

— econsense – Forum for Sustainable Development of German Business e. V.

Contribution to the EU Commission's consultation on the review of the non-financial reporting directive

10 June 2020

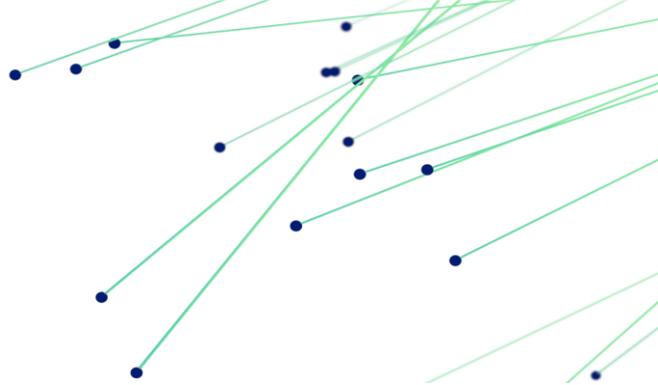
Introductory remarks on the nature of the econsense network and its comment to the NFRD consultation

econsense – Forum for Sustainable Development of German business is a network of large, internationally operating companies, the majority are listed companies. Our members are dedicated to sustainability. Due to our nature as a network and not an industry association we do **not speak for German business as such but contribute to this consultation based on the experiences and knowledge of our members.**

Our **competence and strength as a network are fed by the expertise of our members and by the diversity of our network.** Particularly regarding the topic of sustainability reporting it is **important to explain the composition of the econsense member community.** Among our 38 corporate members we have companies from different sectors, listed and a few non-listed companies, we have companies with an integrated report, companies that report separately and the Big Four auditing companies. The reporting members/data preparers are at different stages regarding sustainability strategy and reporting and the auditing companies have a completely different function in the process of sustainability reporting. This **unique network composition** is the reason why, even though **all econsense members welcome the revision of the NFRD and support the overall direction of the revision, our members have different views** regarding selected consultation questions.

Our many years of experience, particularly in the field of sustainability reporting, show that this **internal dialogue competence and culture as well as the wealth of experience of our members make us a sought-after dialogue partner** for policy makers.

Sustainability reporting has been a top priority issue for our members since econsense was founded 20 years ago. During this time, **sustainability reporting has developed continuously.** In the beginning, sustainability reporting was more of an instrument tailored to an individual company for transparency towards its central stakeholders beyond the financial market. It served the purpose of transparency towards employees, citizens and neighbors, civil society actors and politics on all topics relevant from the point of view of the reporting company and its stakeholders beyond the key financial figures. Already with the Non-Financial Reporting Directive (NFRD) in 2014, the **function of sustainability reporting has changed significantly.** Sustainability indicators are intended to be equally significant as financial indicators. As the sustainability network



of the German economy, **we expressly welcome this development of upgrading sustainability information.**

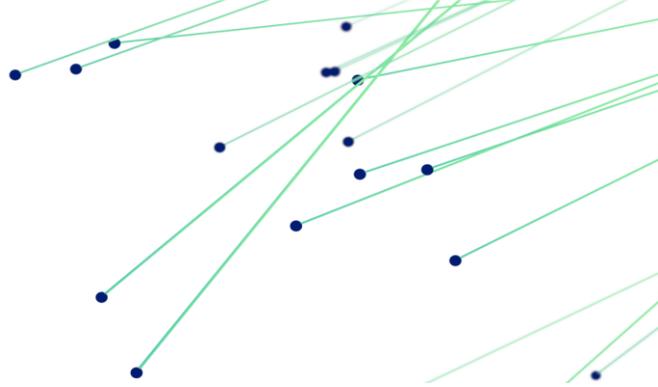
In the following text as well as in our comments in the questionnaire **we will be transparent on the diverging views and explain which sub-group of our membership supports which option for what reasons. We strongly believe that this level of transparency supports an informed debate and would be happy to continuously contribute to this debate as a network.**

Before we comment on the sections of the consultation in detail, we would like to share some **introductory, more general remarks and recommendations on sustainability reporting** with the EU Commission:

- Ensuring an **international perspective on sustainability reporting is essential.** European regulation at least needs to consider coherence and connectivity with internationally applied standards and practices even if leadership is envisioned.
- We see the need to ensure **coherence with related regulatory initiatives** in the EU like taxonomy regulation and its delegated acts regardless of the timelines, especially regarding core content and terminology.
- In our view it is important to stay focused on the **disclosure of relevant information** for the data users and preparers that have actual **value for the strategic development of a company** and are used for steering a company or for assessing a company's performance.
- We would strongly advice to once and for good **avoid the term "non-financial"** in EU-language in general and in the directive since the times during which ESG-information did not have financial impact on a company are long gone. As an alternative, which would directly connect to Sustainable Finance Action Plan, we pledge for the term **"sustainability information"**.
- It is difficult to aggregate the costs and resources allocated to the reporting and assurance of sustainability information separately, thus in the following text **no comments on costs** will be made.

On 1. QUALITY AND SCOPE OF NON-FINANCIAL INFORMATION TO BE DISCLOSED

The econsense members evaluate the EU Commission's identified prime **target group** of sustainability information as well as the **problems regarding the scope and quality** of the sustainability information currently disclosed by companies pursuant to the NFRD (lack of comparability, limited reliability, not all relevant information is disclosed) **differently.**



Target group of sustainability information

Whether the sustainability information provided by a company is sufficient and useful (comparable and reliable) depends to a great extent on the needs of the target group that uses the information. As for the NFRD revision we see the **need for clarification of the definition of the target group** which is directly **linked to the questions, where the sustainability information is located**.

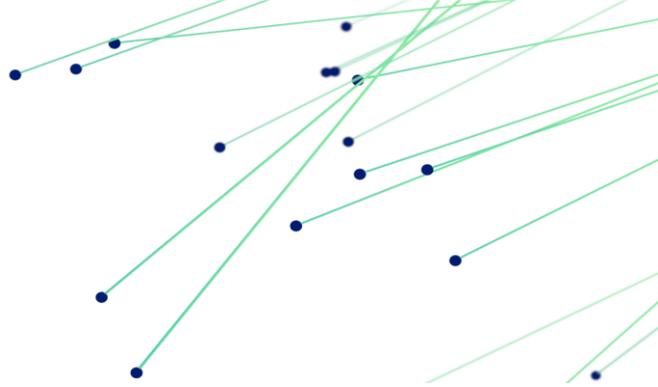
1. **Both, companies that have an integrated report as well as auditors regard investors/financial market as the primary target group** of sustainability reporting (as defined for management reports). Consequently, the sustainability information can only be part of the management report.
2. On the other hand, econsense-members, that report **sustainability information separately, define the target group for sustainability information broader**. They explicitly address investors as well as rating agencies or society in general and chose separate reporting exactly for this reason.

Scope and quality of sustainability information

1. The **data preparers** among the econsense members are of the opinion that **sustainability reporting** according to the current directive is **already sufficient in terms of scope and quality**. If there was one category where improvements could be achieved, it would be the **category of comparability**, however, tradeoffs between comprehensiveness and reliability/comparability need to be considered. They encourage the EU Commission to find the right balance between objectives of “comparability” and “all relevant non-financial information”; **focusing on a very limited set of relevant information across all sectors** helps in terms of comparability and reliability of information.
2. The **auditors** see the NFRD revision as a chance to improve comprehensiveness, reliability and comparability of sustainability information.
3. The econsense members do have a **common opinion** on the following issue: They support better alignment of the definition of environmental matters with the objectives of the taxonomy regulation (Question 7).

Recommendations

- It is a fact that companies currently provide sustainability information for different target groups.
- We **recognize the key role and growing importance of the financial market** as a target group and the need for **improving comparability**.
- The data preparers among the econsense members consider the matters as outlined in the current directive sufficient. If at all, the topics “climate” and “supply chain” could be addressed explicitly due to their universal relevance for business.

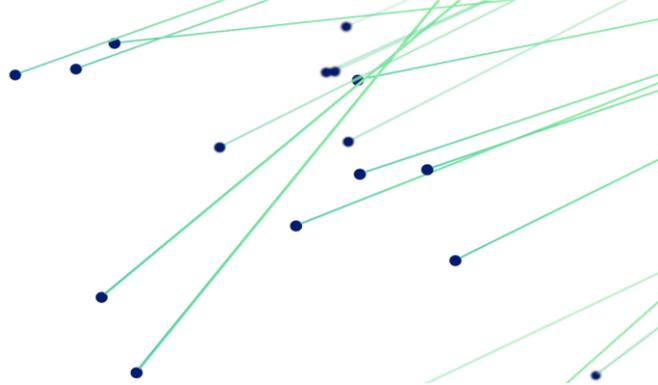


On 2. STANDARDIZATION

Though there is no such thing as one internationally accepted ESG reporting framework **there are several well accepted and much used frameworks**, comprehensive regarding all dimensions of E, S and G, sector specific or principles based. For the econsense members, internationally operating companies from different sectors, **GRI** and Global Compact are the most frequently referenced ones. However, the absence of one specific internationally accepted framework together with the confusion particularly in Germany with the definition of the term materiality do have the effect that **companies still struggle to identify the aspects/matters** to report on. A **common, international sustainability reporting standard** or **inclusively developed and agreed upon** a limited set of **KPIs** could help.

Recommendations

- The majority of the econsense members see as primary target group of sustainability information the international investor community and operate internationally themselves. The reporting on sustainability thus should follow an **internationally accepted framework or at least ensure maximum international connectivity**.
- Instead of creating a new EU reporting standard from scratch we would recommend **analyzing existing standards (GRI, Greenhouse Gas protocol, SASB, IIRC) and build on them** by integrating elements.
- Given the unlikely development of an international standard the EU should, in the development process of a common EU standard, **intensively exchange with international standards setters** and once a common standard **exists actively communicate the connectivity** to ensure the knowledge and acceptance of a new standard in the global investor community.
- The EU Commission should focus on a **small number of sustainability criteria across sectors** that are in essence material to the business model, future development, resilience of a company and are relevant to steer a company (management relevant). The key stakeholders regarding the common, cross sector set would be **investors, preparers and auditors/accountants**.
- In addition, a **limited set of sustainability criteria on sector level** could be identified in **multi-stakeholder process** on industry level. Additional stakeholders on sector level should be **sector associations, academia, civil society**.
- Any development of a standard should be supported by a **pilot phase where companies of different size and sector check and validate the applicability**.
- The **body responsible for developing** a European sustainability reporting standard should have **also strong expertise in the field of financial reporting** to ensure connectivity.



- Involvement of preferably **EU public bodies or authorities should be considered regarding the relevance of their role in terms of implementation and interpretation of a common standard**; We recommend involving bodies needed for development or implementation as accounting standards-setters.
- **Cooperation and exchange with national accounting standards-setters** has worked well in Germany.

Since we are a network of large companies, we will not comment on the questions referring to SMEs.

On 3. APPLICATION OF THE PRINCIPLE OF MATERIALITY

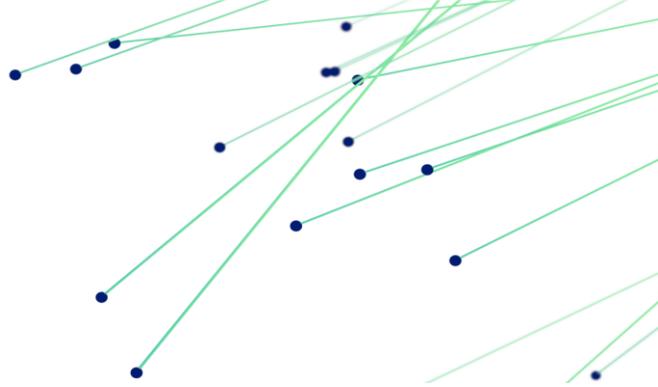
Materiality is unquestionable a **key guiding principle for any kind of reporting** to ensure completeness but also relevance of the reported content. In the context of reporting it therefore balances the information that could be reported and the information to be reported as a minimum standard. Therefore, materiality should remain central in the revision of the NFRD. Nonetheless the application of the materiality principles has caused **major discussions, especially in Germany**.

The German implementation of the NFRD does not include the **societal view standalone** but only in conjunction with the business relevance (so called double materiality discussion). Reporting practice nonetheless has shown that German reports are not completely different. Most likely the **societal view has been considered business relevant** in most cases. But the experience in Germany has shown that these different interpretations of materiality may become a problem if there is a major gap between business relevance and (perceived) reporting relevance.

Therefore, further **coherence of the different EU initiatives** is expected and strongly recommended. The **EU itself pre-defines business and reporting relevant** topics e.g. via the European Green Deal, the Sustainable Finance Action Plan (incl. taxonomy) and many other initiatives but it **pre-defines** also via the NFRD itself, **a possible EU standard** (previous section II) and a possible audit standard (question 30). A valid amount of reporting content is probably already set before any kind of materiality assessment on company level and even before the finalization of the NFRD's revision. Most prominent example is the EU taxonomy where on the EU level KPIs for different industries were pre-defined already by the Technical Expert Group (TEG).

The econsense members do have a **common opinion** regarding the general approach of materiality:

- The concept of materiality within the NFRD needs to be **further clarified and aligned with other pieces of regulation**.
- The revision of the NFRD should **avoid causing confusion for national implementations**.



- The NFRD should **clearly and honestly state where the materiality principle shall be applied** as well as where it is limited meaning where reporting companies are not free and need to apply the given requirements.
- The role of a formalized definition of **materiality within the NFRD should not be overestimated.**

The econsense members do **not have a common view** on the **disclosure of the materiality process**:

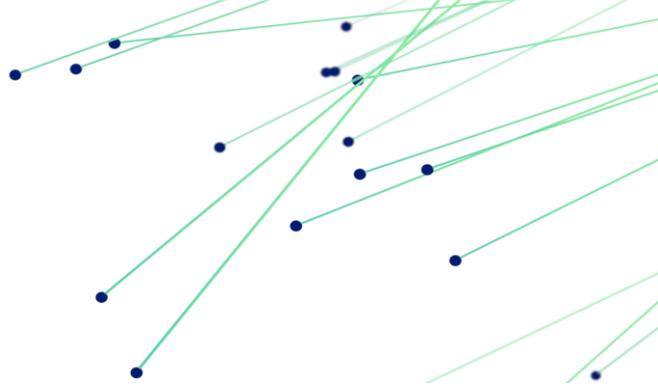
- Some of our **data preparing members** regard **disclosure requirements** for the materiality process that is far from being handled in a standardized way as **problematic**. This relates directly to assurance requirements for the materiality process in question 28 which are also not supported.
- **Some of our members – mainly auditors/accountants – support the disclosure and an assurance requirement (reasonable)** of the materiality process since in their view it is a way to improve data quality, reliability and in the end comparability of the results.

On 4. ASSURANCE

Being part of a very active business network on sustainability, the econsense members do consider **sustainability information equally relevant as financial information** and this should be reflected in the company's management and processes as well as in its disclosure practices. A **precondition for steering** a company's material aspects is the ability to set goals and targets and to **measure and monitor** the progress towards them.

How our members assess the EU Commission's **questions regarding assurance differs** and depends also to which group they belong to, as our comment to 1. Quality and Scope of non-financial information already demonstrates:

1. Most of our **reporting members** – both integrated and separately – note that we are **still far from a common standard and methodology to quantitatively assess material NFI comprehensively**. Many sustainability KPIs still need to "mature". In their view the **current assurance requirements are appropriate**. In its revision of the NFRD the EU commission could define the path for companies to strive for sustainability information to be audited with **limited assurance over time**. They see that enhancing the assurance requirements would not necessarily improve quality or comparability. The **key to data quality is a solid and comprehensible underlying data generation process and methodology**. [In a survey econsense conducted in 2018 to assess the first implementation of the NFRD in Germany (CSR-RUG) we found out that 65 % of companies



chose a limited assurance level and 9 % a reasonable assurance level. 19 % did not involve any third-party verification at all.¹]

2. Some of our members – **some companies that have an integrated report as well as auditors** – argue that if sustainability information really is equally important as financial information the logical consequence should be to also treat it like financial information. They would favor the EU Commission to **define a pathway for companies to achieve reasonable assurance** which would, however, also include a clarification of what reasonable assurance means for sustainability information.
3. The opinion groups about **assurance requirements for the materiality process** are again different. **Most of the data preparers see the disclosure as well as assurance requirements for the materiality process extremely critical.** Due to the lack of commonly accepted quality criteria they expect the assurance process to become more complicated.
4. The **auditing companies** in the econsense network, however, do **support the disclosure and an assurance requirement (reasonable)** of the materiality process since in their view it is a way to improve data quality, reliability and in the end comparability of the results.

Our members have a **common view** on the following aspects:

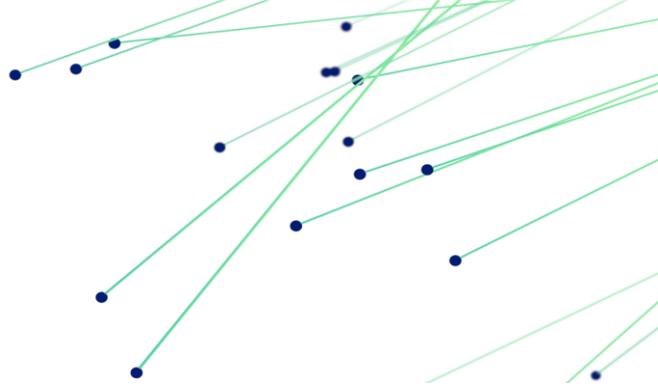
- Assurance engagements should be performed on a **common assurance standard**. Regarding this standard it would be necessary to further assess the what limited and reasonable assurance in detail means.
- They see the **need for further research**, dialogue and guidance for companies on **how to measure**, monitor and report quantitatively on the sustainability matters **“social and employee issues”** and **“human rights”** would be very welcome. EU activities in this field would be welcome.

On 5. DIGITIZATION

To the econsense members it is currently unclear who would use the digitized information. The **effort and costs for data preparers to tag information in reports is very high**. Before tagging can be considered, other elements of the reporting environment need to be set (e.g. reporting standards, assurance standards, assurance level).

Since there are no further details on the **single access point for public corporate information** presented in the consultation document, the **econsense members cannot provide any valid comments** on the subject. It would need to be laid out in detail who would use that information, what kind of information or how it would be collected or validated. **Feeding raw data into**

¹ “New momentum for reporting on sustainability?“, Study by econsense and the German Global Compact Network, 2018, https://econsense.de/app/uploads/2018/10/econsense_Study-on-Implementation-of-the-German-CSR-Directive-Implementation-Act_2018.pdf



another database is complex and costly for companies and should not be required without a detailed concept and impact assessment.

On 6. STRUCTURE AND LOCATION OF NON-FINANCIAL INFORMATION

Germany as many member states has in its national transposition of the NFRD provided companies with **options as to the place and time of publication of the sustainability information**. In a survey econsense conducted in 2018 to assess the first implementation of the NFRD in Germany (CSR-RUG) we found out that 26.5 % of the companies in scope have published their Non-financial Statement in the (group) management report and the majority of these companies has opted to attach it to the report in a separate section. 73.5 % have published the Non-financial Statement outside of the management report, either integrated in the annual report or sustainability report (40 %) or published independently (33.5 %).²

As already explained above, the econsense members do consider **sustainability information equally relevant as financial information** and this should be reflected in a company's disclosure practices. Though agreeing on this fundamental principle, the **econsense members still assess the EU Commission's questions regarding the structure and location of sustainability information differently:**

1. Most of our **reporting members** – all companies that have a separate report and some that have an integrated report – **support the simultaneous provision of sustainability and financial information**. However, they vehemently cling to the **possibility of having options regarding the place** of the Non-financial Statement – as part of the management report or separately.
2. Some of our members – **some companies that have an integrated report** as well as **auditors** – argue that if sustainability information really is equally important as financial information the logical consequence should be to also treat it like financial information which would in case of the location mean that the **sustainability information should be part of the management report**.

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² "New momentum for reporting on sustainability?", Study by econsense and the German Global Compact Network, 2018, https://econsense.de/app/uploads/2018/10/econsense_Study-on-Implementation-of-the-German-CSR-Directive-Implementation-Act_2018.pdfäischen STA