GUEST OF HONOUR ADDRESS

Key Trends in Corporate Governance & Sustainability

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I have been asked to talk about 'Trends in Corporate Governance and Sustainability' in about 12 minutes. I could spend 12 days, but a famous blind woman, Helen Keller once said, "There's something worse than being blind, it's having sight and no vision." Most of us online here can see and what is our vision? We see a world which is constrained from a resource point of view, a natural asset point of view. We see a world that's reached 'ecological overshoot'- a technical term used in limited liability companies; we are using natural assets faster than nature is regenerating them, clearly not a sustainable matter.

By the end of the 20th Century, research was expedited as a result the third industrial revolution of the 70s the computer. Through this research, it was ascertained, that iconic companies listed on iconic stock exchanges like the S&P 500, were exhibiting that 80 percent of the makeup of the market capital of these companies were not reflected as additives in the balance sheet according to financial reporting standards. What were these so-called intangible assets, and why was this change in value-thinking?

Well, first of all, we had from the middle of the 19th Century to turning of the 21st Century the doctrine of the primacy of the shareholder, wherein the success of a company depended on increased profit, increased dividend, and increased share price, even though in a majority of those cases they were being subsidised by society and the environment.

At the time beginning of this Century, I was Chair of the 'United Nations on Governance and Oversight' and I thank the 'International Federation of Accountants' (IFAC) called a meeting at the United Nations, in which we debated this. We realised that in corporate reporting, doing an annual report which was the financial statements according to whether that's IASB standards, or the financial accounting standards board of the US, or the Indian Standards- which are virtually IASB standards; we were not being accountable, whereas it the fundamental duty of Directors to be accountable because we were not reporting on 80% of value. This changed the mindset from 'profit at any cost', provided you are kept within the rules of the according to Mr. Friedman), to- 'are we creating value for society'. The way we make our product- are we having a positive impact or an adverse impact on planet earth, which is already constrained? And so, from a governance point of view, we look back to 1989-1990, we see when Adrian Cadbury was appointed to form his Committee- 'The Committee on the Financial Aspects of Corporate Governance' his remit was- (notice 1990 still the focuses on financial aspects notwithstanding that by 1987 Brundtland (Ms. Gro Harelm Brundtland, former (29th) Prime Minister of Norway and fromer Director-General, World Health Organisation (1998 to 2003) of the 'The Brundtland Report') had said that "organisations operate in a triple context of the economy, society, and the environment". She used the words - 'People', 'Planet' and 'Prosperity', and these are integrated. A few years later another meeting of 2006, at the United Nations, we discussed this question of corporate reporting again, and also how companies are being governed. There were lots of rules-Remuneration Committees, Audit Committees etc., but it was becoming a mindless tick-box exercise, one that wasn't adding value to anything.

It was at this stage, that certainly, I and others started asking questions about what really Governance is, and the future of Governance especially, Corporate Governance in the commercial field. We came to a conclusion that it was not about setting out a set of rules and principles and mindlessly applying them. They were outcomes based, the same as reporting had become outcomes based.

We realised by the second start of the second decade of the 21st Century that we (Directors) were now reporting in two silos-financial and sustainability reporting, according to the GRI Guidelines, of which I was the chair. But that wasn't enough that was divorced from reality because the sustainability issues and the financial issues are not separated in operational terms. Financial capital, human capital, natural assets, intellectual capital- all these things are integrated 24/7. And so other discussions, between 'Accounting for Sustainability' of HRH Prince Charles's Trust, myself and other leaders in this field discussed this and said, these things should be integrated. And so the 'International Integrated Reporting Council' was formed of which I became the Chair. What we said was, because operationally the so-called 'non-financial' today is labelled as 'ESG', is integrated with the financial; so should the reporting be integrated. This was how the International Integrated Reporting Council was formed. Sustainability stuck its head up more than financial reporting. Why? Because we had the spectre of climate change hanging over us.

Well, GRI - the 'Global Reporting Initiative', which was the start of 'Sustainability Reporting', looked at how the company made its product or rendered service. What were the inputs into the company, what were the outputs- its product waste etc., and when that product went out into society, what were the impacts on society; what were the outcomes from those impacts. From inputs to outcomes, that was 2010. By 2015, the United Nations launched the 'Sustainable Development Goals', 16 of them. 17th is 'Collaboration'. Clean Water (SDG 6), Clean Production, outcomes based.

So, I started asking the question- If reporting is outcomes based, shouldn't governance the way we manage and direct it, be outcomes based too? For two years, we discussed this with iconic companies, leading academics and practitioners around the world. The answer came resoundingly in the affirmative. Consequently, the drafting of what is now known today as the 'King IV Report', in which we concluded that governance has to be outcomes based. That is the future. The present and the future. Not just taking mindlessly, a set of rules and ticking boxes, but mindfully thinking, when that collective mind of the board makes a business judgment call, what it is affecting?' what are the outcomes? Well, we said there were four major outcomes. And these are –

1. **Value Creation**, but in a sustainable manner, in our resource-constrained world.
2. **Ethical Values with Effective Leadership**

We had to accept that the company was an incapacitated artificial person with no heart, no mind, no soul, no conscience, and that the corporate leaders were the conscience of the company. When something goes wrong, the wrath of society shouldn't turn against the innocent incapacitated company, but against its corporate leaders.

3. **Adequate and effective Internal Controls**

Internal auditing started becoming as important if not more important than external auditing. External auditing was focused on financial statements- were these financial statements in line and complying with the rules and requirements of the IASB. They were watchdogs, they were not bloodhounds; they were not there to see as Mr. Mitra, said, that what is said in the financial statements are correct, because in those financial statements there's lots of judgments by the Directors in regard to value of properties for example.

So, sustainability in the second decade of the 20th Century changed from looking at how the company makes its product and its outcomes. So it was inside out, but the beginning of the second decade of the 20th Century there were just two seminal events - the collapse of Lehman brothers and the GFC (Global Financial Crisis). Both of them showed us that these three critical dimensions for sustainable development- the economy, society and environment, were having an impact on the limited liability company- its financial conditions, balance sheet, operating performance, income statements, cash flows, risk profile, cost of capital. Suddenly, sustainability like a coin was seen to have two sides. In the second decade of the 21st Century, looking from the outside-in, how these three critical dimensions were impacting companies.

All this led to discussions of collaborations between this plethora of framework providers and standard setters, this alphabet soup. And it was the beginning of 2019 at a conference in London, when it was still physical, I said it was a social outrage! Fortunately, I had the leaders of all these framework providers and standard setters in the room. It was a social outrage that they saw themselves as competitors when they were actually trying to achieve the same end result, striving to get a comprehensive corporate reporting system. That whether you are in Timbuktu or Dhaka or Johannesburg or London, you could read those statements and have a common understanding.

People talk about what's measured can be managed and you can only manage something that can be measured. When you think about it, can you say that you're a successful competitor if you can't compare and the comparisons were becoming diluted?

The pandemic became the ultimate driver when leaders in the corporate reporting and corporate governance field saw that scientists in nine months created a vaccine, they started collaborating and they issued a statement of the group of five. This led to the merger of SASB - Sustainability Accountancy Standards Board that looked from the outside in at 77 industries, with the IIRC, integrating the 'financial' with the so-called 'non-financial', we formed the 'Value Reporting Foundation', which was acquired by the IFRS.

The IFRS has now announced that by June 22, 2022, they will finalise the establishment of the 'International Sustainability Standards Board'. But that standards board is going to be looking from the outside-in. They have coined the word- 'interoperability'. But there will be things where the President of the IOD, India and I are Directors of a company that don't fall with 'enterprise value creation', as it's now called are actually our parts included in the financial statements interoperability.

Hence, the trends to summarise and conclude in corporate governance is it's 'outcomes based'- no longer looking inwards and ticking boxes. Ensuring that we are complying with rules. It's got to be mindful, and in making a business judgment called - “we” the collective mind of the board has to decide what impact it is having on those four critical outcomes, so that external stakeholders can draw a reasonable conclusion that this is a responsible corporate citizen. Secondly, sustainability has got now double materiality inside-out and outside-in. We have the IASSB under the IFRS focusing on enterprise value correction, outside-in. The EU in the next few days will issue their CSRDs (Corporate Stakeholder Reporting Directives), which embraces the double material of the brushes inside-out and outside-in. So you can already see a parallel development on sustainability reporting. The 'Securities and Exchange Commission' of the USA only a few days ago said, they will in the next few days issue their guidelines for financial disclosures on climate change of their companies, and the third phase of it will be to issue statements of the impact of climate change on your suppliers, in your supply-chain. This will look much wider than just looking at the company itself.

Hence the trends in corporate governance is outcomes based. The trends in sustainability is looking and trying to find an answer to this ‘double materiality’.

Thank you very much.

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