Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Directorate-General for Financial Stability
Financial Services and Capital Markets Union
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Berlin, 27 May 2020

Dear Madam or Sir

RE: Non-financial reporting by large companies (updated rules)

On behalf of the Administrative Board of the Accounting Standards Committee of Germany (ASCG), which oversees the work of the German standard-setter and is the body responsible for strategically positioning the organisation, I am writing to summa-rise our key points on the consultation regarding *Non-financial reporting by large companies (updated rules)*, herein referred to as 'the consultation'. This letter accompanies and should be read in conjunction with our detailed responses that we provide in the questionnaire, as you have requested. We commend the Commission for having launched this extensive review and are generally supportive of reaching out and soliciting feedback of stakeholders with regard to possible revisions to the provisions of the Non-Financial Reporting Directive (NFRD).

We are aware of criticisms raised by financial and other stakeholders about the current practice of non-financial reporting. Their key concern is that much of the information provided is not specific enough to allow users a holistic understanding of the current situation and prospects of a company and to compare such information with those of other companies. Various studies on the implementation of non-financial reporting in Europe show that reports often lack focus in that they are limited to presenting general principles and overall approaches of the entity. Specific objectives and results achieved as well as specific information on risks and impacts are often not addressed. Whilst we can understand and share the Commission's objective for strengthening the non-financial reporting provisions, we believe that any changes should only be made having due regard to a number of considerations, some of which we would like to explain below.

Globally active entities need global standards

The Commission's consultation questionnaire addresses the notion of European non-financial reporting standards. Despite a large number of already existing international initiatives, frameworks, standards, taxonomies and metrics, the wording in the document seems to suggest that a specific European standard is needed, nonetheless. It is argued that these internationally recognised reporting standards do not take account of European specificities (whatever they may be). We reject that view. Whilst we accept that differing degrees of willingness to proceed with mandatory non-financial reporting exist around the globe, we do not share the view of those that believe that Europe is distinctly special, should be first, go regional and create its own non-financial reporting environment. The reporting requirements are primarily targeting companies that are sourcing, selling and doing business beyond Europe's borders; further, the areas to be reported on are not genuinely limited by Europe's territory, either – so what would be the perceived benefit of creating yet another non-financial framework to which only companies domiciled in Europe would be subjected? We rather see the real danger of creating an unlevel playing field where European companies are subjected to higher cost and transparency requirements than their non-European competitors.

Whilst we concur that there is no clear "winner" in the area of non-financial reporting standards at this stage, it is equally true that not all existing initiatives carry the same weight in terms authority and completeness. In fact, the majority of German companies reporting under the NFRD do not make use of more than a handful of international frameworks, and these are very well-established in the marketplace. And even if we take into account specific European legislation such as the Disclosure Regulation that has already been passed for financial intermediaries to require them to disclose specific non-financial information about companies they are invested in, we fail to see why international standards and metrics already existing would not be sufficient to cater for these requirements. If the Commission does not want to endorse one specific framework at this stage – which we can understand –, we would nonetheless strongly suggest to at least then drawing from those standards that are internationally recognised and sufficiently widespread in practice (e.g. GRI, TCFD, SASB) instead of developing a European non-financial reporting environment from scratch.

Connectivity between financial and non-financial reporting is important but should not be used as an argument to touch the IAS Regulation

We are increasingly worried that issues are often subsumed under the heading of 'non-financial reporting' that, on the surface, may be subsumed under sustainability, yet typically concern financial aspects. For example, the Commission has repeatedly questioned and investigated whether IFRSs have a negative impact on sustainability and long-term investment behaviour and whether, against this background, the Commission should therefore intervene. While we agree with the view that financial and non-financial reporting should have more regard to the principle of connectivity, this should not be used as an argument to invoke changes to the IAS Regulation. We have not been presented with any convincing evidence that IFRSs indeed have a negative impact on sustainability (but have seen a lot of unsubstantiated assertions). Financial reporting has a specific objective, namely to enable users to make informed decisions, and not to serve a particular political need. We therefore strongly disagree with those that believe that financial reporting should be tweaked in the name of sustainability to achieve a desired outcome. The greatest sustainable value financial reporting can bring to markets is through transparency and not by hiding information from users.

Towards an interconnected reporting framework

In our view, non-financial reporting should not be viewed in isolation; rather, corporate reporting must be seen in its entirety and should reflect the different information needs that exist. For this reason, we have argued in favour of establishing a standard-setting organization that is based on a uniform framework and takes appropriate account of the differences existing between the stakeholders. Ways and means to create a unified framework that appropriately combines standard setting for financial and non-financial corporate reporting, as well as organisational issues, were recently discussed by Accountancy Europe in their Cogito paper *Interconnected Standard Setting for Corporate Reporting*.

Among other things, this paper addresses the so-called multi-stakeholder approach. According to this approach, the standardisation of corporate reports should be geared to the information needs of all stakeholders. From the wording used in the consultation (in particular the use of the term 'different user groups') we deduce that the Commission also follows such an approach. Further, and as said above, we believe that connectivity between financial and non-financial reporting is an important cornerstone in pursuing holistic corporate reporting. This, however, requires a uniform agreed-upon framework as a basis, which we acknowledge, does not exist at this stage (but may find its foundation in some of the principles advanced by the IIRC).

Based on the current situation where there is only an internationally recognised standard-setter for financial reporting, intermediate steps need to be considered, as it would simply be unrealistic to strive for a multi-stakeholder framework in one go. We recommend to initially acknowledge the traditional focus on providers of capital when further developing corporate reporting as their views are at least directionally similar (in contrast to the range of views of other stakeholders, which may even conflict with each other) and therefore easier to align. By keeping that focus, we believe that the alignment of non-financial frameworks and their reconciliation with financial reporting principles might be easier to achieve.

Auditability of non-financial information

An important principle in financial reporting is the principle of reliability. Since reporting provides addressees with the basis for making informed decisions, the information must be objectively free from error and based on a specific norm/standard. It should also be confirmed by an independent expert in order to enhance the credibility of the information. Conceptually speaking, the same goes for non-financial reporting. However, there are at least two big differences when it comes to non-financial reporting: Firstly, the vast majority of non-financial information is narrative and consists of unstructured data. That means that the data is not robust enough to enable a third party to objectively assess whether the information is factually correct or not. Secondly, as of today, we are not aware that a uniform set of high-quality auditing standards exists that could cover the entirety of all non-financial reporting aspects and would provide a robust judgement framework against which the information reported by an entity can be assessed as being correct or not by an independent third party. There may be areas where a certain assurance level already exists or may be easier to achieve than for others, but to assume that the same degree of assurance as exists in financial reporting can be achieved easily and in the short term across all non-financial information provided is a false assumption.

We therefore urge the Commission to refrain from imposing a mandatory full scope audit of non-financial information too soon as this will likely create an expectation gap on the part of the stakeholders receiving the information. Rather, we suggest the Commission work with the relevant parties in that area to seek ways how the challenges mentioned above can be addressed best.

Should you wish to discuss any of the above-mentioned issues in more detail, please feel free to reach out to me any time.

Yours sincerely,

Prof Dr Ralf P Thomas

Chairman of the ASCG's Administrative Board