ECCJ
European Coalition for Corporate Justice

EU reform on Non-Financial Reporting
Questions and answers

1. What is "non-financial reporting" and why does ECCJ believe it is important?

Non-financial reporting refers to the disclosure of information on the social, environmental and human rights aspects of a company activity. It is also known as environmental, social and governance (ESG) reporting, sustainability reporting, extra-financial reporting, narrative reporting or non-financial disclosure.

There is now a wide recognition among companies, investors, governments, academics, and other stakeholders of the value to companies of collecting and disclosing non-financial information. European civil society believes the disclosure of such information is an important step towards improving companies' respect for human rights and the environment. The global influence of large European multinational companies' on the planet and the lives of millions is unquestionable. The new definition of Corporate Social Responsibility (CSR) adopted by the European Commission refers to "the responsibility of enterprises for their impacts on society[1]". However companies' impacts on the environment and society at large, whether it be positive or negative, remain generally opaque. Very little information is available, especially on impacts from global supply chains. It is therefore difficult for affected communities, civil society, consumers, investors and shareholders to have a full picture of a company's activity and understand where the responsibilities lie. In addition, reporting on such issues helps to improve risk management for companies by identifying where the company should take appropriate action to prevent, mitigate and remedy risks and negative impacts.

Current legislation[2] asks Member States to *"where appropriate"*[3] require companies to include information related to environmental and social matters**.** Most Member States did not go further and left reporting up to companies' discretion. As a result, the Commission estimates that only 2,500 out of 42,000 European large companies report on such issues on an annual basis – and when they do, in the absence of clear standards, the information is often incomparable and incomplete and does not adequately meet the needs of users.

2. What is ECCJ calling for?

Europe needs effective corporate reporting legislation that will give strong guidance and:

- require all large companies which operate in the EU to report on the social, human rights and environmental impacts and risks that their operations worldwide – including their complete supply chains – have on society, and not just their bottom line[4].
- Require the commission to develop indicators on key social, human rights and environmental impacts to ensure companies measure and report on their impacts and risks, for example resource use, in a comparable way through European harmonised indicator methodologies[5].
- Introduce effective monitoring and enforcement measures to ensure full, accurate and credible disclosure, including the possibility for external stakeholders to challenge the information provided

3. What is meant by impacts and risks?

Impacts and risks have to be understood in the light of the above-mentioned new definition of CSR from the Commission. We believe this means that any company should identify its major non-financial impacts, while

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[1] A renewed EU strategy 2011-14 for Corporate Social Responsibility
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0681:FIN:EN:PDF

[2] Fourth and Seventh Directives on Company Law, amended in 2006 by the Accounts Modernisation Directive 2006/46/EC

[3] The preamble of Directive 2003/51/EC clarifies that Member States "may choose to waive the obligation to provide non-financial information".

[4] The information should not be limited to disclosing on general information or policies. Companies should be required to disclose information about human rights, social and environmental impacts and risks, including details of circumstances in which they have caused, contributed to or been associated with such impacts, and the steps they have taken to mitigate and remediate these impacts. Companies should focus on reporting the risks associated with their specific business, especially if they are engaged in high-risk activities such as extractives; carry out business operations in high-risk countries; or where supply chains are involved.

[5] The European Commission should, as a first step, use a multi stakeholder process to develop guidance and benchmarks for the use of performance indicators

preventing and mitigating its negative impacts. The definition of risks and impacts should cover all serious risks and impacts on extended stakeholders affected by the company activity, not only those that are deemed relevant for its performance.

Risks of adverse impacts may occur in relation to companies' own activities or may be directly linked to companies' operations, products or services by a business relationship. This is recognised in major international frameworks including the OECD Guidelines for Multinational Enterprises and the Guiding Principles on Business and Human Rights implementing the UN “Protect, Respect and Remedy” Framework.

4. Why should the disclosure cover the companies’ supply chain?

The disclosure requirements should not be limited to the companies’ subsidiaries. Companies’ structure has been evolving a lot in the past years. Companies are increasingly subcontracting their production outside the European boarders. However due to a clear economic imbalance of power, the EU multinationals are very often the ones setting prices, deadlines, and de facto, imposing the salaries and work conditions. Disclosure should be therefore extended to suppliers. Companies usually argue that it would undermine their profit as competitors would know where they are sourcing from, but already several renowned companies are publishing a list of their suppliers[6].

In the wake of the horsemeat scandal and the large scale death and injury toll from recent incidents in garment factories in Bangladesh it is beyond doubt that supply chains represent a significant risk to companies, communities in which they operate and customers. Companies need to know what is happening in their supply chains and show that they are aware of and are managing risks appropriately

5. Why enforcement mechanisms are needed?

In the absence of enforcement mechanisms, each of the goals that the proposal seeks to meet is undermined. A recent study from SOMO on the use of the Global Reporting Initiative (GRI) in sustainability reporting by European electricity companies shows that there are systematic, widespread and significant discrepancies between what some companies claim they are reporting on and what they actually report on[7]. Effective enforcement mechanisms are needed to ensure compliance with the requirements. This could take the form of stronger misleading advertisement rules where companies could be held accountable for the accuracy of the information provided.

6. What are the benefits of a robust legislation and who will benefit from it?

Employees, communities, consumers and society at large: disclosure of information is a key element in wider company-stakeholders engagement and companies’ license to operate in the society. Access to accurate information about companies’ activities is a first step which enables people to hold companies to account when human right violations and serious environmental damage occur. In the longer term, better information has the potential to help prevent such abuse, build stronger and trust relations with employees, local communities and consumers. Following the economic crisis, European citizen’s trust in companies has been considerably shaken[8] and information on the practices and the improvement of corporate behaviour is a first step to restore this relation.

The environment: Reporting on supply chain as well as ‘own estate’ operations is the first stage in cutting environmental impacts. Simple, clear, standard, performance indicators are needed to assess key impacts, the Commission should develop guidance to enable companies to report on their: land footprint, water footprint, material consumption and greenhouse gas emissions (GHG) from their supply chains. The UK retailer Marks and Spencer saved 800,000 tonnes of GHG emissions on its own estate between 2007-2011 which saved the

[6] Examples of companies disclosing their supply chains on their websites include HP, Dell, Nike, Adidas.

[7] The analysis revealed that over 60% of the claims of ‘full’ reporting on the indicators included in this study are at least partly false or misleading. http://somo.nl/publications-en/Publication_3918

[8] According to two recent Eurobarometer surveys, more than 40% European citizens think companies have a negative impact on society; 62% do not feel well enough informed about the impacts of companies on the environment and their lives; and 87% agree that the EU should try to ensure private companies comply with social and ethical standards.

company £70m. It is now looking to reduce emissions from its supply chain.[9] One of the first ways many companies address material resource efficiency is through reducing the amount of material going to landfill. However, more gains are obtained by re-designing products to use fewer materials in both their manufacture and packaging. Unilever has a target to halve the waste associated with the disposal of its products by 2020 ('per consumer use' from 2008 levels). This will be achieved by reducing the weight of materials used in packaging and through recycling

Investors and shareholders are increasingly demanding good quality information about potential risks (and impacts) associated with the companies they invest in order to be able to take valid mid and long-term decisions. "Long-term value is enhanced by embedding long-term sustainability considerations into [companies'] business strategy and by fully disclosing their progress to investors. This will help capital to be allocated to more sustainable, responsible companies and strengthen the long term sustainability of the financial system."[10]

Companies' management boards: a clear and common regulatory framework on non-financial disclosure would improve corporate governance, giving company directors a more comprehensive understanding of the impacts and risks associated with their company's operations and leading to better informed and sounder decision-making at board level. Companies which properly analyse and disclose non-financial information increase their competitiveness and benefit from easier access to capital, improved performance on financial markets and increased stability[11] and can save cost through a better management of its resources[12]. Failure to understand impacts and risks can have serious consequences for a company's relationships with its stakeholders, its liability, its public image, financial position and long-term development.

7. Is a regulatory approach at European level the best way to improve corporate transparency?

Large companies have failed to adequately meet growing demand from stakeholders (including investors, shareholders, employees and civil society organisations) for non-financial transparency. The benefits related to non-financial disclosure are acknowledged, but perceived as long-term and difficult to quantify in a precise manner, so often companies tend to go for a short-term perspective. Also, current CSR or sustainability reports tend to focus on the less controversial issues. Light touch regulations, as in Denmark, have proven to be ineffective to push companies to publish the right information[13]. Strong regulation and guidance on what to report on is therefore needed

Several Member States have adopted legislation on reporting, multiplying the disclosure requirements but a consistent approach is needed. A clear regulatory framework at EU level which would raise reporting obligations throughout the Union and improve the relevance, consistency and comparability of non-financial information. It would contribute to levelling the playing field for companies operating across Europe and substantially raise the number of companies reporting and the quality of the reports.

8. What is the content of the EU proposal and what are its main shortcomings?

The proposed reform[14] applies to large companies with more than 500 employees and a net turnover of €40m or a balance sheet total of €20m, which limits the scope of the legislation to 0,3% of companies by not applying the

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[9] See: http://plana.marksandspencer.com/media/pdf/ms_hdwb_2012.pdf

[10] Aviva plc - Corporate Sustainability Reporting Coalition http://www.aviva.com/media/news/item/the-eu-in-2013-embedding-corporate-sustainability-reporting-15615/

[11] Two European Commission Competitiveness Report available at http://ec.europa.eu/enterprise/poloicies/sustainablebusiness/files/csr/documents/csrreportv002_en.pdf; KPMG International Survey of Corporate Responsibility Reporting 2011available at http://www.kpmg.com/PT/pt/IssuesAndInsights/Documents/corporate-responsibility2011.pdf

[12] EU industry could yield up to €604bn in net benefits through greater resource efficiency, concludes a new study for the European Commission.

[13] The Danish disclosure requirements, based on a 'comply-or-explain' approach, have pushed above all companies to communicate on their CSR policy, but it has never been question of requiring companies to disclose key information related to human rights and the environment. Also, by publicly declaring it had no policy in this area, the companies was considered as complying with the disclosure laws.

[14] http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf

European definition of a large company provided in the Accounting Directives[15]. These companies would have to disclose information in a statement that is included in their annual report, that covers environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on the boards of directors. The proposed legislation has been designed with a non-prescriptive mind-set, and leaves significant flexibility for companies to disclose in the way that they consider most useful information on their policies, results of policies and risks. Companies may use international, European or national guidelines which they consider appropriate (for instance, the UN Global Compact, ISO 26000, or the German Sustainability Code), which have varying requirements (see question 10 for more information on this point). Disclosure may be provided at group level diluting the information coming from each individual company within a group, and thereby masking the true location of the risk.

9. Is this legislation creating undue burden to companies?

The main arguments raised against mandatory disclosure of information include high costs, excessive administrative burden for businesses, especially SMEs, in a period of economic crisis.

- The costs of non-financial reporting are extremely low if compared with the financial reporting costs[16]. Financial reporting usefulness is not questioned despite its cost, non-financial reporting should be the same. Moreover, non-financial reporting helps to save costs by identifying and preventing potential scandals or improving resource management.
- Companies are required to disclose information which is often already available, considering that most multinationals have already in place management tools to recollect information from their subsidiaries and supply chain.
- The proposal avoids unnecessary administrative burden on companies, especially on the smallest ones, which are not subject to new disclosure requirements. As the Commission states, “costs associated with the required disclosures for large companies are commensurate to the value and usefulness of the information and the size, impact and complexity of the undertakings”.

Finally but most importantly, the economic context should never be used as an excuse for choosing irresponsibility. The European Parliament recently acknowledged that “global economic crisis arose from fundamental errors with respect to transparency, accountability and responsibility and from short-termism[17]” and calls the EU to ensure lessons are learnt by all. Respect for internationally recognised environmental and human right standards are beyond short term profit and are part of a company’s licence to operate in the society; their violation should not provide a competitive advantage to some careless companies.

10. Are the national and international frameworks referred in the proposal relevant for a proper disclosure of social, environmental and human rights risks and impact?

The proposal seeks to allow corporations maximum flexibility in reporting by allowing them to draw on a range of international, national and EU based frameworks when providing the necessary information. Such frameworks are of varying form, intent and quality. By nominating such disparate instruments the proposal risks further fragmentation of reporting requirements. In addition this flexibility cannot allow for some sort of a race to the bottom where corporations seek out a framework which is inconsistent with either European legislation or international expectation.

Although the OECD Guidelines and UNGPs are not reporting tools as such, the ECCJ believes that these two instruments should represent the minimum requirement, replacing the current reference to all existing national, EU based and international standards. Furthermore ECCJ believes that Commission should provide on-going guidance on the use that is to be made of those frameworks as well as developing new standardised performance indicators such as the four environmental footprints.

http://www.corporatejustice.org

[15] Over 250 employees, net turnover of over €35m and balance sheet of over €17.5m

[16] In a study conducted in 2011, the French Institute for CSR evaluated the cost of creating and verifying information in compliance with the French law to 1 to 5% of the costs needed to put in place financial reporting.

[17] European Parliament resolution of 6 February 2013 on corporate social responsibility: accountable, transparent and responsible business behaviour and sustainable growth (2012/2098(INI))