Get ready for European Sustainability Reporting Standards

Understanding the first set of ESRSs

August 2023

Get ready for European Sustainability Reporting Standards

What's the issue?

Under the CSRD, many more companies in the EU will need to prepare extensive sustainability reports as part of their management reports.

ESRSs will be applied by:

- all large and most listed EU companies;
- large subsidiaries of non-EU parents (group exemptions apply); and
- non-EU companies with a turnover in the EU of more than EUR 150 million.

In July 2023 the European Commission (EC) published the final text of its first set of ESRSs. For the first wave of companies, disclosures will be required as early as the 2024 reporting period[1].

What's the impact?

The ESRSs are ambitious and will have a significant impact on the scope, volume and granularity of sustainability-related information to be collected and disclosed by companies.

They introduce the concept of double materiality (the multi-stakeholder approach) and expand a company's reporting boundary to cover material information across its value chain.

A company will need to report on how its activities and value chain affect the environment and people, as well as how sustainability-related matters affect its cash flows, financial position and financial performance.

What's next?

- Make yourself familiar with the reporting requirements under the ESRSs.
- Identify what you will be required to report.
- Prepare: based on a phased timeline, adoption will start for the first tranche of companies for years beginning on or after 1 January 2024.

[1] The EU Parliament and the EU Council now have a period of up to potentially four months to object. If they raise no objections then this first set of ESRSs will apply for the first companies for FY 2024.

Abbreviations and key terms

10 questions to start getting ready

01 What has been released?

02 When and to whom will ESRSs apply?

03 What are ESRSs based on?

04 What will companies need to disclose?

05 What phase-in reliefs will apply?

06 What is double materiality?

07 What reporting boundary do you need to consider?

08 What if you have already adopted other frameworks?

09 What about assurance?

10 What do you need to do now?

01 What has been released?

Ten topic-specific ESRSs

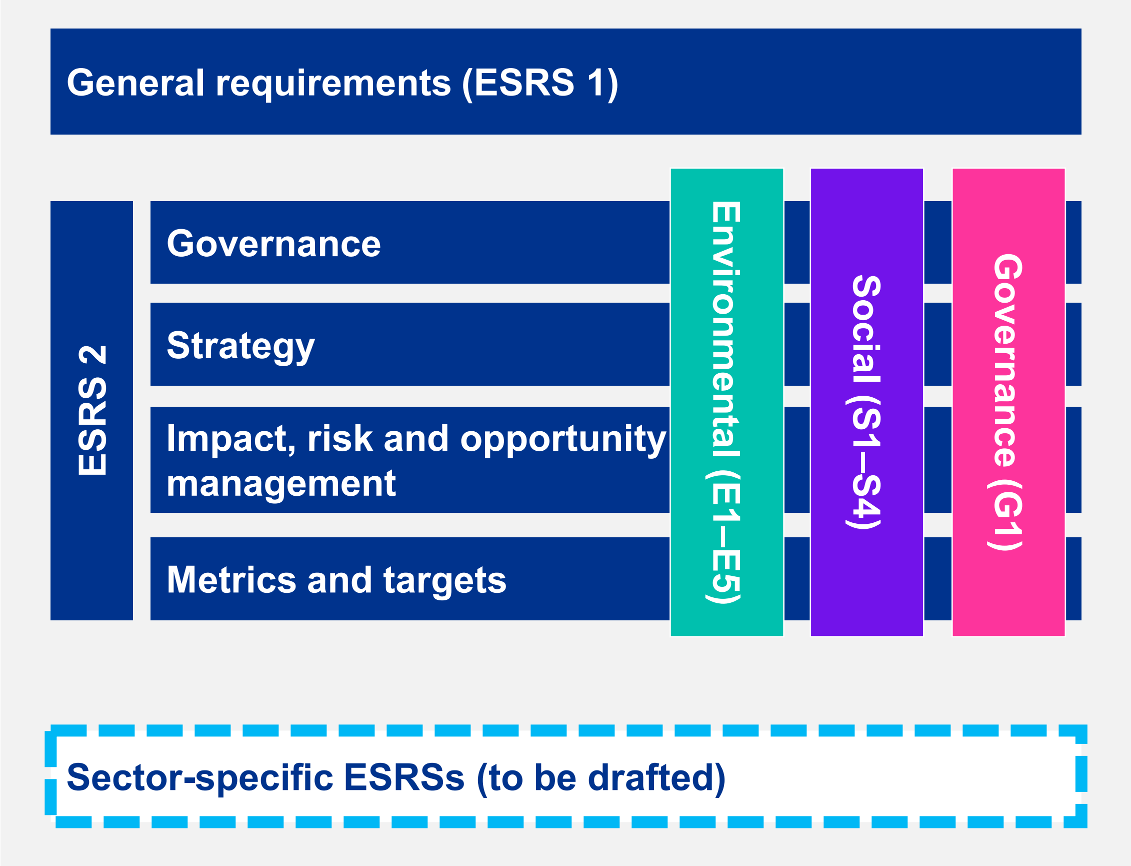
- Provide topic-specific disclosure requirements on:
  - governance;
  - strategy; and
  - impact, risk and opportunity management.
- Establish metrics and explain how to disclose related targets for each topic.

Two cross-cutting ESRSs

- Explain fundamental concepts from the CSRD.
- Set cross-cutting disclosure requirements applicable to all topics for:
  - governance;
  - strategy;
  - impact, risk and opportunity management; and
  - metrics and targets.
- Provide principles of disclosure and presentation structure.
- Establish transition options, including phasing-in.

For future release: Sector-specific ESRSs

- Additional standards to address sector-specific requirements are yet to be developed for later adoption.

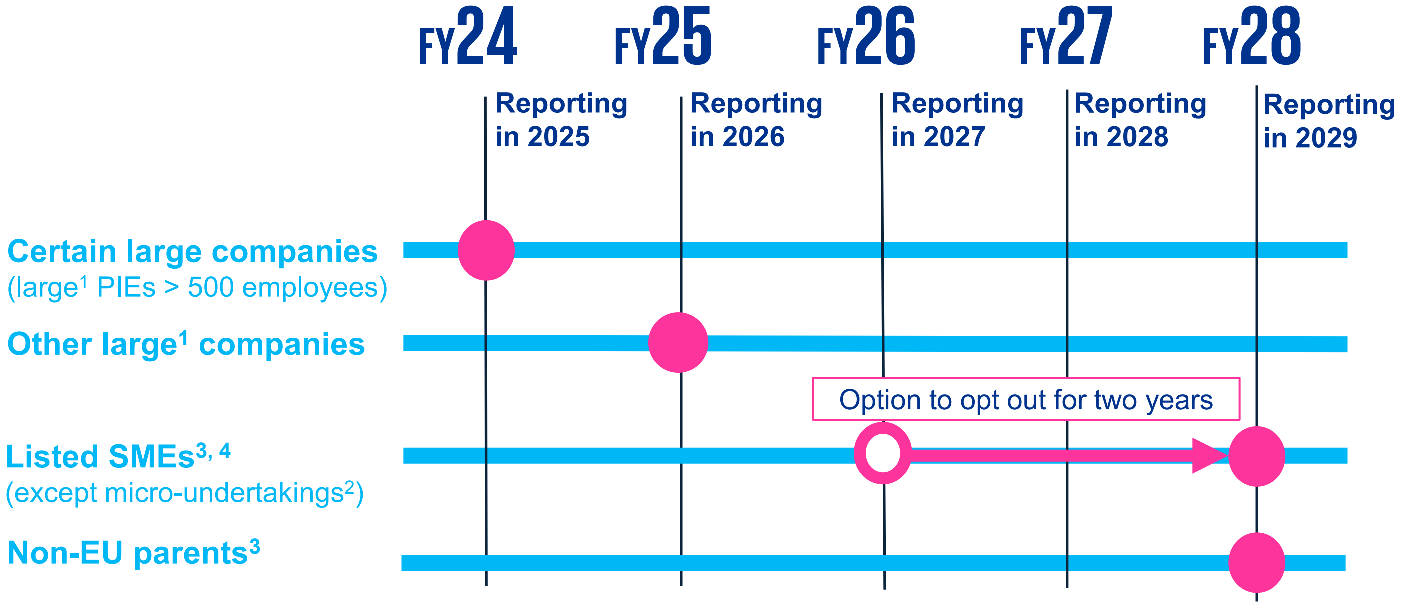


02 When and to whom will ESRSs apply?

When: ESRSs will apply for years beginning on or after 1 January 2024 (reporting in 2025). Phased introduction will start with public interest entities (PIEs) and companies with listed securities on EU-regulated markets which are large and have more than 500 employees (e.g. those already subject to reporting requirements under the NFRD).

Who: Ultimately, ESRSs will be applied by (group exemptions may apply):

- large EU companies[1];
- companies with listed securities on EU-regulated markets (except micro-undertakings[2]); and
- ultimate non-EU parent companies[3] with a combined group turnover in the EU of more than EUR 150 million.



1 Large companies are those that, on the balance sheet date, exceed two of the following three criteria (including EU and non-EU subsidiaries): 250 employees, net revenue of EUR 40m or total assets of EUR 20m.

2 Micro-undertakings are companies that do not exceed two of the following three criteria (including EU and non-EU subsidiaries): 10 employees, net revenue of EUR 700,000 or total assets of EUR 350,000.

3 Separate standards will be developed for SMEs and non-EU parent companies.

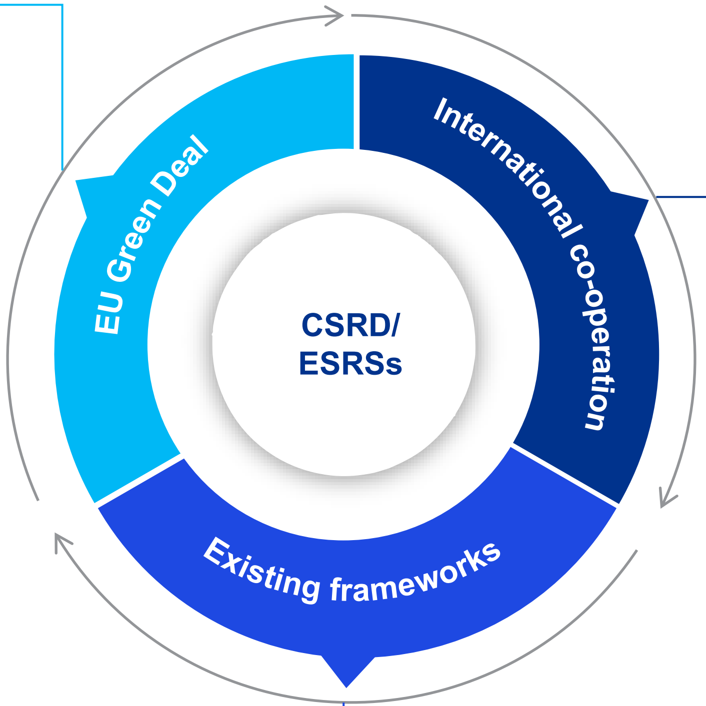
4 Small and non-complex institutions and captive insurers are treated like listed SMEs (opt-out option until 2028 does not apply unless they also meet the definition of SME).

EFRAG will develop and publish additional sets of ESRSs in due course. This will include sector-specific standards, standards for SMEs and a standard on non-EU parent companies.

03 What are ESRSs based on?

EU Green Deal

Designed to support the European Green Deal and to align with existing sustainability frameworks in the EU – e.g. SFDR and EU Taxonomy.



International co-operation

EFRAG, the EC and the ISSB collaborated when developing the standards, aiming to maximise interoperability between ESRSs and IFRS® Sustainability Disclosure Standards.

Existing frameworks

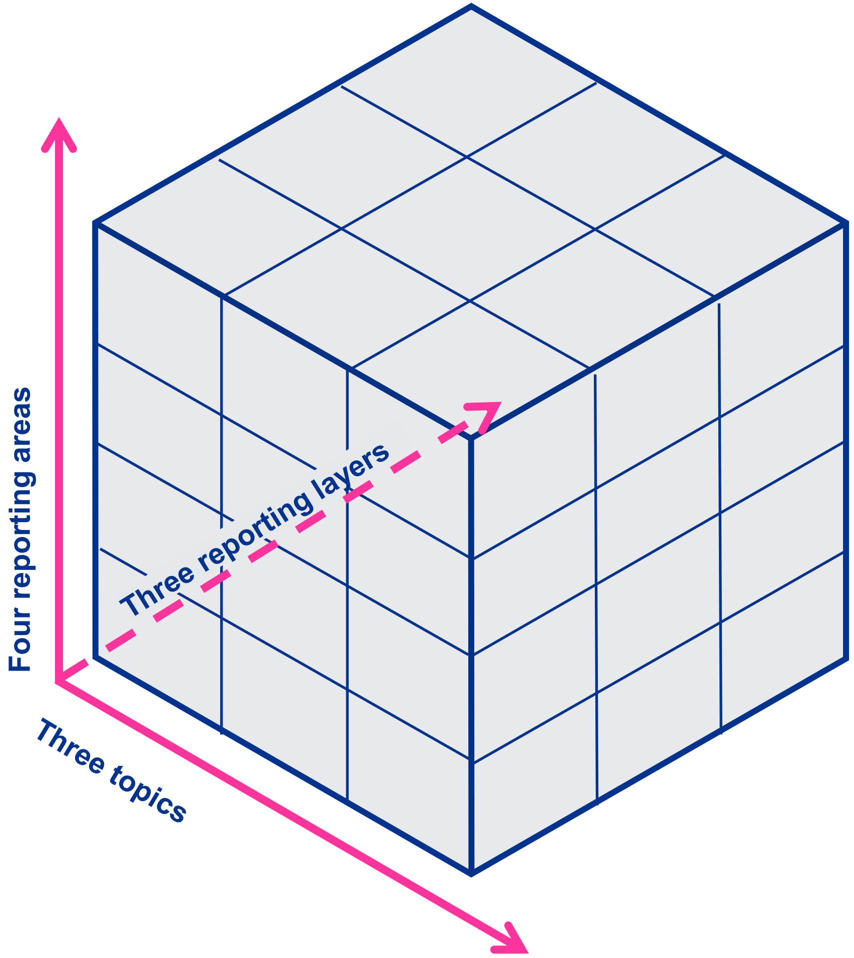
EFRAG developed the standards to align with the reporting areas used in the TCFD's recommendations. Many disclosure requirements are similar to or based on these recommendations and the standards developed by the GRI.

The CSRD requires ESRSs to consider global standard-setting initiatives for sustainability reporting to the greatest extent possible. However, ESRSs will go further where necessary to meet the EU's own ambitions and to be consistent with the EU's legal framework.

04 What will companies need to disclose?

Four reporting areas

- **Governance** – disclosures relating to the governance of sustainability topics will apply to all companies.
- **Strategy** – disclosure requirements in this area will apply to all companies and all topics.
- **Impact, risk and opportunity management** – disclosures on impacts, risks and opportunities will need to be provided for topics that are assessed to be material.
- **Metrics and targets** – specific sets of sector-agnostic metrics and targets will need to be disclosed for material topics by a company, regardless of its industry.



Three topics

- **Environmental**:
  - Climate change
  - Pollution
  - Water and marine resources
  - Biodiversity and ecosystems
  - Resource use and circular economy
- **Social**:
  - Own workforce
  - Workers in the value chain
  - Affected communities
  - Consumers and end users
- **Governance**:
  - Business conduct

Three reporting layers

- **Sector-agnostic disclosures** – disclosure requirements applying to all companies (for maximum comparability).
- **Sector-specific disclosures** (standards under development) – disclosure requirements applying to companies of a specific sector (for maximum relevance).
- **Company-specific disclosures** – additional disclosure requirements on material impacts, risks and opportunities not covered by topical standards.

05 What phase-in reliefs will apply?

The ESRSs include specific reliefs that companies could apply in the early years of adoption to support them in transitioning from existing methodologies or reporting frameworks.

The EC has introduced certain phasing-in measures to reduce the reporting burden for companies.

Year 1–2 relief

Comparative information is not required in year 1.

Phasing-in
Certain disclosure requirements will only become effective in the second or third year of reporting[1].

Year 1–3 reliefs

Other available frameworks could be used to develop relevant disclosures on material sustainability-related matters in advance of sector-specific ESRSs.

Information on the value chain need not be estimated and could be omitted if information is not available[2].

Company-specific disclosures developed prior to initial application may continue to be used.

Until 2030

EU subsidiaries of non-EU parents could choose to prepare only one combined report, including all those subsidiaries that would be obliged to report independently of the remaining group due to size or listing status.

1 Some phase-in measures are available to all companies, others only to companies with less than 750 employees.

2 This relief is not applicable to datapoints relevant for other EU laws or where it relates to internal information. It includes both upstream and downstream information.

06 What is double materiality?

Company-specific materiality assessments

Double materiality refers to two dimensions of materiality – ‘financial’ and ‘impact’.

Companies will need to perform materiality assessments for both dimensions and report matters that are material in either dimension.

Companies will be able to conclude that information is immaterial on the level of a topical standard, of an individual disclosure requirement or even of a single datapoint.

Compared with the draft ESRSs developed by EFRAG, the EC has reduced the number of disclosure requirements that are always mandatory independently from the company-specific materiality assessment. The only remaining disclosure requirements that are always mandatory are those required by ESRS 2 *General Disclosures*.

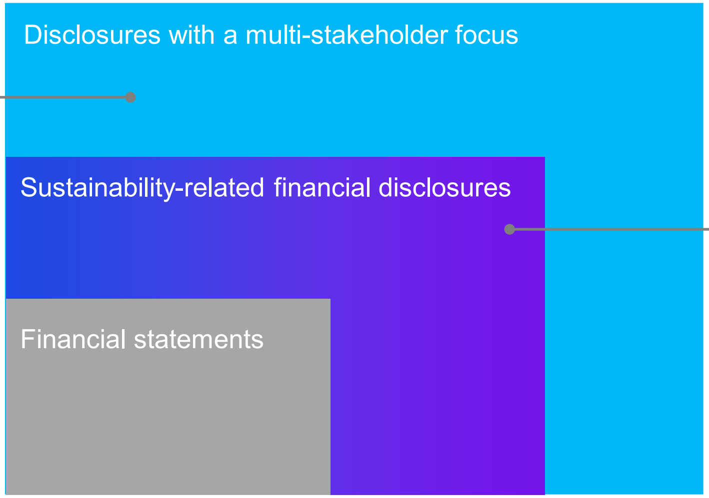
Impact materiality

Under the ESRSs, impact materiality will require disclosure of sustainability-related matters that relate to a company’s material actual or potential, positive or negative, impacts on people or the environment over the short, medium or long term.

Application requirements in ESRS 1 *General Requirements* specify the steps that a company needs to consider to assess impact materiality.

This assessment includes impacts in a company’s upstream and downstream value chain.

Materiality will be assessed based on severity and likelihood of the impact.



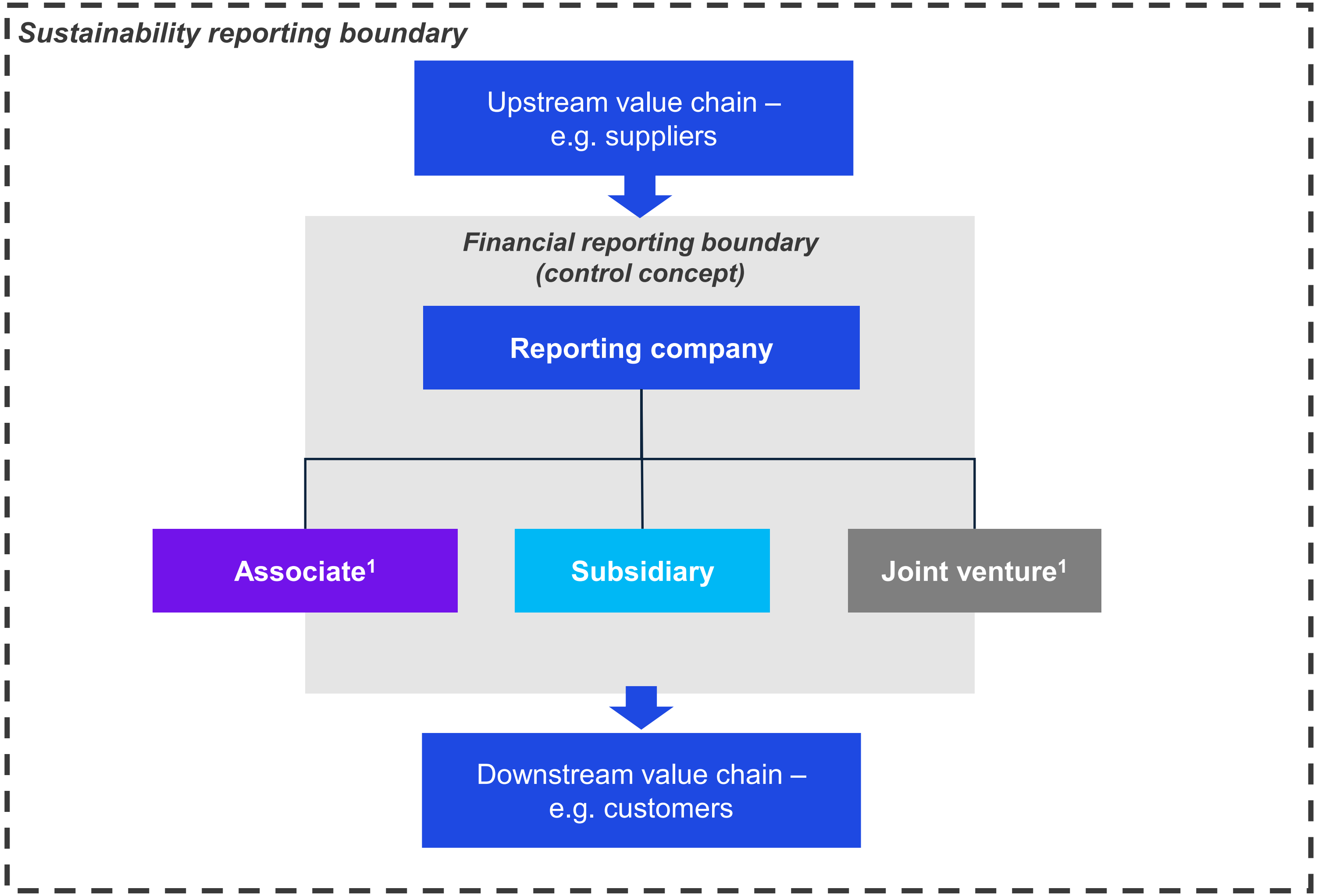
Financial materiality

Under the ESRSs, financial materiality will require disclosure of sustainability-related matters that (may) trigger material financial effects on a company’s development – e.g. cash flows, financial position or financial performance – in the short medium or long term.

This assessment will not be limited to matters within the company’s control.

Materiality will be assessed based on likelihood and (potential) size of the financial effect.

07 What reporting boundary do you need to consider?



Reporting boundary for sustainability reporting

The reporting boundary will be based on the financial statements – but expanded to cover material impacts, risks and opportunities related to the upstream and downstream value chain.

If information from the value chain is not available, then a company will use estimated data using all reasonable and supportable information. In the first three years of application, the ESRSs will allow transitional measures if information cannot be obtained.

The ability to obtain the necessary data depends on various factors – e.g. the contractual arrangements in place and the level of control over the value chain.

1 Equity investments and joint ventures may form part of the upstream or downstream value chain.

08 What if you have already adopted other frameworks?

Build and adapt

- Identify conceptual differences from existing frameworks by comparing definitions, guiding principles and the basis of preparation, as well as the principles of cross-cutting requirements.
- Assess the scope of the ESRSs. Because they may be significantly broader than any existing sustainability reporting framework, companies that adopt other frameworks will need to identify any gaps and assess how to fill them.
- Map how specific disclosure requirements in the ESRSs differ from those in the existing frameworks.
- Identify where additional data will be needed and whether frameworks will allow collaborative reporting or require the company to issue two separate reports.

Existing sustainability-related information set

↓

Refocus and supplement as necessary

Align definitions and methodologies	Reassess materiality
Identify and assess gaps	Expand the reporting boundary

Items to consider if previously adopted TCFD

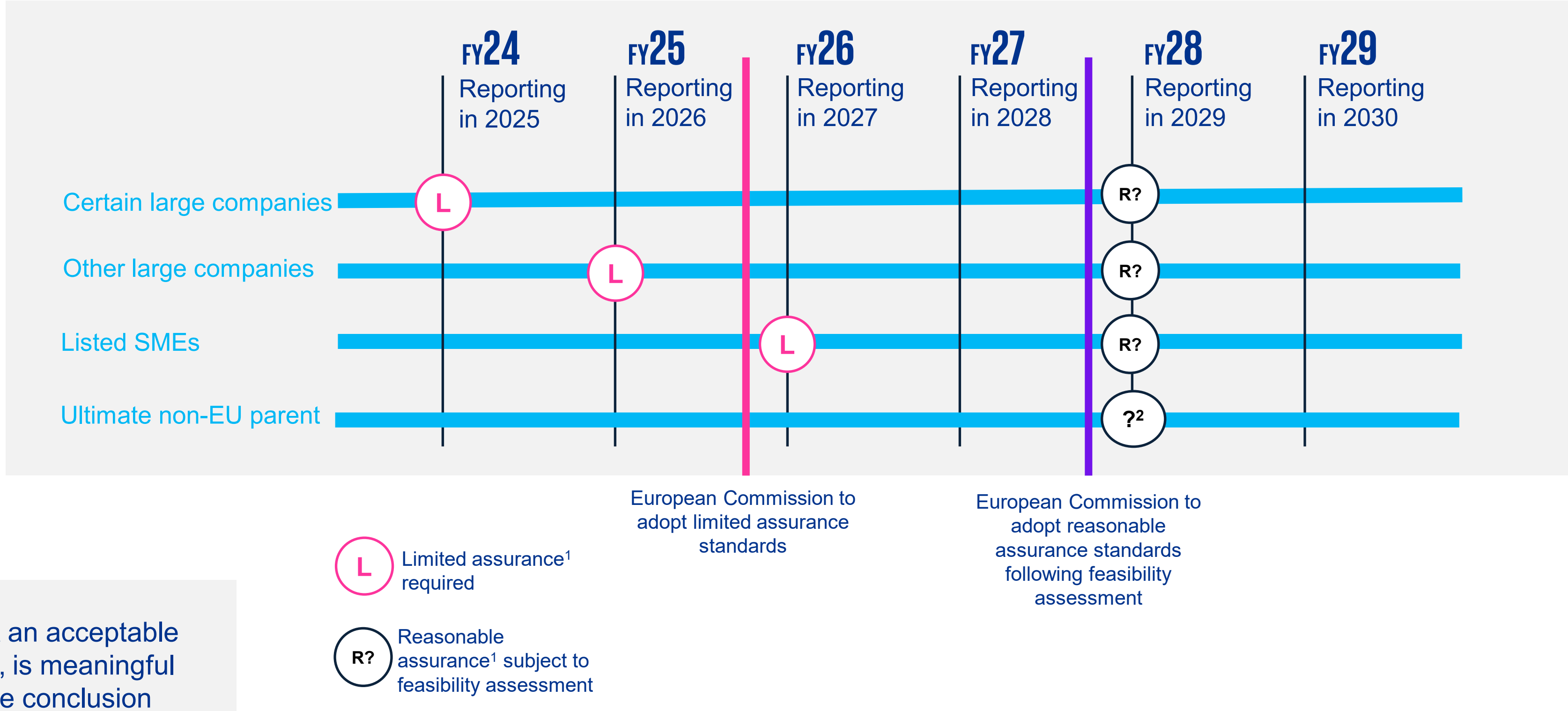
- The scope of ESRSs is broader than the TCFD recommendations because they apply the double materiality concept; the TCFD applies a materiality concept focused on investors. The TCFD focuses on climate only, so companies will need to significantly expand their disclosures on other environmental topics as well as social- and governance-related disclosures.

Items to consider if previously adopted GRI standards

- Disclosure requirements are partly based on GRI standards and EFRAG has cooperated with GRI to aim for alignment.
- Under the ESRSs, companies could include disclosures based on GRI standards when developing their company-specific disclosures.

09 What about assurance?

- The CSRD requires assurance across all topics:
  - Limited assurance from the date of initial reporting
  - Ambition to move to reasonable assurance at a future date
- Member states may choose to allow assurance over sustainability reporting to be separate from the financial statement audit – i.e. by a separate auditor or independent assurance provider.



Limited assurance is a level of assurance at an acceptable level that, based on professional judgement, is meaningful for the intended users. It results in a negative conclusion (i.e. ‘nothing has come to our attention to indicate that the information is materially misstated’).

Expressing reasonable assurance requires the assurance provider to obtain sufficient appropriate evidence to conclude that the sustainability-related information is prepared, in all material respects, in accordance with the applicable reporting criteria (positive conclusion).

1 Read more about ESG Assurance in Audit. The assurance requirements will have no bearing on a company’s responsibility to report accurate information from the first reporting year – e.g. limited assurance does not mean limited reporting.

2 Assurance will be based on jurisdictional requirements of the third country parent or that of a member state. In the absence of an assurance opinion, the company would need to issue a statement indicating this.

10 What do you need to do now?

1 Understand the impact

- Understand when, where and how the CSRD scoping requirements will impact your company and wider group.
- Understand how the ESRS requirements differ from your current reporting.

2 Determine what is material

- Understand the scope and breadth of your value chain.
- Undertake a double materiality assessment to determine which topics are relevant to report on, following the processes set out in the ESRSs.
- Decide what information is material about those topics from an impact and financial perspective.

3 Assess maturity

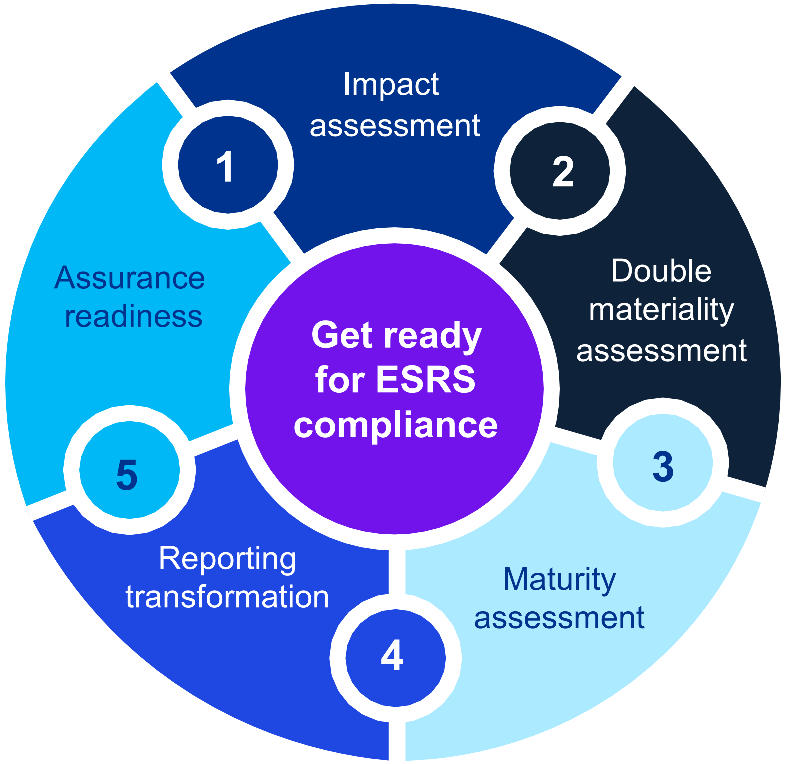
- Assess the maturity of processes, the control environment, data model and policies.
- Understand the current distribution of roles, available knowledge and capacity.

4 Transform reporting

- Design the future state of your reporting – including designing the most efficient reporting structure to meet group and individual company needs.
- Develop and deploy your target operating model, including training as well as support for change management.

5 Get ready for assurance

- Assess the control environment, data quality and availability of sufficient documentation to support assurance.
- Rectify issues ahead of the formal assurance process.



Abbreviations and key terms

CSRD

The EU's proposed Corporate Sustainability Reporting Directive, amending and significantly expanding the existing requirements for sustainability reporting in the EU under the NFRD

EC

European Commission

EFRAG

European Financial Reporting Advisory Group, which is mandated by the European Commission responsible for developing ESRSs

ESRS

European Sustainability Reporting Standards as published by the EC as of 28 July 2023[1]

EU Taxonomy

The EU's framework to facilitate sustainable investment (Regulation (EU) 2020/852)

GRI

Global Reporting Initiative

ISSB

International Sustainability Standards Board

NFRD

The EU's Non-Financial Reporting Directive (Directive 2014/95/EU)

SFDR

The EU's Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088)

TCFD

Task Force on Climate-related Financial Disclosures

1 In July 2023 the European Commission (EC) published the final text of its first set of ESRSs. The EU Parliament and the EU Council now have a period of up to potentially four months to object. If they raise no objections then this first set of ESRSs will apply for the first companies for FY 2024.

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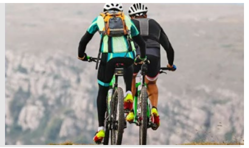
Whether you are new to sustainability reporting or a current user, you can find digestible summaries of recent developments and more detailed guidance on the current proposals.

ISSB | Sustainability reporting resource centre

Tracking the development of IFRS Sustainability Disclosure Standards

ESRSs | Sustainability reporting resource centre

Practical guidance on the ESRSs



ISSB priorities

Understanding the future focus

ESG reporting

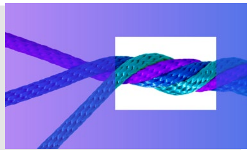
US resources for financial reporting professionals

First Impressions – IFRS S1 and IFRS S2

Insights and illustrative examples

Comparing sustainability reporting proposals

Comparing proposals from the ISSB, EU and US



Read the global KPMG Impact Plan

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