

The European Commission must take action to improve the reporting obligations of companies on sustainability issues

Over 20 leading human rights, environment and anti-corruption organisations with an interest in improving corporate transparency have joined together to call on the European Commission to improve the legal framework for corporate sustainability reporting.

The European Commission's Action Plan on Sustainable Finance¹ and the related legislative proposals² are a crucial step towards achieving the Paris Agreement and the Sustainable Development Goals by reorienting capital flows to support a long-term, sustainable and just economy. To achieve this objective, EU policy-makers must review and clarify the EU Non-Financial Reporting Directive³ in order to establish minimum legal requirements for corporate sustainability reporting.

Investors are increasingly demanding comparable and consistent⁴ sustainability data from companies to help inform investment decisions and engagement. This information is also key for civil society and public authorities to assess and monitor corporate responsibility and accountability. However, at present there is wide divergence in companies' reporting practices, which leads to a lack of concise, consistent, comparable information for investors and other stakeholders.

Research studies consistently evidence the need to specify a mandatory baseline of disclosure requirements.⁵ The European Parliament⁶ and civil society organisations⁷ have also called for the definition and standardisation of corporate disclosure on sustainability issues based on international standards and reporting frameworks that already provide the necessary expertise and guidance, but cannot replace legislation.

The current requirements and guidelines under the EU Non-Financial Reporting Directive fail to provide⁸ much-needed clarity to address these challenges. The upcoming review of the Directive, as well as the review of the guidelines on non-financial reporting, provide a key opportunity to move forward on this crucial agenda.

We call on the European Commission to review and develop the reporting framework for corporate disclosure on environmental, social, human rights and anti-corruption issues and specify baseline mandatory requirements and metrics. A common standardised reporting framework is a prerequisite to creating a sustainable and just economy and financial system, and allowing investors to fulfill their existing and upcoming legal obligations to undertake Environmental Social and Governance (ESG) assessments.

CONTEXT

Under the [EU Non-financial Reporting Directive](#), large companies and financial corporations operating in Europe are now required to disclose information on environmental, social, human rights and anti-corruption matters, necessary for understanding the company's impacts. Improving this disclosure framework has a vital role in the EU Commission's Action Plan and related legislative proposals, which aim to reorient capital flows towards sustainable investments and manage risks stemming from climate change, environmental degradation and social issues.

1. EU Commission's Action Plan on Financing Sustainable Growth available [here](#).

2. EC [Legislative proposals](#) as a follow-up to its Action Plan on Financing Sustainable Growth, on 24 May 2018.

3. 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 Text with EEA relevance.

4. See "[A Discussion Paper By Global Investor Organisations On Corporate Esg Reporting](#)" written by Kris Douma, Principles for Responsible Investment and George Dallas, International Corporate Governance Network.

5. See Accounting for Sustainability report '[Financing our Future](#)' and [EY study](#) (80% of over 300 institutional investors say that companies do not adequately disclose environmental, social and governance risks that could affect their current business models)

6. European Parliament resolution of 29 May 2018 on sustainable finance (2018/2007(INI)) available [here](#).

7. NGO recommendations for the EU Sustainable Action Plan available [here](#).

8. Communication from the European Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information) C/2017/4234.

The effectiveness of the Action Plan is predicated, however, on the quality and usefulness of public companies' disclosure. In this respect, two interconnected, yet independent sets of information required under the Directive are crucial for understanding the full value of a company and its accountability. Companies need to report on the risks of severe impacts on society and the environment as well as their management. At the same time, they also need to disclose their analysis of risks of impact on the company itself stemming from sustainability issues, particularly relevant in the case of climate-related information (as specified in the Financial Stability Board's Task Force on Climate-related Financial Disclosures Recommendations). Without adequate information on these two matters, they cannot be factored into investor decision making.

The Directive requires companies to disclose information on their business model, policies (and the outcomes of these policies), principal risks, and key performance indicators (KPIs) with respect to environmental and social issues relevant to their business. However, the problem is that the requirements do not specify in sufficient detail what information and KPIs must be disclosed, nor the concrete issues to which they relate. The Directive contributes to further confusion by allowing significant flexibility for Member States in their implementing legislation (in relation to the presentation of information and use of reporting frameworks). This undermines the objective of the law to increase the consistency and comparability of sustainability information.

As a result, the quality of corporate sustainability reporting will continue to vary significantly and keep failing to provide relevant information to investors and other stakeholders. Many reports do not fulfil the objective and purpose of sustainability reporting, which is to identify the principal environmental and social impacts, risks and opportunities, disclose company actions and strategies to address them, and facilitate investors' and stakeholders' analysis of these factors.⁹

This is a major obstacle to the move towards sustainable financial markets, as investors need high-quality reporting on critical information to inform their decisions and engagement. Civil society and public authorities also need this information to hold companies to account where they are connected to serious adverse impacts on the environment or society. Without it, capital will continue to be misallocated¹⁰ and financial risk will be missed, while transparency and accountability will not be achieved. Ultimately, the EU will not reach the objective of contributing to a quick transition to a truly sustainable and just financial system and, subsequently, economic model.

In order to enhance the standardisation and comparability of information, as well as the conciseness and relevance of disclosure, **the EU legal framework for corporate sustainability reporting should be clarified according to the following recommendations:**

A. GENERAL FRAMEWORK

- ▶ **Require integration of the non-financial statement into the annual report.** While additional information may and should be provided in stand-alone reports, key information on environmental, human rights and social issues should be provided directly in the annual report alongside a table with KPIs.
- ▶ **Provide a clear structure for disclosure of mandatory non-financial information in the annual report** to ensure clarity and comparability of corporate disclosure, as well as its ability to be audited. This will be enabled by the legal specification of content required to be included in the non-financial statement, as further specified in section B.
- ▶ **Specify the reporting requirement as regards risks and impacts in the supply chain.** The current formulation of the Directive requires companies to disclose the risks connected to their business relationships and supply chains "where relevant and appropriate", but it does not explain what it means. Reporting should be mandatory for significant risks of adverse impacts. For this, the level and detail of disclosure concerning business operations including its supply chains should be further specified with respect to concrete environmental, human rights and social issues.
- ▶ **Strengthen the requirements and guidance on monitoring and enforcement, as well as requirement for independent verification.** The Commission should commit to periodically review reporting requirements to ensure their effectiveness based on monitoring and analysis of company reports. Similarly, there should be

9. For example, according to the latest Accounting for Sustainability report entitled '[Financing our Future](#)' few of the largest companies in the world acknowledge climate change as a financial risk in their annual reports (72% of the N100 do not, and 52% of the G250 do not). Of the minority that do acknowledge climate risk, very few attempt to quantify or model the business value at stake.

10. A February 2017 paper by Harvard Business School and Oxford University's Saïd School of Business reported that 45% of 368 institutional investors globally found that a lack of data comparability across firms was limiting their ability to use sustainability information in their investment decisions.

increased oversight of these disclosures by national financial regulators and supervisors supported by the right of interested parties to question the veracity or completeness of the information.

- › **Expand the application of the non-financial reporting requirements to all large undertakings¹¹ as well as to small and medium enterprises which operate in high risk sectors.** Companies may have a significant environmental and social footprint and/or may carry material financial risk from sustainability issues irrespective of their turnover, number of employees, or public/private character.¹²
- › **Integrate in the definition of directors' duties the obligation of the board to develop both a sustainability strategy and targets.** These may correspond with public goals, such as the Paris Agreement (and associated national plans) to keep global warming well under 2-degree Celsius, and the UN Guiding Principles for Business and Human Rights which require companies to avoid causing and contributing to human rights abuses, and to prevent and mitigate them in their value chains.
- › **Facilitate the centralisation of data in an open data format.** This would enable direct and straightforward access to the information by all stakeholders.
- › **Specify a strategic and limited set of precise mandatory sector-specific KPIs for companies to report on their major ESG impacts in a standardised and comparable way.** The Directive should specify in the appropriate format for which sectors reporting on ESG-related KPIs is mandatory.

B. SPECIFIC RECOMMENDATIONS ON SUSTAINABILITY AREAS

B.1 Environment

- › **Integrate precise requirements corresponding to the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), including forward-looking climate scenario analysis that would enable the assessment of the degree of alignment with the Paris Agreement¹³, directly in the Directive itself.** This would provide investors and companies with regulatory certainty concerning required information on: governance, strategy, risk management, and metrics and science-based targets for climate-relevant risks and opportunities.
- › **In sectors where it is strategic, specify sector-specific mandatory KPIs for reporting on other environmental factors corresponding with planetary boundaries, in particular use of natural resources (water, land, materials), emissions, waste and pollution, biodiversity and ecosystems and the impact of products and services.** The Directive should specify for which companies or sectors reporting on individual environmental factors and indicators should be mandatory. The requirements should facilitate effective implementation of the proposed [Regulation on the establishment of a framework to facilitate sustainable investment](#).¹⁴

B.2 Human Rights

- › **Specify clear mandatory criteria for reporting on human rights risks and their management,** based on the United Nations Guiding Principles on Business and Human Rights (UNGPs)¹⁵ and the OECD Due Diligence Guidances,¹⁶ and aligned with the growing body of legislation in Europe on mandatory human rights due diligence, in particular the French *devoir de vigilance* law. These should include information about significant human rights risks, actual impacts and the effectiveness of mitigation measures, as well as the criteria against which companies assess and prioritise risks, how they address actual impacts and how they engage with and respond to affected

11. Denmark and Sweden will require all companies with more than 250 employees to make disclosures according to the new legislation on non-financial information. Similarly, the Spanish Parliament has recently approved expanding the scope along the same lines as the Nordic countries.

12. The European Commission's impact assessment (IA) estimated that 2500 large EU companies voluntarily disclosed non-financial information, and that 94% of the total (42000 EU large companies) did not. The IA identified regulatory failure as one of the reasons for this underreporting. Yet, the regulatory response in form of the NFI Directive covers only approximately 6000 large companies. The need for regulation for those large EU companies which do not fall under the scope of the current Directive remains relevant.

13. The Intergovernmental Panel on Climate Change (IPCC) approved the Special Report on Climate Change in October 2018 calling to limit global warming to 1.5°C. The report will be a key scientific input in the Katowice Climate Change Conference in Poland in December 2018, when governments will review the Paris Agreement to tackle climate change.

14. Art. 5 of the European Commission legislative proposal focuses on six environmental objectives: 1) climate change mitigation; 2) climate change adaptation; 3) sustainable use and protection of water and marine resources; 4) transition to a circular economy, waste prevention and recycling; 5) pollution prevention and control; 6) protection of healthy ecosystems.

15. UNGPs underline that corporate responsibility to respect human rights requires companies to have in place policies and processes through which they can both know and show that they respect human rights in practice. Particular attention should be paid to the disclosure of identified human rights risks and information about mitigation measures regarding operations and business relationships.

16. The OECD Due Diligence Guidance for Responsible Business Conduct, OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector, and OECD-FAO Guidance for Responsible Agricultural Supply Chains.

people. Furthermore, companies should be required to disclose information that is critical for understanding how they address human rights risks and impacts in their supply chains.

- › **The Directive should allow the establishment of further reporting criteria relating to the particular risks of specific sectors**, such as labour and farmers’ conditions in consumer goods and agricultural supply chains, operations that pose risks to indigenous peoples’ rights, land grabbing, operations in conflict affected areas or risks related to services or products such as exporting surveillance technology.
- › **Introduce a requirement for full supply chain disclosure for companies facing systematic supply chain related human rights risks**, at a minimum companies outsourcing production of consumer goods to factories in high-risk areas.¹⁷

B.3 Anti-corruption

- › **Specify mandatory elements of disclosure on companies’ anti-corruption programmes, implementation and monitoring, which allow assessment of their quality.** This should include reporting on companies’ whistleblowing policies, which must adhere to best practices and international standards, as well as disclosure of all political donations and lobbying activities.
- › Require companies to provide real data regarding their structures and ownership of subsidiaries as well as **publicly disclose exhaustive lists of subsidiaries, affiliates, joint ventures and other controlled entities to allow external assessment of corruption risks and prevent money laundering, tax evasion and tax avoidance.**

17. Such information is attainable via Customs authorities in certain jurisdictions, such as the U.S and India, and contributes to transparency by providing information on whether and how businesses are linked to human rights and environmental harm. Such a measure would build upon existing EU measures toward greater shareability of supply chain information in the public interest, as required by the Responsible Mineral Sourcing Regulation.

SIGNATORIES

				
				
				
				
				
				