

Comparing the implementation of the EU Non-Financial Reporting Directive in the UK, Germany, France and Italy

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Introduction

This summary considers how the EU Non-Financial Reporting Directive 2014/95/EU (Directive) has been implemented in the UK, Germany, France and Italy. In doing so, it considers, by way of overview (Part A), the:

- main trends identified across those countries in implementing the Directive;
- key differences between the surveyed states in how they have implemented the Directive; and
- difficulties, and unexpected consequences, that some of the drafting of the Directive raises.

It then considers, in more detail (Part B), some of the substantive elements of the Directive and how these have been dealt with by each of the surveyed states.

This paper is accompanied by a summary table illustrating the differences between the surveyed member states' implementation of the Directive (Schedule I) and more detailed summaries of how each member state has done so (Schedule II (UK), Schedule III (Germany), Schedule IV (France) and Schedule V (Italy)).

For the purposes of this paper, the report that must be prepared by companies in each state as a result of the implementation of the Directive shall be referred to as the 'non-financial information statement', 'statement' or 'report', regardless of how the title of such report might be translated from the relevant jurisdiction into English.

Part A

Main trends

- In each of the countries surveyed, only companies with 500 employees or more are required to provide a report (provided they meet certain other criteria), which generally aligns with the position set out in the Directive. This contrasts with the position in some other countries, including Denmark and Sweden, which require (or will require, over the coming years) companies with 250 employees or more to prepare a report as well.
- All of the surveyed states, except France, focus the reporting requirements on listed companies, whereas France includes some unlisted companies that are above certain financial and employee thresholds.
- All of the surveyed states, except France, require companies to report on the same, broadly delimited environmental, social or governance (ESG) factors. However, Italy also requires reporting on certain additional ESG aspects in relation to each ESG factor and France requires companies to report on broadly similar factors but refers to them differently (and far more extensively). All of the surveyed states, including France, require the same information to be provided in relation to each prescribed ESG factor (such as a description of the business model and an overview of principal risks).
- Generally, where the Directive has not been clear about its intention (particularly in relation to the meaning of materiality and the way the business model should be reported on), the states surveyed have replicated the wording of the Directive, thus failing to provide any further clarity.
- Similarly, where the Directive has left a matter to member states' discretion, surveyed states do not necessarily take the opportunity to develop the legislation further. This is particularly the case in relation to sanctions for non-compliance (where France has not included any substantive sanctions at all).
- On the majority of other aspects, states have implemented the Directive in varying ways, with France being particularly progressive in its approach (albeit that it started from a substantially more progressive position), and Germany arguably being more conservative.

Key differences

- France has extended the scope of the non-financial information statement to cover certain unlisted companies (it is the only one of the four states surveyed to do so, although, interestingly, it no longer requires listed enterprises with less than 500 employees or below financial thresholds to carry out ESG reporting which it did do previously).
- Only the UK and France have required the non-financial information statement to be included in companies' annual management reports, rather than providing the option to separately publish the statement (thus weakening the premise of integrated reporting).
- Italy and France have included far more prescriptive requirements in relation to the various ESG factors that should be reported on, whereas the UK and Germany have merely repeated the basic requests of the Directive.
- Italy and France are the only states surveyed to specifically require reporting on certain additional ESG aspects in relation to each ESG factor. For example, in relation to environmental matters, the legislation in Italy requires the use of renewable and/or non-renewable energy to be reported on. In France, there are a large number of additional factors to be reported on (including some key performance indicators (KPIs)).
- Italy has used the non-financial reporting requirements to pursue its domestic agenda for enhanced reporting on bribery and corruption. Similarly, France has built on its existing extensive ESG reporting regime. However, the UK, has missed an opportunity to further develop reporting in relation to modern slavery, by failing to reference it at all in the implementing legislation.
- The approach to verification varies between states. Whilst Italy, for example, requires an internal and external audit of the information to be carried out in relation to all reporting companies, in France the information provided is only required to be audited for companies above certain financial thresholds. Further, although in the UK the audit clearly has to consider whether there are any false statements in the report, there is some lack of clarity over whether this is expressly required in the other surveyed states.
- There is particular ambiguity about the materiality test as regards the impacts of principal risks. Whilst the Directive appears to suggest that the test should be 'scale and gravity', the surveyed states have not differentiated this from the broader test of materiality that appears to apply and which is based on whether information would influence the economic decisions of readers.
- The Directive requires reporting on principal risks related to business relationships to be provided 'where it is relevant and proportionate'. This condition has been included in all of the surveyed states, with the exception of Italy, but neither the Directive nor the national transpositions provide any guidance for its interpretation.
- It is also unclear how the description of a company's business model should refer to the ESG factors that the non-financial information statement considers. In the absence of clarification, there is a risk that companies provide a description of their business model that is disconnected from the ESG matters at hand, thus undermining integrated reporting.
- The Directive fails to provide any specific KPIs that should be applied by companies, or any guidance as to what they should be trying to illustrate. Only France has set out KPIs in the implementing legislation (such as frequency and severity of workplace accidents). None of the other surveyed states have set out specific KPIs or how they should be measured. There is a risk, as a result, that a multitude of KPIs are used across companies, making comparative analysis very difficult.
- The Directive also fails to specify how the non-financial information statement should reference aspects of financial reporting, and none of the surveyed states have provided any clarity on this point.
- In France, which already had progressive non-financial reporting provisions in place, the scope of reporting has been narrowed in respect of listed enterprises with less than 500 employees and those below financial thresholds that are now exempt.

Issues with, and unexpected consequences of, the Directive

- There remains inadequate clarity around the definition of 'materiality' and therefore the extent of information that should be provided in the reports. For so long as this remains unclear, there are likely to be inconsistencies in the scope of reporting between companies, and jurisdictions.

In brief, the Directive has significantly extended the scope of non-financial reporting in the UK, Italy and Germany, whilst in France the scope of non-financial reporting was already vast. Although generally the implementation of the Directive has been a positive step, there are a number of gaps in the Directive itself, which have not been adequately addressed in the implementing legislation. In particular, further information regarding the test for materiality needs to be provided, and the integration of the non-financial information system with other financial and non-financial reporting needs to be strengthened.

Part B

Scope

None of the jurisdictions considered in this paper took the opportunity to expand the scope of the Directive to cover, for example, all large listed companies (i.e. companies with 250 or more employees and meeting certain financial criteria, rather than only those with 500 employees or more) or to extend the scope of reporting to medium sized companies. This does mean that the vast majority of companies are not obliged to comply with the non-financial reporting requirements introduced by the Directive. For example, in 2016 in the UK, 99.9% of all businesses were small and medium-sized enterprises but none of these are required to report.¹

By contrast, in some other countries, including Denmark and Sweden, the requirement is (or will be, over coming years) for all companies with 250 employees or more to produce a non-financial information report, thus significantly increasing the reach of the requirements.

Interestingly, the number of listed companies required to report on ESG factors in France has decreased as a result of implementing the Directive (as listed companies with less than 500 employees are no longer required to report). This is perhaps a little concerning given that France was previously one of the more progressive states in terms of non-financial reporting, owing to Law No. 2010-788 on the national commitment for the environment (Grenelle II). However, the result may not be entirely unintended, given that the Directive expressly states that the 'new disclosure requirements should apply only to certain large undertakings and groups' in order to reduce the regulatory burden on small and medium-sized enterprises.²

Format

Of the four jurisdictions considered in this paper, only the UK and France have gone beyond the requirements of the Directive to require the non-financial information statement to be included in the annual management report (rather than either being included in the annual management report, or being prepared as a separate report). The requirement for inclusion in the annual management report will give gravity and prominence to the non-financial reporting statement, which will be circulated to shareholders on a yearly basis ahead of the general meeting. This will also improve the integration of financial and non-financial reporting and should be seen as a positive step.

Conversely, in Germany, if the non-financial information statement is not included in the annual management report, it can be published on the company's website up to four months afterwards, provided that the annual management report refers to this publication and the

website. This time lag will inevitably mean that a number of shareholders whose attention is captured for the purposes of reviewing the annual management report and preparing for the annual meeting, will be lost, and that the information will therefore not be given the same level of attention. BASF (a German chemical company), Deutsche Bank and Deutsche Börse AG have all said that providing information in a separate report is a step backwards.³

It is also unclear what level of prominence the non-financial information statement will have on German companies' websites (where it is to be published if not included in the annual management report). In a comparative scenario - in the UK, a company's modern slavery statement must be clearly linked to from the homepage of a company's website, but there has not been any clarity on whether this will be the case in Germany in relation to the non-financial information statement.

ESG factors to report on

The UK, Italy and Germany all conform to requiring reporting on the ESG factors prescribed by the Directive, that is: environmental matters; social and employee matters; respect for human rights; and anti-corruption and anti-bribery matters. The only slight difference between them is that the UK and Germany separate out 'social and employee matters' to being two separate categories of 'employees' and 'social matters', perhaps giving more specific focus to each aspect and reducing the risk of one being overlooked.

However, Italy has expressly set out the information that it requires in relation to each ESG factors, such as greenhouse gas emissions and air pollution (in relation to the environment), measures implemented to prevent violations and discriminations (in relation to human rights) and the specific instruments in place to fight corruption and bribery. In this way, Italy comes close to setting out specific KPIs by which each ESG factor can be assessed, but it stops short of actually prescribing the KPIs that should be used. It is worth noting here that Italy has not gone so far as to list all of the types of information that the Directive lists as examples of each ESG factor.

France has taken a very different, far more expansive, approach. It has not referred to the ESG factors prescribed in the Directive (i.e. environment, social and employee, anti-bribery and corruption). Instead, it has prescribed more specific factors to report on (which do, however, relate to the prescribed ESG factors). As an example, rather than requiring companies to merely report on 'environmental matters', it requires them to include information also on 'the impact of the company's activities as well as its services and products on climate change'. This level of detail is useful and notable (as, with the exception of Italy, the other surveyed states

have only referred to the broad ESG factors, rather than setting out examples of what might fall within each). France has also provided 42 specific aspects - indicators (based on those included in Grenelle II) that are to be reported against.

The approach of France and Italy should be applauded, given that the Directive states that 'at least' environmental, social and employee-related matters, respect for human rights, anti-corruption and bribery matters should be reported on'.⁴ It is positive to see certain states going beyond the minimum requirements of the Directive.

Conversely, it is disappointing to see that in Germany and the UK there is very little detail given on the types of issues that these ESG factors might cover. The Directive gives specific examples of which issues should be covered, for example reporting on environmental matters should include, as appropriate, health and safety, the use of renewable energy and/or non-renewable energy, greenhouse gas emissions, water use and air pollution.⁵ However, neither state has referred to this in the implementing legislation.

Materiality

The materiality test (i.e. the test for what extent of information on each of the ESG factors needs to be provided) remains unclear across jurisdictions.

The Directive prescribes that information must be provided to the 'extent necessary for an understanding of the company's development, performance and position and the impact of its activity', wording that has been carried across into the legislation in the UK, Italy, Germany and France.

There has been very little information provided in each state as to how to determine the 'extent necessary'. The Accounting Directive (Directive 2013/34/EU) (which the Directive amends to include the provisions relating to the non-financial information statement) provides that the 'extent necessary' requires information to be provided 'where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking'. This approach has also been referred to in Italy, where the CNDCEC (the National Council of Doctors of Commerce and Auditors) has drawn on the International Accounting Standard Board Framework's definitions of 'relevance' and 'materiality' which similarly refer to information that 'influences the economic decisions of readers by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations'. It is unclear in this context who these 'users' or 'readers' might be but, in a UK context, guidance from the Financial Reporting Council in relation to the strategic report (the part of the annual management

report in which the non-financial information statement must be included) replaces these terms with that of 'shareholder', reflecting the UK's shareholder-centric interpretation of corporate reporting. This approach has been endorsed by the London Stock Exchange (and the Borsa Italiana Spa) which has suggested that reporting on ESG factors should consider 'investor materiality'.⁶ Encouragingly, however, draft amended guidance on the strategic report from the Financial Reporting Council has recently suggested that the interests of other stakeholders should also be taken into account (as the Directive also confirms), as well as the range of interests and priorities of different shareholders.⁷ If this guidance is approved, it would be a welcome step in developing the materiality concept.

The Directive does, however, appear to introduce a separate test of materiality in relation to the 'principal risks' that are meant to be disclosed in relation to each ESG factor. This materiality test, and its consequences, are considered below.

The lack of clarity from the Directive on materiality is disappointing, as materiality is one of the most fundamental aspects of reporting. Without a clear definition, companies may take significantly diverging approaches in relation to the extent of information that they provide, whilst complying with the broader requirements for reporting in general. The risk is that even if the procedural aspect of preparing a report is complied with, the more substantive aspect of providing useful information on ESG factors is undermined.

Information to be provided in relation to each ESG factor

• Business model

The Directive does not provide adequate clarity on how the business model should be reported on. It states that, in relation to each ESG factor, a brief description of a company's business model should be provided. However, it does not state whether such business model should bear relevance to each ESG factor, or whether it should merely be referred to in order to inform the reader of the company's overall business approach. Whilst it seems logical that, given the requirement to report on the business model in the context of non-financial reporting, the business model should be explained in terms that are relevant to each ESG factor (for example, by an energy company highlighting the impacts of carbon risk in its forecasting), there is a risk that, given the lack of detail on this point in the legislation, this aspect is overlooked. This issue has not been clarified in the implementing legislation in the UK, France or Germany.

Italy has, however, assumed the intention of the Directive by including in its implementing legislation the requirement for a company's description of its business

model to expressly refer to the ESG factors that are being reported on, which is very encouraging.

There is similar confusion in the Directive and across the surveyed states over the extent to which the non-financial information statement should make specific reference to a company's financial information. Each of the states surveyed makes reference to the fact that the non-financial information statement should refer to, and include additional explanations of, amounts included in the company's accounts, although both the German and French legislation qualifies the need for such references by whether they are 'required'. Further guidance is needed on how such references might be made, the level of detail they might go into, and how companies should integrate non-financial information into their forecasting, in order to strengthen this aspect of integrated reporting.

- **Policies, due diligence to implement those policies, and their outcomes**

In all of the surveyed states, the wording from the Directive on policies and due diligence has generally been replicated in the implementing legislation (without providing any further detail on the types of policies that may be reported on, or how their outcomes could be measured). Different states have, however, adopted slightly different approaches to KPIs, as discussed below.

- **Principal risks - general**

The Directive requires that principal risks related to each ESG factor are described, including (where relevant and proportionate) a company's business relationships, products or services which are likely to cause adverse impact in those areas (and an explanation of how the company manages those risks). The legislation in the UK and Germany imports this language exactly from the Directive, whilst France does not refer to adverse impacts nor require an explanation of how a company manages the risks.

There is however substantial uncertainty over what 'impact' might mean, and none of the surveyed states have assisted in providing clarity. This is particularly unfortunate given that a number of the countries surveyed previously required companies to report on their development, performance and position in the context of ESG factors, but none of them required impact reporting. European Commission guidance says this should cover 'positive or adverse' impacts and that a company should disclose material information on principal risks 'regardless of whether they stem from its own decisions or actions or from external factors'.⁸ On this basis, we can assume that both positive and negative impacts should be reported on.

However, further confusion arises in relation to how the materiality test described above should apply to the disclosure of principal risks. The Directive expressly states

that companies 'should provide adequate information in relation to matters that stand out as being most likely to bring about the materialisation of principal risks of severe impacts', and for these purposes the severity of impacts should be judged by their 'scale and gravity'.⁹ As regards the impact of principal risks, therefore, the Directive seems to suggest that the materiality test is based on the scale and gravity of the materialisation of the risk, rather than whether knowledge of a principal risk would influence readers' economic decisions (which appears to be the applicable test for materiality elsewhere in the Directive). This distinction in the materiality test for 'impact' as opposed to other aspects of the report, does not appear to be clearly marked in any of the surveyed states.

- **Principal risks - business relationships**

In the UK, Germany and France, information on business relationships should only be included in the report when 'relevant and proportionate' (as prescribed by the Directive).

In Italy, however, the requirement for information on business relationships, products or services to be included in the report is not qualified by being 'relevant and proportionate', and nor is it limited to when such impact is likely to be 'adverse'. The Italian legislation also helpfully confirms that, as specified in a recital to the Directive, 'business relationships' includes supply chains and subcontractors (a point that is not emphasised in any of the other surveyed states).

In France, the implementation of the Directive also expressly states that where a due diligence report has been prepared in accordance with Law No. 2017-399, the 'Duty of Care of Parent Companies and Ordering Companies', this can be relied upon in the non financial information statement, emphasising integrated reporting and France's increased focus on supply chain due diligence.

It is regrettable that in the UK (where the Modern Slavery Act 2015 has only recently come into force) the opportunity was not taken to further develop or integrate reporting on supply chains and subcontractors in the way that Italy and France have done. However, recent draft guidance issued by the Financial Reporting Council suggests that supply chains are to be considered relevant to this aspect of the legislation in the UK at least.¹⁰

- **KPIs**

The UK, Germany and France all require KPIs that are relevant to the company's business model to be set out. However, in both Italy and France, the KPIs must be specifically referred to when setting out the outcome of the policies the company has adopted. The requirement here for companies to display the method

they have adopted for assessing efficacy is crucial, as it should assist in presenting more objective, and specific, information.

Similarly, in Italy, if KPIs are adopted that are not in line with the industry that a company operates in, or if a company changes its KPIs from one year to the next, this difference must be explained and reasons must be provided. This encourages consistency and due consideration of the KPIs that are being deployed. Further, the performance under the KPIs must be assessed against the performance under the same KPIs in the previous year, emphasising and illustrating that improvement is expected.

What is still lacking in the Directive, and the implementing legislation across the surveyed states (with the exception of France), is suggestions (or prescriptions) of what relevant KPIs might be and how they should be measured. Without this being clear, there is the potential for a multitude of different KPIs to be used, making comparisons between companies very difficult. Having a sufficient level of comparability between businesses' 'corporate social responsibility' efforts was noted in the Directive as being important to investors and stakeholders (including consumers).¹¹

Verification

The approach taken to verification of the non-financial information statement varies between the surveyed states. The strongest verification procedure appears to be in Italy and the UK but, generally, strengthening of the verification requirements would be welcomed in order to ensure that robust information is being provided by companies.

In Italy, both an external and internal audit must be carried out and must be published alongside the non-financial information statement. The internal audit must also be reported on to the shareholders' meeting and included in the annual management report. In addition, the Italian legislation does require that information in the non-financial information statement is consistent with the financial information in the annual management report.

The UK is the only state to expressly require that the information in the non-financial information statement be audited for material misstatements (although in Italy directors can be fined if false material information is included and/or material information is omitted in the statement, and in Germany directors can be fined for providing false information). In France, the auditor must give a 'reasoned opinion' with regard to risks, policies pursued, the outcome of these policies along with KPIs and the specific additional factors that should be reported on (although the auditing requirement only applies to companies above certain financial

thresholds). In Germany, the obligation is only to audit the fact that the non-financial information statement has been submitted (i.e. the audit does not consider whether the statement complies with the requirements of the legislation), although as stated above directors can be fined for providing false information.

Basis of reporting

All of the jurisdictions considered adopt the 'comply or explain' approach in relation to the policy aspects of the non-financial information statement. This means that a company must state that it has a policy in relation to a specific ESG factor or, if it does not have a policy in relation to a specific ESG factor, it must provide an explanation of why that is the case. In relation to the other aspects of reporting, companies in all the surveyed jurisdictions must simply 'comply'.

Consequences of non-compliance

In the UK and Germany it is a criminal offence on the part of the directors not to prepare and publish the non-financial information statement in accordance with the relevant requirements. Thus, if a policy was not referred to in the non-financial information statement, and no explanation was given as to why that was the case, an offence would be committed. However, if no reference to KPIs was made (and there is no comply or explain requirement in relation to this factor), this omission would in itself mean that the directors had committed an offence. In this way, the comply or explain provision in relation to policies waters down, rather than enhances, the level of compliance needed in relation to this factor.

The consequences of non-compliance vary across the jurisdictions from administrative monetary penalties (in Italy) to imprisonment (in Germany) and, in Italy, the consequences have been extended to the external auditors and the individuals internally who verify the non-financial information statement.

Contrastingly, and surprisingly given the strength of France's ESG reporting requirements, the only consequence of non-compliance in France is that any interested party or individual may send a request to the presiding judge of summary proceedings, that the information be provided. Where the application is granted, the penalty and the procedure costs will be borne by the directors or the members of the executive board.

This is an interesting display of the divergence of approach that can be taken when the Directive is particularly vague; on the implications of non-compliance, the Directive only states that member states are responsible for implementing procedures to ensure compliance.

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11. Directive, recital (3).

Appendix I Comparative Table

Implementation of the Non-Financial Reporting Directive 2014/95/EU in the UK, Italy, Germany and France

Scope	
UK	Public interest entities with 500+ employees (i.e. listed companies, insurers, banks, and certain partnerships, excluding medium-sized companies and companies entitled to small companies exemption)
Italy	As above
Germany	As above
France	Listed companies with a balance sheet of at least 20 million Euros or net turnover of 40 million Euros and 500+ employees Unlisted companies with a balance sheet of at least 100 million Euros or net turnover of 100 million Euros and 500+ employees
Format	
UK	Must be part of annual management report
Italy	Part of annual management report OR As a separate report, provided that it is referenced in the annual management report and published in the company's register
Germany	Part of annual management report OR As a separate report, provided that it is referenced in the annual management report (although it can be published on the company's website up to four months after publication of the annual management report)
France	Must be part of annual management report and must be published on a company's website for five years
ESG Factors to report on	
UK	Information about: <ul style="list-style-type: none"> • environmental matters • employees • social matters • respect for human rights • anti-corruption and anti-bribery matters
Italy	Information about: <ul style="list-style-type: none"> • environmental matters • social and employee matters • respect for human rights • anti-corruption and anti-bribery matters <p>Italy also requires specific information on the relevant ESG factor which covers, as a minimum:</p> <ul style="list-style-type: none"> • user of energy resources and water use • greenhouse gas emissions and air pollution • impact of principle risks linked to a company's operations on the environment and health and safety; • social and employee related matters including gender equality • respect for human rights measures implemented to prevent violations and discrimination; • instruments in place to fight corruption and bribery.

- Germany** Information about:
- environmental matters
 - employee matters
 - social matters
 - respect for human rights
 - anti-corruption and anti-bribery matters

- France** Information about:
- consequences of the company’s activity on the environment
 - the impact of the company’s activities as well as its services and products on climate change;
 - its commitments to sustainable development, circular economy and the prevention of food waste;
 - the collective agreements reached and the impact on the economic performance of the company and the working conditions;
 - measures taken to tackle discrimination and promote diversity.

Listed companies that are within scope must also provide information on their activities and how it relates to the protection of human rights and anti-corruption matters.

The implementation Decree further requires companies to report information in relation to 42 aspects (39 for unlisted companies) that specify and supplement the aforementioned general requirements. They are divided in three categories:

- environmental information;
- societal information; and
- social information.

Materiality

UK Information must be provided to the ‘extent necessary for an understanding of the company’s development, performance and position and the impact of its activity’. No reference made to a separate materiality test to be applied in respect of principal risks.

Italy As above

Germany As above

France As above

Information to provide

UK In relation to each ESG factor:

- a brief description of the company’s business model;
- the policies and any due diligence process undertaken to implement the policies in relation to the ESG factors;
- the outcome of those policies;
- the principal risks relating to the ESG factors and (where relevant and proportionate) the business relationships, products and services which are likely to cause adverse impacts on those risk areas and a description of how the company manages principal risks; and
- a description of the non-financial key performance indicators relevant to the company’s business.

Italy In relation to each ESG factor:

- the company’s business model (expressly referring to ESG factors), including the compliance model adopted pursuant to legislative Decree 231/2001;
- the company’s policies, including any internal due diligence process implemented, the results achieved by the policies, and the related key performance indicators;
- the principal risks deriving from the company’s activities, products, services or business relationships business relationships, including, where relevant, supply chains and subcontractors.

Germany In relation to each ESG factor:

- a brief description of the undertaking’s business model;

- a description of the policies pursued by the undertaking in relation to those matters, including due-diligence processes implemented;
- the outcome of those policies;
- the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse
- impacts in those areas, and how the undertaking manages those risks;
- non-financial KPIs relevant to the company's business.

France

In relation to each ESG factor:

- a brief description of the company's business model;
- the policies and any due diligence process implemented in order to prevent, identify and mitigate the occurrence of the risks;
- the principal risks relating to the ESG factors and (where relevant and proportionate) the business relationships, products or; and
- the outcome of those policies, including the KPIs.

Basis of reporting

UK

In relation to policies only, 'comply or explain' (i.e. state that the company has a policy in relation to a specific ESG factor or, if it does not have a policy in relation to a specific ESG factor, an explanation of why not).

Italy

As above

Germany

As above

France

As above

Implications of non-compliance

UK

Failure to comply is an offence committed by each director, punishable by a fine.

Italy

As above , except that auditors and the individuals responsible for verification/control are also caught.

Germany

The company, members of its management board and members of its supervisory board can be held liable for failing to provide the non-financial report or for false and misleading information.

France

No particular implications, apart from the ability of stakeholders to demand the release of information in court.

Verification

UK

Must be audited for compliance with legal requirements and any material misstatements.

Italy

- Must be audited for compliance with the relevant requirements and the report must be attached to the non-financial information statement and jointly published with it.
- An internal audit of the non-financial information statement must also be carried out, and must be reported on to the general shareholders' meeting and in the company's annual report.

Germany

The financial auditor is responsible for verifying the submission of the non-financial information statement. There is no requirement for either the verification of the contents of the report, nor the verification by an independent body, although directors can be fined for false information.

France

Information must be verified for those companies with 500 employees or more and a turnover of 100 million Euros or more. The audit must confirm that the non-financial information statement complies with the requirements of the legislation, and must state what due diligence was carried out as part of its audit. The report must be circulated to shareholders.

Appendix II UK: Disclosure of Non-Financial Information

Existing legal requirements to disclose ESG information in the UK

A. Introduction

Listed companies in the UK have been required to produce an annual ‘strategic report’ since late 2013, which provides the main mandatory source of information on the environmental, social and governance (ESG) factors that are related to a company’s operations. The requirements of a strategic report are in addition to a range of other reporting requirements, which apply differently to companies depending on their size, sector and status as listed or non-listed companies. Examples of these other ESG reporting requirements in the UK are included in Table I.

Since the UK implemented the EU Non-Financial Reporting Directive 2014/95/EU (Directive) in January 2017,¹ the requirements of the strategic report have been enhanced by the inclusion within that report of a ‘non-financial information statement’. This statement must be produced by a wider range of corporate entities than are required to produce a full strategic report, and the reporting requirements in relation to ESG factors are significantly more prescriptive. In particular, the ‘non-financial information statement’ must explain the impact of a company’s activities in relation to particular ESG factors, rather than purely reporting on the development, performance or position of a company in relation to the extent relevant to each of those factors.

In relation to those ESG factors that companies are already required to report on (including those set out in Table I), it may be that some companies are already collating some of the information and analysis that they are required to include in the non-financial information statement. However, companies will need to be careful that such information complies with the specific requirements of the non-financial information statement, and may need to revise their data collection processes and analysis as a result.

The introduction of the non-financial information statement reflects part of a broader trend of increasing mandatory reporting on ESG issues, which may lead some companies not yet required to produce a non-financial information statement or strategic report to consider preparing these reports on a voluntary basis, as a matter of good governance.²

This schedule gives an overview of the requirements of the strategic report, and how these have been supplemented by the new requirement to produce a non-financial information statement. The key changes are summarised below, with more detail being provided in the sections that follow.

The schedule closes by considering how the requirements of a non-financial information statement support and strengthen reporting on particular ESG factors that are already being reported on outside of the strategic report, and by considering the obligations of directors to ensure that this reporting is correct.

Comparison table

Factor	Strategic Report (2013 onwards)	Non-Financial Information Statement (2017 onwards)
Scope	All companies (except those entitled to small companies exemption) Enhanced requirements for quoted companies	Public interest entities with 500+ employees (i.e. listed companies, insurers, banks, and certain partnerships, excluding medium-sized companies and companies entitled to small companies exemption)
Format	Part of annual report	Part of strategic report
Frequency	Each financial year	Part of strategic report and so subject to the same requirements.
ESG Factors to report on	Quoted companies must include information about: <ul style="list-style-type: none"> • environmental matters • employees 	Information about: <ul style="list-style-type: none"> • environmental matters • employees • social matters

<p>Information to provide</p>	<ul style="list-style-type: none"> • social, community and human rights issues • gender diversity, <p>in each case, to the extent necessary for an understanding of the development, performance or position of the company's business.</p> <p>In relation to each ESG factor above, information about any relevant policies of the company and the effectiveness of those policies.</p>	<ul style="list-style-type: none"> • respect for human rights • anti-corruption and anti-bribery matters, <p>in each case, to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity.</p> <p>The information in the non-financial statement must include:</p> <ul style="list-style-type: none"> • a brief description of the company's business model; • the policies and any due diligence process undertaken to implement the policies in relation to the ESG factors; • the outcome of those policies; • the principal risks relating to the ESG factors and (where relevant and proportionate) the business relationships, products and services which are likely to cause adverse impacts on those risk areas and a description of how the company manages principal risks; and • a description of the non-financial key performance indicators relevant to the company's business.
<p>Basis of reporting</p>	<p>Statement of which ESG factors (if any) the report does not contain information about.</p>	<p>In relation to policies only, 'comply or explain' (i.e. state that the company has a policy in relation to a specific ESG factor or, if it does not have a policy in relation to a specific ESG factor, an explanation of why not)</p>
<p>Implications of non-compliance</p>	<p>Failure to comply is an offence committed by each director, punishable by a fine.</p>	<p>Part of strategic report and so subject to the same requirements.</p>
<p>Approval</p>	<p>Approved by the Board of Directors and signed by a director or company secretary on the Board's behalf</p>	<p>Part of strategic report and so subject to the same requirements.</p>
<p>Verification</p>	<p>Must be audited for compliance with legal requirements and any material misstatements.</p>	<p>Part of strategic report and so subject to the same requirements.</p>

B. The requirements of a strategic report

1. What is a strategic report?

A strategic report, which must be produced by all UK companies (except small companies meeting the relevant small companies exemption) on an annual basis, is intended to "inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company)."³

The strategic report should provide a forward-looking, fair, balanced and understandable explanation of what a company's strategic management, business environment and business performance is. It should be comprehensive,

but also concise, only including ‘material’ information (i.e. information that, if omitted, would have an impact on a shareholder’s understanding of the economics of a company as taken from its annual report).

Where a company is a parent company and that parent company prepares group accounts, the parent company must produce a consolidated strategic report (Group Strategic Report) which refers to the undertakings in the consolidation.⁴

2. What factors does a strategic report have to cover?

The most extensive reporting under the strategic report applies to quoted companies,⁵ which have to report on:

- the main trends and factors likely to affect the future development, performance and position of the company’s business;
- environmental matters;
- employee matters; and
- social, community and human rights issues (expressly including gender diversity statistics, regardless of their materiality).⁶

In each case, information has to be provided ‘to the extent necessary for an understanding of the development, performance or position of the company’s business’, although information that, if disclosed, would be ‘seriously prejudicial’ to the interests of the company, can be withheld.⁷

Disclosable information should arguably include factors that, in the future, may affect the business environment of the company (for example, access to particular raw materials that a company is dependent on)⁸ or climate-related factors.⁹

3. What is the basis of reporting and monitoring compliance?

Where a company does not include information in relation to environmental, employee or social, community and human rights issues in its strategic report, it must state which of this information it does not include. It is not required to provide any explanation of why that information has not been included.¹⁰

Since 2015, the strategic report must, however, be audited for compliance with the legal requirements and any material misstatements. The audit report must state whether the information in the strategic reports is consistent with that of the annual accounts and in accordance with the applicable legal requirements. It must also state whether, in the light of the auditor’s knowledge and understanding of the company and its environment, it has identified material misstatements in the strategic report (if any) and, if so, the nature of each misstatement.¹¹ This represents an enhanced level of monitoring and assurance since the strategic report was introduced.

C. Changes to the strategic report due to the implementation of the Directive in the UK

1. How has the Directive been implemented in the UK?

To implement the Directive, sections 414CA and 414CB have been added to the Companies Act 2006.¹² As a result, companies within scope with financial years starting on or after 1 January 2017, will have to produce a ‘non-financial information statement’ as part of their strategic report, disclosing specific ESG information about the Company. As this legislation has already been brought into force in the UK, it should be relatively protected from the legislative changes resulting from Brexit, although this will remain to be seen.

It is notable that although the Directive provides for companies to include their non-financial information statement in either the annual (management) report or a separate report to which the annual (management) report refers, the UK prescribes that the non-financial information statement must be included in the strategic report, which is part of the annual report. The way in which the Directive has been implemented in the UK has, in this case, therefore brought added significance, and prominence, to the non-financial information statement.

2. Which companies must produce a non-financial information statement?

Section 414CA provides that a non-financial information statement must be produced by large public interest entities (including listed companies, banks, insurers and certain partnerships), with 500 or more employees. Companies meeting the 'small companies exemption' are therefore excluded, as are medium sized companies.¹³

As a result of this broadened scope, more entities (specifically, partnerships and some private companies) are now required to produce a non-financial information statement than are required to produce a full strategic report that covers ESG issues. For the entities that are caught, the non-financial information statement will lead to a substantial increase in their reporting, whereas those entities that had to produce a full strategic report already will now need to consider the extent to which their existing reporting needs to be enhanced/supplemented.

Where a company produces a Group Strategic Report, the non-financial information statement must also be consolidated, to refer to the undertakings included in the consolidation.¹⁴ Generally speaking, a subsidiary company does not need to prepare a non-financial information statement if it is included in:

- a Group Strategic Report (provided that: the Group Strategic Report refers to the company and any of its subsidiaries; the financial year end of the parent is the same as, or earlier than, the company's year end; and the Group Strategic Report includes a non-financial statement for all of the companies in the consolidation);¹⁵
- a consolidated management report that meets the requirements of Article 29 of Directive 2013/34/EU (the Directive 2013) or in a separate report meeting the requirements of Article 19a (non financial statement) or 29a (consolidated non-financial statement) of the Directive 2013 (provided, in each case, that: the report is prepared by a parent established in an EEA state; and that the report refers to the company and its subsidiaries).¹⁶

3. What factors does a non-financial information statement have to cover?

Section 414CB states that the non-financial information statement must contain, at a minimum, information relating to:

- environmental matters;
- the company's employees;
- social matters;
- respect for human rights; and
- anti-corruption and anti-bribery matters.

In order to convey this understanding, the non-financial information statement must include:

- the company's business model;
- the policies pursued by the company in relation to the each ESG matter and any due diligence processes implemented by the company in pursuance of those policies;
- the outcome of those policies;
- the principal risks relating to the ESG matters arising in connection with the company's operations and, where relevant and proportionate:
 - its business relationships, products and services which are likely to cause adverse impacts in those areas of risk; and
 - a description of how it manages those principal areas of risk; and
- non-financial key performance indicators (KPIs) relevant to the company's business (KPIs being 'factors by reference to which the development, performance or position of the company's business, or the impact of the company's activity, can be measured effectively').¹⁷

There is no clarity regarding the extent to which the company's business model is supposed to expressly refer, or link, to the ESG factors that are being reported on. However, it can be assumed that, as the purpose of the non-financial information statement is to provide information on the company's engagement with ESG factors, the business model should bear relevance to those factors. For example, it would be relevant for an energy company, when setting out its business model, to highlight the impacts of carbon risk in its forecasting, and to consider the present and future environmental and social matters that the company is taking into account as it develops its model.

The wording in relation to principal risks has been taken directly from the Directive. The Financial Reporting Council (FRC) has not yet published its guidance on the non-financial information statement but it has published a draft of

the guidance (Draft Guidance)¹⁸ and opened it to consultation. Encouragingly, the Draft Guidance expressly states: “The entity should look beyond its own operations and consider risks arising from business relationships, products and services, including the other parts of the supply chain in which it sits.” The European Commission guidance (EC Guidance) is also helpful on this point and states: “A company is expected to disclose material information on principal risks, regardless of whether they stem from its own decisions or actions, or from external factors, and to explain the processes used to identify and assess such risks.”¹⁹ It is clear from this that the provisions in relation to principal risk are intended to include supply chain factors, as well as the company’s own operations.

4. How is materiality determined for the purposes of deciding which information to include in the non-financial information statement?

Information on the ESG factors must be provided to the ‘extent necessary for an understanding of the company’s development, performance and position and the impact of its activity’. This is the same threshold for information as applies to the strategic report more generally.

In the context of the strategic report, the FRC has said that “[w]here information is required ‘to the extent necessary for an understanding’, it should be included in the strategic report when it is material to shareholders.”

It has defined information as ‘material’ “if its omission or misrepresentation could influence the economic decisions shareholders take on the basis of the annual report as a whole.”

It has also said: “[o]nly information that is material in the context of the strategic report should be included within it. Conversely, the inclusion of immaterial information can obscure key messages and impair the understandability of information provided in the strategic report. Immaterial information should be excluded from the strategic report.”²⁰

As it stands, the FRC’s existing guidance on the strategic report suggests that information should be provided to the ‘extent necessary’ to give an understanding of the development, performance and position of a company and the impact of its activity, and the ‘extent necessary’ will be judged by the extent to which, if such information was omitted or misrepresented, it would influence the economic decisions shareholders of the company would make.

On this basis, it would seem prudent for a company to report on each ESG factor, but where one is not material to its business, it can say that is the case rather than provide any more detailed information.

Positively, the FRC’s Draft Guidance suggests that the non-financial information statement should “provide information that is useful to all stakeholders taken as a whole”. Further, it suggests that to determine materiality “an entity should consider whether the fact or circumstance would affect the ability of the entity to generate or preserve value in the long term.”

Even more strikingly, the Draft Guidance acknowledges that different shareholders have different needs and priorities and that all of these should be taken into account when determining materiality: “a company’s shareholder base may comprise groups with different needs and interests and the needs of all significant shareholder groups, including those who take a long-term view on investment, should be considered when determining whether a matter is material.” These proposed forward-looking amendments are very encouraging, although it remains to be seen whether they will be implemented in the final form of the guidance.

5. How does reporting under the non-financial information statement interact with reporting under the strategic report?

Generally, the reporting requirements under the non-financial information statement are more prescriptive and rigorous than under the strategic report.

For companies already producing a strategic report, they will be used to reporting to varying degrees on the above ESG factors (particularly in relation to environmental, employee, social and human rights matters). To that end, compliance with the requirements of the non-financial information statement will lead to automatic compliance with certain (but not all) of the provisions in relation to the strategic report.²¹ However, there is no existing requirement under the strategic report to report on anti-bribery and corruption, or in relation to the specific policies and risks that are relevant to the prescribed ESG factors. Companies that are currently producing a strategic report will therefore need to consider how to report on these aspects. In relation to policies and risks, this may take substantial work, particularly given that the basis of reporting under the non-financial information statement is ‘comply-or-explain’ so any failure to have a relevant policy will need to be explained (see further below).

However, it should also be noted that the non-financial information statement does not cover all of the relevant reporting requirements of the strategic report, and so those aspects will need to be dealt with separately. For example, the non-financial information statement does not require separate reporting on community issues or gender diversity, although the strategic report does and so companies will need to continue reporting on these issues in their strategic report.

6. How does reporting under the non-financial information statement interact with financial reporting?

The non-financial information statement should refer to, and include additional explanations of, amounts included in the company's accounts.²² We can expect that such references could include, for example, explanations of payments made to governments (in the context of the anti-bribery and corruption factor), employee costs (in relation to employee matters), and the use of a carbon price in financial modelling.

It should also be noted that the auditor will be required to state in his/her report whether the information in the strategic report (including the non-financial information statement) is consistent with the company's accounts for the same period and so the non-financial information statement should be tightly linked to the company's other reporting.

7. What is the basis of reporting and monitoring compliance?

Unlike the strategic report (where an absence of ESG information merely needs to be noted in the report), under the non-financial information statement, where policies are not pursued in relation to any of the ESG factors that should be reported on, the company has to explain why this is the case.²³ Such explanation is required to be 'clear and reasoned'. Presumably, given the materiality threshold, one such explanation could be that the ESG factor is not material to the company's business (supported by a clear and reasoned explanation as to why that is the case).

However, this comply-or-explain approach does not apply where a company has not reported on the principal risks it faces, its business model or its non-financial KPIs. However, if a director approves a strategic report (which will include the non-financial information statement) that does not comply with the requirements of the Companies Act 2006, s/he commits an offence (see Section D). It is not clear how strictly this will be interpreted, and whether it would cover a situation where a strategic report does not consider, for example, the principal risks that a company faces.

A company can also exclude from its non-financial information statement information "about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company."²⁴ It seems that the omission of such information does not need to be explained, although it would likely to be good practice to do so (if only to avoid the risk of appearing not to have complied with a particular disclosure requirement).

D. Obligations of directors to ensure accurate corporate reporting

The strategic report (including the non-financial information statement) must be approved by the board of directors and signed by a director on behalf of the company.²⁵

Any director who approves a strategic report (including a non-financial information statement) that does not meet the relevant requirements, and who knew it did not comply or was reckless as to whether it did, and did not take steps to ensure compliance, commits a criminal offence, punishable by a fine.²⁶ This position is unchanged as a result of the introduction of a non-financial information statement.

More generally, it is also a criminal offence for a director to publish a written statement or account which is or may be misleading, false or deceptive in a material way if they do so with the intent to deceive a company's members or creditors about its affairs. If convicted, a director would be liable to a maximum sentence of seven years' imprisonment.²⁷

There is also the potential for investors to bring compensation claims against listed companies where a person discharging managerial responsibilities knew or was reckless as to whether a statement was untrue or misleading, or knew an omission was a dishonest concealment of a material fact, and this will apply to the non-financial reporting statement as it does to other aspects of annual reports.²⁸ This risk has been considered recently by ClientEarth, in letters to BP, Glencore and their investors, to warn that information that the companies provided in their annual reports did not adequately address the risk of oil demand growth being depressed and further may 'provide investors with a misleading impression of the future viability of the business.'²⁹

Directors should be mindful of these consequences, particularly in relation to existing reporting requirements on ESG issues, which may now have to be reported on in more detail as a result of the non-financial information statement. For example, under section 54 of the Modern Slavery Act 2016, the ‘modern slavery statement’ that in-scope companies are required to produce ‘may’ include information on policies, risks and due diligence relevant to modern slavery, but this content is not mandatory. Contrastingly, within the non-financial information statement, it is compulsory for a company to report on each of these aspects.³⁰ Given this, directors should be aware that simply replicating the content of their modern slavery statement in their non-financial information statement in relation to employee and human rights issues, will not automatically meet the relevant requirements. Similarly, whilst failing to supply a modern slavery statement does not have any criminal consequences for directors, failing to produce a non-financial information statement does.

Thus, directors should be aware that it is now much more difficult to avoid, without consequence, reporting on particular issues. In this way, the non-financial information statement may bring ‘teeth’ to existing ESG reporting requirements that have previously been criticised for not having any means of enforcement.

Table I: Examples of other ESG reporting requirements in the UK

Nature of ESG reporting	Source of information (to be produced annually)	Companies affected	Relevant legislation
Report on the steps taken during the financial year to ensure that slavery and human trafficking is not taking place in a company’s business or supply chain	Slavery and anti-human trafficking statement to be available on company’s website	Companies and partnerships who supply goods and services and carry on business in the UK, with an annual turnover of over £36million	Modern Slavery Act 2015
Report on the company’s greenhouse gas emissions	Director’s report (part of annual report)	Quoted companies	Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410), as amended by The Companies Act 2006 (Strategic Report and Directors’ Report) Regulations 2013
Report on the company’s diversity policy, implementation and results	Corporate governance statement	Listed companies	Disclosure Guidance and Transparency Rules
Report on the company’s gender pay gap (including the difference between the average hourly rate of pay and the average bonus paid to male and female employees; the proportions of male and of female employees who receive bonuses; and the relative proportions of male and female employees in each quartile pay band of the workforce.)	Statement to be available on company’s website	Companies employing 250 or more people	Equality Act 2010 (Gender Pay Gap Information) Regulations 2017)

References

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2. Clifford Chance, 'Companies need to get ready as more mandatory reporting requirements on non-financial issues take effect', https://www.cliffordchance.com/briefings/2017/03/companies_need_togetreadyasmoremandator.html
3. Section 414C(1) Companies Act 2006
4. Section 414A(3) Companies Act 2006
5. Those companies whose equity shares have been admitted to the official list in the UK (or are listed in an EEA state, or on the New York Stock Exchange or the NASDAQ), section 385 Companies Act 2006
6. Section 414C(7) Companies Act 2006
7. Section 414C(14) Companies Act 2006
8. KPMG, 'A practical guide to the strategic report', p 9, available at <https://assets.kpmg.com/content/dam/kpmg/pdf/2014/09/practical-guide-strategic-report.pdf>
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10. Section 414C(7) Companies Act 2006
11. Section 496 Companies Act 2006, introduced by s 11 The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2015
12. Introduced by section 4, The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016
13. See sections 382-384 Companies Act 2006 for an explanation of the small companies exemption and section 465 Companies Act 2006 for the test in relation to a medium sized company.
14. Section 414CA(2) Companies Act 2006
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21. Section 414CB(7) Companies Act 2006
22. Section 414CB(5) Companies Act 2006
23. Section 414CB(4) Companies Act 2006
24. Section 414C(14) Companies Act 2006
25. Sections 414A(1) and 414D(1) Companies Act 2006
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28. Paragraphs 3(2) and 3(3), Schedule 10A Financial Services and Markets Act 2000
29. Client Earth, 'Letter to BP: Potential legal risks of corporate reporting regarding oil demand forecast to 2015' available at: <https://www.documents.clientearth.org/library/download-info/letter-to-bp-potential-legal-risks-of-corporate-reporting-regarding-oil-demand-forecast-to-2035/>
30. Section 414CB(2) CA 2006. For further discussion on this point, see Freedom Fund <http://freedomfund.org/blog/directive-201495eu-becomes-law-and-strengthens-the-modern-slavery-act/>

Appendix III Germany: Disclosure of Non-Financial Information

A. Introduction

Prior to the transposition of EU Non-Financial Reporting Directive (2014/95/EU) (Directive), Germany didn't have a comprehensive legislation in relation to CSR reporting. It did, however, have the Sustainability Code (Code), which was a non-mandatory code providing a framework for CSR reporting.

Germany transposed the Directive into national law on the 19 April 2017 as the *Gesetz zur Stärkung der nichtfinanziellen Berichterstattung der Unternehmen in ihren Lage-und-Konzernlageberichten (CSR Umsetzungsgesetz)*.¹ This law expands upon the existing regulations of annual management reports by amending the *Handelsgesetzbuch* (the amended *Handelsgesetzbuch* being referred to in this paper as HGB n.F.).² It is estimated that approximately 500 companies will be affected by this legislation.³

The schedule below provides an overview of the requirements of the previous legislation, and of the new requirement to produce a non-financial statement. The key changes are summarised below, with more detail being provided in the sections that follow.

Comparison table

Factor	§289(3) Handelsgesetzbuch a.F. (2005 onwards)	Non-Financial Information Statement (2017 onwards)
Scope	Companies that fulfill two out of the three conditions: <ul style="list-style-type: none"> • a balance sheet of €20+ million; • turnover of €40+ million; • 250+ employees.⁵ 	Companies that fulfill the following criteria: <ul style="list-style-type: none"> • fulfill the conditions of a large company;⁵ • are capital-market orientated;⁶ and • 500+ employees;⁷ Large banks ⁸ and insurance companies with 500+ employees fall also within the scope. ⁹
Format	To be published as part of the annual management report. ¹⁰	The information can be published as part of the annual management report ¹¹ or as a separate report. If published as a separate report, it must: <ol style="list-style-type: none"> (a) be published along with the annual management report; or (b) be made available on the company's website within four months after the publishing of the annual management report for a period of ten years, provided that the annual management report refers to this publication (and the website).¹²
Frequency	Annually	Annually
ESG Factors to report on	Information pertaining to environmental and employment matters to the extent that 'they are of significance for the understanding of the business or its situation'. ¹³	The non-financial statement must include information on the following aspects: <ul style="list-style-type: none"> • environmental matters; • employee matters; • social matters; • respect for human rights; • anti-corruption and anti-bribery matters in each case, to the extent necessary for an understanding of the company's development, performance and position, and the impact of its activity. ¹⁴

Information to provide in relation to each factor	<p>Not provided for in the legislation.</p> <p>However, it should be noted that the legislation states that the statement can make reference to the ‘amounts and disclosures in the annual financial statement.’¹⁵</p>	<p>The non-financial statement must contain a brief description of the company’s business model, as well as:¹⁶</p> <ul style="list-style-type: none"> • a description of the policies undertaken, including any due diligence processes; • the outcome of those policies; • the principal risks relating to the business of the company and those that have or could have negative effects on the ESG factors, as well as a description of how the company manages these principal risks; • the principal risks relating to the business relationships, products and services (where relevant and proportionate) which cause or are likely to cause adverse impacts on the ESG aspects as well as a description of how the company manages these principal risks; and • a description of the non-financial key performance indicators relevant to the company’s business.¹⁷
Basis of reporting	<p>Not provided for in the legislation.</p>	<p>The ‘comply or explain’ principle applies in respect of policies.¹⁸ All other requirements must be complied with.</p>
Omission of information	<p>Not provided for in the legislation.</p>	<p>In exceptional circumstances, it is possible to omit disclosures relating to future developments in negotiation if: (a) the omission would place the company under significant disadvantage; and (b) the omission would not prevent a true and fair understanding of the business.¹⁹ The omitted information must be included in the information disclosed the following financial year.²⁰</p>
Implications of non-compliance	<p>Not provided for in the legislation</p>	<p>Directors who have not complied may be subject to a fine or imprisonment.²¹ A non-complying company may also be fined in exceptional cases.²²</p>
Verification	<p>Not provided for in the legislation.</p>	<p>The financial auditor is responsible for verifying the submission of the non-financial statement.²³ There is no requirement for either the verification of the contents of the report.</p> <p>Companies who undertake independent verification of the non-financial information are required to publish the results in the same manner as the non-financial statement.</p>
Consolidation	<p>Not provided for in the legislation.</p>	<p>Parent companies²⁴ are required to disclose non-financial information in line with the above requirements if they fulfill the following requirements:²⁵</p>

- (a) they are capital-market-orientated;²⁶
- (b) for the companies included in the consolidated non-financial statement:
 - (i) they do not fall under the exemption requirements; and
 - (ii) they have a total of 500+ employees.²⁷

Subsidiaries, that would otherwise be required to produce a non-financial statement, may be exempt from their reporting obligation if:

- a) their parent company has published a consolidated report mentioning the subsidiary;
- b) the report is published in line with the German law or the law of another Member State or EEA in accordance with the Directive;
- c) the report contains a non-consolidated group declaration;
- d) the report, as well as where it is to be found, is referred to in the financial report; and
- e) the report is published publicly in English or in German.²⁸

B. Previous ESG reporting requirements

Prior to the implementation of this Directive, there was minimal legislation pertaining to ESG reporting in Germany. However, following the 2007 economic crash, this type of reporting gained popularity leading to minor non-financial reporting legislative changes and the endorsement of the non-mandatory Sustainability Code (Code) in 2011 by the German Federal Government.

1. What is the Sustainability Code?

The Code is a framework devised by the German Council for Sustainable Development for reporting on non-financial information and was influenced by the Global Reporting Initiative (GRI) Guidelines, the United Nations Global Compact Principles and the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises.²⁹ It has since been endorsed by Angela Merkel stating ‘that even more companies [should] apply it.’³⁰ However, only approximately 220 companies including Deutsche Börse and Deutsche Telekom use this Code and over 440 annual declarations of conformity³¹ have been made.³² The Code is not for exclusive use by large companies, but can be used by any sized companies including small and medium enterprises, for which it arguably may be of the most use.³³

2. What factors does the sustainability code report have to cover?

The Code requires a declaration of conformity from the company. In this declaration, the company is recommended to outline the business model, scope of consolidation, definitions used and significant assumptions and estimates made.

The Code is comprised of twenty criteria which are divided into four categories: strategy, process management, society and environment. These criteria are listed in Table I. In addition, the Code contains performance indicators selected from the GRI and European Federation of Financial Analysts (EFFAS) Guidelines.

3. What is the basis of reporting and monitoring compliance?

If a company fails to report on a certain criterion, it must give reason (‘comply or explain’). The Code defines this as: ‘companies report or explain any deviation when data has not been collected or the information required for the case in question is not material’.

The company can have the information externally audited but if it does have its information audited, it is not required to disclose the audit results (in contrast to the position under the HGB n.F. in relation to non-financial information).

The Code was recommended by the European Commission as a possible framework for non-financial reporting and

was updated in late August to reflect the requirements of *CSR Umsetzungsgesetz*.³⁴ More detail on the Sustainability Code is included in Table I, and examples of other ESG reporting requirements in Germany are included in Table II.

4. Was there any legislation in place that required non-financial reporting?

Pre-existing legislation regarding ESG reporting is found in the *Handelsgesetzbuch alte Fassung* (HGB a.f.).³⁵ This legislation, as introduced by the *Bilanzrechtsreformgesetz*,³⁶ required large corporations³⁷ to disclose non-financial information pertaining to environmental and employee factors in their annual management report in so far as it furthered the understanding of the development or position of the business. The information, if so required, could make reference to the disclosures in the annual financial statement.³⁸

The requirements of CSR Umsetzungsgesetz Report

1. How has the Directive been implemented in Germany

In order to implement the Directive, the part of the HGB relating to annual management reports and annual consolidated management reports of certain large corporations was amended and new segments were added, as well as amending parts of the *Aktiengesetz* (AktG).³⁹

As a result, companies falling within the scope will be required to produce a non-financial statement either as part of their annual management report or as a separate report,⁴⁰ disclosing specific ESG information for financial years beginning on or after 1 January 2017. Some German companies such as BASF, Deutsche Bank, Deutsche Börse, EnBW and others have stated that providing the information in a separate report would be a step backward and advocate for the use of integrated reporting.⁴¹

2. What companies must disclose non-financial information?

Large public-interest corporations, as well as large banks and large insurance companies are required to disclose non-financial information.

A corporation is required to prepare a non-financial statement, if:⁴²

- (a) It fulfills the requirements of a large corporations as set out below:
 - (i) Large corporations are those companies that fulfill two out of the three following requirements:
 - 1 - €20+ million balance sheet;
 - 2 - €40+ million revenues; or
 - 3 - 250+ employees.⁴³
 - (b) They are capital-market orientated;⁴⁴
 - (c) They have 500+ employees.

Banks and insurance companies who are considered large⁴⁵ and have 500+ employees are also required to prepare a non-financial statement.⁴⁶

Small and medium companies are therefore excluded from this reporting obligation.

Parent undertakings that are obligated to produce a non-financial statement are obliged to prepare a consolidated version of the non-financial statement as per the Directive.⁴⁷ This is governed in the provisions of the HGB n.F.⁴⁸ Banks and insurance companies, who fulfill the same criteria above, are also required to prepare a consolidated non-financial statement.⁴⁹

With regard to the subsidiaries, the HGB n.F. states that they are not required to disclose non-financial information provided that the parent company has published the requisite information in compliance with the Directive⁵⁰ and that their report contains a non-consolidated group declaration.⁵¹ Furthermore, the report must be published in either English or German.⁵² It could be inferred from the reading of the legislation that this exemption also applies to parent companies who are established outside the EU but publish their report in compliance with the EU regulations.⁵³

There is an exemption provided for in the Directive for parent companies that are also subsidiaries. This exemption applies if the exempted parent undertaking and its subsidiaries are included in the annual consolidated management report or the separate report of another undertaking and is in accordance with the Directive.⁵⁴

3. What factors is the report required to cover?

The legislation stipulates that the company provides a brief outline of the company model⁵⁵ and information be provided on the following elements:

- environmental factors eg. gas-house emissions;
- employee issues eg. safety regulations;
- social concerns eg. measures taken to ensure the protection and development of local communities;
- respect for human rights eg. avoidance of human rights' abuses; and
- measures to combat corruption and bribery eg. preventative instruments.⁵⁶

The legislation provides numerous examples for the above elements.

In regard to the company's business model, there is no guidance in the legislation as to whether the ESG factors reported on need to expressly refer, or link to the business model. However, it may be assumed that, as the purpose of the non-financial information statement is to provide information on the company's engagement with ESG factors, the business model should bear relevance to those factors. For example, it would be relevant for an energy company, when setting out its business model, to highlight the impacts of carbon risk in its forecasting, and to consider its present and future environmental and social matters that the company is taking into account as it develops its model.

In order to convey an understanding of the elements, the non-financial statement must include:

- a description of the policies undertaken, including any due diligence processes;
- the outcome of those policies;
- the principal risks relating to the business of the company and those that have or could have negative effects on the ESG factors, as well as a description of how the company manages these principal risks;
- the principal risks relating to the business relationships, products and services (where relevant and proportionate) which cause or are likely to cause adverse impacts on the ESG aspects as well as a description of how the company manages these principal risks; and
- a description of the non-financial key performance indicators relevant to the company's business.⁵⁷

In regard to the framework used to provide this information, the company can choose between international, European and national standards. The company is required to state the framework used and ensure it satisfies the requirements of the Directive.⁵⁸ If the company decides not to use an existing standard, they are required to provide an explanation for their decision.⁵⁹

Furthermore, in line with the requirements of the Directive, the HGB n.F. requires that corporations⁶⁰ include a diversity statement which outlines 'the composition of the representative bodies and the supervisory board in terms of aspects such as age, gender, educational or professional background'. In addition, the aims of the diversity policy must be stated, as well as how it is being implemented and the results achieved.⁶¹ If a corporation does not pursue a diversity policy, it is required to explain why in the company's management statement.⁶²

4. How is materiality determined for the purposes of deciding which information to include in the non-financial information statement?

Non-financial information is to be provided to the extent necessary for understanding the development, performance and position of the company, as well as the impact of its activity. This is the same threshold as the Directive. The addition of 'impact of its activity' is worth taking note of, as this is a new element of the materiality test. It is yet to be seen how this will be interpreted in Germany, as there is no guidance on this or on the principle of materiality in German legislation (although the Accounting Standards Committee of Germany (ASCG), recognized by the German government, has published guidelines on this matter).⁶³

Despite this, the principle of materiality can be inferred from the HGB as an element of the 'True and Fair' principle found in German accounting legislation.⁶⁴ This principle states that accounting data must reflect a true and fair view of the company's assets, finance and profitability. In addition to this, the Code makes reference to materiality as a criterion since the company is required to disclose the 'aspects of sustainability [that] have a significant impact on its business operations'.⁶⁵

Furthermore, through EU legislation, German legislation has been influenced as the Accounting Directive defines material information as ‘the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking. The materiality of individual items shall be assessed in the context of other similar items’.⁶⁶

In addition to this, the wording in relation to principal risks has been taken directly from the Directive and since the German finance market authority (BaFin) has not published guidance on the non-financial statement, the guidance published by the European Commission (EC Guidance) may shed some light on this matter. The EC Guidance provides an explanation of materiality, in particular on the new element of ‘impact’. It states that the report should cover the impact of the company’s activity, be it ‘positive or adverse’ and that ‘a company is expected to disclose material information on principal risks, regardless of whether they stem from its own decisions or actions, or from external factors, and to explain the processes used to identify and assess such risks.’ The EC Guidance also states that the materiality test in respect of principal risks is scale and severity (rather than whether knowledge of that risk would influence a reader’s economic decisions). The EU principle of indirect effect comes into play here as the German legislation must be interpreted in line with the Directive insofar as it does not explicitly contravene with domestic law.

5. How does reporting under the non-financial information statement interact with financial reporting?

In respect of the elements referred to above the non-financial statement may make reference to the financial report, and include additional explanations, insofar as it is necessary for furthering the understanding of the report.⁶⁷ We can expect that such references could include, for example, explanations of payments made to governments (in the context of the anti-bribery and corruption factor), employee costs (in relation to employee matters), and the use of a carbon price in financial modelling.

6. What is the basis of reporting and monitoring compliance?

If a company does not pursue a policy for one of the factors required to be reported on (for example, environmental factors), it is required to provide a clear explanation as to why it has not provided this information.⁶⁸ In regard to all other elements of the report (e.g. principal risks, business model and non-financial KPIs), companies must simply ‘comply’ with the stated requirements.

In certain exceptional circumstances, information may be omitted if it concerns prospective developments or issues currently being negotiated, and (a) the disclosure of this information would result in a substantial disadvantage to the company and (b) the omission would not prevent a true and fair understanding of the business.⁶⁹ This omitted information must be included in the next report if the reasons for not including this information are no longer valid.⁷⁰

The auditor must confirm that the non-financial statement has been produced.⁷¹ There is no mandatory requirement for the information itself to be audited, however, if there is a voluntary audit of the information, the results must be published. This obligation only comes into effect as of the 2019 financial year.⁷²

It must be noted that auditing responsibilities of the supervisory board⁷³ have now been extended to non-financial reporting as it falls within their responsibility to examine the contents of the non-financial report.⁷⁴ This goes beyond the requirements of the Directive as it does not suggest examination by the supervisory board. The supervisory board can also commission an external audit of the contents of the non-financial statement.⁷⁵

Obligation of directors to ensure accurate corporate reporting

It falls within the duties of the management board to provide the non-financial statement to the supervisory board.⁷⁶ The supervisory board reviews the annual management report as prepared by the management board, and therefore the non-financial statement (if the non-financial statement is included in the annual management report). If the non-financial statement is published separately, the management board must submit it to the supervisory board.⁷⁷ Due to concerns given the stringent sanctions for infringement, an additional section was added to the legislation which contains a provision allowing for an external audit of the non-financial information.⁷⁸

In the case of infringement, members of the supervisor and management boards can be held personally liable. In exceptional cases, companies may be held liable and suffer financial harm.⁷⁹ Therefore, the legislation governing sanctions for misrepresentation and penalties is of paramount importance.⁸⁰

For the non-financial statement, the same sanctions apply as with the financial statement.⁸¹ Under the provisions of the Commercial Code, the members of the management or of the supervisory board can be held liable for providing

false and misleading information and may be subject to imprisonment of up to three years or a fine.⁸² The Commercial Code also provides sanctions for failure to produce a non-financial report or producing it incorrectly, as well as failure to provide a diversity statement.⁸³

If an administrative offence⁸⁴ is committed during the preparation of the non-financial statement, a sanction may be imposed against the responsible individual:

- (a) a maximum of € 2,000,000; or
- (b) an amount equal to two times the economic benefit arising out of the infringement.⁸⁵

Companies may also be held liable for an administrative offense. In this case, the corporation could be fined:

- (a) Maximum €10 million;
- (b) 5% of its annual turnover; or
- (c) an amount equal to two times the economic benefit arising out of the infringement.⁸⁶

The amendments of the fines applicable to banks and insurance companies are the same as the above.⁸⁷

Table I: Sustainability Code Indicators

Criteria	Strategy
1. Strategic Analysis and Action	The company discloses how it analyses the opportunities and risks of its major activities in the context of sustainable development. The company explains what concrete measures it is undertaking to operate in compliance with the essential and recognised sector specific, national and international standards.
2. Materiality	The company discloses what aspects of sustainability have a significant impact on its business operations and how, in its strategy, it takes them into account and systematically addresses them.
3. Objectives	The company discloses what qualitative and/or quantitative as well as temporally defined sustainability goals are set and operationalised, and how their level of achievement is monitored.
4. Depth of the Value Chain	The company states what significance aspects of sustainability have for added value and how deep into the value-added chain the sustainability are verified.
Process Management	
5. Responsibility	Accountability in the corporate management with regard to sustainability is disclosed.
6. Rules and Processes	The company discloses how the sustainability strategy is implemented in the operational business by the way of rules and processes.
7. Control	The company discloses how and what performance indicators on sustainability are integrated into its periodical internal planning and control and how the reliability, comparability and consistency of the data applied to internal controls and external communications are safeguarded through appropriate processes.
8. Incentive Schemes	The company discloses how target agreements and remuneration schemes for executives and employees are also geared towards the achievement of sustainability goals and how they are aligned towards long-term value creation. It discloses the extent to which the achievement of these goals form part of the evaluation of the top managerial level (board/managing directors) conducted by the monitoring body (supervisory board/advisory board).
9. Stakeholder engagement	The company discloses how the socially and economically relevant stakeholders are identified and integrated into the sustainability process. It is disclosed whether and

<p>10. Innovation and product management</p>	<p>how an ongoing dialogue takes place with them and how the results are integrated into the sustainability process.</p> <p>The company discloses how innovations in products and services are enhanced through suitable processes which improve sustainability with respect to the company's utilisation of resources and with regard to users. Likewise, a further statement is made with regard as to how the current and future impact of the key products and services in the value chain and in the product lifecycle are assessed.</p>
<p>Environment</p>	
<p>11. Usage of Natural Resources</p>	<p>The company discloses the extent to which natural resources are used for the company's business activities. Possible options here are materials, the input and output of water, soil, waste, energy, emissions, land and biodiversity as well as emissions for the lifecycles of products and services.</p>
<p>12. Resource Management</p>	<p>The company discloses what qualitative and quantitative goals it has set itself with regard to its resource efficiency, its use of renewables, the increase in raw material productivity and the reduction in the usage of ecosystem services, and how these goals have been met or will be met in the future.</p>
<p>13. Climate-relevant emissions</p>	<p>The company discloses the GHG emissions in accordance with the Greenhouse Gas (GHG) Protocol or standards based on it and states the goals it has set itself to reduce emissions.</p>
<p>Society</p>	
<p>14. Employment Rights</p>	<p>The company reports on how it complies with the employment rights of both nationally and internationally recognised standards and how it promotes employee involvement in sustainability management.</p>
<p>15. Equal Opportunities</p>	<p>The company discloses in what way it has implemented national and international processes and what goals it has to promote equal opportunities and diversity, occupational health and safety, the integration of migrants and people with disabilities, fair pay as well as a work-life balance.</p>
<p>16. Qualifications</p>	<p>The company discloses what goals it has set and what measures it has taken to promote the employability of all employees, i.e, the ability of all employees to participate in the working and professional world, and to adapt it to demographic change.</p>
<p>17. Human Rights</p>	<p>The company discloses what measures it takes for the supply chain with the aim of ensuring that human rights are respected globally and that forced and child labour as well as all forms of exploitation are prevented.</p>
<p>18. Corporate Citizenship</p>	<p>The company discloses how it contributes to corporate citizenship in the regions in which it conducts its core business activities.</p>
<p>19. Political Influence</p>	<p>All significant input relating to legislative procedures, all entries in lobby lists, all significant payments of membership fees, all contributions to governments as well as all donations to political parties and politicians should also be disclosed by country in a differentiated way.</p>
<p>20. Conduct that complies with Law and Policy</p>	<p>The company disclose which measures, standards, systems and processes are in place to prevent unlawful conduct and, in particular, corruption , and how they are verified. The company depicts how corruption and other contraventions in the company are prevented and exposed and what sanctions are imposed.</p>

Table II: Examples of other similar developments in Germany

Nature of the law	Companies affected	Relevant legislation
<p>Requirement of a 30% quota of either gender on the supervisory boards that are 50/50 co-determined. These are boards in which half of the members are employee representatives.</p> <p>All publicly-listed German companies are required to set a target for participation of women in supervisory and management boards. This quota must not be lower than the current composition, unless the 30% quota has already been fulfilled.⁸⁸</p>	<p>Publicly listed German companies with 2,000+ employees.</p> <p>Approximately 100 companies affected.</p> <p>3,500 smaller businesses obliged to set gender-equality goals.</p>	<p>Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst (so-called Frauengesetz).⁸⁹</p>
<p>The German National Action Plan on Business and Human Rights (the Plan) implements the UN Guiding Principles on Business and Human Rights⁹⁰ by requiring that companies respect human rights throughout their operations and implement due-diligence in this regard. However, it does not enforce any penalties if the obligations are not met. The Plan does however state that if progress is not made by half of the large companies, then legal avenues will be considered.⁹¹</p>	<p>German companies with 500+ employees</p>	<p>German National Action Plan on Business and Human Rights</p>
<p>Regulation to prevent conflict minerals and materials from being exported to the EU in order to stop the exploitation of mineworkers in politically unstable areas. This will place an obligation to import responsibly sourced materials. This law will come into force on 1 January 2021.</p>	<p>EU companies</p> <p>Approximately 600-1000 companies across the EU affected directly, of which approximately 20 will be German.</p>	<p>Regulation EU 2017/821 of the European Parliament and the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas.</p>

References

1. Published in the Bundesgesetzblatt 2017 I Nr. 20, 18.04.2017, S. 802 ff; the requirement to publish the auditor's report only comes into effect 1 January 2019.
2. The German Commercial Code - a. F. refers to the former version of this code, while n.F. refers to the current amended version.
3. 550 according to German Secretary of State during a speech at the German UN Global compact ("Erfasst werden alle kapitalmarktorientierten Kapitalgesellschaften oder ihnen gleichgestellte Unternehmen sowie der Großteil der Kreditinstitute und Versicherungen. Das sind in Deutschland voraussichtlich circa 550 Unternehmen): https://www.globalcompact.de/wAssets/docs/Arbeitstreffen-und-Teilnehmerkonferenz/Teilnehmerkonferenz-12-10-2016/Keynote_StS-Billen-CSR-RL-UmsG.pdf . The study by Hans-Böckler-Stiftung counted 536 companies: https://www.boeckler.de/pdf/p_mbf_report_2016_27.pdf
4. § 267(3) HGB n.F.
5. As defined by § 267(3)(1) HGB n.F.

6. As defined by § 264(d) HGB n.F.
 7. § 289(b)(1) HGB n.F.
 8. Large as defined in § 267(3)(1) HGB n.F.
 9. §§ 340(a)(1a) and 341(a)(1a) HGB n.F.
 10. § 289(3) HGB a.F.
 11. § 289(b)(1) HGB n.F.
 12. § 289(b)(3)(2) HGB n.F.
 13. § 289(3) HGB a.F.
 14. § 289(c)(2) HGB n.F.
 15. § 289(1)(3) HGB a.F.
 16. § 289(c)(1) HGB - the same language as the Directive is used, however formatting is different, as requirement for description of company model is separated from the other requirements.
 17. § 289(c)(3) HGB n.F.
 18. § 289(c)(4) HGB n.F.; See also § 161 of the German Stock Corporation Act (AktG) for 'comply or explain' principle.
 19. § 289(e)(1) HGB n.F.
 20. § 289(e)(2) HGB n.F.
 21. §§ 331, 334(1)(3) and (4), 334(3) HGB n.F.
 22. § 334(3a) HGB n.F.
 23. § 317(2)(4) HGB n.F.
 24. As per § 290 HGB n.F.
 25. § 315(1) HGB n.F.
 26. As defined in § 264(d) HGB n.F.
 27. See exemption requirements § 293(1)(1) and (2) HGB n.F.
 28. § 289(b)(2) HGB n.F.
 29. 'More companies report on the German Sustainability Code', Sustainability reports available here <http://www.sustainability-reports.com/more-companies-report-on-the-german-sustainability-code/>
 30. 'Focus on Germany: the uptake of sustainability measures by Europe's largest economy', Global Reporting available at <https://www.globalreporting.org/information/news-and-press-center/Pages/Focus-on-Germany-the-uptake-of-sustainability-disclosure-measures-by-Europes-largest-economy.aspx>
 31. Part of the report
 32. The Sustainability Code homepage, available at <http://www.deutscher-nachhaltigkeitskodex.de/en/home.html>
 33. A guideline document has been produced for small and medium enterprises, available at: http://www.deutscher-nachhaltigkeitskodex.de/fileadmin/user_upload/dnk/dok/leitfaden/The_Sustainability_Code_Guideline_for_SMEs.pdf
 34. DNK Pressemitteilung: 'DNK-Datenbank optimiert: Nutzerfreundlichkeit, Prüfprozess, nichtfinanzielle Erklärung', Rat für nachhaltige Entwicklung available here http://www.deutscher-nachhaltigkeitskodex.de/fileadmin/user_upload/dnk/pressemitteilungen/170830_DNK_Pressemitteilung_Datenbank.pdf
 35. § 289(3) HGB a.F.
 36. 'Weiterentwicklung der investororientierten Unternehmensanalyse durch die Reform der Lageberichterstattung', Stephanie Utesch at page 36.
 37. Corporations are defined as per §267 Abs. 3 HGB n.F. as those which fulfill two out of the three following conditions: (a) a balance sheet of €20+ million; (b) turnover of €40+ million; (c) 250+ employees. Capital market-orientated companies as per §247(d) HGB n,F, are also regarded as corporations.
 38. § 289(3) HGB a.F.
 39. §§ 289(b-e), 315(b-c) HGB n.F. and §§ 111, 171 AktG; Aktiengesetz is the German Stock Corporation Act.
 40. § 289(b)(3) HGB n.F.
 41. 'The adoption of the EU Non-Financial Directive in Germany', Matthias Schmidt available here <http://integratedreporting.org/news/the-adoption-of-the-eu-non-financial-directive-in-germany/>
 42. § 289(b)(1) HGB n.F.; See § 267 (4) and (5) HGB n.F. for further requirements.
 43. § 267(3)(1) HGB n.F.
 44. As defined by § 264(d) HGB n.F.
 45. As defined by § 267(3)(1) HGB n.F.
 46. §§ 340(a)(1a) and 341(a)(1a) HGB n.F.
 47. Article 29(a) Directive
 48. §§ 315(b) and 315(c) HGB n.F.
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49. §§ 340(i)(5) and 341(j)(4) HGB n.F.
50. It can either be as per the national law of the Member State, or as per the national law of another contracting state to the EEA.
51. § 289(b)(2)(1)(2) HGB n.F.
52. § 289(2)(3) HGB n.F.
53. 'Bundestag beschließt CSR-Richtlinien-Umsetzung', Corporate Social Responsibility Kompetenzzentrum available here <http://csr-kompetenzzentrum.de/bundestag-beschliesst-csr-richtlinien-umsetzung/>
54. Article 29(a)(3) Directive
55. § 289(c)(1) HGB n.F.
56. § 289(c)(2) HGB n.F.
57. § 289(c)(3) HGB n.F.
58. § 289(d) HGB n.F.
59. *ibid*
60. As defined in § 289(f) HGB n.F.
61. Article 20(a)(g) Directive; § 289(f)(2)(6) HGB n.F.
62. § 289(f)(5) HGB n.F.
63. E-DRÄS 8 Änderungen des DRS 20 Konzernlagebericht, 20 July 2017, available (in German) at: <https://www.drsc.de/projekte/aenderung-drs-20-an-csr-rlug/>
64. Grundsatz der Wesentlichkeit, available here https://www.haufe.de/finance/finance-office-professional/bertrambrinkmannkesslermueller-haufe-hgb-bilanz-komme-45-grundsatz-der-wesentlichkeit_idesk_PI11525_HI5517391.html
65. The German Sustainability Code, available here https://www.nachhaltigkeitsrat.de/fileadmin/user_upload/dokumente/publikationen/broschueren/RNE_The_Sustainability_Code_Text_no_52_June_2016.pdf
66. Article 2(16) Accounting Directive (2013/34/EU)
67. § 289(c)(3)(6) HGB n.F.
68. § 289(c)(4) HGB n.F.
69. § 289(e)(1) HGB n.F.
70. § 289(e)(2) HGB n.F.
71. § 317(2)(4) HGB n.F.
72. §§ 289(b)(4) and 315(b)(4) HGB n.F. to be amended by Article 2 of the CSR Umsetzungsgesetz
73. German law makes use of a two-tier board system: management board (Vorstand) and a supervisory board (Aufsichtsrat). The management board is responsible for the day-to-day running of the company whereas the supervisory board is responsible for supervising the actions of the management board (§111 AktG). This system is mandatory for stock corporations and large limited liability companies.
74. § 171(1)(4) AktG n.F.
75. § 111(2)(4) AktG n.F.
76. § 170(1) AktG n.F.
77. § 170(1) AktG n.F.
78. § 111(2)(4) AktG n.F.
79. 'Erweiterung der Finanzberichterstattung um nichtfinanzielle Aspekte', Dr. Tobias Kahnert available here <http://hoganlovells-blog.de/2017/04/26/erweiterung-der-finanzberichterstattung-um-nichtfinanzielle-aspekte/>
80. §§ 331 and 334 HGB n.F.
81. § 331(1) and (2) HGB n.F.; § 334(3) and (4) HGB n.F.; § 340(n)(3) and (4) HGB n.F.; § 341(n) HGB n.F.
82. § 331(1) and (2) HGB n.F.
83. § 334(1)(3) and (4) HGB n.F.
84. As per § 30 Act on Administrative Offences (Gesetzes über Ordnungswidrigkeit - OwiG)
85. § 334(3) HGB n.F.
86. § 334(3)(a) HGB n.F.
87. §§ 340(n)(3) and 341(n)(3) HGB n.F.
88. §§ 76(4) and 111(5) AktG
89. § 96(2) AktG
90. National Action Plan on Business and Human Rights, available here http://www.csr-in-deutschland.de/SharedDocs/Downloads/DE/NAP/nap-im-original.pdf?__blob=publicationFile&v=2
91. 3 entry points to implement the German National Action Plan, available here <https://business-humanrights.org/en/3-entry-points-to-implement-the-german-national-action-plan>

Appendix IV France: Disclosure of Non-Financial Information

A. Introduction

France is regarded as a role model for CSR reporting and prior to the implementation of the EU Non-Financial Reporting Directive (2014/95/EU) (Directive), had already legislated extensively in this area. It was the first country to legislate for mandatory reporting on sustainability issues in the 1970s with the introduction of the *bilan social*, a document published by companies with over 300 employees disclosing information on 134 performance indicators relating to employment matters.¹

In 2001, France enacted legislation that supplemented the *bilan social* by increasing its scope of reporting and readership. It required all listed companies to disclose information in their annual report on the social and environmental impact of their activities and to publish the report, in contrast to the *bilan social* which only required the report to be submitted to the government.² This legislation was expanded upon in 2010 by the *Grenelle II* to include unlisted companies provided that they exceeded certain employee and/or turnover thresholds (total assets or turnover exceeding €100 million and 500+ employees).³ Companies falling into these categories were required to disclose information on 'how they take (took) into account the social and environmental consequences of (their) activity and (their) social commitments in favour of sustainable development.' Table I sets out in more detail information on *Grenelle II*, and Table IV provides examples of other ESG reporting requirements in France.

As of the 1 August 2017, the non-financial reporting legislation as implemented in accordance with the Directive came into force. France implemented the Directive into national law through the *Ordonnance n° 2017-1180 du 19 juillet 2017* (Ordinance 2017). This was further supplemented by the Decree n° 2017-1265 du 9 août 2017 (Decree 2017) which came into force 1 September 2017. This legislation replaced the provisions of the *Grenelle II* law and modified the requirement to produce a CSR report.⁴

The schedule below provides an overview of the previous requirements of the CSR report and of the new requirements of the non-financial statement. The key changes are summarised below, with more detail being provided in the sections that follow.

Comparison table

Factor	CSR Report (December 2011 onwards)	Non-Financial Statement (2017 onwards)
Scope	All listed companies, as well as unlisted companies with 500+ employees and €100m+ for turnover or balance sheet. ⁵	Companies that fulfill the following requirements: <ul style="list-style-type: none"> Listed companies that have a) a balance sheet of €20m+ or net turnover of €40m+ and b) 500+ employees; Unlisted companies that have a balance sheet or net turnover of €100m+ and 500+ employees (i.e. the same unlisted companies as were covered by Grenelle II).⁶
Format	Published as part of the annual report.	Published as part of the annual report. ⁸ The non-financial statement must be published on the website within eight months and for a period of five years. ⁹
Frequency	Annually	Annually
ESG Factors to report on	Unlisted companies must disclose information on 29 indicators and listed companies on an additional 13 indicators, that is on 42 indicators in total. The indicators are divided into the following three themes:	Unlisted companies must disclose information on 39 out of 42 indicators outlined in the previous legislation. Listed companies must disclose information on all 42 indicators.. More generally, the legislation requires all companies to provide information that is necessary

	<ul style="list-style-type: none"> • environmental information; • social information; • societal information.¹⁰ 	<p>for the understanding of the company's position, its development, its financial and economic performance and the impact of its activity,¹¹ concerning:</p> <ul style="list-style-type: none"> • consequences of company's activities on the environment; • the impact of the company's activities as well as its services and products on climate change; • its commitments to sustainable development, circular economy and the prevention of food waste; • the collective agreements reached and the impact on the economic performance of the company and on the working conditions; • measures taken to tackle discrimination and promote diversity.¹² <p>Listed companies are additionally required to disclose information on their activities in relation to respect of human rights (incl. ILO conventions) and anti-corruption matters.¹³</p>
Information to provide in relation to each factor	<p>The management report must set out the measures taken in order to account for the social and environmental consequences of the company's activities and to fulfil its societal commitments in favour of sustainable development.</p>	<p>The description must include a brief description of the business model,¹⁵ as well as the following information in regard to each factor outlined above:</p>
	<p>For each theme (environment, social engagement and labour-related information), a variety of indicators are proposed and companies can select the most relevant indicator to show their status on an issue.¹⁴</p>	<ul style="list-style-type: none"> • a description of the policies pursued by the company or group of companies, including, where applicable, the due-diligence processes implemented in order to prevent, identify and mitigate the occurrence of the risks referred to below; • the principal risks related to the matters of the company or group of companies, including, where relevant and proportionate, its business relationships, products or services; • the results of these policies, including the key performance indicators (KPIs).¹⁶
Basis of reporting	<p>'Comply or explain' (i.e. state compliance with the reporting requirement or explain why the company has not complied).¹⁸</p>	<p>The legislation provides a list of factors (based on the 42 topics included in Grenelle II) to be reported on in so far as relevant and proportionate to the main risks and policies followed.</p> <p>The report can include, if required, references to the financial report.¹⁷</p> <p>'Comply or explain' in relation to policies only.¹⁹</p> <p>All other requirements must be complied with.</p>
Implications of non-compliance	<p>No sanction.</p>	<p>In the case where information is omitted from the report, any interested parties may demand that this information be communicated.²⁰</p>
Verification	<p>Obligatory verification of the information by an independent organisation.²¹</p>	<p>Obligatory verification of the information by an independent third party for companies that exceed the following thresholds: (a) 500+ employees; and (b) €100m+ in total assets or turnover.²²</p>

B. The requirements of CSR Report

What is the CSR Report as per Grenelle II?

Previously, all listed companies as well as unlisted companies which surpassed certain thresholds, were required to report on non-financial matters.²³

Application of Grenelle II	
Listed Companies	All revenue and employment levels
Unlisted Companies	Employees: 500 plus; and Revenue: €100m+

In regard to subsidiaries, there was a marked difference between listed and unlisted subsidiaries. All listed subsidiaries were required to comply with the requirements of non-financial reporting.²⁴ Unlisted subsidiaries could be exempt from their reporting obligation if (a) the parent company had prepared a consolidated report and broke down the data per subsidiary and (b) the subsidiary had made reference to the location of the consolidated non-financial information in its management report.²⁵ If a subsidiary had prepared a non-financial statement, it was required to make reference to its parent company.

2. What factors does the CSR Report have to cover?

Grenelle II required a detailed report to be provided disclosing information on 29-42 indicators with unlisted companies reporting on 29 indicators and listed companies on an additional 13 indicators.²⁶ These indicators were divided into three main aspects: social, environmental and societal.

The legislation did not propose any specific methodology for reporting and therefore the company could frame the information as it saw fit. If the company used a national or international framework for the report, it was required to state the framework used.²⁷

The legislation proposed various sub-indicators to demonstrate progress in regard to each indicator and the company could select the most relevant sub-indicator to demonstrate its progress. For example, one of the indicators under the topic of environmental aspects was pollution and waste management. The legislation listed under this indicator a number of indicators from which the businesses could choose in order to reflect their status on an issue.

Eg. Environment

Indicator: Pollution and waste management

Sub-indicators:

- Measures to prevent, reduce or compensate for air, water and soil emissions severely affecting the environment;
- Measures to prevent, recycle and dispose of waste;
- Taking into account noise and other forms of pollution.

The management report required that information be provided for the 'closed financial year and, where applicable, during the previous financial year, so as to allow comparison between the data'.²⁸

3. What is the basis of reporting and monitoring compliance?

In the case of omission or impossibility of publishing certain required information, the company was required to give reason ('comply or explain'). The report was verified by an accredited independent third-party, appointed by the CEO or managing director.²⁹ The report was required to have the auditor's opinion on: (a) a 'fair presentation of the information contained in the management report'; (b) the 'explanations relating, where appropriate, to the absence of certain information'; and (c) the 'diligence which it has carried out to carry out its verification mission'.³⁰

This report was to be presented at the shareholder's meeting and to the board of directors.³¹

C. The requirements of the non-financial statement

1. How has the Directive been implemented in France?

In order to implement the Directive, parts of the Commercial Code were amended and new segments were added through the Ordinance 2017 and the Decree 2017. As stated above, the provisions of *Grenelle II* have now ceased to apply, although such provisions have strongly influenced the implementing legislation.³²

After the transposition of the Directive, both listed and unlisted companies are mandated to report on non-financial matters, but only if they exceed defined thresholds (which used to apply only to the latter).

Companies falling within the scope will be required to produce a non-financial statement as part of their annual report disclosing specific ESG information.

2. What companies must disclose non-financial information?

The implementation of the Directive has narrowed the scope of listed companies required to report on non-financial information. As per the new legislation, companies that fulfill the following requirements are required to disclose non-financial information:

- Listed companies that have (a) a balance sheet of at least €20 million or net turnover of €40 million and (b) 500+ employees;
- Unlisted companies that have (a) a balance sheet of at least €100 million or (b) a net turnover of €100 million and 500+ employees.³³

The thresholds applicable to unlisted companies are the same as they were under *Grenelle II* and so there is no narrowing of scope in this regard. However, whereas previously all listed companies were required to report on ESG factors under *Grenelle II*, now the above thresholds apply, meaning that certain listed enterprises no longer need to report.

The transposition of the Directive will shrink the number of subsidiaries affected as all subsidiaries may now be exempted from their reporting obligations, whereas previously only unlisted subsidiaries could be exempted. In contrast to the previous legislation, the current legislation does not require data to be broken down as per individual subsidiaries.

A parent company³⁴ which fulfills the requirements as listed above is compelled to provide a consolidated non-financial statement including information on all its subsidiaries.³⁵ Subsidiaries are exempt from their reporting obligation, if:

- (a) the parent company is established in France and the disclosed information is in line with French legislation; or
- (b) the parent company is established in one of the Member States and the disclosed information is in line with the legislation of that Member State.³⁶

3. What factors is the report required to cover?

The legislation differentiates between the factors that listed companies should report on, and those that unlisted companies should report on.

Listed and unlisted companies are required to report on the following factors:

- the consequences of the company's activities on the environment;
- the impact of the company's activities as well as its services and products on climate change;
- its commitments to sustainable development, circular economy and the prevention of food waste;
- the collective agreements reached and their impact on the economic performance of the company and on the working conditions of its employees; and
- measures taken to tackle discrimination and promote diversity.³⁷

In addition to the above, listed companies are required to disclose information on the effects of their activities regarding the protection of human rights (incl. with respect to ILO conventions) and the fight against corruption.³⁸

The Decree 2017 provides a list of factors (based on those included in *Grenelle II*) to be reported on (as set out in Table II and III) in so far as relevant and proportionate to the main risks and policies followed.³⁹ The factors are provided in two lists: one list sets out information that is required from all companies within scope of the implementing legislation and the other list sets out information that is required only from listed companies (such as the factors in relation to the protection of human rights and anti-corruption matters). The majority of the information that was, under *Grenelle II*, only required from listed companies is now required from all companies.

The Decree 2017 outlines the information required in regard to each factor outlined above:

- a description of the policies pursued by the company or group of companies, including, where applicable, the due-diligence processes implemented in order to prevent, identify and mitigate the occurrence of the risks referred to below;
- the principal risks related to the activities of the company or of group of companies, including where relevant and proportionate, its business relationships, products or services; and
- the results of these policies, including the key performance indicators.⁴⁰

In addition, a brief description of the business model must be provided.

If possible, the information disclosed should refer to the previous year, as well as the current financial year closed, in order to allow a comparison of this data.⁴¹ The report shall include, where required, references to the financial report.⁴²

In regard to the framework used to provide this information, the company can choose between international and national standards. The company is required to state the framework used.⁴³ The Commission has recently released guidelines in order to assist with drafting the non-financial statements.⁴⁴

Companies who are obliged to provide a due-diligence report under the Duty of Vigilance law may rely on this information for their non-financial statement.⁴⁵

The report must be made available to the public and published on the company's website at most eight months after the end of the financial year and must remain accessible for a period of five years.⁴⁶

Furthermore, in line with the Directive, the French Commercial Code requires companies to have a diversity policy in relation to the company's "administrative, management and supervisory bodies with regard to aspects such as age, gender, or educational and professional backgrounds"⁴⁷ if they fulfilled two out of the three requirements:

- (1) 250+ employees;
- (2) balance sheet worth €20 million; or
- (3) net turnover of €40 million.⁴⁸

It must state the objectives of the policy, how it has been implemented, and its outcomes. If no policy is pursued, the company is obliged to give a reason.⁴⁹

4. How is materiality determined for the purposes of deciding which information to include in the non-financial statement?

Non-financial information is to be provided to the extent necessary to understand the development, performance and position of the company, as well as the impact of its activity. This is the same threshold as the Directive. The addition of 'impact of its activity' is worth taking note of, as this is a new element of the materiality test. It is yet to be seen how this will be interpreted in France as there is no guidance on this matter.

The European Commission Guidance (EC Guidance) may shed some light on this matter as it provides an explanation of materiality, in particular on the new element of 'impact'. It states that the report should cover the impact of the company's activity, be it 'positive or adverse' and that the 'company is expected to disclose material information on principal risks, regardless of whether they stem from its own decisions or actions, or from external factors, and to explain the processes used to identify and assess such risks.' The EU principle of indirect effect comes into play here as the French legislation must be interpreted in line with the Directive insofar as it does not explicitly contravene with domestic law.

Furthermore, the Directive states that companies 'should provide adequate information in relation to matters that stand out as being most likely to bring about the materialisation of principal risks of severe impacts', and for these

purposes the severity of impacts should be judged by their 'scale and gravity'.⁵⁰ Given the principle of indirect effect, this can be interpreted into the legislation.

In addition, through EU legislation, French legislation has been influenced as the Accounting Directive defines material information as 'the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking. The materiality of individual items shall be assessed in the context of other similar items'.⁵¹

5. How does reporting under the non-financial statement interact with reporting under the CSR report?

As previously mentioned, France had extensive laws governing the disclosure of ESG information. The transposition of this Directive has meant that listed enterprises below the newly introduced threshold that previously had to report on ESG factors no longer have to.

Companies that were producing a CSR report, will be familiar with reporting to varying degrees on the above ESG factors (particularly in relation to environmental, employee and social matters). However, the CSR report did not require (a) a description of the business model, or (b) reporting on the outcomes of the policies, the principal risks or KPIs, except where required by individual indicators.

There are certain issues which are covered by *Grenelle II*, that the Directive has not explicitly addressed, for example: absenteeism, the use of land etc. However, these factors have been included in the French transposition of the Directive.⁵²

6. How does reporting under the non-financial statement interact with financial reporting?

The non-financial statement may make reference to the financial report in so far as it is necessary for furthering the understanding of the statement.⁵³ We can expect that such references could include, for example, explanations of payments made to governments (in the context of the anti-bribery and corruption factor) and employee costs (in relation to employee matters).

7. What is the basis of reporting and monitoring compliance?

A 'comply or explain' principle applies in relation to disclosure of policies, meaning that companies can omit policy information, provided that they communicate a clear and justified reasoning for doing so.⁵⁴ In respect of a company's principal risks, business model or non-financial KPIs, the company must simply comply with the requirement to disclose information.

The information provided is verified by an independent third-party only for companies that exceed the following thresholds: (a) 500+ employees; and (b) €100m+ in balance sheet or turnover.⁵⁵ The auditor is appointed by the managing director or the chairman of the managing board and this appointment may not exceed six years and must be accredited by the French Accreditation Committee (COFRAC) or by another accreditation body which is part of European Coordination of Accreditation Agencies.⁵⁶ The auditor is responsible for certifying the quality of the company's report and providing:

- (a) a reasoned opinion in regard to risks, policies pursued, outcome of these policies along with KPIs and the factors listed in Table II; and
- (b) the diligence in which the audit was carried out.⁵⁷

The report provided by the auditor will be sent to the shareholders of the company along with the management report.⁵⁸

D. Obligation of directors to ensure accurate corporate reporting

There are several types of companies in France but only *société anonyme* (SA) is required to have a board of directors. They may have either a one-tier management system⁵⁹ or a two-tier management system.⁶⁰ The majority of French companies have a one-tier management system.

The obligation of directors to ensure accurate corporate reporting are two-fold: (a) in drafting the annual report; and (b) in appointing an independent third-party to verify the said report.

Drafting the report

It is the responsibility of the board of directors and the management board, as the case may be, to set out when drafting the annual report the environmental, social and societal matters relating to the business.⁶¹

If a company fails to provide a non-financial statement in accordance with the legislation, any interested party or individual may request the presiding judge of summary proceedings that the information be provided. Where an application is granted, the associated penalty and the procedure costs will be borne by the directors or the members of the management board, as the case may be.⁶² There do not appear to be any other options for sanction, despite the fact that the non-financial statement will be part of the annual report, in relation to which sanctions against the chief executive officer and chairperson are available for non-compliance.⁶³

It appears that the legislation largely relies on the public and other interested parties to act as ‘watchdogs’.

Appointing an independent third-party auditor

The independent third-party who verifies the document is appointed by either the managing director or the president director.⁶⁴ There is no specific sanction provided for in the legislation if an auditor is not appointed.

Table I: Grenelle II Indicators

Those marked with a star (*) only apply to listed companies.

Indicators	Sub Indicator
Environmental information	
General environmental policy	Company efforts to take into account environmental issues and, where appropriate, assessments or environmental certifications. Employee training programs on environmental protection. Resources devoted to prevention of environmental risks and pollution. The dollar amount of provisions and guarantees for environmental risks, provided that such information is not likely to cause serious harm to the company in ongoing litigation.*
Pollution and waste management	Measures to prevent, reduce, or compensate for air, water, and soil emissions severely affecting the environment. Measures to prevent, recycle, and dispose of waste. Taking into account noise and other forms of pollution.
Sustainable use of resources	Water use and water supply based on local constraints. The consumption of raw materials and steps taken to improve their efficient use. Energy consumption, measures to improve energy efficiency, and percentage of renewable energy used. Land use.*
Climate change	Greenhouse gas emissions. Adaptation to climate change impacts*
Protection of biodiversity	Measures taken to preserve or enhance biodiversity.

Societal information	
Company's territorial impact and economic and social activity	Employment and regional development. Neighboring and local populations.
External relations with individuals or organizations interested in the company's activities	Opportunities for dialogue with these individuals or organizations. Partnership or corporate philanthropy.
Subcontracting and suppliers	Taking into account social and environmental issues in purchasing policies. Percentage of outsourced work and the inclusion of social and environmental responsibility in conversations with suppliers and subcontractors.*
Loyalty practices*	Actions taken to prevent corruption.* Measures taken to promote consumers' health and safety.*
Human rights*	Actions taken to promote human rights.*
Social information	
Employment	The total number and distribution of employees by sex, age, and geographical area. Hiring and firing of employees. Current salaries and salary progression.
Work Organisation	Working hours. Absenteeism.*
Social Relations	Social dialogue efforts, including procedures for informing, consulting, and negotiating with staff. Collective bargaining agreements
Health and Safety	Health and safety conditions Agreements signed with trade unions or staff representatives on health and safety. Occupations accidents (incl. frequency/severity) and occupational diseases.*
Training	Training policies. Total training hours.
Equal treatment	Policies and measures taken to promote equality between women and men. Policies and measures taken to promote the employment and integration of disabled persons. Policies and actions taken to prevent discrimination.
Promotion and enforcement of the International Labour Organisations Basic Conventions*	Respecting freedom of association and collective bargaining.* Elimination of discrimination in employment and occupation.* Elimination of forced or compulsory labor.* Effective abolition of child labor.*

Table II: Decree factors that all companies must report on

Indicators	Sub Indicator
Environmental information	
A. General environmental policy	<p>Company efforts to take into account environmental issues and, where appropriate, environmental assessments or certification procedure.</p> <p>Employee training programs on environmental protection.</p> <p>Resources devoted to prevention of environmental risks and pollution.</p> <p>The dollar amount of provisions and guarantees for environmental risks, provided that such information is not likely to cause serious harm to the company in pending on going litigation.</p>
B. Pollution and waste management	<p>Measures to prevent, reduce, or compensate for air, water, and soil emissions severely affecting the environment.</p> <p>Measures to prevent, recycle, and dispose of waste.</p> <p>Taking into account any form of pollution specific to an activity, in particular noise and light nuisance. and other forms of pollution.</p>
C. Circular Economy	
I. Waste Prevention and management	<p>Measures of prevention, recycling, re-use and other forms of recycling and elimination of waste.</p> <p>Actions taken to combat food waste.</p>
II. Sustainable use of resources	<p>Water use and water supply based on local constraints.</p> <p>The consumption of raw materials and steps taken to improve their efficient use.</p> <p>Energy consumption, measures to improve energy efficiency, and percentage of renewable energy used.</p> <p>Land use.</p>
D. Climate change	<p>Greenhouse gas emissions generated as a result of the company’s activities, in particular through the use of the goods and the services it produces</p> <p>Measures taken to adapt to the consequences of climate change. impacts.</p> <p>The voluntary medium- and long-term reduction targets for reducing greenhouse gas emissions and the means used for this purpose.</p>
E. Protection of biodiversity	<p>Measures taken to preserve or restore biodiversity.</p>
Societal information	
A. Societal Engagements in favour of sustainable development	<p>The impact of the company’s activity on employment and local development.</p> <p>The impact of the company’s activity on local or riverside communities.</p> <p>The maintained relationships with civil society stakeholders.</p> <p>Partnership or corporate philanthropy.</p>
B. Subcontracting and suppliers	<p>Taking into account social and environmental issues in purchasing policies.</p> <p>Percentage of outsourced work and the inclusion of social and environmental responsibility in conversations with suppliers and subcontractors.</p>
C. Loyalty practices	<p>Measures taken to promote consumers’ health and safety.</p>

Social information	
A. Employment	The total number and distribution of employees by sex, age, and geographical area. Hiring and firing of employees. Current salaries and salary progression.
B. Work Organisation	Working hours. Absenteeism.
C. Health and Safety	Health and safety conditions in the workplace. Workplace accidents, in particular their frequency and severity, as well as occupational illnesses.
D. Social Relations	Social dialogue efforts, including procedures for informing, consulting, and negotiating with staff. The record of collective agreements, in particular with regards health and safety at work
E. Training	Training policies implemented with regard to environmental protection. Total training hours.
F. Equal treatment	Policies and measures taken to promote equality between women and men. Policies and measures taken to promote the employment and integration of disabled persons. Policies and actions taken to prevent discrimination.

Table III: Decree factors that listed companies must report on

Factor	
Indicators	Sub Indicator
A. Anti-Corruption	The actions taken in order to prevent corruption.
B. Human Rights	
I. The promotion and respect of the requirements of International Labour Conventions	Respect for freedom of association and the right to bargain collectively. Elimination of discrimination in employment and occupation. Elimination of forced or compulsory labour. Elimination of child labour.
II. Other actions taken to protect human rights	

Table IV: Examples of other similar developments in France

Nature of the law	Companies affected	Relevant legislation
<p>Anti-corruption compliance program which includes:</p> <ul style="list-style-type: none"> • a code of conduct which defining prohibited behaviours; • an internal warning system designed to enable employees to report on any violations of the code of conduct; • risk-mapping which identifies, analyses and ranks the company’s exposure to any risk related to bribery; • assessment procedures in light of risk-mapping; • internal or external accounting controls; • training program for employees on bribery and influence peddling; • disciplinary sanctions against employees for violation of code of conduct; and • internal control procedures to assess the efficiency of the compliance program. 	<p>Companies who are (a):</p> <ul style="list-style-type: none"> • based in France with 500+ employees in France; • Belong to a group of companies with 500+ employees and parent company’s headquarter is in France; <p>And (b)</p> <ul style="list-style-type: none"> • Company consolidated or non-consolidated sales of 100m+; • French group with consolidated sales over 100m+, the obligation is to the group as a whole including subsidiaries in and outside of France. <p>These obligations will concern 1570 companies.⁶⁵</p>	<p>Law no. 2016-1691 du 9 décembre 2016 (Sapin II).</p>
<p>Report which outlines the measures taken to prevent human right⁶⁶ and environmental abuses throughout their supply chain.⁶⁷</p> <p>This report is to include:</p> <ul style="list-style-type: none"> • risk-mapping which identifies, analyses and ranks risks; • assessment procedures in light of risk-mapping in relation of subsidiaries and the supply chain; • measures taken to mitigate risks and prevent serious violations; • alert mechanism that collects potential and actual risks; and • a monitoring scheme to assess measures. <p>Report is publically available and included in the company’s annual report.</p> <p>This law extends beyond the requirements of the Directive as it</p>	<p>Companies that fulfill either of the following requirements for two consecutive years:</p> <p>(a) headquartered in France with 5000 plus employees in France; or</p> <p>(b) headquartered in France or abroad and employing 10,000 plus employees worldwide.</p> <p>Approximately 100-150 companies will be affected.⁶⁹</p>	<p>Law No. 2017-399 (Duty of Vigilance).</p>

<p>provides for a duty of care in regard to human right and environmental abuses, as well as requiring measures to be taken to prevent these abuses, whereas the Directive requires solely the disclosure of information and not the pursuit of additional methods to address these impacts.⁶⁸</p> <p>Requirement to report on the management of climate-related risks and the integration of social and environmental parameters in investment policies on the basis of 'comply or explain'.</p> <p>The information is to be published in the annual report and on their website.</p> <p>Applies from 2016 financial year.</p>	<p>French listed companies, banks, credit providers and institutional investors.</p> <p>Smaller investors exemption: those investors with a balance sheet of less than €500m are exempt from the detailed reporting obligation and are solely obliged to provide a general overview of how they integrate ESG factors.</p> <p>Approximately 840 asset managers affected.</p>	<p>Article 173, Energy Transition for Green Growth Law 2015.</p>
<p>Requirement of at least 40% representation of either gender on their board.</p>	<p>Listed companies with 500 plus employees and a turnover or balance sheet of at least €50 million for three consecutive years.</p> <p>This threshold will be lowered to 250 employees from January 2020.</p>	<p>Loi n° 2014-873 du 4 aout 2014 pour l'égalité réelle entre les hommes et les femmes</p>
<p>Regulation to prevent conflict minerals and materials from being exported to the EU in order to stop the exploitation of mineworkers in politically unstable areas. This will place an obligation on EU companies to import responsibly sourced materials. This law will come into force on 1 January 2021.</p>	<p>EU companies</p> <p>Approximately 600-1000 companies affected directly.</p>	<p>Regulation EU 2017/821 of the European Parliament and the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas.</p>

References

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6. Article 1 Decree 2017
7. Article L 225-102-1 (IV) French Commercial Code (former version); Decree 2012
8. Article L 225-102-1 (1) French Commercial Code
9. Article 3 Decree 2017
10. See Table I
11. Ibid
12. Article L 225-102-1 (III) French Commercial Code
13. Ibid
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15. Article 2 Decree 2017
16. Ibid
17. Article 3 Decree 2017
18. Article R 225-105 (III) French Commercial Code (former version)
19. Article 2 (i) Decree 2017
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27. Article R 225-105 (IV) French Commercial Code (former version)
28. Article R 225-105 (II) French Commercial Code (former version)
29. La législation sur le reporting ESG en France, available here http://www.diplomatie.gouv.fr/IMG/pdf/La_legislation_sur_le_reporting_ESG_en_France_cle03f7ad.pdf
30. Article 1 (II) Decree 2012
31. Article L 225-102-1 French Commercial Code (former version)
32. Déclaration de performance extra-financière: évolution de la réglementation sur le rapport RSE, available here <http://www.bl-evolution.com/blog/declaration-de-performance-extra-financiere-evolution-de-reglementation-rapport-rse/5535>
33. Article 1 Decree 2017
34. As defined by Article L 223-16 French Commercial Code
35. Article L 225-102-1 (II) French Commercial Code
36. Article L 225-102-1 (IV) French Commercial Code
37. Article L 225-102-1 (III) French Commercial Code
38. Ibid
39. Article 2 Decree 2017
40. Article 2 Decree 2017
41. Article 3 (i) Decree 2017
42. Ibid
43. Article 3 Decree 2017 (II); Examples: UN Global Compact, OECD guidelines for multinational enterprises and ISO 26000

44. European Commission Guidance, available here [http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52017XC0705\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52017XC0705(01)&from=EN)
45. Article L 225-102-1 (III) French Commercial Code
46. Article 3 Decree 2017
47. Article L 225-37-4 (6) French Commercial Code
48. Article 1 Decree 2017
49. Article L 225-37-4 (6) French Commercial Code
50. Directive, recital (8).
51. Article 2(16) Accounting Directive (2013/34/EU)
52. See Table II
53. Article 3 (I) Decree 2017
54. Article 2 (I) Decree 2017
55. Article L 225-102-1 (V) French Commercial Code as amended by Article 4 Decree 2017
56. Article 4 (I) Decree 2017
57. Article 4 (II) Decree 2017
58. Article L 225-102-1 (V) French Commercial Code
59. Contains a single board of directors and the management is divided into (a) the board of directors and (b) the chairperson.
60. Contains a management and a supervisory board. The management board is responsible for day-to-day management of company and the supervisory board is responsible for supervising this day-to-day management.
61. Article L 225-102 French Commercial Code
62. Article L 225-102-1 (VI) French Commercial Code
63. Article L 242-6 (2), L 244-1 and L 243-1 French Commercial Code
64. Article 4 (I) Decree 2017
65. Official press kit for the Bill dated 30 March 2016, p. 41
66. Identical to the human rights identified in the UN Guiding Principles on Business and Human Rights
67. The scope of the law covers the parent company, its subsidiaries, subcontractors and suppliers that is has an 'established business relationship with'.
68. French duty of vigilance law takes trend toward mandated corporate disclosure regimes to a new level, available here <http://humanrights.freshfields.com/post/102e4aq/french-duty-of-vigilance-law-takes-trend-toward-mandated-corporate-disclosure-reg>
69. European Coalition for Corporate Justice Report 'French Corporate Duty of Vigilance Law', available here <http://corporatejustice.org/documents/publications/french-corporate-duty-of-vigilance-law-faq.pdf>

Appendix V Italy: Disclosure of Non-Financial Information

Existing legal requirements to disclose ESG information in Italy

A. Introduction

Limited liability companies in Italy are required to produce a management report (“*relazione sulla gestione*”) containing an appropriate analysis of their situation, operating trends and performance.¹ Since 2008, companies have been required to incorporate in the analysis relevant non-financial performance indicators, including information relating to environmental and employee matters, where this is necessary for a proper understanding of their situation, operating trends and performance.² Thus far, therefore, companies have had no obligation to include this information if their balance sheet and other financial indicators already illustrated their position and performance with sufficient clarity. As a result, corporate reporting on environmental, social and governance (ESG) factors in Italy has previously been very limited.

Following Italy’s implementation of the EU Non-Financial Reporting Directive in January 2017,³ there is now a more prescriptive requirement for public interest entities (PIEs) to provide a ‘dichiarazione di carattere non finanziario’ (non-financial statement), either within the management report or as a separate report, on a much wider range of ESG factors. Notably, PIEs are required to report on their impact in addition to their situation, operating trends and performance.

This section gives an overview of the requirements of the management report, and how these have been supplemented by the new requirement to produce a non-financial statement. The key changes are summarised below, with more detail being provided in the sections that follow. The section closes by considering the obligations of directors to ensure that reporting on ESG factors is correct.

Comparison table

Factor	Management Report (2008 onwards)	Non-Financial Statement (2017 onwards)
Scope	All limited liability companies (except those entitled to small companies exemption)	Public interest entities ⁴ with 500+ employees that have have: (a) a balance sheet total of €20m+; and/or (b) a net turnover of €40m+, at the end of the relevant financial year. Therefore, small and medium sized companies (and some large companies) are excluded from scope.
Format	Part of annual report.	The legislation provides two options: (a) included in management report as a specific section labelled ‘Non-Financial Statement’; or (b) issued as separate report provided it is labelled ‘Non-Financial Statement’, referred to in the management report and published with it in the relevant company’s register.
Frequency	Each financial year.	Each financial year.
ESG Factors to report on	Information pertaining to non-financial indicators relevant to the specific company’s business, including: <ul style="list-style-type: none"> • environmental matters, • employee matters in each case, where appropriate and necessary for an	Information pertaining to: <ul style="list-style-type: none"> • environmental matters; • social and employee matters; • respect for human rights; and • anti-corruption and anti-bribery matters in each case, to the extent necessary for an understanding of the company’s development,

<p>General information to provide in relation to each factor</p>	<p>understanding of the company's position and performance.</p> <p>No information specified or required by the legislation.</p>	<p>performance and position and the impact of its activity.</p> <p>In relation to the ESG factors above, a description of:</p> <ul style="list-style-type: none"> the company's business model, including the compliance model adopted pursuant to legislative Decree 231/2001;⁵ the company's policies, including any internal due diligence processes implemented, the results achieved by the policies, and the related key performance indicators (KPIs); the principal risks, whether created or suffered, deriving from the company's activities, products, services or business relationships, including, where relevant, supply chains and subcontractors.
<p>Specific information to provide in relation to each ESG factor above</p>	<p>No information specified or required by the legislation.</p>	<p>In relation to the relevant ESG factors above, information must be provided on, at least:</p> <ul style="list-style-type: none"> the use of energy resources (distinguishing between renewable and non-renewable energy) and water use; greenhouse gas emissions and air pollution; the impact of the principal risks linked to the company's operations on the environment and on health and safety, measured where possible on realistic medium-term prospects; social and employee-related matters, together with the actions taken to ensure gender equality, implementation of relevant conventions of supranational and international organisations, and dialogue with social partners; respect for human rights, measures implemented to prevent violations of human rights and actions taken to prevent forms of discrimination; measures taken to fight corruption (both active and passive) and bribery.
<p>Basis of reporting</p>	<p>No requirement to justify lack of information in relation to non-financial factors.</p>	<p>In relation to policies only, 'comply or explain' (i.e. state compliance with the reporting requirement or explain why the company has not complied).</p>
<p>Implications of non-compliance</p>	<p>No additional implications for failure to report on ESG factors other than general.</p>	<p>Non-compliance is an offence punishable by a fine against each of the directors, auditors and/or individuals responsible for verification/control.</p>
<p>Approval</p>	<p>Issued and approved by the board of directors.</p>	<p>Issued and approved by the board of directors.</p>
<p>Verification</p>	<p>Auditors must examine whether the information in the management report is consistent with the information in the balance sheet and include their opinion in the audit report.</p>	<p>Must be verified by the auditor in charge of the statutory audit of the financial statement or by an authorised auditor specifically appointed.</p> <p>The auditor must issue a specific separate report verifying that the non-financial statement has been provided in compliance with the relevant requirements. This report must be attached to the non-financial statement and published jointly with it.</p>
<p>Control</p>	<p>No further control mechanism required.</p>	<p>The board of statutory auditors (or a different internal control corporate body) must check compliance of the Non-Financial statement and report on the results to the general shareholders' meeting in its annual report.</p>

B. The requirements of a management report (“*relazione sulla gestione*”)

1. What is a management report?

A management report is a document issued annually alongside a company’s balance sheet and intended to provide an ‘accurate, balanced and comprehensive analysis of a company’s situation, operating trends and performance, both as a whole and in the various specific sectors of activity’.⁶ In particular, the analysis should focus on a company’s expenditures, revenues and investments, as well as the main risks to the company’s business.

All limited liability companies must produce a management report, with the exception of companies which do not issue securities traded on regulated markets and, in their first year of operation or for two consecutive years, do not exceed two of the following limits: (a) €4,400,000 active balance sheet; (b) €8,800,000 net turnover, and (c) 50 employees. Such companies (i.e. ‘small companies’⁷) as well as ‘micro-companies’⁸, are exempted from the requirement to produce a management report, provided that they include information on (i) number and nominal value of shares owned by the company and (ii) number and nominal value of shares acquired or disposed of by the company in the notes of their balance sheet.⁹

2. What factors does the management report have to cover?

Alongside the factors mentioned above, companies should report on non-financial performance indicators relevant to their specific activities, including information on environmental and employee matters. It can be inferred from the legislative text, however, that companies must provide this information only where neither their balance sheet, nor other financial indicators are capable of illustrating their position and performance with sufficient clarity (although this concept is not defined or explained).¹⁰

Moreover, the legislation does not provide guidance as to which non-financial performance indicators should be included or the methodology that should be used to explain them. The only (non-binding) guidelines have been independently produced by the National Council of Doctors of Commerce and Auditors (*Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili*, “CNDCEC”). Generally, according to the Council, companies must provide information on any damage to employees and/or the environment for which the company was deemed responsible and sanctioned, while they may choose to report on policies and investments undertaken to improve environmental and employee-related impacts.¹¹

C. Changes following the implementation of the Non-Financial Reporting Directive in Italy

How has the Directive been implemented?

The Directive has been fully transposed in Italy by legislative Decree No. 254 of 30 December 2016, in force since 25 January 2017 (the Decree). As a result, companies falling within the scope with fiscal years starting on or after 1 January 2017 will be required to produce a non-financial statement either as part of the annual management report or in a separate report to which the annual management report refers (and there does not appear to be any express requirement for this separate report to be circulated to shareholders). This report will have to disclose specific ESG information on the company.

2. Which companies must produce a non-financial statement?

The Decree provides that a non-financial statement must be produced by large PIEs, i.e:

- Italian companies admitted to trade on Italian regulated markets or on regulated markets of any other EU Member State;
- banks;
- Italian insurance companies; and
- reinsurance companies having registered office or a secondary office in Italy

provided they (1) have had an average of more than 500 employees and (2) have exceeded a balance sheet total of €20 million and/or a net turnover of €40 million over the relevant financial year.¹² It is estimated that around 250 companies in Italy meet this threshold.¹³

PIEs that are parent companies of a group that meets (on a consolidated basis) the same criteria set for large PIEs (i.e. a large public-interest group) must prepare on an annual basis a consolidated non-financial statement containing information necessary for an understanding of the group's development, performance, position and the impact of its activity. The information would be the same as required for the non-consolidated statement.

In addition, any company that is not within scope may nonetheless prepare and publish a non-financial statement on a voluntary basis.¹⁴ In such cases, the statement should be prepared on a proportional basis, taking into account the size of the company, the accounting results and any cross-border activity, in order to accurately describe its operating trends, performance and impact.

Furthermore, voluntary statements provided by small companies are not subject, unlike the mandatory statement, to verification (see section C8 below) in order to be considered compliant with the Decree, provided that (1) such statement clearly indicates that the statement has not been verified; and (2) at the end of the relevant financial year, the relevant company fulfills at least two of the three requirements: (a) less than 250 employees; (b) less than €20 million total balance sheet; and (c) less than €40 million net turnover.

3. Exemptions

Based on the text of the Decree, those companies whose securities are listed on listing venues which do not fall within the definition of regulated markets pursuant to the relevant EU rules (i.e. multilateral trading platforms such as AIM, EuroMTF, etc.) do not fall within scope and are therefore not required to produce a non-financial statement.

Moreover, in order to avoid duplication, the following exemptions apply:

- a large PIE is not required to issue the non-financial statement if it is included in the consolidated non-financial statement issued by: (a) an Italian parent company required to prepare the statement in accordance with Italian law; or (b) a parent company regulated by the law of an EU Member State required to prepare the consolidated statement according to Directive 2013/34/EU as amended by the Directive;
- similarly, a large PIE which is the parent company of a large public-interest group is exempt from its obligation to issue the consolidated non-financial statement if it is also a subsidiary already included in the consolidated non-financial statement issued by (a) or (b) above.¹⁵

4. What factors does a non-financial statement have to cover?

The non-financial statement must contain information relating to environmental matters, social and employee matters, respect for human rights, as well as anti-corruption and bribery matters. In relation to these ESG factors, the statement must contain, as a minimum, a description of:

- the company's business model, including the compliance model¹⁶ with reference to the ESG factors that are being reported on;
- the company's policies, including any internal due diligence process implemented, the results achieved by the policies, and the related KPIs;
- the principal risks deriving from the company's activities, products, services or business relationships, including, where relevant, supply chains and subcontractors.¹⁷

In general, companies are free to choose their preferred reporting standards among those relevant to their businesses, identify the KPIs that best describe their activities and impacts in relation to the ESG factors, and adopt the calculation methodologies that they consider most appropriate. However, regardless of the standards adopted, companies must at least provide information on:

- the use of energy resources (distinguishing between renewable and non-renewable energy) and water use;
- greenhouse gas emissions and air pollution;
- the impact of the principal risks linked to the company's operations on the environment and on health and safety, measured where possible on realistic medium-term prospects;
- social and employee-related matters, together with the actions taken to ensure gender equality, implementation of relevant conventions of supranational and international organisations, and dialogue with social partners;
- respect for human rights, measures implemented to prevent violations and actions taken to prevent discrimination;
- instruments in place to fight corruption (both active and passive) and bribery.¹⁸

The information must be compared to that given in the previous financial years (although for the first year of application (2017) the comparison may be given in general terms only). Moreover, if a company wishes to adopt its own standards and KPIs (rather than those generally used in its industry) - or different ones compared to the previous financial years - the company must describe them and clearly explain the reason for their adoption in the non-financial statement.¹⁹

It is evident from the above that the Italian legislator has used the discretion left to EU Member States by the Directive and implemented more stringent requirements.

5. How is materiality determined for the purposes of deciding which information to include in the non-financial statement?

Information on ESG factors must be provided to the 'extent necessary for an understanding of the company's activities, operational trends, performance and impact'.²⁰

Although the reference to a company's 'impact' is an important addition to the previous requirements under the management report, no official guidance has yet been provided by the Italian authorities on what information is deemed to be 'necessary'.

In its guidance on ESG reporting under the management report,²¹ the CNDCEC provides that companies, in order to ascertain which environmental and employee information needs to be included, should refer to the principles of 'relevance' and 'materiality' as defined by the International Accounting Standard Board Framework (IASB Framework). Pursuant to the IASB Framework, information is 'relevant' when it "influences the economic decisions of the readers by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations". It is 'material' if "its omission or misrepresentation could influence the economic decisions of readers relying on the financial statements".

Notably, recent guidance produced by the London Stock Exchange Group and Borsa Italiana Spa²² provides that when reporting on ESG factors, companies should also focus on, amongst other priorities, 'investor materiality'. More specifically, they should explain how ESG issues may impact their business and therefore, business strategy and performance while taking into consideration the information required by investors in its field.

However, the European Commission guidelines for implementation of the Directive observe that, in addition to this standard of materiality, the Directive introduces a particular materiality test in respect of the 'principal risks' that are to be disclosed, and this test depends on the scale and severity of such risks. According to the principle of indirect effect of EU law, Italian implementing legislation must be interpreted in line with the relevant EU Directive as long as such interpretation does not explicitly contravene domestic law. Therefore, it would be prudent to assume that, under the Italian non-financial reporting legislation, companies should disclose principal risks that have a severe impact, or an impact of a particular scale, rather than applying the standard test of materiality which is based on whether the risk would influence the economic decisions of readers.

6. How does reporting under the non-financial statement interact with reporting under the management report?

Prior to this requirement entering into force, companies could effectively choose to disclose information on environmental and employee issues, and policies in the management report on a case-by-case basis. There was also no requirement to justify the lack of this information. With the new legislation, companies are now obliged to provide not only information on environmental and employee-related matters, but also on social matters, respect for human rights, as well as anti-corruption and anti-bribery matters.

According to a recent study,²³ which evaluated the 2015 annual reports of 134 major Italian listed companies, only 40% of the companies already reported to some extent on this ESG information (e.g. through the use of voluntary 'social', 'sustainability' or 'CSR' reports) and may be prepared to comply with the mandatory non-financial statement requirement. These companies will however have to ensure that the information is disclosed in the required format and according to the criteria now prescribed by the legislation. The other 60% will need to quickly align themselves, especially given that any failure to provide the relevant information will need to be explained (see further below).

7. How does reporting under the non-financial statement interact with financial reporting?

Where appropriate, the non-financial statement must make reference to data and amounts found in the balance sheet.²⁴ We can expect that such references could include, for example, explanations of employee costs (in relation to employee matters).

Also, as explained in more detail below, the Decree requires auditors to state in their report whether the information in the non-financial statement is consistent with the company's accounts for the same period and so the non-financial statement should be tightly linked to the company's financial and other forms of reporting.

8. What is the basis of reporting and monitoring compliance?

Under the non-financial statement, where policies are not pursued in relation to one or more ESG matters, companies must provide a clear and detailed explanation of why this is the case (the 'comply or explain' principle). This is a major difference with regard to the management report, where there was no requirement to note the omission of ESG information.

However, the 'comply or explain' approach does not apply where a company has not reported on its business model or on the principal risks it faces. In this case, the requirement will simply be for the company to 'comply' with the requirements of the legislation.

The company's directors may, however, after consulting with the board of statutory auditors (or an internal control body), may authorise the omission in the non-financial statement of specific information concerning imminent developments or transactions in the course of negotiation. However, this type of information may only be omitted if the disclosure of such information could jeopardize the commercial position of the company and provided its omission does not prevent a fair and balanced understanding of the company's situation, operational trends, performance and impact in relation to the relevant ESG factors. If the company makes use of this 'safe harbour', it must disclose in the non-financial statement that it has done so.²⁵ In contrast to the 'comply or explain' approach that must be adopted outside of this 'safe harbour', the reason for a 'safe harbour' omission does not require explanation.

9. Diversity policy

In addition to the non-financial statement requirement, the Decree implements the Directive's requirements in relation to diversity.²⁶

Thus, large PIEs which are Italian companies listed on regulated markets are now required to include in their annual corporate governance report²⁷ a description of the diversity policy applied in relation to the composition of the management and control bodies with regard to aspects such as age, gender, educational and professional background, the objectives of the diversity policy and its results in the reporting period. If no such policy is applied, the company must provide a clear and detailed explanation as to why this is the case.

The information on the diversity policy may be omitted by companies which, at the end of the relevant financial year, do not exceed at least two of the following thresholds: (a) €20 million balance sheet total; (b) €40 million net turnover; or (c) an average of 250 employees during the relevant year. Therefore, at least some medium sized companies (those towards the smaller end of the spectrum) appear to be exempt from this reporting requirement. In contrast to the position under the non-financial statement (where only those large companies with more than 500 employees are required to comply), all large companies are required to report on diversity.

D. Responsibility for accurate non-financial reporting

1. Obligations of directors

The company's directors are responsible for ensuring that the non-financial statement is prepared and published in accordance with the Decree and must act with due diligence and professionalism.²⁸

Any director who (1) omits to file the non-financial statement with the company's registry; (2) omits to attach the report issued by the auditors to the non-financial statement; or (3) files a non-financial statement that is not in compliance with the Decree; can incur administrative monetary penalties ranging from €20,000 to €100,000 imposed by the Italian Securities Commission (*Commissione Nazionale per le Società e la Borsa* - CONSOB).

Moreover, if the director omits material information and/or includes false material information in the non-financial statement, the applicable penalties range from €50,000 to €150,000.²⁹

Thus, directors should be mindful that within the non-financial statement, it is compulsory for a company to report on each of the ESG factors specified by the Decree and non-compliance would result in serious consequences.

2. Obligations of the internal control corporate body and auditors³⁰

The company's board of statutory auditors (or the different internal control corporate body) is responsible for overseeing compliance with the Decree and reporting on its control activities to the general shareholders' meeting in its annual report. The same sanctions applicable to the directors are applicable to the statutory auditors/internal control body should they: (a) omit to report on the non-conformity of the non-financial statement at the shareholders' meeting or (b) the non-financial statement filed with the registry omits material information and/or includes false material information.

Finally, the independent auditors appointed to audit the financial statement of the company are required to (1) verify the effective preparation of the non-financial statement by the directors and (2) issue a dedicated report (separate from the one on the financial statements and published together with the non-financial statement) on the conformity of the ESG information provided with the provisions of the Decree as well as the methodology and key indicators adopted by the company. Should they fail to do this, they are liable for penalties ranging from €20,000 to €50,000 and from €20,000 to €100,000 respectively.


Notably, these provisions go much further than the requirements of the Directive, whereby auditors are only entrusted with the responsibility of checking that the non-financial information has been provided.

References

1. Article 2428 of the Italian Civil Code.
2. Legislative Decree No.32/2007.
3. Legislative Decree No. 254/2016.
4. Pursuant to art. 16(1) legislative Decree No. 39/2010 this includes listed companies, banks, insurance and reinsurance companies.
5. This refers to measures effectively adopted by the directors to prevent regulatory offences, i.e. fraud, corruption, etc.(Art. 6(a), Legislative Decree 231/2001).
6. Art. 2428 of the Italian Civil Code, as amended by legislative Decree 32/2007.
7. Ministerial Decree of 18 April 2005, adopting the EU definition of 'micro', 'small' and 'medium' company.
8. Those which, in their first year of operation or for two consecutive years, do not exceed: (a) €2,000,000 active balance sheet or turnover; and (b) 10 employees.
9. Art. 2435-bis of the Italian Civil Code.
10. 'La Relazione sulla Gestione – Art 2428 Codice Civile', Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili, accessible at: [http://www.gr.camcom.gov.it/selfp/fckeditor/upload/Relazione%20gestione%20bilanci\(1\).pdf](http://www.gr.camcom.gov.it/selfp/fckeditor/upload/Relazione%20gestione%20bilanci(1).pdf)
11. Ibid, page 31.
12. Article 2 of the Decree, read in conjunction with Article 16(1) legislative Decree 39/2010,
13. PierMario Barzaghi, KPMG, as quoted by Laura La Posta in "Responsabilità d'impresa in bilancio", Il Sole 24ore, 16 May 2016.
14. Article 7 of the Decree.
15. Article 6, legislative Decree 254/2016.
16. This refers to measures effectively adopted by the directors to prevent regulatory offences (Art. 6(a), Legislative Decree 231/2001).
17. Article 3(1), *ibid*. The law does not provide an explicit interpretation of what 'where relevant' means. However, it is safe to assume that the principles of materiality and severity of impacts can provide guidance also in this context (see below s. C5).
18. Article 3(2), *ibid*.
19. Article 3(3),(4) and (5), *ibid*.
20. Article 3(1), *ibid*.
21. 'La relazione sulla gestione dei bilanci d' esercizio alla luce delle novità introdotte dal D.lgs 32/2007 - Informativa sull'ambiente e sul personale', CNDCEC, accessible at <http://www.gr.camcom.gov.it/selfp/fckeditor/upload/Informativa%20ambiente%20e%20personale.pdf>

22. 'Revealing the full picture - your guide to ESG reporting', London Stock Exchange Group, accessible at https://www.lseg.com/sites/default/files/content/images/Green_Finance/ESG_Guidance_Report_LSEG.pdf
23. Andrea Venturelli, 'L'impatto della direttiva "Non financial and diversity information" sui bilanci delle società quotate', accessible at: http://www.osservatoriosocialis.it/wp-content/uploads/2017/03/ppt_Venturelli-REV.pdf?x41909
24. Article 3(3) of the Decree.
25. Art. 3(8), legislative Decree 254/2016.
26. Legislative Decree 58/1998 as amended by Article 10 of the Decree.
27. Published according to article 123-bis of Legislative Decree 58/1998, the Italian Securities Act)
28. Art.3(7), *ibid.*
29. Article 8, *ibid.*
30. Arts. 3(10) and 8 *ibid.*

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