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Background

Professor Carol Adams is an expert in corporate reporting, its influence on the identification of risks and opportunities, strategy, culture and governance - all of which have significant implications for sustainable development.

How can the structure of incentives across the investment chain be changed to promote long-term sustainable development?

The Financial Reporting Council (FRC) could provide significant impetus for change through its current consultation and review processes concerning; Guidance on the Strategic Report; the Corporate Governance Code; and, the Stewardship Code. The consultation process asked questions concerning the emphasis on long-term focus, recognition that value is more than profit and impacted by a wider range of risks and opportunities, the recommendations of the Financial Stability Board’s Task Force on Climate related Financial Disclosure (TCFD) and the Sustainable Development Goals (SDGs). All of this is compatible with promoting long term sustainable development.

There is significant corporate and long-term investor interest in the Sustainable Development Goals (SDGs) although meaningful progress to developing strategies to contribute to them is slow. The UK government could leverage this interest and perception of the opportunity the SDGs bring and encourage a faster and more meaningful response. Adams (2017a) sets out a five- step approach for developing strategy to contribute to the SDGs which is aligned to an approach to corporate reporting which focuses on long term value creation, specifically the International <IR> Framework. It encourages companies to make explicit reference to the existence of sustainable development issues in the external environment which pose a risk to a company’s ability to create value for shareholders and other stakeholders in the long term (see Adams, 2017b).

Research demonstrates that when Boards are involved in the development of corporate reports that take a long-term focus and recognise that value is more than profit (as is the case with integrated reports) they are cognisant of a wider range of risks and opportunities (see Adams 2017b). They then set strategy accordingly, i.e. strategy that addresses sustainable development risks and opportunities. Incorporating the TCFD recommendations and a requirement to consider sustainable development risks and opportunities into the the Companies Act Strategic Report requirements would therefore be effective because it is a report of the Board Directors.

The FRC’s draft Guidance on the Strategic report has synergies with the Task Force on Climate related Financial Disclosure (TCFD) and the International <IR> Framework, but unfortunately does not make this explicit. There are also synergies with the work of the Climate Disclosure Standards Board (CDSB) and the Global Reporting Initiative (GRI) (for example, with respect to the encouraging the identification of major stakeholders – something the GRI Standards tell reporters how to do).

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2 http://integratedreporting.org/resource/international-ir-framework/
3 Adams, CA, (2017b) Conceptualising the contemporary corporate value creation process, Accounting Auditing and Accountability Journal 30 (4) 906-931 http://dx.doi.org/10.1108/AAAJ-04-2016-2529 Also available here
4 See footnote 3.
But the FRC does not include an explicit reference to such standards/frameworks/guidelines. This is something legislation could do.

Limited reference to ‘sustainability’ in Directors’ remuneration disclosure tends to mean long term profitability rather than climate change performance or responsiveness to sustainable development risks and opportunities. Companies could be required to disclose how Directors’ remuneration is linked to their climate change and sustainable development targets.

Change across the investment chain requires education on the impacts of climate change and the need to address the Sustainable Development Goals and how to incorporate this into decision making. The government could encourage Corporate Boards to include this expertise in their skills matrix and encourage professional accounting bodies to address it in the training – in order to create value long term sustainable development issues must be incorporated into investment decision making. Incentives are needed to encourage Business Schools to research and develop expertise in this area rather than follow journal rankings and lists (such as the FT 50 list) which discourage research in accounting and corporate reporting and particularly research conducted outside North America.

**How effective are the Task Force on Climate-related Financial Disclosures’ (TCFD) recommendations likely to be at moving investment into ‘clean’ sectors?**

The TCFD recommendations are excellent and will reveal the extent of risks and opportunities of moving investment into ‘clean’ sectors. However, they will only be effective if they are mandatory and if legislation making them mandatory is enforced (see below). Based on prior government consultations on social and environmental disclosures around the world it is likely that corporate and industry association responses will advocate a delay in legislation and cite compliance costs and inexperience and barriers to disclosure. Submissions of this nature do not consider the benefits in terms of decreased risk and increased opportunity that disclosure brings – until there is a requirement to disclose, not all the relevant information will be collected by companies.

The Government has said it will ‘encourage’ publicly-listed companies to adopt the TFCD’s recommendations on climate risk disclosure. How could it do this? Is a voluntary approach sufficient?

No, a voluntary approach will not suffice for companies and long term investors to mitigate risks, take advantage of opportunities or sufficiently contribute to holding back climate change.

There is a significant body of academic research which finds that companies apply voluntary reporting recommendations and frameworks selectively and that they reference such frameworks and use corporate disclosures to manipulate public perception. (See, for example Adams, 2004; 2002).

There is also evidence that mandatory disclosures which are not enforced are not complied with. For example, the Companies Act 1985 (Sched. 7, Para. 9) required all organizations with more than 250 employees to disclose, in the Directors Report, their policy with respect to applications from disabled persons; continuing employment of, and appropriate training for, persons who become disabled during employment; and, the training, career development and promotion of disabled persons. Despite the simplicity of these requirements, research conducted on the 1991 reports of the top 100 UK companies found that only 34 complied in full, a further 52 companies provided partial compliance, while 14 made no mention of disabled employees.

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5 [https://www.ft.com/content/3405a512-5cbb-11e1-8f1f-00144feabdc0](https://www.ft.com/content/3405a512-5cbb-11e1-8f1f-00144feabdc0)
Reporting on the TCFD recommendations should be mandatory and enforced. There is overwhelming evidence from a substantial body of academic research on social and environmental sustainability related disclosures over a period of about three decades that it is not until it becomes a compliance requirement – which is enforced - that companies will act. And the time to act is now.

‘Soft’ regulation including letters from Ministers could be effective in starting to change behaviour whilst legislation is being developed/amended to incorporate the TCFD recommendations. The effectiveness will depend on the degree of follow up.

KPMG (2017)\(^7\) highlights the tendency for companies to ignore climate change despite its significant financial implications.


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