Federation of European Accountants

VIEWS

EU Directive on disclosure of non-financial and diversity information

The role of practitioners in providing assurance

POSITION PAPER

AUDIT & ASSURANCE

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HIGHLIGHTS

This FEE Position Paper focusses on the role of practitioners in providing assurance on the requirements of the EU Directive on disclosure of non-financial and diversity information. Member States should have transposed this Directive into their national laws by 6 December 2016; companies will need to apply this to their reports from 2017 on.

The Directive requires 6,000 large European companies to disclose information at least on environmental, social, and employee-related matters, as well as on the respect for human rights, anti-corruption, and bribery issues. These companies also have to disclose the diversity policy for their administrative, management and supervisory boards.

Statutory auditors need to "check" whether these disclosures are actually reported. Member States may also require an independent assurance service provider to "verify" this information.

In this paper, FEE sets out what these provisions mean in practice and how the European accountancy profession can add credibility and trust to the data reported, and serve stakeholders' needs.

Background information

New EU legislation[1] introduces additional non-financial information (NFI) disclosure requirements for large public interest entities (PIEs) with more than 500 employees. The scope includes approximatively 6,000 large companies and groups across the EU. These entities are required to provide information on, at least:

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- environmental matters
- social and employee-related aspects
- respect for human rights
- anti-corruption and bribery issues

While reporting on environmental, social and employee-related aspects is current practice, providing information in respect of human rights, anti-corruption, and bribery issues is currently less common.

The entity must disclose a brief description of its business model and, for each of the above areas, the following information:

- a description of policies, including due diligence processes implemented
- outcomes of these policies
- the risks relating to those areas and how the company manages those risks
- the relevant non-financial key performance indicators

Reporting is mandatory yet flexible as the Directive adopts a 'report or explain' approach. An entity that does not pursue policies in one or more of these areas is required to explain why.

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As per the Directive, NFI has to be disclosed in the management report or in a report separate to the financial statements.

Moreover, an amendment to the corporate governance requirements of the Directive relating to PIEs also requires the disclosure of the entity's diversity policy in respect of its administrative, management, and supervisory bodies[2].

As indicated in the legislative text, the statutory auditor shall "check" whether the required non-financial disclosures are included in either the management report or a separate report. Additionally, Member States may

[1] Article 19(a) paragraphs 1 to 4 of Directive 2014/95/EU, amending Directive 2013/34/EU (The Directive). The official legislative text is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0095
[2] Article 20 of the Directive

require that this NFI be "verified" by an "independent assurance service provider"[3].

The transposition date for EU Member States is 6 December 2016, meaning that companies will be required to publish their first reports in 2017.

These new requirements warrant greater emphasis on NFI disclosures. If accompanied with proper guidance, they could help standardise the current reporting practices while retaining a degree of flexibility. FEE will shortly issue another publication that provides guidance on how best to apply these new reporting requirements in practice. This publication aims at discussing specifically the role of the statutory auditor and/or the assurance provider.

Current trends in NFI reporting and NFI assurance

Growth in NFI reporting

According to a CFA institute survey, almost three-quarters of investment professionals worldwide (73%) take environmental, social, and corporate governance (ESG) issues into consideration in their investment process.

The number of entities that report on NFI on a voluntary basis has significantly increased. When comparing the 2013 and 2014 Global Reporting Initiative (GRI) reports database for Europe, there has been a 15% increase in the number of reports issued, showing a positive trend in NFI reporting[4]. According to GRI, 95% of the world's largest corporations now publish some form of sustainability report.

Many stakeholders including investors, clients, business partners, and NGOs are seeking this type of information and are creating external pressure for companies to report. For instance, according to a CFA institute survey[5] published in 2015, almost three-quarters of investment professionals worldwide (73%) take environmental, social, and corporate governance (ESG) issues into consideration in their investment process.

New EU regulatory requirement to disclose NFI is a step towards new ways of reporting and the European accountancy profession is committed to playing its role in improving corporate reporting further.

Even if, technically, financial and non-financial information can still be considered in isolation, integrating management of NFI issues into everyday business decision-making is now a must for the transition towards better and more meaningful corporate reporting. This new EU regulatory requirement to disclose NFI is a step towards new ways of reporting and the European accountancy profession is committed to playing its role in improving corporate reporting further[6].

[3] Article 19(a) paragraphs 5 and 6 of the Directive
[4] http://database.globalreporting.org/
[5] Refer to https://www.cfainstitute.org/about/press/release/Pages/08172015_121834.aspx
CFA institute is a body representing investment professionals worldwide
[6] FEE recently published The Future of Corporate Reporting accessible at:
http://www.fee.be/library/list/50-corporate-reporting/1529-1510future-corp-rep.html

Growth in NFI assurance

Stakeholders want to know if the NFI reported is reliable and can be trusted. Many companies now face significant pressure to give stakeholders confidence in what they report and external assurance helps provide this credibility and trust. Over the last decade, the largest European entities have voluntarily asked an independent third party to provide assurance over sustainability or corporate responsibility reports. This assurance – provided by the statutory auditor or a member of the accountancy profession in 90% of cases – is instrumental in bringing value to the data reported and in enhancing the relevance and reliability of these reports.

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International organisations working on reporting initiatives such as the GRI, the International Integrated Reporting Council (IIRC), or the World Business Council for Sustainable Development (WBCSD) have also recently been running projects to enhance discussion and foster debate on assurance over NFI[7]. According to the CFA institute survey referred to above, investors use the assurance provided over NFI in their investment decision and 69% of respondents think it is important that ESG disclosures be subject to independent assurance.

The role of the accountancy profession

The role of the statutory auditor according to the NFI Directive

According to the NFI Directive requirements, the statutory auditor shall "check whether the required information is included in either the management report or a separate report". FEE believes that this "check" requirement should be seen as part of the auditor role around other information.

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The role of the statutory auditor on other information is explained in the International Standard on Auditing (ISA) 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*[8]. Other information being defined as financial or non-financial information (other than the financial statements and the auditor's report thereon) included in an entity's annual report. NFI, as reported according to the revised Directive, should be considered as other information. In this standard issued by the International Auditing and Assurance Standards Board (IAASB), the auditor is required to read and consider other information, and take any appropriate actions. In its report, the auditor needs to include either a statement that there is nothing to report or, if the auditor has determined that there is an uncorrected material misstatement of the other

[7] See Reporting Matters, WBCSD 2014 report or Global Reporting Initiative guidelines version G4

[8] This revised version of ISA 720 will be applicable as from 15 December 2015 and is accessible at: https://www.ifac.org/publications-resources/international-standard-auditing-isa-720-revised-auditor-s-responsibilities--0

information, a statement describing any uncorrected material misstatement of other information. The auditor should also ‘remain alert’ for indications that the other information not related to the financial statements or the auditor’s knowledge obtained in the audit appears to be materially misstated.

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FEE believes that this requirement is a compliance and regulatory procedure that the statutory auditor performs on other information in the remit of its audit assignment. This compliance and regulatory requirement is a “consistency check” and is not aimed at providing any comfort to stakeholders about the quality of the data reported. No assurance is provided over the NFI reported.

The fact that the Directive leaves room for flexibility on the inclusion or not of NFI in the management report may pose practical issues:

- If the entity reports NFI in the management report, the auditor has the necessary information when completing the statutory audit. The auditor’s report therefore needs to include either a statement that there is nothing to report or, if the auditor has determined that there is an uncorrected material misstatement of the other information, a statement describing that material misstatement;
- If the entity reports NFI in a separate report which could be issued with delay, i.e. after the issuance of the auditor’s report – as proposed in the Directive – the auditor has no vehicle available anymore to report on any material misstatement if need be. Even if using this separate report option is possible under the legislation, the auditor has to communicate with management or those charged with governance their expectations in relation to obtaining the final version of the NFI report in a timely manner prior to the date of the auditor’s report, such that the auditor can consider this NFI report before issuing the auditor’s report. If this is not the case, it will be necessary for the auditor to mention in the auditor’s report that NFI has not been obtained and could not be read and considered.

The role of the assurance provider according to the NFI Directive

In addition to the mandatory “check” from the statutory auditor, Member States may require that the NFI be “verified” by an “independent assurance services provider”[9]. FEE believes that this option refers to an assurance engagement that could be provided by the accountancy profession. As mentioned above, this is the type of service that brings value to the data reported and could be useful to stakeholders by enhancing the relevance and reliability of NFI.

[9] Article 19(a) of the Directive 2014/95/EU, amending Directive 2013/34/EU

It should be noted that, in addition to the largest European entities taking the initiative to get their sustainability or corporate responsibility reports assured by an independent third party, assurance over sustainability reports is also currently mandatory in some European countries, for instance in France and Sweden.

The accountancy profession, applying the IAASB framework (or national equivalent), is equipped to respond to assurance needs over NFI. If NFI is 'assurable' as per the characteristics of any assurance engagement, and if there is market demand, the accountancy profession is able to respond to this call with relevant skills, appropriate standards, and proven experience to deliver quality. Demand related to assurance on NFI will depend upon the benefits that the users expect and experience. It is also important that the profession has active input in shaping the solutions to meet this potential demand. From the entity's side, internal systems should be in place to collect the necessary data as, in theory, insufficiently robust systems would pose a problem in terms of whether assurance could be provided. For example, where systems are lacking, it may be impossible to assess the completeness of the reported information.

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In practice, according to the profession's experience to date, assurance over sustainability or corporate responsibility reports can be either positive or negative. These engagements differ in terms of the work effort provided and the procedures performed, the evidence required to base the conclusion or opinion on, the report issued, and the assurance or comfort level provided. While in some cases positive assurance would be appropriate, there are instances where providing negative assurance is more relevant, for instance as a first step. Whatever the scope of the assurance provided, robust examination and verification procedures are key features of the assurance methodology which are likely to be of the greatest value to users.

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The assurance report, prepared (in most of the cases) in accordance with the International Standards on Assurance Engagements (ISAE) 3000[10], has been instrumental in fostering trust between preparers and users. In some engagements, ISAE 3410 can be also applicable, for instance for greenhouse gas (GHG) statements.

It is worth mentioning that the entity can appoint their statutory auditor as the "independent assurance service provider" which would provide appropriate synergies with the work done in the course of the audit of the financial statements. This service would be subject to legal restrictions on the provision of non-audit services from the statutory auditor.

[10] ISAE 3000 is a generic standard for any assurance engagement other than audits or reviews of historic financial information. It gives comprehensive procedures for evidence gathering processes and assurer independence.

Conclusion

With the experience gained in sustainability and corporate responsibility reporting and assurance, the accountancy profession is a key player in designing the framework and expectation regarding NFI reporting and assurance.

With the experience gained in sustainability and corporate responsibility reporting and assurance, the accountancy profession is a key player in designing the framework and expectation regarding NFI reporting and assurance, and is ready to contribute to national technical consultations and debates.

FEE believes that finding the right answer from the internationally applicable standards perspective is the way forward. International standards for sustainability and corporate reporting and assurance are a strategic priority for the accountancy profession in the future.

Ultimately, a good system for providing reliable insight into environmental, social, ethical, and governance matters is vital if these are to be raised to a higher level in tomorrow's economy. This will help to shed light on what business needs to do to be sustainable in the future and will lead to better decision making in the marketplace.

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WHO WE ARE

FEE represents 50 professional institutes of accountants and auditors from 37 European countries, with a combined membership of over 800,000 professional accountants working in different capacities. As the voice of the European profession, FEE recognises the public interest.

FEE is in the EU Transparency Register (No 4713568401-18).