



**ACCOUNTANCY
EUROPE.**

SUSTAINABLE FINANCE

The accountancy profession's
contributions to EU strategy

Position paper

VIEWS.

**GOOD GOVERNANCE & SUSTAINABLE ECONOMY
MARCH 2018**

HIGHLIGHTS

The EU's transition to a low-carbon, resource-efficient and sustainable economy has benefits for us all. The financial system has a critical role to play in this process, by ensuring that the economy contributes to long lasting welfare.

Professional accountants are crucial in building a comprehensive sustainable financial system. This publication provides our contributions to the European Commission's sustainable finance strategy. We focus on the three areas where we can contribute most:

- corporate reporting to accommodate long-term horizons
- disclosure requirements to address investors' needs
- accounting frameworks to be in line with long-term investments

We call on the EU institutions to open up the dialogue with private sector stakeholders and we invite organisations with similar interests to join the debate on sustainable finance.

INTRODUCTION

Sustainability is the theme of our times. Europe needs to move urgently towards a low-carbon, climate-resilient society, where renewable energy and smart technologies increase our quality of life, maintaining prosperity without damaging our planet. The financial system has a key role to play in this transition by ensuring that the economy contributes to long lasting welfare from an environmental, social and governance (ESG) perspective.

To build a comprehensive sustainable financial system, it is necessary to look at a whole range of financial regulations and initiatives into areas such as: disclosures with long-term horizons, corporate reporting including non-financial reporting, independent assurance and accounting frameworks. The accountancy profession has expertise to assist in:

- defining the models, approaches and boundaries for transparency and comparable information (reporting)
- ensuring reliability of the reporting information (providing independent assurance)

In January 2018, the High-Level Expert Group (HLEG) on sustainable finance delivered its final recommendations to the European Commission (EC). We welcome their suggestions to shift Europe's financial system to a long-term focus and move towards a sustainable economy. We urge the EC to take immediate action where necessary. As key actors in the sustainability reform agenda, we especially recognise the importance of: i) embedding sustainability factors in corporate reporting ii) changing short-term financial behaviour.

This publication adds our views to the HLEG final recommendations. We have decided to focus on three key areas:

- corporate reporting: corporate reporting is a means to communicate disclosures and inevitably the former cannot be looked at without the latter. This is why we have decided to include this area in this publication, even though not mentioned in the final HLEG report. In the section below, we share ideas on how corporate reporting can address better the investors' needs.
- disclosures: upgrading current requirements can better address investors' expectations towards sustainability disclosures. In the dedicated section, we provide some recommendations to address current challenges.
- accounting frameworks: in response to the HLEG's concerns on the accounting treatment of long-term investments, we have included some clarifications on the related accounting standards.

Our position follows three principles:

1. Current corporate reporting practices can be improved to accommodate long-term horizons
2. Companies should approach non-financial reporting through a value creation lens for both the business itself and its key stakeholders
3. Accounting frameworks can produce comparable and consistent information for sustainable long-term investments

And can be summarised as follows:

- connecting financial and non-financial information is key to obtain a full view of a company's financial performance. Corporate reporting is also about forward-looking information including longer-term risks affecting the business.
- non-financial and financial standard-setters should coordinate further to ensure the non-financial perspective is not overlooked in the reporting standards
- the EC should consider the Task Force on Climate-related Financial Disclosures (TFCD) recommendations at the European Union's (EU) level. The Non-Financial Information (NFI) Directive should be aligned accordingly

- to address investors' needs on disclosures, companies should focus on identifying the matters and related key performance indicators that make a difference to their core business and its value
- independent assurance ensures reliability of information reported to stakeholders
- IFRS are not designed to encourage or discourage long-term or any particular type of investments. The financial reporting purpose is to provide information for users of financial statements on what is currently happening

CORPORATE REPORTING: TO ACCOMMODATE LONG-TERM HORIZONS...

...CONNECT FINANCIAL AND NON-FINANCIAL INFORMATION IN A COMMON REPORTING FRAMEWORK

Today, corporate reporting is mainly viewed as financial reporting, often disregarding non-financial reporting or forward-looking information which includes longer-term risks affecting the business. To support sustainable investments, companies need to go beyond disclosing information on the resources needed to operate for the upcoming year, as currently required. Businesses that consider, evaluate and report on ESG factors are more likely to take a long-term view, better appreciate the risks and build resilience into their business models, than those that do not.

Corporate reporting will need to evolve to cover longer-term risks expected in the coming three, five or more years. Standard-setters should collaborate with the relevant organizations to allow corporate reporting to accommodate long-term horizons. The International Accounting Standards Body (IASB) as a globally recognised standard-setter can play a more prominent role in this regard.

Connecting financial and non-financial information is key to obtain a comprehensive view of a company's financial performance. We acknowledge that non-financial reporting practice is still evolving, and it will take time to reach the same maturity level as financial reporting.

A global initiative to consider in corporate reporting comes from the International Integrated Reporting Council (IIRC). The Integrated Reporting framework focuses on how an organization's resources are creating value by covering six capitals to communicate a clear, concise, and integrated story. Many companies around the world, including in the EU, have started applying or experimenting with this framework or its underlying principles. We encourage the IIRC to continue its work on integrated reporting and develop further the ongoing 'dialogue' with the relevant stakeholders.

...EVOLVE CORPORATE REPORTING TO ADDRESS MORE DIVERSE STAKEHOLDERS' NEEDS

Corporate reporting should further evolve to address an increasingly wider audience which goes beyond investors including employees, consumers and NGOs. Companies' stakeholders recognize the value of NFI, including ESG matters; it helps investors analyse a company's value and long-term financial performance; it helps other stakeholders to assess a company's contributions to society or if they want to do business with the company itself.

We developed the Core & More¹ concept to present corporate reporting in a 'smarter' way. It organises information in a more connected, logical and structured way, based on its importance to stakeholders. The Core report would capture key information about the company relevant for a broad range of stakeholders. The More reports would include supplementary detailed information for specific audiences. Using technology (hyperlinks) would interlink those reports².

¹ Accountancy Europe, *Future of Corporate Reporting (2015)*, <https://www.accountancyeurope.eu/wp-content/uploads/FEECogitoPaper - TheFutureofCorporateReporting.pdf>

² Accountancy Europe, *Core & More an opportunity for a smarter corporate reporting (2017)* <https://www.accountancyeurope.eu/wp-content/uploads/170918-Publication-Core-More.pdf>

...ALLOW EXPERIMENTATION AND INNOVATION IN CORPORATE REPORTING

Technology is a key tool to enhance corporate reporting practices. Digital reporting would make it easier for users to navigate reports and find the most relevant information for them. For example, applying our Core & More concept, a user seeking further details on information in the Core report, could click a hyperlink to find this information in a More report.

We strongly support setting up an EU *Corporate Reporting Lab* as a platform to discuss and experiment with corporate reporting practices. This would be similar to the *UK Financial Reporting Lab*, where the Financial Reporting Council (FRC) gathered companies and investors to innovate and improve corporate reporting³.

DISCLOSURE REQUIREMENTS: TO ADDRESS INVESTORS' NEEDS...

...CONSIDER THE TFCD RECOMMENDATIONS

A significant number of companies are disclosing NFI for its strategic value in management and investment decisions⁴. In recent years, legislative and market-led initiatives have enhanced NFI disclosures by companies and financial institutions. For example:

- EU NFI Directive has been fully transposed into national law and, as of 2018, companies are required to disclose NFI and related policies and risks⁵
- TFCD issued recommendations to promote voluntary climate-related risks disclosures by listed companies

We support the HLEG recommendation to endorse the TFCD recommendations at EU level. The TCFD recommendations can help to improve climate-related disclosures by companies, including risks and their mitigation. To achieve consistency and comparability, the EU NFI Directive should be adapted accordingly. However, companies should have enough time to experiment allowing for best practice to evolve and should continue improving their overall NFI disclosures including all three ESG aspects.

...INTEGRATE ESG FACTORS INTO COMPANIES' STRATEGY AND ENHANCE VALUE-DRIVEN REPORTING

Currently, non-financial reporting remains very much compliance-driven. The company's senior management needs to consider and properly integrate ESG factors into the company's strategy to improve the reporting on non-financial matters. Companies should also align their strategies with the United Nations' Sustainable Development Goals (SDGs), as overarching goals that societal actors need to contribute to their core business.

Companies should approach non-financial reporting through a value creation lens for both the business itself and its key stakeholders⁶. They should identify key areas where they create or destroy value and take that into account to build their strategy and future vision. Companies should:

- focus on identifying the matters and related key performance indicators that make a difference to their core business and its value
- make the link between any non-financial performance indicator and the company's financial performance

³ Financial Reporting Council's website <http://www.frc.org.uk/investors/financial-reporting-lab>

⁴ KPMG survey (2017) https://home.kpmg.com/content/dam/kpmg/campaigns/csr/pdf/CSR_Reporting_2017.pdf;

EY survey (2017) [http://www.ey.com/Publication/vwLUAssets/EY_-_](http://www.ey.com/Publication/vwLUAssets/EY_-_Nonfinancial_performance_may_influence_investors/$FILE/ey-nonfinancial-performance-may-influence-investors.pdf)

[Nonfinancial performance may influence investors/\\$FILE/ey-nonfinancial-performance-may-influence-investors.pdf](http://www.ey.com/Publication/vwLUAssets/EY_-_Nonfinancial_performance_may_influence_investors/$FILE/ey-nonfinancial-performance-may-influence-investors.pdf)

⁵ Accountancy Europe, CSR Europe and GRI, *Member State Implementation of EU NFI Directive* (2017)

<https://www.accountancyeurope.eu/publications/member-state-implementation-eu-nfi-directive/>

⁶ PwC report *Reporting with impact* (2017) <https://www.pwc.co.uk/sustainability-climate-change/assets/pdf/reporting-with-impact.pdf>

Future-oriented information can be robust if it is based on sound assumptions and is properly explained in the reporting. Such disclosures will provide investors with valuable information for their decision-making. Risk reporting should also be focused much more on tangible, meaning identifiable and quantifiable, long-term risks. However, this is not something that companies can resolve on their own; regulators can help to create the long-term focus.

...ESTABLISH A COMMONLY ACCEPTED FRAMEWORK OR STANDARDS FOR NON-FINANCIAL REPORTING PURPOSES

The lack of one commonly accepted framework or standards can lead to dispersed and inconsistent disclosures. Companies can pick from a wide range of initiatives and frameworks available in the market to meet the growing demand for non-financial reporting. This affects the comparability of the information reported and increases the reporting burden for companies.

Frameworks on non-financial reporting should be better aligned with each other. In the long run, standard setters and relevant organizations should establish a commonly accepted framework or standards for non-financial reporting purposes. We reiterate the call for decisive leadership by an appropriate body to achieve greater standardization in non-financial reporting as stated in our *Call for Action* initiative⁷.

...REVERT TO INDEPENDENT ASSURANCE TO PROVIDE TRUST TO STAKEHOLDERS

Stakeholders need assurance that the reported information can be trusted. As HLEG indicates, sustainability or non-financial information currently is not subject to the same level of assurance compared to financial information. However, there is growing market demand for NFI to be assured by an independent assurance provider; investors, senior management and other stakeholders seek for reliable information to improve their decision-making process.

Independent assurance is the most efficient and economical way to ensure reliability of information reported to stakeholders. Also, by going through independent assurance, companies benefit from improved internal processes as the assurance provider can identify issues and suggest ways for their remediation.

We recommend to carefully consider the appropriate level of assurance, the scope and desired outcomes before conducting an assurance engagement. The maturity level of a company's reporting processes can have an impact on the outcome of the assurance engagement.

As professional accountants, we can play a significant role in providing our expertise in assurance matters. We consider NFI assurance and explore further the role of the assurance practitioner in our publication *How to respond to assurance needs on non-financial information?*⁸.

ACCOUNTING FRAMEWORKS: TO BE IN LINE WITH LONG-TERM INVESTMENTS...

...ALLOW INVESTORS TO HAVE A FULL PICTURE OF THE BUSINESS REALITY

We recognize the concerns HLEG raises regarding the attractiveness of long-term infrastructure investments. Nevertheless, we need to better assess whether the lack of attractiveness is a result of investors' behaviour, regulatory barriers or whether additional changes need to be made to the International Financial Reporting Standards (IFRS).

⁷ Accountancy Europe, *Call for Action: enhance the coordination of non-financial information initiatives and frameworks* (2017), <https://www.accountancyeurope.eu/publications/call-for-action-nfi-frameworks/>

⁸ Accountancy Europe *How to respond to assurance needs on non-financial information* (2017) <https://www.accountancyeurope.eu/publications/respond-assurance-needs-non-financial-information/>

The B20 Forum⁹ investigated the effect of fair value accounting principles to long-term investments¹⁰. The findings show that investors, when making decisions, focus more on the underlying features and risks of investment opportunities. The report concludes that changes to accounting principles would not increase the attractiveness of long-term infrastructure investments.

IFRS are not designed to encourage or discourage long-term investments or any type of investments. The financial reporting purpose is to provide for users of financial statements information on what is currently happening. Accounting is not to cover any risk, as volatility resulting from risk exposure can reduce investors' trust in the business. If an entity takes on risks that make its results more volatile, it is because it simply reflects a real economic phenomenon.

The HLEG recommends:

1. amending the EC Regulation (EC) 1606/2002 International accounting standards to authorize the EU to change specific aspects of IFRS standards published by the IASB ("carve-in") before transposing them into EU law.

We call for great caution in considering such radical changes because:

- Allowing more flexibility may set an uncontrollable and unpredictable trend that would lead to creating European rather than global standards. This would isolate Europe from global capital markets and may hinder investment. It will create confusion in the marketplace, increase the cost of capital for European issuers and costs for preparers, especially those with multinational operations.
 - Such changes would diminish Europe's influence on the standards-setter and its global standing. It is not unlikely that such de facto European standards would be seen with suspicion by global investors.
 - They would result in losing all the benefits in terms of transparency and comparability from the leadership provided by Europe in having IFRS adopted in more than 150 countries around the globe.
2. adopting IFRS only if they consider sustainability and long-term investment objectives.

While we recognise the legitimacy and relevance of this suggestion and would share the end-objective, we are concerned that:

- this approach would not focus on first holistically improving NFI and financial reporting
- such a change, by adding endorsement criteria, would be premature at a time where priority should be given to consolidating the Maystadt reform
- instead, clarifying existing criteria set forth by the IAS Regulation, for instance by additional guidance to have regard to sustainability aspects, would be more helpful

...LOOK INTO REPORTING STANDARDS FROM A NON-FINANCIAL PERSPECTIVE

IFRS provides transparency that can support long-term investment; specifically IFRS 9 on financial assets. It can help investors and lenders make efficient and informed decisions. It can render investments more attractive by ensuring the provision of the necessary information to investors.

We recognize the need for the IASB to look into reporting standards from a non-financial perspective as well. The IASB has decided to update its *IFRS Practice Statement Management Commentary*¹¹ recognizing that non-financial value drivers were essential for companies to meet the needs of a wider community of report users. We support the IASB's decision as it can be an important step towards better integration of non-financial factors.

⁹ The Business 20 (B20) is the official G20 dialogue with the global business community.

¹⁰ B20 Report - *Unlocking Investment in Infrastructure*, <https://www.iasplus.com/en/publications/miscellaneous/b20-report>

¹¹ The IASB's *Management Commentary Practice Statement* provides financial and non-financial information relevant to users of the financial statements.

We also note that the European Financial Reporting Advisory Group (EFRAG) is currently investigating, upon European Commission's request, the potential effects on long-term investment of IFRS 9's requirements on accounting for equity instruments.

Frameworks on non-financial reporting should be better aligned with each other and follow common key principles to tackle today's overdiversification of existing initiatives. Once established, these principles should promote connectivity between financial and non-financial information and would contribute to coherent, consistent and comparable wider corporate reporting. In the long run, we would like to see a single robust non-financial reporting framework. Such framework should be underpinned by principles similar to those that currently exist in financial reporting.

Corporate Reporting Dialogue (CRD) initiative successfully brought together different reporting framework developers and standard setters to cooperate and improve corporate reporting practice. We encourage the IASB, as the global standard setter, to take the lead on coordinating this issue and to engage other important players based on their expertise.

We are open to engage with the EU institutions, to exchange views and provide any further technical information that could stimulate the IFRS debate.

NEXT STEPS

Building an EU strategy on sustainable finance requires time and efforts of multiple stakeholders. The accountancy profession has a key role to play by assisting companies with processes to be more transparent and informative on how value is created for stakeholders.

Changing corporate behaviour by embedding sustainability factors into an organisation's strategy and decision-making processes is imperative. Accessible and reliable information provides an understanding of a company's financial performance and its drivers, which guides investment and management decisions.

We call on the EU institutions to open up the dialogue with private sector stakeholders. The HLEG final recommendations are the first step towards a roadmap for sustainable finance. We look forward to further discussing the EC Action Plan and sharing expertise, as this paper indicates. We invite organisations with similar interests to join the debate on sustainable finance.



Avenue d'Auderghem 22-28, 1040 Brussels



+32(0)2 893 33 60



www.accountancyeurope.eu



@AccountancyEU



Accountancy Europe

ABOUT ACCOUNTANCY EUROPE

Accountancy Europe unites 51 professional organisations from 37 countries that represent **1 million** professional accountants, auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond.

Accountancy Europe is in the EU Transparency Register (No 4713568401-18).