

DISCUSSION







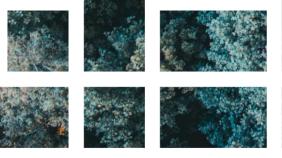


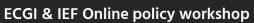
DR. ADRIAN DE GROOT RUIZ







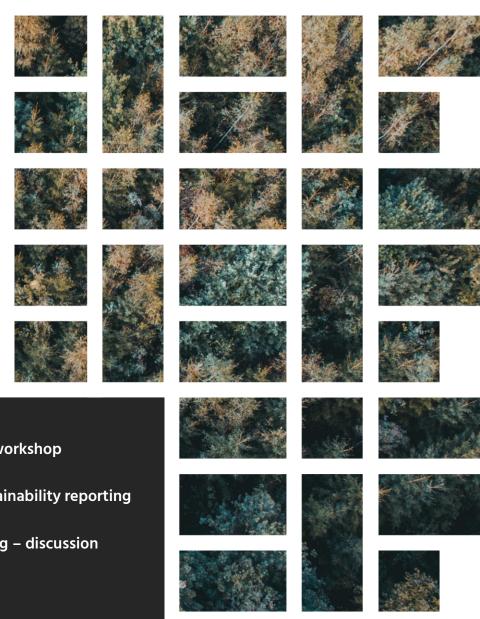




IFRS Consultation on sustainability reporting

Academic Keynote Briefing – discussion

4 December 2020



DISCUSSION

Reflections

- Potential for IFRS impact in sustainability vs financial reporting
- Is disclosure necessary and/or sufficient condition to internalize externalities?

Focus on

- Role of externalities
- How could corporate reporting look like to deal with externalities?
- Current reporting practices



A Friedman doctrine-The Social Responsibility Of Business Is to **Increase Its Profits**

By MILTON FRIEDMAN

TAMING G.M .- Chairman James Roche of General Motors (right) replies to members of Campaign G.M. (below, wearing "Tame G.M." buttons) at the corporation's stockholders' meeting in May. Representatives of the campaign demanded that G.M. name three new directors to represent "the public interest" and set up a committee to study the company's performance in such areas of public concern as safety and pollution. The stockholders defeated the proposals overwhelmingly, but management, apparently in response to the second demand, recently named five directors to a "public-policy committee." The author calls such drives for social responsibility in business "pure and unadulterated socialism," adding: "Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society."









of Campaign G.M.



Joseph Onek, lawyer and a founder



New York Times Graphics

business is to ask precisely what it implies for whom. business in a free-enterprise system, Presumably, the individuals who I am reminded of the wonderful line are to be responsible are businessabout the Frenchman who discovered men, which means individual proat the age of 70 that he had been prietors or corporate executives. speaking prose all his life. The busi-Most of the discussion of social rebelieve that they are desponsibility is directed at corporafree enterprise when they declaim that business is not contions, so in what follows I shall mostly neglect the individual procerned "merely" with profit but also promoting desirable "social" prietor and speak of corporate ends: that business has a "social executives. conscience" and takes seriously its IN a free-enterprise, private-propresponsibilities for providing employ-ment, eliminating discrimination,

speak eloquently about the

avoiding pollution and whatever else

may be the catchwords of the con-

temporary crop of reformers. In fact

they are-or would be if they or any-

preaching pure and unadulterated socialism. Businessmen who talk this

way are unwitting puppets of the in-tellectual forces that have been un-

dermining the basis of a free society

The discussions of the "social re-

sponsibilities of business" are notable

for their analytical looseness and

lack of rigor. What does it mean

to say that "business" has responsi-

bilities? Only people can have re-

sponsibilities. A corporation is an

artificial person and in this sense

may have artificial responsibilities, but "business" as a whole cannot be

said to have responsibilities, even in

this vague sense. The first step to-

one else took them seriously-

erty system, a corporate executive is an employe of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom. Of course, in some cases his employers may have a different objective. A group of persons might establish a corporation for an eleemosynary purpose-for example, a hospital or a school. The manager of such a corporation will not have money profit as his objective but the rendering of certain services.

ward clarity in examining the doc-

trine of the social responsibility of

In either case, the key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary reponsibility is to them.

Needless to say, this does not mean that it is easy to judge how well he is performing his task. But at least the criterion of performance is straightforward, and the persons among whom a voluntary contractual arrangement exists are clearly

Of course, the corporate executive is also a person in his own right. As a person, he may have many other responsibilities that he recognizes or assumes voluntarily-to his family, his conscience, his feelings of char-ity, his church, his clubs, his city, his country. He may feel impelled by these responsibilities to devote part of his income to causes he regards as worthy, to refuse to work for particular corporations, even to leave his job, for example, to join his country's armed forces. If we wish, we may refer to some of these responsibilities as "social responsibil Itles." But in these respects he is acting as a principal, not an agent; he is spending his own money or

time or energy, not the employers or the tim has contracted to purposes. If these sponsibilities," they responsibilities of in-

What does it mean corporate executive sponsibility" in his c nessman? If this st pure rhetoric, it mus is to act in some way the interest of his em ample, that he is to creasing the price of

jective of preventing inflation, eve though a price increase would be in the best interests of the corporation Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law in order to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire "hardcore" unemployed instead of better-qualified available workmen to contribute to the social objective of re-

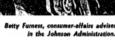
ducing poverty. In each of these cases, the cor porate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his "social responsibility" reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some em-

MARC BENIOFF, chief executive of Salesforce "I'll never forget reading Friedman's essay when I was in business school in the 1980s. It influenced — I'd say brainwashed — a generation of C.E.O.s who believed that the only business of business is business." NYT 2020

JOSEPH STIGLITZ, professor of economics at Columbia University "Friedman's essay and his other writings on this subject were, unfortunately, enormously influential. They helped change not only the mind-set of the business community but also laws and norms on corporate governance." NYT 2020



Jerome Kretchmer, New York Environmental Protection Administrator.



G.M.'s parent organization.





CURRENT IFRS STANDARDS PROVIDES THE INFORMATION REQUIRED FOR RATIONAL INVESTORS ABSENT EXTERNALITIES

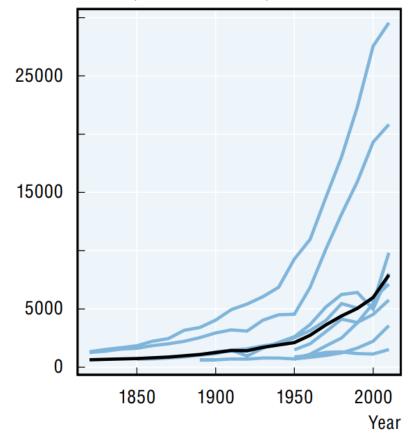


- Businesses
- Selfish Investors
- Pro-social investors
- Governments

PROFIT-BASED MARKETS HAVE BROUGHT MASSIVE MATERIAL WELFARE

- Profit and price-based market economies have grown material welfare substantially
- Global GDP/capita has grown tenfold between since start industrialization in 1810 (Bolt ea 2014)
- Share of people living in extreme poverty declined from 42% in 1981 to 10% in 2015 (WB)
- This decline is due to mainly due to economic growth (Perez de la Fuente, 2016) and export of price-based market economies

World GDP per capita (USD at 1990 PPP)





IN THE PRESENCE OF EXTERNAL COSTS, PROFIT MAXIMISATION LEADS TO LARGE WELFARE LOSSES

- Climate change could result in 25% decline in global GDP by end of the century as found by study of 66 central banks (NGFS, 2020)
- A million species are threatened with extinction (IPBES, 2019)
- Annual environmental external costs of agriculture are estimated 12 trillion USD (Nature, 2019)
- 2008 saw a global financial crisis that reduced GDP for a decade in 20 countries (IMF, 2019)
- 20% of the global working population are working poor (ILO, 2019)
- More people than ever are enslaved in our economy: 50 million or 1 in 200 (Hodal, 2019)
- 690 million people were undernourished in 2019 (FAO, 2020) while 11 million deaths and 255 million healthy life years are lost annually due to unhealthy eating patterns (GBD 2017)
- A zoonosis, a well-known externality of animal husbandry, will cause >1.3 million deaths (JH, 2020) and a cumulative output losses of 9 trillion in 20-21, the deepest recession in 80 years (IMF, 2020)



DUE TO EXTERNALITIES, THE SOCIAL RESPONSIBILITY OF THE FIRM IS TO OPTIMIZE STAKEHOLDER WELFARE

A Free Market Manifesto That Changed the World, Reconsidered

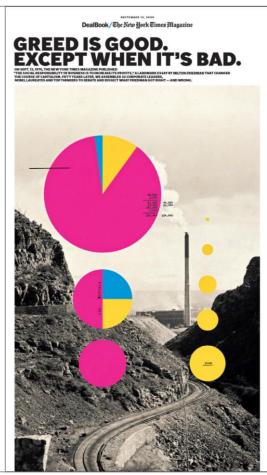
Milton Friedman's libertarian economics influenced presidents and inspired "greed is good." So what did Friedman get right — and wrong? Today's business leaders and economists weigh in.



Introduction by Andrew Ross Sorkin

Published Sept. 11, 2020 Updated Sept. 14, 2020

Sept. 13 is the 50th anniversary of a seminal moment in the world of business: the publication of Milton Friedman's essay in The New York Times Magazine entitled "The Social Responsibility of Business Is to Increase Its Profits."



MARC BENIOFF, chief executive of Salesforce

Just look where the obsession with maximizing profits for shareholders has brought us: terrible economic, racial and health inequalities; the catastrophe of climate change. It's no wonder that so many young people now believe that capitalism can't deliver the equal, inclusive, sustainable future they want. It's time for a new kind of capitalism — stakeholder capitalism, which recognizes that our companies have a responsibility to all our stakeholders. Yes, that includes shareholders, but also our employees, customers, communities and the planet."

LARRY FINK, chief executive of BlackRock

"Some historical context is critical to understanding Friedman's opinions. With that in mind, and in a context where developedmarket governments are far less interventionist, I think that companies can and must do more to contribute and serve all of their stakeholders."

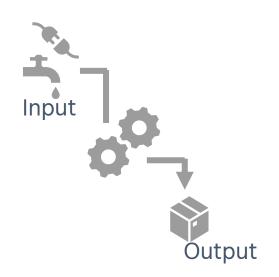
Business Roundtable
Redefines the Purpose of
a Corporation to
Promote 'An Economy
That Serves All
Americans'



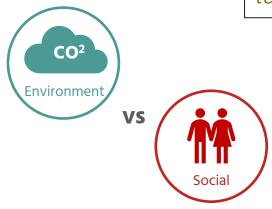




NEW INFORMATION NEEDED AS CURRENT INFORMATION ON EXTERNALITIES IS INSUFFICIENT TO INFORM DECISIONS

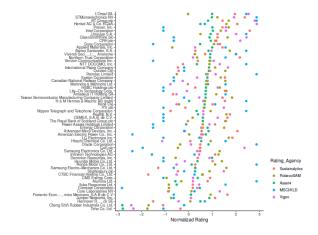


Sustainability/CSR/ESG reporting is often **output or input focused** rather than addressing what is material to stakeholders



Incomparability between metrics

If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? (Friedman, 1962)



Sustainability/CSR/ESG metrics are subject to **bias** and **inconsistencies** with low correlations

*Figure from: Berg Kölbel & Rigobon (2019)



INFORMATION REQUIRED FOR RATIONAL DECISION MAKING UNDER EXTERNALITIES

- 1. Covering all material impacts of a firm
- 2. Quantified
- 3. Valued ('expressed in numeraire')
- 4. Attributed
- 5. Differentiated per impact, capital & stakeholder
- 6. Differentiated per welfare dimension



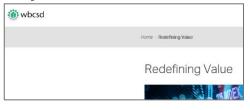
IMPACT-WEIGHTED ACCOUNTS: ORGANIZE ACCOUNTS AROUND ORGANISATIONAL GOALS

- 1) Create financial return for investors, short-term 4 1) Investor value creation account and long-term
- 2) Create net value for each other stakeholder, 2) Value creation account including clients, employees, and communities
- 3) Do no harm by respecting the rights of its _____ 3) External cost account stakeholders and avoid imposing external costs;
- 4) Contribute to sustainable development in line with the UN's SDGs.

 4) SDG Account

BUSINESSES ARE STARTING TO REPORT ON THEIR QUANTIFIED AND VALUED IMPACT

Key initiatives

















How many in 2019?



VBA



Diversity in reporting



SME Examples

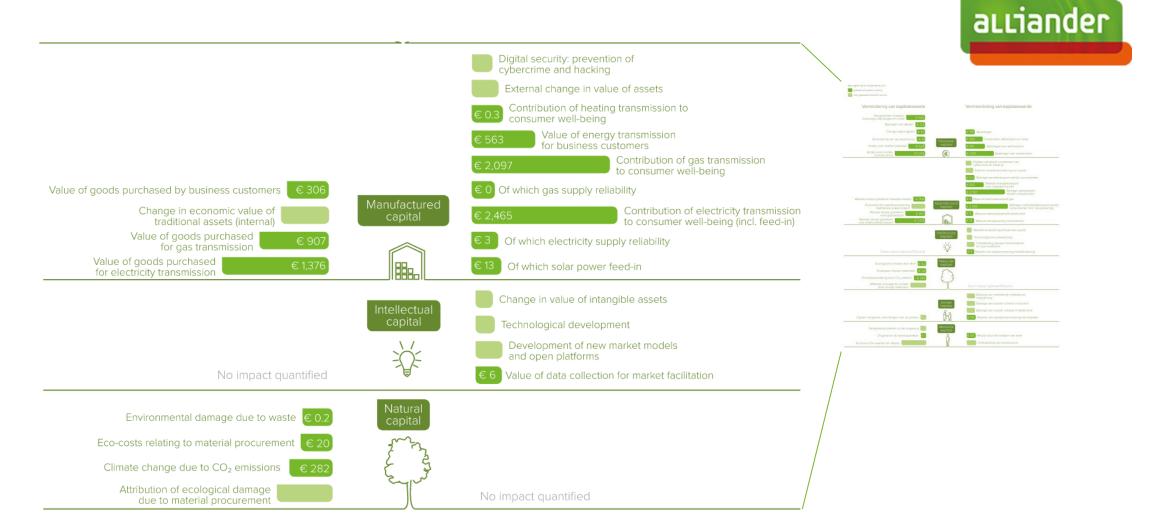








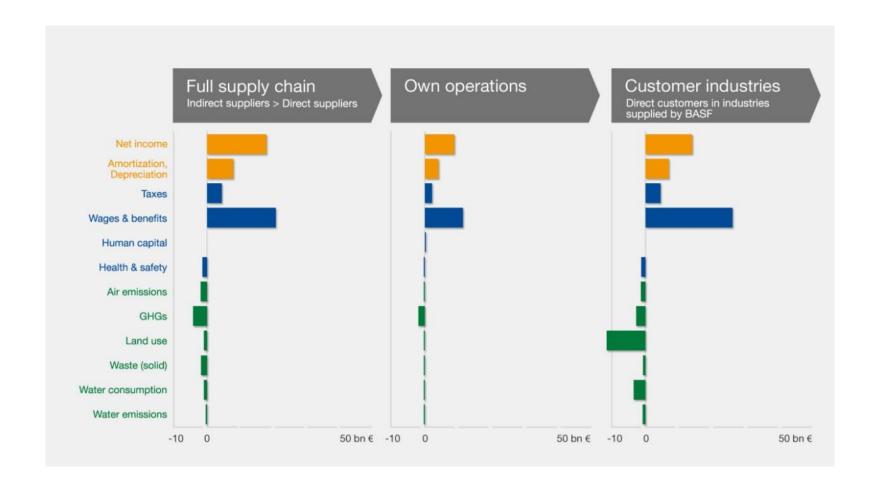
ENERGY: ALLIANDER INTEGRATED PROFIT & LOSS





MANUFACTURING: BASF VALUE TO SOCIETY







FINANCIAL INSTITUTIONS: ABN AMRO IMPACT STATEMENTS



Integrated Profit & Loss Statement

This Assessment provides an overview of ABN AMRO's financial and non-financial impact

-7	Dotti	Staken	oraci	group	anu	type	or cap	Jitai.

		4.	2.0	4	4.4
		Clients	Employees	la constant	Conintra
			Employees	Investors	Society
	Financial 1 Payments by clients	000000000	*******	0000000	********
	2 Payments made by other stakeholders	***************************************			
\sim	3 Payments to suppliers for expensed goods and services				*******
	4 Employee payments		******		
	5 Income tax payments				
	6 Interest payments	******		*******	•••••
	7 Net profit/loss 8 Corrections for non-financial profit items			********	
	9 Payments to suppliers for investments				
	10 Cost of capital	0000000		0000000	0000000
	11 Value of capital			******	*******
	12 Value of services (financial) provided by suppliers				00000
	13 Consumer client value of lending services (non-mortgage)	******			
	14 Business client value of lending services 15 Consumer client value through home ownership	0000000			
	16 Change in share price not captured in comprehensive income	******		******	
	16 Change in share price not captured in comprehensive income 17 Other financial impacts			******	
	June manual Hydra				
	Manufactured				000000
Α.	18 Contribution to final goods and services in value chain				******
~	19 Client value through increase in house value	******			
	20 Client value of money transfers	********			
	21 Client value of money storage and management 22 Client value of other infrastructure services	******			
	22 Chert value of other intrastructure services 23 Value of infrastructure services provided by suppliers	******			000000
	24 Value of goods provided by suppliers				000000
	25 Client value of housing	******			
	26 Gross increase in tangible assets			*****	
	27 Depreciation of tangible assets			000000	
	Intellectual				0000
	28 Consumer client value of asset management	*******		0000	0000
4	29 Consumer client value of other fee-based services	******			
\vee	30 Business client value of other fee-based services				
	31 Change in intellectual assets			0000	0000
	32 Occurrence of cybercrime	0000			
	33 Unintended incidents with personal information	00000			
	Human		00000	*****	0000000
_	34 Well-being effects of employment		******		******
(1)	35 Creation of human capital		*****	*****	*****
~/	36 Value of employee time spent on work		000000		
	37 Value of services provided by suppliers				0000000
	38 Occupational health and safety incidents		•		
	Social				00000
_	39 Decrease in cash-related crime	***		200000	
•	40 Change in brand value and customer loyalty			******	
~	41 Gender discrimination in access to higher skilled jobs				0000
	42 Underpayment				0000
	43 Child labour				000
	44 Financial distress due to difficulties to repay loans	00000			
	45 Social benefits of home-ownership	-30000			
	Natural				0000000
	46 Contribution to climate change				00000
4	47 Use of scarce materials				00000
	48 Air pollution				
	49 Water pollution				00000
	50 Use of scarce water				

This table shows	the net value of	outputs minus	inputs per	impact group
		outputs in the	arbara ber	underer Broad

/alue created for stakeh mpact by stakeholder group (EU		lent – presented in	ranges)		
	Clients	Employees	Investors	Society	Positive impacNegative impa
Financial					0 - 50 50 - 100
Manufactured			•	•	100 - 500 500 - 1,000
Intellectual			•	•	1,000 - 5,000
(ii) Human		•	•		5,000 - 10,000
Social	•		•	•	Where there is no range, we have not included an assessment due to a lack
• Natural					of data or because the impacts were not consider sufficiently material.



FINANCIAL INSTITUTIONS: ABN AMRO IMPACT STATEMENTS



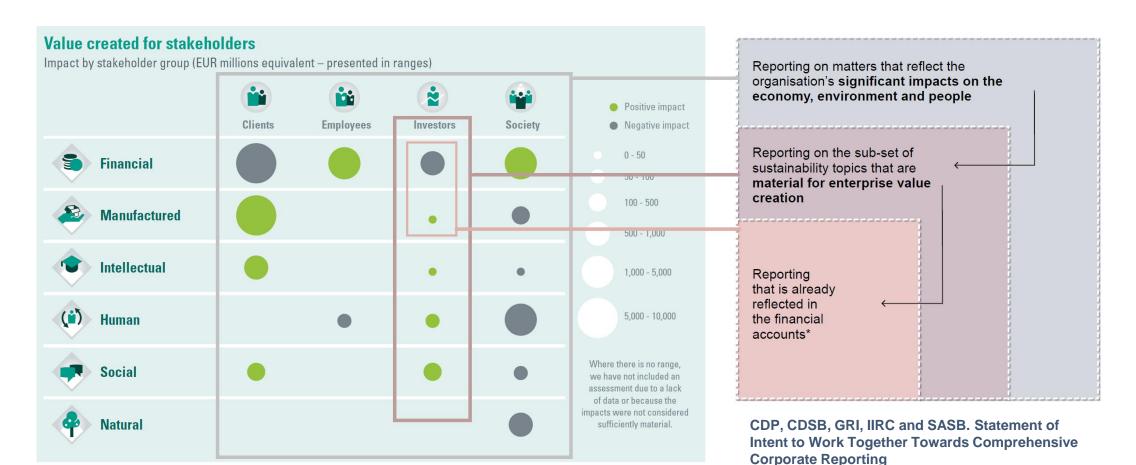


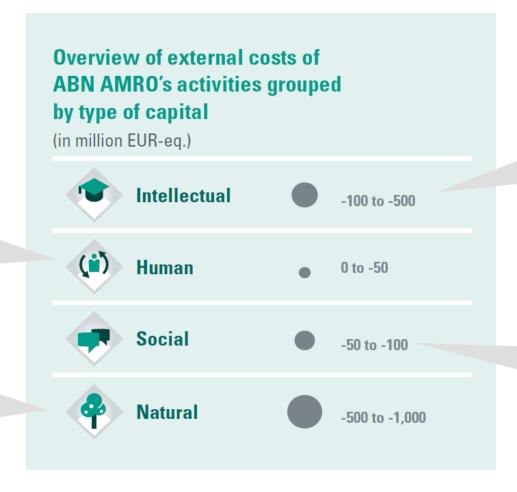
table is intended as a summary only. Spheres relate to types of value (equivalent to IIRC capitals), created for each stakeholder group and show net value of outputs minus inputs EUR millions equivalent). For further details, see page 17.



ABN AMRO BANK: EXTERNAL COSTS

Health issues, such as burnouts for our employees, and safety incidents in our value chain

Business activity from our lending and investments resulted in air pollution, land transformation and climate change

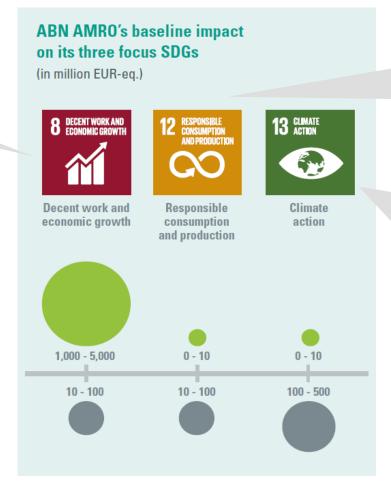


Cybercrime and unintended incidents with personal information affected wellbeing of our clients

We have a shared responsibility for human right violations that may occur in our value chains.

ABN AMRO BANK: SDG CONTRIBUTION

- Human rights and labour standards
- Loans and support to SMEs
- Social impact bonds



- Grant loans that improve energy efficiency and help industries with cleaner technologies.
- EUR 590 million to fund circular economy initiatives.

- Help clients make housing more energy efficient.
- Provide green financing
- Increase sustainable investments of clients
- Investing 20% of our energy portfolio in renewable energy by 2020



QUESTIONS/CONSIDERATIONS FOR IFRS CONSULTATION

- Could taking holistic perspective help to minimize changes in principles?
 - Climate is existential risk and good to begin with. But there are many more.
- How can IFRS create dynamic and inclusive standardisation process?
 - Measuring sustainability is a young discipline requiring a multidisciplinary and multi-stakeholder approach
- Could SSB focus lie on impacts not dependencies (IASB)?
 - Impacts are relevant from both single and double materiality perspectives
 - Dependencies may also be remit of IASB and/or financial analysts?

