ECCJ
European Coalition for Corporate Justice

Non Financial Reporting
ECCJ briefing for decision makers

Background

There is now wide recognition among companies, investors, governments, academics, and other stakeholders of the value in companies to collecting and disclosing non-financial information[1]. It is a useful management tool, a source of valuable risk management information to investors, a vital basis for the creation of shared value on social, environmental and human rights issues and a key element in wider company-stakeholder engagement.

Empirical evidence indicates that disclosing non-financial information improves companies' social, environmental and human rights policies and management systems, thereby reducing risks and negative impacts. Studies by the European Commission and KPMG, for example, show that analysis and disclosure of non-financial information increases companies' competitiveness, access to capital, performance on the financial markets and stability.[2]

Despite this companies have failed to keep pace with the growing demand for non-financial information. The European Commission estimates that only 2500 out of the 42000 EU large companies formally disclose non-financial information each year and that the disclosed information does not adequately meet the needs of the stakeholders.[3]

The proposal from the Commission COM(2013)207 seeks to address this problem by amendments to the Accounting Directives[4] designed, inter alia, to increase:
(i) Corporate transparency, accountability and performance;
(ii) The relevance, consistency and comparability of non-financial information; and
(iii) The efficiency of the Single Market.

These goals, as general propositions, are endorsed by the European Coalition for Corporate Justice (ECCJ).

Reporting on risks, avoiding and remedying damages

A key element of the proposal from the Commission revolves around reporting on risks, policies to manage those risks and the outcomes of those policies. Outcomes relate to whether such policies prevented a risk from materialising into an adverse impact or mitigated/remediated any damage.[5]

The concept of risk has several aspects. The company faces some risks while it may pose other risks to the surrounding society. These last risks can, in turn, also pose risks to the company. For example in 2010, BP faced a risk that an adverse incident could prevent the functioning of its Deepwater Horizon platform in the Gulf of Mexico, causing costs of $1m each day. At the same time the platform posed risks to BP's employees, the environment and the community in the gulf. As we now know, these risks materialised on 20 April 2010. The platform was destroyed, eleven lives lost and the largest offshore oil spill in history was released. Within months, almost $100 billion had been wiped from the company's stock market value.[6] There has been on-going investigation and litigation including in relation to other companies in the supply/value chain.

All aspects of risk need to be incorporated into reporting in order for the proposal to achieve its goals. Whilst it is vital that companies have policies in relation to all of the areas nominated in the proposal detailed information need only be provided in relation to the particular matters in each area that stand out as being most likely for risk to materialise along with those that would have the most severe consequences or impacts if they did or have already.[7]

The location of the risk

What we think of as a company or firm is in reality often a network of a large number of companies with interrelated ownership. This is the case for many reasons including tax and risk management purposes. Such groups of companies are required to file consolidated financial information but they are also required to file individual company information. This makes sense as the use of consolidated reporting cannot be allowed to mask the true situation with regard to risk. The users of the reports need to be able to accurately identify where exactly in the corporate group a risk sits.[8]

Supply chains

In the wake of the horsemeat scandal and the large scale death and injury toll from recent incidents in garment factories in Bangladesh it is beyond doubt that supply chains represent a significant risk to companies, communities in which they operate and customers. Companies need to know what is happening in their supply chains and show that they are aware of and are managing risks appropriately.[9]

Frameworks: international, national, EU based and EU legislation

The proposal seeks to allow corporations maximum flexibility in reporting by allowing them to draw on a range of international, national and EU based frameworks when providing the necessary information. Such f frameworks are of varying form, intent and quality. By nominating such disparate instruments the proposal risks further fragmentation of reporting requirements. In addition this flexibility cannot allow for some sort of a race to the bottom where corporations seek out a framework which is inconsistent with either European legislation or international expectations. A minimum requirement must be stipulated and the Commission should provide ongoing guidance on the use that is to be made of such frameworks.[10]

Resource Use indicators - “What gets measured, gets managed”..

Companies are facing a resource crunch, this imposes risks to supply chains and raw material prices are increasing as a result. A simple, standardised way to measure resource consumption across company supply chains is needed in order to identify hotspots and incentivise action on resource efficiency: A simple example is a company that reconfigures its logistics so as to reduce the distance that goods are transported thereby achieving on-going cost savings for itself while at the same time cutting carbon emissions. A recent report prepared by the consulting firm founded by Michael Porter and Mark Kramer, who developed the concept of creating shared value, noted the following:

> To effectively deliver on shared value strategies, companies need shared value measurement tools that track progress, analyse results, and yield actionable data and insights. However, today’s companies lack the systems and tools to adequately gather such data and therefore make decisions without critical information - leaving significant value on the table.[11]

The Sustainable Europe Research Institute (SERI) has developed a simple measurement approach for supply chains using four indicators: land footprint, water footprint, materials consumption and GHG emissions. The European Commission broadly adopted these in the 2011 resource Efficiency Roadmap.[12] The European Parliament overwhelmingly supported their adoption in May 2012[13]and the Commission has proposed them in their consultation on measuring resource use.[14]

Each of the objectives of the proposal , as well as the goal of maximising shared value, would be furthered by the Commission providing guidelines that would standardise the measurement methodology with regard to the 4 indicators and appropriate best performance indicators.[15]

Small companies should not be unduly burdened

The proposal is not intended to create unnecessary administrative burden especially on the smallest companies operating in the Single Market. The ECCJ does not oppose that course. The definition of large company, however, should be interpreted in accordance with the existing definition in the 4th Directive under which a company is large if it has an average number of employees exceeding 250 and either a balance sheet exceeding €17.5 million or net turnover exceeding €35 million.

Enforcement

Each of the goals that the proposal seeks to meet is undermined by corporate non-compliance. In order to combat this there needs to be a mechanism by which those with legitimate interests can enforce compliance. The precise details of any such mechanism are most appropriately dealt with at the Member State level. Useful examples of this can be found in EU consumer law.[16]

Conclusion

- Risk has a number of aspects all of which must be addressed.
- The location of risk within a group of companies needs to be ascertainable.
- A choice of multiple frameworks cannot be used to avoid complying with European legislation or international expectations and must not lead to further fragmentation and uncertainty.
- Key performance indicators are important for sustainability and creating shared value.
- Small companies should not be unduly burdened.
- The effectiveness of the amendments in achieving their goals is enhanced by enforcement mechanisms at the Member State level.

About the European Coalition for Corporate Justice

The ECCJ comprises 21 members, whose platforms contain in excess of 250 civil society organisations spread across 15 European countries, including NGOs, trade unions, consumer advocacy groups and academic institutions. The ECCJ was represented in the expert group convened by the European Commission in preparation of the proposal.

Contact:
Jérome Chaplier, Coordinator.
coordinator@corporatejustice.org
0032-2-8931026

1 Also known as “Environmental, Social and Governance” or “ESG” information.
2 European Commission Competitiveness Report available at http://ec.europa.eu/enterprise/poloicies/sustainable-business/files/csr/documents/csrreportv002_en.pdf ; KPMG International Survey of Corporate Responsibility Reporting 2011 available at http://www.kpmg.com/PT/pt/IssuesAndInsights/Documents/corporate-responsibility2011.pdf
3 See European Commission Proposal Explanatory Memorandum available at http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf p.4.
4 Fourth Council Directive of 25 July 1978 on the annual accounts of certain types of companies (78/660/ECC); Seventh Council directive of 13 June 1983 on consolidated accounts (83/349/EEC).
5 A convenient way to understand these concepts is to consider the definitions provided in the United Nations Guiding Principles on Business and Human Rights (UNGPs), unanimously endorsed by the Human Rights Council in June 2011, and expanded upon in the interpretive guide released by the Office of the High Commissioner for Human Rights available at [add address]. The definitions relate to human rights issues which are one of the areas addressed by the proposal but the general concepts remain the same when considering the other areas such as environmental risk for example. Under the UNGPs a human rights risk includes any risk that a company’s operations may lead to an adverse human rights impact, it relates to potential impacts. An adverse human rights impact occurs when an action removes or reduces the ability of an individual to enjoy his or her human rights. An actual human rights impact is an adverse impact that is occurring or has already occurred. Mitigation of human rights impacts refers to actions to reduce the extent of an impact. Remediation or remedy refer to both the process of providing a remedy for an adverse impact and the substantive outcomes to make good the adverse impact.
6 Stout, L. (2012). The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public. Berrett-Koehler Publishers, San Francisco. p. 1-2.
7 See ECCJ proposed amendments to Article 46 (1)(b) of Directive 78/660/EEC and Article 36(1) of Directive 83/649/EEC.
8 See ECCJ proposed amendment to Article 36(1)(b) of Directive 83/349/EEC.
9 See ECCJ proposed amendment to Article 46(1) of Directive 78/660/EEC and Article 36(1) of Directive 83/649/EEC.
10 See ECCJ proposed amendment to Article 46(1)(b) of Directive 78/660/EEC, Article 36(1) of Directive 83/649/EEC and ECCJ proposed Article 5.Given the near universal endorsement of the United Nations Guiding Principles on Business and Human Rights, which incorporate the core ILO Conventions, and the fact that, apart from Cyprus and Malta, all Member States are either Members of the OECD or adhere to the OECD Guidelines for Multinational Enterprises these two instruments represent the most logical minimum requirements of those noted in the proposal. Both require due diligence processes.
11 Hills, G., Russell, P., Borgonovi, V., Doty, A. & Ilyer, L. (2012). Shared value in Emerging Markets: How Multinational Corporations are redefining Business Strategies to Reach Poor or vulnerable Populations. P. 45. Available at http://www.fsg.org/Portals/0/uploads/Documents/PDF/Shared_Value_Emerging_Markets.pdf
12 Available at http://ec.europa.eu/environment/resource_efficiency/pdf/com2011_571.pdf
13 See http://www.europarl.europa.eu/sides/getDoc.do?pubRef=//EP//TEXT+TA+P7-TA2012-0223+0+DOC+XML+VO//EN
14 See http://ec.europa.eu/environment/consultations/resource_en.htm
15 See ECCJ proposed amendment to Article 46 (1)(c) of Directive 78/660/EEC and Article 36 (1) (c) of Directive 83/349/EEC. For further information on the work undertaken by Friends of the Earth Europe in this area see: http://foeeurope.org/sites/default/files/news/eccj_nfr_briefing_final_13-05-2013.pdf
16 See ECCJ proposed Article 3. A good example from EU consumer law is Article 11 of 2005/29/EC Directive on Unfair Commercial Practices