FAQ on the draft European Sustainability Reporting Standards

1 Why do we need European Sustainability Reporting Standards?

- A timely adoption of the integral set of European Sustainability Reporting Standards (ESRS) as sent by EFRAG to the European Commission is essential to the **achievement and implementation of the EU Sustainable Finance Agenda and the European Green Deal**, including the commitments to decouple growth from resource use and "leave no person and no place behind". Any delay would go against the fundamental building blocks to build a sustainable future.

- Sustainability data is essential for all economic actors to effectively monitor and anticipate their interaction with their operating environment. The current proliferation of government and business initiatives means that companies need to deal with divergent information requests and demands from various reporting standards, frameworks, ratings and indices across all ESG areas.

2 Is the EU proposal coherent with the international developments?

- The draft ESRS are aligned with the proposed standards by the International Sustainability Standards Board under the IFRS Foundation. The architecture of the ESRS mirrors the ISSB standards, which are based on the Task Force on Climate-related Financial Disclosures, and integrate all of the proposed IFRS disclosures and principles (subject to specifications to ensure alignment with requirements stemming from EU legislation, including the SFDR). The financial materiality assessment is aligned with the ISSB.

- Furthermore, the draft ESRS are aligned with the Global Reporting Initiative's (GRI) Reporting Standards, integrating GRI's indicators to the extent they are applicable across all sectors. The impact materiality assessment is aligned with GRI and sustainability due diligence norms (in particular UN Guiding Principles for Business and Human Rights and the OECD Guidelines for Multinational Enterprise). On biodiversity, the draft ESRS are also aligned with the latest recommendations by the Task Force on Nature-related Financial Disclosures.

- The draft ESRS is therefore a one stop shop for impact as well as financial-related sustainability reporting (subject to sector specifications). The topical ESRS cover the full spectrum of environmental, social and governance topics, and are designed in a way that complement each other and create a coherent system.

Moreover, further convergence between European and international standards can be expected. The ISSB latest announcements this December show that the global efforts to establish a common international baseline are drawing and adapting its work plan to follow up with proposals on biodiversity, and human rights and human capital.

3 How did EFRAG endorse the draft standards?

- The EFRAG Sustainability Reporting Board adopted the draft ESRS **by multi-stakeholder consensus:** They were adopted after a comprehensive review of the original exposure drafts, which **reduced the number of data points** required to the critically necessary minimum (50% of the initial exposure drafts). The draft ESRS only include disclosure requirements which are sector-agnostic, and which are clearly based on the CSRD.

- A cost-benefit analysis commissioned by EFRAG, which was based on data and estimations reported by companies, has revealed that the additional costs will be marginal. This confirms the conclusion of the impact assessment that accompanied the CSRD proposal that the average recurring costs incurred by the company as a result of the legislation are negligible in relation to the company's total costs and are proportionate to the size of the company.

4 Which disclosure requirements are mandatory?

- Most disclosure requirements in the ESRS are not mandatory. This is because a majority are subject to the undertaking's assessment of materiality. Mandatory disclosures are largely limited to those **corresponding to the KPIs required by the Sustainable Finance Disclosure Regulation.**

- There are **twelve cross-cutting disclosure requirements** (DR) on governance, strategy and materiality assessment, which are mandatory, but of descriptive nature: They ask undertakings to describe their governance, business model and strategy, and the process and results of the assessment of material impacts, risks and opportunities.

  Topical standards further clarify what should be disclosed under these cross-cutting disclosure requirements vis-a-vis specific issues and include:

  - 38 DRs asking companies to indicate if it has adopted a policy, action plan, or target; 17 of these DRs are fully or partially mandatory, which means that a company must always indicate if it has or has not adopted relevant measures, while the remaining DRs can be fully omitted if deemed not material

  - 30 DRs on metrics (KPIs), of which 16 are fully or partially mandatory

  (For further details see section 1 of the Annex below.)

- It is misleading to call out the over 1000 **data points in all disclosure requirements**, because data points is a catch-all term that describes any specific quantitative or qualitative requirement. For example, ESRS specify that a description of a policy should cover "key contents", "scope", "most senior level accountable for implementation", "third-party standards", etc. Each of these quality criteria represents a data point. Similarly, the disclosure requirement on climate targets specify data points including base year, specific milestones, scope 1-2-3 breakdown, information on whether the target is science-based, etc.

5 What value chain information do the ESRS require companies to disclose?

- In line with the CSRD, ESRS requires companies to assess their material impacts, risks and opportunities across the value chain. However, **ESRS does not require disclosure of any specific metrics (i.e. hard data) on the value with the exception of Scope 3 GHG emissions.** This is based on a deliberate consideration of the EFRAG Sustainability Reporting Board and Technical Expert Group. There was a consensus among the members of these two bodies that it is not meaningful to specify such metrics on sector-agnostic level. Moreover, for the first three years of the application of ESRS, companies can rely on data available in-house with regard to value chain disclosures

- ESRS 1 sets further criteria for disclosing entity-specific information including with respect to the value chain to ensure that companies consider the usefulness and reliability of metrics for inclusion in its entity-specific disclosures.

6 What do companies have to report on biodiversity?

- Biodiversity and climate change are closely intertwined. The IPCC's 6th Assessment Report indicates that land use change should reach net zero by 2030 to keep 1.5°C within reach [1]. Similarly, the International Energy Agency (IEA) assumes no overall deforestation by 2030 to calculate its 1.5°C-aligned pathways. In line with these goals, the EU Biodiversity Strategy for 2030 aims to put Europe's biodiversity on a path to recovery by 2030, and ensure that by 2050 all of the world's ecosystems are restored, resilient and adequately protected.

- From the perspective of climate transition, addressing and reporting on land use change and deforestation has equally high priority as GHG emission reduction and phasing out fossil fuels. ESRS E4 focuses primarily on providing guidance and setting framework for biodiversity reporting, rather than strict requirements. **All of the metrics listed in E4 are subject to materiality, related to own operations only and principle-based.** *(See further details on disclosure requirements in ESRS E4 in the Annex, section 2 below).*

[1] Synthesis Report of the IPCC Sixth Assessment Report (AR6) - Figure 4.1: Sectoral emissions in pathways that limit warming to 1.5ºC, p. 58

7 What do companies have to report on social issues?

- CSRD requires the undertaking to report on their sustainability due diligence, including principal impacts connected with the undertaking's value chain. In this regard, CSRD refers to the international instruments including the UN Guiding Principles on Business and Human Rights, the OECD Guidelines and the OECD Due Diligence Guidance for Responsible Business Conduct. CSRD further stipulates that European sustainability reporting standards shall specify the information that undertakings are to disclose about their respect for human rights.

- Human rights are not limited to the labour rights of the workforce, but extend to human rights of all people who may be affected by business. To address the above CSRD requirements, the social standards reflect the range of stakeholder groups whose human rights may be affected and provide a framework for undertakings to conduct their materiality assessment regarding potential human rights impacts and related risks and opportunities, and to report on human rights due diligence in the context of both their operations and value chain.

- **It is important to note that S2 ("Workers in the value chain), S3 ("Affected communities") and S4 ("Consumers and end users") include specification of what the undertakings should report on their policies, actions and targets, but - unlike S1 which deals with "Own workforce" - they do not specify any metrics.** Such metrics can only be defined on a sector-specific basis, and therefore were purposefully not included in the sector-agnostic standards. **If the undertaking identifies that it has material impacts in the given area but it has not addressed them yet, it may comply with the entire standard by simply stating that it has not adopted relevant policies, actions and targets and why** and potentially indicate plans to develop them.

- The three standards are very similar in content: they have minor distinctions in specifying some of the particular ways in which due diligence relates to the stakeholder group concerned and their human rights. This replication of content was done on purpose in order to provide clear guidance to the undertakings on how to structure their reporting vis-a-vis the distinct groups of people whose human rights can be affected in distinct segments of the value chain and business relationships. ESRS allows companies to combine their disclosures on these matters - as well as on environmental issues covered by E standards - where it is practicable.

8 How do the CSRD and the draft ESRS address phasing-in?

❯ Phasing in is addressed at three levels:

- CSRD delays the application of the legislative requirements to
  - large non-listed companies until financial year 2025
  - Listed small and medium undertakings until financial year 2026 (with an opt-out possibility until 2028)
  - Foreign multinational groups until financial year 2028

- CSRD further provides an additional 3 years grace period regarding value chain for each of the categories of the undertakings above. This means that companies may rely solely on their in-house information for the assessment and description of their impacts, risks and opportunities until 2027 (large listed companies, banks and insurers), 2028 (large non-listed companies) and 2029 (listed SMEs) respectively.

- EFRAG Sustainability Reporting Board further recognised that companies may need extra preparation time for certain disclosures - including those that are required by the CSRD directly. These phased-in disclosure requirements are specified in ESRS 1, Appendix D. They include in particular:
  - Potential financial effects of sustainability matters (including climate physical and transition risks) may be completely omitted for the first year of preparation of its sustainability statements. Furthermore, for the first three years, the undertaking may report only qualitative information (i.e. no quantitative data).
  - Reporting on adequate wages and social protection of non-employee workers (e.g. agency workers) for the first year of preparation of its sustainability statements.

Annex

1. Details on mandatory datapoints in the topical standards

❯ Topical standards include 30 disclosure requirements on metrics:
- 16 of them are mandatory, of which 12 concern climate changes and own workforce
- 14 need to be reported only if they correspond to matters identified by the company as material

❯ **In other words, the minimum that is required by the ESRS include cross-cutting disclosure requirements and the 16 mandatory topical metrics.** The remaining requirements focus on policies/actions/targets, which can be complied with by a statement that the undertaking has not adopted them. Thus, the first-time reporters can comply with the ESRS in a cost-effective manner if they choose so.

	Policies - Actions (incl. Transition plans) - Targets (can be complied with by a statement that they have not been adopted)		Metrics	
	Mandatory	"Report if material"	Mandatory	"Report if material"
E1 Climate	4	-	5	-
E2 Pollution	-	3	1	2
E3 Water	1	2	1	1
E4 Biodiversity	1	3	-	2
E5 Circular economy	-	3	1	2
S1 Own workforce	5	-	7	5
S2 Workers in the value chain	2	3	-	-
S3 Affected Communities	2	3	-	-
S4 Consumers & end users	2	3	-	-
G1 Business conduct	1	2	1	2
Total	**17**	**21**	**16**	**14**

List of mandatory topical metrics [2]:		
E	**S**	**G**
Energy consumption, intensity per revenue and mix broken down by (certified) renewable/non-renewable origin • Gross scope 1, 2 and 3 and total GHG emissions and intensity per revenue • GHG removals and GHG mitigation projects financed through carbon credits (if applicable) • Internal carbon pricing (if applicable) • Potential financial effects of material physical and transition risks related to climate change (subject to phase-in) • Emissions (if applicable) • Air pollutants • to Water • Inorganic pollutants • Ozone-depleting substances • Water • Total consumption • Recycled and reused • Waste • Amount and % of non-recycled waste, • Amount of hazardous and radioactive waste	Characteristics of own employees (headcount) • Gender and country breakdown • Permanent/temporary non-guaranteed hours breakdown • Turnover • Characteristics of non-employee workers (number) • the most common types of workers • the type of work they perform • Collective bargaining coverage and social dialogue • Diversity indicators • Gender distribution • Age distribution • Health and safety indicators • Fatalities • Accidents • Days lost • Compensation indicators • Annual total compensation ratio • Gender pay gap • Work-related incidents and complaints and severe cases of human rights issues and incidents	Confirmed incidents of corruption and bribery • The number of convictions and the amount of fines • The number of confirmed incidents in which own workers were dismissed or disciplined for corruption or bribery-related incidents

[2] See: https://www.google.com/url?q=https://www.efrag.org/Assets/Download?assetUrl%3D%252Fsites%252Fwebpublishing%252FSiteAssets%252F07.%252520Draft%252520ESRS%2525202%252520General%252520disclsoures%252520November%2525202022.pdf&sa=D&source=docs&ust=1680766774712202&usg=AOvVaw12WeMlKMF-CwsiOhviDU19, p. 27.

2. Disclosure requirements on biodiversity (ESRS E4)

❯ In terms of disclosure requirements, the ESRS E4:

1. Requires companies to disclose

- Whether and how they assessed specific biodiversity impacts (this is a specification of cross-cutting disclosure requirements on the description of materiality assessment)
- Whether they have a transition plan compatible with targets outlined in Global Biodiversity Framework of no net loss by 2030 (unlike climate transition plan, this disclosure is not mandatory)
- Number and area of sites in biodiversity-sensitive areas if the undertaking has such sites
- Land use based on life-cycle analysis if the undertaking operates in specified high-risk sectors and has identified material impacts with regards to land-use change

2. Provides guidance which general metrics the undertakings shall consider disclosing if it identified it has certain material impacts, including on:
   a. Land-use change
   b. Alien species
   c. State of species
   d. State of ecosystems

E4 explicitly notes the following (emphasis added):

Performance measures on biodiversity and ecosystems are currently the object of much ongoing collective work at the time of the drafting of this [draft] Standard. ***That is why the Disclosure Requirements proposed in this [draft] Standard are mostly principles-based to clarify the categories of performance measures expected, as well as laying out the features of quality biodiversity and ecosystems-related measures rather than proposing specific measures per se.***