Teneo '23 & ESG Series

A European Perspective on Sustainability Reporting

Teneo Insights / December 2023

In this fifth report of Teneo's '23 & ESG Series, we take a look at reporting trends through a European lens. Other reports in the series highlight the top 10 takeaways and key statistics of 2023 sustainability reports, DE&I data, Australian sustainability reports and sustainability report design considerations.

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The goal of sustainability disclosure is to give stakeholders a means to assess a company's sustainability performance. Yet the rapid proliferation of different ESG disclosure frameworks over the years has created a proverbial "alphabet soup" that confused even the most experienced sustainability professionals. This year, the European Union completed an important milestone in the large-scale overhaul of its legal regime by completing the first stage of the European Sustainability Reporting Standards (ESRS), developed in partnership with the Global Reporting Initiative. It coincides with the finalisation of the International Financial Reporting Standards (IFRS) and their global ambitions. Both aim to provide transparent, comparable and reliable sustainability data to the market. But each follows different areas of focus, methodologies and reporting requirements.

While **the IFRS disclosure standards are voluntary, the ESRS are mandatory for both European and non-European companies who are listed in Europe (including thousands of U.S. companies).**

The clock is ticking for boards to make the right reporting decisions. The first wave of companies will already have to report under the ESRS in 2025 on their performance for the 2024 financial year. To help companies better understand and prepare for this evolving ESG disclosure landscape, we provide our perspective on the state of European sustainability disclosure and how it compares against other major frameworks. (Appendix).

The EU is Just Getting Started

While the United States SEC climate disclosure rules are delayed, the first set of disclosure standards is about to become law in Europe under the ESRS. These disclosure standards are sector-agnostic and cover data points in 12 categories, including decarbonisation, circular economy, biodiversity and workers' rights. The rules require companies to conduct a materiality assessment based on both the impact on financial value as well as the impact on society and the environment (i.e., double materiality). Where the assessment shows a topic to be non-material, it may be omitted from the reporting. The only two exceptions: Companies must always disclose the methodology (so-called "General disclosures"), as well as the outcomes of the "climate change assessment" (i.e. even when considered immaterial, a justification must be delivered). The European Commission will add further sector-specific requirements and data points, which reflect the particular impact of individual industries. These are expected over the next few years. In what might be good news for some companies, the EU is also considering delaying the implementation of certain standards for non-EU companies, though those details still need unveiling. The EU's goal is to focus on more immediate priorities, including implementation, guidance and standards for small and medium-sized businesses that may ultimately receive relief from the more burdensome requirements of the ESRS.

CSDDD: Further reporting requirements will capture the value chains of companies. In a new Corporate Sustainability Due Diligence Directive (CSDDD), companies will need to vet their suppliers for a catalogue of dozens of environmental and human rights standards. The granularity of the reporting will likely dwarf existing due diligence standards established under the Organisation for Economic Cooperation and Development (OECD) guidelines. Part of the required materiality assessment will be many first-time concepts without clear-cut definitions or methodologies. Further sector-specific due diligence laws banning products "contaminated" with deforestation and forced labour complete the picture and could force companies aiming to do business in Europe to downsize or even abandon sourcing operations in problematic non-EU countries (if violations cannot be remediated).

European Countries Outside the EU are Advancing, Too

Meanwhile, the UK is going to introduce rules mandating company sustainability disclosures in line with the International Sustainability Standards Board (ISSB) in 2024. The ISSB aims to consolidate and enhance existing sustainability reporting initiatives, such as the Sustainability Accounting Standards Board (SASB) Standards, the Task Force for Climate-related Financial Disclosures (TCFD) recommendations, the Integrated Reporting Framework and the Climate Disclosure Standards Board (CDSB) Framework. The ISSB has developed the IFRS Sustainability Disclosure Standards, which are understood as a global minimum standard and are being used as the basis for national frameworks by some countries, such as the UK.

Switzerland is equally revamping its sustainability reporting framework, lowering the current reporting thresholds for employee count and turnover in line with the EU scope. Swiss companies will in the future be able to choose whether to report according to the ESRS or an equivalent international framework.

Standards Interoperability is the Goal – But is it Likely?

The various sustainability reporting standards are not mutually exclusive and can be complementary. The EU, ISSB and GRI are continuously working on improving the interoperability. The Corporate Sustainability Reporting Directive (CSRD) also requires the EU to collaborate in good faith towards the convergence of global standards, to reduce the risk of inconsistent reporting requirements for companies with a global footprint.

But while interoperability is the aspiration, it may not be likely in the near future. Impact definitions, key terminologies, the delineation of industry sectors and calculation methodologies remain far apart. For example, the concept of the "value chain," which includes downstream operations, cannot be found in global frameworks, which focus entirely on the upstream (supply) chain.

What Does This Mean for European Companies?

Businesses operating in the EU will be required to make strategic choices about the "right" sustainability disclosure standard to follow: Which legal and compliance regimes are our company subject to? Regardless of legal requirements, which standards may best represent our investments and improvements? Which disclosure standards do our stakeholders want us to report to, including our major investors?

It would be easy to deride Europe for trying to build the plane while flying it. But **there is a strong case to embrace sustainability reporting as a company asset.** Political backlash and budget crises are causing European governments to withdraw money from the green transition that is desperately needed to meet planetary targets. Companies will need to make up for this shortfall and become crucial in mastering the ecological industrial transition. The rising cost of capital will force investors to think twice about where their money has the greatest impact, and sustainability disclosures may give high-performers a first-mover advantage in attracting the capital needed to meet their goals.

Appendix: Comparative Overview of the Three Major Global ESG Disclosure Standards

Standards	ESRS	IFRS	GRI
What does the acronym stand for?	European Sustainability Reporting Standards	International Financial Reporting Standards	Global Reporting Initiative
Who publishes the standard?	European Financial Reporting Advisory Group (EFRAG)	International Sustainability Standards Board (ISSB)	GRI is an independent non-profit entity
Is the standard mandatory?	Yes, they will be mandatory for EU and non-EU companies that meet certain revenue, balance sheet and employee thresholds.	Voluntary, though some countries are basing regulatory initiatives on the IFRS.	Voluntary, though some countries are basing regulatory initiatives on the GRI.
What standards already exist?	All 12 general standards.	General Information (IFRS 1) and Climate Information (IFRS 2)	GRI Standards (Core and Sector Standards)
Is the set of published standards complete?	No. Sector-specific standards are to be developed by 2028; and company-level reporting further down the line. Separate disclosure on supply chain due diligence, forced labour and deforestation are being introduced.	No. Sector-specific standards are expected to be developed in the future.	Yes, though the GRI frequently updates its standards to reflect best practices and stakeholder input.
When will the standards become effective?	For companies covered by existing NFRD reporting, they will publish their first report in 2025 for FY 2024.	2025 for FY 2024.	The GRI Standards are currently in effect and organisations can use them for reporting at any time.
Where will disclosure be required?	The information will be included in the management report with provisions, articles and guidelines.	Part of the company financial statements.	Comprehensive sustainability report, including specific disclosures on material aspects and their impacts.
For whom will the information be primarily intended?	A broad set of stakeholders, including investors, customers, suppliers, employees, governments and civil society	Investors, banks and other creditors.	A broad set of stakeholders including investors, consumers, employees, local communities, governments and civil society.
How will topics for reporting be identified by the company?	By executing a mandatory double materiality assessment considering both financial and societal impacts.	By assessing those ESG issues that have a potential impact on financial performance only.	By executing a mandatory double materiality assessment considering both financial and societal impacts.
Does it require information from the value chain?	Yes	Yes, but reflects on its significant economic effects.	Yes, GRI emphasizes the importance of assessing the entire value chain for material topics.
Is external assurance required?	Yes	IFRS verification is only recommended but may be required by certain jurisdictions.	Not required by GRI, but many organisations choose to obtain external assurance for their GRI-based reports to enhance credibility.

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