

***Non-financial reporting:
ensuring a sustainable global recovery***

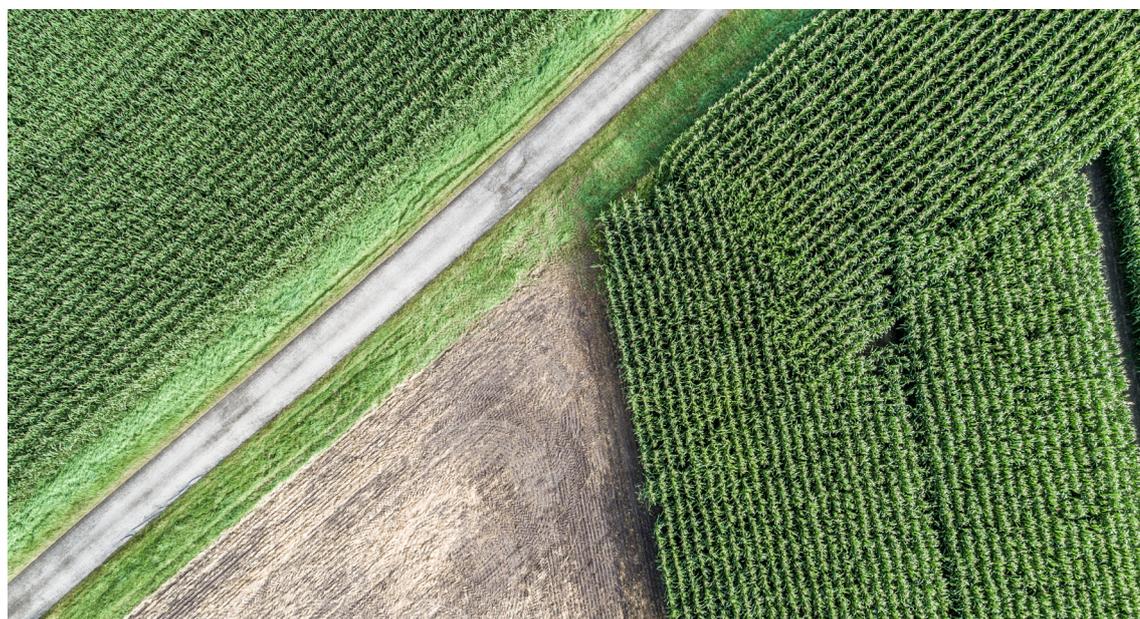
Introduction

There is a pressing need to expedite the sustainable rebuilding of economies the world over, including in Europe. The COVID-19 pandemic has battered human, social and economic capital across the globe. In responding to the virus and charting a post-coronavirus recovery path, we cannot lose sight of the wider unfolding picture of climate emergency, massive biodiversity loss and increasing inequality. For change to happen, business has to respond. Improved reporting on environmental and social issues is central to efforts to encourage system change. Businesses need to better understand the strategic value nature and society has for them - and they need to recognise and be accountable for the impact of their activities.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. We work with governments, regulators and businesses and lead, connect, support and regulate more than 154,500 chartered accountant members in over 149 countries. We are committed to enabling our members and the broader accountancy profession to make collaborative and inclusive choices towards a more sustainable and resilient future, helping to effect positive change.

This paper seeks to provide a constructive contribution to the important debate on non-financial reporting taking place in Europe and elsewhere, prompted in no small part by the ongoing legislative review of the EU's 2014 Non-Financial Reporting Directive (NFRD). While any future revisions to the NFRD will be of interest first and foremost to EU countries, corporates and stakeholders, the issues addressed are of keen international concern. EU legislative change will provide an important point of reference for other jurisdictions too.

Our views are framed by what we believe can best deliver effective change in order to facilitate the transition to sustainable and resilient economies worldwide. Experience tells us that the EU can be a real motor for global change, providing regional regulatory coherence while also generating momentum towards the identification and application of common solutions to address shared challenges.



Our key points

1	We strongly encourage all efforts to move towards the establishment of a single principles-based and internationally recognised global framework providing comparability and consistency for non-financial reporting.
2	We believe in the longer-term goal of a global corporate reporting structure, encompassing both financial and non-financial reporting.
3	Current moves to consolidate existing standards, guidelines and frameworks need to be accelerated and made more open and transparent.
4	High quality standards need to be based on a shared understanding of the goals and purposes of reporting. Next steps must also address the urgent need to define and agree a solid conceptual framework for non-financial reporting.
5	We recognise the particular momentum in Europe in this area and believe that the EU can act as a global leader to catalyse international alignment and the establishment of a new corporate reporting framework.
6	Concurrently, steps can be taken at European level to work towards the rapid identification of standards that can address specific EU policy objectives and regulatory needs.
7	This could lead to a more direct role for the European Financial Reporting Advisory Group (EFRAG) in helping to elaborate a new conceptual framework and in assuming some standard-setting functions where there is a pressing need for action at European level.
8	An enhanced way of working could be envisaged between the EU/EFRAG and an eventual International Non-Financial Standards Board (INSB) which is open to the collaborative development of standards.

WHAT IS THE CURRENT STATE OF PLAY?

Enhanced non-financial reporting can play a critical role in the transition towards more sustainable and resilient societies and economies. Even more so in the aftermath of the COVID-19 crisis, businesses need to both understand the implications for their activities of environmental and social factors and be accountable for their impact on the nature, people and the economy.

Broadened non-financial disclosures also provide the key information needed by shareholders, regulators and other stakeholders on the overall performance and impact of companies and other organisations. It is unsurprising that the demand for enhanced and more accessible corporate financial and non-financial information has continued to grow over the years, driven by investor needs, societal expectations and regulatory demands.

The result has been the emergence around the world of a wide range of non-financial standards, guidelines and frameworks that can be applied by companies. This proliferation of initiatives has, over time, led to a confusing landscape which risks undermining the overall usefulness and credibility of non-financial reporting. It is now time to come together to find a solution to the demand for improved non-financial reporting.

WHAT IS THE END GOAL?

The coronavirus pandemic and the climate emergency are global challenges and call for global responses. Equally, capital markets participants call for global reporting standards enabling greater transparency, comparability and consistency. The IFRS experience indicates that a universal reporting language can offer many potential economic and social advantages. We believe the same holds true for non-financial reporting.

ICAEW has been a persistent champion of the creation of a single set of high-quality global accounting standards and their application by publicly traded and other companies around the world. When it comes to non-financial reporting, our ultimate goal is also that of a single set of high quality, authoritative standards that have international resonance. Given the pressing urgency of the challenges, such standards must be available in the mid-term, not the long term.

At international level, this calls for the establishment of an independent non-financial reporting standard-setting body overseen by an authoritative, internationally recognised umbrella body, which can represent relevant public organisations, to coordinate activities globally and help cement a common viewpoint on the desired direction of travel. We strongly encourage all efforts in this direction.

We believe that this could ultimately take the form of a global corporate reporting structure along the lines of the model put forward in the Accountancy Europe Cogito paper, *Interconnected standard setting for corporate reporting*, published in December 2019. The Cogito paper sets out a three-tier reporting structure, including a stronger and broader approach to public oversight through an enhanced monitoring body, the restructuring of the IFRS Foundation into a body with a broader corporate reporting mandate and the establishment of a new International Non-Financial Reporting Standards Board (INSB) responsible for formalising non-financial reporting standards.

WHAT IS HAPPENING IN EUROPE?

We recognise the particular momentum in Europe in this area, in light also of the EU's stated intention to achieve climate neutrality by 2050 and to restart economic activity post-COVID-19 by building on the European Green Deal.

Given the urgency of the challenge of transitioning to sustainable and resilient business, we welcome the EU's prioritisation of action with regard to non-financial reporting, as also evidenced by the current review of the NFRD. We support the approach taken to date by the EU to mandate non-financial reporting by setting out essential requirements in legislation, leaving technical details to standards, while ensuring a strong enforcement regime. This mirrors the IFRS model whereby standard-setters create the standards but adoption is determined by governments.

We consider that it is possible for the EU to concurrently address the legal legitimacy, independence and suitability to European circumstances of non-financial reporting standards while helping to catalyse global stakeholders to actively promote the creation and application of international non-financial reporting standards.

HOW TO MOVE FORWARD?

We believe it is time to consider some practical steps to enable the EU to move ahead rapidly while also supporting the end goal of a global corporate reporting structure. We note that activity to consolidate existing standards, guidelines and frameworks is starting to take place. This may lead to the restructuring of the IFRS Foundation to enable the emergence of a single INSB. The pace, buy-in and eventual outcome remain uncertain. EU action, if framed in an innovative, outward looking and collaborative way, can make an important contribution to a global solution, while also addressing EU regulatory objectives.

High quality standards need to be framed by agreed over-arching 'rules of the game', providing a shared understanding of the goals and purposes of reporting. A solid, high-level 'conceptual framework' enables a consistent approach to the development, interpretation and application of detailed standards. This is currently lacking for non-financial reporting, and is needed urgently. It would provide a critical grounding for the standards, setting out fundamental concepts. In a European context, a conceptual framework would sit alongside the definition of key policies and top-level principles in a revised and versatile NFRD. Looking further ahead, consideration should be also given to the development of a broader conceptual framework for connected reporting, paving the way for an interconnected standard-setting approach for both financial and non-financial reporting, an idea explored in the Accountancy Europe Cogito paper.

Next steps could also lead to a 'bridged' approach to setting non-financial reporting standards in the mid-term. In a European context, this could encompass a more direct role for EFRAG in helping to elaborate a new conceptual framework and, potentially, to assume some standard-setting functions where there is a pressing need for action at European level. At the same time, the EU could continue to act as a global leader in helping to catalyse international alignment and the establishment of a new corporate reporting framework.

Inspired by approaches taken in other policy areas, with particular reference to the European 'standardisation' framework for products and services, we believe that steps could be envisaged that would enable the EU to help progress the definition of a globally-relevant conceptual framework, work towards the rapid identification of standards that can address the specific legal obligations set out in recent EU legislation and EU policy objectives, and promote the development of a suite of international non-financial reporting standards.

WHAT DOES A 'BRIDGED' APPROACH TO STANDARD SETTING LOOK LIKE?

We believe that a 'bridged' approach could lead to enhanced non-financial reporting in the EU while retaining the prospect of globally consistent standards. It would embed a presumption that the EU (and others) prioritise the development of international standards, provided that they meet local legislative and market requirements. A focus on international standards would also encourage other jurisdictions to take an interest in the development and adoption of such standards. Within the EU, such an approach could be based on an understanding, potentially laid down in legislation, that departures from international non-financial reporting standards would be minimised, objectively justified and preferably temporary.

In practical terms, we consider that the next steps could therefore include the following –

- At European level, explicit recognition in legislation, via the forthcoming review of the NFRD, of a preference for international non-financial reporting standards while providing a route for the development of European standards for which need has not been recognised or is not pressing at international level.
- Evolution of EFRAG towards also assuming a role in the development of non-financial reporting standards, with changes to governance, resources and working processes to ensure that EFRAG can call upon the best European and international expertise.

- A collaborative approach between EFRAG and existing international frameworks and initiatives as well as the IASB (in the interim, as an INSB is set up) to urgently move ahead with the definition of a globally acceptable conceptual framework for non-financial reporting. This could eventually feed into the development of a global conceptual framework for connected reporting.
- Establishment of a new way of working by a new INSB that is open to building on standards developed by the EU or other individual jurisdictions, as part of a global suite of standards.
- Eventual agreement between the EU and an INSB enabling the collaborative development of standards. This could refer to the ability of the EU (and other individual jurisdictions) to request work on specific standards and/or the possibility for the EU to take a 'lead' in certain circumstances.

HOW TO ENHANCE COOPERATION BETWEEN EUROPEAN AND INTERNATIONAL BODIES?

Assuming that the role of EFRAG does evolve and that a new international non-financial reporting standard setter is set up within a broader corporate reporting framework, we think it is possible to envisage an enhanced form of working between the two bodies to ensure:¹

- Transparency of work, with the possibility of both sides being able to input into the content of standards under development - with cooperation being ensured through respective internal rules of procedure;
- Avoidance of duplication of work, enabling expertise to be focused and used in an efficient manner;
- A more rapid process of development and maintenance of standards, by establishing early consensus; and
- Shared commitment to ensure the appropriate involvement of all relevant interested parties and stakeholders by both bodies.

Specific steps to encourage enhanced technical cooperation, could include:

- Regular exchange of information, including on draft proposals;
- Mutual representation at technical working level;
- The possibility of the two bodies deciding jointly who leads on specific projects;
- Clarity over likely future work programmes, including (from the European perspective) an overview of the standards which are deemed necessary and for which the EU may 'request' work by the standard-setting bodies (while still allowing for the possibility of making urgent 'unplanned' requests to address a specific need);
- Annual assessment of global alignment efforts, with reference to new, agreed standards, as well as an overview of the collaborative working arrangements in practice; and
- Provision for a mechanism to flag issues of concern.

WHAT ARE THE IMPLICATIONS OF A 'BRIDGED' APPROACH TO STANDARD SETTING?

Importantly, the potential implications of a more 'bridged' approach to non-financial reporting standard setting could include the following -

- Acceptance that the EU (and other jurisdictions) can make formal requests to an international non-financial reporting standard setter for the development of specific standards that should be responded to positively or negatively.

¹ The following section borrows from the 1991 Agreement on Technical Co-operation between the International Organization for Standardization (ISO) and the European Committee for Standardization (CEN), otherwise known as the 'Vienna Agreement'.

- An understanding that if there is not sufficient interest and/or urgency at the international level, then an EU standard-setting process can kick in. The same could apply for other jurisdictions.
- A willingness to consider and/or build on European (or other jurisdiction-specific) standards that are authoritative, of high quality and globally relevant as international standards.
- Recognition that such an approach would require closer working with European and other individual jurisdictions' authorities and stakeholders, as well as the establishment of more structured feedback mechanisms.

WHAT WOULD THIS MEAN FOR EFRAG?

For an evolved EFRAG, such an approach could potentially imply the following -

- Affirmation that EFRAG 'promotes international standards first and makes every effort to ensure that no conflicts exist between international non-financial reporting standards and European ones' - this could be made clear in relevant EU legislation as well as in EFRAG statutes.
- Commitment to encouraging international input in the development of European standards and to respond adequately to comments from an international non-financial reporting standard setter, based also on close technical cooperation.
- Openness to involving multi-stakeholders in governance and working structures, thereby ensuring an inclusive representation of European stakeholders encompassing public, private and non-governmental bodies.
- Possible new forms of 'partnership' with non-EU bodies, whether through 'affiliation status', 'cooperation agreements' or other forms - as well as openness to a broader range of non-EU expertise in technical working groups, whether with 'observer' or other status.

OUR NEXT STEPS: CONTRIBUTING TO THE DEBATE

Now is the time to act. This is demanded by the nature and urgency of the combined challenges posed by the COVID-19 pandemic, the climate and biodiversity emergencies and increasing inequality within societies. Requiring better non-financial disclosures can help organisations to deliver meaningful change with the urgency and scale required.

While we believe that active steps need to be taken immediately to start the process of developing a global corporate reporting structure, achieving effective and sustainable international change will take time. The EU can play a critical role in catalysing and supporting international efforts in this direction as well as pursuing change in Europe. Moreover, in recognising the momentum for action at European level, particularly in light of the review of the NFRD, we hope that the practical, short to medium-term steps that we have set out can further encourage a phased yet aligned European and international approach towards interconnected standard setting.

We hope this paper provides a practical contribution to the various debates currently taking place in different forums, with the aim of fostering broad consensus between all key actors and stakeholders.

Share your thoughts



**We welcome all comments
and suggestions on this paper.
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