Telling the whole story: Why it’s more than just a numbers game

The rise of unified financial and non-financial reporting

A Frost & Sullivan White Paper

In collaboration with Workiva

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ABSTRACT

The goal of unified reporting is to give a comprehensive picture of the organisation, thus helping management, investors and other stakeholders make better-informed decisions. In order to achieve this goal, companies will now need to focus on both financial and non-financial (environmental, social, governance, sustainability) data and information to satisfy stakeholders.

Why is this important?

Firstly, with digital reporting requirements introduced in Europe, financial reporting has evolved quite quickly. Transparency on financial reporting has been even more emphasised with the European Single Electronic Format (ESEF), and the reporting of non-financial information is starting to catch up.

New regulations in Europe are mandating large public-interest entities to disclose non-financial information. However, beyond the regulation, investors increasingly want information about non-financial issues because they want to align their money with their values and principles, and they want to know how these issues affect the bottom-line of a company.

Reporting on non-financial information is not without its challenges, though. The lack of comparability and consistency, which is largely due to the lack of a uniform global framework, makes it difficult. Plus, financial reporting and sustainability teams tend to operate in silos.

But, companies are turning to technology to help drive collaboration by unifying these teams in reporting platforms, which also provides them with the capability to improve the consistency, transparency and auditability of their unified reporting.

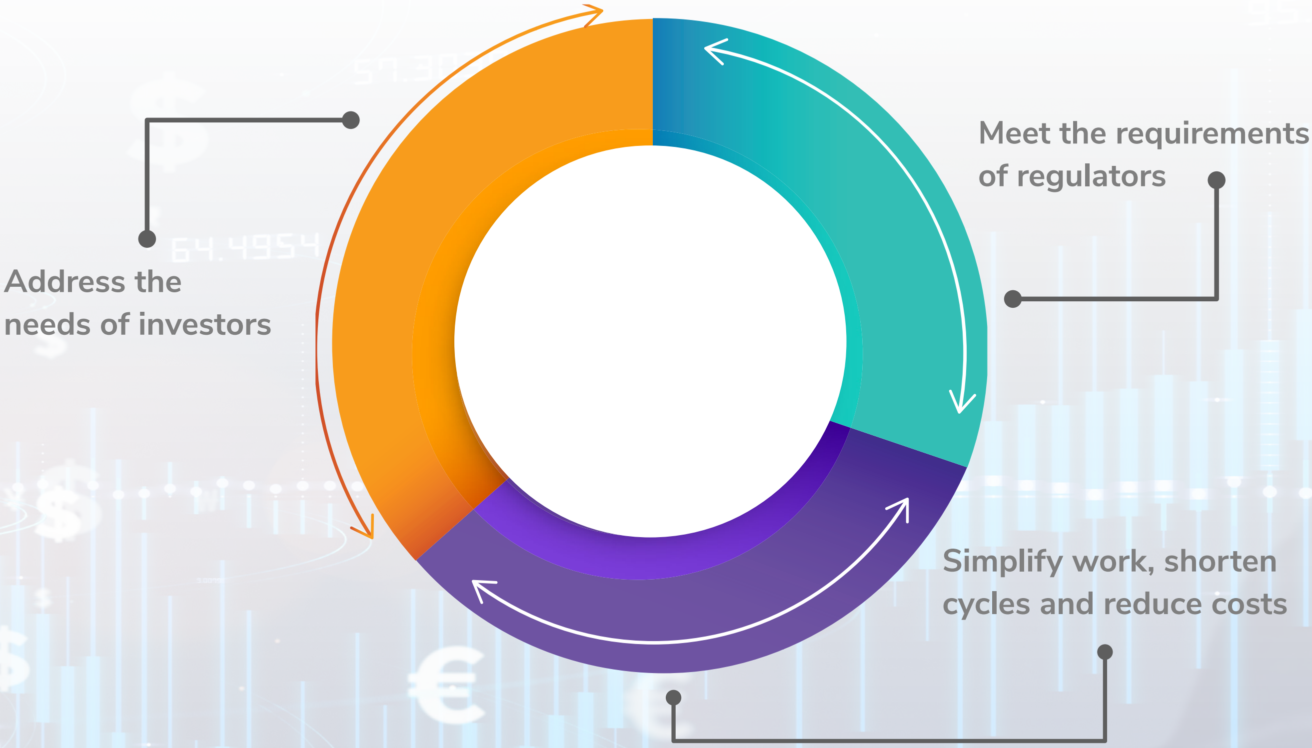
INTRODUCTION

A spreadsheet, an Enterprise Resource Planning (ERP) tool, a presentation, a Customer Relationship Management (CRM) platform; organisations' data and information is proliferating and fragmented, often sitting across multiple locations in differing formats.

Against this backdrop, businesses small and large find themselves operating in increasingly complex environments whilst, in parallel, public and private stakeholders expect greater access to and understanding of their strategies, policies, actions and performance.

Today a number of factors are converging which are both pushing and pulling reporting companies to fundamentally rethink the way in which they process and present financial and non-financial information which is destined for external communication.

In particular, they are looking to;



A range of vendors have responded by developing and launching cloud-based solutions which join the dots between companies' existing platforms and programmes, linking numbers and narrative, connecting teams and facilitating the advent of joined-up reporting.

This paper explores the factors which are driving their adoption and examines the benefits that they bring to the companies themselves, as well as those with an interest in the reports and what they mean for the businesses, their stakeholders and their environments.

ADDRESSING THE NEEDS OF INVESTORS

Sustainable investing isn't new. In 1971, Pax World launched the first sustainable mutual fund in the United States which is still available today and managed by Impax Asset Management. Founded by two Methodist ministers who were looking to avoid supporting companies that were contributing to the Vietnam War, the vehicle was representative of much of the early Socially Responsible Investing (SRI) where religious groups were looking to apply an ethical framework by "negatively screening" businesses that were exposed to areas such as alcohol, gambling, tobacco and weapons.

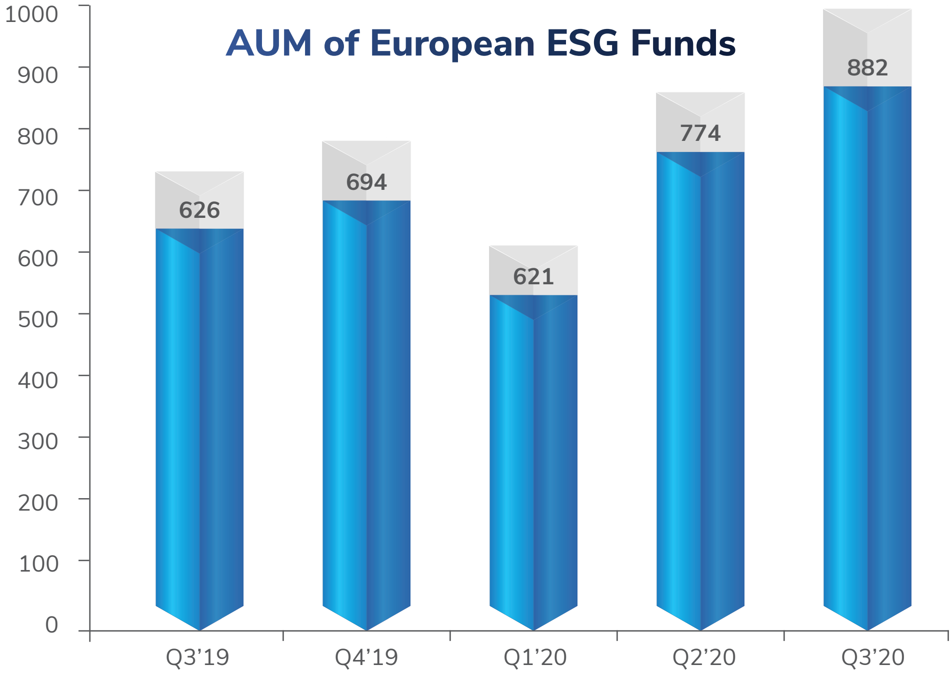
This exclusionary approach has rapidly evolved into something more holistic. Today, SRI is at the heart of – or at least part of – very many fund managers' strategies with investors looking to align their holdings with their values. In parallel, corporations are facing an unprecedented range of risks and challenges, from tackling climate change and managing their supply chains to handling adverse events. The Covid-19 epidemic of 2020 has only heightened investors' scrutiny of – and the public's interest in – how companies address Environmental, Social and Governance (ESG) issues.

The demand for non-financial reporting which is as robust and transparent as that which is used for financial metrics and, ideally, makes the link between the two, is driven by growth in ESG funds.

These cover the whole spectrum, as neatly defined by John Hale, Head of Sustainability Research at Morningstar, from strategies which "consider" or "integrate" SRI criteria into their investment processes to "impact" and "sustainable sector" vehicles which look to have a positive effect on the environment or society or are limited to holdings in green products, solutions and services.

According to recent Morningstar data, the Assets Under Management (AUM) of European ESG funds increased from €626m at the end of the third quarter of 2019 to €882m a year later, passing the bar of one billion in US dollar terms for the first time. In 2020, they have so far attracted a cumulative €13b of inflows representing an unprecedented proportion of the overall market. This growth stems from the success of existing vehicles as well as changes in strategy with 32 "regular" funds moving to an SRI approach, 29 of which have officially joined the ESG category as defined by analysts.

> "Today, BlackRock announced a number of initiatives to place sustainability at the center of our investment approach [...] We believe that all investors, along with regulators, insurers, and the public, need a clearer picture of how companies are managing sustainability-related questions."
>
> **Larry Fink, Chairman and Chief Executive Officer, BlackRock, 14th January 2020**



Source: Morningstar, Les Echos, Frost & Sullivan

ESG funds represented **66**% of total net inflows in Europe in September 2020

The popularity of ESG funds can in part be explained by demographics; a "$30 trillion intergenerational wealth transfer" (David Nadig, CEO, ETF.com) is taking place with baby boomers being replaced by their children who are typically more interested in how companies behave and think about their investments differently, valuing sustainability above returns. In addition – and somewhat paradoxically – it has been demonstrated that there is no performance penalty associated with ESG funds; research from Morningstar which analysed 4,900 Europe-domiciled funds found that 58% outstripped their peers over ten years with this number rising to 64% over three years.

Investors in the Nordics have been at the cutting edge of SRI. On the sell-side, ESG-focused strategies in the region are spoiled for choice with Sweden, Finland and Norway consistently ranking in the top five of the Institutional Shareholder Services' (ISS) annual ESG Country Report, whilst the movement has received renewed impetus as major local vehicles, such as Norway's Government Pension Fund Global (*Statens Pensjonsfond Utland*), double down on their ethical commitments. A recent survey by NN Investment Partners showed that nearly half of Nordic investors are actively deploying impact strategies with managers increasingly engaging with companies on best practice.

MEETING THE REQUIREMENTS OF REGULATORS

In addition to the demand from investors, the need for effective and connected reporting is also a response to a clear and growing regulatory "push". Existing and emerging legislation at national and, in particular, supranational level is compelling all listed companies to provide;

- Consistent and comparable financial reporting
  - The European Single Electronic Format (ESEF) specifications of Directive 2013/50/EU, which was implemented from the beginning of January 2020, notably require businesses to report their financial statements in a harmonised way, making them machine-readable and facilitating easy access and analysis
- Information on the way in which they manage social and environmental challenges
  - The Non-Financial Reporting Directive (NFRD) 2014/95/EU, for example, is under review with changes expected to be announced in the first quarter of 2021. The European Commission considers that non-financial information currently disclosed by companies does not fully meet the needs of investors so is consulting on new standards for reporting which is relevant, reliable and decision-useful

These requirements overlay a range of existing global standards on financial reporting such as the International Financial Reporting Standards (IFRS), as well as increasingly well-accepted norms in respect of non-financial disclosures.

The Global Reporting Initiative's (GRI) sustainability reporting framework, for example, aims to "enable organisations to be transparent and to take responsibility for their impacts"; its standards are used by hundreds of multinationals as well as small and medium enterprises (SME) in more than 90 countries to communicate on topics ranging from anti-corruption to water, biodiversity to occupational health and safety and from tax to emissions.

> "The demand for validated and comparable sustainability reporting will increase in the Nordic area regardless of company size"
>
> **Norwegian Accountant Federation**

Most recently, in late November 2020, the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB) announced their intention to merge into a single organisation, the Value Reporting Foundation, the aim of which is to "simplify the corporate reporting landscape [and to provide] the market with a clear solution for communicating about the drivers of enterprise value [and] sustainable performance."

At a local level, attention on non-financial reporting has been sharpened by the recent launch of the Nordic Sustainability Reporting Standard (NSRS) which is expected to be piloted from March 2021. The project, coordinated by the Norwegian Accountant Federation (NAF) on behalf of the Nordic Prime Ministers and working with professional bodies in both Sweden and Finland, is primarily aimed at SMEs but was prompted by recognition that "the demand for validated and comparable sustainability reporting will increase in the Nordic area regardless of company size". It is hoped that more generally it will support the move from a linear to a circular economy.

So, where do we go from here? The regulatory agenda is currently turning to the need for a common ESG language to give clarity to the public, investors and companies alike. This, in turn, is further increasing scrutiny on the transparency of both financial and non-financial reporting.

In Sweden, the Swedish Investment Funds Association's Ethical Committee for Fund Marketing (*Etisk nämnd för fondmarknadsföring*) has clamped down on the terms that are being used by funds to market SRI strategies to individuals and institutions.

At a European level, the Commission is working on wider framework to aid sustainable investing but the industry as a whole still faces difficulties when it comes to recognising whether everyone is on the same page. The Taxonomy Regulation will not enter into practice until the beginning of 2022 at the earliest but, together with the proposed Disclosure Regulation and Low Carbon Benchmarks Regulation, is indicative of the overall direction of travel; the final aim is to combat "greenwashing" and to allow all stakeholders to identify what is sustainable and what is not.

SIMPLIFYING WORK, SHORTENING CYCLES AND REDUCING COSTS

Technology has a key role to play in facilitating unified reporting across a single platform, allowing public and private companies to address the requirements of investors and regulators through the provision of transparent and timely financial and non-financial reporting.

In addition to meeting these "external" demands, the cutting edge cloud-based solutions which are available today also bring a range of benefits to the reporting companies themselves.

Internally, effectively connecting and complementing existing point, legacy software (e.g. Microsoft Office) and/or proprietary systems has the ability to;

01
Enable collaboration, by facilitating real-time editing

02
Increase efficiency, by linking data and commentary automatically

03
Provide consistency, by creating a "single data truth"

04
Heighten traceability, by tracking changes

- Enable collaboration, by facilitating real-time editing
    - In large, multinational organisations, tens and sometimes hundreds of people work on reporting at any one time with contributors often sitting in different time zones. Allowing multiple people to manipulate the same document in parallel breaks down internal silos, removes bottlenecks and encourages joined up working
    - The Covid-19 pandemic has been transformative in many respects, notably shifting millions of workers from the office to the home. A survey by Slack suggest that only 12% of employees would like to return to a 9-to-5 model whilst 72% would prefer a hybrid approach reinforcing the need for flexible collaboration platforms

- Increase efficiency, by linking data and commentary automatically
    - Typically, public companies communicate on hundreds of different metrics which are generated from disparate systems, stored in diverse documents and destined for different presentations, creating hundreds of thousands of linked instances across their reporting processes. Manually editing data and commentary in multiple locations is onerous but enabling automatic updating, which allows any changes to flow through the platform to the final reports, saves both time and effort

- Provide consistency, by creating a "single data truth"
    - In addition to process considerations, many global organisations have complex legal structures with reporting commitments in multiple jurisdictions which are bound by differing, local filing requirements. Cloud-enabled connected reporting removes the danger of version control issues and ensures that the same numbers are included in all communications, no matter the language or location

- Heighten traceability, by tracking changes
    - Manually editing data and commentary in multiple documents not only creates the potential for errors but also makes any changes difficult to identify and follow. By using a single, connected platform, complete transparency is created which means that it is possible to see what has been adjusted, where, when and by whom. Furthermore, access can be extended to external auditors

Overall, the effective use of joined-up reporting solutions has the potential to simplify complex work thereby shortening quarterly and annual cycles whilst at the same time reducing costs. In addition to enabling collaboration, increasing efficiency, providing consistency and heightening traceability, a connected and joined up approach unifies the people and processes behind reporting as well as the presentations themselves.

It also promises to have a broader positive impact on companies by freeing up employees from entering, checking and formatting data. At a personal level, finance teams have reported higher levels of job satisfaction as they have the time to focus on analysis rather than processes. At a company level, organisations deploying cloud-based connected reporting solutions benefit from their staff being able to concentrate on strategic initiatives that are designed to improve performance rather than just report on it.

THE FINAL WORD

In addition to addressing the needs of investors, meeting the requirements of regulators and simplifying work, shortening cycles and reducing costs, the move to connected reporting sits in the context of a wider shift towards greater digitalisation across the business world.

The launch of the Nordic Smart Government initiative is indicative of this. In September 2020, the region's ministers of trade and industry approved a strategic roadmap which will pave the way to the establishment of an interoperable ecosystem of digital solutions that is intended to provide real-time business information and "make companies' economic data securely accessible and usable for the purposes of innovation and growth."

Separately and more broadly, Frost & Sullivan's 2020 Global Cloud Survey of over 400 European businesses showed that 44% currently use cloud solutions and 38% plan to in the next two years; 76% of the latter are driven by a desire to "improve processes and efficiency".

Connected reporting solutions both meet the immediate needs of and bring tangible benefits to investors, the general public, regulators and companies alike. They also have the potential to help better equip public and private businesses for the ongoing and inevitable journey towards further digital transformation in the years ahead as cloud-enabled Software as a Service (SaaS) platforms continue to fundamentally remodel companies' processes, products and services.

ABBREVIATIONS

AUM	Assets Under Management
CRM	Customer Relationship Management
ERP	Enterprise Resource Planning
ESEF	European Single Electronic Format
ESG	Environmental, Social and Governance
GRI	Global Reporting Initiative
IFRS	International Financial Reporting Standards
IIRC	International Integrated Reporting Council
NAF	Norwegian Accountant Federation
NFRD	Non-Financial Reporting Directive
NSRS	Nordic Sustainability Reporting Standard
SAAS	Software As A Service
SASB	Sustainability Accounting Standards Board
SME	Small and Medium Enterprise
SRI	Socially Responsible Investing

SOURCES AND FURTHER READING

Pax World Funds, **Impax Asset Management**

A taxonomy of sustainable funds, **Morningstar**

Gestion d'actifs : comment l'ESG est devenu incontournable à la faveur de la crise, **Les Echos**

Swipe to invest: the story behind millennials and ESG investing, **MSCI**

How does European Sustainable Fund's Performance measure up?, **Morningstar**

ISS ESG Country Report 2019, **Institutional Shareholders Service**

The first 20 years of investing responsibly, **Norges Bank Investment Management**

Nearly half of Nordic institutional investors invest in impact strategies, **NN Investment Partners**

Non-Financial Reporting Directive: the pursuit of data that is relevant, reliable and comparable, **Linklaters**

Welcome to GRI, **Global Reporting Initiative**

IIRC and SASB announce intent to merge in major step towards simplifying the corporate reporting system, **International Integrated Reporting Council**

Why this standard?, **Nordic Sustainability Reporting Standard**

Uttalande från Etiska nämnden för fondmarknadsföring om fondnamn, **Etiska nämnden för fondmarknadsföring**

Moving beyond remote: Workplace transformation in the wake of Covid-19, **Slack**

Nordic ministers approve Nordic Smart Government roadmap, **Nordic Innovation**

2020 Global cloud user survey, **Frost & Sullivan**

