



ESG STUDY

Executive Summary of the Final Report on the Horizontal Study commissioned by the Federal Ministry of Justice and Consumer Protection and on Recommendations for action regarding the NFRD Revision

Editorial note:

The following Executive Summary is a convenience translation of the respective section in the full report. The full report is available in German only, and the German language version shall in any case be regarded the authoritative version.

Executive Summary

Commissioning

- ES.1 On March 19, 2020, the German Federal Ministry of Justice and Consumer Protection ("the Ministry") commissioned the Accounting Standards Committee of Germany ("ASCG"/DRSC) to conduct a study on the implementation of the requirements introduced by the Non-Financial Reporting Directive (NFRD) Transposition Act.
- ES.2 As part of the work, (a) the **non-financial reporting of 100 representatively selected companies** over the **three-year period 2017-2019** was examined in a horizontal study based on **15 predefined topical areas**, (b) **four** three-hour **outreach events** were held, each with 25 participants from all stakeholder groups (preparers, auditors and users of the information, including representatives of civil society), and (c) **recommendations for action** on the upcoming revision of the NFRD with regard to eight overarching issues based on the above sub-work were submitted.
- ES.3 Since the sample companies are equally composed of capital market-oriented companies on the one hand and banks and insurance companies on the other, the **results of this study are not readily comparable with the results of other studies**.
- ES.4 The study has three chapters. In the first chapter, the commissioning and the methodological approach are presented in detail (paras. 1-46). The second chapter presents the results of the horizontal study on the questions requested by the Ministry (paras. 47-234). Finally, the last chapter presents the requested recommendations for action along with detailed justification (paras. 235-423).

Key results of the horizontal study

(a) Formal aspects (chapters 2.1, 2.2 and 2.13 to 2.15)

- ES.5 All of the **location, format and publication variants** listed in the Act were identified at the companies surveyed. The **majority** of companies publish the non-financial statement **outside the management report**. The **separate non-financial report** is the most frequently chosen format.
- ES.6 The **length of the non-financial statement** is subject to a certain discretion since not all of the law's requirements are equally relevant for all companies and business models, and due to differences in the layout and format of the statement, which led to the ASCG defining a standard page. A range of four to 225 pages with an **average of 41 pages** per statement was observed, measured over the entire period of the study. As a rule, separately published non-financial statements are more extensive, which is particularly pronounced in the case of banks and insurance companies.
- ES.7 **Most non-financial statements were prepared using frameworks**. The degree of compliance was very heterogeneous. GRI standards were cited most frequently; the German Sustainability Code was used in particular by financial institutions. In approximately one third of the reports in which no reference to the use of a framework was apparent, there was no corresponding justification for non-application.
- ES.8 **Almost 60%** of the non-financial statements examined were **not subjected to an external review** of their content. External auditing is significantly more common among capital market-oriented companies than among unlisted banks and insurance companies. Where external audits were performed, the **majority of the audits were performed with limited assurance**. Most of the audits were performed by the companies' auditors (87.6%), with the Big4 companies accounting for the largest share (88.4%).

(b) *Content aspects (chapters 2.3 to 2.12)*

- ES.9 In just under half of the reports, the underlying **understanding of materiality** was described; in a further 35% of the reports, it could be derived from the specification of the framework used. Most reports stated that the double materiality principle was applied to determine the content to be reported such that aspects are only reported if the issue to be reported is material *both* for the value creation within the company *and* for the impact on the company's environment (termed a '**double materiality constraint**').
- ES.10 Almost all sample companies reported on all **minimum aspects** required by the act. However, the **issues reported and the depth of reporting vary considerably**. This is probably due to the diversity of the underlying business models and reporting based on the principle of materiality.
- ES.11 **Clear statements on the reporting about consumer issues cannot be made** based on the non-financial statements examined. This is probably due to the fact that consumers are a subset of all customers and most of the report contents cannot be attributed to consumers alone unambiguously. The survey results should therefore be understood as possible maximum scores if the sample companies have at least included consumers in all cases of **customer issues**. Although consumer issues are not among the minimum aspects required by the Act, most of the sample companies reported on corresponding content relating to customers. One or more concepts on customer concerns were reported by about 40% of the sample companies.
- ES.12 **Information on data protection and data security** is a sub-aspect that was **addressed in almost 50%** of the non-financial statements of the sample companies. The location of the content of the sub-aspect was company specific. With an increasing tendency, the explanations went beyond individual statements and took the form of independent concepts – albeit at a low level.
- ES.13 The **reporting of concept results varied** during the period under review. Except for the aspect 'respect for human rights', more than 70% of the reports provided information on results; however, the **substance of the reported results is very heterogeneous**. Most of the reports reported on the status of the **implementation of measures**; quantitative information in the context of the conceptual results was also found in more than 50% of the reports. Information on the achievement of objectives was rarely observed in this context.
- ES.14 **Less than half** of the non-financial reports in the sample contained **information on quantified targets**. Just over a quarter of the reports mentioned the achievement of targets. Specific information on the time reference of the targets and on target/actual comparisons is observed less frequently. The **aspects 'environmental issues' and 'employee issues' are dealt with in much greater detail** than other aspects. Over the period under review, an increase in report quality/content (in terms of the concept categories) can be observed.
- ES.15 **Non-financial key performance indicators** were reported most frequently and also with the highest average number for the **aspects 'employee issues' and 'environmental issues'**. The aspect 'respect for human rights' was underpinned by non-financial performance indicators in the fewest reports. From the information in the reports **the KPIs' relevance for managing the company could be derived in very few cases only**.
- ES.16 **Risks** were most frequently reported in relation to **'employee issues' and 'combating corruption and bribery'**. For the individual reporting elements, the focus was predominantly on risks arising from business activities and on the management of risks. However, the **reporting is not yet very detailed**: Risks from products and services are only

rarely covered, as are, for example, risks from business relationships, apart from the aspect 'respect for human rights'. The **temporal relationship** of the non-financial risks was **hardly ever stated** in the non-financial statements.

Recommendations for action

Scope (paras. 242 et seqq.)

ES.17 The ASCG recommends that the Ministry, in the event of a desired extension of the scope of non-financial reporting, primarily consider **abandoning the capital market criterion** and introduce that suggestion in the European discussion. Only secondarily does the ASCG encourage consideration of **lowering the number of employees to the 250 employees** otherwise specified in the Accounting Directive for large corporations.

Location (paras. 275 et seqq.)

ES.18 The ASCG recommends that the Ministry consider standardising the form of publication by **requiring disclosure in the German Federal Gazette** (*Bundesanzeiger*) and that the discussion focus on providing a **self-contained presentation of non-financial information**. In addition, the ASCG recommends to the Ministry that the location of the non-financial statement **within the management report should continue not to be mandatory**.

Aspects to be reported (paras. 304 et seqq.)

ES.19 The ASCG recommends that the Ministry should, for the revision of the NFRD, in particular, press for a **clarification of the provisions** regarding '**concepts**' (including their results) and '**due diligence processes**'. In this regard, the ASCG recommends that the Ministry promote the **adoption of the corresponding content of GAS 20 as a mandatory component of the Directive in the European consultation process**.

Non-financial risk reporting (paras. 321 et seqq.)

ES.20 Due to the increased importance of risk reporting, the ASCG recommends that the Ministry presses for a **definition of the term 'risk'** as '*negative deviation from a target*' in Art. 2 of the **Accounting Directive**. Furthermore, the ASCG recommends pressing for a more precise definition of the term 'inside-out risks' and for **non-financial risk reporting to be unambiguously referred to in the directive as two-sided reporting**. In addition, the ASCG recommends that the Ministry advocate **lowering the entry hurdle for reporting** from 'very likely' to 'likely' but leaving it at 'serious adverse effects' for the consequences. Finally, the Ministry is advised to **focus the reporting on the presentation of the nature of the risks**, the measures decided by the company to mitigate them and the **measures actually taken**, as well as the **achievement of targets**.

Non-financial key performance indicators (paras. 350 et seqq.)

ES.21 The ASCG recommends that the Ministry always **balance mandatory disclosure of KPIs** against the principle of relevance for reasons of comparability over time and between companies. Certain **KPIs that are in the public interest (and ideally already established internationally)** may be assumed to be relevant in the NFRD itself and required of all companies; however, their number should remain limited to a minimum set. Against the background of existing requirements under Section 289 (3) of the German Commercial Code (HGB), the Ministry is also advised to **limit the requirement to report KPIs that are not considered relevant for management purposes** to the cases mentioned above, so as not to interfere with established capital market communication.

Materiality understanding (Tz. 364 et seqq.)

ES.22 The ASCG recommends that the Ministry **press for a clarification** of the statements in the Accounting Directive with respect to the materiality principle **in the direction of an 'or' linkage**. Furthermore, the ASCG recommends that the **principle of materiality be supplemented by the principle of relevance**, which logically precedes it. In addition, the ASCG recommends that the **requirement for zero statements or misstatements be addressed** in the context of non-financial reporting – but only where these serve to make the information provided clear and understandable.

Standardisation (paras. 384 et seqq.)

ES.23 The ASCG recommends to the Ministry that the **comparability** of information should **not be considered in isolation from the criterion of the relevance** of the information for the addressees. In the event of a standardisation requirement in the directive, the ASCG recommends that the Ministry addresses **making use of global frameworks and industry-specific standards**. In the event that stand-alone European standard-setting is introduced, the ASCG strongly recommends that the Ministry advocate that this be **limited to the exploration of metrics to meet European-specific Level 1 standards**. In particular, any **activities should not spill over into accounting/financial reporting**. In line with the principle of differential reporting of information according to the type and size of the company, the Ministry is advised to **promote the use of simplified frameworks**, in particular for those companies that would be required to report in the event of a possible extension of the scope of application.

Audit requirement (paras. 399 et seqq.)

ES.24 The ASCG recommends that the Ministry press for the **introduction of an audit requirement in stages** at the European level. In this context, it is recommended that, in the event of the introduction of an audit requirement, the Ministry should initially advocate an **audit review** (audit with limited assurance) and suggest its **evaluation after a few years** and, if necessary, adjust it in the direction of an audit with reasonable assurance. In the event of an extension of the scope of the NFRD at European level, it is recommended that the Ministry advocate the introduction of an audit requirement for **companies falling within the scope of the standard for the first time with a time delay**, in order to be able to establish the processes, controls and systems required for an audit.

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