

Private and confidential

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Dear Olivier

Cogito Paper: Interconnected Standard Setting for Corporate Reporting

EY welcomes the opportunity to comment on the Accountancy Europe ("ACE") Cogito Paper on Interconnected Standard Setting for Corporate Reporting ("the Paper").

ACE's initiative to start a debate on how to develop a universally applicable framework for corporate reporting, both financial and non-financial information ("NFI") is an important and timely one. The European Commission has recently launched a public consultation to review the Non-Financial Reporting Directive ("NFRD") that also aims at evolving the framework for corporate reporting including the development of relevant standards.

OVERALL SUMMARY

EY supports the development of more robust NFI reporting standards including a suitable set of metrics as soon as possible. However, the structure of standard setting should not distract us from acting now to address important existing stakeholder needs while at the same time building in the longer term towards globally consistent frameworks and standards.

Therefore, we acknowledge that national or regional short-term solutions will be necessary but encourage such efforts consider a long-term goal of globally consistent frameworks and standards to measure, monitor and report on NFI. Therefore, any short-term solutions should be flexible and take into account, as far as possible, what has been or will be agreed at the international level.

BACKGROUND

Corporate reporting is changing to keep pace with rapidly changing economic realities and to address the ever growing and evolving needs of investors and a broader stakeholder audience.

Factors that drive these changes in content, format and delivery model of corporate reporting include technology and a proliferation of data, the increasing importance of intangibles, and changing expectations about the role of business in society. As ACE rightly also highlights, climate change, environmental degradation, human rights, social concerns are of growing global importance to companies, investors, creditors, policymakers, regulators and society at large.

As a result, there is a demand for more robust, reliable and comparable reporting in these areas. Investors regard financial reporting as critical but insufficient on its own to anticipate and value future events and expected cash-flows. Although current regulations are in place to supplement financial

statements with other information elements such as purpose, business model, strategy and future prospects, there is a call to expand on this and make it more consistent and coherent.

These elements are seen as increasingly relevant to enhance investors' and other stakeholders' confidence in how they evaluate the future in a more insightful and anticipatory way. This is one of the reasons why the vast majority of companies in the GF250 (78%) include non-financial information and sustainability related data in their annual reports.

In Europe, non-financial reporting is becoming an increasingly regulated component of the annual report. A few countries have also passed legislation mandating assurance on non-financial information. Regulation is expected to continue and increase, as well as the development of frameworks and standard setters. This proliferation, though well-meant, adds complexity and in turn creates confusion and introduces gaps, overlaps and contradictions.

Despite the universal demand there remains a lack of a single, universally agreed framework which provides sufficient guidance on the content of NFI; let alone globally consistent standards.

EY has long recognised the importance of NFI. It has a strong NFI reporting and verification practice with, for example, more than 500 practitioners across Europe. In a bid to find solutions to the challenges set out above, EY also developed its Long-Term Value framework, tested with multinational companies, asset managers and asset owners through the Embankment Project for Inclusive Capitalism (see Appendix for more details). Accordingly, EY is highly committed to the systemic change called for by ACE and well placed to provide views on the Paper.

OUR VIEWS

Urgency is the most important criterion at the present time

The Cogito Paper identifies nine criteria to evaluate potential standard setting approaches. We agree with them. However, we believe the most important one at this stage is urgency. Developing robust NFI reporting standards that result in comparable, relevant and reliable disclosures is critical to meet the market and social demands described above.

Whereas some issues like climate change are global, others like water scarcity, air quality or social regulations are local. The NFI reporting maturity level is very different from one region to another across the globe. Accordingly, a global framework and consistent standards will take time to define and can only be a long-term goal.

Although we believe the ultimate and longer-term goal should be a single universal framework and set of standards (or at least frameworks and standards that are globally consistent), the time for action is now. Debates and decisions to restructure the current global standard setting framework (before then setting standards) is likely to take longer than the stakeholders are willing to wait. Thus, other approaches are likely to be more expedient.

That said, any national or regional short-term solution, however well-meaning and helpful, needs to consider the long-term goal of globally consistent frameworks and standards. Such solutions therefore need to be flexible and take into account as much as possible what has been or will be agreed internationally.

The European Union has a strong leadership role to play globally on the development of NFI reporting standards

As well as urgency, the interests of broader stakeholders need to be considered in NFI reporting and standardisation. This means there is an important role for policymakers like the European Union (“EU”) in creating a legal framework in which robust standard setting can take place. This would include important criteria for such standard setting e.g. independence, free from political interference, due process, participation of all relevant stakeholders, etc.

The EU is well placed to demonstrate leadership in this area. Its member states are one of the biggest “users” of the current international financial reporting standards framework. The EU is also leading globally in the debate about sustainable finance and the importance of reporting on environmental, social and governance aspects of business.

As mentioned above, the European Commission is currently reviewing the NFRD. This will create important momentum in the development of a universally applicable and consistent framework on corporate reporting. In parallel, coordination and consolidation of existing initiatives will need to continue. It will be important that the EU also continues to encourage, agitate and lead in the global conversation driving towards the universal framework and globally consistent standards we refer to above.

There is an urgent need to define major non-financial topics and a core set of metrics

EY believes that the concept of double materiality used in the NFRD is aligned with the materiality lens of the Cogito paper. It aims at capturing impacts and value creation not only for shareholders but also for all stakeholders, by considering financial impacts from companies’ internal perspectives and impacts on value creation for other stakeholders.

There has been more than ten years of experience in conducting materiality analysis by sector (through global standards and rating agencies such as GRI, SASB, MSCI). This means that the market, at least in Europe, has reached a level of maturity such that the time is right to synthesize these standards and to define the major NFI topics or risks as well as the related metrics.

The only way to achieve greater information comparability is to define a core set of metrics for transversal issues like CO2 emissions or social aspects, and sector specific metrics for other issues like responsible products.

In addition, a greater nexus between financial and non-financial information should remain a global and long-term goal. Progress on this today is not as rapid as one might like because financial accounting is well established, reliable and rigorous whereas environmental and social accounting (i.e. the monetization of externalities) is still experimental. However, future environmental and social accounting methodologies should better facilitate this. Currently, the main nexus available is a framework concept based on reliability and comparability.

In this regard, because of the interconnection between financial and non-financial information and the desirability of internationally consistent frameworks and standards for NFI, whoever sets the standards for NFI should work closely with financial reporting standards setters from whose experiences they will surely benefit.

Lastly, the role of technology in measurement and standardization should be considered from the start. However, this consideration should not slow down NFI standardization – even its application in the preparation of financial information is not fully embedded and mature.

Assurability must be considered in NFI standard setting

Whatever NFI standards are created, it is important that they can be assured to bolster user confidence. ISAE 3000 is the international assurance standard that would be relevant, and it requires as a pre-condition that the framework has criteria that are 'suitable'. However, the existing frameworks for NFI are evolving and not as mature as financial reporting frameworks. The IAASB is seeking to develop guidance for Extended Forms of External Reporting (currently under consultation) with a primary purpose of assisting assurance practitioners in determining how to apply ISAE 3000 to these evolving frameworks (or entity-developed frameworks).

Flexibility and agility in NFI standard setting is key

Any NFI standard setting process should be both anticipatory and flexible to accommodate developing changes in information needs. NFI should respond to the intended stakeholders' information needs and expectations.

That said, a two-way communication and feedback loop with all stakeholders will be required. The standard setting structure should encompass a robust and politically independent due process focusing on user needs and involving the key stakeholders.

Conclusion

In summary, EY supports the development of more robust NFI reporting standards including a suitable set of metrics as soon as possible. The structure of standard setting however should not distract us from acting now to address important existing stakeholder needs while at the same time building towards a globally consistent framework and standards in the longer term.

We hope these comments provide helpful input to ACE's further considerations and engagement on this topic. We look forward to actively participating in the further dialogue with ACE and other stakeholders on the evolution of corporate reporting and standard setting.

If you have any questions or comments on this letter, please contact Andrew Hobbs, EY EMEIA Public Policy Leader (ahobbs@uk.ey.com).

Yours sincerely



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APPENDIX

The Embankment Project for Inclusive Capitalism

In 2017, EY and the Coalition for Inclusive Capitalism created the Embankment Project for Inclusive Capitalism (EPIC), which launched a proposed reporting framework in November 2018¹. Tested with 31 companies, asset managers and asset owners, the framework has useful metrics and narratives that can help businesses to measure and articulate the value they create for a broad range of stakeholders. These new metrics and narratives relate to the following key areas:

- ▶ **Talent:** the way companies manage their human capital when it comes to compensation and benefits; recruitment; training and development; diversity and inclusion; wellbeing and creating a purpose-driven culture of engagement.
- ▶ **Innovation:** fulfilling unmet needs, maintaining the focus on the end user during the innovation process and fostering trust in the organization.
- ▶ **Society and environment:** how companies impact on external stakeholders and communities by contributing to business-relevant social and environmental goals.
- ▶ **Governance:** the effectiveness of the board in providing appropriate oversight, governance mechanisms to ensure board quality and independence, and the ability of leadership, in conjunction with the board, to develop and assess long-term strategy.

EPIC also identified some important criteria that could be applied to improve the quality of all corporate reporting. It said that corporate reporting should:

- ▶ Be clear about context
- ▶ Be material to stakeholders
- ▶ Be core to the company's purpose, strategy and business model
- ▶ Be assured and trusted
- ▶ Be simple to understand
- ▶ Offer a more complete view of value

¹ [Embankment Project for Inclusive Capitalism](#), 2018, Coalition for Inclusive Capitalism