

## **The International Auditing and Assurance Standards Board and its “Emerging External Reporting” - project - EER 2016-**

### **Observations about the EER-project formulated in the framework of the UN-SDG-2030 agenda.**

The purpose of this note is to contribute to the reflections and debate about the issue of “Emerging External Reporting” launched by the IAASB. The observations have been formulated in the framework of the UN-SDG-2030-agenda. The initiatives taken and to be taken about the major and urgent sustainability issues as defined in this UN-initiative would be enhanced by a timely and effective reflection and action about accounting and auditing by platforms like IAASB.

The EER-Discussion Paper identifies the following key issues about which the note intends to contribute:

“EER frameworks are aimed at a wide variety of investors and other stakeholders, as potential users of such reports often have different information needs and focus on different time horizons.

It is important to understand how such frameworks address:

- The type of decisions that different users make on the basis of EER reports.
- The relevance of non-financial information to user decision- making, and how this connects with the scope and qualitative characteristics of information that should be included in EER reports.
- The relevance of wider information that users have access to, in addition to EER reports, both from the entity itself and from other sources.
- The principles of communication that users wish to see applied, and the necessary play-offs between them.

.....key messages:

- User credibility and trust are enhanced by “Four Key Factors”: a sound reporting framework, strong governance, consistent wider information and external professional services reports”.

end of quote from the IAASB-Discussion Paper.

#### **Main issues in the note:**

- Governance
- “Action in society” (including references to risk materiality)
- New public revenues
- Analytical work.

#### **Governance:**

“Governance and Regulation” is the big unresolved issue - how do the UN member states act to implement their respective commitments to the UN-SDG-2030 agenda -. Linking the agenda to “A Safe Operating Space for Humanity” defined in the analysis of the “Planetary Boundaries” - the major global environmental issues - is the starting point for developing a number of observations in relation to “emerging external reporting” -“EER”-.

Risk analysis and risk management in relation to the “Planetary Boundaries”- issue in the public interest is the subsequent problem area to consider. The assumption is that these risks are systemic and material, to society globally. Based on that logic governments will have to address the major environmental risks for society in order to bring about the transformation of the economy

that is needed to reach the UN-goals. The "Planetary Boundaries and a Safe Operating Space for Humanity"-analysis, updated in 2015 and signalling four of the 9 PB-issues to be in the danger zone - , provides a robust framework to address the risks and uncertainties inherent in the different interdependent issues with a view to risk mitigation in the public interest. The risks inherent in the 9 PB-issues and its concept of "a Safe Operating Space for Humanity" are all directly related to human activity, i.e. to the currently unsustainable production- and consumption levels in predominantly the traditionally called industrialised countries. These risks could and should be seen as material to society.

The lack of effective and timely identification, assessment and management by governments of these risks to society globally implies a regulatory uncertainty, expected to prevail for a number of years, at country level and internationally. This relative lack of (political) action is prevalent in a situation where the questions about "what, why and how" in relation to the 9 "Planetary Boundaries"-issues have been addressed sufficiently to warrant ambitious and far-reaching and farsighted policy and action by governments. "Adaptive policy and integrated assessments" would be an option to consider, with a forward looking perspective in function of the risk mitigation options and actions over time and a fundamental review of existing policies and measures, including financial instruments and issues. Environmentally harmful subsidies are a relevant example of the latter. "Energy efficiency" as part of the broader issue of resource efficiency may well be another problem area to consider: energy efficiency markets develop at different rates in different countries, with differences related to the interpretation and/or use of accounting rules and the pace at which financial services are developed in support of energy efficiency projects (e.g. the experience in the USA and in the EU, and the Investor Confidence Project, as launched by the Environmental Defense Fund in Europe - [edf.org](http://edf.org) ).

The statement about the relative lack of action appears to be obvious when looking at the risks to society, i.e. to its citizens and to society as a whole. The risks inherent in the PB-issues are related to complexity and uncertainty and (hence) require much more ambitious policy responses than has been the case so far. Not addressing the risks adequately may further open the door to "risk transfers" from markets to society, as is the case in a number of issues related to (re)insurance, e.g. (actual and potential) uninsurable risks of flooding in urban coastal areas. (A public sector-approach in relation to climate change risk (pricing) to be mentioned is the analysis of the "Social Cost of Carbon" as an ongoing regulatory project in the USA, providing a regular update of ranges of carbon prices corresponding to given discount rates).

The financial consequences of the type of "benign neglect" at the public level may become very burdensome for the taxpayer, especially if it establishes itself as a trend in society for other markets and market players in the economy. The relative neglect of risk assessment in the public interest may also imply a loss of perspective of the opportunities a systemic risk assessment and management in the public interest would provide. Pension systems and current and future entitlements are a relevant example to consider, mainly applicable to high income countries where these systems have been in place for at least a number of decades. With unchanged policies in the face of the challenges of the SDG-agenda the risk of not meeting the projected outcomes of future entitlements will increase over time in potentially unpredictable and detrimental ways.

An effective and timely transformation of the unsustainable production- and consumption patterns as well as the development of a financial system aligned to the SDGs in general and to the required transformation, should ensure an optimal level of risk mitigation v.a.v. the PB-issues.

#### **"Action in society".**

Methods to deal with the global sustainability agenda have been developed and applied by an increasing number of actors globally over the past few decades, across a broadening range of issues of relevance now to the UN-SDG-2030 agenda. Governments appear to be a step or two behind these processes as far as the relevant governance-issues are concerned.

(These) methods are evolving over time in a number of "spheres" - science, the private sector, finance more recently - concurrently and not necessarily in a "connected" way.

The agreement at the UN to put into place a new methodology for "economic and environmental accounting" for the national accounts of its member states - UNSEEA - could be seen as an option to promote consistency and coherence as far as the metrics of dealing with the sustainability agenda are concerned : assessment of indicators may well need special attention with a view to their robustness, quality and relevance to the agenda and its implementation. Currently indicator work is incomplete e.g. in the field of bio-physical indicators, a challenge complicated by the interdependencies among the 9 PB-issues. These indicators when agreed upon will serve to underpin their applications in decision making by public and private sector actors.

In the framework of risk assessment and risk management - a concept that is applicable to all levels of "governance and action" and that could be phrased as Risk Mitigation in the public interest and in the private interest within the framework of the public interest - risk pricing is a core issue to consider.

**Materiality of risk** is being addressed in several initiatives. The following examples are briefly represented here (source : [GreenBiz.com](http://GreenBiz.com)):

**- World Resources Institute :  
Sustainable Investing Initiative**

“Advancing sustainable investment practices in the mainstream investor marketplace through tailored data, research, and peer-to-peer learning.

In the face of increasing resource scarcity and other global sustainability challenges, the profitability of businesses over the long-term is directly impacted by material sustainability risks and opportunities. While there is growing interest in employing investment strategies that account for these factors – through favouring companies poised to thrive in a resource constrained world - the barriers are many. Not only are there no tested road maps for investors to follow, but key market participants have been slow to develop mainstream products and recommend them to clients. As a result, sustainable investment products with high quality returns are lacking, as are the data for evaluating sustainability risk and opportunity – particularly for certain sectors, regions, and asset classes”.

**- SustainAbility :**

SustainAbility 2016:

**“Sustainability Incorporated • Integrating Sustainability into Business**

Executive Summary Pathways to Integration

Curabitur a erat est. Nullam ut iaculis velit.

Many companies claim that sustainability is embedded in their DNA or sits at the heart of their business. The reality is that very few corporations have fully integrated or embedded sustainability into their business models. While corporate sustainability programs have made significant progress on initiatives like reducing carbon emissions, conserving water and improving labor conditions, few have broken out of the sustainability silo and been embedded into the company’s main strategy to form a fundamental part of business value creation.

The need for integrated sustainability is urgent: in order to address today’s pressing global issues such as resource scarcity, climate change and inequality, the private sector must integrate environmental and social considerations into every business decision. Embedding sustainability into business not only helps secure a sustainable future but it also benefits companies, enabling them to prepare for future risks, act on opportunities and create more value for the business and its

stakeholders. And yet, we acknowledge the challenge business faces in trying to do this as it operates within the larger global system of markets, policies and stock exchanges in which financial capital is ranked above all other forms of value. This larger system discourages attempts to integrate sustainability in ways that are material. We therefore see the need to integrate sustainability simultaneously into business and larger global systems”.

end of quotes.

#### **“New public revenues”.**

“Payments for eco-system services” - PES - deals with the internalisation of the negative externalities arising from impacts and emissions resulting from human activity, and leads to outcomes that can relate directly to accounting and can be audited subsequently. The prime example of a PES is "carbon pricing" in relation to climate change mitigation, and “PES” is increasingly applied to eco-systems related to the PB-issues, beyond the climate change issue only. Water is a well documented problem area, and is now also addressed by credit rating agencies and in decision making.

The revenues from “PES” and the associated benefits to society may accrue over different timeframes. Mitigation options in e.g. climate change are long term, implying the need to account for the outcomes of any given "action to mitigate" over the long term, with the outcome having relevance at the global level. Optimal mitigation has a link with (the) climate adaptation options. PES-options other than climate mitigation - e.g. water, biodiversity, land use, nitrogen- and phosphates cycles - are much more local with action having the potential to lead in many cases to positive outcomes in the medium term perspective, of 3 to 7 years.

Work on PES and on natural capital over the past decade illustrates these developments, and both the private sector and finance are increasingly applying the logic of these approaches and methodologies in business plans and operations, and may also include “science-based approaches” and data analytics.

An option to consider in terms of accounting and subsequently auditing is the integration of risk mitigation management - RMM- and the outcomes annually in the reporting of entities falling under the reach of EER: PES would ensure accounting for the outcomes in economic and financial terms, and the RMM to ensure accounting for the outcomes in terms of the relevant environmental outcomes (reduction/elimination of negative externalities) as a matter of public interest to be accounted for (“accountability for sustainability”).

#### **Analytical work:**

In support of the UN-SDG 2030 agenda and in relation to “EER”, ongoing work of UN-agencies could be referred to.

UNEP has been addressing e.g. the following issues, in addition to work on Climate change:

- UNEP Resource Panel and [IPBES.net](http://IPBES.net) (Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services), building on UN Millennium Ecosystems Assessment 2005
- Green Economy
- The UNEP Inquiry into the Financial System.

In finance analytical work of the IMF underlines the relevance of addressing issues such as local air pollution and health, and energy subsidies. In relation to climate risk pricing observations can be found about financial stability, environmental fiscal reform and the re-investment of revenues in the economy deriving from risk pricing. (A summary of the two IMF working papers are added for information at the end of this note).

In the context of and as a follow-up to the initiative “The Economics of Eco-system services and Biodiversity” the Natural Capital Coalition has issued a number of publications: “Natural capital at risk” (2013) and the "Natural capital protocol" (2016), covering e.g. damages to the related to economy as a consequence of negative environmental externalities related to climate change and

biodiversity, estimated to be in the range of 5000 to 6000 billion US dollars annually, and rising in case of insufficient action. The "mirror image" of these damages are opportunities to be seized by green economy-initiatives. The Natural Capital Coalition analysis addresses impacts and the "measurement and valuation routes relevant to the objective and scope" of a given entity.

Risks in relation to the PBs has been recognised by a number of central banks, as well as by the IMF (establishing a link between these risks and financial stability and environmental fiscal reform at the level its member states, in its analytical work)

Climate- and carbon risk start to be integrated in regulatory systems as is the case in France with new disclosure requirements for the private sector. Work by the 2 Degrees Investing Initiative on "carbon metrics" and "alignment of portfolios with climate goals" in co-operation with the financial industry and universities can be referred to in this respect.

"("Big") Data" and the rapid ongoing development of measuring environmental impacts and emissions by way of electronic sensors as a "dynamic area" by itself. Applications for the purposes chosen may be an issue of interest to address (data analytics methodology, effectiveness, quality...). Consultancy work on internalising the negative externalities provides insights and tools beyond climate risk: the "Water Risk Monetizer" developed and marketed by Trucost and Ecolab in 2013 is a relevant example. Standards & Poor's (intend to) acquire Trucost, a symptom - or symbol - of the "rapprochement" between finance and economy, as demonstrated as well by the co-operation between Morningstar and Sustainalytics.

Developments in work related to Supply chains, with ongoing work by e.g. the McKinsey Global Institute on the "Resource Productivity"-series: "Starting at the source: Sustainability in supply chains" provides insights of e.g. environmental impacts with the example of "environmental impact associated with the consumer sector is embedded in supply chains", covering scopes 1,2,3. The project "Sustainability Accounting Standards Board" and "Open source" mapping as developed by e.g. "Sourcemap.com" can be cited in the same vein. The impact of shipping and its visualisation by way of "data points" are demonstrated by [shipmap.org](http://shipmap.org), developed by Kiln Digital and the University College of London Energy Institute (source: [greenbiz.com](http://greenbiz.com) December 1, 2016).

"Environmental Justice": mapping of major environmental issues with the emphasis on the social issues, developed by [EJATLAS.org](http://EJATLAS.org), an outcome of the EU-sponsored research project "EJOLT".

Air pollution and health is a theme that comes back a number of times, an issue of great concern to a great number of people globally. The IMF working paper cited above covers one angle, initiatives at the city level is another - <http://www.bbc.com/news/science-environment-38170794> Cities diesel ban - , and matters of compliance with existing regulatory systems are about legal action, e.g. initiatives by [ClientEarth.org](http://ClientEarth.org) in a number of EU member states, is a third angle to think about. These separate and related processes may have the potential of generating synergy in dealing with this major problem area where concrete and substantive benefits to citizens and society are to be achieved.

The various examples referred to above have the potential to drive a trend towards a form of "self compliance for the sake of accountability for sustainability outcomes", where interaction of stakeholders, science and business plays an increasingly important role. A trend of this nature, coupled with the options of knowledge sharing and co-operation and co-creation among actors, may constitute a strong impetus to governments to act pro-actively in relation to the UN-SDG-2030 agenda, in interaction with stakeholders.

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Brussels, December 2016.

## **Annex:**

### **IMF working papers: summaries:**

“IMF Working Paper

Fiscal Affairs Department

IMF working paper.

This Working Paper should not be reported as representing the views of the IMF.

The views expressed in this Working Paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy. Working Papers describe research in progress by the author(s) and are published to elicit comments and to further debate.

### **How Much Carbon Pricing is in Countries’ Own Interests? The Critical Role of Co-Benefits**

Prepared by Ian Parry, Chandara Veung, and Dirk Heine

Authorized for distribution by Michael Keen September 2014

#### **Abstract**

This paper calculates, for the top twenty emitting countries, how much pricing of carbon dioxide (CO<sub>2</sub>) emissions is in their own national interests due to domestic co-benefits (leaving aside the global climate benefits). On average, nationally efficient prices are substantial, \$57.5 per ton of CO<sub>2</sub> (for year 2010), reflecting primarily health co-benefits from reduced air pollution at coal plants and, in some cases, reductions in automobile externalities (net of fuel taxes/subsidies). Pricing co-benefits reduces CO<sub>2</sub> emissions from the top twenty emitters by 13.5 percent (a 10.8 percent reduction in global emissions). However, co-benefits vary dramatically across countries (e.g., with population exposure to pollution) and differentiated pricing of CO<sub>2</sub> emissions therefore yields higher net benefits (by 23 percent) than uniform pricing. Importantly, the efficiency case for pricing carbon’s co-benefits hinges critically on (i) weak prospects for internalizing other externalities through other pricing instruments and (ii) productive use of carbon pricing revenues.

JEL Classification Numbers: H23, Q48, Q54, Q58

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The working paper observes e.g. the interaction of carbon taxes (or tax-like instruments) with the broader fiscal system: page 25: “.....Carbon taxes (or tax-like instruments) interact with the broader fiscal system in two important ways. First, large efficiency gains are generated when revenues are used to lower other distortionary taxes (or for other purposes producing comparable gains in economic efficiency)—this is termed the ‘revenue-recycling’ effect. Second, however, higher energy prices tend to compound the distortions from taxes in factor markets by reducing (via a contraction in overall economic activity) work effort and capital accumulation.”

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IMF Working Paper

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IMF Working Papers describe research in progress by the author(s) and are published to elicit comments and to encourage debate. The views expressed in IMF Working Papers are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

### **How Large Are Global Energy Subsidies?**

Prepared by David Coady, Ian Parry, Louis Sears, and Baoping Shang

May 2015

#### **Abstract**

This paper provides a comprehensive, updated picture of energy subsidies at the global and regional levels. It focuses on the broad notion of post-tax energy subsidies, which arise when consumer prices are below supply costs plus a tax to reflect environmental damage and an additional tax applied to all consumption goods to raise government revenues. Post-tax energy

subsidies are dramatically higher than previously estimated and are projected to remain high. These subsidies primarily reflect underpricing from a domestic (rather than global) perspective, so that unilateral price reform is in countries' own interests. The potential fiscal, environmental, and welfare impacts of energy subsidy reform are substantial. JEL Classification Numbers: Q31; Q35; Q38".

end of quote.

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