



INVITATION TO CONTRIBUTE TO THE AD PERSONAM MANDATE OF EFRAG BOARD PRESIDENT JEAN PAUL GAUZÈS ON NON-FINANCIAL REPORTING STANDARD SETTING

Issued 30 October 2020

ICAEW welcomes the opportunity to comment on the 'Ad personam mandate on Non-financial Reporting Standard Setting' questionnaire published by EFRAG on 1 October 2020 a copy of which is available from this [link](#).

KEY POINTS

- Non-financial reporting is still an emerging area; there are advantages and disadvantages to basing a new standard-setting model on what is in place for financial reporting. Other approaches to the setting of standards in different economic areas could also provide models.
- Managing the competing demands of a diverse and broad body of constituents / stakeholders will be a significant operational challenge. This calls for a rigorous and transparent due process that ensures the right balance between technical coherence, consensus building and agility. Decision-making needs to be protected from undue commercial, political, regulatory or economic influence.
- Consideration should be given to structures and ways of working that can enable close and successful collaboration with both existing international frameworks and initiatives and – potentially – with a future Sustainability Standards Board under the aegis of the IFRS Foundation.

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MAJOR POINTS

1. In our position paper '*Non-financial reporting: ensuring a sustainable global recovery*', published in June 2020 alongside our representation to the European Commission's consultation on the revision of the Non-Financial Reporting Directive, we set out our belief that the EU can act as a global leader to catalyse international alignment and the establishment of a new corporate reporting framework. We acknowledged that this could lead to a more direct role for EFRAG in assuming some standard-setting functions, particularly where there is a pressing need for standards that address specific EU policy objectives and regulatory needs.
2. Since the publication of our paper, the European Commission has mandated EFRAG to undertake preparatory work for the elaboration of possible EU non-financial reporting standards and, in the *ad personam* mandate, to provide reflections on changes to EFRAG's due process, governance and funding that might be required in case EFRAG were to be entrusted with a standard-setting role. We welcome the opportunity to provide some additional thoughts on the latter mandate.
3. We also note that earlier this month the Trustees of the IFRS Foundation launched a consultation on the potential development of a Sustainability Standards Board (SSB) to sit alongside the International Accounting Standards Board (IASB). We continue to strongly encourage all efforts to move towards the establishment of a single principles-based and international recognised global framework providing comparability and consistency for non-financial reporting. In the longer-term, such endeavours should lead to a global corporate reporting structure, encompassing both financial and non-financial reporting. Achieving these goals calls for an open-minded approach to the potential collaborative development of standards between different bodies and institutions.
4. Unlike financial reporting, non-financial reporting is still an emerging area, with a limited but growing corpus of standards. There are, therefore, advantages and disadvantages to basing a new standard-setting model for non-financial reporting on what is in place for financial reporting. We encourage EFRAG to take the opportunity to explore other approaches to the setting of standards in different economic areas as these may involve useful models which could be adapted and replicated. In our June 2020 paper, we particularly reference some of the approaches of the European Committee for Standardisation (CEN).
5. Should the decision be taken to charge EFRAG with a standard-setting role, it will be vital to get off to a good start, to build credibility and momentum for longer-term success. In our view, this requires that the first standards will be of practical help in responding to business and stakeholder needs; it calls for a focus on areas where there is broadest consensus. Equally, the credibility of standards rests on the integrity, rigour, and independence of the standard-setting process.
6. We encourage EFRAG to consider articulating an overarching vision for the organisation that distinguishes between the potential three pillars of IFRS endorsement, the work of the Lab and the setting of non-financial reporting standards. This could build on framework objectives for financial and non-financial reporting articulated in legislation.

ANSWERS TO SPECIFIC QUESTIONS

PART 1 – Governance – structure and due process

Question 1.1. How can it be best ensured that standards are developed based on an inclusive and transparent due process? What should be the characteristics of such a due process?

7. We believe it essential for the long-term credibility and independence of the standard-setting process that measures are put in place to ensure that high quality and proportionate

standards are developed in the public interest, underpinned by robust reasoning, careful research and broad consultation.

8. There is a tension between the need to develop standards quickly to meet growing demands and the need to build consensus, which takes time. This calls for a rigorous and transparent due process that ensures the right balance between technical coherence, consensus building and agility. The standard-setting process needs to allow space for reflection, adaptation and improvement. The application of modern design-thinking could help by encouraging a more iterative approach to standard-setting, based on learning through testing and the close involvement of users and stakeholders at key stages of the development process.
9. We note that there has been a lot of focus on how to strengthen standard-setting processes in related areas, leading to recommendations that may have relevance for EFRAG. We refer, for instance, to the proposals by the Monitoring Group in relation to international audit and ethics standard-setting. A number of the Group's recommendations on how to enhance the existing regime may have relevance to EFRAG, including around size of the board, board operating procedures, role of technical staff, remuneration, voting quorum for the approval of standards, and nomination process.
10. As stakeholders, we believe it important to ensure accountability around the process. This can be further achieved by good practices, such as:
 - Measures to ensure that well developed proposals are brought to the eventual decision-making body and that this body engages less in detailed drafting
 - Policies to minimise unnecessary complexity and avoid overlap
 - Tools facilitating the high-quality and systematic evaluation of major proposals, bolstered by the explicit reference to the impact and practicality of acceptable solutions
 - Effective techniques to facilitate the development of standards on a holistic basis while preventing the proliferation of excessive detail
 - Processes to ensure appropriate stakeholder input and to enable proper evidence-gathering at the right time, with the right degree of oversight
 - Provisions to ensure standards are reviewed and reconsidered, including appropriate measures to manage potential refinements and re-exposures as well as the carrying out of effects studies and post-implementation evaluations.
11. Size of committees also matters. Our experience of other standard-setters suggests that it is hard to avoid the impression that lengthy and complex standards can also result, at least in part, from the development by committees that are too large and unwieldy. Thought should be given to alternative ways to ensure inclusivity without granting everyone a seat at the committee table.
12. EFRAG might also reflect on potential ways to ensure that legitimate public interest concerns – from all potential stakeholders – can be raised and addressed. The expansion of non-financial reporting will generate an increasing level of lobbying. Measures to encourage stakeholders to be transparent about their interests might facilitate the filtering of representations, with a view to ensuring that significant public interest objections are identified and, wherever possible, resolved. Such steps could also facilitate eventual adoption processes (as covered below).

Question 1.2. How can relevant European institutions and agencies be involved in the development of future standards and in the standard-setter? Should there be a particular role for ESMA?

Question 1.3. How can relevant national public authorities be included in the governance of the non-financial reporting pillar? Which authorities would be the most relevant and how should they be included?

Question 1.4. Should private sector and civil society representatives be involved in the standard-setting work? If so, what would be suitable options for doing so in a balanced way? Which stakeholders should be involved? Should the standard-setting pillar be a public-private partnership like in the financial reporting pillar?

13. Our response refers to questions 1.2, 1.3 and 1.4.
14. Experience tells us that managing the competing demands of a very diverse and broad body of constituents / stakeholders is likely to be one of the biggest operational challenges facing EFRAG. We believe it critical to retain focus on the result that is sought: ensuring high quality non-financial reporting that meets the information needs of key stakeholders. EFRAG will need to ensure that a system is in place that can call upon the best European and international expertise, accommodates different points of view in trying to get to the 'right answer', and protects decision-making from undue commercial, political, regulatory or economic influence. Given the multiplicity of stakeholders, this will require a multilateral approach which ensures the right balance of interests without intentionally or unintentionally giving greater voice to any one group.
15. It is our long-held view that standards should be issued only by a properly constituted and independent standard-setter.¹ A clear division between the responsibilities of standard-setters and regulators remains of high importance to preserve independent standard-setters from undue influence. It is also important that regulators and other public bodies can provide input in the public interest; they may of course have legitimate requirements for certain information and these need to be addressed. Nonetheless, we do not believe regulators should sit and vote directly on standard-setting bodies. Blurring boundaries between political and technical dimensions can result in unnecessary disagreements over issues such as due process, if not lead to opaque or muddled standards. We also caution that issues relating to the length and complexity of standards can be the result of regulatory pressure.
16. We believe that the input of regulators and public bodies is best managed through the 'surrounding' governance structure. A European variant of a three-tier governance structure, such as that of the IFRS Foundation, might provide an appropriate form to ensure the involvement of different stakeholders, ensuring the independence of the actual standard-setting body but enabling oversight by a broader group of 'trustees' and appropriate accountability to relevant public European authorities. This would need further thought, but such a structure could include mechanisms for those public authorities to communicate public interest concerns, with an expectation that such concerns would be addressed by the independent standard-setting body. Consideration should also be given to a formal mechanism for input from national standard-setters.
17. Equally, national public authorities will need to continue to play a central role alongside EFRAG in contributing to shaping the debate by sharing experience and supporting EFRAG in other ways, including helping to undertake coordinated research, field testing and outreach activities. This is vital to help ensure the overall quality of potential European non-financial reporting standards and aid consistency of application.
18. A light-touch adoption mechanism may also be appropriate to establish the legitimacy of non-financial reporting standards. This would also be an important way to ensure democratic accountability via the involvement of national authorities and the European Parliament. The non-adoption of a standard should be rare if there are sufficient structures in place to address concerns throughout the standard-setting process, as suggested above. In any case, we consider that this process should be simpler than that in place for the endorsement of IFRS requirements, with due emphasis on accountability, fewer separate stages, and clearly defined timetables.
19. Robust enforcement is an essential corollary of good reporting; a strong enforcement regime will eventually need to be in place to realise the full benefits of non-financial reporting standards. We believe that independent standard-setters should not enforce the standards

¹ By way of example, we refer to the recent [resolution](#) issued by the American Accounting Association outlining specific examples where the financial reporting standard-setting process has been circumvented by Congress.

that they develop. Ensuring proper application and consistent enforcement – without straying into the area of general interpretation – should fall to European and national regulators.

Question 1.5. If there were to be SME standards derived from future EU non-financial reporting standards, how should the SME angle be addressed in the governance and in the standard-setting process?

20. We consider it critical that the SME perspective is taken into account from the outset. As the backbone of the European economy, SMEs are both directly and indirectly impacted by the growing demand for non-financial information. The views of SMEs must be appropriately represented in the process. This is vital for the development of proportionate and balanced standards from the start rather than as a later after thought.
21. Our own experience tells us that it can be difficult to ensure SME representation and there may be different ways of ensuring their interests are heard by the standard-setting body. While there may be existing examples, for instance affiliates / advisory groups, which could provide inspiration, there is a danger of spending a disproportionate amount of time on suggestions on how to incentivise SME involvement which are likely to run into the same problems as before. We see the need for a significantly different approach which builds non-financial reporting standards from 'SME' foundations.
22. As noted in our introductory remarks, we believe that it is vital that the development of any first standards is based on areas where there is wide consensus, and which can respond to practical information needs. This calls for a 'think small first' attitude, enabling the development of standards which can deliver the greatest advance in non-financial reporting with the most limited economic impact on businesses. Such standards could subsequently be scaled-up. This would be a different approach to scaling-down standards for SMEs or the development of a simplified standard for SMEs, which we do not necessarily believe would limit the burden on SMEs arising from information demands arising in their supply chain or from financial institutions.
23. We stress that this does not mean that we are advocating that all SMEs should fall under the scope of a revised NFRD. Rather, it would enable the development of standards that have in-built practicability where SMEs are concerned and can therefore be voluntarily embraced by SMEs – as well as by those entities falling directly under the scope of the NFRD.

Question 1.6. Which governance structure would you foresee for the EFRAG EU non-financial reporting standard-setting pillar? How would this fit in with the overall EFRAG governance structure? What relation would there be with the financial reporting pillar, if any?

24. We believe it is important that an eventual EFRAG non-financial reporting standard-setting pillar is purpose-driven rather than governance-driven. As outlined above, we consider that a (simplified) three-tier governance structure could be appropriate. Given the wider range of stakeholder interests, this would likely need to differ from the current EFRAG governance structure as it relates to either the IFRS endorsement pillar or the Lab pillar. Equally, a three-tier model, for instance along the lines of the IFRS Foundation and reflecting some of the recent recommendations from the audit Monitoring Group, would differ from the governance structures in place in EU authorities, such as ESMA.

PART 2 – Governance – cooperation with standard-setters and other initiatives

Question 2.1. Any future possible EU non-financial reporting standards must be built on existing reporting standards and frameworks to the greatest possible extent:

- ***How can the relevant existing standard-setting organisations be closely associated in the future standardisation work? How would you see cooperation and involvement?***

- ***More broadly, how should cooperation with existing public and / or private initiatives producing international standards and frameworks be established, to ensure that any future non-financial reporting standards applying in the EU build to the greatest extent possible on existing standards and frameworks?***
25. As noted previously, we believe it important that while steps are potentially taken to enable EFRAG to move ahead with development of non-financial reporting standards, the EU should continue act as a global leader in helping to further catalyse international alignment and the establishment of a new corporate reporting framework. This calls for the potential development of European standards to be framed in an innovative, outward looking, and collaborative way, building wherever possible and appropriate on existing standards and frameworks.
 26. We re-iterate the call made in our June 2020 paper *Non-financial reporting: ensuring a sustainable global recovery*, for a way of working that enables the collaborative development of standards with both existing international frameworks and initiatives and – potentially – with a future SSB under the aegis of the IFRS Foundation.
 27. We strongly encourage the establishment of structures and modes of working that can enable close and successful collaboration with other bodies without leading to organisational paralysis. While there are existing partnership models that could be considered – for instance through affiliation status, companion or liaison bodies, cooperation agreements and / or participation in technical bodies – enhanced collaboration may require organisational experimentation as simply replicating what is done by other standard-setters may not be sufficient.
 28. As inspired by the 1991 Vienna Agreement referenced in our June 2020 paper, continued enhanced coordination between the key standard-setting organisations boards, especially a potential future SSB, could be framed by a mode of working which encourages -
 - transparency of work, with the possibility for the key bodies to be able to input into the content of standards under development – with cooperation ensured through respective internal rules of procedure
 - avoidance of duplication of work, enabling expertise to be focused and used in an efficient manner
 - a more rapid process of development and maintenance of standards, by seeking to establish early consensus
 - shared commitment to ensure the appropriate involvement by both bodies of all relevant interested parties and stakeholders.
 29. Specific steps to encourage enhanced technical cooperation could include:
 - regular exchange of information, including on draft proposals
 - mutual representation at technical working level
 - the possibility of the key bodies deciding jointly who leads on specific projects
 - clarity over likely future work programmes, including (from the European perspective) an overview of the standards which are deemed necessary and for which the EU may ‘request’ work by the standard-setting bodies (while still allowing for the possibility of making urgent ‘unplanned’ requests to address a specific need)
 - annual assessment of global alignment efforts, with reference to new, agreed standards, as well as an overview of the collaborative working arrangements in practice
 - provision for a mechanism to flag issues of concern.

Question 2.2. How to establish an appropriate coordination between financial and non-financial reporting so as to ensure that financial and non-financial reporting provide an integrated view of the performance, position, development and impacts of reporting companies?

30. Financial reporting remains critical. Financial and non-financial reporting need to be mutually reinforcing; the outcome has to be an integrated package. As we indicated in our response to the recent NFRD consultation, we believe that investors, preparers and reporters will need to be involved in the setting of non-financial reporting standards. This points to the long-term goal of a corporate reporting structure, encompassing both financial and non-financial reporting. In the interim, given EFRAG's different mandates, different governance structures will likely need to be in place for the non-financial reporting pillar, as also discussed above. We believe that EFRAG is in a good position to build on existing experience, gained from the financial reporting endorsement processes and, more recently, through the work of the Lab.

PART 3 – Possible changes to the financing of EFRAG

Question 3.1. What ideas do you have for the financing of the non-financial reporting pillar? Should the financing reflect the public-private partnership?

31. Stable funding, adequate resources and appropriately skilled and experienced staff are pre-requisites for an effectively functioning standard-setter. Given the centrality of non-financial reporting vis-à-vis key European climate targets and broader sustainable policy objectives, it is critical that the necessary funding is in place to ensure success.
32. In our view, this means avoiding a funding set-up which may lead to heightened tensions between different parties over regular incremental increases. Rather, we consider a different approach to financing to that in place for current EFRAG operations – and similarly applied by other standard-setters in related areas – is needed.
33. We suggest that consideration is given to a 'seed capital' approach to funding to ensure that the necessary resources are available from the start. This could be built by an initial fundraising round focused on external sources, particularly foundations, to be matched by EU funding. We note that the EU has growing experience of organising pledging events. If such an approach is pursued, it would be important to ensure that EFRAG's independence from potential funders. Having a fully articulated vision of EFRAG's mission, particularly with regard to the non-financial reporting standard-setting pillar, would be particularly important to ensuring clarity over the purpose and use of such funds. We emphasise the importance of making it clear that funding must cover EFRAG overheads and not be earmarked for specific standard-setting 'projects.'

PART 4 – Any other comments