**Position paper**

# 'Towards a global, investor focused standard setter for corporate non-financial reporting'

**6 July 2020**

*This position paper concludes the final views of Eumedion, following the publication of Eumedion's Green paper in October 2019[1], the feedback received during the Eumedion Conference 2019[2], the formal and informal responses received[3] and the insights shared during the round table that Eumedion organised together with Accountancy Europe on 9 March 2020[4].*

***Key messages of the position paper***

*Investors struggle to understand how a company creates long-term value and how a company lives up to the valid needs of society where non-financial performance matters.*

*There is a need for an International Non-financial reporting Standards Board ('INSB') to ensure that enforceable and consistent investor-relevant non-financial information is faithfully represented in the management report section of the corporate annual report[5].*

*Eumedion calls on the IFRS Foundation to establish the INSB, as a second separate board next to the International Accounting Standards Board.*

*External auditors should provide at least limited assurance on the entire management report, irrespective of whether a matter bears any relation to the annual financial statements. Reasonable assurance should at least be applied to certain non-financial key performance indicators. This would enhance the reliability of corporate non-financial reporting.*

The attention of investors and other stakeholders for corporate reporting beyond the annual financial statements has increased dramatically over the last decade. Stakeholders, such as customers, employees, suppliers, pensioners and investors are increasingly becoming aware of and vocal on sustainability and other strategic topics. Investors that integrate sustainability factors in their investment, engagement and voting decisions have become mainstream and rely heavily on the

[1] https://www.eumedion.nl/clientdata/215/media/clientimages/2019-10-green-paper-international-non-financial-information-standard-setter.pdf?v=191128110859
[2] https://www.eumedion.nl/actueel/nieuws/dringende-noodzaak-van-consolidatie-in-de-huidige-wirwar-van-duurzaamheidsverslaggeving-verslag-van-het-eumedionsymposium-2019.html
[3] https://www.eumedion.nl/actueel/nieuws/eumedion-publiceert-green-paper-toekomst-nietfinancile-verslaggeving.html
[4] https://en.eumedion.nl/Latest-news/News/support-for-eumedions-call-to-standardise-nonfinancial-reporting.html
[5] In this position paper 'corporate annual report' is defined as the corporate report that comprises: i) the management report, ii) the annual financial statements and iii) the external auditor's report.

quality of corporate reporting. The ultimate beneficiaries of investment portfolios also increasingly expect institutional investors to act as responsible investors. Many institutional investors would not be able to live up to their fiduciary duty if they were to ignore sustainability factors. Many companies have become more committed to long-term value creation for all stakeholders[6], including the wider society. This is increasingly reflected in the corporate annual reports. The company's reporting on sustainability performance and narrative that explains the company's ability to create long-term value for all of its stakeholders, here jointly identified as non-financial reporting ('NFR'), are more and more considered as material for investors' decisions.

However, companies struggle to provide relevant and comparable NFR, as many frameworks have emerged and none of them cover the full breadth of topics. Where there is overlap between the frameworks, it remains unclear how meaningful the differences between them are. This poses a major challenge for companies.[7] It also poses a major challenge for investors that want to understand how a company creates long-term value and how a company lives up to the valid needs of society where non-financial performance matters.

Existing efforts to harmonise the reporting frameworks for NFR – such as the Corporate Reporting Dialogue – are laudable, but the progress so far has been slow. In the meantime, these existing frameworks keep investing in widespread adoption of their partly overlapping standards.

**A standard setting body dedicated to investor-relevant NFR**

Eumedion recognises that the NFR needs of the different stakeholders groups can diverge substantially. The fact that companies increasingly become multi-stakeholder oriented does not imply that individual stakeholder groups are best informed by combining in a single corporate report all the information that is relevant for each group. Companies already effectively differentiate in how they communicate with different stakeholder groups. Stakeholders like employees and customers have other communication channels that are much more timely, detailed and direct; much better than corporate annual reports can provide. Eumedion's stance is that in principle all corporate information that is relevant to investors' decisions should be faithfully represented[8] in the corporate annual report[9].

The corporate annual report already benefits from two authoritative global standard setters: financial reporting is covered by the International Accounting Standards Board ('IASB') and the auditor's report is governed by the International Auditing and Assurance Standards Board (IAASB). Eumedion's stance is that there is a need for an International Non-financial reporting Standards Board ('INSB') to

[6] The Dutch Corporate Governance Code, revised in 2016: https://www.mccg.nl/download/?download=1&id=3367, and the US Business Round Table redefined the purpose of a corporation to promote 'An economy that serves all Americans' https://opportunity.businessroundtable.org/ourcommitment/.
[7] https://www.accaglobal.com/uk/en/technical-activities/technical-resources-search/2016/may/mapping-sustainability-reporting-landscape.html, page 31 - conclusions.
[8] In line with IFRS' Conceptual Framework such reporting, ideally, is complete, neutral and free from error.
[9] A standard setter could see merit in allowing companies to integrate certain related disclosures through a reference in the management report, as long as the relevant highlights for investors remain mentioned in the corporate annual report and there is a lasting availability of the subdocument.

ensure that investor-relevant, reliable, consistent and comparable NFR is incorporated in the management report section of the corporate annual report.

The INSB should explore what key performance indicators ('KPIs') have universal relevance for (nearly) all companies. Examples of topics that could qualify for 'generic' KPIs are: $CO_2$ footprint (scope 1, 2 and 3), customer retention, the internal pay ratio, net promoter score, employee engagement score, and diversity. We expect the INSB to benefit tremendously from and build on the excellent work that existing frameworks like the Sustainable Accounting Standards Board ('SASB'), the Task Force on Climate-related Financial Disclosures (TCFD), the International Integrated Reporting Council ('IIRC') and the Global Reporting Initiative ('GRI') have accomplished over the years, as these frameworks provide a solid basis for the much needed harmonisation. We expect that the INSB, once established, will quickly make the much needed progress.

There is a wide variety of potentially company-relevant non-financial KPIs; these are much more diverse in nature than the variety of financial KPIs. Unlike financial reporting where standards tend to be written generically for all sectors, the INSB will also need to define KPIs at a sector level; alike the approach explored by the SASB. However, even within a single sector the variety of business models of companies can still be so wide that it may require significant judgments by the company to safeguard that the resulting disclosures indeed are relevant for investors. The INSB should safeguard relevance by requiring that a company discloses a materiality assessment[10].

Companies should have sufficient discretion in defining their own company-specific KPIs, just as they already have in financial reporting. The INSB could, for example, require that any company-defined KPIs do meet certain generic criteria like a clear and consistent definition; in line with the Guidelines on Alternative Performance Measures as issued by the European Securities and Markets Authority.[11]

We would expect the INSB to set narrative requirements inspired by the Integrated Reporting Framework of the IIRC, the Embankment Project for Inclusive Capital[12], and the World Economic Forum's Business Council[13]. However, the purpose of NFR should not be to explain an ever moving difference between the market value of a company and the book value of a company that some frameworks seem to aim for.

The INSB may find a solid basis for drafting its Conceptual Framework ('CF') in the CF of the IASB[14]. Even though fostering comparability, verifiability, timeliness and understandability as mentioned in the IASB's CF seem quite universal, these characteristics do need to be regarded in the context of the more challenging environment of NFR. In this environment there often are no transactions to base the measurement on, and comparison may be limited to peers within sectors, or even to the past

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[10] GRI provides a standard for making a materiality assessment: https://www.globalreporting.org/standards/media/1036/gri-101-foundation-2016.pdf#page=%2010, pages 10 and 11.
[11] https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1057_final_report_on_guidelines_on_alternative_performance_measures.pdf
[12] https://www.epic-value.com/#report
[13] https://www.weforum.org/whitepapers/toward-common-metrics-and-consistent-reporting-of-sustainable-value-creation
[14] https://www.iasplus.com/en/news/2018/03/cf

performance of the company itself only. For NFR narrative, the INSB should to be reluctant in setting strict presentation requirements to allow companies sufficient degrees of freedom in conveying their story. The INSB should refrain from defining normative thresholds for par or sub-par performance.

**Call on IFRS Foundation to establish the INSB**

Independence of the INSB is a precondition for gaining credibility and should be embedded in a well-designed governance structure. Independence safeguards that the interests of stakeholders and preparers of NFR are properly balanced. Independence should also safeguard that no single jurisdiction dominates the standard setting process as this will hamper adoption by other jurisdictions, thereby endangering the ultimate goal of global harmonised standards.

Eumedion calls on the IFRS Foundation ('Foundation') to establish the INSB, as a second separate board next to the International Accounting Standards Board (IASB). The Foundation has a very strong and proven governance structure and is widely considered to be authoritative and independent. Its authority already benefits from the reputation that it and the IASB have built up over the past decades as 140+ jurisdictions require its International Financial Reporting Standards ('IFRS')[15]. The envisaged target audience of the INSB, investors, is set to be in line with the Foundation's target audience. The Foundation oversees a state-of-the-art due process for standard setting. Under the oversight of the Foundation, the IASB is well-known for carefully balancing the interests of preparers and users of reporting. We consider the Foundation to be the most suitable body to take on this important oversight role.

**EU leadership**

The EU needs to be credited for its important role in accelerating the adoption of IFRS to the current near-global level. The benefits of global standards for financial reporting are widely recognised[16], and there is every reason to assume that these benefits would also apply to global, harmonised NFR standards. Unfortunately, not all jurisdictions around the globe are yet as committed to a sustainable future and the role of corporate reporting therein as the EU. Eumedion urges the EU to adhere to its leadership role in this field; however we fully concur with ESMA's chair Steven Maijoor notion that *'Given the global reach of the challenges posed by the transition to sustainability, Europe can play a leading role in promoting this consolidation at international level. It would not only be short-sighted but also detrimental for investors – who typically operate in global financial markets – to build a set of corporate ESG disclosure standards that is only regional.'*[17] Eumedion would welcome a leadership role of the EU that clearly recognises the global nature of the challenges faced; the need for, ultimately, global NFR reporting standards; and the necessity of a governance structure of the

[15] https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/#analysis

[16] Maystadt Report 2013:
http://register.consilium.europa.eu/doc/srv?l=EN&t=PDF&gc=true&sc=false&f=ST%2015614%202013%20INIT
EC's evaluation of Regulation (EC) N° 1606/2002 of 19 July 2002 on the application of International Accounting Standards https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015SC0120&from=EN, page 28.

[17] https://www.esma.europa.eu/sites/default/files/library/esma32-67-642_european_financial_forum_2020_-_12_february_2020_-_speech_steven.pdf

standard setter that fosters international buy-in from jurisdictions whose commitment to a sustainable future is similar to the EU's.

**Role of existing frameworks**

Eumedion urges existing standard setters to significantly enhance their individual and combined global rollout by supporting the establishment of an INSB, also in terms of sharing intellectual property. Without co-operation it remains questionable whether a worldwide roll-out of any individual framework is feasible at all. The outcome of a constructive intellectual co-operation is likely to result in a much higher quality INSB framework that is widely adopted, at lower costs.

**Engagement and endorsement**

Even though legal endorsement of NFR standards by jurisdictions around the globe is the ultimate objective, investors and other stakeholders can be expected to engage with companies to voluntarily adopt INSB's issued standards, ahead of legal requirements.

**Enhancing the audit of the management report**

The quality and reliability of NFR relies as much on proper standards as on a proper audit process. External auditors need to develop appropriate assurance approaches to the various topics covered by the INSB. The auditor's reports have gone through a major transformation over the past decade. External auditors provide more insight what their activities encompassed and now explain what their key audit matters were. Still, the external auditor's centre of attention is effectively limited to providing reasonable assurance on financial reporting. However, investors rely as much on NFR for their decision-making. Currently, responsibilities for external auditors regarding the quality and reliability of the management report differ amongst jurisdictions. European law requires among other things that the external auditor states whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit of the financial statements, there were material misstatements in the management report identified.[18] This no longer meets today's societal needs. External auditors should provide at least limited assurance[19] on the entire management report, irrespective of whether a matter bears any relation to the financial statements. Reasonable assurance should at least be applied to certain non-financial KPIs.

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[18] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, article 34.
[19] The IAASB definition of 'Limited assurance engagement' can be found here: https://www.ifac.org/system/files/publications/files/IAASB-2018-HB-Vol-2.pdf, page 127-128.