Issue 3/August 2023

EU Sustainability Developments

European Sustainability Reporting Standards (ESRS)

What you need to know

1. As part of the European Green Deal, the Corporate Sustainability Reporting Directive (CSRD) requires to report sustainability information under the reporting framework of the European Sustainability Reporting Standards (ESRS) as adopted in the European Union (EU).
2. The affected undertakings amount to an estimate of over 50,000 compiled of both large and listed undertakings (except listed micro-undertakings) based in the EU, but also to third-country undertakings based outside the EU with undertakings within the EU, i.e., subsidiaries or branches. Non-listed SME are not in scope of CSRD.
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 undertakings as well as banks and insurance undertakings, already subject to the Non-Financial Reporting Directive (NFRD); 1 January 2025 for large undertakings that are not presently subject to the NFRD; or 1 January 2026 for listed small- or medium-sized entities (SMEs). Listed SMEs can opt out until 2028.
4. On 31 July 2023 the EC adopted the first set of ESRS applicable to all undertakings subject to the CSRD. The standards are now available in 23 official languages. However, these final standards are not in force until the delegated regulation has passed the scrutiny of the European Parliament and Council and is published in the Official Journal.
5. Main components brought by CSRD and ESRS include the concept of 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, which include investors, but also other users such as undertakings business partners, trade unions and social partners.
7. Sustainability information mandatorily to be reported in the management report must be verified by a third party with limited assurance (moving towards reasonable assurance, following an assessment by the EC to determine if reasonable assurance is feasible for auditors and undertakings) in accordance with an assurance standard adopted in the EU. Such a standard is currently in development.
8. The ESRS consider the existing European law and initiatives as well as European and international sustainability reporting initiatives, aiming to facilitate the interoperability with various standards, such as ISSB, TCFD and GRI, and to avoid double disclosure efforts by undertakings.
9. The EC is establishing an interpretation mechanism to provide formal interpretations of the standards. Additionally, the EC has requested EFRAG to publish supplementary guidance and educational materials that will cover topics such as the materiality assessment process and other related issues.
10. The EC and EFRAG maintain close collaboration especially with the ISSB and the Global Reporting Initiative to aim for a high level of interoperability between the mandatory disclosure requirements under ESRS in the EU and other sustainability reporting frameworks that might become mandatory in other jurisdictions. The International Sustainability Standards Board (ISSB) has recently issued its first two IFRS Sustainability Disclosure Standards which have been developed to bring global consistency to the way companies disclose sustainability-related risks and opportunities throughout their value chain, helping to improve trust and confidence in company disclosures and to inform investment decisions. The application of these standards is not mandatory in the EU.

Building a better working world

Background

On 21 April 2021, the EC issued a legislative proposal for the CSRD that would require undertakings 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 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 EC. After the consultation, EFRAG made substantial modifications to its initial drafts before submission to the Commission with a particular view on reducing administrative burden for undertakings, including reducing the number of reporting requirements by nearly half.

In early 2023 the EC conducted a consultation with Member States on the draft standards submitted by EFRAG. The consultation process also involved various EU bodies, including the three European Supervisory Authorities[1], the European Environment Agency, the European Union Agency for Fundamental Rights, the European Central Bank, the Committee of European Auditing Oversight Bodies, and the Platform on Sustainable Finance.

Following this consultation, the EC made several adjustments to the standards submitted by EFRAG to ensure proportionality and facilitate the correct application of the standards by undertakings. As a result, an updated version of the draft standards was published on 9 June 2023.

Introduction to the first set of ESRS

After a four-week period of public consultation that ended on 7 July 2023, the final delegated regulation supplementing Directive 2013/34/EU of the European Parliament and of the Council (CSRD) as regards sustainability reporting standards has been adopted. The final delegated regulation and its annexes including the ESRS can be accessed here.

The first set of European Sustainability Reporting Standards (ESRS) adopted by the EC on 31 July 2023 are applicable to all companies subject to the CSRD. However, they are not in force until the delegated regulation passes the two-month scrutiny period, which can be extended for an additional two months if needed, by the European Parliament and Council and until it is published in the Official Journal.

[1] The European Securities and Markets Authority, the European Banking Authority and the European Insurance and Occupational Pensions Authority

This first set of ESRS, comprising 12 standards, follow the CSRD regulation and cover environmental, social and governance matters. The set includes both cross-cutting and topical standards. These standards are related to the reporting requirements under Article 19a and 29a of the CSRD-amended Accounting Directive. In addition, the standard's architecture foresees the publication of sector-specific standards and standards for SMEs that are still under development. Also, a separate set of reporting standards will be developed for third-country company reporting requirements under Article 40a – 40d of the CSRD-amended Accounting Directive, i.e., the preparation of a sustainability report on group level of the ultimate parent based in a non-EU country.

Already published

Cross-cutting standards

ESRS 1
General requirements

ESRS 2
General disclosures

Topical sector-agnostic standards

Environment	Social	Governance
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		

Coming later

Sector-specific standards
(coming later)

SMEs' proportionate standards
(coming later)

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 in topical ESRS should cover the following reporting areas:

a. **Governance:** the governance processes, controls and procedures used to monitor, manage and oversee impacts, risks and opportunities

b. **Strategy:** how the undertaking's strategy and business model 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 the undertaking identifies impacts, risks and opportunities and assesses their materiality, as well as how it manages material sustainability matters through policies and actions

d. **Metrics and targets:** how the undertaking measures its performance, including targets it has set and progress towards meeting them.

Three topics

1. Environmental
2. Social
3. Governance

Three disclosure layers

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

The first set of standards only covers sector-agnostic standards, including cross-cutting and topical standards. Sector-specific and SME-proportionate standards are still being developed.
Undertakings should present the sustainability information required under the ESRS in their management reports.

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. An undertaking should disclose all material information about its sustainability-related impacts, risks and opportunities in accordance with the applicable ESRS. According to ESRS 1 all standards and all disclosure requirements and data points within each standard will be subject to materiality assessment by the undertaking, except for disclosure requirements specified in the "General disclosures" standard (ESRS 2). A detailed explanation of the conclusions of the materiality assessment must be provided if an undertaking concludes that climate change is not material and therefore it does not report in accordance with ESRS E1.

ESRS 1 states that when an undertaking discloses information about policies, actions, and targets concerning a sustainability matter that has been determined to be material, it must include the information prescribed by all the Disclosure Requirements and data points within the applicable topical and sector-specific ESRS related to that specific matter, and in the corresponding Minimum Disclosure Requirement on policies, actions and targets required under ESRS 2. However, undertakings should also consider that the ESRS include several voluntary data points such as those referred to biodiversity transition plans, certain information related to non-employee workers and others.

Under the ESRS, there are requirements to report standardized disclosures that apply to all entities (sector-agnostic standards) and those that will 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 undertaking. There are two main groups of stakeholders:

- Affected stakeholders: individuals or groups that have interests that are or could be affected — positively or negatively — by the undertaking's activities and its direct and indirect business relationships across 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 undertakings), and
  - Other users, including the undertaking's business partners, trade unions and social partners, civil society and non-governmental organisations, governments, analysts and academics.

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 undertaking and an overview of the undertaking's business but also specific disclosures in relation to specific circumstances such as time horizons, value chain estimation, sources of estimation and outcome uncertainty, changes in preparation and presentation of sustainability information, or reporting errors in prior period. Additionally, disclosures about governance, strategy, impact, risk an opportunity management, including disclosures on the materiality assessment process, and metrics and targets are covered by ESRS 2.

The structure and index in this standard replicate the four-pillar structure presented by TCFD/ISSB, improving 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 undertaking's sustainability statements to understand the undertaking's impact on these dimensions, the undertaking's material risks and opportunities related to these areas, and ultimately their impact on the undertaking's ability to create enterprise value.

Topical standards prescribe disclosure requirements that cover the four reporting areas determined by ESRS 2 (i) governance; (ii) strategy; (iii)impact, risk and opportunity management, as well as (ii) 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 undertakings 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 topics the environmental standards aim to enable users of sustainability statements to understand the plans and capacity of an undertaking 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 an undertaking's strategy and approach, and the processes, procedures and performance in relation to their business conduct.

Affected undertakings, timelines, assurance and reporting period

- **Who are the affected undertakings?** The CSRD provisions apply to all large undertakings, whether listed on a regulated market in the EU or not, and small listed undertakings (except listed micro-undertakings). To be classified as "large undertaking" at least two of the three following criteria need to be met:[2]

  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

  An estimated of more than 50,000 undertakings in the EU will be required to publish sustainability information under ESRS. Also, non-EU ultimate parent undertakings that generate more than €150 million revenue per year within the EU and that have either a branch in the EU either with a turnover exceeding €40 million or a subsidiary that qualifies as a large undertaking or a listed SME within the EU must comply with CSRD. Their EU undertakings are required to file a report on sustainability impacts at the group level of that non-EU ultimate parent starting from their financial year 2028, with first sustainability statement having to be published in 2029. A separate set of ESRS will be developed for this case. Also, the EU may deem other standards to be an equivalent to these ESRSs.

- **When do undertakings 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 undertakings already subject to the Non-Financial Reporting Directive (NFRD) such as large, listed undertakings, large banks and large insurance undertakings (all with more than 500 employees), along with large non-EU listed undertakings with over 500 employees (reporting in 2025 on 2024 data)
  - From 1 January 2025 for large undertakings not currently subject to the Non-Financial Reporting Directive (reporting in 2026 on 2025 data)
  - From 1 January 2026 for listed SMEs, including non-EU listed SMEs (reporting in 2027 on 2026 data); SMEs can opt-out until 2028
  - From 1 January 2028 for non-EU undertakings (filing of 2028 data)

[2] Including following undertakings 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

Additionally, the ESRS include various topical phase-ins that allow to reduce the initial reporting burden or by delaying application of certain requirements:

- **All undertakings** may omit information related to:
  - Their value chains for the first three years that they apply the standards.
  - Anticipated financial effects related to non-climate environmental issues (pollution, water, biodiversity, and resource use) in the first year that they apply the standards.
  - Certain data points related to their own workforce (social protection, persons with disabilities, work-related ill-health, and work-life balance) in the first year that they apply the standards.
- **Undertakings with less than 750 employees** may omit in the first or first two years:
  - Scope 3 GHG emissions data (first year)
  - Disclosure requirements specified in the ESRS S1 "Own workforce" standard (first year)
  - Disclosure requirements specified in the ESRS E4 "Biodiversity and ecosystems" (first two years)
  - Disclosure requirements on ESRS S2 "Value-chain workers", ESRS S3 "Affected communities", and ESRS S4 "Consumers and end-users" (first two years).

- **Is assurance mandatory?** Limited assurance for reported sustainability information will be required for all undertakings in accordance with the provisions of the CSRD. The Directive includes an option to move toward "reasonable assurance" at a later stage following an assessment by the EC.
- **What is the reporting entity for the sustainability statement?** The reporting entity shall be for the same reporting undertaking as the financial statements. For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, the sustainability statement will be for the group.
- **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 final standards are not in force until the delegated regulation is published in the Official Journal.

The delegated regulation will be formally transmitted to the European Parliament and to the Council in the second half of August. During this stage, there is a scrutiny period of two months, which can be extended for an additional two months if needed. Although the European Parliament or the Council have the authority to reject the delegated act, they may not amend it.

Regarding the pending sets of ESRS, EFRAG is currently developing the draft versions of the proportionate standards for listed SMEs. EFRAG is also developing simpler voluntary standards for use by non-listed SMEs, which are not subject to the CSRD, so that these undertakings can respond to requests for sustainability information in an efficient and proportionate manner.

EFRAG is expected to establish a single access point on its website where stakeholders can submit ESRS application questions. Furthermore, EFRAG will release regular non-binding technical guidance related to the implementation of ESRS. In this context, The Commission has proposed that EFRAG gives priority to developing guidance on materiality assessment and on reporting concerning value chains. EFRAG is anticipating the publication of draft guidance on these two topics for public consultation soon.

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 also welcome the European Commission and EFRAG further 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 undertakings. We encourage reporting undertakings to start preparing as early as possible for the implementation of these standards and related procedures as this is not just a reporting exercise. The application of the standards is complex, and many judgmental areas remain and will require the involvement of various experts. Challenges like interpreting the new concept of double materiality assessment and covering a very wide scope of information, including across the value chain will require detailed analysis and sufficient time for implementation.

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