

EU sustainability reporting: focused requirements instead of complex and incoherent rules

January 2022

Summary

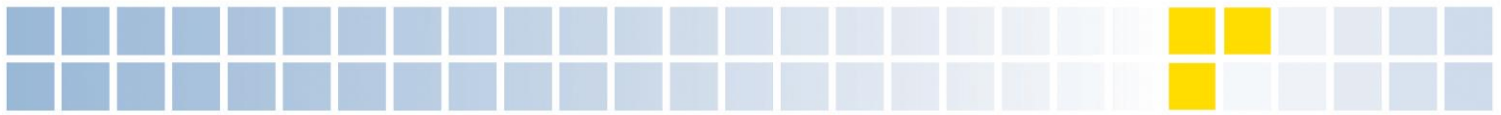
German business unreservedly supports the need for corporate sustainable governance and adequate sustainability reporting. Nevertheless, the EU institutions are currently a long way from having a holistic approach combining corporate reporting requirements which are coherent and simultaneously manageable. Various parallel legislative initiatives drawn up in different Directorates-General of the European Commission and set to be adopted in different Council formations and parliamentary committees are being assembled in an uncoordinated final text which companies will have to implement on the ground. This seems likely to result in a wide-ranging and bureaucratic reporting obligation with some unnecessary duplications.

It is therefore necessary to streamline the entire set of norms. The overlaps between the various reporting obligations do not serve the cause. Moreover, this is no way for the Commission to meet its stated objective of better European regulation. The legislative initiatives arising from the Green Deal and EU Action Plan for Financing Sustainable Growth can be implemented in companies only with a high administrative effort and therefore place a question mark over the usefulness of the changes. The design of sustainability is a task for company managers not an administrative exercise.

Large number of reporting obligations

Taxonomy Regulation

The Taxonomy Regulation adopted in June 2020 establishes a classification system designed to steer capital flows for financing the green transformation, with certain economic activities being defined as sustainable on the basis of technical assessment criteria. Neither the criteria for environmental objectives nor the reporting methodology have yet been determined definitively in a delegated act, but extensive reporting obligations have already been imposed on the affected companies with effect from January 2022. Article 18 of the Taxonomy Regulation lays down concrete requirements with reference to the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight ILO fundamental conventions and the International Bill of Human Rights which must also be taken into account in reporting on the taxonomy.



Social taxonomy

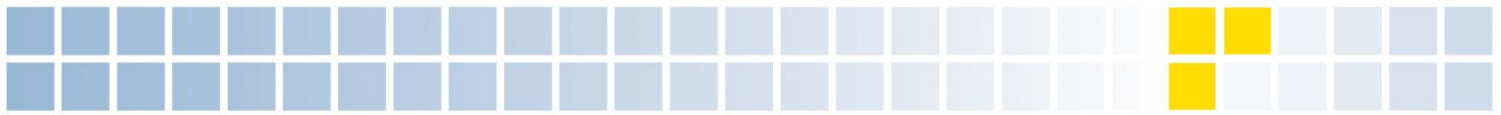
Efforts are being made to expand the taxonomy to include social aspects. Business activities would then be listed with impacts deemed to be positive for society as measured against a set of criteria. Reports from the Commission and the relevant subgroup of the Platform on Sustainable Finance are expected in the first quarter of 2022. Once again, it is possible that the social taxonomy would require companies to report in great detail on socially desirable business activities and human rights standards. In addition, the taxonomy proposals for gas and nuclear energy aspects demonstrate the difficulties of regulating sensitive policy areas not via an ordinary legislative procedure but through a delegated act with more limited democratic legitimacy.

Proposal for a directive on sustainability reporting and EU reporting standards

The proposal for a revision of CSR reporting was published in April 2021. Following its adoption, the Corporate Sustainability Reporting Directive (CSRD) is due to be implemented in the Member States by 1 December 2022. It is currently envisaged that the substantive rules will essentially apply from 1 January 2024 and hence for fiscal year 2023. The European Commission has tasked the European Financial Reporting Advisory Group (EFRAG) with establishing the non-financial reporting standards. The general standards are due to be determined by 31 October 2022 through a delegated act; these will be supplemented with sector-specific rules over the subsequent year. Broadly speaking, the content of reporting should be oriented around information about the six environmental objectives which are also enshrined in the Taxonomy Regulation. There will also be social and governance-related criteria. Among other things, the management report must expressly mention, looking backward, the impacts of business activities on sustainability aspects, including already implemented due diligence processes, and, looking forward, business strategies and planned strategies to achieve sustainability objectives. In addition, it is planned that all companies which fall within the scope of CSRD should also be obliged to report in accordance with the EU taxonomy.

Sustainable corporate governance

After several postponements, a further Commission proposal is now expected which also foresees an initiative on binding corporate human rights due diligence as part of the Sustainable Corporate Governance package. At the same time, due diligence requirements on environmental and social themes are also expected, meaning that companies would face a new statutory obligation to report on their due diligence in relation to sustainability issues. Whereas the concepts of human rights due diligence are firmly enshrined in both the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises and many companies take measures to report on it, due diligence in relation to environmental and social aspects is not clearly defined. This would therefore lead to fresh legal uncertainties. It is also completely unclear how this initiative ties in with the ban on products made using forced labour announced by Commission President von der Leyen in the “State of the Union” speech. The Commission is potentially planning a fifth legislative initiative on the same theme.



All in all, an unreasonable set of burdens

Duplications and overlaps

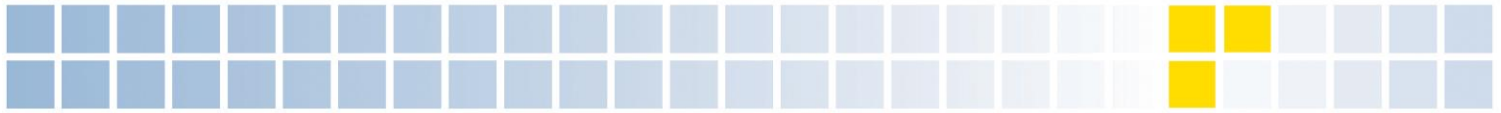
The envisaged rules involve considerable burdens, in particular against a background where companies already apply numerous voluntary or binding national and international instruments on sustainability aspects (OECD Guidelines, UN Guiding Principles on Business and Human Rights, German law on supply chain due diligence) and have signed up for sectoral initiatives or quality seals. To this is added the fact that the initiatives described above pursue human rights, ecological and social objectives which cover the same ground and hence require redundant reporting obligations. Generally speaking, a changed perspective that focuses on sustainability reporting is of central importance: the coherence of laws is indispensable, since all requirements, themes and indicators have to be reflected in companies and incongruent requirements lead to major implementation problems and legal uncertainty. The different legislative texts are also characterised by deficient definitions, unspecified legal concepts and a large number of unclear rules which greatly impede application at company level. Yet uniform principles for interpretation of the requirements are important to enable the desired comparability of sustainability reports.

Excessive demands on corporate resources and capacities

The extension of the reporting obligation envisaged in the sustainability reporting directive to companies which are not publicly traded would lead in Germany to a number of cases which is some 30 times higher than today (around 550). Companies which meet two of the three criteria from the Accounting Directive would be captured: (a) balance sheet total EUR 20,000,000; (b) net turnover EUR 40,000,000; (c) average number of employees during the financial year 250. In practice, even independent individual traders within cooperative groups (B2B relations) with a smaller workforce would potentially be affected by their information and participation obligation. The European Commission itself calculates that the implementation cost across Europe on its own would be EUR 1.2 billion in one-off costs and EUR 3.6 billion in annual follow-on costs. These expenditures are in addition to the costs generated in application of article 8 of the Taxonomy Regulation (EUR 1.2 to 3.7 billion in one-off costs and EUR 0.6 to 1.5 billion in recurring annual costs). Given the current challenges of the green and digital structural change, additional obligations are particularly burdensome for small and medium-sized enterprises. It is difficult to understand why companies which are not publicly traded should be expected to report under the EU taxonomy.

Untidy timetable and tight implementation period

The envisaged timetable is too tight and can be implemented only with difficulty. Implementation of the complex overall rulebook with the announced phased new rule introductions runs counter to the available and deliverable capacities in the affected companies. Moreover, the implementation period is much too short. Adaptation of realities in companies needs sufficient time so that they can adjust their reporting processes to the new complex requirements. This is particularly true for those companies which have not hitherto been required to report and often do not yet have corresponding structures for workers, IT systems and processes. Basically, it must be ruled out that new standards only become known when they already have to be applied.



The implementation deadlines applicable for companies must therefore be suitably extended.

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Transparency Register: 7749519702-29