Is your organization prepared for the CSRD?

ESG voices podcast series

Musical intro

Announcer: Hello and welcome to another episode of ESG voices! This podcast series addresses the opportunities and challenges within ESG, through interviews with ESG specialists from KPMG and beyond. Throughout this series, we will discuss a broad range of environmental, social and governance issues, aiming to support governments, businesses, and communities in creating an equitable and prosperous future.

The EU's new Corporate Sustainability Reporting Directive also known as the CSRD is transforming ESG reporting. Almost 50,000 companies are subject to mandatory sustainability reporting. Even companies with longstanding experience in sustainability reporting will likely require advancements in their ESG data collection, processing, and reporting systems.

The clock is ticking for CSRD reporting and companies should ask whether they are ready.

To dig into all this, I am delighted to be joined by Marco Frikkee, Partner, Sustainability Reporting, KPMG in the Netherlands, Dr. Jan-Hendrik Gnändiger, Partner, EMA ESG Reporting Lead, KPMG in Germany, Alexia Perversi, Senior Manager, ESG Reporting, KPMG in the UK and Helena Watson, Director, International Standards Group (ISG), KPMG International.

Announcer: Marco, according to The KPMG 2022 global CEO Outlook survey, 69 percent of CEOs see significant stakeholder demand for increased reporting and transparency on ESG issues. To kick off todays podcast, how has sustainability reporting changed in the last few years and how important is it for business leaders to be able to explain their organization reporting strategy?

Marco: Yeah, there is indeed a change happening in in the world of sustainability reporting. The large corporates did already report on a voluntary basis typically on a GRI (Global Reporting Initiative) basis. But what you see is that they are expanding their information. I think due to the, let's say, attention and emphasis on carbon and reduction of carbon emissions, you see that more information is provided on that on that topic. The TCFD (Task Force on Climate-Related Financial Disclosures) also trigger to have more disclosure on carbon. And the disclosure is also more and more focused on the implication of climate change for the financial position of the company. So that I see changing right now. Another important change I see is that next to the public, large public companies, you see that also large private companies and smaller public companies start to invest in more sustainability reporting capabilities. You see that they realize that sustainability and then I mean, sustainability as a topic is an important new element in their business strategy, and that they need to support the transformation also with more transparent sustainability reporting. The reason why they are also spending more time, effort on the reporting is that the stakeholders and also the financial stakeholders, incentivize companies also when they are more transparent on their sustainability and also have risk appetite, investment appetite for bringing transparent companies or transparent from sustainability reporting perspective into the investment books, which is of course helpful if you want to optimize shareholder value.

Announcer: So Jan-Hendrik, Could you explain to us what the EU's new Corporate Sustainability Reporting Directive (CSRD) is and why it came to fruition?

Jan-Hendrik: I think that the CSRD is changing the way companies do their ESG reporting and overall this will lead to a totally new transparency. And the main objective can be explained that the EU wants corporations to report their ESG information is more comparable and more reliable and to achieve more comparability the EU has decided that precise accounting standards has to be applied, and these accounting standards are called the European sustainability reporting. standards (ESRSs) there are 12 finalized and published. And I think the main change here even compared to SEC or ISSB requirements is that the ESG understanding in accordance to ESRs is much broader when it comes to environmental topics. It includes of course climate, but also biodiversity, also water, also waste and also circular economy. The social aspects are scoping in the whole value chain, upstream and downstream. And I think the other part of the CSRD to achieve more reliability will be achieved by a mandatory limited assurance requirement. And I think it's also necessary to say that the companies which are affected are in a large number because right now, there are only around about 10,000 companies affected by ESG reporting regulation and when the CSRD is relevant from 2024 it will be over 50,000 because all large companies no matter if they are capital market or not have to report in accordance to the CSRD applying the ESRSs and pasting that limited assurance requirements.

Announcer: Helena, could you highlight how the CSRD is different from other reporting standards?

Helena: So the CSRD is going to be European regulation. Thats immediately different from something like proposed international standards from the ISSB or international sustainability standards board, the ISSB would never have the power to mandate assurance or that companies should adopt certain policies. That's very much the job of regulators not reporting standards. But if we look at the European reporting standards that are being introduced via the CSRD and compare that to what's coming from the ISSB there are some really key differences to be aware of, so the first one for me is the target audience. The European standards adopted double materiality principles. So, they're trying to cater for both the traditional audience of financial reporting, which is investors, but they're also trying to cater for other stakeholders like customers or employees or civil society. Now the ISSB target audience is the same as financial reporting, so just your investors, and that does lead to some differences in approach. Another difference is granularity. The European standards are so much more granular than a set of principles based standards like those from the ISSB. You know, the European standards have a list of nearly 400 mandatory data points, which you would just not see in standards based on just on materiality principles. One misconception though, on differences that I think many people have, though, is that the coverage of the European standards is much greater than those from the ISSB. I wouldn't say that that's necessarily true. It's just that there are more standards in the initial batch of the European standards. For now, the ISSB the proposals they just include in general requirements and the climate proposal, but under that general requirements proposal, you would need to report on all of the topics that matter to the business. It's not just about reporting on climate, so for me, not necessarily a narrower set of reporting topics than you would under CSRD.

Announcer: Jan-Hendrik, could you highlight how the CSRD impacts organizations, and could you walk our listeners through the CSRD reporting timeline?

Jan-Hendrik: In terms of timeline, it will cause companies which are already under the non financial reporting directive, meaning more than 500 employees in the public interest entity. They need to apply the CSRD from 2024 on and all other companies which will be affected for the very first time having a business in the EU and having more than 250 employees. More than 20 million of total assets and or more than 40 Millions of revenue have to apply from 2025 on, doing the reporting and make sure that the assurance requirements can achieve. Well how does that impact the organization? I think right now it's still about understanding what does the CSRD means and how the ESRs can be applied. I mean, think about all the topics which needs to be reported. You want to make sure that you are aware of these information that you can get them out of the group. Organization, that is a huge challenge because you need to identify new processes, you need to document them, you need to think about corporate governance aspects like one financial control system, you also need to think about IT systems and of course, that is a very important questions: Who was responsible for that? Because there is a sustainability department in the accounting department needs to be considered and governance aspect as well as reporting to the management board and provides a report so all these questions will be relevant for organizations when it comes to the application of the CSRD.

Announcer: Alexia, could you highlight some of the key changes under the CSRD that organizations should be aware of?

Alexia: The key changes can be grouped into three broad categories. So increase in scope, introduction of European sustainability reporting standards, and mandatory assurance. So, let's take a look at these in a bit more detail. The CSRD introduces detail scoping requirements, which we won't focus on during this podcast. What I'd like to point that out, though, is that a number of EU companies which are not yet reporting on sustainability, will have to prepare to do so as early as the financial year 2025. This is a significant step up and this is also the sentiment across large PIE's in the EU, who are already producing some form of sustainability reporting and implications of the CSRD; however, extend beyond the EU and capture non EU companies either in their own right as ultimate parents of a group with significant activity and presence in the EU or a subsidiaries of an EU headed group. But let's have a look at the reporting requirements themselves. The overall aim of this CSRD is to bring sustainability reporting on a par with financial reporting and what does that mean? It means that reporting is required in a dedicated section of the management report. So going forward, sustainability information will need to be produced at the same time as financial information and presented in a way that enables the users to make necessary connections with financial information. Number two reporting must be prepared in accordance with the 12 new European Sustainability Reporting Standards. This has wide ranging impacts on reporting so I'd like to focus a bit on what this implies. So the suite of standard code standards comprises two cross cutting standards and 10 topics specific ones covering environmental, social and governance matters. These are structured around the four pillar architecture of the TCFD and ISSB requiring disclosures across governance strategy, impact, risk and opportunity management, metrics and targets. The disclosure requirements are split between mandatory disclosures which are to be reported irrespective of the outcome of the materiality assessment. And disclosures which are required only if a sustainability matter is deemed as material in line with this materiality assessment that companies are required to perform. When it comes to materiality, the standards prescribed and assessment from both an impact and financial materiality perspective considering the entire value chain. This process results in reporting that meets the needs of a wider stakeholder group but not just investors. So, we've gone through reporting dedicated in a dedicated section of the management report, reporting that must be prepared in accordance with 12 new standards. But finally, we need to think about reporting which will need to be assured by an independent assurance provider whilst that inception limited assurance will be required for compliance with European Sustainability Reporting Standard with a move to reasonable assurance a few years later, the sheer volume of disclosure requirements and data points implied by the standards will pose significant challenges to prepare us when collecting the information as they will need to implement robust processes to obtain quality data in a timely manner. And to give you an idea, there are approximately 100 disclosure requirements and over 1000 qualitative and quantitative data points from those. This may seem like a lot of information, but there is a lot to do to get ready to meet these requirements in a short space of time. So, getting started and defining an action plan as soon as possible will be critical.

Announcer: Alexia, I am sure this is a question a lot of organizations will be asking - does the CSRD only impact EU organizations?

Alexia: One of the changes introduced by the CSRD is the extension of the scope of entities for sustainability reporting. So, in an effort to create a level playing field for companies doing business in Europe, the directive captures non EU parents with significant operations and physical presence in the region for reporting. I would like to draw your attention to the term significant operations, as the threshold here is only 150 million euro, which is incredibly low. physical presence is also defined as any EU subsidiary captured by the CSRD general requirements or a branch with turnover of 40 million euro. These entities will be required to produce sustainability reporting in line with the CSRD at consolidated level for the first time in financial year 2028. Whilst the EU has not yet defined the exact reporting requirements for non EU parents, it is expected that the reporting will be less extensive than the reporting currently required for EU entities in scope. It is also expected that companies will have the option of using European Sustainability Reporting Standards equivalent reporting frameworks to produce CSRD compliant reporting. The European Commission will determine what these are in the future. Although they have indicated that these frameworks will need to consider double materiality and require reporting across environmental, social and governance topics. The determination of an appropriate sustainability reporting strategy that is both compliant and efficient won't be an easy task and will require detailed consideration of both the CSRD requirements but also their interoperability with other major sustainability reporting proposals such as the ISSB and the SEC.

Announcer: Jan-Hendrik and Helena, what are some of the biggest challenges organizations face or will likely face when it comes to the CSRD?

Helena: So, for me, these new European standards are very detailed, and they're very granular. They're also mandatory and they're subject to assurance. So, to me the biggest challenges that companies need to be ready for that, focus on you know, collating the data, have clear audit trails, quality controls and documentation. But that also gives rise to other challenges. And I think the standards are being brought in quite quickly. So, there's a real challenge to build up capacity to be able to adopt them. Now, from the standard setter side it's having the capacity and time to develop the right guidance to support companies like yourselves to apply, you know, explain what the standards mean, but from the companies as well it's about having enough people in the business who are experienced with the right subject matter to be able to actually manage both the business and the reporting. You know, building up that capacity and the relevant guidance is going to be really challenging over the next couple of years.

Jan-Hendrik: I think this is the transparency, I mean, given the fact that there are so many aspects to consider, so many aspects to report group wide and that an auditor is coming along and have to express an assurance opinion on it in new transparency regarding the ESG reporting, will be the results and on the other hand, companies are telling an equity story green equity story for many years now. And I think right now companies need to ensure that once the CSRD is applied and the new transparency is on the table open for everyone as it has to be published. But this is in line with the equity story which have been taught for so many years that this is in line with the rating these companies have used over the years. Even the rating agencies might change if there are more information, standardized information and disinformation have to be audited. And I think the other aspect is still that the responsibility needs to be set when the sustainability department shall be responsible for the new ESG reporting requirements, then that's great. However, they want to make sure that there's sufficient accounting knowledge and on the other hand, the accounting department needs to make sure that the CSRD requirements are integrated in the management report and therefore it's linked to the financial statement as well. And I think these two departments need to communicate together and all the interfaces within the strategy department but to corporate governance and management systems needs to be considered and these are huge challenges on top of the content discussion. There is an organization and management discussion necessary and I think it's important to start it right now.

Announcer: Marco, what are some of the biggest opportunities?

Marco: Yeah, so maybe to make a distinction between the initial phase to implement the CSRD here that is, I think a unique opportunity to get the focus on the sustainability strategy in various aspects. Have focus on the articulation of the strategy, but also the way you want to steer that strategy to a high level to high performance, high sustainability performance. That that attention you will get in the project on this topic will be substantial and that is needed. In my view, at least it supports that the real sustainable sustainability transformation, which companies will face in the way they do business, that phase so the project phase will bring that that insight, and maybe also the energy to make that happen. If you see a view look at the way the CSRD could support the business for a bit of a longer term perspective, I do think that the new information you will see occurring in reporting will also be used for the internal steering on achieving your targets. And I do think that that is focus on next to financial performance, which we all know for quite some time also on sustainability performance, that you will see that that real transition and change in those domains will happen through the use of this new information. Jan- Henrik, of course explained about the challenges, but I do think that if you have a bit of a longer term view on it, then this will be very beneficial for, I would say planet and society. Of course next year's will be tough but over time, this will be very beneficial in my view.

Announcer: Jan-Hendrik , what should companies start to think about now as they embark on their CSRD reporting journey?

Jan-Hendrik: Yeah, well, I think there are some aspects which needs to be discussed and verified before the design and implementation of the CSRD is started and I think the one thing is that once you have clarity about the scope. I mean, what does it mean? How many of your subsidiaries or legal entities are in scope? And what shall the reporting strategy look like? I think that is a very important discussion. And on the other hand, I think it's also interesting to work out how mature is the existing ESG reporting? I think that it's fair to say that many companies have been working on ESG reporting, and I think the reports are great. However, the regulatory environment is changing so it makes sense to start and analyzes how the existing report can be. used and what needs to be done and then before going into kind of gap assessments or project plans, we would always advise our clients to start the materiality assessment because the materiality assessment is not brand new. It has been done in the past. It is part of many frameworks like GRI, for example. However, the CSRD has created and developed a new understanding how material aspects can be identified. There is a specific standard. It's very technical, however, it needs transparency or strategic aspects about capital market expectations and also of course, compliance and requirements. And our advice would always be to start with a materiality assessment to make sure that you have identified the most material aspects and for those aspects it's worse to start a gap assessment and to start thinking about the project plan, how the design and implementation of a CSRD reporting should look like and what needs to be done in terms of FTE, in terms of knowledge in terms of systems, processes, controls, and of course reporting. systems. So, this will be our advice to structure and start securing.

Announcer: Jan-Hendrik, how does mandatory reporting assurance come into play with CSRD?

Jan-Hendrik: I mean, it is quite clear in the CSRD and also in the ESRSs, it will be mandatory to integrate a chapter in the management report called sustainability statement. There are some opportunities to choose how it is reported. However, at the end of the day, you need to make sure that you are applying all accounting standards or ESRSs. There are standards for topics, five for environmental and four for social, one for governance, and it's quite necessary to make sure that you have a mature reporting system in place that you have visibility and the relevant processes and that you make sure in these processes with proper controls that completeness and accuracy is ensured and that the documentation is sufficient because the auditor has to provide a limited assurance opinion on it. And that is pretty much what needs to be considered at this time.

Announcer: And finally, what is once piece of advice you would give to leaders based on todays topic?

Helena: I think for me, it's make sure that this doesn't just become a compliance exercise that is disconnected from your strategy. The objectives of you know, why are we doing this? It's all about supporting the EU to become this sort of modern resource efficient competitive economy. If you're adopting the standards, it should support companies to incorporate sustainability issues that matter, incorporate it into their strategy, their business model, their objectives. So, what I'm trying to say is this should be a collaborative exercise across the whole organization. And that's from the very top down, not just a compliance exercise that becomes a reporting burden.

Marco: Yeah, I think that will be the following. I think the implementation of the CCD is huge effort and huge project. But it is quite important that this project, that there is a clear understanding why sustainability matters for a company before you move into this reporting project. It should be very clear and transparent why you do it from a lets say, a business perspective, why the sustainability matters for the company so that business leaders will support such a project, and that the end result will not only be good reporting, but also revised Management Information System focused on real sustainability performance.

Jan-Hendrik: Well, I would advise to make sure that the roles and responsibilities are clear. And on top of it, companies might want to make sure that the number of people who are working on this huge exercise are sufficient and that the knowledge, which is necessary, especially from a technical perspective, is available.

Alexia: I guess my advice, bearing in mind what everyone else has talked about is act now. Preparing to comply with the new requirements will take time so it's actually worth taking time early to understand the requirements and how they will impact your businesses and reporting and design a clear and achievable plan which will enable you to get there safely and in time.

Announcer:

Thanks to all of you for speaking with me today, you've given our listeners a lot to think about when it comes to CSRD and the evolution of ESG reporting!

Join us again next time for more insights from ESG leaders and innovators. You can also find the latest insights covering a range of ESG topics by visiting kpmg.com/ESG.

Thanks for listening!

Musical exit