Funding the Future

The EU ducks delivering real sustainability reporting

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The European Union announced its plans for new, mandatory, sustainability reporting this week. The Institute of Chartered Accountants in England and Wales has a good summary here.

Unfortunately there are problems.

The first clue comes from the fact that what was called the Non-Financial Reporting Directive (NFRD) is now going to be retitled the Corporate Sustainability Reporting Directive (CSRD). But it remains non-financial reporting.

The planned mandatory disclosures will require that businesses disclose descriptions of:

* Business model and strategy, including plans and implementation
* Sustainability targets, and progress towards achieving them
* Role of the boards
* Policies in relation to sustainability factors
* Due diligence processes for own operations and supply chain
* Principal risks and dependencies
* Indicators relevant for measuring the above
* Intangibles, including intellectual, human, social and relationship capital
* Process carried out to identify the information disclosed.

As the ICAEW notes:

Such disclosures should be qualitative as well as quantitative, providing both forward-looking and retrospective information according to short, medium and long-term horizons, as appropriate.

But what is very clear is that none of this goes near touching the accounts themselves. Everything is strictly off balance sheet. The logic is, in that case, straightforward if unstated. It is that sustainability remains a peripheral issue to the hardcore task of making money. This is wrong. The reality is that making money is now in practice constrained by the limits of the environment, and that is what accounting standards should respect, but as yet do not.

As a consequence, we can celebrate what Biden has had to say this week. We can cringe at Johnson's response (and it was cringeworthy). But until business really has to account for climate change on its balance sheet all this disclosure will remain greenwash, aided and abetted by the fact that only limited audit scrutiny will be required.

It's very obvious that the politicians are joining with St Augustine in a variation on his famous prayer which now goes 'Lord, make me sustainable, but just not yet'. But we can't afford to wait this time. And until business really has to say how it is going to meet its obligations it will not act.

So, just in case there is doubt let me be clear what I wanted.

First, a plan, with explanation. That's what the EU is requiring.

Second, a full cost for closing down the existing business model, and its replacement by a new one, because that is what we are talking about. I am not going to get that.

Third a provision for that cost on the balance sheet now in exactly the same way as a provision is made for the cost of closing down any other business model a business runs.

Fourth, annual reporting on progress - including on finances - in meeting this aim.

It's not rocket science. It's easily stated. It's pretty standard accounting fare when it comes down to it. But it's not being offered.

The EU says in its document that the new report is meant to meet the needs of the users of sustainability data:

The primary users of sustainability information disclosed in companies' annual reports are investors and non-governmental organisations, social partners and other stakeholders. Investors, including asset managers, want to better understand the risks of, and opportunities afforded by, sustainability issues for their investments, as well as the impacts of those investments on people and the environment. Non-governmental organisations, social partners and other stakeholders want to hold undertakings to greater account for their impacts of their activities on people and the environment.

I agree with all that. They then added:

The current legal framework does not ensure that the information needs of these users are met. This is because some companies from which users want sustainability information do not report such information, while many that do report sustainability information do not report all the information that is relevant for users.

I have to say that the new standard will fail in exactly the same way for the reasons I have noted. It does not provide the financial data that people, and not just investors, will want.

The critical decisions to be made now all focus on who can, and cannot, survive the transition to being sustainable. The new disclosures will not show that because they will not be in the accounts.

And the new disclosures must really direct capital - and that requires accounting data within the proper financial framework for that reporting - which is the accounts themselves.

Why isn't this happening? I suspect because if the data that I want were to be provided far took many companies would be what I call carbon insolvent. In other words they would not know how to cover their costs for this transition. For that reason I am quite sure that there has been extensive lobbying to keep this essential data out of the accounts. And that is exactly why we need it there. Which is what sustainable cost accounting would deliver.