# ESG reporting and disclosure: Navigating the data challenges

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# A radical step-change across the Non-Financial Reporting (NFR) landscape

**Against the backdrop of ambitious decarbonisation targets set by the EU, coupled with the surge of social justice issues in the wake of the invasion of Ukraine, activities performed for *public good* are now a growing point of focus for financial market analysts[1]. Investors have shifted their attention to sustainable companies, scrutinising how they incorporate ESG strategies into their corporate strategy and the ESG-related metrics that they report to the market.**

Stemming from the Paris Agreement and the EU's Sustainable Finance Action Plan, the Corporate Sustainability Reporting Directive (CSRD) (the "Directive") is a timely response to growing investor perception that companies who report on Environmental, Social and Governance (ESG) risks are more likely to excel at both managing these risks and delivering greater long-term value. The directive will result in a *four-fold increase in the scope* of reporting entities across the EU, from 11,600 under the pre-existing Non-Financial Reporting Directive (NFRD) to in excess of 49,000 under the new regime.

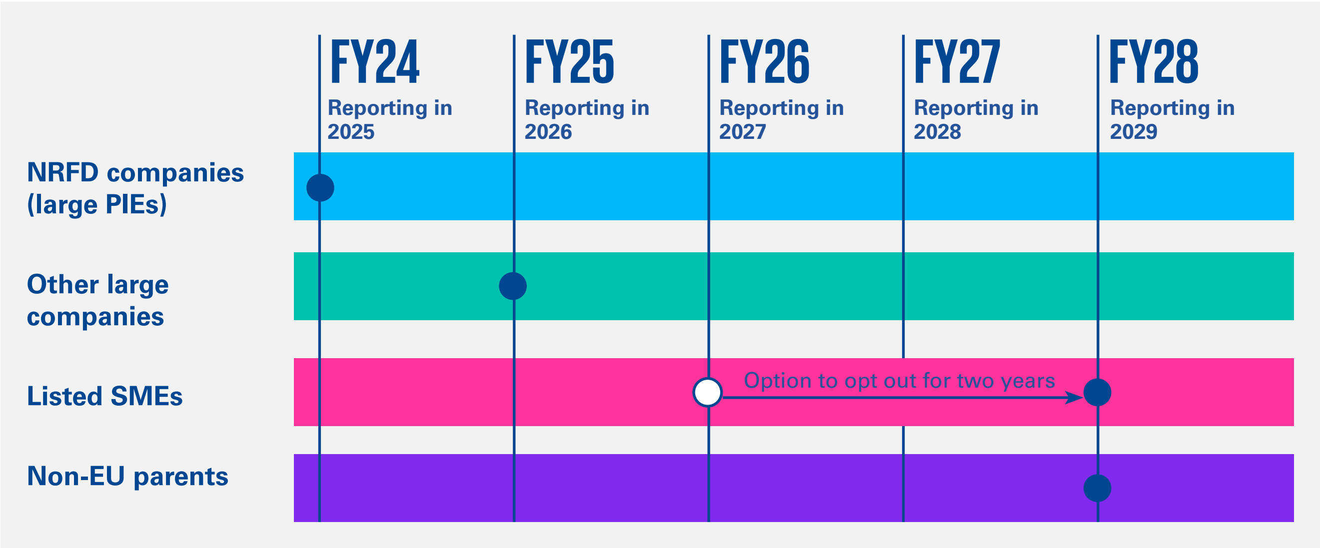
However, the challenges faced when meeting the increased data requirements of the CSRD should not be underestimated, and in this paper we will explore how best to position your organisation for successful NFR implementation.

## The current state of NFR

A recent analysis conducted by KPMG[2] on the ESG agendas of companies, demonstrates that sustainability reporting has become standard practice for many large global companies, with steady growth over the past decade. From an Irish perspective, we noted that the target setting and monitoring of ESG metrics requires significant focus for both listed and non-listed Irish companies ahead of CSRD implementation deadlines.

1 Guidance for Integrating ESG Information into Equity Analysis and Research Reports
2 KPMG Survey of Sustainability Reporting 2022

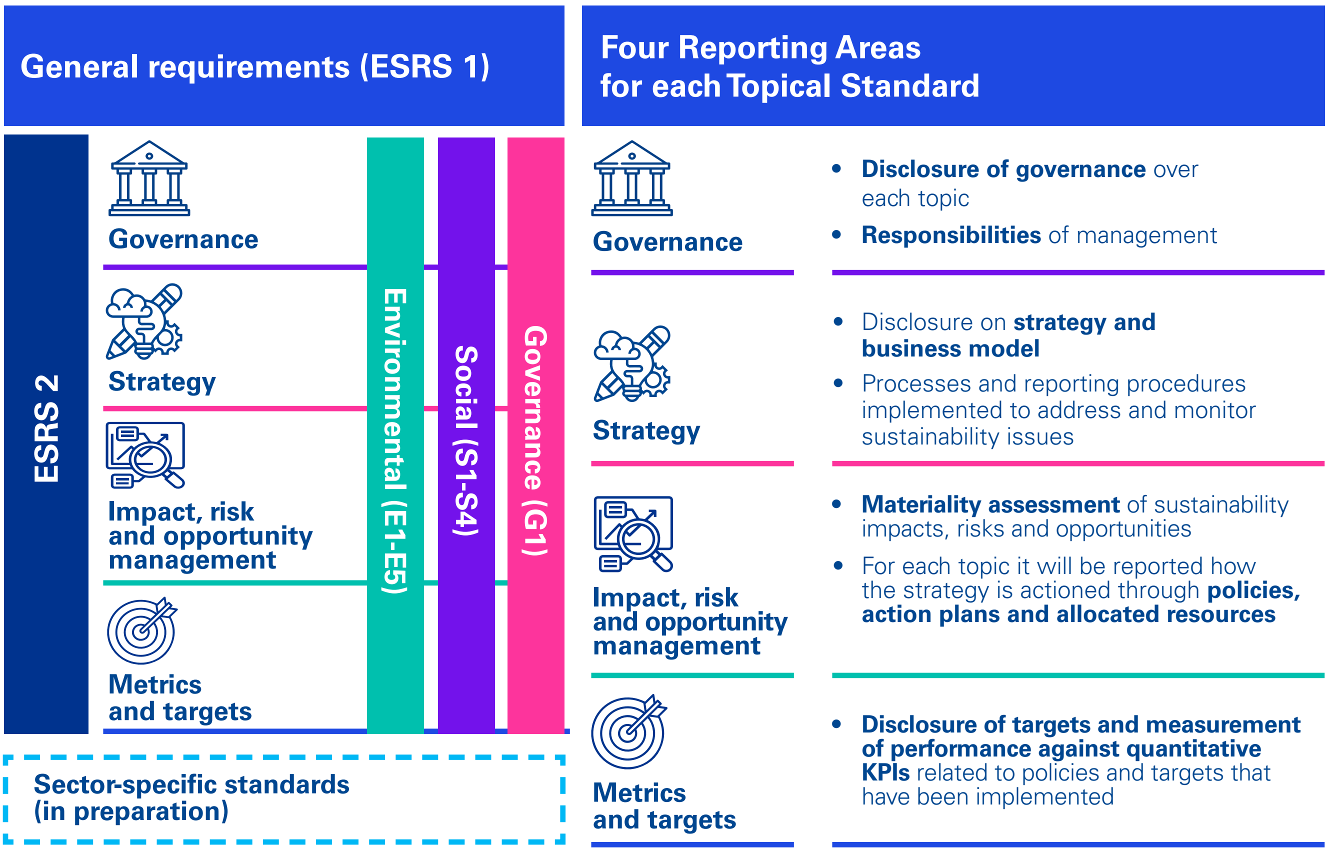
## The CSRD horizon




Effective for reports for years commencing from 1 January 2024, with progressive implementation to FY2028 reporting, the new mandatory CSRD reporting regime aims to transform the way in which EU-based companies consider ESG issues within their operations.

Representing an unprecedented step change across the traditional reporting landscape, progressively **the same rigour will need to be applied to non-financial as financial metrics.** There is a potential for significant challenges in collecting, storing and interpreting relevant ESG data such as Greenhouse Gases (GHG) inventories, water and waste consumption or diversity and inclusion data.

The specific reporting requirements of CSRD are detailed in the twelve European Sustainability Reporting Standards (ESRS) and companies will need to report on a significant volume of data in line with these Standards (after applying Double Materiality considerations). The European Parliament approved these reporting standards, which are currently being brought into law in all EU jurisdictions. Furthermore, sector specific standards are due later in 2023.



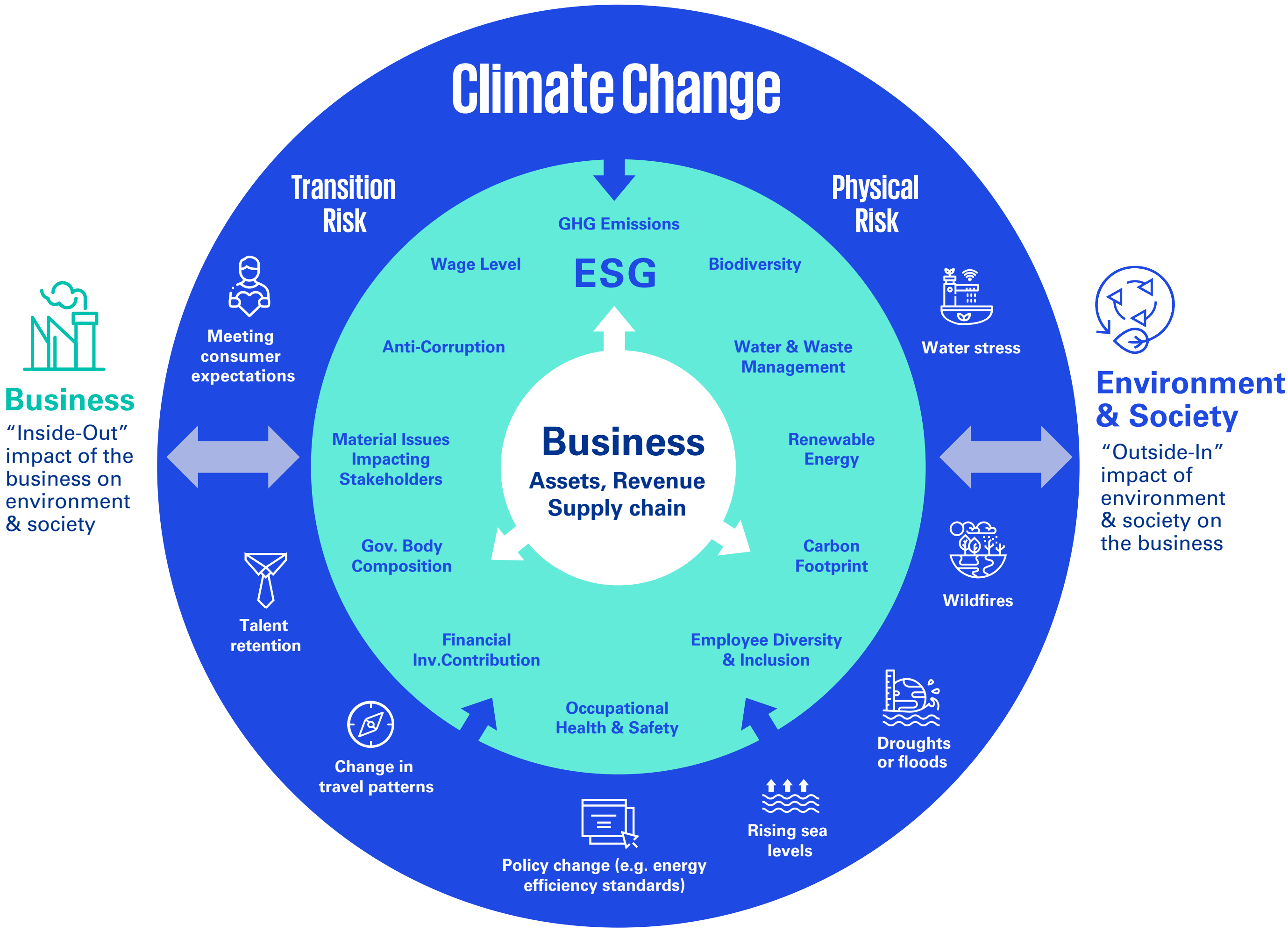
**In-scope entities will need to disclose their performance and targets using newly mandated ESG KPIs, reformat their existing management report structure and seek assurance over their sustainability reporting**.

However, a critical point of relevance to CSRD readiness is *that the entire universe of non-financial ESG metrics will not be required for every organisation.* The breadth of non-financial reporting considerations faced by companies will differ depending on their strategy, industry and the relevance of ESG risks and opportunities identified.

Relevant metrics are identified and rationalised through a process referred to as a Double Materiality assessment. The concept of Double Materiality seeks to provide a more granular insight into not only how issues of sustainability and social governance affect companies' activities and finances ("Outside-In"), but also the impact the organisation has on society at large ("Inside-Out"). This means that many companies will need to re-assess their existing operations and value chain to determine which ESG impacts are most relevant to their business model and underlying metrics used to monitor these impacts over time.

## Rationalising ESG Reporting through Double Materiality Assessment

Double Materiality represents the impact of society and the environment on the business ("Outside-In") and the reciprocal impact of the business on society and the environment ("Inside-Out").



## Developing an ESG Data Strategy to Avoid a Siloed Approach

Companies are at differing levels of maturity in relation to ESG reporting, based on sectoral and stakeholder requirements and strategic importance given to ESG matters. Many of these companies, in starting their CSRD journey, will perform a gap analysis of current reporting and disclosure activities against the requirements of CSRD and the outcome of a Double Materiality assessment. In general, companies require a significant amount of additional data and reporting disclosures to adhere to CSRD, which will require a much more cohesive ESG Data Strategy. The primary objective of such an ESG Data Strategy should be to 'productionise' reporting in a manner that is well governed and controlled so that it is assurance ready.

The graphic on the right outlines an illustrative ESG Data Lifecycle to support this initiative.


### 01. Define CSRD Requirements

As a first step, management must develop a high-level understanding of how CSRD will apply to the business. It is vital to build an in-house ESG team, dedicated to helping the firm achieve its CSRD objectives. This team is responsible for defining the company's CSRD requirements and overseeing performance throughout the entire data lifecycle. Commonly, this team combines disciplines across sustainability, risk and/or financial reporting. The team should consult with key stakeholders, so that the chosen strategy aligns with the company's strategic plan and combined interests across the business.

Significant effort will be required to gather mandatory reported information including: Double Materiality; supply chain emissions; sustainability due diligence; and ESG risk and opportunities; along with specific ESG metrics relevant to both the industry and the company. In addition, each individual topic has a multitude of specific underlying KPIs - for example, the gathering of waste management information might include quantitative metrics such as Volume of Waste per Employee, while also accounting for more qualitative measures of waste management such as the different types of waste being produced or the method by which they are disposed.

### 02. Data Collection

All companies, particularly those currently lacking a sophisticated ESG data management programme, will need to invest significant time and personnel into fulfilling their NFR objectives. The Final Report sent by the European Financial Reporting Advisory Group (EFRAG) to the European Commission includes insightful recommendations to companies looking to meaningfully collect ESG data in the CSRD context[3]. Companies must set measurable and realistic targets for each core ESG KPI, collect data pertinent to all stakeholders and ensure that data gathered is both granular and timely. Additionally, companies must be aware that poor quality ESG data may lead to inaccurate representation of ESG related metrics to the market, leaving the entity open to greenwashing allegations and potential reputational damage.

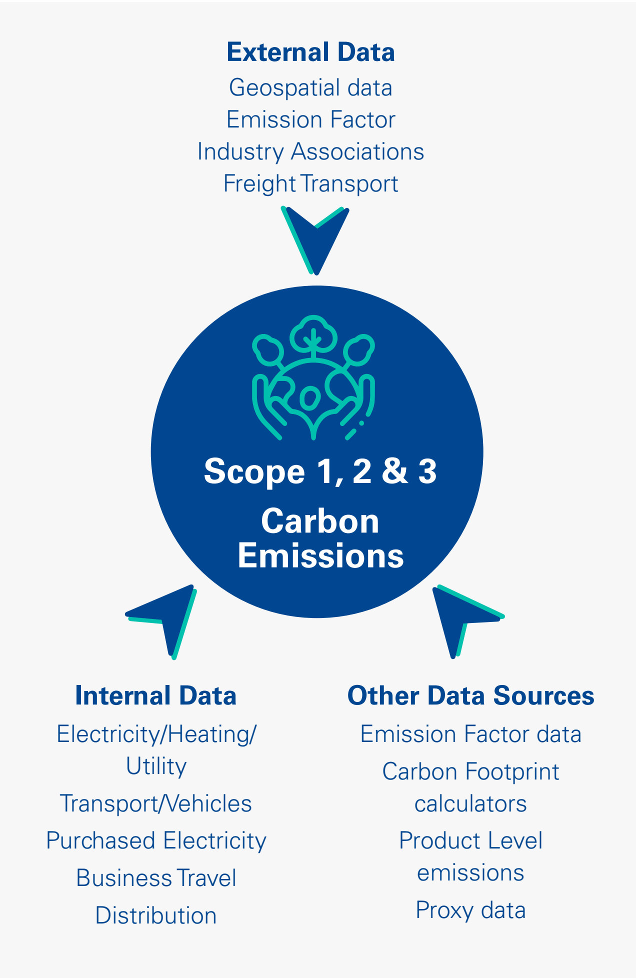
While the majority of companies are gaining an awareness of the types of data they should be collecting to ensure CSRD compliance, only a minority – with well-defined ESG strategies and reporting structures – are in a strong position to begin doing so. The primary challenge will be understanding and benchmarking internal and external data collection points necessary to meet the challenge.

3 European Financial Reporting Advisory Group (2021) "Proposals for a Relevant and Dynamic EU Sustainability Reporting Standard-Setting

As an example, GHG emissions data is one of the areas covered by ESRS E1, Climate Change. This will require a significant amount of internal and external data, as detailed in the below graphic.

ESRS E1 defines 'Scope 1' as 'GHG emissions from sources owned or controlled by the undertaking'; 'Scope 2' as 'Indirect GHG emissions are a consequence of the operations of the undertaking but occur at sources owned or controlled by another company'; and 'Scope 3' as 'All indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions'. Scope 3 GHG emissions are considered as estimated emissions in comparison to Scope 1 and 2, as their calculation is based on a combination of methods and primary and secondary data ranging from precise figures (supplier-specific or sites-specific methods) to extrapolated figures (average-data or spend-based methods)[4].

**Emissions Data Reporting – Internal and External Data Sources (ESRS E1 Climate Change)**




## 03. Data Aggregation

ESG data is mainly captured from a company's source systems, although it can also be supplemented with external sources of ESG data, such as geospatial data which is more efficient and economical for a company to source externally.

To meet the data requirements associated with CSRD implementation, companies will need to invest in infrastructure to both capture and store ESG data. Companies must have the capacity to both store and interpret this data quickly, so that they can report reliable data in a timely manner. The nature and complexity of ESG data requirements is likely to increase over time, so scalable solutions are essential.

Cloud-based solutions may offer companies a cost-effective and efficient solution to manage the vast amount of both internal and external data required for ESG reporting. Cloud-based solutions also provide broader access to analytical tools which, when used correctly, can convert unstructured data into valuable ESG insights. This enables companies to elevate the quality of their ESG reporting to meet the CSRD standard.

Data modelling will need to be in the scope of a company's own model governance approach. Future-focused modelling will be used in line with the concept of Double Materiality reporting.

Once the ESG data has been generated or obtained, data will need to be integrated and aggregated into relevant reporting systems, including classifying data and calculating KPIs and other information for disclosure.

4 ESRS E1 (efrag.org)

## 04. CSRD Reporting

Prior to the CSRD, companies that voluntarily engaged in ESG reporting generally drafted a separate ESG / Corporate Social Responsibility document. However, under the CSRD, all non-financial information must be included in the company's Management Report and must be published in a digital XHTML format for ease of retrieval and use.

Any deviations between the data gathered and the company's stated targets should be noted in external reporting for transparency purposes. The company's progress in achieving these targets should also be disclosed. In this way, companies can accommodate both retrospective and future-focused information. When considering the impact of future-focused information, provisions for both transition risk and physical risk should be made. The table overleaf is an example of a point in time calculation of Emissions which will form the basis of any future-focused targets.

## 05. Limited Assurance (mandatory)

Under the CSRD, companies will initially be required to seek a limited level of external assurance on reported ESG data. The level of assurance requirements is likely to increase over time. Therefore, it is crucial that ESG data management is formalised in a manner conducive to limited assurance. In practice, companies need to demonstrate robust data governance practices regarding structures, ownership models, quality and the controls supporting the sourcing, aggregation and reporting of ESG data. Companies should strive to fully comply and engage with the limited assurance process, fostering a healthy relationship with external auditors, while also gaining positive recognition as a leading CSRD-cognisant organisation.

5 KPMG Netherlands (2022) "ESG Assurance: To increase credibility towards stakeholders and improve quality of ESG information

## Example of Emissions Calculation for CSRD Reporting
### (ESRS E1, Appendix B, para AR4[6])

| | Retrospective | | | | Milestones and target years | | | |
|---|---|---|---|---|---|---|---|---|
| | Base year | Compa-rative | N | % N / N-1 | 2025 | 2030 | (2050) | Annual % target / Base year |
| **Scope 1 GHG emissions** | | | | | | | | |
| Gross Scope 1 GHG emissions ($tCO_2eq$) | | | | | | | | |
| Percentage of Scope 1 GHG emissions from regulated emission trading schemes (%) | | | | | | | | |
| **Scope 2 GHG emissions** | | | | | | | | |
| Gross location-based Scope 2 GHG emissions ($tCO_2eq$) | | | | | | | | |
| Gross market-based Scope 2 GHG emissions ($tCO_2eq$) | | | | | | | | |
| **Significant Scope 3 GHG emissions*** | | | | | | | | |
| Total Gross indirect (Scope 3) GHG emissions ($tCO_2eq$) | | | | | | | | |
| Purchased goods and services | | | | | | | | |
| [Optional sub-category: Cloud computing and data centre services | | | | | | | | |
| Capital goods] | | | | | | | | |
| Fuel and energy-related activities | | | | | | | | |
| Upstream leased assets | | | | | | | | |
| Waste generated in operations | | | | | | | | |
| Processing of sold products | | | | | | | | |
| Use of sold products | | | | | | | | |
| End-of-life treatment of sold products | | | | | | | | |
| Downstream leased assets | | | | | | | | |
| Franchises | | | | | | | | |
| Upstream transportation and distribution | | | | | | | | |
| Downstream transportation and distribution | | | | | | | | |
| Business travels | | | | | | | | |
| Employee commuting | | | | | | | | |
| Financial investments | | | | | | | | |
| **Total GHG emissions** | | | | | | | | |
| Total GHG emissions (location-based) ($tCO_2eq$) | | | | | | | | |
| Total GHG emissions (market-based) ($tCO_2eq$) | | | | | | | | |

**Note:** *Quantitative information shall include measurement against milestone and target years for 2025, 2030, 2050 and Annual % Target/Base Year*

6 ESRS E1 (efrag.org)

## End-of-Lifecycle Considerations

**CSRD reporting is here to stay. Under the regime, companies will be obliged to repeat the tasks associated with the data lifecycle annually. ESG performance metrics will need to be actively monitored, successfully integrated into risk appetite decisions and be suitably prepared for annual reporting.**

A company will need to complete the disclosures, in line with requirements, and expect continuous improvement over time. At the closing stage of a given data lifecycle, it is worthwhile for the ESG team to link in with key stakeholders to evaluate the entire process. The group should be able to identify what worked well during the year as well as any areas that could be improved going forward.

## Next Steps

**With CSRD reporting requirements fast approaching, now is the time for management teams to begin revising each aspect of their ESG agenda, and making the necessary adjustments to ensure that the protocols are in place for successful ESG data sourcing, aggregation and reporting in line with ESRS requirements.**

The following represent some practical steps for CSRD implementation:

- CSRD Readiness assessment;
- Double Materiality assessment;
- Develop strategies and reporting processes;
- Data gap analysis and Data strategy; and,
- Build of NFR framework (assurance ready)

Getting acquainted with the data lifecycle, establishing a knowledgeable cross-functional working group and planning for disclosure are mission-critical steps to set for success as non-financial metrics move from the periphery to the core of the future reporting landscape.

**For further information please get in touch.**

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