AK EUROPA

Position Paper
January 2022
Economic

Corporate Sustainability Reporting

Sustainable business requires co-determination

COM(2021) 189

Executive summary

On 21 April 2021, the Commission published several envisaged changes concerning sustainability reporting. The planned rules of the draft Corporate Sustainability Reporting Directive (CSRD) are intended to extend considerably the "non-financial reporting obligation" applicable until now to certain European companies with respect to scope, extent of reporting and inclusion in the framework of corporate governance. These measures are urgently needed since the Non-Financial Reporting Directive (NFRD) has major deficits , as numerous evaluations of previous reporting practice, the findings of the Commission's "Fitness Check" and the "Impact Assessment" presented together with the draft directive show. Points of criticism are the limited scope of companies to which it applies, the variously implemented reporting duties, insufficient comparability and reliability and a lack of internal and external quality assurance. In addition, high levels of freedom and the principle of "voluntary commitment" with respect to the choice of reporting standards and topics reported have led to a clear failure to achieve the goal of accountability concerning the sustainability performance of companies.

With its draft directive, the Commission has recognised the major need for reform and has laid the groundwork for new, European sustainability reporting. This step is urgently needed to push ahead with the transition to a socially and environmentally just economy. European companies are to be subject to increased accountability with respect to publishing comprehensive, transparent, and verifiable information about their sustainability performance. The legislative proposal extends the scope of application and provides for extended and more precise sustainability reporting requirements. Furthermore, the application of uniform European reporting standards is planned and will be presented by the European Financial Reporting Advisory Group (EFRAG) by May 2022. It will be mandatory for the new reporting standards on environmental, social and governance aspects to be included in the management report from 2023.

In addition, the draft directive explicitly provides for the inclusion of sustainability reporting in corporate governance and thereby steps up the requirements and responsibilities of management and supervisory bodies with respect to sustainable business practices.

Austrian Federal Chamber of Labour's key demands:

Overall, Austrian Federal Chamber of Labour (AK) welcomes the Commission's ambitious draft directive for a new, European sustainability reporting. It is crucial, however, that the rules in question are not watered down by the Parliament and the Council, as was unfortunately the case with the original NFRD. Instead, this first considerable achievement needs to be further refined, for example with respect to comprehensive social and governance reporting, with the explicit inclusion of consultation with trade unions and other co-determination actors, such as works councils. Companies need to be given precise rules about how to report on the working conditions of employees, as well as on subcontracting and suppliers.

AK points out that stepping up the accountability and publicity requirements for companies concerning the environment, social matters, and governance serves as an effective lever for works councils and supervisory boards to work towards a socially and environmentally sustainable approach to corporate management. This should be laid down accordingly in the directive. Furthermore, the draft directive should by no means serve to lower existing, more extensive reporting standards that are in effect in EU Member States such as France. In view of the urgent need for action and in line with the current sustainable finance initiatives, AK strongly urges compliance with the target schedule so that the new sustainability reporting can take effect from the 2023 financial year.

AK's position

Main demands of AK

- **Extension of the reporting obligation:** The planned extension of the scope of companies to which the legislation applies is urgently necessary and a very positive step. Accordingly, the number of companies subject to the reporting obligation is set to rise from 11,600 at present to around 49,000 companies in the future. A point of criticism, however, is that the "exemption for groups" has been retained, according to which subsidiaries remain exempted from the reporting obligation if their parent company prepares a sustainability report. As practices to date have shown, the aggregation of information concerning social and environmental standards at the overarching group level often means that social and environmental issues relating to individual subsidiaries can no longer be presented transparently. In addition to an end to the "exemption for groups", AK calls for an extension of the reporting obligations to foundations as well as to companies with significant transactions in the EU but headquarters in a non-EU member state (e.g., US online retailer Amazon.com, Inc.).

- **EFRAG as a standard-setting body:** The Commission has commissioned EFRAG, which is dominated by private legislative associations, business associations and lobby groups of banks and insurance companies, with setting the standards for the new European reporting. That gives the impression that employer and business associations have been given the opportunity through the "back door" to establish reporting indicators in line with their own interests. To counteract that, trade unions should play a substantial role in the upcoming EFRAG Governance, which is to be rolled out by the start of 2022. In AK's opinion, the directive itself should be adjusted with respect to social and governance reporting indicators so that the political leeway of non-governmental standard-setting bodies is kept to a minimum. Trade unions and civil society must be included in their downstream work to refine the requirements established by policymakers.

- **EU sustainability standards:** New, uniform European reporting standards must at least ensure that the information requirements of stakeholders affected to a considerable degree by corporate activities and their effects are met. That includes the demands of trade unions, works councils and employees that working conditions and working relations be presented transparently in reliable sustainability indicators (Key Performance Indicators, KPIs). Here, AK calls for the following adjustments to be made: the narrow set of standards in the draft directive regarding social aspects should certainly be supplemented by the "comprehensive" version of the social reporting standards (= module GRI-400) of the Global Reporting Initiative (GRI) as a minimum set of standards.

- **Corporate governance:** The explicit inclusion of sustainability in corporate governance is very important for ensuring the implementation of sustainability targets within the framework of corporate management ("sustainability strategy") and to carefully monitor sustainability risks. To eliminate failings in current practice, it is vital that executive and supervisory boards are held more accountable for addressing the sustainability performance of the company. Given the above, AK demands that at least one member of the audit committee should have relevant sustainability expertise ("sustainability expert"). In addition, there should be a requirement for mandatory consultation on questions of sustainability strategy and sustainability reporting with the co-determination bodies, namely the European works council, the (group) works council and the employee representatives on the supervisory board.

- **Mandatory audit:** AK is strongly in favour of requiring sustainability reporting audits to be carried out by an external third party. Nevertheless, this rule – which in the first instance only requires an audit with "limited assurance" –

does not go far enough. The obligation for an audit with "reasonable assurance", equivalent to that applicable to financial reporting, should be in place from the time that the directive comes into force. To ensure appropriate quality assurance, further steps should be taken regarding accreditation, training, expertise, and responsibility, as well as the independence, appointment, and dismissal of the auditors. It is therefore critical for (further) training and qualification of audit service providers and statutory auditors to take place, as well as for the opportunity to be provided for the involvement of other audit bodies that have sustainability expertise, e.g., certified experts from the sustainability field. Such measures are necessary to raise the auditing standards and to ensure the required consistency and reliability of the new sustainability reports.

On the individual regulations

AK's position with respect to key individual rules of the CSRD is set out below. Please note that the remarks on the planned amendments to Directive 2013/34/EU (Accounting Directive) and to Directive 2006/43/EC (Statutory Auditors Directive) apply accordingly to the rules (such as on preparation and auditing) concerning the consolidated sustainability reports.

1. Sustainability: the name matters

Under recital 7 of the draft directive, "non-financial reporting" is renamed as "sustainability reporting". The new term is of considerable symbolic importance since elimination of the negation in the term "non-financial" further underlines the link between a company's business success and sustainability performance and also clears up the widespread misconception that "non-financial" information does not have a financial impact. That is an important step in the context of the targeted integration of sustainability and financial reporting and contributes to lending sustainability information as much weight as financial reporting in the accounts.

2. Amendments to Directive 2013/34/EU (Accounting Directive)

2.1. Scope of application

Under Article 19a of the legislative proposal, the scope of companies subject to the sustainability reporting requirement is extended considerably. From 2023, all large companies with share capital under the Accounting Directive, large banks, and insurance companies, as well as all companies listed on regulated markets in the EU (except for listed micro-companies) are to be included in the scope. Companies that are not established in the EU but are listed on a regulated market in the EU, are also included in the scope. While previously only capital market-oriented companies and banks and insurance companies with over 500 employees were subject to the reporting obligation, the proposal provides for the reporting obligation to apply to large companies, irrespective of their capital market orientation and the threshold of 500 employees.

AK had called for such an extension of the scope for many years. This is urgently needed so that as many companies as possible – prompted by information transparency – contribute to achieving the Sustainable Development Goals (SDGs) and the targets of the Green New Deal. As many companies as possible should therefore be subject to the reporting obligation. AK advocates extending the reporting obligations to companies that have significant transactions in the EU but have their registered office in a non-EU Member State (such as the American online retailer Amazon.com, Inc.), which should likewise be subject to sustainability reporting. That is not mentioned in the draft directive.

In addition, the "exemption for groups", according to which subsidiaries remain exempted from the reporting obligation if the parent company prepares a sustainability report, should be removed. Especially in the context of compliance with social and environmental standards, a high level of aggregation is counterproductive and often far from informative. Experiences in connection with the exemption for subsidiaries in the framework of establishing an audit committee at the group level clearly show that large subsidiaries require a separate audit committee. AK therefore calls for subsidiaries to be included in the scope if the criteria of size are met and as a minimum, country-by-country reporting should be performed.

AK supports the plan for capital market-oriented small and medium-sized companies (SMEs) to be subject to the sustainability reporting requirements from 2026. The Commission plans to publish separate rules geared towards the limited resources of SMEs by 31 October 2023, enabling companies that cooperate with SMEs to generate the required information for their own reporting more easily. In AK's view, it needs to be ensured that the relevant stakeholders, including trade unions, workers councils, and employees, are involved in the development of those separate rules.

Rules set out in the Commission's proposal for a Corporate Sustainability Reporting Directive (CSRD) in detail

Scope of application	• All large companies with share capital (public limited company, limited liability company, e.g. including: limited partnership with a limited liability company as general partner), as well as large banks and insurance companies irrespective of legal form (e.g. relevant to cooperative banks and savings banks) • Capital market-oriented small and medium-sized (SMEs) companies • Foreign companies listed on regulated capital markets in the EU • On a consolidated basis: all parent companies of large groups • Now only modified and partly limited exemption rules

Content	• Explicit inclusion of a "double materiality perspective"
	• Reporting obligation on the process of materiality analysis
	• Extended requirements with respect to
	  • content (e.g. aims and strategies),
	  • format (e.g. retrospective and prospective information) and
	  • circumstances (e.g. coverage of the whole value chain; matters concerning new governance)
	• Harmonisation (e.g. with the rules of the Taxonomy Regulation)
	• New obligation to report on immaterial resources

Standardisation	• Mandatory application of new European standards to be developed by EFRAG • Development of a new endorsement procedure in the EU for those new standards
Formal aspects	• Mandatory disclosure in the management report • Mandatory publication of the reporting in electronic format
Corporate governance	• Extension of the "balance sheet oath" to sustainability reporting • Mandatory audit by statutory auditors or other service providers (only "limited assurance" in the first instance) • Extensive training and qualification requirements for those audit service providers • Mandatory role of the audit committee • Clarifications and extensions with respect to enforcement and penalty mechanisms

Source: European Commission, 2021

2.2. Reporting obligation, content

Both the number of companies to be subject to a reporting obligation in future and the reporting obligations themselves are considerably extended and made more precise under Article 19a, which is an important step in AK's view. Accordingly, AK supports the fact that the new reporting provides for extended requirements with respect to content (e.g., aims and strategies), format (e.g., retrospective, and prospective information) and circumstances (e.g., coverage of the whole value chain; matters concerning new governance). In the future, companies will be required to report not only on significant environmental, social and worker-related matters, but also on relevant aspects of corporate governance. Information must be provided, for example, about the role of the company's bodies (with respect to sustainability factors), business practices and culture, anti-corruption measures and political engagement (including lobbying). Furthermore, aspects including resilience of the business model and the corporate strategy with respect to sustainability risks, as well as the compatibility of the business planning with the Paris climate target of limiting global warming to 1.5 degrees Celsius must be disclosed.

2.3. Form of reporting

AK welcomes the elimination of the right to choose between integrated and separate reporting. It is also very positive that in future, according to Article 19a (1), sustainability reporting should be set out solely in the (consolidated) management report and therefore be at the core of the accounts; through mandatory disclosure in the (consolidated) management report, sustainability parameters are accorded equal importance to that of financial indicators. It may be assumed that the requirement for inclusion in the management report will encourage companies subject to the reporting obligation to integrate the generation of sustainability information more closely with the existing financial reporting processes.

2.4. "Double materiality"

The draft directive takes a clear position on the "principle of materiality" and thus reinforces the "double materiality" approach, i.e., both the effects of the environment on the company "outside-in" and the effects of the company on its environment "inside-out" should be presented in equal terms. Nevertheless, the content of Article 19a (1) concerning that question remains very abstract. The Commission should make this point more precise so that the leeway for companies is kept as narrow as possible, which will have a positive effect on transparency and comparability of reporting.

2.5. Immaterial assets

The current NFRD does not contain any rules on reporting concerning immaterial assets. Under Article 19a (2) of the draft directive, corresponding rules are now set out, which are intended to create a link to already activated immaterial assets in financial reporting and to list additional information (e.g., in the form of extended reporting on research and development activities of companies). However, in AK's view, it remains open how that new rule is intended to be implemented conceptually, also with respect to the question of whether the focus should be more on financial or sustainability reporting. AK therefore calls for specific rules for companies on how to comply with that information requirement.

3. EU sustainability standards

Under Article 19b (2), the draft directive provides for the mandatory application of new European reporting standards to be developed by the European Financial Reporting Advisory Group (EFRAG). AK agrees with the rule that these standards, according to the draft, should be "understandable, relevant, representative, verifiable and comparable" and "represented in a faithful manner". The six environmental objectives of the European Union, which also define the structure for the taxonomy (climate change mitigation, climate change adaptation, water and marine resources, circular economy, pollution, biodiversity and ecosystems), as well as information concerning governance aspects (such as the role of the company's administrative, management and supervisory bodies, including with respect to sustainability matters, and their composition, business ethics and corporate culture, including anti-corruption and anti-bribery measures) are mentioned as subject areas to be taken into account

Under Article 19b (2) (b), in addition to the information on environment and governance, the following information on social aspects is listed to be disclosed:

- Equal opportunities for all, including gender equality and equal pay for equal work, training and skills development, and employment and inclusion of people with disabilities
- Working conditions, including secure and adaptable employment, wages, social dialogue, collective bargaining and the involvement of workers, work-life balance, and a healthy, safe, and well-adapted work environment
- Respect for human rights, fundamental freedoms, democratic principles, and international standards

Under the aspect of "equal opportunities for all", with respect to gender equality, a specific disclosure obligation should be established concerning the gender pay gap and how it changes over time, broken down by employee groups in the company. In matters concerning "working conditions", reference is made to "social dialogue". However, specific co-determination bodies (trade unions, works councils and employee representatives on the supervisory board) and their rights are not mentioned. That failing must be remedied.

European reporting standards concerning social aspects should certainly ensure that the information requirements of stakeholders affected to a considerable degree by the company' activities and the effects thereof are met. That includes, in particular, the requirements of trade unions, works councils and employees for a transparent, comparable presentation of working conditions in the sustainability indicators to be reported, together with the associated sustainability targets and risks. Furthermore, AK calls for the information to be extended as follows: the present set of standards regarding "social aspects" should certainly be supplemented by the reporting standards of the Global Reporting Initiative (GRI) and thereby be made more specific. With respect to cooperation between EFRAG and the Global Reporting Initiative (GRI), it should be noted here that the GRI standards are implemented in their "comprehensive" form as a minimum set of standards, with the social standards (module GRI-400) at least taken into account. Those already established social standards should certainly be implemented as the "minimum set of standards" for the new European reporting content. As an example, four indicators from the (far more comprehensive) set of indicators (as at 2016) are listed:

- GRI-401-1 (fluctuation by age group, gender, and religion),
- GRI-404-1 (hours of training by gender and employee category),
- GRI-405-1 (diversity of governance bodies and employees, for gender, age group and other diversity indicators, such as minorities or vulnerable groups, respectively) and
- GRI-407-1 (concerning right to freedom of association and collective bargaining).

The aim must be that companies receive rules that are as clear as possible on the presentation of key performance indicators (KPIs), which will then be reflected both in the sustainability targets and the targets for corporate management (the board and directors). In AK's opinion, the comprehensive version of the GRI standards lends itself particularly well to that.

Existing, far-reaching and extensive reporting standards in Member States such as France should certainly be taken into account, where a comprehensive statutory framework has already been in place since 2014. Listed companies are required to report on defined performance indicators from three fields – social, environmental and information about social engagement for the benefit of sustainable development. Existing reporting standards should certainly not be watered down by the draft directive. Instead, companies need to be given precise rules on how to report correctly on the working conditions of employees. The same also applies to reporting on subcontracting and suppliers. It needs to be ensured that the effects on employees, suppliers in the value chain, consumers and the environment are set out in quantitative terms so that stakeholders can voice their demands and the management can define targets accordingly.

3.1. EFRAG governance

In summer 2020, the Commission entrusted the European Financial Reporting Advisory Group (EFRAG) with drawing up the new standards. AK is critical of this unorthodox European approach to standardisation. To date, the EFRAG member organisations have been dominated by private legislative associations, business associations and lobby groups of banks and insurance companies. However, the interests and requirements of trade unions, works councils, consumers and civil society should certainly be taken into account when establishing the new reporting indicators. Drawing on the position of the German Trade Union Confederation (DGB) in CSRD, it would be positive if the relevant governance structures had a tripartite composition consisting of representatives from business, trade unions and NGOs.

Furthermore, the standards to be developed by EFRAG according to Article 19b (2) should take into consideration specific aspects of the various branches and business models and be coordinated as closely as possible with organisations with experience in developing sustainability standards – known as the "Group of Five" (GRI, SASB, IIRC, CDSB and CDP) – taking into account current initiatives, such as those of the IFRS Foundation, which is engaged in the development of global standards. In addition, it is problematic that the envisaged endorsement process for European standardisation currently still seems very vague. In AK's view, specific and transparent rules therefore still need to be established here.

3.2. Digital tagging

Furthermore, Article 19b (2) of the draft proposal provides for sustainability reporting to be digitally "tagged" so that it is machine-readable and can be included in the uniform access point (European Single Access Point, ESAP) envisaged in the action plan on the Capital Markets Union. In AK's opinion, the collection of information in the ESAP offers a good starting point for designing a possible EU Green Claims Initiative to protect citizens in an even more targeted manner against "greenwashing".

4. Penalties

In AK's view, the proposed amendments under Article 51 represent necessary measures in order to penalise companies in the case of violations. This further underlines the importance of sustainability reporting. In this context, the submission of a public statement (according to paragraph 2a) by a responsible natural person or legal entity is also deemed important information for stakeholders in companies. The place of publication should also be governed by law.

Amendments to Directive 2004/109/EC (Transparency Directive)

The planned changes (reporting in the management report and the audit requirement) will also affect enforcement (see Article 28d). Under the Commission's proposal, sustainability reporting is to be subject to enforcement (applicable only to capital market-oriented companies) by the national supervisory authorities. The European Securities and Markets Authority (ESMA) is to establish suitable guidelines for the supervisory authorities. AK considers that a very positive step with respect to evaluating the implementation of the new rules in practice.

Amendments to Directive 2013/43/EC (Statutory Auditors Directive)

In general, AK welcomes the fact that the existing rules on statutory auditing in the scope of financial reporting are to be extended to the auditing of sustainability information and wishes to highlight the following aspects. To date, companies are not subject to a statutory obligation to have their sustainability information audited. It has been seen in practice that many companies voluntarily commission an audit and have it performed. The added value of such an audit is also high for stakeholders. In the draft directive, the Commission therefore intends to introduce an audit obligation, but only with "limited assurance" in the first instance.

The draft directive does provide that the Commission will evaluate this rule after three years and, where applicable, extend it to an audit obligation with "reasonable assurance" (equivalent to the obligation for financial reporting). However, this provision falls short, since an audit obligation with "reasonable assurance" is essential in order to harmonise financial and sustainability reporting. AK therefore calls for the obligation to conduct an audit with "reasonable assurance" under the proposed CSRD. Furthermore, under the draft, besides a statutory auditor, the audit can also be performed by an independent audit service provider with relevant expertise. AK welcomes this rule but considers it necessary to define precise criteria for the audit process and quality assurance in order to ensure auditing quality and frequency, which is equivalent to financial reporting.

1. Training of statutory auditors

Under the draft directive, the Member States are required to ensure that the statutory auditors maintain the theoretical knowledge, professional competence, and values – corresponding to ethical aspects – at a sufficiently high level for auditing of the sustainability information through continuing professional development (as per Article 13), with breach of that requirement incurring appropriate penalties. AK welcomes these rules (see Articles 6 to 10), since they serve to ensure a high standard of auditing for sustainability reporting. Ultimately, the relevant stakeholders should be able to trust in the audit results. AK also considers the explicitly named extension to the auditing of sustainability information with respect to requirements such as the independence and objectivity of the statutory audit (Article 25b) to be essential.

2. Audit report

AK supports the proposed rules concerning the audit report (as per Article 28). During auditing of the sustainability reporting by the statutory auditor, the date, reporting period, framework used for reporting, scope of the audit and the audit standards used should be included in the audit report. If several auditors or audit companies have been commissioned, the audit report is signed by all auditors or at least by those auditors responsible for auditing the annual financial statements and sustainability reporting, on behalf of each audit company.

3. Penalties, dismissal, and resignation

(see Articles 30g and 38a)
AK considers it essential that all the rules applicable to the auditing of financial reporting regarding the "investigations and sanctions regime" and the "dismissal and resignation of statutory auditors and audit companies" should also apply to the auditing of sustainability information.

4. Audit committee

The supervisory board is given a key role in supervising and checking the sustainability strategy and sustainability-oriented risk management. In the scope of that, the responsibilities and role of the audit committee are extended to the audit obligation for sustainability reporting as per Article 39. The responsibility of the audit committee now involves equivalent supervisory obligations for the financial report and the sustainability report. In order to further increase the importance of sustainability reporting in the audit committee, AK proposes that – in line with financial reporting – at least one member of the audit committee should have relevant sustainability expertise ("sustainability expert").

Amendments to Regulation No 537/2014 (Statutory Auditors Regulation)

AK welcomes the planned prohibition (under Article 5) of the provision of consulting services (as for the statutory auditing of the financial report) by the auditors who audit the sustainability reporting. AK regards implementation of the mandatory provision of information concerning fees (as per Article 14) for the auditing of sustainability information as essential. It is vital that the auditing of sustainability reports be categorised as an "audit service" and not – as currently under the draft directive – as "non-audit services".

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About us

The Austrian Federal Chamber of Labour (AK) is by law representing the interests of about 3.8 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore, the Austrian Federal Chamber of Labour is a part of the Austrian social partnership. The Austrian Federal Chamber of Labour is registered at the EU Transparency Register under the number 23869471911-54.

The main objectives of the 1991 established AK EUROPA Office in Brussels are the representation of AK vis-à-vis the European Institutions and interest groups, the monitoring of EU policies and to transfer relevant Information from Brussels to Austria, as well as to lobby the in Austria developed expertise and positions of the Austrian Federal Chamber of Labour in Brussels.