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IMPLICATIONS OF THE NEW EUROPEAN UNION NON-FINANCIAL REPORTING DIRECTIVE

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ABSTARCT

The European Union introduced a new directive on non-financial reporting, which should be implemented into member state legislation in 2016 and effective in business year 2017. This paper introduces the legislation and some implications it will have. Also there will be discussion of the general trends on sustainability and corporate social responsibility, and how those are related to the EU directive.

The research question for this paper is “what are the implications of the EU directive on non-financial reporting?” The question is approached on academic level with discussion of the broader topics around the matter and also on research level with analysis of several questionnaires on non-financial reporting.

In the analysis it was found that non-financial reporting is really a global standard now and companies should no longer ask if they should report but rather how to report and what information to include in those reports. Also majority of investors are now expecting transparent and coherent reports on non-financial performance and companies should address this with careful consideration.

On the other hand, it was found out that current reporting standards are not sufficient enough and there will be a lot of work to do to reach a sufficient level of quality. Furthermore, the directive is compromising and does not provide a framework to reach the eligible level of quality. Hence the directive mostly serves as a strong statement by the European Commission to support sustainable development and brings hope of positive future development.

Even more, the directive does not solve any current problems in the field of sustainability and there is a lot of work to do in international context to address the complex problems of modern society.

Keywords: directive, non-financial, reporting, sustainability

RESUMO (Abstract in Portuguese)

A União Europeia introduziu uma nova directiva sobre relatórios não-financeiros, que deve ser implementada na legislação dos estados membros em 2016 e efectiva no ano de 2017. Esta dissertação introduz a legislação e algumas da implicações que esta terá. Haverá também uma discussão das tendências gerais nas áreas de sustentabilidade e responsabilidade social corporativa, e em como estas estão relacionadas com a directiva da UE.

A pergunta de pesquisa desta dissertação é: “Quais são as implicações da directiva da UE sobre relatórios não-financeiros?”. A questão é abordada a um nível académico, com uma discussão sobre os tópicos alargados acerca do assunto, e a um nível de investigação, com a análise de vários questionários sobre relatórios não-financeiros.

A pesquisa revelou que os relatórios não-financeiros são agora um standard global, e que as empresas não devem continuar a questionar-se se deveriam reportar, mas sim como devem reportar e que informação devem incluir nesses relatórios. Para além disto, a maioria dos investidores exigem relatórios transparentes e coerentes sobre a performance não-financeira, e as empresas devem lidar com esta exigência com consideração e cuidado.

Por outro lado, foi descoberto que os standards para a criação de relatórios existentes não são suficientes, e será necessário bastante trabalho para atingir um nivel de qualidade satisfactório. A directiva é comprometedora e não proporciona uma estrutura através da qual se possa atingir o nível de qualidade pedido. Deste modo, a directiva serve maioritariamente como uma tomada de posição por parte da Comissão Europeia para apoiar o desenvolvimento sustentável, trazendo a possibilidade de um futuro desenvolvimento positivo.

A directiva não resolve nenhum dos problemas actuais na área da sustentabilidade, havendo ainda muito trabalho para fazer no contexto interncional para lidar com os problemas complexos da sociedade moderna.

Palavras-chave: directive, não-financeiros, relatórios, sustentabilidade

Contents

1. INTRODUCTION

Healthy environment, human rights and equitable society are some basic measures affecting everyone across the globe, and the European Union (EU) citizens have every right to expect their government to be the forerunner. In Europe we tend to even take these measures as given, and might lack some healthy criticism against other parties involved, namely first sector private parties, multinational corporations, who are gathering more political power as well.

If we seek to run transitions to more sustainable economy, it is clear that we have to be ready to finance it. It is equally important to notice that we have to finance the transition, but not the system on a running basis, meaning that sustainable economy models should and could be self-sufficient. It is often argued that the economy runs the world, when in fact it is the other way around; the planet enables the economy. With this understanding it comes clear that unsustainable models harm the economy and the sustainable economy models can provide concepts to develop economic guidelines which are in line with the physical limits of our planet and provides economic well-being.

Typically we understand the risks and acknowledge the dreads of unsustainable operations, but our political decision making is fully motivated by the idea of infinite growth in the infinite world, which is of course an absurd idea. Perhaps we could argue having some problems in the political system itself when it motivates leaders into this kind of thinking, but this paper would not drill too deep into that discussion. Instead this study will focus more on general trends in sustainable economy, corporate social responsibility, non-financial reporting and the European Union legislation on the matter.

The research question for this paper is “what are the implications of the EU directive on non-financial reporting?” To address this question, it is critical to understand the historical development and universal position of the matter, current context and global trends, foreseeable future and possible future development paths. It has to be acknowledged that this is one very big and broad question, and the purpose of this paper is to provide a good general insight, multi-contextual understanding and interdisciplinary vision.

The paper first provides a context giving an update on recent events on climate science, then clarifying some key concepts and historical developments behind them, introducing EU legislation and the directive on non-financial reporting and finally discusses how it fits the bigger picture of sustainable economic models. It has to be noted that the EU directive is something to take place in the future, so there is not really good research available yet and the study is focusing on global trends around the matter.

Due to the nature of the subject, being a future legislation, the research part consists of analyzing several publicly available surveys around and on the subject.

In the discussion part the EU directive is observed in the bigger context aiming on identification of the cross-linkage between the concepts and finally discussing the possible future development.

While sustainability, corporate social responsibility and non-financial reporting all are much wider by definition than only environmental aspect, this paper is mostly focusing on that part leaving other themes like human rights, anticorruption and equality for the future discussion.

2. CONTEXT

Companies, enterprises, corporations and others alike are an integral part of today´s society and play a major role on world development on many levels. They as entities contribute a major effect on our surrounding environment compared to individuals. Therefore the changes we are witnessing on our environment are strongly linked to such entities and their behavior and actions. Hence, corporate social responsibility becomes a justified demand when we see it in the context, and this chapter is dedicated to provide a context; the changes on climate and environment strongly enhanced by business entities. Corporate social responsibility of course is much more than only the environmental aspect, but since it is the most critical one in global context, endangering the living conditions as we know them, it deserves a whole insight on its own.

The last years have been quite transitional in climate science. There have been several unexpected development patterns, or at least unpleasant development with unexpected rate. In the following subchapter is listed few notable recent findings connected to and affecting on climate, environment and future predictions on climate change development.

2.1 Recent events on climate science

Methane explosions in Siberia

Very surprising, and with the best current understanding strongly linked to climate warming, phenomenon has been taken place in northern Siberia, Russia, in the frozen Yamal peninsula. Enormous explosion craters seemed to appear out of the blue, and there have been several of them already reported. Apparently they were caused by methane released as permafrost thawed, which again is assumed to be linked to warm summers in the past years. Methane hydrate, or so called methane ice, covers vast amounts of methane gas underneath, and once this methane ice gets unstable, the whole structure blows up like a big bottle of campaign leaving only huge crater behind. This is well known phenomenon deep in the bottom of the oceans, but now appearing on land surface is rather unexpected and worrying.

Methane is very strong greenhouse gas, and this makes a good case how difficult it is to predict all the effects and rebound effects of climate change. The eruptions at the bottom of the ocean have occurred some thousands of years ago and most likely had a strong influence on the climate change at the end of last ice age. How the recent events prove to effect on current development, we can only guess at the moment. (Moskvitch, 2014)

Eastern Antarctic getting unstable

Another big surprise has been observed at Antarctic, which seems to get unstable as well. For a long time scientists thought that Greenland is in great danger, but that Antarctic should be safe, since it is so remote and surrounded with sever circumstances. Some years ago it was found that the western Antarctic is getting alarmingly unstable as well, and in fact could fully collapse since the sea water slowly corrodes the ice from beneath. Some scientists argue it is not a matter of if, but when it will happen.

Still the eastern Antarctic was believed to remain stable and safe, until the recent studies showed something other. Totten Glacier, the primary outlet of the Aurora Subglacial Basin, has found to be in very vulnerable position, and could face the same destiny as western Antarctic. Again, we don`t know the time table, but once the process of collapse has started it is assumed to be irreversible. This Totten Glacier alone has a potential to raise worldwide sea levels by 3.5 meters. (Greenbaum *et al.* 2015)

California hit by extreme drought

California region in the United States have faced extreme drought in last few years. There has been less rainfall, snow glace of the mountain areas have been shrinking, water storage reservoirs have been emptying and groundwater levels decreasing. In some point it was announced that the drought ended with a heavy rain, but after some rain they are back in drought. The farmers are suffering, the locals are advised to save on water usage, new dwells have to be drilled deeper than ever and the state officials are busy drying to secure water availability to citizens (Cook *et al,* 2015). Still for example Nestlé is selling local water to consumers with huge profits, only making the problem worse (Heyes, 2015). Recent study also shows that the region might be facing mega-droughts, and climate change plays a part as well; "In the Southwest and Central Plains of Western North America, climate change is expected to increase drought severity in the coming decades" (Cook *et al*, 2015).

Amazon rainforest in danger

Amazon rainforest have found to have long-term decline as carbon sink. Scientists studied Amazon rainforest over three decades and found out long-term decreasing trend of carbon accumulation. This is due not only tree growth rate increase leveling off, but even more increasing mortality of the biomass. The increasing carbon level was expected to be beneficial for the biomass, but now the man-made carbon fertilization is assumed to force the trees to grow too fast and robust and thus produce lower quality wood and makes them vulnerable for certain diseases. (Brienen *et al*, 2014) As Eli Kintisch wrote on Science magazine; "The unexpected finding itself isn't evidence of impending catastrophe, but it highlights the unpredictability of the effects of climate change and a warming planet." (Kintisch, 2015)

Oceans are getting sick

Oceans are getting increasingly acidic due to increased carbon dioxide in the atmosphere that is absorbed into oceans. As more carbon dioxide is dissolved into seawater, the more carbon acid is formed in the oceans, lowering the pH which equals to increasing acidity. In turn, acidification leads to certain marine organisms to produce less sulfur compounds helping cloud formation, thus making the planet warmer. Fall in these emissions could have major global scale positive-feedback loop amplifying atmospheric warming. (Barford, 2013)

The ocean acidification is also strongly linked to sea life health, which has been observed suffering from the effect. Even though the research methods have seen reasonable criticism and the exact effects on marine life are uncertain, there is a consensus that the effects will be negative in general (Cressey, 2015). Even more when the entire ecosystem is considered, including sea temperature rise, over fishing and harmful foreign compounds, such as plastics, oil spills, fertilizers and many other, it is clear that the oceans are getting sick and, additional to declining fish catches, we will see other unpleasant effects such as thousands of sea lion pups starving at California beaches. “The warm water is likely pushing prime sea lion foods—market squid, sardines and anchovies—further north, forcing the mothers to abandon their pups for up to eight days at a time in search of sustenance”, explains the Phys.org (Flaccus, 2015). The ocean warming is also linked to local extraordinary storms, heat waves and drought. (Goldenberg, 2015)

The sixth mass-extinction has begun

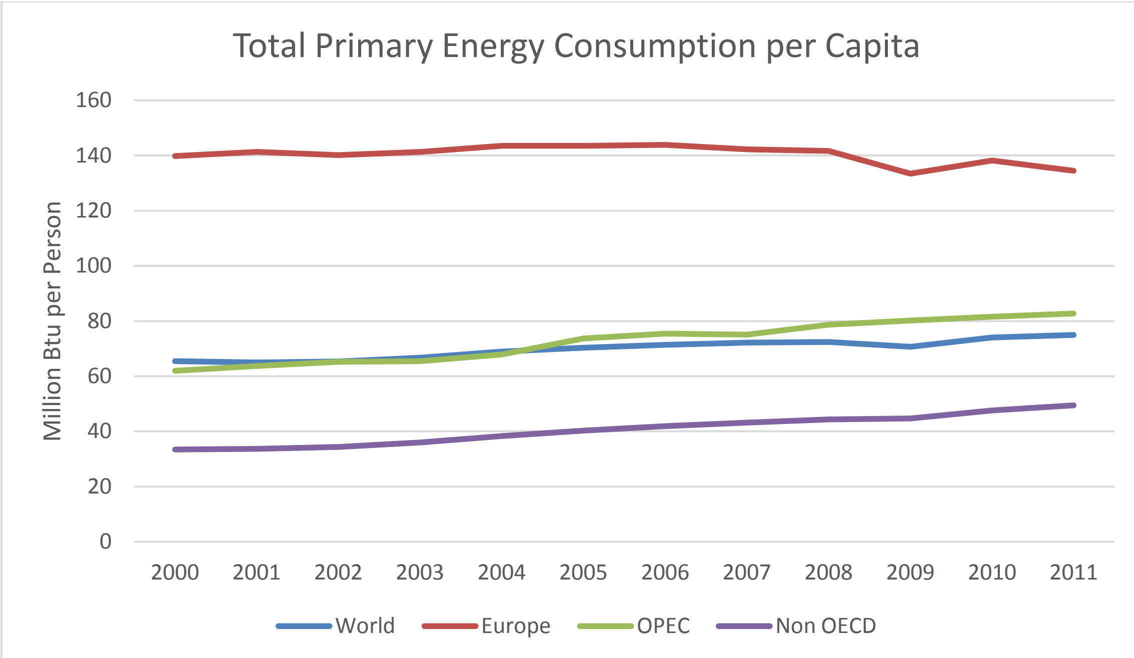
The world has seen five mass-extinctions in the history, one of them swiping dinosaurs out of the planet. The worst mass-extinctions have destroyed over 90% of all life on the planet. Now, we are at the brink of the sixth such an event, and it is due to human affect. “We can confidently conclude that modern extinction rates are exceptionally high, that they are increasing, and that they suggest a mass extinction under way” (Ceballos *et al*, 2015). Many biodiversity benefits could be lost forever if the current high extinction rate will continue, and it could happen as soon as in three human lifetimes. “Averting a dramatic decay of biodiversity and the subsequent loss of ecosystem services is still possible through intensified conservation efforts, but that window of opportunity is rapidly closing” (Ceballos *et al*, 2015).

The life on earth involves species dying out, the “unfit” in Darwin´s terminology. There´s very few if any species left from the dusk of the planet earth, which is a natural cycle of life. What we are experiencing now is not the standard cycle. (Ceballos *et al*, 2015).

Of course there are numerous other major news from the field, good and bad ones, which are not listed here. Even though there is no proven catastrophe facing us right here right now, at best we could conclude that there are several worrying signals and unpleasant layers of uncertainty. All these events and findings just makes the case how difficult it is to provide reliable climate modeling, how we tend to continuously underestimate the effects of human action on climate change and how climate change effects on our environment and daily lives. This is the changing environment where we live and where companies have to operate as well. When we see the corporate social responsibility in this context, it becomes clear that we can expect more from the companies.

2.2 The role of Europe

It is a fair assumption that Europe should lead the way to more sustainable economy. Europe has the resources, political system, level of education and supporting public opinion to run the transition. Moreover, Europe is way above the world average on primary energy consumption, as seen on graph 1 below



Graph 1: Total Primary Energy Consumption per Capita. Data extracted from U.S. Energy Information Administration (EIA, 2015)

The energy consumption is strongly linked to harmful emissions, which again are linked to environmental well-being. Therefore it is not only the Europe's possibility to lead the way, it is an obligation. Sometimes it is argued that Europe is already doing a lot and in fact running a sustainable economy. That is one very controversial statement with many assumptions built in. Typically those conclusions are drawn from data which very exclusively focuses on one specific point, but ignores the system level implications. For example, many European factories are doing really well sustainability wise, but still large shares of consumer goods consumed in Europe is produced outside of Europe, where standards are not necessarily that high. Therefore Europe is outsourcing the negative impacts of the high standards of living.

The next chapter further discusses the concept of sustainability and consumption.

3. CONCEPT OF SUSTAINABILITY

The word sustainability is wildly used in many different contexts and it is not always clear what is meant when something is described as sustainable. The concept has many levels of meanings and can be seen suffering of equivocation and misunderstandings. It is constantly redefined by the user, context and purposes.

In the era of cheap energy, namely oil, gas and coal, production and consumption has been steadily growing and sustainability has definitely not been the top priority. In fact, many producers have been intentionally planning their products not to last too long in terms to stimulate demand, increase sales and thus consumption. Hence, in the last few decades sustainability has had very little value for very few and this have created a whole culture of disposable goods and overconsumption. Public policies have even been built on the assumption that consumption should increase and private consumption growth has been seen as the driving force for the economy.

The world of politics and research was introduced with and they wildly adopted the concept of sustainability after the famous Brundtland report by the United Nations, where large scale concerns on environment and future living conditions were first time properly addressed. The report suggested that future development should be sustainable in a way that current needs can be satisfied without destroying the same opportunity from future generations. The current needs did not regard the overconsumption in western cultures but rather fulfilling the basic needs of the poor all over the world (Brundtland, 1987).

Besides social equality, the report gives significant weight for ecological sustainability, which is mostly defined as preserving natural resources, limiting emissions, reduction of waste and protecting ecosystems (Brundtland, 1987). This is not in contradiction with economy, actually quite opposite, there is a strong connection between healthy environment and healthy economy.

The Brundland report has faced some criticism about too abstract definition of sustainability and inconsistency in the use of the concept has caused some confusion. One major question was the connection with economic growth and this connection has become one major separator of different understandings of the concept.

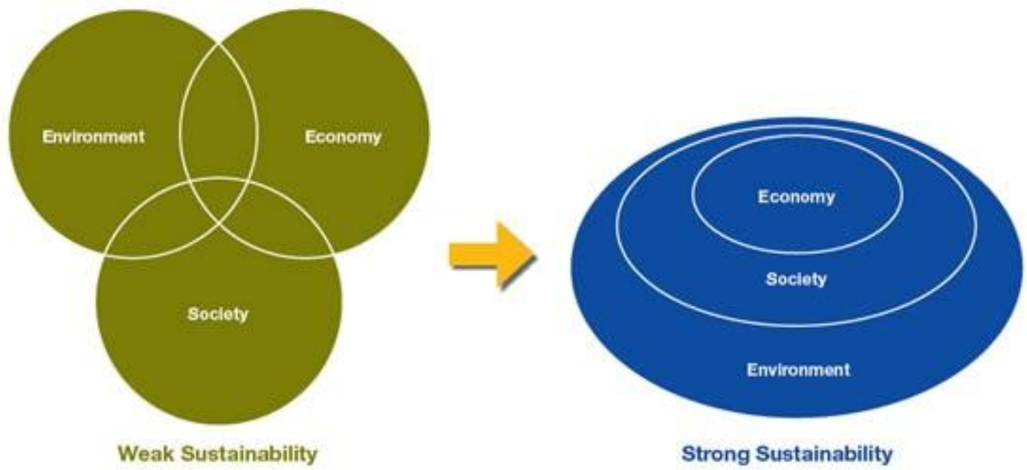
Already in 1992 in The United Nations Conference on Environment and Development (UNCED), commonly referred as The Earth Summit, there were tens of different definitions of sustainability. However they managed to introduce “Agenda 21”, a worldwide sustainable development action plan.

The concept of sustainability has seen many definitions and levels of understanding which are by nature divided into two major categories; weak and strong sustainability. (Dietz *et al*, 2007)

The weak sustainability refers to idea that man-made capital can be more valuable and relevant then ecological capital and even more they are substitutes to each other, meaning reduction of one can be replaced with increase of another. In practical terms, this is the belief that technology can replace environmental losses we create, or that machines could one day replace plants and animals while maintaining a healthy ecosystem. This idea largely rests on belief that people can control the nature (Dietz *et al*, 2007).

The other perspective, strong sustainability, is almost the opposite of the weak sustainability, and rests on the idea that environment, economy and society are supporting each other, but cannot replace each other. This gives a significant reason to protect ecological system, since people and man-made structures are just one part of the ecosystem and nature sets the limits for human activities, thus admitting that people cannot control the nature (Dietz *et al*, 2007).

The two categories of sustainability are generally visualized with three circles, where each form of capital has its own shape and place. The weak sustainability separates the three, partly overlaps them and gives the same significance for each of them, while the strong sustainability places them inside each other and makes them build one wholeness as illustrated on picture 1 below



Picture 1: Illustration of weak and strong sustainability (USDA, 2014)

Very few corporations are interested in sustainability if it does not generate profit or promise of future profit. Furthermore, in real world business context sustainability is generally understood as weak sustainability, if it is concerned at all. And here we face the dilemma of relative concept of sustainability; while zero-polluting factory is certainly better than polluting factory, the first cannot adequately exist according to strong sustainability. This is also known as Jevons paradox; technological development leads to greater efficiency (on certain resource), which leads to greater consumption of the named resource, rather than actual decrease in demand. Many policy makers and business world seem to believe that resource efficiency would lead to lower demand for the resource and greater sustainability (Bauer *et al*, 2009). Unfortunately they are wrong, when so called "rebound effect" shows that resource saved in one point of value chain will always pop up in the other. This can be easily seen on energy markets, where demand only increases while supply and price decrease (Haddock-Fraser et al, 2010).

This logic makes us to draw the conclusion that resource efficiency together with our current market mechanisms are extremely harmful for the ecological capital, or nature, and does not fit in the world of sustainable ecosystem. Obviously it is not the resource efficiency itself that proves to harm the environment, but rather the social structure of economy which recognizes only the economic growth. All the policies and society development are targeting economic growth, especially measured in terms of gross domestic product (GDP). Unfortunately economic growth has so far always meant growth on consumption of natural resources and growth on harmful emissions (Jackson, 2011). So the economic growth has always implied nature destruction, and decoupling the two is the big challenge of the future. Since the understanding of the concept of sustainability proves to be very limited, this paper ignores the misunderstandings and incorrect use of the term, and focuses on practical, real world actions to move towards sustainable development, where resource efficiency is considered improving sustainability and the assumption of decoupling economic growth and resource consumption holds.

In order to progress on the discussion, it is necessary to have general framework for the concept. For this purpose the common definitions of sustainability has been taken as basis for the work. The European Union is still relying on The United Nations (United Nations, 1997) on definition of sustainability, referring to:

(a) Use of the biosphere by present generations while maintaining its potential yield (benefit) for future generations; and/or

(b) Non-declining trends of economic growth and development that might be impaired by natural resource depletion and environmental degradation.

Also The Organisation for Economic Co-operation and Development (OECD) is using this United Nations definition as the ground rule.

The next chapter introduces the concept and definitions of corporate social responsibility, and sustainability is one of the key topics in that discussion.

4. CONCEPT OF CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility (CSR) can be traced back with meanings of many levels and wide variety. In the past many local communities were defined by their industrial operations and the leaders were respected citizens with strong influence on the local community, often taking care of the whole social environment offering additional services such as nurses and child care to support the families of the workers. While it is notable that the CSR have been concerned, at least on some level, throughout the history, the formal studies have been emerging in a scale since 1950´s.

In the early studies the issue was typically referred just as Social Responsibility, perhaps because the corporate world is rather new context and the responsibility was seen more as a personal responsibility of the leaders, rather than responsibility of an entity. Many see *Social Responsibilities of a Businessman* by Howard R. Bowen (1953) to mark the beginning of the modern era literature of CSR. Bowen sets down a primary definition as "obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society". (Bowen, 1953, p.6) Bowen saw social responsibility as inevitable shape shifter of the future business practices. In the 1950´s the focus was mostly on doing something good for the society.

In the 1960´s the line of study got much more attention and many publications were introduced. One notable author with new definition of CSR was Keith Davis with his article in California Management Review where he states that social responsibility refers to "businessmen´s decisions and actions taken for reasons at least partially beyond the firm´s direct economic or technical interest" (Davis, 1960, p.70). Davis also suggests that socially responsible actions can bring in some long-term business value thus making good business sense to take socially responsible action, even without immediate economic gain. Furthermore, Davis pointed out that the social responsibility should be addressed in management context and later introduced his famous "Iron Law of Responsibility" stating that "social responsibilities of businessmen need to be commensurate with their social power" (Davis, 1960, p.71) arguing that avoiding the social responsibility will lead to erosion of the social power.

William C. Frederick introduced another definition of social responsibility as it "implies a public posture toward society's economic and human resources and willingness to see that those resources are used for broad social ends and not simply for the narrowly circumscribed interests of private persons and firms (Frederick, 1960, p.60).

Joseph J. McGuire introduced yet another important clarification in his definition, being the first one to clearly state that the concept should be broader than only economic and legal obligations. McGuire wrote "The idea of social responsibilities supposes that the corporation has not only legal and economic obligations but also certain responsibilities to society which extend beyond these obligations" (McGuire, 1963, p.144). He also argued that a business must act adequately like a proper citizen would.

Clarence C. Walton made a remarkable contribution on the line of study and became one of the most respected researches of the field. In his significant book *Corporate Social Responsibilities* he presented his idea of intimate relationship between corporation and society and that top managers must keep this relationship in mind when making decisions. He emphasized the certain level of voluntarism acknowledging the degree of other organizations indirectly affected and that some non-returning costs may imply (Walton, 1967).

In 1970´s there were already a variety of definitions and call for the actual legislative actions on this growing understanding of importance of corporate responsibilities. In 1971 the Committee for Economic Development introduced their publication *Responsibilities of Business Corporations* in which they note that "Inasmuch as business exists to serve society, its future will depend on the quality of management's response to the changing expectations of the public. (CED, 1971, p. 16)" and introduced their famous definition of social responsibility as three concentric circles, where:

> *The inner circle includes the clear-cut basic responsibilities for the efficient execution of the economic function - products, jobs and economic growth.*

The intermediate circle encompasses responsibility to exercise this economic function with a sensitive awareness of changing social values and priorities: for example, with respect to environmental conservation; hiring and relations with employees; and more rigorous expectations of customers for information, fair treatment, and protection from injury.

The outer circle outlines newly emerging and still amorphous responsibilities that business should assume to become more broadly involved in actively improving the social environment. (For example, poverty and urban blight). (CED, 1971, p. 15)

What was really meaningful in this publication is the fact that the Committee for Economic Development represented business people and thus clearly shows the importance of these matters.

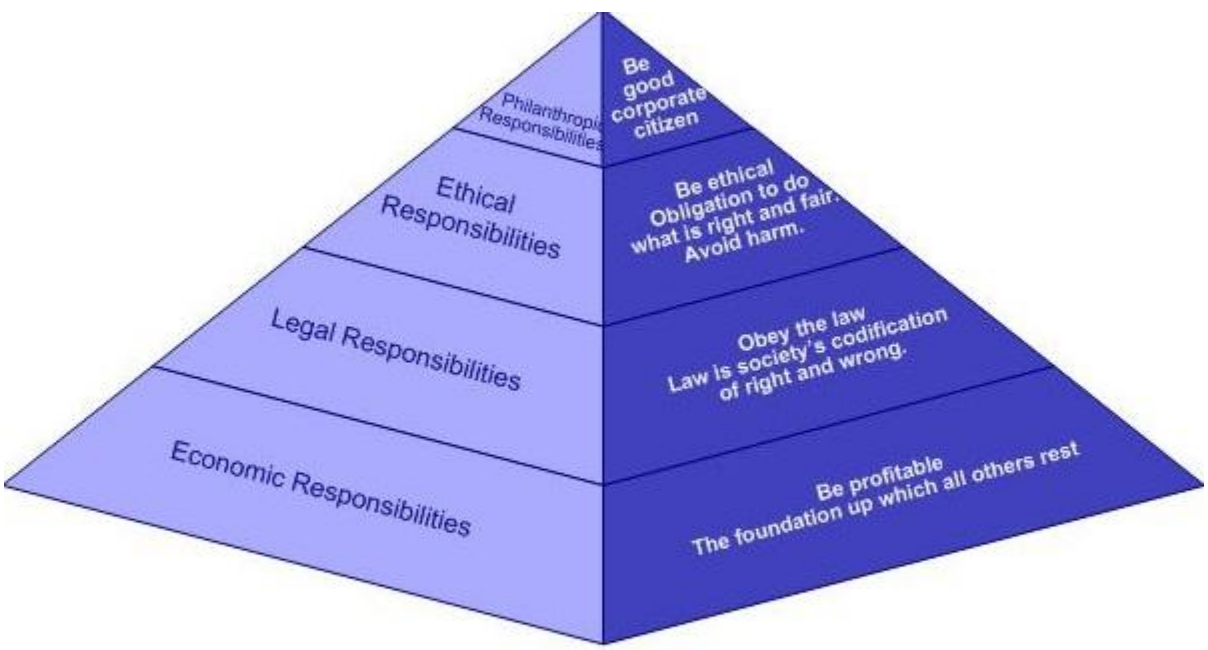
Keith Davis made another notable publication is 1973, where he made a comparison of quotes of two economists showing the already bi-polarized understandings and distinguished views of the matter, quoting Milton Friedman with “few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible” (Friedman in Davis, 1973) and Paul Samuelson with “a large corporation these days not only may engage in social responsibility, it had damn well better try to do so” (Samuelson in Davis, 1973).

Richard Eells and Clarence Walton introduced an broader aspect to corporate social responsibility with engaging the corporation and surrounding society as a whole, stating “as business system as it exists today can only survive in an effectively functioning free society, the corporate social responsibility movement represents a broad concern with business’s role in supporting and improving that social order” (Eells & Walton, 1974, p. 247).

In the 1970´s it was already largely accepted that a corporate expenditure or action may have multiple motives, not solely business or social responsibility purposes, thus making the clear identification rather impossible in many cases. Also it was widely noted that social responsibility was expanding into wider contexts, gaining new definitions and competing terms and that the original term of social responsibility was getting multiple meanings for as many users and contexts. Also it was largely accepted that fulfilling legal requirements is not enough, and that the social responsibility starts where the legislation ends.

In the 1980´s and 1990´s the concept of CSR got even further expanding views and the focus were on developing new concepts, such as the Stakeholder Theory, and produce informative research, rather than philosophical. Many corporations and smaller businesses as well had implemented CSR strategies on some level and the new ways to manage and process data gave new tools and insights to the field of study.

In 1991 Archie B. Carroll published an article "The Pyramid of Corporate Social Responsibility", where he introduces four areas that define corporate social responsibility and describes it as a pyramid with four main aspects: legal, economic, ethical and philanthropic. This pyramid of corporate social responsibility has become widely known and is intended to describe the main obligations that a business has to its stakeholders (Carroll, 1991). The pyramid is shown in the picture 2 below



Picture 2: Carroll´s pyramid of CSR (Dudovskiy, 2012)

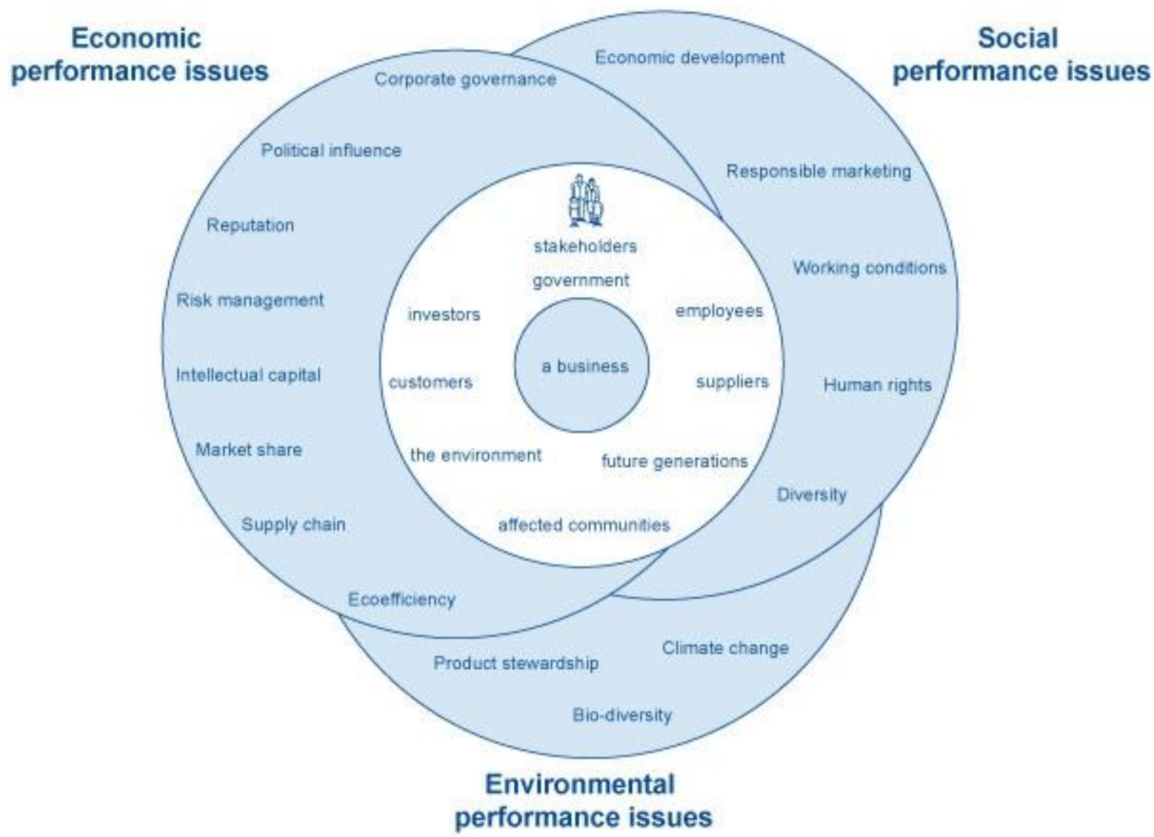
It is important to note that corporate social responsibility, or any alternative term or concept in the field, can never be fully locked on one meaning, because the social aspect makes it an ever evolving and culturally tied vague concept, meaning it will continuously transform along with the cultural changes and expectations general public and societies have towards corporations.

Today corporate social responsibility (CSR) is more than ever a challenging concept with many meanings for many users. It seems like there would be almost infinite amount of definitions and contexts of the matter. The lack of agreement on the definition is one of the main challenges and one area which should be addressed by international community. Already there has been many terms and approaches to address the non-financial activities and reporting, including Corporate Social Responsibility, Sustainability Reporting, Environmental Social Governance, Ecological Footprint, Triple Bottom Line and many others.

Since the early days of CSR, United Nations have been a strong contributor and active promoter of the matter. Today, United Nations Industrial Development Organization (UNIDO) defines CSR as:

> *Corporate Social Responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple*-Bottom-Line-*Approach"), while at the same time* addressing the expectations *of shareholders and stakeholders. In this sense it is important to draw a distinction between CSR, which can be a strategic business management concept, and charity, sponsorships or philanthropy. Even though the latter can also make a valuable contribution to poverty reduction, will directly enhance the reputation of a company and strengthen its brand, the concept of CSR clearly goes beyond that (UNIDO).*

UNIDO definition has also been drawn into a picture, visualizing the concept and interconnections of the included concerns, shown on the picture 3 below



Picture 3: CSR definition in picture by UNIDO (UNIDO)

The European Commission`s definition of corporate social responsibility was subjected to some political game, since the old definition from 2006 basically blocked all the future policy settings stating it should be on a voluntary basis, whereas the new definition is open-ended by nature and gives freedom to build on. Without the new definition it would have been impossible to advance the EU directive on non-financial reporting. Below we see the old 2006 definition

> *"A concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis." (EUbusiness, 2006)*

compared to the new one from 2011, as

> *"the responsibility of enterprises for their impacts on society". (European Commission, 2011)*

where the Commission also further explains what an enterprise should do to meet that responsibility.

Corporate social responsibility reporting has developed with giant leaps in recent years and several international initiatives have been taken to standardize and integrate the reporting models. Global Reporting Initiative (GRI) has developed standard Sustainability Reporting tools and guidelines, which has been wildly accepted and adopted by the international community. They also provide companies with guidelines to meet the EU directive criteria based on their G4 Sustainability Reporting guidelines.

In the following chapter EU legislation is outlined, the EU directive is introduced and the implications are discussed.

5. EUROPEAN UNION NON-FINANCIAL REPORTING DIRECTIVE

In this chapter the EU legislation is introduced and discussed with significant weight on spelling out the EU directive on non-financial reporting.

5.1 EU legislation and general legal processes

The European Union is based on the rule of law and follows modern democratic principles.

The European Union has a standard decision making procedure referred as Ordinary Legislative Procedure, which involves three parties, the European Parliament, the European Council and the European Commission. The Parliament is directly elected and carries the direct political accountability for EU citizens. The Council is built of the 28 member state governments, and thus holds accountability for the local citizens. The two entities together has to approve all the EU legislation. The role of the European Commission is to propose and enforce legislation as well as implement policies and the EU budget. The Commission has one commissioner from each member state and the roles are circulated around and politically decided, outside of democratic processes (European Union, 2015).

The European Union law is divided into two main frameworks, the so called primary and secondary legislations. The primary legislation consists of EU treaties which sets the ground rules and foundation for all EU actions and policy making. For example, the Maastricht Treaty effective in 1993 was the establishment of the European Union, and Lisbon Treaty effective in 2009 was the replacement of the declined EU constitution and agrees a set of policies to define and unify the European Union (European Union, 2015).

The secondary legislation is derived from the EU treaties and should not set contradictories between the two. This framework consists of EU regulations, directives, recommendation and other means of execution of desired paths of policy development. Regulation is a binding legal act, which should be applied as such across the European Union (European Union, 2015).

EU directive is a legal act setting one clear goal that every member state must achieve, but does not force the form and methods on how exactly the goal should be reached. Instead it is the responsibility of each member state to find the best practices. If individual member state already has sufficient legislation to fulfill the goals of an EU directive, no legislative actions are required. National implementation is observed by the European Commission and failing to implement directed actions may lead to legal actions in the Court of Justice of the European Union. As an example of directive, the Birds Directive, effective in 2009, was set to protect certain species of wild birds in the European Union. It was originally implemented in in 1979 by the European Community and was the first directive of environmental protection by the European Community, which later became the European Union and the directive was re-written. As explained on the EU declaration; "It requires Member States to outlaw all forms of non-selective and large scale killing of birds. It promotes research to underpin the protection, management and use of all species of birds covered by the Directive." (European Commission, 2009)

5.2 The directive on non-financial reporting

European Parliament adopted the EU directive 2014/95/EU on 22 October 2014 when the Official Journal of the European Union (the official compendium of EU legislation) published the announcement of the directive. Now the EU officially explains the directive as:

> *"The Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups amends the Accounting Directive 2013/34/EU. It requires companies concerned to disclose in their management report, information on policies, risks and outcomes as regards environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues, and diversity in their board of directors. This will provide investors and other stakeholders with a more comprehensive*

picture of a company's performance. This is a legislative initiative with relevance for the European Economic Area (EEA).

The new rules will only apply to some large companies with more than 500 employees. This includes listed companies as well as other public-interest entities, such as banks, insurance companies, and other companies that are so designated by Member States because of their activities, size or number of employees. The scope includes approx. 6 000 large companies and groups across the EU.

The Directive leaves significant flexibility for companies to disclose relevant information in the way that they consider most useful, or in a separate report. Companies may use international, European or national guidelines which they consider appropriate (for instance, the UN Global Compact, the OECD Guidelines for Multinational Enterprises, ISO 26000, ...).

The Directive entered into force on 6 December 2014. EU Member States have two years to transpose it into national legislation" (European Commission, 2014).

Appendix 1 is the full publication of the Official Journal of the European Union concerning the directive and there the full legal details can be found.

Background to pass the directive

Richard Howitt of the United Kingdom, a Member of European Parliament (MEP), who acted as European Parliament Rapporteur on Corporate Social Responsibility, has been an active contributor on the non-financial reporting discussions. Right after the release of the passed directive, he published an article on The Guardian (Howitt, 2014) with the title of "The EU law on non-financial reporting - how we got there", where he provides us a good insight of the process and political game behind passing the directive. He explains how he first proposed to change the EU reporting directives as early as 1999 and have come across business lobbyists who apparently hold significant power in the EU decision making, and having to overcome some major political obstacles. According to Howitt, it took some intensive campaigning, expert lobbying operation and cross-party pressure on every front to make the change happen. He writes how he had to explain that

> *"with India, China, Brazil and South Africa all making some requirement for corporate sustainability reporting, it was humiliating to take part in global initiatives saying the EU would not."* (Howitt, 2014)

He sums it up saying the new law is not perfect at all, but it is a very good first step and a landmark decision on corporate accountability (Howitt, 2014).

This struggle to pass the legislation proves how diverse the understanding and commitment of different interest groups are at the moment. Furthermore, it is safe to say that corporations are not too happy to adopt such initiatives, but rather would keep it only on nice words and ceremony speeches.

5.3 Understanding the directive

The first thing to notice is the terminology; non-financial reporting. This is a neutral term basically covering all intended actions of corporate social responsibility, sustainability and others, leaving plenty of room to adjust.

At this moment, in summer of 2015, the European Union initiative is only a directive, which has not gone into effective member state legislation. The member state legislation should be effective in 2016 and in business year 2017 we will see the first reports. At this moment it is assumable that the companies under regulation are trying to build up understanding of the actual legal implications and the industry specific influences. Obviously increasing bureaucracy and extra costs are among the main concerns.

Many companies have implemented at least some level of sustainability or responsibility reporting already, and the forerunners are enjoying some edge here. Competitive pressure for the once not reporting any voluntary disclosers is closing in. Furthermore, this is not the first time ever when there is some legislative requirements on non-financial reporting; state-owned companies have been obligated to report since 2007 following Global Reporting Initiative (GRI) framework and Johannesburg Stock Exchange required South African listed companies to disclose integrated reports in 2010. So there are many examples and officially accepted frameworks available to follow.

Majority of investors these days expect some sort of discloser as well, and companies have been increasingly willing to provide such reports. This will be studied more carefully in the next chapter.

All these recent trends just make the case how the EU directive is a logical addition to global development and will most likely be implemented into local legislations without major protests.

The directive is a compliment to previous directive of corporate reporting, which required companies to publish management report where balanced and comprehensive analysis of organizations business and market position is demonstrated. The previous directive required to include financial information, but also non-financial information “to the extent necessary”. That have proven to be vague too much and now the new directive clearly requires specific disclosures.

The non-financial report will be mandatory, however there is extensive flexibility on the execution. The report can be integrated into management report or delivered separately. Also the form of the report can follow several frameworks. The directive requires several elements to be included but the formal additional guidelines and key performance indicators are still to be announced. At the moment, we can only hope that the European Commission will communicate them well enough to avoid unnecessary confusion.

The decision to only include large publicly listed companies with more than 500 employees or 50€ million in revenue limits the directive´s impact quite a lot. Furthermore, EU decided to implement a directive, instead of regulation, so the member states can adjust with the local implementation. However the CSR effect will “drain down” when large companies ask their stakeholders to provide information for their reports and the entire supply chain feel the pressure, inside and outside of the EU.

6. METHODS AND METHODOLOGY

Research methods are the tools, techniques and procedures used in research to obtain and analyze data, for example surveys, interviews, quantitative and qualitative analyzing techniques, etc. Methods and how they are used are shaped by methodology (Saunders et al. 2009 p.3).

Methodology is the approach of how research is done, how information is found, and how knowledge is gained. The word methodology consists of two parts, method and –ology, a branch of knowledge. Methodology therefore explains why certain methods are used in research. In other words, methodology is the theory of how research should be undertaken (Saunders *et al*. 2009 p.3).

The methodology for this research was developed along the way with gathering greater understanding of the universal nature of the issue and defining terminology and concepts. The process started with understanding the EU directive itself and the direct straightforward impacts. In this point the basic assumption was that the non-financial reporting would be mostly in the interests of NGOs and some other active individuals or organizations already involved with social responsibility and sustainability activities. Along with the directive, the regulating officers would get naturally involved as well, but still the most important audience of corporate reporting – investors, would be dismissed. In fact, it seemed like the general attitude in corporations was that investors would not appreciate non-financial reporting too much since it could reveal unpleasant facts. On the same time, the investor perspective was expected to contribute the missing key point to motivate corporations to get committed to adequate reporting. Investors, or money to be more precise, if anything can run the transition in attitudes and should be in the center of attention. New question arise; what do investors expect from corporate non-financial reporting? Do they even care? Many opinions were quoted in news articles but academic studies were not so plenty, and the information was at best unstructured. To address the question five publicly available reports about survey results were found to provide valuable information and it was seen that further validation of that information could provide more meaningful tools to evaluate the implications of the EU directive.

Finding an appropriate method to qualify information was rather challenging when the information available was very limited and the standard research methods are so widely diverse these days. On the other hand, theories about research methods are themselves ever evolving as well and many creative approaches and hybrid methods have been developed and acknowledged. There is even a full rising school of thought that studies should not be limited into categories of qualitative or quantitative research, when real world problems are hardly ever limited in a way. The search for proper method was decided along with the methodology and only started after the theoretical frameworks had been developed and studied. The original assumption was there would not be adequate information available, due to the nature of the subject being a future legislation, but soon enough it was found out that several institutions have conducted surveys about and around the matter. This gave tools to digest information and work with relevant secondary data. With this new information available, the method had to be processed out and several approaches were considered.

6.1 Data

The chosen data is a collection of secondary data; five reports of survey results, including EU level surveys or global surveys including EU specifications. Secondary data can refer to both, raw data and published summaries, and in this research the latter is analyzed. In the beginning primary data was considered as the only option but seen as well beyond reach due to resource limitations. All the reports were publicly available survey reports concerning non-financial reporting conducted by independent and acknowledged institutions including KPMG, PwC, EY, ACCA and Eurosif. KPMG, PwC and EY are all Europe based professional services networks providing majority of corporate level auditing. ACCA, the Association of Chartered Certified Accountants, is a global body for accountants and Eurosif is a European wide sustainable and responsible investment (SRI) membership organization. All the reports are introduced in more detail in the “Analysis” chapter.

Since the field of CSR and sustainability is very fast moving and ever evolving, only latest information was considered relevant enough. Therefore anything older than 2013 was not considered into this study. The older information would be only relevant into purpose of developing trends and patterns, but in this study the interest was lying on current and future perspectives. Problem with secondary data like this is that the motives of the original survey conductors might be commercial and the trustworthiness of the information could be questioned. However untruthful information would come up and harm significantly the conducting entity, so we can assume them to operate in the best interest of themselves.

6.2 Method

The reports under study provide plenty of figures e.g. “X percent agree that…” which could be understood to indicate quantitative nature of the research. However, this kind of surveys does not provide accurate, standard numerical scale to measure the level of investor expectations precisely, hence being qualitative themselves. Furthermore, this research is qualitative since, even though numbers are used to build up the conclusions, the analyzing methods are qualitative and some of the analysis is done based on text, not numbers. The benefit of a qualitative study is that it aims to understand and gain insight into the subject (Ghauri & Gronhaug, 2005).

Economics should never be confused with natural sciences or so called hard sciences. Economics is social science, and therefore can never be concluded in a same exact certainty as for example physics can. Of course some precise points of information can be measured as in econometrics but the conclusions are always subjective. This research is focusing on opinions of certain group of people and the people have for sure been aware that their responses are recorded, which again might trigger the respondents to answer in a certain way. Also the neutrality, or lack of neutrality, of the question setting might be guiding the answers in a certain way e.g. who would say “no” if asked “do you support healthy environment?”? With such data in hand and problem to answer, content analysis became a relevant option.

Content analysis conventionally refers to set of techniques to analyze and understand collections of text or similar data. It provides a structured, consistent method to increase objectivity and to identify trends. The goal of the approach is to increase the value of information by methodologically clarifying unstructured information. It can be performed with quantitative approach when the analysis is conducted with statistical tools and the results are numbers or with qualitative approach when the results are explanatory. Qualitative content analysis is not a linear process, but rather cyclic one where more and more information is gained on each round of theory, method and analysis checks.

Content analysis is a tool to reveal new perspectives of information. The content can be basically anything; text, voice recordings, video, pictures etc. as long as it has a connection to the issue under study and can be collected, observed and analyzed. The object of the study can be the content itself or some phenomenon described by the content. The content can be explicit and implicit information and should be treated respectively. Rather than one agreed approach, content analysis is rather a larger title with several subtitles, it has many forms and many ways to carry out the research and many similar approaches has many different names. Three largely acknowledged approaches are conventional, directed and summative (Hsieh & Shannon, 2005). The differences within the approaches rest on coding schemes, origins of codes and effect on trustworthiness. In conventional content analysis the text directly determines the coding categories. With the directed approach, research theory and relevant findings guides the initial coding. A summative approach includes counting and comparison, typically key words or concepts, and builds the linkage between contexts. This is similar to grounded theory, which is not a theory but rather a research method.

Grounded Theory is a research method which was originally introduced by Glaser & Strauss in their 1967 book *The Discovery of Grounded Theory* (Glaser & Strauss. 1967). Grounded theory fits especially well for the research intended to explain social environment implications and people, groups or organizations as a producers of those implications. Furthermore it is intended for new situations where little knowledge is available and where unexpected factors has a high probability to occur. Grounded theory is not meant for testing existing theories but rather to develop a new theory based on content and the development of the research. Tesch (1990, 72-72) has categorized 26 qualitative research types into four main categories and onward into several subcategories according to the interest of the research. Tesch argues that grounded theory research is intended to discover regularities, identification and categorization of elements, and exploration of their connections. However this study does not fill the needs for grounded theory, where developing a theory is the main goal. This study is more focusing on summarizing and finding general rules and patterns on the base material.

Template analysis is a method described as combining elements of different before mentioned content analysis approaches and grounded theory, where the interest is finding themes among data. A list of codes, a template, is developed and used similarly as in science; laid over the data to identify patterns and similarities. The template of codes can be updated and adapted along with the evolving research. With this flexibility and interdisciplinary nature it is more contemporary and some argue preferred over the conventional rigid methods. Coding can be added as many layers as needed, but too many would only create unnecessary confusion (Easterby-Smith *et al*, 2012 p.165).

For the analysis themes and codes were developed to break down and categorize information. Boyatzis describes a theme being “a pattern in the information that at minimum describes and organizes the possible observations and at maximum interprets aspects of the phenomenon” (Boyatzis, 1998, p. 161). Themes are features of text arising from the engagement of the researcher. Codes are the labels put on text to mark themes. In the beginning, after some basic theoretical research, two major categories were identified: the process of reporting and the content of the reports. As an individual side branch, the used terminology was dedicated with significant interest as it was seen to play significant role and identified in the theoretical research as a major point where improvement would be needed. However, for research purposes in this study terminology was assumed not to influence the investor perspective itself. That could be another interesting topic of future research.

After the main categories were identified and tested, four subcategories were identified: types of information, usage of information, future expectations and sentiment towards non-financial reporting and the subject of the question on matter. The pragmatic approach developing themes is the key to success and should always be kept in mind when coding. The coding could be arranged hierarchically to drill into deeper details of subcategories, but in this paper the template is a coded list since the question can be answered without extreme immerse.

This classification made it possible to analyze the reports to identify similarities and differences in the opinions and expectations. Using themes made the information more accessible and understandable enabling to build up understanding of the research problem. The next chapter introduces the analysis and discusses conclusions.

7. ANALYSIS

This chapter introduces analysis of several survey reports concerning global trends on non-financial reporting and investor views on non-financial disclosures.

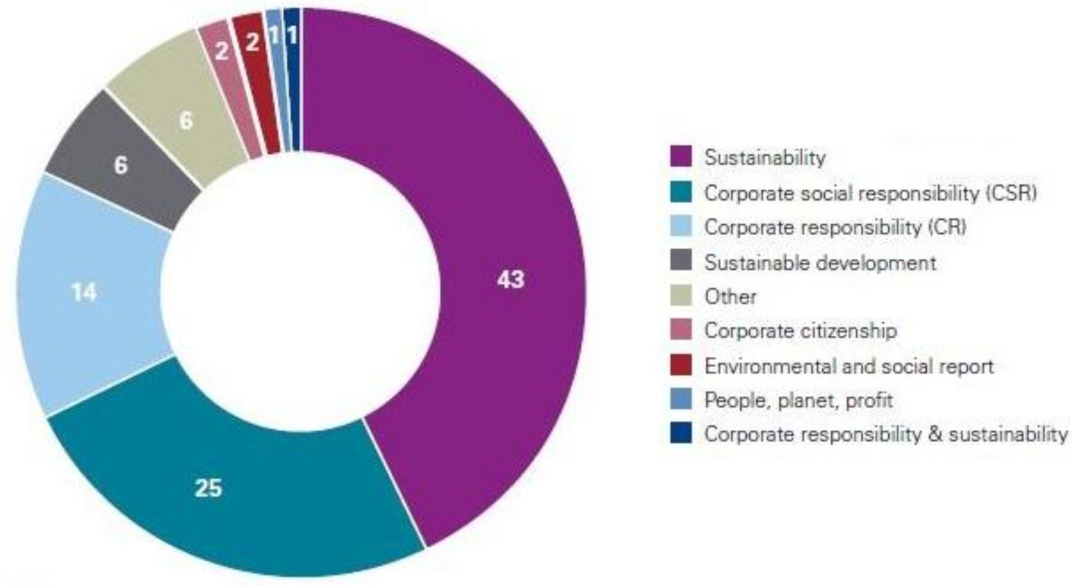
7.1 Investors

Investors are individual persons, groups or institutions, who invest money or other resources on enterprises, such as corporations, with expectation of financial or other gain. Typically investors are assuming to get the investment and little more back as the companies pay dividends and even more when the value of the company increases. Deciding on where to invest should be made after careful consideration and companies should pay close attention on their investor relations and how to make the company attractive to investments. Traditionally sound financial performance and promise of the continuity of the performance were enough, but new measurements have been introduced over time and recently corporate social responsibility and sustainability measures have become more and more relevant. Investors play key part on setting the standards and expectations for the corporations; public corporations just simply can´t afford to lose the attractiveness in the eyes of investors, since the value of a publicly noted company is largely determined by the demand of the shares. Investors are also one of the main audiences of corporate reports, others including other stakeholders and regulatory officials.

7.2 Global trends on non-financial reporting

KPMG conducted a general survey on corporate responsibility reporting (KPMG, 2013). They divided the survey into two main parts, first to map the global trends on CSR and second, to analyze the quality of CSR reports worldwide. The key findings included several interesting points providing another point of view and general insight on CSR reporting.

They first surveyed the 100 biggest companies in each of 41 countries included into the survey to build up a general understanding of the global trends. The first point to notice is about terminology and definitions, which proved to have wide variety across the globe, as seen in picture 4 below



Picture 4: The global terminology for non-financial reporting (KPMG, 2013).

According to the survey, the emerging economies are catching up the gap quickly, and fall just a little short from developed economies. Europe is still the global leader on the matter. Furthermore the gap between leading and lagging industries is narrowing down and non-financial reporting has become really a global, cross-industrial standard.

Companies increasingly are attaching the non-financial information into their annual financial reports and the most widely used global standard is GRI framework. Also third party assurance is becoming a common practice.

The two key points KPMG found out was that it is not anymore a question if companies should report non-financial data, but rather how and what information should be reported and that integrated reporting is the growing trend where management should commit to.

The second part, the analysis of quality of the reports, was conducted by creating a 100 point grading system, where key performance indicators were evaluated. The survey covered Fortune 250 companies worldwide and again the European companies were found to be the forerunners.

The best quality was found on reporting targets and indicators, measuring the quality of meaningful, adequate targets and key performance indicators to assess their progress and performance. On the other hand, the biggest need for improvement was found to lay on reporting suppliers and value chain, meaning companies tend to focus only on internal practices and falling behind to assess the total impact of their business and value chain.

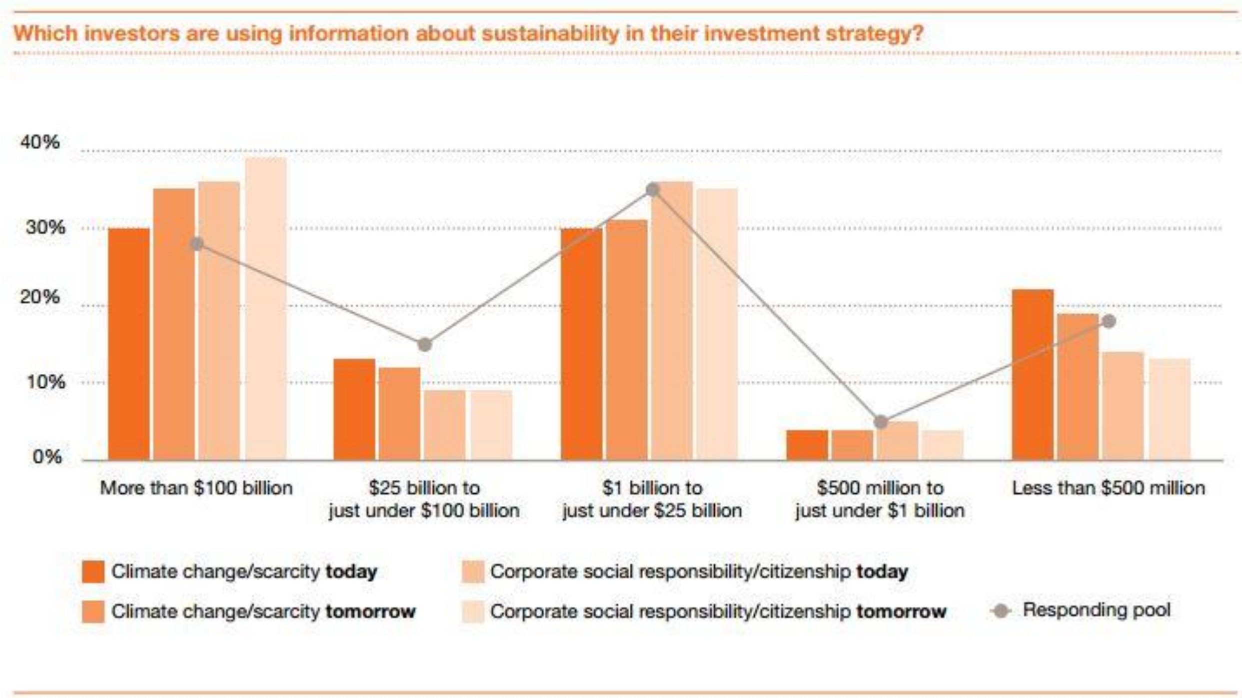
The key aspect KPMG points out is that companies increasingly view CSR as core business risks and opportunities and that should be having a strong linkage to the value of the business. Investor views and relationship management are growing concerns on the financial impact of the risks and how companies should address those.

Interestingly enough, KPMG conducted another survey “The KPMG survey of business reporting” (KPMG, 2014) reflecting general reporting issues, and the findings were somewhat different then on the other survey. It seems that companies are saying good things when asked directly about CSR, but when talking about business in general, the CSR issues are of minimal interest. KPMG suspects that this minimal interest is due the business world assumption that non-financial data is only in the interest of other stakeholders, but not of investors, and most importantly there is no strong linkage between CSR performance and financial value. Building the linkage and communicating it in an investor friendly way was viewed as a critical improvement area.

7.3 Investor views on non-financial reporting

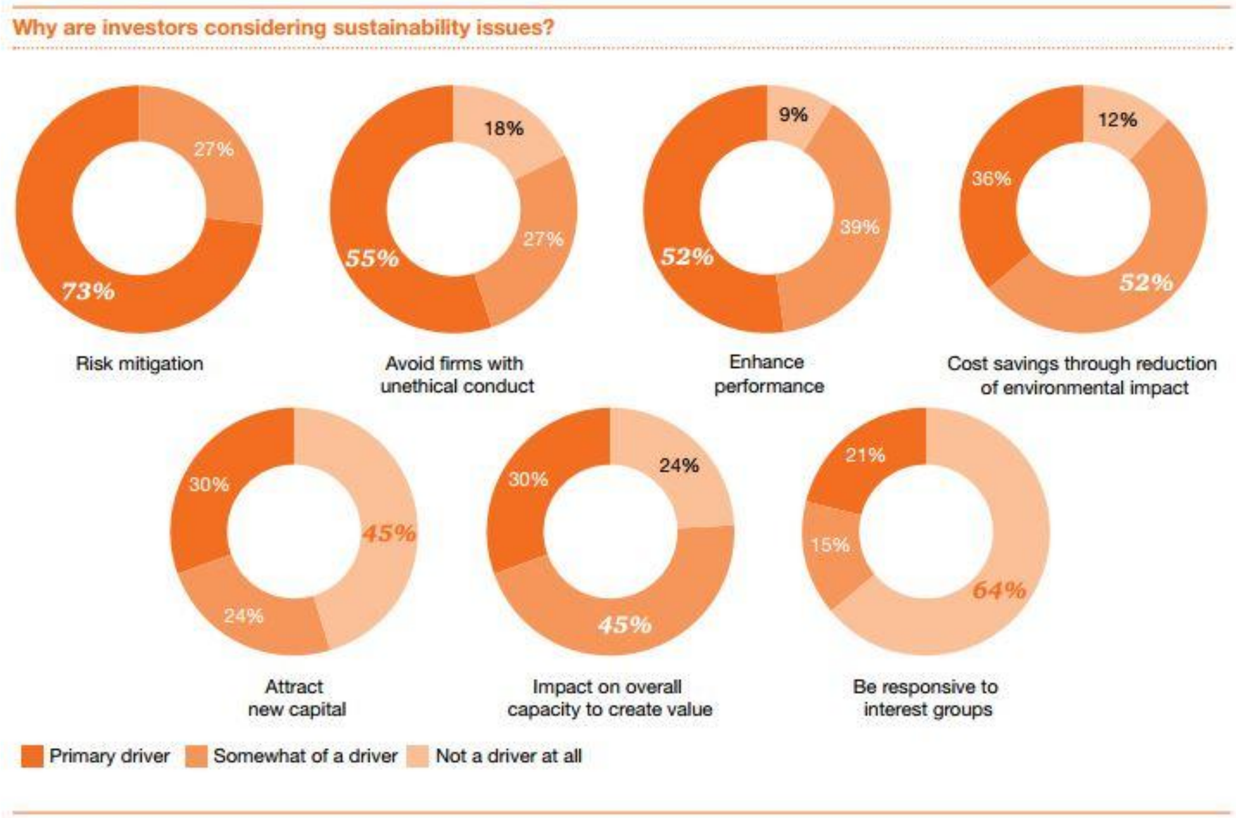
PricewaterhouseCoopers, or PwC, conducted a survey in 2014 on importance of sustainability and corporate social responsibility for the major investors worldwide, and published their results in "Sustainability goes mainstream: Insights into investor views" – report (PwC, 2014). The survey and some key findings are introduced below;

To gain understanding of the audience, it was asked who uses sustainability as criteria and based on that information the investors were clustered. It turned out that the very large investors are more likely to attach sustainability concerns in their investment strategy, as show below in picture 5



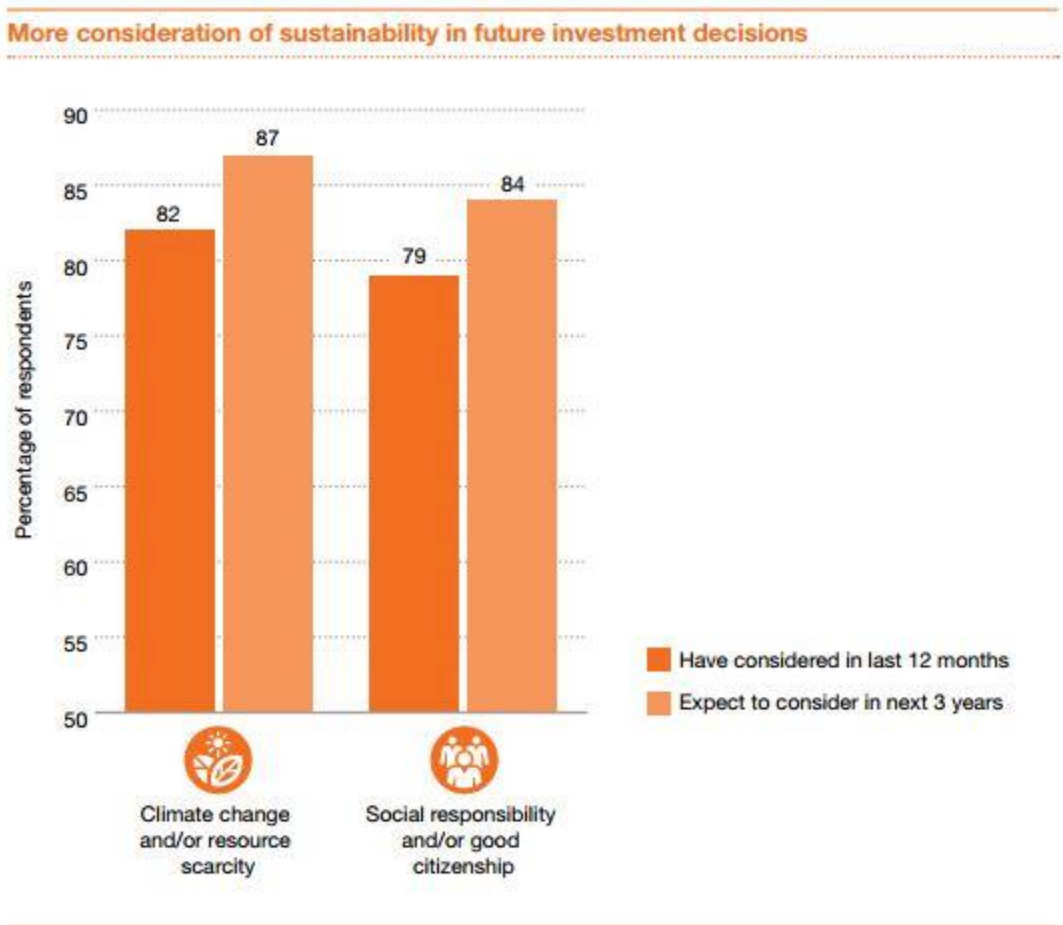
Picture 5: Which investors use sustainability as criteria? (PwC, 2014)

Also, it was asked why do they do so, why do they consider sustainability issues in their investment strategy? It was found out that the main motivator is risk mitigation, as seen in picture 6 below



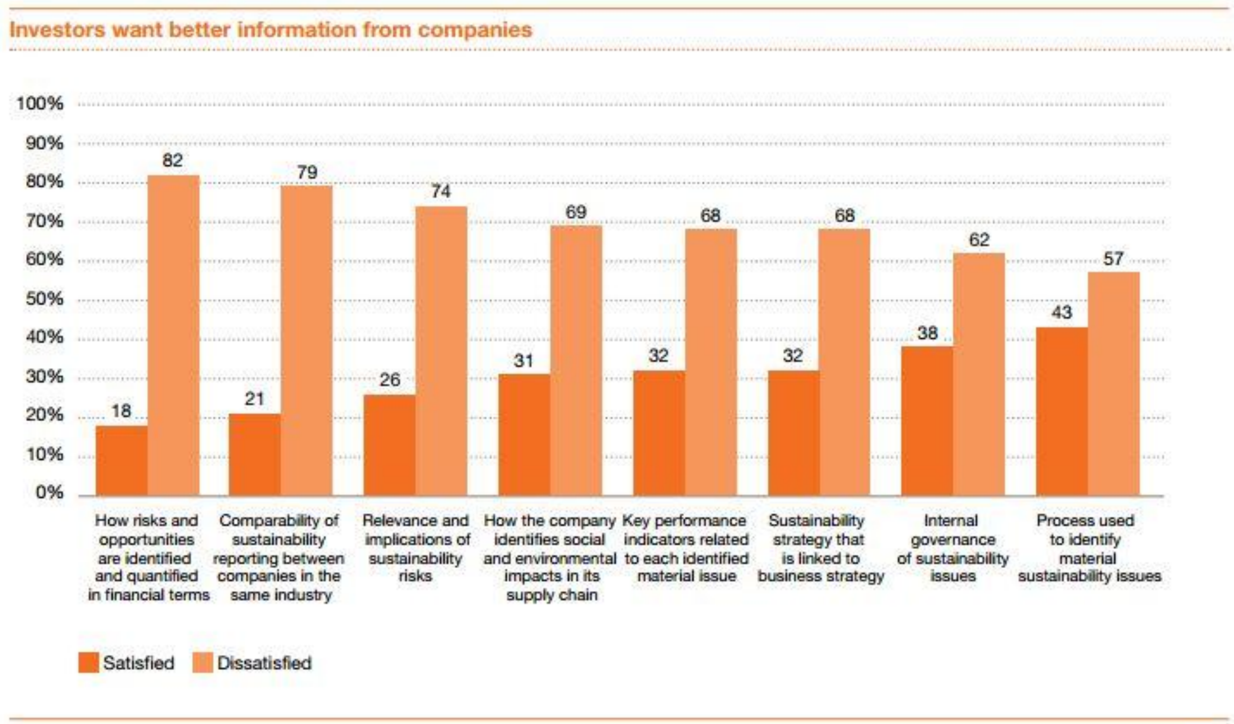
Picture 6: Why do investors consider sustainability issues? (PwC, 2014)

The importance and future relevance was assessed with several questions, and the picture 7 below shows the clear acceptance of the sustainability matters and how the relevance will only increase in the future



Picture 7: How investors consider sustainability now and in the future (PwC, 2014).

The quality of the information available was asked to be rated and to characterize issues where more information was needed. Picture 8 below shows the urge for better information and that the type of information needed seems to be in line with the investor motivators for the matter, risk assessment being number one area where more information would be welcomed



Picture 8: Better information is needed (PwC, 2014)

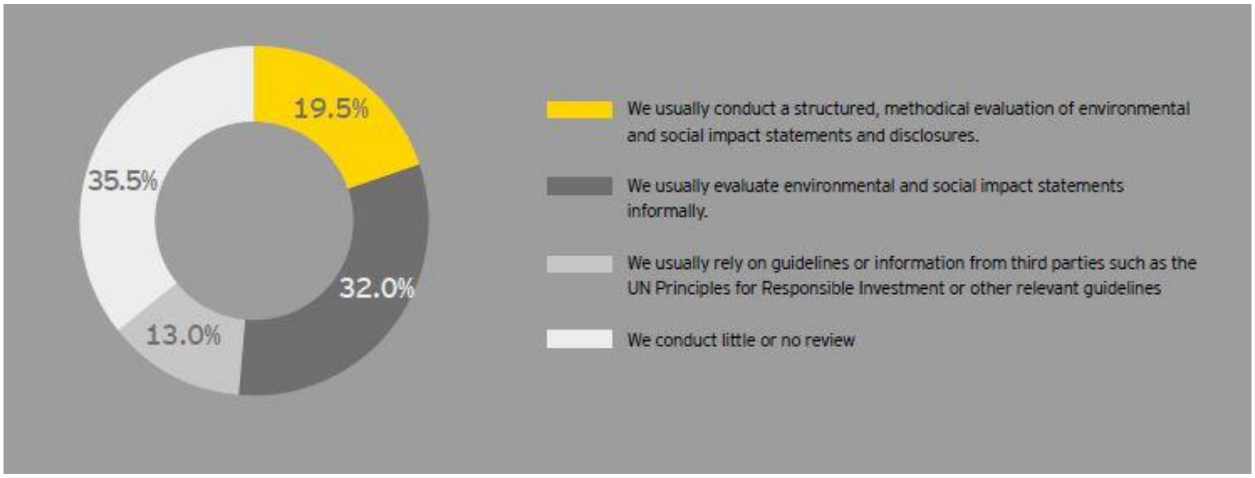
Finally, investors give a strong acceptance for periodic assessment of sustainability matters, as shown in picture 9 below

Picture 9: investors give a strong yes for periodic assessment (PwC, 2014).

The survey was conducted to better understand the investor perspective on importance of sustainability matters on corporate reporting and if they are affecting investment decisions and strategies. While they do acknowledge some limitations with the data due to insufficient sample size on certain matters, however according to the survey, linkage between investment decisions and sustainability does already exist and will only grow importance in the future. Furthermore, investors would happily welcome periodic assessment of sustainability matters.

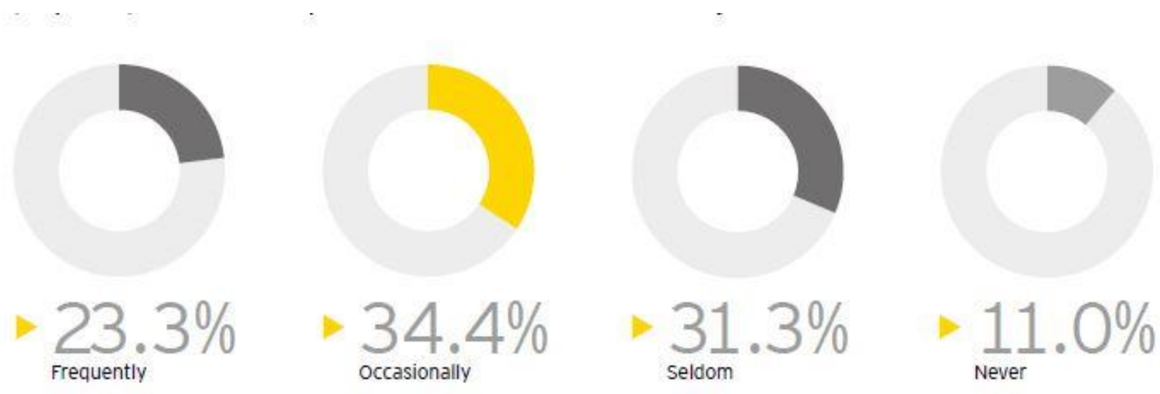
EY (Ernst & Young) conducted similar survey in 2013 and published a report in 2014 titled "Tomorrow's investment rules: Global survey of institutional investors on non-financial performance" (EY, 2014). The results are introduced below:

They asked if investors use non-financial date on their investment decisions and how methodological their approach was in that matter. The picture 10 below shows that investors do pay notable attention on the matter, with more than 50% saying they rely on corporate reports



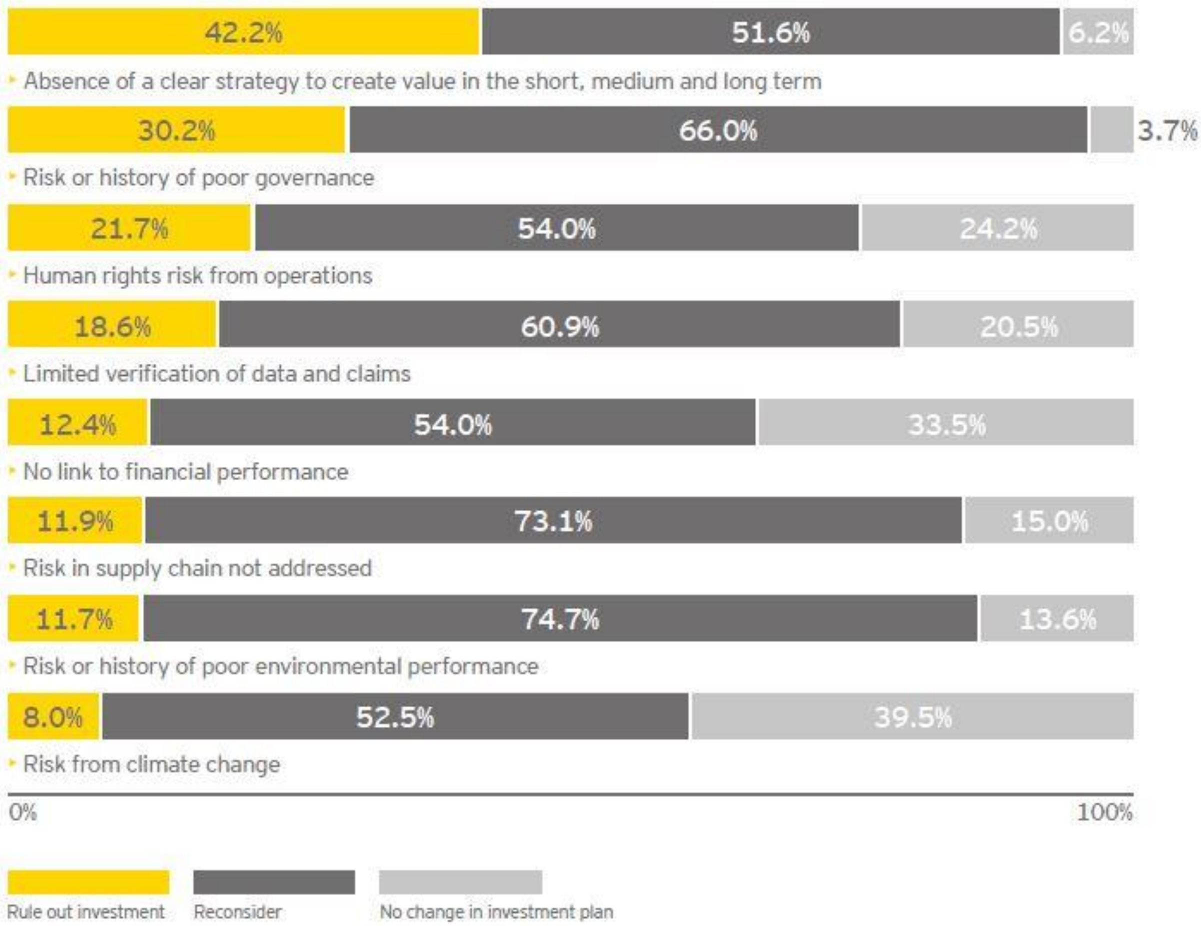
Picture 10: How investors evaluate non-financial disclosures (EY, 2014).

Also it was found out that investor do at least occasionally find non-financial performance as a key measure for their investment decisions as shown on picture 11 below



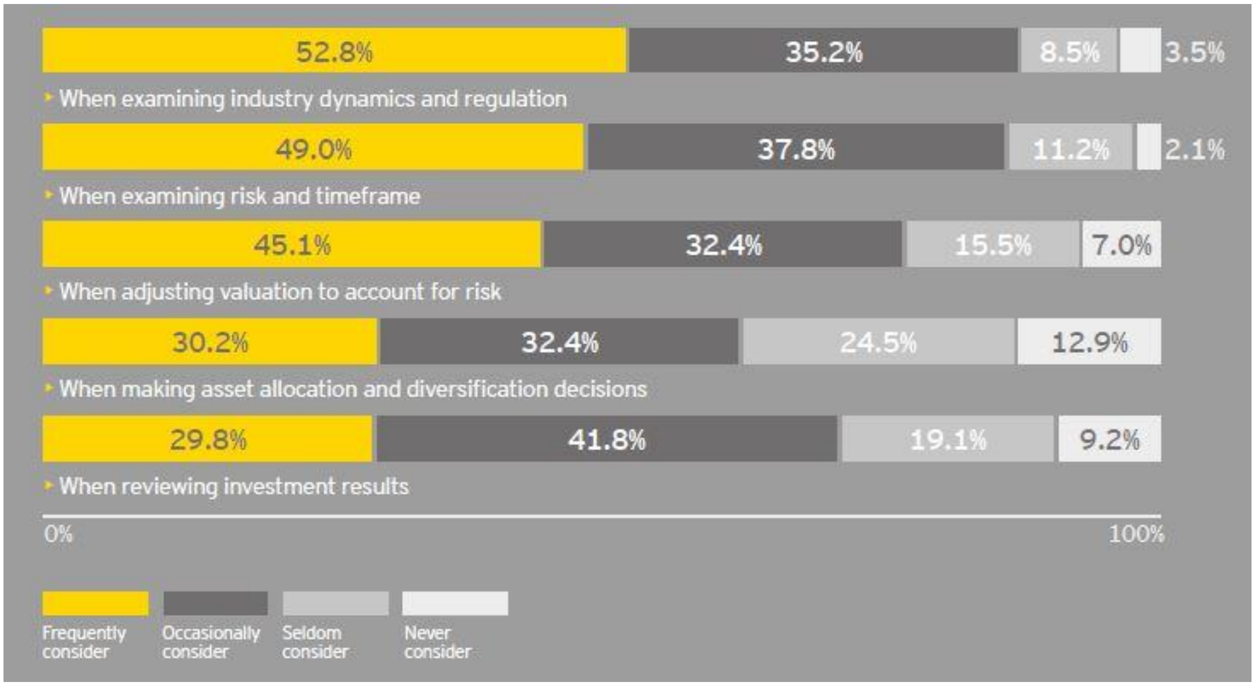
Picture 11: How frequently non-financial performance played a key role on investment decision (EY, 2014).

Evaluating the weight of certain disclosers in the company report, investors were asked which ones would make them to rule out or reconsider the investment. It's clear that non-financial information or information with no direct business impact had less value as shown on picture 12 below



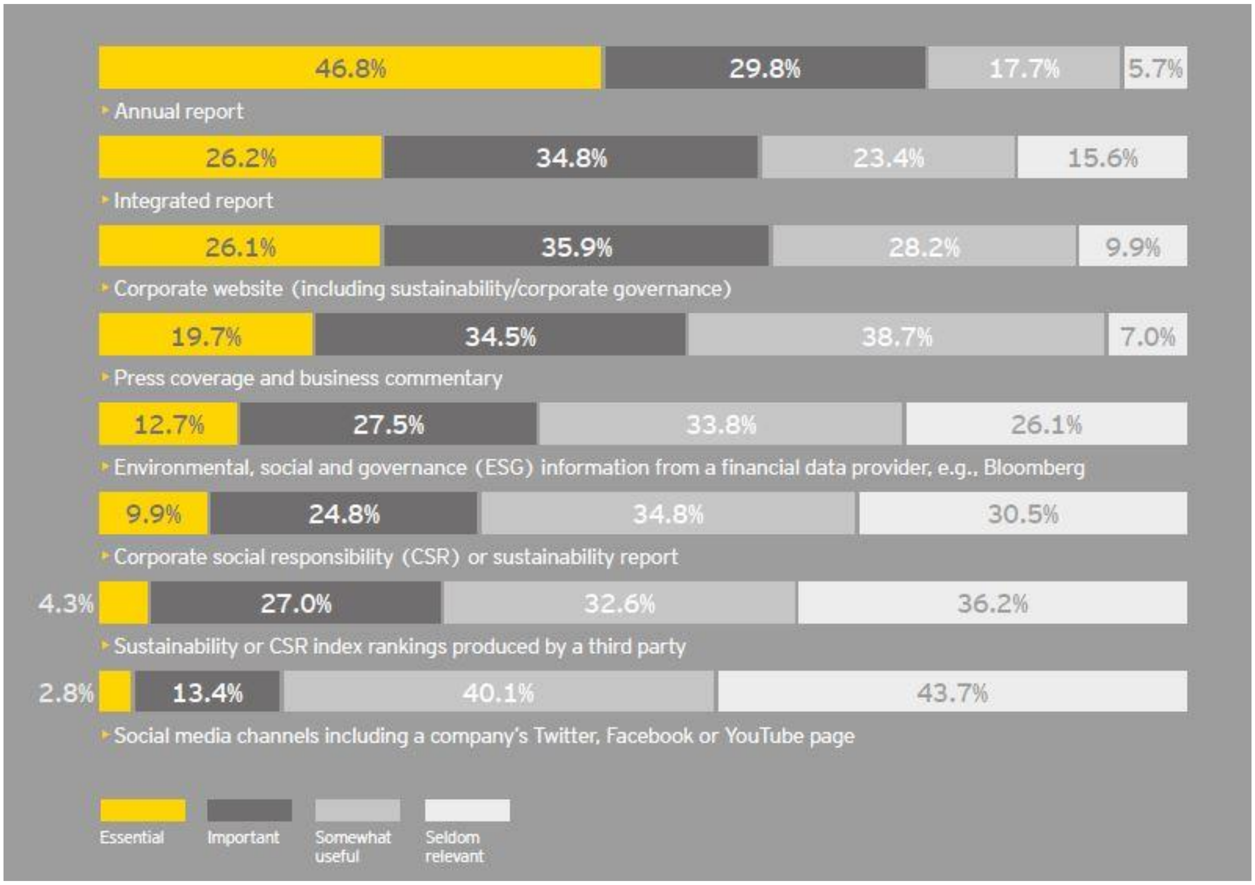
Picture 12: How certain disclosures would affect investment decision (EY, 2014).

When asked in which state of decision making non-financial data is considered, the answers show that typically upfront rather than later, as shown on picture 13 below



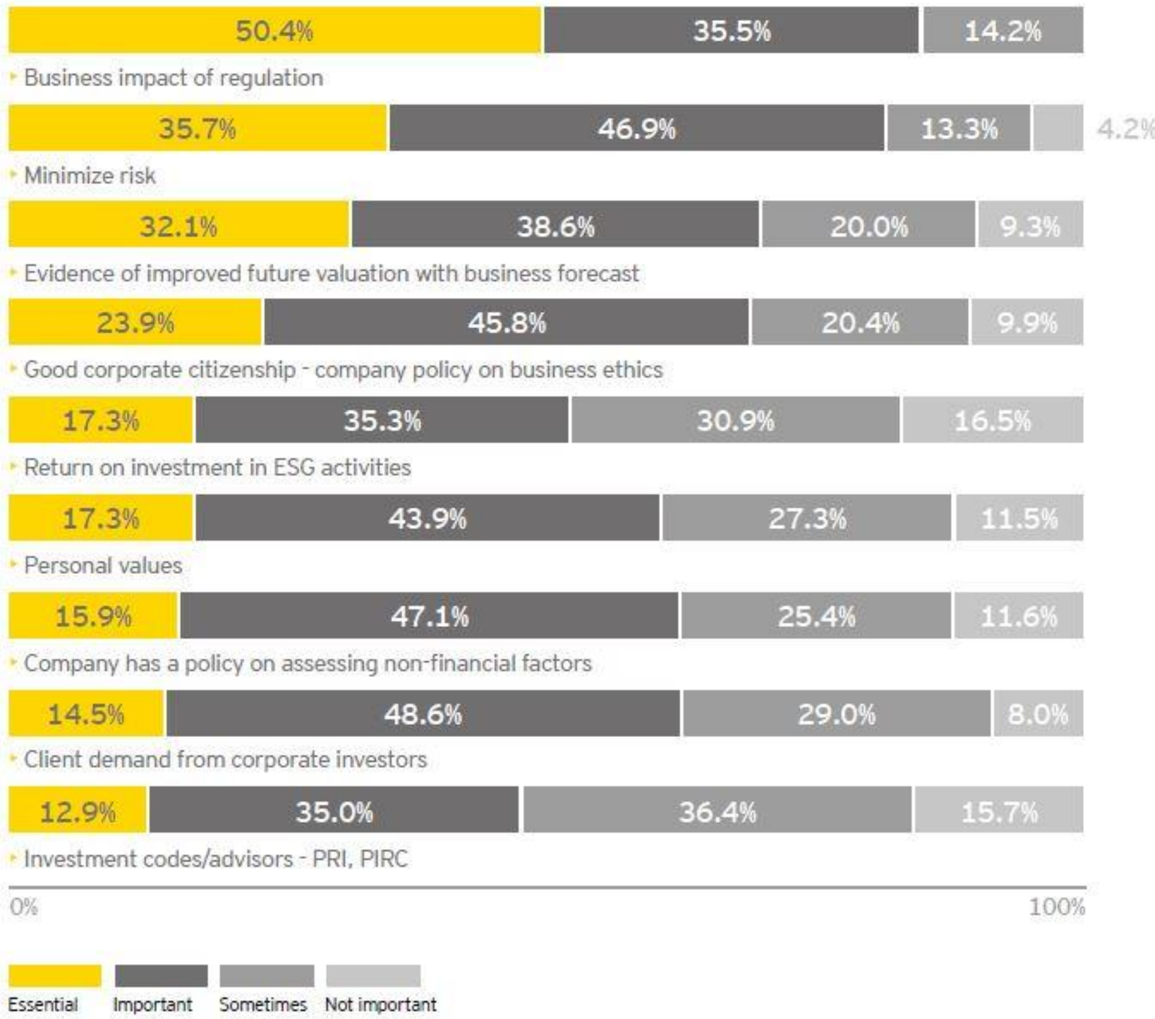
Picture 13: How frequently non-financial information is taken into account in different stages of investment decision-making (EY, 2014).

Annual report is still the main source of information for the investors, as seen on picture 14 below



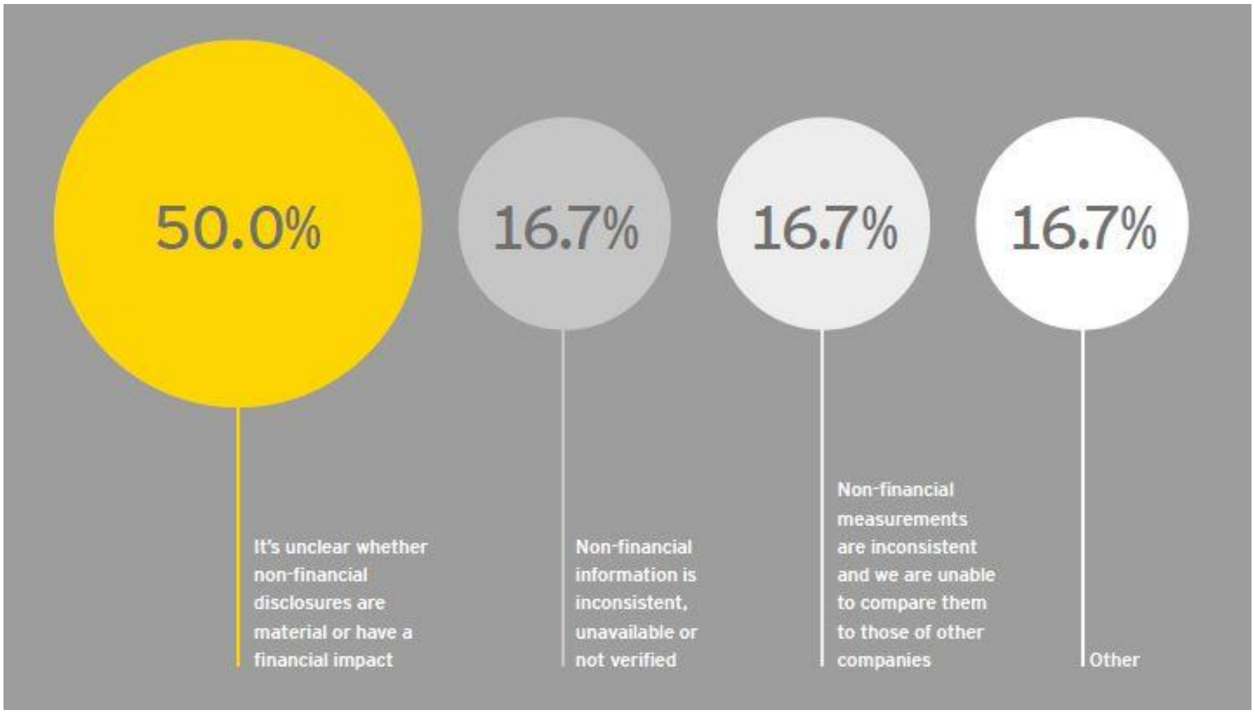
Picture 14: Importance of different information sources (EY, 2014).

When asked how investors use the information, again the most important factor is risk reduction as seen in picture 15 below



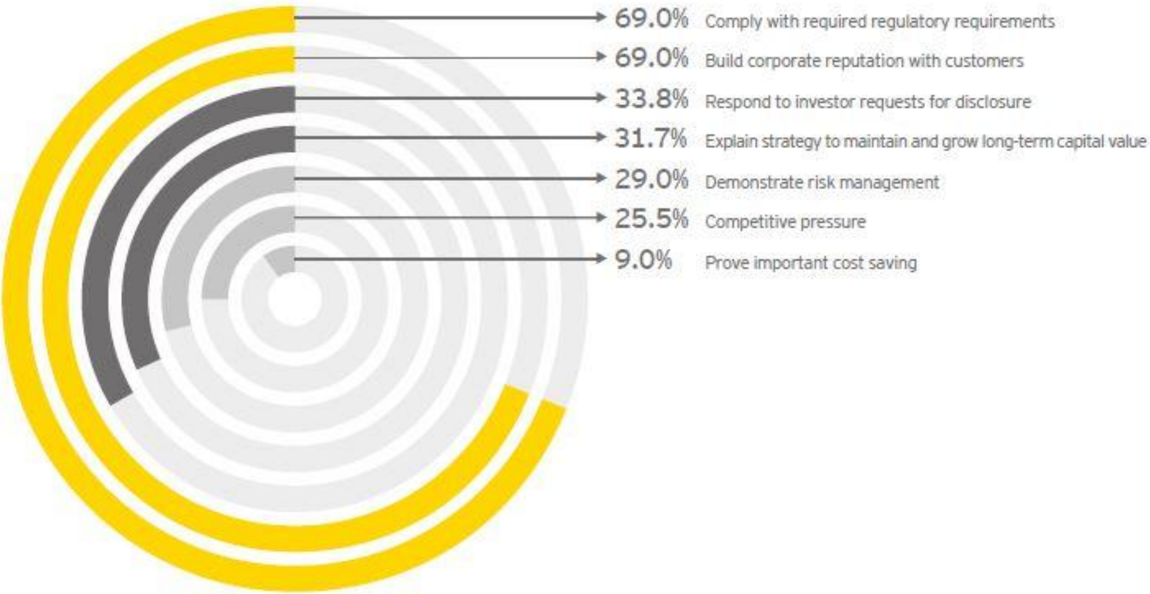
Picture 15: Importance of different issues (EY, 2014).

When asked why not to use non-financial information, picture 16 shows that the clear top reason is that investors are not sure if the information is any relevant



Picture 16: Reasons not to consider non-financial issues (EY, 2014).

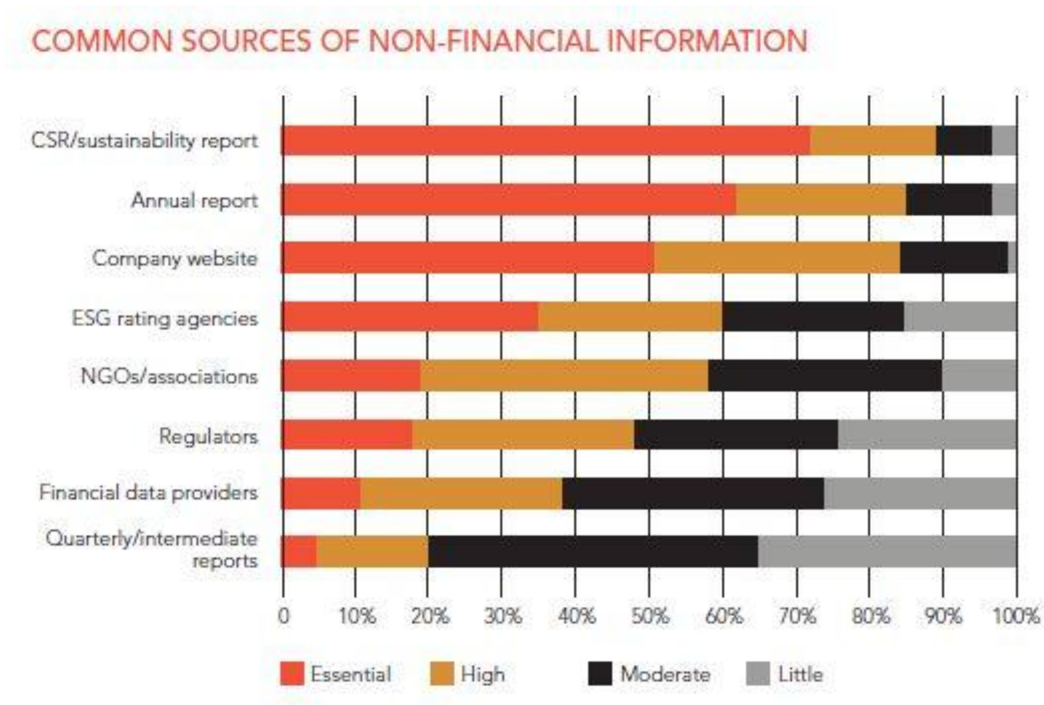
Finally, when asked what do investors believe what motivates companies to report non-financial information, they assumed it is mostly to comply with regulation and reputation building as seen on picture 17 below



Picture 17: What investors believe motivates companies to report non-financial performance (EY, 2014).

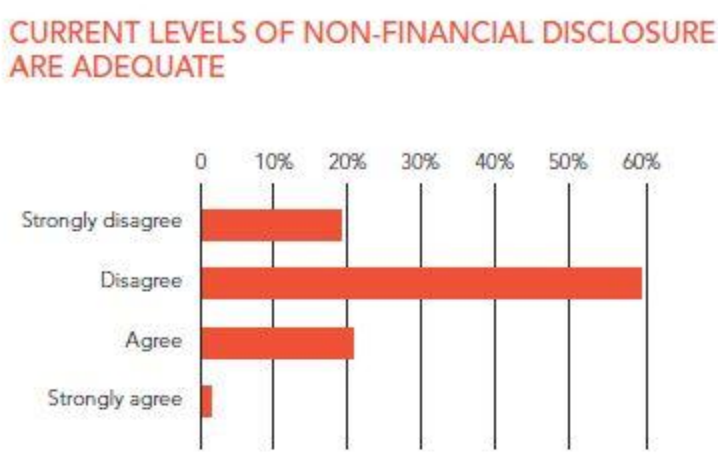
The Association of Chartered Certified Accountants (ACCA) and the European Sustainable Investment Forum (Eurosif) conducted a survey on European investors, analysts and other stakeholders and published a paper with the title of “What do investors expect from non-financial reporting?” (ACCA, 2013), focusing solely on the investor aspect on the European Union directive on non-financial reporting. The key findings are presented below;

The reports produced by the companies are the most important sources of information for the investors, as seen on picture 18 below



Picture 18: sources of information (ACCA, 2013).

Investors are rather unsatisfied with the information available, only little over 20% agreeing that the current levels are adequate as seen on picture 19 below



Picture 19: adequacy of information (ACCA, 2013).

Investors seem to strongly take a stand that boards should be more accountable for non-financial discloser, as seen on picture 20 below

Picture 20: sufficiency of accountability (ACCA, 2013).

Moreover, over 90% of the investors agree that reporting should be more integrated as seen on picture 21 below

Picture 21: support for integration of reports (ACCA, 2013).

The key findings these two leading accounting organizations came up with clearly points out the need for transparent and coherent reporting.

7.4 Conclusions

It is clear that investors are more and more giving weight for the non-financial performance of corporations and now it is up to the corporations to provide transparent and coherent information. Europe is the leading region on global scale to drive the non-financial performance and the reporting on the matter. However it is equally clear that there are several problems in the reporting standards and that there is a lot of work to do to reach an acceptable level of quality.

Main improvement areas are materiality of information, linkage between non-financial and financial performance, comparability of the information and conformity of the reporting standards. Furthermore, the EU should make a clear stand on terminology and definitions of concepts and promote the standardization on international arenas.

The European Union directive on non-financial reporting is a logical next step on global trends and serves the purpose as the first EU level legislation. It is a compromising directive giving hope for the future development. It is also a significant statement by the European leaders to drive the development towards sustainable economic models. The directive is not even close to be comprehensive, and the next big steps have to include scalability concerning majority of the companies, unifying the standards and implementing accountability measures.

8. DISCUSSION

Many people have problems understanding exponential growth, perhaps because almost everything on our everyday lives grow linearly and people are so used to linear thinking. Within economics and politics there is a lot of talk about growth rates and in many cases growth is the holy destination where everything else shall be sacrificed. In this context we are always talking about exponential growth. But what does it mean for the world when something is growing exponentially? Here we have to address the concept of doubling time, where any measurement having steady growth will have a time when the figure has been doubled. In other words, if it takes some time to grow 5% for a measure, it will take some longer time to grow 100%. So applying the math, we understand that anything growing 2% per year will have a doubling time of 35 years, 5% growth giving doubling time of around 15 years and 7% growth 10 years. And if consumption would double every decade, the last decade consumption is more than in all of the history was ever consumed all together. With this understanding the long term global trends, like population growth or energy consumption growth, seem to have whole new meanings. Furthermore, when economic growth is coupled with natural resource consumption growth, the limits of growth becomes clear.

Almost all of the global problems we have today can be traced back to overpopulation of the world. It took hundreds of thousands of years for human population to reach one billion. Then it took only another two hundred years or so to reach seven billion in 2011. According to United Nations predictions, without unexpected events, the world will have around 8.5 billion people by 2030, between 9.4 and 10 billion in 2050 only to reach something between 10 and 12.5 billion in 2100. Global birth rates have been declining for decades already, but all the time people live longer than ever before. (United Nations, 2015).

This exponential growth reveals the basic human dilemma; everything we regard as good, such as ending the world hunger, ending wars and giving everyone access to medical care only make the population problem worse. It is hard to imagine any politician to promote for lower population when it implies higher death rates and humane suffering. Surly there will be a time of zero and negative population growth and that will change everything, but the current problems has to be solved first.

8.1 Energy

Introduction

In western philosophy the mind and the body are seen as two independent objects, and therefore there are very few, if any, limitations for human mind. Similarly the western development and progress of the civilization is seen to be a result of higher intelligence and achievement of superior mind. This thinking is still deep in our culture and, consciously or unconsciously, shapes our community and decision making and can be well seen in the genuine belief in technology and human's ability to solve all the problems with more and more complex solutions. Advanced human intelligence certainly allowed us to develop creative solutions, but this explanation is undermining the fact that we are still only using our intelligence to allocate energy.

While energy does not explain everything, and does not give ultimate answers for modern dilemmas, understanding energy and its role in society we can rule out some uncertain predictions of the future when they are impossible without certain energy premises.

To grow from hunter-gatherers into civilization building societies, the human needed to develop one special skill; to deploy external energy. All the animals and early stage people were dependent on currently available food gathered and consumed at the spot, and they were not able to create complex structures. Over the time, people learned to harness external energy such as animal power on farms and gravity on watering systems, leading people to have excess energy. When all the energy was not required just simply to survive, other functions came available in societies. Gradually people were able to build complex societies and reach greater and greater achievements.

Energy also provides a trustworthy a stable unit, for example calorie or joule, to measure consumption needs of certain transactions. It does not change over time or according to people preferences, like monetary value or price would do. Hence, energy provides an objective perspective on societies, and following energy streams and developments we can assume to have a tool to somewhat predict future trends. So when we notice that societies tend to collapse after their energy intake drop dramatically, we can assume this rule to be universal and hold on other societies as well, including current ones (Tainter, 1988).

Energy as a concept can be understood in variety of ways and can be observed in many forms; heat, light, sound, magnetism, electricity and so on. Energy can be measured when it changes form from one to another, where we also always loose a share according to thermodynamics. People have this same ability to convert energy from food to heat, movement, voice and so on, but very rarely we are satisfied only with basic level of energy need and thus tend to use energy from outside sources as well.

Surplus energy is the basic fundamental for all existing life. In the modern complex society calculating energy balances of different projects is extremely difficult, and often we have the notion that we are delivering value, when in fact we are wasting energy. The excessive modern surpluses and the distribution of them have been attempted to explain through various economic theories, but those theories does not concern energy flows, rather typically only monetary or price development.

Short history of energy and human societies

People started to measure energy at the times of industrial revolution, when James Watt needed to explain the energy capabilities of steam engine and created equivalent unit with the energy of horse, a horsepower. According to thermodynamics, the amount of energy in the universe is constant, only changing place and form.

Traditionally people have been mostly depended on the energy of the sun. Currently mankind is also consuming nuclear and fossil energy, which ultimately is solar energy stored in the ground. Since the recreation time of fossil fuels is millions of years, they are practically gone once consumed to the end. This sun-plant-human energy chain is extremely beneficial for human and provided basic needs for nutrition. When animals stepped in to the picture, ability to harness more energy increased when many plants not suitable for people was consumable for animals. Furthermore, animals serve sort of as a stock for energy, which can be consumed when needed.

This extra energy and some inventions such as use of fire and clothing made it possible for people to conquer new areas of the planet (Cottrell, 2009).

When people learned farming and to use animals at the farm work the farming got significantly more efficient and provided more surplus energy. Farming and increased efficiency enabled population growth and more complex societies with increased number of different functions and professions. The farmers' societies are kind of self-regulating in terms of size when surplus energy will never grow over certain limits, e.g. crops cannot grow eternally no matter how much energy is put in.

Building strong boats made people to move on water, but implementing sail revolutionized man's ability to move between places and how the world was seen. For a first time, there was infinite source of free energy which could not be over consumed nor was depended on size of the population. Never before had people have such powerful and efficient source of energy. Some early societies never deployed these techniques of water and wind energy, even when they were aware of them, while others started to implement all the newest inventions and further develop them. Greeks and Phoenicians were highly skilled sailors and developed complex and far reaching societies but faced some problems with trade when some societies preferred to stay in the old habits and stabile living instead of international trade. This divided societies into two different development paths; traditional low energy societies and ever evolving high energy societies. High energy societies created new institutions such state, army, church, which were all above the original people on hierarchy scale. Eventually international trade exploded and resource thinking got hold; it made sense to decentralize production and trade goods between geographical areas when there were excess and transportation was relatively cheap. Even thou sail and sailing boats are certainly not the only explanation, the modern world and geopolitical power relations can largely be seen as result of that development, and only now when overall energy supply, demand and forms are changing, we can see the changes in future geopolitical power transitions (Cottrell, 2009).

Steam engine provided profound foundation for industrial revolution, and coal was the number one fuel for that. In the world which was build based on the needs of sailing, coal had one major problem; the mines were typically far away from coast and harbors, and land transportation was highly energy consuming. With introduction of locomotive and railroads, the energy loss on transportation reached acceptable limits when very energy intense coal could be distributed in the needs of industry and transportation. In this point, not only the costal societies but also the ones in inlands started to gain from the huge excess energy and many villages shifted into high energy cities (Cottrell, 2009).

USA used to be the biggest winner in coal powered industrialization; the reserves were huge, technologies were adapted from Europe and labor pool overwhelming. While steam engine changed the development paths of society and nation, utilization of oil and natural gas made it even more intense. The excess energy of oil and gas compared to energy input of one human worker was like nothing before and the reserves seemed endless. Along the fossil fuels we now have nuclear power as well, which, as known, has high potential but also involves higher risks for people and the environment. All these energy sources are convertible into electricity, which can be transported easily, cheaply and without noise or other negative impacts on surrounding spaces. Then again, electricity can be converted into heat, light, noise, infrared and many other forms of consumable waves or mechanical work. These features makes electricity such a practical utility, even when converting electricity will always lead into loss of some share of energy (Cottrell, 2009).

The small scale combustion engines shaped the western societies more than any single one invention, when fast and affordable transportation became available for single individuals. Also man's ability to shape the environment stepped on a whole new level (Cottrell, 2009).

Many who have been trying to explain human society's development have failed when they have focused only on human factors, ignoring man's ability to control energy. Many, especially in west, believe that western values and methods provide inevitable shift from low to high energy societies for everyone all over the world. We have seen that it is not that simple for one society to transform itself, and cultural heritage may prevent the development. In the end, the most important energy factor in one society is the amount of available food against the size of population, the minimum requirement of course being that people have enough food to survive. In the modern world, we would have enough food for everyone but the distribution is unequal and some peoples are suffering malnutrition while others have obesity problem. Now when machines have almost fully replaced human work at fields, the agriculture did not set limits for human population. The energy used on agriculture has to compete with other investments, so productivity has to be as high as possible. That can be reached with two main strategies, increase the area of land per one farmer or increase the production of land area. In the USA both strategies were deployed and these excess energies were also used to support European rise into high energy society, even though many European countries were not happily deploying all the strategies necessary (Cottrell, 2009).

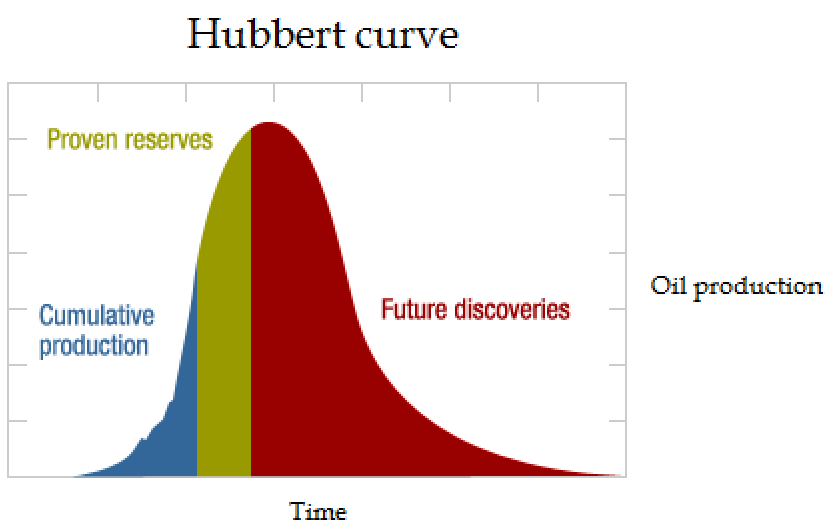
When agriculture got more efficient and machines replaced human labor, the high energy societies were to face a whole new problem; the farmers moving to cities needed jobs. This transition did not always happen smoothly and in early 1900's cities poverty and homelessness was common. Eventually there were two major paths to follow in the transition from low to high energy society; capitalism and communism. Capitalism was mostly deployed in Western Europe, when communism was the choice for China and CCCP. Both lines of development were relying on industrial agriculture, but the massive excesses gathered from there were distributed very differently, as we now know (Cottrell, 2009).

When people extended from their own bodies to use external energy and all these new energy converters were deployed, they had difficulties to really tell apart the work done by themselves and the others, such as animals or ships. The common misconception was that people are just working more or harder, when in fact they only deployed new ways of consuming energy already existing on the planet. Increased efficiency was explained with social concepts like distribution of work, and energy as an effective factor was dismissed in early state and still is in main stream social sciences.

Social studies does however provide us valuable information and these points of views tend to be interconnected in many turns. For societies to develop further, introducing monetary system was absolutely crucial.

Oil and energy reserves

Dr. Marion King Hubbert was a geoscientist who created the theories of peak oil and Hubbert curve (picture 22). In short, the theories explain and predict that since the global oil reserves are limited, the global oil supply will in some point of time hit the peak, and Dr. Hubbert predicted that the drop of production will not be a sudden crash, but rather follow a bell-shape curve just like the increase of production has been following so far. This means, we will see a declining oil production, and without dramatic changes in our society, parallel with increasing demand.



Picture 22: The Hubbert curve (Katusa, 2012)

Dr. Hubberts theory of peak oil has been largely accepted and the limitations of nonrenewable energy sources agreed on. Still the fundamental question is not answered; have the peak been reached yet and if not, when will it happen? The topic is very controversial and many interest groups promote very different views. In the end, it is only a matter of when the price of production of a unit of oil will be so high that the markets are not willing to pay it. This implies that the oil will never be fully consumed from the planet, but cheap-enough oil will end one day, which will of course rise the price of all forms of energies and will have a significant effect on modern society. Energy return on energy investment (EROEI) will not be met with any currently available substitute to petroleum (Hall & Klitgaard, 2012).

We do not have full scientific consensus, yet alone political consensus, on the timing of the peak oil. Recent studies suggest that majority of the scientific field predicts the peak to occur sometime between 2010 and 2030 (Madureira, 2014).

Resource curse

Resource curse refers to a situation where a country, despite vast natural resources, fails to notably grow their economy and/or to deliver the benefits of the resources to their citizens. This is most clearly visible in developing African or Latin-American countries where major oil and gas fields are continuously discovered but the citizens are left in poverty, often with disastrous environmental impacts only leading to deeper poverty and in some cases to loss of prerequisites of living. Typically these countries are suffering from weak administration and rule of law, which gives giant corporations full power to share the benefits as they wish, and their wish does not typically concern too much of the local citizens. The corporate social responsibility may show big words and fancy talks in Europe or the United States, but outside the western countries the people, environment and weak rule of law are brutally abused. On the other hand the local governments are spending the gathered fortunes on public investments with terribly inefficient execution and good share is lost on corruption, reinforcing the current leaders and their closed ones. The bad execution of public spending together with so called Dutch Disease is one of the main causes of the resource curse. The Dutch Disease refers to a situation where boom in one industry leads to decline of the other industries due to reallocation of resources and inflation and currency value effects of foreign income, leaving the country with polarized and vulnerable economic structure (Ebrahimzadeh, 2012). If this foreign income is from, let´s say oil, which has a tendency for remarkable market price changes, the country is also implied with big changes on income and higher risk for conflicts.

The resource curse can also be seen as finance curse, where too large financial sector has the same effect, like for example Cayman Islands is typically seen having. Furthermore, it may occur in developed countries as well, like in the case of Finland, where mobile phones created a tech boom and left the country suffering with decline of traditional industries.

Summary and Implications

Energy is the basic fundamental of the world. The vast amounts of cheap excess energy we have today is the corner stone of our modern society and without very fast and profound innovations on energy technology we will be experiencing resource scarcity and the significant implications that will have on our modern lives. This can be best understood observing current low energy societies, identifying the preconditions those societies have for their existence and fitting those preconditions into modern cities with current population density.

For these reasons energy must be taken into account when allocating resources.

8.2 Gross Domestic Product

Gross domestic product (GDP) is the most important single one measurement of modern economics, and many other relevant measurements are presented as relative to GDP. European Union describes GDP as “basic measure of a country's overall economic health” and “measure for the overall size of an economy” (Eurostat, 2015). The Organization for Economic Co-operation and Development (OECD) defines gross domestic product as follows;

> “Gross domestic product is an aggregate measure of production equal to the sum of the gross values added of all resident institutional units engaged in production (plus any taxes, and minus any subsidies, on products not included in the value of their outputs). The sum of the final uses of goods and services (all uses except intermediate consumption) measured in purchasers' prices, less the value of imports of goods and services, or the sum of primary incomes distributed by resident producer units” (OECD, 2001).

To say this short, it is the value of all the products and services produced in one country during one year. GDP has been traditionally wildly used for measurement of development and well-being, but this idea has faced lot of criticism as well. Some relevant questions have been asked as well, such as; should unsustainable forms of business be added into GDP e.g. the more forests are destroyed the better off we are? What about assumed value of prostitution and illegal drugs, like in Great Britain statisticians started counting the economic "contribution" of them too e.g. the more heroin addicts the healthier the economy?

Gross domestic product measures output only, excluding input, taking no stand on the quality of the output, and by nature ruling out everything that is not monetized. It does what it was created for; offer a value of marketed goods and services – and indeed does it quite well. Keeping that in mind, GDP still serves the purpose for some statistical causes. What GDP does not provide is general well-being of a nation or surroundings, yet it is widely used as basis for policy setting. When we now talk about economic growth, we are talking about GDP growth. Due to our monetary system and how money is created, we have to have ever-growing economy.

How money is made?

Bank of England published their Quarterly Bulletin 2014 Q1 with the title of "Money creation in the modern economy", where the authors explain the process of creating money; "Whenever a [commercial] bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money", so in other words "Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits" (McLeay *et al*, 2014). So most of the money in the world is not created by central banks letting out money, but rather commercial banks giving loans, which in turn means that against every unit of money there is a unit of debt, and the debt has interest rate or similar mean of expense. To cover that expense of the money, the economy has to grow all the time. The entire economy is based on debt and the growing stacks of debt, which even according to the current economic theories and policies cannot be sustainable in the long run.

8.3 New models of economy

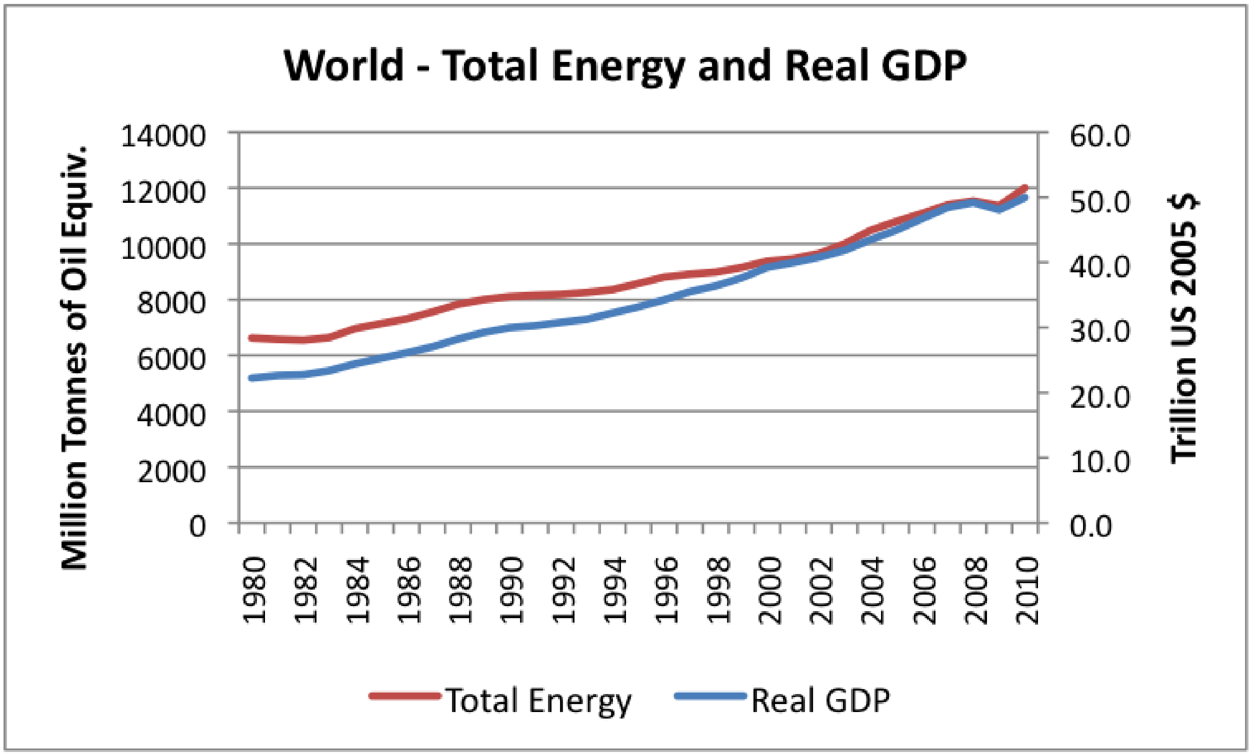
Growth of GDP is based on economic, numeric growth, but the possibilities of economic growth were questioned as early as in 1970's with the Burdtland report. Their main question was can we have infinite growth in finite world? Over the years there have been many initiatives to introduce a more comprehensive measuring tool, but none of them have been implemented on a scale.

One recent initiative is Social Progress Index (SPI), which concerns aspects such as basic human needs, wellbeing and sustainability. The SPI is complementing GDP, assessing country´s social and environmental performance relative to GDP. This is very welcome development, when GDP does not necessarily correlate with social well-being. The SPI has got a lot of attention worldwide and might be the next small step towards sustainable model.

There has been a lot of talk also about Green GDP, which is seen to measure environmental consequences of economic growth factored into conventional GDP. The Green GDP puts a monetary value on set of environmental factors. There is no common agreement on what should be calculated in, but several measures have been suggested such as biodiversity loss, carbon dioxide emissions, waste produced, and ecosystem services and so on.

The problem with the Green GDP is that no one is really leading the talk and there have not been a credible initiative to implement such measure on international scale.

Both of these examples are still missing out the most crucial factor – energy. Economic growth is coupled with energy consumption growth, as seen on picture 23. Economic growth provides the basics for social well-being which again grows the energy consumption. Energy consumption growth is also coupled with other resources consumption growth and emissions growth. The population is growing exponentially and energy consumption per capita is growing. More and more people are enjoying social well-being, which is financed with debt and the debt is created with energy demand that cannot be met sustainably.



Picture 23: Total energy and real GDP (Tverberg, 2011)

To overcome the problems we would need reforms on many areas of society. Typically the leading elite has very little interest to make system level changes when the system has proven to be very beneficial for them. That is why we need global initiatives and interdisciplinary co-operation to address the issues and to build institutions to apply the changes. European Union directive on non-financial accounting is a good example of a small step towards better practices.

The current economical measurement system has to be reformed to recognize the resource consumption and total energy consumption. Wealth distribution has to be allocated according to the energy streams. Western world-type high level energy societies cannot be replicated on every corner of the world and the energy consumption has to be decoupled from economic and social well-being. The practical solutions for these problems would be a good future research work.

9. FINAL CONCLUSIONS AND FURTHER RESEARCH

9.1 Literature Overview

Companies, enterprises, corporations and others alike are an integral part of today´s society and play a major role on world development on many levels. They as entities contribute a major effect on our surrounding environment compared to individuals. Therefore the changes we are witnessing on our environment are strongly linked to such entities and their behavior and actions. Hence, corporate social responsibility becomes a justified demand when we see it in the context of apparent changes on climate and environment strongly enhanced by business entities.

To provide a context, this paper introduced six major headlines from climate science in past couple of years; methane explosions in Siberia, eastern Antarctic getting unstable, California hit by extreme drought, Amazon rainforest in danger, oceans are getting sick and the sixth mass-extinction has begun.

The example cases helps to understand the critical nature of the subject, but also clarifies how difficult it is to provide reliable climate models and that we have a tendency to continuously underestimate the effects of natural destruction our modern society is practicing in the name of capitalism and economic growth. On global level, Europe is a main contributor.

The word sustainability is wildly used in many different contexts and it is not always clear what is meant when something is described as sustainable. The concept of sustainability has seen many definitions and levels of understanding which are by nature divided into two major categories; weak and strong sustainability. Very few corporations are interested in sustainability if it does not generate profit or promise of future profit. Furthermore, in real world business context sustainability is generally understood as weak sustainability. That involves Jevons paradox; technological development leads to greater efficiency (on certain resource), which leads to greater consumption of the named resource, rather than actual decrease in demand. So called “rebound effect” shows that resource saved in one point of value chain will always pop up in the other. Obviously it is not the resource efficiency itself that proves to harm the environment, but rather the social structure of economy which recognizes only the economic growth. All the policies and society development are targeting economic growth, especially measured in terms of gross domestic product (GDP). Unfortunately economic growth has so far always meant growth on consumption of natural resources and growth on harmful emissions. The European Union is still relying on The United Nations (United Nations, 1997) on definition of sustainability, referring to:

(a) Use of the biosphere by present generations while maintaining its potential yield (benefit) for future generations; and/or

(b) Non-declining trends of economic growth and development that might be impaired by natural resource depletion and environmental degradation.

Corporate social responsibility (CSR) can be traced back with meanings of many levels and wide variety. It is important to note that corporate social responsibility, or any alternative term or concept in the field, can never be fully locked on one meaning, because the social aspect makes it an ever evolving and culturally tied vague concept, meaning it will continuously transform along with the cultural changes and expectations general public and societies have towards corporations. The European Commission`s definition of corporate social responsibility goes as "the responsibility of enterprises for their impacts on society".

The EU directive is a logical addition to global development and will most likely be implemented into local legislations without major protests. The directive is a compliment to previous directive of corporate reporting and now the new directive clearly requires specific disclosures. The CSR effect will "drain down" when large companies ask their stakeholders to provide information for their reports and the entire supply chain feel the pressure, inside and outside of the EU.

9.2 Main findings

After the analysis it became clear that investors are more and more giving weight for the non-financial performance of corporations and expecting corporations to provide transparent and coherent information. However it is equally clear that there are several problems in the reporting standards and that there is a lot of work to do to reach an acceptable level of quality.

Main improvement areas are materiality of information, linkage between non-financial and financial performance, comparability of the information and conformity of the reporting standards. Furthermore, the EU should make a clear stand on terminology and definitions of concepts and promote the standardization on international arenas.

The European Union directive on non-financial reporting is a logical next step on global trends and serves the purpose as the first EU level legislation. It is a compromising directive giving hope for the future development. It is also a significant statement by the European leaders to drive the development towards sustainable economic models. The directive is not even close to be comprehensive, and the next big steps have to include scalability concerning majority of the companies, unifying the standards and implementing accountability measures.

The investor's interest towards non-financial performance and acceptance of reporting gives a solid ground to build legislation and escalate development of sustainable economic models. That would be a logical path concerning the context provided in chapter 2. Furthermore, the concept of sustainability has to be clarified when resource efficiency is one major fundamental of modern corporate social responsibility. The complex problems and possible measurements of economical development introduced in the chapter 8 become more feasible when the concepts are clarified and investors among other stake holders are supporting the development. European Union has a chance and means to be the leader of sustainable future, now it is up to policy makers to come over those obstacles.

9.3 Limitations of the work

This section discusses limitations for this work, some on general level and some concerning this research particularly.

Due to resource limitations, primary data was not an option to investigate investor engagement. Secondary data can be just as sufficient, but implies some limitations as well. In this case, the amount of secondary date could have been more comprehensive. Also the motives of the original survey conductors might be commercial and the trustworthiness of the information could be questioned.

In social science the conclusions are always subjective. This research is focusing on opinions of certain group of people and the people have for sure been aware that their responses are recorded, which again might trigger the respondents to answer in a certain way. Also the neutrality, or lack of neutrality, of the question setting might be guiding the answers in a certain way e.g. who would say “no” if asked “do you support healthy environment?”?

For this research, some profound assumptions had to be made. First one is that the political system can make changes and transform itself. Without that assumption, this research would be worthless. Also the resource efficiency was assumed to increase sustainability, even when it is proven to work the opposite way. This is because the resource efficiency is one of the fundamentals of corporate social responsibility.

Investor perspective was assumed not be influenced by the terminology, when in fact it might have a significant impact.

9.4 Recommendation for further research

The obvious future research should study the implications of the directive after it has become effective. Also the effect of terminology on investor opinion could be an interesting field of study. The most critical subject has to be dealing with the measurements of economics and economic growth. The effects and possibilities of decoupling energy usage, resource usage, natural destruction and economic growth is the field where most work could be done.

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I

(Legislative acts)

DIRECTIVES

DIRECTIVE 2014/95/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 22 October 2014

amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 50(1) thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee ([1]),

Acting in accordance with the ordinary legislative procedure ([2]),

Whereas:

(1) In its communication entitled 'Single Market Act — Twelve levers to boost growth and strengthen confidence — "Working together to create new growth"', adopted on 13 April 2011, the Commission identified the need to raise to a similarly high level across all Member States the transparency of the social and environmental information provided by undertakings in all sectors. This is fully consistent with the possibility for Member States to require, as appropriate, further improvements to the transparency of undertakings' non-financial information, which is by its nature a continuous endeavour.

(2) The need to improve undertakings' disclosure of social and environmental information, by presenting a legislative proposal in this field, was reiterated in the Commission communication entitled 'A renewed EU strategy 2011-14 for Corporate Social Responsibility', adopted on 25 October 2011.

(3) In its resolutions of 6 February 2013 on, respectively, 'Corporate Social Responsibility: accountable, transparent and responsible business behaviour and sustainable growth' and 'Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery', the European Parliament acknowledged the importance of businesses divulging information on sustainability such as social and environmental factors, with a view to identifying sustainability risks and increasing investor and consumer trust. Indeed, disclosure of non-financial information is vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection. In this context, disclosure of non-financial information helps the measuring, monitoring and managing of undertakings' performance and their impact on society. Thus, the European Parliament called on the Commission to bring forward a legislative proposal on the disclosure of non-financial information by undertakings allowing for high flexibility of action, in order to take account of the multidimensional nature of corporate social responsibility (CSR) and the diversity of the CSR policies implemented by businesses matched by a sufficient level of comparability to meet the needs of investors and other stakeholders as well as the need to provide consumers with easy access to information on the impact of businesses on society.

([1]) OJ C 327, 12.11.2013, p. 47.
([2]) Position of the European Parliament of 15 April 2014 (not yet published in the Official Journal) and decision of the Council of 29 September 2014.

(4) The coordination of national provisions concerning the disclosure of non-financial information in respect of certain large undertakings is of importance for the interests of undertakings, shareholders and other stakeholders alike. Coordination is necessary in those fields because most of those undertakings operate in more than one Member State.

(5) It is also necessary to establish a certain minimum legal requirement as regards the extent of the information that should be made available to the public and authorities by undertakings across the Union. The undertakings subject to this Directive should give a fair and comprehensive view of their policies, outcomes, and risks.

(6) In order to enhance the consistency and comparability of non-financial information disclosed throughout the Union, certain large undertakings should prepare a non-financial statement containing information relating to at least environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters. Such statement should include a description of the policies, outcomes and risks related to those matters and should be included in the management report of the undertaking concerned. The non-financial statement should also include information on the due diligence processes implemented by the undertaking, also regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts. It should be possible for Member States to exempt undertakings which are subject to this Directive from the obligation to prepare a non-financial statement when a separate report corresponding to the same financial year and covering the same content is provided.

(7) Where undertakings are required to prepare a non-financial statement, that statement should contain, as regards environmental matters, details of the current and foreseeable impacts of the undertaking's operations on the environment, and, as appropriate, on health and safety, the use of renewable and/or non-renewable energy, greenhouse gas emissions, water use and air pollution. As regards social and employee-related matters, the information provided in the statement may concern the actions taken to ensure gender equality, implementation of fundamental conventions of the International Labour Organisation, working conditions, social dialogue, respect for the right of workers to be informed and consulted, respect for trade union rights, health and safety at work and the dialogue with local communities, and/or the actions taken to ensure the protection and the development of those communities. With regard to human rights, anti-corruption and bribery, the non-financial statement could include information on the prevention of human rights abuses and/or on instruments in place to fight corruption and bribery.

(8) The undertakings which are subject to this Directive should provide adequate information in relation to matters that stand out as being most likely to bring about the materialisation of principal risks of severe impacts, along with those that have already materialised. The severity of such impacts should be judged by their scale and gravity. The risks of adverse impact may stem from the undertaking's own activities or may be linked to its operations, and, where relevant and proportionate, its products, services and business relationships, including its supply and subcontracting chains. This should not lead to undue additional administrative burdens for small and medium-sized undertakings.

(9) In providing this information, undertakings which are subject to this Directive may rely on national frameworks, Union-based frameworks such as the Eco-Management and Audit Scheme (EMAS), or international frameworks such as the United Nations (UN) Global Compact, the Guiding Principles on Business and Human Rights implementing the UN 'Protect, Respect and Remedy' Framework, the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises, the International Organisation for Standardisation's ISO 26000, the International Labour Organisation's Tripartite Declaration of principles concerning multinational enterprises and social policy, the Global Reporting Initiative, or other recognised international frameworks.

(10) Member States should ensure that adequate and effective means exist to guarantee disclosure of non-financial information by undertakings in compliance with this Directive. To that end, Member States should ensure that effective national procedures are in place to enforce compliance with the obligations laid down by this Directive, and that those procedures are available to all persons and legal entities having a legitimate interest, in accordance with national law, in ensuring that the provisions of this Directive are respected.

(11) Paragraph 47 of the outcome document of the United Nations Rio+20 conference, entitled 'The Future We Want', recognises the importance of corporate sustainability reporting and encourages undertakings, where appropriate, to consider integrating sustainability information into their reporting cycle. It also encourages industry, interested governments and relevant stakeholders with the support of the United Nations system, as appropriate, to develop models for best practice, and facilitate action for the integration of financial and non-financial information, taking into account experiences from already existing frameworks.

(12) Investors' access to non-financial information is a step towards reaching the milestone of having in place by 2020 market and policy incentives rewarding business investments in efficiency under the roadmap to a resource-efficient Europe.

(13) The European Council, in its conclusions of 24 and 25 March 2011, called for the overall regulatory burden, in particular for small and medium-sized enterprises ('SMEs'), to be reduced at both European and national levels, and suggested measures to increase productivity, while the Europe 2020 Strategy for smart, sustainable and inclusive growth aims to improve the business environment for SMEs and to promote their internationalisation. Thus, in accordance with the 'think small first' principle, the new disclosure requirements should apply only to certain large undertakings and groups.

(14) The scope of those non-financial disclosure requirements should be defined by reference to the average number of employees, balance sheet total and net turnover. SMEs should be exempted from additional requirements, and the obligation to disclose a non-financial statement should apply only to those large undertakings which are public-interest entities and to those public-interest entities which are parent undertakings of a large group, in each case having an average number of employees in excess of 500, in the case of a group on a consolidated basis. This should not prevent Member States from requiring disclosure of non-financial information from undertakings and groups other than undertakings which are subject to this Directive.

(15) Many of the undertakings which fall within the scope of Directive 2013/34/EU of the European Parliament and of the Council ([1]) are members of groups of undertakings. Consolidated management reports should be drawn up so that the information concerning such groups of undertakings may be conveyed to members and third parties. National law governing consolidated management reports should therefore be coordinated in order to achieve the objectives of comparability and consistency of the information which undertakings should publish within the Union.

(16) Statutory auditors and audit firms should only check that the non-financial statement or the separate report has been provided. In addition, it should be possible for Member States to require that the information included in the non-financial statement or in the separate report be verified by an independent assurance services provider.

(17) With a view to facilitating the disclosure of non-financial information by undertakings, the Commission should prepare non-binding guidelines, including general and sectoral non-financial key performance indicators. The Commission should take into account current best practices, international developments and the results of related Union initiatives. The Commission should carry out appropriate consultations, including with relevant stakeholders. When referring to environmental aspects, the Commission should cover at least land use, water use, greenhouse gas emissions and the use of materials.

(18) Diversity of competences and views of the members of administrative, management and supervisory bodies of undertakings facilitates a good understanding of the business organisation and affairs of the undertaking concerned. It enables members of those bodies to constructively challenge the management decisions and to be more open to innovative ideas, addressing the similarity of views of members, also known as the 'group-think' phenomenon. It contributes thus to effective oversight of the management and to successful governance of the undertaking. It is therefore important to enhance transparency regarding the diversity policy applied. This would inform the market of corporate governance practices and thus put indirect pressure on undertakings to have more diversified boards.

(19) The obligation to disclose diversity policies in relation to the administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender or educational and professional backgrounds should apply only to certain large undertakings. Disclosure of the diversity policy should be part of the corporate governance statement, as laid down by Article 20 of Directive 2013/34/EU. If no diversity policy is applied there should not be any obligation to put one in place, but the corporate governance statement should include a clear explanation as to why this is the case.

([1]) Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013, p. 19).

(20) Initiatives at Union level, including country-by-country reporting for several sectors, as well as the references made by the European Council, in its conclusions of 22 May 2013 and of 19 and 20 December 2013, to country-by-country reporting by large companies and groups, similar provisions in Directive 2013/36/EU of the European Parliament and of the Council [1], and international efforts to improve transparency in financial reporting have been noted. Within the context of the G8 and the G20, the OECD has been asked to draw up a standardised reporting template for multinational undertakings to report to tax authorities where they make their profits and pay taxes around the world. Such developments complement the proposals contained in this Directive, as appropriate measures for their respective purposes.

(21) Since the objective of this Directive, namely to increase the relevance, consistency and comparability of information disclosed by certain large undertakings and groups across the Union, cannot be sufficiently achieved by the Member States but can rather, by reason of its effect, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective.

(22) This Directive respects the fundamental rights and observes the principles recognised in particular by the Charter of Fundamental Rights of the European Union, including freedom to conduct a business, respect for private life and the protection of personal data. This Directive has to be implemented in accordance with those rights and principles.

(23) Directive 2013/34/EU should therefore be amended accordingly,

HAVE ADOPTED THIS DIRECTIVE:

Article 1

Amendments to Directive 2013/34/EU

Directive 2013/34/EU is amended as follows:

(1) The following Article is inserted:

'Article 19a

Non-financial statement

1. Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:

(a) a brief description of the undertaking's business model;

(b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;

(c) the outcome of those policies;

[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

(d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;

(e) non-financial key performance indicators relevant to the particular business.

Where the undertaking does not pursue policies in relation to one or more of those matters, the non-financial statement shall provide a clear and reasoned explanation for not doing so.

The non-financial statement referred to in the first subparagraph shall also, where appropriate, include references to, and additional explanations of, amounts reported in the annual financial statements.

Member States may allow information relating to impending developments or matters in the course of negotiation to be omitted in exceptional cases where, in the duly justified opinion of the members of the administrative, management and supervisory bodies, acting within the competences assigned to them by national law and having collective responsibility for that opinion, the disclosure of such information would be seriously prejudicial to the commercial position of the undertaking, provided that such omission does not prevent a fair and balanced understanding of the undertaking's development, performance, position and impact of its activity.

In requiring the disclosure of the information referred to in the first subparagraph, Member States shall provide that undertakings may rely on national, Union-based or international frameworks, and if they do so, undertakings shall specify which frameworks they have relied upon.

2. Undertakings fulfilling the obligation set out in paragraph 1 shall be deemed to have fulfilled the obligation relating to the analysis of non-financial information set out in the third subparagraph of Article 19(1).

3. An undertaking which is a subsidiary undertaking shall be exempted from the obligation set out in paragraph 1 if that undertaking and its subsidiary undertakings are included in the consolidated management report or the separate report of another undertaking, drawn up in accordance with Article 29 and this Article.

4. Where an undertaking prepares a separate report corresponding to the same financial year whether or not relying on national, Union-based or international frameworks and covering the information required for the non-financial statement as provided for in paragraph 1, Member States may exempt that undertaking from the obligation to prepare the non-financial statement laid down in paragraph 1, provided that such separate report:

(a) is published together with the management report in accordance with Article 30; or

(b) is made publicly available within a reasonable period of time, not exceeding six months after the balance sheet date, on the undertaking's website, and is referred to in the management report.

Paragraph 2 shall apply *mutatis mutandis* to undertakings preparing a separate report as referred to in the first subparagraph of this paragraph.

5. Member States shall ensure that the statutory auditor or audit firm checks whether the non-financial statement referred to in paragraph 1 or the separate report referred to in paragraph 4 has been provided.

6. Member States may require that the information in the non-financial statement referred to in paragraph 1 or in the separate report referred to in paragraph 4 be verified by an independent assurance services provider.'.

(2) Article 20 is amended as follows:

(a) in paragraph 1, the following point is added:

'(g) a description of the diversity policy applied in relation to the undertaking's administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented and the results in the reporting period. If no such policy is applied, the statement shall contain an explanation as to why this is the case.';

(b) paragraph 3 is replaced by the following:

'3. The statutory auditor or audit firm shall express an opinion in accordance with the second subparagraph of Article 34(1) regarding information prepared under points (c) and (d) of paragraph 1 of this Article and shall check that the information referred to in points (a), (b), (e), (f) and (g) of paragraph 1 of this Article has been provided.';

(c) paragraph 4 is replaced by the following:

'4. Member States may exempt undertakings referred to in paragraph 1 which have only issued securities other than shares admitted to trading on a regulated market within the meaning of point (14) of Article 4(1) of Directive 2004/39/EC from the application of points (a), (b), (e), (f) and (g) of paragraph 1 of this Article, unless such undertakings have issued shares which are traded in a multilateral trading facility within the meaning of point (15) of Article 4(1) of Directive 2004/39/EC.';

(d) the following paragraph is added:

'5. Notwithstanding Article 40, point (g) of paragraph 1 shall not apply to small and medium-sized undertakings.'.

(3) The following Article is inserted:

'Article 29a

Consolidated non-financial statement

1. Public-interest entities which are parent undertakings of a large group exceeding on its balance sheet dates, on a consolidated basis, the criterion of the average number of 500 employees during the financial year shall include in the consolidated management report a consolidated non-financial statement containing information to the extent necessary for an understanding of the group's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:

(a) a brief description of the group's business model;

(b) a description of the policies pursued by the group in relation to those matters, including due diligence processes implemented;

(c) the outcome of those policies;

(d) the principal risks related to those matters linked to the group's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the group manages those risks;

(e) non-financial key performance indicators relevant to the particular business.

Where the group does not pursue policies in relation to one or more of those matters, the consolidated non-financial statement shall provide a clear and reasoned explanation for not doing so.

The consolidated non-financial statement referred to in the first subparagraph shall also, where appropriate, include references to, and additional explanations of, amounts reported in the consolidated financial statements.

Member States may allow information relating to impending developments or matters in the course of negotiation to be omitted in exceptional cases where, in the duly justified opinion of the members of the administrative, management and supervisory bodies, acting within the competences assigned to them by national law and having collective responsibility for that opinion, the disclosure of such information would be seriously prejudicial to the commercial position of the group, provided that such omission does not prevent a fair and balanced understanding of the group's development, performance, position and impact of its activity.

In requiring the disclosure of the information referred to in the first subparagraph, Member States shall provide that the parent undertaking may rely on national, Union-based or international frameworks, and if it does so, the parent undertaking shall specify which frameworks it has relied upon.

2. A parent undertaking fulfilling the obligation set out in paragraph 1 shall be deemed to have fulfilled the obligation relating to the analysis of non-financial information set out in the third subparagraph of Article 19(1) and in Article 29.

3. A parent undertaking which is also a subsidiary undertaking shall be exempted from the obligation set out in paragraph 1 if that exempted parent undertaking and its subsidiaries are included in the consolidated management report or the separate report of another undertaking, drawn up in accordance with Article 29 and this Article.

4. Where a parent undertaking prepares a separate report corresponding to the same financial year, referring to the whole group, whether or not relying on national, Union-based or international frameworks and covering the information required for the consolidated non-financial statement as provided for in paragraph 1, Member States may exempt that parent undertaking from the obligation to prepare the consolidated non-financial statement laid down in paragraph 1, provided that such separate report:

(a) is published together with the consolidated management report in accordance with Article 30; or

(b) is made publicly available within a reasonable period of time, not exceeding six months after the balance sheet date, on the parent undertaking's website, and is referred to in the consolidated management report.

Paragraph 2 shall apply *mutatis mutandis* to parent undertakings preparing a separate report as referred to in the first subparagraph of this paragraph.

5. Member States shall ensure that the statutory auditor or audit firm checks whether the consolidated non-financial statement referred to in paragraph 1 or the separate report referred to in paragraph 4 has been provided.

6. Member States may require that the information in the consolidated non-financial statement referred to in paragraph 1 or in the separate report referred to in paragraph 4 be verified by an independent assurance services provider.'.

(4) In Article 33, paragraph 1 is replaced by the following:

'1. Member States shall ensure that the members of the administrative, management and supervisory bodies of an undertaking, acting within the competences assigned to them by national law, have collective responsibility for ensuring that:

(a) the annual financial statements, the management report, the corporate governance statement when provided separately and the report referred to in Article 19a(4); and

(b) the consolidated financial statements, the consolidated management reports, the consolidated corporate governance statement when provided separately and the report referred to in Article 29a(4),

are drawn up and published in accordance with the requirements of this Directive and, where applicable, with the international accounting standards adopted in accordance with Regulation (EC) No 1606/2002.'.

(5) In Article 34, the following paragraph is added:

'3. This Article shall not apply to the non-financial statement referred to in Article 19a(1) and the consolidated non-financial statement referred to in Article 29a(1) or to the separate reports referred to in Articles 19a(4) and 29a(4).'.

(6) In Article 48, the following paragraph is inserted before the last paragraph:

'The report shall also consider, taking into account developments in the OECD and the results of related European initiatives, the possibility of introducing an obligation requiring large undertakings to produce on an annual basis a country-by-country report for each Member State and third country in which they operate, containing information on, as a minimum, profits made, taxes paid on profits and public subsidies received.'.

Article 2

Guidance on reporting

The Commission shall prepare non-binding guidelines on methodology for reporting non-financial information, including non-financial key performance indicators, general and sectoral, with a view to facilitating relevant, useful and comparable disclosure of non-financial information by undertakings. In doing so, the Commission shall consult relevant stakeholders.

The Commission shall publish the guidelines by 6 December 2016.

Article 3

Review

The Commission shall submit a report to the European Parliament and to the Council on the implementation of this Directive, including, among other aspects, its scope, particularly as regards large non-listed undertakings, its effectiveness and the level of guidance and methods provided. The report shall be published by 6 December 2018 and shall be accompanied, if appropriate, by legislative proposals.

Article 4

Transposition

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 6 December 2016. They shall immediately inform the Commission thereof.

Member States shall provide that the provisions referred to in the first subparagraph are to apply to all undertakings within the scope of Article 1 for the financial year starting on 1 January 2017 or during the calendar year 2017.

When Member States adopt those provisions, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such reference shall be laid down by Member States.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 5

Entry into force

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Article 6

Addressees

This Directive is addressed to the Member States.

Done at Strasbourg, 22 October 2014.

For the European Parliament	For the Council
The President	*The President*
M. SCHULZ	B. DELLA VEDOVA