

Brussels, 5 May 2020

The Belgian Association of Financial Analysts (ABAF/BVFA)
Aarlenstraat – Rue d’Arlon 80
BE-1040 - Brussels

By email to : jona@accountancyeurope.be

Dear Jona,

The *Belgian Association of Financial Analysts* (ABAF/BVFA) has read with great interest and has the pleasure to respond to Accountancy Europe’s Cogito paper (“the paper”) on *Interconnected Standard Setting for Corporate Reporting* published in December 2019.

In general, we strongly support the discussion that the paper is launching regarding the role and meaning of non-financial information (particularly for users of financial statements) and that aims at bringing financial and non-financial information more closely together thereby striving for more harmonisation.

Please find below a few additional observations.

- We fully agree with the thesis that financial information alone cannot give a full picture of a company’s performance.

The performance of a company has always to be analysed in a certain context. The results are always achieved against a certain background. Although the discussion is generally broader than this, there is e.g. a very good reason why analysts speak about cyclical companies, growth companies, mature companies... The adjectives “cyclical”, “growth”, “mature”... in our view refer to some extent to the aforementioned context and background.

The context and the background can only be explained by communicating the right non-financial information that consequently is as important as the financial information, provided that both are based on the same harmonised concepts. The non-financial information should complement the financial information and vice versa. Both should therefore be connected.

- In the context of non-financial information, we should not, and we do not want to underestimate the importance of climate change, environmental degradation, social unrest.... and many other similar challenges that humanity is confronted with nowadays.

But having said that, we ascertain that every time non-financial information is discussed - and we agree there is no uniform definition of what non-financial information precisely is because it is still a very broad and at the same time vague concept - the focus is very much on "sustainability" issues. Again, it is quite clear that climate change is a very important challenge that we are currently facing and it speaks for itself that companies should be asked to properly justify themselves with regard to e.g. how they deal with climate changes, but for analysts non-financial information is more than that.

Non-financial information for analysts is also about (non-exhaustive list):

- Business model ("sector")
- Client relationships
- Corporate governance
- Human relations
- Risks and opportunities
- Risk management
- Strategy
- Technology
- ...

Any framework regarding non-financial information should in our view also take these other themes, preferably in a structured way, into account too.

- The paper also discusses – in the context of non-financial information - what is called "internally generated intangibles".

We fully acknowledge that many parties involved in financial- and corporate reporting are investigating these internally generated intangibles at this moment, but we are not always that happy with the direction these discussions often take.

The paper says that internally generated intangibles have become a major component of the market value of companies. However, one should take into account that markets are not valuing assets but are valuing cash flows. The reasoning that we are probably missing out on something ("internally generated intangibles") because the market value is significantly higher than e.g. equity, is a wrong assumption.

Please note that the IASB's *Conceptual Framework for Financial Reporting* explicitly says in paragraph OB7: "General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity."

On the other hand, it is absolutely fair to state that until a few decades ago, cash flows were generated by factories that appeared on the balance sheet. Societies and economies have changed however, and cash flows are now generated by brand names, different kind of networks, specific know-how, marketing, personnel, research, technology... that often do not appear on the balance sheet.

Hence to understand the performance of a company one needs of course input with regard to e.g. the technology used and how the company expects it to evolve, the impact of own research etc... Non-financial information with regard to these intangibles gives analysts the information to analyse the risks associated with the *uncertain* future cash flows, hence to analyse the current valuation. But to assess these as "internally generated intangibles" is not how we would describe the non-financial information that is needed with regard to these intangibles and the cash flows that they generate. Hence, we do not really subscribe to the approach presented in the paper.

- We acknowledge also that it will not be easy to combine global solutions with local solutions. Indeed, several issues are global (e.g. climate change) but it goes without saying that different countries or regions will look at several aspects of non-financial information differently. That said, we could see this as an extra challenge to try to harmonise the different interests of the different parties involved. There is nothing wrong with trying to talk to one another.
- The paper often refers to the important concept of value creation, sustainable value creation or long-term value creation.

The concept of value creation must in the context of non-financial information be considered carefully.

Value creation for analysts is quite simple: if the return on invested capital is above the cost of capital then the entity creates value. But in the context of non-financial information, this is clearly not the way the concept should be approached.

The question is then of course what value creation is when climate change, business model, risk management or other NFI-themes are discussed.

The Integrated Reporting framework developed by the *International Integrated Reporting Council* (IIRC) has developed ideas with regard to so-called value creation. We are hopeful that the work done by the IIRC could help us in developing this idea further when building a NFI-framework.

- We also acknowledge that the debate about corporate reporting has evolved from taking care of the shareholders to taking care of the stakeholders. We fully support this evolution. Given their key role in terms of social welfare, it is fair for companies not only to communicate how well they have been doing “financially” but also to ask them to justify how they have behaved within the society in general. A non-financial information framework could play a central role in developing this idea further.

- We as ABAF/BVFA are not entirely sure about the best structure to take this forward. A couple of points nonetheless:
 - o All stakeholders need to be involved. You cannot build something if parties involved are not heard (in which case the new framework does not stand a chance);
 - o Considering how the financial reporting standards have successfully been developed over the past 15-20 years, it is quite clear that this idea about non-financial information needs an independent body to take this forward. Only an organisation that is allowed to think independently, monitoring the discussions and engaging with all stakeholders involved, is well placed to create something that adds value.

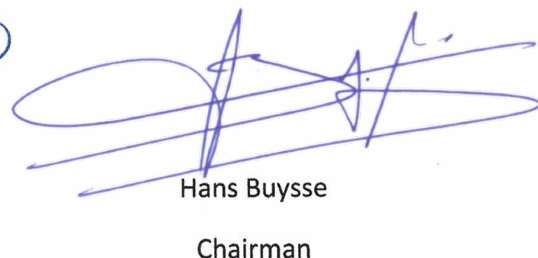
- Finally (admitting that we have not thought too much about these issues)
 - o How would non-financial information be audited?
 - o What about taking on board “investor relations associations” that have plenty of experience when it comes down to communicating with financial market (or “society in general”)?
 - o What about entities that have their own independent approach to non-financial information and are in this respect highly valued by e.g. financial markets. We are convinced they should be taken on board to.

We remain at your disposal if you would like to discuss the issues further and look forward to staying in contact.

Yours sincerely,



Serge Pattyn
Board Member



Hans Buysse
Chairman