

**EU Commission proposals to reform non-financial reporting:
CORE response to the BIS call for evidence October 2013**

CORE is an authoritative and influential network of NGOs, academics, trade unions and legal experts which brings together the widest range of experience and expertise on UK corporate accountability in relation to international development, the environment and human rights. Our aim is to reduce business-related human rights and environmental abuses by making sure companies can be held to account for their impacts both at home and abroad, and to guarantee access to justice for people adversely affected by corporate activity.

This response was prepared by the agencies within CORE working most closely on narrative reporting.

Key points:

- **The EU non-financial reporting proposals represent an opportunity to support responsible, sustainable business practices which must not be lost**
- **The UK Government should rethink its approach to the proposals to ensure that the final EU regulation is effective; the changes proposed in the Presidency text of 17 September risk fundamentally undermining the purpose of the non-financial reporting requirement.**
- **More attention should be given to the risks and impacts of the core business activity rather than defining materiality solely in terms of financial performance**
- **The proposed 'safe haven clause' is too broad and should be deleted**
- **Supply chains should be explicitly mentioned in the reporting requirements**
- **Relevant non-financial information should be integrated into the management report not a separate report**
- **Good quality guidance for companies is needed.**

The EU non-financial reporting proposals represent an opportunity to support responsible and sustainable business behaviour which must not be lost

CORE believes that it is appropriate for large businesses to be transparent and accountable not just to investors but also to other groups including employees, consumers and citizens whose lives are impacted by their business activity.

The disclosure of key social, environmental and human rights information about companies' activities is an important step towards responsible behaviour. It enables workers, communities, civil society and shareholders to understand the impacts of business and hold companies to account. For business, due diligence processes and reporting are essential management tools

that improve risk identification and long-term social, environmental as well as financial performance. Transparency can help improve citizens' trust in business.

The UK Government should rethink its approach to the proposals to ensure that the final EU regulation is effective

We are pleased that the UK is engaging proactively in the EU Council discussions on the European Commission's proposals on non-financial reporting. However we are concerned that some of amendments which the UK has put forward, rather than improving the final legislation, risk creating significant loopholes and fundamentally undermining the ultimate value of EU legislation on non-financial reporting on environmental, social and human rights impacts by companies.

The changes that we believe are necessary to ensure that the proposals lead to high-quality, comparable non-financial reporting, which does not place undue burdens on businesses, are set out below.

More attention should be given to the risks and impacts of the core business activity rather than defining materiality solely in terms of financial performance

Currently the UK has asked for additional caveats to be added to the Commission's proposals which seek to define materiality solely in terms of financial performance. This approach is narrower than that of the European Commission. We believe that if large companies are carrying out due diligence in relation to the risks and impacts of their core business activity, it should be clear that they need to report on significant risks to the environment and society which they have identified. Risks and impacts should not be defined solely in terms of the principal risks to the company financial performance.

The proposed 'safe haven clause' is too broad and should be deleted

Rather than protecting Directors and progressive companies that want to make more long term forward looking statements, the new clause seems to simply limit companies' disclosure obligations. The current wording is too vague and prohibitive. In practice, it could be used to exclude a lot of the information which otherwise would actually meet the UK's added test of being "necessary for an understanding of the undertaking's development, performance or position." This clause would be counter-productive to the purpose of improving the quality and transparency of disclosure, as it provides an easy opt out for those laggard companies who are minded to interpret the provisions as narrowly as they can.

Supply chains should be explicitly mentioned in the reporting requirements

Given that business relationships are relevant to the environmental and human rights risks and impacts set out in the Commission's proposals, it is important to flag up explicitly that supply chains need to be considered by the company as part of its internal policy processes and non-financial reporting.

Relevant non-financial information should be integrated into the management report not a separate report

The Lithuanian proposals include amendments which would allow non-financial information to be supplied outside the management report, either in a separate report or on a website. While we think that it makes sense for the management report to refer to additional material or more in-depth information which might be in another document or on the company's website, it is vital that the key impacts and risks identified by senior management in relation to the environment, human rights, corruption etc. and relevant strategies taken to mitigate risks are integrated into the management report. Otherwise this would effectively distance directors' responsibilities from key non-financial matters still further and will undermine the aim of encouraging businesses to take an integrated and sustainable approach.

Good quality guidance for companies is needed

CORE completely agrees with BIS that it would not be helpful for companies to make lengthy and uninformative statements. This risk which BIS outlines in its consultation document can be dealt with by setting out more clearly in the proposals that the reporting requirements relate to the risks and impacts of the core business activity not just the risk to financial performance and providing comprehensive guidance for companies.

CORE's response to the individual questions in the call for evidence:

Scope

- 1. Do you agree that the EU proposal should be consistent with the UK's traditional approach and therefore limit the scope to (large)-listed companies only?**
- 2. What should the threshold for inclusion be, and why?**

CORE's position is that where large companies have significant impacts on society, they should be required to make appropriate disclosures. We recognise that different businesses operate very different business models, depending on their size, sector and type of core business activity. Therefore we see the EU non-financial reporting proposals as an opportunity to introduce **effective reporting requirements which set out a threshold level of disclosure relevant to the impact and risks of the particular business**. In our view this is a better basis for defining effective EU non-financial reporting requirements than trying to limit them solely to requirements which match the existing UK reporting regime.

The UK's approach that only listed companies should be required to report on environmental, social and human rights issues is therefore too narrow. Again, the key question in determining what needs to be reported should be the risks and impacts of the business itself. Private companies can have a significant impact on issues which affect broader society, such as climate change, land and labour rights. Therefore reporting is not only for equity investors and shareholders. The forthcoming legislation should cover all large companies.

Country by country reporting

- **Do you think that the current proposals for CBCR are likely to be effective, and will these pose an excessive burden on companies?**
- **Would the proposed multilateral and EU-only approaches to tax reporting both achieve a fair balance between considerations of tax transparency and competitiveness, or do you think that one has clear advantages?**

The proposals outlined in paragraph 26 of the BIS consultation document would be a good step forward in creating effective corporate transparency and providing useful, comparative, information to a range of stakeholders on the operation of multinational companies and how the tax system is operating. Investors would be able to obtain a better understanding of the companies they are investing in, and the risks being taken with their money, while citizens would gain more information to hold both companies and governments to account on their tax policies and practices¹. Companies have often raised the issue of the burden that country by country reporting would impose, but these proposals are based on those introduced by the Capital Requirements Directive 4, which HM Treasury in their consultation indicate is unlikely to carry significant costs².

There is a significant difference between the proposals being advanced through the Base Erosion Profit Shifting process, led by the OECD, and those being proposed at the EU level, and that is making the information publicly available. There are two clear advantages of making the information public available. First, making the information publicly available appears to be the only way to guarantee that developing country revenue authorities will be able to access the information; if the information is only available to revenue authorities there is no legal mechanism for revenue authorities to quickly and simply share such reports. Secondly, as stated there are legitimate interests beyond revenue authorities, from investors and citizens, who require the information to be made public; ideally this would happen on an international basis, and beginning with the EU is a good first step to achieve international change. The transparency benefits are clear and will help improve both revenue authorities collection of taxes and societies understanding of how companies operate and how tax policy affects private sector performance. The constraints on competitiveness are less clear, the costs, by the Treasury estimates are insignificant, and it is unclear on what other basis that the publication of such information would hinder companies' ability to be competitive.³

Materiality

- **Do you agree with the EU Council Presidency that companies should be allowed to decide whether or not to have one of the related policies according to the relevance/materiality to their specific business?**

¹ See http://eurodad.org/uploadedfiles/whats_new/reports/cbc%20report.pdf

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/244163/PU1562_CBCR_1.pdf pg 17

³ E.g. solely UK companies have to declare most of the envisaged details in their publicly available accounts but it is not deemed that they are placed at a significant competitive disadvantage to companies that also have operations in countries with lower reporting standards for their overseas operations.

In our view this question is misleading. There appears to be confusion in the EU Council Presidency text over the proposed approach of ‘comply or explain.’ Here we think that the addition of lines from the Companies Act “to the extent necessary for an understanding of the undertaking’s development, performance or position” to paragraph 19 (1) does not lead to a useful text for effective EU regulation on non-financial reporting. It also seems to create an unhelpful confusion of two models of reporting.

The Commission’s proposal is based on a ‘comply or explain’ model. Under this model, where a company does not have a policy in a specific area, it would be required to provide an informed explanation setting out the process that it has gone through to reach the conclusion that the level of risk is such that no policy is required. In CORE’s view it is difficult to see why large companies would find it burdensome to explain why they didn’t have a particular policy, if they had identified that it was not relevant to their particular business. The explanation would be based on their assessment of risks. The explanation would therefore help users of the report to understand how the company approaches and assesses risk at the strategic level. In our view this is one of the clear objectives of the reform to non-financial reporting. More large companies would need to consider their environmental, social and human rights impacts, supporting more responsible and sustainable business practices. If there are no significant risks and impacts in relation to the environment for example, then the company would not need to report but it would have the rationale for explaining why this information was not included. The argument that an implicit requirement might result in a tick box exercise with limited impact on undertaking behaviour does not add up here. In fact the language in the Council Presidency text which creates a large loophole in addition to existing flexibility in the Commission’s original proposals is much more likely to limit the impact of the proposals on companies’ behaviour.

CORE recommendation: delete the addition of “to the extent necessary for an understanding of the undertaking’s development, performance or position” from paragraph 19 (1) and instead make the definition of risks and impacts in the proposals clearer, as set out below.

Risks

- **Should companies report in all policy areas on their risks and risk management activities?**

The European Commission proposal already includes quite a lot of flexibility and the ‘comply or explain’ model means that it does not impose a blanket requirement for companies to report on all policy areas. To prevent any confusion, it seems important to spell out explicitly in the text that the risk and risk management activities which an individual company has to report on are linked to its particular business activities.

CORE believes that this important point can be addressed by making the definition of risks and impacts in the proposals clearer so that it is easier for businesses to understand what they should report on and what is not relevant.

Therefore CORE recommends that the text is amended to clarify reporting on risks and impacts as follows (Article 46.1.b) (iii) of the original Commission proposal:

(iii) the risks related to these matters **linked to the company's operations, products, services or business relationships, which are likely to cause, or have caused, severe impacts in these areas;** and how the company manages those risk,

and in Article 46.1.(c) of the original Commission proposal

To the extent necessary for an understanding of the company's development, performance or position, **and human rights, social and environmental impacts** the analysis shall include both financial and non-financial key performance indicators relevant to the particular business.

Safe harbour provision

- **Do you agree with the need to include a “safe harbour provision” in this proposal?**

CORE does not think that the text added as a safe harbour provision is actually effective as a positive mechanism to encourage directors to make longer-term statements. Rather than setting out clearly criteria which would mean that directors would not be held liable if those statements later prove to be wrong, the language added seems instead to limit disclosure in a potentially large number of situations. We are concerned that this provision, coupled with the other changes to the text mentioned above, would severely restrict the amount of information that would be disclosed in practice. Therefore we think that it should be deleted.

Gender diversity

- **Do you agree that the information about gender diversity at various levels of the organisation should always be provided, as a priority above any other diversity disclosure?**

Given that the proposed reporting requirements are limited to the largest companies which will have a dedicated human resources function, it does not seem unreasonable to expect the company to provide information about gender diversity at various levels of the organisation. Clearly this does not prevent companies from providing other diversity information as well if they have identified that is relevant for their business.

Comparability

- **Do you agree that the degree of flexibility provided will allow sufficient comparability and effectiveness of the information?**

No. At present the additional flexibility measures and the unhelpful combination of two reporting systems as out lined above risk undermining the value of the EU non-financial reporting proposals as a whole. The rationale for the European Commission proposal was that only a fraction of large businesses were reporting non-financial information. In 2012 the AVIVA

coalition also identified the failure of the voluntary reporting model to deliver ESG data of a sufficient quantity and quality, despite the actions of some more progressive companies.

CORE believes that the value of EU-wide reporting requirements for non-financial information is to bring the thousands of companies which are not reporting up to a common minimum threshold level of disclosure. Too many loopholes in the regulations will undermine this objective, as less progressive companies will have a number of arguments for choosing not to disclose.

- **Do you instead think that the list of internationally recognised frameworks should be limited to those that would allow a sufficient degree of detailed comparable disclosure? If so, which would you recommend?**

Yes we do. The UNGPs and the OECD Guidelines set out standards for corporate conduct, including standards in important areas such as labour rights, and should be referred to as a baseline in the new legislation. A standard method for reporting resource consumption – land, water, greenhouse gas emissions and materials – is also required. The possibility for companies to rely on a wide range of international, European and national frameworks which have very different natures – such as Global Compact, ISO 26000, Global Reporting Initiative or the German Sustainability Code – could lead to fragmentation and incomparability. This flexibility will not level the playing field and could allow for some sort of a race to the bottom where companies seek out a framework which is inconsistent with either European legislation or international expectations.

- **Do you think that the EU Proposal should include a requirement for companies to consider their supply chain?**

Yes, we think that supply chains should be explicitly covered. As Professor John Ruggie has made clear, the corporate responsibility to respect human rights includes due diligence in relation to supply chain business relationships. David Cameron has committed the UK to implementing the UN Guiding Principles on Business and Human Rights and the EU also supports their implementation. Therefore rather than a separate set of reporting requirements, it makes clear sense for disclosure of human rights risks and impacts and a company's due diligence measures to be part of a single integrated approach to EU non-financial reporting.

The identification of risks must cover the companies' supply chains and language that would include these business relationships is set out above in relation to risks. In the wake of the horsemeat scandal and the large-scale death and injury toll amongst workers 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.