Expert Paper

Non-Financial reporting standards ("NFRS")

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Introduction

- The idea to develop binding reporting standards for non-financial information is gaining traction rapidly on EU level but also internationally. The European Commission has issued a request for technical advice mandating EFRAG to undertake preparatory work for possible EU Non-Financial Reporting Standards. In September, the five main framework and standard-setting institutions of international significance in the field of non-financial reporting – CDP, CDSB, GRI, IIRC and SASB – announced a shared vision for a comprehensive corporate reporting system and a commitment to collaborate to achieve it. In November, IIRC and SASB announced their intent to merge. Additionally, the IFRS Foundation suggests to establish of a new Sustainability Standards Board (SSB) beside the existing International Accounting Standards Board (IASB).

- ERT also observes a growing interest in sustainability or ESG reporting from a variety of stakeholders, including investors, customers, suppliers, (future) employees and NGOs. At the same time, a dynamic development at the level of the standard-setters is happening in order to establish global standards for non-financial reporting.

- Already today a large number of international initiatives, frameworks, standards, taxonomies and metrics for the reporting of non-financial information exist. There are already actors with a quite long experience for both perspectives of sustainability management and reporting, the so-called "outside-in perspective" (e.g. TCFD, SASB) and "inside-out perspective" (e.g. GRI). These have already produced reporting norms, principles or standards that have been increasingly applied over the last years. Some of these initiatives and frameworks overlap, but ultimately each standard- or framework-setter is seeking to produce specific products for its own stakeholders. Some organisations focus on non financial standard-setting, some focus on creating a framework for non-financial information, and some focus on frameworks for climate-related disclosures. None of these standards is comprehensive, all require differing level of details which makes it necessary to use several standards at the same time multiplying the costs for companies. Diverse approaches and objectives pose the threat of increasing fragmentation globally.

- **ERT members lack clarity about how they should report on sustainability in an aligned way.** Concerns are also emerging over increasing regional and domestic regulatory requirements and their impact on global competitiveness. The current **fragmented framework leads to inefficiencies and ineffectiveness** with regards to sustainability disclosures. Different standard-setters require different types of reporting with differing indicators and KPIs and differing level of details. This leads to **high additional reporting costs for the preparer.** The user is confronted with a potentially huge number of KPIs and information on the sustainability of the preparer. Ultimately it becomes more and more difficult for the user to assess and compare the sustainability of preparers.

- **However,** non-financial reporting cannot be viewed in isolation. Instead, corporate reporting must be seen in its entirety and should reflect the breadth of relevant topics covered.

Recommendations

1. The benefits of international standards

- **An international standard-setting organisation for sustainability reporting should be established,** that is based on a uniform, international framework. **An internationally recognised sustainability reporting standard** would allow businesses to build public trust through greater transparency of their sustainability initiatives, which will be helpful to investors and an even broader audience in a context in which society is demanding initiatives to combat climate change. Companies would only need to use a single trusted set of standards which **reduces (local and) international reporting costs and could lower their cost of capital.**

- As the societal developments and challenges press for fast solutions in this respect, **ERT is convinced that a standard setting body** with global recognition and long experience of high-quality standard setting, **is absolutely necessary.**

- **The ERT welcomes the IFRS Foundation's initiative to create a Sustainability Standards Board (SSB)** and to develop globally accepted standards for non-financial reporting. For financial reporting, the IFRS standards provide an internationally recognised set of accounting standards that bring transparency, accountability and efficiency to financial markets on a global level. Businesses only need to use a single trusted set of standards which lowers their cost of capital and reduces international reporting costs.

- It is ERT's conviction that the major challenge of a new sustainability reporting standard setter will not primarily be to create new standards but to consolidate, converge, and select certain already developed solutions out of the existing normative material. Up to now the different normative promulgations (frameworks, guidelines, rules, standards etc.) exist in parallel and they have been competing with each other. For the near future there is a strong need to bring these different solutions together and **forge one set of global standards,** and to further develop these consistent standards thereafter.

2. The disadvantages of a European set of standards

- ERT strongly believes that the **EU should not go regional and create its own non-financial reporting standard.** A specific European standard would create the **risk of an unlevel playing field** where European companies are subjected to higher cost and transparency requirements than their non-European competitors and possibly double work in countries where differing standards exist. In addition, European standard setting might even turn out to be slower than achieving global consistency based on already existing and converging initiatives.

- The EU should support the establishment of a sustainability standards board and the process at IFRS level to harmonize standards for sustainability reporting as preparers would benefit from global consistency. Strong support from public authorities all around the globe would be one of the success factors for any initiative to set up globally accepted standards at international level. The Commission should engage with other major economies to align and to drive forward the current momentum. The **EU should also stimulate an exchange between the IFRS Foundation and international standards setters** (like GRI, SASB, TCFD, CSDB and IIRC) and play an **active role in the standard-setting at international level.** It would be very important, and absolutely necessary for the success of a global initiative to include the above mentioned other major standard setters in this field to benefit from their experience, to reduce the time of developing the standards and to bundle the efforts.

- To be truly successful, any global initiative needs to cover all relevant sustainability reporting topics instead of focusing on a small set of indicators. It should also take into account the double materiality perspective which allows preparers to report both the external effects on the reporting entity and the impacts produced by the organization on the outside environment.

- **ERT does not believe it necessary to question the current IFRS** and do not support attempts to create non-financial reporting standards that would supersede the current endorsed IFRS. There is indeed no convincing evidence that the IFRS have a negative impact on sustainability.

- It is also worthy to highlight that such a set of global standards should embrace the double materiality perspective introduced by the European Commission which allows preparers to report both the external effects on the reporting entity and the impacts produced by the organization on the outside environment, adopting therefore a multi-stakeholder approach. It is also important that such global effort takes into consideration the wide range of sustainability reporting topics, without focusing on some of them only.

3. How to set up international standards: main principles

- ERT would like to highlight that **preparers** and users **need to be involved in the development process of internationally accepted sustainable reporting standards** from the beginning to ensure that the sustainability reporting standards are implementable for the preparers and at the same time meaningful for users. Any development of a standard should be supported by a pilot phase where companies of different size and sector check and validate the applicability. **ERT members would be willing to actively support this process by offering the "road testing" of potential draft standards.**

- Reported information must be objectively free from error and based on a specific standard. To achieve globally consistent sustainability reporting practices and to further improve quality, reliability and in the end comparability of non-financial data, sustainability information reported by companies will ultimately need to be subject to external assurance. ERT supports consideration being given to assurance requirements ensuring that assurance requirements are proportionate and fit-for-purpose based on the underlying reporting framework.

- **ERT supports the connectivity principle,** as a key principle of the agenda of the Commission. There are clear opportunities but also potential trade-offs between economic, environmental and social objectives. Financial and non-financial reporting have to be more closely interwoven as all of these areas are strongly interlinked and mutually reinforcing.

- We support the EU initiative to drive the global development of such harmonised methods. We also appreciate the broader thinking that sustainability must be further embedded into the corporate governance framework and not only focused on ecological aspects. Integrating the measurement of ESG impacts into the governance structure of companies as "Integrated Thinking" is a key task at company level to ensure sustainability in all aspects.

The European Round Table for Industry (ERT) is a forum that brings together around 60 Chief Executives and Chairmen of major multinational companies of European parentage, covering a wide range of industrial and technological sectors. ERT strives for a strong, open and competitive Europe as a driver for inclusive growth and sustainable prosperity. Companies of ERT Members are situated throughout Europe, with combined revenues exceeding €2 trillion, providing around 5 million direct jobs worldwide - of which half are in Europe - and sustaining millions of indirect jobs. They invest more than €60 billion annually in R&D, largely in Europe.

This paper was developed in the Working Group on Finance & Tax of the European Round Table for Industry.

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