Sustainability Reporting as a Driver of a Sustainable Economy

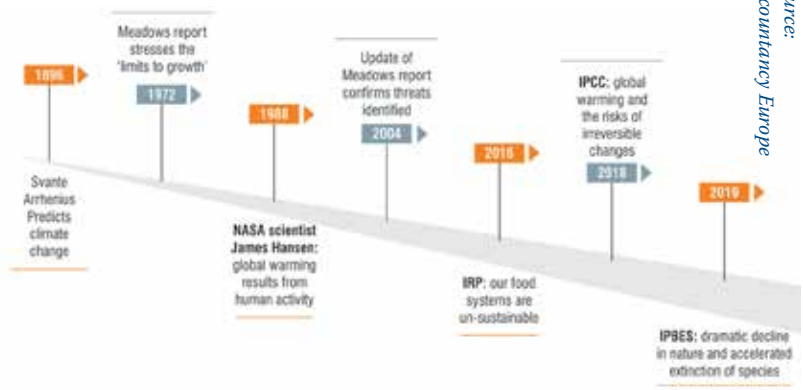
Florin Toma

The Author is President, Accountancy Europe. He can be reached at florin.toma@jpa.ro and eboard@icai.in

Even before the Coronavirus pandemic, our planet was in crisis. Ecosystems are massively and rapidly being destroyed, the climate is deteriorating, geopolitics are at a tipping point, and, in many countries, societies are fragmenting. Although causing international economic and social havoc, the pandemic has offered a short respite for the environment, as clouds of emissions reduced over China and many countries in Europe during lockdowns. Read on ...

As European countries begin loosening restrictions, we are at a crucial moment to consider, not only a new normal, but a more sustainable approach to business. Accountancy Europe has released a publication on the issues - *Corona crisis: lessons for a more sustainable future* (May 2020). If we carry on as before the pandemic, study after study have shown our impending doom. Warnings of climate change are not new (see figure **Timeline of climate warnings**) and there is now indisputable scientific evidence that continuing a path of endless growth is suicide. It is time to act.

Figure – Timeline of climate warnings



Source: Accountancy Europe

Correcting Market Failures

Measuring environmental, social and governance (ESG) impacts is the first step to correct market failures that perpetuate short-term thinking. Reporting on these non-financial matters helps redirect markets and investors. This transparency will help us better identify long-term risks and make sustainable choices. Investors need high-quality, comparable non-financial

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information (NFI) to fully assess the risks and opportunities of their investments. They also need assurance on the reliability of that information.

We must not only demand this of the private sector. The public sector needs to take action and measure its ESG footprint as well. After all, EU Member States spend on average 45% of their GDP on providing public goods. The public sector controls many key areas directly affecting climate change, such as power generation, transport infrastructure and waste disposal. It also has the legislative power to drive forward not just sustainability and good governance in public sector goods and services, but in the wider economy as well. See also our recent publication *Coronacrisis: actions for the public sector* (May 2020). Accountants and auditors play an instrumental role in supporting businesses and governments to put sustainability at the heart of decision-making. This is especially relevant, as the European Union (EU) has been actively legislating sustainability matter, most recently with its ambitious Green Deal to make Europe the first climate neutral continent by 2050. As the regional umbrella organisation uniting 51 professional accountancy bodies from 35 countries, Accountancy Europe informs the EU policy agenda related for 1 million European accountants' daily work.

Non-Financial Reporting is Still Evolving

There is much potential for effective NFI reporting to bring greater transparency. This would allow boards to adopt sustainable strategies, investors to make informed investment decisions and policymakers to develop appropriate legislation.

However, there are now hundreds of NFI initiatives that are leading to confusion and increasing the potential for further greenwashing. Businesses can use any NFI framework that allows them to selectively disclose only the positive side of the story. For an effective response to these global issues and stakeholder demands, we need to improve NFI reporting, through harmonisation and legislative initiatives. If consistent, clear and comparable reports are available, corporate governance can begin to make the right decisions to ensure the shift to a sustainable economy.

...In Europe

In January this year, the European Commission (EC) announced that it will support a process to develop European non-financial reporting standards. The Commission will soon invite the European Financial Reporting Advisory Group to begin the preparatory work for these standards. The intention is to build on the existing reporting initiatives, using the elements that work best.

Since 2018, EU law has already required large companies to annually report certain non-financial and diversity information. As part of the Green Deal, the Commission is now revising this Non-Financial Reporting Directive (2014/95/EU) (NFRD). We are responding to this consultation, but had already recommended five steps to strengthen NFRD' requirements in our *Sustainable Finance Call to Action* (October 2019). Specifically, we see the need to:

- Expand the scope beyond large publicly listed entities (PIEs).

- Indicate a minimum set of mandatory reporting criteria.
- Require companies to disclose their non-financial information in the annual management report.
- Introduce minimum reporting criteria for forward-looking disclosures.
- Ensure the reliability of reported information.

...and in the World

There is not a financial planet and a real planet: these are one and the same. Financial and non-financial information are intimately connected, and it makes no sense to consider them separately. Corporate reporting standards also need to be interconnected. However as mentioned above, the proliferation of NFI reporting initiatives has overwhelmed stakeholders. Although work on European non-financial reporting standard and revising the NFRD are encouraging, they remain regional. We welcome EU leadership to move us towards one global reporting solution, as we recognise intermediate steps may be needed.

As part of Accountancy Europe's Cogito series that aims to stimulate debate, we published a discussion paper on *Interconnected standard setting for corporate reporting* by an independent task force (December 2019) . The paper outlines a solution that:

- Addresses the urgent global issues.
- Strengthens governance through an enhanced collaboration of the public and private sector for oversight and standard setting.
- Transforms existing structures to accommodate additional players to effectively address broader stakeholders' needs.
- Provides an effective connection between financial and non-financial reporting to create long-term value.
- Incorporates technology from the start.

Different options are still up for debate but there is an urgent need for consolidating Non-Financial Information standards and for ensuring an interconnected approach, focused on long-term value creation and stakeholder demands. How corporate reports are presented will also need simplification and refocusing on the most material and relevant information. In previous cogito work, we initiated the Core & More concept to present corporate reports in a more connected and structured way; linking financial and non-financial information to accommodate diverse stakeholders' needs.

Beyond Corporate Reporting

Assurance

So much greenwashing is going on that more and more stakeholders are calling for independent assurance on NFI. Since NFI reporting lacks global or regional harmonisation, it is not yet subject to the same level of assurance as financial information. As NFI reporting evolves, it is important to ensure that the information can be verified now or in the future. European accountants approach NFI assurance in different ways, because countries have different legal requirements. See our fact sheet *Towards reliable non-financial information across Europe* (February 2020) . Another reason for this diversity is the different levels of maturity in NFI reporting. In our report with the World Business Council for Sustainable Development (WBCSD) *Responding to assurance needs on non-financial information* (May 2018) we provided key steps towards NFI assurance based on analysing diverse expert feedback.

Corporate governance

Given the magnitude of the challenge, it is unlikely that transparency from NFI reports will produce the necessary paradigm shift. Markets have proved to be a great transformative force: we need to leverage their power to move towards a sustainable economy. Changing how the economy operates starts with how businesses are run; corporate governance is therefore instrumental.

Boards have the power to transform their businesses. Investors should give boards space to start this change and make sustainability the cornerstone of business decisions. Policymakers and regulators also can play a role in

shaping how business is done. The publication *10 ideas to make corporate governance a driver of a sustainable economy* (June 2019) looks into this in more detail. The aim is to achieve integrated thinking that will embed sustainability at the heart of decision-making at all levels.

The Role of Accountants

The accountancy profession supports the move towards a sustainable economy. With NFI reporting, accountants can support companies and governments in establishing robust indicators and processes for measuring and reporting their ESG performance. This includes improving internal control processes and evaluating their quality.

Accountants can help improve how a company communicates with its stakeholders, building on legislative requirements and best practices. To inform investors for their capital allocation decisions, reporting should disclose relevant financial and NFI.

Independent assurance is key to ensuring that information is trustworthy so that markets can function efficiently. It can enhance the quality and reliability of NFI that companies report. Accountants have the skills to audit information and processes independently. Accountants identify issues and report on the company's material weaknesses, which leads to improved processes.

Accountants are also well placed to take on new roles, such as Chief Value Officer (CVO) in place of a Chief Financial Officer. The role would entail a broader perspective on value creation and fully integrate ESG factors with financial performance. The CVO would help transform how the business is run and ensure that the business model shifts towards sustainability.

Good business decisions start with reliable information. The accountancy profession has leveraged its expertise in the field of NFI and now has long-standing experience in helping companies make the right changes to reduce their environmental footprint – and costs. As businesses change their benchmarks for success, accountants contribute by measuring impacts, disclosing information, and adding credibility to what is reported.

Accountants can be key partners in developing the public sector's ESG reporting. And not only for national governments; accountants can support the EU Institutions in shaping policies to encourage Member States in this area.

Act Now to Safeguard Tomorrow!

Accountancy Europe started the debate on the future of corporate reporting in 2015. Since then, we have led the thinking on corporate reporting. In addition to the initiatives highlighted above, we have noted the need for innovation and for leveraging technology; we called for the set-up of an EU Corporate Reporting Lab;

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and outlined that corporate information was of interest to a wider variety of stakeholders and not only shareholders. We hope that by taking the lead in Europe we can make a positive influence around the world.

We are striving to achieve better non-financial reporting and support integrated reporting. Shareholders and stakeholders are realising that non-financial reporting can shed extra light on financial reporting and that only the integration of the two makes sense. We are pleased to see that the EU's corporate reporting agenda is following the same lines.

Our economy brings increasing development and wealth but also causes natural resource depletion, pollution, overconsumption and social unrest to a level that is not sustainable anymore. The only way forward is changing how the economy operates today.