

Reflections on the Implementation Process of the EU directive on non-financial reporting

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Abstract

Purpose

The EU directive 2014/95 concerns rules for reporting of non-financial information for all large listed EU and EEA companies. This study compares the implementation in the directive and studies some issues and that not have been researched before about issues that are of importance for the future work in the EU on sustainability reporting guidelines.

Methodology

The study has been prepared thorough research of documents available online, discussions with experts in Sweden and a field visit to Austria, Slovakia and Hungary.

Findings

While the directive was general in its wording, some member states have tried to be more exact in its implementation, often pushed by stakeholders' comments in the consultation process. This shows the importance of a consultation process.

Originality/value

It is of importance in EU legislation regarding an evolving substance on one hand to clearly mark a bar which all member states must fulfil while on the other hand allow advanced member states to make their own additions. It is likely that the EU in its next step will increase harmonization based on best practices. This study explains how legislation could serve the pupose both of harmonization and advancement.

Keywords

CSR, Corporate Social Responsibility, reporting, sustainability reporting, reporting of non-financial information, Directive, 2014/95 EU

1. Background

Reporting on CSR issues such as sustainability, business ethics, anti-corruption and related issues is an important method for companies to communicate with stakeholders. The growing numbers and wide variety of CSR reports however to make comparisons between companies more difficult.

The EU Directive on reporting on non-financial information 2014/95/EU (EU NFI) was adopted by the EU Parliament and the EU Council of Ministers on October 22, 2014, and came into force on December 6, 2014. The directive contains changes to the recently adopted Accounting Directive 2013/34/EU.

According to EU rules a directive must be transposed into national legislation not more than 2 years after the date of entry into force, i.e. not later than 6 December 2016. Some member states (MS) could not meet this deadline.

According to article 2 of the directive the Commission should publish non-binding guidelines for the methodology of reporting on 6 December 2016. This was published in July 2017 as a Communication from the Commission 2017 C 215/01. In this 28-page document the Commission mentions the importance of the establishment on 28 October 2016 of a High-Level Expert Group on Sustainable Finance with which the Commission will consult on the implementation. The document lists 21 important guidelines and standards that companies can use. The document underlines that not only such international and EU-based guidelines can be used but also national ones. For each of the themes examples and KPIs are given. Although some points in the directive that seem unclear are explained here, such as materiality (*information 'to the extent necessary for an understanding of the [...] impact of (the company's) activity'*) and the comply or explain rule, the Communication underlines that only the text of the directive is binding and that interpretations can only be made by the European Court of Justice. The Communication also deals with the issue of greenwashing in the following statement under chapter 3.2 "The non-financial statement should give fair consideration to favorable and unfavorable aspects, and information should be assessed and presented in an unbiased way."

The fact that the Commission postponed the publication has as a result that all MS except Belgium and Spain finalized the transposition before the publication of the Communication.

2. Current research

The EU directive and its consequences have already attracted some attention. For example, the negotiations within the EU about the text of the directive have been studied by Kinderman (2017), who points to the importance of the strong support from some member states like France for the conclusion of the negotiations contrary to the opposition from some member states such as Germany. His main sources are interviews with the presidency of the Council at the time, Greece.

The implementation of the directive has also been studied. However, research papers dealing with implementations tend to focus on individual countries, such as Denmark (Buhmann 2013, Marx et al. 2017), Italy (Venturelli et al. 2017) and Poland (Matuszak and Rozanska 2017). Few reports are of more comparative kind.

Gregor (2017) compared the implementation of the EU directive in Germany, France, Italy and the UK. A finding of the study was that each country, especially France, UK and Italy, had developed some aspects of the directive more in detail.

A larger overview of all the EEA countries transposition was issued by CSR Europe together with GRI and Accountability Europe (2017), indicating that the reporting process will support business as it increases stakeholder trust, generates continuous improvement in business impact, highlights the business integrity and provides substantial learning from the reporting process. The study is based on

data available up to 13 September 2017, which means transposition in all 26+2 countries except Spain.

Despite these efforts, however, the few comparative analyses lack information about the implementation process across the 26+2 countries, to what extent it is harmonized and what the profile is of the major additions to the EU directive. Understanding this is of importance since the whole EU project in this area is unique. Not only is there traditionally a skepticism of harmonizing rules for companies as it could favor companies in some countries, but also the issue of non-financial reporting is in some countries seen as the responsibility of companies and not of governments. The aim of my paper is to evaluate advantages and disadvantages of an EU framework based on the results of the implementation.

3. Research questions

In reviewing the implementation, the following issues have been studied:

1. Have some MS gone beyond the EU minimum?
2. Have MS conducted consultations with stakeholders and have this influenced the outcome?
3. How will the EU NFI directive change the number of reporting companies in the MS?
4. Has the EU NFI directive led to a harmonization of reporting procedures among MS?

4. Methodology and terminology

In order to find information about the implementation the most useful tool is to look at publicly available material on the web sites of parliaments, governments and CSR organisations. In this study, we only look at the final documents that emerge from legislation procedures, being aware of that governments in earlier stages have proposed various ideas. Apart from web research and email communications, face-to-face interviews have been done with government officials and NGOs in Austria (respACT and Ministry of Justice), Hungary (Követ and Ministry for National Economy), Slovakia (Pontis Foundation) and Sweden (Ministry of Justice, KPMG) and the organizations CSR Europe and GRI. It is too early to discuss the results of the legislation in qualitative terms as most of the reports will only be available in 2018.

EU NFI directive applies to all 28 MS + the two EEA countries Norway and Iceland, that is 30 countries.

Terminology used

Large companies in EU definition (Directive 2013/34/EU) fulfil at least two of the following three criteria

- More than 250 employees;
- Total balance of at least 20 million €;
- Net turnover of at least 40 million €.

The EU NFI directive mentions in § 14 “those large undertakings having an average number of employees in excess of 500”. Countries that have implemented this definition of large companies from the directive 2013/34/EU do thus not need to repeat these conditions in their legislation.

Public Interest Entities (PIE) are in EU definition (Directive 2014/56/EU) companies that are either listed on the stock exchange, banks, insurance companies or otherwise decided by the government as PIE. The last-mentioned definition can vary between MS. In Slovenia, Sweden and UK only listed companies count as PIE. According to a Federation of European Accountants (FEE) report *Definition of Public Interest Entities (PIEs) in Europe* in November 2017, the following countries had more than 1,000 PIEs apart from the listed companies – Poland (1350), Spain (1319), France (1313), Portugal (1204) and Ireland (1146). Some of these countries have excluded other companies than listed companies, banks and insurance companies from its scope. Some have named certain financial institutions such as pension funds. Spain and Portugal have set a limit of higher balance sheet/turnover to exclude smaller PIEs from its scope. In its survey from 2017 Accountancy Europe finds that there has been a harmonization among MS since the Audit reform in 2014.ⁱ

5. Main points of the directive

The directive consists of an introduction with 23 explanatory statements followed by 4 articles of which the first article contains all amendments to Directive 2013/34/EU.

The key provision of the Directive is in Article 1 (Article 19a of the Accounting Directive), which requires that large undertakings are to *“include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking’s development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters”*.

The second most important clause is the scope. The EU NFI directive requires large public-interest companies (PIEs) with more than 500 employees to provide a non-financial statement (§ 14). Member states have however different definitions of large companies as this is depending on if the definition in the new accounting directive 2013/34/EU (see preceding paragraph 4) has been implemented or not. According to the overview by CSR Europe 19 of the 26+2 countries use the definition “more than 500 employees and either a balance sheet over 20 million € or a turnover of more than 40 million”. Some countries have a scope of “all PIEs with more than 500 employees”. The definition of PIEs is also not uniform across the EU as mentioned in the preceding paragraph 4.

The report should contain relevant and material environmental and social information, employee matters, respect for human rights, and anti-corruption and bribery matters (§ 7). EU NFI directive employs the “report or explain” policy which gives companies the possibility to avoid reporting on certain issues provided that they present an explanation. While the directive is vague on the use of the “comply or explain” rule, the Guidelines of 2017 are more explicit as the limit the “comply or explain” rule to risks and not to policies.

The EU NFI directive does not give detailed rules for how a NFI Report should be undertaken. It only lists a number of guidelines that can be used or reporting such as EMAS, UN Global Compact, OECD Guidelines for MNEs, UN Guiding Principles (on Business and Human Rights) Reporting Framework, ISO 26 000, ILO Tripartite Declaration of principles concerning MNEs and the Global Reporting Initiative (§ 9). Certain organisations protested that they were not listed among the 7 abovementioned frameworks and in the Guidelines from 2017 there is a list of 21 reporting standards and frameworks.

The EU NFI directive gives companies that are members of groups a possibility to refer to the NFI Report by the mother company (§ 15). This clause has led to some discussions how to handle mother companies/subsidiaries outside the EU/EEA area, and also whether non-listed mother companies, such as municipally owned holding companies should be included.ⁱⁱ

The EU NFI directive leaves to MS to decide on whether external verification should be required (§ 16). This has been used to a limited extent, in France, Italy and UK. The CSR Europe survey also mentions that Bulgaria, Cyprus, Denmark, Iceland, Latvia and Romania have some form of audit requirement.

The EU NFI directive gives governments the option to allow companies not to disclose information related to impending developments or matters under negotiation (Safe harbour clause) through the new article 29a 1 in the Accounting directive. According to the survey by CSR Europe all countries except 6 have use inserted safe harbour clauses.

The Directive is explicit about what the NFI Report should include a short description of the company's business model, a description of the company's policies including "implemented due diligence processes"; the "outcome of those policies ", the principle risks related to ESG matters and their management, which are linked to the activity of the company, including its "business relationships, products or services" and a presentation of the most important "non-financial key performance indicators "(KPIs).

One section of the directive (§§ 18, 19) concerns measures to report on policy of diversity. As this in some countries already covered by legislation, it is complicated to analyse the impact of this part of the directive and it is therefore not discussed in this study. One paragraph (§ 20) deals with country-by-country reporting of taxes companies pay. This issue has been discussed in G20 and OECD and has been handled in other EU directives.

6. EU position

The proposal by the Commission for reporting of non-financial information was launched on 16 April 2013 by the Commissioner for the Internal Market and Services, Mr Michel Barnier. On the same date one year later, on 16 April 2014, the EU Parliament made its decision, but MS through the Council of Ministers did not do so until the summer of 2014. As the Council of Ministers arrived at a different view from the Parliament, negotiations between the Parliament and the Council ensued.

The main difference between the Commission proposal and the final result is that the Council narrowed down the scope from all large companies with more than 500 employees to companies of public interest (PIE) with more than 500 employees. Thereby the scope of companies in EU was reduced from 16,000 to 6,000 companies according to the Commission's estimates. This line was established at a EU *Coreper II* meeting end February 2014 and was maintained throughout the negotiations with the Parliament.

Since two EU MS, Denmark and Sweden, increased the scope to all companies with more than 250 employees, the scope in EU can be calculated to be 8,000. The Swedish government bill calculates that the number of Swedish companies covered according to the EU minimum rules would be around 100, while the number with the proposed threshold of 250 employees would be 1,600. As the Swedish bill uses the above-mentioned criteria for large company (fulfilling more than one of the three criteria) it is reasonable to calculate up to 2,000 affected companies (such with few employees but big turnover and assets such as energy companies and real estate companies. In Denmark, it is assumed that 1,100 companies will be subject to mandatory reporting.

According to Article 3 of the EU NFI Directive, the Commission shall no later than 8 December 2018 submit a report to the EU Parliament and to the Council on the implementation of the directive. EU NFI is now handled by the Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union, DG FISMA, Unit B.3.

7. Consultations

EU MS are following their normal practice in arranging consultations before transposing a directive. Some countries publish both their questionnaire/proposal and the replies on internet, others only publish summaries. Some countries publish a summary of replies received from stakeholders and comments to them. Even if this as a very transparent method, a government can bypass some of the critical views either by simply ignoring them or by relying on views from other stakeholders.

Some countries (Austria, UK, Germany) present a consultation document with several questions to answer, other countries (Sweden) publish a document with facts and opinions and leave it up to consulting participants to decide what to focus on. We have looked in detail at the consultation process in Austria, Germany, Sweden and UK.

Austria. The EU NFI directive is in Austrian terminology NaDiVeG (Nachhaltigkeits- und Diversitätsverbesserungsgesetz). The consultation period was June-August 2015. The consultation document issued by the Ministry of Justice of 7 pages summarized the directive and contained 17 questions. The answers are published online. Also, other ministries than the Ministry of Justice could send written replies to the consultation document.

Germany. The consultation period was March-May 2015. 55 companies and organisations have sent comments. These are all published on the government web site.

Sweden. The consultation period was end December 2015-end March 2015. The report (Ds 2014:45) is a 108-page document that includes proposed changes of wordings of six laws. 41 replies were received. In Sweden consultations are not done with individual companies, only their organizations. The replies are available but not published on the web.

UK. The consultation period was February–15 April 2016. The Department of Business, Innovation and Skills (BIS, now BEIS) had compiled a list of 100 companies and organisations that were invited to send in replies. BIS send out a 47-page document with key points and 15 questions to be answered. 76 replies were received.

In UK and Sweden, the different ministries do not send comments to the enquiry, their views are integrated in the consultation proposal.

Some countries (Austria, Italy) did consultations in two rounds in which the second was a consultation based on a detailed proposal from the government.

Several new MS did not arrange consultations at all and only arranged for a necessary decision by parliament or by government on delegation from parliament. This is a quick process and these countries were some of the fastest in the implementation process. A disadvantage with being early is that you can not include experiences from other member states in your decision making.

8. Implementation

According to EUR-Lex website the following national implementation measures were reported by 2018-01-15.ⁱⁱⁱ

Country	No of measures	Latest measure
Belgium	1	2017-09-03
Bulgaria	2	2016-06-03
Czech Rep.	21	2016-12-30
Denmark	1	2015-06-01
Germany	1	2017-04-18
Estonia	5	2015-12-31
Ireland	2	2017-08-04
Greece	1	2016-07-07
Spain	1	2017-11-25
France	3	2017-08-11
Croatia	3	n.a.
Italy	1	2017-01-10
Cyprus	1	2017-06-02
Latvia	4	2016-12-29
Lithuania	5	2016-12-23
Luxemburg	1	2016-08-04
Hungary	5	n.a.
Malta	1	2016-12-02
Netherlands	4	2017-03-23
Austria	1	2017-01-17
Poland	2	2017-01-11
Portugal	39	2017-07-28
Romania	5	2017-02-27
Slovenia	2	2017-03-31
Slovakia	5	2015-06-11
Finland	3	2016-12-29
Sweden	18	2016
United Kingdom	4	2016

The difference in the number of measures indicated is usually depending on how many laws that need to be changed. In some countries the only applicable law is the law on accounting or the company law. In other countries there are laws on banks, insurance companies and other entities that also need to be changed.

9. Summary and answers to research questions

Summary

The EU Directive on non-financial reporting has become one of the dominant trends in corporate reporting in Europe. Other trends, that in some ways complement the EU NFI, in some ways compete as a model, are the projects for integrated reporting (mainly advanced by the International Institute of Integrated Reporting, IIRC) and the projects to introduce sustainability reporting requirements at stock exchanges.

EU NFI has successfully been transposed into legislation in all MS. The trend towards diverging rules has thereby been stopped and we will have similar NFI reporting within the EU/EEA area. The number of reporting companies will rise even if the increase is not dramatic. In countries where stock exchanges are the main vehicles for pushing companies to report, such as South Korea, Taiwan, Hong Kong and Singapore, a similar trend can be observed.

EU NFI covers all traditional CSR issues and can therefore be said to favour reporting systems that have ambition to cover all pertinent systems such as the Global Reporting initiative (GRI), and UN Global Compact Report on Progress, while reporting tools for specific areas such as CDP (for carbon emissions), UNGP Reporting Framework must be complemented with other reporting tools.

Legislation vs. voluntary and self-regulating programs have been a topic for discussion in many MS. EU NFI directive in § 23 therefore states that SMEs should not be targeted as it would increase their regulatory burden.

The "comply or explain" rule can be regarded as watering out the ambitions. However, experiences from Denmark, where this rule was first introduced, show according to a study by Copenhagen Business School covering the first 3 years of mandatory reporting that the percentage of companies referring to this excuse is rapidly diminishing.^{iv}

The fact that no MS has mandated external audits can raise doubts about the quality of the reports. The audit firm has in most cases ?? according to the directive only to mention whether or not a NFI report has been published. This has been a subject for discussion in countries where a consultation process has been held. A minority of stakeholders have argued in favour of mandatory external audit. The main argument against mandated external audit is that it should be decided on according to the requirements of the market. Those companies who really need to prove that their report is of high standard would need to pay for it themselves.

The focus in the discussion varies somewhat among MS. Environmental issues and gender issues are often at the forefront in developed economies. In Eastern Europe, according to the interviews conducted, there has been an interest in the issue of anti-corruption as that is perceived as a considerable problem in these societies.

Answers to research questions

1. Have some MS gone beyond the EU minimum?

Sweden, Denmark and EEA members Norway and Iceland have gone considerably further than the EU minimum on scope, choosing to apply the legislation to all companies (instead of PIEs only) with more than 250 employees (instead of >500 employees).

While the directive only mentions listed companies (PIEs) some countries, such as the three above-mentioned and France, have also included non-listed countries. France has thereby gone beyond the EU minimum but has limited its scope compared with *Grenelle II* as a number of unlisted companies were included compared to *Grenelle II*. In France's implementation of the EU directive only unlisted companies with more than 500 employees and turnover/or balance sheet of more than 100 m€ have been included.

No MS has demanded external verification of all reports, but Italy and UK have various requirements of external auditing.^v

Only Italy has introduced sanctions for non-fulfilling of the reporting requirement. Needless to say all companies with integrated reporting might face sanctions if facts in the annual report are not correct.

Some MS have been concerned by the rather long time-period (6 months as maximum) stated in the EU NFI (Article 1.4.b) between the publication of the Annual Report and the NFI report. One argument is that many things can happen in the meantime and the two reports can therefore be difficult to compare. Another argument is that publishing the NFI report later than the annual Report will make the NFI report less read. Germany has shortened it to 4 months. Some MS have in their

legislation added requirement on how the report shall be published by the companies and for how long time the report shall be available on the company web site.

2. *Have MS conducted consultation procedures with stakeholders and have this influenced the outcome?*

Several countries have completed 1-2 consultations rounds with stakeholders such as: Germany, Italy, Austria, Sweden, France, UK. This has clarified certain issues in the national drafts, but the ultimate decision is by the parliaments and the end result is depending on the position of the various political parties. The consultation process has also engaged a large number of stakeholders. In countries where no consultations have been undertaken the level of awareness is lower. As an example, my interviews with the heads of Követ in Hungary and Pontis in Slovakia indicated that these important NGOs were never part of any consultation while RespACT in Austria played an important role in informing the business community about the proposals and balancing different views among companies.

3. *How will the EU NFI change the number of reporting companies in the MS?*

Developed economies that have not exceeded the EU minimum (e.g. Germany, UK) will probably not see any big rise in number of reports as these companies are already producing similar reports. Developed economies that have exceeded EU minimum level will see a large rise (Sweden and Iceland), while Denmark, and Norway already have a large number of reporting companies due to existing legislation. France had a large scope under *Grenelle II* but has chosen to slightly limit the scope when implementing the directive.

As for less developed economies a rise of the number of reporting companies is likely. A simple way to measure the number of reports is to look at the database figures of GRI and UN Global Compact

4. *Has the EU NFI Directive led to a harmonization of reporting procedures among MS?*

The EU NFI directive will probably lead to a harmonization of MS reporting procedures.

Harmonization means both equalizing the content and lowering the ceiling for the most developed countries and raising the floor for the least developed countries. As the greatest difference in application is the scope (broad ambitions by “Viking countries”) rather than content one can argue that the aim of harmonization has been met. Reading details of the implementation in West European countries it can be argued that differences in implementation make comparison between jurisdictions difficult. On the other hand, alternative frameworks such as GRI4 and GRI standards are implemented differently by different companies. The EU could have aimed for a more detailed directive which might be a result of the review in 2018.

10. Further research work

After a couple of years, the content and quality of NFI reports can be studied. Two aspects deserve special attention.

If the EU NFI has led to more reports. If so, the EU directive could have played an important role. If not, the whole procedure with an EU directive seems to be without great value.

If reporting has become less dynamic and innovative i.e. even ambitious companies' reporting is limited to the new legally required minimum only. This is an indication I have received from conversations with audit firms. The lack of excellence could of course be balanced by a higher turnout but reporting need continuous progress to combat reporting fatigue and to make European companies competitive in relation to companies from other parts of the world.

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