Sustainability reporting for Irish SMEs - A challenge and an opportunity

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The Corporate Sustainability Directive has been transposed into Irish Law

Having been signed into legislation on 5 July 2024, Irish large listed and public interest entities will face meeting the requirements of the EU Corporate Sustainability Reporting Directive (CSRD) for the current financial year. However, listed SMEs will not come within the scope of the CSRD until 2027 (with respect to the 2026 financial year), with an opt-out in place for two further years to 2029 (for the 2028 financial year).

A key feature of the European Sustainability Reporting Standards (ESRS), provided for within the CSRD, is their focus on value chain reporting. In an economy characterised by SME activity, large Irish firms now face the task of collecting sustainability information from SME suppliers and customers, while SME management face the issue of aggregating and reporting this information.

The European Financial Reporting Advisory Group (EFRAG) has recently released an exposure draft of voluntary sustainability reporting standards for non-listed SMEs as part of the European Commission's SME Relief Package to support SMEs in accessing sustainable finance. Notwithstanding this, sustainability reporting is apt to present a major challenge for the Irish SME sector. Our research has examined the challenges of sustainability reporting for accounting practitioners of 400 SMEs. We find that accounting practitioners can provide substantive assistance to SMEs in meeting their value chain commitments as the CSRD takes effect.

Currently, the European Commission has not expressed an intention to impose an umbrella mandate on SMEs to publish sustainability reports. Despite this, it is inevitable that SMEs will need to report to their larger suppliers and customers which must satisfy value chain disclosure requirements. The design of the ESRSs has been largely informed by the well-established Global Reporting Initiative (GRI) sustainability reporting guidelines. Indeed, SMEs can voluntarily use these guidelines to produce sustainability reports. While European SMEs will likely use EFRAG's voluntary sustainability reporting standards for non-listed SMEs once finalised, the GRI has provided a good testing ground for examining SMEs readiness for sustainability reporting.

Value Chain Pressures

The ESRSs provide some transitional provisions for larger companies which cannot gather value chain data for the first two to three years of reporting, which may bring some relief to SMEs, yet certain areas are treated with a sense of urgency. As the climate crisis continues to threaten the planet and its people, the greatest demands will be for Green House Gas (GHG) emissions' information as larger undertakings will be required to report their Scope 3 GHG emissions under ESRS E1 'Climate Change'. While large organisations may be somewhat familiar with using tools such as the GHG protocol to measure and monitor emissions, this may be an unfamiliar development for many SMEs.

Workforce is another area where data is likely to be required in the coming years under ESRS S2 'Workers in the Value Chain'. The only standard devoted to the value chain, companies which determine workforce as a material topic will require data from value chain entities sufficient to enable an understanding of impacts on value chain workers particularly in respect of working conditions, equal treatment and other human rights.

While there are no other standards specifically referring to 'the value chain' in their title, the extent to which disclosures on Consumers and End Users (ESRS- S4), Biodiversity and Ecosystems (ESRS E4) and the Circular Economy (ESRS E5) are just some areas where value chain-related impacts, risks and opportunities will require disclosures. For instance, concerning ESRS E4 on biodiversity, SME suppliers may well be expected to inform their customers of their use of, and dependency on, natural resources and natural resources such as crops and animals. In a country with a buoyant agri-food sector, such requirements should not be underestimated in an Irish SME context.

Research Findings from the Irish SME context

Commenced prior to the publication of the ESRS standards, our research used the GRI framework to examine related reporting challenges and support requirements for SMEs. Given the pace at which EU sustainability disclosure requirements are expanding, we also employed the EU Green Taxonomy, a regulation closely related to the ESRS standards, to examine SMEs reporting readiness.

Guided by prior research and commentary, which strongly indicates that SMEs accounting practitioners are apt to be a reliable source of insight on SMEs' sustainability reporting needs, we engaged with Irish accounting practitioners to fully understand these issues. When one considers the roles accounting practitioners currently perform for SMEs advising on financial reporting, they are perhaps the natural choice to support SMEs on their sustainability reporting challenges.

With respect to challenges, the research data we collected from accounting practitioners enabled us to identify a number of issues, including:

- **Cost.** Initial setup costs, ongoing data management expenses and potential operational changes are financially challenging, and respondents identified these as the greatest barrier to implementing sustainability reporting.
- **Resources.** Limited human and financial resources make it difficult to allocate the necessary staff and budget towards developing and maintaining comprehensive sustainability reporting practices.
- **Education/knowledge. T**here is a significant knowledge gap within SMEs on the importance, processes and required metrics for sustainability reporting.
- **Data capture.** It can be difficult to track progress and report accurately on sustainability metrics because inadequate technology and systems make the collection, management and analysis of sustainability data challenging.

Concerning supports required, we consider both financial and non-financial supports that could reduce the financial costs and challenges for SMEs in implementing a system of sustainability reporting.

Accounting practitioners identified two financial supports that would help SMEs adopt sustainability reporting and the associated operational changes: government or EU grants/tax incentives or carbon credits; and subsidised education and training programmes, which would build long-term capacity within the SME sector.

Accounting practitioners also cited non-financial supports, most notably simplified disclosure requirements, which could significantly reduce the complexity and resource demands placed on SMEs. Given the intricacy of the data and reporting requirements of the ESRS, this sets something of challenge for standard setters.

Nonetheless, the voluntary sustainability reporting standards for non-listed SMEs suggest that the modular approach taken will accommodate SMEs in adopting sustainability reporting in an incremental manner.

Particularly desirable for our accounting practitioner respondents is the creation of a specialised agency, or equivalent, to provide SMEs with tailored support, including consultancy, resources and tools for sustainability reporting. Such an agency could act as a bridge, simplifying the process and making sustainability reporting more accessible for SMEs. With the recent launch of the National Enterprise Hub, the opportunity exists for the Department of Enterprise Trade and Employment to further support Irish SMEs in fulfilling their sustainability reporting requirements.

Our research suggests that while the journey towards sustainability reporting is fraught with hurdles for SMEs – from financial constraints to technological gaps – the collective will and support from the broader ecosystem can turn these challenges into opportunities.

As greenwashing concerns continue to grow, the need for complete, accurate and reliable data to be supplied by SMEs is central. While larger entitles in value chains have a role to play in facilitating smaller organisations by requesting data in a structured and specific manner, and by using their own internal controls to assure the adequacy of such data, it is important to bear in mind that such systems are in their infancy and lack the sophistication of those used in financial reporting. Financial support and subsidised education for SMEs is fundamental. These measures not only demystify the process of sustainability reporting but also ensure that SMEs are not left behind.

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