FULL DISCLOSURE: MONTHLY BRIEFING ON EU CORPORATE TRANSPARENCY REGULATION, DECEMBER 2021 ISSUE

Insights into climate indicators for companies: What to report under European sustainability reporting standards

In 2021, the development of the Corporate Sustainability Reporting Directive (CSRD)[1] and its new and far-reaching reporting standards has gained further momentum in the EU. These reporting standards provide companies with clarity on what and how they need to report and reduce administrative burden. At the same time, they ensure comparability and relevance of information, while guaranteeing that investors and all users of sustainability data get the information they need. **The European sustainability reporting standards will specify disclosure requirements for all environmental, social and governance (ESG) categories.**

Mandated by the EU Commission, the European Financial Reporting Advisory Group (EFRAG) set up a Project Task Force (PTF) which, in February 2021, delivered key recommendations[2] on how to develop European sustainability reporting standards. In 2021, following the CSRD proposal adopted by the Commission in May, the PTF has been extended to include around 80 experts and secretariat members[3] representing various types of expertise and stakeholders, and tasked with the preparation of a draft proposal for the first set of EU standards (see Sustainability Reporting Standards Roadmap[4]).

This draft will be handed over to a permanent EFRAG structure responsible for developing EU sustainability reporting standards, which will be established in early 2022. **The CSRD proposal stipulates that EFRAG should be responsible for carrying out a due process for drafting, consulting and delivering the proposed standards to the EU Commission for consideration and adoption.**

The initiative of the European Union to produce Sustainability Reporting Standards has been widely welcomed, in parallel with international discussions about global standards.[5] The International Sustainability Standards Board (ISSB) was officially launched at COP26 to deliver such global standards. The decision to move the ISSB headquarters to Frankfurt also strengthens the position of Germany as an international hub for sustainable finance.

In this context, European active leadership is seen as necessary to maintain the ambition and momentum for the transition to business sustainability, as well as meeting the specific needs stemming from the EU legislative framework on sustainable finance and the European Green Deal.

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[1] EU-Commission: https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en, Last retrieved: 2021-12-11.
[2] EFRAG (2021): https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520PTF-NFRS_MAIN_REPORT.pdf , Last retrieved: 2021-12-11.
[3] EFRAG (2021a): https://efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520%2520PTF%2520ESRS%2520composition%2520and%2520kick%2520off%2520FINAL.pdf, Last retrieved: 2021-12-11.
[4] EFRAG (2021a): https://www.efrag.org/Activities/2010051123028442/Non-financial-reporting-standards, Last retrieved: 2021-12-11.
[5] IFRS (2021): https://www.ifrs.org/projects/work-plan/sustainability-reporting/, Last retrieved: 2021-12-11.

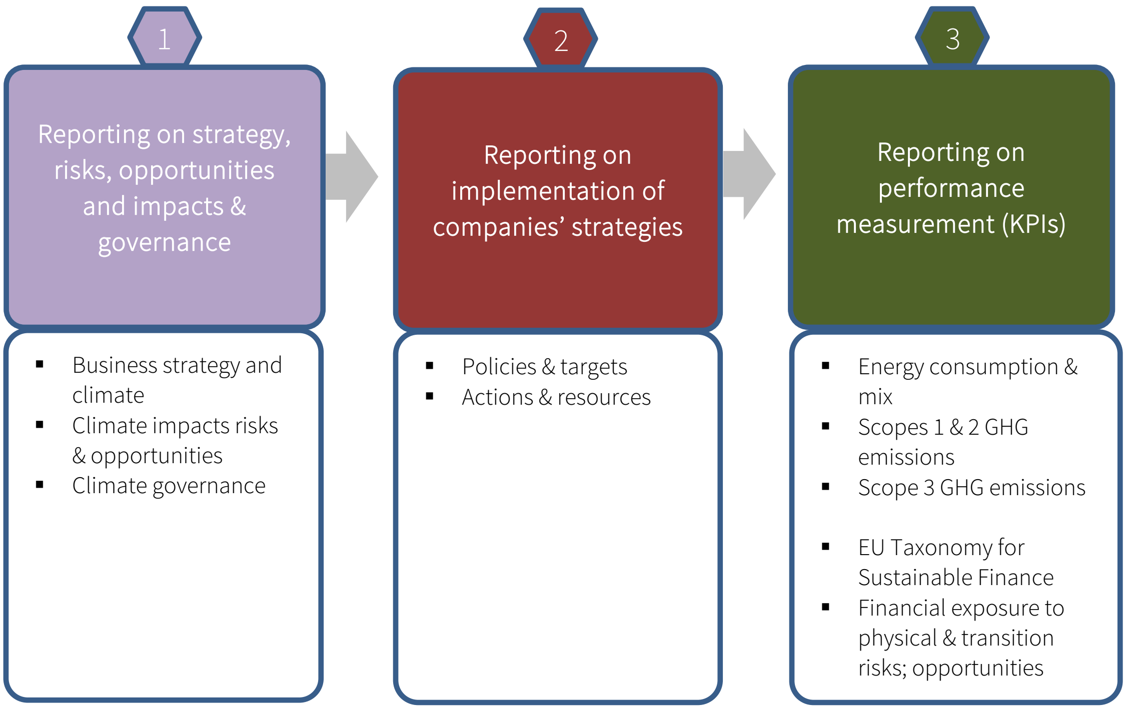
Principles and objectives for the EU climate standard

In September, the EFRAG project task force published a publicly available working paper entitled *'Climate standard prototype'*,[6] which gives a first insight into future European standards on this specific and crucial issue. The paper itself will undergo further extensive discussion within the Project Task Force before opening a public consultation.

The prototype responds to the CSRD requirement to ensure transparency around the plans and capacity of reporting entities to adapt their business models and operations to the transition to a sustainable economy and limiting global warming to 1.5 °C.

The scope of the prototype is strictly framed by the CSRD proposal and aligned with the key performance indicators (KPIs) needed by investors in line with the EU's Sustainable Finance Disclosure Regulation (SFDR) and EU sustainable taxonomy. The prototype indicates how the proposal builds on existing standards, including in particular the Task Force on Climate-related Financial Disclosure (TCFD), Global Reporting Initiative (GRI) and CDP. The EFRAG prototype brings these different regulatory elements together in a coherent three-tiered structure, as shown in Figure 1.

Figure 1: The three areas of disclosure requirements described by the EFRAG prototype



Source: Own illustration based on Frank Bold.

Note: PTF-ESRS Cluster 1 is currently developing cross-cutting standards on the reporting areas 'Strategy' and 'Implementation'. The draft proposals in this document are limited to additional climate-related disclosures.

[6] EFRAG (2021b): https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520PTF-ESRS%2520Climate%2520standard%2520prototype%2520working%2520paper.pdf, Last retrieved: 2021-12-11.

1. Reporting on strategy, risks, opportunities and impacts and governance

The CSRD will define the disclosures required by companies under its scope on their overall strategy. Under the Directive, companies should report such information for all their material sustainability matters taken together, based on their own determination of what is material. The climate prototype addresses a number of specific climate elements that will be included in such overarching, crosscutting criteria. The requirements provide companies with a significant degree of flexibility. Companies will need to explain what their strategy is, what their assessment of risks and impacts is and how those affect their business model, and what governance arrangements they have in place to manage sustainability-related matters. The standards will provide criteria for business transparency on such elements, including the description of the overall strategy and assessment of sustainability matters, but will not prescribe the adoption of any particular arrangements. Some selected questions on strategy are listed below:

- **Actual and potential effects of climate-related risks and opportunities on the business model and strategy**
- **Resilience of the current business model(s) and strategy to climate-related risks; and whether the resilience was varied by using climate scenarios**
- **How the current business model and strategy cause and drive GHG-emissions** and other climate-related impacts in own operations and along the value chain.

2. Reporting on strategy, risks, opportunities and impacts and governance

As is the case for strategy disclosures, the implementation level is also defined in the CSRD directly and its details will be clarified in the upcoming crosscutting standards. However, unlike the strategy level, companies will report information for each material topic separately.

At this level, the climate prototype specifies what should be disclosed about the company's climate change mitigation targets. It does not prescribe that companies must adopt a target – they will be able to report 'null' values. The purpose of the standard is to ensure full transparency and comparability, which is currently not the case.

As shown by the latest research of the Alliance of Corporate Transparency,[7] only 39% of 250 analysed corporations obliged to report under the NFRD have disclosed their climate targets. Out of 108 German companies, 50 (46%) have reported a climate target and 38 (35%) have reported a science-based target or target aligned with the Paris Agreement. The message to companies from the prototype is that they will have to report their targets in a unified format, making it much easier for users of the reports to find information and work with it, ensuring that such information is based on the same metrics and methodologies, and covers the entirety of companies' emissions at a particular Scope. If companies have them, the following information about targets must be reported:

[7] Alliance of Corporate Transparency (2021): https://www.allianceforcorporatetransparency.org/news/new-data-on-companies-climate-and-human-rights-disclosures-lessons-for-the-eu-reform.html, Last retrieved: 2021-12-11.

Disclosure of targets for 2025 and 2030 (and, if relevant, every five years from 2030 to 2050) covering:

- Scopes 1 and 2 GHG emissions in absolute value
- Scopes 1 and 2 GHG emissions in intensity terms
- Total GHG emissions Scope 3 based on significant categories in absolute value
- Total GHG emissions Scope 3 based on significant categories in intensity terms

Optional targets on carbon intensity related to specific EU objectives on buildings and logistics:

- Carbon intensity of the undertaking's tertiary activities (administration buildings)
- Carbon intensity of the undertaking's logistics

Carbon neutrality / net zero target:

- Disclosure of GHG emission reduction targets for 2025 and 2030 (and, if relevant, every five years from 2030 to 2050)
- In comparison with the best available 1.5°C climate scenario related to the company's activity or sector
- If 1.5°C scenarios are not available in comparison with the –55% of GHG reduction in 2030 aligned with EU climate goal
- Presented as a graph showing the evolution over time towards net zero

3. Reporting on performance measurement (KPIs)

The core of the climate prototype concerns metrics and key performance indicators (KPIs). **This is the only truly mandatory part of the standard. While companies have discretion with regard to their strategy, governance, policies and targets, at the performance measurement level they will have to gather and disclose the required data.**

The climate prototype is based on existing EU metrics, in particular the proposed metrics corresponding to investors' disclosure obligations under the Sustainable Finance Disclosure Regulation,[8] and also the EU Taxonomy.[9] It is also aligned with the TCFD, and draws from CDP and GRI standards as well. The following disclosure data is mandatory:

[8] SFDR (2021): https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2021/962778/JC%202021%2003%20-%20Joint%20ESAs%20Final%20Report%20on%20RTS%20under%20SFDR.pdf, Last retrieved: 2021-12-11.

[9] Art. 8 Taxonomy Regulation requires companies that fall under the Non-Financial Reporting Directive (thus in future CSRD) to disclose the proportion of turnover and CapEx and /OpEx from products and services associated with Taxonomy-aligned activities. The climate prototype therefore places these metrics in the overall structure of disclosure requirements.

Energy consumption and mix:

- Final energy consumption in MWh
- Energy consumption mix
- Share of green hydrogen in the total energy consumption (%)
- Energy intensity per activity
- Disclosure of offices' energy intensity for all companies to be aligned with EU green buildings objectives
- Office energy intensity (kWh/m2)

Greenhouse gas emissions:

- Scopes 1 & 2 GHG emissions in absolute value
  - Total carbon emissions Scope 1 (tCO2e)
  - Share capped by regulated emission trading schemes (%)
  - Total carbon emissions Scope 2 (tCO2e, market-based)
- Scopes 1 & 2 GHG emissions in intensity terms (tCO2e/production unit)
- Total GHG emissions Scope 3 (tCO2e) broken down by material categories of Scope 3
- Scope 3 material categories in intensity terms (tCO2e/production unit)

Reporting on Scope 3 emissions may be a challenging task, but companies will need to provide this data to their investors, banks and insurers, as well as increasingly to public authorities. The prototype therefore aims to provide a common framework and clarity on the methodology. The prototype outlines several optional disclosures that companies may report on, but they must do so separately from main GHG disclosures, and support the data by means of narrative disclosures on methodologies and quality standards applied. **Finally, the prototype specifies additional forms of presentation for the above data as needed by financial market participants due to their own disclosure obligations on the carbon intensity** of their investments, in order to ensure transparency on alignment with EU objectives in the area of finance, buildings and logistics.

The final area of metrics concerns the financial data that describes companies' exposure to climate-related risks and opportunities. These disclosures are recommended by the TCFD, although the actual metrics are not yet fully established. Therefore, the climate prototype formulates the required KPIs in a flexible manner, combining narrative requirements with recommendations for quantitative indicators.

Future development of the climate standard: What's next?

With the production of this first paper on an initial climate prototype, the EFRAG Project Task Force has given us key insights into what future EU sustainability reporting standards might look like. The scope of disclosure requirements is already largely set by existing EU legislation and consensus on important data expressed in the international reporting standards.

The proposal will help make more relevant and comparable climate reporting easier and less costly for companies. The prototype has three main features:

1. **It clarifies what information is material with respect to climate targets and net-zero ambitions.**
2. **It provides a comprehensive structure for presentation of climate-related information to facilitate easy assessment and comparison by investors.**
3. **It rests on a compact mandatory data set, which is not negotiable, but also not difficult to comply with.**

These proposals will ultimately be handed over to a new structure within EFRAG in the first quarter of 2022, which will provide a platform for expert input, Member States' engagement and public discussion. Nevertheless, companies should already give their attention to this and the other prototypes expected. This work already gives a good indication of the direction of travel, and the timetable remains for companies to start collecting the mandatory data from 2023 so they can be reported in their next annual report.

This article is part our series **"Full Disclosure: Monthly Briefing on EU Corporate Transparency Regulation"**, in which we aim to shed light on the need for and benefits of forward-looking reporting requirements in a changing EU regulatory environment. The series includes to date:

- **Sustainability due diligence – what it means for companies and how EU sustainability standards can help** (August Issue): https://germanwatch.org/en/20859
- **(Financial) Opportunities of European sustainability reporting rules for small businesses** (July Issue): https://germanwatch.org/en/20502
- **Climate transition plans: How EU standards can help companies to focus on the right data** (June Issue): https://germanwatch.org/en/20333
- **The EU Sustainable Finance April package and how EU sustainability reporting standards fit in** (May Issue): https://www.germanwatch.org/en/20152
- **What needs to be reported on sustainability-related governance?** (April Issue): https://germanwatch.org/en/20081

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