



EUROPEAN COMMISSION

## MEMO

Brussels, 16 April 2013

# **Disclosure of non-financial and diversity information by certain large companies and groups (proposal to amend Accounting Directives) - Frequently asked questions**

See also [IP/13/330](#)

## **1. What will change? What information will be disclosed and how?**

This proposed Directive would amend the Accounting Directives (Fourth and Seventh Accounting Directives on Annual and Consolidated Accounts, [78/660/EEC](#) and [83/349/EEC](#), respectively). The objective is to increase EU companies' transparency and performance on environmental and social matters, and, therefore, to contribute effectively to long-term economic growth and employment.

Companies concerned will be required to disclose in their annual reports relevant and material information on policies, results and risks concerning environmental aspects, social and employee-related matters, respect for human rights, anti-corruption and bribery issues, and diversity on the boards of directors.

Companies will retain significant flexibility to disclose relevant information in the way that they consider most useful. They may use international or national guidelines according to their own characteristics or business environment (for instance, the UN Global Compact, ISO 26000, or the German Sustainability Code).

## **2. Why does business transparency matter? Is disclosure of environmental and social information important?**

Transparency leads to better performance. The financial crisis has shown how some companies that fail financially at one point in time may have had significant transparency mishaps before. This is true not only about disclosure of financial information, but also as regards environmental and social transparency.

Companies which are transparent perform better over time, have lower financing costs, attract and retain talented employees, and are ultimately more successful.

Investors are more and more interested in non-financial information in order to have a comprehensive understanding of a company's development, performance or position, and they thoroughly analyse this information in their investment-decision processes.

### **3. Why now? Shouldn't the Commission wait until the economic crisis is over?**

Transparency is part of the solution, not part of the problem. Transparency leads to improved performance, healthy economic growth and sustainable employment.

The requirements of the existing EU legislation have proved ineffective. Currently, fewer than 10% of the largest EU companies disclose environmental and social information regularly. Some Member States have introduced disclosure requirements that go beyond the Fourth Company Law Directive. For instance: the UK introduced legislation in 2006 which is now being updated; Sweden adopted legislation in 2007; Spain in 2011; Denmark amended its legislation in the same year; the latest update in France dates from May 2012. An EU update and a level playing field in the EU Internal Market is needed.

Transparency, economic success, environmental and social performance are all important in the long-term. Tackling transparency in a period of crisis has made the Commission more sensitive and vigilant so that all efforts have been made to avoid an undue administrative burden.

Companies with fewer than 500 employees will not be subject to any new obligations. For larger companies, costs associated with the required disclosures are commensurate with the value and usefulness of the information, and with the size and complexity of the companies involved.

### **4. Why a legal requirement? Would a purely voluntary approach not be enough?**

Over the years, we have seen the limits of a voluntary approach. Today, around 2,500 large EU companies disclose environmental and social information regularly. Regulating the disclosure of some minimum requirements, whilst avoiding an undue administrative burden, in particular for the smallest companies, is the right decision at this time.

### **5. Who will benefit from this measure?**

Each individual company that discloses transparent information on social and environmental matters will realise significant benefits over time, including better performance, lower funding costs, fewer and less significant business disruptions, better relations with consumers and stakeholders. Investors and lenders will benefit from a more informed and efficient investment-decision process. Society at large will benefit from companies managing environmental and social challenges in a more effective and accountable way.

### **6. Is this Directive "comply or explain" legislation?**

Different stakeholders have different views on what "comply or explain" legislation should look like. Jurisdictions claiming that they have a "comply or explain" approach to transparency often have very different legislation.

To be clear, this Directive sets out a requirement. But companies are left with significant flexibility and the legislation contains significant "comply or explain" modalities. For instance, companies will not be required to have a boardroom diversity policy, but when they do not have it, companies will have to explain why not.

Companies will not be required to disclose information that is not relevant or not necessary for an understanding of a company's development, performance or position. This is no box-checking exercise. This is about disclosing material, useful and valuable information for proper management and understanding of a company.

## **7. What is the Commission doing to avoid undue administrative burden, in particular for small and medium-sized companies (SMEs)?**

Companies with fewer than 500 employees will not be required to report environmental and social information. This does not mean that they would not benefit from better transparency. The same logic applies as for larger companies. But smaller companies may lack appropriate human resources and information handling costs may be proportionately higher. Thus the overall administrative burden may be disproportionately high.

In itself, this directive will not result in a direct administrative burden for smaller companies. Nevertheless, as companies of all sizes develop their businesses, they are likely to experience transparency demands from their customers, employees, consumers, investors, lenders and other business partners and stakeholders.

Other measures have been taken to limit the administrative burden for larger companies too. For instance, the disclosure requirements may be fulfilled once at group level, rather than by each company in the group. Auditing and insurance aspects are limited to a check of consistency between the environmental and social disclosures and the financial information.

## **8. How many companies will be subject to the new reporting requirement?**

A fine balance has been achieved so that the benefits of enhanced transparency are realised, whilst an undue administrative burden, in particular for smaller companies, is avoided. No precise statistics are available, but, to be clear, millions of small and medium-sized EU companies will have no new obligation whatsoever.

Currently, around 2,500 large EU companies disclose environmental and social information regularly. Had the Commission used a threshold of 250 employees as for financial disclosures, more than 40,000 large companies would have come within the scope of application. Having increased the reporting threshold to 500 employees actually reduces the number of companies to around 18,000. This means that around 15,500 large EU companies will be required to be transparent on social and environmental matters as a consequence of this legislation, which is an increase of more than 600%.

## **9. OK, this is good for the environment, but how much does this cost companies?**

This initiative is certainly good for the environment. Transparency leads to awareness and brings the attention of senior management and directors to the key impacts of the company's activity on the environment. More environmental transparency translates into better environmental performance.

But beyond environmental benefits, this initiative is good for society and is good for companies and investors. Companies must equip themselves adequately to handle social challenges and issues related to corruption, bribery and respect for human rights. Companies will clearly benefit from more diversity in their boards of directors. The long-term success of EU companies hinges upon excelling at managing these and similar key strategic challenges. Transparency is an effective management instrument in the strategic toolkit box of EU companies.

Although it is difficult to cite hard data, the benefits of transparency by far outweigh the costs. Transparency is key to the common values and understanding of a social market economy. Transparency extends beyond the publication of the company's balance sheet and profit or loss account.

Reverting to costs, there is a broad range of estimates. Most agree that comprehensive reporting on social and environmental aspects costs a large company between 30,000 euro and 600,000 euro per year. This depends on the company's size and complexity. It also varies according to the internal use and external visibility. Many companies have learnt the strategic value of reporting on social and environmental matters for their internal business-decision process, and for their external communications. Many see expenditure on such reporting as an investment rather than as a cost.

But, to be clear, the new directive is not requiring comprehensive reporting on environmental and social aspects (although the Commission certainly encourages it). The proposed Directive requires the disclosure in the annual report of certain information on policies, results and risks. This is estimated to result in an additional direct cost for large companies of less than 5,000 euro per year, i.e. less than 100 million euro per annum on an EU basis.

#### **10. How does this Directive relate to integrated reporting?**

The proposed directive focuses on environmental and social disclosures. Integrated reporting is a step ahead, and is about the integration by companies of financial, environmental, social and other information in a comprehensive and coherent manner. To be clear, this Directive does not require companies to comply with integrated reporting. The Commission is monitoring with great interest the evolution of the integrated reporting concept, and, in particular, the work of the International Integrated Reporting Council.

#### **11. What is the relation with the Commission's recent initiative to increase the presence of women on boards of directors?**

The objective of both initiatives is similar: to diversify the composition of boards of directors so that they better supervise the company's management. However, the logic is a little different.

The presence of women on boards initiative covers gender aspects only, and is based on reaching a certain percentage. The proposed Directive covers other aspects of diversity, such as the educational and professional backgrounds, ages or geographical diversity of directors. Companies will be required to disclose their diversity policies. This is expected to exert indirect pressure by encouraging more diversity. Therefore, the proposals are complementary.

#### **12. Has the Commission foreseen any transition period?**

The Commission is aware that some large companies may need some time to adjust, build skills, and implement in an effective and useful manner their transparency on environmental and social matters. This will be done over time. That's why the measure includes significant flexibility so that companies report in the way that they see most useful, according to their characteristics. It is also foreseen that companies will take advantage of the adjustment time given until this Directive is adopted by the Council and the European Parliament, and transposed by Member States (say, 2016, which means that companies might be required to publish their first reports in 2017). Member States may grant non-listed companies, which currently may be less used to reporting practices, the possibility of an additional transition year.