



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

Meeting Report

Brussels, Monday 12 September 2011

1. Introduction

The Expert Group on Disclosure of Non-Financial information by EU Companies has been established with the specific mandate to provide expert advice to the Commission in the context of the Impact Assessment currently being prepared by the Commission services. A legislative proposal on the disclosure of non-financial information by companies is planned for the first half of 2012.

The Group held its second meeting on 12 September 2011, under Chatham house-rules. The meeting was chaired by Mr Jeroen Hooijer, Head of Unit, Financial Reporting and Accounting, DG MARKT. Member of Cabinets and officials from other Directorates General closely involved with this dossier (namely DG ENTR and DG EMPL) were also invited to attend. *The list of attendants is provided in Annex 1.*

2. Summary of the discussion

Experts were asked to provide their inputs on the basis of two non-papers prepared by the Commission services and circulated ahead of the meeting. The non-papers contained questions of general and specific nature and are provided in Annex 2. The following aspects were discussed:

General Approach

Overall, most of the 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, and thus give companies responsibility of identifying Key Performance Indicators (KPIs) most relevant to their particular circumstances. Most experts agreed that a one-size-fits-all approach to KPIs would be counterproductive, although some argued that some core, sector-specific KPIs, could be identified. Several experts added that the clarity of the principles will be a key element to ensure an efficient legislation.

Moreover, a number of participants highlighted that any new obligation should comply with the principle of proportionality and avoid any undue administrative burden on companies, especially given the current economic climate.

Several experts also underlined that a clear definition of the underlying policy objectives is crucial (e.g. whether the requirement should aim at improving the quality of the reports rather than the quantity, impulse a new way of thinking by the company and expand the reporting culture, try to create incentives to enhance CSR performance, add to EU competitiveness through enhanced value creation, etc.)

Finally, some experts highlighted the importance for the Commission to ensure appropriate evaluation and monitoring mechanisms, in order to maximise the impact of any new requirement.

Reporting Principles and Topics

Some existing international frameworks were mentioned as possible references for principles-based legislation, including the UN Global Compact, the OECD Guidelines for Multinational Companies, the UN "Protect, Respect and Remedy" Framework for Business and Human Rights¹, as well as the ISO 26000 and the IASB Management Commentary. Such frameworks were indicated by most experts as complementary rather than mutually exclusive, as they address different group of stakeholders and cover broader areas than mere sustainability reporting. One expert also underlined the important differences that exist between normative and reporting frameworks (such as the Global Reporting Initiative). In this respect, several participants agreed that legislation could include a reference to international normative frameworks. The issue was raised as to how such a reference would be included and in what framework.

Some experts also suggested that legislation may draw upon a core group of **principles** that are common to some of the above mentioned frameworks, referring to the quality as well as the content of the reports.

As regards the quality, one expert suggested that appropriate consideration should be given to the principles of comparability, accuracy, timeliness, reliability, clarity and insurability. Another expert, however, suggested that a too prescriptive approach in this respect might have negative effects, discouraging companies rather than encourage them to undertake a disclosure exercise.

As for the report content, reference was made to principles such as transparency (i.e. by integrating a sustainability strategy into the report), accountability (i.e. by putting the reports to an investor vote, or asking companies to ensure effective stakeholder consultation) responsibility (i.e. by boards taking ownership of the reports) and incentives (i.e. by including ESG considerations when setting remunerations and creating adequate non-monetary incentives). In addition, materiality, stakeholder inclusiveness, sustainability context, and completeness were also suggested as underpinning principles defining the report content.

Furthermore, different views were expressed as to whether legislation should mandate a **set of specific topics** to be covered by non-financial reports. One participant underlined that there is a growing consensus over a minimum list of topics companies should report on. Some experts proposed that legislation should require that companies disclose information on whether they have a CSR policy as part of their overall strategy, how this translates into their operations, how they assess their own performances, and which of

¹ Commonly referred to as "Ruggie Framework"

the existing international frameworks is used as reference. Another expert suggested that companies should also be required to disclose their corporate structure, potential risks or human rights violations in their supply chain and any steps taken by the company to deal with such issues.

However, some other participants argued that any predefined list of topics would not represent an appropriate solution, as it would not leave enough flexibility for companies and could undermine the quality of the reports.

Scope and nature of the requirement

Experts discussed whether a disclosure requirement should take the form of a **general reporting obligation**, or rather be translated into a "**comply or explain**" approach. Several experts argued that the latter could ensure an adequate level of flexibility, while at the same time representing a significant incentive for all companies to disclose relevant information. However, some other experts also highlighted that a "comply or explain" approach would only be meaningful if, should a company decide not to comply, the reasons for doing so are thoroughly explained (i.e. a mere statement of absence of a CSR policy would not be enough) and that is also made clear the kind of obligations they need to "comply" with. One expert invited the Commission to assess the legal implications of the different approaches.

Moreover, several experts mentioned that any new reporting requirement should only apply to large companies. It was highlighted that many SMEs do disclose non-financial information in a number of ways other than formal reporting, and that a potential reporting obligation for SMEs would represent an administrative burden. At the same time, the growing tendency among SMEs to produce CSR reports was also mentioned. The need to be careful not to create unnecessary administrative burdens for industry in general was raised throughout the discussion by several participants, and the challenge would be to create a *win-win-win* situation. The costs of publishing a formal CSR report for a small company were estimated by one participant between 15/25.000 € a year, including certification. One expert also called on the Commission to consider the knock-on effects on SMEs, even if an obligation is imposed only on large companies. As far as the benefits are concerned, the Commission asked participants to provide more (quantitative) material.

Business Accountability

Experts discussed whether an obligation to disclose non-financial information could help building trust in business and the market, as well as increase the level of companies' accountability towards society as a whole. It was highlighted that involving stakeholders in the disclosure process was complex. Nevertheless, several experts argued that engagement of stakeholders is a key element to add value to reporting, and helps the consideration of information that may otherwise go unreported. In this respect, some experts discussed the opportunity for legislation to include formal assurance and verification systems, indicating that this could significantly contribute to reliability and consistency. However, a number of issues were also raised with regard to the auditability of the content, the capability of the verifier, and the significant costs that an obligation of this kind could impose on companies. Some experts expressed the view that different forms of verification should also be considered.

Company Performance

Experts discussed to what extent mandatory disclosure could lead companies to better integrate social and environmental aspects into their business operations and strategies, and arrive at positive impacts on their long-term financial performance. According to several experts, academic and anecdotal evidence indicates a clear positive correlation between value creation and reporting practices, as integration of non-financial issues is indeed relevant to firm level performance and support better long term risk management and value creation. The overall increased long-term competitiveness, easier access to capital and reduction of reputational risks were also mentioned amongst the potential positive impacts of increased and better non-financial reporting. Some examples of companies choosing to go beyond current legal requirements, in order to anticipate a competitive advantage in the future, without reducing their competitive position in the short term, were also mentioned.

The role played by Integrated Reporting was mentioned by several experts, arguing that this could avoid report proliferation and reflect more effectively a company's strategy and business model. Some experts argued that any legislative proposal should at least not prevent a possible future introduction of integrated reporting modalities. One expert underlined the need to clarify the relationship between social and environmental disclosures and other Corporate Governance issues, in particular with regards to risk statements and incentives. Another expert mentioned that the companies' boards should have ownership on reporting in order to make it most relevant and effective.

Capital Markets

Several experts expressed the view that there is a significant and increasing demand for non-financial information in the financial markets, and that there is evidence that responsible investment considerations are being increasingly mainstreamed. According to some experts, this demonstrates that the voluntary approach to non-financial reporting has so far failed to provide the market with a satisfactory level of transparency on relevant non-financial information. However, some experts also underlined that a significant number of institutional investors are established in the EU but investing globally, thus calling the Commission to work towards a global response to this problem.

3. Next Steps

Experts were invited to submit written comments on the issues discussed, together with any other relevant material, at their earliest convenience. Next meeting is scheduled on 30 September 2011.

ANNEX 1

Attendants

Ms Teresa Fogelberg	GRI
Mr Filip Gregor	ECCJ
Mr Luc Hendrickx	UEAPME
Mr Petr Kriz	PwC
Ms Claudia Kruse	ICGN
Mrs Nicole Notat	Vigeo
Mr Jan Noterdaeme	CSR Europe
Mr. François Passant	Eurosif
Ms Rebekah Smith	BusinessEurope
Ms Susanne Stormer	Novo Nordisk
Mr John Swannick	EABIS
Mr Steve Waygood	Aviva Investor

DG MARKT

Jeroen Hooijer
Nicolas Bernier Abad
Massimo Zaffiro
Delphine Langlois
Szusanna Lantos

DG ENTR

Lauro Panella (Member of Cabinet)
Pedro Ortun Silvan
Kim Henrik Holmstrom
Tom Dodd

ANNEX 2

Meeting of the Experts Group on Disclosure of Non-Financial Information by Companies

Brussels, 12 September 2011

Morning Session

Non-paper for discussion

1. Improving company disclosure of social and environmental information

Existing EU legislation requires enterprises to disclose environmental and employee-related information to the extent necessary for an understanding of the company's development, performance or position². Member States may exempt SMEs. Some Member States have introduced disclosure requirements that go beyond existing EU legislation. There is a possibility that different national requirements could create additional costs for enterprises operating in more than one EU Member State.

Transparency is an important element of accountability, and contributes to building public trust in enterprises. Disclosure of social and environmental information facilitates engagement with stakeholders and the identification of material sustainability risks. Many market incentives for CSR can only work if there is adequate disclosure of social and environmental information from enterprises.

Disclosure of social and environmental information can significantly benefit employees, consumers, and investors, as well as affected local communities. The recent public consultation organised by the Commission shows that certain stakeholders consider that current disclosure practices fail to meet their needs, while other stakeholders consider that current practices are acceptable or useful. To meet the needs of enterprises and other stakeholders, information should be material, reliable, comparable, accessible, clear, timely, forward-looking as well as retrospective, and cost-effective to collect. The involvement of stakeholders in the disclosure process increases the likelihood that the information disclosed will meet stakeholder needs. Assurance of reported information can enhance its reliability.

A growing number of European companies disclose social and environmental information using different means and channels. SMEs often communicate such information informally. In particular, one source estimates that about 2,500 European companies publish CSR or sustainability reports, which puts the EU in a position of global leadership³. However this is still only a small fraction of the 42,000 large companies operating in the EU.

Several international frameworks for the disclosure of social and environmental information exist like the Global Reporting Initiative, the UN Global Compact, the OECD Guidelines for Multinational Enterprises and the ISO 26000 Guidance Standard on Social Responsibility.

² Fourth Directive on Annual Accounts 2003/51/EC

³ CorporateRegister.com

Integrated financial and non-financial reporting represents an important goal for the medium and long term and the Commission follows with interest the work of the International Integrated Reporting Committee.

Policy measures to improve disclosure of social and environmental information must take account of the differences between companies, including the specific characteristics of SMEs, and avoid unnecessary administrative costs.

2. Questions for discussion

An EU legislative proposal could aim at improving transparency, comparability and relevance of non-financial information, while at the same time ensuring adequate flexibility and avoiding any undue administrative burden on companies.

General Approach

Would a *principles*-based international reference framework be an appropriate tool, or should legislation envisage the adoption of more *detailed reporting requirements* (i.e. Key Performance Indicators)? Should any new reporting requirement apply only to large companies?

Business Accountability

What kind of legislative requirement regarding non-financial disclosure would have the greatest impact in terms of increasing the accountability of companies and building trust in business?

Companies' Performances

To what extent would mandatory disclosures lead companies to better integrate social and environmental aspects into their business operations and strategies, and have greatest positive impact on their long-term financial performance?

Capital Markets

What kind of legislative requirement regarding non-financial disclosure would most help investors to better build relevant non-financial information into their valuation models and decision-making?

Meeting of the Experts Group on Disclosure of Non-Financial Information by Companies

Afternoon Session

Brussels, 12 September 2011

Non-paper for discussion

1. Issues with current reporting practices

The EU is a global leader in terms of number of non-financial reports. However, not all large EU companies do publish such information, or do so only to a limited extent. One source estimates that about 2500 EU large companies report regularly on their non-financial performance, out of an estimated total of 45000.⁴

Moreover, a significant number of the non-financial reports currently disclosed do not follow international standards or guidelines, and, according to the results of a public consultation concluded by the Commission in January 2011⁵, many users claim that information is not sufficiently material, accurate, timely, clear, comparable or reliable.

Today, the EU legislation on non-financial reporting does not establish a detailed framework, nor provide reference to any standards. Also, the legal framework at Member States' level appears to be quite fragmented: a few MS have adopted mandatory reporting obligations, with different approaches varying from very detailed reporting requirements to more general provisions, or a "comply or explain" obligation.

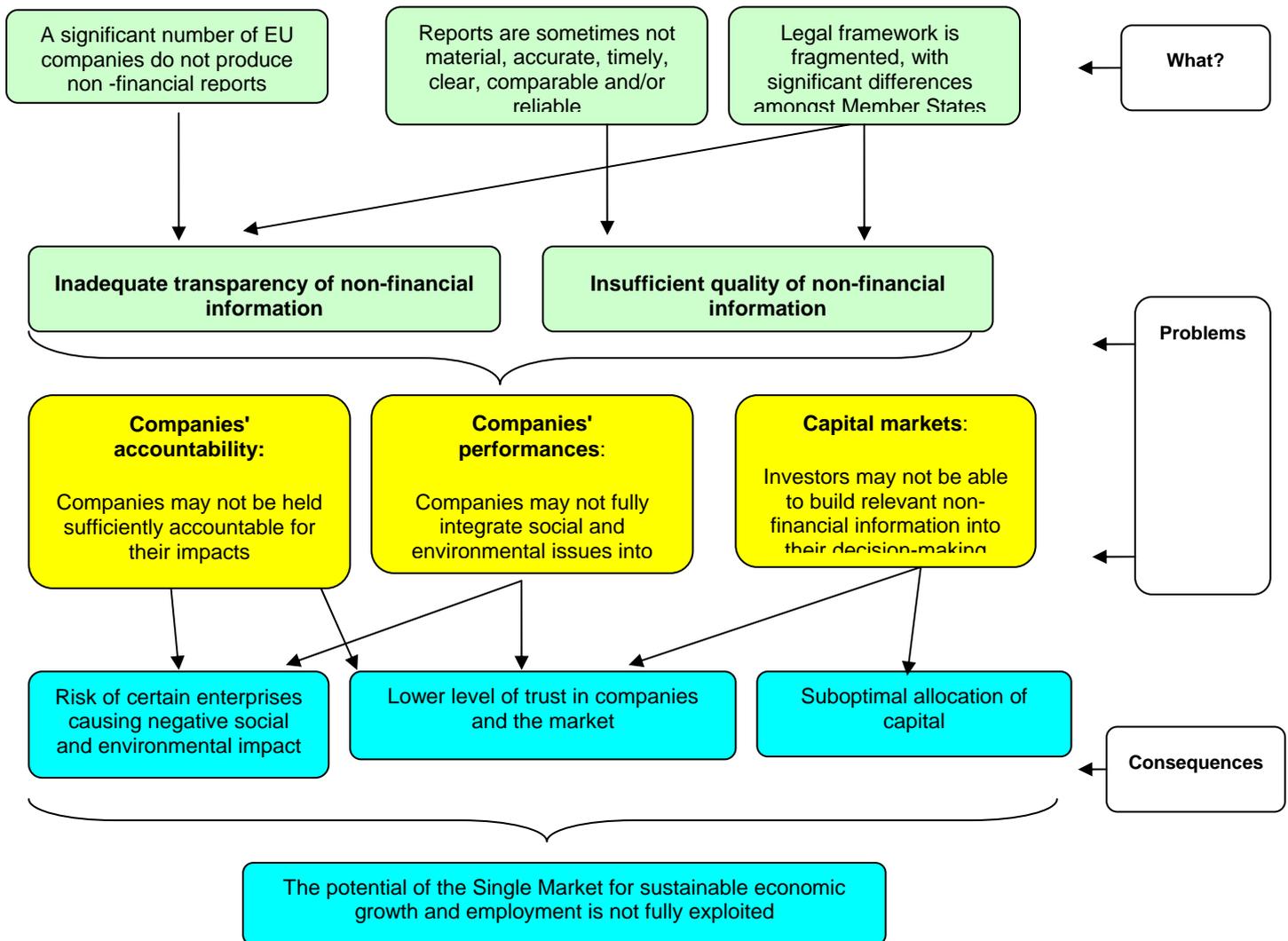
The current reporting practices result therefore in a diverse level of transparency of non-financial information within the internal market, as well as a differing quality of non-financial information even when such information is disclosed.

This hampers benchmarking between companies, and translates into a lack of completeness and consistency of reporting by companies within the EU. On the whole, this is a problem as concerns (i) the level of **companies' accountability** towards society, (ii) their **capacity to fully integrate social and environmental issues** into business operations and strategy, and (iii) the **capacity of investors to build relevant non-financial information** into their valuation models.

⁴ CorporateRegister.com

⁵ See http://ec.europa.eu/internal_market/consultations/docs/2010/non-financial_reporting/summary_report_en.pdf

These issues are depicted in the chart below:



2. Could EU legislation address such problems?

The Commission intends to present in 2012 a legislative proposal on the transparency of the social and environmental information provided by companies in all sectors.

In order for such proposal to ensure the required improvements in terms of transparency and quality of non-financial information, while at same time ensuring an adequate level of proportionality, flexibility and avoiding any undue administrative burden on companies, a number of options should be considered.

The Commission services would like to seek the advice of the Expert Group on some specific issues presented below. Please note that the list of questions is not exhaustive, and some of the policy options it refers to are not mutually exclusive:

- Should there be a **general reporting obligation**, or should legislation only require a "**comply or explain**" approach?
- Should EU legislation embody a predefined **set of EU principles**, or should it contain a **reference to international frameworks**?

- Please list which principles, in your view, might be included in the legislation, if any
- Please list which of the international frameworks, in your view, would be the more appropriate ones, if any.
- What international frameworks do you consider to be complementary with one another?
- Should EU legislation mandate a **set of specific topics** to be covered by non-financial reports? If so, please list which topics should be covered by EU legislation.
- Should legislation contain a **review clause** in order to allow for regulatory improvements in the future, including the definition at a later date of **specific KPIs**?