

Jean-Paul Gauzès  
Square de Meeûs 35  
B-1000 Brussels  
BELGIUM

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By email: [jean-paul.gauzes@efrag.org](mailto:jean-paul.gauzes@efrag.org)

Dear Mr Gauzès

**Re: Ad personam mandate on Non-Financial Reporting Standard Setting**

Ernst & Young Europe LLP (hereinafter EY) being owned by partners of the Ernst & Young Global Limited member firms operating in Europe welcomes the opportunity to offer its views on the possible changes to the governance and financing of EFRAG, in the event that EFRAG is entrusted with the development of possible EU non-financial reporting standards.

EY believes that, in the absence of a single globally accepted set of standards for non-financial reporting, the focus in the EU should be on developing a common European framework including a set of robust non-financial reporting (NFR) standards to meet the market and social demands in the short term. We also believe that EFRAG is well-positioned as an organisation to be entrusted with the development of possible EU non-financial reporting standards.

**Multi-stakeholder approach**

Given the diversity and complexity of the field, a broad consensus is needed among all of the important parties primarily involved in the implementation and use of the new standards, to achieve a good result. Therefore, we believe that the due process should follow an inclusive and multi-stakeholder approach, equally informing and consulting with:

- All competent EU bodies or authorities to ensure coherence and alignment with related initiatives on non-financial matters at both EU and international levels
- Key stakeholder groups directly involved in the non-financial information (NFI) value chain (e.g., investors, preparers, auditors/accountants), along with academics who could provide independent and challenging views
- Other groups (e.g., civil society representatives/NGOs, academics, trade unions, local authorities, etc.) competent with respect to the different categories of NFI - such as environment, social matters, human rights, ethics and corruption -for a broad alignment on the proposed standards

## **Roles to be fulfilled**

In our view, there are three important roles that would need to be fulfilled when setting standards:

- **Governance/oversight role (A)** - This role is responsible for the governance and oversight of the standard setting body (i.e., relationship with stakeholders, nominations, quality of the due process, funding), but is not involved in any technical matters relating to standards that it develops. The representatives who act in this role are accountable to the members of the organisation and public authorities who have empowered it.
- **Standard setting role (B)** - This role is carried out by a team of independent experts with an appropriate mix of recent practical experience in the reporting area for which they are responsible. The representatives who act in this role are responsible for the development and interpretation of standards.
- **Technical support role (C)** - This role can be carried out by a dedicated technical staff and/or by topic-specific working groups comprised of external technical experts. The technical team would take their instructions from the standard-setting role, prepare technical papers, do outreach and field studies, and draft proposals.

## **Separate governance/oversight role**

We believe that a strong and transparent governance/oversight role is crucial to ensure the credibility and acceptance of non-financial reporting standards by all stakeholders. Therefore, the governance/oversight role needs to be separate so that it can focus on the relationship with stakeholders, nomination of those in the standard setting roles, the quality of the due process, and the funding of different parts of the organisation.

## **Separate non-financial reporting standard setting team**

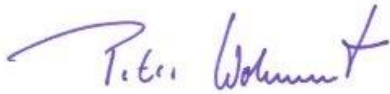
We note that EFRAG's role regarding financial reporting (i.e., providing endorsement advice on international standards) is fundamentally different from its prospective role regarding NFR standards (i.e., standard setting). Therefore, we believe it is necessary to keep the standard setting role for non-financial reporting separate. In addition, as both financial and non-financial reporting are broad ranging and complex in their own right, the volume of work could easily exceed the available agenda time of a single group, requiring trade-offs that may jeopardise the important role of EFRAG in both fields.

## **Periodic reassessment of governance arrangements**

Finally, as the EU non-financial reporting standard setting organisation will develop and mature while the international standard setting landscape around it changes, we would recommend the periodic reassessment of whether the organisational and governance arrangements need to be revisited. For example, depending on developments, there may be a need for an NFR interpretations committee or an 'interconnection committee' to ensure alignment between financial and non-financial reporting. In the long term, it is also important to ensure that the organisation is well positioned towards building a globally consistent framework for corporate reporting and set of standards for NFRI.

Should you wish to discuss the contents of this letter, please contact me or Leo Van Der Tas, EY's Global IFRS Leader ([leo.van.der.tas@nl.ey.com](mailto:leo.van.der.tas@nl.ey.com)) on +31 8840 75035.

Yours sincerely



Peter Wollmert  
EY EMEIA Assurance Leader  
[peter.wollmert@de.ey.com](mailto:peter.wollmert@de.ey.com)

## Appendix - Response to Questionnaire

### **1. Governance - Structure and due process**

*1.1 Standards need to be developed in the public interest and no individual category of stakeholder may exercise undue influence: 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?*

We believe that the due process should follow an inclusive and multi-stakeholder approach, equally informing and consulting with:

- all competent EU bodies or authorities to ensure coherence and alignment with related initiatives on non-financial matters at both EU and international levels;
- key stakeholder groups directly involved in the non-financial information (NFI) value chain (e.g. investors, preparers, auditors/accountants), along with academics who could provide independent and challenging views; and
- other groups (e.g. civil society representatives/NGOs, academics, trade unions, local authorities, etc.) competent with respect to the different categories of non-financial information - such as environment, social matters, human rights, ethics and corruption -for a broad alignment on the proposed standards.

Given the diversity and complexity of the field, a broad consensus among all important parties, primarily involved in the implementation and use of the new standards, is needed to achieve a good result. In addition, best practice for a standard setter would also include consultation about its work plan, effect analysis for each significant proposed standard, feedback statements on comments received and post-implementation reviews once practical experience has been gained with a standard.

*1.2 Relevant European institutions and agencies shall be invited to be fully involved in the development of future standards, including the European Securities and Markets Authority (ESMA): How can these 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?*

As noted in our response to question 1.1 above, all relevant European institutions and agencies should be consulted in the development of both the future standards and the standard setter to ensure coherence and alignment with related initiatives on non-financial matters at both EU and international level.

ESMA plays a valuable role in the consistent application and enforcement of EU IFRS. Consistency in the application of EU IFRS is fundamental to a proper functioning of the single European market, in particular, the Capital Markets Union. There is consistent evidence indicating that a single set of high-quality financial reporting standards is a prerequisite to high quality financial reporting. Given ESMA's role in the enforcement of financial reporting standards developed by the IASB, it seems crucial that non-financial reporting (NFR) standard setting benefits from ESMA's experience, but that this should be balanced against the domain expertise of other European institutions and agencies. In particular, it should be noted that non-financial reporting covers many areas of expertise that are within the remit of European institutions and agencies other than ESMA. Therefore, it would make sense if ESMA took an (observer) role that is similar to its role in the current EFRAG structure for financial reporting.

*1.3 To permit relevant national public authorities to provide input about whether any future standards are responsive to the public interest, how can these authorities be included in the governance of the non-financial reporting pillar? Which authorities would be the most relevant and how should they be involved?*

The interaction between national public authorities and EU-related bodies raises questions as to the stage at which the input is provided and whether the interaction is advisory in nature or it involves participation in the decision-making.

Assuming that NFR standard setting will be a public-private cooperation, there are several levels in the decision-making process. The NFR Directive defines the overall framework and determines both the scope of the topics covered and the entities affected by the standard-setting. Approval of the amendment of the NFR Directive would follow the normal decision-making process involving national public authorities.

The work that would be carried out by the NFR standard setter would be more detailed in nature as it would concern developing the detailed requirements regarding the various NFR topics. In our view, an NFR standard setter would consider the views of national public authorities as part of the outreach activities that are conducted by the technical support team. While the national public authorities would not be represented in the governance/oversight role or the standard setting role, it would be for the European Commission to consider whether it needs to set up a specific NFR advisory committee or whether Member State input is obtained as part of its legislative procedures. However, the exact form of this would presumably depend on whether or not there would be an endorsement process for NFR standards.

*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?*

The standard setting process itself should follow specific criteria to preserve quality: independence from external factors (e.g., political interference), impartiality, and due process. The body responsible for developing the EU NFR standards should have strong experience and knowledge of financial reporting to ensure connectivity and integration with NFI. However, it should be borne in mind that NFR standard setting requires a different and broader set of skills and expertise which are specific to the NFR field.

Given the need for domain-specific expertise, private sector and civil society representatives would be able to provide substantial contributions to the technical development of the standards. The inclusion of stakeholders mentioned in Question 1.1 could be achieved through their participation in the governance/oversight role. In addition, similar to the European Financial Reporting Lab, it would be possible for EFRAG to set up working groups that contribute to the technical development of standards on specific topics under an EFRAG permanent staff responsibility, while the decision-making power remains the standard setting role.

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

We believe the application of these NFR standards should be broad and include SMEs, where the size criteria could be derived from those set by the Accounting Directive (Directive 2013/34/EU).

Ultimately this is a political decision, but we would note the following:

- There needs to be a reasonable cost/benefit trade-off in determining the scope of the requirements
- Some small and medium-sized companies may have a sustainability impact that is disproportionate to their financial size
- Sustainability issues do not just affect corporate entities, but would also be relevant in the context of other organizations, such as local authorities, national health services and public transportation companies that have a large footprint in social, employment and environmental terms.

To the extent that SMEs would fall within the scope of NFR standards, it would be possible to require that outreach activities by the technical team would explicitly consider the impact on SMEs and that the standard setting role would specifically address the impact of NFR standards on SMEs in the basis for conclusions accompanying the standards.

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

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## Separate non-financial reporting standard setting team

We note that EFRAG's role regarding financial reporting (i.e. providing an endorsement advice on international standards) is fundamentally different from its prospective role regarding NFR standards (i.e., standard setting). Therefore, we believe it is necessary to keep the standard setting role for non-financial reporting separate. In addition, as both financial and non-financial reporting are broad ranging and complex in their own right, the volume of work could easily exceed the available agenda time of a single group, that could result in trade-offs that may jeopardise the important role of EFRAG in both fields.

## Periodic reassessment of governance arrangements

Finally, as the EU non-financial reporting standard setting organisation develops and matures while the international standard setting landscape around it changes, we would recommend periodical reassessment to determine if the organisational and governance arrangements need to be revisited. For example, depending on developments there may be a need for an NFR interpretations committee or an 'interconnection committee' to ensure alignment between financial and non-financial reporting. In the long term, it is also important to ensure that the organisation is well positioned to build a globally consistent framework for corporate reporting and set of standards for NFRI.

### **2. Governance - Cooperation with standard setters and other initiatives**

*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 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 framework 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?*
- ▶ *How can the EU non-financial reporting standard setting have a global impact?*

Whatever solution or regime is chosen for NFR, it is important to address urgent stakeholder needs while, at the same time, building towards a globally consistent framework for corporate reporting and set of standards for NFRI in the long term. This is particularly important where NFR is relevant for the proper functioning of capital markets as they are global.

We agree the work of the NFR should, as much as possible, build on and align with international standards in the NFR domain. Representatives of existing international standard setting bodies could be involved in technical working groups that develop the standards or, to the extent that they themselves represent stakeholder groups, be represented in the governance/oversight role.

EU non-financial reporting standard setting could have a global impact in several ways:

- By participating in the due process of international standard setting, it would be possible to influence the development of standards
- By implementing NFR standards in Europe and leading the world by example

- Inclusion of international standards expertise in the EU standard setting process as described above should also influence global standardisation.

**2.2 How to establish an appropriate coordination between the 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?**

We believe that the interconnection between financial and non-financial reporting is an important consideration, but that priority should be given to bringing the NFR standardisation to an appropriate level of development first.

In structuring the interconnection between financial and non-financial reporting, it should be borne in mind that non-financial information is defined and calculated very differently from financial information. For Example, NFI performance is often expressed in physical units as tCO<sub>2</sub>e per units of production like KW/h, t of clinker, p.km, etc. rather than in monetary units. The NFR team should have the appropriate knowledge, skills and expertise available in all of the domains within NFR such as environmental and social impact, to set standards that lead to high quality non-financial information. Assuming there will be a demand for providing assurance on this non-financial information, it is also important that the NFR team safeguards the verifiability of the disclosures required in the standards. In order to avoid inconsistencies arising, there could either be an 'interconnection committee' consisting of selected members from both sides or, alternatively, this could be facilitated by the governance/oversight role. This is particularly relevant if (part of) the non-financial information is included in the financial statements or in the annual report together with financial information, rather than in a separate report. Finally, interconnection can be established by involving experts with accounting standard setting experience in the NFR standard setting process and vice versa.

**3. Possible changes to finance of EFRAG**

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

In our view, the bodies that are represented at the governance/oversight level in the EFRAG structure should provide funding and that funding should reflect the public private partnership nature. In addition, some of the financing would be funding in-kind by stakeholders who make experts available and participate in outreach work and field tests. Finally, to ensure that non-financial reporting stakeholders with limited resources are able to participate in the work of EFRAG, we believe that funding from the European Commission would be essential to the success of the NFR work.

**4. Do you have any other comments you want to share?**

No.