Principles for Responsible Investment

CONSULTATION RESPONSE

FINANCIAL ACCOUNTING STANDARDS BOARD: AGENDA CONSULTATION, FILE REFERENCE NO. 2021-004

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PRI Association

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INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,300 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the future standard-setting agenda of the Financial Accounting Standards Board.

ABOUT THIS CONSULTATION

The purpose of this Invitation to Comment (ITC) is to solicit broad stakeholder feedback about the future standard-setting agenda of the Financial Accounting Standards Board (FASB).

The PRI welcomes the invitation to comment on the financial reporting topics that the Financial Accounting Standards Board (FASB) should consider adding to its standard-setting agenda. Specifically, the PRI provides comments on questions 1, 2, 5, and 6 of the Board's invitation to comment.

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KEY RECOMMENDATIONS

The PRI welcomes FASB's consideration of future standard-setting actions on disclosure of ESG matters and their effect on financial statements and the disaggregation of corporate income tax disclosure on a country-by-country basis.

The PRI's key recommendations are:

- To produce further guidance requiring ESG and climate-related disclosure, incorporation of these matters in financial statements and consideration by auditors.
- To require disaggregation of corporate income tax disclosure on a country-by-country basis.

ESG RELATED DISCLOSURE

The PRI encourages the Board to further review ESG and climate-related disclosure to produce detailed guidance on incorporation of these matters in financial statements and require consideration by auditors.

ESG and climate related matters have a clear and immediate impact on company financial statements. For example, the shift to sustainable alternatives will lead to declining demand for oil and gas, an increase in demand for renewable energy products and services, and a phaseout of internal combustion engines in favour of electric vehicles. These medium-term economic shifts impact financial statements today as these statements include estimates and assumptions about the future. At the asset level, these shifts can lead to shorter estimated useful lives or alterations of assumptions in determining expected future cash flow. In 2020 alone, the oil industry wrote down $145 billion in assets – equivalent to 10% of the companies' collective market value[1]. While these write-downs are not all related to climate risk, future climate risk to financial markets is expected to far outpace the economic damage of the Covid-19 global pandemic[2]. To best understand and work to mitigate this risk, investors need clear, consistent reporting on climate-related risks.

Lack of clarity on ESG and climate related matters in financial reporting continues to result in lack of information for investors, inconsistent reporting from companies and an overall inability of markets to account for climate risk and opportunities across businesses and economies. A recent report by the Carbon Tracker Initiative and Climate Accounting Program (CAP), supported by the PRI, has shown significant issues with company incorporation of climate risk in financial statements[3]. The study reviewed 107 publicly listed carbon-intensive firms and their auditors and found that of the company statements reviewed, over 70% did not indicate if or how they had considered climate matters when preparing 2020 financial statements. Further, 72% of companies reviewed had inconsistent treatment of climate matters within their financial statements compared to their disclosure of climate related risks in other reporting.

[1] https://www.wsj.com/articles/2020-was-one-of-the-worst-ever-years-for-oil-write-downs-11609077600

[2] https://www.swissre.com/media/news-releases/nr-20210422-economics-of-climate-change-risks.html#:~:text=Climate%20change%20poses%20the%20biggest,in%20the%20next%2030%20years.

[3] https://www.unpri.org/download?ac=14597

Recently, both the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB) have provided clarity on their existing requirements for accounting and audit, noting that climate must be considered and material assumptions shown[4]. In jurisdictions where such guidance has been implemented, both investors and a significant coalition of investor organizations are requesting companies and their auditors consider material climate risks in forthcoming financial statements. Auditors have also welcomed the additional guidance and clarity on consideration of these increasingly understood and measurable risks and committed to play their part.

While FASB's Staff Educational Paper on the intersection of ESG matters was an important first step, the PRI encourages the Board to further review ESG and climate-related disclosure to produce detailed guidance on incorporation of these matters in financial statements and require consideration by auditors.

DISAGGREGATION OF CORPORATE TAX DISCLOSURE ON A COUNTRY-BY-COUNTRY BASIS

The PRI recommends FASB introduce public country-by-country reporting (CbCR). CbCR would:

- Enable investors to better assess tax risks and opportunities in their portfolio and provide visibility of high-risk transactions;
- Ensure the relevance of GAAP standards with changing investor expectations;
- Create a level-playing field for companies and minimise uncertainties.

The PRI has been working with institutional investors to promote corporate tax responsibility since 2015. We initiated our work with a guide to help investors understand the risks related to aggressive tax planning and provide a framework for investor-company dialogue on the issue. In 2017, the PRI supplemented this guidance with a set of disclosure recommendations for companies to strengthen corporate income tax disclosure on tax policy, governance and risk management, and reporting areas (explanatory notes can be accessed here). Between 2017-19, based on research commissioned by the PRI, 36 institutional investors representing US$2.9 trillion in assets under management collaborated to engage large healthcare and information technology companies to enhance corporate tax transparency. The findings of this engagement are published here. In June 2021, a PRI-commissioned report reviewed the global trends in corporate tax disclosure, drawing on a

dataset covering 1,300 large listed companies across both developed and emerging markets.

Granular tax disclosure requirements will enable better investor assessment of tax risks and opportunities

Tax risks translate into earnings, reputational and governance risks at the company level as well as contribute to macro-economic and societal risks.[5] There is increasing recognition that it is in investors' long-term financial interests to better identify tax related factors that could present a downside risk and integrate those risks in valuation and investment decisions. However, PRI-commissioned

[4] https://www.ifrs.org/content/dam/ifrs/news/2019/november/in-brief-climate-change-nick-anderson.pdf and https://www.iaasb.org/publications/consideration-climate-related-risks-audit-financial-statement

[5] https://www.unpri.org/download?ac=5601

research on global tax disclosure, undertaken by FTSE Russell finds that over half of companies globally make no material tax disclosures at all.[6] While the number of commitments made by corporations around tax is growing, meaningful quantitative disclosures remain few and far between. This creates a significant challenge for investors seeking to understand how corporate tax affairs are managed.

Granular disclosure will ensure the relevance of GAAP standards with changing investor expectations.

Recent developments have made the need for enhanced tax transparency even more pressing. These include the proposed global tax reforms backed by the Biden administration and more than 130 countries[7] and the EU's continued focus on tax[8]. Growing fiscal strain due to the COVID-19 pandemic has added urgency to these discussions with governments looking to corporate taxes as a means to raise public funds.

These measures are likely to result in greater scrutiny of tax practices and potentially increase tax liabilities for multinational corporations. Consequently, they will also contribute to investor and public expectations that companies demonstrate that corporate income taxes paid match business substance.

Granular disclosure will create a level-playing field for companies and minimise uncertainties.

There is growing appreciation among the financial community that the absence of country-level information has hampered efforts by investors to understand corporate tax practices and prevented tax risks from being fully factored into investment decisions. As a result of this recognition, more investors have supported calls for public CbCR[9].

In June 2021, EU legislators reached a political agreement on a directive which would mandate public country-by-country disclosure of corporation tax paid for multinationals with turnover of over €750 million[10]. In the US, the House of Representatives approved legislation in June 2021 that would see companies with annual revenues over $850 million obliged to publicly report country-by-country tax data[11]. Despite the regulatory momentum, only 2% of U.S companies disclose country-by-country information compared to 18% of companies in developed Europe[12].

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[6] https://www.unpri.org/download?ac=13650

[7] https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm

[8] https://www.consilium.europa.eu/en/press/press-releases/2021/06/01/public-country-by-country-reporting-by-big-multinationals-eu-co-legislators-reach-political-agreement/

[9] UN PRI Investor Letter
https://dwtyzx6upklss.cloudfront.net/Uploads/u/m/t/investorsignonletteronpubliccbcr_signatories_final_758353.pdf

Fact Coalition Investor Letter

https://thefactcoalition.org/investors-send-letter-to-the-oecd-in-support-of-country-by-country-reporting/

[10] https://www.consilium.europa.eu/en/press/press-releases/2021/06/01/public-country-by-country-reporting-by-big-multinationals-eu-co-legislators-reach-political-agreement/ .

[11] This legislation is currently pending before the Senate Committee on Banking, Housing, and Urban Affairs: https://www.congress.gov/bill/117th-congress/house-bill/3007/text?q=%7B%22search%22%3A%5B%223007%22%5D%7D&r=2&s=1

[12] Ibid.

Investors and companies stand to gain from country-level reporting. This is information that companies are already collating and privately providing to tax authorities in line with BEPS Action 13.[13] A small number of multinational companies are also publicly reporting this level of information and have demonstrated that this is both feasible and does not lead to negative consequences in terms of public backlash or competitiveness[14]. In response to the PRI-coordinated engagement on tax transparency, several companies have indicated that mandatory requirements on CbCR will ensure a level playing field and reduce first-mover concerns[15].

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of FASB to create guidance on incorporation of ESG matters in financial statements and establish public country-by-country reporting.

Any question or comments can be sent to policy@unpri.org.

[13] https://www.oecd.org/tax/beps/beps-actions/action13/

[14] https://www.unpri.org/download?ac=13650

[15] https://www.unpri.org/governance-issues/advancing-tax-transparency-outcomes-from-the-pri-collaborative-engagement/5541.article