WHITE PAPER

Global Cohesion & Materiality – The Impact of the latest EU Delegated Act on CSRD/ESRS

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By Lorenzo Fantini, Jannik Leiendecker, Giovanni Covazzi, Rhiannon Heard, Anand Kumar and Maria Cava
Following the publication of EFRAG’s European Sustainability Reporting Standards draft on 16th December 2022 in the Official Journal of the European Union, the European Commission published a draft Delegated Act on the 9th June 2023 adopting a modified ESRS draft. The draft Delegated Act will enable the Commission to adopt the first set of ESRS by 30th June 2023, as required by the EU Accounting Directive.

The Commission’s amendments, detailed in the draft Delegated Act, aim to support correct application of the standards by entities, reduce the expected cost of disclosures for the impacted entities by €230M annually, and ensure that the required reporting is proportionally appropriate. Moreover, the commission has requested EFRAG to publish supplementary guidance on selected issues, including the materiality assessment processes, and will itself be developing a formal interpretation mechanism of the standards to support ease of adoption. The current ESRS applies across sectors, but it is anticipated that EFRAG will develop additional sector-specific sustainability reporting standards.

For the current ESRS draft, the Delegated Act details five areas of modification that are required to enable adoption of the ESRS by the Commission:

**Materiality:** The requirement for conducting a double materiality assessment retains its central role in the ESRS. All disclosure requirements and corresponding data points within each standard will require a materiality assessment, except for the standards in the ESRS 2 “General Disclosures”. This amendment increases the emphasis on the materiality assessment required, while reducing the burden on entities.

**Phasing-in of requirements:** Prior to the Delegated Act, EFRAG proposed a phased-in approach to ESRS, which required large public-interest entities (PIEs with >500 FTE) to comply from FY2024. Requirements would subsequently be introduced for large EU entities (>250 FTE) from FY2025, SMEs from FY2026 (with an optional two-year postponement) and non-EU companies from FY2028. To supplement this, the Commission has proposed additional phasing-in for all entities in the first year and further phase-in for entities with less than 750 employees, detailed below. Here, the first year refers to year 1 disclosure that is required based on entity type & size, e.g., for large EU entities, the first year would be FY2026.
• All entities may omit the following reporting in the first year:
  • Anticipated financial effects related to non-climate environmental issues (pollution, water, biodiversity, and resource use)
  • Certain datapoints related to their own workforce (social protection, persons with disabilities, work-related ill health, and work-life balance)

• Entities with fewer than 750 employees may omit the following reporting:
  • Scope 3 Emissions (E1–6) in the first year
  • KPIs related to own workforce (S1) in the first year
  • Disclosure requirements for the first two years in the standards of Biodiversity (E4), Value-chain Workers (S2), Affected Communities (S3) and Consumers & End-users (S4)

This additional phased approach aims to remove the barrier to reporting and distribute the cost to entities while also retaining the benefits of disclosure.

**Making certain disclosures voluntary:** To further reduce the cost to entities and encourage disclosure, the commission has converted additional data-points (sub-KPIs) from mandatory to voluntary. Voluntary disclosures refer to KPIs and data points detailed as “may disclose” within ESRS. Examples include:

• **[ESRS E4 – 1]** Biodiversity transition plan – Entities may now optionally disclose their biodiversity transition plan to improve strategy alignment with global frameworks. However, disclosure on the impact of biodiversity on the entity’s strategy and its corresponding resilience is still required.

• **[ESRS S1 – 7]** Characteristics of non-employees – It is now optional to disclose the types of non-employees and their work for and relationship with the undertaking. However, the number of non-employees and their characteristics are still mandatory.

**Further flexibilities in certain disclosures:** As with the selection of voluntary, “may-disclose” KPIs, the ESRS has adjusted some data points to incorporate a flexible approach that further eases adoption and subsequent disclosure. Some examples are below:

• **[ESRS 1 – 3.5]** Details of the types of financial effects arising from sustainability risks that may require disclosure are no longer included in the disclosure requirement. Instead, the definition for disclosure simply refers to risks arising from past or future events.
Safeguarding disclosures previously included disclosure of the protection in place for workers who refuse to act unethically, even if such refusal may result in the loss of business and a specific non-retaliation policy. This disclosure is now more general, and requires details on internal whistle-blower reporting channels, associated training and measures to prevent non-retaliation in an attempt to protect whistle-blowers.

**Coherence and interoperability:** As the ESG reporting landscape develops, companies will be required to adhere to multiple KPIs. The Commission has introduced technical modifications to align the ESRS reporting standards with other EU directives, including the Pay Transparency Directive and the European Pollutant Release and Transfer Register. Engagements with global standard setting initiatives has also led to additional ESRS adaptations. Interoperability between the International Sustainability Standards Board (ISSB), Global Reporting Initiative and ESRS is vital for simplifying reporting disclosure, and thus ESRS amendments have been made accordingly. This is additionally reflected in BCG's more granular breakdown of ESRS KPIs to allow comparison across regulations, as shown in Exhibit 1.

### Exhibit 1 - ESRS KPIs

Companies will be asked to report against material topics

<table>
<thead>
<tr>
<th>ESG topic areas from CSRD/ESRS</th>
<th>Process description</th>
<th>Policies</th>
<th>Targets</th>
<th>Action Plans</th>
<th>Transition Plans</th>
<th>Potential financial effect</th>
<th>Other KPIs (illustrative, not exhaustive)</th>
<th>Quantitative KPI</th>
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</thead>
<tbody>
<tr>
<td>Climate change</td>
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<td>☑</td>
<td>☑</td>
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<td>☑</td>
<td>• Gross Scopes 1-3 GHG Emissions</td>
<td>18/37</td>
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<td>• GHG removals and mitigation</td>
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<td>Pollution</td>
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<td>☑</td>
<td>• Pollution of air, water and soil</td>
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<tr>
<td>Water &amp; marine resources</td>
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<td>☑</td>
<td>• Water consumption</td>
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<tr>
<td>Biodiversity &amp; ecosystems</td>
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<td>☒</td>
<td>☒</td>
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<td>• Resource outflows</td>
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<td>• Resource inflows</td>
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<td>Affected communities</td>
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<td>☑</td>
<td>• Diversity indicators</td>
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<td>• Political influencing activities</td>
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</tbody>
</table>

Source: BCG.

1. The overview shown represents a rough classification - within the category, individual KPIs can vary per thematic block.
2. In the first step, publish those targets that insurance companies have already set. Increasing expectation that targets will also be set on the “target KPIs” - therefore, further expansion stages should be taken into consideration.

ESRS = European Sustainability Reporting Standards.
The updated draft Delegated Act highlights the opportunity for a materiality-based approach. This reconfirms our belief that companies can adopt a Smart Compliance approach for ESG readiness, involving the following elements:

1. **Conduct a comprehensive double materiality assessment** to optimize ESG reporting scope and ensure efficient process development from day one.

2. **Ensure all stakeholders are involved in the set-up** to meet ESRS data-point disclosure and capture all stakeholder know-how in an efficient way.

3. **Take an objective perspective when selecting processes and systems** for efficient roll-out and implementation, including smart vendor selection for the ESG reporting system, and the design of lean data collection processes.

4. **Build on existing data and strategies** through smart integration of financial KPIs, adapting current structures to encompass ESG compliant strategy and reporting.

5. **Leverage the newest technologies**, using state-of-the-art ESG reporting solutions and automated systems (e.g. GenAI) to enable rapid data collection and swift disclosure.

As ESG reporting requirements continuously evolve and become more complex, it is crucial for EU companies to stay updated and take proactive measures to ensure compliance and capture opportunities. Our Smart Compliance approach, developed with our Center for Climate & Sustainability Policy & Regulation, will enable EU companies to navigate ESRS compliance and ensure global ESG reporting coherence. The opportunities are certainly out there, and the time to act is now!

For further information, please see our external publications on:

1. “The New Double Materiality Assessment”

2. “How EU Financial Institutions can prepare for CSRD/ESRS”

3. “European Insurance in light of upcoming CSRD/ESRS requirements”

4. “How the automotive industry can prepare for CSRD/ESRS”