POSITION PAPER

BUSINESSEUROPE

5 July 2013

DISCLOSURE OF NON-FINANCIAL INFORMATION

KEY MESSAGES

1 European business is committed to the objective of transparency and credibility. The reasons advanced by the Commission to justify the need for regulation insufficiently recognise existing business practices. There is no clear evidence that increased regulation on reporting is needed to boost Corporate Social Responsibility (CSR) activities.

2 The Commission's proposal risks undermining the very principle that has made CSR successful. CSR as a whole must be voluntary and business-driven in order to create shared value for both society and companies – principles that have already proven successful in several Member States.

3 The proposal creates red-tape for business, which is underestimated by the Commission. In light of the fragility of the economic situation across Europe, it is essential that no further competitive disadvantage for European companies on global markets is created to the detriment of European citizens.

4 Notwithstanding the fundamental concerns European businesses have with this initiative, BUSINESSEUROPE has the following key messages for the concrete content of the proposal:

- A broader "comply or explain" approach than proposed by the Commission.
- A unified scope for both non-financial information and diversity disclosure requirements limited to listed companies with more than 500 employees.
- An explicit clarification that no mandatory auditing of non-financial statements is required, also allowing companies to decide themselves whether to publish a non-financial statement as part of annual report or separately.
- Exclusion of related risks from the disclosure requirement.
- No duty to disclose information on diversity in boards before an assessment of current initiatives at national level is conducted and provided that evidence of the need for EU legislative action is adduced.

KEY FACTS AND FIGURES

The Commission's proposal would impact on 18,000 companies in the EU.	95% of the 250 largest companies worldwide now report on their social and ecological behaviour.	In line with their CSR practices, companies use a broad diversity of reporting instruments, such as questionnaires to investors, press releases, websites, etc.

WHAT DOES BUSINESSEUROPE AIM FOR?

- *BUSINESSEUROPE aims to stabilise current EU legal requirements on disclosure of non-financial information, which correspond to companies' diverse situations and needs. Companies are best placed to decide themselves whether and how best to communicate to their stakeholders on CSR activities.*

- *Further EU actions in this field must be based on general principles respecting the business-driven differentiated approach to CSR that has rightly prevailed so far. Otherwise, this would damage the diversity and innovation of company practices based on differing needs.*

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I. Introduction

1. On 16 April the European Commission published a proposal for a directive of the European Parliament and of the Council amending Council directives 78/660/EEC and 83/349/EEC (referred to as "accounting directives") as regards disclosure of non-financial and diversity information by certain large companies and groups.

2. The Commission's proposal consists of two main elements:

   - Companies with more than 500 employees would be obliged to include a non-financial statement in their annual report. This non-financial statement would include information relating to at least environmental, social and employee, respect for human rights, and anti-corruption and bribery matters. The company would be obliged to disclose a description of its policies pursued in relation to these matters, the results of these policies as well as the related risks and how the company manages them. According to the Commission, these reporting requirements would cause the approximately 18,000 affected companies to incur administrative costs of 600 – 4,300 Euros per annum.

   - Listed companies with more than 250 employees would be obliged to add a description of their diversity policy for their administrative, management and supervisory bodies to their corporate governance statement. The description of the company's diversity policy would include aspects such as age, gender, geographical diversity, educational and professional background, the objectives of the diversity policy, how it has been implemented and the results achieved in the reporting period. According to the Commission, these reporting requirements would cause affected companies to incur additional administrative costs of 600 – 1,000 Euros per annum. Approximately 5,000 listed companies would be affected by this directive.

3. The European Council conclusions of 22 May 2013 refer to the Commission's proposal on disclosure of non-financial and diversity information by large companies and groups, indicating that it "will be examined notably with a view to ensuring country-by-country reporting by large companies and groups".

4. BUSINESSEUROPE has the following comments on the proposal.

AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

BUSINESSEUROPE a.i.s.b.l.

WWW.BUSINESSEUROPE.EU

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
EU Transparency register 3978240953-79

II. General comments

Voluntary and business-driven nature of Corporate Social Responsibility (CSR) is central to its success

5. Europe is in crisis. All energies and policies should converge to provide the conditions for growth and jobs in Europe to enable recovery from the crisis.

6. As it is shaped today, CSR contributes to this goal. CSR has developed over years into a very successful way of creating shared value, which at the same time contributes to business goals and benefits society through increased consideration of long term environmental and social challenges faced by companies.

7. The driver for CSR activities is and should remain the real or expected positive return in terms of business position in the market, image, coherence with company ethics, risk management, etc. In line with this, the decision to engage in CSR activities should be taken by the company itself, based on its own convictions, its size, the specific nature of its business and the challenges it faces.

8. Companies are different. So are their CSR priorities and activities. There is a wealth of diverse initiatives in tune with various contexts and needs. Companies are best placed to select the issues and initiatives that are most relevant for them.

9. Central to the success of CSR is its voluntary and business-driven nature that ensures shared value for both businesses and society. Business-driven social responsibility implies that a company links its CSR activities to its core business, thereby allowing companies to develop initiatives tailor-made to their specific situation. Business-driven CSR has already contributed to innovation and commitment, also respecting the fact that CSR is about addressing issues beyond what companies are bound to respect by law[1].

10. European businesses are concerned about the new definition of CSR proposed by the European Commission in its 2011 communication and which forms the basis for this proposal. The new definition moved away from the voluntary nature of CSR by introducing a legal aspect to moral obligations which is not appropriate. The risk is to undermine innovative CSR activities towards a mere box-ticking exercise.

CSR reporting should continue to follow a business-driven approach to CSR

11. The Commission's assessment that there has been a market and regulatory failure in the area of CSR reporting, which would justify obliging companies to disclose non-financial information, is not supported by evidence.

[1] In Germany, for example, companies spend 11.2 billion euros on CSR every year. 63% of German small, 71% of medium and 96% of large companies have CSR policies in place.

12. More and more companies are disclosing information on their CSR activities. Studies have shown a rapid increase since the mid-1990s. According to a 2011 study by KPMG, 95% of the 250 largest enterprises worldwide now report on their social and ecological behaviour. In Spain for example, 33 out of 35 companies in the IBEX index publish voluntarily a CSR report. Furthermore the number of EU companies publishing CSR reports using the Global Reporting Initiative (GRI) guidelines increased from 270 in 2006 to over 850 in 2011. The uptake of CSR reporting by European companies is clearly manifested by the fact that European companies outnumber any other regional grouping of companies in the UN Global Compact for which company signatories submit annual communication on progresses in their reports.

13. This shows that European businesses have responded to the need for transparency regarding CSR activities to inform various stakeholders. This is in particular the case for listed companies.

14. The necessary diversity of CSR practices implies that companies of all sizes should be able to adapt their CSR reporting to their specific situation and to the various needs of their stakeholders, such as investors, customers, NGOs, trade unions, the media, etc. Stakeholders have different information needs and expectations. This means that the information has to be provided in different formats and to a different degree of detail, taking into account their relative importance for each company. Also, companies have a legitimate interest in defining the extent, method and modalities of their reporting activities.

15. SMEs and larger companies that are of medium size do not necessarily see the need or have the resources to disclose social and environmental information. Other means of reporting such as questionnaires to investors, press releases, websites, e-mails or information printed on their products are often better suited to their local set-up. For them, in line with the “think small first principle”, no written reporting must be required.

16. The costs, time and organisation requirements involved in terms of collecting information have been drastically underestimated by the European Commission. Putting in place the necessary measurement, control and coordination tools often requires extensive resources – see below point 38. It is also a complicated task to gather and check the information, as well as to communicate on it.

17. There is no evidence to support the assumption that mandatory rules on disclosure of non-financial information will lead to companies automatically becoming more responsible and more competitive. By contrast, European companies would face the risk of losing competitive ground globally. Their international competitors, for example the USA and China, face more limited reporting obligations. Obligations where they exist are more likely to be focused on environmental issues. And many countries do not have any legal requirements in place.

The Commission's approach should be reconsidered

18. The extent, nature and modalities of CSR reporting have to be adapted to the specific CSR activities practiced by companies. By making reporting on specific CSR areas mandatory, the Commission's proposal would require companies to focus on these areas regardless of whether they are relevant for them. This could transform CSR into a mere box-ticking exercise.

19. As a consequence, the business-driven nature of CSR activities, which allows companies to develop initiatives tailor-made to their specific situation and therefore is the very principle that makes CSR so successful, would be undermined. The Commission's approach is difficult to reconcile with its acknowledgement that CSR "development should be led by enterprises themselves".

20. A fundamental incoherence in the Commission's approach is that it treats financial and non-financial reporting in the same way although they are different in essence. Whereas financial reporting provides quantitative information, for many areas of non-financial reporting only qualitative elements can be communicated. This is particularly the case for social issues, e.g. core labour standards.

21. Considering that European businesses are active on a worldwide scale, CSR policies and corresponding reporting activities are also conceived in the global context in which businesses operate. CSR reporting frameworks must therefore be global in scope in order to address global challenges. No European requirements should undermine or diminish the value of reporting in accordance with global initiatives such as the UN Global Compact and the GRI guidelines..

22. Due to the heterogeneity of company needs, priorities and corresponding CSR policies, it is not appropriate to introduce an obligation to issue Key Performance Indicators (KPIs). The Commission's decision not to introduce KPIs for CSR policies goes in the right direction but is not sufficient.

23. BUSINESSEUROPE is strongly opposed to making auditing of CSR reporting mandatory, which would be in many countries the consequence of the inclusion of non-financial statements, sustainability or diversity reports in the annual report. It is important that companies can choose freely whether to include a non-financial statement in the annual report or to publish it separately.

24. Moreover, the business community is concerned that the draft directive may serve as a first step to introduce mandatory integrated reporting at EU level. Integrated reporting is and should remain one of the means at the disposal of companies to report on their CSR activities.

25. We are also concerned that companies are faced with an increasing number of uncoordinated obligations for reporting at European and national levels. For example, the cumulative effects of planned initiatives such as the "organisation environmental footprint" need to be fully taken into account. If introducing any new requirements, the Commission should ensure that the total amount of reporting does not increase.

26. For all these reasons, BUSINESSEUROPE considers that the current EU legislative framework on disclosure of non-financial information remains valid. We do not support more rigid and prescriptive EU requirements in this domain. We invite the European Commission to reconsider its initiative. If this is not the case, the European Parliament and Council should improve it in line with the specific comments included in this position paper.

27. More specifically, BUSINESSEUROPE is concerned about the scope of the proposed directive, the nature of the new requirement to publish a non-financial statement, the widening of the list of non-financial issues on which companies should report, the requirement to disclose information on related risks and the new requirements on diversity reporting.

Country-by-country-reporting

28. BUSINESSEUROPE is concerned about the European Council's request of 22 May to expand the Commission's proposal on disclosure of non-financial and diversity information by an additional requirement of country-by-country reporting on payment of taxes to all large companies. This proposal was made without any proper analysis and without a clear context.

29. International taxation, which seems to be the driving force behind the initiative from the European Council, is a very important and complex issue that should be based on internationally agreed principles.

30. Instead of improving transparency, country-by-country reporting would lead to disclosure of data out of context, which will not improve tax compliance or the understanding of the underlying tax issues. Already today, companies are struggling to streamline the reporting in order to improve the communication with investors. Adding more information that is not essential to investors and may confuse other users is a step back for the overall reporting package. If not, then the reports will end up having information overload, and thus the essential information will – against the proposal's intention - be lost to the reader.

III. Specific comments

Scope of the new requirement to disclose non-financial information

Art. 46 (1) b) 78/660/EEC and Art. 36 (1) 83/349/EEC

31. The Commission has proposed applying the new requirement to companies with an average number of 500 employees during the financial year and a balance sheet exceeding EUR 20 million or a net turnover of EUR 40 million.

32. This means that the new requirement would apply to a large number of companies, not only large, multinational companies. For many of the companies covered, this will represent an unjustified heavy burden in terms of costs and administration. In this respect, BUSINESSEUROPE notes that the Commission's proposal gives Member States the possibility to apply the new rules to listed companies for a limited time.

33. This possibility should become the general rule so that the directive would only apply to listed companies with more than 500 employees. Respectively, the threshold of the company's balance sheet should be raised to at least EUR 40 million and the net turnover to at least EUR 80 million.

New requirement to issue a non-financial statement

Art. 46 (1) b) 78/660/EEC and Art. 36 (1) 83/349/EEC

34. The main content of the Commission's proposal is to impose on companies the requirement to include a non-financial statement in their annual financial report.

35. This ignores the various ways in which companies can be transparent and disclose non-financial information other than by publishing statements and/or reports. CSR can be very well communicated without the need for a report or a statement. For analysts and investors, for example, in many cases, reports are much less important than individual one-to-one-meetings. Other tools, including providing information via websites, through dialogue or interviews, and in an ad hoc way can be equally effective.

36. CSR activities should in no way become a part of a mandatory integrated reporting approach. Some companies already have integrated reporting and value this as a way to disclose non-financial information. However, this should not be viewed as the only way for companies to be transparent on their non-financial performance. European policy should ensure that companies have the flexibility to communicate with their stakeholders in the most appropriate and practical way.

37. In addition, a company active only on a regional basis should not be obliged to use specific disclosure tools because the local community can already see how it is operating on a daily basis and it would be redundant. Many companies already disclose social and environmental information, simply by being close to or involved in the community in which they conduct business.

Administrative burden

38. The Commission's impact assessment estimates the costs involved of issuing a non-financial statement to be 600 – 4,300 Euros per company / per annum. This is undoubtedly far too low. According to a recent study conducted by the Centre for Strategy and Evaluation Services - CSES, the total cost of disclosing non-financial information in the form of a full report can be estimated to be in the range of EUR 155,000 to EUR 604,000 per year per large company. We acknowledge the Commission's choice to limit administrative burdens by not requiring a separate

report. However, assessing costs of the initiative on the basis of an enquiry among 71 companies is not a satisfactory method for determining the impact on many others.

39. Considering only costs linked to drafting a short statement is not appropriate. Many more costs will derive from the need to introduce new reporting mechanisms. The important needs for additional analysis that the new requirement would create for the companies concerned in terms of internal measurement and control tools and coordination are not taken into account adequately. Especially the costs of setting up consolidation procedures need to be taken into account. Another set of costs relates to sub-contractors and suppliers. In order to report on CSR policies, some companies may ask their subcontractors and suppliers to report on their CSR activities in order to be able to report properly themselves.

40. According to a study about the impact of the legal requirement for reporting on CSR in the Danish Financial Statement Act, the administrative burdens associated with CSR reporting were 7-8 times higher the first year of reporting than was expected before the bill was passed.

41. The costs deriving from this directive would increase significantly unless it is clarified that auditing of non-financial statements is not mandatory.

42. Finally, the European Council's recent request of including country-by-country reporting requirements to the proposal would be very costly for business. There are no official calculations on the administrative costs of a country-by-country reporting requirement in the Impact Assessment for this proposal. Based on the figures issued by the Commission in its Impact Assessment[2] for the now adopted reporting requirement for extractive and forestry activities, the total cost of applying country-by-country reporting to the 18000 companies that are in the scope of this proposal would range from 17 to 37.5 billion euros in the first year and from 4.5 to 11.5 billion euros in the following years.

<u>Wider "comply or explain" needed</u>

Art. 46 (1) b) 78/660/EEC and Art. 36 (1) 83/349/EEC

43. The proposal requires companies that do not have a policy in place on one of the four issues to provide an explanation for not disclosing information on it.

44. BUSINESSEUROPE asks for a broader application of "comply or explain", which allows companies to assess themselves whether or not a topic is relevant for them. Companies are only required to explain their choice and if they have policies in place they must report on them.

[2] COMMISSION STAFF WORKING PAPER Part II IMPACT ASSESSMENT for financial disclosures on a country by country basis. Link: http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/SEC_2011_1289_2_en.pdf

45. In the original Danish “comply or explain” model from 2009, for example, companies were free to choose what subjects they included in their CSR activities, which gave them an incentive to form their own CSR strategy in a way they perceive most valuable. For example, the success of the Danish model, which has encouraged 94% of Danish companies to report on their CSR activities, should be ascribed to its business-driven and flexible nature combined with strong references to global frameworks.

Issues to be reported on

Art. 46 (1) b) 78/660/EEC and Art. 36 (1) 83/349/EEC

46. The proposal requires companies to disclose information on environmental, social and employee matters, respect for human rights and anti-corruption and bribery matters.

47. BUSINESSEUROPE is very concerned about the extension and detailed nature of the list of topics which companies would have to report on. BUSINESSEUROPE points out the great danger of extending the list of topics, which could lead to a never-ending political debate on the issues that should be covered. This approach is not compatible with the diverse contexts and needs of companies.

48. The list of issues which companies address as part of their CSR activities and on which they may choose to report depends on their relevance for the company in question and on whether the provision of such information on these issues is material, possibly based on a company assessment of risk and opportunity.

Disclosure of related risks

Art. 46 (1) b) iii 78/660/EEC and Art. 36 (1) iii 83/349/EEC

49. The proposal stipulates that the non-financial statement would need to describe company policies, the results of these policies and the risks involved and how the company manages them.

50. BUSINESSEUROPE strongly opposes the proposed obligation to disclose information on risks. Companies constantly identify and assess risks and opportunities. This is one of the most difficult, time-consuming, expensive and sensitive tasks of the management of the company. Requiring the disclosure of information on risks would impose disclosure of sensitive business information which must remain confidential. It is important to avoid interfering with the business model as defined and implemented by the company’s management and distortions of competition. It should be for individual companies to decide whether, and if so, how they disclose this information.

Reference to already existing international frameworks

Art. 46 (4) 78/660/EEC and Art. 36 (4) 83/349/EEC

51. The proposal allows companies to rely on national, EU-based or international frameworks. Moreover, where a company has already prepared a report which covers the information requested in the non-financial statement and makes this report part of the annual report, the company would no longer be obliged to provide the non-financial statement.

52. It is essential to bear in mind that many European businesses are active on a worldwide scale. Their CSR policies and corresponding reporting activities are conceived in the global context in which they operate. Therefore, duplication of administrative reporting burdens must be avoided, particularly at national level, by allowing the adaptation of the existing international frameworks to companies' specific circumstances and reporting needs, while respecting the business-driven nature of CSR.

53. In this respect, the Commission's proposal rightly recognises that many large companies already abide by the principles of international CSR frameworks, for example the UN Global Compact, the OECD guidelines or the ILO tripartite declaration on multinational enterprises and social policy; and some of them use the Global Reporting Initiative (GRI) as a basis for their reporting. Any policy measure should be based on existing international frameworks, standards and guidelines as well as equivalent national guiding principles, provided that any regulatory compulsory requirements are avoided. We stress the importance of our national federations' consultation prior to any introduction of new national reporting obligations.

54. Reports based on existing frameworks are often published as stand-alone documents. In order to avoid excessive administrative burdens, companies must be allowed to refer to these reports rather than making them an integral part of the annual report.

55. Moreover, it should be clarified that this reference is also applicable to companies whose headquarters are located outside the EU and which publish a sustainability or diversity report at group level.

New requirements on diversity reporting

Art. 46a (1) g) 78/660/EEC

56. The proposal includes a duty for listed companies to publish information on the composition of their administrative, management and supervisory bodies in order to promote diversity in the selection of members of their boards.

57. Initiatives taken in many countries, for example through national law or corporate governance codes, must be continued and assessed before any regulatory measure is envisaged at European level.

58. There is no justification for a different scope as regards disclosure of information on diversity. The draft directive should be amended to introduce a unified scope for both non-financial information and diversity disclosure requirements limited to listed companies with more than 500 employees.

59. The proposal requires companies to provide an “explanation” for not disclosing non-financial information and a “clear and reasoned explanation” for not disclosing information on diversity. In both cases, the directive should be consistent in allowing companies to provide an “explanation”. This is sufficient and would have the advantage of not creating any room for diverse interpretations as to the meaning of this requirement.

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