



**ACCOUNTANCY
EUROPE.**

MULTI-STAKEHOLDER ANALYSIS OF CORPORATE FAILURES

Building resilience in the corporate reporting ecosystem

Discussion paper

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HIGHLIGHTS

Corporate incidents are very likely in today's highly uncertain environment. Global crises, new business practices, evolving stakeholder expectations and technology give rise to new ways of doing business. This comes with opportunities but also risks.

This paper discusses solutions to reinforce the corporate sector's resilience by mitigating the risk of corporate incidents. The most effective means for this is through collective learning.

Learning from corporate incidents is already happening. However, this often takes place in silos while lawmakers provide quick fix or makeshift solutions. It is in the public interest to develop better solutions. Only a systemic approach that promotes collective learning can deliver meaningful improvements.

This publication explores a Corporate Resilience Network (CRN), which would provide a multi-stakeholders approach to analysing corporate incidents and draw learning points. The CRN would provide recommendations for systemic improvements based on real-life experience, with input from all corporate ecosystem stakeholders.

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INTRODUCTION

Corporate incidents are very likely in today's highly uncertain, and dangerous, global context. Catastrophic events such as the climate crisis, war, inflation, supply chain security and others are presenting new risks. In parallel, new business practices, evolving stakeholder expectations and technology give rise to unprecedented ways of doing business, with all the associated opportunities but also risks.

It is in the public interest to develop new approaches to reduce the risks of major corporate incidents, ensure robust learning from mistakes and reinforce corporate resilience. A systemic approach that considers the perspectives of all key corporate ecosystem stakeholders is pivotal.

Learning from corporate incidents is already happening, but key stakeholder groups – companies, auditors, supervisors, investors etc. – focus solely on their own assumed responsibility. Meanwhile, lawmakers provide quick fixes or makeshift solutions.

The focus should be on holistic learning for the future. Only a systemic approach –where all corporate ecosystem stakeholders' diversity and perspectives are brought together – can significantly improve this status quo.

OBJECTIVE

This paper aims to spark discussions among corporate ecosystem stakeholders, including board members, directors, chief financial officers (CFOs), auditors, investors, regulators, supervisors and policymakers, on the need for innovative and systemic approaches to improve the corporate ecosystem.

A SYSTEMIC APPROACH

We propose solutions to strengthen the overall corporate resilience through better collective learning in the ecosystem. This would bring together corporate ecosystem stakeholders to share their perspectives and learn from experiences. Stakeholders' cooperation to learn and adapt would reinforce companies' overall resilience. Such collective learning between these interdependent stakeholders would reduce corporate incidents' risks to re-occur.

The paper proposes, as an example solution, to set up a "Corporate Resilience Network (CRN)". This body would have the mandate to analyse corporate incidents and draw collective learning points based on real-life experience for systemic improvements.

As an independent body under one umbrella, the CRN would bring together corporate ecosystem stakeholders responsible for companies' decision-making, data gathering, reporting, auditing, financing, and regulation. The network would conduct rigorous root-cause analyses into major corporate incidents, and issue neutral recommendations for systemic improvements that are based on collaborative deliberation.

SCOPE

This publication focuses on major incidents that lead to insolvency, bankruptcy, near-collapse or total loss of trust in a major company, with resulting systemic shocks and implications for the broader public interest. Such incidents can stem from several causes, including macroeconomic and other 'megatrend' effects, and companies' failure to address them.

However, many incident causes can also be endemic to the companies, including material misreporting (financial information and risk exposure), significant management fraud, audits' failure to detect these and many other factors – often a combination of several. There are no simple answers and fixing the ecosystem partially cannot provide robust and lasting solutions.

Corporate incidents this paper refers to generally involve:

- major public interest implications and learning opportunities
- recommendations on systemic improvements to reduce the risk of similar incidents

CORPORATE INCIDENTS: CURRENT LANDSCAPE

Assessments, analyses and recommendations for improvements following corporate incidents are already conducted. Through these procedures, authorities and stakeholders want to ensure that the corporate ecosystem learns for the future.

EXAMPLES OF POST-INCIDENT ACTIONS

- policymakers conduct hearings and consultations to identify gaps or ambiguities in existing laws and regulations and the need for advancements
- investigations and subsequent court cases following a corporate incident which aim to discover the underlying reasons behind the case, and assign liability on the responsible parties
- accounting regulators and audit enforcers conduct investigations and recurrent reviews based on which they issue recommendations for mitigating actions
- processes within audit firms for internal quality reviews and findings, as well as root cause analyses to identify generic issues to address. Also, audit firms in some EU countries pull their root cause analyses together to explore common causes and effective ways to address them e.g. on the issue of fraud. There are also specific learning organisations aimed at improving audit quality, such as the Foundation for Auditing Research (FAR) in the Netherlands
- certified fraud examination organisations such as the Association of Fraud Examiners (ACFE) provide training for fraud examiners and promote collective learning. For example, ACFE publishes Report to the Nations, an annual report on corporate fraud ,which includes insights on incidents types, perpetrators, common trends and factors
- audit committee chairs' forums where best practices and risk factors are shared and discussed, e.g.: UK's Audit Committee Chairs' Independent Forum (ACCIF)

AN INCOMPLETE PICTURE

These analyses however often take place independently of each other, are not always made public or lack sufficient detail. Regulators' investigations are conducted 'from the outside' without substantive input from other corporate ecosystem stakeholders. Audit committee chairs' forums only focus on and share perspectives from the experience of CFOs and companies' internal governance angles, and at different times, usually after the incident.

Audit firms for their part focus on audit quality, while court cases are ultimately about assigning responsibility for incidents. Their findings may not help to develop systemic learnings for incident prevention as it is not the courts' role. Investigations, conclusions and evidence found may include useful learning material. However, litigation often closes the door to collective learning: in courts every party will hold on to, and defend, their point of view. Finally, policymakers may consult multiple stakeholders and experts. Still, their decisions often depend on factors such as political majorities or feasibility, or public acceptance/pressure.

Each piece of the corporate sector puzzle addresses specific angles but not resulting in a complete picture. There are several problems with the current corporate incident learning pattern, including:

- blame games and self-defence by each corporate ecosystem party rather than seeking solutions
- quick fixes – new legislation, regulators' recommendations or soft law guidance – that fail to address real underlying problems
- a false sense of security, through the perception that current corporate incident learning practices are robust and lead to sufficient outcomes
- focus on finding culprits. This is needed as it also functions as a deterrent against others doing the same but too often comes at the cost of collective learning which would help to ensure that others do not repeat the same mistakes and reduce the risk of similar incidents reoccurring

COLLECTIVE LEARNING

The alternative to these silo-based learning processes is one based on collective learning. Such collective learning initiatives and culture already exists in some sectors.

AVIATION

Accidents or near-miss incidents are analysed, and data and insights are shared, with relevant actors in the industry. The main purpose is to improve overall aviation safety by identifying the root causes of an incident and introducing measures to minimise the risk of them happening again. Pilots, mechanics, airline companies, aviation regulators, airplane manufacturers and others share insights and information to discover the cause. Together, they minimise the risks of such incidents re-occurring

HEALTHCARE

As shown for example by the COVID pandemic, health regulators, researchers, academics, the healthcare industry, World Health Organization (WHO) and others coordinated efforts to identify the health threats, assess the severity of the virus, analyse its spreading patterns and more, to develop an effective, global and coordinated response. Also, within countries, doctors and hospitals are sharing experiences and learning collectively from dealing with COVID

CORPORATE SECTOR

In both aviation and health care, human lives are directly and immediately at stake. This warrants a strong, coordinated, and collaborative response.

This should be emulated in other sectors too, given the proven effectiveness in aviation and health. This also applies for the corporate and financial sectors, which are among the backbones of societies, public finances and wealth. While there are usually no immediate human lives at stake, major failures in corporate and financial sectors lead to people, regular citizens and pension funds, losing vast amounts of money. It can also result in major job losses, risking people's livelihoods.

Other similarities with the aviation and health sectors include that incidents of varying severity and impact can occur. The corporate sector tracks key performance indicators (KPIs) and data rigorously. It is also held accountable by the public in case of corporate failure.

ADDITIONAL BENEFITS

Collective learning and stronger corporate resilience would also directly benefit the key stakeholders in the corporate ecosystem, especially since these players are mutually reliant and interdependent. For example:

- investors could take further comfort from the fact that companies' resilience is fostered by rigorous learning processes and outcomes enabled by collective learning
- company boards, managers and employees can build stronger internal controls and business practices by learning about potential pitfalls, risks and threats that they alone or without knowledge of others' mistakes might not otherwise take into account. This will also give a signal to other ecosystem actors that the company is worth their trust
- auditors would benefit from greater insights into why and how certain errors in companies' audits occur, and what additional factors or red flags to consider. This will enable auditors to target their resources and efforts better while serving their public interest role for the benefit of companies, investors, regulators and societies at large
- regulators and supervisors could take additional comfort as mistakes and failures are rigorously learned from, and recommendations for improvements are based on multi-stakeholder. On that basis, regulators and supervisors can take better legislative and enforcement actions that will contribute to a more resilient corporate sector

CORPORATE RESILIENCE NETWORK

There can be many ways and solutions to promote better collective learning in the corporate sector. One possible approach to introducing such collective, systemic learning could be through a 'Corporate resilience Network' (CRN).

We need a robust, holistic, impartial and transparent analysis based on multi-stakeholder perspectives, root-cause analysis and a co-learning culture in addition to the existing incident learning processes. This would be the most effective way to better understand the incidents' causes, develop recommendations, reduce the risks of recurring incidents, thus improving the overall corporate resilience.

As an independent body under one umbrella, the CRN would bring together corporate ecosystem stakeholders responsible for companies' decision-making, data gathering, reporting, auditing, financing, and regulation. The network would conduct rigorous root-cause analyses into major corporate incidents, and issue neutral recommendations for systemic improvements that are based on collaborative deliberation. These recommendations could also lay the ground for policymakers that consider legislative reforms.

Although 'positive' case studies and good examples can also provide learning outcomes, the CRN's focus should be on learning from incidents. This is because it is especially in 'bad times' that the diffuse stakeholder groups withdraw to their own silos.

This paper is not prescriptive on the detailed design or terms of reference of a prospective CRN. However, we present general principles that should be fulfilled.

GENERAL PRINCIPLES

CREATING A 'SAFE SPACE'

The CRN's success requires an honest, confidential, and safe discussion between the stakeholder groups involved. Information and key sources relevant to the cases will be needed to further the discussion in the network. CRN's participants should feel safe to exchange and discuss e.g. without fear of liability.

As a safe environment, the CRN should operate under Chatham House rules especially when dealing with information providers. Individual statements, who said what, who contributed and provided information etc. should

be kept strictly private. The CRN would be responsible for protecting the sources' identity, anonymisation of the collected facts and making general trend observations and recommendations.

As a first step, the CRN could examine and report on a multitude of relevant cases and identify 'common themes' or recurring ones. The CRN would then report on its findings and propose recommendations addressed respectively to each of the key ecosystem players.

STIMULATING A 'JUST CULTURE' AND A LEARNING ENVIRONMENT

The CRN is a framework to achieve cross-stakeholder collaboration. A core condition for such collaboration is a particular kind of mindset, or culture, which institutional or organisational solutions such as the CRN alone cannot accomplish. Only through a just culture can the self-interest mentally be broken, as it promotes a safe learning environment.

In a just culture¹, learning from incidents is balanced with taking responsibility for consequences. It prevents people from being found guilty for honest mistakes, but also from getting away with reckless behaviour. An important element in a just culture is the line between acceptable and unacceptable behaviour. But that is not simple to draw, because culpability depends on the facts, law, context, language and interpretation. And who draws the line is an equally important element.

The CRN cannot bring about a 'just culture', but it can function as a forum where stakeholders can become closer to such a culture through interaction, discussion and collaboration on case analysis. The CRN's design should take this into consideration.

CASE SELECTION

The CRN should be responsible for selecting the incidents to be analysed. However, broad principles can be established, with a purpose to learn from facts and experience through a systemic approach.

SCOPE

The incidents that fall under the scope should be corporate failures where the CRN sees:

- major public interest implications and learning opportunities
- potential for recommendations around systemic improvements that would help reduce the risk of similar incidents reoccurring

TIMING

When choosing their cases, the CRN should consider the time when each cases occurred according to some principles:

1. Start with 'cold cases': looking at older cold cases to build up its expertise in collective learning
2. Continue with 'warm cases': the CRN could develop its approach and methodologies by looking at more recent cases. Cases should be chosen carefully as not to interfere with the potential outcome of e.g. ongoing court investigations. However, balance should be struck, cases should still have relevance to society and the CRN's recommendations should still be relevant. Therefore, these 'warm cases' would be in a cooling off stage but already have sufficient details for observations to be made. For example, court cases might still be ongoing, but that there has already been initial reports and analyses on the case's details, as well as knowledge of the key players and factors involved
3. Evolve to analyse hot cases: eventually, the CRN could propose 'real time' collective learning outcomes by looking at hot cases from their first moment of appearance. With experience and insights gathered over time, the CRN could even provide early warning analysis of risk factors before an incident occurs.

¹ As defined by professor Sidney Dekker, see for example:
https://books.google.be/books/about/Just_Culture.html?id=ZA0uXmtR96MC&redir_esc=y

For this to work, the question of how this might co-exist with potential parallel court cases or other existing processes such as regulators' enforcement priorities would need to be resolved

CRN ORGANISATION

This section outlines some general principles and 'building blocks' that would be needed for a well-functioning CRN or equivalent bodies.

LEGAL BASE OR MANDATE

The CRN's effectiveness will require a legal base or 'political mandate' for:

- legitimacy to issue credible recommendations
- capacity to collect and anonymise data, gather and protect information, and analyse cases
- means to overcome confidentiality issues that impede cooperation
- resources – whether through industry contributions, public funding or other sources such as charities or a combination of these
- participation and collaboration from the relevant ecosystem stakeholders to inform its research

The CRN could work at a pan-European, or at national levels, or through a combination of these. For example, a pan-European CRN analysing corporate incident trends with a broader perspective could be complemented by local insights provided by national CRNs, making the European CRN a 'network of networks'.

Options based on existing examples could be considered for the legal base or mandate, as well as funding. Some examples for inspiration include:

<u>EU Tax Observatory:</u>	set up by the European Commission following calls from the European Parliament. It has a legal mandate to produce research on the impact of tax avoidance and evasion on the EU economy. The European Commission is responsible for 77% of the funding, and makes a funding package available for every two years, to which multi-stakeholder consortia can apply via a tendering process to set up the Observatory.
<u>European Systemic Risk Board (ESRB):</u>	legal mandate and responsibility – including strict rules around professional secrecy – for the macroprudential oversight of the EU financial system and the prevention and mitigation of systemic risk. ESRB monitors and assesses systemic risks and, issues warnings and recommendations (which are not legally binding but non-compliance with ESRB's recommendations must be justified). As an EU organisation, it is publicly funded.
<u>The Dutch Safety Board (DSB):</u>	legally mandated and funded by the Dutch government to carry out investigations and drawing lessons from major accidents and disasters with the aim of prevention. They have a broad scope and investigate cases of aviation, construction and services, crisis management and aid provision, defense, human and animal health care, industry and networks, pipelines, rail transport, shipping, as well as water. It operates independently from the Dutch government and other parties, and decides for itself which incidents and subjects it will investigate. They have shown to incorporate 'digital safety' incidents in their scope.

STRUCTURE AND COMPOSITION

The CRN will require a combination of experts and people with their own roles to make this concept a reality. The following stakeholder groups could be considered to ensure that CRN's objectives are fulfilled. The appointment of these persons should be based on a balanced and transparent process.

NEUTRAL FACILITATORS AND INDEPENDENT EXPERTS

CRN could benefit from a group of neutral facilitators and independent experts. They would be experts in building bridges and a collective learning culture; not necessarily experts in corporate matters. They would be key to providing the CRN with the skills and experience needed for its learning processes.

This group could act as a 'neutral facilitator', with people with background in understanding the human mind, such as psychology and neuroscience. They would ensure that the CRN works towards its silo-breaking objectives, and is able to conduct its incident assessments with a collaborative and independent mindset.

The group could also have a role in conducting exercises to break silos, advising on methodologies for thorough root cause analyses, organising and providing training for the CRN stakeholders, and more. It should thus also include members with background in investigations and research.

Overall, this group would help guide the CRN's work. It would also ensure that the CRN is body where genuine collective learning and multitude of perspectives prevail.

Core stakeholders

The CRN's main work would be conducted by a group of people with background in the corporate ecosystem areas. These include people with background in corporate governance (board members, CEOs, CFOs, non-executive directors, audit committee chairs and members, internal auditors, investors etc.), external auditing as well as regulators and supervisors. This would align with the key pillars of the corporate reporting ecosystem identified by the European Commission in its 2021 [public consultation](#).

Involving stakeholders from these backgrounds would ensure that the 'key angles' of the corporate ecosystem are covered:

- corporate governance encompasses how businesses are run, their decisions are made and internal processes on strategy, fraud and mismanagement are established
- external auditors provide confidence to investors and other external stakeholders that the company's reported information is truthful and reliable
- regulators and supervisors ensure that the company fulfils the necessary legal obligations and criteria that apply to it

SUPPORTING STAKEHOLDERS

The information for the CRN's analyses would be based on publicly available data but more importantly gathered from supporting stakeholders' insights into the cases at hand.

It would include the corporate ecosystem stakeholders specific to the case and country – notably corporate governance, external audit, law enforcers and regulator representatives. Depending on the case, information could be gathered from a broader range of relevant stakeholders including investors, proxy voters, lawyers, investigative journalists, academics, whistleblowers, law enforcers, insurers, anti-fraud officials as well as non-governmental organisations (NGOs).

These information providers would play an additional crucial role. Together with the facilitators, they help ensure that the core stakeholders group – which brings together the key corporate ecosystem stakeholders – does not become a silo itself. They thus bring in additional facts and outside perspectives into the CRN's analysis, allowing the approach to be as objective as possible.

CRN'S RECOMMENDATIONS

The CRN would issue public recommendations to reinforce corporate resilience. These recommendations would be addressed to companies, auditors, regulators or policymakers. This way policymakers too would be able to

draw on a unique source of collective expert insight. This could inform and shape their thinking on the need for legislative, regulatory and standard setting related responses and improvements.

The CRN's ways of working towards these recommendations would also depend on its legal mandate and terms of reference. The Dutch Safety Board's way of working could inspire the one of a CRN as follows:

1. assessment on case choice by the CRN
2. data collection based on public information, information providers' accounts etc.
3. collected data analysis
4. data review and initial analysis, sending the preliminary analysis outcome to the parties concerned for their feedback
5. devising recommendations for improvement under different types: e.g. soft and hard (law), and groups: e.g. culture, governance (with soft and hard dimensions, incl. processes, controls, methodologies, standards), policy/regulation enforcement (of existing regulations), hard law and other recommendations for policymakers
6. findings and recommendations publishing (at least initially on an anonymised basis and looking at a set of cases and the trends emerging from them rather than a specific case)
7. roll-out: public conferences, fora to discuss the findings and recommendations
8. monitoring follow-up

CHALLENGES TO A CRN

The general CRN principles described above are an 'ideal' which would be most conducive to achieving the set objectives. However, there are several practical obstacles and challenges to consider during the CRN set phase.

LACK OF MANDATE AND AUTHORITY

Without a legal mandate, the CRN would not have sufficient authority to conduct its analyses. Its recommendations would also lack the necessary weight. Much of the CRN's work would then be redundant and not of the desired quality and impact.

INDEPENDENCE

The CRN should be independent from all stakeholder groups, despite bringing together different corporate ecosystem stakeholders in a collaborative setting. A challenge will be to ensure that the CRN members have enough distance from their sectoral background and interests to enable a neutral approach. Likewise, the CRN's funding should be designed in a way that ensures its full independence from both political and special interest interference.

TIMELINESS

It may be a challenge to identify a point in-between a case not being too hot, where no sufficient information may be available beyond initial media reporting, and too cold where the potential learning points and recommendations would no longer be relevant or of interest. The case selection would have to rely on the judgment of the CRN itself, as each case will be different with varying degrees of political interest.

CASE SELECTION

The CRN would need to carefully consider how many cases it can simultaneously analyse, and how many cases it needs to look at before being able to provide recommendations around identified trends. The research should also consider the companies' legal environment and corporate governance traditions. The focus should be on

‘major’ cases that have public interest implications and systemic learning opportunities, but this will again be a difficult judgment call for the CRN itself.

PROFESSIONAL SECRECY

The CRN’s participants might be bound by professional secrecy rules which may impede sharing useful information and insights. This would limit their ability to assist the CRN. Lawmakers should consider conditional and ad hoc lifting of such provisions, or establishing appropriate new legislation, if they want to be able to develop innovative systemic approaches.

PARALLEL COURT INVESTIGATIONS

The CRN’s purpose is to develop recommendations and systemic learning, not to assign blame or find culprits. This is the purpose of the court investigations into a case. However, the parties involved in a case will be providing evidence to the court and defending themselves, and despite CRN’s commitment to data protection and privacy, they might hesitate to share information out of fear that it could undermine their court case and impact liability.

DATA PROTECTION

CRN would be committed to securing the data provided, information providers’ identities and specific company names or case details. Moreover, the CRN’s findings would at least initially be published on the basis of a collation of many major cases, not focusing on an individual case. Despite these ‘safeguards’, there is always the risk, real or perceived, that data from within CRN might be leaked or lost.

KICK OFF PHASE

The challenges above can be overcome: if there is a will, there is a way. They should not prevent from exploring the merits of the CRN approach, discussing its desirability and potential, and taking initial steps towards rendering the idea into reality. Moreover, law making has remained fairly unchanged in the past decades, in stark contrast to the profound changes that have occurred in the economy, society and environment. New innovative approaches to policymaking would thus help.

A starting point towards achieving a CRN or similar system could be for stakeholder groups to set up an informal structure to do preliminary work, outlined below. If this proves to be useful, a case could be made towards policymakers at EU and national levels to provide a legal mandate for a full CRN.

Initial work and steps could include:

Looking into cold cases and supervisors’ findings to develop a taxonomy of common and recurring problem sources in corporate incidents, whether linked to fraudulent schemes, overwriting procedures, tone at the top, internal controls, audit or other issues. This would also include comparing incident reports and recommendations made at the time with what recommendations could have been made in retrospect. Based on these cold cases, the ‘early CRN’ could already develop a typology of tipping points to analyse issues and develop systemic improvements in future incidents.

Foster a mutual learning culture by conducting the groundwork needed for it. This could begin with efforts to generate a mutual learning culture through collaboration exercises with the support of psychologists, neuroscientists and group work specialists. This could also include **analysis and devising methods** to break silos in the corporate sector, develop mutual understanding and ensure cross-stakeholder exchange of insights and perspectives. This could be achieved through fictional incident scenarios and simulations. This exercise should lead to a better understanding of the systemic obstacles to learning and changing together.

Training and exercises on root-cause analyses and investigative methods, getting support and training from fraud investigation experts. This would be crucial to providing the early-CRN with the fundamental investigative skills and know-how that will be needed for case analysis.

First CRN **analyses into warm corporate incident cases**. These cases will be different and up to the early-CRN to determine what a sufficiently warm case might be. These can range from cases involving litigation but to cases with sanctions issued even if there is no litigation pending.

Setting up a dialogue with organisations in other sectors where collective learning is already happening, such as aviation and healthcare. This would provide insights into how some obstacles, e.g. the question of parallel court investigations, could be overcome.

CONCLUDING REMARKS

The idea of a CRN presented in this paper could be one solution to promote collective learning in the corporate ecosystem. The objective is to ensure that relevant stakeholders in the corporate ecosystem learn together from incidents, acquire a holistic picture of all factors at play, and issue robust recommendations for improvements that reduce risks.

Failure to learn together, and continuing to analyse facts in silos, will provide false or very limited solutions, and at worst gives false comfort that a problem has been resolved. If the mistakes re-arise, the same silo thinking prevails again, leading to further inadequate solutions. Moreover, resources and cost would be wasted in inefficient outcomes.

Ultimately, the CRN – or any equivalent solution for promoting collective learning – will require political support, a legal mandate, the active support of the corporate ecosystem players as well as a change of culture. This is a prerequisite for successful collective learning, and this paper ultimately aims to open the conversation with these stakeholders to strengthen corporate resilience.

Accountancy Europe looks forward to exploring the ideas presented in this paper with corporate ecosystem stakeholders and policymakers. It plans to organize events and workshops to further discuss possible solutions, obstacles and benefits.

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