Compliance and reporting under the EU Non-Financial Reporting Directive

Requirements and opportunities
April 2017

New reporting rules require certain large EU companies to include in their management report a non-financial statement. The objective is to lay the foundation for a new model of corporate reporting that complements financial transparency with environmental and social information necessary to understand a company's development, performance and position, as well as the impacts of its activities on society.

This briefing identifies who will be affected and explains how to comply with the new reporting requirements, as well as discussing the implications of the Directive for organisations generally.

Frank Bold has been involved in the legislative process and in the European Commission Expert Group on Non-financial Reporting and continues to monitor and assist in the transposition of the European framework to national law.

Frank Bold

Key requirements

The EU Non-Financial Reporting Directive has introduced a new requirement for large EU companies to **disclose information about policies, risks and outcomes regarding:**

- Environmental, social and employee matters
- Respect for human rights
- Anti-corruption and bribery issues

Who must report?

The requirements will apply to more than 6,000 large public-interest entities, that is, individual companies or group of companies that meet the following criteria:

- More than 500 employees.*
- Balance sheet in excess of 20 million Euros; or net turnover in excess of 40 million Euros.
- Limited liability companies incorporated under the law of a country within the European Economic Area ("EEA").
- Companies listed on an EU stock exchange (even when they are registered in a country outside the EEA).
- Banks and insurers whether listed or not.

*A number of member states have gone beyond the minimum requirements of the directive. In Sweden, Iceland and Denmark, the requirements will apply to all companies with more than 250 employees.

Preparing the report

Companies have considerable discretion over what information to disclose, as well as the format and structure of the information they report. The Directive nevertheless contains basic mandatory elements. Companies are required to disclose at a minimum the following information.

Reporting principles:

Consistent and coherent: the management report should be viewed as a single, consistent set of information

Material: information on performance, position, development, as well as impact of the company's activity - reflecting information needs of all stakeholders

Strategic and forward-looking: risks and impacts on business model and strategy

Content:

(a) a brief description of the company business model

A system of inputs, activities, outputs, and outcomes by which the company creates value. In short, the company should describe what they do, how and why they do it, i.e. what value and for whom it aims to create value. The information should explain the consequences of the model on matters covered in the Directive and vice versa.

(b) a description of the policies pursued by the company in relation to those matters, including due diligence processes implemented

A statement of material issues and the company's management approach to them, including policy commitments, objectives, due diligence mechanisms to address impacts, and integration in internal governance. Company may provide a clear and reasoned explanation for not having a policy in one or more of the core areas, based on a materiality analysis.

(c) the outcome of those policies;

Fair and comprehensive view of the outcome of policies that correspond with their stated objectives and that result from the company's operations and activities. Outcomes should be documented by appropriate KPIs (see below).

Tips:

Compare policy choices and results with sectoral benchmarks

Regulations may influence in KPIs, consider current and potential legislations affecting your company's activity

(d) the principal risks related to those matters linked to the company's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the company manages those risks;

Risks of internal as well as external origin, short and long-term, individual and systemic. Assessment should be provided of potential and actual effects on the company as well as on society and the environment. Risks should be considered according to the likelihood and severity impacts, measured in terms of scale and gravity. Companies should disclose how they prevent, mitigate and remedy impacts. The information should cover matters connected the company's value chains and business relationships based on a materiality assessment.

(e) non-financial key performance indicators relevant to the particular business.

For tracking performance against policy objectives and the chosen way of addressing the risks, companies should use consistently appropriate Key Performance Indicators (KPIs). KPIs should reflect broadly recognized metrics, widely used in their sector or for specific thematic issues.

The European Commission has indicated a number of recommended disclosures.

Environmental matters	The actual and potential impacts on the environment, and health and safety, land use, water use, use of materials, greenhouse gas emissions and energy use, air pollution, protection of biodiversity, and waste management.
Social & employee-related matters	The implementation of fundamental conventions of the International Labor Organization, working conditions, health and safety, respect for the right of workers to be informed and consulted, human capital management and dialogue with local communities.
Human rights matters	Mechanisms and actions in place to prevent, mitigate, and remedy human rights abuses and their application, in the company's own activities and through its business relationships, including its supply and subcontracting chains, occurrence of severe impacts, and specific disclosure on handling complaints and providing remedy.
Anti-corruption & bribery matters	Policies, organisation, decisions, and management instruments concerning fighting corruption.
Supply Chains	Disclosure for the abovementioned matters should cover supply chain matters insofar as it is necessary to understand the company's development, performance, position or impact (the latter to be understood in line with the international standards). Specifically for supply chains of tin, tantalum, tungsten and gold from conflict-affected and high-risk areas, companies are expected to disclose information on their due diligence and concrete risks identified and their management.
Diversity (only applied to large listed companies)	Policies for diversity in relation to the reporting entities' administrative, management, and supervisory bodies on topics such as age, gender, or educational and professional background.

Steps for preparing a non-financial report

Boards are responsible for setting up proper governance systems for the relevant matters and have the ultimate responsibility to ensure the report is adequately prepared by overseeing and signing off the document. **Below are the key steps to consider before preparing a report under the directive.**

A **Gather information on company's policies and their outcomes with respect to:** non-financial matters covered by the legislation and their application in company's strategy and relations with employees, business partners, and policy-makers.

B **Analyse how those policies are embedded in:** governance, due diligence, risk assessment and internal audit processes.

C **Map, analyse, and determine salient issues and risks of severe impacts** specific for the company as well for the company's sector, geographies, business model and strategy sector, business relationships.

D **Collect information on the actual management of key risks and impacts**, including on integration of findings and actions taken.

E **Identify key stakeholders for the identified issues** and if and how they were engaged in the identification of key risks and designing policies.

F **Assess whether chosen policies, due diligence processes, targets, and indicators** correspond to principal ESG risks connected to the company and the information needs of the company's stakeholders.

G **Analyse short-, mid- and long-term consequences** of salient non-financial issues and risks facing the company or its business model.

H **Implement necessary changes and select material information for the report.**

Using voluntary frameworks as guidance

The directive allows companies to rely on national, Union-based or international frameworks for ESG reporting, as far as their reports cover the information required by the legislation. These frameworks can provide companies with a structured reporting approach to key issues and enhance comparability.

Where the company decides not to rely on any particular framework, it is advisable to consult those frameworks as part of the process of identifying salient issues and selecting key indicators. **Some of the most relevant international reporting frameworks include:**

- Integrated Reporting <IR> Framework
- Global Reporting Initiative (GRI) G4
- UN Guiding Principles on Business and Human Rights Reporting Framework
- Sustainability Accounting Standards Board (SASB) reporting standards
- Climate Disclosure Standards Board (CDSB) Framework for reporting environmental information
- Future Fit Benchmark
- Recommendations of the FSB Task Force on Climate-related Financial Disclosures (TCFD)

Compliance

Companies will need to begin gathering information in order to be prepared to publish the required information alongside financial information for the financial year (2017). The directive does not require an audit of the non-financial statement, other than that it has been provided, however EU Member States may require that the information contained within be verified by an independent assurance service provider.

! If a company does not pursue any policies in relation to one or more of the matters listed, it must provide a clear and reasoned explanation for not doing so. EU Member States may also allow companies to omit specific information that would seriously prejudice the company's commercial position.

There is no specific requirement on whether to provide the information in a separate report, such as a corporate social responsibility or sustainability report, or in the annual report. There are, however, specific rules concerning consolidation.

- The Directive states that if companies prepare a separate report corresponding to the same financial year, Member States may exempt the company from reporting this information in their annual management report, provided that such separate report is published together with the annual report or is made publicly available within six months after the balance sheet date on the company's website, and is referred to in the management report.
- Subsidiary companies will not be subject to separate reporting obligations if information complying with the requirements is contained within a consolidated annual report of a parent company.

Relevance

The Non-Financial Reporting Directive is part of a general trend to increase corporate transparency and disclosure, including anti-corruption and money laundering laws, measures to eliminate child labour and modern slavery, human rights and environmental due diligence, and other initiatives to promote corporate responsibility.

Related developments

Companies with cross-border or global operations should be aware of overlapping requirements that apply in various Member States*, including:

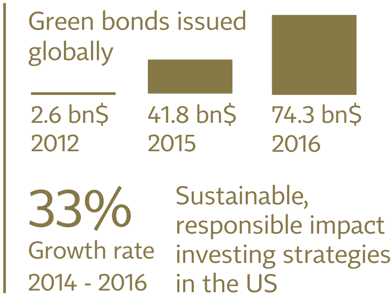
- National laws pursuant to the OECD Convention on Combating Bribery of Foreign Public Officials Antibribery Convention, including the UK Antibribery Act 2010, as well as the new French and German anti-corruption laws (known as Sapin II (France) and Gesetz zur Bekämpfung der Korruption (Germany).
- EU Conflict Minerals Regulation, expected to be adopted in May 2017, which will require EU companies to ensure they import tin, tantalum, gold, and tungsten from responsible sources only and report on their supply chain due diligence policies and practices
- The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 in the UK requires companies quoted on the London Stock Exchange to report specific information on greenhouse gas emissions in addition to information required by the Non-financial Reporting Directive.
- The UK Modern Slavery Act 2015 requires companies doing business in the UK to report on their supply chain due diligence
- The French law on duty of vigilance requires companies to develop and disclose due diligence plan for human rights and environmental abuse in their own operations as well as those of established business partners and by extension in supply chains.
- The French Energy Transition for Green Growth Law 2015, Article 173, requires listed companies, banks, and institutional investors to report on financial risks and business model risks associated with climate change.
- The California Transparency in Supply Chains Act 2010 requires retail sellers and manufacturers doing business in the state to disclose their efforts to eradicate slavery and human trafficking from their direct supply chains for tangible goods offered for sale.
- The US Executive Order 13627 (2015) requires all federal public procurement contracts to be screened and assessed to prevent human trafficking in supply chains.

*It is outside the scope of this briefing to provide detailed information about each of these developments. Companies that believe they may be covered by any of the above should seek counsel.

Guidance for best practice

The way corporate activity is accounted for is crucial to shaping the way investors and other stakeholders see and assess a corporation. At the same time, the form of corporate reporting used will influence how the board establishes targets for the company and decides the means to achieve those targets.

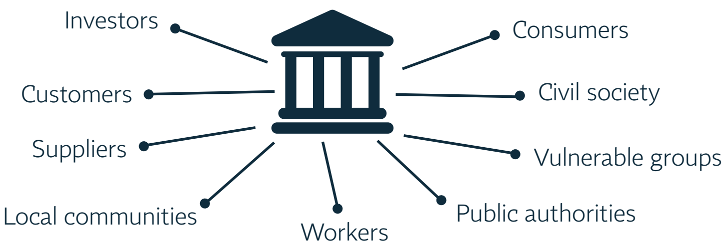
Business and political trends are firmly shifting towards a responsible and sustainable economy; both risks and investment opportunities arise from this process. This is supported by research that demonstrates that corporations with good environmental, social and governance ("ESG") performance and reporting outperform their peers on the stock market and benefit from the lower cost of capital.



The Non-Financial Reporting Directive provides a roadmap for integrating the results of the non-financial reporting exercise into business strategy. This in turn will reduce current and future negative impacts and help companies to identify opportunities to create positive long-term value.

There are several tools available to companies, which they may use to engage with non-financial issues from a strategic business perspective, including Integrated Reporting, the Future Fit Benchmark, the B Corporation impact assessment and certification process, as well as the recommendations of the FSB Task Force on Climate-related Financial Disclosures.

Potential stakeholders



This briefing is for general information only and is not intended to provide legal advice. For further information on the matters outlined in this briefing, please contact Paige Morrow or your usual Frank Bold contact.

paige.morrow@frankbold.org
http://en.frankbold.org