Introduction to sustainability reporting and consequences for companies

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Agenda

1. ESG reporting - Legal requirement and opportunity
2. Main differences between the reporting of european and non-european companies
3. ESRS reporting principles and the sustainability reporting process
   3.1 ESRS 1 and 2 Cross-Cutting Standards
4. Transitional provisions

ESG Reporting
Legal requirements and opportunities

The European legislation relating to Corporate Sustainability

Approved in November 2022 by the European Council and in force as of 5 January 2023, the Corporate Sustainability Reporting Directive (CSRD) extends the sustainability reporting obligation to:

- public interest entities by 2025 (data FY 2024);
- large companies by 2026 (data FY 2025);
- listed SMEs by 2027 (data FY 2026);
- parent companies by 2029 (data FY 2028) residing in non EU countries that have generated net revenues in the EU exceeding Euro 150 million in the last two consecutive financial years and that have at least: (i) a subsidiary company that meets the size requirements of the CSRD or (ii) a branch that has generated net revenues exceeding Euro 40 million in the previous financial year.

On 21 October 2023, ESRS (European Sustainability Reporting Standards) officially entered the European legal framework and Member States had the obligation to transpose the Directive by August 2024.

Italy transposed the EU Directive (CSRD) on 30 August 2024 (Legislative Decree published on 10 September 2024).

EU Directive no. 2023/2775 established renewed parameters for classifying companies based on size.

A company is considered a large enterprise if it exceeds at least two of the following parameters:

(i) Total assets Euro 25 million;

(ii) Net revenues Euro 50 million;

(iii) 250 employees.

It is estimated that, when fully operational, the companies that will have to draw up the sustainability report in Europe will be more than 49.000 and in Italy more than 7.000. The sustainability information will be an integral and substantial part of the company external reporting.

The CSRD (Corporate Sustainability Reporting Directive) provides for:

- Sustainability disclosures to be included in the management report.
- Disclosures according to the European Sustainability Reporting Standards ("ESRS") prepared by EFRAG (European Financial Reporting Advisory Group) and adopted by the European Commission on 31 July 2023. This requirement ensures greater comparability between company disclosures. Specific standards will be introduced for SMEs. Disclosure must cover the company and its value chain.
- Requirement of certification by a statutory auditor of sustainability information (at the moment limited assurance, will come to reasonable assurance).
- Digitized disclosure (XBRL).

Main differences between the reporting of european and non-european companies

Main differences between the reporting of European and non-European companies

European companies

1. ESRS (European Sustainability Reporting Standards): these standards have been developed by the European Financial Reporting Advisory Group (EFRAG) and are **mandatory** for large public interest entities from 2024, for large companies from 2025 and for listed SMEs from 2026. The ESRS require a **double materiality analysis t**hat includes both impact materiality and financial materiality while, for example, the GRI standards focus primarily on impact materiality e the ISSB standards focus primarily on financial materiality, i.e. the sustainability impact on the company's financial performance.
2. Format and timing: information must be integrated into the annual report and written in XHTML format, with specific tags for sustainability data.
3. Progressive application: as we have seen, the reporting obligation applies progressively, starting with large companies and extending to listed SMEs and non-European companies with significant activities in the EU.
4. Reporting obligations: CSRD obliges companies to disclose detailed information on environmental, social and governance (ESG) issues. This includes the impact of their activities on people and the environment.
5. SFRD (Sustainability Finance Disclosure Regulation): this regulation obliges investment companies and financial advisors to disclose information on the sustainability of their financial products. The aim is to guide capital towards sustainable investments and prevent so-called 'greenwashing'. Companies are required to disclose the potential negative sustainability impacts of their investments and explain how they manage these risks.

Main differences between the reporting of European and non-European companies

Non European companies:

1. Variety of standards: non-European companies follow a variety of reporting standards, such as the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB) and the International Sustainability Standards Board (ISBB).
2. Voluntariness and compulsoriness: in many countries, the sustainability reporting is still voluntary, although there is growing pressure to adopt transparent and standardized practices.
3. Integration into financial statements: non-European companies often integrate ESG information into their annual reports but without the requirement for a standardized format as required by the CSRD.
4. International reporting standards don’t require a **double materiality analysis**.

The CSRD Corporate Sustainability Reporting Directive is an advanced sustainability reporting model, with precise and standardized obligations for European companies. Outside Europe, ESG reporting often lacks uniformity and mandatory. This creates important differences between companies and could create uncertainty for non-professional investors.

Reporting Principles
European Sustainability Reporting Standards

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The European legislation relating to Corporate Sustainability

Digitized Sustainability Reporting will be integrated and linked with the financial results reported in the traditional statutory financial statements and therefore management control and risk management will have to include ESG variables (XBRL).

Companies must:

a) consider within their Enterprise Risk Management model (ERM) the risks related to climate and other environmental, health and social issues, including child and forced labor;
b) include information on material impacts, risks and opportunities related to the entire upstream and downstream value chain, as resulting from due diligence activities and materiality analysis.

Nowadays, the value of companies is increasingly represented by intangible assets (reputation, qualified employees, relationships, etc.) that are directly influenced by sustainability factors, and companies that do not manage them risk eroding their value.

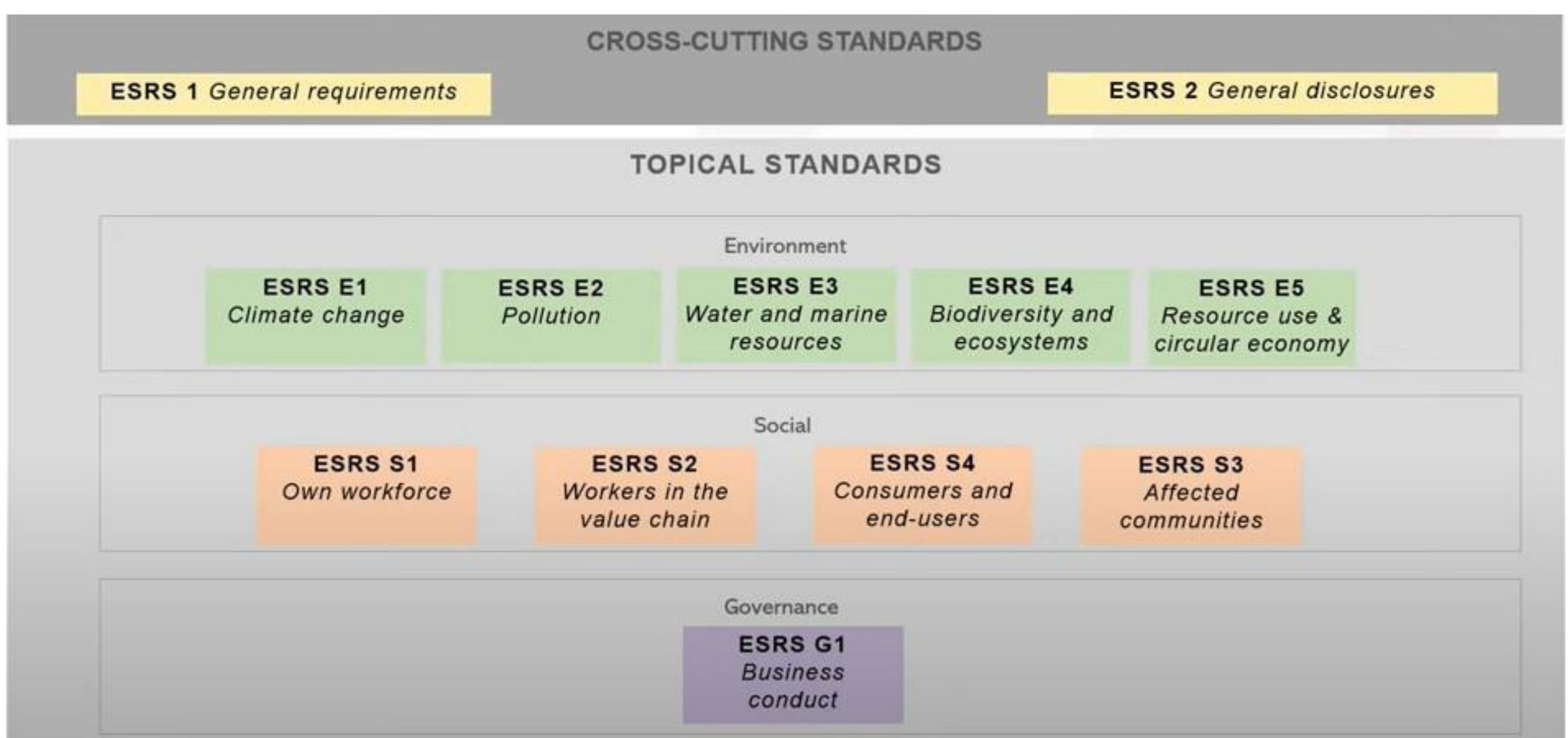
Sustainability Reporting Standards

On 31 July 2023, the European Commission adopted the first set of ESRS, i.e. the application standards that will enable companies to fulfil their reporting obligations under the new CSRD.
The standards are designed to be highly interoperable with the GRI Standards, consistent with the recommendations of the Financial Stability Board's Task Force on Climate Related Financial Disclosures (TCFD), and will reflect the disclosure requirements of the EU Green Taxonomy and the Corporate Sustainability Due Diligence Directive (CSDD).

The first set consists of 12 Standards: two general Cross Cutting Standards and ten Topical Standards (Environmental, Social, Governance) divided by topic: 5 environmental, 4 social and 1 on governance.
The CSRD also stipulates that EFRAG will continue its work with the further issuance of sector-specific standards.

Sustainability Reporting Standards

The set of ESRS standards prepared by EFRAG and adopted by the European Commission



Three macro reporting areas:

- **Environment**
- **Social**
- **Governance**

Reporting areas :

1. Strategy, including:
    a. Strategy and business model in relation to sustainability;
    b. Governance and organization in relation to sustainability;
    c. Materiality assessment of its sustainability-related impacts, risks and opportunities.
2. Implementation measures, covering policies, targets, actions and action plans, allocation of resources.
3. Performance metrics.

The reporting areas of strategy and business model, governance and organization and materiality assessment are covered by cross-cutting standards since they are address several or all topics.

There are two additional levels of reporting:

- Sector specific (standards being prepared by EFRAG);
- Specific to the company for any topics not covered by topical standards.

A relevant difference between European and international standards concerns the **double materiality analysis.**

It is one of the main innovations introduced by the CSRD: the company must assess: (i) the impact that its actions have on the environment and society (so-called "**Impact Materiality")** and (ii) the way in which environmental, social and governance factors can influence the financial and operational stability of the company (so-called "**Financial Materiality**").
"**Impact materiality**" refers to the positive or negative, actual or potential effects that may affect people or the natural environment and that are caused by an organization in the short, medium and long term. Materiality analysis considers three types of impacts: direct impacts from the organization's operations, joint with third parties, and indirect from the value chain.
"**Financial Materiality**" refers to the risks and opportunities that sustainability issues can generate on the economic performance of the organization in the short, medium and long term, influencing both the aspects accounted for in the financial statements and the unaccounted for items (reputation, for example).

For material issues, **disclosure must be extended both up and down the value chain.**
If the information is not available, the company must use estimates based on reasonable and verifiable information.
For the first three years of reporting, the ESRS principles allow for certain information related to the value chain to be omitted, explaining the reasons for the omission and action plans to obtain the information.

Dual materiality analysis process

The materiality analysis process and its inputs should be described in the sustainability report.

Understanding the context and defining the stakeholder engagement strategy

1. Analysis of company activities, business model, business relationships and value chain.
2. Definition of the time horizon to be used in the materiality analysis.
3. Analysis of the legal and regulatory landscape to which the company is subjected.
4. Definition of the stakeholder engagement strategy.

Identification of the list of potentially material issues and their impacts, risks and opportunities

1. Use of any existing identification and analysis processes.
2. "Top down" or "Bottom up" approach.

Determination of the final list of material topics

1. Definition of materiality thresholds.
2. Materiality impact analysis.
3. Financial materiality analysis.
4. Assessing the validation of results with the involvement of stakeholders.
5. Aggregation of results and definition of their interactions.

Stakeholder engagement is an important part of the ongoing due diligence process on which materiality analysis is based.

European Sustainability Reporting Standards – materiality in different frameworks

#1 GRI (Global Reporting Initiative)

Encourages Double Materiality

GRI guidelines don't mandate a specific approach, but they encourage companies to report on both financial materiality (how ESG factors affect their finances) and impact materiality (their social and environmental impacts).

#2 SASB (Sustainability Accounting Standards Board)

Financial Materiality (Industry- Specific)

SASB focuses on industry-specific ESG metrics that have a financial impact on companies. However, they acknowledge the importance of considering broader sustainability impacts.

#3 TCFD (Task Force on Climate- Related Financial Disclosures)

Financial Materiality (Climate- focused)

TCFD recommendations target climate-related risks and opportunities with a financial materiality lens.

#4 CDP (Carbon Disclosure Project)

Impact Materiality (Focuses on specific areas)

CDP focuses on environmental impact, particularly in climate change, water security, forests, and supply chain. They request data on a company's environmental performance and strategy.

#5 CSRD (Corporate Sustainability Reporting Directive)

Double Materiality

CSRD from the EU emphasizes double materiality. Companies will need to report on how sustainability issues affect their business and vice versa.

#6 SEC (US Securities and Exchange Commission)

Financial Materiality (Climate- focused)

The recent SEC climate disclosure rule mandates reporting on climate-related risks and opportunities with a financial materiality focus.

European Sustainability Reporting Standards

Topics, sub-topics e sub-sub-topics to be considered in the materiality analysis

EFRAG published the list of data points in excel format (approx. 1200 dp)

Governance
Business conduct
Corporate culture
Environment
Circular Economy
Waste
Resource outflows
Ressource inflows
Biodiversity & Ecosystems
Impacts & dependencies on ecosystems
Land-use & fresh-water
Direct impact drivers of biodiversity loss
Climate change
Energy
Climate change mitigation
Climate change adaptation
Water & Marine resources
Water
Pollution
Substances of concern
Pollution of air, water, soil
Social
Own workforce
Equal treatment and opportunities for all
Working conditions
Workers in the value chain
Equal treatment and opportunities for all
Working conditions
Other work-related rights
Costumers & end-users
Information-related impacts
Personal safety
Social inclusion
Affected communities
Security related impacts
Economic, social and cultural rights
Rights of indigenous people

ESRS 1 and ESRS 2 cross-cutting Standards

The CSRD identified the general principles on which the information to be reported should be based in five points:

1. Characteristics for information quality
2. Double materiality
3. Value chain
4. Time horizon
5. Due diligence

Although there is not enough time to cover the entire content of the 12 ESRS Standards, it's important to highlight that ESRS 1 and 2 govern the entire structure of ESG reporting, regardless of the company's sector of activity.

ESRS 1 and ESRS 2 cross-cutting Standards

In fact:

ESRS 1 – «General Requirements»	ESRS 2 – «General Disclosures»
It outlines the general requirements for sustainability reporting in line with European regulations. The general principles of ESRS 1 are: 1. Relevance 2. Faithful representation 3. Comparability 4. Verifiability 5. Understandability In Appendix 7, a non-binding structure for sustainability reporting is suggested.	It's structured around 4 pillars that establish sustainability reporting requirements for all companies. This standard, in particular, covers four specific areas: 1. Governance (GOV) 2. Strategy (SBM) 3. Impact, Risks and Opportunity Management (IRO) 4. Result and objectives, or metrics and targets (MT)

ERS standard 1 - appendix F- suggests the structure of the sustainability statement

In Italy in the management report, which is a part of the annual report

- Analysis of the company's development and performance and its position
- Description of main risks and uncertainties
- Probable company development
- Corporate Governance Report

Sustainability Report

General Information (ESRS 2)

- Topic-specific information
- Sector specific information

- List of disclosure requirements provided
- Table of all datapoints derived from other European regulations

Thematic standards

- Environment
- Social
- Governance

- Management of impacts, risks and opportunities and metrics and targets
- Sector-specific disclosure
- Company-specific disclosures
- EU Taxonomy disclosure

Transitional Provisions

Transitional Provisions

[c.d. Phasing-in]:

A company (or group) with **less than 750 employees** (on average) may omit:

First year:

- Scope 3 emissions (SCOPE 3) and total GHG emissions
- own workforce disclosure requirements (S1)

First two years:

- all information obligations on biodiversity (E4),
- workers in the value chain (S2) .
- affected communities (S3),
- consumers and end-users (S4)

All companies may omit:

First year:

- information on the expected financial effects of material physical and transition risks, and potential climate-related opportunities.
- Disclosure obligations (S1-7-8-11-12-13-14-15)