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TECHNICAL REVIEW

SMPs (accountants) and their role in the face of new sustainability reports

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ABSTRACT

In recent years, the non-financial information or sustainability reporting has experienced exponential interest and increase. Undoubtedly, the impetus that led to continued work with more intensity in this line was the so-called "Green *Deal"* that the European Commission announced in 2019. The steps to reform the directives with relations or influence on non-financial information or sustainability have meant that, in some way, the information requirements by all stakeholders in this process have increased. Therefore, the information corporations must prepare and publish is not only restricted to traditional financial information included in their financial statements but also includes non-financial or sustainability information. SMPs (accountants) can and should advise our companies, entities, and institutions where we work, we are partners, or they are our clients, on how they can adopt sustainable management practices within the so-called ESG and improve their sustainability performance. We certainly have a crucial role in supporting the quest for sustainability and a sustainable economy in the EU. This presents a double challenge, namely a significant opportunity and responsibility, for which our profession is undoubtedly prepared and will continue to grow in the coming years. In this area, two new facts were key in 2022, to be highlighted with the content of this article and that demonstrate the determined impulse of the EU in this area: on the one hand, the approval of the so called CSRD Directive and, on the other, the elaboration of the draft of the first group of European standards for corporate reporting on sustainability (ESRS). – SET 1), which has recently been adopted as a delegated act of the European Commission, and we are awaiting final publication by the European Parliament and Council for effective use from 1 January 2024.

Keywords: Sustainability; Non-financial reporting; Sustainability reporting; SMPs (accountants).

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1. Introduction

Non-financial information is that which collects corporate data referring to everything related to environmental protection, social responsibility and the treatment of workers, respect for human rights, anti-corruption and bribery, and diversity in boards of directors, as set out in Directive 2014/95 / EU, which in turn amended Directive 2013/34 / EU. Although, this informative plot of corporations (companies, entities, institutions) was initially called non-financial information to differentiate it from financial information, the name was changed while developing the new European directive on the matter. So, it has been renamed sustainability information, from the original term Sustainability *information* included in the *Corporate Sustainability Reporting Directive* (2022/2464/EU). However, all these terms continue to coexist and are often used synonymously.

Therefore, the information that corporations must prepare and publish is not only restricted to traditional financial information included in their financial statements but also includes non-financial or sustainability information, reflected in the sustainability reporting, which is included in the financial statements. However, regardless of where the two parts that make up the corporate information are included when publishing one or another information, it is a fact that they increasingly have the same relevance; they are the *"two sides of the same coin."*

In this sense, and in line with the objective of this article, we can say that the main characteristics and development of non-financial or sustainability information mean that two key aspects have to be taken into account for the purposes of our SMPs (accountants): their ***preparation (elaboration) and publication, as well as their adequate verification (assurance).***

Indeed, our profession, the accountants, must be part of the solution and the growth of the corporate information. In fact, it is already happening, because both from an economic and accounting point of view, as well as financial and management, the annual accounts, the report on sustainability, and other documents that collect any other type of information about the company or entities, they contribute to value it and differentiate it. Undoubtedly, those corporations, companies, institutions, and entities that operate in an increasingly globalized world – whether through direct investment, exports, other international businesses, access to financing, and other national interests – must prepare and publish not only "traditional" financial information but also non-financial or sustainability information, and not only for their management interest but for the necessary translation to the market.

In addition, not only in large and medium-sized corporations but ever more increasingly in SMEs and other entities, the disclosure of non-financial or sustainability information becomes a key element too, for example, to have first access to markets, obtain financing in a more agile way, arouse interest to establish the first contacts with customers, suppliers, investors, partners, participants or donors; or to comply with the requirements of information on sustainability that is demanded being part of the "value chain" (suppliers, customers, partners, among others) of other obligated corporations (Ortiz-Martinez, 2021; Ortiz Martinez & Marín-Hernández, 2021).

All this makes it very appropriate that SMPs (accountants), on the one hand, continue to acquire the knowledge and skills necessary to coordinate and prepare sustainability reports, which undoubtedly implies the study, analysis, and understanding of everything related to sustainability (taxonomy, standards, requirements) that contribute to adopting the culture of sustainability and therefore comply with corporate reporting requirements in the Environmental, Social and Governance (ESG) areas, and on the other hand update and develop the basic knowledge for its verification (assurance).

2. New Corporate Sustainability Reporting Directive 2022/2464/EU (CSRD)

On April 21, 2021, the European Commission published the proposal for a Directive on Corporate Sustainability Reporting (CSRD), thus revising the previous Non-Financial Reporting Directive 2014/95/EU. The proposal for a Directive on sustainability reporting was part of the Sustainable Finance Action Plan.

As we have already indicated, at the end of 2022, more specifically on December 16, 2022, the new directive 2022/2464/EU of the European Parliament and of the Council of December 14, 2022, amending Regulation (EU) No. 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU was published, as regards to sustainability reporting by companies.

It revises the disclosure requirements for non-financial information set out in the Non-Financial Reporting Directive 2014/95/EU to be consistent with the broader legal framework on sustainable finance, including Regulation 2019/2088/EU on disclosures on sustainable finance and Regulation 2020/852/EU on EU taxonomy, as well as intended to be in line with the objectives of the European Green Deal.

Its objective is to improve sustainability information at the minium possible cost. The main characteristics and news of the proposal for a Directive on sustainability reporting are the following (Marín et al., 2023):

1. It extends the scope of non-financial reporting requirements: the Non-Financial Reporting Directive 2014/95/EU (NFRD) covered only large public-interest entities with more than 500 employees (around 11,700 companies). The scope of the proposed Sustainability Reporting Directive extends to all large companies and all companies listed on EU regulated markets, except micro-enterprises (which can cover around 50,000 companies). This includes non-EU-established companies listed on EU regulated markets and EU subsidiaries of non-EU companies. Insurance undertakings and credit institutions, irrespective of their legal form, are also included in the scope. For listed SMEs, the rules will be adapted to the capacities and resources of these companies (principle of proportionality), and they are given three years from the entry into application of the proposed Sustainability Reporting Directive to submit the information under it (i.e., from 1 January 2026), unlisted SMEs (the majority in UE and Portugal) can decide to use them voluntarily; however, EFRAG itself, with the acceptance of the European Commission and the strong support of the EFAA for SMEs, has also managed to develop voluntary standards for SMEs (VSMEs) that will soon be published (November 2023) for comments.

2. It specifies, in more detail, the information that companies must submit:

- Description and relevant indicators of the business model and strategy of the enterprise indicating: (i) the resilience of the business model and strategy to risks related to sustainability issues; (ii) opportunities arising from sustainability issues; (iii) resources to ensure that the business model and strategy are compatible with the transition to a sustainable economy; (iv) how the business model and strategy take into account stakeholder interests and the impact of the strategy on sustainability issues; (v) how the strategy has been implemented concerning sustainability issues.

- Description and relevant indicators of the sustainability objectives and the progress made towards achieving them.

- Description and relevant indicators of the role of administrative, management, and supervisory bodies in sustainability issues.

- Description and relevant policy indicators about sustainability issues.

- Description and relevant indicators of the due diligence process applied to sustainability issues.

- Description and relevant indicators of the negative impacts (actual and potential) on the most significant sustainability factors related to the company's value chain (including its operations, products and services, business relationships, and supply chain), as well as the measures taken to prevent, mitigate or remedy such effects and the outcome thereof.

• Description and relevant indicators of the main risks related to sustainability issues and their management.

• Information on intangible assets, defined as the non-physical resources that contribute to the creation of value of the company (including intellectual, human, social, and relational capital).

• Information about the process for determining disclosed information.

• About its scope, the information referred to in the previous points will be both prospective and retrospective, qualitative and quantitative. It must take into account short, medium, and long-term time horizons.

• In addition, it clarifies the principle of dual significance set out in the Non-Financial Reporting Directive 2014/95/EU, removing any ambiguity about the fact that companies must provide the information necessary to understand how sustainability issues affect them, as well as the information necessary to understand the impact they have on people and the environment.

3. It requires verification of sustainability information (assurance). At first, there is talk of limited verification, including the option of moving towards a reasonable verification requirement at a later stage. This includes amendments to Directive 2006/43/EC (Audit Directive) and Regulation (EU[i]) No 537/2014 (Audit Regulation[ii]).

4. The possibility for companies to be allowed to present the required information in a separate report that is not part of the annual report is removed.

5.A single electronic reporting format is established: information must be disclosed in a digital and machine-readable format.

6. The definition of "sustainability factors" is incorporated to refer to all information related to environmental and social issues, as well as personnel issues, and to respect human rights and the fight against corruption and bribery under Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector. It also refers to the presentation standards (Standards – ESRS UE) of information on sustainability. It is noted that those standards shall require that the information to be submitted be understandable, relevant, representative, verifiable, comparable, and fairly represented and that, taking into account the purpose of each standard, they shall:

• Specify the information that companies are required to disclose on environmental factors, including information on (i) climate change mitigation, (ii) adaptation to climate change, (iii) marine waters and resources, (iv) resource use and the circular economy, (v) pollution; and (vi) biodiversity and ecosystems.

• Specify the information that companies should disclose on social factors, including information on (i) equal opportunities for all, including gender equality and equal pay for equal work, training and skills development, employment and inclusion of persons with disabilities; (ii) working conditions, including safe and adaptable employment, wages, social dialogue, collective bargaining and worker participation, reconciliation of family and private life and a healthy, safe and adapted working environment; and (iii) respect for human rights, fundamental freedoms, democratic principles and the standards set out in the International Bill of Human Rights and other fundamental United Nations human rights conventions, the International Labour Organization (ILO) Declaration on Fundamental Principles and Rights at Work, the fundamental conventions of the International Labour Organization and the Charter of Fundamental Rights of the Union European.

• Specify the information that companies are required to disclose on governance factors, including information on (i) the role of the administrative, management, and supervisory bodies of the company, including sustainability issues, and their composition; (ii) business ethics and corporate culture, including the fight against corruption and bribery; (iii) the company's political commitments, including its lobbying activities; (iv) the management and quality of relationships with trading partners, including payment practices; and (v) the company's internal risk management and control systems, including about the company's reporting process.

3. First set of ESRS-EU standards

As a result of the above, also at the end of 2022, although worked throughout that year, the draft of the first set of European sustainability reporting standards (ESRS – EU) was already available, which, as we said in the previous section, were referenced in the new directive.

The EFRAG, within the European Reporting Lab, set up the so-called *Project Task Force on preparatory work for the elaboration of possible European nonfinancial reporting standards* (PTF-NFRS). The creation of this ad-hoc technical working group aimed to advise the European Commission on future sustainability reporting standards so that a series of recommendations or proposals would be issued to the future European body issuing corporate sustainability reporting standards.

The final report of the PTF-NFRS published in February 2021: *Proposals for a Relevant and Dynamic EU Sustainability Reporting Standard Setting*, is worth mentioning. Among its main conclusions can be highlighted:

• the demand for sound conceptual guidelines when addressing non-financial reporting standards, highlighting the public good, qualitative characteristics of information, time horizons, clear boundaries, double materiality, and connectivity between financial and sustainability reporting;

• the establishment of a coherent and comprehensive architecture, with a layered design – information independent of the sector in which the company operates (referred to in the report as sector agnostic), sector-specific and organization-specific –, relevant reporting areas and coverage for ESG classification; and

• the requirement that information should be presented with the sustainability benchmark should be connected to internal information systems, and digitization should be ensured.

The final report by the TFP-NFRS raised 54 proposals or recommendations on the scope and structure of future sustainability reporting standards without specifying specific disclosure requirements, indicators, or metrics.

Once this work was concluded, it was analysed and discussed within the Su*stainability Reporting Standard Board* during the year 2022, in more than 45 sessions, opening in parallel a period of public consultation during the summer of 2022, which concluded on August 8, 2022. As we have indicated, this first set of ESRS had been developed within EFRAG as a continuation of PTF-NFRS, specifically in the PTF-ESRS (*Project Task Force on European Sustainability Reporting Standards*), the technical working group that was intended to develop the standards for the EFRAG *Sustainability Reporting Pillar,* a newly created Board (SRB), to continue the work with the support of the Technical Expert Group (SR-TEG).

The structure of EFRAG was thus doubled, differentiating between the traditional part of financial information (FRB) and that of information on sustainability (SRB). The new pillar is the one that has finally taken up the ESRS to approve them. The first set of standards cited above was approved by the SRB on November 14, 2022, and sent to the European Commission for follow-up. Recently, on July 31, 2023, the European Commission announced its adoption of the Delegated Act on the first set of ESRS (press announcement, Q&As webpage & implementing and delegated acts – CSRD webpage). The Commission submitted the ESRS delegated act to the European Parliament and Council for scrutiny. If approved (it happened in October 2023), the ESRS delegated act will take effect on January 1, 2024.

On the other hand, EFRAG is now developing a separate proportionate standard for listed SMEs (LSME ESRS), as the CSRD requires, and a standard for voluntary reporting by non-listed SMEs (VSME). These SME standards will be subject to public consultation in late November 2023.

4. SMPs (accountants) and sustainability

Following what was developed by the EFAA for SMEs (2018, 2021, 2021a, 2021b) and pointed out by Marín & Thompson (2022), the various ways and forms (activities) in which SMPs (accountants) have an opportunity and responsibility to contribute to sustainability would be mainly focused through the ***preparation (elaboration), publication and verification (assurance) of that corporate information (sustainability),*** and we can summarize it in the following aspects.

• *Advising on best practices in sustainability*: SMPs (accountants) can and should advise our companies, entities, and institutions where we work, our partners, or clients on how they can adopt sustainable management practices within ESG and improve their sustainability performance. Among other aspects, and without wishing to be exhaustive, these can be how to reduce the carbon footprint, or how to comply with health, safety, environment, compliance governance, or how to create the necessary databases.

• *Adopting sustainable practices*: SMPs (accountants) are responsible for changing their work to be more sustainable. Therefore, they must adopt sustainable management best practices - ESG.

• *Preparing sustainability* reports: SMPs (accountants) are the trusted business advisors of their SME clients. SMPs have traditionally collaborated and prepared financial information and reports, both for management purposes and external reports, for our companies, entities, institutions, and clients. In the future, it is already happening like this; SMPs (accountants) must be prepared because a growing number of clients, or the companies, entities, or institutions in which we work, will request or it will be essential to prepare, coordinate and prepare information and sustainability reports. In fact, for many of them, it is already "mandatory," or it is highly recommended for others for reasons of competitiveness or requirements from its so-called "value chain". For that reason, to be a proficient advisor, SMPs need to maintain a thorough understanding of their clients' strategies. Understanding and helping shape their sustainability strategy is a logical part of this. In addition, in terms of opportunity, clients could voluntarily disclose sustainability information and, in doing so, position themselves as leaders or preferred partners in the markets in which they operate. Sustainability reporting can also be considered a management tool to improve performance in general. Voluntary reporting can help make their businesses attractive destinations for capital, customers, and employees as well as valued members of the local communities in which they operate.

• *Providing assurance on sustainability reporting*: SMPs (accountants) typically perform the audit or provide other forms of assurance/verification on financial information and customer reports. In the future, SMPs (accountants) can expect – in fact, it is already happening – that an increasing number of companies, entities, institutions, and clients seek guarantees on their sustainability information and reports that they prepare and publish (verification). In addition, for the interested parties' stakeholders, it is an additional requirement practically inalienable. In fact, the CSRD requires the company's statutory auditor, another auditor (according to Member State's option), or an independent assurance services provider (IASP) (Member State's option) to provide limited assurance on a company's reported sustainability information. As we have mentioned, there is also the option of moving toward reasonable assurance at a later stage. Member States should set out equivalent requirements for IASPs around quality, independence, and oversight in line with the Audit Directive. In the same way it did for the sustainability reporting standards, the European Commission will issue a delegated act for the standard for sustainability reporting assurance. The European Commission will likely want to leverage the work of the International Audit and Assurance Standards Board (IAASB). The IAASB is developing a standard for sustainability reporting assurance. Presently, the IAASB is publicly consulting on its proposed International Standard on Sustainability Assurance (ISSA) 5000, *General Requirements for Sustainability Assurance Engagements*, and plans to issue a final standard in 2024.

Therefore, as we have already indicated, SMPs (accountants) will need to continue to develop the capacities to provide high-quality sustainability services. In the coming years, sustainability reporting and verification (assurance) will grow exponentially in number and sophistication. Developing these new capabilities will be vital to being competitive in the market for sustainability reporting and verification services for large companies and, of course, SMEs too; it will be a crucial element to competitiveness. (Marín et al., 2021; Ortiz-Martinez et al., 2023).

5. Conclusions

SMPs (accountants) have a crucial role in developing sustainability reporting and a sustainable economy in the EU. This situation presents a double challenge, namely a significant opportunity and responsibility (Marín Hernández, 2021). Undoubtedly, our leading organizations related to the profession, such as EFRAG or IFRS Foundation, have already unfolded their activity and committees for these two areas, those dedicated to financial reporting and those dealing with sustainability reporting, a clear and unequivocal signal that sustainability has come to stay and that our profession and the SMPs are and will be an indispensables (crucial) actor.

Likewise, professional organizations such as IFAC or EFAA for SMEs (with all its members organizations-PAOs) have worked in the same direction. In the specific case of Portugal, from the OCC, a pioneering and intense activity has been carried out and continues in this field, both in training and preparation of guides and support texts and in terms of collaboration with national and international authorities for the adequate development of regulations. Likewise, bridges have been drawn between the University, our faculties, and the profession's representatives to continue growing in this area.

SMPs (accountants) have proven time and again that we can overcome similar challenges, seize opportunities, and fulfil our responsibilities. It is the responsibility of the profession, as well as its interest. However, more importantly, it is a matter of public interest for a sustainable and competitive economy in the EU and, therefore, in Portugal.

Endnotes

[i] Directive 2006/43/CE of the European Parliament and of the Council, of 17 May 2006, relative to the statutory audit of the annual accounts and of the consolidated accounts, by which modify the Directives 78/660/CEE and 83/349/CEE of the Council and derogates the Directive 84/253/CEE of the Council. Available in: https://eur-lex.europa.eu/legal-content/ES/TXT/?uri=celex%3A32006L0043

[ii] Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements for statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC. Available in: https://eur-lex.europa.eu/legal-content/ES/ALL/?uri=uriserv:OJ.L_.2014.158.01.0077.01.SPA

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