BRIEFING

Implementation Appraisal

European Parliament

Non-financial Reporting Directive

This briefing is one in a series of implementation appraisals produced by the European Parliamentary Research Service (EPRS) on the operation of existing EU legislation in practice. Each briefing focuses on a specific EU law that is likely to be amended or reviewed, as envisaged in the European Commission's annual work programme. Implementation appraisals aim at providing a succinct overview of publicly available material on the implementation, application and effectiveness to date of specific EU law, drawing on input from EU institutions and bodies, as well as external organisations. They are provided by the Ex-Post Evaluation Unit of EPRS to assist parliamentary committees in their consideration of new European Commission proposals, once tabled.

SUMMARY

Companies' actions have significant impacts on life in the EU and around the world, in terms of products and services, jobs and opportunities, and working conditions, human rights, health, the environment, innovation, education and training. EU citizens expect companies to understand the positive and negative impacts they have on society and the environment, and to prevent, manage and mitigate any negative impacts, including in their global supply chains. This duty is referred to as corporate social responsibility (CSR) or responsible business conduct (RBC).

Under the European Green Deal, funding economic activities that support environmental, social and governance-related objectives is key to fostering sustainable growth, financing the green transition and unlocking the investment needed to achieve, not least, the EU's 2050 climate neutrality objective. An important way to direct financial and capital flows to sustainable investment is to improve data availability and companies' and financial institutions' disclosure of non-financial information (i.e. information relating to the environment, social and employee-related matters, respect for human rights, and action to address corruption and bribery). This makes it easier to measure, monitor and manage companies' performance and their impact on society.

The adoption of Directive 2014/95/EU on the disclosure of non-financial and diversity information (referred to as the 'Non-financial Reporting Directive' – NFRD) set the EU on a clear course towards greater business transparency and accountability on social and environmental issues. The directive serves as a vital instrument in terms of advancing the EU's agenda for CSR.

On 11 December 2019, in its communication on the European Green Deal, the Commission announced its intention to review the NFRD as part of the strategy to strengthen the foundations for sustainable investment. A public consultation, launched between February and June 2020, and aimed at collecting the views of stakeholders with regard to a possible revision of the NFRD, identified several shortcomings in the implementation of the NFRD, relating for instance to a lack of comparability, reliability and relevance of the non-financial information provided. In its adjusted 2020 work programme, adopted on 27 May 2020, the European Commission indicated the first quarter of 2021 as target delivery date for the revision.

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1. Background

This briefing examines the **implementation of Directive 2014/95/EU on the disclosure of non-financial and diversity information (the 'Non-financial Reporting Directive' – NFRD)**[1] with a view to the upcoming European Commission proposal for its revision. The Commission proposal, to be accompanied by an impact assessment, is expected in the first quarter of 2021.[2]

On 11 December 2019, in its **communication on the European Green Deal (EGD)**,[3] the Commission identified the need for a **renewed strategy on financing sustainable growth**, acknowledging the key role of the private sector in financing the green transition and the need for long-term signals in order to direct financial and capital flows to green investment and avoid stranded assets. The new strategy, expected in the first half of 2021, will focus on a number of actions, including the review of the NFRD. As highlighted by the Commission, it is important that companies and financial institutions improve their disclosure of non-financial information so that investors are fully informed about the sustainability of their investments.

While the adoption of the **NFRD in 2014** was **a major step towards greater business transparency** and accountability on social and environmental issues, **users of non-financial information, mainly investors and civil society organisations, are now demanding more and better information** from companies about their social and environmental performance and impacts. Moreover, there is a global trend with a wide variety of different organisations and stakeholders calling for consideration of a new regulatory approach to non-financial reporting.

As will be explained in this briefing, the current text of the NFRD and its implementation suffer from **several deficiencies**. As outlined in the inception impact assessment published by the Commission in January 2020,[4] there is not enough publicly available information about how non-financial issues, and sustainability issues in particular, impact companies, and about how companies themselves impact society and the environment. In addition, companies incur unnecessary and avoidable costs when it comes to reporting non-financial information, and face uncertainty and complexity when deciding what, where and how to report non-financial information. For some financial sector companies, this complexity also arises from differing disclosure requirements contained in various pieces of EU legislation. Moreover, companies are under pressure to respond to additional demands for non-financial information from sustainability rating agencies, data providers and civil society, irrespective of the information they publish as a result of the NFRD.

In order to tackle these shortcomings, the planned **revision of the NFRD** seeks therefore to:

- ensure that investors have access to adequate non-financial information from companies so as to be able to take account of sustainability-related risks, opportunities and impacts in their investment decisions;
- ensure that civil society organisations, trade unions and others have access to adequate non-financial information from companies to be able to hold them to account for their impacts on society and the environment; and
- reduce **the unnecessary burden** on business relating to non-financial reporting.

In order to foster long-term sustainable and responsible corporate behaviour, as set out in the EGD, the revision of the NFRD will be complemented, inter alia, by legislation on sustainable corporate governance, to be presented by the Commission in the second quarter of 2021,[5] as part of the renewed strategy on financing sustainable growth.

It should also be noted that some new pieces of EU legislation, including the Regulation on sustainability-related disclosures in the financial services sector (Sustainable Finance Disclosure Regulation, SFDR),[6] the Regulation establishing a framework to facilitate sustainable investment (Taxonomy Regulation)[7] and the amendment to the Benchmark Regulation regarding climate-related benchmarks,[8] can only fully meet their objectives if more and better non-financial information is available from investee companies.

The Non-financial Reporting Directive: An overview of current legislation, transposition and review clauses

The Non-financial Reporting Directive (Directive 2014/95/EU, NFRD) is an amendment to the Accounting Directive (Directive 2013/34/EU)[9] and was adopted in 2014.

The disclosure of non-financial information is considered as vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection. The **objective of the NFRD** is therefore to raise the transparency of the social and environmental information provided by undertakings in all sectors to a similarly high level across all Member States and thus **to improve the disclosure of non-financial information by certain large undertakings.**

Under the NFRD, **large listed companies, banks and insurance companies ('public interest entities') with more than 500 employees** are **required to publish reports** on the policies they implement in relation to social responsibility and treatment of employees; respect for human rights; anti-corruption and bribery; and diversity on company boards (in terms of age, gender, educational and professional background). In particular, the NFRD requires companies to disclose information about their business models, policies (including implemented due diligence processes), outcomes, risks and risk management, and key performance indicators (KPIs) relevant to the business. At present, around **6 000 of the largest EU companies** are **required to disclose non-financial information under the NFRD.**[10]

However, the NFRD leaves a fair amount of **flexibility** in the implementation of its provisions. In particular, it does **not require the use of a non-financial reporting standard** or framework, nor does it impose detailed disclosure requirements (such as lists of indicators per sector). Accordingly, it gives companies significant flexibility to disclose relevant information in the way they consider most useful. As a result, companies may include a non-financial statement in their management report or, under certain conditions, prepare a separate report.

In addition, companies can **use international, European or national guidelines** to produce their statements. International and European non-financial reporting frameworks and standards include, inter alia, the Global Reporting Initiative (GRI),[11] the Sustainability Accounting Standards Board (SASB),[12] the International Integrated Reporting Framework (IIRC),[13] the Task Force on Climate-related Financial Disclosures (TCFD),[14] the United Nations (UN) Guiding Principles Reporting Framework,[15] the UN Global Compact,[16] the OECD guidelines for multinational enterprises[17] and ISO 26000.[18] The German Sustainability Code (DNK)[19] is an example of a national non-financial reporting standard. It should be noted in this context that the Commission, in July 2020, mandated the **European Financial Reporting Advisory Group (EFRAG)** to develop **recommendations for a potential future European non-financial reporting standard**.[20]

Moreover, the NFRD leaves companies some room for manoeuvre by stipulating that where the company does not pursue policies in relation to one or more of the five matters mentioned above, the non-financial statement shall provide a clear and reasoned explanation for not doing so **('comply-or-explain')**.

It should also be noted that the NFRD requires companies to disclose information 'to the extent necessary for an understanding of the development, performance, position and impact of [the company's] activities.' This means companies should disclose not only how sustainability issues may affect the company ('outside-in risks'), but also how the company affects society and the environment ('inside-out risks'), the so-called '**double materiality**'. As shown by the outcome of several consultations (see below), this concept has, however, been found to be difficult to implement (with many stakeholders arguing that the directive does not include an adequate definition of the concept of materiality).

Finally, as regards **assurance of non-financial reports** (i.e. verification of the non-financial information provided), the NFRD includes only a requirement that the statutory auditor (or audit firm) check whether the non-financial information has been provided (as a non-financial statement included in the management report or as a separate report). All Member States had to transpose this requirement into national law. The NFRD also includes an option for Member States to go beyond this minimum requirement by requiring statutory auditors to carry out additional checks, for example regarding the consistency of the non-financial information provided with the financial information, or by having the non-financial information verified by an independent assurance services provider. Several Member States currently make use of this option in their national law.[21]

Member States' **transposition deadline for** the NFRD was **6 December 2016**.[22] Undertakings covered by the directive had to **report for the first time in 2018** (for the 2017 financial year). In **2017**, in line with Article 2 of the NFRD, the Commission published **non-binding guidelines for companies on how to report non-financial information**.[23] In June **2019**, under the sustainable finance action plan, the Commission published **additional guidelines on reporting climate-related information** (providing an explanation, inter alia, of the double materiality perspective with regard to climate-related information).[24]

Under Article 3, the **Commission** was to submit a **report** to Parliament and Council on the directive's implementation, including its scope, in particular regarding large non-listed undertakings, its effectiveness and the level of guidance and methods provided. The report was to be published by 6 December 2018 and accompanied, if appropriate, by legislative proposals. With some delay, in **2019** and **2020**, the Commission launched **several public consultations** in order to gather data and views on the problems that needed to be addressed with regard to non-financial reporting.

It should be noted that in some respects the NFRD reporting requirements overlap with the sustainability reporting requirements laid down in other pieces of EU legislation (such as the Capital Requirements Regulation, the SFDR and the Taxonomy Regulation), placing additional reporting requirements on the companies concerned by the NFRD (in particular financial sector companies). The findings on the directive's implementation are set out below in the context of its future revision.

2. EU-level reports, evaluations and studies

European Commission public consultation (February to June 2020)

In line with the commitment to review the NFRD in the EGD, Commission services drew up a comprehensive consultation strategy, including – alongside targeted stakeholder surveys, interviews, workshops, meetings and two external studies[25] – an online public consultation. The public consultation was open from 20 February to 11 June 2020. In January 2020, in preparation for the impact assessment, the Commission also published an inception impact assessment, summarising the problem, possible policy options and likely impacts of the review. Stakeholders were invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information, including on possible impacts of the different options. The feedback period was open from 30 January 2020 to 27 February 2020. In its summary report on the public consultation, the Commission provides a factual overview of contributions to the public consultation. A total of 588 responses were received, with individual companies representing the biggest single group of respondents (32 %), followed by business associations (20 %) and NGOs (14 %). Of the companies responding, 70 % were large companies and 30 % were small and medium-sized companies (SMEs). Furthermore, 29 % of respondents stated that they were both preparers (i.e. companies that reported non-financial information) and users.

In the summary report, the Commission outlines the following **key messages**:

1) In terms of the quality and scope of non-financial information disclosed, there are several **problems** for both **users and preparers** of non-financial information (relating, in particular, to a **lack of comparability, reliability and relevance** of non-financial information provided, as well as **overlaps of different pieces of legislation on sustainability reporting**).

As regards problems for **users**, a majority of respondents believed that the non-financial information provided by companies was deficient in terms of comparability (71 %), reliability (60 %) and relevance (57 %). These figures were even higher when looking just at respondents who identified themselves as users of non-financial information (84 %, 74 % and 70 % respectively).

It should be noted that respondents in favour of enlarging the scope mentioned approximately 50 non-financial matters (relating, in particular, to the Taxonomy Regulation, governance and the supply chain) and 240 non-financial categories (including, targets and companies' progress against those, climate scenario analysis and forward-looking information) on which companies should be required to disclose non-financial information in addition to that already required under the NFRD.

On problems for **preparers** of non-financial information, 64 % of reporting companies stated that additional requests for non-financial information, for example from rating agencies or NGOs, were a significant problem. Moreover, 43 % of respondents (and 38 % of preparers) agreed that companies reporting under NFRD faced uncertainty and complexity when deciding what, where and how to report non-financial information.

On reporting scope, half of the respondents considered that companies should be required to disclose non-financial information on intangible assets (i.e. resources with no physical substance but long-term value for a business, e.g. intellectual property, software and human capital).

When it came to interaction of reporting requirements under the NFRD and other legislation, as mentioned, most respondents stressed that **all legislation regarding reporting and disclosure should be streamlined** (67 %), avoiding gaps (36 %) and overlaps (29 %). For respondents from the financial sector, these figures were even higher (97 %, 45 % and 39 % respectively).

Many respondents argued that the revised NFRD should be aligned with the Taxonomy Regulation, the SFDR, the CRR, the Commission's non-binding guidelines on climate reporting, and as much as possible with widely adopted frameworks (such as the recommendations issued by the Task Force on Climate-Related Financial Disclosures (TCFD) or the Global Reporting Initiative (GRI), the reporting frameworks most frequently mentioned in the public consultation).

Here, many respondents from the financial sector highlighted difficulties in meeting SFDR and Taxonomy Regulation requirements when information cannot be reliably obtained from their clients and investee companies. Moreover, many respondents considered that common definitions of environmental matters, based on the six objectives set out in the Taxonomy Regulation, would be helpful to ensure coherence between the NFRD and the SFDR. Others felt that the Taxonomy Regulation should not be the sole reporting solution on environmental issues under the NFRD.

Finally, many respondents, also from the financial sector, felt that the NFRD should be a regulation rather than a directive so as to enhance comparability, consistency and standardisation.

2) There is a **very strong support** for a requirement on companies **to use a common reporting standard**. In this context, most respondents were in favour of the development of **simplified standards for SMEs**.

Eighty-two per cent of respondents (representing public authorities, large companies and environmental organisations alike) believed that a requirement on companies to use a common standard would address the identified problems (lack of comparability, reliability and relevance).

Similarly, many respondents agreed that the **EU could play a leadership role in promoting the establishment of a unified set of international non-financial disclosure standards**. In this context, the EU should cooperate with other major jurisdictions and non-EU investors to make sure that the EU standard is widely recognised.

In addition, many respondents stressed that the design of any common European non-financial reporting standard should build on existing standards (such as the GRI, the TCFD or the UN Guiding Principles Reporting Framework) and involve a wide range of stakeholders.

Under the consultation, preparers were also asked the recurring **annual cost** of applying a non-financial reporting standard or framework. Based on 80 responses received including this information, the average cost of fully applying a standard or framework is €100 865 per year, with the lowest cost incurred when applying the OECD guidelines for multinational enterprises (€1 096 per year) and the highest cost, not considering outliers, when applying the TCFD (€493 000 per year).

In relation to **SMEs**, 74 % of respondents were in favour of developing **simplified standards**, with more respondents supporting mandatory (46 %) as opposed to voluntary standards (39 %) on average. The proportion of users favouring mandatory use was 57 %, while SMEs favoured a voluntary standard (64 %) over a mandatory standard (27 %).

In any case, according to business associations and companies, the very challenging economic situation at present makes it all the more necessary to ensure **proportionality of reporting requirements and to avoid excessive red tape**, especially in the case of SMEs.

3) There is **strong support for stricter audit requirements.**

A significant majority of respondents (67 %) supported stricter audit requirements for non-financial reporting (with 78 % of users compared to 59 % of preparers in favour of stronger assurance requirements). Should mandatory assurance be introduced, many users indicated they would prefer reasonable assurance (51 %), while a majority of preparers expressed a preference for limited assurance (52 %). Also, many respondents (68 %) supported the **inclusion of a company's materiality assessment process** within the scope of the assessment by an assurance provider. This goes hand in hand with the wish of many respondents to require companies to disclose this process (see below). Similarly, 69 % of respondents were in favour of assurance engagements being performed on the basis of a common assurance standard.

It should be noted that concern over the **cost of assurance**, especially reasonable assurance, was a common point raised by all categories of respondents. According to the public consultation, the average cost for respondents of any kind of assurance (limited, reasonable or a mix) is €50 000.

4) There is **strong support** for **digitalisation of non-financial information**.

A significant proportion of respondents (64 %) believed that:

- it would be useful to require the **tagging of non-financial information** to make it machine-readable (64 %);
- tagging of non-financial information would **only** be **possible if** the **reporting** was made **against standards** (65 %); and
- all reports containing non-financial information should be available through a **single access point**, enhancing its searchability, readability and comparability.

It should be noted that a greater proportion of users agreed with these statements than preparers.

Many respondents saw **digitalisation as a game changer** that would enable corporate reporting policy to improve analysis, comparability and decision-making, and fundamentally change the way business is conducted, with benefits for all. By contrast, failure to digitalise would lead to real world inefficiencies that could hamper or jeopardise the entire non-financial reporting effort.

However, a significant proportion of preparers questioned the **cost-benefit** of making information machine-readable and a number of respondents from business proposed fewer tagging requirements for SMEs to avoid disproportionate costs, to make machine readability voluntary for SMEs, restricting machine readability to only a core subset of data reported, or using IT standards other than the European single electronic format (ESEF).

As to an **EU central point of access**, there was no doubt for a majority of users that such a single access point should be developed. In particular, NGOs, consumer and environmental organisations, and trade unions reported that non-financial reporting information was barely accessible as they had only limited financial capacity to pay for access. By contrast, business respondents underlined the need for companies to continue to be able to publish the information via other channels, such as on their websites. It should be noted that in its new action plan on a capital markets union for people and businesses,[26] adopted in September 2020, the Commission announced its intention to propose the establishment of an EU-wide platform (European single access point) providing investors with seamless access to financial and sustainability-related company information.

5) There is **strong support for a requirement on companies to disclose their materiality assessment process**.

Most respondents (72 % overall and 83 % of users) thought that companies reporting under the NFRD should have to disclose their materiality assessment process. Many, including preparers, financial authorities and national standard setters supported the concept of **double materiality**, as introduced in the June 2019 non-binding guidelines on climate-related non-financial information, but considered that this concept should be further clarified and explicitly included in the directive.

In this context, 69 % of all respondents agreed that the materiality definition pursuant to Article 2(16) of the Accounting Directive is relevant to determine the companies' development, performance and position (outside-in risks). As to the relevance of this definition in order to determine the companies' impact on society and the environment (inside-out risks), views were split, with 46% of respondents considering this definition as relevant and 43% as not relevant.

6) There is **moderate support for requiring all information to be disclosed in the management report**.

Under the NFRD, companies may currently choose where to file their non-financial statement (i.e. in their management report or, under certain conditions, in a separate report). In the consultation, 55 % of respondents were in favour of disclosing all information in the management report, thereby removing the current option of publishing the information in a separate report. A significant proportion (79 %) of social and environmental organisations supported this option.

More specifically, there were split views on the location of non-financial information, even within the same group of stakeholders. While some respondents, mainly preparers, considered that the segregation of non-financial information is of secondary importance and does not entail significant burdens, arguing that this option allows the company to devise its own reporting frameworks and takes account of different companies' needs, some preparers supported the publication of both financial and non-financial information in the management reports (as, according to them, it provides a better understanding of the company's overall performance and strategy). A third group of respondents (mostly environmental and social organisations, but also preparers) considered that EU legislation should require the location of non-financial information in the management report.

7) With a view to possibly **expanding the scope of the NFRD, strongest support** was expressed for including:

- **large companies not established in the EU, but listed in EU regulated markets (72 %);** *
- **large companies established in the EU, but listed outside the EU (71 %);** *
- **large non-listed companies (70 %);** *
- **all large public interest entities (in effect removing the current 500 employee threshold and applying the size thresholds set out in the Accounting Directive) (62 %);** **
- **all EU companies with listed securities, regardless of their size (62 %);** **
- **all public interest entities regardless of their size (45 %);** **
- **companies that are subsidiaries of a parent company, currently exempt (32%);** **
- **all limited liability companies regardless of their size (21%).** **

** Non-public interest entities; ** Public interest entities (PIEs), i.e. entities established in the EU whose securities are admitted to trading on an EU regulated market, as well as licensed credit institutions and insurance companies having their registered office in the EU and entities designated by a Member State as such. Note that the NFRD currently only covers public-interest entities.*

The consultation proposed three possible ways to broaden the NFRD's scope to additional PIEs, and five ways to extend the scope of the NFRD to other non-PIEs. **Views** expressed during the consultation **ranged from not extending the scope of the NFRD to extending it to all companies established, listed or operating in the EU.**

Some company representatives were against any extension at all, while others supported only inclusion of all large public interest entities (PIEs), as defined by Member States, or leaving it up to

Member States. Some argued that the first step should be to extend the scope to non-EU companies operating in the EU or listed in the EU and non-listed companies (without changing the size criteria), stating that this would already result in a significant increase in the number of reporting companies.

Many respondents argued for the equal treatment of companies (i.e. to apply the same size thresholds regardless of whether the company was listed or not), as the impact on society and the environment does not depend on listing of securities. Many respondents stated that the size thresholds should be aligned with those established by the Accounting Directive for large companies (250 employees). Many also stressed the need for an alignment of financial and non-financial information reporting obligations, with some arguing that the same proportional approach to financial reporting (i.e. gradual increase of reporting obligations with the increase in company size) should apply to non-financial reporting.

Moreover, most respondents agreed that **SMEs** needed **special treatment** and that the **principle of proportionality** should be kept in mind. Many representatives of financial institutions pointed out that they needed non-financial information from their clients and investees to meet their own reporting obligations stemming from EU legislation and thus the scope of issuers covered by the NFRD should take that into account.

Interestingly, there were **significant differences between different stakeholder groups**. While, for example, 74 % of users supported the idea of including all listed companies regardless of their size under the scope of the NFRD and only 9 % of users disagreed with this option, only 43 % of SME respondents agreed on this and 38 % disagreed. The proportion of financial sector companies that agreed all listed companies regardless of their size should be included in the scope was 70 %.

Related European Commission public consultations and studies

As outlined in the consultation strategy on the review of the NFRD, the outcomes of the following **related consultation activities and studies** carried out by the Commission in the past are also particularly relevant and will be taken into account in the review:

- Open online public consultation on corporate reporting: In 2018, this consultation enabled the Commission (Directorate-General for Financial Stability, Financial Services and Capital Markets Union – DG FISMA) to gather data and views on non-financial reporting issues needing to be addressed.
- Targeted online consultation on climate-related reporting: In 2019, when developing the new guidelines for companies on how to report on climate-related information, the Commission organised a targeted online consultation on climate-related reporting. In addition, the Technical Expert Group on Sustainable Finance organised a call for feedback on its recommendations with regard to reporting climate-related information. The results of these consultation activities, although specific to the climate issue, are an important complement to the consultation strategy on the review of the NFRD.
- In 2019, the Commission (Directorate-General for Justice and Consumers – DG JUST) contracted a study on due diligence requirements through the supply-chain (published in January 2020). The tasks of this study included a survey of relevant stakeholders, the results of which also complement the current consultation strategy, in particular with regard to stakeholder views on the impacts of company reporting on human rights and environmental due diligence.
- Open online public consultation on a Renewed Sustainable Finance Strategy: From 8 April to 15 July 2020, the Commission (Directorate-General for Financial Stability, Financial Services and Capital Markets Union – DG FISMA) launched an open online public consultation on a renewed sustainable finance strategy.

3. European Parliament position / MEPs' questions

Resolutions of the European Parliament

Parliament has expressed its views repeatedly on the issue of non-financial reporting. In its resolution[27] on sustainable finance, adopted in May 2018, Parliament called for a revision of the

NFRD. More specifically, it argued for inclusion of proportional and mandatory disclosure in the revised NFRD; consideration of enlargement of its scope, stressing, however, that the reporting framework requirements should be proportionate with the risks incurred by the institution, its size and degree of complexity; development of further environmental, social and governance (ESG) reporting requirements, including a list of indicators measuring sustainability impacts and covering the most significant sustainability risks; and compulsory third-party audited reporting.

In a more recent resolution[28] on sustainable corporate governance, adopted on 17 December 2020, Parliament set out its expectations in terms of sustainable corporate governance and, with a view to the revision of the NFRD, made a series of recommendations. It called, in particular, for a legislative framework to include mandatory standards and ensure that information disclosed is clear, balanced, understandable, comparable among companies within a sector, verifiable, objective and includes time-bound sustainability targets. Moreover, as in 2018, Parliament called for the scope of the directive to be extended to cover all large listed and unlisted companies established in the EU, as defined by the Accounting Directive. These non-financial reporting requirements should also apply to non-European companies operating in the EU market, so as to ensure a level playing field. Finally, Parliament asked the Commission to identify high-risk sectors of economic activity with a significant impact on sustainability issues that could justify the inclusion of SMEs in the scope of the directive.

Written questions

Written question by Saskia Bricmont (Greens/EFA, Belgium) and Heidi Hautala (Greens/EFA, Finland), 19 September 2019

This written question was put in the context of future EU legislation on due diligence and the review of the NFRD, with a view to complying with the sustainable development goals (SDGs), the Paris Agreement and the chapters on trade and sustainable development in free trade agreements.

Referring to Directive 2014/95/EU (requiring large companies to publish information on policies, outcomes and risks concerning environment, diversity, human rights and other issues, and on due diligence throughout the supply chain, so as to address existing and potential negative effects, and improve transparency concerning the effects that companies may have on the environment) and the guidelines for companies on reporting climate-related information, the Members asked when the Commission would gather information on a webpage to compare performance, disseminate good practice and assess whether additional provisions were needed. On future EU legislation on due diligence and referring to due diligence legislation passed by some Member States, the Members also asked whether the Commission intended to propose a directive to ensure that these were not just isolated initiatives. They also wanted to know whether the Commission would integrate the guidelines on climate-related reporting into binding rules so as to help implement the SDGs and the Paris Agreement and to ensure full compliance with the chapter on trade and sustainable development included in a batch of free trade agreements being passed at the time.

Answer given by Mr Reynders on behalf of the European Commission, 24 January 2020

The Commissioner reiterated the commitment to deliver on the UN SDGs and the Paris Agreement, as businesses must behave responsibly, contribute to sustainable development and comply with human rights obligations. The Commission promoted responsible and sustainable supply chains in all policies. Here, full use should be made of measures already in place, including full implementation of existing EU legislative measures (such as instruments introducing sector specific due diligence requirements (Regulations (EU) No 995/2010 and 2017/821) and Directive 2014/95/EU providing for a due diligence reporting requirement for large companies). In its European Green Deal communication adopted on 11 December 2019, the Commission had announced a review of the NFRD for 2020.

In the context of the implementation of its 2018 action plan on financing sustainable growth and the European Green Deal, which indicated that sustainability should be further embedded in corporate governance, the Commission had contracted a study on due diligence requirements throughout supply chains, also covering child labour. The study's final report, due in January 2020, and experience from implementation of the existing EU due diligence rules, would inform the work of the Commission. Moreover, the Commission would propose to make upholding the Paris Agreement an essential element for all future comprehensive trade agreements.

Written question by Eero Heinäluoma (S&D, Finland), 4 December 2019

This question was put in the context of the Commission's 2019 report on gender equality in the EU and the need to ensure transparency and responsible behaviour of companies in terms of respecting human rights. With reference to that report (in which the Commission highlighted that progress in Europe's endeavours to achieve gender equality was slow, with a wide gender pay gap across the EU, and women earning on average 16 % less than their male counterparts, with little change in the last few years), the Member considered that gender equality goes far beyond closing the pay gap and that improving women's rights in the corporate sector everywhere in the world is key to improving gender equality. In the light of this and Ursula von der Leyen's commitment to introduce binding measures to achieve equal pay, the Member asked how and when the Commission intended to increase the number of female board members in listed companies and what was its objective in terms of the percentage of women on boards. Moreover, the Member asked whether the Commission would use the NRFD review as an opportunity to promote a more gender-neutral policy among large companies and how the EU would ensure that every company was transparent and responsible in terms of respecting human rights and in their efforts to combat child labour.

Answer given by Ms Dalli on behalf of the European Commission, 13 March 2020

The Commissioner confirmed that promoting gender equality in decision-making and the 2012 proposal for a directive was a Commission priority (the importance of legislative measures was clear since the share of women on company boards had improved in recent years mainly in countries that had taken legislative action on the issue). The Commission also used other tools, such as 'diversity charters', to promote gender balance in decision-making positions and supported Member States and stakeholders through awareness raising, political dialogue and exchange of good practices. The recent Directive 2019/1158 on work-life balance for parents and carers should also have a positive impact on how women reconcile their personal and professional responsibilities and therefore on their career progression. The Commissioner explained, however, that under the NFRD, companies may choose to include gender balance information, but are currently not obliged to do so. The scope of the reporting obligations would be a key element in the 2020 review of the directive.

On the fight against child labour, the Commission referred to a study on supply chain due diligence requirements, contracted as part of the 2018 action plan on financing sustainable growth, also covering child labour. The final report of this study and experience of implementing the EU's existing due diligence rules would inform the Commission's work. Sustainability would also be further embedded into corporate governance as part of the European Green Deal.

4. Council of the EU

On 5 December 2019, the Council adopted conclusions on 'Deepening the Capital Markets Union'. The document stressed, among other subjects, that the Commission and Member States should seek ways to further promote sustainable financing by providing for reliable, comparable and relevant information on sustainability risks, opportunities and impact within the EU (paragraph 16). In the annex to the conclusions, in the context of the transition to sustainable economies, the Council called upon the Commission to consider the development of a European non-financial reporting standard taking into account international initiatives, with specific attention to climate-related disclosures in order to promote Paris alignment of investment flows.

5. European Court of Auditors

On 6 June 2019, the European Court of Auditors (ECA) published a Rapid case review[29] on the status of reporting on the achievement of the SDGs and sustainability at EU level and reporting by individual EU institutions and agencies. The review reveals that the Commission – with one exception in the area of external action (where the Commission has started to adapt its performance reporting system to the SDGs and sustainability) – does not report on the contribution of the EU budget or EU policy to achieving the SDGs. Although it recently published a reflection paper describing selected SDG-related policies, sustainability reporting is currently not built into the Commission's performance framework, and the necessary pre-requisites for meaningful sustainability reporting, such as a long-term strategy, are, according to the ECA, largely not yet in place. One EU institution (the European Investment Bank), and one EU agency (the European Union Intellectual Property Office), currently publish sustainability reports.

6. European Economic and Social Committee

The European Economic and Social Committee (EESC) addressed non-financial reporting in an exploratory opinion of 18 September 2020.[30] The opinion's main focus is on mandatory due diligence, with the EESC affirming, in particular, that it is time for the Commission to propose legislation on mandatory due diligence that acknowledges responsibility based on current standards and offers a clear and secure legal framework for European businesses. However, the opinion also touches upon the issue of non-financial reporting. In particular, the EESC states that future due diligence legislation must prescribe which individual actions should be taken by companies throughout the whole due diligence process to assess risk in coherence with other EU legislation, including the revised NFRD. As to identification and assessment of potential adverse impacts of corporate activities on human rights and the environment, the EESC considers that this should be set out in a formal, detailed document that is accessible, transparent and sincere. However, reporting requirements should be proportionate and respect legitimate business secrecy.

ENDNOTES

1 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

2 Adjusted Commission Work Programme 2020, Annex I (p. 1, point 4 under 'Financing the sustainable transition').

3 Communication on the European Green Deal, pp. 16-17.

4 Inception Impact Assessment, 30.1.2020.

5 Commission Work Programme 2021, Annex I (p. 3, policy objective 'Sustainable corporate governance').

6 Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector.

7 Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment.

8 Regulation (EU) 2019/2089 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks.

9 Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.

10 Disclosure of non-financial and diversity information, FAQs, European Commission.

11 The Global Reporting Initiative (GRI), founded in 1997, is an independent, international organisation that helps businesses and other organisations take responsibility for their impacts by offering a framework for sustainability reporting. In 2016, GRI transitioned from guidelines to setting the first global standards for sustainability reporting.

12 The Sustainability Accounting Standards Board (SASB), founded in 2011 in the US as an independent standards-setting organisation, sets industry-specific sustainability disclosure standards, intended to capture sustainability matters that are financially material. The SASB promotes the standardised measurement and disclosure of corporate performance on critical sustainability factors, thus facilitating communication between companies and investors in this area.

13 The International Integrated Reporting Council (IIRC), a global non-profit organisation founded in 2013, is a coalition of regulators, investors, companies, standard setters, the accounting profession, academics and NGOs. The coalition promotes communication on value creation as part of corporate reporting. The IIRC's goal is to establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors.

14 In June 2017, the Task Force on Climate-related Financial Disclosures (TCFD), established by the G20's Financial Stability Board, published recommendations to encourage financial institutions and non-financial companies to disclose information on climate-related risks and opportunities.

15 The UN Guiding Principles Reporting Framework is the first comprehensive guidance for companies to report on human rights issues in line with their responsibility to respect human rights. The UNGP Reporting Framework was launched in February 2015.

16 The UN Global Compact is a voluntary initiative that seeks to advance universal principles on human rights, labour, environment and anti-corruption through the active engagement of the corporate community, in cooperation with

civil society and representatives of organised labour. Introduced as an annual requirement for participants in 2004, the Communication on Progress (CoP) is the UN Global Compact's reporting framework. It serves as the initiative's main accountability measure based on commitments from companies to make progress towards its 10 principles. The UN Global Compact is currently reviewing its CoP and plans to launch a new CoP in 2021.

[17] The Organisation for Economic Co-operation and Development (OECD) guidelines for multinational enterprises, first adopted in 1976 and last updated in 2011, are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide non-binding principles and standards for responsible business conduct in a global context consistent with applicable laws and internationally recognised standards. The Guidelines are the only multilaterally agreed and comprehensive code of responsible business conduct that governments have committed to promoting.

[18] The International Organization for Standardization (ISO) voluntary international standard ISO 26000 (Guidance on Social Responsibility) is intended to help organisations contribute to sustainable development. It provides, inter alia, guidance for all types of organisations, regardless of their activity, size or location, on communicating commitments, performance and other information related to social responsibility. Unlike some other ISO standards, ISO 26000 provides guidance rather than requirements and thus cannot be certified.

[19] The German Sustainability Code (Deutscher Nachhaltigkeitskodex, DNK) was developed in 2010 as an international transparency standard for corporate responsibility by the German Council for Sustainable Development in dialogue with representatives of the political world, capital markets, the business community and NGOs. It provides support with establishing a sustainable development strategy and offers a way in to sustainability reporting.

[20] EFRAG mandate, July 2020.

[21] A 2020 factsheet by Accountancy Europe, covering 26 European countries including 24 Member States (including the UK – still a Member State at the time of the analysis – but not Ireland, Luxembourg, Malta or Poland), shows that 12 Member States had the minimum requirement in place, 9 Member States had an additional requirement with a consistency check and 3 required mandatory independent assurance.

[22] A November 2020 study on CSR and its implementation in EU company law, by Parliament's Policy Department for Citizens' Rights and Constitutional Affairs, examined the transposition of the NFRD in six Member States.

[23] 2017 Guidelines on non-financial reporting.

[24] 2019 Guidelines on non-financial reporting: Supplement on reporting climate-related information.

[25] While the Commission contracted two studies to gather additional data for the impact assessment (one on company reporting under the NFRD and another on sustainability-related ratings, data and research), only the study on sustainability-related ratings, data and research has been published at the time of publishing this briefing.

[26] A Capital Markets Union for people and businesses-new action plan, 24 September 2020, European Commission.

[27] Resolution of 29 May 2018 on sustainable finance, European Parliament.

[28] Resolution of 17 December 2020 on sustainable corporate governance, European Parliament.

[29] Review No 07/2019: Reporting on sustainability – A stocktake of EU Institutions and Agencies (Rapid case review).

[30] Opinion on mandatory due diligence, September 2020, European Economic and Social Committee.

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