approach"* **falls well short** of accounting for sustainability in any meaningful way. It has:

- No triple bottom line (economic, social and environmental impacts)
- No performance information (philosophy or methodology)
- No norms for sustainability performance (just incrementalism therefore)
- No stakeholders beyond financial stakeholders
- No context-based sustainability
- No integrative reporting concept (such as progression toward a future state)
- No impacts on third parties

We recognise that other institutions are in the process of proposing triple bottom line approaches to sustainability reporting. As of June 2022, it remains unclear how they will emerge and fit together. Given that uncertainty, our response to the S1 Exposure Draft is based upon the document itself as a stand-alone proposal.

We have serious concerns as to whether the financial accounting profession which has shown persistent inability to measure real value creation in financial capital can be an acceptable vehicle to measure sufficiency of performance in the maintenance of multiple capitals, most of which it still fails to recognise.

Question 2 – Objective

(a) & (b) Neither the definition, nor the proposed objective *of disclosing sustainability-related financial information*" is at all clear.

Sustainability is undefined in S1. Brundtland and Elkington both considered that sustainable impacts would be those that could be continued ad infinitum including the ability of future generations to enjoy them (WCED, 1987; Elkington, 1997). This amounts to the principle of capital maintenance applied to the carrying capacity of multiple capitals: economic, environmental and social.

The concept of sustainability requires the consideration of sufficiency (in multiple capital impacts) to replace the maximisation of any single capital impact (such as enterprise value). This demands information on the sufficiency of impacts on all vital capitals. Establishing how much is enough to be sustainable in each area of impact allows norms to be set for the maximum environmental impacts and the minimum economic and social capital impacts needed to be sustainable. These do not need to be monetised, but they may be. Only by setting norms of sustainability performance is it possible to determine whether actual performance is sustainable, on schedule to become sustainable, or simply unsustainable.

Since economic performance is part of sustainability accounting, financial information must form part of this normative reporting process. However, whether other areas of impact are considered *sustainability-related financial information* remains undefined in S1.

Sustainability accounting requires norms and actual performance to be reported, whether they be financial or not. S1 fails to make this clear.

Question 3 – Scope

"Sustainability-related risks and opportunities that cannot reasonably be expected to affect users' assessments of the entity's enterprise value are outside the scope of sustainability- related financial disclosures."

This is the essence of the S1 philosophy: The Stock Market is the ultimate arbiter of performance. But it cannot and does not have anything to do with Sustainability performance. Instead, sustainability accounting should seek to provide the information required to assess the full sustainability performance of organizations in today's world. S1, by contrast, seeks to ensure that financial primacy dominates.

Stock market prices (often way beyond the control of the reporting entity itself) exercise a major influence on enterprise value. But the market is far from perfect, shareholders are increasingly transient, focusing on the short-term financials, not the longer-term survival of the environment or the social capitals on which they all depend. Externalities escape financial accounts, but sustainability accounting attempts to include them, whether in financial terms or in non-financial terms. Economic, social and environmental impacts on third parties form an essential part of any serious sustainability reporting initiative.

Typical scoping challenges that are not addressed in S1 include defining and harmonising the boundaries between Scopes 1, 2 & 3 (i.e., the entity itself, energy suppliers & the supply chain). As it stands, S1 focuses exclusively on Scope 1, but all involved in sustainability work recognise that outsourcing can render scope 1 performance meaningless without considering scopes 2 & 3 in the value chain. If no definitions are available, at least the principles upon which they are determined should be offered along with the necessary disclosure needed for users and assurers.

The S1 proposals may be capable of implementation in any jurisdiction, but they will universally fail to enable businesses or other institutions to move towards becoming sustainable. The underlying philosophy of S1 is flawed. Its exclusion of stakeholder considerations other than shareholders is a major failing. It allows nothing of context-based management and its lack of conceptual framework is lamentable. Moreover, it undermines the years of work and progress that sustainability accounting had accomplished before 2013 and indeed since then. Its failure to recognize and embrace generally accepted integrated accounting principles is particularly troubling (https://www.sustainableorganizations.org/GAIA-Principles.pdf).

ED S1 is therefore destined to become a white elephant; prominent and sacrosanct, but unable to justify its place in the real world for lack of real value added. It has scoped its way to oblivion in a world demanding real change that the accounting profession apparently finds too tough to contemplate.

Adopting a “risks and opportunities” approach to sustainability reporting for the narrow benefit of shareholders will have the effect of protecting financial accounting as it is; immune from change.

Sustainability accounting attempts to include financial accounting data as well as non-financial data in an integrated triple bottom line framework that allows stakeholders to evaluate the stewardship and performance over time of the management team. In most entities, the current state of financial accounting (and non-financial data) is too poor to allow any observers to judge performance towards creating value in all capitals.

Therefore, designing a reporting framework to deliver meaningful sustainability data is a key task; a task absent from S1. Regulators who assume that this can be done “from on high” and cascaded to industries and countries around the world are deluded. Performance information needs to be relevant to users throughout the reporting organisations. Too often aiming for technical data comparability comes at the cost of meaning-making. Devolving the setting of performance standards to operations levels in the context(s) of each part of the reporting entity stimulates the drive and engagement to deliver better all-round performance. It also can allow consolidation protocols to monitor progression across the world and from the lowest operational levels to the very top of the hierarchy.

Without any such devolved engagement, internal reporting becomes a mere compliance activity. Divisions and sub-divisions of the holding company can then not be held to performance norms to which they and their own stakeholders did not contribute. Such holistic change management thinking is lacking from this S1.

It seems that the modus operandi adopted in IFRS S1 is therefore to narrow the focus of its scope to quoted businesses and their financial capital creation. By this misplaced focus on reporting to shareholders (and assuming that financial reporting itself needs no reform) the opportunity to adopt meaningful integrated reporting is being missed by the ISSB, not to mention the obligation to deliver on its promise: to provide a coherent standard for sustainability reporting.

By excluding financial performance from the triple bottom line, S1 fails to explore the sufficiency of profits as part of the sustainability equation. It is obvious that businesses need to create value that exceeds their costs. Without adequate profits, entities are unable to deliver on any other promises; they will fail. Therefore, Sustainability information MUST include adequate profit to shareholders. Discussions of “how much is enough?” are vital to serious sustainability norm setting. The MultiCapital Scorecard, for example, adopts the concept of Residual Income for this purpose; covering a cost of equity capital in line with the returns of peer risk group companies. This and alternative approaches should definitely be part of the scope of S1.

Question 4 – Core Content

… the entity shall provide disclosures about:

In each of these areas, which are all dealt with separately below, it would help users if a particular question can be framed as follows for example.
"Disclosures should answer the questions:

1. what is the status considered to be sufficient to be sustainable in the long-term?
2. how will that Sustainability Norm be measured?
3. what are the annual performance targets needed to reach that sustainability norm?"
4. how has actual performance measured up to the above?

- *Governance*

(a) Are objectives clear and appropriately defined?

No. Users should include stakeholders with valid standing.

(b) Are disclosure requirements appropriate?

No. Material actual breaches should be reported.

- *Strategy*

(a) Are objectives clear and appropriately defined?

No. "Risks & Opportunities" omit the strategies needed to become imbued with positive sustainability throughout the entity. Once 3rd party valid stakeholders' interests are included, the strategic balances between competing demands on resources become a key strategic issue. No entities can meaningfully list all risks and opportunities.
IFRS needs to ground its requirements in what is reasonably feasible.

(b) Are disclosure requirements appropriate?

No. The extent and depth of the S1 disclosures <u>require an excessive amount of work</u>.
Focusing on risks and opportunities also fails to ensure entities formulate strategies to deal with multiple risks in their strategy formulation. It is this integrated thinking that is required. Integrated reporting then follows naturally.

- *Risk Management*

Are objectives clear and appropriately defined?

No. Users of general-purpose financial reporting will never be capable of assessing and evaluating an entity's objective risk profile. Partly because perception of risk will vary between individual users. But also because these proposed disclosure objectives cannot be assessed for all plausible future individual risks and opportunities. Recall that the more turbulent the environment, the more frequently its risks and opportunities need reappraisal. S1 assumes a placid stability.

Are disclosure requirements appropriate?

No. The inability for companies to comply with these S1 requirements will result in directors of the reporting entities facing the tension between spending thousands of hours on attempting technical compliance or on thinking about how to become a more adaptive entity and on implementing that change. In turbulent times, reappraisal of risks and opportunities needs to be an ongoing process.

- *Metrics & Targets*

Are objectives clear and appropriately defined?

No. The objectives do not call for disclosure of sustainability performance per se, much less integrated triple bottom line performance.

Are disclosure requirements appropriate?

No. In order to properly disclose sustainability and/or triple bottom line performance, context-based metrics must be used (https://en.wikipedia.org/wiki/Context-Based_Sustainability#Context-Based_Metrics), with which performance can be measured and disclosed relative to sustainability norms and not just in incremental terms.

Question 5 – Reporting Entity

(a) Yes, technically. The Integrated Sustainability Report should relate to the same entity as the financial statements. However, the financials relate essentially to Scope 1 (only the organisation itself). Serious sustainability reporting has to include Scopes 2 & 3 as well, recognising that (particularly in Scope 3) the entity cannot exercise control over all the impacts. In some cases, it can only influence the impacts. This is particularly true in the cases of suppliers of suppliers and customers of customers, et cetera, throughout the value chain.

(b) Yes, technically. It is *clear and capable of consistent application*, but because Scope 3 impacts cannot all be under the control of the reporting entity, the meaning of the disclosures ascribed by Users needs to recognise that the entity can do no more than influence those impacts.   At present, we are unaware of any fully satisfactory mechanisms for accounting for influence. However, we might reasonably expect them to emerge in the fullness of time as demand for them grows. One aim of S1 should (in our opinion) be to identify such issues and recognise that traditional accounting practices fall short of what is and will be needed.

(c) No. Integrated Reporting should incorporate economic performance measures, adopting the normative approach applicable to non-financial capital impacts. Traditional financial accounting fails to report true economic performance in very many respects (e.g., no cost of equity is recognized for financial capital, no recognition of the value creation in intangible assets, no recognition of the impact of inflation). Moreover, the sufficiency principle required for sustainable performance contrasts starkly with the maximisation of profits at the heart of traditional accounting and financial primacy.

However, we agree with §38 that the entity should disclose the published financial statements for the period to which the integrated sustainability accounts relate.   It will be interesting for Users to see the reconciliation between the two.

Question 6 – Connected Information

(a) Is the requirement clear on the need for connectivity between the various sustainability-related risks and opportunities?

No. If the Entity is regarded as a complex adaptive system (which we believe it to be) it becomes impossible to provide the information required for all the risks and opportunities it faces. There is no single or simply-described causal link between individual risks (or opportunities) and either the governance (etc.) or the financial statements. It is therefore specious to attempt to identify cause and effect of single risks and opportunities or expect linearity of outcomes (singly or collectively) in that way.

(b) What do you propose and why?

We propose a coherent framework of sustainability reporting that sets out how much is needed in each area of impact for each vital capital in the entity's own context to be sustainable, and what the entity's own corresponding responsibility is to preserve, create or maintain them. We call these Sustainability Norms. Measures of impacts on all vital capitals of an economic, social or environmental nature should, in turn, be integrated in the accounting system. Risks and opportunities can be included in this work. Trajectory targets from the present status towards accomplishing the Sustainability Norms provide annual performance standards to which actual progression can be compared.

The reason why we make this proposal is that as a result of our research and experience working with international businesses, we recognise that much of what passes as sustainability reporting is nothing of the sort. We have therefore developed and published a set of principles that allow entities of all sorts (but businesses in particular) to address Sustainability in a practical manner but within a coherent conceptual framework. Our proposal has been tested in practice and, with a complete methodology for its implementation, is published in an "open source" form under a Creative Commons license for use by end-users free of charge.

The book, *The MultiCapital Scorecard*, is based on our belief that sustainability performance information needs to be useful to the reporting entity in its own context. All other approaches that take insufficient account of local context can deliver **unsustainable** performance while misleadingly carrying the label of Sustainability.

Delivering meaningful sustainability performance information requires a normative context-based approach. The connectedness of information of economic, social and environmental impacts demands a truly integrated approach to management and reporting. The measurement of Progression towards becoming fully sustainable is both a metric and an Integrative Principle; the best we have yet encountered.

Question 7 – Fair Presentation

As we do not agree that the isolation of Risks and Opportunities represents the Sustainability of any entity adequately, we believe that S1 fails to fairly present any aspect of Sustainability.

The IFRS needs to open its mind to the concept of capital maintenance and to the principle of the carrying capacities of multiple capitals that underpins Sustainability thinking. Harbouring the belief that traditional financial accounting simply requires some added information constitutes a major delusion. It is unfit for purpose.

The vast quantities of risk and opportunity data demanded in S1 cannot resolve its underlying inadequacy. Parading S1 as a solution under a banner of Sustainability is blatant misrepresentation.

Question 8 – Materiality

Here again we encounter the fundamental inadequacy of S1; Users must include valid non-financial stakeholders to whom performance duties are also owed, recognizing that enterprise value creation cannot be the sole materiality criterion. Chapter seven of *The MultiCapital Scorecard* book is dedicated to an even-handed approach to Materiality in an entity dealing with multiple capitals and their disparate impacts.

Whereas S1 recognises the importance of context in Sustainability reporting, our responses to (a) (b) and (c) are all that S1 fails to deal adequately the with the fundamental issue of materiality because of the shortcomings set out above (i.e., that material areas of impact must include consideration of duties owed to all stakeholders to manage one's impacts on all vital capitals important to their well-being). In answer to "what is needed?", we refer to *The MultiCapital Scorecard* book, chapter 7.
(d) If the Entity has a code of conduct that binds it to respecting the laws of the territories in which it operates, we agree that it must do so in practice.

Under what authority can IFRS consider itself above the laws of the land?

Question 9 – Frequency of Reporting

Yes, reported at the same time but in the form of more meaningful Integrated Reporting.

Question 10 – Location of Information

In our opinion, the IFRS should focus on the major issues outlined above, rather than trying to micro-manage the location of the unprincipled information.

Question 11 – Comparatives, Sources, Uncertainty and Errors

§63 Comparatives should be Sustainability Norms rather than past years.
§79 Agreed. Better to be approximately right than precisely wrong.
§84 Errors. S1 illustrates how errors in principles outweigh errors in detail.

Question 12 – Statement of Compliance

§91 This hubris exceeds the irony that **<u>S1 will deliver no assurance that Sustainability is in any way being accounted for in this draft proposal</u>**.

It would be hugely comedic were it not for the fact that this is a missed opportunity to get to grips with externalities, climate crisis, scarce global resources, depleted social capitals and limitless ambitions for economic value extraction. The accounting profession could now be the saviour of the world. But instead, IFRS seems more concerned with preserving incrementalism, financial primacy, and its own ascendant position in the field.

Questions 13, 14, 15

We have no comment on these paragraphs.

Question 16 – Costs, Benefits and Likely Effects

The complete lack of stakeholder engagement (a key component of successful change) in S1's proposals will ensure that very little of this facade of sustainability will change behaviour in practice.

Because the reporting resulting from S1 answers no specific question (such as *Is the reporting entity sustainable?*) it is destined to failure. All the costs and efforts spent on this project will therefore be completely wasted. IFRS only knows its own cost; implementation costs will be extensive but are unknowable.

High costs, but zero benefit. History will judge it accordingly; a white elephant!

Question 17 – Other comments

We have taken the liberty of inserting our comments throughout the Q&As above as relevant where needed, and have also prepared the comments below on Appendices A and C.

<u>IFRS S1 EXPOSURE DRAFT COMMENTS ON APPENDIX A</u>

<u>ABSENCES FROM THE DEFINED TERMS</u>

There is no definition of SUSTAINABILITY. This is a fundamental flaw. We suggest the following definitions be used:

1. the study or management of human impacts on the sufficiency of vital capitals important for human well-being, including economic, social and environmental impacts
2. the subject of whether or not a human social system, such as an organization, is performing in accordance with its own responsibilities to preserve, create or maintain vital capitals at levels required to ensure stakeholder well-being

Meaningful sustainability reporting requires Sustainability Norms to be set as the long-term performance targets that would represent SUFFICIENCY in each area of impact. Without these, there can be no means of telling if performance has been sustainable. Sustainable performance requires sufficient impact in all vital capital areas.

SUFFICIENCY in all areas therefore replaces maximisation in any single area of impact as the PURPOSE of the entity's performance and its sustainability reporting. As some of these goals will not be achievable immediately, TRAJECTORY TARGETS should be developed from the "here and now" as a pathway to reaching these Sustainability Norms.

Also absent from S1's definitions is INTEGRATED REPORTING. It should embrace all the above and, importantly, set an INTEGRATIVE CONCEPT to connect the various strands. Measuring PROGRESSION towards Sustainability Norms offers such an integrative concept, as does the multi-capital-based SUSTAINABILITY concept upon which it rests. It may be measured in financial or in physical terms. Trajectory targets set interim goals.

Together, all the above omissions provide the conceptual framework so obviously lacking from the alphabet soup of the accounting institutions' work of recent years. Contrary to the claim that they have *"garnered significant market uptake"* (p7), we believe that they have left a gaping chasm between users' needs and the intellectual integrity required to move towards respectful accounting for multiple capital impacts.

The MultiCapital Scorecard book (2016 Chelsea Green) sets out examples of how all the above come together. It also shows how consolidated reporting with both central and decentralised context-based norm setting can work in practice.

BUSINESS MODEL

Up to and including *".. fulfil the entity's strategic purposes"* is valid. But whether or not those purposes include *"the creation of value …"* the rest of the sentence is redundant.

Furthermore, the IFRS has no authority to mandate that a business model must by definition create value over all three time horizons. Many do not create value over the short, medium AND long term. We therefore propose that the definition should have a full stop after *"purposes."*

DISCLOSURE TOPIC

"…. based on the activities conducted by the entities" is valid but insufficient. Disclosure may validly relate to the absence of activity. We therefore suggest the insertion of *"or not"* after "*conducted"*. The rest of the paragraph is redundant because disclosure does not depend upon an IFRS or other standard. The revised text should therefore read; *"…. based on the activities conducted or not by the entities."*

ENTERPRISE VALUE (EV)

Market capitalisation plus net debt represent the value an acquisition of the entity would cost at current market prices (excluding any control premiums). We question not the definition of enterprise value, but we do challenge the concept throughout Exposure Draft S1 that EV should be the overriding aim of financial accounting. We consider that performance measurement is a key requirement of accounting. Clearly, that should embrace economic, social and environmental capital impacts.

Moreover, even if we were to accept the EV purpose of financial accounting, we would have to point out the ever-increasing gap between the asset values of enterprises shown up in their financial accounts and their entities' market values. Because financial accounts (1) fail to recognise most of the intangible assets (e.g., reputations, brands,) created by companies, (2) fail to recognise unrealised value created, and (3) also usually ignore the impacts of inflation, even as (4) social assets such as systems and people also escape their grasp.

According to Ocean Tomo's Market Value Study of 2020, Tangible Assets (to which financial accountants and auditors dedicate most of their energy and resources) now represent no more than 10% of market values. This means that financial accounts currently ignore 90% of the market values of the major corporates.

This demonstrates the enduring inability of the accounting profession to measure economic value creation. It is not fit for that purpose.

Consequently, management accounting fills that void in order to enable managers, directors, other leaders and decision takers to act on the best information available. Since Paccioli published his seminal work in 1492, active traders and other value creators have led the world in setting business performance norms, based upon the economic principles of capital maintenance. Accounting professionals have followed these innovators by incorporating management accounting concepts into their financial performance systems. One prime flaw is that they usually ignored externalities, focusing instead on historic costs reflected only in transactions. Another important flaw is that financial accounts ignore the cost of equity capital.

Despite this historic trend and its existing critical failure to measure value creation, the IFRS seems now to be attempting to hijack sustainability accounting in an unprincipled attempt to reinforce financial primacy with top-down regulations that value comparability above meaningfulness. Ironically, this is happening just as the world recognises that economic, social and environmental externalities can no longer be ignored.

GENERAL PURPOSE FINANCIAL REPORTING

After *"… reporting entity"* insert "*in its context*".

Context-free information is not usually useful to users and can be completely misleading, particularly in sustainability performance management.

USERS (= PRIMARY USERS)

Replace "*other creditors*" with "*other valid stakeholders*".

The implicit assumption that creditors have a greater right to recognition than all other valid stakeholders is out of keeping with sustainability reporting norms. People who have invested their working lives, their energies, ideas and loyalty in a company, or others to whom duties and obligations may be owed for other reasons, have standing at least equal to that of a simple trade creditor or a holder of shares for a few minutes.

SUSTAINABILITY-RELATED FINANCIAL DISCLOSURES

Where do non-financial disclosures appear?

Addressing non-financial duties and obligations is critical to sustainability performance. There should be no requirement to translate each such disclosure into monetary terms. But deliberately ignoring the non-financial dimension is untenable.

Furthermore, given the extent to which the IFRS relies on the term "sustainability-related" in its draft (including in the very title of it), we suggest a definition for what is meant by that phrase is needed. In our view, the correct interpretation would be one that equates the phrase with: "impacts on human, social, constructed, economic, and natural capital sufficiency". This would make it clear, just as it should, that "sustainability-related" is meant to refer to whether or not an organization's impacts on all vital capitals are such that they put neither their sufficiency nor the well-being of those who depend on them at risk.

<u>IFRS S1 EXPOSURE DRAFT COMMENTS ON APPENDIX C</u>
<u>Qualitative characteristics of useful sustainability-related financial information</u>

We have read and reviewed Appendix C (pp 43 – 48).

Once again, we draw attention to the error of addressing only “financial” disclosures for “investors and creditors” alone. These boundary errors perpetuate both the inadequacies of financial primacy and the exclusion of the interests of other valid stakeholders.

Moreover, they invalidate use of the term “sustainability” as S1 requires no test of capital maintenance of the social, environmental, or real economic assets on which the entity relies. Without reporting impacts on the sufficiency of these vital capitals, there can be no assertion about the “sustainability” or otherwise of the reporting entity.

Consequently, we consistently argue that a normative approach to performance reporting is required for meaningful “sustainability” reporting. The basic norm for meaningful reporting in each area of impact has to answer the questions, “How much is enough to be sustainable?” and “Are we?”.

Bearing in mind these fundamental concerns (and to avoid repetition) we draw attention to *the following statements*, together with our suggested corrective measures to rectify the text.

§C2 The assertion that “Sustainability-related financial information is part of general-purpose financial reporting” is patently untrue as a description of the status quo. It does not yet exist and it skews the debate about its future to frame it in this manner. Indeed, we argue that economic performance and non-financial performance reporting SHOULD BE essential components of Integrated Reporting (IR). IR should include all material impacts on all vital capitals if it is to become the complete form of Sustainability reporting (as proposed by the IIRC). In that case, general purpose financial accounting would naturally become a subset of Sustainability reporting; not vice versa.

§C8 The materiality to which S1 refers is always Financial Materiality. Failure to recognise any other sort of materiality undermines the use of the term and vitiates labelling it as anything to do with Sustainability.

We do agree that materiality should be assessed in the context of each specific entity.

§C10 *“… complete, neutral and free from error*” are inadequate and misleading. The information needs to be **meaningful** above all else. As §C9 points out, substance trumps form. But *maximising freedom from error* without mentioning meaning-making suggests that it is better to be precisely wrong than approximately right. We reject that prioritisation.

§C16 *“.. comparable, verifiable, timely and understandable.”* are not as important as meaningful. “Meaningful” should be the first quality on the list.

§C17 *Comparability*

S1 (a) adopts the traditional idea that incremental changes over time provide useful comparative information or alternatively *(b)* proposes peer entity performance.
Unfortunately, neither of these comparators can give any assurance that the entity is performing in any way that can be called Sustainable.

Sustainability reporting requires a normative approach. Performance norms need to be established in the context of each entity. They need to answer the question “How much is required to become sustainable?”. Without this basic test, it is entirely possible and indeed probable that incremental change will be **exacerbating unsustainable** performance.

Therefore, we propose that the first item (new a) should be “Meaningful sustainability norms”. We recognise that this undermines the importance of the very Financial Information that lies at the heart of S1. But its importance cannot be over-stated. It allows users to evaluate the balance of performance efforts across multiple vital capitals. Sufficiency thereby replaces maximisation in any one or two capitals. Progress towards hitting or missing sustainability norms (or the trajectory targets to reach them) then provide the essential comparators for each entity in its own contexts.

§C19 *“Comparability is the goal”.*

This can only be the goal if sustainability norms have become the prime comparators, and even *if* such norms vary across organizations – which they surely will. It is how they all perform relative to their own context-based norms that makes comparisons possible in integrated reporting (https://sustainablebrands.com/read/new-metrics/can-performance-reporting-for-different-companies-be-both-context-based-and-comparable).

§C31 *“The completeness, clarity and comparability … all rely on information being presented as a coherent whole.”*

With respect, presenting sustainability information *as a coherent whole* requires a conceptual framework with an integrative component. Both are missing from S1. The world is awaiting these as part of the implementation of Integrated Reporting, but IFRS S1 appears to be failing to deliver either. Scoping-down to *“sustainability-related financial information”* side-steps the real issues and misses the opportunity to elevate the profession to help save the world from self-destruction.