Getting to grips with ESRS

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The new reporting standards have changed everything for organisations. So how are early adopters getting on? Lorraine McCann finds out.

The world of sustainability has become an alphabet soup, as companies across Europe struggle to get to grips with CSRD (Corporate Sustainability Reporting Directive) and ESRS (European Sustainability Reporting Standards). Together they have ushered in a new era in corporate sustainability reporting, focused on enhancing transparency and accountability in sustainability. The European Financial Reporting Advisory Group (EFRAG) recently published an overview of emerging insights gleaned from companies implementing ESRS. So what kind of challenges have early adopters faced, what has emerged in terms of initial practices and most importantly, what does it all mean for you?

Let's start at the very beginning

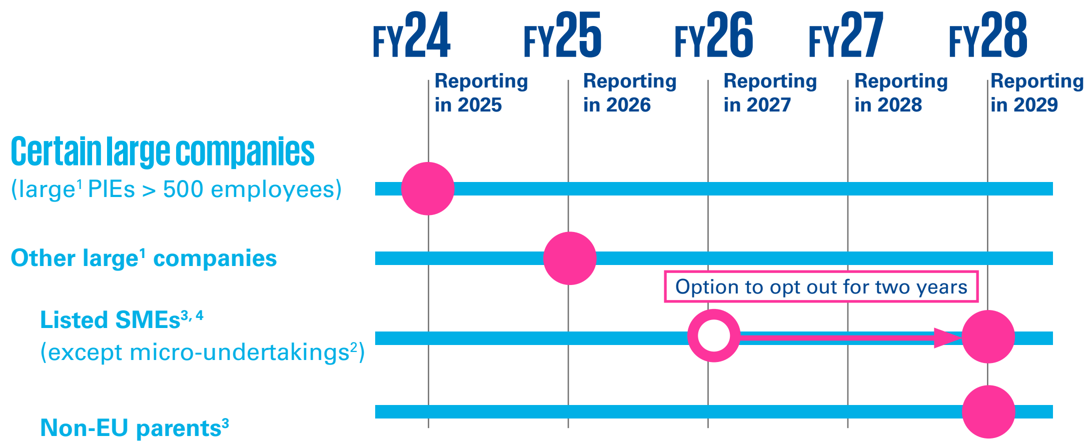
The introduction of the CSRD is already effective and will be phased in, starting with large Public Interest Entities (PIE) with more than 500 employees.

Under CSRD, companies will be required to report across a diverse range of sustainability topics, including climate change, biodiversity, and human rights.

Underpinning the CSRD, the 12 ESRSs outline the mandatory reporting requirements. They require companies to provide information on a range of areas from governance and strategy to material sustainability topics and the impacts, risks and opportunities arising from them, as well as metrics and targets.

Ultimately ESRSs will apply to large EU companies[1], most companies with listed securities on EU-regulated markets, regardless of whether they are based in the EU[2]; and ultimate non-EU parent companies with a combined group-level turnover in the EU exceeding EUR 150 million for each of the last two consecutive financial years[4].

1 Large companies are those that, on the balance sheet date, exceed two of the following three criteria (including EU and non-EU subsidiaries): 250 employees, net revenue of EUR 50m (formerly EUR 40m) or total assets of EUR 25m (formerly EUR 20m). The new thresholds take effect from FY 2024. EU member states can choose to adopt them early from FY 2023.
2 Exemptions apply, for example, for micro-undertakings (companies that do not exceed two of the following three criteria (including EU and non-EU subsidiaries): 10 employees, net revenue of EUR 900,000 (formerly EUR 700,000) or total assets of EUR 450,000 (formerly EUR 350,000) and for certain debt listings. The new thresholds take effect from FY 2024. EU member states can choose to adopt them early from FY 2023.
3 Separate standards will be developed for SMEs and non-EU parent companies.
4 Small and non-complex institutions and captive insurers are treated like listed SMEs (the option to opt out until 2028 does not apply unless they also meet the definition of an SME).



When and to whom the CSRD will apply.

What can we see already

The EFRAG has published a study titled "State of Play as of Q2 2024: Implementation of European Sustainability Reporting Standards (ESRS): Initial Practices from Selected Companies." It provides an overview of early practices and challenges observed in the implementation of the ESRS among selected large European companies. It focuses on the preliminary practices and challenges encountered by 28 large European companies across various industries as they begin implementing ESRS for the 2024 reporting year.

The study's findings are categorised into four main areas: materiality assessment, value chain, gap analysis on data points, and Environmental, Social, and Governance (ESG) reporting organisational approach.

Double Materiality Assessment

The report found that companies are beginning to undertake Double Materiality Assessments (DMA), which consider both financial and non-financial impacts. Most companies reported seeing DMA as a strategic exercise rather than just a compliance requirement, aiming to integrate it into business strategy and decision-making. Approximately 85 per cent of companies plan to incorporate ESG reporting and DMA results into their business strategies. In addition, around 70 per cent are using a data-driven approach combined with expert input. Given the significant time and effort required to undertake a DMA, it certainly makes sense for companies to leverage its outputs beyond just a compliance lens.

Datapoints

Most companies have made use of EFRAG's Implementation Guidance 3 (IG 3) for gap analysis, with some also using it to prepare for digital tagging taxonomy. However, many had not yet integrated DMA outcomes into their gap analysis of datapoints, potentially leading to over-reporting and diverting focus from relevant information. Approximately 95 per cent use IG 3 for gap analysis and 20 per cent are preparing for digital tagging/reporting taxonomy (XBRL). In addition, some 80 per cent report facing data retrieval complexities across E, S, and G. Approximately 75 per cent adopted the phase-in option, with around 40 per cent using Information Materiality at a datapoint level, with some 10 per cent targeting full disclosure of material topics. This highlights the need for better integration of DMA outcomes to ensure accurate and relevant ESG reporting.

Value Chain

The study found a growing emphasis on understanding and reporting the sustainability impacts across the entire value chain. However, this area is the least developed, with approximately 90 per cent of companies still working to refine their value chain mapping and seeking the right balance of granularity. Approximately 45 per cent have already adopted a more detailed approach, going beyond high-level upstream, downstream, and own operations. While some undertakings initially prioritised direct business relationships (Tier 1) for Policies, Actions and Targets (PATs) and Impacts, Risks and Opportunities (IROs) in the implementation of ESRS, several, especially non-financial institutions, are now extending their focus beyond Tier 1.

ESG Reporting Organisational Approaches

The organisational approach to ESG reporting varies widely and is outside of anything that could be mandated by EFRAG, it found. The new reporting regime has prompted many companies to enhance cross-departmental collaboration and standardise ESG reporting processes, including data quality controls similar to financial reporting. The companies expressed consensus that CSRD reporting has highlighted the need for standardising ESG reporting processes and required several additional capabilities and resources. The ownership model for ESG reporting is evolving, with approximately 65 per cent assigning it to a single function and around 35 per cent using a co-leadership approach. Approximately 90 per cent have started improving data quality controls, and some 85 per cent recognise the need for IT transformation. These findings show that companies are prioritising robust and integrated ESG reporting frameworks to meet new regulatory demands and improve sustainability performance.

What does this all mean for businesses?

Firstly, it's important to remember that the EFRAG findings are based on a limited sample of companies and should not be generalised to all companies within the scope of the CSRD. Neither should the practices contained in it be seen as best practices, or definitive guidance for ESRS compliance.

The study highlights several key areas where companies are making strides, such as materiality assessment and value chain reporting. However, it also underscores significant challenges, particularly in data collection and integration across the value chain. These challenges indicate that while early adopters are paving the way, there is still much more work to be done to achieve comprehensive and consistent ESRS compliance across the board.

In an Irish context, many of the findings align with KPMG's real-world experience supporting local companies on their CSRD journeys. Early adopters have faced similar challenges to their European counterparts, particularly in materiality assessment and value chain analysis. Among the key challenges faced by Irish corporates due to the demands of CSRD is the time burden felt by sustainability teams, transforming them into reporting teams and hindering their focus on practical sustainability initiatives. This has led to a debate within businesses about who "owns" CSRD. While the default has often been the sustainability department, finance teams in Irish corporates are increasingly taking the lead.

So, while the EFRAG study provides a snapshot of the current landscape, it is crucial for companies to keep evolving their practices and learning from each other. The insights gained from early adopters should be used as a foundation for further development rather than a final blueprint. As more companies begin to implement ESRS, a broader and more diverse set of practices will emerge, contributing to a more robust and effective sustainability reporting framework. In the meantime, we're here to help.

How can you prepare?

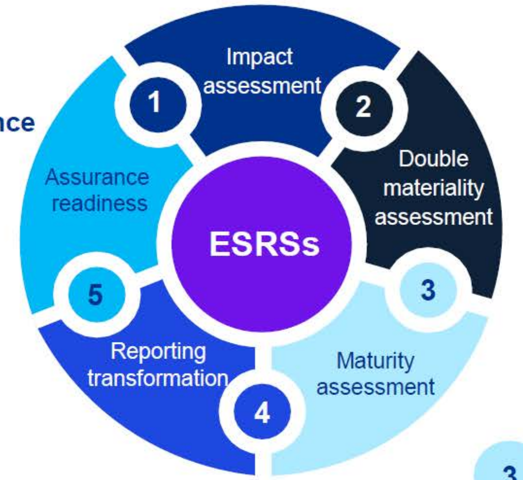
KPMG offers a comprehensive, end-to-end approach and can support you throughout your CSRD journey. As illustrated below, we have developed a five-step approach to get ready for ESRS compliance

1 Understand the impact

- Understand when, where and how the CSRD scoping requirements will impact your company and wider group
- Understand how the ESRS requirements differ from your current reporting

2 Determine what is material

- Understand the scope and breadth of your value chain
- Undertake a double materiality assessment to determine which topics are relevant to report on, following the processes set out in the ESRSs
- Decide what information is material about those topics from an impact and financial perspective



3 Assess maturity

- Assess the maturity of processes, the control environment, data models and policies
- Understand the current distribution of roles and available knowledge and capacity

4 Transform reporting

- Design the future state of your reporting, including designing the most efficient reporting structure to meet group and individual company needs
- Develop and deploy your target operating model, including training and support for change management

5 Get ready for assurance

- Assess the control environment, data quality and availability of sufficient documentation to support assurance
- Rectify issues ahead of the formal assurance process

This approach can help you

We believe KPMG's five-step approach can help you achieve the following milestones towards ESRS compliance:

- See beyond compliance and realise opportunities by making reporting part of your business processes.
  - » Embed sustainability into risk management and strategic decision making across the company.
  - » Set sustainability targets and determine key metrics required to meet current and upcoming regulations.
  - » Establish a cross-functional governance structure to collect, report, and approve sustainability data.
- Determine the most efficient approach to sustainability data management, including systems, processes, and controls.
- Build trust in your reporting through high-quality disclosures and preparing for assurance.

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Get in touch

KPMG Sustainable Futures is a dedicated cross-functional team of experts who help corporates and public sector clients respond to the ESG agenda, including decarbonisation and integrated climate and nature transition plan strategies.

Whether your organisation is just beginning its sustainability journey, reporting on its progress, or financing new initiatives, we have the knowledge and the people to support you.

If you have any queries related to the CSRD, need assistance with your sustainability assurance, or seek guidance on CSRD requirements, please contact our team below. We'd be delighted to hear from you.

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