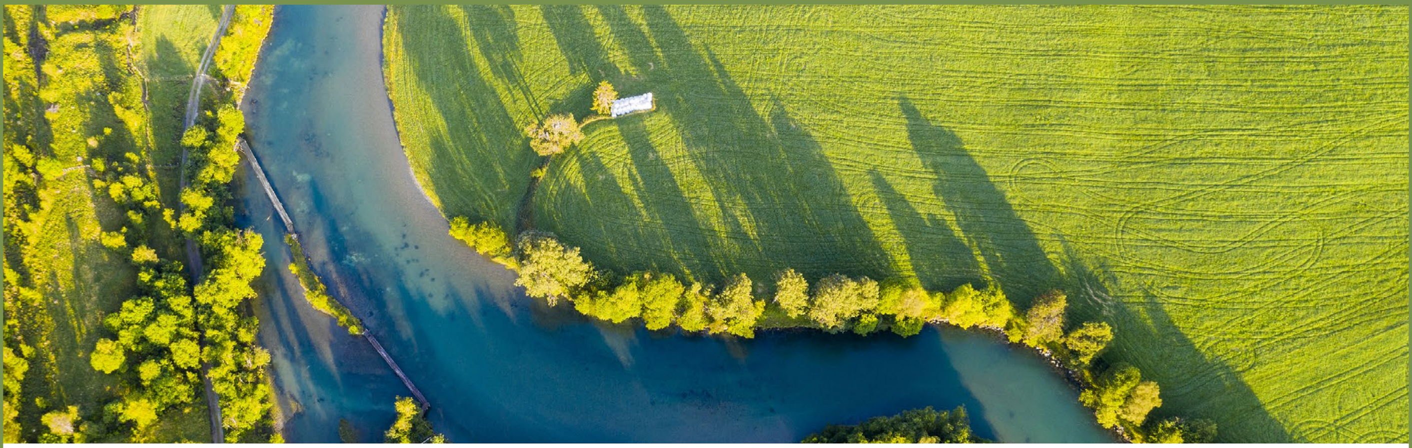


First set of draft ESRS: putting sustainability and financial information on an equal footing

On November 22nd 2022, EFRAG delivered the first drafts ("Set 1") of European Sustainability Reporting Standards (ESRS) to the European Commission, **laying the foundations of the standardised common language for sustainability-related matters throughout Europe** as required by the Corporate Sustainability Reporting Directive (CSRD) which will be published in the EU Official Journal at the beginning of December.

What are we talking about?

ESRS will be the standards mandatorily applicable in the European Union for all companies required to prepare sustainability statements in accordance with the CSRD. These standards prescribe **both the content and format** of sustainability-related information.

ESRS intend to meet users' needs for **high-quality, comparable and relevant information** as regards sustainability matters, raising sustainability information on an equal footing with financial information. ESRS therefore specify qualitative and quantitative information to be disclosed, adopting both a retrospective and forward-looking approach. In addition, the disclosed information will have to be based on conclusive scientific evidence where appropriate.

Covering the **full spectrum of ESG topics from a double-materiality perspective** (i.e. companies will have to report both on the impacts of their activities on people and the environment, and on how various sustainability matters affect them), Set 1 of ESRS covers all information that is likely to be **material regardless of the sector(s) companies operate in**. Sector-specific standards will subsequently complement these sector-agnostic standards. Entity-specific information will also have to be provided, where necessary.

The reporting structure of ESRS is **aligned with the Recommendations of the Task Force on Climate-related Financial Disclosures** (TCFD). ESRS therefore cover the following four reporting areas: (1) Governance, (2) Strategy, (3) Management of impacts, risks & opportunities, (4) Metrics and Targets.

In practice, Set 1 includes **12 draft sector-agnostic standards**: two "cross-cutting" standards (ESRS 1 on General requirements and ESRS 2 on General disclosures) – applying to all sustainability matters – and ten "topical" standards:

- **five standards covering environmental matters**: ESRS E1 on Climate change, ESRS E2 on Pollution, ESRS E3 on Water and marine resources, ESRS E4 on Biodiversity and ecosystems, ESRS E5 on Resource use and circular economy;
- **four standards covering social matters**: ESRS S1 on Own workforce, ESRS S2 on Workers in the value chain, ESRS S3 on Affected communities and ESRS S4 on Consumers and end-users; and
- **one standard covering governance matters**: ESRS G1 on Business conduct.

In drafting ESRS, EFRAG has ensured that its proposals **comply with other EU legislation** such as the Sustainable Finance Disclosure Regulation (SFDR) regarding the "principal adverse impacts" indicators, or the information required by regulatory technical standards prepared by the European Banking Authority (EBA) regarding Pillar III sector-agnostic disclosures.

Sustainability statements will have to be presented in a **clearly identifiable dedicated section of the management report** (under four headings: general information, environmental information, social information and governance information). Besides, a company may incorporate information by reference to a list of other reports (subject to conditions).

According to the CSRD, sustainability statements will have to be both **human and machine-readable**, using the European Single Electronic Format (ESEF) based on an XBRL taxonomy yet to be prepared.

What's changed compared to the Exposure Drafts issued for public consultation earlier in 2022?

The final drafts delivered in November to the EC have been developed with proper due process and are largely based on the **13 Exposure Drafts** (EDs) issued for public consultation on 29 April 2022 (open until 8 August 2022). Cost benefit analyses have also been conducted.

In its re-deliberations, EFRAG has taken account not only of the feedback received through outreach events and the public consultation – **more than 700 stakeholders submitted comments** – but also of the **changes that were made to the draft CSRD** in the meantime, as part of the political compromise reached at the end of June 2022 between the European Council, Commission and Parliament (EFRAG had initially worked on draft standards in line with the April 2021 draft version of the Directive). The decrease in the number of draft standards (13 to 12) is a direct consequence of this, the scope of governance factors for which information has to be provided according to the revised CSRD now being limited to sustainability matters only.

Considering the feedback received from stakeholders, EFRAG has **streamlined its proposals** in order to remove unnecessary complexity and limit the disclosure requirements (DRs) to sector-agnostic information necessary to meet CSRD objectives. In practice, the number of DRs and related data points have been significantly reduced (by about 40% and 50%, respectively), overall leading to less granular information than in the EDs.

The **materiality approach** has been clarified and simplified (the so-called "rebuttable presumption" which has been much criticised has been removed). The company will therefore have to disclose all the material information to cover the material topics identified performing the double materiality assessment. There will be no obligation to produce *ad hoc* explanations to back up a decision not to provide certain disclosures, except if the company has omitted all the DRs in a topical standard because it has concluded that this topic is not material for itself.

In addition, some specific information will be mandatory in all cases (therefore not subject to the materiality approach). This concerns (i) ESRS 2 on general disclosures, (ii) ESRS E1 on climate change, (iii) sustainability information required by other EU legislation (the SFDR, Pillar III sector-agnostic disclosures, EU benchmarks requirements and the EU Climate Law) and (iv) fundamental social indicators not captured by the SFDR (for this latter, for companies with 250 employees or more).

Regarding sustainability **due diligence**, Set 1 proposes stronger alignment with existing international guidelines without pre-empting the content of the future Corporate Sustainability Due Diligence Directive (CSDDD) which draft text was released in February 2022.

Last but not least, and as requested by CSRD, Set 1 has been **further aligned with international initiatives** in order to promote interoperability with global standard-setting initiatives to the greatest extent possible and therefore avoid ultimately multiple reporting for international companies. In particular, considering the current development of sustainability reporting standards by the International Sustainability Standards Board (ISSB), meaning IFRS S1 on general requirements and IFRS S2 on climate-related disclosures, which are expected to be published as early as possible in 2023, EFRAG and the ISSB have worked together on aligning wording, concepts and requirements of both frameworks as much as possible.

The draft ESRS also incorporate to the greatest extent possible the content of the Global Reporting Initiative (GRI) standards.

What are the transitional provisions?

A company applying ESRS for the first time may defer the presentation of comparative information by one year. Besides, a **phased-in approach** has been decided on less mature topics.

A specific phase-in of three years has been included for information regarding the value chain (also reflecting the corresponding provision in the CSRD) subject to certain conditions, notably in order to limit the burden for small and medium-sized enterprises (SMEs) that are a part of the value chain.

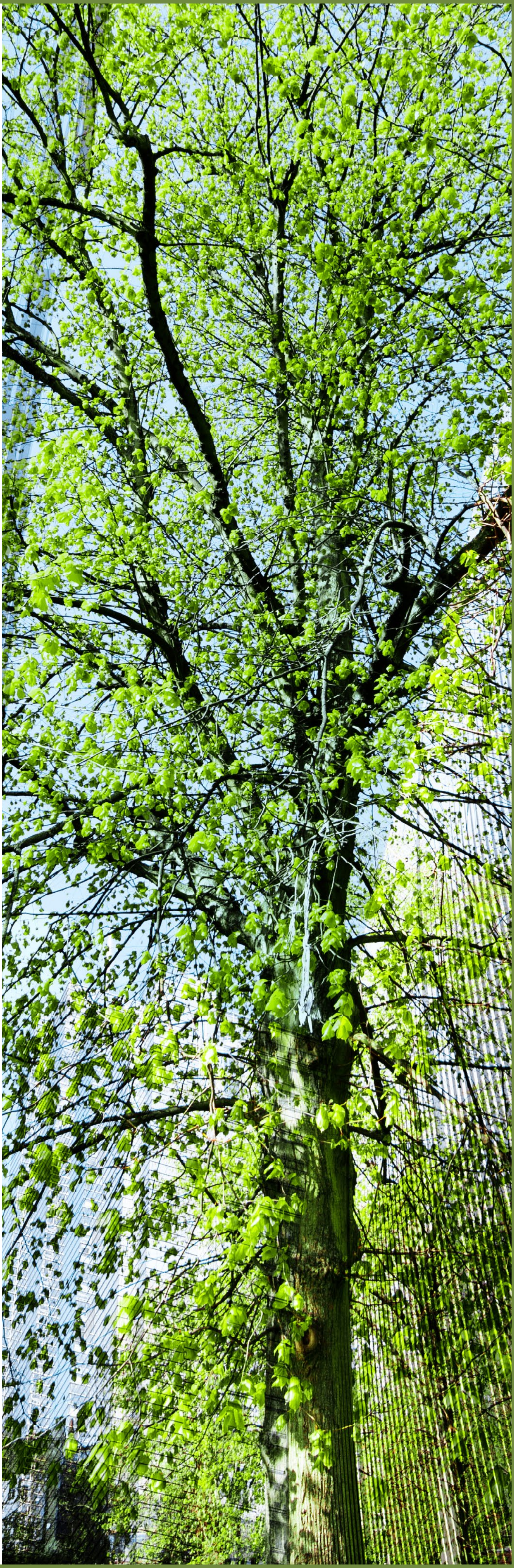
A phase-in from one to three years has also been introduced for 12 DRs (out of 82 in total), in particular the DRs required by ESRS E1 to ESRS E5 on potential financial effects of material environmental-related risks and opportunities. Compliance with these DRs could be achieved by reporting qualitative disclosures only if it is impracticable to prepare quantitative disclosures.

What's next?

The European Commission will adopt Set 1 by **30 June 2023** by way of delegated acts (no transposition into national law is needed), followed by a scrutiny period by the European Parliament and Council. By then, the EC will consult various groups, committees and agencies, including the European Securities and Markets Authority (ESMA), to ensure that ESRS take account of the views of the Member States and that they are consistent with relevant EU policy and legislation. Therefore, **further changes may be brought to the final standards that will be adopted by the European Commission**.

The European sustainability reporting framework **will be subsequently complemented by 30 June 2024** in order to cover:

- **sector-specific standards:** they will be mandatory to all large companies in a given sector. First batch of ten sectors ((1) Agriculture and Farming, (2) Coal mining, (3) Mining, (4) Oil and Gas – mid to downstream, (5) Oil and Gas – upstream, (6) Energy production and utilities, (7) Road transport, (8) Motor vehicle production, (9) Textiles, Accessories, Footwear and Jewelleries, (10) Food and Beverages) will be covered in Set 2, while remaining 31 sectors will be covered over the next two years;
- **standards for listed SMEs**;
- **non-EU company standards**;
- voluntary guidance for unlisted SMEs.



What are the main challenges for companies?

The sustainability reporting standards to be implemented in accordance with the CSRD represent a **major shift** as they create new demanding transparency obligations on companies' commitment to sustainability, all the more since the sustainability statements will have to be audited. At inception, limited assurance will be required over compliance with ESRS, with a possible move to reasonable assurance.

Companies should thus **prepare as soon as possible** in order to comply with the new requirements but also think about how to make it a strategic lever for sustainability – and business – performance.

In practice, companies should first assess whether they are within the scope of the CSRD and when they will have to publish sustainability statements under ESRS for the first time.

Challenges in implementing ESRS will depend on both whether the company was already subject to NFRD requirements and in which Member State the company is established (as the NFRD left significant flexibility to Member States to transpose into national law). In all cases, first-time application of Set 1 will necessitate at least (i) to **revisit the materiality assessment**, (ii) **to consider the entire value chain** and (iii) to perform a **thorough analysis of the disclosure requirements** (and associated data points) listed in ESRS, in order to identify which material information has to be disclosed to cover material impacts, risks and opportunities identified by the company in relation with sustainability matters.

As a reminder, large public interest entities with more than 500 employees which are already subject to the Non-Financial Reporting Directive (NFRD) will have to publish their first ESRS-compliant sustainability statements early 2025 (for the 2024 financial year).

Other large companies will have to report one year later, i.e. early 2026 (for the 2025 financial year).

Listed SMEs will have another additional year to prepare their sustainability statements based on specific standards (unless they opt out from the reporting requirements for two more years, therefore having to report for the first time early 2029 for the 2028 financial year).

Companies located in a third country (and not listed in the EU) that meet the criteria listed in the CSRD will have to apply the new requirements from the financial year 2028 (publication in early 2029) based on specific standards.

How can I learn more?

There is a variety of ways to understand more about the CSRD, which is as follows:

- Read this Mazars publication on the CSRD.
- Listen to this podcast on the transition towards the CSRD.
- Explore existing Mazars publications on the CSRD and Taxonomy – contact us for more information.
- Visit our website to learn more about sustainability insights and guidance, or to speak to one of our experts.

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