

**European Commission's proposal for a Directive
on disclosure of non-financial and diversity information
by certain large companies and groups
COM(2013)207**

Executive summary

EUROCHAMBRES supports the aim of improving transparency of the social and environmental information provided by companies in all sectors when the disclosure of such information helps companies to better manage non-financial risks. This brings a positive impact on companies' long-term sustainability.

Chambers are fully involved in promoting Corporate Social Responsibility (CSR) policies among their members and in supporting enterprises in developing and implementing innovative CSR models and reporting. EUROCHAMBRES, however, considers that CSR is voluntary in nature and that any administrative and financial burdens on companies should be minimised, especially in consideration of the current severe economic crisis.

EUROCHAMBRES is also concerned by the European Council's conclusions to expand country-by-country reporting requirements to all large companies and fears that this proposed directive will be considered as the alternative legislative vehicle for implementing cross-sector country-by-country reporting.

With regards to the proposed directive on disclosure of non-financial regulation EUROCHAMBRES considers that:

- I. CSR is in nature a voluntary commitment and the current regime is satisfactory**
- II. CSR should be a business-driven process**
- III. The proposal would lead to an increase of administrative and financial burdens for companies**
- III. bis The proposal would lead to negative consequences all along the supply chain**
- IV. Consistency and comparability of non-financial information will not be achieved**
- V. A one-size-fits-all approach cannot be pursued**
- VI. Any attempt by co-legislators to include country-by-country tax reporting should be rejected**
- VII. A unified scope for non-financial and board diversity reporting should be set, if the proposed directive is adopted.**

EUROCHAMBRES' priorities¹

I. NON-FINANCIAL REPORTING SHOULD BE VOLUNTARY

EUROCHAMBRES is convinced that CSR represents an important element of a company's activities and believes the Commission's definition of CSR as "*the responsibility of enterprises for their impact on society*", reflects the positive behaviour of the vast majority of SMEs, naturally committed to adopting and implementing CSR principles. National, regional and local Chambers are constantly involved in helping and supporting enterprises to fully understand the added value of integrating CSR policies in their activities and in addressing in the most efficient way social, environmental and human rights concerns relevant to them.

Many companies across the European Union already voluntarily integrate social and environmental concerns into their business operations and strategies. However, as highlighted by a recent study², it is recognised that SMEs in particular lack the time and financial resources to report on non-financial information. SMEs, moreover, often operate at local level and have a direct link with the communities, to which they respond in their behaviour on a daily basis, thus limiting the direct impact of non-financial reporting on their reputation-building process (European Business 2009).

Under the current legal framework, businesses can freely decide if and to what extent to disclose non-financial information to the public or to their shareholders and stakeholders, following a balanced evaluation of consequent positive outcomes in terms of market share, image and accountability.

EUROCHAMBRES firmly believes that this approach should be maintained. Companies are best placed to decide whether to voluntarily commit beyond the pure legal requirements when it comes to the disclosure of non-financial information. Obliging businesses to disclose non-financial information would impinge on business efficiency and competitiveness and jeopardise the capacity to innovate.

CSR policies are dynamically evolving over time and enterprises should be allowed to flexibly adapt the way they address non-financial concerns and risks based on their company's size, sector of activity, competition policy, investors', customers' and shareholders' interests etc. Concerned companies should continue providing the information about their CSR related activities on a voluntarily basis both with regard to the format and the degree of relevant information.

¹ The Eurochambres' position paper has been drafted based on the Commission proposed Directive amending Directives 78/660/Ec and 83/349/EEC repealed by Directive 2013/34/EU. All references made to the repealed Directives and to the articles therein included have to be considered as referring to the new numbering as referred to in the correlation table attached to the Transparency Directive.

² Wensen, Katelijne van; Wijnand Broer; Johanna Klein and Jutta Knopf 2011 "*The state of play in sustainability reporting in the EU*", pp. 72, 84

The Commission affirms that currently only approx. 2,500 large companies out of the total of 42,000 report on non-financial aspects of their activities on a yearly basis. A recent study³ reports that at present 95% of the world's 250 largest companies include non-financial reports and elements in their annual reports and many other businesses already report on environmental and social issues.

With regard to such data, and more precisely with regard to the obligation that would be imposed on large companies, EUROCHAMBRES considers that the Commission did not correctly evaluate that multinational enterprises (hereinafter MNEs) and SMEs approach CSR in a very different way and that their reasons to commit or not to CSR policies and reporting hugely vary. The Commission, moreover, does not sufficiently consider that SMEs are directly affected by MNEs' and larger companies' behaviour and that any obligation imposed on large companies to report on non-financial and diversity information would have direct effects on all SMEs, as they are an integral part of a complex supply chain.

Recommendations:

Reconsider the mandatory approach to non-financial and diversity reporting and encourage companies to come forward with their CSR commitment, rather than making reporting compulsory.

Broaden the "comply or explain" approach, should the proposed directive be adopted.

First and better assess the impact of the mandatory reporting requirement on SMEs and the supply chain.

II. CSR SHOULD BE A BUSINESS DRIVEN PROCESS

EUROCHAMBRES is convinced that for many companies Corporate Social Responsibility is self-evident and part of the company culture and considers that many SMEs, which represent 99% of the European companies, already voluntarily adopt a CSR policy even if often they don't explicitly report on it.

The decision about the disclosure of non-financial information belongs to the enterprise marketing strategy and is an integral part of companies' natural competition policy: companies themselves are best placed to identify policy areas that are most relevant to them.

Chambers are fully aware of the difficulty for companies to give evidence of adopted CSR policies and outputs and consider that the European Commission should further investigate to correctly estimate companies' commitment to CSR before shifting to a mandatory approach to CSR.

³ "KPMG International Survey of Corporate Responsibility Reporting 2011", available at <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/corporate-responsibility/Documents/2011-survey.pdf>

Under the current European legal framework, enterprises identify CSR policies that are relevant for their organization and define the priorities and contents of their non-financial reports (Environment, labour and employment, society and community, product responsibility etc.) based on their company's objectives and corporate culture. CSR topics generally vary according to regulations, consumer demand, incentives to engage in CSR, type of sector involved in and the degree of CSR implementation in a sector or country.

Companies (especially SMEs) often abstain from reporting on non-financial issues for the difficulty to collect and organize the required data even if they adopt a CSR policy in a specific area. Their decision not to report on non-financial aspects is essentially based on the assessment of the final receivers (stakeholders, shareholders, customers etc.) interest in obtaining the information.

EUROCHAMBRES estimates that, in case the current proposal would be adopted, the European Commission will impose companies to primarily focus on policy areas that are not necessarily relevant to them and their stakeholders, with the indirect consequence of reducing CSR reporting to a mere formal exercise that, *de facto*, would void the good results of European companies' voluntary commitment to CSR in the last decade.

EUROCHAMBRES believes that, in consideration of fast changing markets and company objectives, a flexible, voluntary and business-driven approach to CSR should be maintained in Europe and that companies' commitment to CSR should not to be discouraged by a "tick-box exercise" approach of rigid and binding legal reporting requirements.

Recommendations:

Maintain the current voluntary approach to non-financial and diversity reporting.

Reconsider the effectiveness of the mandatory disclosure of certain non-financial information especially with regard to the interest of the final receivers.

III. INCREASED ADMINISTRATIVE AND FINANCIAL BURDEN

EUROCHAMBRES is convinced that the proposed directive, as it stands, imposes unjustified and unbearable administrative and financial burdens on companies and that such burdens have been heavily underestimated by the European Commission.

According to the Commission, the global number of non-financial reports per year has increased from almost zero in 1992 to approx. 4000 in 2010 and it is considered that the total number of EU large companies disclosing non-financial information

through annual reports or stand-alone reports amounts to approx. 2500p.a.⁴ Concerning disclosure of non-financial issues the Commission, based on a recent survey, assumes that only few companies report on their sustainability performance during their Annual General Meeting⁵.

EUROCHAMBRES argues that, before making CSR reporting compulsory, the Commission should consider implementing and supporting local and national projects that have been set up to support companies both in implementing CSR policies and in reporting on them to the public.

With regard to the costs of CSR reporting, the Commission estimates that increased costs for disclosing non-financial information will amount to a total between EUR 600 and EUR 4,300 per year per company. Based on the findings of a study published by the Danish Commerce and Companies Agency to evaluate the impact of the bill on CSR adopted in Denmark in 2008, the Commission estimates that, for the disclosure of diversity policy information, a further amount ranging from EUR 600 to EUR 1,000 should be added.

EUROCHAMBRES considers that the total costs deriving from the draft Directive implementation are miscalculated.

Indeed, apart from the accuracy of the aforementioned data, it has to be highlighted that the cited Danish publication stated that in Denmark the administrative burden associated with CSR reporting was 7-8 times higher than was expected before the bill was passed and that the data referred to did not include one-off costs that had been included in a different report on an ex-post measurement of real one-off costs and recurring costs⁶.

Moreover, according to the 2011 CSES study on “Disclosure of non-financial information by companies”, the total cost for reporting on non-financial information incurred by surveyed companies across Europe ranges from EUR 155,000 to EUR 604,000 for large companies and in the range of EUR 8,000 to EUR 25,000 for smaller companies⁷. The total direct costs (considering that 18,000 companies will fall under the directive scope) could be roughly estimated ranging from EUR 2,790

⁴ Commission Staff Working Document Impact Assessment accompanying the Document Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non-financial and diversity information by certain large companies and groups

⁵ CSES, 'Disclosure of non-financial information by Companies', 2011, p.12

⁶ http://www.dcca.dk/graphics/publikationer/CSR/CSR_and_Reporting_in_Denmark.pdf

⁷ The study is available via the following link:

http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207-study_en.pdf

The study also calculated the costs of non-financial reporting in relation to staff numbers. Costs for smaller companies per employee (€68 to €212) are substantially higher than those for larger companies (€3 to €13).

million to EUR 10,872 million at for the European large companies, only considering non-financial reporting.

The benefits of non-financial reporting for concerned enterprises are unlikely to be quantified. According to the 2011 CSES study, companies generally consider that CSR reporting increased confidence in the company among stakeholders and investors improved the brand image and had a positive outcome on risk management. However, when companies were asked to quantify the benefits of non-financial reporting, only 3 companies tried to do so and finally only one could provide an estimate of its financial benefit⁸.

Given such diverging data about costs for companies stemming from new obligations (and benefits deriving from them), EUROCHAMBRES deems it necessary to further analyse and assess the real financial impact of the proposed directive on companies before proceeding. To avoid many medium enterprises, as defined by the EU, falling within the scope of the proposal and to avoid bureaucratic burdens for smaller companies, EUROCHAMBRES considers that the thresholds set by the proposed directive for mandatory requirements to apply, should be raised.

EUROCHAMBRES recommends that both the threshold provided for the companies' balance sheet and net turnover should be raised to EUR 100 million.

Point 14 of the Commission proposal's recitals also states that *"the report of the statutory auditors should also contain an opinion concerning the consistency or otherwise of the annual report, including non-financial information contained in the annual report, with the annual accounts for the same financial year"*.

EUROCHAMBRES considers there is no valid justification for such a provision, which is very likely to substantially increase costs for audited companies and, therefore, argues point 14 of the proposal's recitals should be deleted.

The Commission's proposal should be also amended to clearly define that no assurance report on the company's non-financial report is required.

Recommendations:

Reassess the calculation of total costs deriving from the non-financial and diversity reporting obligations.

Amend the proposed directive by raising the threshold provided for the companies' balance sheet and net turnover to EUR 100 million.

Identify and quantify benefits of non-financial reporting for businesses before imposing it as mandatory on companies.

⁸ CSES, pp. 27-31

Delete point 14 of the proposed directive's recitals on auditors' opinion on the consistency or otherwise of the annual report, herein included the non-financial information, with the annual accounts.

Clarify that no mandatory auditing on non-financial information is required.

III bis. NEGATIVE CONSEQUENCES ALL ALONG THE SUPPLY CHAIN

EUROCHAMBRES supports Corporate Social Responsibility (CSR) activities and recognises the added value of voluntary CSR practices for SMEs. Nonetheless, Chambers fear negative spill-over effects will arise from the new non-financial reporting requirements and will affect SMEs even though the direct obligation to report on non-financial and diversity policies does not apply to them.

EUROCHAMBRES believes that the Commission proposal does not sufficiently consider the risk that larger companies, which will have to mandatorily report on non-financial information and on diversity policies, will easily transfer the risk to their suppliers thus "forcing" smaller companies (that would not fall under the current proposal obligations) to adopt the same (or similar) CSR policies with a subsequent increase in their obligations and with that their administrative and financial burden in a period of economic recess where one of the biggest concerns for SMEs is access to finance and lack of resources.

Regarding CSR in the chemical, construction and textile sectors for example, it has to be highlighted that companies operating in these sectors are mainly SMEs (e.g. 96% in the chemical and textile sectors), that sectors' experts consider SMEs lack financial and human resources in order to engage in CSR and that most sectors' SMEs already suffer from cost pressure all along the supply chain⁹.

Recommendations:

Amend art.1, (1), (b), (iii) and art.2, (1), (a), (iii) of the proposed directive by excluding related risks from the mandatory reporting requirement.

Introduce effective mechanisms to avoid that non-financial and diversity reporting obligations are transferred to SMEs all along the supply chain.

IV. CONSISTENCY AND COMPARABILITY OF NON-FINANCIAL INFORMATION WILL NOT BE ENSURED

⁹ "Does corporate responsibility pay off?"(2010) Available at: http://ec.europa.eu/enterprise/policies/sustainable-business/files/csr/documents/competitiveness/101124_csr_comp_final_report_long_version_final_en.pdf

EUROCHAMBRES is convinced the current proposal will not ensure a level playing field, nor will it provide investors, shareholders, employees and civil society organizations with harmonised and comparable key, useful information¹⁰.

The current proposed directive recital [points 4), 6), 8), 13) and 17)] and their explanatory memoranda are vitiated by conflicting and inconsistent declarations about the achievement of the recalled harmonization and coordination of collected data at European level since they promote the adoption of new reporting schemes that would be used along with the already existing ones.

EUROCHAMBRES believes that the comparability of data, that is one of the Directive's cornerstones in the Commission's view, would not be achieved by imposing mandatory reporting on non-financial and diversity policies and that the application of CSR standards should pursue a voluntary approach.

As stated in the *"CSR and Competitiveness European SMEs Good Practice: Consolidated European Report, 2007"*, SMEs normally apply CSR without even identifying their activities as such and the difficulty in comparing available "hard fact data" in a cross-country analysis mostly depends on the fact that all data only stems from individual research studies that focus on diverging definitions and apply different methodologies¹¹.

Whilst the Commission considers that the draft directive will address the problem of CSR reporting requirements and policy fragmentation, Chambers consider that the proposal doesn't provide for any real common tool to achieve a harmonised CSR reporting system. The proposed directive, indeed, clearly declares that companies may rely on national, EU- based or international frameworks that include, in an open and non-exhaustive list: the UN Global Compact, the Guiding Principles on Business and Human Rights implementing the UN "Protect, Respect and Remedy" Framework, the OECD Guidelines for Multinational Enterprises, ISO 26000, the ILO Tripartite Declaration of principles concerning multinational enterprises and social policy, and the Global Reporting Initiative (GRI).

The already extensive list of possible reporting schemes is furthermore incremented by the Commission's encouragement to industry, interested governments and relevant stakeholders to develop new models. Member States could also set more ambitious requirements, thus potentially creating a system that runs counter the proposed directive's aims and that would only oblige companies to publish more diversified and less comparable data.

Public policy instruments are often seen as an effective lever to increase the commitment to CSR and the quality of sustainability reporting. However it is

¹⁰ See COM(2013) 207 final "DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups"

¹¹ CSR and Competitiveness European SMEs' Good Practice: Consolidated European Report, 2007

recognized that these instruments must take into account the significant differences between large companies and SMEs, and as long as regulation does not result in a wide variety of national reporting schemes and obligations, hindering comparability and the aggregation of local data in regional or global reports¹².

EUROCHAMBRES considers that the imposition of mandatory reporting obligations with regard to CSR and diversity policies on companies will not improve the comparability of data at European level and deems that this element of the Commission's proposal should be rejected.

Recommendations:

Reconsider the effectiveness of such proposal in providing for consistency and comparability of required non-financial information.

V. THE ONE-SIZE-FITS-ALL APPROACH CANNOT BE PURSUED

Juxtaposed to the dynamic evolution of markets and companies' approach to their customer, stakeholders and shareholders, who are the final beneficiaries and readers of non-financial and diversity reports, the Commission has taken a one size fits all approach when drawing up the proposed directive.

EUROCHAMBRES believes companies are best placed to decide whether to adopt a CSR policy in a specific area and that the current legislative framework adequately addresses businesses' competitive environment and needs.

Many studies encourage the application of CSR principles in a flexible and tailored way, especially when it comes to SMEs. The need for harmonisation of reporting standards and performance indicators is also stressed by both reporting companies and readers, while realising that a 'one-size-fits-all' approach has its limitations.

Recommendations:

Introduce a more flexible approach to CSR reporting.

Turn from the "one size-fits-all" approach characterising the proposed directive.

VI. COUNTRY-BY-COUNTRY TAX REPORTING

EUROCHAMBRES firmly rejects any attempt to use the proposed directive as an alternative legislative vehicle for implementing cross-sector, country-by-country reporting and to further extend mandatory reporting requirements to financial or tax data. Such an approach would interfere with the freedom of establishment provided for in the EU Treaty and impose unreasonable administrative burden on European companies expressed already in tens millions of euro.

¹² Wensen, Katelijne van; Wijnand Broer; Johanna Klein and Jutta Knopf (2011)

The current annual report already includes non-financial information if relevant to the particular business. With regards to access to finance, some aspects related to disclosure of information by companies beyond that might play a role in investment and financing of such entity. Depending on a company, its products or branch, non-financial information could be in the interest of its stakeholders. However, a decision on if and how to reveal such information should be made case-by-case based on the interests of different stakeholders. Therefore companies should be encouraged to examine if and which non-financial information could contribute to better decision-making with regards to investment.

In the context of the latest discussions on tax avoidance and tax evasion, it should be highlighted that public country-by-country reporting is not the preferable instrument for improving tax transparency, as it displays strategic information also to competitors who are not subject to tax secrecy. Therefore the G8-summit strictly limited the disclosure of such data to tax authorities. Also, an economic activity of multinational corporations is tightly linked to the existence of a number of small and medium-sized enterprises being either their suppliers or subcontractors. Any consideration of changes in the system shall be based on a thorough assessment of the impact on the whole economic ecosystem and not just a fraction of it.

For these reasons, EUROCHAMBRES does not support country-by-country reporting on tax matters because rather than improving transparency, it risks further reducing public understanding of the tax debate by introducing data of high complexity without preserving the context. Instead EUROCHAMBRES would like to see this debate move beyond pure country-by-country reporting. It would be worthwhile to consider how companies can explain their tax affairs to policy makers and the general public from their own perspective, while preserving transparency and increasing understanding of the issue.

Recommendations:

Avoid extending the mandatory requirements to financial and tax country-by-country reporting as it would interfere with the freedom of establishment.

Reconsider the effectiveness of country-by-country reporting as an instrument to improve tax transparency.

Identify different instruments to allow companies to explain to policy makers and general public their tax behaviours in order to increase mutual understanding.

VII. REPORT ON DIVERSITY POLICIES

EUROCHAMBRES shares the Commission's view about the importance of fighting discrimination at all levels and of promoting well-balanced work environments. Nevertheless, it considers that discrimination and gender issues are sufficiently addressed by current national and European legal frameworks and legislative proposals.

As highlighted in the explanatory memorandum of the proposed directive, discrimination on grounds of religion or belief, disability, age or sexual orientation, sex, racial or ethnic origin are prohibited respectively by Directive 2000/78/EC, Directive 2006/54/EC and Directive 2000/43/EC. The issue of gender-balance within companies' boards is being addressed by the European Commission in the proposed directive on improving the gender balance among non-executive directors within listed companies. EUROCHAMBRES considers that, before imposing any further burden and obligation on European companies, it would be advisable that the European Commission takes into account the outcomes of the proposed directive. National regulations and corporate codes of conduct on discrimination and gender also contribute to define and shape companies' behaviour and responsibility.

EUROCHAMBRES considers that a more extensive investigation on and evaluation of European and national regulations and best practises at corporate level must be undertaken before any mandatory requirement is set at European level.

In addition, with regard to the recalled "group thinking phenomenon", the Commission does not provide sufficient and scientific evidence to substantiate the need for companies' obligation to annually publish a diversity report. The model of "group thinking" underpinning the Commission's decision was developed in 1972 and it is considered outdated by many authors¹³ who criticise it both with regard to its effectiveness and its applicability to company boards.

The Commission should reconsider and further investigate whether this is the right reference for the recalled proposed directive.

EUROCHAMBRES also doubts that art. 50 (1) of the TFEU can be considered as the correct legal basis to legislate with reference to the diversity reporting obligation.

Indeed, even if read in conjunction with art. 50 (2), g), TFEU. art. 50 (1) aims at attaining the freedom of establishment as regards a particular activity and, when combined with par.2, lett. g), it only allows the EU institutions to carry out their institutional duties by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 54 with a view to making such safeguards equivalent throughout the Union.

Concerning the requirement to submit a "clear and reasoned explanation" in case a company does not adopt a diversity policy and the corresponding requirement to give a simple "explanation" for companies not disclosing non-financial information, EUROCHAMBRES considers the proposed directive to be inconsistent.

¹³ See: Baron (2005); Henningsen, David Dryden, Henningsen, Mary Lynn Miller, Eden, Jennifer, Cruz, Michael "Examining the Symptoms of Groupthink and Retrospective Sensemaking" 2006; Fuller and Aldag (1998);

In the Chambers' view the Commission should address such inconsistency by setting a single requirement and by allowing companies to provide an "explanation" in both cases. This would avoid administrative and organizational burdens and would solve any legal uncertainty arising from the inclusion in the text of vague and different legal requirements that would possibly be open to subjective and diverse legal interpretations (clear and reasoned explanation).

Recommendations:

Assess the outcomes of current national and European initiatives, before introducing the mandatory disclosure of diversity policies at corporate level.

Assess whether art. 50(1) of the TFEU is the correct legal basis for the proposed directive with regard to the diversity reporting obligation.

Amend art. 1, par (2), (g) of the proposed directive requiring for a "clear and reasoned explanation" in case a company does not adopt a diversity policy and **introduce** the requirement to submit a simple "explanation" instead, as provided for the disclosure of non-financial information.

VIII. UNIFIED SCOPE FOR NON-FINANCIAL AND BOARD DIVERSITY REPORTING

The different scope for non-financial and board diversity reporting seems to be unjustified and not supported by any legal evidence. It also increases the administrative burden for companies that will have to deal with different requirements for, in the Commission's view, interlinked reporting requirements.

EUROCHAMBRES considers that the draft directive should be amended by establishing the obligation to publish the non-financial and diversity reports upon listed companies with more than 500 employees.

To ensure that medium enterprises, as defined by the EU, do not fall within the scope of the draft directive, EUROCHAMBRES proposes the threshold of the companies' balance sheet and net turnover to be raised to EUR 100 million, should it ultimately be adopted.

Recommendations:

Amend the proposed directive and **provide for** a unified scope for non-financial and board diversity reporting requirements **by establishing** both non-financial and diversity reporting obligations upon listed companies with more than 500 employees and a balance sheet and net turnover higher than EUR 100 million.