INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES
The Premier Global Society of Financial Executives

QUARTERLY

53rd Issue | November 2022

THE PREMIER GLOBAL SOCIETY OF FINANCIAL EXECUTIVES

www.iafei.org www.facebook.com/IAFEI

Message from the Chairman

Dear IAFEI members,

It is my pleasure to present the 53rd issue of the IAFEI Quarterly.

I hope everyone is safe despite the COVID-19 virus globally and its variant and other public health concerns.

With the opening of borders by most countries, business and leisure travel grew exponentially. Although, this resulted to increased economic activity, the risk of contracting these diseases also intensified.

This continues to prove that SUSTANABILITY should be at the top of our priorities.

I believe that we have the tools and the understanding to built a sustainable future. We've conducted an ESG webinar last August with the help of professionals from Ernts & Young (EY) Greater China as Resource Persons. Sustainable development will demand the integration of our economic, social and environmental resources.

We will continue to improve the services that IAFEI provides to member organizations by providing value proposition initiatives. I am excited to update you on the new programs soon. For any suggestions and comments, you may share it through the IAFEI Secretariat at mbvinluan.iafei@gmail.com and secretariat.iafei@gmail.com.

Thank you and all the best!

Sincerely,

XIAOJIANG PAN
Chairman

Table of Contents

Charting the new era of globally accepted international sustainability assurance standards

by Len Jui, The Deputy Chair of International Auditing and Assurance Standards Board and KPMG China Partner on the IAASB's readiness to take action amid a growing demand for assurance on sustainability reporting

Globally, there is increasing demand from a broad range of stakeholders for organizations to provide transparency about their sustainability, including environmental, social and governance (ESG) matters. There is also a global trend whereby organizations are shifting from voluntary reporting to reporting in accordance with requirements mandated by their local jurisdictions. Sustainability matters may indicate how an organization has impacted the environment, people, and economy, and vice versa. These matters may also have impacts on financial reporting, for example, asset impairments or restructuring efforts necessary to mitigate climate-related risk. Here in Hong Kong, the topic of sustainability reporting including ESG and climate-related disclosures have been on the agendas of both the Hong Kong Securities and Futures Commission and Hong Kong Stock Exchange. The investing community, those in charge of governance and management are also engaging in initiatives to promote both awareness of the issues in the public interest, and improve compliance with required disclosures and changes to a company's operating strategy to address the sustainability-related impacts. As demand for assurance on sustainability reporting grows, there is an urgent need for globally accepted international sustainability assurance standards that can be used by all assurance professionals. While International Standard on Assurance Engagements (ISAE) 3000 (Revised) Assurance Engagements Other than Audits or Reviews of Historical Financial Information and ISAE 3410 Assurance Engagements on Greenhouse Gas Statements as issued by the International Auditing and Assurance Standards Board (IAASB) provide a robust foundation for such engagements, and are currently widely used by audit practitioners, the IAASB's strategic focus needs to be on:

a) Being the globally recognized standard setter for assurance on sustainability reporting. In this vein, it is essential that the IAASB is integrated in discussions at global and jurisdictional levels, to reinforce the IAASB's rigorous due process that is characterized by accountability, inclusiveness, transparency, public consultation and public oversight, and the quality of its auditing and assurance standards. b) Focused actions to respond to global needs for specific assurance standards on sustainability reporting, which build upon existing IAASB standards and guidance in a priority manner. In delivering its work plan, the IAASB is currently undertaking information gathering and research activities to: • Understand the topics (underlying subject matter), aspects about the topics (aspects of the underlying subject matter), mechanism for reporting (the subject matter information), and reporting standards (criteria) underlying sustainability reporting.

• Understand the challenges in performing assurance engagements on sustainability reporting, and the urgency and priority of these challenges. • Identify and prioritize possible actions the IAASB should take in addressing assurance on sustainability reporting. The IAASB's work will build upon its existing standards and guidance that already deal with this topic more broadly. In September, the board will consider an outline of the project plan, a draft structure of the standard, requirements to be brought in from ISAE 3000 (Revised) and ISAE 3410 and, time permitting, material from its Extended External Reporting Guidance to be incorporated as requirements in the standard. The IAASB's key stakeholders outreach will be ongoing as we continue to focus on developing a set of globally accepted international sustainability assurance standards. The target is to have the project proposal approved at the December meeting

53rd Issue 2022 November

The IAASB have heard practitioners calling for more guidance on assurance of sustainability information to address a number of related topics. However, it is important for the reporting standards to continue to develop under rigorous due process and finalized with proper public oversight. It is encouraging to see the significant developments being made by the International Sustainability Standards Board, the European Commission's Corporate Sustainability Reporting Directive and the United States Securities and Exchange Commission's Proposed Rules to Enhance and Standardize Climate-Related Disclosures for Investors. The assurance standards need to be reporting framework neutral, similar to the IAASB's International Standards on Auditing. Therefore, it is important that the assurance standards are capable of application to the reporting standards without any gaps. The development of a suite of International Sustainability Assurance Standards (ISAS) requires time and the proper due process needs to be followed. The desired output is a high-quality suite of standards that are able to be applied by practitioners consistently across the globe to achieve high quality sustainability assurance engagements. The progress to develop ISAS is an evolution process not a revolution process. In the evolution process, standards will be developed, updated and continually improved to reflect changes in reporting standards, address practical issues and meet public interest needs. Stakeholders such as national standardsetters, assurance providers, users of information and regulators all have key roles to play. Hong Kong is in a unique position as a global financial hub built on an established capital market infrastructure and supported by effective regulatory oversight and a mature accounting profession. The IAASB looks forward to engaging with stakeholders in Hong Kong as it embarks on the evolution of high-quality assurance standards in support of high-quality sustainability reporting in the public interest.

Len Jui

The Management Accounting (R)Evolution in Sustainability Reporting

Naomi Siegel Soderstrom, Anas-Ur-Rasheed Khan, Rachel Alexandra Solano
Department of Accounting, University of Melbourne

I.Introduction In 2019, the Business Roundtable issued a statement that redefined the purpose of corporations, broadening corporate goals from a focus on shareholders to include consideration of a wider range of stakeholders, including customers, employees, suppliers, and communities (Business Roundtable, 2019). This statement represents a dramatic shift in corporate responsibility from a US perspective, but aligns with many initiatives that have been occurring worldwide. From a corporate reporting standpoint, a broader notion of corporate responsibility is reflected in the requirements to provide Integrated Reports (King, 2009) in South Africa, Strategic Reports in the UK (The Companies Act, 2006), disclosure of social and environmental information for companies in the European Union (EU) (Directive 2014/95/EU), and mandatory CSR reporting in China (CRSC, 2018). Although increasingly mandated in many parts of the world, the choice to report and the precise format of sustainability reporting largely remain at the company's discretion and circumstance (Carp et al., 2019). This creates huge variation in the nature and value of the reported information. In the absence of specific mandates, but with increasing pressure on organizations to provide sustainabilityrelated information, there has been a deluge of promulgated reporting frameworks and standards. A 2020 European Financial Reporting Advisory Group (EFRAG) study found 17 different standards and frameworks used by European Union companies for climate-related reporting alone (EFRAG, 2020). In this paper, we develop a taxonomy to analyze the nature of commonly-used forms of reporting and explore trends in the concepts underlying their structure. We find that sustainability reporting is moving from an emphasis on reporting outputs to more introspective discussion of firm processes related to sustainability, which we argue, reflects an increasing management accounting orientation for the guidance. We also discuss the potential for companies to "greenwash" and obfuscate performance under more processoriented reporting approaches and the necessity for assurance to evolve to curtail this type of behavior.

The overarching goal of corporate reporting to support decision-making has not changed over time. What has changed is the underlying concept of sustainability and form in which it is reported. Current reporting guidance ranges from standards that identify specific metrics to be presented in standalone reports (e.g., Global Reporting Initiative, GRI) or included in corporate financial statements (e.g., Sustainability Accounting Standards Board, SASB), to broader frameworks that focus on reporting principles rather than specific metrics (e.g., Integrated Reporting, "").1 Some guidance focuses on individual sustainability dimensions, such as the environmental focus of Climate Disclosure Standards Board (CDSB) and Taskforce on Climate-Related Financial Disclosures (TCFD) standards. Others, such as the framework and GRI standards address multiple dimensions of sustainability, including not only environmental, but also social, economic, and governance dimensions. Although standalone sustainability reports and sustainability reporting included in financial reports primarily focus on stakeholders that are external to the company, the information reported can also be useful internally, as companies seek to understand and manage their material sustainability impacts (Corporate Reporting Dialogue, 2016). Sustainability information can feed into management control systems and internal reporting systems that facilitate decision-making regarding costs, riskmanagement, internal budgeting, etc. However, the level of integration of sustainabilityrelated information into these systems varies dramatically (Gond et al., 2012). In addition to informing stakeholders, nonfinancial sustainability information contained in external reports can provide guidance for managers in measuring and incentivizing sustainability performance (i.e., "you manage what you measure"). Reporting on sustainability helps companies solidify their understanding and definition of sustainability concepts within their company's context, reflect on their past performance, and plan for future implementation of activities (Zambon and Del Bello 2005).

exemplifies this concept; although purports to focus on support for external providers of capital (IIRC, 2013), the framework speaks to a much broader range of stakeholders by emphasizing an organization's social awareness and subsequent image through a multi-dimensional reflection of how the company creates value (Deegan and Blomquist, 2006). This "Integrated Thinking" aspect of obliges managers to incorporate sustainability aspects into their internal decision-making. The focus on driving management decision-making through reporting has become an increasing theme of standards and frameworks over the last 20+ years of sustainability reporting. A s o u r d i s c u s s i o n s u g g e s t s , s o m e frameworks and standards are closer to traditional financial accounting disclosures that cater to the information needs of external providers of capital and focus on outputs and performance-based measures. Others are more process-oriented and are better characterized as having a more management accounting approach, which encourages managers to consider sustainability impacts on their organizations and change internal processes to become more sustainable. We argue that there is a general move away from the more external output-oriented forms of disclosures to more internal, process-oriented forms. We use the general terms "output" versus "process" to differentiate between these approaches.1 Based upon the output/process distinction, we develop a taxonomy and use it to explore prominent forms of guidance and identify reporting trends. This exercise is particularly important given the largely voluntary nature of sustainability reporting. Our analysis provides insight into the balance between output- and process-based reporting approaches and can help report users (both internal and external) better interpret company disclosures.

II.Reporting Taxonomy Our four-dimensional guidance taxonomy is depicted in Table 1. While not exhaustive, these dimensions help us explore whether there has been an ideological shift in frameworks and standards over time. Based upon our analysis, we find that there is a general evolution of reporting standards and frameworks from relatively straight forward retrospective and output-focused reporting of non-financial performance metrics toward a more forwardlooking and process-focused orientation, encouraging management to consider sustainability throughout the company's strategic and operational decision-making. The first dimension of our taxonomy, stakeholders, asks two questions: ① who are the focal stakeholders identified as the report's audience; ② to what extent can organizations determine who the focal stakeholders should be. This dimension helps us understand whether the guidance encourages companies to go through the process of identifying key stakeholders, or if the focal stakeholder is predefined. This distinction provides insights into the number of guidance-driven requirements for companies to understand themselves and the nature of their social responsibility. The second dimension, issues, concerns the sustainability topics covered by the guidance. Although the specific areas included are partially informed by the nature of the focal stakeholders, there is still variation across different forms of guidance. This variation is based upon the underlying goals and values of the groups framing the guidance, for example, a focus on environmental issues or a broader definition of sustainability. The third dimension, temporal focus, identifies the degree to which the standard or framework is retrospective or prospective (see the Social Performance Model of Carroll 1979). Retrospective reporting focuses on a summary of actual performance over the prior period. Prospective reporting is focused on activities and events that have not happened, so it must rely on projections, estimates, and incomplete information. The choice of temporality thus impacts the verifiability and completeness of the reported information. We note that similar to financial reporting, the choice to report retrospectively does not preclude companies from providing insights into the future, since the historical information can be used to develop projections. Finally, the fourth dimension, orientation, identifies the degree of process versus output focus implied by the guidance. More outputfocused guidance centers around detailing

Table 1 Taxonomy of Major Sustainability Reporting Guidance

Items	Focal Stakeholders	Issues	Temporal Focus	Orientation
CDP	Stakeholders with financial interest	Metrics are specifically determined by CDP, and are climate change, water, forests, and supply chain	Retrospective	External
CDSB	Intended audience is investors, although there is recognition that other (undefined) stakeholders may benefit from the reported information	Environmental	Retrospective	Primarily external, but includes internal reporting of environmental strategy, policies, management, and governance
GRI (G2)	Focal stakeholders are determined by the reporting organization and comprise of diverse groups	Economic, environmental, and social, integrated with financial performance	Reporting is primarily retrospective, although there are implied future implications for the items reported. Emphasis is on disclosure of a set of quantified metrics	Primarily external orientation, although requiring reporting on managerial practices and emphasizes the importance of sustainability in management and creating long-term practices. No specific managerial model is proposed
GRI (STD)	Focal stakeholders are determined by the reporting agency. Diversity of potential stakeholders is increase, including a diverse array of potential stakeholders, including both traditional, integrated, and legal extensions	Focus on impacts of the organization's economic, environmental, and social contributions	Information must be placed in context, with an awareness of future orientation through impact. Disclosures are primarily retrospective	Consideration of the significance of reporting factors results in a mixture of internal and external orientation. No specific managerial model is proposed
IIRC	Stakeholders whose priority is the "value over time" of the organization. The explicit stakeholders of focus are external providers of capital, although IIRC believes all stakeholders will find the reports useful	The framework provides some general issues to include in reports and encompasses all aspects of sustainability, but the reporting organization determines which issues are material, with a focus on issues related to how the organization creates value over time	Future-oriented	Internally-oriented, focusing value creation through the lens of Six Capitals and "Integrated Thinking" to help companies understand how they create value
SASB	Investors and other financial statement users are the primary stakeholders	Material issues are defined by SASB by industry. Reporting organizations can choose which aspects on which to report	Majority of metrics are retrospective, but suggested qualitative disclosures include some future elements related to trends, events, and uncertainties	Primarily external orientation, although reporting on operation metrics is assumed to provide incentive for managers to change operations to improve the metrics reported
TCFD	Investors, leaders, and insurance underwriters—financial orientation	Financial impact of climate change on reporting organization	In addition to reporting backward-looking data, framework encourages organizations to analyze and report on the potential impacts of climate change on the organization's financial success	Focused on organizational decision-making, responsiveness, and development of strategic responses to climate change

Note: CDP = Carbon Disclosure Project; CDSB = Carbon Disclosure Standards Board; GRI = Global Reporting Initiative; GRI (G2) = Second generation of GRI reporting; GRI (STD) = GRI Reporting Standards; IIRC = International Integrated Reporting Council; SASB = Sustainability Accounting Standards Board; and TCFD = Taskforce on Climate—related Financial Disclosures.

information for decision-makers without providing strong incentives for managers to examine their strategies, products, and processes. Process-focused guidance includes requirements for companies to articulate their sustainability strategies and goals, examine their internal processes using a sustainability lens, and identify areas where sustainability performance can be improved. Using the structure provided by our taxonomy, we examine a set of key frameworks and standards. We chose these forms of guidance based upon their prominence and the diversity of reporting that they represent. In addition to placing each form of guidance within our framework (summarized in Table 1), we provide a brief description of its key features. Figure 1 places each form of guidance within a timeline. This allows us to visually explore trends in the evolution of reporting approaches across time.

1. Carbon Disclosure Project (CDP)

The Carbon Disclosure Project (CDP) started out as voluntary database where organizations could report their carbon emissions, with their first questionnaire distributed in 2003 Since then, the CDP has broadened the scope of information to encompass a large number of metrics concerning environment, forests, and water security. Rather than comprising individual reports developed and distributed by the reporting companies themselves, CDP serves as an aggregator, tracking retrospective global carbon and other environmental indicators and providing data. CDP also produces reports derived from the data to submitting companies and investors. CDP entered a collaboration with GRI in 2013 to align their reporting frameworks and currently links questions and the benchmarking reports they produce to other guidance such as the United Nation's Sustainable Development Goals (SDGs) and TCFD recommendations. CDP's goals are focused on global environmental issues, seeking to elicit "corporate awareness through measurement and disclosure… (to promote) effective management of carbon and climate change risk."

CDP's orientation is primarily output-focused. CDP's stakeholders are determined by CDP itself, primarily comprising stakeholders with financial interests. These stakeholders are generally external to the company, although managers can use their data in combination with data from other companies for benchmarking exercises. The questions included in the CDP surveys are primarily direct, although there are some opportunities for companies to provide some additional information through freeform answers. When CDP started aligning its questionnaire with other forms of reporting guidance, they added questions for some areas that are more internally-focused. However, these questions are fairly direct, for example, governance questions include: "where is the highest level of direct responsibility for climate change with your organization?" and "Do you provide incentives for the management of climate change issues, including the attainment of targets?" (CDP, 2020). Inclusion of questions derived from other reporting standards and frameworks comprise summaries of activities related to issues required by the other frameworks rather than representing a fundamental concept underlying CDP's own reporting structure. Including these broader questions has the potential to incentivize managers to examine their sustainability strategies and the effectiveness of their processes. However, because the issues are not integral to CDP, such a result would only be indirectly driven by management's reactions to the response of stakeholders once the data are disclosed rather than directly stimulated by reporting via CDP.

2. Global Reporting Initiative (GRI)

GRI, was founded by the United Nations Environment Programme (UNEP), Ceres, and the Tellus Institute in 1997 with the goal developing a "universal framework to measure and report on organizational economic, environmental, and social performance" (GRI, 2008, p.2). The first GRI guidelines (G1) were released as a pilot in 2000. In 2002, GRI hit a major milestone, with publication of a second version of the guidelines (G2) and formal inauguration at the United Nations as a Collaborating Centre of UNEP. Since then, the guidelines have evolved, with periodic releases. The most recent version was reframed as a reporting "standard" with specific reporting requirements rather than a "guideline" comprising suggested report elements. In conjunction with the reframing of the guidance, in 2015, the GRI established a separate standards board, the GSSB, underscoring the significant difference between providing guidance versus setting disclosure standards. KPMG (2017) finds that GRI is the most popular framework for corporate responsibility reporting, with 75% of the largest 250 companies in the world following GRI in their reporting.

Early versions of the guidance (e.g., G 2) were more output-oriented and retrospective, with a substantial portion of the guidelines comprising reporting of suggested sustainability indicators. Although the guidelines require discussion of the company's sustainability strategy, governance structure, and management systems, the focus was on "articulating and understanding contributions of the reporting organizations to sustainable development" (GRI, 2002, p. 1).1 The guidance fosters a primarily indirect impact on process, since "sustainability reporting opens internal conversations where they would not otherwise occur" (GRI, 2002, p. 4). G2 was specifically not designed to be a management system (GRI, 2002). Instead, the objective of the guidance was to help companies prepare reports that present a balanced picture of sustainability performance, promote comparability, facilitate benchmarking, and serve as a data source that can foster discussions about the organization's sustainability. The recent GRI standard continues to focus on the themes from the earlier guidance but has a much more developed set of performance indicators and provides increased guidance for the assurance of the GRI reports. Although still not directly focusing on process, GRI has developed linkages between the information reported under GRI standards and other more process-focused initiatives, including ISO 26000, which provides guidance on integrating social responsibility throughout organizations2 and the UN's Sustainable Development Goals3 , which include specific targets for business to support. These linkages help provide well developed metrics that companies can use to track their progress in improving sustainability related processes that are the focus of other forms of guidance.

Based upon GRI's evolution and its increased influence on measurement to impact company process, we depict G2 guidelines and the GRI standard separately in Figure 1.4 A defining characteristic of GRI throughout its evolution is the focal stakeholder for reporting. One of GRI's fundamental reporting principles is "inclusiveness", where companies are encouraged to engage a wide range of stakeholders to determine the contents of their sustainability report. As GRI notes, the range of users of a sustainability report is much broader than that of financial reports (GRI, 2002). Both GRI guidelines and the GRI standards require companies to discuss the process of stakeholder engagement and explanation of stakeholder prioritization for reporting.

3. Climate Disclosure Standards Board (CDSB)

The CDSB was founded in 2007. It is an off shoot of the CDP, who hosts CDSB's Secretariat and is responsible for basic management of the CDSB. The Board itself is comprised of leaders from a number of business and environmental non-governmental agencies, currently including members from CDP and SASB (described below). Throughout its history, the intention of the CDSB Framework has been to integrate information into mainstream reporting (i.e., corporate annual reports) to support decisionmaking by investors. The focus of CDSB's Climate Change Reporting Framework was originally limited to climate change-related risks and opportunities. The scope increased in 2013 to include environmental information and natural capital. The Framework was updated in 2018 to highlight linkages between its recommendations and those of 20 different forms of reporting guidance. The relation between the CDSB framework and TCFD is particularly showcased, since "the CDSB Framework is an essential tool for companies seeking to implement the TCFD Recommendations" (CDSB, 2018, p. 2).

The CDSB framework includes both qualitative and quantitative disclosures. Suggested disclosures are primarily retrospective, although discussion of climate risks (either qualitative or through quantitative scenario analyses per TCFD recommendations) is inherently forward-looking. The framework does not present or stipulate specific managerial tools, although it does have some process focus, since it challenges companies to disclose the results of a deep analysis of and company response to material impacts of climate change on strategies and operations. An interesting aspect of the framework is that the framework directs that disclosures be integrated throughout the annual reports (or provide cross-references) to explain the links between the organization's (sic) governance, strategy, policy outcomes, risk management and environmental performance (metrics and targets) (CDSB, 2018, p. 16). This reporting requirement encourages companies to integrate environmental issues into their overall business concept and operations. However, the framework maintains a largely output orientation since it builds on its CDP history (Thistlethwaite and Paterson, 2015) and relies on other frameworks, many of which are output-oriented, to inform suggested disclosures.

4. International Integrated Reporting Council

The International Integrated Reporting Council (IIRC), which was formed in 2010, spearheaded a paradigm shift in corporate reporting sustainability reporting with the notion of "Integrated Reporting". An integrated report "provides a clear and concise representation of how an organization demonstrates stewardship and how it creates value, now and in the future." (IIRC, 2011, p. 6). The stated focal stakeholders are investors and other external providers of capital, although the IIRC views the reports as providing valuable information to a wide range of stakeholders (IIRC, 2013). Since its inception, has become increasingly popular as a reporting strategy (KPMG, 2017).

Key to the concept of value creation for is "integrated thinking", in which organizations employ and impact six different types of capital (financial, manufactured, intellectual, human, social and relationship, and natural capitals) as they create value through their business processes. Integration means that all of the capitals and their impacts must be evaluated together, including both positive and negative impacts (IIRC, 2020). The result of integrated thinking is then communicated through a single concise report that helps investors (and other stakeholders) understand "how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term."1 This concept is a contrast to the traditional financial report, which focuses on retrospective reporting of financial information (i.e., only financial capital).

represents a radical shift from the other frameworks and standards through its emphasis on internal processes, making the report as almost a byproduct of the process exercise: "The IIRC's long term vision is a world in which integrated thinking is embedded within mainstream business practice in the public and private sectors, facilitated by Integrated Reporting as the corporate reporting norm" (emphasis added) (IIRC, 2013, p.2). Although many companies view as the catalyst to enhance integrated thinking, it is possible to score highly on integrated thinking principles without producing an integrated report (Deloitte, 2015). Although is clearly strongly process-oriented, its focus on reporting of material aspects and the defined nature of the capitals orient somewhat toward an output-based perspective.

5. Sustainability Accounting Standards Board (SASB)

SASB was founded in 2011 with the mission to support investors through development of disclosure standards that supplement annual financial reports and provide information about sustainability issues that are most likely to have financially material impacts on the company.1 SASB has developed reporting standards that are industry-specific and are based upon a multistakeholder analysis of sustainability issues for each industry. The standards are designed to provide guidance for (primarily) non-financial disclosures that are outside of the financial statements themselves, but are part of the additional information that is included in other portions of the annual report, such as in the Management Discussion and Analysis portion of US 10-K filings. SASB standards include consideration of five broad sustainability dimensions: environment, social capital, human capital, business model and innovation, and leadership and governance. Although designed to supplement US regulatory filings, SASB's standards have been included in discussions of revisions to international financial reporting standards (International Accounting Standards Board, 2019) and SASB has worked with other groups to harmonize and advance sustainability reporting.

Under SASB standards, companies have leeway in choosing topics to report, although the standards define which topics should be considered. Most of the information is retrospective, since (as the SASB standards note) forward-looking statements in financial reports must be carefully crafted to avoid civil liability for material misstatements. SASB's emphasis on defined reporting measures, standardization, comparability across companies within an industry (SASB, 2017) makes SASB standards fundamentally outputoriented. The standards include reporting on internal processes, (primarily through the business model and innovation, and leadership and governance dimensions), but these disclosures focus on communication of outputs from company processes rather than driving an understanding of and change in the processes.

6. Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD was established by the Financial Stability Board, which monitors and makes recommendations about the global financial system (https://www.fsb.org/about/.). TCFD's task was to develop recommendations for climate-related disclosures that could "promote more informed investment, credit, and insurance underwriting decisions" and "in turn would enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks." (TCFD, 2017, P. 8). TCFD disclosure recommendations were first released in June, 2017. With a focus on understanding potential financial impacts of climate change on business, TCFD presents a forward-looking, risk-based, and processoriented model. Disclosing companies are asked to evaluate and disclose climate-related risks associated with physical damage from extreme weather events, changing weather patterns, and rising temperatures and sea levels, as well as policy and legal, technology, market, and reputation risks associated with transition to a lower carbon economy. In addition to risks, companies are asked to evaluate potential opportunities related to resource efficiency, changing energy sources, new or improve products and services, markets, and "resilience", which includes participation in innovative energy-related programs and employing resource substitution/diversification (TCFD, 2017).

Similar to many other forms of sustainability guidance, the TCFD framework include sustainability-related disclosures centered on climate change such as governance mechanisms, risk management processes and GHG-related metrics, and any related targets.

The key aspect that differentiates TCFD from other guidance is the recommendation that companies perform scenario analyses. These analyses are aimed at providing investors with information regarding resilience of the company's strategy in the face of climate change impacts. TCFD guidance recommends that reporters include disclosure of impacts to the company of different climate-related scenarios, including a 2°C or lower scenario. The guidance is unique in that it proposes that companies perform a specific type of risk analysis, which is highly introspective and compels organizations to change internal processes to enable management of the identified risks and opportunities.

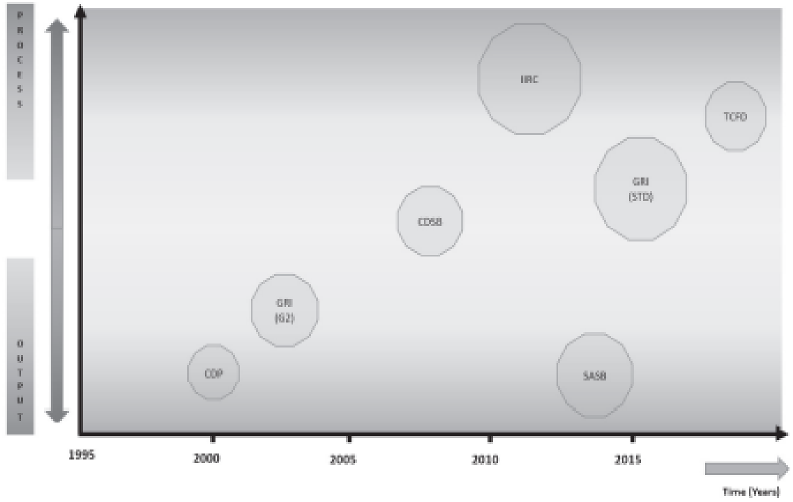


Figure 1 Conceptual Approach and Relative Coverage of Sustainability Dimensions of Major Forms of Reporting Guidance Over Time

Note: CDP = Carbon Disclosure Project; CDSB = Carbon Disclosure Standards Board; GRI = Global Reporting Initiative; GRI (G2) = Second generation of GRI reporting; GRI (STD) = GRI Reporting Standards; IIRC = International Integrated Reporting Council; SASB = Sustainability Accounting Standards Board; and TCFD = Taskforce on Climate-related Financial Disclosures. The relative focus of the reporting guidance on output versus process is subjectively evaluated based upon the taxonomy in Table 1. Symbol size indicates the breadth of sustainability issues focused on in each form of guidance. Placement on the timeline indicates the time that the guidance was promulgated.

TCFD recommendations have been gaining acceptance, but uptake has been somewhat slow. In their 2019 status report, TCFD notes that on average only 3.6 out of the 11 (5) recommended disclosures for organizations with (without) material climate risks are made globally (TCFD, 2019). This is likely due to the complexity of the disclosures, difficulty of integrating the disclosures into mainstream reporting, and company reticence to disclose information that is proprietary. In spite of the low rate of adoption, given the urgency related to climate change and increased interest in disclosures, it is likely that TCFD recommendations will become mandatory disclosure in many jurisdictions. In 2019, the United Kingdom's Green Finance Strategy included an expectation that all listed companies and large asset owners must disclose in line with TCFD recommendations by 2022 (HM Government, 2019). In a CDSB blog posting, Nadine Robinson, CDSP's Technical Director, noted that multiple governments are signaling that they want to make some form of TCFD disclosure recommendations mandatory. In many jurisdictions, there would be little or no additional regulatory requirements to make such disclosure mandatory.1 Further, many of the other reporting frameworks and guidance are explicitly aligning themselves with TCFD framework (see Corporate Reporting Dialogue, 2019).

Figure 1 provides a visual comparison of the frameworks along key dimensions of our taxonomy and over time. In the figure 1, we subjectively place each form of guidance along the y-axis, based upon their relative output versus process focus. We place each form of guidance along the x-axis, based upon when the standard or framework as originally conceptualized was promulgated. As we note in our discussion, there is increasing alignment of the standards and frameworks—Figure 1 is based upon the conceptual approach that formed the basis for establishment of the framework or standard. We include both GRI (G2) and the GRI standard because of the significant evolution in GRI reporting from "guidelines" to standards. The size of the icon indicates the breadth of focus (e.g., environment alone versus other dimensions of sustainability) of the guidance. With the exception of SASB, Figure 1 indicates a growth over time toward more process-based reporting. Further, newer versions of existing standards tend to include more of a process focus; the GRI standards are more process focused than GRI G2 and CDSB, which is an offshoot of CDP, is relatively more process focused. The breadth of reporting is also generally increasing. These trends are likely to continue as the degree of alignment in frameworks increases.

SASB and GRI have announced a collaborative effort to coordinate their standards and explain how the standards complement each other (Makower, 2020). In January 2020, at the request of the World Economic Forum's International Business Council, the Big Four accounting firms prepared a consultation draft that recommends a set of core metrics and disclosures2 that companies should provide. The recommended disclosures draw from all the existing standards that we have discussed (and others), and further, align the suggested disclosures with the United Nations' Sustainable Development Goals. 3 As of writing this article, these proposed standards are under consultation and have not been finalized.

III. Discussion and Conclusion

As the impacts of climate change become more apparent and there are growing concerns regarding other sustainability-related issues such and income and racial inequality and human rights, organizations are increasingly being asked to report on their sustainability performance. Unlike traditional financial reporting, sustainability reporting is largely voluntary and there are a multitude of standards and frameworks that firms use to guide their disclosure strategy. Based upon development of a reporting taxonomy and analysis of major reporting frameworks, we argue that sustainability reporting is moving from an emphasis on reporting outputs to an introspective discussion of firm processes related to sustainability. This change moves sustainability reporting from what is arguably closer to a financial accounting approach, where in reporting is fundamentally based upon the outcome of prior performance, to more of a management accounting approach, where the information provided can help managers to incorporate sustainability into their strategy formulation, strategy implementation, performance measurement, and provision of incentives. This evolution in reporting does not represent a reduction in the importance of providing information that is relevant to external stakeholders.

Indeed, all of the reporting frameworks that we discuss encourage companies to report to some extent on how sustainability is addressed through the firm's strategies, policies, and processes. Reporting from a more management accounting standpoint can help decision-makers external to the organization. In addition to the metrics themselves and underlying performance, the choice of what to report and the extent to which the firm implements the chosen form of guidance can help external report users gain insights into the firm's understanding of its social obligation, responsibility, and responsiveness (Sethi, 1979).

The voluntary nature of reporting exacerbates the possibility of firms using sustainability reporting to "greenwash" rather than to provide a faithful representation of their performance and commitment to sustainability. This issue is reflected in inconsistencies across different forms of reporting and company strategies. As an example, Amazon's CEO, Jeff Bezos, was one of the co-signers of the Business Roundtable's (2019) statement on the importance of sustainability in business. One of the commitments in the statement was "investing in our employees…dealing fairly and ethically with our suppliers…supporting the communities in which we work…[and] generating long-term value for shareholders". However, less than a month later, Amazon announced that one of its subsidiaries, Whole Foods, would be ending medical benefits for part-time workers.2 Interestingly, Amazon's 2019 Annual Report cites "sustainability" only once, in reference to measuring Amazon's carbon footprint,3 The report refers to climate only through its Climate Pledge commitment to be net zero carbon by 2040 and refrains from discussing climate change in the risk analysis section of the report, even though they "have extensive physical infrastructure and deliver more than 10 billion items worldwide in a year". In a separate sustainability report,4 Amazon provides indepth discussion of its efforts to reduce carb emissions, address human rights issues along their supply chain, empower their employees and partners to support sustainability, and other issues. Consistent with Annual Report disclosures, the sustainability report does not include any discussion in the spirit of TCFD recommendations concerning the impact of climate change on Amazon's operations.

In consistencies across different types of corporate reporting is one of the issues that the IIRC hopes to address with . Firms that have internalized sustainability and are integrating sustainability throughout their organization should have more consistent reporting.

As sustainability reporting evolves to encompass more of a process and forward looking focus, it may become easier for companies to obfuscate the nature of their sustainability-related activities. An output orientation facilitates reporting of data that are quantitative, consistent across companies and over time, and are verifiable. A more management accounting and process-oriented approach encourages disclosure of information that is more likely to be qualitative, unique to each firm, and more forward-looking.1 These characteristics can make the disclosures less credible. Assurance plays a large role by providing confidence in reported information and can discipline managers to report faithfully. Research indicates that report users find assured sustainability reports to be more credible (Pflugrath, Roebuck and Simnett, 2011) and that assurance improves the quality of reporting (Pinnuck, Ranasinghe, Soderstrom and Zhou, 2020). However, overall the level of assurance for sustainability-related information is much lower than for financial statement audits.2 This is likely driven by the variety of sustainability frameworks and standards, the more qualitative and forward-looking nature of information disclosed, and the voluntary nature of both reporting and assurance. As corporate sustainability reporting evolves in ways that move the reporting further away from a traditional output focus, it is imperative that assurance methodology also evolves. This will help ensure successful achievement of sustainability reporting guidance’s underlying objectives of providing external report users with an understanding of the firm’s sustainability performance and encouraging management to include sustainability in their strategy.

References

[1] Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans", 2019. Downloaded from https://www.businessroundtable.org/business-roundtable-redefines-the-purpose of-a-corporationto-promote-an-economy-that-serves-all-americans.

[2] Carbon Disclosure Project: CDP Question Changes and Map: 2019 – 2020. Downloaded from https://6fefcbb86e61af1b2fc4-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/ cms/guidance_docs/pdfs/000/000/480/original/CDP-climatechange-changes-document.pdf?1579626431.

[3] Carp M, Păvăloaia L, Afrăsinei M B and Georgescu I E. Is sustainability reporting a business strategy for firm's growth? Empirical study on the Romanian capital market. Sustainability, 2019, 11(3): 658.

[4] Carroll A. A three-dimensional conceptual model of corporate performance. Academy of Management Review, 1979, 4(4): 497-505.

[5] China Securities Regulatory Commission - Deepening Reform and Opening up of Capital markets, Aiming at High-quality Development. 2018. Downloaded from http:// www.csrc.gov.cn/pub/csrc_en/Informations/phgall/201801/ t20180122_333003.html.

[6] Climate Disclosure Standards Board. CDSB Framework for reporting environmental information, natural capital and associated business impacts. CDSB Secretariat: London, 2018.

[7] Corporate Reporting Dialogue. 2019. Driving alignment in climate-related reporting. International Integrate Reporting Foundation. Downloaded from https://integratedreporting.org/ wp-content/uploads/2019/09/CRD_BAP_Report_2019.pdf.

[8] Deegan, Craig, and Christopher B. "Stakeholder Influence on Corporate Reporting: An Exploration of the Interaction between WWF-Australia and the Australian Minerals Industry."Accounting, Organizations and Society, 2006, 31(4): 343–372.

[9] Deloitte. 2015. Integrated reporting as a driver for integrated thinking? Downloaded from https://www2.deloitte.com/ content/dam/Deloitte/nl/Documents/risk/deloitte-nl-riskintegrated-reporting-a-driver-for-integrated-thinking.pdf.

[10] EFRAG, How to Improve Climate Reporting, 2019. Downloaded from http://www.efrag.org/Assets/ Download?assetUrl=/sites/webpublishing/SiteAssets/ European%20Lab%20PTF-CRR%20%28Supplement%201%29.pdf.

[11] Global Reporting Initiative- June Guidelines. 2000. Downloaded from https://web.archive.org/ web/20000511150529/http://globalreporting.org/Guidelines/ Guidelines.htm.

[12] Global Reporting Initiative Sustainability Reporting Guidelines, 2002.

[13] Global Reporting Initiative- Sustainability Report. 2008. Downloaded from https://www.globalreporting.org/ resourcelibrary/GRI-Sustainability-Report-2007-2008.pdf

[14] Gond, Jean P, Suzana G, Christian H and Jeremy M. "Configuring Management Control Systems: Theorizing the Integration of Strategy and Sustainability."Management Accounting Research, 2012, 23(3): 205–223.

[15] International Accounting Standards Board. 2019. Staff paper, Overview of the staff's approach to revision. https://www. ifrs.org/-/media/feature/meetings/2019/may/iasb/ap15-management-commentary.pdf .

[16] International Integrated Reporting Council, 2011. Towards Integrated Reporting Communicating Value in the 21th Century. Downloaded from https://integratedreporting.org/wpcontent/uploads/2011/09/IR-Discussion-Paper-2011_spreads. pdf.

[17] International Integrated Reporting Council Framework. 2013.

[18] International Integrated Reporting Council. 2020. Integrated Thinking & Strategy State of Play Report. Downloaded from https://integratedreporting.org/wp-content/uploads/2020/01/ Integrated-Thinking-and-Strategy-State-of-Play-Report_2020. pdf.

[19] "The KPMG Survey of Corporate Responsibility Reporting 2017." 2017. Downloaded from https://assets.kpmg/content/ dam/kpmg/xx/pdf/2017/10/kpmg-survey-of-corporateresponsibility-reporting-2017.pdf.

[20] HM Government. 2019. Green Finance Strategy Transforming Finance for a Greener Future. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf.

[21] King III. 2009. King Report on Governance for South Africa. Downloaded from https://cdn.ymaws.com/www.iodsa.co.za/resource/resmgr/king_iii/King_Report_on_Governance_fo.pdf.

[22] Makower, J. 2020. "GRI and SASB Are Collaborating. Is That Good News for Companies? Greenbiz." Downloaded from https://www.greenbiz.com/article/gri-and-sasb-arecollaborating-good-news-companies.

[23] Oll J, Rommerskirchen S. 2018. What's wrong with integrated reporting? A systematic review. Nachhaltigkeits Management Forum 26, 19–34. https://doi.org/10.1007.

[24] Pflugrath G, Roebuck P, and Simnett R. Impact of assurance and assurer's professional affiliation on financial analysts' assessment of credibility of corporate social responsibility information. Auditing: A Journal of Practice & Theory, 2011, 30(3): 239-254.

[25] Pinnuck M, Ranasinghe A, Soderstrom N and Zhou J, Restatement of CSR reports: Frequency, magnitude, and determinants. University of Melbourne working paper, 2020.

[26] Sethi S, A conceptual framework for environmental analysis of social issues and evaluation of business response patterns. Academy of Management Review, 1979, 4(1): 63-74.

[27] Sustainability Accounting Standards Board. 2017. SASB Conceptual Framework https://www.sasb.org/wp-content/uploads/2017/02/SASB-Conceptual-Framework.pdf.

[28] Task Force on Climate-related Financial Disclosures. 2019. Status Report. https://www.fsb-tcfd.org/wp-content/uploads/2019/06/2019-TCFD-Status-Report-FINAL-053119. pdf.

[29] Task Force on Climate-related Financial Disclosures: 'Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures', 2017.

[30] Thistlethwaite J and Paterson M. Private governance and accounting for sustainability networks. Environment and Planning C: Government and Policy, 2016, 34(7): 1197-1221.

[31] Zambon, Stefano, and Adele Del Bello. "Towards a Stakeholder Responsible Approach: The Constructive Role of Reporting."Corporate Governance: The international journal of business in society, 2005, 5(2): 130-141

We Do Not Need More Regulation

— From the Börsen-Zeitung, Frankfurt am Main, Germany, June 15, 16, 2022, article provided by GEFIU, now CFO Forum Deutschland, Association of Chief Financial Officers Germany, The German IAFEI Member Association

Interview with **Mr Christian Illek,** CFO of Deutsche Telekom AG
The interview was made by **Heidi Gohde**.

Whether and when T – Mobile US will ever pay a dividend, leaves the CFO Christian Illek unanswered. At the cell towers the M & A wheel is turning around. And also at the chronically sick business clients division partial divestments are possible. The ownership at BT – Group, though, is not for sale. Meanwhile, states the CFO, there have naturally happened valuation decreases.

Mr. Illek, the Telekom Group has advanced well, strategically, in the past years, and this pays off in the operating business, especially also in the USA. It does not translate, though, into the dividend and the investors are grumbling, that not enough of the growing cash flow is arriving at them. Will this ratio over the medium term again determine more the dividend ?

We have a clear dividend policy. We continue to regard the restated earnings per share as the right measure, at which the dividend is oriented. Because the earnings per share do reflect the ownership situations at the various group companies.

It thus also reflects, which portion really economically relates to the shareholders of Deutsche Telekom, after considering the portions of the external investors. We are managing since 2020 at record speed the integration of Sprint in the USA into the Group. This at the beginning - also in this year - is lowering our earnings. But we have envisaged a significant growth at the cash flow and also at the restated earnings per share, to the amount of over 18 billion €, respectively more than 1,75 € per share in 2024. This is meant to reflect itself alongside our dividend policy also in increasing dividends, and thus reward the patience of our shareholders.

When will T – Mobile US pay a dividend ? At this, the Telekom as major shareholder is not without influence.

The management of T – Mobile US has signaled, that between 2023 and 2025 a total of up to 60 billion Dollar will be made available for dividends to the shareholders.. This shows, which growth potential especially by way of the merger with Sprint is inherent in the Group. At this wants T – Mobile US its shareholders to participate. In which form, whether through dividends or through share buybacks, the corporation will decide when time will have come.

How, then, the shareholders of Telekom can participate in the performance of the Group?

Here it is about two dimensions: Shareholders as a matter of principle, do benefit on the one hand from the value increase of the share, and on the other hand from the dividend policy.

Our planned earnings growth is meant to influence both positively. The value of the T - Share is meant to increase with higher earnings. Through our dividend policy and with increasing earnings, also the dividend is intended to grow. Once again: We are planning an increase at the earnings per share from 1,22 Euro 2021 to more than 1,75 Euro per share 2024. In total, the shareholders should then benefit from both factors.

The significant debt mountain at last has grown further. Are there plans - also with a view to the business dynamics in the USA - to perhaps de-leverage somewhat faster than planned, now when the interest rates are rising?

We have roundabout 136 billion Euro net debt. Of which 98 billion Euro are net financial debt, without leasing. They, in the first quarter, have decreased against the preceding quarter by 2.5 billion Euro. Our debt ratio will improve already also alone by our increasing operation earnings (ebitda). When we will increase our ebitda in a sustained way, then I am also not forced, to lower the debt significantly. But we have an ambitious target: The targeted debt range is 2,25 to 2,75 as factor of the total net financial debt, including leasing, to the restated ebitda: There we are not yet for a while, but we want to be there by 2024. In the meantime, all three big rating agencies are reflecting in their evaluations, that in an operating manner we are on a solid way, in order to attain our targeted objectives.

The Telekom must refinance this year 7 billion Euro. Will you soon tap the capital market?

In the present year the situation is relatively relaxed. The number, which you mention, is the maturities of all group companies 2022. T – Mobile US this year has maturities of roundabout 3.9 billion Dollar and is financing itself. Above that it has repaid a Group internal refinancing. In addition, the divestment of T – Mobile NL has brought us a cash flow of roundabout 4 billion Euro. For taking up debt capital we are therefore looking at the second half year. Here we can imagine to issue a sustainable bond.

Telekom Group in the first quarters 2021 and 2022

Sales, Billion €	2021	26,4
	2022	28,0
Ebitda AL, restated, Billion €	2021	9,2
	2022	9.9
Restated Earnings per Share, in €	2021	0.25
	2022	0.45
Net Corporate Debt, Billion €	2021	129,5
	2022	136,0
Rating: Moody´s		Baa1 / stable
Standard & Poor`s		BBB / stable

Green Bonds are in the trend. Also in the industry, where other corporations already show interest savings which they achieve by conformity to ESG criteria. What do you expect?

For us this will be a first experience, because so far we have not yet issued such a bond. Also , we are not issuing it for commercial reasons, but because we have given ourselves defined ESG targets. In so far it is also a signal to our inside. In addition to this, we have to first see, to which higher level interest rates will move in the fourth quarter. The is presently an increasing trend, especially at the longer end, and with a view to inflation we have to expect, that over the longer term, we shall not see any more the interest rate level, to which we have been used in the past years.

How high then is the interest expense of the Telekom, respectively the average interest rate?

We have in the Group an interest expense of 3.9 billion Euro for the financial debt, without leasing. Of this, 85 % relate to the US business. All present financings in the USA have a fixed interest for an average maturity of ten years., In addition, in the coming years, here several old Sprint bonds with coupons between 6 and almost 8 percent are expiring. We have, with net financial debt, without leasing, outside the USA, of roundabout 32 billion Euro an interest expense of roundabout 0.6 billion Euro. The reason for this is naturally, that we are coming out of a time of extremely low interest rates. Here, that is at the liabilities ex USA, we expect, on the basis of present forecasts, in the capital market in the current year a low double digit amount as expense from rising interest rates.

Telekom Group, Shareholder Structure

as of December 31, 2021

KfW Bank	16,6 %
Federal Republic of Germany	13,8 %
Softbank	4,5 %
Institutional Shareholders	47,7 %
Private Shareholders	17,4 %

Market Capitalisation,

as of August 31, 2022 — 93,4 billion €

A significant improvement of the financial leeway is promising the divestment of the cell towers, which has been announced since long. Do you have in the meantime in these negotiations a price range?

Please understand, that we are not commenting on ongoing M & A processes and speculations. We are registering a high interest in a transaction from various sides. This shows, that we have an attractive asset. We are presently checking, whether a transaction is possible, an if yes, how it could look like. At our decision, the valuation is an important but not the only criteria. This necessitates diligence, therefore we have quite consciously not given a time frame for the decision**.**

But you have certainly planned a certain reallocation of the financial means ?

Once again: At first we complete the process of the strategic evaluation. At the end of it stands the decision, whether we have a transaction with the cell tower portfolio, or not, and when yes, how this looks like. Please understand, that we will not distribute the fur of the bear, before it is caught. Independently of this, we have three priorities in our Group and Finance Strategy: 1. To attain the threshold of 50,1 % at T - Mobile US, 2.We want to invest, on both sides of the Atlantic, the necessary means for our clear network leadership, be it at 5G, be is especially also at glass fiber. 3. The return into our debt range.

As is heard of, Telekom is negociating with Vodafone respectively Vantage Towers about the creation of a "national Champion" in mobile phone infrastructure - in accordance with the model Italy one could say. There, the deal was approved by the European Union on the basis of an Open Access. Should this here not be acceptable in view of the enormous market power, would you also generate a regulated Champion?

Once again: We are not commenting on speculations in the media. But it is clear, we do not need more regulation in Germany. We have a competitive market at the cell towers.Alone the new fourth network operator 1 & 1 has contracts with 4 suppliers. In addition, you must not forget, that we just want the thirdparty business. Our Co-location ratio presently is about at the same level as at other cell tower companies. That means, we today already have to a significant degree other mobile phone network operators on the network transmission masts. And we do want to have more thirdparty business for the transmission locations.

The party – mood at M & A has been somewhat dimmed recently, also as to the valuations. How have they developed from your point of view?

One of course can see that valuation decreases have happened, especially in the tech range. And they are not insignificant. They not only take place at the stock exchange, but also in the venture capital field. Telecommunication infrastructure in my view continues to be a looked for investment category, also even though here and there valuation corrections have taken place at stock exchange listed players. This however in my view is due to rising interest rates and notdue to a deteriorated environment

When do you expect a closure of the project deal ?

We are making a Strategic Review - this can lead to a transaction, or also not. We there have no pressure for activity. We have said at the beginning of the process quite consciously, that we do not define a time frame for this process. This continues to be so.

How from your point of view are in Brussels the framework conditions for a deal, which eventually may call for regulatory decrees?

That the European telecommunications market has too many players, which operate within too small segments, is still totally undisputed. In so far it is good, when in one country one promotes the consolidation. We have good experiences with this, for instance in the Netherlands and in Austria. This strengthens the competitiveness in the market and thus the customers benefit from this. We also encourage our competitors, to think alongside these dimensions, because this creates a greater critical mass

Sometimes still the deconsolidation is tried, also the de-merger in Service and Infrastructure., among others at Telecom Italia or also at BT. Will there the Telekom package play a role?

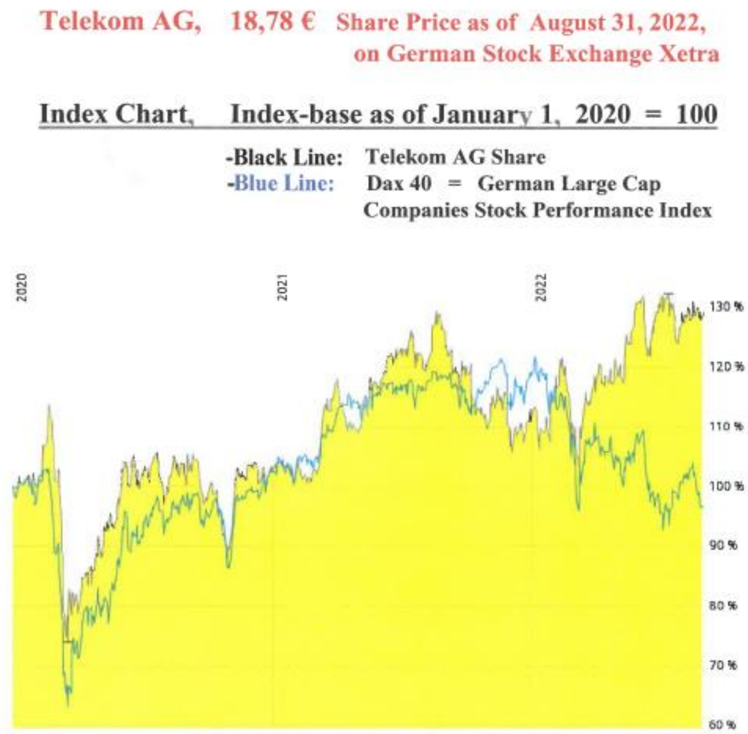
Our share at BT is invested in the pension assets, which we have deposited for the corporate pensions of our employees. Now, fortunately, BT has signaled, that it wants to again pay a dividend. For this reason we have deposited our share into the pension assets, in order that they benefit from this.

So in any case you want to continue to own the BT package?

The share package serves the purpose of fulfilling our obligations from our corporate pension scheme. For this reason it is lying in the pension assets, in order that they benefit from this.

So in any case you want to continue to own the BT package?

The share package serves the purpose of fulfilling our obligations from our corporate pension scheme. For this reason it is lying in the pension assets and there it is lying well.



You have opened the network of the Telekom already for third parties, in order to finance the buildup of the glass fiber network. Are further transactions imaginable, such as the infrastructure fund IFM?

We have regionally put on track many different partnerships and we cooperate with city network operators, cities and community entities, in order to accelerate with their infrastructure the buildup of glass fiber networks. Naturally we will show ourselves as open. In so far I would not exclude this. Presently, though, we are fully busy.

How are developing the cost for personnel adaptations at the Telekom, perspectively, will they occasionally decrease?

This fluctuates in a narrow band range. Personnel rearranging always goes along with exceptional charges. Therefore it happens at us without noise. We have in the past four years in this way reduced net roundabout 17.000 jobs. And we shall have to continue to become slimmer.

What is the cost per year ?

The expenses here are always in the range of 1 billion Euro.

An ongoing restructuring situation is the business customer division T - Systems. Are there plans for a partial divestment ?

The restructuring there will continue. We also already have sold parts, the subsidiary in South Africa, the mainframe-business to IBM, and we have withdrawn from the desk top business.
This is permanent hard work, especially in the classic IT business, where we shrink. On the contrary, we build up new business areas, which are growing, especially in the Cloud and at the Digital Services. The objective of this transformation process is that these areas are strengthened so much, that the relationship turns around and that they have more business weight, than the Legacy areas.

When will this be the case ?

At last, the turnover of T – Systems has shrunk by 1,9 %. Perspectively we want to grow turnover by 1 percent. Here we see signs for a stabilization especially also, when one takes into account the intended portfolio restructurings. At the restructured ebitda we are planning 5 % growth. At this we are benefitting also from our restructuring measures. It will still take a while, until we get closer to our objective. Here I do not want to name a time frame.

Are, until then, further part-divestments planned ?

This we do not exclude. We have always said, that we will divest single areas, for which there are better owners. As we also have already done so.

Your big competitor Vodafone has problems in the German market. Does Telekom benefit from this ?

At the beginning of 2020, when Vodafone for the first time has announced its 1 - Gigabite – Offer for 40 Euro, the capital market was afraid that this would have negative consequences for us: that we would have to lower prices, or would otherwise lose customers. The fears proved to be unjustified. We since continue to be on our way with a net new customer share of over 50 % in the broad band market. This among other reason is so, because customers in the fixed network not only value broad band, but also value the trademark, the service and the stability.We therefore have presently a good amount of customers coming to us, and this I also expect for the total of this year.

About the Person

The role of the CFO of Deutsche Telekom at other times was already significantly less stressful than presently; when not only financial debt, but also costs were much too high, and when sales and earnings were too weak. Christian Illek, who took over the job at the beginning of 2019 from Thomas Dannenfeld, found a broadly positioned Group at both sides of the Atlantic, after the Mega-Deal with Sprint in the USA was already negotiated, though not yet approved. There is though no lack of work for the Chemist with a PHD: Open financing subjects are the increase of the majority investment at T – Mobile US, the buildup of glass fibers in Germany and the reducing of the financial debt mountain. At this not insignificant act of power, it should be helpful for Illek, that he knows best Telekom from all sides. Apart from a three year intermezzo at the top of Microsoft Deutschland, the manager is in the Group since 2010.

From Börsenzeitung, Frankfurt am Main, Germany, June 15, 16, 2022. Responsible for English translation: GEFIU, now renamed into CFO Forum Deutschland, the Association of Chief Financial Officers Germany, the German IAFEI Member Association, translator: Helmut Schnabel

Make no mistake about this: Inflation is a global story

by Abelardo "Billy" Cortez, IAFEI Secretary and Treasurer (interim)

The global economy markets continue to limp along on a wing and prayer. As expected, the global financial markets remain highly volatile as fears of rising inflation continue to spread globally.

US consumer prices were again resurgent last month, fueling concerns of another large interest-rate hike in the US capital market from the Federal Reserve. So-called core CPI, which takes out the more volatile food and energy components, advanced 0.6% from July and 6.3% from a year ago, the first acceleration in six months on an annual basis. Given that, there's really not much to add to the observation since shelter, food and medical care were among the largest contributors to the US price growth.

Increasingly, it looks like a possible recession in the economic horizon in the near future. Issues over rising inflation being addressed by many countries include high jobless rate, falling wages, supply chain disruptions, trade and fiscal deficits, the ongoing Ukraine war, and a devastating climate change that might end up with subpar global growth this year. The global capital markets, along with the constant drumbeat of recession, have become vulnerable to a high level of market volatility making it likely we may not witness a global consumption growth this year, a lackluster event we'd rather not imagine at all.

Today's market is more about emotions. Investors have become emotion-driven, rather than reason-driven; they readily think up a thousand and one reason to avoid getting into, or even staying a bit longer in the capital markets, afraid that something unexpected may happen, but deep inside, they know that piles of cash shouldn't stay idle longer.

Worldwide, the highly elevated inflation rates are forcing a good number of central banks, including the US Fed, to reduce without hesitation their respective nations' money supply by raising interest rates and bring down the inflationary threats to acceptable levels. As Fed Chair Jerome Powell said last week, the Fed will act "forthrightly" in order to achieve price stability soon. The upward trajectory of US inflation, however, points to a continuing high cost of living for most Americans because their consumer prices have remained elevated and widespread, a big hurdle toward the Fed's inflation target of around 2%.

Market traders are betting the Fed will raise interest rates again by three-quarters of a percentage point.

On another point. The recent rise and fall in global interest rates have sent bond prices moving like yo-yos, rendering the bond market no longer the safe harbor it once was. For instance, when you buy a corporate bond today and interest fall, you'll make a profit if you sell. However, if interest rates climb back up, you'll lose if you have to sell your bond before maturity. Bond values move in the opposite direction to interest rates: up when interest fall and down when interest rates rise. You make a profit with bonds in two ways: by earning a fixed rate of interest, or by selling at a higher price over what you paid for.

Since bonds set interest rates and pay back the principal at a future date, they do not offer a good hedge against inflation. Over the long run, stocks still outperform bonds as inflation hedge, though it may be a long run.

When corporate bonds are first issued, they are sold at face value, but afterward they move up and down in price, trading in the secondary market either above par at a premium, or below par at a discount in response to varied changes in interest rates. When one speculates or does any serious investing, keep this in mind, the relationship between risk and reward holds there is no free lunch when it comes to investments; you just have to take more risks. A word of caution. Even if all the relevant information is available to you, don't just assume there is already a level playing field between you (the investor) and the bond issuing company. Peter Lynch, the legendary fund manager, advised investors to invest only with familiar companies whose businesses they really understand. At the very least, one must be pragmatic enough to change plans when facts and conditions change.

Outcomes also matter, not only intentions.

Atty. Abelardo "Billy" Cortez is former FINEX national president and chairman of FINEX Foundation, former co-chairman of the Phils. Capital Markets Development Council and currently member of FINEX Ethics Committee. He's Finance Committee chairman of San Beda Law Alumni Association. He is presently board director and executive committee member of the International Association of Financial Executives Institutes (IAFEI). A former independent board director at First Metro Investment Banking Corp, he is currently independent board director at other First Metro companies such as First Metro Securities Brokerage, Corp, First Metro Exchange-Traded Fund (ETF), PBC Capital Investment Corporation and First Metro Save and Learn FOCCUS Dynamic Fund (Metrobank Group).

.

Atty. Abelardo "Billy" Cortez
Independent Board Director at First Metro Securities, he is the Secretary of IAFEI and Past President of FINEX

Unrelenting inflation: Will price pressures ever let up?

by Michael Wolf, Global economist**,** Senior manager, Deloitte
Originally published in www2.deloitte.com on 31 August 2022

How inflation in advanced economies evolves from here will depend on the underlying drivers of inflation in each region

Advanced economies are experiencing high inflation and all the challenges that come along with it. After more than a decade of trying to drive inflation up, advanced-economy central bankers now find themselves scrambling to contain consumer prices that are seemingly out of control. Inflationary environments increase the costs of doing business, can often squeeze margins, raise the probability of recession by compelling central banks to tighten monetary policy, and make price and wage setting more variable and difficult.

How inflation evolves from here will depend on several interconnected variables that differ across countries. Those variables include central-bank policy, inflation expectations, wage growth, and exchange rates. In this article, we explore where inflation is expected to be most persistent and what signposts to look for as early indicators that inflation is receding or becoming entrenched, which include:

- **Central-bank policy:** The effectiveness of central-bank policy to restrain inflationary pressures depends, in part, on whether inflation is caused by supply or demand factors. Higher interest rates are likely to be more effective in places such as the United States, where demand factors are a larger contributor to the inflationary environment.

- **Inflation expectations:** Although inflation expectations have eased in most regions, they can change quickly and reinforce actual inflation by changing the behavior of participants in the market economy. So far, elevated inflation expectations have persisted in the euro area, making the region most at risk of expectations-driven inflation.

- **Wage growth:** The developed world has been experiencing abundant labor shortages. Most wage growth remains below headline inflation, which signals that a wage-price spiral remains a relatively low risk. However, in the euro area, the United Kingdom, Japan, and Canada, wage growth is running faster than core inflation (which excludes food and energy).1 This raises the risk of a spiral materializing.

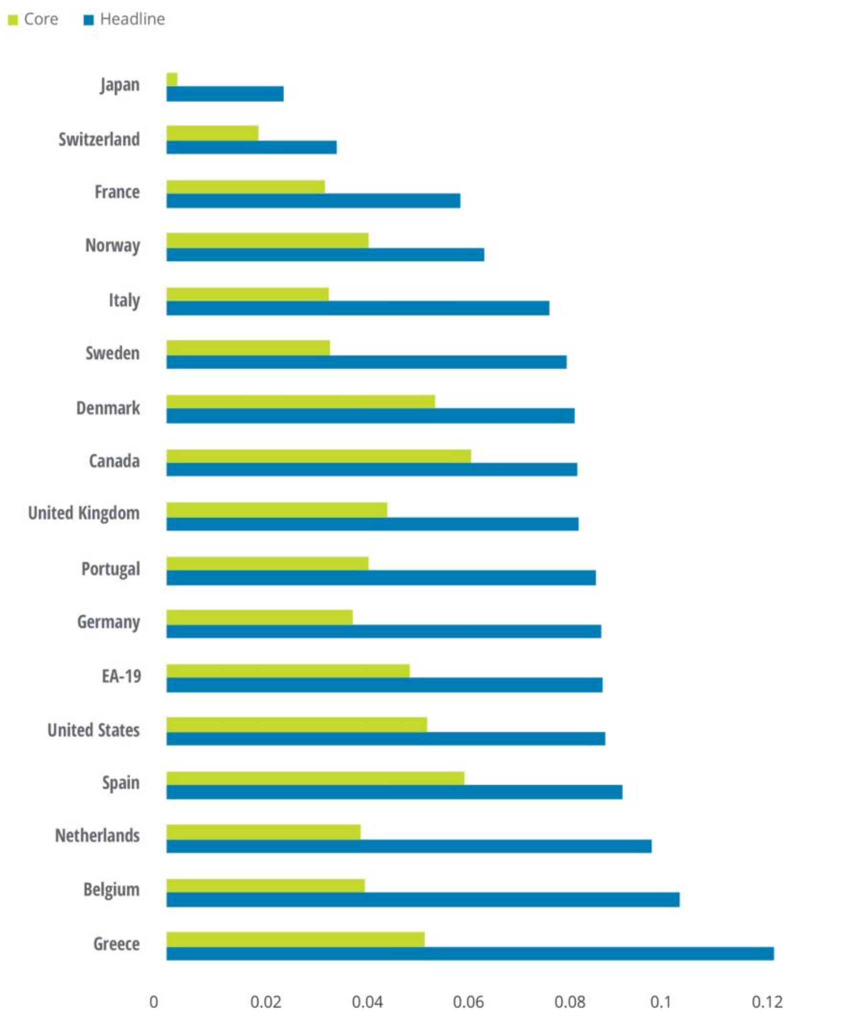
- **Exchange rates:** The differential movements of central-bank policy rates in different countries will largely determine how exchange rates evolve from here. Japan currently has one of the largest differentials with the United States,2 contributing to a weak yen. This makes Japan highly exposed to rising import prices. Changes in monetary-policy positions will largely determine how important imported inflation will be.

Using a harmonized consumer price index that allows for cross-country comparisons, it is clear that inflation is running hot in every advanced economy (figure 1). Headline inflation in the United States was 9.1%[3] year over year in June, while it was 8.6% in the eurozone, 8.2% in the United Kingdom,[4] and 8.1% in Canada.[5] Japan is the exception among the major advanced economies—its headline inflation rate was just 2.3% year over year[6] over this period, only slightly above its central bank's 2% target. Even after excluding the volatile food and energy components, inflation is still higher than most central banks would like. Core inflation in the United States, the United Kingdom, and Canada was more than 5% on a year-ago basis in June. In the euro area, it was a more modest 3.7% over the same period. Japan and Switzerland are the only advanced economies to have posted core inflation below 2%.

FIGURE 1

Advanced economies the world over are reeling under high inflation

Inflation growth (YoY change, June 2022)



Note: Core prices are harmonized for cross-country comparison.
Source: National statistical agencies, accessed via Haver Analytics.

Deloitte Insights | deloitte.com/insights

Higher inflation is the result of insufficient supply relative to demand. This imbalance can result from a rise in demand, a fall in supply, or some combination of the two. Knowing which factor contributes the most to inflation is useful in determining how inflation may progress in the future. For example, supply-side causes of inflation will subside when the related disruptions abate and more supply is available. Meanwhile, demand-side causes of inflation likely require contractionary policy, typically from a central bank, to bring demand back in line with existing supply.

Supply versus demand shocks

Researchers at the Peterson Institute for International Economics developed a basic methodology to determine the magnitude of supply and demand shocks.[7] Supply shocks could come in a variety of forms, including pandemic-related disruptions to the labor supply, factory output, and port capacity, along with diminished availability of food and energy following Russia's invasion of Ukraine. Fiscal and monetary stimuli are the main demand shocks. Using data from the International Monetary Fund (IMF), we apply this methodology to a wider group of economies to better understand the nuances of inflation in each region.

The results of applying this methodology show that nearly every major economy has experienced negative supply shocks since the pandemic hit (figure 2). The good news about supply-side inflation is that it can ease on its own. Indeed, pandemic-related disruptions to supply are already doing just that. For example, more people are back at work and fewer locations continue to implement lockdowns.8 As a result, the cost of shipping has come down9 and goods inflation excluding energy has moderated in numerous geographies.

FIGURE 2

Nearly all advanced economies have seen negative supply shocks since the pandemic hit

Demand vs. supply shock for advanced economies

Notes: The position of the blue dots shows how large the demand and supply shocks to each labeled country have been since the pandemic hit. Our analysis builds on the research from the Peterson Institute for International Economics, which lays out a methodology to decompose demand and supply shocks to various economies. The institute used data from the Organisation for Economic Co-operation and Development to estimate the size of each shock. Here we use data from the International Monetary Fund and expand the analysis to more diverse geographies.

Sources: International Monetary Fund; Peterson Institute for International Economics; Author calculations.

Deloitte Insights | deloitte.com/insights

Euro-area countries, where inflation is mostly due to supply shocks, should be prime beneficiaries of the easing of supply-side constraints. Unfortunately, much of the euro area's supply shock comes from the ongoing war in Ukraine, which could last much longer. Although some food commodity prices have fallen after a deal was reached to allow Ukraine to export its grain through the Black Sea,10 energy prices remain elevated.11 If energy prices remain where they are, their year-over-year growth rate will not come down much until February or March next year once base effects take hold. Even that scenario may be too optimistic as it likely hinges on there being no escalation of tensions with Russia. As of this writing, there is a risk of further disruption of the natural-gas market in Europe.

Some demand-side shocks are also beginning to ease on their own. Heightened risk of recession has lowered expectations for global growth12 and contributed to a pullback in economic activity. Governments have also mostly ended their pandemic-related stimulus packages, creating a fiscal drag on economic growth relative to last year. A weakening of demand will benefit economies, such as the United States, where positive demand shocks are at least partially to blame for higher inflation.

Despite demand easing a bit on its own, countries that saw positive demand shocks will likely need central bank intervention to bring inflation back down to 2%. Monetary policy is reasonably effective at restraining demand drivers of inflation, though it does little to rein in supply-driven inflation. Apart from the Bank of Japan, most developed-economy central banks have begun to tighten monetary policy.13 The United States, which arguably experienced the largest demand shock among developed economies, has also seen some of the fastest rate hikes this year, which pushed the policy rate to between 2.25% and 2.5% in July. More rate hikes are likely to be necessary to bring inflation down further. For example, some rule-based measures of the policy rate suggest that it should rise to 9% or more depending on the rule's specifications.14 It is unlikely that any of the developed-economy central banks will raise rates that high, but it gives some indication of how high the rates could go if inflation does not moderate soon.

Unfortunately, in economies such as the eurozone, where there is little evidence of a demand-side shock, weakening demand may do little to alleviate inflationary pressures. Consider that much of the inflation seen throughout Europe is directly tied to the spike in food and energy prices that occurred after Russia's invasion of Ukraine. Energy prices in Europe are unlikely to come down significantly without some type of resolution in Ukraine. This puts Europe at an elevated risk of worsening stagflation, where high inflation coexists with weak or falling GDP growth.

Great expectations for inflation

In economies where supply shocks are the primary or exclusive drivers of inflation, raising interest rates will be far less effective at bringing down price growth. Despite this fact, most developed-economy central banks—concerned that inflation expectations could become entrenched—have raised interest rates. This means that, as consumers witness high inflation, they begin to expect those price gains to persist, which can lead to behaviors such as hoarding that drive up demand—and, therefore, inflation. Higher expectations can also put upward pressure on wage growth as workers increasingly demand to be compensated for the costs they expect to rise in the future.

Inflation expectations in Europe have been relatively high, likely reflecting the extreme price swings of petrol and food that consumers faced after Russia's invasion of Ukraine. In Italy, inflation expectations after 24 months were 4.8% in Q2 2022, while they hadn't been more than 2% since 2012.15 In Germany, consumers expect inflation to average 5.4% for the next five years. Even though German bond markets16 adjusted their implied inflation rate over five years down to 2.9% in June from 3.5% in April, it is still well above the sub-2% implied inflation that was consistent before the pandemic.17 To prevent these elevated expectations from causing higher actual inflation, the European Central Bank has eliminated its negative interest rate policy and is expected to tighten further.

Even in Japan, where overall inflation has been much weaker, expectations for inflation are up considerably from where they had been previously. The Tankan survey of businesses puts inflation at 2% over the next three years, a record high going back at least to 2014.18 One consumer survey shows that nearly 60% of consumers expect inflation to be more than 5% over the next year—a significant jump from where inflation currently stands.19 This is particularly surprising given that consumer expectations of inflation are often based on what consumers have experienced recently—currently, inflation is far lower than 5%. The Bank of Japan has yet to tighten its policy, but higher rates may be inevitable should more inflationary pressures mount.

In the United States, the United Kingdom, and Canada, inflation expectations look slightly better anchored. US bond market–based measures of longer-term inflation expectations are now in line with prepandemic norms after having come down recently due to fears of recession.20 US consumer expectations for inflation over the next five years were at 2.8% in June, while they were typically around 2.5% prior to the pandemic.21 In the United Kingdom, bond-market inflation expectations for the next five years were 3.8% in June, down from 4.7% in March but still slightly above the 3.4% recorded in September 2019.22 Even consumer-based inflation expectations for five years were just 3.5% in Q2 2022, about where they were when the pandemic hit.23 In Canada, consumer expectations for inflation over the next five years were at 4%, slightly lower than the peak reached back in 2018.24

Expectations can change quickly in either direction. Although most inflation expectations have come down somewhat recently, the risk of those expectations returning remains serious, especially in economies such as Europe, where inflation may persist regardless of what is happening in the domestic economy. This may cause central bankers to keep monetary policy relatively tight even as domestic demand deteriorates.

.

Watch for a wage-price spiral

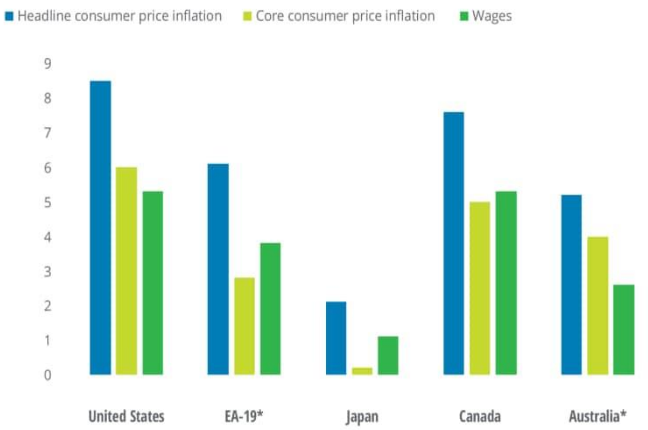
Central bankers are also wary of a wage-price spiral, where prices push wages higher and vice versa. Despite tight labor markets throughout most of the developed world, wage growth generally remains below headline inflation. In Q1 2022, when headline inflation for the eurozone was 6.1% year over year, wages were up just 3.8%.25 Even in Spain, where monthly earnings per worker were up 5.4% year over year in Q1, headline inflation was still 2.9 percentage points stronger.26 In the United States, average hourly earnings were up 5.1% from a year earlier in June, well below the 9.1% reading for inflation.27 In Japan, average monthly earnings, which include bonuses, were growing slightly over half the rate of inflation.28 Even in the United Kingdom, where weekly earnings of the private sector were up a lofty 7.2% from a year earlier on a three-month moving average basis, wage growth trailed headline inflation, which was up 8.4% over the same period.29

Although wage growth is running behind headline inflation growth, it is running ahead of core inflation in some cases (figure 3). In the United Kingdom, for example, core inflation was just 6.1% year over year, more than a full percentage point behind wage growth over the same period. In the euro area, core inflation was just 2.6% year over year in Q1, also more than a full percentage point lower than wage growth over the same period. In Canada, wage and core inflation growth in June were growing at the same rate. Even in Japan, western core inflation was up just 0.2%, firmly shy of the 1.1% wage growth. However, in the United States, wage growth was still running below core inflation in June when prices excluding food and energy were 5.9% higher year over year.

FIGURE 3

While wage growth lags headline inflation in most developed economies, it is running ahead of core inflation in some cases

Inflation vs. wages (YoY % change, May 2022)



Note: * Data used is from Q1 2022.

Sources: National statistical agencies, accessed via Haver Analytics.

Deloitte Insights | deloitte.com/insights

Because inflation has been so heavily concentrated in food and energy throughout Europe, and to some extent in Japan, a wage-price spiral may be more likely. Workers are faced with higher prices for necessities such as petrol and food and likely demand higher wages as a result. The problem in these economies is that other sectors are not seeing strong demand. After all, the positive demand shock in these economies has been relatively weak or nonexistent.

As wages rise to compensate for higher costs of living, sectors outside of food and energy may be forced to raise their prices to compensate for their increased labor cost. Thus, a wage-price spiral is born. It is in the United States, where demand is stronger and inflation more widespread, that a wage-price spiral seems least likely. The fact that wage growth has not been stronger, and has even moderated in the United States, given the incredible tightness in the labor market remains a conundrum for economists.

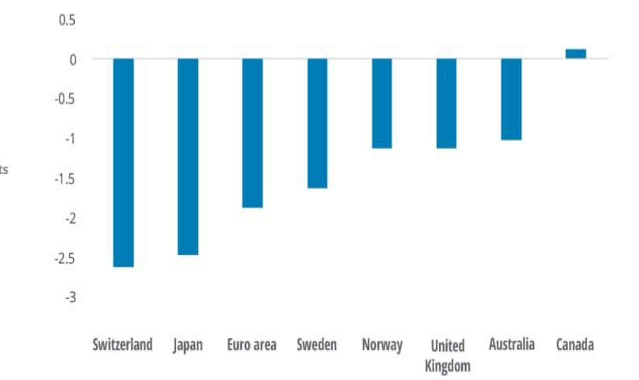
Falling currencies raise prices

Although what happens domestically is critically important to predicting inflation, changes in global economic conditions also need to be taken into consideration. Most critically, what happens in the United States can have sizable effects on inflation elsewhere in the world. As the United States continues to raise interest rates at a more aggressive pace than most of its developed-economy peers, capital has flowed into dollar-denominated assets. This dynamic has strengthened the value of the US dollar and weakened the value of other major currencies, including the euro, pound, and yen.

FIGURE 4

Dovish central banks put downward pressure on their currencies

Central-bank policy rate (deviation from US policy rate, July 2022)



Source: National central banks, accessed via Haver Analytics.

Deloitte Insights | deloitte.com/insights

The euro and pound have each lost between 14% and 15% of their value against the US dollar in the year to July, while the Japanese yen has lost 25% of its value against the dollar over the same period.30 A weaker exchange rate raises the cost of imports denominated in foreign currency. The prices of globally traded commodities, which are often priced in US dollars, were already expensive. A stronger dollar makes those commodities even more costly.

Import prices shot up 29.1% year over year in April31 in the euro area and 46.2% in June in Japan.32 Much of the increase can be attributed to higher food and fuels costs. However, other goods are also more expensive. For example, in the euro area, the prices of imported consumer goods excluding food, beverages, and tobacco were up 7.9% year over year in April.33 In Japan, textile import prices were up 13.2% year over year in June, highlighting the inflationary effects of a weak currency.34

Moving forward, exchange-rate pressures may begin to ease. Concerns over recession in the United States are raising doubts that the Fed can hike rates as quickly as the market currently expects. A less hawkish Fed would give other central bankers some breathing room as their currencies stabilize or even strengthen against the dollar. On the other hand, should the Fed be able to avoid a recession while other countries fall into one, we could see additional strength in the dollar and therefore more imported inflationary pressure.

It's clear that inflation is a challenge throughout most of the developed world. How inflation evolves from here will depend on central-bank policy, inflation expectations, wage growth, and exchange rates. The effect these factors will have on each economy will depend on the underlying cause of inflation. Monitoring these variables and putting them in the proper context will allow business leaders to better anticipate the inflationary environment moving forward and make necessary changes faster than competitors.

References:

1. National statistical agencies, accessed via Haver Analytics; author calculations. *View in Article*
2. Bank of Japan and US Federal Reserve Board, accessed via Haver Analytics. *View in Article*
3. Bureau of Labor Statistics; Haver Analytics.*View in Article*
4. Statistical office of European Communities; Haver Analytics.*View in Article*
5. Statistics Canada; Haver Analytics.*View in Article*
6. Japan Ministry of Internal Affairs and Communications; Haver Analytics.*View in Article*
7. Joseph E. Gagnon, "The inflation story differs across major economies," PIIE, June 30, 2022.*View in Article*
8. Our World in Data, "COVID-19: Stringency index," accessed August 18, 2022.*View in Article*
9. Augusta Saraiva, "Companies see relief in falling spot rates for transpacific freight," Bloomberg Asia, June 23, 2022.*View in Article*
10. Rob Picheta et al., "Kyiv and Moscow agree deal to resume Ukraine grain exports from Black Sea ports," CNN, July 23, 2022.*View in Article*
11. Market Watch, "Brent crude oil continuous contract," accessed August 18, 2022.*View in Article*.
12. Martin Farrer, "Global recession risk rising as economic outlook 'darkens significantly', IMF says," The Guardian, July 14, 2022.*View in Article*
13. Leika Kihara, "BOJ retains easy policy, Kuroda shuns chance of near-term rate hike," Reuters, July 21, 2022. *View in Article*
14. Haver Analytics.*View in Article*
15. Banca d'Italia; Haver Analytics.*View in Article*
16. Bond-market or investor expectations of inflation are calculated by comparing government bond yields with the yields for inflation-protected government bonds.*View in Article*
17. Deutsche Bundesbank; Haver Analytics.*View in Article*

18. Bank of Japan; Haver Analytics.View in Article
19. Japan Cabinet Office; Haver Analytics.View in Article
20. Federal Reserve Board; Haver Analytics.View in Article
21. University of Michigan; Haver Analytics.View in Article
22. Bank of England; Haver Analytics.View in Article
23. Bank of England; Ipsos; Haver Analytics.View in Article
24. Bank of Canada; Haver Analytics.View in Article
25. Statistics Office of the European Communities; Haver Analytics.View in Article
26. Instituto Nacional de Estadistica; Haver Analytics.View in Article
27. US Bureau of Labor Statistics; Haver Analytics.View in Article
28. Japan Ministry of Health Labor and Welfare; Haver Analytics.View in Article
29. UK Office of National Statistics; Haver Analytics.View in Article
30. Federal Reserve Bank of St Louis.View in Article
31. Statistical Office of the European Communities; Haver Analytics.View in Article
32. Bank of Japan; Haver Analytics.View in Article
33. Statistical Office of the European Communities; Haver Analytics.View in Article
34. Bank of Japan; Haver Analytics.View in Article

Michael Wolf

The Residential Real Estate Market Is Slipping. Is it 2008 Deja Vu?

by Emily Mogen, ACoM, CPM®, National Manager, Trust Real Estate, Key Private Bank *(originally published at www.key.com)*

There are troubling numbers but most factors indicate we are not heading for another housing bubble burst.

We had seen these real estate signs before. By the summer of 2020, homes are selling at record prices. Owners are getting multiple offers for above the asking price within hours after putting their houses on the market. Agents are unable to sign contracts fast enough. But then the decline begins. Single-family and condo/co-op sales go down 3.6% between April and May 2022 with an overall drop of 7.7% since April 2021. Houses remain on the market longer and longer.[1]

Are we spiraling toward a repeat of the burst of the residential real estate market bubble of 2008?

Not likely, even though some of the numbers are troubling.

An explosion in construction precipitated the residential real estate boom of the mid-2000s. Builders were raising subdivisions at record rates, fueled by easy money from lenders and suspect qualifications for buyers. Then it all crashed. Homes sat on the market for months, "underwater," as they were valued less than the amount owed on their mortgages.

In contrast, this latest housing boom was an unexpected by-product of the COVID-19 virus that infected the country and the world.

After the initial economic pause from COVID in March 2020, housing trends changed. People stuck working in their apartments desired more space. Millennials, a huge population group, aged into their prime buying years. Interest rates were low. Inflation was not a factor. Home prices were considered reasonable. So investment took off.

As the health crisis began to abate toward the end of 2020, it seemed as if the residential real estate market might return to normal. However, available inventory remained low in many parts of the country because folks hunkered down during COVID and improved their properties. Real-estate values also continued to soar because of supply chain issues, higher costs for construction material and a shortage of laborers.

So what happened?

As we reached the halfway point of 2022, a number of economic factors have begun to depress the real estate market again:

- Inflation remains elevated and has reached the highest level in four decades. As a result, the Federal Reserve (the Fed) has raised interest rates multiple times with more hikes to come, causing mortgage interest rates to exceed 5% for the first time in years.
- A bear market, down more than 20% at times, has put a big dent in the portfolios of many investors.
- Higher mortgage interest rates coupled with the higher home prices – the national median price of existing and new homes is now over $400,000 – has increased the average cost to purchase a home by 10.8% from 2021 to 2022 and it is expected to continue to rise further by an additional 3.2% going into 2023.[2]

All of this has led potential buyers to balk before investing in residential real estate.

The Residential Real Estate Market Is Slipping. Is it 2008 Deja Vu?

But is it really that bad?

Many factors indicate what is happening now is not a repeat of 2008, such as:

- The excess home supply from the construction boom before 2008, plus the wave of foreclosures, led to the real estate bust. Today, supply remains short and demand is still strong.
- We have tighter lending guidelines and standards for mortgages compared to the loose credit of the early 2000s. The mortgage delinquency rates are only around 3%, compared with a peak of 9.3% during the housing crisis.[3] Presently, there are only 2.5 million adjustable-rate mortgages outstanding now; there were 13.1 million in 2007, just before the crash.[4]
- Savings rates are stronger as a result of the COVID Economic Stimulus and Relief Bill, which may help cushion any anticipated uptick in unemployment if we have another recession.

The unemployment rate remains at a low 3.6%, half of what it was in December 2008, when more than 11 million people were out of work. And we think many of those folks who might be vulnerable to unemployment today are already out of the hunt because the labor force participation rate at 62.3% is lower than it was in February 2020 at 63.4% (the Fed defines the labor force participation rate as "the percentage of the [civilian] population that is either working or actively looking for work").

We should note that the current housing slide has not equally affected all areas of the country.

The Sun Belt states, in particular, remain a strong market. According to seasonally adjusted federal data, almost 90% of the new homes sold in May were either in the South or the West. Median sales prices have increased in all sectors of the country year-over-year. But in the Northeast, median sales price has moderated. Still, the region has the highest median sales price in the US at $563,000, up about 10% year-over-year. In the Midwest, the median sales price in Q1 was $406,800, up from $320,600 the previous year, the largest increase of any of the four sections of the country.[5]

Key takeaways

Recessions affect every aspect of the economy, and real estate and housing are not exceptions. However we believe prices will continue to increase/appreciate, though at a much smaller pace because of the inventory situation and number of buyers. Most price declines during a recession are minimal.

As we move into 2023, we believe we will experience a leveling off and return to normal appreciation. Residential real estate is still a worthy investment.

About the Author

Emily Mogen specializes in fiduciary property management, helping individuals, families, professionals, business owners, foundations, and executives navigate the complexities of Trust Real Estate. With more than 22 years of experience, she provides advice and services for real estate investments, sales, purchases, inspections, ADA compliance, environmental issues, rent collection, renovations, management of mineral, oil, and gas assets, and property management. She attended the University of Akron, holds the Accredited Commercial Manager and Certified Property Manager designations from the Institute of Real Estate Management, and holds an Ohio real estate license. Emily is Treasurer and past President of the Northern Ohio Chapter of the Institute of Real Estate Management (IREM), President of the National Trust Real Estate Association (NTREA), a Member of the Commercial Committee at the Akron Cleveland Association of Realtors® (ACAR), and a Member of the National Association of Realtors.

Sustainability Reporting: Some Insights

. . . "sustainability" terminology may be interpreted or used differently by stakeholders. . . . the term "sustainability" is broadly understood to refer to information related to environmental, social, or governance ("ESG") matters (be they related to reporting on investor focused sustainability information material to enterprise value and the effective functioning of global capital markets or multi-stakeholder focused sustainability reporting that captures impacts of a reporting entity on economy, environment and people) and therefore is consistent with the public expectations for the work of this board

Kevin Dancey
CEO, International Federation of Accountants

Sustainability has become a basic expectation of organizations and is related to stewardship and governance.

Sustainable funds have been set up and are attracting capital at a rapid pace. It was reported that in the United States, such funds reached US$ 1 billion in 2020 accounting for twice the amount in the preceding year and approximating more than 10 times than in 2018's value.

Investors in their capital allocation consider sustainability through what may be called as ESG lens, i.e., environmental, social, and governance information. The information are subjected to analyses that engagements of independent professionals/firms are resorted to objectively report on the entities' ESG compliance.

Some Concerns on Sustainability Reporting

Data

The lack of reliable and comparable ESG data is a key challenge to create a level playing field in the ESG "marketplace". Technology is adopted to facilitate massive volume of data processing to track and analyze them.

The use of technology in sustainability reporting should take into account some basic things like the kind of data to be collected and tracked. More importantly, the set/type of technology tools to use to collect, track and analyze the information should be determined. Data analytics software is one of those tools. Timeliness of collection, tracking, analyzing and reporting is key to useful reports in support of decision-making.

Standards & Enforcement
In the absence of a common standards and enforcement mechanism, it can be challenging to measure the impact of certain ESG factors. It is even harder to track and disclose metrics, especially in the case of some of the social factors that tend to be more qualitative in nature and less well-defined. Of significance is the fact that those who provide assurance on sustainability reports come from different disciplines

International professional bodies like the International Ethics Standards Board for Accountants (IESBA) and the International Auditing and Assurance Standards Board (IAASB) through technical working groups initiated crafting standards. In developing standards, the following may be worth noting –

- Comprehensiveness (to limit exceptions)
- Coherence
- Implementability
- Clarity and conciseness
- Scalability
- Relevance

On September 15, 2022 the International Organization of Securities Commissions (IOSCO) released a statement making public its support for IESBA and the International Auditing & Assurance Board (IAASB) in developing standards relating to Assurance of Sustainability. The IESBA Chair Gabriela Figueiredo Dias reacted to the statement, “Ethics standards, including independence requirements, are foundational to public trust in the assurance of sustainability-related information. It is crucial in the public interest that all assurance providers, whether or not they are from the accountancy profession adhere to the same high bar of ethical behaviour and independence in such assurance work . . . .”

IAASB Chairman Tom Seidenstein said, “There is a clear need to ongoing dialogue and collaboration to ensure sustainability reporting, assurance, and regulation develop in a cohesive manner to provide decision-useful information to stakeholders. . . .”

Consultations/dialogues with a broad range of stakeholder groups and exposure of drafts to solicit comments/views as well as close coordination with all concerned are imperatives in standards setting. Public interest is a prime consideration.

Indeed, the enormity of concerns renders standards setting for sustainability reporting daunting. Things take time to evolve and so, standards setting. With collective efforts from concerned sectors, it may be facilitated for the sake of objectivity and reliability in reporting with a basic expectation of high quality outcome.

The foregoing represents some highlights from the meeting materials and discussions during the September 8, 2022 meeting of the Consultative Advisory Group of the International Auditing & Assurance Standards Board (IAASB) and September 23, 2022 meeting of the Consultative Advisory Group of the International Ethics Standards Board for Accountants (IESBA). IOSCO’s support was released on September 15, 2022.

IAFEI SECRETARIAT
c/o FINEX Philippines Office
U1901, 19/F, 139 Corporate Center, Valero St.,
Salcedo Village, Makati City
E: secretariat@iafei.org
T: +63 2 8114052 / 8114189
F: +63 2 8114185
url: www.iafei.org