BENCHMARK INTELLIGENCE FOR THE ACCOUNTING INDUSTRY

INTERNATIONAL Accounting BULLETIN

May 2016 Issue 561

www.InternationalAccountingBulletin.com

Hats off

Panama Papers kick-start greater push for tax transparency

- Comments: Panama Papers not in the public interest
- NFI Directive a possible goldmine
- Country survey: Cyprus
- Rankings: UAE, Turkey, Saudi Arabia

timetric

EU Directive: a goldmine for the accounting firms?

Accounting firms might see the EU Directive on disclosure of non-financial information as a cash-cow, but they will have to demonstrate their relevance to reap the benefits, as **Vincent Huck** reports

EU member states have to implement the EU Directive on disclosure of non-financial and diversity information (NFI Directive) by the end of this year. The EU law came into force on 6 December 2014, but a two-year transposition period has been granted to prepare for the changes. Companies affected will need to comply with the national rules from 2017 onwards.

The Directive requires 6,000 large European companies to disclose information at least on environmental, social, and employee-related matters, as well as on respect for human rights, anti-corruption, and bribery issues. The companies also have to disclose the diversity policy for their administrative, management, and supervisory boards.

The NFI Directive tries to bridge the gap between companies' cold, objective and measurable financial results and the subjective, yet meaningful, NFI.

The enterprises affected are those considered as Public Interest Entities (PIEs). These PIEs are companies with more than 500 employees; listed companies; insurers and credit institutions (listed or not). EU member states can expand the definition of PIE and include additional types of companies.

Reporting such information in a comparable and consistent way, at a time when there are no unified standards (let alone a recognised standard-setting authority) isn't going to be easy.

The NFI Directive only specifies what information should be reported, but it doesn't specify how to do it. The market is saturated by a plethora of initiatives, frameworks and standards that aim at exploring the how. The European Commission (EC) consultation seeking stakeholders' views on some guidelines which could help to iron out problems of application ended on 15 April.

The consultation received 346 responses and the summary of responses should be available by the summer. The non-binding guidelines should be published by 6 December 2016.

However, attendees of a joint event by the Federation of European Accountant (FEE) and the International Integrated Reporting Council (IIRC) were told not to wait for guidance, but to start to learn by doing and failing.

Speaking to International Accounting Bulletin after the event, Hilde Blomme, FEE deputy CEO, says FEE has concluded that there are three different frameworks that could be used to comply with the Directive: the Global Reporting Initiative (GRI) framework, the Sustainability Accounting Standards Board (SASB) framework, and Integrated Reporting (IR).

The event held at FEE's Brussels headquarters looked at IR in particular and its suitability to help companies comply with the Directive.

"I think what I like about the Directive is that it talks about the 'why' but it doesn't try to talk at the moment about the 'how'," said IIRC CEO Paul Druckman. "I think that's the right way. We've been criticised quite strongly at the IIRC, that we don't tell you how to do an integrated report. Well, you tell me how you run your business, and I'll tell you how to do the integrated report. It has to be the first before the second, and that's why it's very good that we're not trying to prescribe formats in both the Directive and in what we're doing."

There are two critical differences between IR and NFI, Druckman continued. First that the breadth of IR includes all that is included in the Directive, but also all that is talked about in financial reporting. And second that IR is a market-driven initiative.

"It's not difficult to start [with IR]. Just start," he concluded. "It's really not difficult unless you don't have a strategy, you don't have a business model and you can't write. Then you've got a problem."

Richard Howitt, an MEP involved early in the creation of the NFI Directive adds: "Don't think these great guys and girls from the EC have got all the answers," adding that companies shouldn't wait for the guidance and then see it as a compliance exercise.

That's completely the opposite of what needs to happen, Howitt continues. "I think the guidance can be helpful, but my plea to everyone is [...] get started, learn by doing. Don't wait for someone else to solve it for you. If you start now you're going to be part of changing the entire culture and business model of companies and economies in a way that makes sustainability for companies, people and the planet, real."

While larger companies already report to a certain extent on NFI and have the means to be compliant with the Directive requirements, smaller PIEs might need or want to seek help from external advisors. As such the implementation of the Directive provides an incredible opportunity for firms.

Moreover with reporting comes the question of giving assurance on the information disclosed. While the Directive puts the responsibility of checking that the information is disclosed on the statutory auditor, it leaves the option of a voluntary audit to other entities.

RSM global leader for quality and risk, Robert Dohrer says: "I see it as a real opportunity for the accounting profession and audit firms to state a claim in this new world of NFI."

Some entities have created a specialised niche in advising companies on NFI reporting and could be a threat to the accounting profession, he continues, and while the profession has taken a few reputational hits recently, he believes the Directive is an opportunity to reverse this perception and "to demonstrate that some of the key qualities we possess are a real match to providing this assurance."

David Chitty, international accounting and audit director at Crowe Horwath International, says: "It's an opportunity for firms, but also an opportunity for companies to think about how they most effectively report and present corporate communications

"Because we're talking about NFI disclosures and communication, there will be other professionals the company may well consult for their PR or media skills, or specialist consultancy skills in fields related to what the company does. I'm not sure accountancy firms are the main players. Firms will have to demonstrate they can provide services that are relevant and add value to companies when they are reporting and communicating."

But if they do and are successful, accountants might see the NFI Directive as the goose that lays golden eggs

As Howitt said at the IIRC/FEE joint event: "My dream isn't to give more business to accountants, though I think I probably have." ■

"My dream isn't to give more business to accountants, though I think I probably have," Howitt

Following his presentation at the joint IIRC/FEE event, **Richard Howitt** answered a few questions from the session's moderator **Wim Bartels**

Wim Bartels, FEE, member of ESG reporting Task Force: You said that this would apply to 6,000 companies in Europe and they will report on things they have never reported on before. If I were to challenge that, I would say that this applies to the large companies who already to a large extent work on sustainability and sustainability reporting. My question to you is where do you think and hope that this might change what the large companies are already doing?

Richard Howitt MEP: It's going to be a significant change in a significant number of companies. Are they large companies? Yes, they are, and there's a very good case to say that it's right to start with large companies and then perhaps to extend in later years or perhaps use the supply chain to influence behaviour in smaller companies. Or not to do either of those things. But there's going to be a big change of practice, and work that the GRI has done on the importance of regulation to increase reporting: their biannual study called 'Carrots and Sticks' which KPMG do with them, shows that where regulation is there, there's a big increase in the level of reporting. So regulation is not the answer to all of this. I've never said that and neither has the European Union. But as being part of the answer, it definitely is, and there's very good evidence that this new directive will significantly increase the amount, and we hope the quality, of reporting.

Bartels: I've spoken to a number of companies who have said this is another reporting burden. Two questions: what is your view on that? And second, what is your recommendation for companies to deal with the NFI directive?

Howitt: If that does happen, I would regard myself and all my colleagues as having failed, because that's not what we want at any stage. And I believe [FEE's] paper about reforming reporting is the right one. What we need is more relevant reporting. So, I think there will be less reporting, fewer pages, fewer figures in the future, but more relevant and more material figures, and I think that's where we're going.

Bartels: We're in a room with a number of accountants. What is the recommendation for the role of accountants?

Howitt: I've not got involved in this work, now for over 15 years, because I had any background whatsoever in the accountancy profession. You've taught me, literally; FEE has taught me; Paul [Drukman] has taught me, all about accountancy.

Issues of business responsibility, corporate accountability and sustainability, that's my background. But I worked out that you can only get so far being motivated by that, and you, the accountants in the room, are the people that tip the balance into making companies and economies more sustainable, and more respectful of people, not just the environment.

That's what my dream is. My dream isn't to give more business to accountants, though I think I probably have. My dream is to ensure that we have more sustainable economies and more respectful human rights and communities, and I believe that what you're doing is essential to achieving that. ■

Q&A with FEE deputy CEO Hilde Blomme

Following the joint IIRC/FEE event, **Hilde Blomme**, deputy CEO at FEE, talked to **Vincent Huck** about the NFI Directive implementation and its impact for accounting professionals

***International Accounting Bulletin*: For companies to comply with the EU NFI Directive, is integrated reporting the best option? Today's event seemed to give that message.**

Hilde Blomme, deputy CEO, FEE: That might the message coming out of today's event, because obviously this was a joint event between FEE and the IIRC, which promotes the integrated reporting framework and integrated thinking. FEE has done a paper on what the reporting within the NFI Directive would mean, and we have come to the conclusion, based on discussions internally and with our stakeholders, that there are actually three different frameworks that could be used to comply with the Directive.

They are the GRI framework; the SASB framework, an American framework not very well known in Europe, but actually quite useful; and the integrated reporting framework, which is one that you can use in combination with others to respond to the requirements of the NFI Directive.

Based on discussions with companies, we know that some larger businesses in Europe already do much of what will be required in a year or two. What they're looking at is how they can use what they're doing now to comply with the Directive, which might not be linked to any framework. It might be based on how, over the years, they have developed their own reporting internally.

Another message from our event this afternoon is that this is a journey. This is not something where you say 'Oh, I have to do this; now I have to go from doing nothing to being a perfect company reporting on this'. It takes some time, because companies have to establish some processes internally, they have to gather the data, and they have to organise to interlink the different data in order to harvest all the information needed to do that reporting.

This is important, because in doing so, they will try to find systems or frameworks that might be integrated reporting or that might be something else, which could help them in their reporting, rather than have a framework or a system imposed on them in order to respond to these new requirements.

So, integrated reporting might be the way forward; it's a well-developed framework, and is something that is getting more and more take-up. It might be the solution for a lot of companies, but it also might not be the only one.

***International Accounting Bulletin*: The Directive says the statutory auditor shall check whether the required information is**

included in the management report (or in a separate report, as appropriate). However, when it touches on verifying and giving assurance, it mentions 'an independent assurance services provider', which leaves it open to other players. Should the auditing profession be worried about new competitors?

Blomme: We are not worried. The Directive asks for a check by the auditor, which auditors will do. It is a very low level of assurance, not event assurance, just an existence check: do they actually give the information that's required by the Directive without looking at the information, without looking at the content?

Depending on what member states decide to do – and that is not yet known, because it's in the very early stages of implementation – there may be something else referred to as 'verification'. If some member states ask for this and they leave open who the assurance provider should be, then other consultancies and organisations will definitely be stepping up, ready to provide this service.

If a member state takes that option, I'm sure that within that country, the profession together with other players will be ready to provide that assurance. There will be competition and that's fine. We believe that in general, our profession is well equipped to give that assurance and if they are asked to do so, they will step up to the plate and do it.

What we're not doing, and what our membership is not doing, is pushing for this. We really leave it up to the member states to decide, and whether member states will push for it or not is completely open, because we are at the very early stages of implementation.

There is also the possibility that a member state doesn't mandate on assurance, but a company might still believe that it has more market credibility if it has some level of assurance on that information. And if it decides to purchase an audit, we're sure that a statutory auditor or another audit firm which is not statutory auditor will be ready to provide the service. Companies will still be in a competitive market; they will shop around and make decisions, but that's what open markets are about.

So, I think the profession is well equipped and ready to offer the service. But, we don't claim that this is our territory and only our territory.

***International Accounting Bulletin*: You said that it's the early stage of implementation, but surely we are in the last stage now, since it has to be implemented by December. Is that correct?**

Blomme: This is part of the accounting directive. First, it was the micro-entities, which was voluntary; member states could implement this, or not. Then there was the accounting directive. The deadline for this was actually mid-2015 and most member states were at least six months late. So they were implementing it at the end of 2015 and early 2016. There are still some that are working on it.

This NFI part was added on, and has a later deadline. But you can imagine that if member states have not even worked through the big chunk of implementing the accounting Directive, since there are nearly 100 member state options to go through, they haven't even thought about the NFI Directive.

This is a smaller piece, so hopefully they will be able to include it within their discussions. But the implementation deadline date for the end of 2016, actually applies to the reporting period starting in January 2017. That's why companies will only start reporting on 2017 in 2018.

We should not expect all member states to have adopted this by the end of 2016, because they're already behind with the previous parts of the Accounting Directive, which are more difficult than the NFI section. The NFI is a small part,actually just a few pages.

***International Accounting Bulletin:* Is the Directive a goldmine for accountancy firms?**

Blomme: There are two parts to it. First, there is the reporting part. We are talking about thousands of large entities throughout Europe that will need to do NFI reporting. A lot of them are already doing something in that direction. Those companies are now looking into ways to comply with the NFI Directive without significantly changing what they are already doing. Those companies are very capable of looking after themselves, and they will sort out how they implement those requirements.

Then, there's another category of companies, perhaps those that are smaller, and have not done any of this information reporting until now, so it's new for them. They haven't really thought about it until now and they might want to have a service provider that helps them.

They might think about an audit firm or an accountancy firm that they already work with, or they might think about another consultancy, not within our profession. So, in terms of reporting, there may be some service offerings that come out of this for our profession.

We already mentioned assurance. Whether or not something comes for audit and accountancy firms on this depends on how member states decide to implement and how companies then want to go about it.

We never pushed for this Directive to include anything like the service offerings, both in helping reporting and in providing assurance that our profession can offer. We have stayed away from that. We felt there was quite some resistance from companies to be obliged to do this from the outset. They thought that it should be done on a voluntary basis. Whatever comes our way, I'm sure we'll be ready for it and accept it, but we won't push for it. That continues to be our mantra.

***International Accounting Bulletin:* Is the Directive a good thing?**

Blomme: It's about value creation and longer-term sustainability. If one thinks about the Volkswagen case, it's clear how important it is to start thinking about those things, to say something and to be transparent.

It cannot be anything but a good thing. This is the way forward. You can't just keep all those things to yourself, perhaps fiddling with them a little. No, you have to be transparent. From the public interest point of view, we are standing behind this.

You also don't just deal with the sophisticated investor anymore; it's the broader public that wants this information. They want to know if this shoe or this shirt is produced in an emerging country, and made by somebody who earns $5 a month.

Finally, I think that if you have to disclose this information as a company, it's going to be a push to actually do what you feel you should do. Because I think that the vast majority of companies want to be honest and report on what they truly do. They will have to look into how they do their business and what it means. And then if they need to report on it, they will start to think about whether they should be embarrassed about this information.

Ultimately they don't want to be embarrassed, so it might change their business practices, and that's what we hope. If a business practice has an element they are ashamed of, then hopefully, having to disclose NFI will spur them to change it. ■