TEXTE
08/2022

Recommendations for the design of sustainability reporting standards under the Corporate Sustainability Reporting Directive (CSRD)

Policy Paper

by:

Christian Lautermann, Esther Hoffmann, Carla Young
Institute for Ecological Economy Research (IÖW), Berlin

Markus Duscha, Walter Kern
Fair Finance Institute, Heidelberg

Theresa Steyrer, Kaya Feddersen
Arqum GmbH, Berlin

publisher:
German Environment Agency

TEXTE 08/2022

Ressortforschungsplan of the Federal Ministry for the Environment,
Nature Conservation, Nuclear Safety and Consumer Protection

Project No. (FKZ) 3719 14 102 0

Report No. (UBA-FB) FB00759/ENG

Policy Paper

Recommendations for the design of sustainability reporting standards under the Corporate Sustainability Reporting Directive (CSRD)

by

Christian Lautermann, Esther Hoffmann, Carla Young
Institute for Ecological Economy Research (IÖW), Berlin

Markus Duscha, Walter Kern
Fair Finance Institute, Heidelberg

Theresa Steyrer, Kaya Feddersen
Arqum GmbH, Berlin

On behalf of the German Environment Agency

Imprint

Publisher
German Environment Agency
Wörlitzer Platz 1
06844 Dessau-Roßlau
Tel: +49 340-2103-0
Fax: +49 340-2103-2285
buergerservice@uba.de
Internet: www.umweltbundesamt.de

/umweltbundesamt.de
/umweltbundesamt

Report performed by:
Institute for Ecological Economy Research (IÖW), in cooperation with Fair Finance Institute and Arqum GmbH
Potsdamer Str. 105
10785 Berlin
Germany

Report completed in:
January 2022

Edited by:
Section I 1.4, German Environment Agency
Töpfer Christoph

Publication as pdf:
http://www.umweltbundesamt.de/publikationen

ISSN 1862-4804

Dessau-Roßlau, January 2022

Abstract: Recommendations for the design of sustainability reporting standards in the context of the Corporate Sustainability Reporting Directive (CSRD)

The European Commission's draft of the new Corporate Sustainability Reporting Directive (CSRD) is intended to extend European sustainability reporting standards to cover all companies falling under the scope of the directive. Based on a comprehensive evaluation of non-financial statements of German companies and supplemented by expert interviews, this policy paper formulates proposals for the design of these standards in order to improve company reporting on environmental topics.

In particular, the paper addresses the requirements to be met in reporting on environmental targets, actions, and indicators. In addition to specifying requirements for the various individual aspects, the paper also focuses on the achievement of a consistent, "big picture" approach, thus allowing the results of the various measures and their effectiveness to be more easily understood and interpreted. Additionally, we address the topic of greenhouse gas (GHG) neutrality; here, recommendations are made to align reporting on GHG neutrality more closely with global and European climate targets and to make this reporting more meaningful. In particular, our point of reference should be the Net-Zero standard of the Science Based Targets initiative (SBTi), under which the voluntary compensation of CO_2 emissions is not a permitted option for neutralization. Finally, the paper focuses on how to make reporting on environmental topics compatible with disclosure requirements for the financial industry. At the very least, the standards should incorporate all of the adverse environmental indicators mandated for reporting by the so-called Sustainable Finance Disclosure Regulation (SFDR). Reporting for each of the environmental topics should be mandatory; however, the level of detail with regard to topic-related strategies, policies, targets, and actions should be based on the relevance of the respective topic for the reporting entity.

Kurzbeschreibung: Empfehlungen für die Gestaltung von Standards zur Nachhaltigkeits-berichterstattung im Rahmen der Corporate Sustainability Reporting Directive (CSRD)

Der Entwurf der Europäischen Kommission zur weiterentwickelten Corporate Sustainability Reporting Directive (CSRD) sieht unter anderem die Entwicklung europäischer Nachhaltigkeitsberichtsstandards vor, die von allen unter den Geltungsbereich der Richtlinie fallenden Unternehmen angewandt werden sollen. Das vorliegende Policy Paper formuliert auf Basis einer umfassenden Auswertung von nicht-finanziellen Erklärungen deutscher Unternehmen und ergänzender Experteninterviews Vorschläge zur Ausgestaltung dieser Standards, um die Berichterstattung über Umweltthemen zu verbessern.

Dabei geht das Papier darauf ein, welche Anforderungen an die Berichterstattung über Umweltziele, Maßnahmen und Indikatoren zu stellen sind. Neben konkretisierenden Anforderungen an die einzelnen Elemente geht es dabei insbesondere auch um eine konsistente Gesamtschau, aus der sich die Ergebnisse von Maßnahmen und ihre Beiträge zur Zielerreichung ablesen lassen. Vertieft betrachtet wird zudem das Thema Treibhausgasneutralität. Hier werden Empfehlungen gegeben, um die Berichterstattung über das Ziel Treibhausgasneutralität stärker an globale und europäische Klimaziele anzupassen und die Berichterstattung darüber aussagekräftiger zu gestalten. Empfohlen werden insbesondere eine Orientierung am Net Zero Verständnis der Science Based Targets Initiative (SBTi) und eine Klarstellung, dass die freiwillige Kompensation von CO_2-Emissionen keine Option der Neutralisierung im Zusammenhang mit dem Net Zero Ziel ist. Ein weiterer Fokus wird darauf gelegt, wie die Berichterstattung über Umweltthemen kompatibel mit den Anforderungen an die Offenlegungsanforderungen für die Finanzbranche gestaltet werden kann. Hierfür sollten die Standards zumindest alle verpflichtenden Indikatoren für Umweltthemen enthalten, die gemäß

der sog. Offenlegungsverordnung (Sustainable Finance Disclosure Regulation - SFDR) von der Finanzbranche zu berichten sind. Hierbei sollte zu jedem Umweltthema verpflichtend zu berichten sein. Die Detailtiefe der Berichterstattung in Bezug auf themenbezogene Strategien, Politiken, Ziele und Maßnahmen sollte sich jedoch an der Relevanz der jeweiligen Themen für das Unternehmen bemessen.

Table of content

List of figures

List of tables

List of abbreviations

ACT	Alliance for Corporate Transparency
ASCG	Accounting Standards Committee of Germany
AIF	Alternative Investment Fund
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
BMU	Bundesministerium für Umwelt, Naturschutz und Reaktorsicherheit (Federal Ministry for Environment, Nature Conservation and Nuclear Safety)
CSRD	Corporate Sustainability Reporting Directive
DRSC	Deutsches Rechnungslegungs Standards Committee e.V. (Accounting Standards Committee of Germany - ASCG)
EFRAG	European Financial Reporting Advisory Group
EMAS	Eco Management and Audit Scheme
ESA	European Supervisory Authorities
GHG	Greenhouse Gas
IFRS	International Financial Reporting Standards
IPCC	Intergovernmental Panel on Climate Change
KPI	Key Performance Indicator
MiFID	Markets in Financial Instruments Directive
NFRD	Non-financial disclosure directive
PAI	Principle Adverse Impacts
PAS	Publicly Available Specification
SBTi	Science Based Targets initiative
SFB	Sustainable-Finance-Beirat der Bundesregierung (Sustainable Finance Advisory Board of the Federal Government)
SFDR	Sustainable Finance Disclosure Regulation
TCFD	Task Force on Climate-Related Financial Disclosures
UBA	Umweltbundesamt (German Environment Agency), Dessau
UCIT	Undertakings for the Collective Investment in Transferable Securities
WBSCD	World Business Council For Sustainable Development
WRI	World Resources Institute

1 Introduction

The Non-Financial Reporting Directive (NFRD), adopted at the European level in 2014 and transposed into German law in 2017, was intended to advance the sustainability reporting of large European undertakings. To date, however, it has not achieved the desired effect. Under the banner of the European Green Deal and the Sustainable Finance Strategy of the European Commission, the directive is currently being comprehensively revised and renamed as the Corporate Sustainability Reporting Directive (CSRD). A draft from the European Commission from April 2021 is available. The CSRD draft provides, among other things, for the development of European sustainability reporting standards applicable to all entities within the directive's scope. A project task force at the European Financial Reporting Advisory Group (EFRAG) published a set of recommendations for the design and development of the standards (EFRAG 2021a). The Project Task Force is currently preparing drafts of the reporting standards, including standards for individual environmental and social topics as well as universal ("cross-cutting") standards for strategy- and business model-related sustainability reporting requirements. With respect to climate change mitigation and climate adaptation, the EFRAG Task Force published a working paper at the beginning of September 2021. The working paper is based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), among others, and currently being further developed (EFRAG 2021b). At the national level in Germany, actors such as the Sustainable Finance Advisory Board of the Federal Government (SFB 2021) and the Accounting Standards Committee of Germany (DRSC 2021) are contributing with their own proposals. At the international level, the International Financial Reporting Standards (IFRS) Foundation recently announced that it would set up an International Sustainability Standards Board with respective specialist committees (IFRS 2021a). At the same time, prototype standards for climate-related disclosure requirements and general requirements for disclosure of sustainability-related financial information have been published that address in particular the financial effects of sustainability-related risks and opportunities for companies (IFRS 2021b).

A reasonable point of departure for suggestions on further development of mandatory sustainability reporting and the design of European sustainability reporting standards is the current reporting practice of undertakings subject to NFRD. In a comprehensive study that evaluated the reports of all German capital market–oriented companies in the scope of the NFRD (a total of 477 reports, 249 from 2018 and 228 from 2019), we found numerous weaknesses in the reporting practice with respect to environmental matters (Lautermann et al. 2021). Based on our earlier findings, in this paper we **discuss selected reporting requirements on environmental topics and develop recommendations for the European sustainability reporting standards**. The recommendations are directed in particular to policy decision makers and the standard setter. Accordingly, we concentrate on those aspects where the CSRD draft, the proposals by EFRAG (2021a), and those of the Sustainable Finance Advisory Board (SFB 2021) are still rather vague or could be meaningfully supplemented:

a) How can more explicit reporting requirements for **targets, actions and performance indicators** improve the quality and meaningfulness of reporting on **environmental topics?** (Chapter 2)

b) How can the standards improve reporting on **carbon neutrality or net-zero CO_2 emissions** and better align corporate targets with global and European climate targets? (Chapter 3)

c) How can the standards ensure that reporting on **environmental topics** is **compatible** with the disclosure requirements of the **financial sector**? (Chapter 4)

In order to develop and validate the recommendations, we held discussions with a total of 15 experts, from individual companies, consulting and auditing firms, and financial market participants. We thank them for their feedback and contributions, which are greatly appreciated.

2 Reporting on environmental topics, specifically on targets, actions and outcomes

In our evaluation study (Lautermann et al. 2021) we find that currently only a few companies are consistently reporting on *targets, actions and outcomes* related to environmental topics.[1] In the following, we suggest ways in which the reporting could be improved—both with respect to the individual elements (targets, actions, outcomes), as well as to the coherence between them. The proposals we make in this section relate to all of the environmental topics addressed by the CSRD draft: climate change mitigation, climate change adaptation, water, circular economy (including resource use and waste), pollution and biodiversity.

2.1 Current reporting practice

The reporting practice of the German capital market-oriented undertakings under the scope of the NFRD varies significantly among the different environmental topics (see Figure 1 and Lautermann et al. 2021).

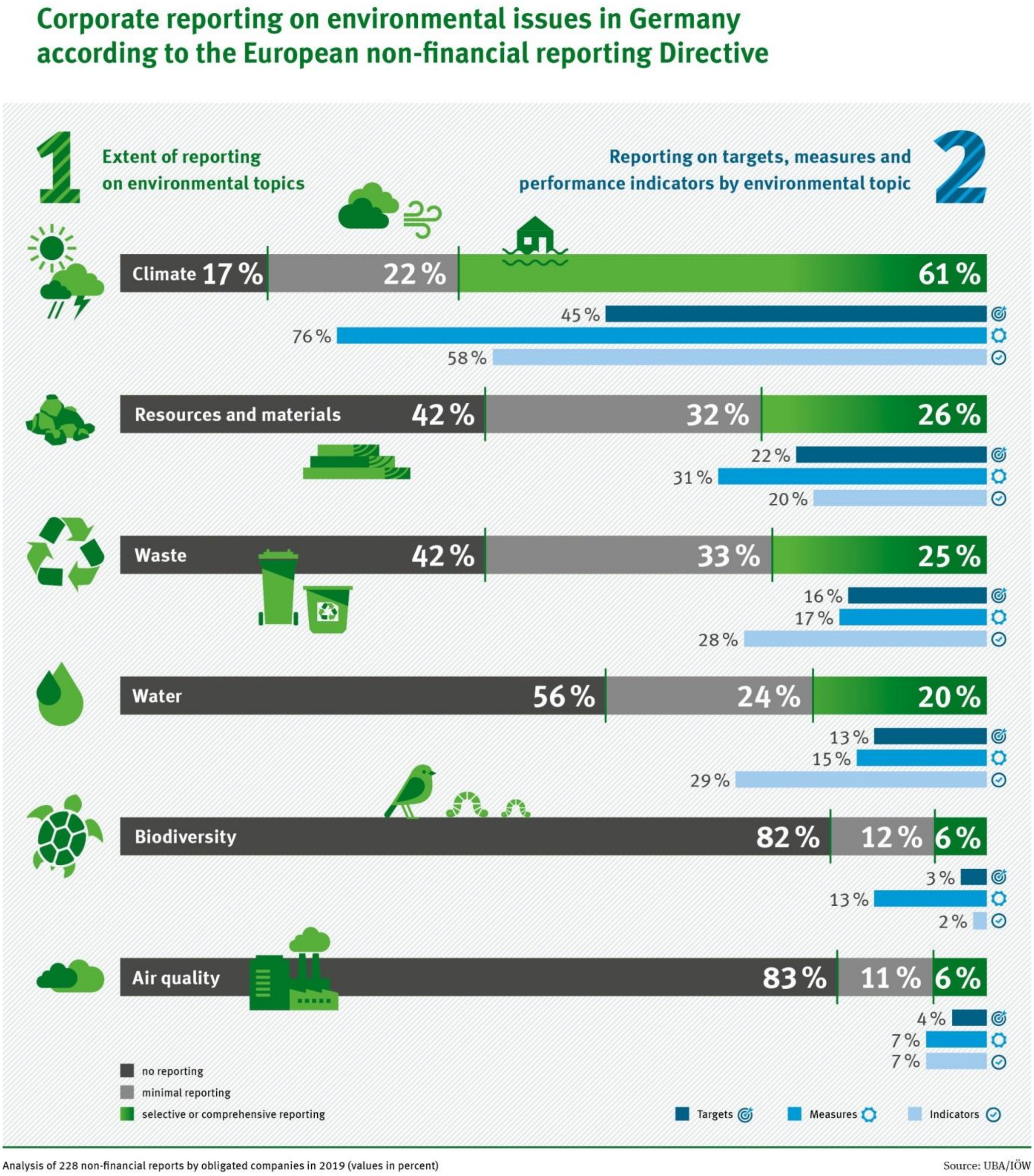
While most undertakings report on climate, over 80% do not disclose information on biodiversity and air pollution at all. A closer look at the reporting on targets, actions, and indicators reveals even bigger gaps: Here, too, reporting on climate change is most advanced, with 76% of undertakings reporting on actions, 58% reporting on indicators, and 45% reporting on targets. The lowest disclosure rates can also be found for biodiversity and air pollution. Reporting on actions to address environmental topics is most common for climate, resources and materials, but also biodiversity, as opposed to waste and water, where companies are more likely to provide information on indicators rather than on actions or targets. A systematic representation of targets, actions and performance indicators, substantively and temporally correlated, is only to be found in exceptional cases—and then, only for climate.

Very rarely are all three reporting elements represented in a contextually relevant and understandable form (see Lautermann et al. 2021, pp. 25, 28–29). Thus, it becomes difficult to track how reported actions contribute to the achievement of targets and how progress is being measured. Often only selective actions are reported. In addition, it is often unclear to what extent reported actions are actually being implemented and whether they relate to the entire company or only to selected subsidiaries or sites. Only rarely is it possible to ascertain how relevant the actions are in comparison to an undertaking's overall environmental impact.

A study by the Alliance for Corporate Transparency on implementation of the reporting obligation in Europe reveals a similar picture for the individual environmental topics: Results are most likely to be reported for climate and waste—and only in the rarest of cases are these correlated with targets (see ACT 2019, p. 14). The authors highlight a significant deficit in the reporting of results for all environmental topics and point to a frequently observed discrepancy between the existence of "policies" and the lack of associated performance indicators (ibid., p. 18).

[1] We use the similar terms *outcome*, *performance*, and *performance indicators* as follows: Outcome is the general term; performance reflects a qualitatively or quantitatively assessed outcome; performance indicators are used for quantitative evaluation (see also 2.3.3).

Figure 1: Corporate reporting on environmental topics in Germany according to the European non-financial reporting directive



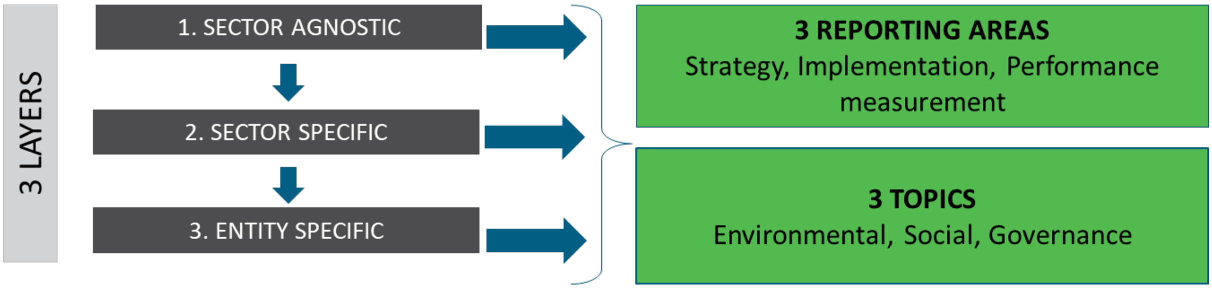
The studies show a clear need for more detailed specifications and standardization of the requirements for reporting on targets, actions, outcomes/performance indicators for environmental topics. Otherwise, reporting on these material topics will presumably remain inconsistent.

2.2 Previously discussed recommendations

In the CSRD draft, Art. 19a (2)(a–g) explicitly determines the elements that are to be reported for material sustainability topics. The required information includes, among other things: targets, including the progress being made toward achieving them; actions to be taken, including their success, and the relevant indicators. Also noted is that backward- and forward-looking aspects should also be addressed and the reporting should include both qualitative and quantitative information. In addition, the CSRD draft makes it clear in Art. 19b (2)(a) that future reporting standards must address the environmental topics of climate change mitigation, climate change adaptation, water, circular economy, pollution, and biodiversity, in line with the environmental objectives established in Art. 9 of the Taxonomy Regulation (EU) 2020/852.

The EFRAG Project Task Force (EFRAG 2021a) recommends that the sustainability reporting standards should be structured around the **three topics** "Environmental, Social and Governance" and contain disclosure requirements for an undertaking's strategy, its implementation and performance measurement ("**three areas of reporting**", cf. EFRAG 2021a, p. 91, #30, see also Figure 2 and Figure 3). The standards should also include sector-agnostic and sector-specific disclosure requirements and allow undertakings to determine additional entity-specific disclosures as needed ("**three layers of reporting**"). (See Figure 2, based on EFRAG 2021a, recommendation #24, p. 23.) Deviations from mandated disclosures should only be possible by means of a workable "comply or justify" procedure.

Figure 2: Overview of reporting layers, areas, and topics

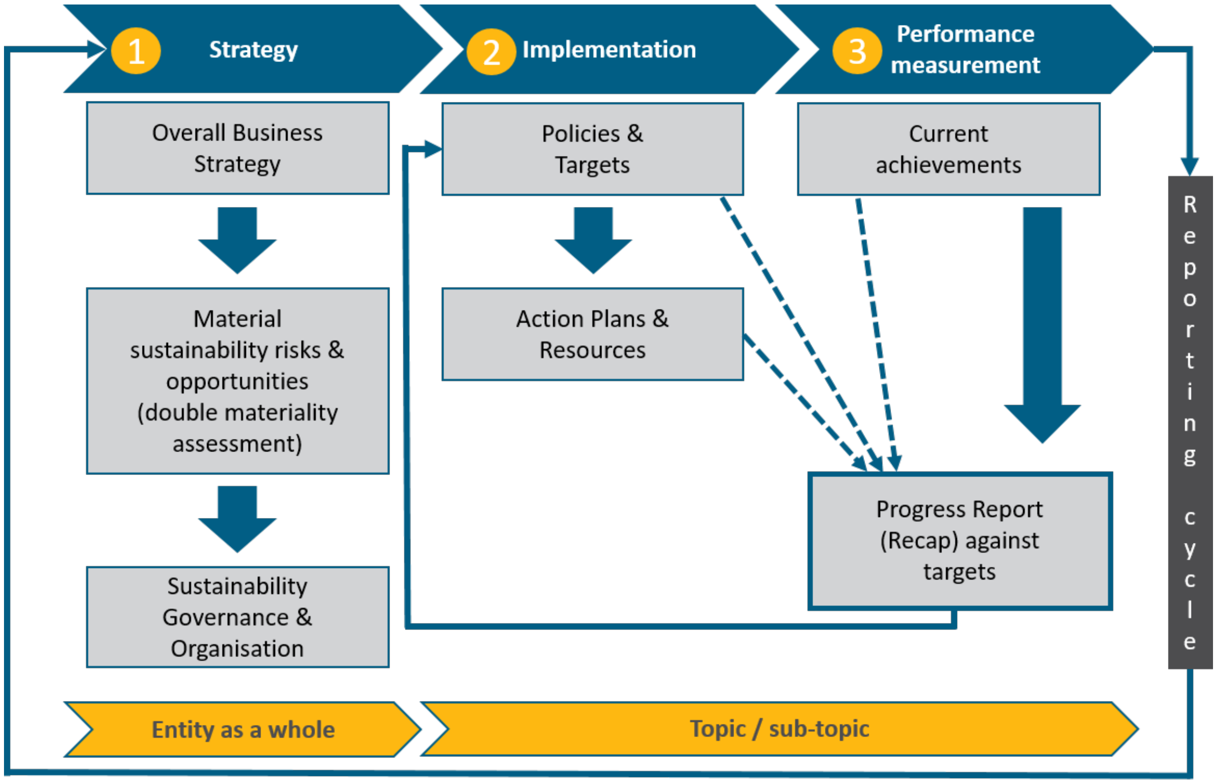


Source: authors' own representation, based on EFRAG 2021a, p. 9; IÖW

While information on strategy relates to the entire company and is broad in focus, implementation and performance measurement should be reported on a topic-specific basis. Both targets and actions are assigned to "implementation"; in recommendation #33 these two sub-reporting areas are designated "policies & targets" and "action plans & resources" (EFRAG 2021a, p. 94, #33). Notes on the operationalization of reporting on targets and their achievement are listed in proposal #18 of the EFRAG Task Force recommendations (ibid., pp. 21, 69–70). For actions in the broader sense, the task force recommendations do not provide more detailed information on how to operationalize reporting on them in the standards other than to note that—as with targets—the information should be on a topic-specific basis.

For the topics of climate change mitigation and adaptation, the EFRAG Task Force has specified in a working paper what the reporting requirements for climate targets, actions, and performance indicators could consist of in detail (EFRAG 2021b, pp. 24ff.). The working paper also provides for a table of actions with a description, time horizon, expected GHG emissions reduction, and dedicated resources. In addition, it lists exemplary categories of actions and explains that actions should be split by upstream, own operations and downstream and that their time horizons should be consistent with the milestones or target year (ibid. pp. 33–34).

Figure 3: Overall structure for reporting areas



Source: EFRAG 2021a, p. 96

Finally, for reporting on performance assessment, the EFRAG Task Force recommends in its final report from March 2021 that both a retrospective and a forward-looking perspective be addressed (EFRAG 2021a, p. 95, #34). This was further specified in the working paper for the climate standard as encompassing data on the past three years ("retrospective") and milestone targets for 2025, 2030 and, if relevant, 2050 ("forward-looking") (EFRAG 2021b, p. 25ff.).

2.3 Recommendations to the standard-setter

Despite the spotlight on climate change in the public debate, all six EU environmental objectives are of great social and economic importance. Accordingly, the European Sustainability reporting standards under the CSRD must provide for disclosure of the corresponding information for all environmental topics.

On the subject of climate change mitigation, a study by the Sustainable Finance Research Platform (2019, p. 4) notes that requiring firms to disclose their greenhouse gas emissions leads to significantly greater reductions as compared to the use of voluntary disclosure. Mandatory reporting for further environmental topics can consequently yield a new impetus in these areas.

With reference to the recommendations of the EFRAG Project Task Force (EFRAG 2021a), in the following we focus on targets, actions, and outcomes and their interactions, as these will be the central elements of the topic-specific standards (see Figure 3). In order to achieve high quality, consistency, and thus the best possible comparability in reporting on targets, actions, and outcomes on the various environmental topics, we propose minimum requirements that should be anchored in the reporting standards under the CSRD. The standards should address the three elements individually as well as their collective representation.

2.3.1 Reporting on targets

The disclosure of environmental targets serves several purposes and is essential to proper sustainability reporting. Targets should allow readers of a sustainability report to assess the ambition of an undertaking, how it develops over time, and how it compares with those of other undertakings.

We recommend that the standards specify **requirements for quantified reporting on targets** and, in addition, **operational requirements for their formulation and presentation**:

- Environmental and sustainability targets should be specific, measurable, deadline-based, and especially, quantified (see, for example, RNE 2020, p. 38 and UBA 2013).
- For globally relevant environmental aspects (e.g., GHG emissions) as well as locally relevant (e.g., particulate matter pollution), the target should be reported in *absolute* terms so that they reflect the intended reduction of an undertaking's actual environmental impact.
- The standards should also regulate *relative or intensity-based* targets (i.e., an environmental impact in relation to a reference value, such as a unit of output or turnover): For this purpose, the most meaningful reference values should be specified—where reasonable, with respect to the sector—in order to ensure comparability. Depending on the topic, the standards should specify whether absolute and/or relative targets shall be reported.
- The physical units for reporting targets should be clearly specified for each environmental topic and could be based on the core indicators in Annex IV of the EMAS regulation[2].
- To further operationalize reporting on targets, the standard setter should scrutinize links to established methods of impact measurement (broadly speaking: inputs, outputs, outcomes, impacts; see, for example, Brunn & Barth 2014, p. 9; Wördenweber 2017, p. 205). This would allow for a distinction between the various forms—and thus qualities—of targets. Targets such as increasing investments in a specific environmentally relevant area of activity or expanding certification and audit activities (inputs), for example, are of a different sort of targets than those of reducing the ecologically relevant impacts of activities in these areas.
- In those environmental areas where quantitative reporting on targets may not be required, the standards should at least provide **guidelines and good examples of reporting qualitative targets**.
- Where necessary, the standards should provide further directions for the meaningful formulation of qualitative targets and ambition statements. This can involve, for example, making reference to topic-specific initiatives or frameworks.

The standards should also specify how an undertaking should report on **short- and medium-term interim targets, as well as long-term targets** (see EFRAG 2021a, p. 95, #33), so that users of the report can track an undertaking's progress in achieving its targets:

- The principal **time frames** for the formulation and reporting of targets should be **defined** in the standards in order to ensure comparability. This would allow for **uniform time frames**

[2] Regulation (EG) No. 1221/2009; Annex IV amended by Regulation (EU) 2018/2026.

for short, medium, and long-term targets, which however, may vary depending on the specific environmental topic and should be derived from scientific findings or international and/or European policy objectives. For climate, this would mean reporting on targets, for example, for the subsequent year, for 2030, and for 2050. For other topics, such as biodiversity, the time frame should be shorter. The determination of specific years makes possible the comparability of targets between undertakings. Alternatively, the specific meanings of short-, medium-, and long-term could be defined as measured from the year in which the undertaking adopted a target (e.g. within 5 years, 5–10 years, 10 years and beyond).

- The standards should specify that reporting on targets and their attainment be referenced against a specified **base year**. The base year should be as representative as possible of an undertaking's activities. The specification of a single year—e.g., 2020—for all entities, however, can be counterproductive, as it may not be truly representative of a respective undertaking in certain cases. Instead, consideration should be given to the specification of a blanket time frame from within which the reporting undertaking can then select the most representative base year.
- Since the reporting occurs annually, reporting on short-term **targets** should generally include **the subsequent year**—unless the targets rely on multi-year projects for which subsequent-year results may not yet be available (see 2.3.2: Projects as a specific type of action). For the sake of transparency regarding the achievement of short-term targets by means of specific actions, comparisons should as a rule always be based on previous-year targets.
- Additionally, it could be stipulated that legacy targets must be reported in order to **track adjustments and alterations**. Alternatively, it could be mandated that modifications or changes in targets shall be reported.
- Finally, the standards could stipulate that the **environmental targets** shall be presented in a coherent, consolidated form, as it can already be observed as best practice in corporate sustainability reports (see Table 1).

Table 1: Best practice: Consolidated representation of climate targets including time frame

Scope	Environmental performance indicator	Baseline year	Target year	Target (%)
Group	(Relative/absolute) energy consumption	2005	2030	–55
Group	(Relative/absolute) carbon dioxide emissions	2010	2030	–35
Group	(Relative/absolute) particulate matter emissions	2010	2023	–60
Group	(Relative/absolute) emissions of relevant VOCs (volatile organic compounds)	2010	2023	–30
Group	(Relative/absolute) NOx emissions (nitrogen oxides)	2010	2023	–25

Source: authors' representation; IÖW–anonymously reproduced from real report examples.

2.3.2 Reporting on actions

Users of sustainability reports should be able to assess the appropriateness, magnitude, and effectiveness of an undertaking's actions with regard to the different environmental topics. For this purpose, the standards should allow users to assess whether the actions reported are sufficient to achieve the respective targets and challenges. Finally, reporting standards should also enable comparisons to previous actions taken by the undertaking or to the actions of other undertakings. To achieve this, we recommend the following approaches in designing the reporting standards.

In its recommendations, the EFRAG Project Task Force distinguishes between the action plan and the resources (financial, human, or technological) needed to support it (EFRAG 2021a, p. 94). In order to do justice to the various types of actions, we would advise a further conceptual **differentiation and operationalization**:

- The standards should distinguish between an overall approach and specific actions. Detailed reporting requirements should be established for both.
- The **overall approach** corresponds to the **action plans** proposed by the EFRAG Project Task Force. With this approach, an undertaking defines a longer-term, comprehensive set of actions to be taken. These are geared towards various environmental sub-strategies (or "policies") and the achievement of superordinate, longer-term goals. Such an action plan should not be renewed annually, but should be valid for a number of years.
- This is not the same as reporting on **specific actions**. These should only relate to actions taken in the respective reporting period or still being undertaken (see below: projects) that contribute significantly to the achievement of (shorter-term) targets. Logically, the standards should stipulate that relevant (!) individual actions should be considered part of the overall action plan and reported herein.

Accordingly, the standards should discourage the inclusion of irrelevant or marginal actions. They should provide that an undertaking only reports **relevant actions, that are significant in terms of their magnitude**:

- Individual actions that are local or clearly limited in scope should not be the focus of reporting. The standards could even require that such marginal actions, which are rather of an illustrative value, shall be reported separately, so as not to distract readers from the essentials.
- To take account of the fact that several individual actions can collectively be relevant, the standards could specify a consolidated or bundled representation.
- Further, the standards could stipulate that for the reporting of planned actions the undertaking shall include information on their specific intended outcome, such as the anticipated environmental impact and/or their contribution to target achievement.

Figure 4 offers an example of a coherent, consolidated presentation of actions including information on their intended impact for the topic of climate.

Figure 4: Best practice: Depiction of actions together with their impact

Project	Approach	Impact
Use of own regenerative energy	In-house photovoltaic systems at specific locations	Annual power generation; CO_2e emissions savings in metric tons annually
Green power share	Increase green power share in the energy mix by X%	CO_2e savings in metric tons annually
Reduction of energy consumption	Increased energy efficiency via LED lighting fixtures, optimized data centers, and indoor climate control	CO_2e savings in metric tons per year; MWh reduction in annual power consumption
Environmental friendly transport services	Greater availability of employer-sponsored transit passes and employee bicycles; expansion of company charging stations	Number of additional leasing bicycles, employer-sponsored transit passes, charging stations

Source: Lautermann et al. (2021): p. 24

To further operationalize the reporting on actions, we recommend developing a **systematic approach to the various types of actions**.

- A central criterion should be the **degree of maturity of an action**. The standards should make it possible to directly identify in the report whether an action is in the planning stages or already being implemented, whether it is part of a pilot project or already being implemented on a widespread basis, e.g., at all sites of an undertaking. The standards should help ensure that these differences are not only easily followed, but also clearly discernable when comparing reports.
- Depending on the type of action, requirements on **reporting continuity** may also have to be considered by the standard setter. If, for example, a pilot project is reported in one year, the subsequent year's report should include information on its success or failure and, if applicable, its subsequent broader implementation.
- In particular, for those actions that are part of a **multi-year project**, it would be important to require ongoing, unambiguous progress reports.
- In addition, it may be worth examining whether a further categorization of actions would be reasonable and practical, e.g., according to efficiency, consistency, substitution, or other ecologically relevant actions.

2.3.3 Reporting on outcomes

Reporting on outcomes should enable the users of sustainability reporting to evaluate an undertaking's environmental performance on the basis of key performance indicators (KPI), specifically:

- to determine the current performance of the undertaking and to compare it with the performance of others,

- to compare the undertaking's current performance with its past performance in order to track development,
- to measure the current performance of the undertaking against its own targets and overall (policy) objectives and thus identify needs for adjustment.

With this in mind, we recommend application of the following principles for standardizing reporting on outcomes.[3]

In accordance with the various target groups and purposes of environmental and sustainability reporting, the standards should distinguish between at least **two basic forms of representation**—the **tabular depiction of quantitative results** and their **textual interpretation and commentary**—and present them accordingly:

- For the presentation of quantitative data, the standards should ensure clarity and comprehensibility of tabular data (see below) as well as meet the requirements for **machine readability** (cf. European Commission 2021, p. 43).
- Since the reporting of outcomes is not limited to the provision of data in the form of quantitative performance indicators, the standards should also establish a framework for the accompanying **commentary**. This includes requirements that the outcomes, especially with respect to targets and time frames, must not only be described, but most importantly **interpreted, categorized, and evaluated**. Keeping with the desire to focus on the essentials, a binding specification for the provision of the commentary could at the very least include reporting of significant deviations and trends.

In order to ensure a meaningful interpretation of reported outcomes and to avoid arbitrariness, **normative reference values** for the individual environmental topics should also be specified in the standards.

- Normative reference values should be based on the **concept of planetary boundaries**, i.e., on absolute global—or, as appropriate, regional target values.
- For each environmental topic, the standards should include **at least one key reference value** for the reporting of outcomes (e.g. for climate change mitigation, the goal of GHG neutrality, see Chapter 3). Where appropriate, the standards should provide specifications or guidelines on methodology and representation.

Regardless of the concept or process underlying the performance indicators used, the standards should ensure a uniform and systematic representation in the report:

- They should specify **representation as a time series** including a minimum period (e.g., three-year comparison) as well as the use of indicators for forward-looking representations such as the path to achievement of longer-term targets.
- They should require that undertakings provide information about the business areas or activities covered by performance indicators (**degree of coverage**), that the entire undertaking or a sufficiently representative area of the undertaking be included, and that

[3] Specifications for the selection and use of metrics for performance assessment are to be differentiated for the individual areas of activity in the standard. Excluded here.

non-compliance—for example when, after a merger or acquisition, not all sites are included in the inventory boundaries—must be declared.

- Given that the relevant environmental data is commonly collected on a site-by-site basis and that in addition to the summary in the sustainability statement the underlying data is also to be compiled and provided in a machine-readable format, the standards should also provide for the **release of all site-specific data** (e.g., as machine-readable file attachment).

2.3.4 Reporting on targets–actions–outcomes in context

Targets, actions, and outcomes and/or performance indicators are systematically related: actions are intended to achieve certain targets; performance indicators are used to evaluate the outcomes of these actions and the achievement of targets. Reporting standards should accordingly include **requirements for a coherent representation**. In order to clearly emphasize the interrelationships within this reporting triad, the principles of systematization, clarity, and comprehensiveness should be anchored in the standards. Specifically, the standards should require the systematic presentation of data, including summary tables that illustrate the relations between targets, actions, and outcomes and provide meaningful context. Figure 5 and Figure 6 show how such summaries are used in reporting practice.

The standards should also require information on **target achievement (or non-attainment)** (see EFRAG 2021a, p. 95: "possible corrective actions through revised Action Plans"):

- Such a requirement should in any case apply to those environmental topics in which operational minimum requirements (such as quantitative targets, see above) can be applied, as they make it possible to verify that a target has been achieved.
- In cases of non-attainment, the standards could require an explanation of why a target was not met, why it was adjusted (or not), and which **corrective actions** were taken.
- In addition, explanations could be required indicating those actions that did not bring the expected outcome and the indicators that were used to determine this.
- The standards may also stipulate that in the event of significant deviations or trends (see above), consequences for action should be drawn and reported accordingly.

Figure 5: Best practice: Clear representation of targets in combination with performance indicators

Topic	Target	Indicator	Target Date	Status quo 2019	Page
Climate Protection and Energy Efficiency					
Emissions	Reduce CO_2e emissions by 65%, compared to the base year	Absolute CO_2e emissions (Scope 1, 2, and 3)	2025	Compared to previous year: 5%	
	Reduce CO_2e emissions by 75%, compared to the base year	Absolute CO_2e emissions (Scope 1, 2, and 3)	2030	Compared to base year: 55%	
	Climate neutrality	Absolute CO_2e emissions (Scope 1, 2, and 3)	2040		
Energy efficiency	Increase energy efficiency by 40% in MWh/t, compared to the base year	Energy efficiency	2025	Current energy efficiency in MWh/t and percentage	

Source: Lautermann et al. (2021): p. 22

Figure 6: Best practice: Overview of targets, actions, and outcomes

Topic	SDG-Relevance	Baseline 2014	Our target for 2020	Status 2018	Actions planned for 2019	Status
Water	6 CLEAN WATER AND SANITATION	Initiation of water quality reviews; publication of results	90% of our suppliers in compliance with water guidelines	65% compliance currently among suppliers	Further engagement and discussions with suppliers	Not yet on track; greater effort necessary

Source: Lautermann et al. (2021): p. 29

3 Reporting on the target of GHG neutrality

The terms carbon neutrality, GHG neutrality, climate neutrality, and net-zero emissions are increasingly being used, not only in the context of political objectives, but also by business. The climate targets and climate change mitigation actions of businesses are an important contribution to the global, European, and national goal of climate neutrality. The use of the various terms, however, suggests that there is still a deficit in generally recognized concepts and established methodological standards for setting GHG neutrality targets and their implementation at the business level. In practice, this results in an abundance of differing targets, strategies, and implementation plans for GHG neutrality. While some undertakings, for example, see GHG neutrality as an (immediate) offsetting of their emissions through compensation, for other organizations, the achievement of neutrality is a long-term process of reducing emissions to a minimum and removing the remaining emissions through carbon sinks. In this heterogeneous landscape, neutrality targets, reduction approaches, and climate strategies are hardly comparable—both within a given industry and across sectors.

Diverse options are also to be found at the level of initiatives and standardization approaches dealing with the design of enterprise-related GHG neutrality or net-zero targets. These include, for example, the SBTi Corporate Net Zero Standard (2021), the "1.5°C Business Playbook" of the Exponential Roadmap Initiative (2020), "A Framework for Collective Carbon Neutrality" by Carbone4 (2020), the WWF "Fit for Paris" guidelines (2021), the "Net Zero Company Benchmark" of the Climate Action 100+ Initiative (undated), and the Glasgow Finance Alliance for Net Zero (2021). In addition, the International Organization for Standardization is currently developing ISO 14068 "Carbon neutrality". These initiatives each pursue different perspectives on how GHG neutrality is to be achieved. The Task Force on Climate-related Financial Disclosures (TCFD) has listed examples of various climate-related targets in its Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans. The task force makes a distinction between net-zero targets and carbon-neutral targets in the sense that net zero requires that the remaining CO2e emissions be attained by means of natural and technological carbon sinks, whereas carbon neutrality can also be achieved through voluntary compensation/offsetting of emissions (TCFD 2021).[4]

Among the various initiatives, the work of the SBTi has received broad international recognition. In its recently published Corporate Net Zero Standard, the SBTi differentiates between "near-term" and "long-term science-based targets" (SBTi 2021, p.9). According to the standard, a company can only claim to have reached "Net Zero" when it has also achieved its long-term targets (SBTi 2021, p.10). Net zero is therefore not simply a status to be realized with regards to the current GHG inventory, but an objective to be achieved in accordance with the 1.5°C path by fulfillment of the "long-term science-based target" and neutralization of the equivalent amount of the residual GHG emissions. Additionally, neither avoided emissions from company products nor offsets may be included in the GHG inventory and thus in target achievement. (SBTi 2021, p. 21)

While other standards for GHG neutrality, e.g., the "PAS 2060 Carbon Neutrality" specification (BSI 2014), allow remaining emissions to be offset through emission credits or certificates, this interpretation of neutrality is viewed critically by an increasing number of actors and initiatives. One point of criticism is that offsetting an undertaking's GHG emissions gives the impression that the undertaking has already achieved emissions-free operations, even though actual emissions may be increasing or remain in fact unchanged. Undertakings with very different

[4] At the time of analysis, the revised version of the "Guidance on Climate-related Metrics, Targets and Transition Plans" had not yet been published; this statement is based on the version published in June 2021.

approaches to avoid and reduce GHG emissions can thus mistakenly be perceived as being equally ambitious in their efforts. Also under criticism is the idea that an undertaking might achieve GHG neutrality with certificates from climate change mitigation projects dealing in the avoidance of future emissions (so-called ex-ante distributions). The possibility of achieving GHG neutrality by purchasing carbon offset certificates can also reduce the incentive for companies to invest in decarbonizing their own processes and value chains. Consequently, the SBTi Corporate Net-Zero Standard does not provide for any offsetting options, but does affirm such efforts as additional means to support climate change mitigation beyond an undertaking's own activities and value chains. Certificates from high-quality climate change mitigation projects would be a possibility in this regard.

While the means of achieving GHG neutrality are still being discussed, it is undisputed among experts, that the concept of corporate GHG neutrality requires a hierarchy of actions focused first and foremost on avoidance and reduction of carbon emissions.

3.1 Current reporting practice

Our analysis of the non-financial reporting of capital market-oriented undertakings in Germany shows that they—in comparison to other environmental topics—report extensively on the topic of climate. However, there are large gaps in their reporting on climate change mitigation targets with respect to GHG neutrality (Lautermann et al. 2021, pp. 22–23): At present there is little or no reporting on GHG neutrality, and what there is, varies greatly in its approach. There are large differences in the interpretation and scope of the included GHG emissions; in some cases it is not even clear which emissions are being included in the GHG inventory and neutrality statements. The role that voluntary compensation plays in achieving neutrality is often not apparent, nor whether the stated target of GHG neutrality is comparable to or consistent with the global policy goal of "net zero." Some companies specify that GHG neutrality can only be achieved by means of offsets (i.e., through voluntary compensation), but do not clearly specify whether such actions are considered to be a permanent or interim solution. The specific nature of such actions and projects is often not adequately described, nor the level of compensation for emissions. Some companies compensate with credits from international climate change mitigation projects; others rely on a combination of international and national projects or other types of offsets. For the most part, it is not possible to determine which operational and strategic approaches a company has used or intends to rely on to achieve GHG neutrality. Our supplementary evaluation of the reporting on GHG neutrality in the financial and sustainability reports of the undertakings listed in the DAX 30 in 2020 confirms this. Although 25 of the 30 corporates address the issue of GHG neutrality, for most of them the specific nature and scope of the emissions being addressed remains unclear.

A study by the University of Stuttgart found in a 2019 survey that 60% of businesses surveyed want to become carbon neutral in the coming years, with indeed the substantial majority (80%) already by 2025. The study illustrates the current trend towards GHG neutrality in the corporate landscape, which is largely based on voluntary compensation and offsetting (see Schneider 2020).

3.2 Previously discussed recommendations

The draft CSRD requires information on "the plans of the undertaking to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement" (see Art. 19a, 2a, iii) in order to achieve transparency on corporate strategies in the context of international climate change mitigation efforts.

The recently published "Climate Standard Prototype working paper" of the EFRAG Project Task Force proposes a disclosure requirement whether or an undertaking has set or by when it plans to set a GHG neutrality/net zero target and calls for clarification of the target-setting process and the underlying assumptions regarding reporting limits and levers (EFRAG 2021b). Because of current difficulties with definitions and a lack of generally agreed methodological standards for GHG neutrality targets,[5] an open approach has been chosen in which an undertaking is at least required to maintain transparency with respect to its understanding of GHG neutrality and related assumptions.

The CSRD draft also emphasizes the need for climate-related information for the evaluation of corporate risk and strategic resilience in the face of various climate scenarios. In addition, it addresses the need for information on GHG accounting and reduction as well as the role and quality of the compensation services (offsets) being relied on, calling for an alignment of greenhouse gas accounting and offset standards" (see Recital 41).

In this regard, the EFRAG Climate Standard Prototype Working Paper offers the possibility of reporting CO_2e emissions from offsetting projects in absolute quantities when accompanied by a description of the quality criteria (EFRAG 2021b).

The final report of the SFB deals at various points with GHG and climate neutrality, but with a focus on the climate neutrality policy objectives and their effects on business. According to the SFB, certain undertakings (including large non-financials) should report on "the impact which a sudden policy change to achieve climate neutrality as early as 2035 would have on their key economic indicators, and what strategies the companies would use in response" (SFB 2021, p. 23). The focus is therefore on transition risks and company resilience. The final report of the SFB, however, makes no mention of the need for undertakings, regardless of transition risks associated with the policy framework, to proactively adopt a strategy on GHG neutrality (i.e. a transition plan) and to include it in their reporting, also with respect to implementation planning.

The sources mentioned offer only a few specific recommendations for reporting on GHG neutrality or net zero; in the subsequent recommendations we accordingly expand on those and provide additional suggestions for reporting requirements on GHG neutrality and net zero. When elaborating the proposals, we have, among other things, given thought to the GHG neutrality initiatives mentioned in the introduction to chapter 3 above.

3.3 Recommendations to the standard setter

Against the background of the previously outlined heterogeneous landscape of current reporting practice and methodology guidelines and standards, we recommend that reporting requirements be generally based on the Net Zero interpretation offered by the SBTi. The reporting standard should **focus on an undertaking's perspective contribution to global climate neutrality** and thus **whether and to what extent it is advancing on a long-term, net-zero target path**.

Specifically, the standard should require the following:

- Undertakings should report their targets in the area of **GHG neutrality**, but it is imperative that they also clarify **their own specific use of the term**. This should make transparently

[5] At the time the Climate Standard Prototype Working Paper was published, the SBTi Net-Zero Standard as the first net-zero standard had not yet been published.

clear the extent to which an undertaking is contributing to the goal of global net zero or other overriding global, European or national climate goals.

- Undertakings should report **whether or not they are on the path to achieving net-zero**. If the answer is in the affirmative, then the following specific information should be provided:

Information on strategy and governance:

- Undertakings should report on **the integration of net zero into their own strategic planning** and how they intend to achieve this target. They should also report on **their own transformation, including changes to the business model**, as necessary, in order to achieve the goal of net zero (description of the transition plan).
  The goal of net zero can only be achieved through the implementation of a clear strategy, and thus long-term orientation, of a company and its business model as a whole.

- **Undertakings should report on the governance and incentive structures** established in order to achieve the target of net zero. This allows an assessment whether the target is supported by the necessary responsibilities and processes for its achievement, and for improvements and corrections in the event of non-attainment. This would include, at the very least, 1) identifying the **responsibilities and competencies** for the net zero target (operational and strategic), including the responsibility of top management and executives in the attainment and reassessment of targets, as well as 2) information about **management-level incentives**, thus revealing the extent to which the executive compensation system is linked to the achievement of net zero.

Information on the target path and intermediate goals:

- The **net-zero target** and **intermediate targets** should be reported as **absolute reduction targets**, in addition to which **relative reduction targets** (e.g., percentage savings in emissions per year or per reporting period) should be specified.

- In addition to the net-zero target for the target year, **short, medium, and long-term GHG emissions reduction targets (interim targets) should be reported against a base year**. A clear reduction path for emissions should be the result. As explained in Section 2.3.1 various options are possible for the specifications that the standard can draw on with regard to the target years. In order to align with the political objectives of the EU, at the very least, intermediate targets for 2030 and 2050 should be insisted upon.

- Undertakings should report on the **annual GHG emissions reductions** in such a way that the prior reduction path is also evident and that attainment of the long-, medium- and short-term reduction targets is fully transparent and verifiable.

Information on the emissions scopes included in the net-zero target:

- Undertakings should report on **which activities are included in the net-zero target** (Scope 1, 2 and Scope 3 categories, if any). If Scope 3 emissions are not yet included, this should be justified. In this case it should also be reported on how these emissions are being handled and whether or when they will be integrated into the target in the future.

Information on processes and control:

- Undertakings should report on the actions planned to achieve their targets (i.e., action plans) and the underlying operational monitoring (KPIs, etc.; see also Section 2.3.4).

- Companies should comment on whether (interim) targets have been attained. In the case of **non-attainment**, a company should be required to explain why the targets were not achieved and the necessary corrective actions. In addition, the primary obstacles standing in the way of short-, medium-, and long-term target achievement should be elucidated.

Reference to climate science:

- Companies should report **whether their reduction targets are science-based** and the temperature path their reduction target is based on.

Information on the scope of the GHG inventory:

- A complete, coherent, transparent, and precise accounting of the relevant GHG serves as the essential basis for every GHG emissions reduction target (WBCSD and WRI, 2004). As a basis for interpreting the net zero target, including intermediate targets, the standard should provide clear guidelines for reporting on the GHG inventory.
- Undertakings should account for **at least all Scope 1 and Scope 2 emissions**. With regard to Scope 3 emissions, only the significant categories should have to be reported. For this purpose, based on the specifications of the GHG Protocol Scope 3 Standard, a **significance analysis for all 15 categories of Scope 3 emissions** (WBCSD and WRI, 2011, p. 5) should be carried out and reported. If necessary, the threshold value of PAS 2060 may be used, which defines an emission source as significant if it accounts for more than 1% of the Scope 3 inventory (BSI 2014). It is important that the standard creates clarity in this regard, stipulating a proportionate yet ambitious approach to GHG accounting.
- In order to show the relationships between GHG emission sources, the emissions should be **separately reported by scope and category**; i.e. for Scope 3 a breakdown into the 15 significant categories (e.g., purchased goods and services, business travel, use of the products sold) must be provided.
- Significant emissions categories that have not yet been fully quantified should be listed and provided with an explanation as to why they have not yet been accounted for. An undertaking should **provide information on how it plans to calculate these emissions in the future**.
- The standard should specify **calculation methods** and refer to the GHG Protocol Corporate Standard, Scope 2 Guidance, and the Corporate Value Chain (Scope 3) Accounting and Reporting Standard (WBCSD and WRI 2004; 2011; 2015).

Data reliability requirements:

- Since the GHG inventory forms the basis for an undertaking's climate change mitigation actions and achievement of individual climate targets, the GHG inventory and the achievement of net-zero targets should be subject to **a prospectively higher standard of assurance** (reasonable – instead of limited – assurance).

Information on the role of voluntary compensation and sinks:

The standard should make clear that the distinction between climate change mitigation projects outside of the undertaking's value chain—often the basis for compensation projects—and sinks for the removal of emissions is of fundamental importance and undertakings should take this distinction into account in their reporting. Behind the voluntary compensation projects undertakings invest in, one does find in some cases projects that contribute to carbon sinks (e.g., reforestation projects). Under the Paris Agreement, however, in the long-term these will no longer be available (or only to a very limited extent) for voluntary compensation, inasmuch as double counting is to be avoided. Accordingly, a distinction should be made between short-term compensation by means of sink and mitigation projects and the long-term establishment of alternative sink projects.

- Undertakings should have the opportunity to report on their **voluntary compensation efforts and strategies**. In accordance with the decisions made in Glasgow, such emissions reductions derived from additional climate change mitigation projects are to be addressed under the UNFCCC guidelines; accordingly residual emissions are to be offset in an environmentally conscientious manner (i.e., avoiding the double counting of single emission reductions by multiple parties). The standard, however, should emphasize that this is not a neutralization option in connection with the net-zero target.
- Undertakings should describe their **plans for building own or supporting national and international carbon sinks**. Since policy decisions are still pending as to the extent to which natural sinks in particular will available in the future to the attainment of the net-zero target, business activities and thus the reporting on this aspect will probably remain incomplete.

4 Ensuring that reporting on environmental topics is compatible with the requirements of the financial sector

Overall, corporate reporting on environmental topics does not currently satisfy the requirements of the financial sector, which is already subject to its own extensive reporting obligations. Our recommendations here are focused on how standardized reporting on environmental topics can enable the financial sector to better fulfill its own reporting obligations and support sustainability-related decision-making.

4.1 Current reporting practice

For all of the environmental topics examined in our evaluation (Lautermann et al. 2021), we found that the information reported is by and large not presented in a manner sufficiently standardized to enable comparability. As a consequence, the financial sector cannot rely solely on environmental information from non-financial statements, but is forced to draw on other sources, which happens to be also insufficient for a proper assessment due to the limited standardization of this information.

As already explained in Chapter 2, the scope of reporting on the various environmental topics varies greatly (see Figure 1 in Section 2.1 as well as Lautermann et al. 2021)—and is rarely explained by the reporting entities. This leads to further uncertainties for decision-making in the financial sector.

The European study by the Alliance for Corporate Transparency (ACT 2019) came to a similar conclusion with regard to the differences in reporting on environmental topics.

More tangible requirements and guidelines on the part of the planned European reporting standards therefore have the potential to generate better and more easily comparable information on environmental topics and thus also fulfill the information needs of the financial sector, which, given current developments, will likewise continue to increase.

4.2 Regulatory situation in the financial sector

In recent years, the "EU Action Plan: Financing Sustainable Growth" (European Commission 2018) led and will continue to lead to modifications in the regulatory framework of the European financial sector. The European Commission sees the plan as a "part of broader efforts to connect finance with the specific needs of the European and global economy for the benefit of the planet and our society. Specifically, the action plan aims to:

1. reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
2. manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
3. foster transparency and long-termism in financial and economic activity. (European Commission 2018, p. 2)"

Various measures have been initiated in this context. The following are particularly important for this paper:

1. As of 10 March 2021, the so-called Sustainable Finance Disclosure Regulation (SFDR; EU 2019/2088) obliges EU fund managers of alternative investment funds (AIFs)[6] and undertakings for collective investment in transferable securities (UCITS),[7] as well as investment firms offering portfolio management or investment advice, in accordance with the MiFID II legislative framework (see European Parliament and Council of the European Union 2014), to disclose how sustainability risks are accounted for in their investment processes and products and how they deal with principle adverse impacts (PAI) of their investment decisions with respect to sustainability factors. Additionally, managers of funds promoting environmental or social characteristics (SFDR Art. 8, so-called light green funds) or pursuing a sustainable investment objective (SFDR Art. 9, so-called dark green funds) must also disclose information on how these characteristics and targets are to be achieved and measured.
2. The EU Taxonomy Regulation (EU 2020/852), which entered into force on 12 July 2020, will lead to new disclosure obligations effective 1 January 2022 as part of non-financial reporting, both for financial market participants who offer financial products in the EU (including pension funds), as well as undertakings that are obliged to provide non-financial reporting under the NFRD (EU Directive 2014/95/EU). Accordingly, financial market participants who want to market a green financial product are obliged to report on the taxonomy-compliant portion of their investments in the portfolio. Undertakings that fall under the NFRD have to include information in their non-financial statements about how and to what extent their activities are eligible to and aligned with the provisions of the Taxonomy Regulation.

In order to meet these requirements, the financial sector increasingly needs forward-looking sustainability information from undertakings in order to better be able to assess risks in these areas, than it is possible with backward-looking or status quo information.

4.3 Previously discussed recommendations

Since the EU sees sustainable finance as a central lever for promoting sustainable development in the real economy, the EFRAG Project Task Force addresses the special needs of financial institutions in a number of recommendations in its February 2021 report (EFRAG 2021a).

In Recommendation #08, for example: "the European Standard Setter (ESS) should consider financial institutions' specific needs as users of sustainability information, in order for them to appropriately direct investment flows to relevant projects and meet their own specific sustainability reporting obligations regarding indirect impacts. In particular, the ESS should consider the following:

> a) it should cover all sustainability topics, not just climate-related;
>
> b) to be investment decision-useful, sustainability information needs to include in particular quantitative forward-looking information; and
>
> c) sustainability information data needs to be collected in a timely manner and easily accessible." (EFRAG, 2021a, p. 19)

In addition, the EFRAG Project Task Force makes clear: "The first set of standards must meet the needs of recently adopted EU legislation in the field of sustainable finance, in particular the

[6] AIF: Alternative investment fund: An investment fund whose investment assets or special assets do not consist of stocks, bonds, or investment certificates.

[7] UCITS: In Europe, UCITS: Undertakings for the Collective Investment in Transferable Securities (OGAW: Organismen für gemeinsame Anlagen in Wertpapieren) These are mutual funds that invest in legally defined types of securities and other financial instruments.

SFDR. Failing to do so would create major inconsistencies at the heart of the EU's sustainable finance policy." (EFRAG, 2021a, p. 11)

The Project Task Force also addresses another challenge facing the financial sector: "financial institutions are often global players, financing and investing in clients that may have global footprints themselves, therefore subject to a varying level of reporting requirements. The diversity of information they are able to collect from their global clients—produced based on different standards and frameworks—is another complexity factor for them. In this regard, the objective of co-construction and convergence of future reporting standards with other international initiatives used as reference by global reporting entities is of critical importance." (EFRAG, 2021a, p. 49)

The draft CSRD is in line with these recommendations: "This proposal builds on and revises the sustainability reporting requirements set out in the Non-Financial Reporting Directive, in order to make sustainability reporting requirements more consistent with the broader sustainable finance legal framework, including the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation, and to tie in with the objectives of the European Green Deal." (European Commission 2021, p. 5)

For implementation of the SFDR, a regulatory technical standard was drawn up by the Joint Committee of the European Supervisory Authorities (ESAs, 2021), which has not yet entered into force. The draft includes mandatory and additional indicators to be reported that are intended to provide information on important negative impacts on sustainability, so-called **Principal Adverse Impacts (PAI) indicators**. As of 1 July 2022, disclosure of these PAI indicators (so-called Level 2 requirements) will presumably become mandatory for the financial sector.[8]

The recently published Climate Standard Prototype working paper by the EFRAG Project Task Force on European sustainability reporting standards (EFRAG 2021b) already takes large parts of the aforementioned recommendations into account.

4.4 Recommendation to the standard setter

Based on the results of our evaluation of non-financial reporting in Germany and the information requirements of the financial sector, we focus in this section on the following aspects:

1. Minimum compatibility with the requirements of the SFDR
2. Consistency and congruence between SFDR and CSRD
3. A balanced approach to extent and relevance of information

[8] Since March 2021, financial undertakings must already report on adverse sustainability impacts at the undertaking level, so-called "principal adverse sustainability impact statements", although not yet by means of indicators. This only applies in the next stage, once the regulatory technical standards enter into force (referred to in the SFDR communication as a Level 2 requirements). (see BaFin 2021)

Ad 1) Minimum compatibility with the requirements of the SFDR

Given that for the financial sector more extensive reporting requirements on environmental topics already exist, we recommend taking these as the starting point for the minimum content of the various environmental standards under the CSRD. This will ensure that reporting from undertakings in other sectors provide the sustainability data required by the financial sector.

The future European reporting standards should at the very least include all *mandatory* indicators for environmental topics that are to be reported by the financial sector in accordance with SFDR. Furthermore, the *complementary* PAI indicators should be taken into account when developing the topical standards.

Indicators exist for all CSRD-mandated sustainability topics (derived from the Taxonomy Regulation; see the PAI indicators shown as examples in **Table 2**). We recommend the use of these **PAI indicators as an important minimum requirement for the development of performance indicators for the sustainability reporting standards** in order to ensure consistency with the information needs of the financial sector.

Table 2: Exemplary Indicators for principal adverse impacts (PAI)

Environmental topic	Mandatory reporting indicators/ metrics	Other indicators/ metrics
Greenhouse gas emissions / Energy performance	Scope 1 GHG emissions Scope 2 GHG emissions From 1 January 2023, Scope 3 GHG emissions Total GHG emissions	Share of energy from non-renewable sources used by investee companies broken down by each non-renewable energy source
Biodiversity	Share of investments in investee companies with sites/operations located in or near to biodiversity-sensitive areas where activities of those investee companies negatively affect those areas	Share of non-vegetated surface area compared to the total surface area of the plots of all assets
Water	Metric tons of emissions to water generated by investee companies per million EUR invested, expressed as a weighted average	Average amount of water consumed and reclaimed by the investee companies (in cubic meters) per million EUR of revenue of investee companies
Waste	Metric tons of hazardous waste generated by investee companies per million EUR invested, expressed as a weighted average	
Emissions		Metric tons of air pollutants equivalent per million EUR invested, expressed as a weighted average

Exemplary excerpts, compiled from: ESAs (2021), p. 60ff.

Contrary to what was otherwise contemplated by EFRAG (2021a), undertakings should **not be able to deviate from reporting of these indicators by means of a "comply or justify" approach**; these **PAI indicators should always be reported**. Such a solution would create the necessary legal certainty for both the undertaking and also the statutory auditors.

Additionally, undertakings should be obliged to disclose supplementary environmental information on a *sector-by-sector* basis.[9] For this purpose, mandatory indicators should at the very least be derived from the supplementary PAIs in the regulatory technical standards for SFDR Level 2 reporting.

At the same time, the PAIs must be **supplemented by further indicators** for environmental topics, as they are in some cases (e.g., the circular economy, biodiversity) insufficient to cover the informational needs of other stakeholders. In the case of the circular economy, for example, it may not suffice to merely report on amounts of hazardous waste; information on the use of recycled or recyclable materials and product-related information, for example, may also be necessary.

Ad 2) Consistency and congruence between SFDR and CSRD

Some financial undertakings will be obligated to report in accordance with the CSRD standards and at the same time with the provisions of the SFDR, which requires to include sustainability risks and effects, both at the corporate and process level, and corresponding information for some of their products. This can lead to overlap, when the same findings are to be reported on the basis of two different sets of regulations.

In our view, it is justified to also oblige financial undertakings to a more comprehensive environmental and sustainability reporting set forth by the CSRD, as they, for example are continually expanding or upgrading their data center capacities due to the ongoing digitization in the industry which results in significant GHG.

Likewise, it is legitimate to address the specifics of the business models of the financial sector through the SFDR and other legal provisions applicable to financial market participants, since the majority of their environmental effects usually occur indirectly through the companies in which they invest or which they are financing. This could be dealt with, in that the envisaged sector-specific sustainability reporting standards under the CSRD also include reporting requirements on the indirect environmental impacts of financial market participants.

It would have to be ensured, however, that consistency and congruence are maintained at the points of intersection in order to avoid creating contradictory requirements or unnecessary double burdens in sustainability reporting and disclosures. This must also be taken into account in the development of the reporting standards, in particular, the sector-specific standards for the financial sector.

Ad 3) Balance between reporting extent and informational relevance

A potential regulatory requirement to report in detail on all environmental topics, i.e., strategies, targets, actions, and KPIs, could lead to companies investing considerable time in extensive reporting on topics that in their specific situation may be less relevant. At the same time, the quality of the environmental information may be impaired by a profusion of unimportant or less important information.

Our evaluation of the non-financial reporting practice of German companies (Lautermann et al. 2021), showed that many report, for example, on actions addressing environmental topics, but without clarifying the relevance of the information in terms of materiality or their own strategies or targets. Such information then is of little use to the financial sector and ultimately makes it more difficult for them to acquire the information that is truly needed.

[9] On assigning industry-relevant risks and impacts, see, among others, Allianz (2018).

In order to ensure a proper balance between the extent of reporting and its relevance, and to avoid overloading reports with respect to their usability by the financial sector, we recommend that the standards require reporting on each and every environmental topic, but that the depth of the reporting be specifically based on the relevance of the respective topic to the reporting undertaking.

The double materiality assessment process could offer a basis for determining which aspects of which topics need *not* be reported in depth (i.e., comply or justify). For example, undertakings would then be obliged to report the mandatory performance indicators, but not necessarily with respect to all of the reporting requirements on topic-related strategies, policies, targets, and actions that we recommend in Chapter 2. With such an approach, however, it would be wise to consider whether an exception should be made for the topic of climate. After all, climate reporting is both methodologically and also in practice the most advanced, and it is important that the reporting standards embrace the recommendations of the TCFD.

5 List of References

ACT [Alliance for Corporate transparency] (2019): 2019 Research Report. An analysis of the sustainability reports of 1000 companies pursuant to the EU Non-Financial Reporting Directive. http://allianceforcorporatetransparency.org/assets/2019_Research_Report%20_Alliance_for_Corporate_Transparency.pdf (19.01.2022)

Allianz [Allianz Global Corporate & Specialty SE] (2018): Measuring and managing environmental exposure. A Business sector analysis of natural capital risk. https://www.agcs.allianz.com/content/dam/onemarketing/agcs/agcs/reports/AGCS-Natural-Capital-Risk-Report.pdf (17.08.2021)

BaFin [Bundesanstalt für Finanzdienstleistungsaufsicht] (2021): Übersicht über nachhaltigkeitsbezogene Offenlegungspflichten für Finanzmarktteilnehmer (Financial Market Participants - FMP) und Finanzberater (Financial Adviser – FA) gemäß Verordnung (EU) 2088/2019 (Offenlegungs-VO) und Verordnung (EU) 2020/852 (Taxonomie-VO), (26.07.2021). https://www.bafin.de/SharedDocs/Downloads/DE/Anlage/dl_Uebersicht_Offenlegungspflichten_BJ2102_Sustainable_Finance.html (13.09.2021)

Brunn, C., Barth R. (2014): CSR Impact - Practitioners Handbook. From CSR to CIAM: Corporate Impact Assessment and Management. https://www.oeko.de/oekodoc/2100/2014-658-en.pdf (27.10.2021)

BSI [British Standard Institution] (2014): Specification for the demonstration of carbon neutrality. https://www.bsigroup.com/de-DE/PAS-2060-Klimaneutralitaet/ (22.11.2021)

Carbone4 (2020): A Framework for collective carbon neutrality. https://www.carbone4.com/wp-content/uploads/2020/04/Carbone-4-NZI-Guidelines-april-2020-1.pdf (19.11.2021)

Climate Action 100+ (o.D.): The Climate Action 100+ Net Zero Company Benchmark. https://www.climateaction100.org/progress/net-zero-company-benchmark/ (19.11.2021)

DRSC [Deutsche Rechnungslegungs Standards Committee e.V.] (2021): DRSC schließt CSR-Studie ab und übergibt Abschlussbericht an BMJV. https://www.drsc.de/news/csr-studie-abschluss/ (23.11.2021)

EFRAG [European Financial Reporting Advisory Group] (2021a): Final report. Proposal for a Relevant and Dynamic EU Sustainability Reporting Standardsetting. https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520PTF-NFRS_MAIN_REPORT.pdf (19.01.2022)

EFRAG [European Financial Reporting Advisory Group] (2021b): Climate standard prototype Working paper. https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520PTF-ESRS%2520Climate%2520standard%2520prototype%2520working%2520paper.pdf (27.10.2021)

ESAs [European Securities and Markets Authority, European banking Authority, European Insurance and Occupational Pensions Authority, Joint Committee of the European Supervisory Authorities] (2021): Final Report on draft Regulatory Technical Standards, JC 2021 03. 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?retry=1 (17.08.2021)

European Commission (2018): Communication from the Commission Action Plan: Financing Sustainable Growth, Brussels, 8.3.2018, COM(2018) 97 final. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097 (19.01.2022)

European Commission (2021): Proposal for a directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, Brussels, 21.4.2021, COM/2021/189 final. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189 (19.01.2022)

European Parliament and Council of the European Union (2014): Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text (recast) with EEA relevance, in: Official Journal of the European Union L 173/349. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0065 (24.11.2021)

Exponential Roadmap Initiative (2020): J. Falk et al.: The 1.5°C Business Playbook. https://exponentialroadmap.org/wp-content/uploads/2020/09/1.5C-business-playbook-version-1.1.pdf (19.11.2021)

Glasgow Finance Alliance for Net Zero (2021): Our progress and plan towards a net-zero global economy. https://assets.bbhub.io/company/sites/63/2021/11/GFANZ-Progress-Report.pdf (19.11.2021)

IFRS [International Financial Reporting Standards Foundation] (2021a): About the International Sustainability Standards Board. https://www.ifrs.org/groups/international-sustainability-standards-board/#about (23.11.2021)

IFRS [International Financial Reporting Standards Foundation] (2021b): Technical Readiness Working Group: Resources. https://www.ifrs.org/groups/technical-readiness-working-group/#resources (23.11.2021)

IPCC [Intergovernmental Panel on Climate Change] (2018): Annex I: Glossary [Matthews, J.B.R. (ed.)]. In: Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty [Masson-Delmotte, V. et al.(eds.)], https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_AnnexI_Glossary.pdf (17.08.2021)

Lautermann, C.; Young, C.; Hoffmann E. (2021): Klima- und Umweltberichterstattung deutscher Unternehmen. Evaluierung der CSR-Berichtspflicht für die Jahre 2018 und 2019. Herausgegeben vom Umweltbundesamt, Dessau. https://www.umweltbundesamt.de/sites/default/files/medien/5750/publikationen/uba-bmu_fachbroschuere_csr-berichterstattung_final_web.pdf (17.08.2021)

Rat für nachhaltige Entwicklung (2020): Leitfaden zum deutschen Nachhaltigkeitskodex. https://www.nachhaltigkeitsrat.de/wp-content/uploads/2019/01/DNK_Leitfaden_BITV_DE_190226_1.pdf (27.10.2021)

SBTi [Science Based Targets Initiative] (2021): The SBTi Net-Zero Manual & Criteria. https://sciencebasedtargets.org/resources/files/SBTi-Net-Zero-Standard-Corporate-Manual-Criteria-V1.0.pdf (17.08.2021)

Schneider, C. (2020): Der Energieeffizienz- Index der deutschen Industrie. https://www.eep.uni-stuttgart.de/institut/aktuelles/news/Energieeffizienz-Index-Wintererhebung-2019-20-Mehrheit-der-Unternehmen-strebt-Klimaneutralitaet-an/ (17.08.2021)

SFB [Sustainable Finance Advisory Board of the Federal Government] (2021): Shifting the Trillions. Ein nachhaltiges Finanzsystem für die Große Transformation. Berlin. https://sustainable-finance-beirat.de/wp-content/uploads/2021/02/210224_SFB_-Abschlussbericht-2021.pdf (17.08.2021)

SFDR [Sustainable Finance Disclosure Regulation] (2019): Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

Taxonomy Regulation (EU) 2020/852: Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

TCFD [Task Force on Climate-Related Financial Disclosures] (2021): Guidance on Climate-related Metrics, Targets, and Transition Plans. https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf (17.08.2021)

UBA (Umweltbundesamt) (2013): SMARTe Zielformulierung. https://www.umweltbundesamt.de/smarte-zielformulierung (27.10.2021)

WBCSD [World Business Council for Sustainable Development] und WRI [World Resources Institute] (2004): The Greenhouse Gas Protocol. A Corporate Accounting and Reporting Standard, revised Edition. https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf (17.08.2021)

WBCSD [World Business Council for Sustainable Development] und WRI [World Resources Institute] (2011): Corporate Value Chain (Scope 3) Accounting and Reporting Standard. Supplement to the GHG Protocol Corporate Accounting and reporting standard. https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporing-Standard_041613_2.pdf (17.08.2021)

WBCSD [World Business Council for Sustainable Development] und WRI [World Resources Institute] (2015): Scope 2 Guidance, An amendment to the GHG Protocol Corporate Standard. https://ghgprotocol.org/sites/default/files/ghgp/standards/Scope%202%20Guidance_Final_0.pdf (17.08.2021)

Wissenschaftsplattform Sustainable Finance (2019): Verpflichtende klimabezogene Unternehmens-Berichterstattung als Mittel zur Reduzierung von CO2-Emissionen, Policy Brief – 2/2019. https://www.diw.de/documents/dokumentenarchiv/17/diw_01.c.680026.de/sfrp_policybrief2_disclosure_de.pdf (10.09.2021)

Wördenweber, M. (2017): Nachhaltigkeitsmanagement Grundlagen und Praxis Unternehmerischen Handelns. Schäffer-Poeschel Verlag

WWF [World Wide Fund For Nature] Deutschland (2021): Fit für Paris. Ein Leitfaden, wie sich unternehmerische Klimastrategien mit dem Pariser Abkommen vereinbaren lassen. https://www.wwf.de/fileadmin/fm-wwf/Publikationen-PDF/Klima/WWF-Fit-f%C3%BCr-Paris-Leitfaden.pdf (23.11.2021)