ACCOUNTANCY EUROPE COMMENTS ON SMART REPORT - SECURING THE FUTURE OF EUROPEAN BUSINESS: SMART REFORM PROPOSALS

INTRODUCTION

We welcome the SMART reform proposals. To meet the objectives of achieving climate neutrality and sustainability requires an urgent and radical transformation of the economy. Therefore, reforms should be bold and ambitious to make a step change.

We support the important role attributed to auditors in advancing effective corporate governance. Auditors can add value by providing assurance services in respect of corporate governance, internal controls, and sustainability reporting[1]. Corporate reporting critically supports corporate governance by providing the crucial information needed to enable companies to make better decisions. In addition to audit, professional accountants also play a crucial role in their different capacities, at all stages of corporate governance. As good business decisions start with reliable information, accountants contribute by measuring impacts, disclosing information, and adding credibility to what is reported.

We would like to highlight the Accountancy Europe cogito[2] publication *10 ideas to make Corporate governance a driver of a sustainable economy* proposing ideas for actions boards and policymakers/regulators should take to accelerate this transition.

Importantly, the European Commission (EC) DG FISMA are currently focusing on many of the matters covered by the SMART report as part of the EC Sustainable Finance Action Plan. We recommend that SMART engages also with the DG FISMA as SMART's work can be highly valuable for them.

In responding to the request for comments, we have focused our feedback mainly on the section *6.2 Shifting business towards sustainability*.

We remain available in case you have any questions regarding our comments below and if would like to continue the dialogue.

6.2 SHIFTING BUSINESS TOWARDS SUSTAINABILITY

6.2.1 REDEFINING THE PURPOSE OF THE UNDERTAKING AND THE DUTIES OF ITS BOARD

PROPOSAL FOR A NEW CHAPTER II A PURPOSE AND GOVERNANCE OF UNDERTAKINGS

We support the SMART proposal for an amendment of the Company Law Directive 2017 to add the redefinition of the purpose of the undertaking and the duties of the board. Our more specific comments are included below.

ARTICLE 2: THE PURPOSE OF THE UNDERTAKING

We welcome the SMART proposal to specify that the purpose of the undertaking is to create sustainable value within planetary boundaries and would propose to also add the 1.5C goal of the Paris Agreement. Furthermore, the SMART report also refers to the social impact; therefore, this critical contribution to the social imperative should be better reflected in the purpose of the undertaking.

We recommend emphasising that companies need to be specific on their corporate purpose, in particular on how they balance different interests, their key stakeholders and their mission. Company law should also require

[1] Accountancy Europe's discussion paper[1] *Auditor's role regarding providing assurance on corporate governance statements* (2009)

[2] This publication is part of the Accountancy Europe Cogito series, a selection of thought-provoking publications to provide new ideas for the European accountancy profession. With this series, we aim to enhance innovation and our contribution to business and society. This publication aims to stimulate debate; the views expressed thus do not reflect the official positions of Accountancy Europe or any of its 51 member bodies.

that businesses include in their by-laws, how they consider their environmental and social responsibilities and objectives and how these relate to their corporate purpose. The implementation of such proposal will be critical to prevent boilerplate language.

ARTICLE 3: THE DUTIES OF THE BOARD

We support the proposal regarding the duties of the board.

Regarding the duty of the Board to ensure that the undertaking's business model is aligned with its purpose, it is essential to clarify the directors' liability in case they deviate from or do not fulfil this duty. The board needs to act in the interest of the company having due care for their stakeholders. The magnitude of business impact entails a particular responsibility.

To ensure that the board fulfils its sustainability due diligence duty, the company, and where appropriate, directors should bear the full consequences of their actions, omissions, negligence or wrongdoing. On the way to moving to a circular economy, they should be responsible for preventing and mitigating negative environmental and societal impacts.

When considering liability, the balance is always delicate to strike[3]: too heavy responsibilities and excessive liability risk will drive directors away; conversely over-protecting them may reduce their sense of responsibility and may hamper the public interest.

We are certainly not calling for more litigation, but judiciary action is one of the tools that civil society is increasingly using to create change, sometimes because policymakers are perceived as not keeping pace with needs and expectations[4].

Liability regimes differ widely in the EU: this reduces the level playing field between companies and undermines corporate governance' potential to shift markets. Harmonising directors' liability regimes would probably meet serious political and lobbying resistance. However, the EU should explore providing a European framework to mitigate the negative impact of the diverging liability regimes and enforcement. A European collective redress scheme could also support more accessible and consistent environmental justice.

In addition to legal powers, it is of critical importance that supervisory authorities and enforcement agencies are equipped with proper resources and that their human, intellectual, financial and technology capabilities are adequate.

Sustainability assessment should be an integral part of business practice

We would like to see more specific wording by SMART when referring to 'stringent sustainability assessments', It needs to be explained what 'stringent' means in practice and which elements the assessment should entail (i.e. processes, governance, investment programmes, management and control, etc.) when carrying out specific ESG due diligences processes. A delicate balance needs to be struck between the scope of the proposal that should be focused to be effective and the need for details that should remain principles-based.

The requirement for the board to carry out the sustainability assessment every three years may lead to a mechanical and compliance-oriented mindset, which is not aligned with the intention of the SMART proposals. We propose for the sustainability assessment to be established as part of an integral and on-going business practice and due diligence. This would also be consistent with the SMART proposal in relation to the management report to amend Article 19 of the Accounting Directive to include "rules for identification of *ongoing* negative sustainability impacts and principal risks of future negative sustainability impacts".

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[3] An example of good balance seems to be the French Corporate Duty Of Vigilance Law, see https://www.business-humanrights.org/sites/default/files/documents/French%20Corporate%20Duty%20of%20Vigilance%20Law%20FAQ.pdf

[4] See examples of the growing number of lawsuits against corporations and governments across the world addressing their actions or inactions in relation to climate change: 1) http://www.lse.ac.uk/GranthamInstitute/publication/global-trends-in-climate-change-legislation-and-litigation-2018-snapshot/, 2) http://climatecasechart.com/, 3) https://www.bloomberg.com/graphics/2018-climate-change-lawsuits/

This on-going sustainability assessment should figure high on the board agenda. Therefore, we recommend revising this part in light of the above comment.

The proposal to involve external experts to provide assurance on the sustainability assessment will be instrumental to ensure its robustness and credibility. To this end, the independence of these experts and their public oversight is critical[5].

Sustainable value creation should be at the heart of the undertaking's purpose and the duties of the board

It is indeed essential that the specific proposals on the purpose of the undertaking and the duties of the board explicitly incorporate and reference the concept of value creation. Boards need to consider the full range of factors used in the value creation process in a holistic way. This entails an in-depth understanding about the inputs into its business activities, the outputs, and what effects its outputs have on the resources used by the company, in particular its effect on society and the environment

The sustainability assessment must not be presented or perceived as a separate or an add-on matter but should figure as an integral part of the undertaking's business model and activities, including its governance, risk management, strategy, internal controls and business continuity. This assessment needs to be science-based and take into consideration the entire lifecycle of products and activities.

Furthermore, we invite SMART to reflect whether a 'purpose assessment' - i.e. if the company has implemented its purpose in practice in its decisions, governance, decision-making processes and so on. This approach could make it even more integral and better serve the purpose the SMART proposals aim to achieve.

Regular review of the mandatory guidance for sustainability assessment and due diligence

We support the proposal that the mandatory guidance for sustainability assessment including the due diligence requirements should be regularly reassessed. In this respect, incorporating feedback from affected communities will be vital to ensure that the guidance is fit for purpose. Therefore, we recommend clarifying what "open participatory process" means in practice. For example, "open participatory process" could entail a consultation process, a stakeholders' meeting or similar initiatives. Advantages and disadvantages of the current instruments based on practical experience should be reflected. This instrument needs to deliver the most effective and fit for purpose guidance to protect those and ecosystems, which are negatively affected by the undertaking's activities.

We invite SMART to also reflect about the feasibility of mandatory guidance. Usually, guidance by virtue is non-mandatory. If SMART's intention is to propose mandatory requirements for sustainability assessment and due diligence, we propose to consider a different instrument.

Transform the business model

Monitoring progress on this transformation roadmap should be a standing agenda item. Moving to a sustainable economy requires transforming the business model toward circularity. The centrality of business model transformation must be reflected on the board's agenda as a number one priority. In addition, the board will have to broaden its approach to risk management including, e.g. the impact of stranded assets, environmental litigation and reputational risk. Reporting on this process would contribute to transparency and accountability.

Expand the scope beyond large publicly listed entities (PIEs)

Large publicly listed entities (PIEs) represent only a small part in numbers of the European economy, although their impact can be significant. Expanding the NFRD's scope should capture all those companies that have a significant impact on the environment. Stakeholders are interested in non-financial information to better understand a company's performance, its future developments and impact on society.

Reporting on non-financial matters makes businesses better assess, measure and manage their risks and performance on specific ESG-metrics. That could lead to lower funding costs, fewer and less significant

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[5] In addition, all professional accountants are bound by international ethical standards (issued by the IESBA) and international quality standards for their accounting and auditing activities and need to take the public interest into account.

business disruptions, stronger consumer loyalty and better relations with stakeholders. Developing non-financial measurement and reporting disconnected from financial aspects should be avoided. Therefore, we recommend more consideration of integrated reporting.

'Scalability rule'

In the paragraph "The duties of the board in Section 2(1)-(5) shall be proportional and adapted to the scale and complexity of the undertaking" we also recommend adding 'external risks' of the undertaking. This is because small and medium enterprises operating in high risk sectors can have substantial external impacts. Scalability is best achieved with a proportional and principles-based approach. It will be also important to ensure that Member States can implement this provision in a consistent manner.

It would be also helpful if further detail is provided what the scalability approach entails e.g. key KPIs for all businesses, which elements of the business model should be addressed, which key human rights issues, climate risk assessment, etc.

As a general observation regarding the 'scalability rule' i.e. to ensure that regulatory measures (e.g. auditing and reporting) are proportionate to the scale and complexity of the undertaking's activities, we would like to draw the SMART attention to the Accountancy Europe recent cogito[6] publication *From risks to regulation: re-thinking company categorisation*, which could provide useful insight in this regard.

In this paper we suggest that regulatory measures be tailored to the risks and impacts companies pose to their surroundings, rather than their mere size. We put forward a risk mapping scorecard to determine an entity's risk profile to better understand how, where and why an entity impacts its surroundings – economy, environment and society.

An entity's risk profile would trigger specific obligations with respect to their specific risks (accounting, auditing, corporate governance, transparency, prudential obligations). Conversely, exemptions can be granted to entities if the score is low in specific areas, meaning that the entity does not have direct risk implications. The aim is to arrive at more proportionate and relevant requirements.

Such risk-based approach could enable a more targeted and proportionate allocation of regulatory requirements, better suited for the more multi-faceted demands of policymakers, investors and the wider society.

6.2.3 REALISING THE POTENTIAL OF REPORTING – ENSURING RELEVANCE AND RELIABILITY

6.2.3.1 EUROPEAN REGULATORY FRAMEWORK

The EU corporate reporting framework suffers from a lack of coherence and a piecemeal approach with several legal texts dealing with different reporting obligations (e.g. Accounting Directive[7], IFRS Regulation[8], Non-Financial Reporting Directive[9] with non-binding guidelines, Transparency Directive[10]) There is also pending legislation, for instance, on tax disclosures[11]. The interaction between these texts is complex. Their scope is not

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[7] Directive 2013/34/EU, see https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN
[8] Regulation (EC) No 1606/2002 see https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32002R1606
[9] Directive 2014/95/EU, see https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN
[10] Directive 2004/109/EC, see https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004L0109&from=EN, Directive 2013/50/EU, see https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0050&from=EN
[11] COM(2016) 198 - Proposal for a Directive Income tax information by certain undertakings and branches, see https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0198&from=EN

always consistent. They use different thresholds. They do not offer a coherent framework, for instance, the Member States were not able to agree on a set of general principles in the Accounting Directive[12].

There is much progress in the area of non-financial reporting, but there is also proliferation of standards and frameworks. For an effective response to the global issues and stakeholder demands, NFI reporting needs to be harmonised and interconnected with financial reporting.

In our recent cogito[13] paper *Interconnected standard setting for corporate reporting*, we introduce nine criteria and apply them to four approaches to interconnected standard setting for corporate reporting. We set out our vision and offer ideas on how we can make progress towards a global corporate reporting structure. Furthermore, the impact of non-financial reporting is limited if it is not connected to financial reporting. Financial performance results from performance in e.g. strategic planning, resource utilisation and business processes. Performance needs to be judged holistically. Therefore, the use of integrated reporting should be supported.

We support the SMART proposal to require providing information on the environmental and social impact of the undertaking's activities (as discussed in Section 6.2.1) in the management report by amending Article 19 and repealing Article 19a of the Accounting Directive.

6.2.3.2 SMART PROPOSAL FOR A MANAGEMENT REPORT REFORM

We welcome the acknowledgement of the need to streamline the current myriad of reports, and using the management report as the (potentially single) key reporting instrument supporting the financial statements, in particular regarding sustainability related information that impacts the company's (risk) position and relevant KPIs.

However, a few items the report highlights might arguably be appropriately placed elsewhere or some even possibly in the notes to the financial statements such as the various breakdowns of monies paid etc. The management report is intended to serve a specific purpose and so should not include information not essentially aligned to that purpose.

Therefore, a discussion is needed to revisit whether the management report is an appropriate tool to also report information pertaining to public subsidies, donations to politicians, etc. (i.e. as a dumping ground for reporting of matters where the only aim seems to be to drive corporate behaviour or have companies own up to their own behaviour). Information overload can be counterproductive. We recommend that the management report remains focused on strategic aspects.

In respect of the management report proposal, we would like to highlight the Accountancy Europe publication *Disclose what truly matters* providing practical guidance to help companies without prior experience in NFI reporting to comply with the EU NFI Directive. The Directive's requirements are applied in a 'mock-up' management report.

As per the proposal to amend Article 19 of the Accounting Directive (paragraph 4), we agree that the Commission's binding guidance should be regularly updated for it to remain relevant and fit for purpose. We recommend being clearer on the specifics as to what "an open participatory process, integrating expertise and affected communities" means in practice. This will help ensuring the practicality of the provision.

We support the SMART proposal to enhance the stringency and verification of the non-financial information, which is critical to understand sustainability impacts of business. The proposals should be specific to what stringency means in practice.

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[12] https://www.accountancyeurope.eu/wp-content/uploads/FEE_Position_on_EC_CP_Review_of_Accounting_Directives_090421234200939130.pdf

[13] This publication is part of the Accountancy Europe Cogito series, a selection of thought-provoking publications to provide new ideas for the European accountancy profession. With this series, we aim to enhance innovation and our contribution to business and society. This publication aims to stimulate debate; the views expressed thus do not reflect the official positions of Accountancy Europe or any of its 51 member bodies.

In terms of implementation, we would advise that SMART's reform proposals urge companies to take a long-term view in assessing the negative impacts and risks thereof, where the horizon is defined by the time that planetary boundaries are expectedly reached.

Furthermore, as regards additional provisions amending Article 19 of the Accounting Directive, we propose that provision 2 (paragraph 2) not only refers to amounts reported but also to disclosures in the annual financial statements (i.e. the disclosures).

6.2.3.3 SMART PROPOSALS FOR TRANSPARENCY DIRECTIVE

We welcome the proposals relating to amending the Transparency Directive. A high degree of consistency across the entire legislative framework is essential. This is equally valid for its implementation and enforcement.

6.2.4 ASSURANCE OF PROCESSES AND AUDITING OF REPORTING

6.2.4.1 THE EU AUDITING FRAMEWORK

We welcome the proposal highlighting the need for independent audit and assurance on the non-financial information. Non-financial information is crucial for companies, investors and other stakeholders to make sound business decisions. Providing independent assurance on the reported NFI enhances its quality and reliability.

The demand for assurance on NFI has been growing steadily, but the practice still varies across Member States. Our recent publication *Towards reliable non-financial information across Europe* sets out how European countries have transposed the Non-Financial Reporting Directive 2014/95/EU (the NFRD) into national law and the impact on the role of the statutory auditor and independent assurance services provider. The paper also looks into the voluntary assurance practice beyond legal requirements across Europe.

We would also like to clarify that the International Federation of Accountants (IFAC) supports four independent standard-setting boards, which establish international standards on ethics (IESBA), auditing and assurance (IAASB), accounting education (IAESB), and public sector accounting (IPSASB) (cf. "… *standards issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB)).* IFAC, which is the global organisation for the accountancy profession, is not issuing the standards as suggested by the wording of the report but rather promoting adherence to high quality international standards. This is an important point to take into account as the accountancy profession has gone through a number of discussions and reforms to reach the current structure of its governance. Independence in standard setting permits the issuance of standards without being affected by any undue influence or conflict of interest that could compromise their quality. In addition, due process in standard setting ensures that the development of standards is accountable and transparent.

As external auditors, accountants are subject to specific stringent independence requirements and public supervision, they provide assurance on information reported by business with a high guarantee of independence, objectivity and competence. They can offer an independent expert opinion e.g. on the process used to collect and analyse the data, on the reliability and exhaustivity of the data or on the way it is being interpreted, used and reported. With this information at hand, investors and other stakeholders can gain confidence that businesses make the right decisions to become sustainable.

6.2.4.2 SMART PROPOSAL FOR FULL AUDIT OF MANAGEMENT REPORT

We welcome the proposal for full audit of the management report. The full audit of the management report can help to ensure that information is credible and reliable. We also recognise that in practice assurance can only happen when companies have fully developed systems and processes. This will also depend on the auditing and assurance standards that will be further developed. Current experience with regard to (non-mandatory) assurance on NFI indicates that reporting systems still need to "mature" before an assurance engagement could be mandated.

Ensure the reliability of reported information

Stakeholders, including investors, voice the need for independent assurance on non-financial information. Non-financial reporting practice is still evolving, and it is important, at a minimum, to ensure that such information is verifiable, as in it could be subject to assurance now or in the future.

From a practical point of view, it should be ensured that all information is suitable for that purpose. Information needs to be sufficiently “robust” and there need to be clear criteria against which the auditor can “test” it. In this respect, our comments on the content of the management report are also relevant.

Another key issue from a practical perspective regards the scope of the work – whether the audit should focus only on the data or the whole report (as proposed by SMART). In the latter case, the key issue is ‘completeness’, i.e. how should confidence be obtained and provided that the management report covers all relevant (material) information. This should be a specific attention point for implementation, to make it work in practice.

6.2.5 PUBLIC AND PRIVATE ENFORCEMENT

The effectiveness of any law depends on effective enforcement mechanisms. Transparency facilitates effective enforcement and creates incentives to conform. As a principle, businesses should be required to analyse and mitigate the impact of their strategy and operations on the environment and society and to be fully transparent about the outcome of their efforts.

But the benefits of transparency may have limits too. Public disclosures may not always be the most appropriate way to deal with sensitive matters such as the outcome of board evaluations or certain risks management plans. From this perspective, the benefits of private reporting to a well-equipped regulator deserve further consideration. It would imply a culture of dialogue where both the supervisor and the supervisee share the objective to systemically improve and cooperate. External auditors are also be in the position to contribute to such a dialogue.

6.2.5.1 ENFORCEMENT THROUGH THE COMPANY REGISTRAR

Enhancing enforcement through providing the referenced documents to the company registrar may be helpful, in particular if the sanction in the absence of provision of these documents or the provision of inappropriate documents is, as we understand it, the withdrawal of the company’s license to operate. However, this would only work if the company registrar would be equipped with the competences, skills and resources to carry out this role.

It would be important to clarify the rules regarding public access to these documents and further analyse any overlap with public reporting as additional unnecessary administrative hardens on companies should be avoided, especially as massive investments are indispensable to carry out the transition. Furthermore, company registrar operates along different modalities across Europe and may not all be able to carry out such a function. Necessary safeguards should be foreseen to ensure that this does not turn into a pure compliance exercise based on boilerplate documents.

6.2.5.2 PUBLIC ENFORCEMENT THROUGH A EUROPEAN PUBLIC BODY

This point is covered below under the Corporate governance codes (6.3.1.).

6.2.5.3 ENFORCEMENT THROUGH CLAIMS FROM AFFECTED PARTIES

We support the proposals relating to enforcement through claims from affected parties and to link this provision to sustainability due diligence duty. This is also consistent with our comment above regarding clarifying board liability (see duty of the board).

Below we propose some further reflections to achieve more effective enforcement, as discussed in our cogito paper *10 ideas to make Corporate governance a driver of a sustainable economy*:

ENHANCING THE 'COMPLY OR EXPLAIN' PRINCIPLE

A 'comply or explain' approach needs to be strengthened14. It requires time, resources and moreover competence to carry out monitoring, careful assessment and judgement. A forceful redress mechanism is needed to impose corrective action where necessary. Dissuasive sanctions must be applied in case of repeated or ill-intended failure to provide a valid explanation or of inappropriate or misleading explanation. 'Comply or explain' works insofar as it is properly monitored and enforced.

RETHINKING THE ROLE OF SANCTIONS

New thinking about sanctions is necessary. Rules that are not applied or unevenly enforced are not only inefficient, they are counterproductive. Sanctions are not (only) aimed at dissuading or punishing: they are primarily aimed at protecting legitimate businesses and ensuring that there is a level playing field. Sanctions also contribute to a regulatory system's credibility. If non-compliance does not meet systematic proportionate sanctions, the entire system is at risk.

When sanctions appear necessary, they must be proportionate to the extent of the offense, its consequences, notably on the environment, and to the perpetrator's size and means. Applying the same sanctions for SMEs and large companies is not proportionate, nor fair, nor effective. Sanctions must also be proportionate to the damage the company inflicted to market functioning, other stakeholders, as well as the environment or society. Any business weighing cost/benefits in their approach to compliance, should have no doubt that complying is the better option.

Once rules are in place, enforcement is largely a matter for Member States. Therefore, the EC should step up its oversight of Member State' enforcement policies and make this an important element of its infringement policy. This would prevent local political interference and safeguard independence, objectivity and a level playing field amongst European business.

6.2.6 ENABLING SUSTAINABLE SMES

Indeed, to enable SMEs' sustainable business models, regulatory requirements should be proportionate to the scale and complexity of the activities of the undertaking ('scalability'). In addition, and as referred above, external risks of the undertaking should also be part of the equation – not just the size.

SMEs constitute a major part of the economy. It is therefore critical to ensure they are on board to transition to the sustainable economy. Care should be taken against 'one size fits all' approach. Assistance to SMEs (e.g. by means of providing information, data) and taking into account their diversity and unique nature should be foreseen as part of enabling their sustainably. We welcome the proposal to set up a SME Resource, consisting of the Advisory Hub and Portal. This could go even further to provide information in respect of certain, particularly, carbon emissions information.

SMEs in the supply chain and ESG reporting

There has been relatively little evidence that ESG reporting requirements are being passed down the supply chain from large MNEs to SMEs. However, given the importance of SMEs in the supply chain (and the economy in general) it is widely considered to be inevitable that as larger companies increasingly address ESG issues they will turn to their SME suppliers to provide them with key information that will feed into the MNE's NFI reports.

[14] The 'comply or explain' principle provides a good model for enforcement, while also providing flexibility to businesses. It continues to be useful in the field of corporate governance. However, it needs to be strengthened. This principle is only effective insofar compliance is strongly monitored. In a 'comply or explain' context, the quality, specificity and acceptability of the explanations provided in case of non-compliance need to be properly evaluated. Overseeing the UK Corporate Governance Code (since 1992), the Financial Reporting Council (FRC) is one of the most experienced regulators on the 'comply or explain' approach in corporate governance. They admitted in 2017 that 'comply or explain' needs more teeth to restore public trust in business. The FRC found too many explanations for non-compliance the Corporate Governance Code were of poor quality, see FRC, (2017). Developments in Corporate Governance and Stewardship 2016.

We are already seeing financial institutions questioning the sustainability of SMEs business models (in all senses of the word sustainability) when considering financing - especially in terms of stranded assets. Again, we would anticipate this trend to continue.

In this context, a simplified reporting standard would be of benefit for SMEs in the context of a ‘maximum’ standard – i.e. a standard beyond which SMEs should not be forced to go. However, this would require a significant amount of research to determine the key reporting metrics for smaller entities, which are often likely to be highly specific to their role in the supply chain.

ESG implementation by SMEs

While simplified procedures in both due diligence and reporting are essential, the full associated cost of ESG implementation and reporting should be realistically evaluated to ensure the cost does not hinder the ability to comply. A common reporting standard would go some way to reducing administrative burden. However, it will also depend on whether the reporting needs to be subject to compliance processes. An SME can have good health and safety policies but if these need to be subject to a compliance audit then they will need significantly more processes and controls.

ESG implementation i.e. developing policies, systems and training and monitoring these on an ongoing basis will also incur significant expense and many smaller entities simply lack the resources and expertise to do this. Consequently, they need support to implement ESG procedures.

Additionally, obtaining basic information for such elements as carbon emissions is difficult and costly and a disproportionate burden on smaller entities. The development of a non-commercial tool for calculating such costs at an enterprise level could potentially be enormously useful in persuading SMEs to take up their responsibility in dealing with ESG issues.

Help SMEs with ESG compliance

Given the importance of SMEs to the global economy, ideally, all businesses should be required to report at some level on their ESG compliance. However, for reasons mentioned above, it is too soon to make such reporting mandatory until better information systems are in place that SMEs can draw on.

The experience of Greece in this respect could be considered – as it was the only country to extend the scope of the NFR Directive to include (very limited scope) ESG reporting for smaller entities.

Additionally, there is a question of how to define an SME – a term in some countries that can cover an enormous range of businesses. Even the upper threshold of micro-company as defined in the 2013 Accounting Directive is much larger than many businesses.”

6.3 FACILITATING SUSTAINABLE FINANCIAL MARKETS

6.3.1 CORPORATE GOVERNANCE CODES AND STEWARDSHIP CODES

The regulatory framework should be explicit that the board is responsible for the company’s sustainability strategy and its implementation.

We refer to our cogito paper *10 ideas to make Corporate governance a driver of a sustainable economy* including some specific reflections on the European regulatory framework for corporate governance.