THE INCREASING ROLE OF CORPORATE SUSTAINABILITY REPORTING IN THE EUROPEAN UNION AND ITS POTENTIAL EFFECTS ON HEALTH CARE INSTITUTIONS

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Abstract: *The relevance of Environmental, Social and Governance (ESG) reporting in the European union (EU) has been increasing in recent years most notably with the EU Directive 2022/2464 (Corporate Sustainability Reporting Directive – CSRD) which goes into effect in 2023, and associated ESG reporting standards, which introduce more types of required ESG data in annual enterprise reports and engage a wider pool of enterprises. A review of available literature has been conducted aiming to assess the latest changes in the scope of ESG reporting in the EU, to highlight the primary categories of information which will be required according to the new standards, to consider to what extent the new regulation will affect EU health care institutions and to outline expected challenges and opportunities the new regulation poses*

Keywords: *Sustainability reporting, ESG reporting, Corporate Sustainability Reporting Directive, European climate pact, European green deal, Sustainability accounting, healthcare, health care institutions, healthcare accounting*

Introduction

Corporate sustainability reporting involves the disclosure of non-financial aspects of a company's performance. These include data about the environmental and social impact of the firm's economic activity as well as the quality of its governance (transparency, non-discrimination and measures against corruption) referred to as Environmental, Social and Governance (ESG) reporting. Its purpose is to give information to the consumers of financial reports about the company's ESG activities and simultaneously about the firm's operational transparency. ESG reporting has seen a long development process with novel European Union legislation paving the way for international ESG report standartisation.

Aims

The aims of this paper are to review and examine the current and future requirements with regard to ESG reporting in the EU, to highlight the primary categories of information which will be required according to the new standards adopted in the context of the European Green Deal, the CSRD and after the decisions reached during the 2021 United Nations Climate Change Conference as well as to analyse to what extent the new regulation will affect EU health care institutions.

The global drive to ESG policies and ESG reporting

The roots of ESG in the modern context can be traced to a United Nations report from 2004 titled "Who cares wins" and a 2006 report titled "Principles for responsible

development". These reports address all business stakeholders and motivate the need to take ESG considerations into account. The call is aimed at analysts, financial institutions, investors, regulators and business leaders, urging them to implement and require ESG policies for both their business and their counterparties. Since then, a series of legislation drives across the globe, regarding governance and especially environmental matters have been put into place, mirroring the corporate paradigm shift from a profit-based focus to a profit-through-sustainability focus due to the identified role of industry in the negative changes in climate and social inequality. Where there is action, there are reports, and ESG reporting has been developing to match the pace of the change in focus. Gradually, ESG has found its way into major companies. A 2020 PricewaterhouseCoopers (PwC) report has found that by 2019, of 250 of the world's largest companies nearly 95% publish sustainability reports. This finding has been confirmed by a 2023 report by the International Federation of Accountants (IFAC), although as the report points out, another difficulty emerges with the adoption of ESG and reporting frameworks: inconsistent data. Currently, there is a considerable variety of reporting frameworks and standards. PwC identified over 1700 ESG-related metrics and over 360 ESG reporting guidelines available, with four separate standards – the Sustainability Accountings Standards Board (SASB), Task Force on Climate-related Financial Disclosures (TCFD), Carbon Disclosure Project (CDP) and Global Reporting Initiative (GRI). The data reported between standards is difficult to aggregate and to compare due to the differing methodologies employed which makes a key aspect of accounting information difficult to obtain: comparability of data. As of the writing of this publication a universal ESG reporting standard, which is accepted worldwide, does not exist, leading to deficiencies in the insight that can be obtained from the published reports. Additionally, standards currently are non-binding, which has led to criticisms about non-relevant information being reported.

Nevertheless, the impetus to expand ESG reporting has been growing in recent years and the course has been solidified by the 2021 UN climate change conference where a set of measures was agreed upon between state representatives and business leaders with the goal to resist climate change, including by implementing broader ESG reporting requirements.

A bold step forward: the European green deal and the European Union's Corporate Sustainability Reporting Directive (CSRD)

With its latest climate-related Directive – the Corporate Sustainability Reporting Directive (CSRD), planned for in the European Green Deal as a part of the goal to move towards a climate-neutral continent by 2050, the EU has taken the global lead in ESG regulation.

On January 5, 2023 the CSRD went into effect in the European Union and it currently is the most far-reaching mandatory ESG reporting legislation.

Previous requirements for ESG data were regulated by the 2014 Non-Financial Reporting Directive (NFRD) from 2014. It requires large companies (about 11 700 of them)[1] to report information on several key points, including:

- Impact on the environment

[1] Large companies are those with over 500 employees, as well as listed companies, banks, insurance companies and other companies designated by the national authorities as being public interest entities, which covers about 11 700 companies across the EU according to Eurostat data.

- Social policies and employee relations
- Measures against corruption and bribery
- Respect for human rights
- Inclusion and representation on company boards as relates to age, gender, educational and professional background.

Controls on the contents of these reports was not as strict as financial reporting with the NFRD as no reporting framework was mandatory and the overall report did not require assurance (acceptance by an auditor).

The CSRD replaces the NFRD and builds upon it, by requiring a significantly broader scope of data for reports. The goal of the new Directive is to facilitate the creation of detailed, audited, comparable and relevant data while involving a wider range of companies. The Directive addresses the lack of standardisation of ESG reporting by commissioning the development of a set of ESG reporting technical standards (European Sustainability Reporting Standards – ESRS) by which all CSRD reporting is to take place. The European Financial Reporting Advisory Group (EFRAG), a private association, representing various stakeholders has been tasked with the development of the standards. As of the writing of this paper, 12 standards have been planned and developed, passed through public consultation and amendment and have been passed to the European Commission for adoption. By the current timeline, they are set to be implemented by June 30th, 2023. Requirements for complementary information will also be published by the 30th of June, split by sector (as these differ across the economy). The reporting format will be unified and electronic.

The CSRD, besides the broader scope of data, envisages mandatory audits for reporting entities based on reported ESG data, with the reporting standards being binding, similarly to International Financial Reporting Standards (IFRS) for financial reports.

Even though the Directive has already gone into effect, the first mandatory reports are set to be produced for the 2024 financial year.

As stated above, the CSRD has significantly expanded report respondent pool by several changes to the requirements to qualify for mandatory reporting, compared to the NFRD. The most significant of these is the lower bound for number of employees employed - now 250 instead of 500, as well as including all listed companies, regardless of staff size or economic scale of venture (large, medium or small organisation). This is expected to increase the number of reporting entities to approximately 50000 by final rollout of the directive, a nearly five-fold increase. Another significant aspect is that if an ultimate non-EU parent company has substantial activity in the EU (net turnover > than €150 million for two consecutive years and at least one subsidiary meets the general scope of the CSRD or one branch generated a net turnover greater than €40 million in the preceding year), then that parent company has an obligation for ESG reporting, regarding of having a foreign domicile, increasing the global impact of the directive.

The company performance indicators to be reported include all those in the NFRD and:

- Risk accounting for opportunities and robustness with regards to sustainability, which needs to be incorporated into the company's business plans.
- Set targets for sustainable development and the progress that has been made on them an yearly basis
- Sustainability in governance (administrative, management and supervising bodies)

- Implemented sustainability policies
- Implemented schemes for incentivising participation in sustainability matters
- Due diligence of sustainability aspects of the business and processes to conduct it
- Adverse impacts to key aspects of the CSRD in the value chain, including in the provision of products and services, business relationships and the organisation's supply chain
- Main risks to sustainability and their addressing

The CSRD will start applying in several stages over the next four years, initially applying to a group of large EU companies and gradually extending requirements to medium and small listed companies as well:

- By 2025 for companies which are already subject to the NFRD for financial year 2024
- By 2026 for financial year 2025 for large companies which have so far been exempt from the NFRD
- By 2027 for financial year 2026 for small and medium enterprises (excluding micro companies) and some credit institutions
- By 2029 for financial year 2028 for non-EU companies as explained for non-EU parent companies above.

EU Member States will be required to create national laws, which implement the CSRD by the middle of 2024. These laws will be phased in for different groups of enterprises beginning in 2024 with the first reports due in 2025.

Implementing the Directive: overview of the ESRF reporting standards

In order to implement the directive, a reporting framework and standards have been developed, as explained above. These standards take into consideration several broad aspects of the company's performance and impact:

- Environmental factors – climate change effects, adaptation and mitigation plans, pollution, biodiversity, water and marine resources, resource use and the circular economy
- Social factors, including human rights, gender equality, inclusion and diversity, respect for human rights and work-life balance
- Governance – business ethics, corporate culture, lobby activities

The EFRAG reporting framework consists of three elements – layers of required disclosures, reporting areas and reporting topics. The layers of required disclosures are sector agnostic (general economic) disclosures, sector-specific and entity specific disclosures. The reporting areas cover strategy, governance and risk management implementation. The reporting topics are Environmental, Social, and Governance. In total the currently proposed standards would cover 84 individual disclosure requirements and 1144 quantitative and qualitative data points.

Features of the new reporting standards

Several primary features of the standards can be pointed out:

- An altered and expanded definition of materiality – as would be expected, the financial aspect of materiality (whether a piece of data is relevant to the produced report), doesn't have the preemptive role for ESG reports. The concept of Double Materiality is introduced, which relates to both items with an impact from the point

of view of the investors (those ESG matters which affect the company's value creation) as well as from the point of view of a broader interested party perspective (which means reporting on ESG matters which are significant to the economy, environment, and society as a whole). The global drive for ESG responsibility has led to a convergence in materiality in terms of the environment for both investors and wider stakeholders.

- Widening of the reporting boundaries – reporting of an enterprise is to encompass its value chain, not only its own value creation. This means that reports need to include data for the sustainability of business relationships, both direct and indirect, regardless of the amount of control the enterprise has over these entities.
- Timeframe of disclosures: Reporting entities will need to report both on a past basis and a prospective basis (i.e., planning for the future).
- Assurance – a plan to implement assurance (auditing) of CSRD reports envisages limited assurance for all topics to be implemented by 2026 for reports for 2025 with a widened scope of assurance by 2028.

A bird's eye view of the proposed standards

There are 12 standards in total with two "Cross-cutting standards", which apply to all sustainability matters. The "Cross-cutting standards" are (ESRS) 1 – General Requirements and ESRS 2 – General disclosures. They cover the undertaking's general ESG performance.

There are three groups of Topical Standards: Environment, Social and Governance.

General: Cross-Cutting Standards	**Topical: Environmental**	**Topical: Social**	**Topical: Governance**
ESRS 1 General Requirements	**ESRS E1 Climate Change**	**ESRS S1 Own Workforce**	**ESRS G1 Business Conduct**
ESRS 2 General disclosures	**ESRS E2 Pollution**	**ESRS S2 Workers in the Value Chain**	
	ESRS E3 Water and Marine Resources	**ESRS S3 Affected Communities**	
	ESRS E4 Biodiversity and Ecosystems	**ESRS S4 Consumers and End-users**	
	ESRS E5 Resource Use and Circular Economy		

The topical standards are the implementation of the drive to a much wider range of reported data and provide metrics for environmental, social and governance aspects of the CSRD.

What follows is a list of topics, which must be covered in reports according to the new standards, with explanations about each.

Environmental

1. **Climate change (ESRS E1):** A plan and implemented practical steps towards negating the effects of climate change, including targets and spending to achieve them. The report must contain information about energy consumption, greenhouse gas emissions and other related ecological consideration. Fundamentally, the enterprise must report on its plans and actions to conform to the stated goals of the European green deal to transition to a sustainable economy and to limit global warming to 1.5 degrees Celsius and to achieve climate neutrality by 2050.
2. Pollution of the air, water and soil contamination, effects on organisms and food resources, and others **(ESRS E2)**. The reporting entity must describe its policies, the target goals and the amount of resources devoted to minimising these effects. A detailed list of generated or used polluting substances during the production process must be provided including those that are generated by facilities as emissions and products, or as products or services.
3. Water and marine resources **(ESRS E3)**- both negative and positive effects, and a report on the actions taken, including policies, and allocated resources
4. Biodiversity and Ecosystems (**ESRS E4)** - both positive and negative, potential and actual impact. Any actions taken and the corresponding results to prevent, lessen or compensate adverse effects on the biodiversity and ecosystems need to reported.
5. Resource use and circular economy (**ESRS E5)**: The report must showcase the actions taken by the business relating to the use of nonrenewable resources and their depletion and the regeneration of renewables, including actions to prevent, lessen or compensate the effects of resource use and the circular economy. The report includes resources used and provided, waste and steps taken to optimise resource use. Actions taken to accelarate the transition to a circular economy must also be reported.

Social

1. Report on the company's own workforce **(ESRS S1)** - covers working conditions, equal opportunities for staff and work-related rights.
2. Report on workers in the value chain **(ESRS S2)**: The report must specify the effect of company activities on workers in its value chain and in its upstream and downstream value chain (including business relationships and its supply chain). The report must set out implemented policies for engagement, channels of communication for such workers and targets for managing material impact on them due to the company's activities
3. Report on affected communities **(ESRS S3)**: how the business operations affect local communities, including upstream and downstream in the value chain, and what actions are taken to manage risks and opportunities, and dependencies for affected communities
4. Report on consumers and end users **(ESRS S4)**: The report relates to the material impacts that the enterprise's products and services have on its clients, including privacy and health; the mechanisms through which clients can raise concerns and the policies for mitigating material risks and compensating cases for actual negative effects must also be outlined.

Governance

1. Report on governance, risk management and internal control **(ESRS G1)**: The policies on staff diversity, remuneration policies, the composition of

management and others must be detailed in the report as well as policies for business ethics, anti-corruption and anti-bribery, corporate culture, and the associated company strategy, approach, processes and procedures to conform to requirements.

Effects of ESG reporting across sectors and in Healthcare

The lowering in requirements for qualifying an enterprise for CSRD reporting will affect a larger number of enterprises with estimates of up to 800 affected companies in Bulgaria alone including hospitals and other healthcare institutions. For example, this would include a number of the larger hospitals in Bulgaria (“Pirogov”, “Aleksandrovska”, “Acibadem City Clinic”, “Lozenetz” Hospital and others, based on their most recent financial reports). As the criteria include turnover (rather than profit) or balance in the balance sheet besides employee counts, even financially underperforming hospitals are in the scope of the new regulation. Even though Bulgaria is a country with a comparatively small nominal healthcare expenditure compared to the EU (8.5 % of GDP for 2020, which places it below the EU average of 11%, but with a nominal GDP of $70 Billion, one of the lowest in the EU) (Eurostat 2020), a significant number of hospitals will likely be affected. The new ESG regulation presents organisational and financial challenges for those businesses which have not yet implemented ESG policies. In order to comply with the detailed reporting requirements, additional expenses would need to be incurred, including staff training, provisioning of information systems, set up of new procedures and potentially additional subcontractors. Penalties for non-reporting have been left to the member states to implement in their local jurisdictions, and must include pecuniary administrative sanctions as well. Additionally, the gradual requirement for auditing of the ESG reports has the potential to increase the costs for auditing services.

Several opportunities exist for companies, which already perform ESG reporting according to one or more of the currently published standards. The general EU standardisation has the potential to lower costs of data collection and report generation, due to the uniformity of data sets required. Additionally, besides potentially reducing environmental and societal negative effects, ESG responsible companies have the potential to attract environmentally aware investors, as well as to improve their public image.

In the case of health institutions, ESG reporting has been lackluster worldwide. For healthcare organisations in Bulgaria, due to the financial structure of the sector (the share of insurance be it national or private cumulatively is a significant portion of health institution revenue), the potential financial benefits from attracting investors may be muted, while costs remain higher. The sector has historically been underfinanced with end-users having to make significant contributions out of pocket. In this context, a viable strategy for cost control using cost accounting methods may prove useful in both reducing waste and inefficiency (and thus improving ESG performance) while simultaneously providing the organisational structure to create ESG reports according to the new requirements, a relatively understudied subject in Bulgaria.

Conclusion

ESG reporting is rising in eminence worldwide with the EU positioning itself as a leader in standardising ESG reporting requirements and using the force of legislation to drive companies toward sustainability policies. Substantial effort has been made in creating standards to make ESG data useful and comparable, on par with financial

data, required by all enterprises. The new regulation has the potential to add additional administrative burdens for those companies who hasven't ESG systems in place. It is likely to affect many hospitals and other healthcare institutions across the EU, a subset of the economy where sufficient financing has historically been a challenge. Despite these challenges, companies across sectors have the potential to better the environment, both physically and socially, while simultaneously presenting a clearer and more friendly image to stakeholders, investors, asset managers and clients. Healthcare enterprises may experience fewer of the direct benefits of ESG reporting, though its mandatory form has the potential to spur new organisational and cost management methods to be implemented which could help improve overall performance in the sector.

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