



Directorate-General for Financial Stability, Financial Services and Capital Markets  
European Commission  
1049 Bruxelles/Brussel  
Belgium

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**Public consultation on the revision of the non-financial reporting directive**

To whom it may concern,

We welcome the opportunity to respond to the European Commission's consultation on the Non-Financial Reporting Directive. The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group and Corporate Governance Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-size quoted companies.

There are many opportunities on which small to mid-sized companies can capitalise through the use of non-financial reporting, including attracting long term investors, reducing the cost of capital and giving confidence to wider stakeholders about their understanding and management of environmental, social and governance issues. However, the current issues identified by the European Commission concerning comparability, volume and quality of non-financial disclosures must be addressed for these opportunities to be realised.

We urge the European Commission to prioritise addressing these issues before broadening the scope of the Directive and mandating imperfect standards on small to mid-sized companies. While we agree that a standard for small to mid-sized companies would be helpful, we emphasise the importance of proportionality and encourage the Commission to make any standard voluntary in the first instance with a period of transition to avoid high costs being incurred at one point in time.

Appendix A sets out our position in further information and views on the questions included in the consultation.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward  
Chief Executive

## APPENDIX A

### Chapter 1 Quality and scope of non-financial information to be disclosed and general comments

To address the problems with the comparability, volume and quality of non-financial disclosures identified by the European Commission, the objective of the review should be to deliver a more aligned, proportionate and principles-based Non-Financial Reporting Directive (NFRD). The review should focus on supporting companies currently within scope to improve the quality of their disclosures, not extending the current scope.

There is a large discrepancy between larger companies who tend to have more mature and sophisticated process and procedures for analysing, quantifying ESG risks and disclosing non-financial information than small-mid-sized companies (SMEs), many of whom are in a developing or transitional phase with regards to non-financial disclosures, particularly environmental and social disclosures.

Therefore, a gradual, voluntary approach which takes into account the specific features of SMEs should be pursued by the EU before it considers expanding the scope of the Directive.

Further, as the EU develops and delivers its Sustainable Finance Action Plan (Action Plan) it should place careful emphasis on harmonising and integrating the various legislative instruments such as the Taxonomy Regulation, Disclosure Regulation and Benchmark Regulation which place different requirements on the various actors such as companies, investors and those providing financial advice and products. At present the regulatory constraints relating to ESG are marked by their lack of clarity, extreme complexity and rapid change both at an international, European and national level.

The complexity of the developing ESG environment is particularly difficult for small companies who do not have the monitoring, research coverage and technical resources of large companies and therefore have difficulty keeping pace with changing legislative requirements and understanding how to report ESG information in a way which is meaningful for investors. ESG is generally discussed at board level, however SMEs do not tend to follow recognised standards and frameworks because of the resource and financial cost and also the limited demand from investors, who tend to favour direct engagement with the board on ESG issues.

Further SMEs are confronted with numerous questionnaires and ratings from investors and rating agencies based on different methodologies and definitions. The lack of commonality in disclosure requests makes it resource intensive for SMEs to make non-financial disclosures which meet the different needs of investors and ratings providers. As such it would be helpful if the Commission considered how other actors such as investors and ratings agencies request disclosures and consider how it could encourage uniformity or consensus of disclosure requests for the largest companies. Separately a proportionate, voluntary standard/ framework for SMEs could be helpful in this respect.

It is therefore recommended that the various elements of the Action Plan are broken down and assessed with an eye to how they will impact SMEs directly and indirectly. A holistic approach should also be taken to ensure the various pieces of regulation and guidance are aligned and streamlined to minimise administrative burden on all actors within the finance sector. This will minimise the risk of SME's being disproportionately affected and help to prevent the cost of capital rising for SME's.

In response to question 4, we do not believe that companies should be required to disclose additional non-financial information in relation to intangible assets. We believe that the narrative information that is expected by IAS 38 – which outlines the accounting requirements for intangible assets – should be sufficient.

Whilst we recognise that there is a need to improve the reporting of intangibles, as technology becomes more prevalent and the potential number of intangibles is likely to increase markedly, there is considerable uncertainty associated with disclosure around intangibles, namely in terms of their recognition and measurement. As a result, the inclusion of these assets in disclosures often creates confusion and raises

questions for users. Given that there is a possible lack of sufficient and appropriate disclosures, which is causing concern for further non-financial information to be provided, prior to a requirement for companies to disclose additional information regarding intangible assets, a consistent set of principles needs to be established.

Any additional requirements relating to intangible assets must take into consideration the additional costs and administrative burden that this may place on smaller companies, bearing in mind their more limited resources. Smaller companies should be encouraged, but not required, to report on intangible assets in their disclosures only when they believe it provides useful and necessary information for those who access their disclosures and when they have the capacity to do so.

In relation to taxonomy (Question 7), there is the need to align any future version of the NFRD with the Taxonomy Regulation in order to create a comprehensive and harmonised piece of legislation. It should be noted that at present the Taxonomy Regulation relates solely to 'green' economic activity with no accompanying harm, over time this should be extended to include 'S' and 'G' activities.

## **Chapter 2. Standardisation**

In recent years there has been a proliferation of public and private sector standards, frameworks and initiatives which has contributed to the problems identified above. The development of a common standard could help to resolve some of the issues identified. However a one size fits all approach will not work and could further exacerbate the problem particularly for SMEs.

It is important that non-financial reporting requirements are proportionate to size and activities of the company. To this end a simplified standard for SMEs, incorporating sector specific elements and good practice examples would be useful and help to improve non-financial disclosures over time. It should be emphasised that any standard developed should be voluntary at this stage.

While at present our members do not consider there is a single standard which meets their needs completely, elements of a number of the existing standards are routinely used by companies depending on their activities or are adopted through national or international legislation and initiatives, for example the TFCF.

Therefore, it is important that any future EU standard for SMEs is compatible and converges with major existing reporting initiatives to avoid companies having to comply with several standards if they operate worldwide.

SMEs as the preparer and investors and rating agencies as the users of non-financial information should be put at the forefront of the standardisation process to ensure the practices of industry are reflected and the standard/framework is operational. Further it is important that the EU cooperates with other major non-EU jurisdictions and non-EU based investors to ensure the standard has standing outside the EU.

## **Chapter 3. Application of the principle of materiality**

Responding to question 23, we do not believe there is a need to clarify the concept of material non-financial information due to the possibility that the concept will become overly rigid and will not allow for sufficient flexibility for a company's individual circumstances. Additional clarification on the concept would serve to add to the complexity of understanding and applying this for SME listed entities. This will hinder a company's ability to appropriately perform their materiality assessment and determine what information is material to their business. A company must have the ability to define what material information is to them, having sufficient flexibility to conduct this assessment specific to their individual circumstances and according to their activity and sector.

Further in response to question 24, we see that there is benefit in a company providing a disclosure that briefly explains how the materiality assessment was conducted. The information provided within this disclosure is

useful for auditors and other users of the information as it contextualises the non-financial information provided, helping them to understand why some information is included and why other information is not.

#### **Chapter 4. Assurance**

As a general comment, we believe that the provision of assurance for non-financial information should be granted by independent third parties who are accredited in verifying the non-financial information disclosed by companies. To this extent, it should be emphasised that non-financial verification is inherently different from financial audit, both in terms of the nature of the information that is verified as well as it often containing a combination of quantitative and qualitative information, with qualitative information being inherently more difficult to verify. Within the current framework, audit acts as a reasonable form of assurance that relates predominantly to financial statements. As such, it should not be automatically assumed that auditors are competent in non-financial verification.

#### **Chapter 5. Digitalisation**

There is a growing demand from stakeholders including policy makers and regulators to digitise data and structure data in a way which facilitates automated processing and comparison of data. However as non-financial information is generally qualitative and explanatory, digitisation may be of limited value and when taken out of context misleading. That said, there is some disclosure which is quantitative where there may be value in digitisation.

It is our understanding that tagging blocks of text at this stage would bring little added value nor significantly improve the dissemination and use of data, when the additional burden and costs for preparers is weighed against the benefit. However, this should be revisited as non-financial reporting evolves and matures.

#### **Chapter 7. Scope**

As mentioned above, the issues identified by the European Commission concerning comparability, volume and quality of non-financial disclosures by larger companies already included within the scope of the directive must be addressed before the scope of the directive is broadened to capture smaller companies.

At present, there is a large discrepancy between larger companies who tend to have more mature and sophisticated process and procedures for analysing, quantifying ESG risks and disclosing non-financial information than small- mid-sized companies (SMEs), many of whom are in a developing or transitional phase with regards to non-financial disclosures, particularly environmental and social disclosures.

For this reason, if the scope was widened further to capture smaller companies, the non-financial disclosures provided by most smaller companies would be of limited value to investors and a disproportionate level of cost and administrative burden would be placed on smaller quoted companies.

Instead a gradual, voluntary approach which takes into account the specific features of SMEs should be pursued by the EU before it considers expanding the scope of the Directive.

While we agree that a standard for small to mid-sized companies would be helpful to SME's as they develop and mature in their understanding and output of non-financial reporting, we emphasise the importance of proportionality and encourage the Commission to make any non-financial disclosures voluntary in the first instance with a period of transition to avoid high costs being incurred at one point in time.