



6 January 2021

Jean-Paul Gauzès
EFRAG Board President
European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels
Belgium

By email

Dear Mr Gauzès

SECOND CONSULTATION ON THE AD PERSONAM MANDATE

ICAEW welcomes the opportunity to provide further input on your *Ad personam* mandate in line with the consultation document on the potential need for changes to the governance and funding of EFRAG, issued on 30 November 2020, a copy of which is available from this [link](#).

Our comments build on both our response to the EFRAG October 2020 questionnaire (available [here](#)) and our June 2020 position paper '*Non-financial reporting: ensuring a sustainable global recovery*' (available [here](#)).

DUE PROCESS

It is our long-held belief that a rigorous and transparent due process must underpin standard-setting. Proper due process is critical for the long-term credibility and independence of the standard-setter. It is, however, not an end in itself but a means to an end, leading to the development of high quality and proportionate standards in the public interest. Improved non-financial reporting, in turn, is central to efforts to transition towards more sustainable and resilient societies and economies.

We note the governance principles and the due process for the non-financial pillar set out in the consultation paper. While we broadly concur with these, we encourage EFRAG to remain open-minded in assessing how due process steps may need to continue to evolve over time. This will be particularly important for non-financial reporting given the rapidly changing external environment, evolving societal expectations as well as the probable need to respond to new sustainability and other challenges as they arise. It may entail acceptance of a certain level of experimentation to enable non-financial reporting to keep pace with changing information needs.

A more iterative approach to standard-setting could help accommodate the evolution of non-financial reporting standards over time, ensuring that space for reflection, adaptation and improvement is built in from the start. It will be important to ensure that, in the mid- to long-term, there are ways of reviewing and reconsidering standards as well as measures to manage potential

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refinements and re-exposures. This will likely also require the carrying out of effects studies and post-implementation evaluations. Such an approach could also enhance accountability, by helping to ensure that standards meet immediate information needs while also delivering against broader EU policy commitments, including those emanating from the Paris Agreement and UN COPs.

We draw attention to the importance of retaining clarity over the ultimate objective, that of producing information which can help make real progress on sustainability, as this will help ensure the best due process configuration. For instance, being clear about the intended outcome of reporting on a particular area will help determine who is best placed to help define what information will usefully contribute to the desired goal. Identifying the intended audience for new standards, while seeking to understand how such audiences will likely use the information, could help ensure significant input is sought and received at an appropriately early stage from, say, public authorities with related responsibilities, or stakeholders not always involved in the more formal processes, such as representatives from the scientific community.

In addition to ensuring that there is sufficient flexibility to enable EFRAG to draw on input more widely during the development processes, there may be merit in further reflection on how to enhance international collaboration within due process steps. Ideally, this should include but not be limited to global non-financial reporting initiatives. Facilitating cooperation with other third country standard-setters and authorities could help identify and avoid unnecessary duplication and inconsistencies. We note that there may also be complementary routes to encourage such collaboration, such as the EU-backed International Platform on Sustainable Finance (IPSF).

We urge reflection on ways to address the impact and practicality of potential standards. This may call for the establishment of specific structures to bring together preparers, also covering the SME sector, to provide input. Initial work plans and agenda consultations should focus on areas where there is wide demand for standards to deal with practical information needs. We believe that due process steps, building on good regulatory practices, need to ensure the development of proportionate and balanced standards from the start. We note the importance of also embedding proper impact assessments as well as a 'think small first' approach in the standard-setting process. All this also calls for good practices to minimise unnecessary complexity and avoid overlap, while facilitating the evaluation of major proposals also by an explicit reference to the impact and practicality of acceptable solutions.

The suggested governance principles address the need to serve the European public interest. As raised in our response to the October 2020 consultation, we advocate specific consideration of how legitimate public interest concerns, from all stakeholders, can be raised and addressed during the standard-setting process. While the eventual governance set-up is likely to be the primary means of doing so, there may be additional mechanisms to help filter representations so as to identify and, wherever possible, resolve significant public interest concerns.

GOVERNANCE AND REPRESENTATION

We believe that significant benefits arise from having a properly constituted and independent standard-setter. A clear division between the responsibilities of standard-setters and those of regulators and other public bodies helps preserve the standard-setting process from undue influence. It ensures that standard-setters do not interpret their own rules. We recognise that regulators and other public bodies will want to provide input in the public interest and that they will have legitimate requirements for certain information. This should be addressed in a way that avoids blurring boundaries between political and technical dimensions.

The input of regulators and public bodies may be therefore best managed through the surrounding governance structure (EFRAG General Assembly, EFRAG Board, potential other consultative or advisory committees) rather than through direct participation on the two proposed Reporting

Boards and associated Technical Expert Groups. This would ensure the independence of the actual standard-setting body but enable proper oversight and appropriate accountability to relevant public European and national authorities and key stakeholders.

Different European stakeholders may need to be involved in different ways, which may be additional to the core structure suggested in the consultation document. For instance, EFRAG may be tasked with drafting standards which would then need to be given legal standing by the Commission, Parliament and Council. In doing so, these three institutions would likely have significant decision-making powers, outside of EFRAG governance structures. We refer here to our previous comments on the potential appropriateness of a light-touch adoption mechanism to establish the legitimacy of the standards and ensure democratic accountability. Equally, we also reiterate our belief that a strong enforcement regime will eventually need to be put in place. This should fall to European and national regulators, who should not, however, be enforcing standards that they themselves have developed.

As noted above non-financial reporting is rapidly evolving. As policy commitments strengthen and broaden, for instance as outcomes of future UN COP rounds, it is also conceivable that the representation of stakeholders in EFRAG governance structures – and indeed the structures themselves – may need to change in time.

SMALL AND MEDIUM SIZED ENTERPRISES

We agree that it is important to take into account the impact of non-financial reporting standards on SMEs. Wherever possible, standards will need to be useful and relevant for SMEs, responding to practical information needs and thereby facilitating take-up. We acknowledge that this may be difficult in particularly complex areas of measurement. Nonetheless, as indicated previously, we think it critical that the SME perspective is considered from the outset and that SME views are appropriately represented in the process. Workable and effective standards need to be built from an SME foundation and then scaled-up, facilitating voluntary take-up by SMEs as well as entities falling within the scope of a revised NFRD.

COOPERATION WITH OTHER STANDARD SETTERS AND INITIATIVES

We agree that any future European non-financial reporting standards should seek to build on existing standards and frameworks to the greatest extent possible. To do so, relevant bodies need to be closely associated with any standardisation work. The support, experience and expertise of existing initiatives and standard-setters will be key factors in ensuring early success. The longer-term goal of a global corporate reporting structure, encompassing both financial and non-financial reporting, will also be dependent on an open-minded approach to the development of standards by all bodies

This is rapidly evolving area, with significant developments occurring on a regular basis. In our recent **response** to the IFRS Foundation's consultation on a potential Sustainability Standards Board (SSB), we noted that the intended merger of the IIRC and SASB to form the Value Reporting Foundation could be a natural starting point for a potential SSB. Such developments make it even more important for EFRAG to help establish a way of working with existing initiatives and a potential future SSB that can enable a 'bridged' approach to standard setting. The opportunity to build on the current momentum and willingness to collaborative should be seized.

In our June 2020 paper, *Non-financial reporting: ensuring a sustainable global recovery*, we noted that some organisational experimentation may be needed to find the most appropriate kind of involvement, beyond what is already in place in the financial reporting space. Ensuring close, structured engagement with other standard setters and initiatives may require openness to

involving such bodies both in governance and working structures while facilitating collaboration through due process measures. The exact nature of such relationships may need to be set out in bilateral agreements. We refer here again to the 1991 'Vienna Agreement'¹ as well as EU Regulation 1025/2012 as being potentially useful sources of inspiration.

Our response to the October questionnaire set out some suggestions on modes of work based on transparency of work, avoidance of duplication and the search for early consensus. We also outlined some specific measures which could encourage more structured and ongoing technical cooperation.

THE EUROPEAN LAB

We consider that the European Lab should be retained in any new EFRAG structure. The Lab can play an important role in encouraging debate and stimulating innovation by identifying and sharing good practices. It may also be opportune to explore whether the remit of the Lab should be extended, for instance to establish a learning or testing space.

We think it important to ensure that the Lab can explore issues across the full spectrum of corporate reporting (as is the case at the moment), rather than limiting its mandate to non-financial reporting or, alternatively, only to financial reporting. This is particularly relevant given the need for financial and non-financial reporting to be mutually reinforcing, and in light of the long-term goal of a corporate reporting structure that encompasses both.

We note the suggestion that the eventual Non-Financial and Financial Reporting Boards would choose the topics to be addressed by the Lab. We consider it important that the Lab's future projects address areas where there are significant or emerging needs. This calls for an open approach to the identification of future projects that can also source ideas and input from a wide range of companies, investors and stakeholders. This could build on the Lab's 2019 exercise to identify and prioritise future project topics.

FUNDING

Stable funding, adequate resources and appropriately skilled and experienced staff are prerequisites for an effectively functioning standard-setter. We believe that a different approach to financing than that in place for current EFRAG operations is needed and that consequently a separate source of funding should be envisaged for the non-financial pillar. We note again that whatever funding arrangements are eventually put in place, these must not result in any real or perceived threat to the independence of a standard-setting function.

Given the centrality of non-financial reporting vis-à-vis key European policy objectives, we agree that a sizeable level of EU funding could be foreseen, preferably with allocations over a multi-annual basis to ensure a secure and stable footing. We consider it important to ensure any funding set-up does not lead to regular budgetary tensions between different parties, whether EU institutions, member states or private partners.

While we agree that a move towards financial levies could help ensure sustainable financing in the longer term, other approaches could also be explored. In our previous response, we suggested that consideration could be given to raising 'seed capital', for instance via the organisation of a pledging event to raise funds from philanthropic foundations and other stakeholders, to be then

¹ 1991 Agreement on Technical Co-operation between the International Organization for Standardization (ISO) and the European Committee for Standardization (CEN)

matched by EU financing. We believe this could be done in a way that ensures EFRAG's independence from potential funders.

Yours sincerely

A handwritten signature in black ink that reads "Robert Hodgkinson". The script is cursive and fluid, with the first letters of each word being capitalized and prominent.

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