EFRAG update on European Sustainability Reporting Standards (ESRS) and Corporate Sustainability Reporting Directive (CSRD)

IAASB Board meeting

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Sustainability Reporting Board Chair

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Table of content

0. Caveats
1. The key features of the European legal regime: the CSRD
2. The provisions regarding assurance of sustainability statements
3. The challenges of sustainability reporting auditability
4. The key features of the European regulatory regime: the ESRS
5. The standard structure of each ESRS
6. The translation of reporting into digital format
7. A focus on double materiality
8. The pivotal role of the materiality assessment
9. What is underway?
   • Interoperability
   • Standard-setting activities
   • Implementation support: three pillars under consideration for an ESRS ecosystems
0. Caveats

• Specific: auditing standards are not in the remit of EFRAG

• General: EFRAG is co-funded by the European Union and EEA and EFTA countries. The contents of EFRAG’s work and the views and positions expressed are however the sole responsibility of EFRAG and do not necessarily reflect those of the European Union or the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA). Neither the European Union nor DG FISMA can be held responsible for them.
1. The key features of the European legal regime: the CSRD (1/2)

- A mandatory regime for all large entities (250+ employees) and listed SMEs

- A progressive phase-in: 2024 reporting year for NFRD reporters, 2025 for the other CSRD, 2026 for listed SMEs (with opt-out option for 2028)

- Other SMEs encouraged to adopt a simplified voluntary reporting

- A comprehensive coverage of sustainability matters: E, S & G, under standards elaborated by EFRAG and adopted by the EC via delegated acts
1. The key features of the European legal regime: the CSRD (2/2)

- A key concept: double materiality (impacts and financial risks/opportunities)
- Location and timing of reporting: in the management report, i.e., at the same time as financial statements
- Mandatory audit: limited assurance to start with, moving to reasonable assurance
- Digitisation from the first reporting (2025 on reporting year 2024?)

Transposition into national law: focused on some points as harmonisation level already high
2. The provisions regarding assurance of sustainability statements

- CSRD: independent third-party assurance mandatory

- Assurance level: limited to start with, moving to reasonable

- Scope: compliance with CSRD and ESRS, including processes + compliance with digital format + compliance with taxonomy regulation

- Assurance standards: national standards until the EC adopts limited assurance standards (October 2026) and reasonable assurance standards (October 2028)

- Who: statutory auditor and/or (member state option) independent assurance service provider (IASP)

- Educational qualifications/ethical requirements/quality assurance: similar to those applying to financial statements assurance
By contrast with financial reporting:

- An inevitable learning curve in a fast emerging reporting area
- Narrative disclosures as major and autonomous elements of the sustainability statements
- Quantitative disclosures based upon a variety of units of account
- No primary statements, i.e., a series of focuses on critical sustainability matters
- Key role of the materiality assessment
- Importance of forward-looking information
- Importance of value chain information (upstream and downstream)
In terms of auditability/audit:

- Monitoring of a significant implementation project and ongoing reporting process: governance, systems, internal control…

- Importance of the materiality assessment

- Definition and usability of the suitable criteria

- Wording of the opinion in relation to information provided, in particular:
  - narrative
  - beyond the reporting date
  - beyond control…

- Opinion on a report as a whole in the absence of primary statements?
4. The key features of the European regulatory regime: the ESRS

A first set of sector-agnostic ESRS

<table>
<thead>
<tr>
<th>CROSS-CUTTING STANDARDS</th>
<th>TOPOICAL STANDARDS</th>
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</thead>
<tbody>
<tr>
<td><strong>ESRS 1 General requirements</strong></td>
<td><strong>ESRS 2 General disclosures</strong></td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Environment</th>
<th>Social</th>
<th>Governance</th>
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<tbody>
<tr>
<td>ESRS E1 <strong>Climate change</strong></td>
<td>ESRS S1 <strong>Own workforce</strong></td>
<td>ESRS G1 <strong>Business conduct</strong></td>
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<td>ESRS E2 <strong>Pollution</strong></td>
<td>ESRS S2 <strong>Workers in the value chain</strong></td>
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<td>ESRS E3 <strong>Water and marine resources</strong></td>
<td>ESRS S4 <strong>Consumers and end-users</strong></td>
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<td>ESRS E4 <strong>Biodiversity and ecosystems</strong></td>
<td>ESRS S3 <strong>Affected communities</strong></td>
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<td>ESRS E5 <strong>Resource use &amp; circular economy</strong></td>
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**84 Disclosure Requirements**
- Qualitative or quantitative

**1144 Datapoints**

**Double materiality**
- Financial materiality
- Impact materiality

**4 pillars**
- Governance
- Strategy
- Impact, risk and opportunity management
- Metrics and targets

Future sets: sector-specific standards, SMEs standards + implementation support
5. The standard structure of each ESRS

- Main body:
  - ✓ First paragraph of each disclosure requirement (bold): the description of the information required
  - ✓ Second paragraph: the objective of the disclosure requirement (principles-based approach)
  - ✓ Following paragraphs: the specific datapoints to be included (« shall ») under a, b, c..., subdivided, if need be, as (i), (ii), (iii)... (non-limitative list)

- Appendices:
  - ✓ A. Defined terms
  - ✓ B. Application requirement (« shall consider », « may disclose », « may consider »).
  - ✓ Other
6. The translation of reporting into digital format

• Digital taxonomy underway at EFRAG under XBRL

• Tagging to be available in line with reporting timeline, link with ESAP

• Tagging aligned with standard structure:
  ✓ Level 1: Disclosure requirement level
  ✓ Level 2 (« nested »): a, b, c …
  ✓ Level 3 (« nested »): (i), (ii), (iii) … (when required by ESRS)

• Therefore, 3 levels of digital granularity allowing for 3 levels of reading
7. A focus on double materiality

<table>
<thead>
<tr>
<th>Undertaking to disclose material matters (impacts, risks or opportunities)</th>
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<td><strong>Impact materiality</strong>: actual or potential positive or negative impacts on people or the environment over the short-, medium- and long-term time horizons (inside-out)</td>
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**Criteria:**
- severity (scale, scope and remediability)
- likelihood of the impact

**Or**

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<tr>
<th>Financial materiality: a sustainability matter is material if it triggers or may trigger material financial effects (outside-in)</th>
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<tr>
<td><strong>Financial effects</strong> being risks or opportunities that have a material influence (or likely to have a material influence) on the undertaking’s cashflows, development, performance, position, cost of capital or access to finance in the short-, medium- and long-term.</td>
</tr>
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**Or**

| Both |
8. The pivotal role of the materiality assessment (1/2)

- Sustainability statements shall reflect all material impacts, risks and opportunities (IROs): under an objective approach with thresholds, no prioritisation.

- Reporting entity to implement a rigorous materiality assessment process to determine material IROs.

- ESRS providing for (i) mandatory disclosures and disclosures subject to materiality assessment and (ii) explicit/implicit justification (« material/not material for the undertaking »).
8. The pivotal role of the materiality assessment (2/2)

**MANDATORY INFORMATION TO BE DISCLOSED**

The following disclosures/datapoints are to be disclosed and do not follow the materiality assessment:

A. **ESRS 2 – General Disclosures**

B. **EU legislation datapoints** (SFDR, EU Benchmarks, Pillar III, EU Climate law ..). These are in ESRS 2 and topical standards – refer to Appendix D of ESRS 2 for a full list.

C. **E1 – Climate Change**

D. **S1 – Own workforce DRs 1 to 9** for undertakings with 250 employees or more.

**DISCLOSURES SUBJECT TO THE MATERIALITY ASSESSMENT**

To identify the material impacts, risks and opportunities for the undertaking within the short-, medium- and long-term.

- **At topical standards**
  - **MATERIAL**
    - To disclose the information (including, policies, actions and targets)
  - **NOT MATERIAL**
    - Brief explanation

- **At Disclosure Requirement and/or datapoint (Metrics)**
  - **MATERIAL**
    - To disclose the information
  - **NOT MATERIAL**
    - The undertaking may omit the Disclosure Requirement/datapoint
9. What is underway? (1/3)

Interoperability

- 2 objectives:
  - ✔ Building on and contributing to global sustainability reporting progress
  - ✔ EU reporting entities: a single sustainability report

Meetings of the JWG, bilateral meetings at management level and bilateral meetings of climate experts: continued dialogue and cooperation

Comments received: great desire for interoperability ESRS and IFRS S

Tentative decisions:
  - Alignment of concepts: financial materiality and value chain in ESRS 1
  - Alignment of content of disclosure objectives in ESRS 2
  - Confirmation of additions to IFRS S2 in ESRS E1
  - Changes to the Architecture

Differences in timeline and scope at this stage

ESRS providing the EU data infrastructure and is more comprehensive:

- Double materiality
- EU sustainable finance regulation for financial services (SFDR, Pillar 3)
- Other EU regulation and international human rights instruments (for example, Climate law)
- Broader stakeholders

Global Reporting Initiative (GRI)

- Technical cooperation from the beginning to seek alignment on key concepts: impact materiality, due diligence approach …
- Comments received and bilateral meetings underway
9. What is underway? (2/3)

Standard-setting activities

**SET 2 (precise timing under consideration)**

- **Sector-specific standards**: standards for EU companies in 4 sectors: Agriculture, Mining Quarrying and Coal, Oil and Gas, Road Transport

- **SMEs**: Standard for listed SMEs (LSME) + Voluntary guidance for non-listed SMEs (VSME)

**FOLLOWING SETS**

- **4 high-impact sectors**: Energy Production, Motor Vehicles, Food/Beverage, Textiles

- **Financial institutions (banking, insurance, asset management)**

- **The remaining 30 sector-specific standards**

- **Non-EU parent company standard for third-party groups with branches and subsidiaries within the EU over a certain threshold + Amendment to Set 1** in order to implement the ‘cap’ on value chain information
9. What is underway? (3/3)

Three pillars under consideration for an ESRS ecosystem

- Implementation challenges expected for set 1 (and following sets)
  - implementation support

- 1. Elaboration of guidance and Q & A

- 2. Availability of comprehensive ESRS related documentation

- 3. Facilitation of educational initiatives
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