Questions and Answers on the Adoption of European Sustainability Reporting Standards

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Why is the Commission adopting European Sustainability Reporting Standards (ESRS)?

EU law requires all large companies and all listed companies (except listed micro-enterprises) to disclose information on what they see as the risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and the environment. This helps investors, civil society organisations, consumers and other stakeholders to evaluate the sustainability performance of companies, as part of the European green deal.

Nonetheless, there is ample evidence that the sustainability information that companies currently report is not sufficient. They often omit information that investors and other stakeholders think is important. Reported information can be hard to compare from company to company, and users of the information, such as investors, are often unsure whether they can trust it.

Problems in the quality of sustainability reporting have knock-on effects. It means that investors lack a reliable overview of sustainability-related risks to which companies are exposed. Investors increasingly should be made aware about the impact of companies on people and the environment and their plans to reduce such impacts in the future. This knowledge will help them to meet their own disclosure requirements under the Sustainable Finance Disclosure Regulation (SFDR). More generally, if the market for green investments is to be credible, investors need to know about the sustainability impact of the companies in which they invest. Without such information, money cannot be channelled towards environmentally friendly activities.

That is why, in line with the Corporate Sustainability Reporting Directive (CSRD), which outlines the obligation for companies to use standards to fulfil their legal sustainability reporting obligations, the Commission is adopting **common standards** which will help companies to communicate and manage their sustainability performance more efficiently and therefore to have better access to sustainable finance.

The European Sustainability Reporting Standards (ESRS) will be mandatory for use by companies that are obliged by the Accounting Directive to report certain sustainability information. By requiring the use of common standards, the Accounting Directive, as amended by the CSRD in 2022, aims to ensure that companies across the EU report comparable and reliable sustainability information.

Common standards are expected to help companies to reduce reporting costs in the medium and long term, by avoiding the use of multiple voluntary standards as this is the case today. Currently, problems in the quality of sustainability reporting create an accountability gap. High quality and reliable public reporting by companies will help create a culture of greater public accountability.

How have the ESRS been developed?

In accordance with the provisions of the Accounting Directive, as amended by the CSRD, the standards adopted by the Commission are based on technical advice (draft standards) from EFRAG. EFRAG (previously known as the European Financial Reporting Advisory Group) is an independent, multistakeholder advisory body, majority funded by the EU. Its draft standards are developed with the close involvement of investors, companies, auditors, civil society, trade unions, academics and national standard-setters.

EFRAG submitted its draft standards to the Commission in November 2022, after having run a public consultation on initial draft standards earlier last year. Further to that consultation, EFRAG made substantial modifications to its initial drafts before submission to the Commission with a particular view on reducing administrative burden for companies, including reducing the number of reporting requirements by nearly half.

Earlier this year, as required by the Accounting Directive, the Commission consulted Member States on the draft standards submitted by EFRAG, along with various EU bodies such as the 3 European Supervisory Authorities (the European Securities and Markets Authority, the European Banking

Authority and the European Insurance and Occupational Pensions Authority),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.

In accordance with its Better Regulation Guidelines, the Commission also published the proposed final ESRS on the Have Your Say portal in early June for a 4-week period of public comment.

What will companies have to report?

As required by the Accounting Directive, as amended by the CSRD, the ESRS take a "double materiality" perspective – that is to say, they oblige companies to report both on their impacts on people and the environment, and on how social and environmental issues create financial risks and opportunities for the company.

There are 12 ESRS, covering the full range of sustainability issues, in line with EFRAG's proposal:

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

ESRS 1 ("General Requirements") sets general principles to be applied when reporting according to ESRS and does not itself set specific disclosure requirements. ESRS 2 ("General Disclosures") specifies essential information to be disclosed irrespective of which sustainability matter is being considered. ESRS 2 is mandatory for all companies under the CSRD scope.

All the other standards and the individual disclosure requirements and datapoints within them are subject to a materiality assessment. This means that the company will report only relevant information and may omit the information in question that is not relevant ("material") for its business model and activity.

Disclosure requirements subject to materiality are not voluntary. The information in question must be disclosed if it is material, and the undertaking's materiality assessment process is subject to external assurance in accordance with the provisions of the Accounting Directive. The standards

require undertakings to perform a robust materiality assessment to ensure that all sustainability information necessary to meet the objectives and requirements of the Accounting Directive will be disclosed.

If a company concludes that climate change is not a material topic and therefore does not report in accordance with that standard, it has to provide a detailed explanation of the conclusions of its materiality assessment with regard to climate change. This requirement reflects the fact that climate change has wide-ranging and systemic impacts across the economy.

What modifications did the Commission make compared to the draft standards developed by EFRAG?

The Commission made a number of modifications to the draft standards submitted by EFRAG. These modifications ensure that the standards are proportionate, without undermining the achievement of the policy objectives. The modifications fall into three main categories: phasing-in certain reporting requirements; giving companies more flexibility to decide exactly what information is relevant ("material") in their circumstances; and making some of the proposed requirements voluntary.

Firstly, the Commission has introduced some additional phase-in provisions for some of the reporting requirements, on top of certain phase-in provisions already proposed by EFRAG. These additional phase-ins mainly apply to companies with fewer than 750 employees. The costs of reporting are relatively higher for such companies compared to larger companies, and they have generally not previously been subject to sustainability requirements. The additional phase-in provisions give companies more time to prepare, allow them to spread the initial costs over a number of years and should result in higher quality reporting. The additional phase-ins focus on those reporting requirements considered more challenging for companies. They include certain reporting requirements on biodiversity and on various social issues. Depending on the topic, the new phase-in provisions postpone the corresponding reporting requirement for 1 or 2 years for the companies concerned.

Secondly, the Commission has given companies more flexibility to decide exactly what information is relevant in their particular circumstances. This will avoid the costs associated with reporting information that may not be relevant. This is referred to as making more of the reporting requirements "subject to materiality" (i.e. it allows companies to omit information if it is not relevant in their particular circumstances), as opposed to being mandatory for all companies.

EFRAG proposed that the majority of the standards would be subject to materiality assessment, but nevertheless proposed that the following be mandatory for all companies: the cross-cutting standard ESRS 2 ("General Disclosures"), which specifies essential information to be disclosed irrespective of which sustainability matter is being considered; the climate standard; some reporting requirements about the company's own workforce; and datapoints that correspond to information required by financial market participants, benchmark administrators and financial institutions for their own reporting purposes respectively under the Sustainable Finance Disclosure Regulation (SFDR), the Benchmarks Regulation (BMR) or the "pillar 3" disclosure requirements under the Capital Requirements Regulation (CRR). The Commission decided that all the reporting requirements should be subject to materiality, with the exception of ESRS 2.

Thirdly, the Commission made a limited number of reporting requirements voluntary instead of mandatory. The draft standards submitted by EFRAG already included many voluntary datapoints. The Commission further converted a number of the mandatory datapoints proposed by EFRAG into voluntary datapoints. The datapoints concerned are those currently considered most challenging or costly for companies, such as reporting a biodiversity transition plan and certain indicators about self-employed people and agency workers in the undertaking's own workforce.

What does the approach to materiality mean for coherence with other pieces of EU legislation on sustainable finance?

ESRS contain a series of clearly identified datapoints that correspond to specific information that financial market participants, benchmark administrators and financial institutions need for their own reporting purposes respectively under the Sustainable Finance Disclosure Regulation (SFDR), the Benchmark Regulation (BMR) or the "pillar 3" disclosure requirements under the Capital Requirements Regulation (CRR).

If a company concludes that a datapoint deriving from the SFDR, the BMR or the CRR is not material, it will have to explicitly state that the datapoint in question is "not material" rather than just reporting no information. In addition, companies will have to provide a table with all such datapoints, indicating where they are to be found in its sustainability statement or stating "not material" as appropriate.

These provisions aim to facilitate the compliance of financial market participants, benchmarks administrators and financial institutions with their own disclosure obligations respectively under the SFDR, the BMR and the CRR.

Further clarifications will be provided under the respective frameworks or related implementing standards regarding the approach to be taken when a company has assessed a datapoint derived from the SFDR, the BMR or the CRR as not material and has therefore stated "not material" in its reporting. Financial market participants and financial advisers may assume that any indicator reported as non-material by an investee company does not contribute to the corresponding indicator of principal adverse impacts in the context of the SFDR disclosures.

What about SMEs?

The Accounting Directive, as amended by the CSRD, imposes no new reporting requirements on SMEs, except listed SMEs.

For listed SMEs, the Accounting Directive nevertheless provides for a proportionate reporting regime. Listed SMEs are not required to report sustainability information until financial year 2026, with the possibility of an additional two-year opt-out after that. In addition, listed SMEs may report according to separate, proportionate standards that will be less demanding than the full set of ESRS that the Commission has just adopted. EFRAG is currently developing the draft versions of the proportionate standards for listed SMEs.

Some non-listed SMEs, which are not subject to any sustainability reporting requirements under the Accounting Directive, may nevertheless receive requests for sustainability information from customers, banks, investors or other stakeholders. EFRAG is therefore also developing simpler, voluntary standards for use by non-listed SMEs. These voluntary standards should enable non-listed SMEs to respond to request for sustainability information in an efficient and proportionate manner, and so facilitate their participation in the transition to a sustainable economy.

In addition, the Accounting Directive states that the standards for listed SMEs will legally cap the information which ESRS can require large undertakings to obtain from SMEs in their value chains. This provision provides further safeguards against disproportionate trickle-down effects on reporting requirements on SMEs which are in the value-chains of larger companies.

Where can companies get further guidance on the application of ESRS?

EFRAG will periodically publish additional non-binding technical guidance on the application of ESRS. Given its expertise and its role, set out in the Accounting Directive as amended by the CSRD, as the Commission's technical advisor on the development of ESRS, EFRAG is very well placed to provide such guidance.

The Commission has suggested that EFRAG prioritises the development of guidance on materiality assessment and on reporting with regard to value chains. EFRAG expects to publish draft guidance on these two issues for public consultation in the near future.

EFRAG will shortly host a portal for technical questions that companies, or other stakeholders may have about the application of ESRS.

Where appropriate, the Commission will consider providing guidance on questions concerning legal interpretation of the ESRS.

EFRAG will continue its joint work with the ISSB on optimising the interoperability of overlapping ESRS and ISSB standards, which is relevant for companies required to use ESRS and that wish to comply in addition with ISSB standards.

Are ESRS aligned with global standards?

The Commission has worked to ensure a very high level of alignment between ESRS and the standards of the International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI).

From the beginning of the development of draft ESRS by EFRAG, the GRI served as an important reference point, and many of the reporting requirements in ESRS were inspired by the GRI standards.

The ESRS and the first two standards of the ISSB, which were published in June, have been developed in parallel. Intensive and constructive discussions between the Commission, EFRAG and the ISSB have ensured a very high degree of alignment where the two sets of standards overlap.

Companies that are required to report in accordance with ESRS on climate change will to a very large extent report the same information as companies that will use the ISSB standard on climate-related

disclosures. Climate change disclosures under ESRS will provide additional information on impacts relevant for users other than investors such as business partners, trade unions, social partners, and academics.

The very high degree of alignment between ESRS and the two ISSB standards aim to prevent that companies required to report in accordance with ESRS and that wish to also comply with ISSB standards, would have to report separately under ISSB standards.

With the adoption of the ESRS, the EU goes further than any other major jurisdiction to date in terms of integrating the ISSB standards into its own legal framework. In doing so, the EU makes a major contribution towards the development of a coherent global framework and towards the global comparability of reported sustainability information. The approach of integrating ISSB disclosure requirements into ESRS is also fully in line with the ambition of the recent IOSCO decision to endorse ISSB sustainability-related disclosure standards.

At the same time, ESRS are consistent with the EU's own political ambitions with regard to sustainable finance and the European Green Deal. The ESRS contains topical standards covering the full range of environmental, social and governance issues, while the ISSB has so far published a detailed topical standard on climate only. In addition, and as required by the CSRD, ESRS explicitly require reporting on the company's impacts on people and the environment as well as reporting on how social and environmental issues create financial risks and opportunities for the company. The ISSB standards, in contrast, focus more exclusively on how social and environmental issues create financial risks and opportunities for the company.

What happens next and when do companies have to apply European Sustainability Reporting Standards?

The ESRS delegated act adopted by the Commission will be formally transmitted in the second half of August to the European Parliament and to the Council for scrutiny. The scrutiny period runs for two months, extendable by a further two months. The European Parliament or the Council may reject the delegated act, but they may not amend it.

Companies will have to start reporting under ESRS according to the following timetable:

- Companies previously subject to the Non-Financial Reporting Directive (NFRD) (large listed companies, large banks and large insurance undertakings – all if they have more than 500 employees), as well as large non-EU listed companies with more than 500 employees: financial year 2024, with first sustainability statement published in 2025.
- Other large companies, including other large non-EU listed companies: financial year 2025, with first sustainability statement published in 2026.
- Listed SMEs, including non-EU listed SMEs: financial year 2026, with first sustainability statements published in 2027. However, listed SMEs may decide to opt out of the reporting requirements for a further two years. The last possible date for a listed SME to start reporting is financial year 2028, with first sustainability statement published in 2029.

In addition, non-EU companies that generate over EUR 150 million per year in the EU and that have in the EU either a branch with a turnover exceeding EUR 40 million or a subsidiary that is a large company or a listed SME will have to report on the sustainability impacts at the group level of that non-EU company as from financial year 2028, with first sustainability statement published in 2029. Separate standards will be adopted specifically for this case.

For more information

Implementing and delegated acts - CSRD

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