BUSINESSEUROPE

POSITION PAPER

10 July 2018

The Fitness Check on the EU Framework for Public Reporting by Companies

Commission Consultation

The EU financial reporting framework applicable to all companies

Companies operating cross-border within the EU

BusinessEurope strongly supports the use of IFRS for listed companies in Europe and believes that the adoption of IFRS has achieved its primary objective of comparability and transparency within the EU. Similarly, we think that the Accounting Directive has achieved a satisfactory level of harmonisation of public reporting across the EU.

These benefits have been achieved at the cost of a substantial amount of effort on the part of the companies concerned. Any further move towards uniformisation of legal and fiscal regimes across Europe will come at a cost and should be envisaged only if there is a clear and collective demand from companies, investors, constituents and national governments to justify it. Although we acknowledge that differences in national legal requirements do exist, we think that companies have become used to dealing with these. We have not heard any strong evidence to suggest that European and national regulations in their current state represent significant barriers to cross-border trade or other business activity within the EU and we do not think that any further steps in this direction are required at present.

Individual member states are better placed, in our view, to determine what is required in the areas of legal and tax regulations for entities within their jurisdiction with regard to the economic and budgetary circumstances prevailing in the nation. Furthermore, we believe that, in general, local stakeholders of non-listed entities can best be protected at the national level rather than at the EU-level.

Reduction of barriers to doing business cross-borders caused by different national accounting standards.

As stated above, given the strongly positive impact that the IFRS Regulation and the Accounting Directive have had, we are not convinced that the removal of the remaining differences between national GAAPs, and in particular, the removal of the available options in the Accounting Directive, would lead to any significant further benefits. The differences in the national accounting approaches tend to reflect the particularities of the economic and fiscal status of the individual Member state - notably in the link between accounting and taxation - and we think that the Member states should continue to determine what is required in their particular circumstances.

However, it would be helpful to some listed groups if Member States were to have an option to allow subsidiaries to publish individual financial statements on an IFRS measurement and presentation basis with much reduced disclosure requirements

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compared to IFRS, if certain conditions were met. It might also be worthwhile in this respect to pursue a review of IFRS for SME's to establish whether these could provide a useful basis for such reporting. However, such options should not supersede any national requirements as this may cause difficulty for the individual Member State in achieving its own fiscal and budgetary aims.

Overall, we think that the current European framework represents a satisfactory balance between EU-wide harmonisation and a necessary accommodation of each Member State's individual circumstances. Change and uncertainty tend to lead to a lack of efficiency and increased costs, and therefore stability and predictability of regulation are preferable. Apart from possible consideration of the Member-State option discussed above, we do not think that a revision of the Accounting Directive should be a priority for the Commission at present.

Tax reporting

We note that the Commission is currently working on the harmonisation of tax bases for the taxation of corporate profits and the creation of a framework for the free flow of non-personal data in the EU- the Common Corporate Tax Base (CCTB).

We are of the view that this is a political question to be determined by individual member states in accordance with the will of their constituencies. In any event, we do not think that any serious conclusion can be drawn about the usefulness of further alignment until the CCTB has been in place for a number of years and has proved its worth.

Other matters
Harmonisation of storage of bookkeeping and similar data

Currently there is no uniform guidance or regulation for the electronic archiving of bookkeeping and related documents across the EU. This situation can hinder the establishment of service centres or "cloud" storage centres. A degree of EU-wide harmonisation in this respect would be helpful to companies.

The content of financial information

We think that the content of financial reporting at present is sufficiently relevant and complete at present for entities which apply IFRS in the scope of the Europe regulation. The information presented in the financial statements is sufficient to provide a clear picture of the financial position of the entity, and the additional information provided in the notes and the management report should be adequate to enable users to establish their own views on the prospects and value of the entity.

Given the recent and continual concern about the volume of disclosures required of companies, we do not think that the EU should develop additional specific requirements. We would expect users in specific sectors to discuss their requirements with companies in the sector and that such "market forces" would result in appropriate targeted disclosure. This would, in our view, tend to be more useful and relevant than general disclosure requirements.

Alternative performance measures

There are few performance indicators which are common to many or all sectors and entities. IAS 1 deals with some of these at present and the IASB is currently working on alternative performance measures (APMs) in the context of its primary financial statements project. ESMA has developed its own guidelines to provide discipline around the definition and disclosure of APMs.

By their nature, alternative performance measures are specific to sectors and even companies. Industry associations have also developed agreed APMS for their members. We do not think that it is necessary for any further definitions or requirements for APMs to be imposed at this time.

The EU financial reporting framework for listed companies

As already stated, BusinessEurope strongly supports the use of IFRS in Europe and shares the aspiration that IFRS should become the globally accepted set of accounting standards.

We believe that the adoption of IFRS for use in the EU has achieved its primary aim of achieving a "level playing-field" for European listed companies, both in European and in many global capital markets. The abolition by the SEC of the requirement to reconcile from IFRS to US GAAP has been a notable contribution to this for European companies registered on US Stock Exchanges. However, the failure of the IASB and the FASB to agree on identical recent standards, the failure of some world-leading economies to adopt IFRS and the slow rate of progress on the disclosure initiative are a source of concern for European companies. Furthermore, we are concerned that detailed EU requirements which are not reflected by other countries, (such as, for example, country-by-country reporting) may actually place EU companies at a disadvantage.

We think that the European endorsement mechanism is functioning satisfactorily, and that the reorganisation of EFRAG has helped streamline the process. Our perception is that the communication between EFRAG and the European institutions is now better and that today the EU Parliament, to take one example, is involved earlier in the endorsement process than before. However, the slow pace of some steps in the EU process is of concern, since it has led to some late approvals of minor IFRS amendments, and this should be reviewed.

Europe's capacity to influence significantly the IASB is of vital importance to ensure that European interests are not adversely affected by new or amended financial reporting standards. For this reason, the current standard-by-standard endorsement procedure should be maintained. In addition, intervention with the IASB at an early point in its development of standards is also essential. We believe that since its reorganisation following the Maystadt report, EFRAG has shown that it can be the European voice on an authoritative basis and that it can influence the process of the IASB to minimise potential difficulties at the endorsement stage.

Adding new endorsement criteria in the IAS Regulation (e.g. sustainability or long-term investments)

We think that the requirement in the IAS Regulation that endorsement of IFRS must be conducive to the European public good is of vital importance. This concept is vague and can therefore be interpreted in different ways. We agreed with the Maystadt report that this criterion needs to be clarified, but we thought that the two components that were suggested (not endangering financial stability and not hindering economic development) were also vague. Some of our member federations were at that time concerned that adding these criteria could increase the likelihood of non-endorsement of standards whilst others believed that these additions could be helpful to better explain the existing endorsement criteria.

We note that the criteria proposed in the Maystadt report have been incorporated into the endorsement process without any amendment of the IAS Regulation, by means of a request by the European Commission that they be addressed by EFRAG in its endorsement advice. We also note that criteria discussed in the Fitness check, e.g. sustainability (environmental and social aspects) and potential effects on long-term investments already have been explicitly raised by the European Commission in its request for endorsement advice for IFRS as a part of an Impact Assessment. An example of this is the request for endorsement advice from EFRAG on IFRS 17 *Insurance Contracts*. Although the question of sustainability is a valid concern for the economy and society at large, we are not convinced that sustainability is a relevant consideration for accounting standards and are dubious about whether it can be adequately defined in endorsement criteria. In addition, for long-term investment to be included in the criteria for endorsement, a clear and operational definition would need to be provided to EFRAG, and this may be difficult to articulate in this context.

Adding these as new specified endorsement criteria to the IAS Regulation would give them more weight in the assessment of European public good than other non-specified criteria. Some of our member federations are concerned that this could lead to an imbalanced assessment of the European public good or more non-endorsement of IFRS, which would be detrimental to trying to achieve a global financial reporting standard.

We think that the current, holistic approach to endorsement which includes an assessment of sustainability and long-term investment as part of the impact assessment is the appropriate and balanced way to deal with these aspects of the economic impact of a standard. BusinessEurope therefore does not support adding further criteria to the endorsement provisions of the IAS Regulation.

The addition of a carve-in mechanism to the IAS Regulation

BusinessEurope understands that a “carve-out mechanism” refers to the possibility of modifying a standard to some extent, by adding or removing provisions to or from it, without going as far as to reject the whole of the standard. We are in principle opposed to such a mechanism because it is contrary to the objective of a set of global accounting standards and might lead to a fragmentation of “IFRS”, thereby diminishing its global status. We note, however, that a limited number of “carve-ins” has in effect been made to IFRS even in the absence of such a formal mechanism.

The endorsement process is important to demonstrate EU's sovereignty, but the ultimate goal must be to ensure that the IASB takes the concerns of Europe seriously during the standard-setting process. Some think that this may not be the case when IASB knows that EU can just modify a standard that is not exactly in line of the view of the EU. These members believe that a "yes-or-no" endorsement process is more powerful. However, some think that the real probability of a "no endorsement" decision is so remote that the IASB can ignore it. Others are of the view that a carve-out option should be available as a last resort in limited carefully defined circumstances in order to make a standard operational in the European context. This would be helpful in cases where the chronology of the IASB process is sub-optimal, or leads to conflicts between standards, such as in the case of IFRS 4, IFRS 9 and IFRS 17.

Furthermore, we think that the EC should endeavour to enhance the status of IFRS as endorsed for use in the EU by the negotiation of equivalence agreements. This would protect EU companies that are also listed outside Europe from being detrimentally affected by delays or even rejections of standards in the endorsement process. It might also encourage the IASB to take more account of the views of the EU, its largest "customer".

In conclusion, we note that after some 15 years or so of experience of IFRS and the endorsement process our members still have different views of how the endorsement process should work. We think that this shows that a fundamental and transparent debate of all aspects of the question, including, but not limited to, the consequences of non-endorsement and the amendment of IFRS standards by the EU, and the question of equivalence, would help gain a clear view of how the issue could be progressed.

Introduction of an EU Conceptual Framework or the endorsement of the IASB Conceptual Framework

BusinessEurope does not support the introduction of an EU Conceptual Framework or requiring endorsement of the IASB Conceptual Framework. If this were introduced, divergence from IFRS as adopted by the IASB, would almost be guaranteed, especially if this is done in conjunction with additional endorsement criteria.

EU minimum formats for financial reports

BusinessEurope does not support introducing an EU minimum lay-out for financial reports for listed companies. This would bring another layer of divergence from IFRS (i.e. IAS 1). The IASB is currently working with a project on Financial Statement Presentation. We believe that providing constructive input into that project is the right way forward.

Country-by-Country Reporting

Country-by-country reporting for extractive industry and forestry was brought in the EU Accounting Directive as mean to fight corruption. The proposal to introduce public country-by-country reporting on taxes is motivated by a completely different purpose, i.e. to fight tax fraud and tax evasion. We reiterate our comment that these requirements do not contribute to achieving a level playing field for European companies in the global economy.

BusinessEurope welcomes the European Commission's objective to fight tax fraud and evasion. We agree with the principle that businesses should pay taxes in line with where actual profits are generated, and we have provided our support to the recently implemented rules by the EU, requiring companies to report tax information on a country-by-country basis which is then shared between tax authorities ('Non-public CBCR').

However, we continue to be concerned by the Commission's proposal for the EU to unilaterally require public country-by-country reporting by amending Directive 2013/34/EU ('Public CBCR'). Implementation of this proposal would damage the attractiveness of the EU as an investment destination for foreign direct investment (FDI), ultimately reducing overall levels of corporate tax receipts and growth in the EU. Public CBCR would jeopardise the consensus reached at OECD level, after two years of negotiations, on the automatic exchange of CBCRs among tax authorities (BEPS Action 13). The Commission's proposal undermines the role of the tax authorities who have the expertise, and, supported by the OECD agreement, the information to properly enforce tax rules and would not support an informed discussion of companies' tax liabilities by instead providing information to the public that is susceptible of incomplete and misguided interpretation. The proposal may also be regarded as unconstitutional in some Member States. Moreover, companies required to report publicly on top of tax information that is already provided in financial reporting may be forced to provide insight into their business strategies that competitors may not otherwise be able to discern. The proposal for public CBCR is also quite disproportionate in relation to the observed size of the problem; the OECD calculates that only around 5% of corporate tax revenues are currently misallocated between countries.

Digitalisation

Access to financial statements should be facilitated through a national access point and national registers should provide – free of charge – the financial statements in at least a pdf-format or similar readable format. The access point could provide links to the companies' websites where the detailed information is provided if it is a listed entity.

Mandatory formats based on outdated technology like XBRL will not facilitate exchange of financial information. EU should not strive to prescribe standardized labels or concepts for public reporting by companies. We believe that new technology should be employed by the authorities and would like to highlight that current software can extract structured financial data from pdf's and other readable documents. Requirements should make use of modern and recent technological developments like AI.

We do not think that companies should bear the cost of putting in place and maintaining digital reporting systems that are not used by the company for its own purposes, including its communications with investors and analysts. Ultimately it is the shareholders who bear these costs and not those third parties who nonetheless benefit from the information provided.

In the long term, the reporting should be secured in some shape or form. New technologies like block-chain should be considered, so we do not believe that EU legislation should prescribe the method – but rather the principles and objectives.

Non-financial reporting framework

Disclosure/reporting as part of a process

More and more companies are disclosing information on the non-financial aspects of their business, and more generally on their CSR and sustainability activities. The 2017 study of corporate reporting by KPMG shows once again a rise in reporting in Europe.[1] This shows that European businesses are responding to the need for transparency and informing various stakeholders of their activities.

It is important to bear in mind that disclosure of non-financial information is not necessarily linked to responsible or accountable business operations. Disclosure/reporting is only one part of a process. Other elements, such as setting up internal processes, integrating assessment of non-financial aspects/risks into business strategies and engaging with relevant stakeholders, are equally important. These actions are now increasingly at the heart of business practice, in particular for large, listed companies.

Implementation of the EU directive

The EU directive on disclosure of non-financial information and diversity information requires those companies included in the scope to start reporting in 2018. Therefore, it is too early to assess the effectiveness of the directive overall, whether it has met specific objectives, the costs incurred by companies and the impact on their global competitiveness. We also believe that it is too early to proceed with a review of the directive.

Once implementation by companies is more advanced, it would however be useful for the European Commission to compare the administrative burdens and costs caused by the new directive and possible benefits. It is positive that the directive provides for some elements of flexibility in terms of national transposition, however in such an assessment it would be important to also take into account the national transposition measures, as well as other national/regional reporting obligations.

It is important that measures are not taken at the EU level which increase the overall reporting burden on companies. In this respect, we note that the Commission is looking into the possibility of reporting on non-financial information (amongst other types of information) containing electronic structured data. We are strongly concerned about this, as it would very likely lead to an additional layer of reporting requirements for companies and make the process much more complicated and burdensome. We are also concerned it may lead to a risk of double reporting. Linked to this, it is unclear what is meant by digitalisation of information, whether this simply means making it available digitally or this is another way of referring to electronic structured data. The provision of data in an "electronic structure" does also not automatically enhance transparency for the data user. Especially in non-financial reporting, context of data is often essential to understand performance adequately. Specifically for companies operating in a number of different jurisdictions, it is not always meaningful to simply aggregate local data to just one figure for the whole company without explaining the context. Therefore, it is important that the

[1] https://home.kpmg.com/xx/en/home/insights/2017/10/the-kpmg-survey-of-corporate-responsibility-reporting-2017.html

existing elements of flexibility are fully retained in the directive as well as the current scope.

We remain concerned that the costs were underestimated by the Commission in the impact assessment accompanying the original proposal for the directive, as they only covered the cost of issuing a non-financial statement. This disregards other costs which may derive from the new reporting requirements, such as: setting up internal systems/procedures, collecting and checking the necessary information (including potentially from suppliers), measurement, control functions, and coordination between different parts of the company. It is also possible that the directive will increase the reporting burden for SMEs, if they are obliged as suppliers to other companies, to provide information to them.

It is also important to bear in mind that whether the costs of disclosure under the directive are proportionate to the benefits it generates. This will differ from one company to another, depending on, for example, whether they were already reporting on the topics covered by the directive. The Commission should take this into account once an assessment is made.

Flexibility necessary for diverse company situations

Companies must have flexibility to put in place structures and systems for reporting which are well adapted to their individual situation, i.e. the sector and markets in which they operate, their size, business activities and relevant stakeholders. This is essential for companies to be transparent and accountable in a way that is supporting their business performance overall. The fact that the current directive allows companies to assess whether or not a topic is material, i.e. relevant to them, and then to tailor their reporting to this, is a crucial flexibility in this respect. Another important aspect is the possibility in the directive to not disclose sensitive business information which would be seriously prejudicial to the commercial position of the undertaking. In contrast, introducing electronic structured data for reporting on non-financial information would hamper the flexibility needed by companies, as it would require a harmonized taxonomy/format for such reporting, including what has to be reported on. It would also be a move towards integrated financial and non-financial reporting, which should remain an individual choice for each company. Whilst in practice some companies are already operating in this way, including by using the framework of the international integrated reporting council, this should not become a legal obligation.

The diversity of companies (structure, geography, goods and services, customer and suppliers also with diverse expectations) also means that ensuring comparability through non-financial reporting is very difficult if not impossible. Therefore, it is not realistic nor desirable for this to be an objective of the EU non-financial reporting framework. Similarly, taking account of the variety of national transposition measures, in particular regarding the companies covered, we continue to question the goal of creating a level playing field in the EU on disclosure.

Companies disclose non-financial information (on a voluntary or mandatory basis) to many different stakeholders, who all have different information needs and expectations. Information also has to be provided in different formats and to a different degree of detail, depending on each stakeholder group. This can be challenging for companies. Despite this, they are well aware of the expectations of stakeholders and react accordingly. The flexibility in the current directive in terms of how companies should report, and the possibility for those companies which have already prepared a report covering the information requested in the non-financial statement, to not provide the non-financial statement, are crucial elements in this respect and should therefore be retained.

It is important to take into account that there are various ways in which companies can be transparent and disclose non-financial information other than by publishing statements and/or reports. Other tools, including providing information via websites, through dialogue or interviews, and in an ad hoc way can be equally effective as regular reports, and can provide information in a more timely way. For analysts and investors, for example, in many cases, reports are much less important than individual one-to-one-meetings. Particularly, when it comes to legislative requirements, companies should have full flexibility to communicate with their stakeholders in the most appropriate and practical way.

Enhancing efficiency of capital markets

The objective of enhancing efficiency of capital markets is important, in terms of improving access to investment for companies. Disclosure of non-financial information by companies to investors will certainly help investors take account of non-financial information in their investment decisions. However, we should avoid that investors place unnecessary burdens on companies to provide non-financial information, taking into account that the market will also determine whether information is adequate or sufficiently quantifiable. It should be for companies – based on communications with their stakeholders - to decide on what information to provide to whom in which format. In the case of investors, this decision will be based on an assessment of whether the additional information obligations and administrative burdens are outweighed by benefits, notably in terms of access to capital. We also see a useful action by the Commission in assessing the extent to which social and environmental information are integrated into investment decisions as opposed to purely financial considerations, and how this has have evolved over time.

Diversity on companies' boards

Achieving the right mix of talents, skills and experience on companies' boards is key for business and diversity can support innovation, creativity and good governance. Companies are always better placed to find the best board composition in terms of skills and competences and this should remain their prerogative. This is the way to devise the most effective strategies that fit a company's specific circumstances. As already highlighted, reporting, including on company diversity policy can be one, but only one, part of the process. This is preceded by companies setting up internal processes, putting in place objectives and in-house indicators to achieve a better gender balance and diversity in their boards. Companies taking such actions should continue to be encouraged, aiming at a multiplying effect.

SMEs and medium-sized companies

SMEs and medium-sized companies do not necessarily have specific resources to disclose social and environmental information. Other means of reporting such as questionnaires to stakeholders, press releases, websites, e-mails or information printed on their products are often better suited to their individual situation. Also, many companies with only local or regional operations already disclose social and environmental information, simply by being close to or involved in the community in which they conduct business. Extending the scope of the directive would put an unjustified heavy burden in terms of costs and administration on a much larger number of companies, which would be of detriment to their competitiveness with no additional benefit for them. In any case, bearing in mind that the directive is only now being implemented fully by those companies covered in the scope, it is much too early to consider a review.

Commission non-binding guidelines

Within the Commission's non-binding guidelines on disclosure of non-financial information it is clearly stated that the guidelines do not create new legal obligations, do not constitute a technical standard and that the non-financial statements which are a legal obligation in the directive cannot be checked in terms of conformity with the guidelines. It would be useful to assess whether this is true in practice at national level and concerning specific stakeholder groups.

We believe that the guidelines would have been more useful for companies if they had been more principles-based. It is not always clear which elements in the guidelines refer to legal obligations covered by the directive and which are optional guidance for companies. Also, the themes covered in the guidelines are broader than those covered in the directive itself. These aspects may create confusion for companies which choose to use the non-binding guidelines to assist them in implementing the directive.

Since the directive only obliges companies in the scope to report for the first time this year, the extent to which the non-binding guidelines have been used and whether they have proved useful should first be assessed before reviewing them. We are not in favour of adding new themes to the non-binding guidelines. The topics that companies have to report on in their non-financial statement are already included in the directive, with more details in the recitals. In any case, it is for companies to decide on which issues they should report, based on whether they are material/relevant to the them.

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