

## **EUROPEAN COMMISSION PROPOSAL WITH REGARD TO NON-FINANCIAL REPORTING: AMENDMENTS PROPOSED BY SHIFT**

### **Introduction**

On 16 April 2013, the European Commission adopted a proposal for a Directive enhancing the transparency of certain large companies on social and environmental matters. This Directive amends 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. EU companies whose average number of employees exceeds 500, and exceeds either a balance sheet total of 20 million euros or a net turnover of 40 million euros (which is approximately 18,000 companies), would 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.

Shift is an independent, non-profit centre for business and human rights practice, staffed by a team that was centrally involved in shaping and writing the UN Guiding Principles on Business and Human Rights (the "Guiding Principles"), and chaired by their author, Professor Ruggie. Shift helps businesses, governments and their stakeholders put the Guiding Principles into practice.

Shift warmly welcomes the European Commission's proposed Directive. The Guiding Principles make clear that companies are expected to respect human rights, which means that they should avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved. In order to meet their responsibility to respect human rights, companies should have in place appropriate and effective policies and processes, as further described in the Guiding Principles. Increased transparency on human rights, based on improved tracking of performance, can assist companies in meeting their responsibility to respect, and provide important information to stakeholders on companies' progress in their journey of implementing the UN Guiding Principles.

**Shift together with its Chair, Professor John Ruggie, suggest the following amendments to the proposed Directive to enhance its alignment with the UN Guiding Principles. The proposed amendments have been made in track changes format in the text below, with a text box providing an explanation below each amendment. Where the European Commission's proposed language to amend Directive 78/660/EEC recurs in relation to Directive 83/349/EEC, Shift proposes that the same changes should be made.**

## **Proposed Amendments and Explanations**

### Article 1

#### Amendments to Directive 78/660/EEC

Directive 78/660/EEC is amended as follows:

(1) Article 46 is amended as follows:

(a) Paragraph 1 is replaced by the following:

‘1. (a) The annual report shall include a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces.

The review shall be a balanced and comprehensive analysis of the development and performance of the company's business and of its position, consistent with the size and complexity of the business.

(b) For companies whose average number of employees during the financial year exceeds 500 and, on their balance sheet dates, exceed either a balance sheet total of EUR 20 million or a net turnover of EUR 40 million, the review shall also include a non-financial statement containing information relating to at least environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:

(i) a description of the policy pursued by the company in relation to these matters;

(ii) the results of these policies;

(iii) the risks related to these matters ~~and how the company manages those risks~~ including risks to society from the company's activities or through its relationships, to the extent they are linked to the company's operations, products or services;

(iv) how the company manages those risks, including through due diligence processes.

The amendment to Paragraph 1(b)(iii) would make clear that:

(a) the focus should be on risk to society, not to the company alone;

(b) the focus is on the management of impacts potentially linked to the company's operations, products or services, and does not require broader reporting where that connection does not exist.

(c) reporting on risks should include risks arising through the company's business relationships

The addition of Paragraph 1(b)(iv) separates out the provision regarding management of risks that was previously part of Paragraph 1(b)(iii) and makes explicit the relevance of due diligence processes in this context.

| In providing such information the company ~~may~~ should rely on relevant national, EU-based or international frameworks and, ~~if so, shall~~ specify which frameworks it has relied upon.

The stated purpose of the European Commission's proposed Directive is to enhance the relevance, consistency and comparability of non-financial information disclosed throughout the European Union. This will be undermined if there is no convergence in what and how companies report within the broad issue areas identified. The preamble to the European Commission's proposed Directive notes a number of widely-recognized international frameworks, some of which are relevant to specific areas of corporate social responsibility, such as the UN Guiding Principles on Business and Human Rights. It also notes that some national frameworks may be relevant. In order to support reporting that is more relevant, consistent and comparable, it is proposed that this paragraph should more clearly point companies toward the use of one of these frameworks.

(c) To the extent necessary for an understanding of the company's development, performance or position, and the management of its impacts on society, the analysis shall include both financial and non-financial key performance indicators relevant to the particular business.

It would not normally be understood that a company's "development, performance or position" would include its impacts on society. Yet that is a key objective of this proposed EC Directive. We therefore propose that it should explicitly include here a reference to the management of the company's impacts on society.

(d) In providing its analysis, the annual report shall, where appropriate, include references to and additional explanations of amounts reported in the annual accounts.'