

# European Sustainability Reporting Standards (ESRS)

## What you need to know

1. As part of the European Green Deal, the Corporate Sustainability Reporting Directive (CSRD) includes the mandate to report sustainability information under the reporting framework of the European Sustainability Reporting Standards (ESRS).
2. The affected companies amount to an estimate of over 50,000 compiled of both large and listed companies (except listed micro-companies) based in the EU, but also to third-country companies based outside the EU with undertakings within the EU, i.e., subsidiaries or branches.
3. Under the European Commission's (EC) CSRD, the provisions apply to fiscal years starting on or after 1 January 2024 for large public-interest companies as well as banks and insurance companies, already subject to the Non-Financial Reporting Directive (NFRD); 1 January 2025 for large companies that are not presently subject to the NFRD; or 1 January 2026 for listed small- or medium-sized entities (SMEs) and other undertakings (SMEs can opt out until 2028).
4. Sustainability information mandatorily to be reported in the management report must be verified by a third party with limited assurance.
5. Main components brought by CSRD and ESRS include double materiality, inclusion of prospective information, information about the upstream and downstream value chain, and the concept of sustainability due diligence. The latter is closely related to the upcoming Corporate Sustainability Due Diligence Directive (CS3D) that aims to foster sustainable and responsible corporate behavior throughout global value chains.
6. Sustainability information can influence stakeholder decisions. Two main groups of stakeholders are considered in the ESRS: affected stakeholders and users of sustainability reporting.
7. The last version of the first set of ESRS were approved by the EFRAG board on 15 November 2022 and have been subject to editorial review before its final submission to the EC on 22 November 2022. The Commission is expected to adopt this first set of standards by June 2023.
8. The first set of ESRS encompass other international standards in emphasizing the utmost importance of tackling climate change, by requiring subject companies to disclose information on governance, strategy, management of impacts risks and opportunities, and metrics and targets related to climate change irrespective of the companies' judgment of their materiality.
9. The ESRS consider the existing European law and initiatives as well as European and international sustainability reporting initiatives, facilitating the interoperability with various standards, such as ISSB, TCFD and GRI, to avoid double disclosure efforts by companies.

## Background

On 21 April 2021, the EC issued a legislative proposal for the CSRD that would require companies within its scope to report in accordance with ESRS adopted by the EC as delegated acts. The European Financial Reporting Advisory Group (EFRAG) has been appointed as technical advisor to the EC, responsible for providing the ESRS.

On 29 April 2022, EFRAG released the exposure drafts (EDs) on the first set of ESRS and launched a public consultation process involving several groups of stakeholders that ended by August 2022.

The Council has given final approval to adopt the proposal on 28 November.

## Introduction to the first draft of ESRS

The EFRAG Sustainability Reporting Board (EFRAG SRB) and EFRAG Sustainability Reporting Technical Expert Group (EFRAG SR TEG) considered all comments received during the public consultation and, on 15 November 2022, agreed on a first set of ESRS to be submitted to the European Commission, which is expected to be adopted by the Commission by June 2023.

This first set of ESRS, comprising 12 standards, follow the CSRD proposal and cover environmental, social and governance matters. The set includes both cross-cutting and topical standards. In addition, the standard's architecture foresees the publication of sector-specific standards and standards for SMEs that are not yet included in the public consultation.

The ESRS EDs are hyperlinked and can be accessed by clicking on each tile.

Already published			Coming later
<b>Cross-cutting standards</b>			<b>Sector-specific standards</b> (coming later)
<b>ESRS 1</b> General requirements			
<b>ESRS 2</b> General disclosures			<b>SMEs' proportionate standards</b> (coming later)
<b>Topical sector-agnostic standards</b>			
<b>Environment</b>	<b>Social</b>	<b>Governance</b>	
ESRS E1 Climate change	ESRS S1 Own workers	ESRS G1 Business conduct	
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			

## Overview of the first set of ESRS

The overall architecture of the first set of ESRS is designed to ensure that sustainability information is reported in a carefully articulated manner and is based on the following structure:

### Four reporting areas

ESRS 2 determines that the Disclosure Requirements (DRs) in topical ESRS should cover the following reporting areas:

- a. Governance:** the governance processes, controls and procedures used to monitor and manage impacts, risks and opportunities
- b. Strategy:** how the undertaking's strategy and business model(s) interact with its material impacts, risks and opportunities, including the strategy for addressing them
- c. Impact, risk and opportunity management:** the process(es) by which impacts, risks and opportunities are identified, assessed and managed through policies and actions
- d. Metrics and targets:** how the undertaking measures its performance, including progress toward the targets it has set

### Three topics

1. Environmental
2. Social
3. Governance

### Three disclosure layers

1. Sector-agnostic
2. Sector-specific
3. Entity-specific

The current first set of draft standards only includes the cross-cutting and sector-agnostic standards. Sector-specific and SME-proportionate standards are still being developed and will be submitted for a separate public consultation as soon as possible. A company shall present the sustainability information required under the ESRS in its management report.

## Cross-cutting standards

**ESRS 1** and **ESRS 2** are cross-cutting standards, they apply to all sustainability matters.

**ESRS 1** prescribes the mandatory concepts and principles to be applied when preparing sustainability statements under the CSRD. A company should disclose all material information about its sustainability-related impacts, risks and opportunities in accordance with the applicable ESRS. In this context, **ESRS 1** requires companies in scope to disclose certain sustainability information irrespective of the companies' judgment of their materiality, including information on governance, strategy, management of impacts risks and opportunities, and metrics and targets related to climate change. Nonetheless, some disclosure requirements and data points (except those included in **ESRS 2** and **ESRS E1**) may be omitted as long as the objective of the DR is met.

Under the ESRS, there are requirements to report standardized disclosures that apply to all entities (sector-agnostic standards) and those that apply to entities doing business in one or several specific sectors (sector-specific standards).

Sustainability information can influence stakeholder decisions if it has predictive value, confirmatory value or both. Stakeholders are those who can affect or be affected by the company's decisions and actions. The company needs to identify its two main groups of stakeholders:

- ▶ **Affected stakeholders:** individuals or groups that have interests that are or could be affected – positively or negatively – by the company's activities and through its value chain
- ▶ **Users of sustainability reporting:** stakeholders with an interest in the undertaking, which includes:
  - ▶ Primary users of general-purpose financial reporting: existing and potential investors, lenders and other creditors (including asset managers, credit institutions, insurance companies)
  - ▶ Other users, including business partners of the companies, trade unions and social partners, civil society organisations and non-governmental organisations

Some, but not all, stakeholders may belong to both groups.

**ESRS 2** sets out the disclosure requirements of sustainability reporting that are cross-cutting. This includes general characteristics of the company and an overview of the company's business but also specific disclosures on compliance such as approximations in relation to value chain and boundaries, estimation uncertainty, changes in preparation and presentation, and prior period errors. Additionally, disclosures about strategy, governance, and the materiality assessment of sustainability impact, risks and opportunity are covered by ESRS 2.

The structure and index in this standard replicate the four-pillar structure presented by TCFD/ISSB, enabling alignment between different reporting standards.

## Topical standards

The topical standards include disclosure requirements covering environmental, social and governance matters. These requirements are sector-agnostic. They aim to enable users of the company's sustainability statements to understand the company's impact on these dimensions, the company's material risks and opportunities related to these areas, and ultimately their impact on the company's ability to create enterprise value.

Topical standards prescribe disclosure requirements that cover (i) a description of the processes to identify and assess material impacts, risks and opportunities; (ii) impact, risk, or opportunity management, including related policies, targets, action plans and resources; as well as (iii) metrics and targets in relation to specific topics.

These requirements shall be applied in addition to cross-cutting standards.

- ▶ **Environment** topical standards (ESRS E1-E5) outline disclosure requirements for companies to report on matters related to climate change, pollution, water and marine resources, biodiversity and ecosystems, and resource use and circular economy. In addition to these general objectives the draft environmental standards aim to enable users of sustainability statements to understand the plans and capacity of a company to adapt its business model and operations in line with the transition to a sustainable economy, and how it contributes to the various environmental objectives of the European Green Deal, as well as to other EU strategic and regulatory frameworks in this context.
- ▶ **Social** topical standards (ESRS S1-S4) provide a framework for entities to report on topics related to their own workforce, the workers in their value chains, the communities impacted by their operations and the consumers and end-users of their products or services.
- ▶ **Governance** topical standards (ESRS G1) sets out disclosure requirements that seek to enhance users' understanding of a company's strategy and approach, and the processes, procedures and performance in relation to their business conduct.

## Affected companies, timelines, assurance and reporting period

► **Who are the affected companies?** The CSRD provisions apply to all large companies, whether listed on stock markets or not, and listed companies (except listed micro-companies) meeting at least two of the three following criteria:<sup>1</sup>

- a. Balance sheet total of more than €20m
- b. Net turnover of more than €40m
- c. Average number of employees during the financial year of more than 250

SMEs are expected to be given three more years to comply with the CSRD.

Non-EU companies with substantial activity in the EU (with a turnover over €150m in the EU) that have at least one subsidiary (large or listed) or branch (net turnover of more than €40m) in the EU will also have to comply. An estimated of more than 50,000 companies in the EU will be required to publish sustainability information under ESRS.

► **When do companies have the obligation to report sustainability information according to the ESRS?** Consistent with what was said above for CSRD, the standards will take effect between 2024 and 2028 as follows:

- From 1 January 2024 for companies already subject to the Non-Financial Reporting Directive (reporting in 2025 on 2024 data)
- From 1 January 2025 for large companies not currently subject to the Non-Financial Reporting Directive (reporting in 2026 on 2025 data)
- From 1 January 2026 for listed SMEs and other undertakings (reporting in 2027 on 2026 data); SMEs can opt-out until 2028
- From 1 January 2028 for non-EU companies with significant undertakings in the EU (reporting in 2029 on 2028 data)

► **Is assurance mandatory?** Limited assurance for reported sustainability information will be required for all companies. The Directive includes an option to move toward “reasonable assurance” at a later stage following an assessment.

► **What is the period covered by the sustainability reporting?** The sustainability reporting period should be aligned to the reporting period used for the financial statements.

## Future steps

The current first set of ESRS that have been submitted to the EC will now undergo a process of editorial reviews. This first set of standards is expected to be adopted by the Commission by June 2023.

Additionally, SRB has considered that some topics require more research and public consultation in the coming months, such as the approach to the value chain for financial market participants, the possibility to include disclosures on racial and ethnic origin, the disclosure of financial affects arising from opportunities and the threshold for impact materiality.

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<sup>1</sup> Including following companies regardless of their legal form: (a) insurance undertakings within the meaning of Article 2(1) of Council Directive 91/674/EEC; (b) credit institutions as defined in Article 4(1), point (1), of Regulation (EU) No 575/2013 of the European Parliament and of the Council

## Other initiatives on sustainability reporting

The sustainability disclosures in the EU will not only be determined by the final CSRD and ESRS, but also by the EU Taxonomy Regulation and the upcoming Corporate Sustainability Due Diligence Directive. Moreover, there are other relevant sustainability reporting initiatives developing internationally:

1. **IFRS-ISSB:** The International Sustainability Standards Board (ISSB) published two exposure drafts of the IFRS Sustainability Disclosure Standards on [general sustainability-related disclosure requirements](#) and [climate-related disclosure requirements](#) that were subject to public consultation period until 29 July 2022. For further information see the EY publication "[ISSB publishes first two EDs on sustainability disclosure requirements.](#)"
2. **The Securities and Exchange Commission (SEC):** The SEC released a set of [proposed rules on climate-related disclosures](#). These rules were open for consultation until 17 June 2022. For further information see the EY publication "[To the Point – SEC proposes enhancing and standardizing climate-related disclosures.](#)"

### How we see it

We very much welcome the work of the EU to create a set of standards for sustainability disclosures aimed at increasing quality and comparability of sustainability information reported by EU entities. We commend the project task force on ESRS for developing these standards in such a short period of time. We also welcome the European Commission and EFRAG joining the ISSB Working Group discussing the compatibility of jurisdictional initiatives with the global baseline set by the ISSB. Users as well as preparers of sustainability information under ESRS will benefit from international comparability and consistency.

The set of ESRS will be complemented by sector-specific standards and the SME-proportionate standards. Since the reporting framework is broad and will evolve over time, they will have a very significant impact on companies. We encourage stakeholders to comment on the set of draft standards and reporting companies to start preparing as early as possible for the implementation of these standards and related procedures as this is not just a reporting exercise.

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