EUROPEAN COMMISSION
Directorate General Internal Market and Services
CAPITAL AND COMPANIES
Accounting and financial reporting

Expert Group on Disclosure of Non-Financial information by EU Companies

First Meeting

Brussels, Monday 11 July 2011

Introduction

The Expert Group on disclosure of non-financial information by EU companies held its first meeting on 11 July 2011, chaired by Ms Bury, acting Director for Capital and Companies, DG Internal Market and Services. The list of attendants is provided in attachment 1.

The Chair explained that the Expert Group has been established in the context of the impact assessment currently being done by the Commission on disclosure of non-financial information by companies, with the specific mandate to provide expert advice to the Commission. A Commission proposal is planned for the first half of 2012.

Presentation of External Study

The Commission has commissioned the Centre for Strategy and Evaluation Services (CSES) a specific study aiming at providing some qualitative analysis of current reporting practices in the EU (using a limited sample of non-financial reports), and at providing a cost/benefit analysis of non-financial reporting by companies. CSES presented its work plan and explained the objectives and proposed methodology.

Substantive Discussion

The Chair invited experts to provide input on the basis of a non-paper circulated before the meeting (see attachment 2). The following aspects were discussed:

1. Norms, Principles and Guidelines

The members of the experts group were invited to comment on the following questions:

- *Could a principle-based international reference framework for reporting on CSR at EU level improve comparability and relevance of CSR reporting?*
- *What would be the consequences of the adoption of more detailed reporting requirements (i.e. Key Performance Indicators) at EU level?*

Several experts supported the idea of a principles-based approach, rather than a detailed, rules-based one. According to this view, an EU framework on non-financial reporting should leave appropriate flexibility for companies to decide the topics to report on and the metrics to be used.

A number of existing frameworks were mentioned as possible references, including the UN Global Compact , ISO 26000 or the Global Reporting Initiative (GRI) .

A more flexible approach could include incentives for companies which do not yet report currently on non-financial information. Moreover, some experts considered that using key performance indicators (KPIs) was not appropriate, as they considered that the metrics behind indicators are not sufficiently developed yet, particularly as regards social aspects (as depending on the metrics chosen, a report can express business performance in that topics, or the size of the risk the topic offered to the business, the investment in new business opportunities the company see related to that topic, etc.).

An expert proposed that companies should be given the possibility to comply with a framework or explain their reasons for not doing so. Another expert mentioned that a key challenge is to define and harmonise generally accepted KPIs to encourage the mainstreaming and to make easier comparability.

Materiality was considered a key concern by several experts. One expert added that improving materiality of reports is useful to address comparability (if the target report user is well defined). An expert said that the companies' boards should have ownership on reporting in order to make it relevant and effective. One way of doing this could be through a vote at the annual general meeting (AGM).

Integrated reporting was also mentioned by some experts. They argued that this could avoid report proliferation and at reflect more effectively a company's strategy and business model. Finally, an expert stated that it was important to note that the differences in national reporting cultures should be taken into due account.

Some experts expressed that the consequences of adopting more detailed reports requirements (including specific KPIs) into EU legislation might be that the KPIs chosen express the interest of some report users only. Another possible level of detail could be envisaged by proposing a list of topics to be covered by any company when reporting, letting the companies choose the KPIs.

2. Costs-benefits for companies

The members of the experts group were asked to comment on the following questions:

- *Do you have specific information with a cost/benefit analysis in this field?*
- *Would you be able to evaluate which costs would be significant for companies (i.e. setting up, running, total, etc.)?*
- *Which benefits could companies derive from in the medium or long term, and to what extent are these quantifiable?*
- *Do you have evidence that non-financial reporting helps companies to better integrate social and environmental issues into business operations and strategies?*

Several experts highlighted that any undue administrative burden should be avoided. An expert expressed the view that reporting on non-financial aspects was expensive and an administrative burden in particular for the smallest companies.

An expert said that one should distinguish between publishing costs and preparation and data collection costs. Publishing costs can be reduced if “templates” are offered to organize and publish the information on a website, for example. Set–up costs can be substantial, but they can be considered a worthwhile investment on better management, control and information tools. The costs of maintaining the reporting activities for several years should also be considered. The costs should be smaller after the first year (for a beginner reporting company).

Another expert stated that any benefits from reporting were dependent in the actual content of the information disclosed. Reporting costs may be low if the company is interested in the information for its own purposes (rather than it being an externally driven exercise). An expert suggested that reporting produces significant economic benefits through better risk control, cost management and better overall definition of corporate strategies.

3. Business Accountability

The members of the experts group were asked to comment on the following questions:

- *What role do you think better disclosure of non-financial information could play in building higher level of trust in business and increasing the accountability of companies'?*

- *To ensure appropriate quality of non-financial disclosure by companies would there be added value in having this information assessed by external auditors?*

- *Could independent expert opinions on CSR aspects be a tool for companies to improve management and controls relevant for the long-term sustainability and success?*

Experts addressed issues related to report assurance, and some aspects were highlighted: auditability of the content (retrospective information is "easier to audit" than forward-looking content); capability of the verifier, and the specific value added by verification. T

Some experts indicated that assurance contributes to reliability and consistency. Some experts said that there were several types of checks, and that auditing was only one type of assurance. It takes some time for companies to reach the auditing stage of assurance. One expert said that some companies question the usefulness and added value of assurance services currently offered.

Other experts argued that engagement of stakeholders adds value, and helps the consideration of information that may be otherwise go unreported. An expert said that reports published online are *de facto* exposed to "public verification" and in the new “digital era” the concept of auditing will have to be revisited, as there is a clear demand for information to be offered almost on-line in real time.

4. The Capital Market

The members of the experts group were asked to comment on the following questions:

- *Can you elaborate how you consider that investors could directly benefit from better disclosure of non-financial information?*

- *How important is the role of investors in encouraging companies to disclose non-financial information?*

An expert said there is a significant and increasing demand in the financial markets for non-financial information. Another expert said that there is at least anecdotal evidence that responsible investment considerations are being mainstreamed. The attitudes of asset owners are important in this process. Nevertheless, investment decisions are generally driven by financial considerations. There were also comments about the different types of investors to be considered, such as long or short term oriented investors. Different groups might have different requirements when asking for non-financial information from companies, as investors are not a homogenous group.

An expert explained that governmental authorities rather than stock exchanges' regulators are in the best position to request disclosure of non-financial information. Another expert expressed the view that investors remain the main audience of non-financial reports, but only a minority of investors engages with companies in this respect.

<u>Next Steps</u>

- Experts were invited to submit written comments (2 pages maximum) on the issues discussed by end July.

- Next meetings are proposed in principle on 12 September and on 30 September.

- Members of Cabinets of involved DGs will be invited to attend next meeting.

ANNEX 1

Attendants

Members of the Group of Experts

Ms Nelmara Arbex (replacing Ms Teresa Fogelberg)	Global Reporting Initiative
Mr Antoine Begasse (replacing Ms Nicole Notat)	Vigeo
Mr Alain Dromer	Aviva Investor
Ms Jessica Fries	A4S/International Integrated Reporting Committee
Mr Filip Gregor	European Coalition for Corporate Justice
Mr Luc Hendrickx	UEAPME
Mr Petr Kriz	PwC
Mr Jan Noterdaeme	CSR Europe
Ms Susanne Stormer	Novo Nordisk
Mr Roberto Suarez	BusinessEurope
Mr John Swannick	EABIS

DG MARKT	Claire Bury Johannes Jeoren Hoojier Nicolas Bernier Abad Massimo Zaffiro Aisha Khalid Delphine Langlois
DG ENTR	Pedro Ortun Silvan Tom Dodd Elisabetta Colombo
DG ENV	Imola Bedo
DG EMPL	Susan Bird
Centre for Strategy & Evaluation Services	*Mike Gardiner* *Daniel Beresford*

Absents:

Ms Judith Vitt	Federation of German Consumer Organisations
Ms Veronica Nilsson	ETUC
Ms Chiara Mio	University of Venice

Mr Giuseppe van der Helm	Eurosif
Ms Claudia Kruse	ICGN

ANNEX 2

Background non-paper in view of 11 July kick-off meeting

Point 4 of Agenda: Discussion of key subjects

NORMS, PRINCIPLES AND GUIDELINES

One important issue to consider when exploring how to improve non-financial reporting practices are the norms, principles or guidelines to be applied for this purpose. The current EU framework[1] does not provide a specific reference framework as to expected quality for the non-financial information to be disclosed. Differences between Member States and between economic sectors are considerable. For example, Denmark has adopted the UN Global Compact as a reference. The French law rather develops a national frame of reference. The challenge is to find a balance between different circumstances and needs but which can apply across all sectors.

At the moment, it seems that a certain flexibility may need to be maintained. A considerable number of sustainability reporting guidance documents have appeared in recent years. Internationally developed frameworks exist that establish norms, principles or guidelines for reporting on non-financial issues.[2] The number and the sometimes lack of consistency between the various guidance documents can be confusing. In comparison with reporting on financial information, there currently is no truly globally accepted standard-setter for non-financial information, the GRI probably comes closest to this.

The responses to the public consultation on non-financial disclosure conducted by DG Internal Market and Services of the European Commission did not clearly indicate a preference amongst European stakeholders on these issues. However, several comments were made from contributors favouring the adoption of or reference to existing frameworks rather than developing a new reference framework at European level.

Questions for discussion

- ***Could a principle-based international reference framework for reporting on CSR at EU level improve comparability and relevance of CSR reporting?***

- ***What would be the consequences of the adoption of more detailed reporting requirements (i.e. Key Performance Indicators) at EU level? Please consider what level of detail would be desirable and what could be a possible method in developing indicators.***

---

[1] Fourth Company Law Directive (78/660/EC, art 46(b)) on annual accounts, amended in 2003.

[2] Cf. the Global Reporting Initiative (GRI), UN Global Compact, OECD Guidelines for multinational companies and ISO 26000 Guidelines.

COST-BENEFIT FOR COMPANIES

Better disclosure of non-financial information may be a tool to help European companies fully integrate sustainability into their core strategies and operations in a transparent way. In recent years, there have been calls to improve the comparability, reliability and materiality of information disclosed by enterprises. Better disclosure could help investors to develop better company valuation models, which would provide for more reliable assessment of longer-term performance prospects. Better disclosure of social and environmental information could enhance the accountability of enterprises, and consequently contribute to greater public trust in business.

On the other hand it is argued that disclosure of more non-financial information may unduly increase the administrative burden of companies, adding to the length of annual reports which are already considered by many to be too long. The EU has also committed itself to 'better regulation' aiming at cutting red tape. Possible initiatives to promote better transparency and comparability must avoid unduly increasing the administrative burden on companies.

Replies to the public consultation did not provide clear answers as to the estimated costs and benefits of non-financial reporting except for some rather vague statements indicating the costs and benefits as *significant.*

Questions for discussion

- ***Do you have specific information with a cost/benefit analysis in this field?***
- ***Would you be able to evaluate which costs would be significant for companies (i.e. setting up, running, total, etc.)?***
- ***Which benefits could companies derive from in the medium or long term, and to what extent are these quantifiable?***
- ***Do you have evidence that non-financial reporting helps companies to better integrate social and environmental issues into business operations and strategies?***

BUSINESS ACCOUNTABILITY

The Commission's Communication on the Single Market Act (SMA), adopted on 27 October 2010[3], stresses the importance of strengthening consumer trust and confidence in the EU market, and achieving a highly competitive social market economy with sustainable economic growth. The SMA aims to redefine the role of business in today's economy focusing on improving transparency, particularly in the areas of environment, human rights and sustainable development and on ways to enhance corporate functioning.

There are many parties that have an interest in non-financial information from companies. For example, shareholders are concerned with financial performance and are sensitive to possible threats to management's priorities. Consumers may also want better information on the social and environmental performance of companies and products as they may want their purchases to reflect their own values. Some stakeholders, including some non-governmental organisations working on social and environmental issues, consider that better disclosure of non-financial information could be one means of increasing the accountability of companies.

Questions for discussion

- ***What role do you think better disclosure of non-financial information could play in building higher level of trust in business and increasing the accountability of companies'?***

- ***To ensure appropriate quality of non-financial disclosure by companies would there be added value in having this information assessed by external auditors?***

- ***Could independent expert opinions on CSR aspects be a tool for companies to improve management and controls relevant for the long-term sustainability and success?***

[3] COM(2010) 608 final/2

ADVANTAGE FOR CAPITAL MARKET

Some argue that non-financial reporting should be seen as an instrument to build sustainable economic growth. It is argued that as a consequence of poor disclosure of non-financial information, investors might fail to build relevant non-financial information into their decision-making processes.

Non-financial reports can help investors and other stakeholders to complement the financial information they have at their disposal to make comprehensive investment decisions based on environmental, social and governance considerations. This would help investors to manage risk, to identify opportunities and to value companies more accurately. On a macro level, this may facilitate a more efficient allocation of capital in the market.

Questions for discussion

- ***Can you elaborate how you consider that investors could directly benefit from better disclosure of non-financial information?***

- ***How important is the role of investors in encouraging companies to disclose non-financial information?***