Greenwashing Is Over!

EU and Ireland Edition

The New Landscape for Non-Financial Reporting

Quarter 1 - 2024

87% of investors in Ireland believe that ESG should be embedded into corporate strategy [1]. This sentiment is reflected across a shift in non-financial reporting. With the introduction of the Corporate Sustainability Reporting Directive (CSRD) and a new globalised standard from ISSB, there will be a shift to focus efforts into sustainability reporting. Financial reporting is important, but sustainability reporting is vital for businesses who want to meet the expectations of investors, customers, and wider stakeholders who now expect companies to communicate progress on their Environmental, Social & Governance (ESG) factors.

What is the CSRD?
Where did it come from? Who does it apply to?

The CSRD is the replacement for the EU's Non-Financial Reporting Directive (NFRD) aiming to address its shortcomings and bring greater importance to sustainability reporting. With the call for more sustainable focused businesses the EU Commission believes that current reporting standards allow reports to omit information that investors and stakeholders deem as important, whereas the new legislation helps stakeholders to evaluate organisation's non-financial performance on a more uniform basis.

With the introduction of the CSRD 49,000 businesses will need to comply as opposed to the 11,700 which came under the scope of the NFRD. The new legislation will require reporting on more specific areas (see below) opposed to the broader reporting requirements from the NFRD which included items like 'Environmental Protection'. This means that businesses will need to put methods in place for gathering specific data during the year opposed to reporting in the areas they have the most notable progress. This change will allow stakeholders to evaluate businesses on the same criteria. The CSRD also states that third party 'limited assurance' will now be mandatory, with the move to 'reasonable assurance' as the legislation evolves. Another key change is that this information is required specifically to be in the management report opposed to anywhere in the annual report, increasing the significance of this reporting [2; 3; 4].

Mairead McGuinness (2022) the European Commissioner for Stability, Financial Services and the Capital Markets Union, stated that 'Sustainability reporting will now be on an equal footing with financial reporting'. This statement highlights the significance of the introduction of CSRD. Typically for many companies financial reporting has been the focus, but the CSRD aims to change this. For example, the CSRD, mandates that Sustainability reporting must be included in the management report opposed to a separate document or "hidden amongst other statistics" in the annual report – bringing more attention to how companies are considering ESG factors.

The CSRD was first proposed in April 2021 following a call for parliament to review the NFRD in order to sustain progress towards the European Green Deal and the Sustainable Finance Agenda. In November 2022, European Parliament voted to adopt the Corporate Sustainability Reporting Directive with 525 votes in favour. On the 28th of November 2022 the proposal was signed and published in the EU Official Journal with the directive entering into force from 20 days after. The view was that the rules will be rolled out in stages from 2024 to 2028 [1c; 5].

The first set of standards were released in June 2023 and presented the following roadmap for businesses required to comply:

• From January 1st 2024 – Large public interest companies (with over 500 employees) already subject to the NFRD, with reports due in 2025.
• From January 1st 2025 – Large companies that are not presently subject to the NFRD (with over 250 employees) and/or €40million turnover and/or €20 million in total assets; with reports due in 2026
• From January 1st 2026 – Listed SMEs and 'other undertakings', with reports due in 2027. As SMEs have minimal sustainability requirements currently, they can choose to opt out until 2028 should then require more time to gather the correct information and put data collection systems in place.

Although when the CSRD was first announced it was praised for raising the profile of non-financial issues, with the release of the first set of standards, criticism arose of the requirements being too complicated. Changes were agreed in July 2023 as follows:

- A change in criteria which determines companies in scope of reporting against CSRD. Previously the second iteration of businesses required to report was large companies with at least two of the following - 250 employees, a balance sheet total of €20 million and a net turnover of €40 million. Now this criteria has changed
- To extend phase-in times for small businesses around key sustainability factors such as Scope 3 emissions.
- Materiality assessments for sustainability factors to allow businesses to just focus reporting on materiality topics.
- To allow businesses with fewer than 750 employees (in the first year that they apply the standards) to omit Scope 3 emissions and own workforce disclosures
- To allow an additional year for disclosing information on the predicted financial effects which are related to non-climate environmental topics and own workforce data.
- Some disclosures to be voluntary, including biodiversity and transition plans.

Due to the complex nature of the Corporate Sustainability Reporting Directive, we are continuing to see the legislation and guidance evolve. Most recently, on the 24th of January 2024, the Legal Affairs Committee of The European Parliament approved a proposal to delay the full enactment of the CSRD, meaning that adoptions of sector specific sustainability disclosures and obligations for non-EU companies will be delayed until 2026 [6]. The European parliament also instructed the European Financial Reporting Advisory Group (EFRAG) to focus on providing clearer and more detailed guidance on general requirements before moving on to develop sector-specific requirements.

Unified Reporting Standards

One aim of the CSRD is to unify sustainability reporting standards. This is an emerging theme in the landscape of non-financial reporting. Recently both the Securities and Exchange Commission (SEC) and the International Financial Reporting Standards (IFRS) Foundation have begun plans to develop consistent reporting standards.

In May 2022, the SEC proposed amendments to required ESG Disclosures for Investment Advisors and Investment Companies [7]. The goal of these amendments is to promote consistent, comparable, and reliable information for investors considering ESG factors across the US.

This effort comes after COP26, where the International Financial Reporting Standards (IFRS) Foundation announced the plan to form the International Sustainability Standards Board (ISSB). The ISSB will develop a global baseline of sustainability disclosure including a range of ESG topics. The ISSB will build on the work of existing investor-focused reporting initiatives, supported by the Technical Readiness Working Group (TRWG), created by IFRS Foundation Trustees [8]. Members of the TRWG include the Climate Disclosure Standards Board (CDSB), the Task Force for Climate-related Financial Disclosures (TCFD), the Value Reporting Foundation's (VRF) Integrated Reporting Framework and SASB Standards. The group is focused on consolidating and enhancing key aspects of each of these initiatives to eventually develop a unified standards framework – with the view that each of these initiatives will be consolidated within the ISSB.

The ISSB is now fully operational with a board of 14 members. It has started to implement its global footprint by establishing key functions in Frankfurt and Montreal and are working to collaborate with global and regional partners. So far, they have established advisory bodies in the US, China, Japan, the EU and the UK. They have also secured support from the G7, the G20 and African Ministers. Over the last year, the CDSB and VRF have been consolidated into the IFRS, with others from the TRWG expected to follow.

The ISSB have recently issued the first set of standards: IFRS S1 and IFRS S2. IFRS S1 is focused on disclosure of sustainability-related risks and opportunities, that businesses will face over the sort, medium and long-term. IFRS S2 focuses on climate-related disclosures and should be used in conjunction with IFRS S1. Both of these initial standards incorporate the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). Now that these standards have been issued, the ISSB will work with jurisdictions and companies to support the uptake, including development of a Transition Implementation Group and Capacity Building Initiatives.

Both of these examples demonstrate the increased value investors are placing on ESG commitments, highlighting the need for global change in non-financial reporting.

Asesoria's Comment

The EFRAG have confirmed that CSRD will be fully compatible with international initiatives such as the ISSB and SEC but will continue to focus on the EU's objectives and goals, pointing out that the existing initiatives focus on just investors needs opposed to the bigger picture and the ISSB is set to continue this focus.

Companies will need to adjust their non-financial reporting standards to meet the new globalised standards. It is advised that businesses focus on meeting the new CSRD standards as this is likely to be the most stringent and potentially the largest scope of companies required to report.

The CSRD will bring a lot of change to the non-financial reporting landscape over the coming years. 49,000 companies will be required to report under the directive including all large companies and listed companies. This will include EU subsidiaries of non-EU companies as well as small to medium enterprises (SME).

The scope is broader than any sustainability reporting requirement so far. There is a need for companies to focus on double materiality, with the CSRD highlighting that businesses will need to consider both the impact that sustainability topics have on the company's value (known as Financial Materiality), and the entity's impact on the economy, environment, and people (impact materiality).

The CSRD also states that it will be mandatory for businesses to get 'limited' assurance on all information disclosed under the directive. It is expected that 'reasonable' assurance will become a requirement at a later date once companies have had the time to put new processes into place.

This is widely supported by stakeholders with a recent investor survey from PWC Ireland found that 87% of Irish Investment Professionals say that 'Reasonable Assurance' would give then confidence in sustainability reporting [1].

There is still some time to prepare for these changes. With the first wave of companies required to report from January 2024, it is vital to start planning if you have not already.

Businesses should start by assessing their existing sustainability reporting process. Considering factors such as accessibility to sustainability data from their supply chain, the existing data management process, as well as understanding the processes of industry peers. It is also advised that businesses begin to seek out assurance ensuring that you have strategic KPIs in place ready to be assessed. Gap analysis is a useful tool for assessing the business prior to making fundamental changes. Gap analysis is the process of assessing the current business position, performance, and processes, with the view to identify the changes required between the organisations current state and where they need to be.

Businesses can begin by asking:
What do we report on now? What do we need to report on and when? How do we currently collect and manage non-financial data for reporting? Do we need to collect new or different data?
And ultimately how are we going to close the gap?

If you have already begun to plan, now is a good time to develop an actionable roadmap with key internal stakeholders, considering how to put your plan into action. This may include training employees on the new regulations, improving data management processes or working with a consultant to put a strategy in place.

References

1 – PWC, '2023 Investor Survey', 2023
2 – EUR-Lex; Access to European Law, Document 52-21PC0189, 2021
3 – Climate Partner, 'What is the CSRD and how will it affect your business', September 2022
4 – European Parliament, 'News Sustainable economy: Parliament adopts new reporting rules for multinationals', November 2022
5 – EFRAG, 'News Project 531', September 2021
– SEC, 'Proposed Rules', May 2022
6 – European Parliament, 'News Sustainability reporting: MEPs agree with later adoption of standards'
7 – IFRS, 'ISSB at COP27: From Glasgow to Sharm El-Sheikh', November 2022
8 – IFRS, 'Seven key takeaways from the IFRS Sustainability Symposium', March 2023

How Can We Help

As companies face increasing regulation, we have become a trusted adviser to our clients' ensuring regulations and new requirements have timely implementation, using a pragmatic approach appropriate for that organisation. Whether it is working to comply with Corporate Sustainability Reporting Directive (CSRD), Taskforce for Climate Related Financial Disclosures (TCFD) or reporting against UN Sustainability Development Goals (SDG's), we have supported numerous clients to develop their approach to non-financial reporting.

For more information on the topics included in this paper or would like to know more about Asesoria's work with clients contact Melissa Kittermaster, Director on +353 (0) 1 611 1521 or ++ 353 (0) 87 473 7044. If you would like a copy of future thought papers, please contact info@asesoria-consulting.ie to be added to our mailing list.