A&L Goodbody

ESG & SUSTAINABILITY

Sustainability reporting standards series

Part 1 – An overview of the draft European Sustainability Reporting Standards

On 16 December 2022, the Corporate Sustainability Reporting Directive (**CSRD**) was published in the Official Journal of the EU.

This triggers the start of an 18 month period (6 July 2024) within which EU member states must enact national legislation transposing the directive.

6 MIN READ

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CSRD[1] builds on the sustainability reporting requirements introduced by the Non-Financial Reporting Directive (**NFRD**)[2] which itself amends the Accounting Directive[3]. These reporting obligations were referred to in the NFRD as non-financial reporting requirements however it has been generally recognised since this directive entered into force in 2014 that such information does have financial relevance. As such, the general view is that the term "sustainability information" is a more accurate description of the information being sought from companies required to report under this legislation.

Existing requirements under NFRD

By way of reminder, NFRD introduced a requirement on in scope entities to report information on, as a minimum, environmental, social and employee matters, respect for human rights, and anti-corruption and bribery matters. In scope entities are required to disclose information under the following reporting areas:

- business model
- policies (including due diligence processes implemented)
- the outcome of the policies
- risks and risk management
- key performance indicators relevant to the business

with information to be set out in the relevant entity's management report. It is useful to note that under NFRD there are currently certain exemptions relating to the location of this disclosure which will no longer apply under the CSRD. In accordance with the provisions of the CSRD, sustainability information will need to be disclosed in a clearly identifiable, dedicated section of the management report and processed for ease of digital access.

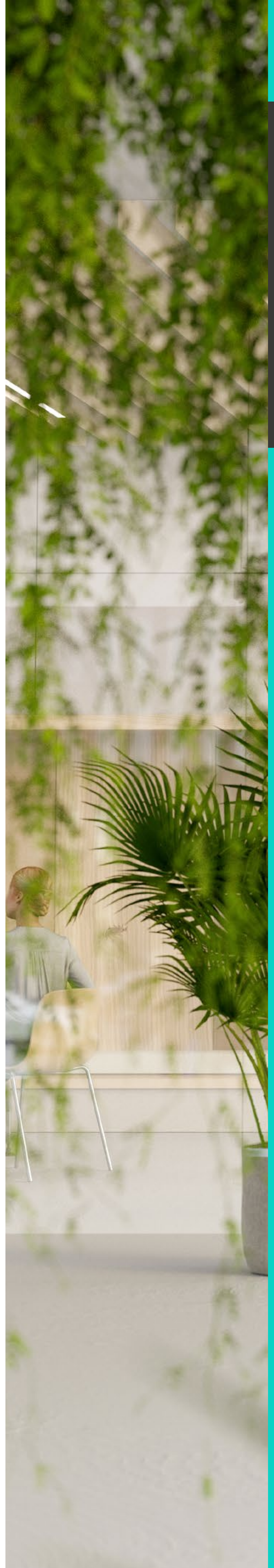
It is acknowledged that the level of detail and format of the disclosures currently provided by in scope entities varies widely. It can accordingly be difficult for stakeholders to compare the progress of organisations against their peers as a result of the assortment of voluntary frameworks and standards being used as a basis for this reporting. This lack of standardisation and the need for reliable, comparable and relevant sustainability information brought home to policy makers the importance of developing mandatory sustainability reporting standards to allow for reliable comparability.

Introduction to the ESRS

Our article from August 2022 provides an overview of the main provisions of the CSRD and notes that the number of entities required to provide sustainability information in their management report is significantly increased under CSRD.

This article focuses on one of the key features of the CSRD, the creation of mandatory European Sustainability Reporting Standards (**ESRS**). While CSRD itself only sets out high level details in respect of the standards such as those set out in Figure 2 below, the more granular information requirements will be set out in delegated acts to be adopted by the European Commission with the first set of ESRS, the sector agnostic standards which will apply to large companies, set to be adopted before the end of June 2023. The European Financial Reporting Advisory Group (**EFRAG**) has been tasked with preparing the draft ESRS and on 22 November 2022, EFRAG delivered the first set of draft ESRS to the European Commission as technical advice. In accordance with the amendments to Article 49 of the Accounting Directive introduced by CSRD, the European Commission is required to request the opinion of the European Securities and Markets Authority (**ESMA**), the European Banking Authority (**EBA**) and the European Insurance and Occupational Pensions Authority (**EIOPA**) on the technical advice prepared by EFRAG. In addition, the European Commission has to consult 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 on this technical advice provided prior to the adoption of each of the delegated acts.

The first set of ESRS exposure drafts were made available for public consultation by EFRAG in April 2022 with comments sought by 8 August 2022. 13 exposure drafts were prepared initially but as a result of the comments received this has been reduced to 12 draft ESRS which were provided to the European Commission on 22 November 2022 together with a cover letter, due process note, explanatory note and annex, a cost benefit analysis and a number of appendices. Details of the topics covered by each of the ESRS



[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*

[2] *Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups*

[3] *Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC*

and the appendices are set out in Figure 1. The ESRS are broken down into two cross-cutting standards on general requirements and disclosures and ten topical standards further broken down to cover specific environmental, social or governance issues.

For those entities with a global presence or operating in multiple jurisdictions it is useful to note that EFRAG advised that they have sought to ensure that there is as much interoperability as possible between the draft ESRS and the proposed standards currently being prepared by the International Sustainability Standards Board (**ISSB**).

Figure 1: *Topics covered by the draft ESRS and appendices*

Standard/appendix	Topic	Type
ESRS 1	General requirements	Cross-cutting standards
ESRS 2	General disclosures	Cross-cutting standards
ESRS E1	Climate Change	Environmental standards
ESRS E2	Pollution	Environmental standards
ESRS E3	Water and marine resources	Environmental standards
ESRS E4	Biodiversity and ecosystems	Environmental standards
ESRS E5	Resource use and circular economy	Environmental standards
ESRS S1	Own workforce	Social standards
ESRS S2	Workers in value chain	Social standards
ESRS S3	Affected communities	Social standards
ESRS S4	Consumers and end users	Social standards
ESRS G1	Business conduct	Governance standards
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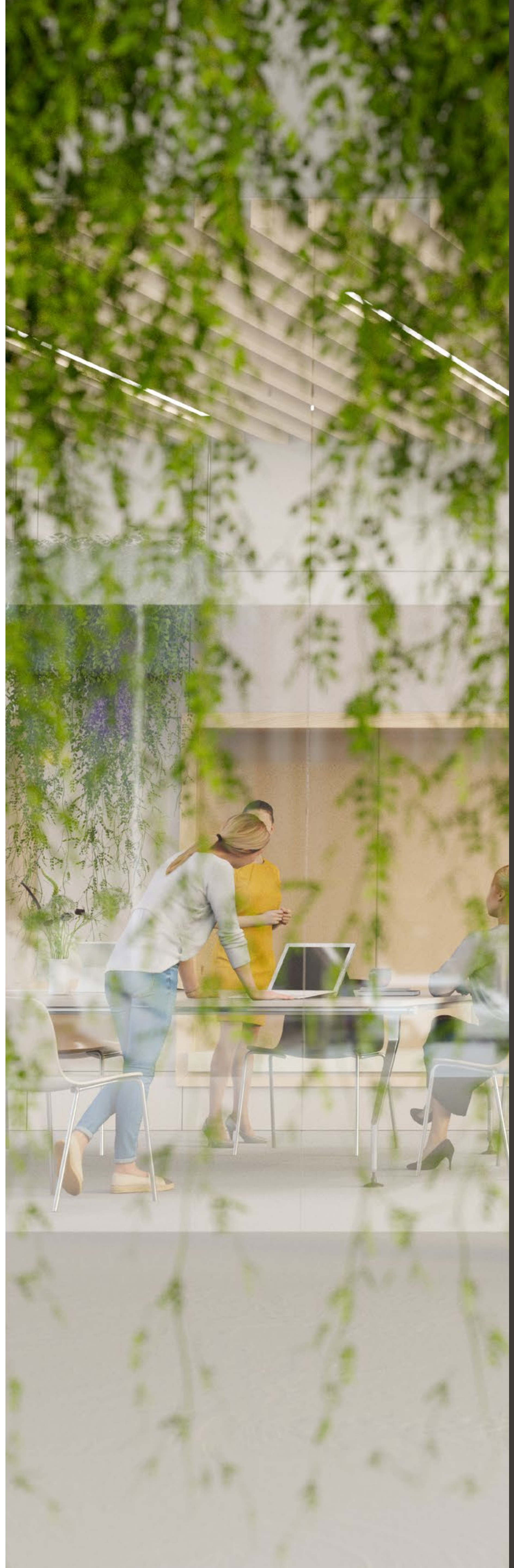

The ISSB was created by the IFRS Foundation in November 2021 during COP26 in order to deliver a global baseline of sustainability disclosures. Two exposure drafts, IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures, were published for consultation in March 2022. The consultation period ended in July 2022 and the ISSB is currently considering the feedback received as part of the consultation process.

Draft IFRS S1 proposes:

1. overall requirements for an entity to disclose sustainability related financial information about its significant sustainability related risks and opportunities
2. requirements that an entity must provide the market with a 'complete set' of sustainability-related financial disclosures.

The proposals set out in draft IFRS S2 build upon the recommendations of the Task Force on Climate-Related Financial Disclosures (**TCFD**) and seek to incorporate industry based disclosure requirements derived from the Sustainability Accounting Standards Board (SASB) Standards.

Both sets of draft standards now follow the same structure which is that set out in the TCFD framework:

- governance
- strategy
- risk management
- metrics and targets

although adaptations have been made to the draft ESRS to account for the **double materiality principle** and to ensure that there is efficient interaction between the general disclosures and the topic specific disclosures that the ESRS are required to cover in accordance with the CSRD requirements.

Next steps

While 2025 is the first year that entities already reporting under NFRD are required to include information in line with the ESRS in their annual reports in respect of their 2024 financial year, in our view all organisations that fall within the **large company definition** under CSRD should now put together a working group and formulate an action plan in respect of the work that needs to be undertaken to prepare to report in line with the ESRS.

Draft SME specific standards are being developed separately as are sector specific standards and these will be published for consultation in due course. In scope SMEs and those considering whether to voluntarily report should, in our view, wait until these SME specific standards are published to start assessing the scope of the work to be undertaken.

This article is the first instalment of our advisory series on the ESRS and further instalments will consider the draft ESRS in more detail as well as examining the approach being taken to the materiality assessment process.

Double materiality principle

Double materiality has two dimensions: impact materiality and financial materiality. A sustainability matter meets the criterion of double materiality if it is material from the impact perspective or the financial perspective or both.

Financial materiality = a sustainability matter is material from a financial perspective if it triggers or may trigger material financial effects on the undertaking.

Impact materiality = a sustainability matter is material from an impact perspective when it pertains to the undertaking's material actual or potential, positive or negative impacts on people or the environment over the short, medium and long term time horizons. A material sustainability matter from an impact perspective includes impacts caused or contributed to by the undertaking and impacts which are directly linked to the undertaking's operations, products, and services through its business relationships.

Large company definition

A large company is one which meets at least two of the following criteria:

- an average of more than 250 employees during the financial year
- a balance sheet of more than €20m
- net turnover of more than €40

Figure 2: *Extracts from Article 29b(2) of CSRD*

ENVIRONMENTAL

Specify the information that undertakings are to disclose about **environmental factors,** including information about:

- climate change mitigation, including emissions on scope 1, scope 2 and, where relevant, scope 3 greenhouse gas emissions
- climate change adaptation
- water and marine resources
- resource use and circular economy
- pollution
- biodiversity and ecosystems

SOCIAL

Specify the information that undertakings are to disclose about **social and human rights factors:**

- equal treatment and opportunities for all, including gender equality and equal pay for work of equal value, training and skills development, the employment and inclusion of people with disabilities, measures against violence and harassment in the workplace, and diversity
- working conditions, including secure employment, adequate wages, social dialogue, freedom of association, existence of work councils, collective bargaining, including the rate of workers covered by collective agreements, the information, consultation and participation rights of workers, work-life balance and a health and safety
- respect for the human rights, fundamental freedoms, democratic principles and standards established in the International Bill of Human Rights and other core UN human rights conventions, including the UN Convention on Persons with Disabilities, the UN Declaration on the Rights of Indigenous Peoples, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work and the ILO fundamental conventions, the European Convention of Human Rights, the revised European Social Charter, and the Charter of Fundamental Rights of the European Union

GOVERNANCE

Specify the information that undertakings are to disclose about the following **governance factors**:

- the role of the undertaking's administrative, management and supervisory bodies with regard to sustainability matters, and their composition, and their expertise and skills to fulfil this role or access to such expertise and skills
- the main features of the undertaking's internal control and risk management systems, in relation to the sustainability reporting process
- business ethics and corporate culture, including anti-corruption and anti-bribery, the protection of whistle-blowers and animal welfare
- activities and commitments of the undertaking related to exerting its political influence, including its lobbying activities
- the management and quality of relationships with customers, suppliers and communities affected by the activities of the undertaking, including payment practices, especially with regard to late payment to SMEs

A&L Goodbody

Key contacts

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

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

Resources

- CSRD — READ MORE
- Proposed directive on corporate sustainability reporting — READ MORE
- EFRAG's first set of draft ESRS — READ MORE
- ISSB's proposed standards — READ MORE