

A global standard setter for non-financial reporting

Introduction

The interest of investors and stakeholders in non-financial information has grown in response to the awareness that financial statements omit salient information about a company (Adams et al., 2011). Currently, there is a lack of convergence in the definition of the underlying concept of non-financial reporting between academics, regulators, quasi-regulators and standard-setters (Stolowy & Paugam, 2018). The non-convergence in the definition of the underlying concept together with the heterogeneity in the reporting channels leads to a proliferation of non-financial reporting standards.

Besides the laudable efforts made to harmonize the reporting frameworks for non-financial information, Eumedion wrote on 30 October 2019 a green paper which calls for a global standard setter for non-financial reporting, an independent, authoritative International Non-financial reporting Standards Board (INSB). During the "Financial Accounting & Reporting" course at TIAS, 24 students from cohort RC 32 were asked to give a reaction on the green paper of Eumedion. A wide variety of opinions were provided in which unanimity could not be found. These vary from "Leave it to the market" and "Let the IASB within the IFRS system provide for it". On one item they were clear, namely that there are too much initiatives today and investors & stakeholders can get confused. One of the suggestions to solve this is described below.

Discussion

Global non-financial reporting standards

Currently, there is a proliferation of non-financial reporting standards in which there doesn't exist one globally accepted set of standards that is appropriate across all forms of non-financial reporting. Since companies use different types of measurements and data on material aspects of non-financial reporting, it is for investors and stakeholders hardly possible to identify trends or make a fair comparison between companies (EY, 2019). Industry-specific International Non-financial Reporting Standards (INRS) could significantly reduce this lack of insight and will foster consistency and comparability within each industry. However, not only investors and stakeholders will benefit from one global reporting standard, but also companies themselves. Due to the more structured non-financial reporting, it will help companies to identify areas for improvement which can ultimately increase efficiency and productivity (EY, 2019).

Since the interest of investors and stakeholders in non-financial information has grown (Adams et al., 2011), they will focus their attention on companies which comply with these global non-financial reporting standards rather than those companies that are less transparent. For companies it will be a strong incentive to comply with the global standards since investors will sell out their assets if the company does not comply, which makes it harder and more expensive to raise capital (EY, 2019).

Global standard setter for non-financial reporting

The demand for a global standard setter for non-financial reporting cannot solely be met by an independent, authoritative INSB, but should also be driven by the market and by institutions outside the regulatory imposition. The difference in incentives between users and preparers of reported non-financial information, which causes 'market failure', calls for some form of regulatory intervention (Barker & Eccles, 2018). Therefore, the regulatory authority is needed to create a level playing field for companies and investors & stakeholders. The market and institutions outside the regulatory imposition should give substance to this level playing field. By using a bottom-up approach investors and stakeholders should give shape, through a feedback process, to the different used Environmental Social Governance (ESG) metrics and their corresponding measurement approaches.

Suitable body to establish the INSB

The demand for this global standard setting process is not served by allocating this to the IASB. The IASB, although having a good reputation, a valid due process, and a proper governance structure, has not been able to become the worldwide accepted financial accounting standard setter. The European endorsement mechanism is not very helpful in this respect. To create one global standard setter for non-financial reporting, the INSB should be established through a fresh start organization supported by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), the standard-setting body of the International Financial Reporting Standards (IFRS) Foundation. This is because the FASB and IASB have a long track record of expertise in standard setting, consist out of an infrastructure and staff of highly skilled professionals, and have well-established governance structures for overseeing their own work (Barker & Eccles, 2018). This is reinforced by the high level of credibility in the FASB and IASB in the investment - and corporate community (Barker & Eccles,

2018). As a logical result, the FASB and IASB should aim to integrate non-financial and financial reporting (i.e., integrated reporting). They should make an effort not to repeat the valuable work performed by the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB), but instead encourage these standard setters to continue their technical work within the new fresh start organization. Advantage should be taken from both the general approach, as established by the GRI, and the sector specific approach, as delivered by the SASB.

Embracement of the standards on a voluntary basis

Although, embracement of the standards on narrative and measurement on a voluntary basis is laudable, it is not enough to foster transparency, consistency, comparability and reliability of both the narrative and measurement of non-financial reporting. Due to the voluntary basis on which non-financial reporting is historically introduced, a non-convergence in the definition of the underlying concept and heterogeneity in the reporting channels has arisen. Ultimately, this has led to a proliferation of non-financial reporting standards.

To create a level playing field for companies and investors & stakeholders, the global non-financial reporting standard should be mandatory for all listed companies worldwide. Listed companies should comply with the global standard or otherwise explain their reasoning to deviate from the standard ('Comply or Explain' principle). The Directive 2014/95/EU sets an important first step in making non-financial reporting mandatory. Also, the global standard should include an indisputable definition on the underlying concept of non-financial reporting and predefined industry-specific narratives and measurements on non-financial reporting. The SASB's development process of industry-specific standards using predefined principles and presentation formatting lays a good foundation for a global standard.

Key Performance Indicators (KPIs)

Rather than drafting KPIs which have a universal relevance for (nearly) all companies, the KPIs should be made industry-specific which will foster consistency and comparability within each industry. Since most of the KPIs on ESG topics are of a qualitative nature, the global standard should include an indisputable definition of each industry-specific KPIs together with a guideline on the narrative and measurement of the KPI. Besides the mandatory industry-specific KPIs, companies should have some freedom to create their own KPIs. These company-specific KPIs should follow a predefined guideline which will foster transparency and reliability. The European Securities and Markets Authority (ESMA) guidelines on Alternative Performance Measures (APMs) together with the SASB standards form a great basis to improve the usefulness and transparency of APMs (i.e., KPIs) to investors and stakeholders.

Supported by a proper audit process

Traditional an audit process evaluates the effectiveness of a company's internal control. Internal control is achieved by designing and implementing an appropriate system of internal control measures which are tailored to the reliability risks, internal control within an organization (Van Leeuwen & Bergsma, 2014). Whereby, an effective internal control system is composed out of the five elements: control environment, risk analysis, internal control measures, information and communication and monitoring (COSO, 2013). The current focus of the auditor is mainly on providing reasonable assurance on financial reporting. To give meaning to the global standards on non-financial reporting, it is essential that auditors also provides reasonable assurance on non-financial reporting.

Conclusion

The non-convergence in the definition of the underlying concept together with the heterogeneity in the reporting channels leads to a proliferation of non-financial reporting standards. INRS could stop the proliferation and significantly reduce the lack of insights for investors & stakeholders and will foster consistency and comparability within each industry. Also, companies will benefit from one global reporting standard since it will help them to identify areas for improvement which can ultimately increase efficiency and productivity (EY, 2019). Besides the laudable efforts made to harmonize the reporting frameworks for non-financial information, Eumedion wrote on 30 October 2019 a green paper which calls for a global standard setter for non-financial reporting, an independent, authoritative INSB. As a reaction on the green paper of Eumedion, it is advocated that the demand for a global standard setter for non-financial reporting cannot solely be met by an independent, authoritative INSB, but should also be driven by the market and by institutions outside the regulatory imposition. To create one global standard setter for non-financial reporting, the INSB should be established through a fresh start organization supported by FASB and the IASB, the standard-setting body of the IFRS Foundation. The global

standard for non-financial reporting should be made industry-specific, include an indisputable definition on the underlying concept of non-financial reporting, and be mandatory for all listed companies worldwide. Also, the corresponding KPIs should be made industry-specific which will foster consistency and comparability within each industry. The global standard should include an indisputable definition of each industry-specific KPIs together with a guideline on the narrative and measurement of the KPI. Besides the mandatory industry-specific KPIs, companies should have some freedom to create their own KPIs. These company-specific KPIs should follow a predefined guideline which will foster transparency and reliability. All this should be supported by a proper audit process which provides reasonable assurance on both financial - and non-financial reporting.

Final remark

Quite some participants were not impressed by the suggested name INSB. This has especially in the Netherlands a bad connotation (NSB). We suggest to name the new fresh start organization: "Global Corporate Reporting Standards Board" (GCRSB) and their standards: "Global Corporate Reporting Standards" (GCRS).

On behalf of TIAS RC 32,

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