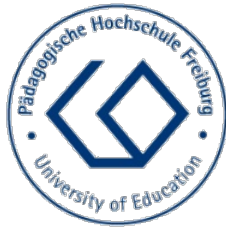


Sustainable Accountability in the EU Textile Market



Hochschule Reutlingen
Reutlingen University



Co-funded by
the European Union

Agenda

- i. Where we come from?
- ii. Where we are at?
- iii. Examples from EU textil market
- iv. Where we go to?

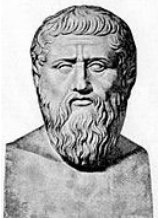
Learning objectives

After this lecture students should:

- Understand the concept of accountability in the context of business
- Provide an overview of current requirements on sustainable business reporting
- Critically reflect sustainable business reporting requirements and its currently foreseeable development
- Name some examples of good practice from the EU textile market

Where we come from?

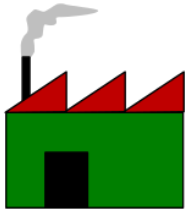
Accountability



- Ethic concept already known by ancient Greeks:
 - Suggesting new regulations or laws only by stepping out in public with a rope about one's neck (*Dykstra* (1939))



- Today def. as „**acknowledging responsibility for my actions**“
- Implicitly requires transparency, observation, evaluation of the actions
- As legal entities companies should also be accountable



How to make a company accountable?

Ethical view: Any company should be accountable for its actions.

Would a company voluntarily report about any actions? Also the ones which cause harm to others?

If not, how could accountability be assured?

- EU legislation supports the demand for accountability of legal entities by regulation.
- One aspect is corporate reporting.

Where we are at?

Requirements on corporate reporting

- Within in the EU, legislation for corporate reporting differentiates between companies which are of public interest (PIEs) and those who are not (non-PIEs):
 - In general, **non-PIEs** need to fulfill the **requirements set by the respective member state** they are located in *)
 - Def. as credit institutes, insurers and **capital market-oriented companies**
 - **PIEs** need to follow the requirements stemming from Regulation (EC) No 1606/2002 which among others asks for **application of the International Financial Reporting Standards (IFRS)** as endorsed by the EU

*) Still, harmonization on EU level has been applied since the contract of Lissabon.

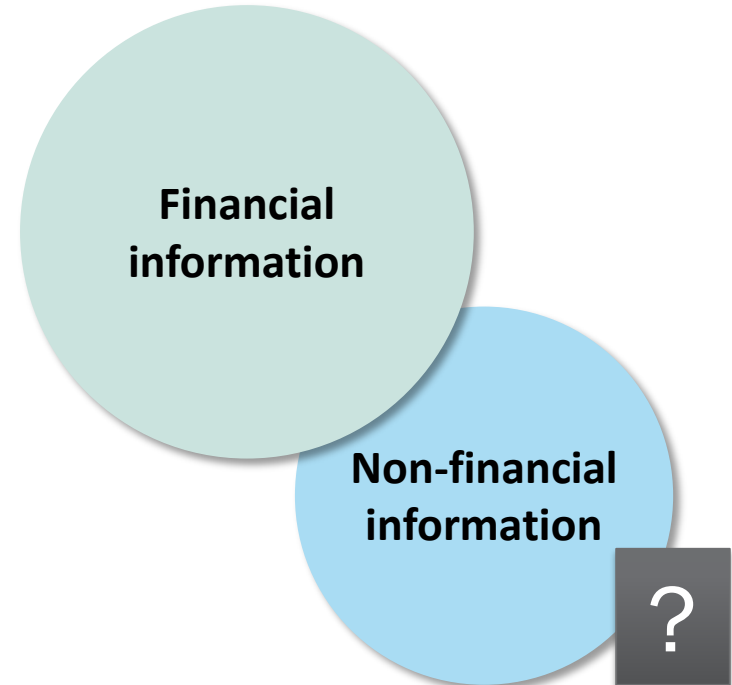
International Financial Reporting Standards (IFRS)

- Issued by the International Accounting Standards Board (IASB), the standard setting body of the IFRS Foundation
- Required by approx. 170 jurisdictions worldwide
- Objective is to provide users of financial statements information that is **useful for decision-making**
- Companies should present a **true and fair view** of their **financial position**, its **performance** and the **cash flows**; means for this are
 - **Statement of financial position**
 - **Statement of comprehensive income**
 - **Statement of cash flows**

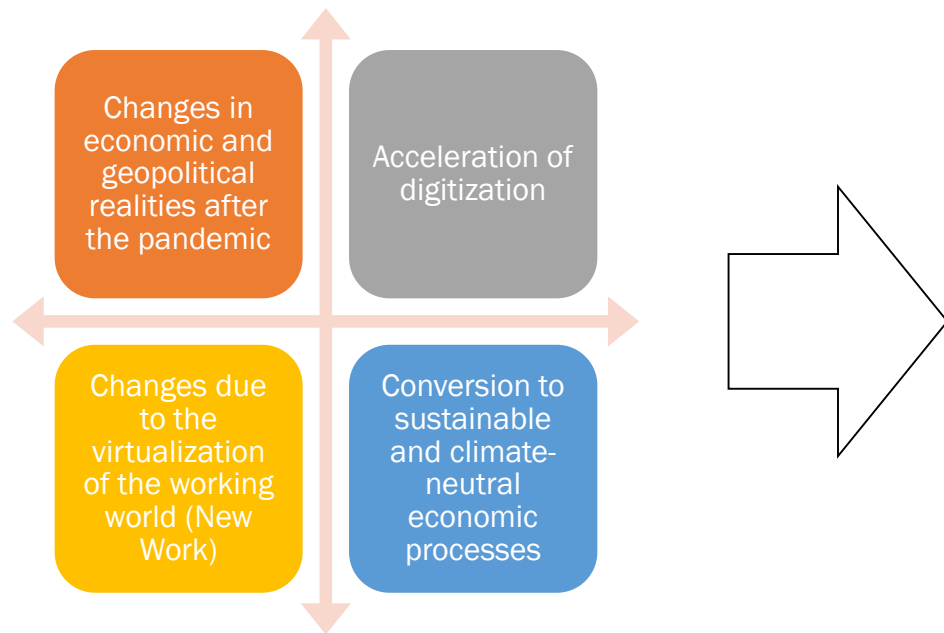
Discuss: How do the IFRS contribute to the concept of accountability?

Brief reflection of reporting requirements

- Financial statements comprise information linked to the past
 - Decision usefulness might be limited in relation to forecasts
- General necessity of further requirements regarding non-financial information



Further aspects on potential relevance of non-financial information

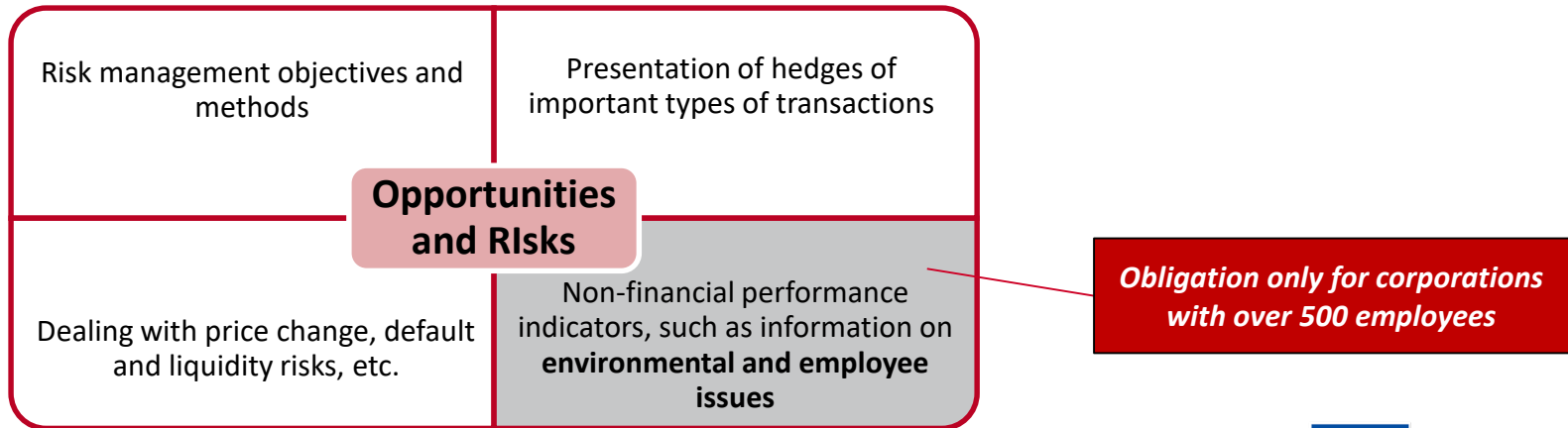


Future reporting will need to include non-financial information more comprehensively to reflect these developments.

Source: KPMG (2021)

Non-financial reporting

- Under IFRS companies might provide a management commentary which is **not compulsory**
- On national level, EU members already require economic outlooks by the management, e.g. the German Lagebericht (§289 HGB)



Implementation of the current requirements by the companies (headlight Germany)

- Compliance with §289 of the German Commercial Code (HGB) in conjunction with the concretization by GAS 20 by medium-sized companies

	2013	2018	2013	2018
Finanzwirtschaftliche Risiken	61	77	32,97%	29,17%
Umfeld und Branchenrisiken	43	69	23,24%	26,14%
Operative Risiken	23	36	12,43%	13,64%
Risiken aus der Entwicklung des Gesamtmarkts	18	29	9,73%	10,98%
Rechtliche Risiken	14	21	7,57%	7,95%
Personalrisiken	9	12	4,86%	4,55%
IT-Risiken	12	15	6,49%	5,68%
Strategierisiken	5	5	2,70%	1,89%

Source: Müller/Seebeck/Weeger (2021), n=100

Despite legal requirement, low level of risk assessment

Assessments of current megatrends (environmental protection, digitization, globalization) are hardly to be found in the companies' management reports

Discuss: What could be the reasons here?

Critical view on current requirements

- Information is not relevant, not reliable, rarely comparable (critics were investors and other stakeholders).
- How should non-financial information then be considered, e.g., for investments?
- Also, too few companies committed.
- Summary:



Corporates



Investors



Public

Importance of sustainable reporting

- Study by *Baumgartner/Ernst/Fischer (2020)* points out the comparatively low significance of sustainable reporting for various groups of addressees

Table 13 Relevance of the information provided in the experimental groups' disclosure vignettes (studies 2 and 3)

Rank	Study 2 (N=225): investment decision			Study 3 (N=228): employment decision		
	Information category	Mean	SD	Information category	Mean	SD
1	Financial situation	6.28	0.99	Employees and workplace**	5.97	1.22
2	Firm strategy**	5.60	1.27	Development of corporate reputation*	5.49	1.21
3	Products and innovations**	5.56	1.19	Financial situation	5.44	1.32
4	Development of corporate reputation*	5.40	1.27	Firm strategy**	5.42	1.30
5	Sustainability**	5.08	1.61	Products and innovations**	5.28	1.17
6	Social commitment**	4.55	1.63	Sustainability**	5.26	1.51
7	Employees and workplace**	4.48	1.47	Social commitment**	4.96	1.44

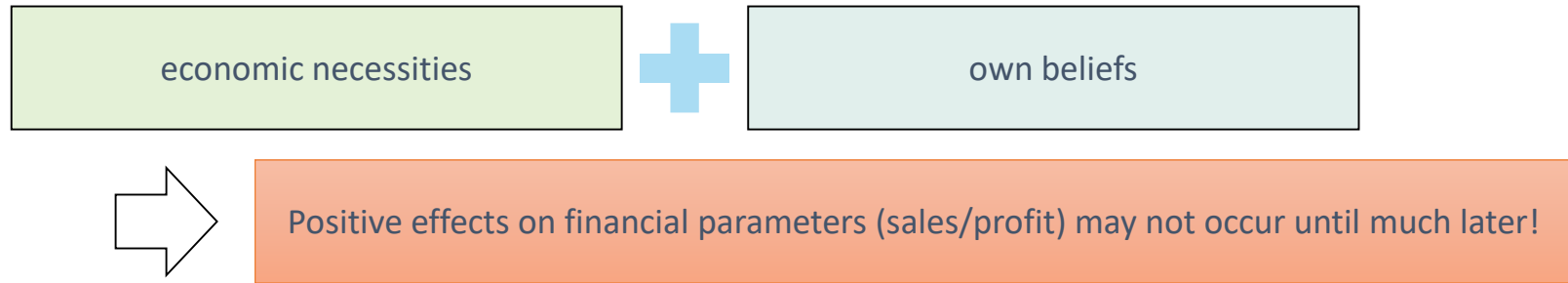
*Direct reputation information; **indirect reputation information

Discuss: What is your perception of the importance of this information?

Examples from the EU textil market

Voluntary sustainability reporting

Nonwithstanding current legal requirements, companies may develop their own sustainability requirements and report about it



Two important currencies: **Credibility and trust!**

Topic: What can the company do for society?

Discuss: What could be the downside of voluntary reporting in terms of sustainable aspects?

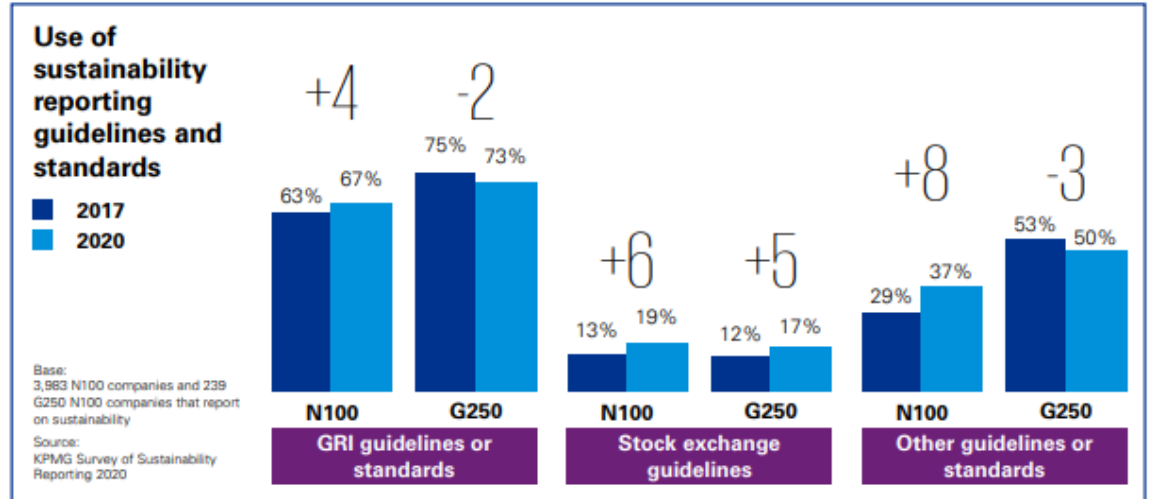
Excursus: No consistent source for sustainable reporting, but...

Examples:

→ Larger companies most commonly use GRI:



ISO 9001



Würth MODYF GmbH & Co. KG

Company	Products	Workwear and safety footwear manufacturer
	Place, Age	Künzelsau, 1997 as a subsidiary of Adolf Würth GmbH & Co. KG
	Size	Employees: 144 / Sales: 56 million euros / Balance sheet total:
Reporting	Type	Voluntary reporting according to GRI standards, separate report, since 2020
	Scope	84 pages
	Content	<ul style="list-style-type: none"> • Linking the five focus topics with the company's strategic orientation <ul style="list-style-type: none"> • Products • Supply chain • Resources • Climate protection • Employees • ISO 9001, ISO 14001 • GRI Index

Wolford AG

Company	Products	Luxury skinwear (legwear, bodywear, lingerie)
	Place, Age	Bregenz (Austria), founded 1950
	Size	Employees: 1,243 / Sales: 119 million euros / Balance sheet total: 162 million euros
Reporting	Type	Separate sustainability report since 2017/18 (obligated qua legal from (AG))
	Scope	44 pages
	Content	<ul style="list-style-type: none"> • Responsible corporate governance and compliance • Sustainability issues and stakeholders involved • Consequences for the sustainability strategy (concrete KPIs) • Areas of responsibility (environment, employees, supply chain) <ul style="list-style-type: none"> • Energy consumption, CO2 emissions, wastewater, waste, water • Working hours, fluctuation, occupational safety, diversity • Certification, materials • GRI index

Further examples of good practise



Analytical considerations	Good or leading reporting practice examples
Business model reporting	
Business model reporting: clarity and comprehensiveness of value creation description	<ul style="list-style-type: none"> • Neste (Energy) • Stora Enso (Forest products and paper) • Schneider (Electronic component and equipment) • FMO (Development banking)
Business model reporting: potential across time horizons	<ul style="list-style-type: none"> • Allianz (Insurance) • Schneider Electric (Electronic component and equipment) • Orsted (Energy)
Business model reporting: dependencies and impacts	<ul style="list-style-type: none"> • SGS (Business support services) • EnBW (Electric and gas utilities) • ABN Amro (Diversified banking) • DSM (Chemicals)
Reporting sustainability matters linkage to business model, strategy	
Sustainability matters effects on company performance	<ul style="list-style-type: none"> • EnBW (Electric and gas utilities) • Arcadis (Consulting engineering and construction) • ABN Amro (Diversified banking) • SGS (Business support services) • Norsk Hydro (Aluminium and renewable energy)
Sustainability risks	<ul style="list-style-type: none"> • Enel (Energy) • Schneider (Electronic component and equipment) • AB Volvo (Automotive) • Novozymes (Pharmaceutical and biotechnology) • BNP Paribas (Diversified banking)
Sustainability opportunities	<ul style="list-style-type: none"> • Enel (Energy) • Schneider (Electronic component and equipment) • CH Hansen (Bioscience) • Acciona (Energy and infrastructure) • Signify (Industrial products-electrical equipment)
Sustainability strategy, targets, KPIs, and progress	<ul style="list-style-type: none"> • Acciona (Energy and infrastructure) • Peugeot (Automotive) • Lenzing (Chemicals) • GlaxoSmithKline-GSK (Pharmaceutical)

* The listing of companies within each category of Table 2 does not indicate a ranking. It is the order of presentation in the Supplementary Document: Good reporting next first.

Source: report of the EFRAG Task Force

The big BUT...

- To map sustainable developments in the companies is one thing
- In order to implement actual sustainable developments it is necessary:

CAPITAL

UNDERSTANDING OF THE CAPITAL
PROVIDERS

WORKING BUSINESS CASES

Discuss the following statement:

“Regulation, and be it via reporting standards, will help along the way.”

Where we go to?

Necessity of sustainability reporting requirements

Stakeholders of companies with **increasing interest** in information about the **consideration of sustainability in corporate activities**

Contrary to the study by Baumgartner et al.

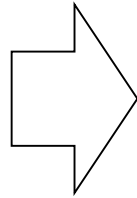
Sustainability reporting recognized by **politicians**
→ Instrument in the context of **combating climate change** as well as increasing importance of ecological and social aspects

Decision-making by companies in the interest of a more ecological and social world, first of all transparency about these aspects of decisions

Discuss: Is the dominance of financial aspects eroding?

Reporting standards to be used and place of reporting

From no consistent source so far to the Vision of the EU Commission



EU-wide single source:



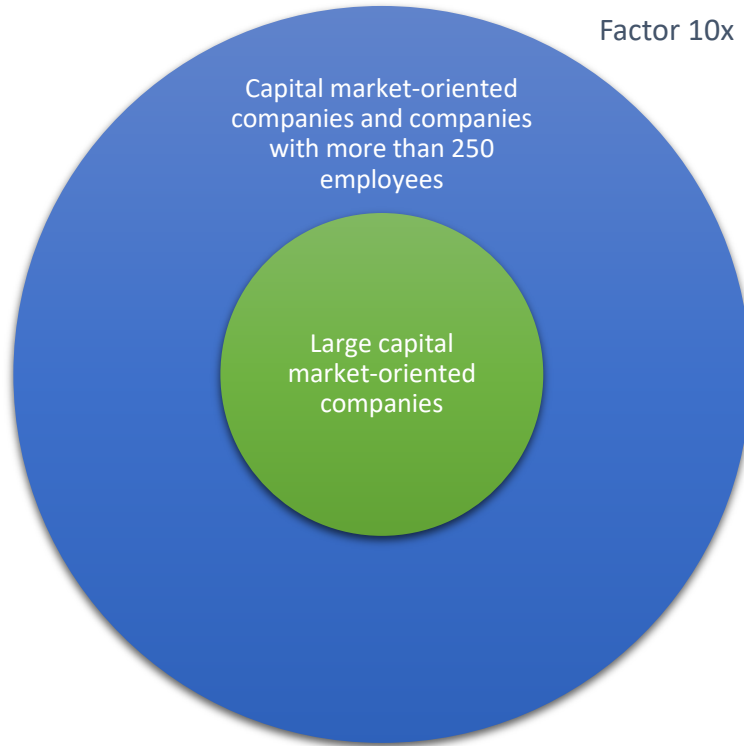
- ➔ Publication of sustainability information in the **management report** of the companies.
- ➔ Format: annual financial statements and management reports electronically in xhtml format.
- ➔ Aspects of sustainability reporting are to be digitally identified (tagging)

Revision of the CSR Directive by the EU



- EU Green Deal: climate-neutral continent by 2050
- Small building block to this:
Complete revision of the existing CSR Directive.
- Publication of the draft in April 2021, with the objectives:
 - More transparency on sustainable aspects
 - Eye-to-eye with financial reporting
 - Ending the "two-tier society" of financial and non-financial information
 - Regulation of clear responsibilities
 - Alignment with the EU Action Plan on Sustainable Finance/EU Green Deal

Extension of the scope of application

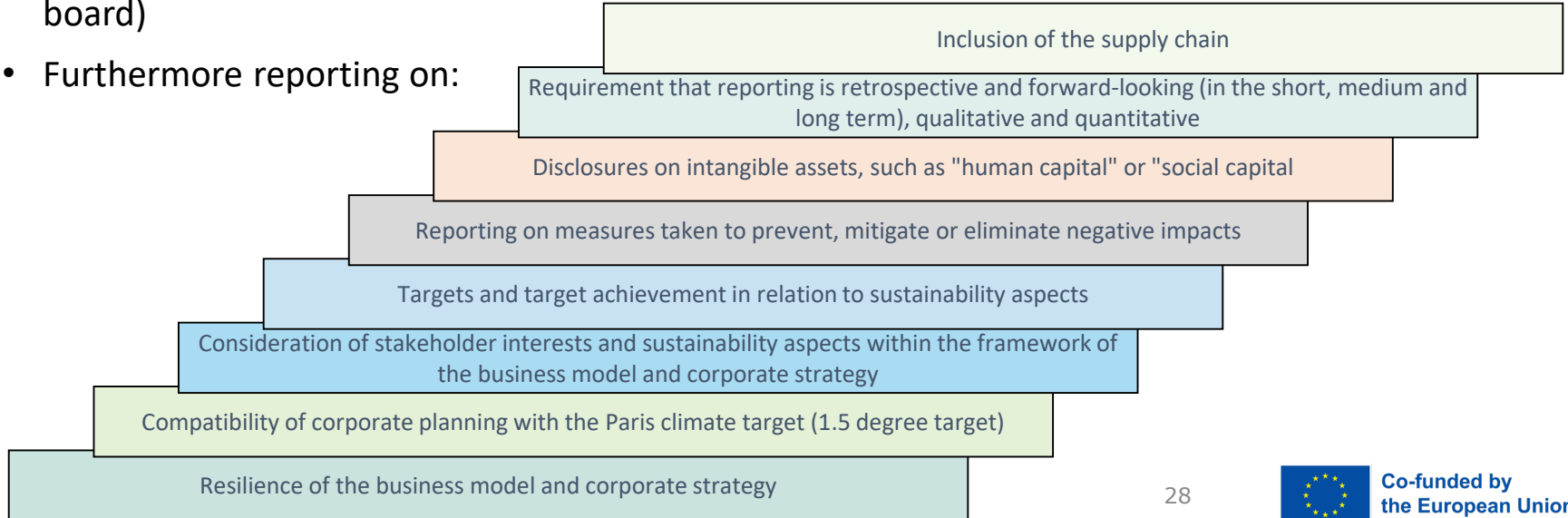


- Previous obligation for approx. 500 companies in Germany alone
- New regulation affects approx. 5,000 companies in Germany
- Larger corporates obligated as of 01.01.2023 (=elimination of capital market and employee criteria)
- Capital market-oriented small and medium-sized enterprises (SMEs) as of 01.01.2026

Expansion and specification of reportable information

- Regulatory content expanded and specified
- Focus on environmental, social and employee issues
- Corporate governance aspects added (e.g. role of management board and supervisory board)

- Furthermore reporting on:



As of today: Questions remain unanswered...

Solutions

No generally accepted imaging system

- So far only little regulated
- Many proposals, concepts, approaches discussed and tried out
- Standardization is missing (also key figures)!

new EU standards ?
(Relevance, Reliability, Comparability)

Depiction horizon of sustainability aspects >>
Period of other reporting

- NBE deals with the entire value chain and should refer to the entire product life cycle
- Consideration of all modes of impact required

Double materiality - environment on company and company on environment ?

Time frame for implementation

- New directive will not apply to the majority of companies until 2026 at the earliest
- Agenda to achieve climate neutrality by 2050 on the one hand, critical points by 2030 on the other hand

Previous commitment or self-commitment after all

Appreciation of the EU Directive

1.

Reconsider timetable for introduction

Bring commitment forward, but reduce audit rigor in first few years after implementation

2.

Take better account of findings from risk and opportunity reporting

esp. with regard to already identified/known needs for action and potential for improvement:
E.g.: assessment/categorization of risks, information regarding gross vs. net view.

3.

Binding specifications for key figures to be reported across all industries

4.

Digitalization in accounting must generally advance

Systems only as good as the data they contain
Need for knowledge carriers

A spark of hope?

- It is not only the EU Commission that has taken up the issue of sustainability reporting:
 - IFRS Foundation - responsible for the internationally recognized accounting standards IFRS - has founded a new entity, the International Sustainability Standards Board (ISSB), which is to develop global basic standards (Global Baseline) in the area of sustainability reporting in the future.
 - The ISSB was already joined by a number of voluntary initiatives when it was founded.
 - With the founding of the ISSB, two prototypes were published on the topics:
 - Climate reporting and
 - general requirements for the disclosure of sustainability-related financial information.
 - The ISSB is based in Frankfurt am Main

→ "Competition" stimulates business.

→ Plus tendencies to align among ISSB, GRI and EFRAG.

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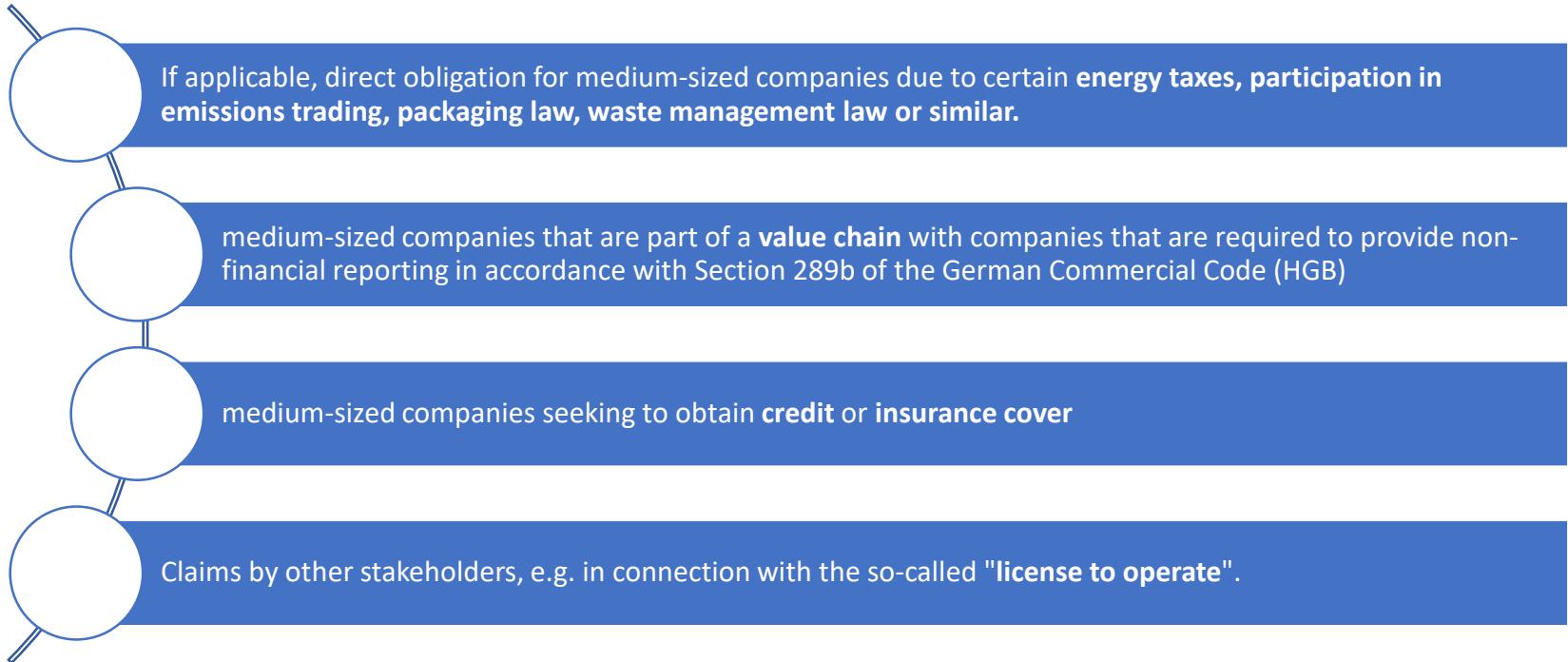
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Backup



More on the German perspective



Clarification of the concept of double materiality



Indicative schedule



Quelle: DRSC, Informationsfolder zum Kommissionsentwurf zur Neuaufstellung der Nachhaltigkeitsberichterstattung, online abrufbar unter https://www.drsc.de/app/uploads/2021/04/210421_CSRD_Briefing-Paper.pdf

Excursus: Responsibilities and audit obligations

Internal structures

- In the future, **management** should actively and demonstrably bear **responsibility** for sustainability reporting.
- The **balance sheet oath**, which has so far only applied to financial reporting, is also to be **extended** to the sustainability report.
- However, the planned obligation for the **supervisory board** to **monitor** non-financial reporting is not new territory for German control bodies.

External structures

- **Extension of the audit obligation** by external auditors to sustainability reports
- Limited audit reliability
- Nevertheless: **increase in reliability** of information
- At the same time, risk of less depth in the published information
- So far, no standardization of the audit by the EU,

Attention to misconduct: The sanctions regime under the Accounting Directive is to be extended to sustainability reporting as well as significantly specified and expanded.