

# **econsense**

## **Discussion Paper**

Proposal for a Directive  
on the disclosure of  
non-financial information  
adopted by the European  
Commission

Status as: 15 July 2013

---

Status as: 15 Juli 2013

## **econsense Discussion Paper**

### **Proposal for a Directive on the Disclosure of non-financial Information adopted by the European Commission**

#### **Occasion**

On 16 April 2013 the European Commission adopted a proposal to amend the Accounting Directives 78/660/EEC (4th Company Directive on the Annual Accounts of certain types of companies) and 83/349/EEC (7th Accounting Directive on Consolidated Accounts). The revised guidelines require certain large companies and groups to disclose “policies, results and risks” as regards environmental matters, social and employee-related aspects, respect for human rights and anti-corruption issues in a "non-financial statement". Large companies with corresponding administrative, management and supervisory bodies should also provide information on their diversity policy concerning these bodies. econsense would like to accompany the practical implementation issues of the topics addressed in the proposal with the following discussion paper.

#### **Introductory Remarks**

econsense shares the view that transparency about non-financial aspects of corporate activity and corporate responsibility are interconnected. The members of econsense therefore have been reporting for many years on non-financial aspects material for their business on a voluntary basis. This transparency has positively affected the companies through improved acceptance and credibility externally as well as by impulses for the strategy and organizational development internally.

More and more German and European companies are dealing with a high level of commitment to sustainability/CSR in their core business. Each new legal measure with the means to increase transparency therefore must be developed and implemented with good judgment and take into account the principles of decision relevance, materiality and proportionality. The reporting burden for companies that already voluntarily report in accordance with recognized standards should not be duplicated in any case. In this context, appropriate transparency requirements should be formulated for institutions and organizations in the state and civil society accordingly.

econsense has always advocated the voluntary non-financial reporting (such as in the discussion of the German Sustainability Code). There are good arguments for doing so. Given the continuously increasing transparency requirements for companies, this voluntary basis is in fact increasingly restricted. Large companies as well as SMEs have to deal constructively with some very demanding transparency requirements from different stakeholders. In addition, consumers and business partners increasingly demand supply

chain transparency, including on some of the issues addressed in the EU proposal. Against the background of these developments, the econsense members believe that the discussion about non-financial reporting should concentrate on issues of practical implementation (including reporting burden, materiality, avoidance of fragmented frameworks, etc.) and not solely on obligation.

### **Flexibility vs. detailed content requirements**

There is currently a considerable dynamism in the market for reporting standards and formats (GRI G4, IIRC, German Sustainability Code, SASB, etc.). Therefore, there is certainly no need for a new "European reporting standard". The flexible nature of the EU proposal (companies choose an appropriate reporting standard for their business model) tries to reflect this. This shall allow companies a less bureaucratic implementation based on standards, which are already used in the voluntary reporting. A detailed specification of the aspects/performance indicators to be reported would not be valuable in any case, as this would unnecessarily restrict the materiality of the information reported.

### **Exemption rules for companies with voluntary sustainability reporting**

The EU directive proposes that companies which already prepare a comprehensive non-financial report on a voluntary basis shall be exempted from the obligation to include an additional non-financial statement in their management report. Thus, duplication in reporting should be avoided and voluntary measures shall be recognized.

However, the exemption rule formulated in the EU proposal contains a certain vagueness: The notes on page 7 (paragraph 3) and page 10 (sub-item 12) demand that this voluntary sustainability report is to be "annexed to the annual report", while the wording of the proposal on page 12 (1b paragraph 4) and page 13 (1b paragraph 4) requires that the voluntary report is "part of the annual report". The difference between these two formulations is greater than it might appear at first. In the first formulation ("annexed to ") an existing sustainability report (e.g. GRI) could be attached to the annual report respectively published in another reporting element outside of the management report. The second formulation, however, would require the integration of the sustainability report into the management report. This would, in most cases, overstretch the claims of materiality, scope, audits, etc. of the management report and pose greater challenges to companies which already voluntarily report according to GRI etc., but not yet "integrated" or "combined".

Not only the integration into the management report, but also the attachment of a sustainability report to the management respectively annual report comes with challenges. Among other things, it would require to synchronize the reporting processes. For many companies, this would be associated with considerable effort and could not be implemented without any transitional period. So far, the sustainability reporting of many companies is delayed in time (i.e. after the publication of the annual report), which is due to the greater complexity of the data collection (diversity of measurement units etc.). The exemption rule for companies with a voluntary sustainability report also fails to recognize that the sustainability report of many companies is published partly or entirely online to save resources and to make the information accessible to a wider circle. The proposed exemption therefore misses

the reality of many companies and the voluntary reporting of many companies according to internationally recognized standards is not sufficiently appreciated.

### **Fragmented frameworks and reporting at group level**

The European Commission wishes to place the currently fragmented legal frameworks in the EU for non-financial reporting into a "level playing field" for companies. Compliance with different national requirements is associated with considerable additional expenses without additional insights for the civil society and the capital market. In this context, it can be highlighted positively that the EU Directive proposes that companies should only report on group level on non-financial aspects. This regulation is of central importance for multinational companies.

### **Specifying "policies" in the non-financial statement**

The EU directive calls on businesses to provide information on "policies" in the relevant areas. However, working with "policies" is not equally disseminated in all European countries. The wording is thus not suitable. It is primarily important that companies create transparency about measures and management systems. The voluntary standards of the Global Reporting Initiative (GRI) for example use the wording "Disclosure on Management Approach".

### **Non-financial reporting in the management report**

The proposal requests the inclusion of a "non-financial statement" in the management report of the annual report. In most cases, this would create another sub-report in addition to frequently found sub-reports such as "Basic principles of the Group", "Report on the economy" and "Risk report". A connection between material non-financial aspects and the economic situation of the company is not created automatically by such a "combined" management report. Moreover, it remains unclear whether certain risks should be reported in the "Risk Report" of the Management Report or in the "non-financial statement".

The inclusion of a "non-financial statement" in the management report would entail significant additional costs for most companies, among others related to auditing. Information provided in the management report must meet audit requirements that are significantly higher than for other report elements in the annual report. The auditing of statements such as respect for human rights in the management report is extremely difficult. In the proposal this topic is neglected. Related to the exemption rule for companies with voluntary sustainability reporting this would result in an inconsistent audit practice: Information in voluntary sustainability reports outside of the management report would continue to undergo only plausibility and consistency checks, while companies without sustainability report would have to undergo auditing of the "non-financial statement" in the management report with a much higher claim.

According to existing legislation (Accounting Directive 78/660/EEC and 83/349/EEC or DRS20 in Germany) the management report should only contain non-financial information that is essential for the understanding of the financial performance and overall position of the group. With the proposed binding "non-financial statement" to environmental, social and employee-related aspects, respect for human rights and anti-corruption this materiality principle is undermined. A supplement of "non-financial performance indicators" to the

management report is still only required if it is necessary for an understanding of the business performance (see also DRS20). However, this materiality principle does not apply to the "non-financial statement". It is therefore accepted that the report contains information that is not relevant for the understanding of business performance.

Material topics can differ greatly from company to company depending on the business model, industry and geography. Moreover, the disclosure of certain information may also jeopardize business secrets. Therefore, internationally recognized reporting standards (including GRI) rely on a "comply or explain" approach. This means that if certain information cannot be disclosed, the company must provide a plausible explanation. Although the EU directive contains a "comply or explain" approach, it only admits companies that if no policy is pursued in relation to one or more non-financial aspects, it is necessary to provide an explanation for not doing so. A "comply or explain" approach in our understanding, which allows a "non-reporting" due to lack of materiality of information or a threat to business secrets, is not included in the EU directive. In the interest of material reports as well as to protect the company in the global competition, however, this understanding of "comply or explain" is essential.

### **Requirement to disclose the diversity policy**

The proposed reporting requirement on diversity policies is not consistent with the proposal COM (2012) 614 of the European Commission (warranty of a more balanced representation of women and men among the non-executive directors/members of the supervisory board of listed companies). The latter proposal calls for a representation of a compilation of the appropriate governing bodies, including targets and measures at the company's website. The diversity of the criteria underlying this reporting requirement and the differing presentation on the website rather than the management report would inevitably lead to excessive overtime for companies.

There are already far-reaching regulations regarding diversity in many EU member states. The German Corporate Governance Code recommends, for example, complying with the principle of diversity in the composition of the supervisory and executive board. Especially with the "declaration of conformity" enshrined in § 161 AktG, the Code contributes significantly to the self-regulation of companies. It should be avoided to duplicate the national requirements in this area.

### **Timing of the review of the EU Accounting Directives**

The publication of the new proposal of the EU Commission on a legal obligation to non-financial reporting falls in the middle of the not yet formally completed redesign of the 4th and 7th European Accounting Directive. This approach leads to considerable legal uncertainty for companies. Econsense advocates at this point to avoid such legal uncertainties.

### **Summary**

This discussion paper is to constructively accompany the practical implementation of the topics addressed in the proposal of the EU Commission. In summary, to our mind, the following points are the cornerstones of an ongoing discussion to non-financial reporting:

- Clear focus on topics that are material in the given context/business model of an organization.
- Flexibility in the choice of recognized voluntary reporting standards and guidelines that are particularly suitable for an organization.
- Properly understood "comply-or-explain" approaches, that offer sufficient flexibility, ensure innovative and integrated reporting.
- Avoidance of additional administrative and bureaucratic effort for companies. For this purpose, reporting at group level and an appropriate integration and mutual recognition of voluntary and mandatory reporting standards are essential.

consensus is at disposal to all stakeholders from politics and society for further discussion about the meaningful implementation of non-financial reporting.

econsense – Forum for Sustainable Development of German Business, is an active network of leading, globally-active companies and organisations with a strong presence in Germany who have a shared interest in shaping the future of sustainable economics and corporate social responsibility – through open dialogue with one another, policymakers and society.

Members:

Allianz, Alstom Deutschland, BASF, Bayer, BMW Group, Bosch, Coca-Cola Deutschland, Daimler, Danone, Deloitte, Deutsche Bahn, Deutsche Bank, Deutsche Börse, Deutsche Post DHL, Deutsche Telekom, DuPont, EnBW, E.ON, E&Y, Evonik Industries, Generali Deutschland, HeidelbergCement, KPMG, Linde, Lufthansa, PwC, RWE, SAP, Siemens, Tetra Pak, ThyssenKrupp, TUI, VCI, Vodafone, Volkswagen

Contact:

econsense – Forum for Sustainable Development of German Business  
Oberwallstraße 24  
10117 Berlin  
Tel.: 030 / 2028 – 1474, Fax: 030 / 2028 – 2474  
E-Mail: [info@econsense.de](mailto:info@econsense.de)  
[www.econsense.de](http://www.econsense.de)