BUSINESSEUROPE

COMMENTS

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TAXONOMY DISCLOSURE OBLIGATIONS (ART. 8)

BUSINESSEUROPE'S RESPONSE TO DRAFT ART. 8 DELEGATED ACT

Companies are committed to integrating sustainability in the core of their business strategy and models, and the Taxonomy Regulation can support their transition. The disclosure of relevant information in relation to companies' economic activities may provide reliable, comparable and relevant data, that would bring clarity and transparency on environmental sustainability to investors, companies and issuers. For these reasons, BusinessEurope supports the overall objectives of the Taxonomy Regulation.

BusinessEurope welcomes the opportunity to respond to the public consultation on the draft Article 8 Delegated Act (DA) of the Taxonomy Regulation. Companies find it very challenging to start preparing for reporting obligations under the Taxonomy Regulation. The draft DA gives a preliminary indication of what corporate disclosure requirements might be. We particularly welcome the improved clarity on some of the "what", "when" and "how" questions. However, we note that the current draft version of the Art. 8 DA is often unclear and sometimes even in contradiction to the Level-1 legislation. This prevents a feasible and comparable implementation of the reporting requirements. To reach the objectives indicated above, it is necessary that the disclosure obligations are legally sound, usable and proportionate. Any deviation from these principles risks undermining the overall reporting concepts of relevance and materiality.

We particularly stress that it is paramount that companies have enough time to implement the disclosure requirements. It cannot be emphasised strongly enough that Taxonomy reporting is likely to be costly and complex to implement: preparing the disclosure is likely to involve hundreds or thousands of detailed technical and accounting judgments, with a need to ensure consistency with other disclosures made in the company's financial statement. The input data required to prepare the disclosures under the Regulation is currently not readily available within the reporting systems of non-financial undertakings and great efforts are needed to set up and adapt reporting processes as well as IT and reporting systems to derive this information. Several technical and accounting judgments will therefore be necessary to generate data, the initial reporting cycles will entail significant manual efforts, and the costs associated with updating legacy systems are still very much unknown. Significantly, while workflows can eventually be automated, many of the required data points require discretionary decisions, implying a significant commitment of human resources on an ongoing basis. Considering the difficulties and uncertainties in implementing the Taxonomy disclosure obligations, we call on the Commission to delay by one year the Art. 8 DA.

To better clarify the concerns and questions that companies have on the draft Art. 8 DA, this paper describes the legal, usability and coherence problems that have been identified by the business community.

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1. Legal issues

The Taxonomy Regulation (in its Art. 8) requires companies to disclose how and to what extent their activities are associated with environmentally sustainable economic activities. However, the draft Art. 8 Delegated Act goes well beyond this. It leads to considerable overreporting and proposes a level of granular information that is not always justified for investors' decisions.

1.a Taxonomy aligned vs Taxonomy-eligible but not aligned vs non eligible
The draft DA not only requires companies to disclose how and to what extent their activities are 'Taxonomy-aligned', but also to report on activities that are 'Taxonomy eligible but not aligned' as well as introduces a new category of 'not eligible' activities. This disclosure requirement raises a number of questions and, from a legal perspective, this detailed information is not required in the Taxonomy Regulation. It would give competitors unprecedented access to company's business models and strategic investment planning, therefore undermining the EU's competitiveness. Furthermore, it would lead to litigation risks against those companies who have activities failing to comply with the Do Not Significant Harm criteria.

From a formal perspective, we notice that 'Taxonomy-eligible but not aligned' activities are not defined in Art. 2 of the DA (more in the coherence chapter), thus leading to misinterpretations. Furthermore, we note that in some cases, the data points requested from non-financial companies are not even used in the metrics to be disclosed by financial companies, raising the question of why this information is requested in the first place.

1.b Accompanying disclosures
The draft DA sets out a list of more than 30 pieces of mandatory information in addition to the data already presented in the disclosure tables (sections 1.2). The right to 'comply by reference' by cross-referencing to other parts of the financial or non-financial statement is not granted. As a result, there is a real risk of the 'accompanying disclosures' effectively becoming a parallel annual report, with all the risk this creates around maintaining coherence with other parts of the financial statement.

Companies are requested to disclose their future objectives and targets for their KPIs and their plans to achieve them. However, this 'other additional information' (as the name indicates) in section 1.2.3.4 not only goes beyond what is requested for companies' CapEx and OpEx plans, but also the Level-1 legislation which does not refer to mandatory disclosure of companies' long-term objectives and targets.

Moreover, we expect that the implementation of this provision will be very difficult if not impossible: companies do not have the full knowledge of the whole Taxonomy package and have no information on how criteria will develop over time. Taking into consideration that a newly built plant might run for more than 10 years, the sales (when the plant is running) might be due to the change in the criteria. Also, the wording in the draft DA, "(disclosure of) future objectives and targets for the KPIs and (corporate) plans to achieve them", is unclear and leaves room to several interpretations: what would be the timeframe of this target disclosure? Should the objectives be the same as the Taxonomy's six environmental objectives? Where should companies disclose these future objectives and targets? Moreover, given the volatile character of certain businesses, objectives and targets could be missed if market conditions developed unfavourably.

We also fear that such disclosure may make companies vulnerable to litigation (as forward-looking information may be considered as speculation in some cases for publicly listed companies, which is not allowed).

Finally, we note that this additional proposed disclosure contains sensitive information. Therefore, publishing this information compromises a level playing field, as only European companies will be required to disclose such commercially sensitive data. We therefore suggest that this disclosure could be envisaged on a voluntary basis only.

2. Usability issues

The proposed disclosure requirements under the Taxonomy Regulation for non-financial corporates will inevitably require upgrades of accounting and reporting systems, as the future obligations will require new reporting processes and structures. Companies have already attempted to organise internally for a few months now, and they notice how challenging it is to prepare the new reporting obligations, as the basis of the corporate disclosure requirements has still not been finalised. The delays in finalising the DA and the current unclear draft provisions impede any implementation of the Taxonomy Regulation at this stage.

2.a Time of first implementation

BusinessEurope acknowledges the proposed simplification of the first reporting year (draft Art. 11). However, many uncertainties still exist. Firstly, the draft Art. 9 only refers to the "share" of Taxonomy eligible and non-eligible activities, leading to misunderstanding of the actual requirements for the 2022 application. Also, the definition of "non eligible activities" is unclear as the scope of the activities described in the DA is subject to different interpretations (e.g. should companies refer to NACE codes only?). Furthermore, considering columns 18 and 19 in Annex II, a simple phase-in (but without one year postponement, as suggested by the Commission) would only park the 2021 reporting problems: in 2023, when disclosing 2022 data, companies would be required detailed (and initially not requested) information. With such a high level of uncertainty for both companies and auditors, very complex requirements and short time to properly prepare and agree on common definitions, we urge the Commission to push back the reporting obligations by one year.

Our recommendation is to implement phased-in reporting starting in 2023. This would provide adequate time for companies to understand the disclosure requirements, assess the eligibility of their economic activities and allow for a proper implementation of the requirements at company level. Introducing limited reporting in 2023, and full reporting in 2024, would also have the advantage that the Delegated Acts for all six environmental objectives would be finalised. Companies could therefore perform their initial assessment of Taxonomy alignment with a full set of screening criteria. We further stress the importance of aligning Taxonomy's reporting obligations (including their implementation) with those that will be created with the new corporate sustainability reporting directive.

Beyond the benefits of better implementation and policy coherence, we stress that a one-year postponement of the phased-in approach would therefore not only be the most workable solution, but also the only way to ensure sufficient data quality and comparability, which are essential to a successful roll-out of the Taxonomy.

Furthermore, we note that the co-legislators foresaw this risk of delay (see recital 57 of the Taxonomy Regulation) and suggested that the Taxonomy's obligations should become applicable 12 months after the relevant technical screening criteria have been established. We therefore stress that companies should not pay for the delayed adoption processes on the technical screening criteria for climate change objectives and reporting requirements, and this request can be accommodated without reviewing the actual Level-1 legislation.

Finally, it should be made clear that the 2022 reporting to be released in 2023 shall be on the basis of criteria and activities that have been formally published in the EU's Official Journal by the end of 2021. It should also be clearly stated that for the 2023 reporting in 2024 the previous year should not be disclosed (as in 2023, only "eligible" activities should be disclosed). This should start only for the 2024 annual report in 2025.

2.b Format of the disclosure

As mentioned in our previous position[1], companies should be granted a sufficient level of flexibility on how to report on their proportion of turnover, CapEx and OpEx related to environmentally sustainable activities. However, the Annex II of the draft DA includes a detailed template for the corporate report. This template adds considerable reporting complexity, potentially discloses sensitive data and in several cases generates information of limited value for investors.

Whilst the Taxonomy Regulation sets an 'obligation of end' (i.e. disclosing the share of their Taxonomy-aligned activities), companies are best placed to decide about the structure and format of their reports.

For a more meaningful disclosure, we expect the DA to concentrate on qualitative data reporting, allowing flexibility to determine the content and presentation of the narrative. To better reflect sectorial peculiarities, limit companies' reporting costs and ensure better market uptake without causing competitive disadvantages for European companies, we recommend that the draft DA is revised to require companies to only report on the proportion of total turnover, CapEx and OpEx that are Taxonomy-aligned, without detailed breakdowns per activity, environmental objective and reason for alignment or non-alignment. Companies may decide to disclose even more and granular data, but this should be a voluntary decision to be accorded to each undertaking.

2.c Reporting of previous periods

The draft DA requires 5 year of retrospective information starting from the first application date (draft Art. 9-3). This draft provision is apt to two interpretations. The first interpretation suggests that companies will need to analyse retrospectively information from 2017 (when data was not prepared under the required format, because the Taxonomy did not even exist), which would be an almost impossible exercise. We also strongly question the value added for investors who are far more interested in a forward-looking report. The second interpretation suggests that the 5 years-retrospective information requirement would be implemented progressively (e.g. in 2025, companies should provide a three years-comparison).

[1] BusinessEurope Position Paper (February 2021), Comments on Taxonomy's reporting requirements (Art. 8) https://www.businesseurope.eu/sites/buseur/files/media/position_papers/iaco/2021-02-22_pp_taxonomy_reporting_obligations.pdf

Although the second interpretation would be more comforting, the business community is still puzzled about this new request and cannot understand the logic behind it. Typically, financial statements are required to provide a one- or two-year comparison. Therefore, we recommend that: 1) the Regulation clarifies that the requirement to provide comparative data does not apply retroactively to reporting periods prior to the effective date of the first year of reporting and 2) companies should not provide for more than one year of comparables.

The second request is due to the fact that the second interpretation described above would also be problematic due to the structure of the Taxonomy: considering that the technical screening criteria are bound to evolve, reporting the three metrics over a 5 years-period would entail complex and recurring re-assessment of historical data based on a framework that continuously updates. This is particularly true for old CapEx projects which might already be finished and therefore such a reassessment would be counterproductive. We therefore ask that this paragraph is completely removed, and the focus is rather maintained on reporting annual data from the previous year and explaining (in qualitative manner) the main changes occurred.

2.d Contextual information
Another usability concern comes from the request to disclose quantitative breakdowns of the numerators for turnover, CapEx and OpEx, over and above the information already provided in the disclosure tables. According to the draft DA (sections 1.2.3.1/2/3), companies will be required to disclose revenue from contracts with customers, lease revenue and/or other sources of income, additions to property, plant and equipment. This kind of information is extremely granular and puts at risk commercially sensitive business plans and models, which would overall undermine the EU's competitiveness. To avoid this kind of risks, we recall that existing financial accountancy rules only request segmented reporting on turnover exceeding 10%. The Taxonomy Regulation and the Non-Financial Reporting Directive (NFRD) refer to material information, whilst this extra requirement goes beyond the very concept of "materiality". In this context, we would recommend giving space to companies to clarify material changes in qualitative terms and to permit 'compliance by reference'.

2.e Compliance with technical screening criteria
In case of contribution to multiple objectives (1.2.2.2), the draft DA requires non-financial undertakings to "demonstrate compliance" with the technical screening criteria in respect to several environmental objectives. However, it is not clear how and why this demonstration should be made, since companies are already required to explain how they "assessed" their compliance with the relevant technical screening criteria and avoided double counting in the calculations (1.2.2.1). We therefore propose to replace the obligation to "demonstrate compliance" by an obligation to explain the relevant judgments applied in the allocation of revenues or expenses to different activities and objectives.

On a more general level, we question the need to split Taxonomy-aligned activities per environmental objective: this distinction is often not easy for companies and the alleged risk of double counting is not a sufficient justification to go beyond the level of disclosure obligations set out in Art. 8 because data are typically verified by external auditors. In addition, we see a clear lack of comparability of these assignments to the individual objectives as this split can currently be defined by every company on its own for the same economic activity.

3. Coherence issues

The draft Art. 8 DA raises a number of language issues, therefore opening to a number of misinterpretations. For instance, it uses multiple terms that so far have not been defined in the legal framework of the European Union or in other reporting standards (e.g. IFRS), leaving substantial room for uncertainty. It includes mistakes (e.g. reference to IAS 12 which deals with income taxes for turnover calculation, whilst it should be IAS 1 which alludes to the income statement line 'revenues') and unnecessary duplications (e.g. columns 20 and 21 in tables 1, 2 and 3 in Annex II) that should be addressed. These are small issues, but they underscore the potential for a rushed drafting process to lead to errors and unnecessarily burdensome compliance obligations.

On a more formal level, the requirement to disclose Taxonomy data within the financial statements of the company is unclear, since financial statements cannot contain non-financial information. It also contradicts Art. 8(1) of the Taxonomy Regulation stating that companies need to include the data in their non-financial statements or consolidated non-financial statements. We would recommend referring to the NFRD/CSRD as these disclosures would be part of those reports.

Another question to be addressed concerns the reporting entity: in its methodology for reporting of KPIs the draft DA refers to both group and entity-level disclosure, but it is unclear when a non-financial statement on the entity-level or a consolidated non-financial statement on a group level is required (and vice-versa).

3.a Definitions and disclosure of metrics

The disclosure of CapEx and (where relevant) OpEx will be essential to demonstrate companies' willingness to contribute to the sustainability objectives. At the same time, we notice that the disclosure of these two metrics can be a complex exercise for corporates. We therefore recommend that the Commission better clarifies the definitions of CapEx and OpEx by referring to international accounting standards. This would mirror the information included in companies' financial statements in accordance with applied IFRS and overall facilitate accurate disclosure and better comparability of data.

As part of the numerator of both CapEx and OpEx, we note with great interest the inclusion of the purchase of Taxonomy-aligned outputs or individual measures to become low-carbon or to lead to greenhouse gas reductions as well as individual building renovation measures. We believe this addition would allow recognising companies' efforts in contributing to sustainability targets but would need further clarifications on how to validate this eligibility in time for reporting (e.g. would the supplier be able to make a statement pre-empting the confirmation of Taxonomy alignment or would the supplier have to wait until the financial statement and thus Taxonomy alignment is confirmed by the auditors?). Furthermore, we notice that the proposed templates for CapEx and OpEx (tables 2 and 3) do not correspond with the purpose described. Also, we would recommend providing examples of "Taxonomy-aligned purchase" to fully clarify the intention of the passage, as well as if non-eligible activities may count these measures.

Finally, we note that the definitions provided do not recognise the role of joint ventures and associates under the Taxonomy. This omission should be addressed by allowing flexibility where this is material. In view of the significant investment required to decarbonise the economy, this form of arrangement is often used by companies to invest in sustainable activities. This is why we consider that its non-inclusion could cause a loss of information to assess the decarbonisation efforts of undertakings or even different

interpretations by companies, therefore affecting data comparability. This approach would be consistent with other reporting requirements, where disclosures are presented for fully consolidated, and equity accounted (equity method).

Specifically on the CapEx plan, we would recommend deleting the requirements for which the plan should be disclosed and approved by the Management Board of non-financial undertakings. Firstly, many investments that a company makes in its transformation lack a sufficient level of materiality and therefore are considered individually irrelevant. Vice-versa, companies should not be obliged to present a vast number of smaller plans individually. Such a disclosure would risk revealing trade and business secrets of European companies at the advantage of international competitors, and overall undermine the EU's competitiveness. To avoid any risk, we would recommend that references to the CapEx plan permit compliance. Companies may decide to disclose further information in relation to their CapEx plan, but this should be voluntary.

Also, we would suggest removing the 7-year maximum time limit for activities to become Taxonomy aligned. Companies may invest in transformation efforts with a longer timeframe than seven years and such investments should not be excluded from CapEx: the nature of certain investments (e.g. R&D or infrastructures) requires an extended timespan. For these reasons, we recommend a maximum time limit of at least 10 years and introduce a "comply or explain" rule if the CapEx plan exceeds the maximum time limit of 10 years. This would be in line with the recommendation of the Platform on Sustainable Finance. We also urge the Commission to explain the objective of the CapEx plan with relevant examples.

Companies are likely to face particular challenges when it comes to OpEx related disclosures. Unlike turnover and CapEx, there is no clear definition of OpEx under IFRS. For some undertakings, such expenditures are not consolidated at global level. This reality is likely to make calculation of both the numerator and the denominator considerably more complex, since the wide room for interpretation will compromise the target of a uniformly applied classification.

Whilst the Commission has previously made clear that OpEx should only be disclosed "when relevant", this disclaimer is not included in the draft DA, suggesting that all companies should disclose the three metrics. We highlight that OpEx is not a standard KPI for steering a company, but it would need to be constructed by the company due to the Taxonomy requirements. This leaves ample room for interpretation as the draft definition for OpEx is still opaque and does not create comparability. Also, we notice that the OpEx KPI is not referenced in the KPIs proposed for financial undertakings. If the OpEx KPI is disproportionately difficult for non-financial undertakings to collect and is not used as an input to reporting by financial undertakings, we question its relevance for corporate reporting. We would therefore very strongly recommend that OpEx should only be reported if relevant and/or on a voluntary basis.

3.b Text inconsistencies

Finally, we notice a number of inconsistencies between the draft DA's Articles and Annex II. The template of Annex II requires companies to report on 'Taxonomy-eligible but not Taxonomy aligned'. However, we notice that this concept is not defined in the draft DA, thus leading to misinterpretations.

Also, we note that a company may have multiple assets for an eligible activity that are deemed non-aligned for different reasons. However, the current version of the Annex II would require each of these activities/non-alignment combinations to be itemised individually. This is potentially confusing for the users and will result in a table that is more complex than the Commission intends.

4. Further suggestion

Given the complexities of implementing new disclosure requirements, BusinessEurope recommends that the Commission establishes a dedicated functional inbox or helpdesk for companies to ask practical questions. For instance, it is not clear how to communicate economic activities not yet covered by the EU Taxonomy without creating reporting distortion or how to approach economic activities enabling the currently defined enabling activities. In some sectors (e.g. chemicals industry), it is also unclear how to approach activities not explicitly mentioned but part of the NACE codes, which might be Taxonomy-eligible, but which are used for internal consumption and are not sold, thus not qualifying for the reporting of turnover under the DA.

Conclusion

Companies have a long experience in performing reporting exercises, following different international, national and regional frameworks, both legal and voluntary. The Taxonomy obligations will require significant changes to existing accounting and reporting systems. This is due to several reasons. Firstly, these systems are not designed to capture data at the economic activity or NACE code-level. Secondly, these systems are not designed to facilitate allocation and reconciliation at a KPI level. Thirdly, these systems are not designed to record the data points that are required by the Taxonomy. This means that corporate internal reporting procedures need to be revised entirely. This will lead to significant additional costs to establish new reporting processes and implement new IT systems. There are also likely to be significant ongoing personnel and training costs, given that many reporting decisions and processes will require discretionary judgment and manual input. For these reasons, we regret the Commission's decision to not carry out an impact assessment.

It is paramount that the Commission provides clear and unambiguous guidance on the interpretation of the reporting requirements and the technical screening criteria for the economic activities. We are convinced that the Taxonomy should not result in the obligation to disclose unduly unnecessary details which would raise complexity, lead to difficulties when investors compare different companies and breach the rules of confidentiality in a competitive market. Instead, the Taxonomy should enable comparative and material reporting, and overall support the companies' transition. We also call on the Commission to stick to the Level-1 legislation and not introduce additional reporting requirement through delegated acts.

To achieve the desired objective, it is necessary that corporates are provided with the exact information and the necessary time, resources, and flexibility to comply with these reporting obligations. Ultimately, we urge the Commission to open a communication channel and provide an implementation guideline to help preparers understanding and implementing the requirements.