

## 2017 heralds new non-financial reporting requirements across Europe

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For many large companies across Europe, 2017 marks the introduction of new non-financial reporting requirements addressing issues such as human rights and corruption for financial years beginning on or after 1 January 2017.

Member States were required to introduce the provisions of the Non-Financial Reporting Directive 2014/95/EU (the **Directive**) by 6 December 2016. The Directive amends and expands the reporting requirements in Directive 2013/34/EU (the **Accounting Directive**). It also seeks to harmonise EU-wide corporate reporting requirements, and requires certain large companies to report on a range of non-financial matters relating to their business. This includes reporting in respect of human rights, the environment, employee protections, anti-corruption and bribery and the diversity of management boards.

In most Member States, a certain level of non-financial reporting already exists following implementation of the Accounting Directive but adjustments will have to be made to accommodate these new requirements. In addition, the Directive is at different stages of implementation across the EU. As a result, companies operating in multiple European jurisdictions may be required to comply with slightly differing requirements.

This Paper examines how a number of EU jurisdictions have interpreted and implemented the Directive and considers what you should be doing now to ensure you meet the requirements across Member States.

### Who is caught?

The European Commission's impact assessment suggests that only 2,500 large companies within the EU

currently prepare a non-financial report. It estimates that approximately 18,000 companies will fall within the scope of the new requirements.

The Directive introduces non-financial reporting requirements on certain large undertakings (i.e. those with more than 500 employees on average during the financial year) which are also “*public interest entities*” (**PIEs**).

PIEs are defined as being companies that are:

- admitted to trading and issue transferable securities on an EU regulated market;
- a credit institution;
- an insurance undertaking; or
- designated as a PIE by a Member State due, for example, to the size, type of business or number of employees.

### The new requirements

The key provision of the Directive is contained in Article 1 (inserted as Article 19a of the Accounting Directive), which requires that large undertakings are to “*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*

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*matters, respect for human rights, anti-corruption and bribery matters”.*

The information must include a brief description of the company’s business model, a description of the policies pursued by the company in relation to the non-financial matters, the outcome of these policies, a description of the principal risks relating to non-financial matters and how the company manages those risks. If the company does not pursue policies in relation to one or more of the non-financial matters, it must give a clear and reasoned explanation for not doing so.

The Directive provides undertakings with some flexibility in a number of areas, including the precise form in which disclosures are made.

## **Implementation of the Directive in Member States**

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### ***The UK***

For many companies established in the UK, the proposed reporting requirements will not be entirely new. The Companies Act 2006 (Strategic Report and Directors’ Report) Regulations 2013 (the **2013 Regulations**) amended the Companies Act so as to require certain non-financial matters to be covered in large companies’ strategic reports, and for quoted companies to provide information on their greenhouse gas emissions in their directors’ reports.

The 2013 Regulations require companies (other than small companies) to prepare a strategic report for each financial year. Large companies must already provide analysis in their strategic report using non-financial key performance indicators. By virtue of the 2013 Regulations, a quoted company’s strategic report must include information on environmental, social and community and human rights issues (the **Strategic Report Requirements**).

The Strategic Report Requirements are, in many ways, similar to the matters which must be disclosed under the Directive. As such, few surprises should be in store for large UK companies already comfortable with the Strategic Report Requirements.

However, certain obligations in the Directive diverge from the current reporting requirements. For example, in relation to the scope of matters to be reported, the Directive requires anti-bribery and corruption matters to be considered, something not currently dealt with under the Strategic Report Requirements. In the same way, companies which currently provide statistical information on such topics as gender diversity will also need to consider more detailed reporting on how policies in this area are being implemented.

Further, the focus on PIEs will mean that those UK companies required to report pursuant to the Directive will not align entirely with those subject to the Strategic Report Requirements. For example, while the UK rules, as they currently stand, apply solely in respect of quoted companies, the Directive’s obligations will apply to certain categories of non-quoted companies.

Additionally, there may be quoted companies which are subject to the Strategic Reporting Requirements but, due to their limited size (in terms of employees), are not subject to the Directive. This mismatch in disclosure requirements was one of the matters raised in the UK Government’s February 2016 consultation on the implementation of the Directive.

The Directive has been implemented via The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 (the **2016 Regulations**). These Regulations apply to companies and qualifying partnerships with financial years beginning on or after 1 January 2017.

The 2016 Regulations amend Part 15 of the Companies Act 2006 by:

- setting out the requirement for companies and groups which are large PIEs and which have more than 500 employees in a financial year to prepare a non-financial information statement as part of their strategic report;
- specifying the content of the non-financial information statement;
- allowing the company to fulfil some of the information requirements by utilising a national, EU-based or international reporting framework;

- exempting from disclosure information about impending developments or matters in the course of negotiation, if the disclosure would, in the opinion of the directors, be seriously prejudicial to the commercial interests of the company (provided that such non-disclosure does not prevent a fair and balanced understanding of the company's development, performance or position or the impact of the company's activity); and
- permitting companies which may fall in and out of the qualification criteria from year to year as a result of financial or workforce-related changes, to comply voluntarily in the years where they fall out of scope.

To date, no companies have been designated as PIEs by the UK Government.

The implementation of the 2016 Regulations will be supported by FRC guidance on the Strategic Report. The FRC is expected to publish draft guidance for consultation in the summer of 2017.

### ***The Netherlands***

The Directive has not yet been fully implemented in the Netherlands, but is expected to be shortly. Article 2:391 of the Dutch Civil Code (**DCC**) has been amended to provide the basis for implementation. This Article of the DCC already contains various obligations to provide an accurate overview of the company's financial situation in their management report which must be in line with the company's annual financial statement (*bestuursverlag*).

The details of the Directive will be implemented through the Decree on the Publication of Non-Financial Information, a draft of which was published on the Government's website on 10 January 2017. Although it is not clear when the Decree will be formally adopted, the draft version expressly stipulates that the requirements will apply retrospectively from 1 January 2017 onwards.

The Directive builds on existing obligations implementing the Accounting Directive which already require certain large undertakings to disclose certain non-financial information in their management report, including information using non-financial key

performance indicators on environmental and employee matters in the context of the undertaking's business model, policies and risks. The draft Decree specifies that the non-financial information should also include information on human rights and anti-corruption matters. However, concerns have been raised in Parliament that, by specifying these matters, the Directive may in fact limit current reporting practice in the Netherlands, rather than broadening it.

The draft Decree follows the same definitions and criteria as the Directive. It applies to PIEs with, on average, more than 500 employees. The company's balance sheet value or turnover must also meet the qualifying level of EUR 20 million or EUR 40 million respectively. In line with the Directive, the Decree also contains an exemption from the reporting obligation for subsidiary undertakings if they are included in another undertaking's consolidated management report or separate report. The Dutch Government has not indicated that it intends to designate additional companies as public entities beyond those which meet the qualifying criteria under the Directive.

The DCC and the Decree contain provisions describing the information which should be disclosed. Companies may also use non-statutory guidance such as the Global Reporting Initiative Guidelines and the OECD *Guidelines for Multinational Enterprises*.

### ***France***

The Directive has not yet been implemented in France. However, Parliament has recently passed a bill enabling the French Government to enact the legislation required to implement the Directive. The Directive must be implemented within six months of the publication of this legislation.

However, given existing corporate reporting obligations, only limited legislative measures are likely to be required.

Since 2001, listed companies have been required to incorporate information on their social and environmental impact in their annual report.<sup>1</sup> In 2010, these requirements were expanded to apply to (i) listed

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<sup>1</sup> Under Article. L. 225-102-1 of the Commercial Code.

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companies and (ii) unlisted companies which meet at least one of the following criteria: total assets or turnover exceed EUR 100 million or the average number of employees during the fiscal year is equal to or exceeds 500. Group companies may issue a consolidated report. The information provided in the annual report is subject to independent third party certification. It is estimated that between 1200 and 1600 French companies will fall within the scope of these obligations.

Despite the existence of corporate non-financial reporting legislation in France, there are differences between the current regime and the new requirements. These are likely to bring a greater number of companies within the scope of the reporting requirements. For example, the Directive contains a lower financial threshold on turnover (EUR 40 million) and the balance sheet (EUR 20 million) than the existing level of EUR 100 million for both turnover and balance sheet. The Directive will also extend non-financial reporting obligations to SARL<sup>2</sup> (limited liability companies) and SAS<sup>3</sup> (simplified joint-stock companies) for the first time.

Under current rules, corporate non-financial information must be reported in the company's mandatory annual report.<sup>4</sup> It is likely that this approach will be followed in the legislation implementing the Directive. The Government may also publish administrative guidelines to assist those making the reports following implementation of the Directive.

### Germany

The Directive has not been implemented in Germany yet although the Federal Government published its implementing Bill<sup>5</sup> on 21 September 2016. It is expected that the Bundestag will pass the bill in the early part of this year. Implementing the Directive will require amendments to the parts of the German Commercial Code (*Handelsgesetzbuch*, **HGB**) relating to the management reports (*Lageberichte*) and the consolidated

management reports (*Konzernlageberichte*) of certain large corporations.

Currently, large corporations<sup>6</sup> must include non-financial performance indicators for the company's business in their management report.<sup>7</sup> This includes information on environmental and employee issues relevant to understanding the development of the company's business or position.

The Bill for implementing the Directive will build on the requirements of the relevant existing provisions of HGB. It will expand a number of obligations, most importantly, requiring information on social matters, human rights and anti-corruption and anti-bribery issues.

Although the original concept paper published by the Federal Ministry of Justice and Consumer Protection (*Bundesministerium der Justiz und für Verbraucherschutz*) for the implementation of the Directive into German law considered going further than the obligations finally contained in the Directive, the Federal Government bill closely follows the Directive. The Bill therefore contains the same definitions and qualifying criteria as the Directive. It requires large undertakings which are PIEs with more than 500 employees on average to prepare a non-financial statement as part of their (consolidated) management report.

The new obligations apply to any corporation (*Kapitalgesellschaft*), limited liability commercial partnership (*haftungsbeschränkte Personengesellschaft*), cooperative (*Genossenschaft*), credit institution and insurance company which meets the following criteria cumulatively:

- it is a large corporation (as defined in Sec. 267 para. 3 HGB) i.e. it exceeds at least two of the following criteria: a balance sheet total of EUR 19,250,000; sales proceeds of EUR 38,500,000; and/or an average of 250 employees during the fiscal year. Capital market-oriented corporations (*kapitalmarktorientierte*

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<sup>2</sup> *Sociétés à responsabilité limitée.*

<sup>3</sup> *Sociétés par actions simplifiée.*

<sup>4</sup> Under Articles L. 225-100 et seq. of the Commercial Code.

<sup>5</sup> *Entwurf eines Gesetzes zur Stärkung der nichtfinanziellen Berichterstattung der Unternehmen in ihren Lage- und Konzernlageberichten.*

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<sup>6</sup> As defined under Sec. 267 para. 3 HGB.

<sup>7</sup> Sec 289 para. 3 HGB.

*Kapitalgesellschaften*) are always deemed to be large corporations; and

- it has an annual average of more than 500 employees; and
- it is capital market-oriented, i.e. it uses an organised market as defined in Sec. 2 para 5. of the Securities Trading Act (*Wertpapierhandelsgesetz, WpHG*) or has applied for admission of securities for trading on an organised market.<sup>8</sup>

Credit institutions and insurance companies must also prepare a non-financial statement if they have more than 500 employees and exceed a balance sheet total of EUR 20 million or sales proceeds of EUR 40 million.

Capital market-oriented parent undertakings (*Mutterunternehmen*) must also prepare a non-financial statement if:

- their balance sheet total or turnover exceeds the thresholds set out in Sec. 293 para. 1 HGB, i.e.
  - (a) at least two of the following three criteria are met on the close of the fiscal year of both its annual financial statement and on the close of the preceding fiscal year: (i) the balance sheet totals of any parent and subsidiary required to be included in a consolidated financial statement exceed a total of EUR 23,100,000, (ii) the turnover of the parent and the subsidiary in the consolidated financial statements exceed EUR 46,200,000 in total, (iii) there is an average of 250 employees or more in the parent and subsidiary's consolidated annual financial statement or (b) at least two of the following three criteria are met in the company's consolidated financial statements on the close of the fiscal year and on the close of the preceding fiscal year: (i) the balance sheet total exceeds EUR 19,250,000, (ii) the turnover exceeds EUR 38,500,000 and/or (iii) the parent and the subsidiaries included in the consolidated financial statements employ more than 250 employees;

- the undertakings included in the consolidated financial statement (*Konzernabschluss*) and the parent undertaking each have an annual average of more than 500 employees; and
- the exemptions set out in Sec. 291 and 292 HGB do not apply i.e. the parent undertaking is not itself a subsidiary of another parent which prepares consolidated financial statements and a consolidated management report.

A subsidiary undertaking (*Tochterunternehmen*) is exempted from the obligation to prepare a non-financial statement if it, and its subsidiaries, are included in either the consolidated management report or the separate report of its parent undertaking.

The non-financial statement is placed in the companies' management report (or consolidated management report). The Bill to implement the Directive provides for three different forms of report:

- including the non-financial information in different parts of the (consolidated) management report;
- bundling the non-financial information in a separate section of the (consolidated) management report; or
- preparing a separate non-financial report.

In addition to the existing obligation to report on environmental and employee-related matters, the report must include information on social matters, human rights and anti-corruption/bribery issues.

Large listed companies (*börsennotierte Aktiengesellschaften*) will also be required to describe the diversity policy of the undertaking's administrative, management and supervisory bodies within their (consolidated) declaration on corporate governance.

### *Spain*

The Directive has not yet been implemented in Spain although this is imminent. Implementation will build on the existing reporting requirements. Currently, companies must report on certain non-financial issues (such as those which are environmental and employee-related) in the management report (*Informe de gestión*) to the extent necessary for

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<sup>8</sup> Securities within the meaning of Sec 2 para.1 sentence 1 WpHG means specifically: (i) shares in companies; (ii) other investments equivalent to shares in German or foreign legal persons, partnerships and other enterprises plus certificates representing shares and (iii) debt securities.

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understanding the growth, performance and position of the company.

State-owned companies, public corporations associated with the State and mutual insurance companies associated with Social Security arrangements are required to publish an annual Corporate Social Responsibility (CSR) report. Joint stock companies may publish their CSR policies and results annually and those joint stock companies with more than 1,000 employees must provide this report to the State Corporate Social Responsibility Council.

Although the Directive has not been implemented, the obligations are expected to fall on PIEs. Under existing legislation, there is a definition of PIE which may be followed in implementing the Directive, namely:

- credit institutions, insurance institutions and entities which issue securities in the official secondary security market or alternative stock market;
- investment services companies and collective investment institutions which during two consecutive years, at the closing date of each year, have at least 5,000 clients or 5,000 shareholders respectively (and the managing bodies which manage such institutions);
- pension funds which, during two consecutive years, at the closing date of each year, have at least 10,000 participants and the managing bodies of these funds;
- bank foundations, payment institutions and electronic-money institutions;
- any other entities not mentioned above, whose net turnover and average staff during two consecutive years, at the closing date of each year, is higher than EUR 2,000,000,000 and 4,000 employees; and
- corporate groups in which the dominant company falls within one of the above categories.

There is existing non-statutory guidance which companies may choose to follow when reporting, including the Spanish National Stock Markets Commission's *Good Corporate Code of Listed*

*Companies*<sup>9</sup> and the Spanish Ministry of Employment and Social Security's 2014-2020 *Strategy for businesses, public administrations and other organizations for move towards a more competitive, productive, sustainable and inclusive society and economy*<sup>10</sup>.

### **Italy**

The Directive has been implemented in Italy by Legislative Decree No. 254 of 30 December 2016 (the **Decree**). It was published in the Official Gazette (*Gazzetta Ufficiale*) No 7 of 10 January 2017.

The Decree has established a new requirement for PIEs (*enti di interesse pubblico*) to disclose non-financial information concerning the environment, social matters, employee issues, respect for human rights and anti-corruption and bribery matters.

Under Italian law, there were pre-existing obligations to provide a management report (*relazione sulla gestione*) alongside either the consolidated financial statement (*bilancio consolidato*) or a company's individual financial statement (*bilancio individuale*).<sup>11</sup>

The management report must provide an appropriate analysis of a company's situation and management, both as a whole and in the various specific sectors of activity. Prior to the implementation of the Directive, companies could choose to include information on environmental and social/employee issues on a case-by-case basis. There was no requirement to justify the lack of any social or environmental policies by the company, nor did any specific non-financial statement have to be attached to, or included in, the management report, as is now the case.

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<sup>9</sup> *Código de Buen Gobierno de las sociedades cotizadas*.

<sup>10</sup> *Estrategía 2014-2020 para empresas, administraciones públicas y el resto de organizaciones para avanzar hacia una sociedad y una economía más competitiva, productiva, sostenible e integradora*.

<sup>11</sup> This is required under the following provisions: (i) Article 2428 of the Civil Code, article 41 of Legislative Decree No. 136/2015, article 94 of Legislative Decree No. 209/2005 in respect of the individual financial statement and (ii) Article 40 of Legislative Decree No. 127/1991, article 41 of Legislative Decree No. 136/2015, article 100 of legislative Decree No. 209/2005 in respect of the consolidated financial statement.

Under the Decree, PIEs are defined<sup>12</sup> as:

- Italian companies whose transferable securities are admitted to trading on the Italian and European regulated market;
- banks;
- insurance undertakings (*imprese di assicurazione*) which have a registered office in Italy and Italian branches of insurance undertakings with a registered office in a third State which are authorised to operate in Italy; and
- re-insurance undertakings (*imprese di riassicurazione*) with a registered office in Italy and Italian branches of non-EU reinsurance undertakings.

The definition extends the meaning of PIEs provided for in the Directive to include re-insurance undertakings.

The Decree imposes requirements on PIEs which are parent undertakings of a large group which had on average, on a consolidated basis, more than 500 employees during the previous financial year. “Parent undertaking” is defined as a company which qualifies as a PIE, which is required to prepare a consolidated financial statement (*bilancio consolidato*) in compliance with national provisions<sup>13</sup> or with international accounting standards.<sup>14</sup> A “subsidiary undertaking” is any company included in the scope of the consolidated statement of the parent undertaking.

The non-financial statement may be included in the management report or may be issued in a separate report. Under the Decree, the non-financial information must be verified either by an auditor in charge of the statutory audit of the financial statements or by an authorised auditor who has been specifically appointed. The auditor’s report verifying that the information is compliant must be attached to the non-financial statement and jointly published with it on the Companies’ Registry (this will take the form of either

publication of the management report, if the information is included within it, or joint publication of a separate non-financial statement alongside the management report if the non-financial statement is provided separately). The non-financial statement must also be published on the company’s website. The Italian Securities and Exchange Commission (*Commissione Nazionale per le Società e la Borsa*) may also impose additional publication requirements.

As yet, there is no published guidance to assist those making the non-financial statements.

### **What should you be doing now?**

The changes brought about by the Directive should be seen as more evolutionary than revolutionary. However, the overall direction of travel as regards operational and financial transparency is clear.

Given that the new requirements will apply across Europe from 1 January 2017, you should now consider how best to comply. Initial steps to take include:

- assessing whether you are caught as a PIE across Europe and which Member States are relevant for reporting purposes;
- considering the impact of consolidated reporting and whether a group wide statement can satisfy the requirements;
- closely monitoring the implementation of the Directive and the publication of guidance on the new requirements (on a Member State by Member State level);
- determining the nature and scope of the new information to be included in your report (recognising that the topics specifically listed are expressed as a minimum requirement only) and the impact of any distinctions in approach between Member States;
- establishing what steps are required to diligence the matters to be reported on;
- considering your preferred benchmark for reporting (do you wish to be best in class or simply comply with the basic legal requirements?);

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<sup>12</sup> Article 16, paragraph 1 of Legislative Decree No. 39/2010 as amended by Article 1 Legislative Decree No. 254 of 30 December 2016.

<sup>13</sup> Under Legislative Decree No. 127 of 9 April 1991.

<sup>14</sup> As provided for by Legislative Decree No. 38 of 28 February 2005.

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- considering how these requirements fit within your wider CSR/compliance reporting policies;
  - considering whether there may be wider legal sensitivities around the reporting of the issues referred to in the Directive and how these should be managed;
  - developing a step-by-step programme to ensure compliance.

## Key contacts

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