



CHANGES TO THE GOVERNANCE AND FINANCING OF EFRAG SHOULD ITS MISSION BE EXTENDED TO NFRS

OBSERVATIONS AND PROPOSALS SUPPORTING THE MANDATE BY EC TO J.P. GAUZES

Last 30 June, by email to the EFRAG Member Organizations, the President of the Board Jean Paul Gauzès announced that he had received two mandates from the European Commission regarding the possible assignment to the EFRAG to promote a European NFRS system. The second mandate, conferred on him personally, contains the request to make recommendations about the possible changes to the governance and financing of EFRAG that could be necessary to create, replacing the European Lab, a permanent and operational structure supporting the new task in case EFRAG is designated in a revised NFRD as the organisation charged with developing European non-financial reporting standards. The recommendations must take into account the contents of the mandate and be presented in a progress report by the end of October, followed by a final report by the end of January 2021.

Considering that the Lab reports directly to the Assembly, and therefore to the Member Organizations, which will then be called to express themselves on the governance and financing changes to be made, President Gauzès urges as of now their active collaboration in carrying out the mandate, inviting them to provide inputs which he will take into account in the progress report, after discussion in a meeting that he will organize after receiving them. By expressing maximum appreciation both for the initiative of the European Commission and for the invitation sent by President Gauzès, we intend to actively collaborate in carrying out the mandate by sending our first views on the subject as of now.

The principles indicated by the Commission concern the placement of the new activity within the Efrag, the indication of the other authorities, institutions and operators to be involved, and the rules to be adopted to ensure impartiality and efficiency of the standards. In this regard, the following considerations and proposals can be made:

1. The transformation of the Lab into a permanent structure able to manage the development of a European NFRS system certainly requires structural and governance changes. However, these changes can be limited to a few additions, significant but not such as to question the current structure of EFRAG, which after the Maystadt reform has reached good results and must be preserved in order not to compromise the quality of the performance and the substantial balance of relationship among stakeholders.
2. The documents of the Commission assume that the new activity is carried out by a second "pillar", replacing the current Lab. If this second pillar means a second Board (with its advisory committees and operating bodies), expressed in its hard core by the Assembly with the same governance rules as the current Board and integrated by representatives of the authorities indicated by the Commission, the hypothesis appears fully acceptable. The second Board would be integrated by representatives, with or without voting rights, of the authorities indicated by the Commission (ESMA, EEA, PSF, etc.), whose task should be to

assess the consistency of the standards with the sustainability objectives of the European Union, without involvement in the management that would remain stakeholders' responsibility. The latter should continue to guarantee funding, albeit with the important contribution of the EU together with the contribution of new subjects interested to the NFRS. The second Board could also include members of the categories whose involvement the Commission recommends, as indicated below, as well as, in the hoped event of an extension of the application of the NFRS to non-EU countries, also representatives of the latter. The President or vice-President could continue to be appointed by the Commission.

3. Coordination with the existing public and/or private initiatives producing international standards and frameworks to build to the greatest extent possible on them, appropriately recommended by the Commission, could be facilitated by the set up of a Technical Committee and the participation of their representative in the second Board. The difficult task of identifying how this coordination / integration can take place in practice should be addressed by the new project task force of the Steering Group. In addition to evident reasons of efficiency and cost avoidance, the connection of the EFRAG activity with the current NFRS producers must also be pursued in order to make the EFRAG standards not only consistent with the European Union's sustainability objectives but possibly also oriented to the global market, in order to increase its effectiveness and reduce the risk of competitive disadvantage for European companies given the presumed greater strictness of a set of standards only for Europe
4. The voice of the representatives of civil society (not already part of the ESO or NO) and of other public or private institutions capable of contributing to the development of the NFRS could be received, sharing the recommendation of the Commission, through an Advisory Committee, with the possible participation of its representative in the Board. The involvement of the authorities, institutions and other subjects with an interest in non-financial standards in the second Board and in the related advisory committees could be regulated by a special agreement to be stipulated between them and the EFRAG. The same agreement could also regulate the corresponding financial contributions.
5. By carrying out the necessary additions of representation for the decisions concerning the NFRS within the second board, with a corresponding reduction in the designations reserved to the Assembly, there is no reason to change the governance rules of the latter and of the existing Board. After all, EFRAG is essentially made by its members as well as its staff. It is they and their management that led to the success that today leads to extend its activity to non-financial information. It is their financial and in-kind contributions that have allowed it to develop. It is their competence and experience in financial reporting that guarantees that coordination with the non-financial information that everyone hopes for in order to achieve integrated corporate reporting. Changing this structure beyond what is strictly necessary would be risky and contrary to the interest of the EFRAG.
6. These considerations apply, in particular, to the NSSs. They represent all categories of professions involved (from accountants to preparers to users), interface companies from all

sectors and collaborate with all authorities and institutions interested in financial reporting and, in perspective, even in non-financial reporting. For functions performed and culture of their representatives, they present sensitivity and attention to the public good. There is therefore no reason why their suitability to contribute to the development of non-financial standards could be questioned, once they and the other stakeholders agree that the necessary and appropriate subjects are present in the new board, in the related advisory committees and in the related operational bodies, in order to integrate their skills in the new activity. In any case, the responsibility of management and of the activity on financial reporting must remain the prerogative of the current stakeholders according to the current governance rules.

7. Once acquired the principle that the development of the NFRS will be entrusted to the new board and that the activity on IFRSs, with particular reference to the endorsement advice, will remain the prerogative of the current board, the question might arise whether the general functions of Efrag (resources, finance, planning and control, communication) should be left to the current Board or assigned directly to the Assembly for greater symmetry between the two Boards. Among the solutions that could be envisaged for this purpose, for example, a permanent Presidential Committee could be set up, composed by the President of the Assembly and 2 or 3 Vice-Presidents, supported by a small staff. The Committee could also perform the function of coordination of the two pillars in order to converge towards integrated corporate reporting.
8. The maintenance of the current governance and financing structure implies, subject to verification to be carried out when the costs and revenues of the new activity will be quantifiable, the maintenance of unified financial management, albeit with separate accounting for management control and attribution of additional contributions for the new activity. It is however likely that the new activity will lead to an increase in costs, even if not in the current two-year period and therefore the need remains to promote a more balanced distribution of the contributions paid by the members within the ongoing discussion on medium-term financing. We believe, in particular, that the parity of powers between the two pillars is a value for the Efrag. It needs to be maintained by respecting a balanced ratio between the respective financial contributions, without which the parity of powers would not be justifiable. Equally unjustified appear disparities between roles and contributions within the pillars.
9. Finally, as regards the recommendation that the standards are developed with a due process respectful of the public interest, inclusive and transparent also in order to avoid undue influences from individual categories of stakeholders, it should be noted that this is already widely guaranteed by the current governance structure and by the requirements present in the statute and internal rules. These requirements should obviously be applied to the second board, with the adjustments required by its enlargement and the set up of the advisory committees.



10. To conclude, the structure and governance adjustments required for the extension of the Efrag activity to the development of the NFRS do not seem to go beyond the establishment of a new board with related advisory committees and operational bodies. The equal participation of the two chapters in the new board could be reduced up to the mere maintenance of control, leaving wide room for the other subjects to be involved, such as representatives of the authorities and institutions recommended by the Commission to integrate the expertise. Structure and governance of the Assembly and the current Board do not require changes, except for possible transfers of competences within them.