

ETUI Policy Brief

European Economic, Employment and Social Policy

N°10/2020

Non-financial reporting: how can it be a resource for workers?

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Key points

Non-financial reporting is the provision by companies of information regarding their policies that have an impact on workers, the environment and society. EU requirements for such reporting are based on Directive 2014/95/EU on the disclosure of non-financial and diversity information by certain large undertakings and groups. This Directive falls short of key demands made by European trade unions. Nevertheless, current reporting requirements present an important opportunity for workers' representatives and trade

unions. Non-financial reporting can help them to initiate social dialogue, or broaden its scope, and to obtain information on key topics and management policies for the preparation of information and consultation processes, negotiations or campaigns.

Introduction

The publication by companies of information on policies regarding working conditions, health and safety, diversity, the environment and human rights – 'non-financial reporting', henceforth 'NFR' – responds to the widespread belief that companies are accountable not only to investors but also to stakeholders and society as a whole.

The current EU requirements are defined by Directive 2014/95/EU (henceforth 'the NFR Directive' or 'the Directive') on the disclosure of non-financial and diversity information by certain large undertakings and groups. Although some Member States have stricter reporting requirements, most EU countries have 'copied and pasted' provisions from the Directive into national law. This Directive thus defines the reporting requirements for around 6,000 companies throughout the EU. In the annual reporting for the fiscal year of 2017, many entities were, for the first time, obliged to disclose information on the impacts of their operations beyond a solely financial dimension.

European trade unions have criticised the Directive on a number of points (ETUC 2019). These include the limited scope of application, the option for companies to 'pick and choose' the standards they use for reporting, and the option to hold back the disclosure of information in certain cases (the 'safe harbour clause'). Nevertheless, thousands of companies are publishing non-financial information based on the provisions in the Directive. Workers' representatives (including trade unions, works councils, European works councils, board-level employee representatives, etc.) therefore need to be aware of this development. This policy brief explains key terminology and provides conceptual knowledge

to facilitate decision-making for workers' representatives on the questions of whether and how to utilise or engage with NFR, an issue upon which there is currently little research and literature.

The Non-Financial Reporting Directive: what is in it?

The NFR Directive, which amends the Accounting Directive 2013/34/EU, came into effect in all EU Member States in 2018. As of this date it requires large companies to disclose certain information on the way they operate and manage social and environmental challenges. Its minimum scope of application covers 'large public interest entities', defined as listed companies, banks and insurance companies with more than 500 employees, a minimum balance sheet total of 20 million euros and an annual net turnover of at least 40 million euros.

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The goal of the Directive is to improve the transparency of social and environmental information. To this end, the Directive helps to evaluate the non-financial performance of the companies and to identify sustainability risks, thereby encouraging these companies to develop a responsible approach to business.

Companies subject to the Directive must give a fair and comprehensive account of policies and their outcomes concerning:

- environmental protection (e.g. emissions, use of renewable energy, and water use)
- social responsibility and treatment of employees (e.g. gender equality, working conditions, social dialogue, and health and safety at work)
- respect for human rights
- anti-corruption and bribery
- diversity on company boards (in terms of age, gender, and educational and professional background)

These companies are required to disclose adequate information on all matters perceived to have a probability of triggering principal risks with potentially severe impacts, as well as on risks whose impacts have already materialised. Companies must provide a description of policies pursued, rather than just providing numbers. Reporting can be done on a consolidated basis for an entire group of companies sharing a single owner, as the obligation applies to parent companies only. The basis for reporting is the national regulation of the country in which the company's headquarters are located.

The Directive allows significant flexibility to disclose relevant information in the way that the company considers most useful. International, European or national guidelines may be used to produce statements. Furthermore, a 'comply or explain' system is employed, meaning that if policies are not yet applied, instead of there being an obligation to put one in place, the company must simply include an explanation as to why this is the case.

The Directive allows Member States to impose country-specific definitions and requirements with regard to scope, disclosure formats (see below) and content, meaning they can also go further than the EU minimum standards. Yet the majority of the (pre-Brexit) 28 EU countries have adopted the Directive into national law on a copy-paste basis, with only a few Member States going beyond the bare minimum. Still, there is some variety to be found between countries. Sweden, for example, applies its rules to all types of companies with over 250 employees, while Denmark lowered the threshold from 500 to 250 employees for listed companies and state-owned limited liability companies. France extended the reporting requirements to non-listed *sociétés anonymes* and non-listed investment funds with a net turnover of over 100 million euros. In Spain, the definition of public interest also includes entities which have a net turnover exceeding 2 billion euros and more than 4,000 employees during two consecutive years. Greece went as far as obliging companies with more than 10 employees and either a net turnover of over 700,000 euros or a balance sheet total of over 350,000 euros to report on environmental performance and employee matters. Spain is the only country that has specified information for reporting that goes beyond the Directive.

Understanding non-financial reporting: key terminology

Disclosure formats

In all countries except for France, the transposition of the Directive includes an option for companies to publish non-financial information separately from the annual report. In practice, this has led to a wide variety of reporting models. We provide a short overview of the most common approaches in order to understand where to look for information and which parts are legally binding.

'Integrated reports' connect financial and non-financial information in the annual report, while also taking a wider perspective of the whole value-creation process. They create a new context by connecting different types of information. The informational value of integrated reports is thus more than just the sum of the two types of information. So far, only a minority of companies produce integrated reports. All non-financial information provided in this way is legally binding, meaning these reports need to meet stricter requirements in order to obtain external assurance.

'Combined reports' are the most common model for reporting. These reports include both the annual report and a 'non-financial statement', but in separate sections without a connection. Companies use these 'non-financial statements' to stay on the safe side, by reporting the minimum needed to fulfil their legal obligation while at the same time making it easier to obtain external assurance, since the information is presented in one comparably short section. Companies that publish 'non-financial statements' often also issue more elaborate documents, referred to as corporate social responsibility or sustainability reports, which contain detailed non-financial information on a broad range of topics.

'Separate non-financial statements' basically constitute the same form of reporting as in combined reporting; however, they are published in a separate manner outside of the annual report, usually on the company's website.

'Corporate (social) responsibility' or 'sustainability' reports are not part of the combined reports, but in some cases include the 'non-financial statements' (in whole, in sections or in different (marked) places). This practice presents somewhat of a legal grey zone, mixing the legally binding 'non-financial statement' with information that is not considered to be part of the legal obligation of NFR. However, many of them are declared to have been prepared in compliance with a reporting framework, and thus are required to fulfil at least these standards. It can also be argued that these reports are especially directed towards rating agencies whose analyses are relevant for the inclusion of companies in sustainable financial indices. In this case, reports have to be considered to contain information which affects stock listings and values (Schäfer and Preller 2003: 153). This market relevance demands, at the very least, a certain robustness concerning the information provided.

The weakest level of NFR in terms of quality is contained in corporate responsibility (CR), corporate social responsibility (CSR) or sustainability brochures. These brochures are usually marketing tools that do not follow any standards. They are not relevant for

analysing a company's non-financial performance and alone they do not constitute an instrument which fulfills companies' obligations stemming from the Directive.

Reporting frameworks

Being aware of the different types of reports is a prerequisite for knowing where to look for information and how to classify it. Furthermore, it is also important to understand which frameworks are followed and why. This is especially true for combined reports, as they bring together two different sets of rules. While the financial annual report part is carried out under international financial reporting standards (IFRS) or other quite specific standards, different standards are applied or referenced in the non-financial statement. The Directive and its transpositions into national law do not provide concrete provisions on how to report NFR, stating only that nationally or internationally recognised frameworks can be used. Under the frameworks listed, we find a wide variety of approaches that differ regarding their level of detail and focus, such as the ISO 26000 guidance on social responsibility, the UN Global Compact, the Eco-Management and Audit Scheme (EMAS), or the Global Reporting Initiative (GRI). Along with the Directive, non-binding guidelines for the disclosure of NFR were also published by the European Commission. So far, these guidelines are only explicitly referred to in less than 5% of reports (Alliance for Corporate Transparency 2019: 34). The absence of binding standards for disclosure makes it hard to analyse NFR, especially when attempting to obtain comparable results. Nevertheless, on a company level it is possible to obtain meaningful results from an NFR analysis. As the first surveys have shown, the most frequently used reporting framework is the GRI. Therefore, we will use the GRI as a starting point to explain two key aspects in the NFR process: materiality analysis and stakeholder inclusiveness.

Materiality analysis

Materiality analysis is a concept already known from financial reporting. It is used to determine what information is most important for understanding and assessing the situation and the performance of a company. This is essential in order to ensure that the most important information is provided and to avoid an information overload. The transpositions of the Directive were followed by a controversy about materiality in NFR. At issue was whether a topic had to be simultaneously financially material AND environmentally and socially material to require disclosure, or if only one of the materiality criteria had to be fulfilled. In June 2019, the European Commission released its 'Guidelines on non-financial reporting: Supplement on reporting climate-related information', which resolved this issue. The guidelines explicitly state that materiality under either one of the dimensions is sufficient (European Commission 2019:4-5). Even though the guidelines are non-binding and the supplement directly addresses only climate change issues, they provide a clear indication of the intent of the Directive. Nevertheless, the discussion continues in academic circles, as this interpretation is seen to be in conflict with other regulations (see Baumüller 2019). The topic is therefore likely to come up in the process of the revision of the Directive.

In practice, for determining materiality in NFR most companies draw so-called 'materiality matrices', which visualize the importance of different topics to different stakeholders, to determine priorities for reporting topics. This methodology originally comes from sustainability reporting. In most cases it is not included in the non-financial statement in detail, even if it is frequently quoted there. This is a good example for how blurry the lines are between combined reports and additional CR, CSR or sustainability reports. From the perspective of workers' representatives, the materiality analysis in NFR is important because: 1) it determines the content of the reports and 2) in most cases it is the result of a process drawing on input from stakeholders, meaning that it potentially opens up NFR for workers' participation.

Stakeholder inclusiveness

Stakeholder inclusiveness – from the perspective of standard-setters like the GRI – serves to ensure that more than just the management standpoint is taken into account when identifying key reporting issues. From a company's perspective, stakeholder inclusiveness also gives its reporting more external credibility. Stakeholders are defined as 'entities or individuals that can reasonably be expected to be significantly affected by the reporting organization's activities, products, or services; or whose actions can reasonably be expected to affect the ability of the organization to implement its strategies or achieve its objectives. ...This includes those who are unable to articulate their views and whose concerns are presented by proxies' (GRI 101 2016: 8). This definition highlights why employees are, unquestionably, stakeholders. In fact, they can be considered the stakeholder with the strongest interest in the long-term economic stability of the company they work for. Under this definition, it can be concluded that in companies with elected workers' representatives, as proxies of the employees they would have to be considered stakeholders for all collective issues. From this perspective, a key question arises: is it desirable for workers' representatives to be engaged in NFR?

Should workers' representatives be involved in NFR?

As in many other situations of worker representation, there is no simple answer to this question. However, it would not be desirable to leave all interpretative authority over these topics to management and financial market actors. In order to find an answer as to whether and how workers' representatives should engage with this issue, the resources deployed have to be weighed against the potential benefits.

Analytical capacities and resource allocation

Any strategy for workers' representatives to actively engage in and further develop NFR requires certain analytical capacities to monitor and intervene in NFR processes. These capacities are a function of analytical skills and time resources, both of which tend to be scarce. Currently, the absence of binding reporting standards leads to a wide variety of reporting practices. In addition, current forms of NFR primarily address investors and rating agencies which are highly specialised in the analysis of company information. These circumstances often lead to abstract and complex reports. At first sight, this is not good news when thinking about analytical capacities.

However, taking a closer look at actual NFR reveals a different picture. Topics reported under 'employee matters' are part of day-to-day business for workers' representatives, and so they already have the expertise to deal with them. For structured analysis in this field only one worker representative with an understanding of the overall NFR process is needed, who can then organise a division of labour, with expert specialists enlisted to assess information for key topics such as 'occupational health and safety', 'training', or 'gender and diversity'. For topics regarding environmental issues or the supply chain, specialised NGOs or workers' representatives in companies in supply and subcontracting chains could possibly fill any gaps in analytical skills.

In order to estimate the actual effort needed for NFR analysis it is therefore necessary to: 1) set a strategic focus, 2) define the scope of analysis, 3) identify work packages, and 4) divide labour between experts.

Establish and expand social dialogue

Why should workers' representatives bother to do all of the above? The simple answer is that understanding NFR opens up possibilities to establish, deepen or extend social dialogue and enables the obtaining of information relevant for negotiations and campaigns.

In those countries where there is little or no institutionalised relationship between workers' representatives and management, NFR is a potential tool for initiating or fostering social dialogue. This is because it contains information on key performance indicators such as the number of employees, contracts, and remuneration, as well as management concepts that might not have been communicated in the past or might not be otherwise accessible. In this case, NFR provides an occasion for worker input that would not normally be available.

In countries where social dialogue is well established, NFR can be a means for expanding it to include topics which are of increasing relevance to workers' representatives, such as environmental performance. Here, the reports can serve as a first source of information and a starting point for dialogue.

One aspect that should not be underestimated in the context of social dialogue is the perceived level of competence of the social partners. Interviews with managers who deal with European Works Councils (EWCs) show that managers want to meet well-informed EWCs at the negotiation table. However, they often perceive EWCs as lacking important competences needed to be strong counterparts in information and consultation processes and problem-solving (Euwema *et al.* 2015: 12). This may also apply to other levels of social dialogue.

Using NFR to advance workers' interests

Results from previous projects (DimasoLab (Kaliga and Oberdieck 2018) and CENOFIA) illustrate how NFR at company level is effectively used by workers' representatives for social dialogue in Spain and France.

In Spain, the structure of social dialogue is an important factor. For some issues, such as occupational health and safety, dialogue with management is well established due to rights defined in specific legislation on the issue. For other topics, however, there is a lack of institutionalised social dialogue. As mentioned earlier, Spain is the only country that has introduced specific obligations for NFR on numerous topics. In addition, some of the largest sectors in Spain, like tourism and agriculture, have strong and immediate effects on the local environment, leading to an increased awareness of sustainability issues. Workers' representatives at Siemens-Gamesa, Indra, Inditex and Repsol regularly analyse their companies' NFR. Due to the aforementioned characteristics of dialogue at management level, the reports are sometimes the only official source of information regarding company policies on certain topics. Information on these policies allows workers' representatives to broaden social dialogue. Strategies and focus vary between companies. At the fashion retailer Inditex, workers' representatives use NFR analysis as one tool for monitoring the global framework agreement. At the technology company Indra, the strategic focus was set on specific issues, especially cross-sectional topics like gender equality. Workers' representatives at renewable energy provider Siemens-Gamesa, meanwhile, carried out a general assessment of NFR and, particularly after the merger of the two companies, tried to identify changes in policies communicated by management.

In France, mandatory NFR has a longer history and therefore is more recognised by workers' representatives. For example, workers' representatives at manufacturing company Saint-Gobain have in the past worked with social data from NFR, in particular during periods of company restructuring. In order to obtain the best possible analysis of the dense and very technical NFR and to spare their own resources, the EWC entrusted the analysis to an external expert. The analyst works not only on public data, which consists of consolidated figures on the global level, but also on internal reporting data broken down by European country and operation. This comprehensive analysis feeds into an internal report used for social dialogue. In particular, it is used to analyse employment risk and procedures accompanying changes in the organisation of the company.

Conclusion

Despite weaknesses in the Directive, NFR can be used by workers' representatives to advance workers' interests. Workers' representatives can be agents pushing for improvements in NFR in companies and policymaking, both at national and European level. The European Trade Union Confederation has welcomed the European Commission's decision to revise the Directive, as this could strengthen such opportunities (ETUC 2019).

NFR can serve as a source of information for workers' representatives, ranging from information as basic as the number of employees in different countries to complex policies and data. Information on the number of employees in different countries, to take this example, can be useful when assessing companies for their eligibility for establishing an EWC, but also in countries where trade unions have little to no information about company structures.

In this regard, a major flaw in the Directive is the absence of a requirement for country-by-country reporting. If detailed information on the country level were available, NFR could become a standard piece of information used in consultation to create a common understanding in EWCs. An obligation for country-by-country reporting should therefore be included in the revision of the Directive. For more in-depth social dialogue, additional information could be valuable, for example to check NFR against collective bargaining agreements or to monitor global framework agreements and address any inconsistencies. It would also give EWCs the information they need to recognise transnational developments and anticipate the potential impacts of company policies.

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All links were checked on 7 July 2020.

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The *ETUI Policy Brief* series is edited jointly by Jan Drahekoupil, Philippe Pochet, Aída Ponce Del Castillo, Kurt Vandaele and Sigurt Vitols.

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The ETUI is financially supported by the European Union.

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