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# IFAC Response to the European Commission Review of the Non-Financial Reporting Directive

***As a Network Partner of the B20, IFAC calls on global bodies—including the G20—to encourage policy-makers, standard-setters, and regulators to take action to facilitate harmonization towards a globally acceptable framework for reporting ESG metrics and disclosures.***

***IFAC stands ready, as a global voice and convener of the accountancy profession, to facilitate coordination, assimilation, and convergence in sustainable reporting approaches.***

The European Commission Review of the Non-Financial Reporting Directive (NFRD) marks another valuable step in the dialogue and evolution towards ***relevant, reliable, and comparable corporate reporting*** of non-financial information.[1] This information will enhance confidence in companies and financial markets—a core tenet of IFAC's mission—explored in greater depth by our Point of View on Enhancing Corporate Reporting.[2] Non-financial reporting answers the call from investors and other providers of capital for better, broader information about company performance and prospects for value creation as well as helps identify opportunities to support sustainable—and less carbon-reliant—business models.[3]

## 1. Rationalization Towards a Global System

The current reporting ecosystem for addressing these issues consists of multiple and competing reporting workstreams—and does not best serve the interests of capital markets, companies or their stakeholders. We agree with the European Commission's desire to see the reporting of this information improved—both between companies as well as between year-to-year reports by the same company. IFAC supports the ***alignment, harmonization, and convergence among existing frameworks and standards*** that results in a global, not regional, approach to non-financial reporting. A fragmented approach will lead to inefficiency, regulatory arbitrage, and increased costs for both companies and their investors and stakeholders.

We applaud the European Commission for its initiative to progress this critical issue. We recognize that this initiative can make an important contribution to the creation of a harmonized global system and ***we urge the Commission to adopt this mindset by engaging input from a broad range of international stakeholders*** in determining the best way forward. Any steps

[1] "Non-financial" refers to measures related to value creation, sustainability or environmental, social, and governance factors—all "non-financial" reporting or "non-financial" information.
[2] IFAC Point of View on Enhancing Corporate Reporting
[3] How to Invest: Ten Big Trends of the 2020s – Ruchir Sharma, Head of Emerging Markets & Chief Global Strategist, Morgan Stanley Investment Management. Trend #10 predicts the rise of "moral capitalism" in the 2020s through the emergence of "…firms that promise to invest in socially and environmentally responsible ways; assets managed by these firms in developed markets doubled between 2012 and 2018 to $30 billion. With support from millennial investors, they are becoming symbols of a new moral capitalism."

taken by the European Union should anticipate and must "fit within" a global system. We urge leaders in the accountancy profession to provide leadership and for active, collaborative engagement by various standard setters and frameworks with expertise in non-financial reporting.

## 2. Taking a Modular Approach

We support efforts to ***draw upon existing frameworks and high-quality metrics/disclosures already developed—principally by organizations*** like the Global Reporting Initiative, the Sustainable Accounting Standards Board, the International Integrated Reporting Council, the International Accounting Standards Board,[4] as well as others within and outside the Corporate Reporting Dialogue (CRD) who have demonstrated expertise. We urge the European Commission to leverage the experience and resources of these organizations and to do its part in contributing towards a global solution. In particular, we support reporting requirements that address *both* societal and company performance impacts and anticipate the need for jurisdiction-specific metrics and disclosures—especially with respect to reporting on social impacts.[5]

Finally, due process—conducted by an independent, expert, public interest, standard-setting body is essential. There is no substitute for thorough, transparent and participatory standard-setting involving all relevant stakeholders. This process engenders confidence in, and widescale adoption of, reporting standards—be they for reporting financial (under IFRS Standards or US GAAP) or non-financial information.

## 3. Role for Frameworks & Standards

The International Integrated Reporting Framework (IR Framework) provides best practices for a comprehensive approach to corporate reporting that adds context and meaning to *how* reported metrics and disclosures inform stakeholders about a company's ability to create value—be it shorter term performance or longer term implications of societal impacts. Integrated reporting also specifically addresses intangibles, intellectual assets and other elements of value creation that may not be captured by metrics focused solely on ESG factors.

However, a framework alone does not achieve relevant, reliable and comparable corporate reporting. High-quality standards, or best practices, that specify *what* metrics and disclosures are to be reported is required.[6] We agree that starting with a strong international framework provides flexibility for jurisdiction preferences—be they industry-specific requirements or a social/environmental focus geared to meet public interest or legislative objectives. The "layering"

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[4] Though the Board's ongoing project to revise the IFRS Practice Statement 1 *Management Commentary* (Practice Statement).

[5] For example, guidance with respect to climate-related information under the European Commission's Non-Financial Reporting Directive (p. 7) illustrates that investors and other stakeholders may have an interest in both the impact of climate change on a reporting entity's performance (i.e., "financial materiality") as well as that reporting entity's impact on climate. Meanwhile, other jurisdictions may have greater focus on corporate reporting that is, first and foremost, financial performance motivated and may also be more industry specific. The European Commission's review of the NFRD illustrates the importance of jurisdiction-specific requirements and resulting risk of regulatory fragmentation.

[6] In IFAC's response to Accountancy Europe's Consultation on Interconnected Standard Setting for Corporate Reporting, we acknowledge the important role that the IR Framework can play in harmonizing key concepts and principles from the various voluntary standards and frameworks for reporting non-financial information and we encourage the International Integrated Reporting Council to use its 2020 strategic review as an opportunity to determine how best to make the IR Framework a central component of non-financial reporting under a globally-supported system of standards (or best practices).

of additional jurisdiction-specific reporting requirements should also conform with metrics and disclosures that are part of a globally accepted system of best practices or standards so that comparability is achieved.[7]

## 4. Role of Assurance

As we emphasize in our response, assurance is critical to confidence in corporate reporting and in delivering relevant, reliable, and comparable information. However, assurance is most effective when applied against metrics and narrative disclosures that are supported by clear best practices or reporting standards.[8] The International Auditing and Assurance Standards Board's Extended External Reporting effort seeks to advance assurance with respect to non-financial information, which will serve to improve user confidence in what is reported, assist companies in developing systems and processes, and promote comparability.[9]

## 5. Engagement of the Accountancy Profession

The accountancy profession is critical to evidence-based decision making, reliable information gathering, and consistent, comparable corporate reporting—be it ESG focused or otherwise. Active engagement by the profession will maximize the benefits of a global solution to non-financial reporting that best serves shareholders and the broader public interest. We urge the Commission to continue to proactively engage with the accountancy profession in moving forward with revising the NFRD. The profession is committed to meeting the challenge of relevant, reliable, and comparable ESG metrics and disclosures.

[7] Institute of International Finance, June 2020, *Building a Global ESG disclosure Framework: A Path Forward*. "On top of a strong foundation in the form of an international framework, there is scope to accommodate regional or jurisdictional perspectives as additional building blocks through the regulatory or legislative process for implementation."
CFA Institute letter to Accountancy Europe (10 June 2020): "…layering on disclosures meant to meet the needs of other stakeholders with other objectives—and considering their location—will provide the needed differentiation and discipline necessary to garner support from all stakeholders…"
[8] IFAC Point of View on Enhancing Corporate Reporting - Role of the Accountancy Profession in Enhancing Corporate Reporting
[9] Public Consultation on Proposed Guidance: Extended External Reporting (EER) Assurance (March 2020)