

## IFRS in Focus

### EC publishes guidelines on the EU Non-Financial Reporting Directive

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#### **The bottom line**

- The European Commission has published guidelines to help companies disclose information required by the EU Non-Financial Reporting Directive in a consistent and comparable manner. These voluntary guidelines do not extend the scope of the Directive, but may influence how companies interpret it.
- The Directive was published in November 2014 and was to be brought into national laws by December 2016. It applies to undertakings within its scope for years starting on or after 1 January 2017 and requires that large public-interest companies with more than 500 employees to disclose relevant and material environmental and social information in their annual reports. The Directive also requires that large listed companies provide information on their diversity policy.
- In most Member States, a certain level of non-financial reporting has been in place since the implementation of the Accounting Directive, hence the implication of the EU Non-Financial Reporting Directive differs between jurisdictions.
- The guidelines are meant to assist preparers complying with the requirements of the Directive and are not meant to stifle innovation in reporting practices.

#### **Background**

In November 2014 the European Union (EU) published a Directive on disclosure of non-financial and diversity information by large companies and groups ([2014/95/EU](#)) (the Directive), that was to be transposed into national law by 6 December 2016. Companies falling within its scope have to disclose relevant information on policies, risks and results as regards environmental matters, social and employee-related aspects, as well as respect for human rights, anti-corruption and bribery issues, and diversity on the boards of directors.

The stated aim of the Directive is to boost corporate transparency and performance, as well as encourage companies to embrace a more sustainable approach to doing business, and enabling sustainable finance. The Directive is part of the Commission's goal of an overarching and comprehensive EU strategy on sustainable finance, and also contributes towards the UN's [Sustainable Development Goals](#) and the 2015 UN COP21 [Paris Agreement](#).

*"Greater transparency is expected to make companies more resilient and perform better, both in financial and non-financial terms. Over time this will lead to more robust growth and employment and increased trust among stakeholders, including investors and consumers. Transparent business management is also consistent with longer-term investment."*

**– EC Guidelines**

For more information please see the following websites:

[www.iasplus.com](http://www.iasplus.com)

[www.deloitte.com](http://www.deloitte.com)

## Guidelines

The Commission adopted guidelines on 26 June 2017 to help companies disclose non-financial and diversity information in a relevant, useful, consistent and comparable manner, and to provide a principle-based methodology that would be relevant to all companies. The Commission developed these guidelines following public consultation and taking into account relevant developments in non-financial reporting in jurisdictions across the EU and at international level. For example, many of the requirements are within the spirit of the International Integrated Reporting Council's <IR> Framework.

### Observation

In most Member States, a certain level of non-financial reporting has been in place since the implementation of the Accounting Directive. The implication of the EU Directive differs between jurisdictions depending on the degree of adjustments that have had to be made to accommodate these new requirements.

## The Directive

### Who?

The Directive applies to all public interest entities (PIEs) that have over 500 employees, on average, in the financial year. Where a company is a parent company at any time in the financial year, a consolidated non-financial statement is required where the aggregate number of employees for the group headed by that company was more than 500, on average, in the financial year.

Subsidiary undertakings are exempt if covered in a consolidated non-financial statement of their parent group that meets the Directive's requirements.

A PIE is defined broadly as:

- a traded company (which means a company any of whose transferable securities are admitted to trading on a regulated market in the EEA);
- a banking company;
- an authorised insurance company;
- a company carrying on insurance market activity; or
- a company designated by Member States as a PIE, for instance undertakings that are of significant public relevance because of the nature of their business.

**What?**

The required disclosures are:

- environmental matters (including the impact of the company's business on the environment);
- the company's employees;
- social matters;
- respect for human rights; and
- anti-corruption and anti-bribery matters

If the company does not have policies in relation to any of the above matters, their statement must provide a clear and reasoned explanation for not doing so.

This information is required only to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity.

The non-financial statement should also include descriptions of:

- the company's business model;
- the policies pursued in relation to those matters listed above, including due diligence processes;
- the outcome of those policies;
- the principal risks relating to those matters arising in connection with the company's operations;
- where relevant and proportionate, the business relationships, products and services which are likely to cause adverse impacts in those areas of risk;
- how the company manages those principal risks; and
- the non-financial key performance indicators relevant to the company's business.

The statement must also, where appropriate, include references to, and additional explanations of, amounts included in the company's annual report.

**Diversity information in the Corporate Governance Statement**

The Directive also requires diversity disclosures but the scope of this requirement is different from the others described above. The requirement applies to traded companies (i.e. those with transferable securities admitted to trading on regulated market in the EEA) but it does not apply to issuers which do not have shares admitted to trading on an EU regulated market, unless the issuer has issued shares which are traded on an EU multilateral facility (i.e. companies with listed debt will usually be exempt). Companies that meet the size criteria to qualify as small or medium-sized under company law are exempt from the diversity disclosures.

Those within scope of the diversity disclosures are required to describe as part of the corporate governance statement their diversity policy including aspects such as age, gender, geographical diversity and educational and professional background. As well as describing the policy, they must explain the objectives of the policy, how it has been implemented and the results of the policy in the reporting period.

**Guidelines structure**

The guidelines contain first a section on the key principles that are the foundation for the required disclosures. The structure reflects the structure of the underlying Directive, covering the content required in the non-financial statement and the disclosure on board diversity. Each section in the guidelines quotes from the Directive, provides more detailed guidance, and then in some cases provides examples of possible disclosures and key performance indicators that companies could adopt.

As the guidelines have the status of voluntary guidance they do not extend the requirements of the underlying Directive. Noted below are some areas that intend to clarify the existing regulations.

Area	Description	Observation
<b>Key principles</b>	<p>There are six key principles that are the foundation of the Directive.</p> <ul style="list-style-type: none"> <li>• Material information</li> <li>• Fair, balanced and understandable</li> <li>• Comprehensive but concise</li> <li>• Strategic and forward-looking</li> <li>• Stakeholder oriented</li> <li>• Consistent and coherent</li> </ul> <p>The guideline clarifies how these principles may be applied within the context of the Directive.</p>	<p>In assessing what is material information, consider not only how to determine whether a disclosure may be material, but when it might be appropriate to disclose the due diligence applied in making the assessment.</p> <p>Each section has examples of how disclosures should link to any related KPIs and alternative performance measures used by the company.</p>

### Observation

The guidelines set out that companies must develop their disclosures with “stakeholders” in mind. The term stakeholders in the context of the Directive refers to a broader group than investors, and may include employees, suppliers, customers and the public. Further, the focus is on stakeholders as a collective group, rather than on the needs or preferences of individual or atypical stakeholders, or those with unreasonable information demands. This is likely to be an area that companies will find challenging.

As well as companies taking the views and needs of stakeholders into account when developing their business model, and reporting on this stakeholder engagement to the extent it is material to the investors, the guidelines imply that companies need to address all the stakeholders’ reporting needs. This goes beyond the traditional audience of the annual report and will depend on how the directive is brought into the law of individual jurisdictions.

### Content

Area	Description	Observation
<b>Business model</b>	<p>The business model describes how a company generates and preserves value through its products and services over the longer term.</p>	<p>A company may consider specific disclosures, explaining the main products it makes, and how they meet the needs of consumers/ customers; how these products are made and what makes its production approach competitive and sustainable; the characteristics of the market where it operates, and how it may evolve.</p>
<b>Policies and due diligence</b>	<p>Companies should disclose their approach to key non-financial aspects, the main objectives, and how they are planning to deliver on this objectives.</p>	<p>If a company has determined that a matter is material but has not yet developed policies they should “provide a clear and reasoned explanation for not having developed those policies”. Other reporting requirements would nevertheless apply.</p>

Area	Description	Observation
<b>Outcome</b>	Companies should provide a useful, fair and balanced view of the outcomes of their policies.	Companies may consider explaining the relationship between financial and non-financial outcomes and how this is managed over time. Some examples of KPIs that may be used to evaluate the outcomes of policies are included.
<b>Principal risks and their management</b>	Companies should disclose information on their principal risks and on how they are managed and mitigated.	<p>When including principal risks and their management, companies should consider short, medium and long-term principal risks, and whether they stem from the company's own decisions or external factors.</p> <p>Companies should also describe the process they use to identify and assess their principal risks.</p>
<b>Key performance indicators</b>	Companies should include material narratives and indicator-based disclosures that are useful in their specific circumstances.	Reported KPIs are expected to be consistent with those used internally by the company.
<b>Thematic aspects</b>	Material disclosures should provide a balanced and comprehensive view of a company's development, performance, position, and the impact of its activities.	<p>Companies should consider how disclosures have changed since last year. If the business model or principal risks have changed materially, they should highlight and explain this.</p> <p>The guidelines include a non-exhaustive but representational list of thematic aspects that companies should consider, including examples within each of the areas of environmental matters; social and employee matters; respect for human rights; anti-corruption and bribery matters; and other areas.</p>
<b>Reporting frameworks</b>	Companies may rely on one or more high quality, broadly recognised national, EU-based or international frameworks.	The guidelines reference several international, EU-based and national frameworks, including the UN Sustainable Development Goals, the International Integrated Reporting Framework, the Sustainability Accounting Standards Board and the UK Financial Reporting Council's guidance on the Strategic Report.

Area	Description	Observation
<b>Board diversity disclosure</b>	While the description of the board diversity policy is not part of the non-financial statement, the Directive does require companies to disclose their policy on board diversity in their corporate governance statement.	The guidance identifies some aspects of diversity that companies should consider, and also the level of disclosure required on their diversity targets, implementation and results.

**Observation**

The guidelines are meant to assist preparers complying with the requirements of the Directive and are not meant to stifle innovation in reporting practices. In fact, the Commission encourages companies to avail themselves of the flexibility under the Directive when disclosing non-financial information.

**Further information**

[Directive on 2014/95/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups](#)

[The EC guidelines on non-financial reporting](#)

[The FAQ on the EC guidelines on non-financial reporting](#)

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