ARE THE BIG COMPANIES READY FOR CSRD & ESRS?

The leading network of entrepreneurs in France, MEDEF, recently carried out an assessment together with Deloitte and EY.

It included the 2022 ESG reporting of 100 large French companies, most of them in the SBF 120 (an index based on the 120 most actively traded stocks listed in Paris).

A recent assessment of 100 large companies in France, shows that the road is bumpy and that there is still a lot of work to do.

The analysis focused on a number of "new" ESRS disclosure requirements selected to illustrate the diversity of topics and the anticipated challenges, without aiming to be exhaustive. The findings are interesting.

Materiality assessment

83% of the assessed companies present a materiality analysis, but only 14% publish a "double materiality" analysis following the two perspectives defined by ESRS 1 (impact vs. financial materiality).

17% of these large companies do not publish a materiality analysis at all. They do, however, list their key ESG issues, as required by the NFRD.

On this point it is important to keep in mind that, although it may be beneficial for the company to be transparent about their materiality analysis, ESRS do not require it to be published.

ESRS do, however, require that the company publish its material impacts, risks and opportunities, and report on its material topics.

This will be a challenge, as robust due diligence processes - taking the entire value chain into account - are not always in place, and the internal risk analysis processes are not always aligned with ESRS requirements for prospective risk analysis with quantified financial effects.

Climate and carbon tunnel vision

The ESRS E1 Climate change standard is one of the most important ESRS standards. Still, a narrow carbon tunnel vision may very well blindside many companies who risk falling short of the regulatory requirement.

The good news is that 73% have defined decarbonization objectives validated by the SBTi.

However, only 17% present and quantify the different decarbonization levers allowing them to achieve their objectives, as required by ESRS E1.

Decarbonization levers is a way of describing what types of actions a company implement, by aggregating types of mitigation actions, such as energy efficiency, electrification, fuel switching, use of renewable energy, products change, and supply-chain decarbonization, that fit with company's specific actions.

Minimum Disclosure Requirements

The Minimum Disclosure Requirements described in ESRS 2 sections 4.2 and 5, also instruct companies to be very detailed when describing their sustainability policies, targets, actions, and metrics.

These requirements, together with the double materiality approach, are unique for the ESRS and will be a challenge for companies who do not yet have efficient governance models in place.

Not only will companies have to report in detail on their past actions, but also on their forward-looking action plans – which will be a new angle to add to the existing governance and reporting processes.

Cultural change

The assessment also showed that there is progress to be made on measuring GHG emissions, as well as getting this data ready in time for the closing of the financial statements.

There is also a need for a cultural change to integrate the notions of medium/long-term financial planning within the sustainability teams. Support from, and a better coordination with, the Financial Departments remain to be organized.

Climate change risk assessment - a challenge

Only 46% of the assessed companies publish (or declare that they take into account) the analysis of at least one climate scenario and quantify their climate risks.

More importantly, 78% do not include their climate transition risks - which include financial and economic risks caused by political and regulatory changes necessary to achieve the goals of the Paris climate agreement, including market and reputational risks.

This is a real challenge. Risk exposure will be a key area of scrutiny for the financial market, as there has been a sevenfold increase in reported losses from climate disasters since the 1970s, according to the World Meteorological Organization.

Extreme weather is causing loss of life, loss of property and business interruptions, with financial effects hitting our businesses.

A study (2), published in the journal Nature Communications, showed a central estimate of an average climate cost of $140bn (£115bn) a year from 2000 to 2019, with a range from $60bn to $230bn - the latest data showing $280bn in costs in 2022.

The researchers stress that lack of data, particularly in low-income countries, means the figures are likely to be seriously underestimated. Additional climate costs, such as from crop yield declines and sea level rise, were also not included.

Two-thirds of the damage costs were due to the lives lost, while a third was due to property and other assets being destroyed. Storms were responsible for 33% of the climate costs, with 16% from heatwaves and 10% from floods and droughts.

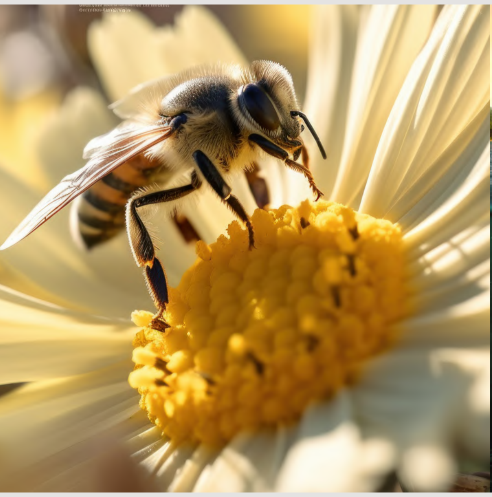
"Dr Stéphane Hallegatte, at the World Bank and not part of the study team, said: 'The key message is that climate change is visibly increasing global economic losses from disasters'."

Pollution, Water & marine resources, Biodiversity & ecosystems and Resource use & circular economy - key priority topics for the EU

The assessment of the current ESG reporting of 100 large French companies, also seems to indicate that the carbon tunnel vision may be obscuring the need to prioritize the 5 other EU environmental goals covered by the topical standards.

It points to important challenges for the ESRS environmental topical standards Pollution (E2), Water & marine resources (E3), Biodiversity & ecosystems (E4) and Resource use & circular economy (E5):

- Less than 10% have defined pollution objectives: air (10%), water (6%), soil (4%) and substances (5%), and estimating the potential risks and impacts of microplastics remains a challenge.
- 31% publish water consumption reduction targets, but few companies presented ambitions to reduce water consumption across the entire value chain.
- Only 6% commit to reducing water consumption in water-risk areas in their own operations and value chain.
- Many companies mention biodiversity as a key issue, but few integrate detailed elements of analysis. Only 13% declare the number of production sites located in or near sensitive areas in terms of biodiversity, which logically is the first step in identifying potential risks to biodiversity.
- Even for high biodiversity impact sectors, as determined by the TNFD framework, the share is only 28%.
- Less than a third of the publications formalize concrete objectives in terms of circularity, as the term is described in the CSRD.
- 30% have formalized objectives related to the circularity of products and their packaging. Mass consumption and distribution sectors are ahead of the rest, with 10 of the 14 companies analyzed having defined clear objectives on this topic. Globally, current business models based on a linear economy and unstructured ad-hoc initiatives need to be thought through and restructured.
- 30% publish objectives related purchase of recycled or bio-sourced materials or products, and 7% related to the reduction in the use of virgin raw materials.
- 51% publish waste management objectives. The Health, Industry, Aeronautics and Defense, Transport and Automotive sectors rise above the rest with 75% (25 out of 33) publishing objectives related to waste management.



Social and governance topics

On the social side, the assessment showed that few companies publish indicators relating to pay gaps as expected by the CSRD, and that taking other workers than the company's own employees into account, will be a challenge.

- 53% publish indicators related to the gender pay gap of their employees at group level. French companies publish a mandatory index for the France scope.
- Only 8% provide information to compare low wages to decent wages. Determining decent wage indicators aligned with EU and international regulations for all in-scope countries remains difficult to date.
- 31% of the companies publish an accident rate including subcontractors, and 7% publish the accident rate of subcontractors separately from the overall rate. A note was made to explain that the concept of subcontractors is not present in the CSRD. The subcontractors mentioned in the report correspond to non-employee in the own workforce (ESRS S1), as well as workers in the value chain (ESRS S2).

The assessment concentrated less on the social and governance ESRS standards.

The disclosure requirements of the standards S3 – Affected Communities, S4 – Consumers and End Users, and G1 – Business Conduct, were not analyzed.

It is interesting to note that these standards hardly contain any predefined metrics at all. They focus on governance, due diligence and the policies, actions, and targets in place to mitigate adverse impact and risks, and advance positive impact and opportunities.

70% narrative disclosures

This illustrates another important challenge with CSRD and the ESRS reporting framework: less than 30% of the disclosure points are about reporting on metrics.

We are used to speaking about "data collection" when organizing sustainability reporting, but the fact is that 70% of the disclosure points in the ESRS are narrative disclosures.

It's about accounting for strategies, processes, policies, actions – including resources – and targets in place (or not) to succeed with the strategic, operational, and financial shift needed to implement the EU Green Deal.

CSRD & ESRS - a cultural shift to a holistic view of business management

Indeed, many still think that CSRD and the ESRS E1 "Climate Change" standard are mostly about reporting on GHG emissions.

Reducing emissions remains a key challenge, but the fact is that less than 20% of the disclosure points in E1 are about reporting on emissions.

Strategy, governance, processes, climate change resilience, and climate-related impacts, risks & opportunities are very much in focus. It's as much about preparing for a different future, and future-proof our businesses, as it is about mitigating climate change. This is also why governance and strategy are a central part of the ESRS framework.

Governance and strategy disclosures and measurements capture companies' overall commitment to sustainable development.

The standard-setters know this, which is why companies will have to gear up to disclose in detail on these processes. They will also be key areas of scrutiny for the auditors.

Mandatory standardized and comparable disclosures will lead to radically increased transparency, and the public benchmarks and rankings that will follow will be important drivers of change.

It will not only guide companies in their transition but also inform investors, consumers, and future employees.

A strong ESG proposal safeguards the company's long-term success

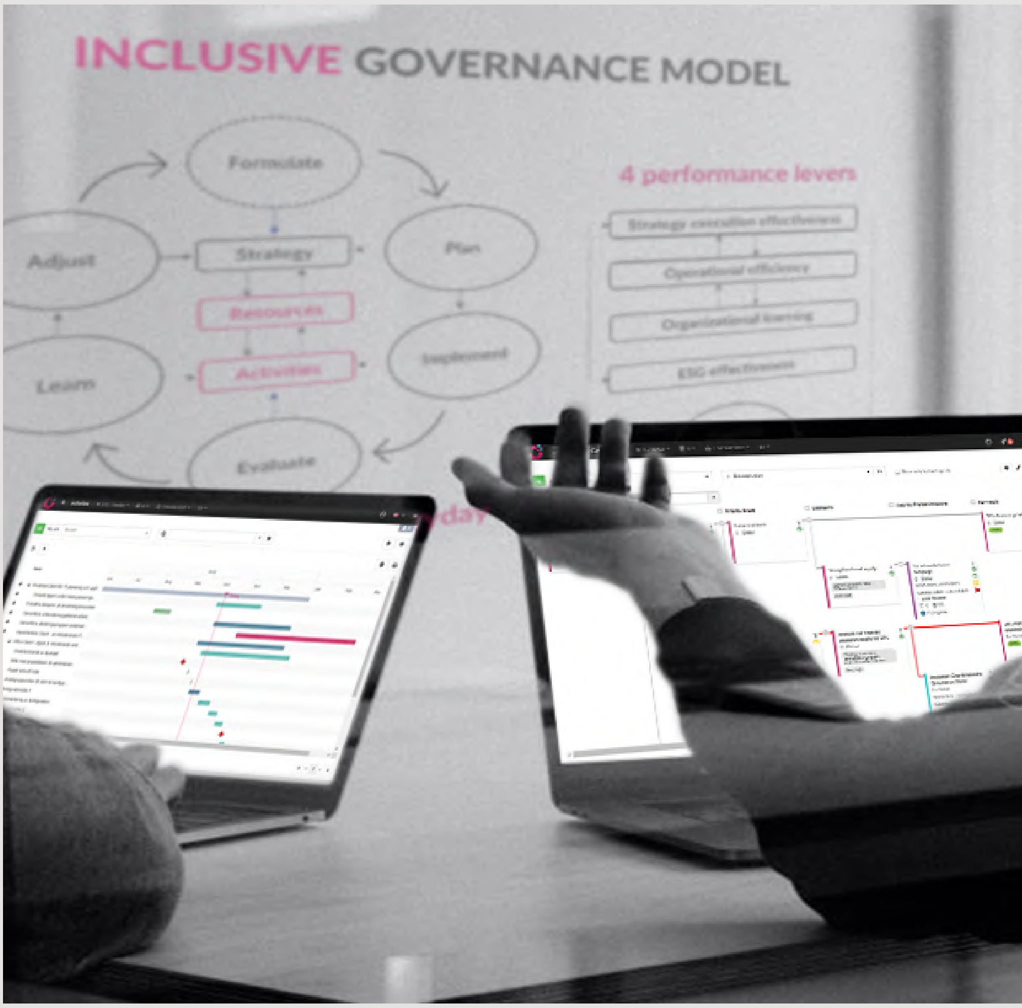
Millennials and Gen Z will soon be dominating our workforce, and they will also make up our customer base and investors.

And all the studies show that they are attentive to companies that help them contribute to environmental and social issues.

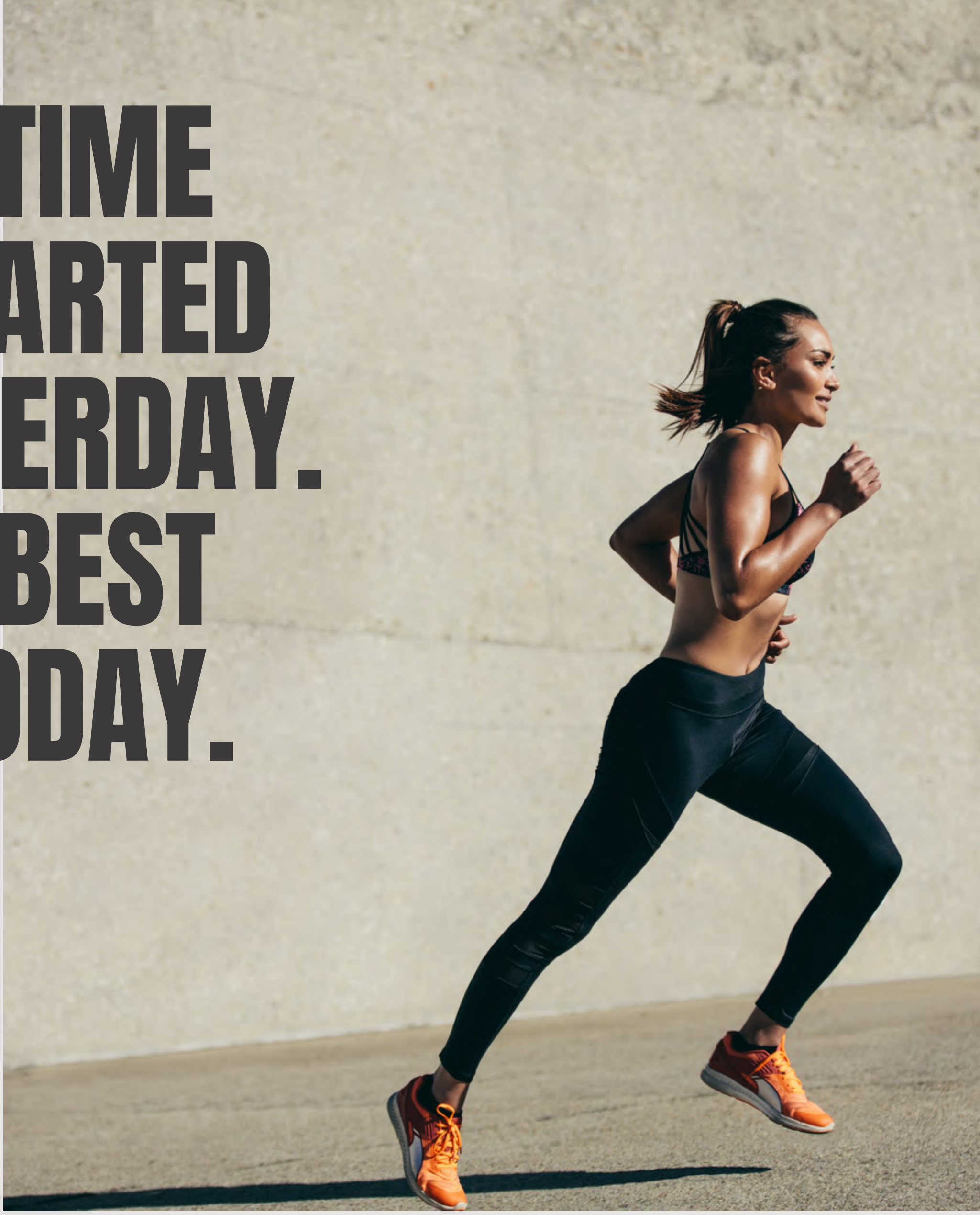
A strong ESG proposal therefore safeguards your long-term success and increases your company's financial value.

It helps companies attract and retain quality employees, combats rising operating expenses, and reduces regulatory and legal interventions.

It drives consumer preference and enhances investment returns by allocating capital to sustainable opportunities, mitigating risks, and avoiding stranded investments that may not pay off because of longer-term environmental or social issues.



THE BEST TIME TO GET STARTED WAS YESTERDAY. THE NEXT BEST TIME IS TODAY.



The assessment (1) of large companies in France shows what we already suspected: there is a long way to go - both to grasp the holistic vision of the ESRS framework, and to get organized around these reporting requirements, that are being elevated to the status of financial reporting.

Up until now we have spoken about extra-financial topics and factors. From now on we will increasingly be speaking about pre-financial factors.

The final adoption of the ESRS signals the transition from political debate to the practical implementation of these new requirements — which are a game-changer for corporate accountability, in the EU and globally.

This is happening today, and we've seen that there is a lot to be done. CSRD is not just a report to fill in, it's a new way of governing that will take several months - even years - to prepare.

There is no time to lose, it's important to start now.

A company aiming for the world to trust that it is truly committed to sustainability, needs to start by focusing on strategy and governance -
it will set the pace for all the rest.

A key priority also needs to be to navigate and learn the standards -
every single disclosure point (approx. 990 in ESRS, whereof approx. 250 metrics, subject to materiality assessment).

With the ESRS the devil is in the details.

And there is no excuse for bad performance on this subject, there are off-the-shelf solutions available to help.

Science-based system support

The science-based SaaS solution Cleerit ESG is a secure off-the-shelf CSRD-compliant and ESRS-ready Sustainability Strategy, Governance & Reporting Software.

Every single disclosure point is digitized - to help companies navigate the ESRS standards, learn, and prepare.

The good news is that it's neither expensive (65€/user/month), nor complicated (you just login), and the ROI is very high – the chances of strategic success triple with features and capabilities to:

- factor in impact and risk exposure,
- identify, assess, and manage material topics,
- unlock the potential of your double materiality assessments,
- define and cascade ambitious targets,
- create actionable roadmaps for strategic success,
- manage ESG data flows and distribute responsibilities within the organization,
- monitor and manage performance –
- while preparing CSRD and
- automating your sustainability reporting with ESRS-ready templates.

Sources

(1) 5th annual review of ESG reporting for the 100 large French companies

Carried out by the leading network of entrepreneurs in France, MEDEF, with Deloitte and EY.

Drawn up from the Extra Financial Performance Statements (financial year 2022) of these groups, selected mainly from the SBF 120 (an index based on the 120 most actively traded stocks listed in Paris) and covering 15 sectors of activity. (October 2023)

Available at:
https://www.medef.com/uploads/media/node/0020/02/15373-medef-ey-deloitte-bilandpef2023-v20.pdf

(2) Article in the Guardian, 9 October 2023:

"Climate crisis costing $16m an hour in extreme weather damage, study estimates".

Available at:
https://www.theguardian.com/environment/2023/oct/09/climate-crisis-cost-extreme-weather-damage-study

The study is available at:
https://www.nature.com/articles/s41467-023-41888-1

Big Challenges Need State-of-the-Art Solutions

We have you covered, wherever you start on your CSRD journey

CLEERIT

A higher goal

www.esg-performance.com

info@cleerit.com