

# Policy Statement

*Standing for trust and integrity*

July 2009



## The Accountancy Profession's Contribution to the Debate on the Crisis (V)

### Shaping a Sustainable Economy

FEE, the Federation of European Accountants – Fédération des Experts comptables Européens, wishes to contribute its views and experience to the debate on the current crisis, the ways to mitigate its effects and to speedup recovery. This paper presents the views of FEE on the financial crisis and sustainability. Four other papers have been issued between December 2008 and March 2009, one presenting background information and analysis on the crisis (I), a second paper on the matters of specific relevance for statutory auditors during the financial crisis (II), a third paper containing views of specific relevance to Small- and Medium-sized Entities (SMEs) (III) and a fourth paper on dynamic provisioning (IV).

In addition FEE is issuing a series of policy statements<sup>1</sup> on core issues in relation to sustainability and the accountancy profession in which FEE wishes to share its strategy on sustainability. FEE acknowledges that the urgent nature of the challenge of sustainability is becoming widely recognised. At organisational level, accountants whether in business, the public sector or within the world of professional practice, must rise to the challenge of sustainability – a challenge which touches on many areas of traditional competencies.

#### About FEE

FEE represents 43 professional institutes of accountants and auditors from 32 European countries, including all 27 EU Member States. It has a combined membership of more than 500.000 professional accountants. In representing the profession, FEE recognises the public interest. Professional accountants work in different capacities in public practice, small and big firms, and public sector; based on the practical experience gained in this daily involvement in all aspects of the economy and the set of values underpinning the profession's practice, FEE believes it has a contribution to make in the current discussions.

#### Background

This policy statement examines the sustainability issues at play during the current financial and economic crisis and suggests steps that can be taken to encourage the embedding of sustainability in business practice. Particular attention is paid to the implications of sustainability on financial reporting, corporate governance and assurance. The specific role of the accountant is also explored.

Excessive short-termism, coupled with a lack of accountability both within financial institutions and between management and shareholders, is seen to be at the heart of the problem of the financial crisis.

**FEE believes that the current financial crisis illustrates the failure of markets to acknowledge that short term thinking can lead to substantial legacy problems in the long term. The financial crisis provides an opportunity to adapt practices and policies that encourage this longer-term thinking and without which the European Union will not achieve its stated aim of being a pole of excellence on sustainability.**

At the Accounting for Sustainability conference held in London in December 2008, His Royal Highness the Prince of Wales, identified three issues<sup>2</sup> :

- Over-consumption and indebtedness: huge increases in debt – caused by a “consume today, pay tomorrow” attitude;
- Over-confidence in the ability of market and regulatory systems to identify and mitigate the risks of over-consumption;
- Short-termism: individuals and organisations have been incentivised to generate short-term profits irrespective of their long-term sustainability.

In addition to responding to the current financial crisis, it is evident that action is urgently needed to meet core sustainability challenges: over-consumption and depletion of resources resulting in climate change and reduced bio-diversity. The “climate crunch” risks becoming a much more fundamental and

alarming issue and is likely to be a more serious economic threat in the future than that posed by the current financial crisis. However, the economic crisis

has created a unique opportunity to re-build global markets with systems that drive, rather than hinder sustainability.

The financial crisis may bring with it a short-term survival instinct rather than a will to invest in the future and in sustainability. But, we cannot afford to put the sustainability agenda aside during the recovery process. More than ever,

organisations need to focus on the long-term sustainability for many reasons, not least to win back public trust. In this respect, organisations should embed new norms of sustainable behaviour in business and across society to ensure that economic activity does not take place to the detriment of environmental, financial or social capital.

## Restoring confidence

### Changing role of business

The financial crisis has created widespread scepticism about whether and how business contributes to the wider interests of society. Organisations need a stable environment in which to plan and respond to economic activity and investment opportunities presented by the sustainability agenda. There is an increasing number of organisations that are tackling environmental and social issues, not only because they are “responsible” but because of the long-term benefits to their organisation.

**FEE believes that a world needs to be created that embraces sustainability as normal business practice...**

Organisations need to focus on long-term sustainability of their business – they need to ensure their financial sustainability and operate responsibly. In doing so, they need to take account of the wider social and environmental systems within which they operate. Shareholders are not the only stakeholder group to consider – having a poor relationship with other stakeholder groups could result in damage to reputation and results. Also shareholders themselves have a role to play in relation to emphasising the importance of long-term sustainability.

Businesses should use the crisis as an occasion to take stock and re-evaluate current business models, realigning them to take advantage of new sustainability opportunities including product innovation, new business and resource efficiency. As noted by the Stern Review<sup>3</sup> on the economics of climate change, the benefits of taking early action on climate change outweigh the costs: “Tackling climate change is the pro-growth strategy for the longer-term, and it can be done in a way that does not cap the aspirations for growth of rich or poor countries. The earlier effective action is taken, the less costly it will be.”

Governments must continue to encourage more sustainable business practices through proper incentives. For example the trillion dollar banking sector bailout is proof that governments can work together, quickly, to help resolve global catastrophes, yet there has not been a comparable investment in sources of sustainable economic activity such as new, clean and green technology or internalisation of costs.

### Corporate Governance

Robust, transparent governance practices need to be embedded in all organisations, along with a re-evaluation of remuneration structures; board level expertise and training; and risk management. This needs to go beyond respecting and complying with relevant corporate governance codes. Sustainability plays an increasing role in restoring and maintaining confidence notably through its longer term focus and nature.

Organisations need to rise to the strategic challenge of long-term sustainable development and through their governance structures embed sustainability into the stewardship, strategy development, decision-making and reporting processes. Sustainability can only be effectively integrated into the governance structure if it has the support of management. Boards and Board committees (notably remuneration and reputation committees) need to embed sustainability in their considerations and decisions, incorporating a longer term focus. The tone at the top is crucial to embed sustainability including ethical behaviour in business in the organisation’s strategy.

### Reporting on organisations’ sustainability activities

There are lessons to be learnt from the financial and economic crisis in relation to management responsibility and accountability. These principles require high quality, reliable information including sustainability disclosures in order to allow shareholders and other stakeholders to assess the sustainability related risks and opportunities in the context of future developments. It is important to have a globally understood language that enables shareholders and other stakeholders to assess how organisations are performing, and any risks or opportunities.

There is a need for greater transparency, and better information is critical in facilitating well informed decision-making that takes account of risk and other factors. Increasingly investors are demanding more developed and sophisticated reporting on non-financial issues. Non-financial information

helps put historical performance into context and portrays the risks, opportunities and prospects for future growth. Non-financial information including sustainability information plays an important role in mitigating the short-termism that until recently dominated financial analysis and valuation. It would be beneficial for organisations to disclose future-oriented, narrative sustainability information looking at risks, opportunities and predicted performance – in addition to past performance data and commentary. The annual report should therefore include forward-looking information both in terms of financial and non-financial information to give readers an idea of where the organisation sees itself in future.

Reporting can take place in different forms and formats, but, in order to engage more fully with the financial community, sustainability needs to be connected to financial reporting. Various initiatives – from connected reporting (illustrated by initiatives such as those developed by Accounting for Sustainability under the Prince of Wales Project and by the Carbon Disclosure Standards Board (CDSB)) to fully integrated reporting - are currently underway to embed sustainability into reporting and to link it better to financial reporting.

Organisations that are transparent on their sustainability practices need to be rewarded not only by socially responsible investors but also by mainstream investors. We believe that mainstream investors must take sustainability issues into account when making investment decisions, reflecting organisations' "new honesty" in the value of the organisation. In addition it should be made easier for such organisations to obtain access to finance as a reward for sustainable behaviour.

In specific areas – for instance relating to carbon usage and trading - special reporting standards are needed. These should be universal to ensure comparability across borders. Some standards in this area are now forthcoming from the World Business Council for Sustainable Development (WBCSD), GHG Protocol, CDSB, ISO standards and IAASB work.

## Assuring non-financial information on sustainability

Reliable and credible information is needed to take the right strategic and operational decisions and to manage the organisation's environmental and social risks. Assurance by independent assurance providers, especially from qualified accountants, enhances the credibility of information. The involvement of an independent practitioner, in assurance services or in separate consultation services, can allow an organisation to benefit from their external expertise and experience and as such improve the quality

of sustainability reports and result in positive changes in the organisation itself.

Specific assurance standards on sustainability information are gradually emerging notably in the area of carbon emissions, in addition to the general standard ISAE 3000 on Assurance Engagements other than Audits or Review of Historical Financial Information which the IAASB is currently revising. The IAASB expects to issue an exposure draft on assurance on a greenhouse gas statement in the second half of 2009. Assurance has an important role in reinforcing the trust and integrity around sustainability information.

## The role of accountants in helping to embed sustainability

A market system that drives business to behave in a sustainable and responsible way is needed. Central to the success of any system are trusted

flows of relevant and accurate information and the processes that underpin them. This is the natural territory of the accountant.

The accountant's role is to continue to provide good quality information that is trusted and properly targeted and underpins the success of sustainability activities.

But the accountancy profession also has a wider role to play. The profession is responsible not only for teaching the next generation of accountants to understand and account for sustainability, but also for providing the current generation with the tools and guidance to enable the full picture to be visible and the right decisions to be made – before it is all too late<sup>4</sup>. Sustainability accounting has to become as much a part of the accountant's role as financial accounting is at present. Unless this is the case, sustainability considerations will not become embedded within organisations' day-to-day operations and decision-making. Recovery from the financial crisis must not mean a return to the same, unsustainable business practices. Doing so would only result in a much more painful, calamitous and, crucially, irretrievable climate crunch.

Accountants have a role to play in the future of business, including small businesses as appropriate to ensure that organisations move forward into a more sustainable future. Accountants need to be fully informed about the issues of sustainability – carbon trading, the carbon-neutral economy, regulatory requirements and issues related to intangibles.

**...This will be achieved through not only compliance driven by government regulation, important though that is, and by operational efficiencies, but also by organisations pursuing strategic opportunities, operating on markets sending proper incentives and thus balancing financial and sustainability considerations for all stakeholders.**

In acknowledgement of the fact that climate change is so fundamental to our common future, accountants – given their pivotal position within organisations - are well qualified to make a vital contribution toward climate change policy and implementation, in areas such as:

- Evaluating the returns on low-carbon investment proposals;
- Developing organisation-relevant carbon and Greenhouse Gas (GHG) Key Performance Indicators (KPIs) and related measurement protocols;
- Advising employers and clients about how emissions trading regimes operate and developing related response strategies;

## The way forward

The right balance needs to be found between short-term expectations and long-term continuity. The financial crisis has taught the positive lesson that the longer term sustainability of organisations is based on more than only financial aspects.

All stakeholders need to be involved to serve the long-term interest of business continuity to serve society's needs. All players should learn from the current crisis, and relevant reporting, investing and communication tools need to be developed.

- Providing improved disclosure of information on organisations' carbon and GHG emissions and climate change risks through the annual report and accounts;
- Auditing and assuring carbon and GHG disclosures;
- Advising employers and clients as to the best courses to take in adapting to climate change, including the probable investment costs and returns from such investments;
- Generally quantifying and profiling the financial consequences of climate change.

FEE believes that a world needs to be created that embraces sustainability as normal business practice. This will be achieved through not only compliance driven by government regulation, important though that is, and by operational efficiencies, but also by organisations pursuing strategic opportunities, operating on markets sending proper incentives and thus balancing financial and sustainability considerations for all stakeholders. ■

### Notes:

<sup>1</sup> Other Policy Statements issued in the Sustainability domain:

- The Contribution of the Accountancy Profession, January 2009
- Cost Internalisation, January 2009
- Non-Financial Information, January 2009
- Multiple-Stakeholders: The Essence of Multidisciplinary Teams, January 2009
- Towards a Sustainable Economy: the Contribution of Assurance, July 2009
- Carbon emissions information, July 2009
- Shaping a Sustainable Economy, July 2009

<sup>2</sup> A speech by HRH The Prince of Wales at the Accounting for Sustainability Forum, St James's Palace 17 December 2008

<sup>3</sup> Stern Review on the Economics of Climate Change, 30 October 2006, by economist Lord Stern of Brentford, The Review discusses the effect of climate change and global warming on the world economy.

<sup>4</sup> The IFAC Sustainability Framework (<http://web.ifac.org/sustainability-framework/splash>) can help professional accountants grasp all the important aspects of sustainability that they may encounter.

