What do investors expect from non-financial reporting?

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Acknowledgements

Thanks to Anders Nordheim, Head of Research, Eurosif, for his contributions to this paper.

Introduction

On 16 April 2013, the European Commission proposed new requirements for disclosure of non-financial information for all large companies in the EU. Investors, being a key audience of corporate reporting, are increasingly looking to assess not just the financial performance of the companies in which they invest, but also the environmental, social and governance (ESG) performance.

In order to gather the views and opinions of the investment community on their use of ESG information and the proposed reporting regime, Eurosif and ACCA conducted a survey of investors, analysts and other stakeholders. The key findings of the survey are presented in this paper.

The information presented in this paper represents:

94 completed surveys

18 countries
including the UK (21%), Netherlands (13%), Belgium (11%), France (11%) and Germany (10%),

responses from analysts and investors from large **mainstream to small** specialist funds.

Key points

Investors' interest in corporate non-financial information is growing. As of 2011, assets managed under investment strategies incorporating non-financial information represented in excess of EUR 10.5 trillion globally, of which almost two thirds are managed by European investors, according to market studies by Eurosif and the Global Sustainable Investment Alliance.

Some key survey findings are as follows:

- The most important sources of non-financial information for investors are sustainability/CSR reports and annual reports.
- A majority of respondents agree that current non-financial information published by companies is linked to the CSR policy. However, they disagree that current reporting is linked to business strategy and risk, and disagree that sufficient information is provided to assess financial materiality.
- In order for non-financial information to be useful to investors it must be comparable across companies. Respondents state that current non-financial reporting is not sufficiently comparable and agree that non-financial information should be better integrated with financial information.
- Qualitative policy statements are important to assess financial materiality, but quantitative key performance indicators (KPIs) are viewed as essential.
- Accountability mechanisms should be part of non-financial reporting, either through new board oversight mechanisms, third-party assurance and/or shareholder approval at AGMs.

What sources of non-financial information do investors use today?

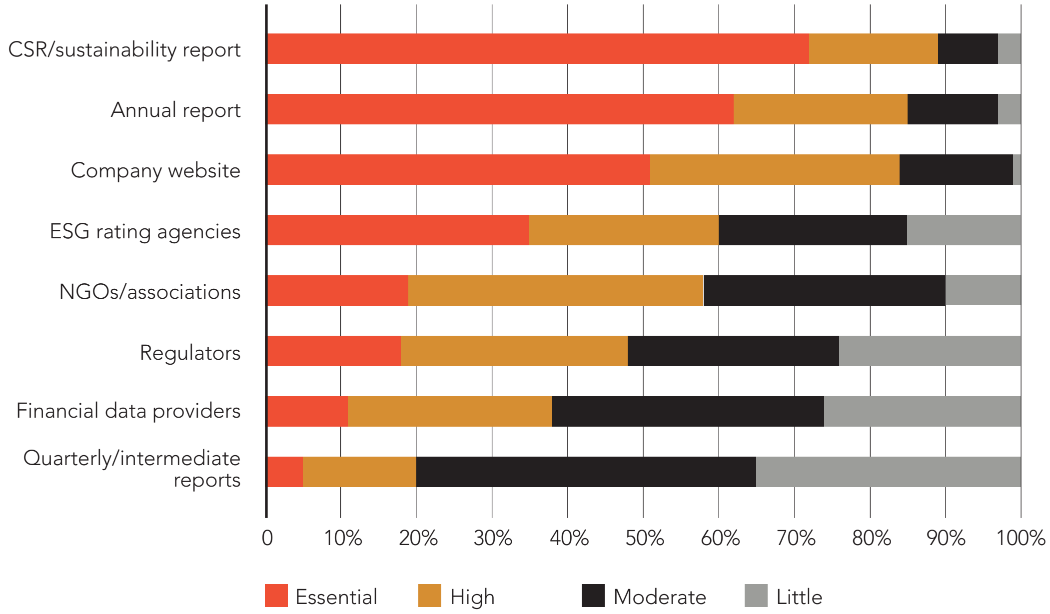
All respondents
made use of non-financial information.

67%
always made use of it.

25%
frequently used it.

8%
sometimes used it.

COMMON SOURCES OF NON-FINANCIAL INFORMATION



The most important sources of non-financial information for investors were **CSR/sustainability reports**, followed by annual reports and the company website.

Other sources of information mentioned by respondents included the media, direct conversations with companies and trade or industry associations.

89%
of respondents felt that CSR/sustainability reports are 'essential' or of 'high importance'.

How adequate is current non-financial reporting by European companies?

78%

of investors surveyed disagreed or strongly disagreed that current levels of non-financial disclosure are adequate.

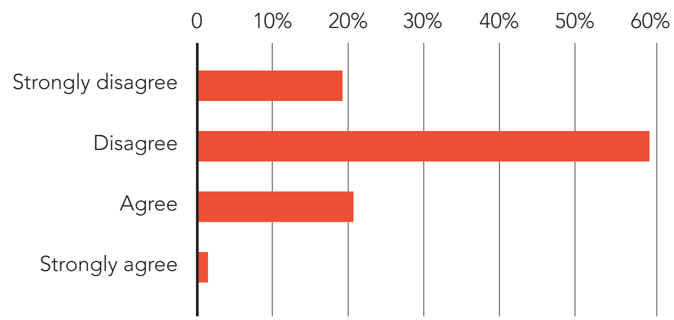
73%

of investors surveyed disagreed or strongly disagreed that current levels of non-financial disclosure **are linked to strategy and risk**.

93%

of investors surveyed disagreed or strongly disagreed that current levels of non-financial disclosure are sufficient to assess materiality.

CURRENT LEVELS OF NON-FINANCIAL DISCLOSURE ARE ADEQUATE



69%

of investors surveyed agreed or strongly agreed that non-financial **disclosure is linked to CSR.**

Which topics should non-financial reporting cover?

The European Commission's proposal sets out that companies should, at a minimum, produce information on:

- **environmental issues**
- **social/employee matters**
- **human rights**
- **anti-corruption/bribery.**

89%

of investors surveyed agreed or strongly agreed that **reporting should be forward looking** in addition to providing information on past performance.

66%

of investors felt that the Commission's proposal should include additional areas to be addressed by companies, suggesting:

- corporate governance
- supply chain impacts
- company specific issues
- sector specific issues.

Comparability of information across companies was seen as poor at present, as **92%** of investors surveyed disagreed or strongly disagreed that current reporting is sufficiently comparable.

84%

of investors disagreed or strongly disagreed that companies make it clear how they identify material non-financial issues.

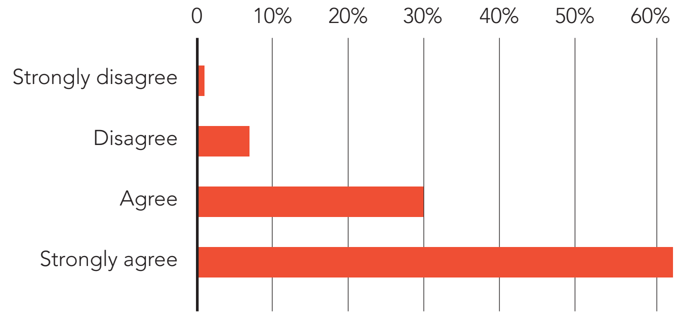
What form should non-financial disclosure take?

The European Commission's proposal would require companies to set out i) a description of its policies, ii) the results, and iii) the risks and how they are managed. Financial and non-financial key performance indicators (KPIs) shall be included to the extent necessary. Thus it would require companies to disclose qualitative information, but not quantitative KPIs.

96% of investors agreed or strongly agreed that quantitative **key performance indicators** are essential to assess corporate sustainability performance.

76% of investors agreed or strongly agreed that qualitative **policy statements** are essential.

FINANCIAL AND NON-FINANCIAL REPORTING SHOULD BE MORE INTEGRATED



There are a number of non-financial reporting frameworks in use at present. **84%** of investors surveyed agreed or strongly agreed that established standardised **reporting frameworks** should be used by companies.

92%

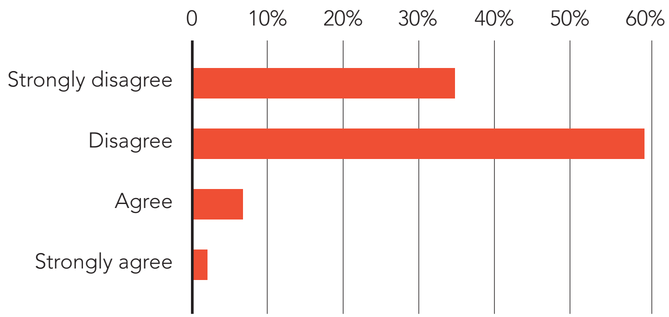
of investors surveyed agreed or strongly agreed that financial and non-financial information should be **more integrated**.

What kind of accountability mechanisms should be applied to non-financial information?

The European Commission's proposal does not make explicit mention of additional accountability mechanisms in relation to non-financial information. As this is proposed to be part of the Accounting Directive, there is an implicit requirement that the information included is verified for consistency with the financial statements.

Investors were asked if additional oversight mechanisms over non-financial information are needed.

BOARDS ARE SUFFICIENTLY ACCOUNTABLE FOR NON-FINANCIAL DISCLOSURE



Investors surveyed were of the opinion that:

- new board **oversight mechanisms** are necessary (88% agreed or strongly agreed)
- non-financial disclosure should be **independently verified** (84% agreed or strongly agreed)
- shareholders should be able **to approve company** non-financial disclosure at general meeting of shareholders (74% agreed or strongly agreed).

92%

of investors surveyed disagreed or strongly disagreed with the statement that **company boards are sufficiently accountable** for non-financial disclosure.

Which companies should be required to produce non-financial reports?

The European Commission's proposal states that all large companies (both listed and private) should be subject to the disclosure requirements on a consolidated basis, with large companies defined as those with:

- **over 500 employees**
- **a balance sheet exceeding EUR 20 million, or revenue exceeding EUR 40 million.**

According to European Commission figures, the proposal will increase the number of companies producing non-financial reports from 2,500 to 18,000 out of a total population of 42,000 large companies in the EU.

This departs from the standard definition of a large company used in the new merged EU Accounting Directive, which is that at least two of the following three must be present:

- over 250 employees
- a balance sheet exceeding EUR 20 million
- revenue exceeding EUR 40 million.

Investors surveyed were almost unaminously in favour of large listed companies needing to report non-financial information, with less support for large private companies.

	Listed	Private
Large	99%	56%
Medium	66%	39%
Small	33%	23%

Implications for policy makers

The survey shows that the European Commission's legislative proposal is on the right track. Current reporting is inadequate and does not provide sufficient information for investors to be able to assess the material non-financial risks and opportunities facing European companies.

Policy makers could improve the impact and relevance of the proposed legislation by looking at:

- introducing mandatory ESG KPIs
- encouraging the use and harmonisation of existing reporting frameworks to increase comparability, and
- improving accountability mechanisms for non-financial information.

Finally, many companies appear to be struggling to understand what non-financial information is relevant for investors and what the most effective way of reporting it is.

Clearly, there is a need for more guidance for companies on how to implement these proposed legislative requirements in practice and how to integrate non-financial data with financial data.

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