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EU Regulation of Corporate Social and Environmental Reporting

Thomas Riise Johansen

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EU REGULATION OF CORPORATE SOCIAL AND ENVIRONMENTAL REPORTING

Introduction

In 2014, the European Union adopted changes to its Accounting Directive, which, after implementation in member states, will require public interest entities with more than 500 employees to disclose non-financial information – including social and environmental matters – in the management report section of the annual report. The amendment of EU regulation represents a high-profile attempt to regulate social and environmental reporting (SER) and this special issue presents research that addresses SER regulation in light of the EU regulation.

The EU regulatory process and the significance of assessing impact

To discuss the EU regulation further including how current and future SEA research relates to this and similar regulatory processes, the first part of the editorial outlines the process that led up to the EU regulation, as well as the role played by impact assessments in that process.

The EU regulatory process

CSR and social and environmental matters have been part of the agenda of the European Commission for several years (e.g. European Commission, 2001; European Commission, 2002; European Commission, 2009a). The 2001 green paper invited companies to report on the 'triple bottom line' (European Commission, 2001) and in 2003 the Accounting Directive was amended to include, where appropriate, indicators relating to environmental and employee matters. In response to the 2006 Communication that promoted a voluntary approach to CSR (European Commission, 2006), in 2007 the European Parliament adopted a resolution, driven by MEP Richard Howitt, that 'reminded' the Commission that the Parliament had invited the Commission to put forward a legislative proposal that required the largest companies in the EU to prepare SER in the same manner as in financial reporting (European Parliament, 2007). The European Commission, however, was not convinced. In direct response to the resolution, it rejected SER regulation on the grounds of administrative burden and because requirements in the 2003-Directive already covered social and environmental disclosures (European Commision, 2007). This showed that minimising administrative burden was key for the Commission and subsequently the idea of disclosure regulation was halted for several years.

Kinderman (2013) indicates that there was internal disagreement in the Commission about whether the 2003 regulation should be supplemented by additional requirements.[1]

[1] The Accounting Directive falls under the responsibility of DG Internal Market, but other DG's in the Commission have been more active in the CSR field, including DG Enterprise, DG Environment and DG

However, as the interviews in Monciardini (2016) suggest, the appointment of Michel Barnier as Commissioner for DG Internal Market (DGIM) in 2010 changed the stance in favour of EU regulation on SER. Later in that year, DGIM launched a public consultation on non-financial reporting (European Commission, 2010). On the basis of the consultation, DGIM concluded that public policy on SER was varied across countries and non-existing or poor in several member states (European Commission, 2011). Shortly after the feedback statement, the Commission announced in its single market act that it would develop a proposal that required reporting on social and environmental matters (European Commision, 2011). The stated reason for the proposal was that a level playing field for European business is required. Thus, a formal regulatory process was established.

The trouble with the impact assessment

As part of a standard regulatory process in the EU, the Commission initiated an impact assessment process intended to explore the impact of different policy alternatives (European Commission, 2009b). The Commission published the final impact assessment report alongside its proposal in April 2013 (European Commission, 2013). A key activity in the impact assessment was the gathering of evidence that could assess the impact of diverse policy options. For this purpose, the impact assessment process draws on the consultation, feedback provided by an established expert group, an external study conducted by a consultancy firm and a range of reports and statements as well as interactions with actors in the process, including lobbyists.

This evidence-gathering was apparently difficult for the Commission and may have been one of the factors that caused the regulation to be significantly delayed. The Commission has recurrently in the regulatory process called for empirical evidence related to the costs and benefits of CSR disclosure. However, this did not appear to be successful as the first draft of the impact assessment report was rejected in a formal opinion issued by the so-called EU impact assessment board, which oversees regulatory processes in the Commission (EC-IAB, 2012). That opinion called for improvement in DGIM's impact assessment, which was criticised for not including robust evidence and for not quantifying the benefits and effectiveness of the policy options under consideration.

Despite this criticism, the final impact assessment report was not convincing in terms of providing an evidence-based discussion of the benefits, costs and other consequences of different policy options and, as highlighted later in this editorial, it barely drew on academic research. For benefits, for example, 'evidence' ended up being derived mainly from conceptual reasoning and consultancy reports. The preferred option was only accompanied by weak statements about how it could increase disclosure levels.

Social Affairs. Before 2010, the DG Internal Market did not seem to agree with the other DGs on the need for regulation.

Moreover, the report does not cite or present evidence regarding the effects of the encouraged voluntary disclosures included in the preferred option. For costs, the report cited a Danish Government study and an external consultancy study and suggested that the costs of the preferred option could range between € 600 and € 4300 per year. It is not clear in the report how such ‘inexpensive’ disclosures can generate increased transparency. The formal impact assessment system looks impressive, but as Torriti (2010) observes in another EU regulatory process, there may be a risk that the process develops policy-based evidence-making based on consensus among stakeholders rather than evidence-based policy-making.

The regulation

The adopted EU regulation on non-financial disclosure is shown in Table 1. This regulation was articulated as ‘smart regulation’ involving a policy mix including a disclosure requirement and voluntary disclosure. While it is mandatory because it requires disclosure, it also comprises of a voluntary aspect as companies without policies related to the matters that are mentioned may choose to provide a minimal disclosure in which they explain why they do not have any such policies in place.

[Insert table 1 about here]

The regulation has been celebrated as a major step forward by a number of actors. The reconciling of multiple, different and partly opposing interests appears to have been made possible by the chosen mode of regulation. The ‘smart regulation’ label appeared to be invented just before the launch of the Commission’s proposal. What was ‘smart’ about the regulation was that it had a binding requirement so that it could be articulated as something mandatory along with a voluntary element. Moreover, restricted to only the largest public interest entities, it could appear as if regulators were imposing minimal administrative burden upon companies. Thus, the regulation was seen as desirable among many actors as (a) the Commission could demonstrate a negligible administrative burden, (b) associations representing businesses, SMEs and countries against binding requirements could be satisfied because of its voluntary nature and its limited applicability to only the largest companies, (c) consultants, CSR-proponents and standard setters in the field of sustainability reporting celebrated the regulation for its legislative status and claimed that companies now had to report more CSR information, and (d) governments in some countries could claim alignment with national affairs and attitudes, including Denmark which had a formal national strategy to gain international acknowledgement of its CSR regulation and Germany which preferred a voluntary approach.

Assessing impact and the role of social and environmental accounting research

There appears to be an increasingly prevalent use of economic appraisals as justification for choices made in regulatory processes, as such ‘evidence-informed’ techniques are often upheld as 'better regulation'. Zeff (1978) provided an early account of how the analysis of economic consequences was involved in accounting standard setting, the development and structured use of economic appraisals has only recently increased both in regulatory practices in general (OECD, 2009; Baldwin et al., 2011) and among accounting regulators (e.g. EFRAG and ASB, 2011; PCAOB, 2014). Such appraisals are most often part of the justification of new regulation, but may also relate to 'post implementation' assessments (Ewert and Wagenhofer, 2012).

There is a potential for research to advance our understanding of how such appraisals or effect analyses become used in accounting regulation processes (Dunlop et al., 2012). There is also a potential for research to inform such regulatory processes. Previously, Bebbington (2013) has reflected on how academics and research studies may work to play a greater role in the evidence base of policy-making and regulatory processes. In view of that, the remainder of this section highlights three areas in which the impact assessment report associated with the EU regulation (European Commission, 2013) seemed weak thus underlining the potential for social and environmental accounting research to inform regulatory processes in the future.

First, the assessment of benefits and costs of policy options were, as mentioned above, not based on much evidence. Furthermore, the impact assessment concentrates on the entity-specific effects of regulation, i.e. what the policy options would imply for the company (costs) and for its immediate stakeholders, in particular investors (benefits). Even though the reporting of social and environmental matters may have (positive) effects beyond these entity-specific effects on disclosure and its use, there are few references to such effects in the impact assessment. For example, the broader effects of requiring companies to disclose more social and environmental information could have been analysed. There are a few general statements that suggest that improved transparency can "act as a catalyst for companies to increase or improve their CSR practices" (p. 38), yet this is not an area that is subjected to further analysis and there is no discussion of whether different policy options may have varying effects on social and environmental performance. This is surprising and somewhat problematic as (a) even within financial accounting standard setting, effects such as the impact of accounting regulation on financial stability, are believed to play a role in regulatory processes (EFRAG and ASB, 2011) and (b) social and environment disclosures cannot simply be viewed as something that only has a role in feeding into users' decision-making – such disclosure requirements may also be viewed as a way of regulating social and environmental matters, where a disclosure requirement is one option among other types of actions.

Second, there are surprisingly few academic studies cited in the impact assessment report. The area in which most studies are cited is board diversity where a handful of published studies feature. In regards to the impact of the range of policy options, studies that could inform discussion of whether to introduce mandatory disclosure, encourage voluntary disclosure or a mix of the two are absent except for a couple of studies (Ioannou and Serafeim, 2010; Ioannou and Serafeim, 2011).[2] This is unfortunate as there is an abundance of social and environmental accounting research that focuses on how, why and to what extent regulation, mandatory or by guidelines, as well as voluntary disclosure may influence reporting practices.

Third, the impact assessment largely overlooks the fact that the context in which disclosure regulation is introduced matters for its effectiveness. For instance, the papers in this special issue illuminate the importance of considering the institutional context in which disclosure requirements function. This points to the potential importance of effective enforcement mechanisms (Costa and Agostini, 2016; Fallan, 2016; Luque-Vílchez and Larrinaga, 2016), stakeholder engagement or accountability mechanisms (Cooper and Owen, 2007; Costa and Agostini, 2016) and correspondence with previous practices and current beliefs about reporting (Bebbington et al., 2012; Luque-Vílchez and Larrinaga, 2016). Thus, as Luque-Vílchez and Larrinaga (2016) note, the interpretation and implementation of the EU regulation in member states appear to be critical success factors.

Contents of the special issue

This special issue on "EU regulation about corporate social and environmental reporting" contains four papers. Three papers encompass empirical insights from Italy, Norway and Spain – which further our understanding of SER regulation in these contexts, while the fourth paper discusses the development of the EU regulation.

In the first paper of the special issue, Costa and Agostini (2016) focus on Italian legislation on the disclosure of environmental and employee matters. This legislation constitutes an implementation of the 2003 amendment to the EU Accounting Directive, reminding us that some SER regulation was already in place before the 2014 changes. Hence, the study by Costa and Agostini provides useful evidence on the impact of a requirement that has been in place for several years. The investigation documents an increase in the quantity of information, whereas the quality of information is generally not improved. Following this, we may expect that the 2014 EU regulation increases the extent to which companies report on social and environmental matters (in countries where similar regulation had not previously been in place), but whether the quality of information will increase as well remains more uncertain. Costa and Agostini argue that the reasons for the ineffectiveness of the regulation could be (a) the lack of focus on stakeholder engagement and institutional change, within which accountability mechanisms could be linked to disclosure (Owen et al., 1997; Cooper and Owen, 2007)

[2] At the time of the impact assessment report, these two studies were at the working paper stage, but they were later to be published in academic journals.

and (b) the ambiguity of the regulatory requirement. As such, it appears that the 2014 EU regulation does not promote institutional change (see also discussion later), but it may to some extent accommodate the latter issue, as it provides more detail on the contents of the disclosure in comparison with the 2003 regulation.

The second paper, by Fallan (2016), aims to study the effects of different ways of regulating environmental reporting in Norway. This represents an interesting endeavor in light of the EU regulation, considering that the so-called ‘smart regulation’ approach adopted by the EU comprises a mix of regulatory means including both mandatory disclosure requirements and voluntary disclosure along with encouragement to prepare disclosures on the basis of international guidelines. Fallan examines four regulatory contexts: mandatory according to law, regulation in a standard, recommendations and the context without regulation, i.e. purely voluntary disclosure. The study finds that legally binding disclosure regulation has an impact on environmental reporting, whereas requirements and recommendations contained within standards are not found to have an impact. It is worth noting, however, that there is no monitoring or enforcement associated with the Norwegian standard in this area, and this may, according to Fallan, explain the lack of impact. The study furthermore suggests that the level of voluntary disclosure is generally higher for those companies that are not legally subjected to disclosure regulation than for those that are. The latter finding suggests that enacting some SER requirements within a jurisdiction’s legal framework may not encourage companies to combine voluntary disclosure with required disclosure in order to provide a more complete picture of environmental performance. Thus, the finding is contradictory to the approach taken in the EU regulation. However, as Fallan also points out, there is a need for much more research that considers the role of different mechanisms of regulating environmental reporting and the potential interplay between them.

Luque-Vílchez and Larrinaga (2016) focus on the Spanish CSR reporting regulation in the third paper of this special issue. This paper employs content analysis to assess the impact of regulation on the quantity and quality of reporting. Moreover, it draws on qualitative interviews to shed further light on CSR reporting regulation as well as to explain findings from the content analysis. The Spanish case contains features that are interesting for an evaluation of the possible implications of the EU regulation for member states that have not introduced SER requirements beyond the minimal requirements contained in the 2003 Directive. Similar to studies carried out in other national contexts (Chauvey et al., 2015; Costa and Agostini, 2016), this Spanish study only finds a limited improvement in the quality of information as a result of the regulation. This leads Luque-Vílchez and Larrinaga to suggest that disclosure regulation in isolation may not be sufficient to raise the level of CSR reporting. They therefore echo the arguments of Costa and Agostini concerning the need for institutional change. The 2011 reporting requirement in Spain was part of a regulatory programme that included the setup of a council (‘SCCSR’) that develops reporting guidelines for CSR reporting, an obligatory submission of the CSR report to that council, the expectation that the disclosed information could be enforced by the government as well as a range of stakeholder engagement activities around the SCCSR (see also Archel et al., 2011 for an analysis of activities prior to 2011). The interviews in the study by Luque-Vílchez and Larrinaga do, however, illustrate that for various reasons these structural elements were not very successful. For instance, views on CSR reporting did not converge within the quite extensive stakeholder consultation activities. Additionally, the reporting practices that existed before the regulation were quite different from what was expected following the 2011 regulation and that the government was not willing to develop enforcement mechanisms. These findings resonate with Bebbington et al. (2012) who stress the necessity of maintaining a normative climate in order for reporting regulation or guidance to be successful.

The fourth paper, written by Monciardini (2016), utilises a political economy approach to shed light on the EU regulatory process. If the success of the EU regulation depends on the acceptance of reporting norms among a broader set of actors (Bebbington et al., 2012; Luque-Vílchez and Larrinaga, 2016), then Monciarini’s study puts forth a positive message, as it illustrates how the EU regulation on non-financial reporting obtained broad support among a ‘coalition of the unlikely’. This informal coalition appeared to represent an alignment of views among investors, NGOs and some trade unions, who supported EU regulation on non-financial disclosure. This coalition was, according to Monciarini, a significant driver in the regulatory process. As Monciarini explains, however, upon closer inspection the coalition may not be that unexpected after all, as all of these stakeholders have an interest in corporate transparency. In addition, he points out that employees, as represented by trade unions, have interests as investors via pension schemes. Monciarini maintains that the informal convergence of interests is not based on a shared interest in social and environmental matters, but rather, it is predicated upon a common interest in calling for action in the name of transparency which could correspondingly limit the power of corporate management. The study also shows that the alignment of views did not encompass stakeholders that represented European enterprises, such as BusinessEurope and employer’s associations in Germany. These appeared as the strongest opponents against EU regulation and, interestingly, both the interviewees in Monciarini’s study and those in other investigations have indicated that this opposition received support from the German Government (Kinderman, 2013). The opposition appeared to be particularly intense immediately preceding the publication of the proposal by the Commission in 2013, and, according to Kinderman (2013), a key issue was that the German Government and the employer’s associations wanted to inject an aspect of voluntarism into the EU regulation. This may explain why the idea of ‘smart regulation’ and a flexible regulatory approach appeared as significant rationales by the end of the regulatory process – a short time before the

Commission’s proposal in 2013, which was eventually approved by the EU Parliament and Council in 2014.

Concluding remarks

Social and environmental accounting research should inform the making of regulation about social and environmental disclosure. This is not easy to accomplish and the EU regulatory process did not draw much on academic research studies. However, the current trends suggest that most regulators attempt to produce evidence-based regulation, or at least appear to be making regulatory decisions based on evidence about the effects of policy options. There should therefore be potential for scholars to encourage policy-makers to make use of social and environmental accounting research. The papers included in this special issue provide examples of research that is highly relevant for policy-making and this editorial further highlights some areas in which the EU impact assessment appeared to incorporate a shortage of substantiated analysis.

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Table 1. The EU regulation on non-financial disclosure (article 29a)

1. Public-interest entities which are parent undertakings of a large group exceeding on its balance sheet dates, on a consolidated basis, the criterion of the average number of 500 employees during the financial year shall include in the consolidated management report a consolidated non-financial statement containing information to the extent necessary for an understanding of the group's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including: (a) a brief description of the group's business model; (b) a description of the policies pursued by the group in relation to those matters, including due diligence processes implemented; (c) the outcome of those policies; (d) the principal risks related to those matters linked to the group's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the group manages those risks; (e) non-financial key performance indicators relevant to the particular business. Where the group does not pursue policies in relation to one or more of those matters, the consolidated non-financial statement shall provide a clear and reasoned explanation for not doing so.