2018 Research Report

The state of corporate sustainability disclosure under the EU Non-Financial Reporting Directive

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The Alliance for Corporate Transparency project analysis of companies' reporting

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Alliance for Corporate Transparency

Disclaimer

It was beyond the scope of this research to examine if the disclosure of individual companies was comprehensive or if all material information was included. Therefore, it is recommended to consider the results of this research together with in-depth case studies of individual companies' reports provided by other initiatives.

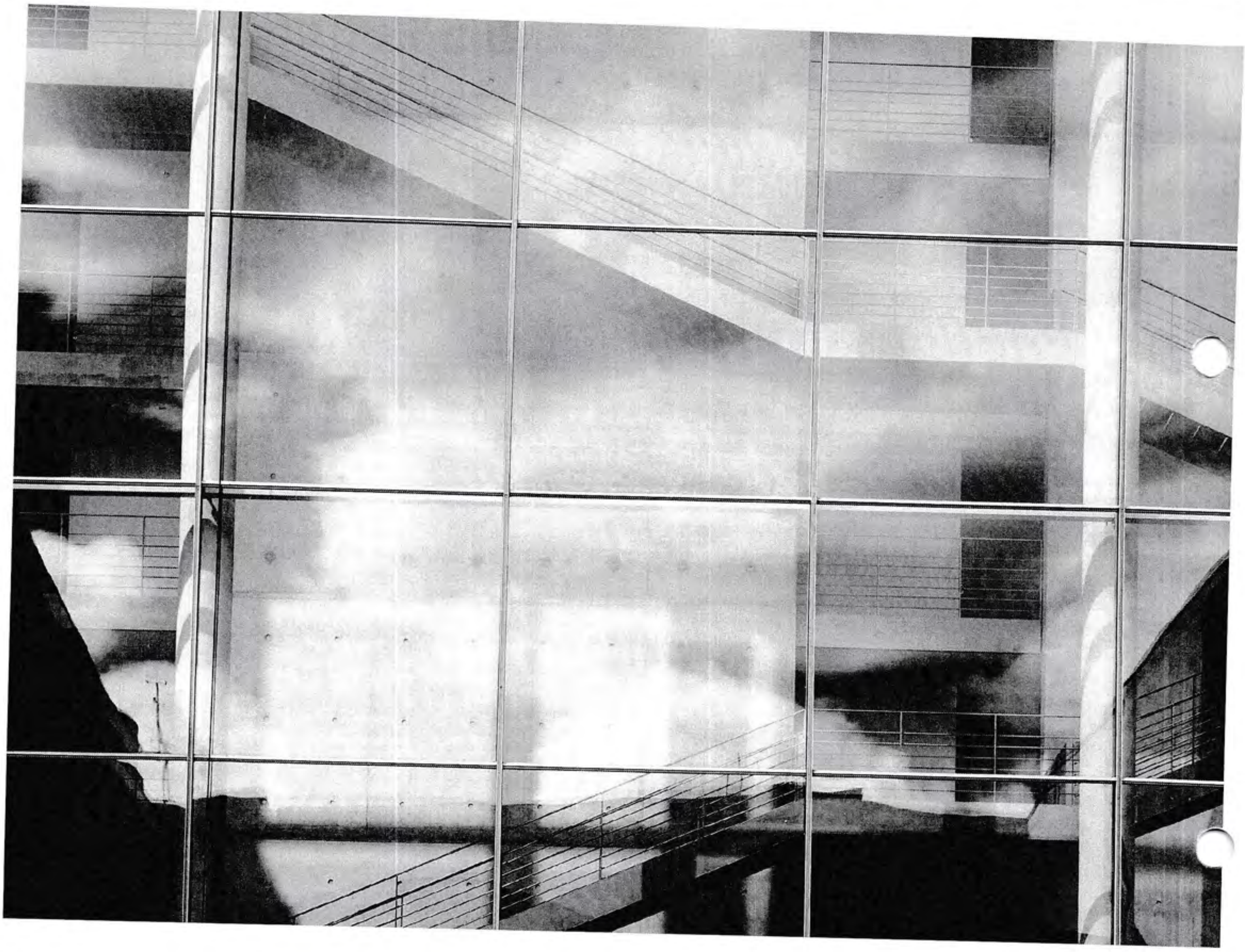
The report provides several examples of disclosure that meets specific criteria used in the research. The purpose of these examples is to demonstrate how these criteria were applied. They do not necessarily represent illustrations of best practice.

The assessment criteria employed in this research do not intend to represent a definitive or final model of best practices or legislation. They were designed to provide a general overview of how companies in specific sectors reported on some of the most important environmental and social issues.

Alliance for Corporate Transparency Project (2019). *2018 Research Report*

Design and layout: PORTA design; Populate Tools; Susanna Arus

Contents



Executive Summary

Background

The EU Non-financial Reporting Directive ("NFR Directive") requires large public companies and financial corporations operating in Europe to disclose information on environmental, social, human rights and anti-corruption matters, necessary for understanding the company's development, performance, position and impact.

Ensuring high quality disclosure on these matters has a vital role in the EU Commission's Action Plan on Financing Sustainable Growth and related legislative proposals[1], which aim to reorient capital flows towards sustainable investments and manage risks stemming from climate change, environmental degradation and social issues. Companies' disclosure is also a key element in ensuring corporate accountability for identifying and addressing risks of adverse human rights impacts in line with the UN Guiding Principles on Business and Human Rights. In addition, mismanaged human rights and environmental risks may result in significant short-term as well as long-term economic impacts on companies in the form of accidents, litigation, supply chain disruptions, damaged reputation and failed or delayed investments.

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However, the NFR Directive does not specify in sufficient detail what information and KPIs must be disclosed, nor the concrete issues to which its requirements relate.

To address this problem, leading civil society organisations and experts came together under the Alliance for Corporate Transparency, a three-year research project with the aim of analysing how European companies implement the requirements of the NFR Directive and recommending how the EU framework for non-financial reporting can be improved.

In 2018, the project has assessed over 100 companies from the sectors of Energy & Resource Extraction, Information and Communication Technologies, and Health Care to provide early reflections on the implementation of the NFR Directive in practice. The initial sample of companies included larger sets of over 20 companies from Spain, France and the UK and smaller controlling samples from Germany, the Nordic region (Denmark, Finland, Sweden) and Central and Eastern Europe (Poland, Czech Republic, Slovenia).

Research highlights

Our initial research in 2018 assessed whether companies provided the type of information explicitly required by the NFR Directive, i.e. the description of policies and due diligence processes, outcomes, principal risks (including with respect to business relationships) and KPIs. It also examined if the disclosed information was specific enough to allow understanding of the companies' impact and strategy. In addition, the research analysed companies' disclosure on particular important environmental and human rights issues, and on their anti-corruption programmes, for which it provided a specific set of criteria connecting the requirements of the NFR Directive with the emerging consensus on what constitutes material information for these issues.

The analysis of the gathered data from companies' reports in every category and on every issue points consistently to one overarching conclusion. The vast majority of companies acknowledge in their reports the importance of environmental and social issues for their business. However, in only 50% of cases for environmental matters and less than 40% for social and anti-corruption matters, this information is clear in terms of concrete issues, targets and principal risks.

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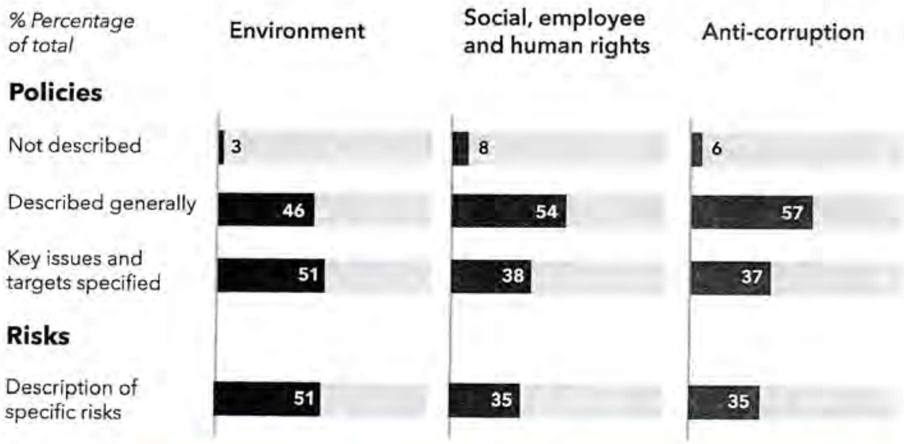
The general information that most companies provide does not allow readers to understand their impacts and by extension their development, performance and position, as required by the NFR Directive. The research did not assess in detail the materiality and comprehensiveness of the information disclosed by individual companies. Therefore the number of companies providing information that fully responds to the objectives of the NFR Directive should be expected to be even lower than that indicated by the numbers above.



With respect to climate change, the biggest gaps in current practice are the lack of reporting by companies in the Energy and Resource Extraction sector on both short and long time horizons and the transition to a below 2°C scenario, which are mentioned by 26% and 21% of companies respectively (the research did not analyse in detail the quality of these disclosures). To address this problem, the legislation should clarify the requirement for the disclosure of companies' long-term transition plans to a zero-carbon economy and their economic implications. This requirement would leave companies sufficient flexibility to determine their plan.

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For other environmental issues, it is worth considering what information, as a minimum, should be specified and explicitly required to be reported on. The research found that despite almost universal reporting on issues such as water use, pollution, and waste, certain important aspects are considered only by a few companies. These aspects include for example pollution from transportation, which is mentioned by 21% of companies, or water consumption and risks in water scarce and borderline areas, which are reflected in 24% of companies' reports. These figures compare to 74% and 70% of Energy and Health Care companies respectively which report on water use. Similarly where companies identify risks to biodiversity connected to their business, they typically do not report on concrete impacts and their management.

Climate change reporting in the Energy sector

63% Policy describes key issues and targets
53% Risk description is specific
68% Effects on company's business and strategy
47% Effects on financial planning
26% Below 2°C scenario
21% Information on short and long time horizons

Regarding social issues, most companies report indicators linked to their direct employees and sometimes their broader workforce. The selection of these indicators is, however, far from standardised. Most companies provide information on the number of employees (92%), overall gender balance (81%), anti-discrimination policies (79%), and health and safety (80%). Fewer companies disclose more detailed information on the effects of their policies (36% report on improvements resulting from their anti-discrimination policies), and very few include outsourced workers in their perspective (1%-25% depending on specific issue) or provide country-by-country information on region-sensitive issues such equal opportunities (6%) and freedom of association (10%).

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Over 90% of companies express in their reports a commitment to respect human rights and over 70% endeavour to ensure the protection of human rights even in their supply chains. **As in other areas, a majority of companies, however, do not provide any information that would allow a stakeholder to understand how this commitment is put into practice.** Only 36% describe their human rights due diligence system, 26% provide a clear statement of salient issues and 10% describe examples or indicators to demonstrate effective management of those issues.

Human rights

Policies and commitments:
90% Commitment indicated
71% Recognition of supply chain issues
36% Description of human rights due diligence process

Risks description:
19% No risks description
48% Vague risks description
26% Clear statement of salient issues

Management of risks:
46% Explanation of determination of salient issues
48% Policies responding to identified risks
41% Description of actions
36% Requirements placed on business partners
24% Concrete operations identified
10% Evidence of effective management
9% Changes in the nature of the risk

These results suggest that in order to drive better transparency that leads to substantial positive change, legislation needs to focus on clear indicators such as human rights due diligence and disclosure in the context of concrete risks and incidents and their management. These requirements can be specified in guidance with regard to concrete risks, such as - for companies with operations outside of Europe - those connected to land acquisition, indigenous peoples, and companies' operations in high-risk areas for civil and political rights. More specific guidance can also be developed for issues that are already addressed in other legislation, such as conflict minerals and digital rights.

With respect to supply chains, there is a need for greater transparency around high-risk supply chains (reported only by 6% of companies), results of audits (25%), companies' understanding of limitations of these audits (8%), and actions taken as results of these audits (16%). The research has also shown that certain workers' rights issues in supply chains are not being reflected by many companies, such as the living wage (mentioned by 22% of companies) and the exploitation of migrant workers (10%).

Companies demonstrate more balanced reporting on anti-corruption matters. Nevertheless, the focus on disclosure of commitments and lack of details on their implementation is noticeable in this area as well. The legislation could more forcibly require disclosure of the main elements of the anti-corruption programme (disclosed by 63% of companies) and its application to third parties (reported on by 43% - 60% depending on the type of disclosure).

Finally, the analysis showed that less than 10% of companies disclose their lobby expenditures and the public positions that they lobby for. The latter should be considered especially in the context of investor-company relationships and the urgent need for a policy reaction to systemic risks such as climate change.