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Policy Paper

Response to the UE public consultation : "Fitness check on the EU framework for public reporting by companies"

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Response to the EU Public consultation: Fitness check on the EU framework for public reporting by companies

July 2018

Question 1. *Do you think that the EU public reporting requirements for companies, taken as a whole, have been effective in achieving the intended objectives?*

- Ensuring stakeholder protection - totally disagree
- Developing the internal market - not relevant
- Promoting integrated EU capital markets - not relevant
- Ensuring financial stability - totally disagree
- Promoting sustainability - totally disagree

Please explain your response to question 1 and substantiate it with evidence or concrete examples:

For a detailed response to Q1 see annex 1 and bibliography

GENERAL CONSIDERATIONS

Accounting isn't a neutral information system for measuring a company's wealth and income. Benefits or costs aren't objective but conventional data, which convey a vision of the company, that results of social and political processes in which actors confront each other in order to shape the representation and distribution of wealth produced in companies. That is why accounting systems are different from one country to another (see Daimler's 1993 financial accounts on Annex1)

Sustainability issues are absent from the underlying vision of accounting systems, which don't integrate companies' impacts on natural and human capital (see Rambaud & Richard in bibliography). Non-financial reporting is supposed to guide companies on sustainable issues but its impact on corporate strategies is far less important than those of accounting standards. As long as climate change, land degradation or human rights abuses only marginally affect companies' business model, it is unrealistic to assume that all economic actors will act upt to the challenges.

CONSIDERATIONS ON IAS/IFRS STANDARDS

1.IAS/IFRS are designed to meet the needs of "investors, lenders and other creditors" (IASB Conceptual Framework 2010). This main objective reflects the predominance since the 1980s of corporate governance and shareholder value according to which managers must preferentially defend shareholders' interests. Accounting standards can therefore be seen as instruments to align management objectives with those of investors. This is reflected in the pre-eminence of fair value accounting. Indeed, accounting at historical cost, via the provisioning system, would leave too much leeway to managers to guide accounting information. Conversely, fair value would have a neutrality enabling investors to have precise information on their interests' situation. Due to this predominance of investors' interests, IAS/IFRS can't effectively protect other stakeholders. They can even weaken them: the quest for short-term financial profitability and very high average return on capital can be to the detriment of the company's continuation. Investment projects can be left behind because their profitability is below the standards, while they are vital for the company over the long term and, thus, for the stakeholders that depend on it (employees, suppliers etc.). This concern was expressed by Larry Fink, BlackRock's CEO, in an open letter to the the largest US and European companies (Wall Street Journal 2014).

2. The aim of IAS/IFRS standards is to provide relevant information to investors not to ensure financial stability. Moreover, as already mentioned, they favour fair value accounting (over historical cost accounting), which are denounced by many academic studies as risky for financial stability: it introduces volatility into companies' financial statements and it is pro-cyclical (it exacerbates fluctuations in the financial system and can even amplify systemic risk).

In a more forward-looking perspective, IAS/IFRS do not incorporate Climate-related financial risks. Meeting the Paris Climate Agreement's objectives will require the early closure of highly carbon-intensive assets such as coal-fired plants. Yet, it seems that no reflection has been undertaken to integrate those stranded assets in accounting standards, either from political authorities or international standard-setter. Given the importance of fossil fuels in the economy, this lack of anticipation is very worrying for financial stability. IAS 37 would be an interesting tool to mobilize for this purpose.

3. Neither the conceptual framework nor the IASB standards emphasize sustainable development objectives. On the contrary, they lead to a short-term vision of the company's accounts and thus constitute an obstacle to EU's objectives on sustainability, which is necessarily part of a long-term logic. As we have seen, IAS/IFRS standards are mainly intended to inform investors. Broadly speaking, they give them the analytical tools to exert pressure on firms by selling their shares if ROE requirements are below the average estimated by the market and/or if dividends are not up to par. In the case of financial corporations, the effect is even greater: market pressure may lead them to reduce the holding period of their financial assets or to select high-risk, short-term profitable projects at the expense of long-term investment. Thus, IMF's Global Financial Stability Report (2014) expressed concern that banks had increased their financial risk-taking (acquisition of financial assets) at the expense of their economic risk-taking (financing productive investment). Moreover, the standard on financial instruments (IFRS 9) may prove harmful for long-term investors because only bonds are

considered long-term. Investments in equities are by definition considered short-term and should therefore be measured at fair value (more example in Annex1).

Question 2. *Do you think that the EU public reporting requirements for companies, taken as a whole, are relevant (necessary and appropriate) for achieving the intended objectives?*

- Ensuring stakeholder protection - totally disagree
- Developing the internal market - not relevant
- Promoting integrated EU capital markets - not relevant
- Ensuring financial stability - totally disagree
- Promoting sustainability - totally disagree

Please explain your response to question 1 and substantiate it with evidence or concrete examples:

The information to be published by companies is generally irrelevant to achieving the EU's objectives for the reasons set out in question 1.

Accounting standards do not take into account environmental and social issues and non-financial information is much less structuring for corporate strategy than accounting standards.

IFRSs are mainly aimed at one category of stakeholders, introduce volatility into corporate accounts, amplify speculative bubbles and are an obstacle to long-term investments.

Question 11*. On top of differences in national accounting rules, national tax laws will usually require the submission of a tax return in compliance with self-standing national tax rules, adding another layer of reporting standard.*

Once a Common Corporate Tax Base is adopted at the EU level, would you consider that the profit before tax reported in the Profit or Loss statement and the determination of the taxable profit should be further aligned across EU Member States?

- Response – Totally agree

Differences in calculation bases (and rates) combined with freedom of establishment and capital movements allow companies to move their establishments to reduce income tax. According to Eurostat, corporate income taxes (including holding gains) fell from 3.1% of GDP in 2006 to 2.6% in 2016. This is a problem for the European Union as a whole (except to consider that no corporate income tax should be levied, which means favouring other sources of levies). This question of tax competition arises on all taxes, but the specificity of corporation tax lies in the ease with which companies car relocate their establishments.

Proposals to combat tax optimisation with the creation of a common corporate tax base could be complemented by measures such as the method of apportionment via the determination of a company's profit at EU level, then the distribution of this taxable base between EU countries according to sales, payroll and capital, each accounting for one third (See "L'entreprise comme commun", Swann Bommier and Cécile Renouard, Editions Charles Léopold Mayer, 2018, pp.72 and 73).

Question 13. *As regards the publication of individual financial statements, the Accounting Directive (Article 37) allows any Member State to exempt the subsidiaries of a group from the publication of their individual financial statements if certain conditions are met (inter alia, the parent must declare that it guarantees the commitments of the subsidiary). Would you see a need for the extension of such exemption from a Member State option to an EU wide company option?*

- Response – No.

The disclosure of aggreagated datas alone, would make it more difficult for stakeholders to analyze a group's financial statements.

Question 17. *Is there any other information that you would find useful but which is not currently published by companies?*

It would be interesting to generalise to all large companies the country-by-country report (turnover, number of employees, results, taxes, public subsidies, etc.) currently produced by financial actors (Directive 2013/36/EU). It is indeed a major tool in the fight against tax evasion practices. In this respect, the adoption of the'Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches (CBCR)' would be a good step, provided that a sufficient number of companies are covered by the Directive and that there are no possible exemptions.

Question 19. *Given the different levels of commitment to require IFRS as issued by the IASB around the globe, is it still appropriate that the IAS Regulation prevents the Commission from modifying the content of IFRS?*

- Yes
- No, due to the risk of uneven level playing field for EU companies vis-à-vis companies established in third countries that do not require the use of IFRS as issued by the IASB.

- No, due to the risk that specific EU needs may not properly be addressed during the IASB standard setting process.
- No, due to other reasons.
- Don't know / no opinion / not relevant

Question 20. *Since the adoption of IFRS by the EU in 2005, topics such as sustainability and long-term investment have come to the forefront of the regulatory agenda. Is the EU endorsement process appropriate to ensure that IFRS do not pose an obstacle to broader EU policy objectives such as sustainability and long-term investments?*

- Response - NO

If you answered no to question 20, please explain your position:

In the early 2000s, the EU decided to delegate the accounting standardisation process for listed companies to a private body, the IASB. Today, the EU's only means of action lies in the endoresement, which results either in adoption or reject, but never in an amendment or a formal proposal to modify the standard. In the case of rejection, it is the IASB that undertakes the work of seeking compromises to satisfy all stakeholders. As a result, the EU's latitude to ensure that IFRS are not an obstacle to achieving broader policy objectives is extremely limited. It is essential to modify the IFRS' endorsement process so that the European Union can adapt them to the European context, in particular with regard to sustainability objectives (see Q1 & Annex1).

Question 21. *How could the EU ensure that IFRS do not pose an obstacle to sustainability and long-term investments:*

- By retaining the power to modify the IFRS standards in well-defined circumstances;
- By making explicit in the EU regulatory framework that in order to endorse IFRS that are conducive to the European public good, sustainability and long term investment must be considered;
- **Other**
- Don't know / no opinion / not relevant

Please specify in what other ways could the EU ensure that IFRS do not pose an obstacle to sustainability and long-term investments:

We agree with the first two proposals.

On the one hand, the EU must be able to modify IFRS standards to adapt them to the European context. This process of modification must be well defined and involve several European bodies including those representing citizens (the European Commission but also Parliament) because, as stated in question 1, accounting standards are far from neutral.

On the other hand, it seems necessary to clarify the notion of "European public good".

Indeed, the European regulatory framework (Regulation N°1606/2002) specifies today that "The international accounting standards can only be adopted if (...)they are conducive to the European public good". However, this concept is not defined. DG Fisma's non-paper at the Accounting Regulatory Committee meeting of 14/05/16 recommends, however, to take into account some criteria (financial stability, economic development, competitiveness, added value for the EU, etc.), none of which relates to sustainability or long-term investment issues. As proposed in this consultation, it seams essential to amend the Regulation on the application of international accounting standards in order to clarify this concept by specifically integrating sustainability and long-term investment issues. Reference could also be made to some of the European Union's major international commitments such as the Sustainable Development Goals or the Paris Climate Agreement.

Question 22. *The True and Fair view principle should be understood in the light of the general accounting principles set out in the Accounting Directive . By requiring that, in order to be endorsed, any IFRS should not to be contrary to the true and fair view principle, a link has been established between IFRS and the Accounting Directive. However, the principle of true and fair view is not laid down in great detail in the Accounting Directive, nor is it underpinned by e.g. a European Conceptual Framework that would translate these principles into more concrete accounting concepts such as recognition and measurement, measurement of performance, prudence, etc. Do you think that an EU conceptual framework should underpin the IFRS endorsement process?*

- **<u>Yes</u>**
- No
- Don't know / no opinion / not relevant

Question 23. *The EU has not endorsed the IASB Conceptual Framework for Financial Reporting. The conceptual framework is a set of concepts used to develop IFRSs but can also be helpful in interpreting how IFRS standards have to be understood and applied in specific circumstances. This could enhance a common application of IFRSs within the EU.*

Should the EU endorse the IASB Conceptual Framework for Financial Reporting?

- Response – <u>totally disagree</u>

Please explain your response to question 23 and substantiate it with evidence or concrete examples:

There are two main accounting models, the continental one and the Anglo-Saxon one (American and international), each governed by a set of general principles that should lead the preparation of accounts. However, only the Anglo-Saxon model has a single, common Conceptual Framework to synthesize its fundamental principles. This was the case with the United States in 1984 and the IASB (then IASC) in 1989 (partially revised in 2010; a new version was published in early 2018 but is not public yet). In continental Europe, accounting principles are enshrined in the laws of each country following the transposition of the European Accounting Directives.

The conceptual framework defines all the concepts necessary for understanding and applying accounting standards. It is a reference used by the standard-setter to establish its standards and by the preparers of accounts in the absence of an existing standard on a subject. The IASB's conceptual framework details the recipients of financial information, the objectives of financial statements, their components, the underlying assumptions and the qualitative characteristics of financial information.

As mentioned in question 1, accounting is not neutral but conveys a subjective view of the company. This is translated in the standards but also and especially in the Conceptual framework.

If the EU does want accounting to contribute to the objectives set out in questions 1 and 2, it seems important that it adopts a conceptual framework that takes these objectives into account. This is not at all the case with the IASB's conceptual framework, as shown, for example, by the fact that investors are the main recipients of international accounting standards, whereas the European Union's objective is to protect all stakeholders.

Another example is the difference in interpretation of the concept of « prudence ». In the continental model, this principle refers to asymmetric prudence that aims to recognize only unrealized losses and not gains. Whereas under the IASB, prudence refers to how decisions are made, which result in recognising both unrealized gains and losses. The IASB's approach can undermine the objective of financial stability: if many companies anticipate profits that do not happen this can lead to a financial crisis. Moreover, it is at the very least difficult to accept semantically: how can it be considered « prudent » to integrate gains that are not certain?

Finally, in the answer to question 1 (and in Annex 1), we developed extensively how IFRS are problematic for long-term investment and thus the achievement of sustainability objectives.

By adopting its own conceptual framework, the EU could thus explore how sustainability issues could be integrated to a greater extent (in particular by promoting long-term sustainable investments). This would build on ongoing research (see Rambaud and Richard in bibliography), as well as other European Union initiatives (potential revision of the NIF Directive, European taxonomy, etc.).

Question 24. *Contrary to the Accounting Directives the EU endorsed IFRSs do not require companies to present financial information using a prescribed (minimum) lay-out for the balance sheet and income statement. Mandatory use of minimum layouts could enhance comparability of human readable financial statements (Electronic structured data reporting based on the IFRS taxonomy have an implicit layout as relationships between elements for which amounts shall be presented are defined).*

Do you agree that prescribed (minimum) layouts enhance comparability of financial statements for users and should therefore be introduced for companies using IFRS.

- Response - totally agree

Reading financial statements that are not using a prescribed (minimum) lay-out forces the external user to immerse himself in the specific choices made by the company.

As a consequence, this reading becomes long and complex and only accessible to experts, who have the interpretative capacities, the time and the means to make it. The use of a prescribed lay-out would make this reading more accessible to non-experts, and would of course facilitate comparisons.

Question 26. *Do you agree that abolishing the quarterly reporting requirement in 2013 by issuers contributed to the following?*

- Reducing administrative burden, notably for SMEs - mostly agree
- Promoting long-term investment (i.e. discouraging the culture of short-termism on financial markets) - mostly agree
- Promoting long-term and sustainable value creation and corporate strategies - mostly agree
- Maintaining an adequate level of transparency in the market and investors' protection - mostly agree

Please explain your response to question 26 and substantiate it with evidence or concrete examples:

The publication of quarterly information can lead managers to focus on very short-term financial indicators, or even to take decisions aimed at doing better in the very short term. Two closely related negative effects for sustainability issues. The 2013 amendment to the Transparency Directive removed the obligation from issuers of listed securities to publish financial information on a quarterly basis. It is now up to States to impose this obligation. However, market pressure that continues to expect high frequency reporting by firms might make them do so even if they aren't legaly obliged. It would be interesting, as recommended in the HLEG's interim report, to analyses whether or not companies continue or not to publish on quaterly basis in countries where the obligation has been withdrawn. If this is the case, it would be interesting to consider a European legislation prohibiting quarterly or even half-yearly publications.

Question 40. Th*e impact assessment for the NFI Directive identified the quality and quantity of non-financial information disclosed by companies as relevant issues, and pointed at the insufficient diversity of boards leading to insufficient challenging of senior management decisions. Do you think that these issues are still relevant?*

- The quality and quantity of non-financial information disclosed by companies remain relevant issues - <u>totally agree</u>
- The diversity of boards, and boards' willingness and ability to challenge to senior management decisions, remain relevant issues- <u>Don't know /no opinion /not relevant.</u>

Several academic studies on French companies show that non-financial information on environment are very heterogeneous and incomplete (see the bibliography).

For example, here is a summary of the Rigot and Demaria study which analyses the environmental information disclosed in 2015 by 37 CAC 40 companies in their annual reports (reference document) and/or Corporate Social Responsibility reports. To this end, the authors use the analysis grid set out in the report of the Task Force on Climate-related Financial Disclosure (governance, strategy, risk management, metrics and objectives).

This study reveals that non-financial information is very heterogeneous (presentation and choice of indicators) and incomplete, particularly on the financial impacts in terms of risks and opportunities.

Governance. French firms communicate very little about the internal governance procedures put in place to take climate risks and opportunities into account. On the other hand, most of them disclose external governance indicators (e.g. membership of the Global Compact, application of international grids such as the GRI or the Integrated Report, green and ethical rewards received by the group).

Strategy. Twenty companies report on targets for reducing GHG emissions (but not always on scope 3), energy consumption or pollution levels. To a lesser extent (16), they also address biodiversity protection strategies and detail programmes related to the circular economy.

Risk management. Companies communicate mainly on the application and compliance to different types of certifications (ISO 14 001, ISO 26 000, ISO 50 001). Eleven groups detail the piloting tools (computerised CSR software) set up for environmental performance management.

Metrics and objectives. Nearly thirty groups detail the quantity of GHG emissions (but they do not always provide information on scope 3), energy and water consumption and waste management procedures implemented. 24 companies specify their carbon footprint by systematically identifying scopes 1 and 2, but more marginally scope 3. The dissemination of financial indicators related to the environment is much rarer. 17 companies indicate that they belong to a green or socially responsible stock market index, but only 10 companies provide quantified financial information on the impacts of climate risks and opportunities with a very wide range of content (e.g. amount of provisions linked to the environment, investments to limit environmental impacts, additional costs induced by climate change).

Question 41. *Do you think that the NFI Directive's disclosure framework is effective in achieving the following objectives?*

- Enhancing companies' performance through better assessment and greater integration of non-financial risks and opportunities into their business strategies and operations - <u>partially disagree and partially agree</u>
- Enhancing companies' accountability, for example with respect to the social and environmental impact of their operations - <u>partially disagree and partially agree</u>
- Enhancing the efficiency of capital markets by helping investors to integrate material non-financial information into their investment decisions - <u>partially disagree and partially agree</u>
- Increasing diversity on companies' boards and countering insufficient challenge to senior management decisions - <u>partially disagree and partially agree</u>
- Improving the gender balance of company boards - <u>partially disagree and partially agree</u>

Please explain your response to question 41 and substantiate it with evidence or concrete examples:

While the establishment of common rules on non-financial reporting is a good step forward, the Directive is still insufficient.

1. It leaves too much latitude to companies on the topics to be addressed. The non-financial report must contain "information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including" (art.1). The guidelines give examples to explain those broad themes and specify key principles. The first one (the most important for the selection of subjects to be disclosed) stipulates that companies must disclose "material information". This concept of materiality commonly used by preparers, controllers and users of financial information is thus extended to non-financial reporting. Given the diversity of companies and subjects, leaving some flexibility is understandable. However, it would have been best to specify which are the major environmental and social issues for all companies and which are the main issues by sectors (the guidelines explains that those KPIs exist). Such a list would provide a European framework enabling all companies in the same sector to move

forward at the same pace and in the same direction. Its absence could disadvantage best practices companies and delay the implementation of a quality set of non-financial information. An automobile manufacturer's GHG emissions are primarily related to downstream consumption (i.e. scope 3). A manufacturer informing scope 1 and 2 will therefore have a much better GHG balance than a manufacturer informing all scopes (even if the latter is engaged in a transformation of its business model). Similarly, if banks and financial companies don't disclose on their investment activities' impact, they miss the major issue. On this subject, EU could usefully draw inspiration from the best practices of the Member States, such as art.173 of French Energy Transition law, which requires investors, insurers and asset managers to communicate information on how their investments contribute to climate change, as well as to assess their portfolio's exposure to climate risks.

2.The Directive allows non-financial information to be aggregated at the group level. In France, this is already leading to regressions: subsidiaries of French or European groups, are considering no longer reporting on CSR. Thus, the precise information concerning them will no longer be public, which could harm its involvement toward sustainability, comparability between companies, and transparency for investors and the public.

3. Extra-financial information is not at the heart of corporate strategy. According to the guidelines, non-financial information can either be included in the management report or in a separate report. This is harmful because the management report is submitted to the company's General Meeting, which is not necessarily the case for a separate report, that can thus become communication tool. Moreover, given that the financial management is committed by the management report, this makes it possible to mobilise it on sustainability issues. It is necessary that non-financial information, such as financial information, be included in companies' annual reports. The directive specifies that non-financial information must include a description of company's business model, policies pursued and their outcomes, risks identified in relation to sustainability issues including due diligence processes implemented, and non-financial indicators. While it is positive that business model, governance and risk management are included in non-financial reports, the intention remains neutral. It can lead to a descriptive rather than strategic disclosure of information, specially since companies may choose not to provide certain information as long as it explains why. TCFD's recommendations go further by placing far more explicitly climate issues at the heart of business strategy. Companies should explain how climate-related risks and opportunities i/ are taken into account in governance and in particular by top management ii/ impact the company's business model and financial planning strategy iii/ are integrated into risk management procedures. These last two categories lead companies to anticipate the profound disruptions that climate change will induce on their activity and their business environment. Finally, the company must also disclose the monitoring indicators and their evolution objectives. Taking these 4 elements into account can allow a real reflection for coherent and in-depth strategies. The TCFD provides specific recommendations for financial actors and for energy, agriculture, construction and transport sectors.

Lastly, lets remind that extra-financial reporting is an important tool but can't be the only one.

Question 42. Do you think that the NFI Directive's current disclosure framework is effective in providing non-financial information that is:

- Material - mostly disagree
- Balanced - Don't know /no opinion /not relevant
- Accurate - mostly disagree
- Timely – mostly agree
- Comparable between companies - mostly disagree
- Comparable over time - mostly disagree

-Material. Given that companies are free to assess the « materiality » of information and indicators (see question 41), it is likely that many of them will fail to provide some important information. For exemple, it will be interesting to see whether all European financial players subject to the directive assess the climate impact of their financial portfolio and their exposure to the financial climate risks. And if they do so, how: indeed, information on the portfolio companies' carbon footprint reduced to scope 1 wouldn't be very relevant.

-Accurate. The Directive requires Member States to ensure that the statutory auditor or audit firm verifies that the non-financial statement has been provided. But, it is left to each Member State to impose the verification of the declaration by an "independent insurance service provider" (&16 of the Directive). Whitout control there is no way to garanty that information will be accurate.

-Timely. Once a year is ok.

-Comparable from one company to another and comparable over time:

The Directive does not provide a clear framework for the disclosure of financial information. Recital 9 of the Directive thus states that " In providing this information, undertakings which are subject to this Directive may rely on national frameworks, Union-based frameworks such as the Eco-Management and Audit Scheme (EMAS), or international frameworks such as the United Nations (UN) Global Compact, the Guiding Principles on Business and Human Rights imple- menting the UN 'Protect, Respect and Remedy' Framework, the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises, the International Organisation for Standardisa- tion's ISO 26000, the International Labour Organisation's Tripartite Declaration of principles concerning multina- tional enterprises and social policy, the Global Reporting Initiative, or other recognised international frameworks."

Given the above multiplicity of frameworks, it will most likely be difficult to make comparisons between companies.

As for the comparison over time, it risks to be complicated by the following elements. We can anticipate that companies will try not to go to far in disclosure in order not to appear to have more impact thant their competitors only because thay have done a better excercice of disclosure This depends, of course, on how far national legislation on this subject has progressed.

Finally, as noted in question 41, subsidiaries will not be obliged to disclose information if the data are consolidated at group level. Because of the size of the groups and their evolution according to the purchases and sales of other companies, this will necessarily harm comparability between companies and over time.

Question 44. *Do you agree with the following statement:*

The costs of disclosure under the NFI Directive disclosure framework are proportionate to the benefits it generates.

- Response - totally agree

Please explain your response to question 44 and substantiate it with evidence or concrete examples:

This question of cost is often used as an argument to reduce ambitions for disclosure of non-financial information. Given that the European Union's stated objective is to contribute to corporate responsibility on vital subjects (ecology, human rights), it seems rather problematic to use such an argument. Moreover, companies have to bear substantial costs for internal management control and audits of their accounts. These costs sometimes amount to millions of euros for companies whose turnover is in the billions. It is inevitable and desirable that complex issues such as social and environmental impacts generate consideration and work, and therefore costs.

Question 45. *Do you agree with the following statement:*

The scope of application of the NFI Directive (i.e. limited to large public interest entities) is appropriate ("Public-interest entities" means listed companies, banks, insurance companies and companies designated by Member States as public-interest entities).

- Response – about right

Please explain your response to question 45 and substantiate it with evidence or concrete examples:

At first, this seems appropriate, especially since the larger the company, the more impact it has. In addition, it is important that all listed companies (even small ones) are involved, as they mobilise public savings and investors need comprehensive information to make their choices.Once European frameworks and methodologies are better established it will be time to extend these obligations to smaller economic actors.

Question 47. *Do you agree with the following statement?*

The non-binding Guidelines on Non-Financial Reporting issued by the Commission in 2017 help to improve the quality of disclosure.

- Response - <u>mostly disagree</u>

Please explain your response to question 47 and substantiate it with evidence or concrete examples:

Although the non-binding guidelines are more detailed than the directive itself, they suffer from the same shortcomings. Their main interest is to explain the key principles that should govern the preparation of non-financial reports and to give examples. But this remains largely insufficient (see the answer to questions 41 and 42).

Question 54. *Do you agree that integrated reporting can deliver the following benefits?*

- More efficient allocation of capital, through improved quality of information to capital providers - <u>partially disagree and partially agree</u>
- Improved decision-making and better risk management in companies as a result of integrated thinking and better understanding of the value-creation process - <u>partially disagree and partially agree</u>
- Costs savings for preparers <u>- Don’t know /no opinion /not relevant</u>
- Cost savings for users - <u>partially disagree and partially agree</u>
- Other differences (please rate here and specify below) - <u>Don’t know /no opinion /not relevant</u>

Please explain your response to question 54 and substantiate it with evidence or concrete examples:

The main interest of the integrated report consists in the fact that this is a synthetic report which tries tu adress the question of long term value creation combining financial and non-financial datas. It can thus force reflection in the company to integrate all its stakeholders, consider its environmental and social impacts, and communicate on these subjects to stakeholders in an easy way to read. However, this exercice is still too free about the information chosen and how it should be presented. It may therefore be limited to a communication exercise and not a strategic one (see answers to questions 41).

Question 55. *Do you agree with the following statement?*

- A move towards more integrated reporting in the EU should be encouraged –Mostly agree
- The costs of a more integrated reporting would be proportionate to the benefits it generates (would be efficient) – totally agree

Please explain your response to question 55 and substantiate it with evidence or concrete examples:

It is important to encourage the joint presentation of financial and non-financial information, to establish clearly the link between the two and to adress the long term value creation of companies.

For the question of cost see Q44.

Annex 1: Detailed response to question 1

Question 1. Do you think that the EU public reporting requirements for companies, taken as a whole, have been effective in achieving the intended objectives?

- Ensuring stakeholder protection - totally disagree
- Developing the internal market - not relevant
- Promoting integrated EU capital markets - not relevant
- Ensuring financial stability - totally disagree
- Promoting sustainability - totally disagree

I. CONSIDERATIONS ON ALL INFORMATION TO BE PUBLISHED BY COMPANIES

While accounting is often considered a neutral information system for measuring a company's wealth and income, this is not the case in reality.

The results, the benefits, the costs that many consider to be objective data are conventional data for accountants, i.e. obeying predefined social rules (this is for example the case of depreciation periods for durable assets such as buildings that are not linked to the real life of the asset).

These conventions convey a vision of the company. They result of social and political processes in which actors confront each other in order to shape in their own way the representation and distribution of wealth produced in companies. This is what we will see, for example, later on for IFRS / IAS standards.

If, in theory, accounting seeks to represent the firm, its assets and its income as realistically as possible, in practice it can only try to come closer to this neutrality because it necessarily conveys a subjective representation of the world. That is why accounting systems are not identical from one country to another. In simplified terms, the Continental model using historical costs is opposed to the Anglo-Saxon model using fair value. The importance of the differences between these two models is well illustrated by the following example. In the early 1990s, the German company Daimler-Benz planned to go public on Wall Street. To do so, it had to reconcile its 1993 financial statements (then in accordance with German standards complying with European accounting directives) with the American standards of the FASB. This exercise highlighted significant divergences between the two accounting standards: the company, which was largely profitable according to national standards, appeared to be in deficit according to American standards. Moreover, the value of its equity was much higher by US standards than by German standards.

The fact that accounting reflects a subjective vision of the company explains our response to questions on sustainability and stakeholders (defined by the list established by the IASB in its 1989 Framework for the preparation and presentation of financial: investors, members of staff, lenders, suppliers and other creditors, customers, governments and public bodies, the public).

Indeed, sustainability issues, whether in their ecological or social dimension, are simply absent from the underlying vision of the various accounting systems. Accounting standards do not integrate the companies' impacts on environment and more generally on natural capital (whether in terms of extraction of natural resources or environmental deterioration via pollution and waste). In this respect, financial and accounting standards cannot achieve the European objectives of promoting sustainability and protecting all stakeholders, in particular the "public".

Sustainability issues are supposed to be revealed and taken into account by companies through the disclosure of non-financial information. The Guidelines on non-financial reporting state that " *The disclosure requirements arising from the Directive make an important contribution towards the Sustainable Development Goals*" and to the implementation « *of the Paris Climate Agreement*" (p2). It may be noted that the European Union is trying to make links, at least symbolically, between accounting standards and non-financial reporting: Directive 2014/95/EU on non-financial information introduces this reporting in Directive 2013/34/EU on annual financial statements and recommends to establish clear links between non-financial and financial information in the management report; similarly, the present consultation concerns both financial and non-financial standards (both subjects where also in the same part of the European Commission's action plan for sustainable finance).

That is, however, far from enough. Indeed, accounting and financial standards are largely predominant to guide corporate strategy. As long as climate change, land degradation or human rights abuses along the value chain have only a marginal impact on the business model of companies, it is unrealistic to assume that all economic actors will act simultaneously to reduce their impacts to sufficient levels (even if non-financial information can guide companies and investors that are particularly involved on sustainability). There are two ways to introduce sustainability into business models: an "external" way (putting a price on negative externalities, setting standards on emissions and pollution) and an internal way via accounting systems for instance. Work exists on this subject which aims for example to impute a cost of repair. See for example Rambaud and Richard's work on « triple depreciation line ».

II. MORE SPECIFIC CONSIDERATIONS ON IAS / IFRS STANDARDS

Stakeholder protection

These standards are explicitly constructed to meet the needs of a category of stakeholders. Indeed, according to the IASB Conceptual Framework (2010) "*The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit* ". While it is specified that financial statements can also be useful for other parties and that IASB will try to meet the needs of as many users as possible, the fact remains that these statements are not primarily addressed to them.

This view that financial statements should primarily serve investors is justified by the "*agency theory*" which aims to account for the nature of the firm (Jensen and Meckling - 1976). Very schematically, according to this theory, the firm is not considered as an entity in itself but as a "*node of contracts*" binding the holders of the factors of production. The "principal" (the shareholder(s)) engages the "agent" (the manager(s)) to perform a service on his behalf, via a delegation of decision-making power.

From this perspective, the firm is essentially considered as an investment of the principal and not as a separate entity. It is on this basis that corporate governance has developed since the 1980s, supporting the principle of shareholder value according to which managers must preferentially defend shareholders' interests.

As there is an asymmetry of information between manager and shareholder (who has the least knowledge on how the company is managed), it is necessary to align the interests of managers with those of shareholders in order to get them to run the company in a way that maximise the return on capital.

In terms of corporate governance, this is reflected in the implementation of incentive mechanisms (e.g. stock options, variable compensation, etc.). In accounting, this implies that financial statements are prepared from the perspective of investors: this is what is set out in the IASB's conceptual framework. Accounting standards can therefore be seen as an instrument to align management objectives with those of investors. In concrete terms, this means removing subjective elements derived from managerial intent from the accounting information. This is reflected in the pre-eminence of fair value accounting in IAS / IFRS. Accounting at historical cost, via the provisioning system, would leave too much leeway to company's managers to guide accounting information. Conversely, fair value (revealed primarily by market value) would have a neutrality enabling investors to have precise information on the situation of their interests.

Due to this predominance of investors’ interests, IAS/IFRS can’t effectively protect other stakeholders: it is simply not their purpose. On the contrary, they can weaken those stakeholders. The quest for short-term financial profitability and for a very high average return on capital can be to the detriment of the company's continuation. The shareholder's remuneration potentially becomes a priority in the strategy, even when profits are not at the expected level, all the more so in a context of a constant decrease in the time shares are held (according to the OECD Journal Financial Markets volume 2011, it went from 5 years in the 1980s to 5 months in the years 2010 - without taking account of high frequency trading). Thus, important investment projects can be left behind because their profitability is below the standards while they are vital for the company over the long term and for the stakeholders that depend on it (such as employees and suppliers). As early as spring 2014, Larry Fink, CEO of BlackRock, one of the world's leading asset managers, expressed concern in an open letter to the CEOs of the largest US and European companies about the tendency of companies to pay too high returns at the expense of investment, which could jeopardize companies' ability to generate returns in the future (Wall Street Journal, 26 March 2014).

Financial stability

First of all, lets remind that the objective of IAS/IFRS standards is not financial stability but to provide relevant and reliable information to investors. Moreover, as already mentioned, IAS/IFRS standards favour fair value accounting (over historical cost accounting), which are denounced by many academic studies as risky for financial stability (see bibliography).

It introduces volatility into companies' financial statements. This becomes excessive when markets become illiquid and prices fluctuate. This is what happened during the 2007-2008 financial crisis, which led several government bodies such as the G20 or the ECOFIN Council to call for measures to stabilise markets. Following the example of the FASB and at the request of Europeans, the IASB then adopted an amendment to IAS 39 allowing the fair value to be abandoned for financial instruments for which there is no longer a liquid market.

Fair value accounting is pro-cyclical. It exacerbates fluctuations in the financial system, can cause a downward spiral in financial markets and even amplify systemic risk.

For example, it can artificially improve the balance sheet of a listed company whose shares rise for speculative reasons, (or, on the contrary, excessively devalue the balance sheet of companies subject to downward speculation). This can mask a company's difficulties: the continuous rise in the price of a share can create an artificial wealth effect by masking an excessive debt ratio. This is, for example, what happened for Carillion, the second largest British construction and services company, which went bankrupt in January 2018 despite the good financial results reported a year earlier. When an entire sector is the object of a speculative bubble (as was the case for the Internet bubble in the 2000s) or when this boom affects the whole economy, the risk then becomes systemic.

In a more forward-looking perspective, IAS / IFRS don't incorporate the financial risks posed by global warming. Theorized in 2015 by Mark Carney (Governor of the Bank of England and Chairman of the Financial Stability Board), these are in particular i/physical risks linked to the damage directly caused by climatic upheavals (increase in extreme phenomena such as storms and hurricanes, rising water levels, etc.) and ii/ transition risks linked to the economic mutation that the shift towards a low-carbon economy implies, in particular if it is badly anticipated or if it occurs suddenly.

We now know that meeting the Paris Climate Agreement's objectives will require the early closure of highly carbon-intensive assets such as coal-fired power plants. Yet, it seems that no reflection has begun on how to account for those stranded assets, either on the part of the political authorities or the international standard-setter. Given the importance of fossil fuels in the economic system, this lack of anticipation of future asset closures is very worrying for financial stability (and of course for sustainability issues). It should be noted that IAS 37 would be an interesting tool to mobilize for this purpose. This standard governs the measurement, recognition and disclosure of information concerning the firms' provisions, contingent liabilities and contingent assets. It is one of the few standards that can be directly linked to environmental concerns. Indeed, the text of the standard explicitly refers to the provisions and contingent liabilities to be set up for decontamination in the event of unlawful damage caused to the environment, or for the dismantling of a polluting installation (oil, nuclear) (§19). The standard specifies that normally an obligation requires the existence of another identified party, but in the case of environmental damage there may be no identified third party or obligation to remedy the consequences. But changes in regulations could lead the company to have to remedy the damage caused later, so there would be an event that could create an obligation and therefore be accounted (IAS 37 §21).

Impact on sustainability.

Neither the conceptual framework nor the IASB standards emphasize sustainable development objectives. On the contrary, they lead to a short-term vision of the company's accounts and thus constitute a major obstacle to the European objective of promoting sustainability, which is necessarily part of a long-term logic. Indeed, it is a question of investing massively today to avoid tomorrow's disasters that could affect human societies and therefore the economy. However, despite considerable needs (to renew the productive apparatus by integrating climate and biodiversity issues, but also to face certain societal challenges such as the ageing of the population), we note in the European Union, a gap between a sluggish investment (in the euro zone, investment has risen from 26% of GDP in 1970 to 20% today) and abundant savings. This is a sign of a poor allocation of savings linked to short-term trends in the markets and the main financial intermediaries. On this point, there is a certain consensus in the academic literature but also a growing awareness among professionals, as evidenced, for example, by the multiplication of investor coalitions that are committed to ensuring that companies better integrate long-term issues such as climate change (e.g. Principles for Responsible Investment, Climate Action 100+).

International accounting standards bear some responsibility for this. As we have seen, IAS/IFRS standards are mainly intended to inform investors. Broadly speaking, they give them the analytical tools to exert pressure on firms by selling their shares if ROE requirements are below the average estimated by the market and/or if dividends are not up to par. In the case of financial corporations, the effect is even greater because of their role as financial intermediaries involved in financing the economy. This market pressure may lead them to reduce the holding period of their financial assets (high portfolio turnover rate) or to select high-risk, short-term profitable projects at the expense of long-term, less short-term profitable investment projects. The IMF's Global Financial Stability Report (2014) was concerned, for example, that banks had increased their financial risk-taking (acquisition of financial assets) at the expense of their economic risk-taking (financing productive investment). By seeking short-term financial profitability and distributing too large a share of profits, companies reduce the implementation of investment projects, which weakens them in the long term and limits their ability to review their business model in the direction of sustainability.

The study by Demaria and Rigot (to be published in the Revue d'Economie Politique), aimed at identifying short-term biases in financial sector regulation, shows that the desire for transparency and neutrality that prevails in these standards helps to convey an instant view of portfolios that goes against what could be long-term financing needed for long-term investment projects. They are therefore not suited to long-term investment practices such as contrarian or countercyclical management.

Finally, IAS/IFRS standards do not take sufficient account of the diversity of investors, although they are far from being a homogeneous category of players. Thus, nothing in common between a hedge fund seeking to make very short-term gains, through very active trading and financial leverage, and pension funds or life insurance companies that have relatively long contractual commitments towards their clients.

Yet, the standard on financial instruments (IAS 39, replaced by IFRS 9) may prove harmful for long-term investors. It promotes, in fact, a reductive vision of the management intention which consists, in terms of asset allocation, in applying a "buy and hold" management principle in a restrictive way. Under this approach, only bonds are managed on a long-term basis (this was not even the case in IAS 39). Investments in shares are by definition considered short-term and should therefore be measured at fair value. Thus, in the IASB's design, financial institutions can only have short-term management of their equity portfolios with a high turnover rate, which has negative consequences for long-term investors.

For example, a pension fund subject to fair value will not be able to completely ignore changes in his portfolio’s value because of the concern that this could cause his future pensioners. It can hedge its portfolio but, on the one hand, short-term hedging has a cost that makes the investment more expensive over the long term and, on the other hand, it transforms a long-term investment into a succession of risk-free short-term investments. The total return over the term will therefore mechanically be closer to that of a money market investment than to that of an unhedged long-term equity portfolio. This loss of return, which pays for the elimination of risk along the way, may discourage long-term investment.

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