A&L Goodbody

ESG & SUSTAINABILITY

Sustainability reporting standards series

Part 3 – Mandatory disclosures

In the first instalment of our advisory series we provided an overview of the draft European Sustainability Reporting Standards (**ESRS**). In the second instalment we focused on the first of the draft standards, ESRS 1, which details the general requirements for reporting in line with the ESRS. We also summarised the information entities need to consider when preparing and presenting their sustainability statements to comply with the reporting obligations introduced by the Corporate Sustainability Reporting Directive (**CSRD**)[1]. In this, our third instalment, we focus on the current draft of ESRS 2, which sets out 'General Disclosures' in respect of a reporting entity's sustainability statements.

9 MIN READ

[1] *Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting*

Cross-cutting standards

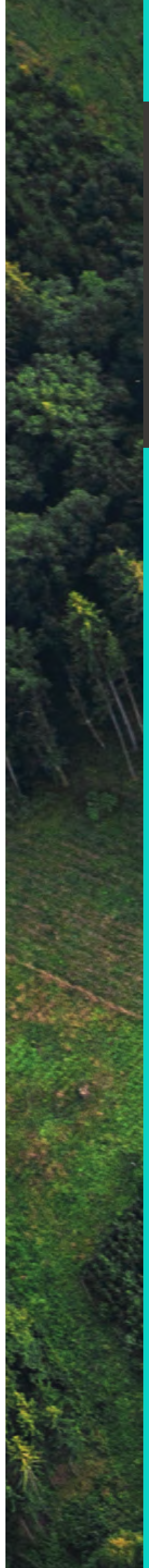
By way of reminder, the European Financial Reporting Advisory Group (**EFRAG**) has been tasked with preparing the European Sustainability Reporting Standards. The initial set of sector agnostic standards has been prepared with drafts sent to the European Commission for adoption prior to the end of June 2023. This set contains 12 separate standards (see Figure 1): 10 topical standards – meaning they relate to specific environmental, social or governance topics; and two cross-cutting standards – meaning they apply across all sustainability matters.

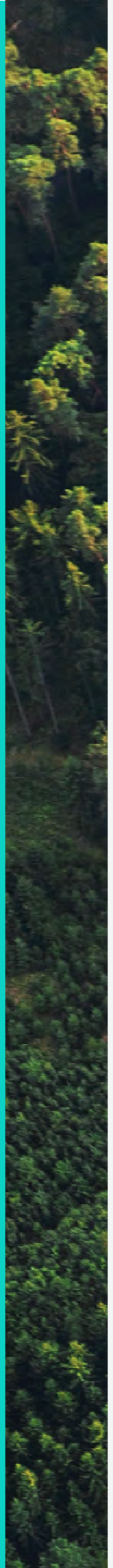
ESRS 2 is the second cross-cutting standard and sets out the general disclosures that reporting entities need to include within their sustainability statements. For more information on ESRS 1, see the second instalment of this series.

EFRAG states that understanding the two cross cutting standards is “critical” to understanding the architecture of the ESRS framework as a whole, and ultimately to ensuring that reporting entities prepare and publish relevant and comprehensible sustainability statements. This, of course, is intended to ensure that the EU’s goal to standardise sustainability reporting information for stakeholders is met and supports a transition to more sustainable business practices.

Figure 1

Cross-Cutting Standards				
ESRS 1 General Requirements		**ESRS 2** General disclosures		
Topical Standards				
Environment				
ESRS E1 Climate Change	**ESRS E2** Pollution	**ESRS E3** Water and marine resources	**ESRS E4** Biodiversity and ecosystems	**ESRS E5** Resource use and circular economy
Social				
ESRS S1 Own workforce	**ESRS S2** Workers in the value chain	**ESRS S3** Affected communities	**ESRS S4** Consumers and end-users	
Governance				
ESRS G1 Business conduct				





Materiality assessment

The disclosure requirements set out in ESRS 2 are mandatory, meaning they must be disclosed by all entities required to prepare sustainability statements regardless of the results of the materiality assessment (for more information on the materiality assessment requirements, see the second instalment of this series). There are other mandatory disclosure requirements that companies also need to be aware of:

- the data points prescribed in topical ESRS that are listed in Appendix C of ESRS 2 (List of data points in cross-cutting and topical standards that are required by EU law) which stem from other EU legislation
- ESRS E1 on climate change and
- for undertakings with 250 or more employees certain disclosure requirements in ESRS S1 on 'Own Workforce' (items 1 to 9 of ESRS S1 only)

Noting that these disclosure requirements are not the focus of this article which is dedicated to the disclosure requirements set out in ESRS 2.

Four pillar approach

The structure of the ESRS was amended by EFRAG to reflect responses received on the initial exposure drafts, made public in 2022. The current draft standards now take a four pillar approach to the structure of the ESRS framework, intended to align with the structure of international sustainability reporting frameworks including the Task force for Climate related Financial Disclosures (**TCFD**) recommendations and the International Sustainability Standards Board (**ISSB**) draft IFRS sustainability standards.

The four pillars are:

governance	strategy
impact, risk and opportunity management	metrics and targets

This four pillar approach essentially lays out the format that each of the standards follows in terms of structure and content. Generally the information sought under each of the four pillars is referred to as a disclosure requirement, each of which contains more granular data points or sub-elements of the particular requirement. For example, Disclosure Requirement GOV-1 requires information on the role of the administrative, management and supervisory bodies to be disclosed in the sustainability statements as set out in paragraph 17 of ESRS while paragraphs 18 to 21 of ESRS 2 detail the specific information that is expected to be covered in this disclosure. For example, paragraph 19 states that

"The undertaking shall disclose the following information about the composition and diversity of the members of the undertaking's administrative, management and supervisory bodies:

a. classification of members between executive and non-executive
b. representation of employees and other workers
c. experience relevant to the sectors, products and geographic locations of the undertaking
d. percentage by gender and other aspects of diversity that the undertaking considers. The board's gender diversity shall be calculated as an average ratio of female to male board members, and
e. the percentage of independent board members."

Paragraph 19 sets out specific data points which need to be covered in the disclosure being prepared to comply with Disclosure Requirement GOV-1.

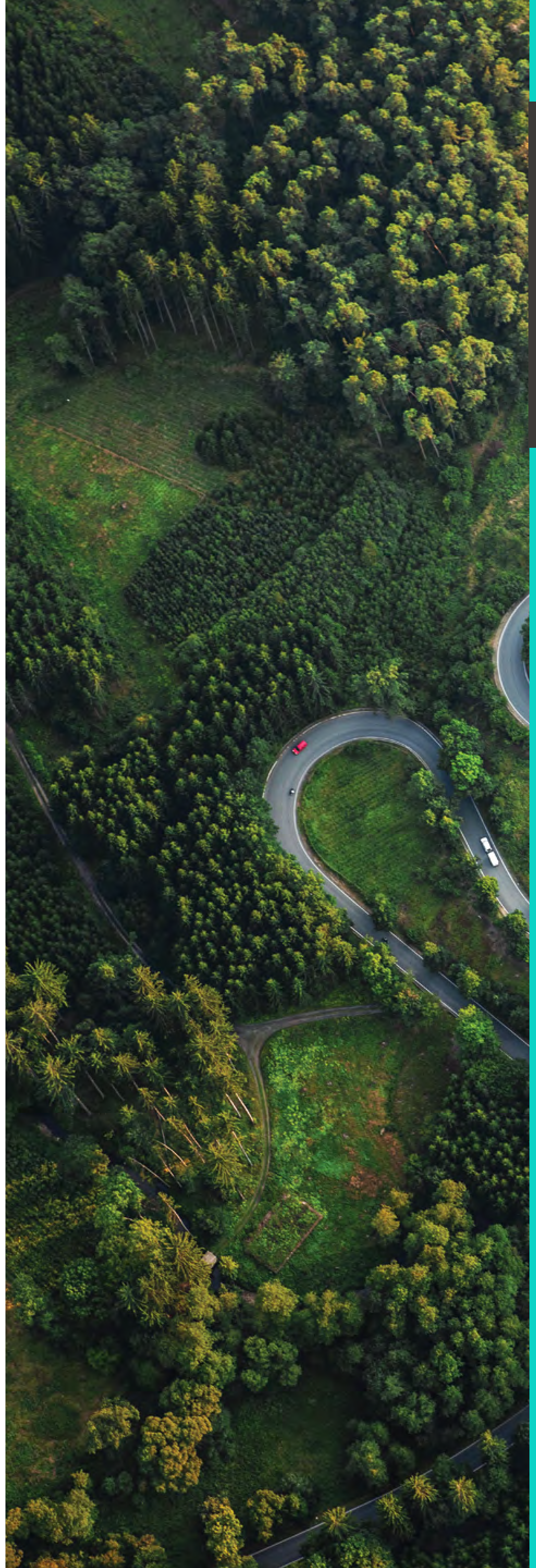
In addition, ESRS 2 contains four Disclosure Content requirements regarding policies, actions, metrics and targets. A Disclosure Content sets out the required content for the information that a company includes when it reports on policies, actions or targets, either pursuant to a Disclosure Requirement in an ESRS or on an entity-specific basis. We consider each of these Disclosure Content (**DC**) requirements below.

The disclosures required to be disclosed by companies in the sustainability statements to comply with the requirements of ESRS 2 are organised in accordance with the four pillars and set out as separate 'chapters' (see Figure 2). ESRS 2 also contains a separate chapter relating to the basis for preparation of the sustainability statements, see below for further details on these requirements.

The interoperation between ESRS 2 and the topical standards is addressed in detail in ESRS 2. For example, ESRS 2's chapter on metrics and targets set out requirements for a reporting undertaking to clarify the metrics it uses to track the effectiveness of its actions in managing material sustainability matters across disclosure topics, and to track the effectiveness of its policies and actions through targets. These requirements are discussed in more detail below.

Figure 2

General Disclosure Requirements				
Basis for preparation	**Governance**	**Strategy**	**Impact, risks and opportunity**	**Metrics and targets**
BP-1 – General basis for the preparation of the sustainability statements	**GOV-1** – Role of the administrative, management and supervisory bodies	**SBM-1**– Market position, strategy, business model(s) and value chain	**IRO-1** – Description of the processes to identify and assess material impacts, risks and opportunities	**DC-M** – Disclosure on the metrics in place with regard to each material sustainability matter
BP-2 – Disclosures in relation to specific circumstances	**GOV-2** – Information provided to and sustainability matters addressed by the undertaking's administrative management and supervisory bodies	**SBM-2** – Interests and views of stakeholders	**IRO-2** – Disclosure requirements in ESRS covered by the undertaking's sustainability statements	**DC-T** –Disclosure on the targets in place with regard to each material sustainability matter
	GOV-3 – Integration of sustainability-related performance in incentive schemes	**SBM-3** – Material impacts, risks and opportunities and their interaction with strategy and business models	**DC-P** – Policies adopted to manage material sustainability matters	
	GOV-4 – Statement on sustainability due diligence		**DC-A** – Actions and resources in relation to material sustainability matters	
	GOV-5 – Risk management and internal controls over sustainability reporting			



Chapter 1 – Basis for preparation

The first set of disclosure requirements in ESRS 2 cover the basis for preparation of the disclosure in an entity's sustainability statements contained in two separate disclosure requirements, BP-1 (General basis for preparation of the sustainability statements) and BP-2 (Disclosures in relation to specific circumstances).

BP-1 deals with the general basis for preparation of the statements, applies to all reporting entities, and provides that entities must disclose the basis for preparation of their sustainability statements, including the following elements:

"information on whether sustainability statements are prepared on a consolidated or individual basis (including a statement on the scope of consolidation and which undertakings are included); to what extent the sustainability statements cover the undertaking's upstream and downstream value chain information in line with ESRS 1 section 5.1 (discussed in more detail below); whether the undertaking has availed of the option to omit specific information corresponding to intellectual property, know-how or the results of innovation (in line with ESRS 1 section 7.7); and, where permitted by the relevant Member State, whether an undertaking's disclosure has relied on exemptions from disclosure of matters relating to an impending development or in the course of negotiation (as provided for in Articles 19a(3) or 29a(3) of the CSRD)."

By contrast, BP-2 requires disclosures only where specific circumstances apply to an entity. For example, when the entity has deviated from the medium- or long-term time horizons defined in ESRS 1 when preparing the sustainability statements. See Figure 3 for an overview of these specific circumstances. Where these circumstances do apply, an entity's sustainability statements must include disclosure on the effect of these circumstances on the preparation of those statements. Where these specific circumstances do not apply, entities are not required to report on these items.

Figure 3

BP-2	Disclosures in relation to specific circumstances
Time horizons	If an undertaking has deviated from the medium- or long-term time horizons defined by ESRS 1, the undertaking shall describe its definitions of these time horizons and the reasons for applying those definitions
Value chain estimation	If metrics include value chain data estimated using indirect sources the undertaking shall identify the metrics and describe the basis for preparation, resulting level of accuracy and (where applicable) planned actions to improve the accuracy of the data in the future
Sources of estimation and outcome uncertainty	If significant estimation or outcome uncertainty exists, the undertaking shall identify metrics it has disclosed that suffer from this uncertainty, disclose the sources and nature of the estimation and factors affecting the uncertainties, and when there is significant outcome uncertainty disclose information about the assumptions it makes about the future and other sources of significant uncertainty related to the disclosed information
Changes in preparation or presentation of sustainability information	If changes in the preparation and presentation of sustainability information occurs compared to previous reporting periods (such as the redefinition or replacement of a metric or target) the undertaking shall explain the changes, explain the reasons for those changes and provide restated comparative figures unless impracticable to do so (and where that is the case disclose that fact)
Reporting errors in prior period	If a material error exists in respect of a prior reporting period, the undertaking shall disclose the nature of the prior period error, the correction to the extent practicable, and where a correction is not practicable the circumstances that led to the existence of that condition and how and when the error has been corrected
Disclosures stemming from local legislation or generally accepted sustainability reporting pronouncements	If an undertaking includes information based on local legislation on generally accepted sustainability reporting pronouncements (see ESRS 1 section 8.2) in its sustainability statements, it shall disclose this fact with a precise reference to paragraphs of the standards applied where they are partially applied

Chapter 2 – Governance

Disclosure on governance generally is dealt with in two ways in the ESRS framework. ESRS 2 includes disclosure requirements regarding governance processes, controls and procedures in its governance chapter, split into five separate disclosure requirements - GOV-1, GOV-2, GOV-3, GOV-4 and GOV-5 (refer to Figure 4 for more information on these disclosure requirements). In line with the mandatory nature of the ESRS 2 disclosure requirements, these disclosure requirements are not subject to the outcome of a materiality assessment.

Separately, governance is also dealt with in ESRS G-1 (Business Conduct), which provides another lens on governance matters captured by the CSRD and deals with external facing matters such as: corporate culture and business conduct policies, the management of an undertaking's relationship with its suppliers and the prevention and detection of corruption and bribery. By contrast to the ESRS 2 Governance disclosure requirements, ESRS G-1 is subject to a materiality assessment (and thus not all disclosure requirements will be required of all undertakings disclosing against ESRS G-1). This means however that in order to obtain a full picture of an entity's disclosures on governance matters , users of the information will need to review the separate disclosures relating to both ESRS 2 and ESRS G-1 (to the extent disclosed in a particular entity's sustainability statements).

Figure 4

Item	Requirements
GOV-1	Undertakings to disclose the composition of the administrative, management and supervisory bodies including their roles and responsibilities and access to expertise and skill with regard to sustainability matters
GOV-2	Undertakings to disclose how the administrative, management and supervisory bodies are informed about sustainability matters and how these matters were addressed during the reporting period
GOV-3	Undertakings to disclose information about the integration of its sustainability-related performance in incentive schemes
GOV-4	Undertakings to disclose a "mapping" of the information provided in their sustainability statements about the sustainability due diligence processes
GOV-5	Undertakings to disclose the main features of their risk management and internal control systems in relation to the sustainability reporting process

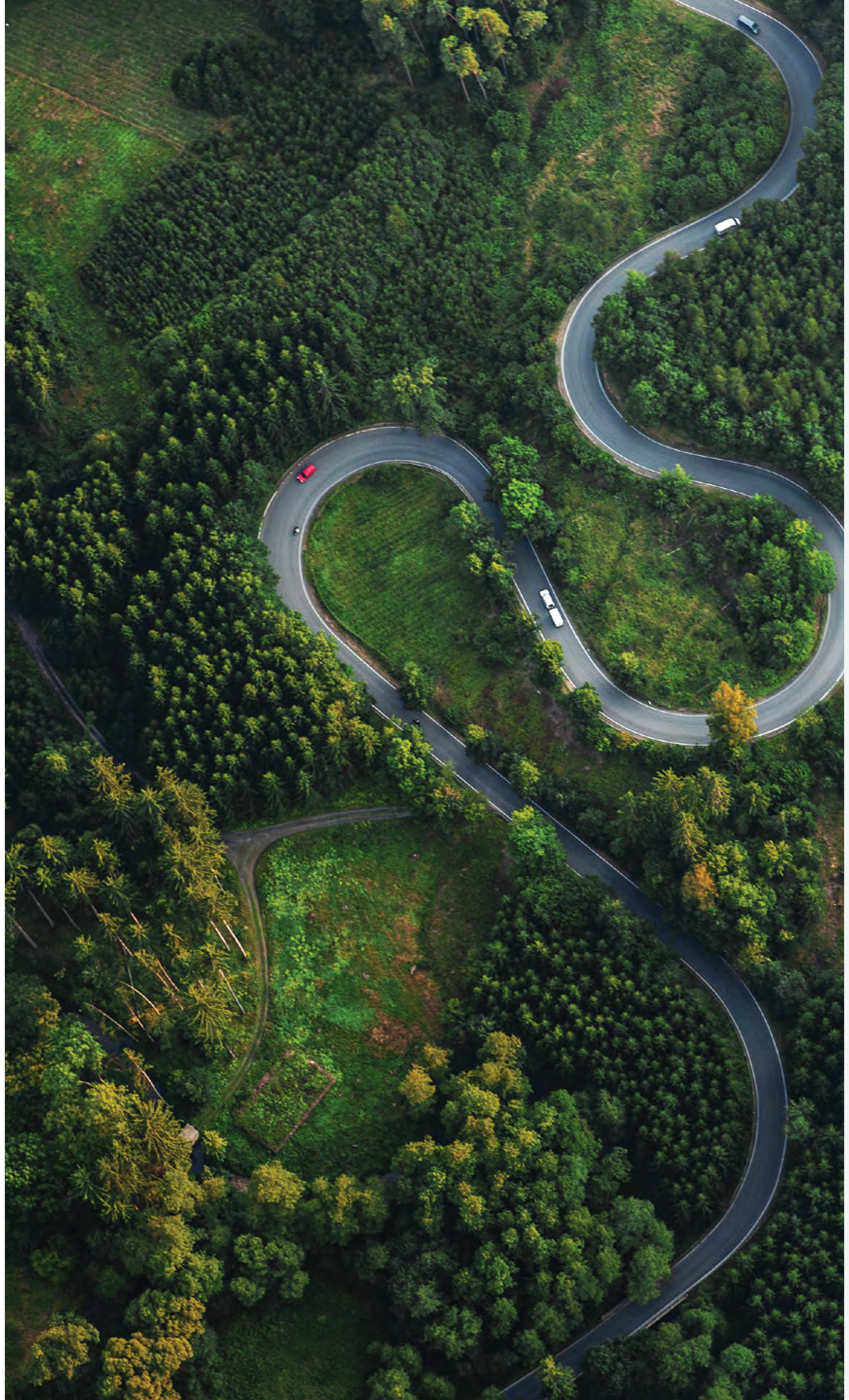
Chapter 3 – Strategy

This chapter requires entities to disclose information on the elements of an entity's strategy that relate to or affect sustainability matters, its business model(s) and its value chain, how the interests and views of its stakeholders are taken into account by its strategy, and the outcome of the reporting entity's assessment of what its material impacts, risks and opportunities are. As noted in our previous instalment on ESRS 1, some disclosure requirements require an entity to include information on its direct and indirect business relationships in the upstream and/or downstream value chain (**Value Chain Information**). Transitional provisions apply in respect of Value Chain Information which limits the extent of the information that is required to be disclosed for the first three years of an entity's sustainability reporting. Where an entity is unable to collect Value Chain Information it is permitted to estimate the information to be reported using all reasonable and supportable information such as sector average data and other proxies (subject to requirements to describe how and to what extent such estimates are included).

This chapter is divided into 3 separate disclosure requirements - SBM-1, SBM-2 and SBM-3 (see Figure 5 for more information on these disclosure requirements).

Figure 5

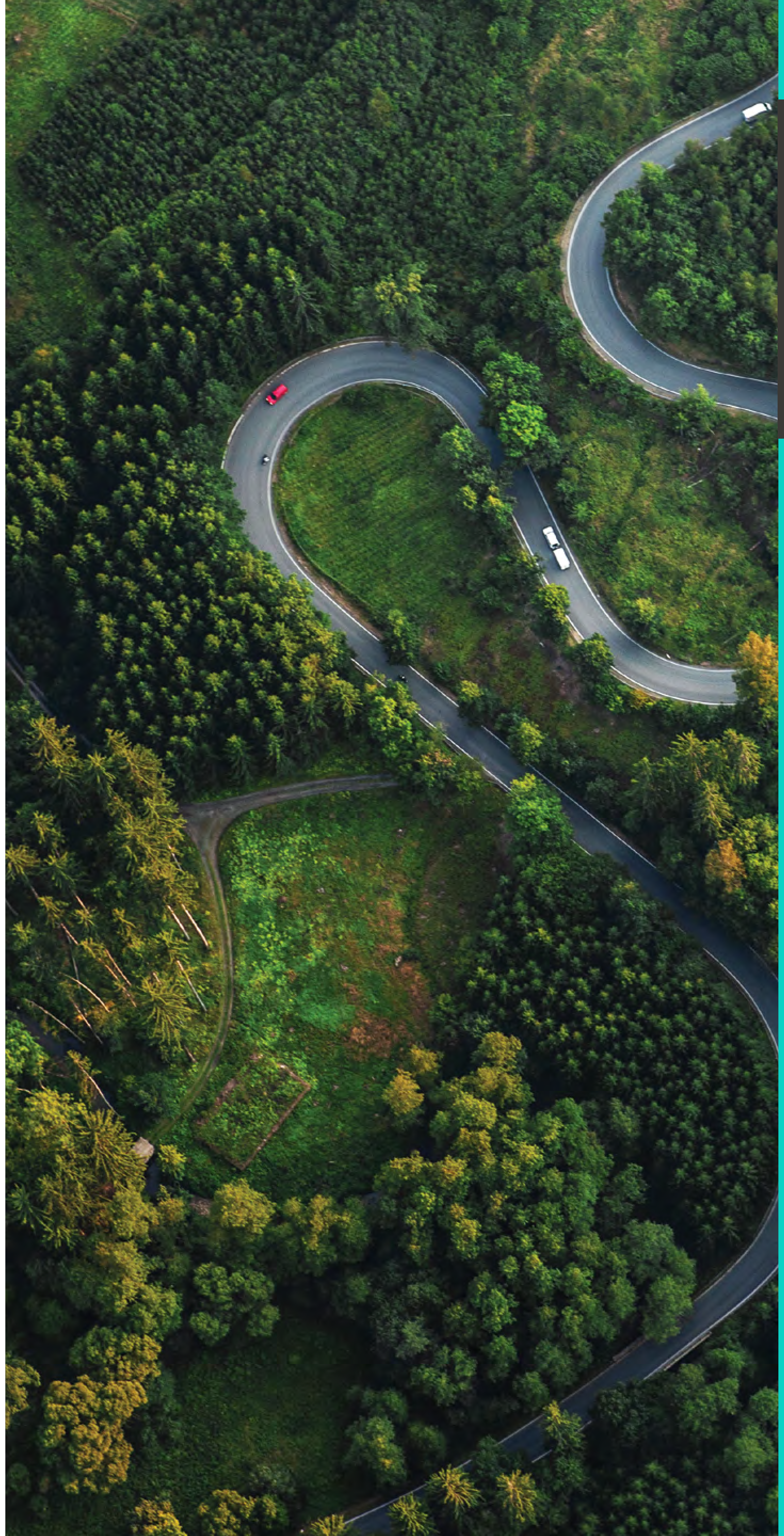
Item	Requirements
SBM-1	Undertakings to disclose their market position, the elements of their strategy that relate to or impact sustainability matters their business model(s) and value chain
SBM-2	Undertakings to disclose how the interests and views of their stakeholders are taken into account by the undertaking's strategy and business model(s)
SBM-3	Undertakings to disclose information about their material impacts, risks and opportunities and how they interact with their strategy and business model(s)



SBM-1 requires disclosure about an undertaking's market position, the elements of its general strategy that relate to or affect sustainability matters and the undertaking's business model(s) and key value chain to provide an understanding of the understaking's exposure to impacts, risks and opportunities and where they come from. It requires a description of significant products and/or services offered, significant markets and/or customer groups served, and headcount of employees by geographical areas. Where a product or service is banned (or potentially to be banned) in certain markets, this is required to be disclosed. If an undertaking is active in certain sectors (including fossil fuels, chemical production, controversial weapons manufacture and the cultivation of tobacco) it must disclose that fact and indicate revenues related to those sectors.

SBM-2 is described by EFRAG as a "due diligence inspired" disclosure requirement. It requires entities to disclose a description of its stakeholders, whether it engages with them and if so how the outcome of the engagement is taken into account by the undertaking. An entity is also required to disclose its understanding of the interests and views of stakeholders in relation to its business model(s) and strategy to the extent these were analysed during the undertaking's sustainability due diligence and materiality assessment processes (see our discussion of IRO-1 below). In common with much of the sustainability statements, where an entity has amended or expects to amend its strategy and or business model(s) to address the interests of its stakeholders this must also be disclosed.

SBM-3 is seen as particularly crucial to the preparation of sustainability statements by EFRAG. It has been aligned with IFRS S-1. SBM-3 requires an entity to disclose its **material impacts, risks and opportunities** (**IROs**) and how they interact with its strategy and business models. It is important to note that this means that disclosures against the requirements in SBM-3 **do require an undertaking to enter a materiality assessment**. Disclosure is required to address both impact materiality and financial materiality (double materiality) as discussed in previous instalments of our series on reporting standards. Disclosure required in respect of an entity's material IROs include the nature of the IROs, the outcome of an entity's materiality assessments in respect of these IROs including a time horizon during which they may be expected to materialise and changes to the previous reporting year. A reporting entity must also consider and disclose information around the resilience of its strategy and business model(s) relating to sustainability. The decision around which IROs are material will drive which topical standards are material for a particular company, which is why EFRAG views SBM-3 as being at the heart of ESRS 2, and why it notes that specifications in topical standards which require reference to SBM-2 and SBM-3 must be read in conjunction with ESRS 2 and "applied when material".

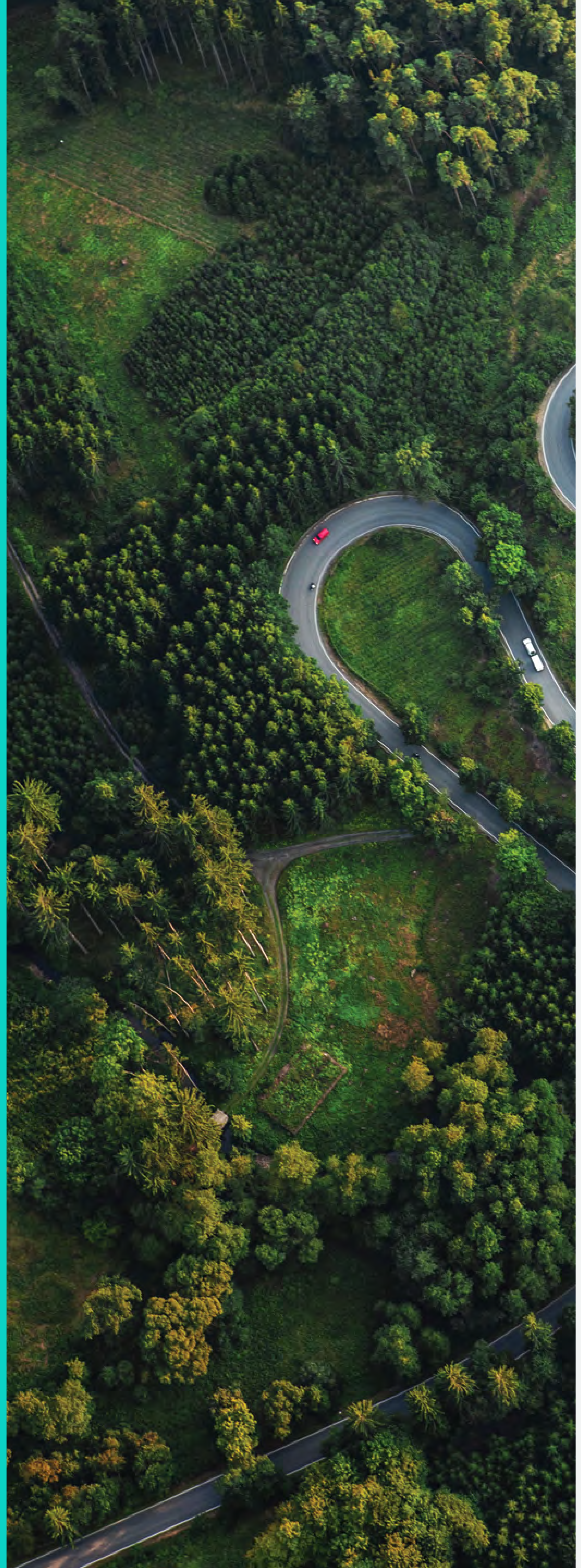


Chapter 4 – Impact, Risk and Opportunity Management

This chapter requires entities to report on their impact, risk and opportunity management. It is divided into four with two separate disclosure requirements – IRO-1, IRO-2 and two DCs (see Figure 6 for more information on these disclosure requirements and Disclosure Contents).

Figure 6

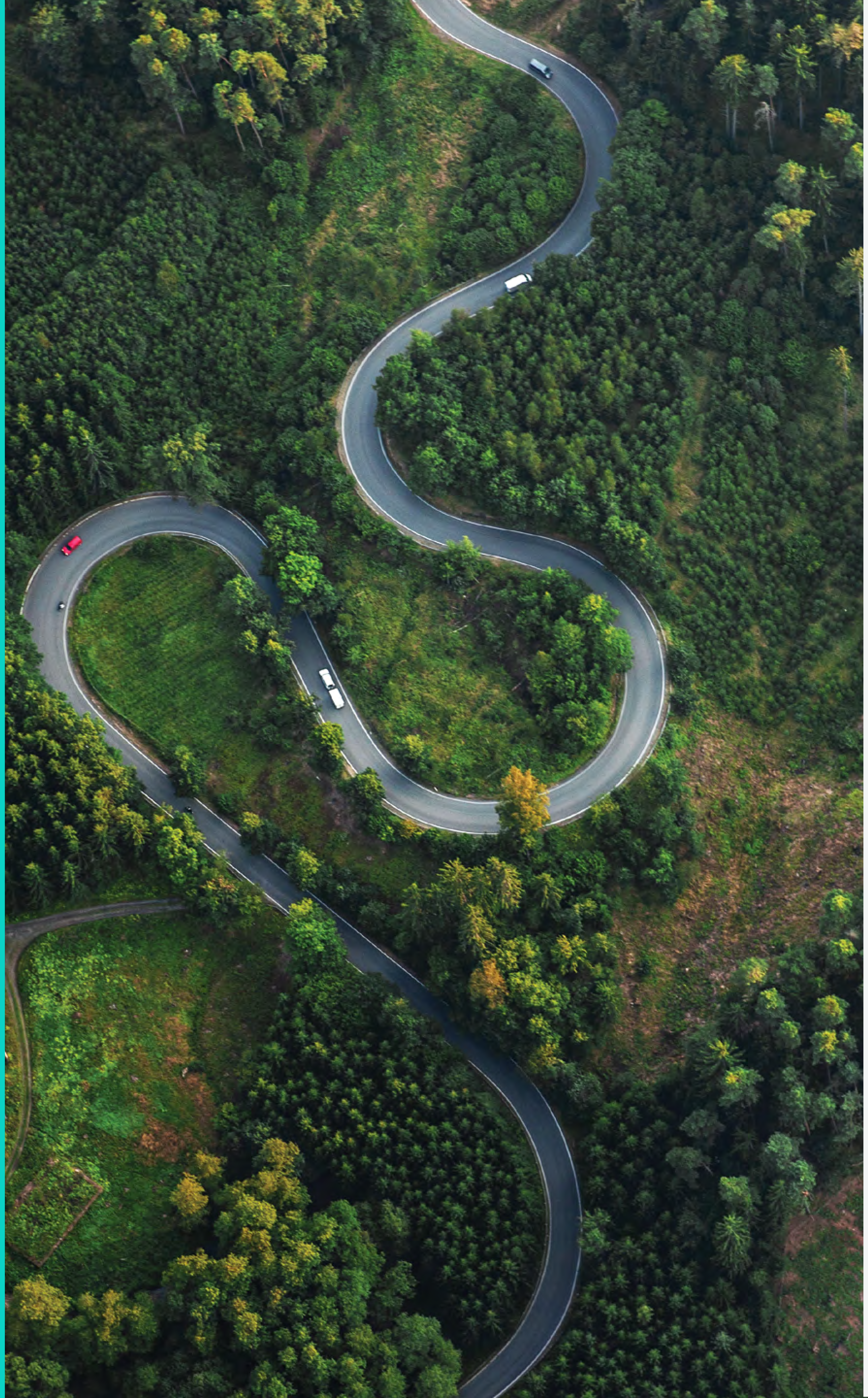
Item	Requirements
IRO-1	Undertakings to describe the processes it uses to identify its impacts, risks and opportunities and through which it assesses which of these IROs are material
IRO-2	Requires an undertaking to include a list of all disclosure requirements complied with in preparing its sustainability statements (to be read in conjunction with ESRS 1 Chapter 8 – *Structure of sustainability statements*)
DC-P	Sets out the information that undertakings need to disclose in relation to the policies used to manage material sustainability matters
DC-A	Sets out the information that undertakings need to disclose in relation to the actions through which they manage each material sustainability matter including actions plans and resources allocated and/or planned



IRO-1 clearly interacts closely with the previous chapter in that it requires a description of the methodology and assumptions applied in ascertaining the IROs that pertain to a company and how an entity has formed views as to which of them are material. The item requires an overview of the process to identify potential impacts on people and the environment, and the process to identify which sustainability-related risks may have financial impacts. This requires a detailed description of how the materiality assessment was performed, a description of the how the internal decision-making is organised, and of course a comparison as to how information being reported in the statement in question has changed from that of the previous year(s). IRO-1 must be disclosed (that is, it is not itself subject to a materiality assessment). IRO-2 requires an entity to prepare what amounts to a sustainability statement "content index". An explanation of any topics that have been omitted is required (for example, where an undertaking has omitted disclosure in respect of ESRS E2 (Pollution) it is required to include a brief explanation as to why it has arrived at an assessment that this topic is not of material significance to the undertaking in question).

DC-P and DC-A are requirements relating to disclosure content rather than separate disclosure requirements. These require companies to disclose information on their policies and actions to manage material sustainability matters. This information will sit alongside the disclosure requirements prescribed by the specific topical ESRS and where no policies have been adopted or actions have been taken in relation to the specific sustainability matter, this needs to be disclosed together with the reasons for this.

In essence, DC-P requires a company to set out its policies for managing risks and pursuing opportunities that it identifies as material, in the disclosure it prepares against each topical standard (or where an action or policy targets IROs that span several topics, it may cross refer to its disclosure against one such topical standard). Descriptions should include key contents of any policy including its general objectives, the scope of any policy and who in the organisation is in charge of implementing the policy. If no such policy exists, that must be disclosed along with whether and when a policy is expected to be implemented. Similarly, DC-A requires disclosure in respect of key actions in implementing any policy if such is required (including actions taken and time horizons for expected further action). Where actions require significant OpEx or CapEx this is to be disclosed, by reference to financial statements.



Chapter 5 – Metrics and targets

This chapter is divided into two DCs and sets out the information required to be included when an entity discloses information on the metrics and targets it uses for each sustainability matter it has determined to be material. Similarly to the disclosures contemplated by DC-P and DC-A, disclosures against these items need to be made alongside the relevant disclosure requirements on topical standards.

DC-M is intended to provide an understanding of the metrics an entity uses to track the effectiveness of its actions to manage sustainability matters. An entity is required to disclose any metrics it uses to evaluate performance and effectiveness (including those defined in the topical standards themselves, and entity-specific metrics whether developed by the undertaking itself or by reference to external sources). A company must disclose, for each metric, whether it is validated by an external body other than the assurance provider. It must also use meaningful, clear and precise labels for metrics used. If currency is used as a metric, this must be done in the presentation currency by reference to the undertaking's financial statements.

DC-T contains requirements for the content of disclosures about an entity's targets with respect to each material sustainability matter. The intention is to provide an understanding of when and how a company tracks the effectiveness of its actions to address material IROs and to provide "measurable time-bound outcome-oriented" targets for an entity to meet its policy objectives for expected results for people and the planet. Reference is required to stakeholder interests and how these are dealt with in target setting. Where no such targets exist, an entity is required to report on whether they will be adopted in future (and if so, when) and to provide an explanation as to whether and if so how it tracks the effectiveness of its policies and actions in relation to material sustainability related IROs.

Conclusion

ESRS 2 (together with ESRS 1) sets out the details on how to comply with the sustainability reporting obligations introduced by the CSRD. The critical point we take away from the drafting and structure of ESRS 2 is the level of complexity, detail and of critical thinking that will be required as organisations begin to gather the information required to be reported in sustainability statements. Drawing conclusions as to materiality, what is an impact, what is a risk and what is an opportunity will require clear thinking and the ability to understand and assimilate complex data points which will be in a state of constant flux. While there is no doubt that there will be a steep learning curve for all stakeholders, the standardisation of information and the ability to compare sustainability statements (and to assess the metrics and data used in compiling them) will present an invaluable opportunity for us all to ensure that we continue to move toward ever more sustainable business practices.

A&L Goodbody

Key contacts

Jill Shaw
ESG & Sustainability Lead
+353 1 649 2072
jishaw@algoodbody.com

Liam Murphy
Senior Knowledge Lawyer
+353 1 649 2169
limurphy@algoodbody.com

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