Green paper

'Towards a global standard setter for non-financial reporting'

30 October 2019

DRAFT: AN INVITATION TO COMMENT

This green paper is a discussion document only. Eumedion expects to formulate a formal position on these matters in April 2020, but first would like to hear the opinions of all stakeholders beforehand. We therefore invite all stakeholders to provide feedback on this green paper before ***1 February 2020****. Feedback can be addressed to martijn.bos@eumedion.nl.*

The attention of investors and other stakeholders for non-financial reporting has increased dramatically over the last decade. Stakeholders, such as customers, employees, pensioners and investors are increasingly becoming aware of and vocal on sustainability issues. Investors that include non-financial information in their investment, engagement and voting decisions have become main-stream. Many companies have become more committed to long term value creation for all stakeholders[1], including the wider society. This is increasingly reflected in their management reports.

However, companies struggle to provide consistent, comparable and reliable non-financial information as hundreds of frameworks have emerged and none of them covers the full width of non-financial reporting. Many of the frameworks overlap and it remains unclear how meaningful the differences between the frameworks are. This poses a major challenge for companies that want to report non-financial information.[2] It also poses a major challenge for investors that want to understand how the company creates long term value and how the company lives up to the valid needs of society where non-financial performance matters.

Existing efforts to harmonise the reporting frameworks for non-financial information – such as the Corporate Reporting Dialogue – are laudable, but the progress is slow and the number of frameworks included is limited. In the meantime, these hundreds of frameworks keep on investing in partly overlapping content and in promoting widespread adoption. Existing frameworks for non-financial reporting could significantly enhance their individual and combined global impact by supporting the establishment of an INSB in terms of sharing intellectual property. Without co-operation it remains questionable whether worldwide adoption is feasible at all. The outcome of a combined intellectual effort is likely to result in a much higher quality framework. The overall benefits of co-operation for society are likely to be much higher, and the costs much lower.

[1] 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/.
[2] https://www.accaglobal.com/uk/en/technical-activities/technical-resources-search/2016/may/mapping-sustainability-reporting-landscape.html, page 31, conclusions.

In the interest of both stakeholders and companies there is a need for the creation of an independent, authoritative International Non-financial reporting Standards Board (INSB). The aim of the INSB is to set International Non-financial reporting Standards (INRS) on all material aspects of non-financial reporting for listed entities across the globe. The standards should not be normative, but should focus on fostering transparency, consistency, comparability and reliability. The INRSs need to address the material information needs of all relevant stakeholders of a company by setting standards for both narrative and for measurement. The INSB will benefit from the tremendous efforts already delivered by the existing frameworks.

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 non-financial reporting are properly balanced.

The IFRS Foundation is the most suitable body to establish the INSB, as a second separate board next to the International Accounting Standards Board (IASB): the IFRS 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 or allow the use of its financial reporting standards. The IFRS Foundation oversees a state-of-the-art due process for standard setting. Under the oversight of the IFRS Foundation, the IASB is well-known for carefully balancing the interests of preparers and users of reporting.

The initial focus of the INSB should be on drafting standards on narrative and measurement that are embraced by listed entities and stakeholders on a voluntary basis. 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: CO2 footprint, customer retention, pay ratio, employee engagement score, and diversity. The variety of potentially relevant non-financial KPIs is much wider than for 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. However, even within a single sector the variety of business models of companies can still be so wide that it could require judgments of the company to safeguard sufficient materiality of the resulting disclosures. Companies should also have discretion in defining their own company specific KPIs, just as they already have in financial reporting. These KPIs are not required, nor prescribed. However, the INRSs could require that company-defined KPIs do meet certain generic criteria; for example in line with the ESMA guidelines on Alternative Performance Measures.

The quality and credibility of non-financial information relies as much on proper standards as on a proper audit process. Auditors need to develop appropriate assurance approaches to the various topics covered by the INRSs. The quality, usefulness and increasing voluntary adoption of INRSs should foster political endorsement of such standards in the future.

The auditor’s reports have gone through a major transformation over the past decade. Auditors provide more insight what their activities encompassed and now explain what the Key Audit Matters were. Still, the focus of the auditor’s attention is limited to providing reasonable assurance on financial reporting. However, investors rely as much on non-financial information for their decision making. Currently, requirements for auditors for the management report differ amongst jurisdictions. European law requires among other things that the auditor states whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit, there were material misstatements in the management report identified.[3] This no longer meets todays societal needs. Auditors should provide at least limited assurance[4] 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 the non-financial KPIs.

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[3] 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.

[4] 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.