

Staying Green: Retaining the integrity of environmental disclosures under European corporate sustainability reporting

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Key messages

- *Leverage the best available scientific evidence to identify and mandate location-specific information on a limited set of scientifically validated and prioritized environmental impacts (pressures).* This will enhance regulatory efficiency while ensuring the disclosures are reliable and decision-useful.
- *Ground double materiality assessments in scientific evidence of key environmental topics.* This will significantly improve the transparency, reliability, and comparability of environmental disclosures.
- *Ensure expert-guided streamlining of corporate sustainability legislation and regulation.* Engaging experts from environmental and sustainability sciences, law, accounting, and other directly relevant disciplines can help reduce compliance burdens without compromising on disclosure integrity and legislative intent.
- *Failing to prioritize and mandate scientifically validated disclosures in streamlining efforts heightens the dangers of significant information gaps and unreported material environmental impacts and risks.* This undermines the reliability and usefulness of ESRS for effective decision-making.

Simplification of corporate sustainability regulation must uphold the integrity and legislative intent underlying environmental reporting

With the forthcoming EU Omnibus Proposal, the push for regulatory streamlining and simplification must not come at the expense of robust and scientifically valid environmental disclosures. Such disclosures fill two fundamental functions:

Disclosure of impacts is fundamental to understanding risks. Absent a mandatory standard (and comprehensive audits), few firms will be incentivised to disclose environmental or social risks, thus hampering risks mitigation and contributing to systemic financial risk.

By mandating disclosure of impacts from firms on environment and people, and opportunities (how environmental or social conditions could improve corporate financial performance), the CSRD generates corporate demand for ways to reduce impacts and seize opportunities, which will accelerate the transition to a more sustainable economy.

European scientific, legal, and accounting communities play a crucial role in ensuring that corporate sustainability reporting retains its integrity under the current waves of geopolitical upheaval and pressures. Insights from these communities can importantly support legislators and policymakers to streamline extant compliance burdens while successfully retaining the ambitions and intent of the CSRD, ESRS, Taxonomy Regulation, and related instruments.

The authors of this brief reviewed ESRS 1, ESRS 2, and ESRS E1-E5, drawing on expertise from environmental and sustainability sciences, law and accounting to identify key areas where streamlining environmental disclosures can be done while also aligning with the best available science. Our proposals support legislative intent and the decision-making needs of investors and other end users including scientists, public agencies, and State actors tasked with evaluating environmental impacts, risks and progress towards sustainability goals.

Streamlining can improve risk and impact identification, benefit decision-making, and support assurance activities while reducing regulatory burdens. This brief emphasizes that engaging Europe's scientific and academic community in any regulatory simplification for corporate sustainability is crucial to preserving the integrity of sustainability disclosures. While this brief focuses on environmental sustainability, stronger and streamlined environmental disclosures will also reinforce social and governance aspects of sustainability. These improvements collectively stand to support EU sustainability goals and promote progress in maintaining a stable, competitive, and equitable European Single Market.

The case for grounding environmental reporting in the best available science

It is paramount that transparency in reporting is pursued and upheld. Mandated disclosure of prioritized environmental impact data, validated by the best available science, can ensure such transparency. This data stands to be decision-useful for investors and companies by providing input data for credible risk assessments relating to nature and climate. In addition,

it is also useful for scientists, public agencies, and other end users tasked with estimating our global proximity to planetary boundaries¹.

Corporate activities affect our climate and the health of ecosystems by exerting various environmental pressures, outlined by the Intergovernmental panel on Biodiversity and Ecosystem Services (IPBES)². These can be translated into measurable impacts, such as greenhouse gas emissions (GHG), water use, land use, emissions of pollutants, invasive species, and volumes of extracted materials. Even though disclosure of such data is not always immediately financially material for a given firm, this information is critical for any credible and reliable assessment of ecosystem health at local and global levels. It is therefore also a foundational input to any assessment of nature-related risks and opportunities.

Furthermore, except for GHG, information on environmental pressure must be disclosed at site-specific levels. This is because identical pressures, such as water or land use, can have vastly different effects depending on location-specific geography and local ecological status. Additionally, even seemingly small environmental impacts at individual sites can, in aggregate and over longer time horizons, significantly impact the ability of ecosystems to deliver the goods and services on which sectors depend.

ESRS guidance currently mandates site-specific disclosures if sites are deemed to be in, or near, biodiversity-sensitive areas (ESRS E4, §19). However, no guidance on interpretation of 'near' is provided. All other mandated impact disclosures (IRO-1) only require a description of the process to identify and assess material impacts, risks and opportunities (see Appendix C of ESRS 2).

Reliable environmental disclosures promote comparability of environmental performance across firms

There are presently twelve ESRS. Five cover environmental topics: Climate Change (E1), Pollution (E2), Water and Marine Resources (E3), Biodiversity and Ecosystems (E4), and Resource Use and Circular Economy (E5), two (ESRS 1 and 2) are cross-cutting standards, and the remainder cover social and governance topics. ESRS 1 sets general reporting principles, while ESRS 2 mandates core disclosures applicable to all companies tasked with CSRD compliance. All other disclosure requirements are subject to a materiality assessment that subsequently determines what information is deemed relevant to a company's business model and required to disclose.

Each ESRS environmental topic (E1-5) includes disclosure guidance on data points related to impacts, targets, mitigation actions, risks, resilience, and methodology. All are subject to materiality assessments. However, as noted above, location-specific information about a

¹ <https://www.stockholmresilience.org/research/planetary-boundaries.html>

² Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES). *Global Assessment Report on Biodiversity and Ecosystem Services*. 2019

company's environmental pressures is foundational to any assessment of progress towards environmental targets, and to credible climate and nature-related risk assessments.

This is therefore a major shortcoming of the current ESRS structure, but one which could be easily amended by shifting datapoints that capture location-specific information on key environmental pressures to ESRS 2, accompanied by relevant amendments to ESRS 1 (Table 1). All remaining environmental datapoints relating to targets, plans, and risks remain in ESRS E2-5, but be subject to a detailed (ESRS2 §57) and not just a brief explanation of the materiality conclusions (ESRS2 §58), in line with E1. This would ensure that ESRS disclosures reflect the scientifically supported fact that nature-related risks and the challenges created by land use change and biodiversity loss are as material and inevitable as climate risk.

While material disclosures are mandatory in terms of reporting or assurance requirements, there is currently a large degree of subjectivity involved in how companies may conduct the double materiality assessment (DMA) process and how the materiality of a given environmental topic is determined. This means that DMAs can and do vary between companies, even within sectors. Consequently, what environmental performance disclosures (i.e. disclosures on a company's environmental pressures) a company deems material and subject to disclosure, also differs. Their reliability and usefulness for assessing and comparing firms' environmental performance and concomitant risks is therefore gravely undermined. This directly prevents ESRS environmental disclosures from promoting market discipline.

A proposal to simplify ESRS guidance for efficient and credible disclosures

Our review of ESRS 1 and 2, and ESRS E1-E5 identifies significant scope for streamlining overlapping data points in existing guidance, thus simplifying and reducing disclosure volume, while addressing above outlined shortcomings.

Concretely, we propose that:

- Datapoints that capture location-specific information on key environmental pressures are shifted to ESRS 2 and accompanied by relevant amendments to ESRS 1. This is a concrete and scientifically grounded solution to simplifying the ESRS. It can significantly reduce the reporting effort and compliance costs on firms, while enhancing regulatory efficiency without undermining legislative intent.
- In collaboration with scientific experts, streamlining of all remaining data-points related to targets, plans, and risks under E1-E5 should be done in line with the best available scientific evidence, such that detailed disclosures of materiality considerations and conclusions are required, as relevant and appropriate.
- The transparency and standardization of the double materiality assessment (DMA) process be improved by letting said process be guided by scientific evidence of environmentally material topics. In line with ambitions to reduce the reporting

effort, environmentally material topics can be tailored to specific sectors. This would significantly improve the reliability and comparability of environmental disclosures.

- All streamlining efforts pertaining to ESRS E1-E5 be undertaken through consultation and dialogue with experts from environmental and sustainability sciences, law, accounting, and other relevant disciplines, as well as national public agencies.

Conclusion

Any regulatory streamlining efforts should leverage the best available scientific evidence to identify and make mandatory the most prioritized environmental impact disclosures. This will ensure the disclosures are reliable and decision-useful.

Streamlining environmental disclosures to focus on the mandated reporting of a smaller set of scientifically validated datapoints on environmental impact will reduce compliance costs for firms and enhance regulatory efficiency without undermining legislative intent.

Failing to prioritize and mandate scientifically validated disclosures in streamlining efforts heightens the dangers of significant information gaps, unreported material environmental impacts and risks, ineffective decision-making and thus hampering the usefulness of ESRS for market discipline.

Table 1. (Pre-Omnibus) ESRS E2-5 datapoints that are environmentally material. The table is not exhaustive but shows concrete examples of datapoints that should be shifted to ESRS 2. Note that none of these datapoints currently require location-specific disclosure. This would need to be amended in order for them to provide decision-useful information. The rightmost column also indicates correspondence to direct drivers of nature and biodiversity loss as identified by the Intergovernmental Panel on Biodiversity and Ecosystem Services (IPBES 2019).

Examples of environmentally material ESRS E2-5 datapoints		IPBES direct driver
E2-4	Pollution of air, water and soil	
§28	The undertaking shall disclose the amounts of: (a) each pollutant, listed in Annex II of regulation (EC) No 166/2006 of the European Parliament and of the “E-PRTR Regulation”, emitted to air, water and soil, with the exception of emissions of GHG which are disclosed in accordance with ESRS E1 <i>Climate Change</i> ; (b) microplastics generated or used by the undertaking	Pollution
E3-4	Water consumption	
§28	The disclosure required by paragraph 26 relates to own operations and shall include: (a) total water consumption in m3; (b) total water consumption in m3 in areas at water risk, including areas of high water-stress,	Land/sea/water use change

	(c) total water recycled and reused in m3; (d) total water stored and changes in storage in m3; and (e) any contextual information necessary regarding points (a) to (d)...	
E4-5	Impact metrics related to biodiversity and ecosystems change	
§38	If the undertaking has concluded that it directly contributes to the impact drivers of land-use change, freshwater-use change and/or sea-use change , it shall report relevant metrics . The undertaking may disclose metrics that measure: (a) the conversion over time of land cover ...	Land/sea/water use change
AR32	With regard to the introduction of invasive alien species , the undertaking may disclose the pathways of invasive alien species and the extent of surface covered by invasive alien species	Invasive alien species
E5-4	Resource inflows	
§31	When an undertaking assesses that resource inflows is a material sustainability matter, it shall disclose the following information about the materials used to manufacture the undertaking's products and services during the reporting period, in tonnes or kilogrammes: (a) the overall total weight of products and technical and biological materials used during the reporting period (b).. (c) the weight in both absolute value and percentage, of secondary reused or recycles components, secondary intermediary products and secondary materials used to manufacture the undertaking's products and services (including packaging).	Direct exploitation
E5-5	Resource outflows	
§37	Undertakings shall disclose the following information on its total amount of waste from its own operations, in tonnes or kilogrammes: (a) the total amount of waste generated; (b) the total amount by weight diverted from disposal, with a breakdown between hazardous waste and non-hazardous waste and a breakdown by the following recovery operation types: i. preparation for reuse; ii. recycling ; and iii. other recovery operations (c) the amount by weight directed to disposal by waste treatment type and the total amount summing all three types, with a breakdown between hazardous waste and non-hazardous waste. The waste treatment types to be disclosed are: i. incineration ; ii. landfill; and iii. other disposal operations	Land/sea/water use change Pollution