Proposed Directive for a Corporate Sustainability Reporting

The world is evolving quickly, and businesses and citizens are becoming more aware of their social and environmental obligations, with this being reflected in the way organisations operate and individuals live their lives.

Businesses are supportive of the global sustainability agenda and are committed to finding ways to integrate sustainability into their operations as seamlessly as possible, without disrupting or adding a disproportionate administrative burden to their operations. Business is also fully aware of the increased expectations placed upon them by stakeholders for more transparency on their activities, as well as the social and environmental impacts of those activities. Indeed, those organisations that embrace and adapt to meet these expectations will be more likely to build the necessary resilience to survive future challenges.

Extension of the Scope

There is concern vis-à-vis extending the scope to listed SMEs. Firstly, it seems that an unintended consequence of extending the scope would be that SMEs appear to be disincentivised from building towards a listing on a regulated market to fall out of the scope of the CSRD. In addition, since the obligations for listed SMEs are higher than for non-listed SMEs, the CSRD proposal is promoting an uneven playing field that SMEs may find burdensome. SMEs are SMEs, irrespective of whether they source funding directly through regulated markets or through the banking system.

We are supportive that the reporting obligation remains at group level, exempting subsidiary companies if the ultimate parent company reports.

Consistency of Reporting

Ensuring that sustainability disclosures are consistent and reliable is essential to meeting the information needs of users, whilst also providing an element of predictability to businesses. To this end, adopting standards on sustainability reporting would bring about more legal certainty on the type of information companies are expected to report and how this is to be calculated and presented. Not only is the reporting landscape fragmented, but companies also often struggle to obtain the necessary non-financial information from suppliers, clients, or other partnering companies. In addition, companies tend to have a broader group of stakeholders, each with differing information needs, making it more difficult to satisfy all expectations within one report without compromising relevance for some user groups. Reporting on sustainability risks and opportunities may also differ depending on the industry, sector, or size of the company, and so the proposal should reflect this reality.

Creating sustainability reporting standards, comparable to IFRS may present problems in its own right, and perfecting sustainable assurance standards should not be rushed. These standards should follow the globally recognised sustainability, such as those published by GRI, to ensure that companies already reporting with these standards have an easier transition, while those organisations that are new to ESG reporting find it easier to build internal capacity. GRI standards have existed for twenty years and are used by most companies worldwide. A recent survey by KPMG confirmed that GRI is the most used reporting standard, accounting for two-thirds of N100 reporters and three-quarters of G250 reporters[1].

It will be challenging for businesses to ensure they remain up to date with the development of different standards, each involving their own reporting requirements, both now and in the future. Aligning to new standards is therefore anticipated to require significant technical and financial resources from companies, in particular SMEs.

Ensuring that sustainability reporting standards are globally aligned is crucial, to guarantee that reports can be compared. EU specific standards which may disproportionately deviate from the global standard will only service to increase unnecessary migration costs for companies who already report according to a pre-existing standard.

Caution must also be exercised when obliging companies to include the impact of their suppliers within their sustainability disclosures. Since a considerable number of suppliers could be smaller in size, they would likely be exempt from reporting on such matters, and so are unlikely to have the required information at hand. This could add an additional burden for companies within the scope of the proposal to access and present that information, while also burdening micro and small companies disproportionately in adhering to their clients' request for information.

Preparation of the Report

Including an obligation to report on sustainability matters in the management report takes away important flexibility for companies in terms of when and where to publish sustainability information, such as the flexibility to report separately to investors and stakeholders. In addition, timing is important to companies. Financial information is far easier to collect, whereas non-financial information may take longer to gather, making it difficult to ensure synchronised releases of such information.

The principle of sustainability reporting is based on the premise that key stakeholders who are impacted by the actions of a company can see how they are affected through the disclosed sustainability information. A standalone sustainability report presents a better opportunity to those stakeholders to extract the required information, rather than having it buried in an extensive management report. Obliging the inclusion of sustainability information in the management report takes away from a company's ability to sufficiently place the information in context.

[1] KPMG Survey of Sustainability Reporting 2020, December 2020

Companies that wish to report in the management report should not be precluded from doing so, but this should remain optional.

Introduction of Mandatory Assurance

Caution must be taken when dealing with non-financial and ESG information, as it must not be treated in the same way as financial information. Financial information provides quantitative information, which is clearly defined and measures. On the other hand, non-financial information often depends on qualitative information and context, which assurance may not necessarily capture without challenges. Sustainability information is extensive and extremely diverse, in particular when compared to financial information. Care should be taken so that mandatory assurance would not lead to disproportionate burdens and costs when compared to the added value, especially when combined with the detailed reporting requirements.

There is also a lack of clarity vis-à-vis who needs to carry out the assurance, and to what extent the assurance needs to be carried out. Clarity needs to be provided on whether those providing assurance on sustainability reports can provide other consultancy services, or whether it is sufficient for firms to provide reporting and assurance services providing the teams are kept separate and independent. This is a further increase in costs, as if a company needs help to prepare a report, as is likely for many of those newly entered into the scope, they will also need to use and pay for another provider for the audit.

It is also not clear that auditors yet have the necessary expertise to move to assurance of sustainability information, and less likely still within the timeline envisaged for implementation of the directive. The availability of such resources, in the right numbers to meet the new demand and to the right levels of expertise, would need to be nurtured through a coordinated effort with educational and regulatory institutions, with the input of stakeholders, to ensure that warranted professionals are available to adequately deliver such services to companies as necessary. It is not an exaggeration to say that such a process may likely need years to develop. The new legal framework should also ensure that the audit opinion is regulated and qualified to ensure certainty and clarity for companies that are being audited for their sustainability levels.

Costs

The Commission estimated huge costs for preparers, which are much higher than the current recurring administrative costs for providing non-financial statements under the current NFRD. These additional costs at a moment when companies are still reeling from the impact of Covid-19 and are trying to rebuild are not acceptable. Businesses should indeed be encouraged in their efforts to protect their cashflow at this time rather than be called upon to assume such additional costs. This adds to the argument that demands for information must be based on justified needs, not on excessive expectations.

Assuming that the directive is not revised again in the short term – which may not be possible due to the fast-changing nature of sustainability reporting – the costs to maintain and collect the required information do not represent minor costs and are significant enough that they will need to be factored in a company's annual budget, which will be felt in particular by SMEs and organisations facing financial difficulties.

Timeline

It is felt that the timeline for developing the standards is not realistic, and is not likely to ensure quality reporting, since the development of standards will be done in parallel to the institutional negotiation on the proposed direction – risking lack of alignment. Quality should be prioritised over speed and the development of standards should commence once political agreement on the proposal is reached.

In addition, the deadline for companies to report under the new obligations is not feasible as it does not give enough time for implementation and capacity-building following adoption and endorsement of the standards. It must be considered that many companies will be dealing with detailed and prescriptive non-financial reporting requirements for the first time due to the extension of the scope.

It is proposed that a transition period is implemented whereby reporting will be voluntary for a pre-determined amount of time, allowing companies to be able to build the required capacity to ensure upholding the required standard of reporting until such a time that reporting becomes an obligation. The Commission should also take into account the fact that educational campaigns will need to be held at an intense pace at national level on the subject.

Conclusion

The CSRD is appreciated as being necessary in the long term, and what it tries to achieve is not in dispute. Change must be brought about in a coordinated and proportionate manner, without placing unnecessary administrative and financial burdens on businesses which may disrupt competitiveness.

The specific needs of SMEs must not be forgotten. Additional administrative burden and costs inevitably lead to decreased competitiveness. The introduction of the CSRD should be complemented with technical and financial assistance aimed especially towards SMEs to help them in this transition to meet sustainability reporting obligations.

For questions or more detailed information please contact EU Affairs Manager Daniel Debono and Senior Adviser Mark Seychell from the Malta Business Bureau's Brussels Representation Office on infobrussels@mbb.org.mt

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