



NOTE

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The Danish Government's response to the public consultation on the revision of the Non-Financial Reporting Directive

It is a key priority for the Danish Government to enable a green and sustainable transformation of the society and accordingly the Danish government has set an ambitious target to reduce CO₂ emissions by 70 % in 2030. Private companies play a vital role in order to fulfil the ambitions of the CO₂ reduction targets nationally and of the Paris agreement, to fulfil the UN sustainable development goals, the purpose of the UN guiding principles for business and human rights and the OECD guidelines for responsible business conduct.

The Danish Government supports the initiative of the Commission in the European Green Deal to evaluate the Non-Financial Reporting Directive (NFRD) and appreciates the opportunity to comment on the Commission's public consultation.

Capital and investment are necessary in order to finance transformation at the company level and even more so in light of the Covid-19 crisis. The core message from leaders at Davos 2020 was not to be misunderstood – investment and finance will increasingly be directed towards sustainable activities. We need to make sure that European businesses are optimally equipped to attract the increasing amount of green and sustainable investment funds both at the European level but also at the global level.

The reporting framework of the non-financial reporting directive (NFRD) plays an important role in enabling company documentation for investors and other stakeholders. Implementation of the requirements of the NFRD has contributed to increased transparency and a shared focus between Member States. The directive has provided flexibility due to the comply-or-explain principle in accordance the wishes of companies in general. However, we see a gap between needs of the users of non-financial information (NFI) and the information given in the reports from companies. The Danish government believes that a revision of the NFRD is needed to strengthen the quality and value-creation of non-financial reporting.

From October 2019, the Danish Business Authority has engaged in a wide stakeholder dialogue on CSR reporting at the national level. While stakeholders have different purposes for reading non-financial information, it is our conclusion that they generally ask for more data in the form of standardised indicators as well as more structure in the reporting format. Many stakeholders are now placing increased importance on non-financial information and they are asking for a higher degree of alignment of reporting on financial and non-financial information. Further, in the autumn of 2019 the Danish government launched 13 climate partnerships representing different sectors and chaired by CEO's of some of the biggest Danish companies. Among their recommendations published this spring, a number revolved around the need for more standardized data and reporting on CO2 emissions.

To reach the goal of more value-creating non-financial reporting we find it important to have easy access to both digital financial and non-financial information. The data should be easily accessible for the investors in the same document and structured non-financial data is recommended.

Finally, we would find it beneficial if more companies could be encouraged to report on non-financial information while keeping in mind that resources, size and competences vary significantly at the company level in Member States. The Danish Government proposes to introduce different level of requirements based on a proportionality perspective to engage more companies including SME's to report as a minimum a set of core KPI's.

Quality and scope of disclosed information

The Danish Government agrees that both investors and other stakeholders are asking for more relevant, reliable and comparable information. Reporting on relevant KPI's is essential for a fair, balanced and understandable report and this will positively contribute to transparency. The updated Non-Binding Guidelines on the NFRD clarifies some of the articles of the NFRD. However, the guidelines are not enough to secure relevant and necessary information.

The Danish Government strongly endorses the Commission to establish a minimum set of standardised ESG indicators. The set of ESG disclosures must be compatible with the needs for information from the financial market participants as required by the Disclosure Regulation and the Taxonomy Regulation, thereby providing companies and investors with structured data to make informed choices on sustainability challenges. When disclosing ESG-indicators, companies must also disclose their targets to provide information on progress for users.

We encourage the Commission to update the section on KPIs in the Directive, not only on climate, but on all topics. In relation to disclosures, focus should be on the quality of the KPIs rather on quantity. A long list of KPIs or KPIs without information on the applied method may be counter-productive due to the risk that companies may focus on reporting on all the KPIs instead of those that are material or only KPIs, which show a positive development. A common and detailed standard method for all KPIs is essential for the quality and comparability of the reports. For a report to be fair, balanced and understandable there must be a link between companies' reporting on their policies and principal risks, and matters related to those risks, as well as to the undertaking's operation and its KPIs.

The requirement to report on **due diligence processes** in the NFRD's article 19a (1) is vague and could be revised to more clearly require companies to disclose whether they practice due diligence processes or not. A simple Y/N option would increase transparency significantly compared to status quo. At the same time, the Danish Government do not believe that substantial requirements to due diligence processes should be part of the NFRD revision if the purpose of aligning financial and non-financial reporting is to be achieved. The Danish Government believes due diligence processes to be a very important part of responsible business conduct and stand ready to discuss the issue outside the scope of the NFRD.

Data ethic relates to the use of increasing amounts of data and the ethical considerations a company must make when applying new technologies. Data is becoming increasingly important in business models, and digital responsible companies will be strengthened by a requirement of reporting data ethic policies. We therefore encourage the Commission to consider including new provisions for companies to prepare a non-financial statement containing information relating to their data ethics policies as part of their annual management reports. The aim is to create focus and transparency on European companies' work with data ethics for the benefit of potential business partners, investors and customers. If data ethics are to be covered by the directive on non-financial reporting, it will become a global competitive parameter that supports a European way for digital responsibility and differentiate European companies from e.g. Chinese and American companies.

With a view to ensure fulfilment of the aims of the European Green Deal and the new Circular Economy Action Plan, we support the Commission's intention to enhance disclosure of environmental data. We also encourage the Commission to include provisions for companies to provide information on the work of the company in the area of circular economy principles. Developing the EU as a circular economy is an important part of delivering on the Paris Agreement on greenhouse gas reductions and at the

same time holds great potential for cost savings and business development for companies. Accordingly, developing standardised KPIs on circular economy is important. The KPIs on circular economy should be aligned with the definitions set forward in the Taxonomy Regulations article 13.

Standardisation

In order to support companies in reporting in compliance with the NFRD, one standard rather than a multitude of standards from different standards setters is desired to ensure quality of the report, but we do not see that any of the existing reporting frameworks and standards are able to cover the entire scope of the NFRD on its own.

Denmark strongly supports a global holistic solution for the disclosure of non-financial information. European companies often have suppliers, investors and customers around the world and non-financial issues like environment and labour rights are also not just European issues. Consequently, the Danish Government sees one global non-financial reporting framework or set of standards as the ambitious goal. European guidelines can be a step in the right direction preferably as a first step solution to the long-term goal of a global standard.

There are several European initiatives on non-financial reporting. It is important that these initiatives are aligned. It is highly important to ensure alignment between the NFRD and the concrete reporting demands of the Disclosure and Taxonomy Regulation.

European Financial Reporting advisory Group (EFRAG) is contributing with great success in regards to the international work on developing standards for financial reporting. EFRAG have competences in relation to developing financial reporting standards and have a good dialogue with both companies producing financial statements (preparers) and the users of the financial statements. EFRAG have been involved in the work with non-financial reporting (NFR) as the EFRAG reporting LAB have been established and are publishing valuable information regarding NFR. We believe that the competences of EFRAG are very useful in the process of the development of guidance of NFR.

Therefore, the Danish Government suggests that until new international standards on non-financial reporting have been developed and approved, EFRAG may issue temporary guidelines on non-financial reporting to the European companies. EFRAG reporting LAB may assist in the work on guidelines for the European companies – especially regarding the development of KPI's.

This will, however, require that EFRAG receives the necessary resources as this is an additional task, but also because it will be necessary to recruit specialists on NFR.

It will furthermore require some changes to the governance of EFRAG in order to make sure that the interest of all relevant stakeholders on NFR are included in the decision-making process regarding issuing guidelines on NFR.

If it is not possible to have an international standard or have European guidelines from EFRAG under condition of the necessary changes in EFRAGs governance structure, then The European Securities and Markets Authority (ESMA) could get a central role regarding NFR. ESMA is fully involved in the work with NFR in the EU and has a broad network with the National Competent Authorities (NCA's) in the EU about the reporting of both financial and non-financial information. ESMA has also knowledge and experience with preparing financial guidelines/standards. ESMA attends to the interest of the financial investors' operating on the financial markets. It will therefore also require changes in ESMA, as ESMA will need to get expertise on not only listed companies but also non-listed companies, both large and SMEs. The decision-making process in ESMA is based primarily on collaboration with the NCAs, but in case ESMA would be tasked with developing guidelines on NFR, it would be necessary to consider governance arrangements to better reflect input from preparers, users and other stakeholders.

The Danish government also has an ambition to enable SMEs to report on ESG matters to a larger extend in order to steer SMEs attention to new sustainable business models as well as attracting investment and capital to sustainable SMEs. Danish studies of NFI reporting illustrates that the level of reporting is still very fragmented and somewhat immature on ESG indicators. Our study and dialogue with stakeholders have also provided insights to the significant transitional task a structured and more value-creating NFI reporting will require in SMEs, as they have to develop processes, systems and skills to report efficiently. Danish SMEs are asking for voluntary, simple reporting solutions allowing them to document sustainable business models and activities with respect to the resources available for small and medium size companies. While we believe that mandatory requirements to a simplified standard for SMEs would be an ambitious goal in the long term, we acknowledge that in the short term a voluntary solution accompanied by SME specific guidance is the optimal solution.

Materiality

The Danish Government is aware that some companies find it difficult to adequately address materiality. This insecurity decreases transparency and

companies are asking for further guidelines on materiality. We strongly believe that the concept of double materiality is reasonable for non-financial reporting and we encourage the Commission to prioritise ensuring that a future standard for non-financial reporting provides clear guidance on how the double materiality principle relates to all of the non-financial matters – environment, social and employee issues, human rights, bribery and corruption – as included in the NFRD.

Assurance

The Danish Government recommends the Commission to seek stronger assurance requirements for non-financial information, with limited assurance as the required level of assurance. Keeping it as a possibility for ambitious companies to choose voluntarily to have Reasonable assurance. The Commission may look at the standard ISAE 3000, however, we believe that both auditors and stakeholders need further guidance on assurance on non-financial information. This guidance must ensure that the stakeholders are aware of the role of the statutory auditor and what auditor checks have been made.

Digitisation

We find it important to ensure future-proof solutions. This can among other things be done by allowing for the use of digital solutions to the widest possible extent, especially in relation to reporting requirements. There is great potential in reporting through the same digital solution for both the financial and non-financial information in the annual reports. This would also ensure a smooth interlinkage between NFI and investments into sustainable activities. This should of course be based on a consideration of cost-benefit.

Structure and location

The Danish Government suggests applying the same structure as known from financial reporting to non-financial reporting. This will help ensure that all relevant information is included. This is important in order to ensure the understanding of the undertaking's development, performance, position and impact of its activities, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

We conclude that the flexibility of the Directive to either publish NFI in the management report or in a separate report have a negative impact on the user's ability to find the information. Hence, we encourage the Commission to require publishing NFI only in the management report. Wherever the non-financial information is published, it is important that only relevant NFI is included and that the information is well structured and enables digital reporting.

Personal scope

For good reasons the scope and requirements of the NFRD has only applied to one category of companies – the largest public interest entities. However, we see two somewhat opposing trends in society today. Firstly, more complex and extended non-financial information is demanded from large companies by various stakeholders especially regarding climate information. The requirements of the Regulation on Sustainable Finance (taxonomy) is one example. Secondly, smaller companies also need to transform their business to sustainable activities and attract investment with fewer resources available for reporting. For these reasons, it may be time to apply different scopes and levels of requirement in the NFRD. For these reasons, we find it difficult to apply a one-size-fits-all approach to reporting.

We encourage the Commission to look at a three-level regulation under the NFRD. First level, keeping the full set of requirements for the public interest companies with more than 500 employees including the reporting requirements for non-financial companies in the Taxonomy Regulation. Second level, introducing a set of a minimum core requirements focused on EGS reporting on a set of relevant KPI's for the public interest companies with 100 to 500 employees and large companies which should seek to achieve coherence with the requirements under the Disclosure Regulation. Reporting on relevant KPIs is essential for a fair, balanced and understandable report and we encourage the Commission to have in mind that the companies differ in size and resources. Third level, a voluntary standard for SMEs with a core of ESG indicators, which should also, to the extent possible, be aligned with reporting requirements in the Disclosure Regulation.

We encourage the Commission to develop simple and clear criteria for the scope of each level and provide sufficient guidance for companies. A complex set of criteria may risk creating new uncertainties for companies and, hence, introduce new burdens.

Level of regulation

The Danish Government believes that regulating non-financial reporting should continue in the form of a directive aligned with the Accounting Directive (Directive 2013/34/EU). Also, some categories of information needs a certain flexibility to apply national considerations like emission factors for calculating CO2 emissions.

In conclusion, requirements in the NFRD should ensure a high level of quality and transparency of information in the reports. We would like to cover all sizes of companies, but stress that no size fits all. We believe that

the criteria highlighted in this paper are important to achieve more comparable and reliable reporting on non-financial information. We look forward to contributing actively to the revision process.