



Challenges of the new European Sustainability Reporting Standards (ESRS)

Key Points

- The EU's Corporate Sustainability Reporting Directive (CSRD) is realigning European sustainability reporting: this extends the previously applicable non-financial reporting requirements in terms of scope, content and coverage. In Austria, the sphere of users required to report on their sustainability performance in terms of environmental, social and governance issues is set to expand from around 100 companies to over 2,000 companies.
- In the future the newly developed European Sustainability Reporting Standards (ESRS) will serve as the framework for the disclosure of this sustainability information. The European Financial Reporting Advisory Group (EFRAG) has developed these standards which will be adopted by a delegated act of the European Commission (Commission) into EU law in June 2023.
- These standards are intended to make a significant contribution to reframing European sustainability reporting. In order to promote the comprehensibility, comparability and transparency of reports for stakeholders, a clearly defined, verifiable and comprehensive framework is required by the European legislator with regard to the disclosure of companies' sustainability performance and their social-ecological responsibility.

Background

In December 2022, the Commission published the new Corporate Sustainability Reporting Directive (CSRD) in the Official Journal. The new directive will replace the previously applicable Non-Financial Reporting Directive (NFRD) of 2014. This paves the way for reframing European sustainability reporting, thereby raising companies' awareness of their social and environmental responsibilities. The CSRD greatly expands the existing regulations on non-financial reporting. Three main thrusts are the expansion of scope, the specification of reporting requirements (including with regard to content, such as reporting of both targets/strategies and facts, e.g. coverage of the entire value chain) according to uniform reporting standards and the incorporation of a mandatory external audit. The new provisions also increase the responsibility of the Executive Board and Supervisory Board for sustainability reporting at the given company.

In the future, all large corporations, capital market-oriented small and medium-sized enterprises (SMEs) and certain banks and insurance companies (in chronological order) will have to disclose a sustainability report on specific environmental, social and governance issues in the management report. In the opinion of AK, it is important that sustainability information is guided by the principle of „double materiality“, i.e. companies must present both the effects of the environment and society on the company („outside-in“, e.g. the effects of heatwaves on business opportunities) and the effects of the company's activities on the environment and society („inside-out“, e.g. emissions and occupational accidents).

Companies were previously free to choose to use a recognised national, EU or international framework as their reporting framework. Numerous studies, such as the AK study „Non-financial reporting – An evaluation of the implementation of the NaDiVeG in listed

companies 2019”, show that most companies use the standards of the Global Reporting Initiative (GRI). The leeway for using different frameworks complicates the traceability of the information provided and leads to limited comparability of reports for stakeholders.

To address that issue, the Commission mandated the European Financial Reporting Advisory Group (EFRAG) to develop proposals for new uniform and mandatory European Sustainability Reporting Standards (ESRS).

Main Findings

The new European Sustainability Reporting Standards (ESRS)

Based on the legal requirements for the application of the CSRD’s European sustainability reporting standards (Article 29b), EFRAG published the exposure drafts on the first set of non-sector-specific disclosures for reporting companies in spring 2022. After a consultation and revision period, EFRAG submitted a finalised Set 1 proposal (see graphic) to the Commission in November 2022. Following the Commission’s ongoing consultation process, the finalised ESRS will be adopted into EU law by a delegated act in June 2023.

The overarching standards include ESRS 1 (general principles for the preparation of sustainability reports) and ESRS 2 (overarching disclosure requirements). In addition to the description of the basic concepts from the CSRD, these standards include cross-thematic disclosure requirements – related to all topics – on materiality assessment and on strategy and governance, as well as the impacts, risks and business opportunities of sustainability-related information. Furthermore, framework conditions for the presentation of information and for the development of company-specific disclosures are also explained.

The thematic standards apply to all companies (regardless of sector) and are based on the regulations in the CSRD. They address sustainability aspects related to the environment (ESRS E1-E5), social issues (ESRS S1-S4) and governance (ESRS G1).

The CSRD (in Article 29b, paragraph 2a) relates to the six environmental objectives of the EU Taxonomy Regulation 2020/852 (climate change mitigation, climate change adaptation, water and marine resources, circular economy, pollution, biodiversity and ecosystems). In addition, the CSRD (in Article 29b, paragraph 2c) sets out the required information concerning governance aspects (e.g. the role of the undertaking’s administrative, management and supervisory bodies, with regard to sustainability matters).

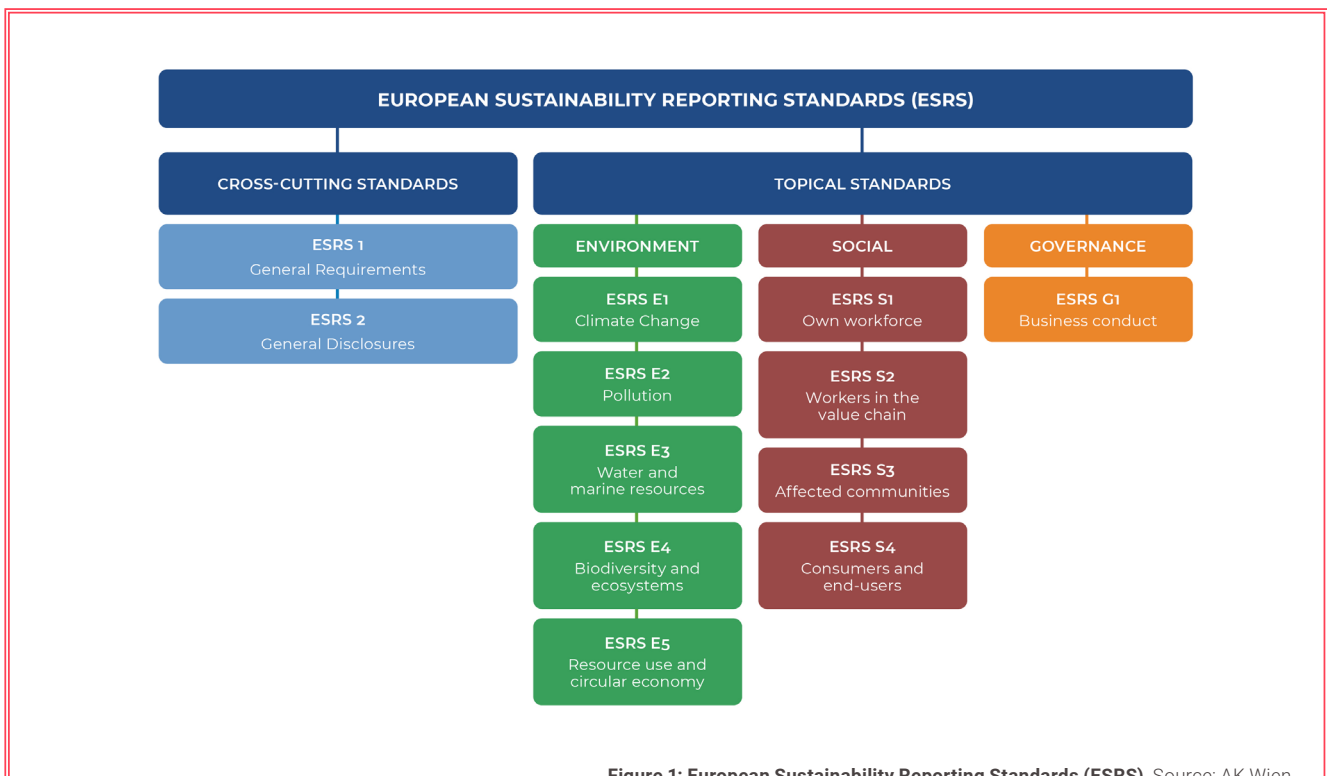


Figure 1: European Sustainability Reporting Standards (ESRS), Source: AK Wien

The following information is required to be specified concerning social aspects (Article 29b, paragraph 2b of the CSRD):

- 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, working time, adequate wages, social dialogue, freedom of association, existence of works councils, collective bargaining, including the proportion of workers covered by collective agreements, the information, consultation and participation rights of workers, work-life balance, and health and safety;
- respect for human rights, fundamental freedoms, democratic principles and international standards

AK's assessment of the standards with particular regard to social issues

The European Sustainability Reporting Standards are essential for reframing European sustainability reporting. This objective is supported by elements including the introduction of basic framework conditions for all companies that are subject to reporting requirements and a mandatory catalogue of performance indicators for the individual sustainability aspects.

However, compared to the aforementioned exposure drafts, there has been a significant reduction in disclosure requirements for companies. Essentially, not all sustainability aspects are to be classified as material. Only the General Disclosures (ESRS 2) and the topic-specific Climate Disclosures (ESRS E1) are still material for all entities.

With regard to social topics, we support the standard ESRS S 1 "Own workforce". These regulations provide important information on the sustainability indicators (e.g. health and safety, remuneration) which are especially relevant to the co-determination actors in the company (works councils, employee representatives). From the point of view of AK, it is important to consider social aspects in the CSRD.

However, the Regulations ESRS S 1-1 to S 1-9 of the current proposal are only mandatory for companies with more than 250 employees. For the successful implementation of the social-ecological transformation of economic activities, all social issues are of essential importance alongside

environmental issues. The entire S 1 standard should therefore also be mandatory for all companies – regardless of their size and industry/sector.

We welcome the objective under ESRS S 1 (Item 8) that companies should disclose their reporting information in accordance with international and European human rights instruments and conventions. Unfortunately, compared to the exposure drafts, the reference to the EU taxonomy has been deleted, mainly in relation to the approach and requirements for reporting according to the minimum social standards („minimum safeguards“). The EU taxonomy is already applied and provides important information on upstream and downstream supply chain activities. Therefore, this deletion is not comprehensible to AK.

Restrictions have also been placed on the specifications of the ESRS E 2-E 5; ESRS S 2-S 4; ESRS G 1 standards. They have only to be disclosed if they have been identified as material in the materiality assessment. However, the materiality assessment must be justified. In the field of corporate governance, the standards were reduced from two to one narrow standard. For AK, this represents a further deterioration of ESRS.

In addition, companies have repeatedly called for a link to international frameworks, as business activities are developing on a global scale and thus also concern international stakeholders. The first projects for the development of standards at the international level have therefore been implemented. The International Sustainability Standards Board (ISSB) published the first two draft IFRS Sustainability Disclosure Standards IFRS S 1 (General Reporting Requirements) and S 2 (Climate-related Disclosures) in March 2022. After a consultation period, the final standards are expected to be published in the first half of 2023. While the ISSB only addresses climate-related aspects, the ESRS has a broader focus on ESG matters.

In order to achieve appropriate comparability and consistency between the ESRS and the ISSB in the future, the ISSB has established a working group with representatives from the Commission and EFRAG. Further developments will show possible harmonisation efforts.

Demands

The following points should therefore be taken into account during the upcoming implementation of the reporting standards in European legislation or the development of further standards:

- The scope of disclosure requirements has been significantly reduced compared to the existing exposure drafts from the summer consultation. Further development of the ESRS must therefore ensure that the information needs of stakeholders who are significantly affected by corporate activities and their impacts are met. Relevant here, in particular, are the requirements of trade unions, works councils and employees for the reported sustainability indicators to provide a transparent, comparable representation of working conditions; in addition, they also require disclosure of the associated sustainability targets and risks.
- The present standards must not be further reduced or watered down in the legislative process. A particularly important example is ESRS S 1 "Own workforce": From the point of view of employee representatives, the entire ESRS S 1 standard should be considered to be essential for all companies (regardless of size and industry/sector) and should be disclosed on a mandatory basis.
- The standards are only available in English so far. A translation of the reporting standards into all official EU languages is necessary to give all stakeholders the opportunity to participate in the development of the ESRS and the related consultation process.
- Numerous terms are not clearly defined and can therefore be interpreted in different ways. They should be defined more clearly and included with the definitions of terms in the appendix (e.g. „highest paid individual“ S1-16 AR 92b). Clearly defined terms not only help companies to draw up their sustainability reporting, but also increase the comprehensibility, comparability and transparency of the reports for stakeholders.
- With regard to the further development of the standards (e.g. Set 2 for further sector-independent and sector-specific standards, a separate framework for capital market-oriented small and medium-sized enterprises and non-EU companies), trade unions, employee representatives, civil society and other relevant stakeholders must be included in the consultation process.
- At EU level, other EU regulations, such as the future Corporate Sustainability Due Diligence Directive, are to be used as a basis for the further development of key content areas of the ESRS.

Literature

EFRAG – ESRS Standards: [First Set of draft ESRS – EFRAG](#)

CSR-D: Nachhaltigkeitsreporting ermöglicht Mitbestimmung: [Nachhaltigkeitsreporting ermöglicht Mitbestimmung | Arbeiterkammer Wien](#)

CSR-D: Neue Regelungen für die Nachhaltigkeitsberichte: [Neue Regelungen für die Nachhaltigkeitsberichte | Arbeiterkammer Wien](#)

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