

Dialogue with standard setters

European Sustainability Reporting Standards (ESRS): The role of EFRAG

Begoña Giner*

1. Introduction by Marco Maffei and Pier Luigi Marchini

In this issue, we continue the discussion on Corporate Sustainability Reporting, which is far from being concluded in the short term. The European Commission has issued Directive 2022/2464/EU with the aim of making disclosure of non-financial information related to environmental, social, and governance issues mandatory.

To date, there are still too many concerns about how the directive will be implemented in practice by large and medium-sized companies across Europe. Therefore, we invited Ms. Begoña Giner, a professor of accounting and finance at the University of Valencia and a member of EFRAG SRB, to reply to some questions that help understand what the European Union's positions are towards the introduction of sustainability reporting principles and the key aspects of the said directive. Then, we focus on the role of EFRAG with regard to the adoption of ESRS. The interview will also focus on the next steps to be taken by the European Union (EU) to make the implementation of these standards effective.

We are deeply grateful to Professor Begoña Giner for contributing to the discussion in this journal from the dual position of academic and standard setter.

* Full Professor of Accounting and Finance at the University of Valencia (Spain). She has been a member of the Technical Expert Group of the European Financial Reporting Advisory Group (EFRAG TEG) and of the International Financial Reporting Standards (IFRS) Council, and President of the European Accounting Association (EAA). She is now an EFRAG Sustainability Reporting Board (SRB) member. E-mail: begona.giner@uv.es.

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2. Can you provide a brief overview of the steps given by the EU to introduce standards on sustainability reporting?

At the EU, the big step towards mandatory disclosure of non-financial information related to Environment, Social, and Governance (ESG) criteria came with the issuance of Directive 2014/95/EU on non-financial reporting and diversity. The *Non-Financial Reporting Directive* (NFRD) obliged large European companies to disclose information on the impact of their activity with respect to environmental and social issues, respect for human rights, and the fight against corruption and bribery. It also referred to the compliance with rules on equality, non-discrimination, and disability, indicating that this information should be disclosed based on recognized national or international frameworks. After that, the Global Reporting Initiative (GRI) Standards were probably the most used framework, at least in Spain.

However, after the issuance and adaptation of the Directive, both academics and professionals questioned the resulting information given its heterogeneity. In view of this, the European Commission (EC) concluded that it was necessary to establish more specific rules to make the information disclosed by companies comparable and more useful (Giner and Luque-Vílchez, 2022).

The process towards mandatory sustainability reporting accelerated due to the EC's commitment to the Sustainable Development Goals (SDGs). In April 2021, a proposal for a *Corporate Sustainability Reporting Directive* (CSRD) was published. Note the change of name from the previous Directive. This new provision covered ESG reporting, and unlike the previous one, announced the existence of specific rules that companies should follow to correct the deficiencies arising from the implementation of the NFRD. In December 2022, the CSRD was published, which does not differ from the 2021 proposal in fundamental aspects. However, the Omnibus simplification package released in February 2025 proposes relevant changes that might affect the Directive. I will refer to them later, but please keep in mind that at this moment, they are still proposals made by the EC.

3. Can you please tell us the key aspects of the Directive?

The 2022 Directive referred, among other aspects, to the mandatory nature of verification or assurance, which was already included in some local legislations, such as in the Spanish Law of adaptation to Directive

2014/95/EU. Although limited verification is required, according to the Directive, this is susceptible to being transformed into reasonable verification in the future, but one of the changes in the Omnibus proposals is to eliminate this provision. It is important to remark that the Directive does not specify whether the assurance must be carried out by an auditor or by another independent expert. The decision remains in the hands of the Member States. Another relevant aspect to highlight is that the Sustainability Statement must be included in the Management Report.

Regarding more conceptual aspects, to me, the most critical one is the introduction of the principle of “double materiality”¹, which affects the scope and objective of the standards (Giner, 2022). This principle establishes that *inside-out* impacts, or impact materiality, must be reported. This implies disclosing information that allows understanding how the entity, including its value chain, affects its environment in a broad sense, i.e., the planet and people. For example, how the entity relates to and affects its employees, or the community in which it operates and with which it relates. This materiality of impact can be interpreted as a further extension of the concept of “public interest” by broadening the objective and the stakeholders to which corporate reporting is oriented (Giner and Mora, 2024).

Based on this perspective, the stakeholders to whom the information is oriented are citizens, consumers, employees, partners, and communities in general, without giving investors special attention.

However, there is also the *outside-in* effect, or financial materiality, which involves reporting on how the value of the company, in terms of its development, performance, and market position, is affected by external social or environmental aspects. For example, how global warming or pollution may influence a company’s performance. The stakeholder group that is the main recipient of this information is investors. The two perspectives are not watertight, and it is likely that over a shorter or longer horizon, the company’s impact on the social and environmental environment will, to some extent, end up having an impact on the entity’s financial situation and performance. These two approaches together were coined as *dynamic materiality* by the World Economic Forum (WEF, 2020).

¹ It was implicit in previous position papers issued by the EC, but not in the NFRD (Baümüller and Sopp, 2022).

Importantly, the CSRD made it clear that there would be *European Sustainability Reporting Standards* (ESRS) prepared with technical advice from EFRAG. It also stated that the standards should bring to disclosures that meet the following qualitative characteristics: understandable, relevant, verifiable, comparable, and faithful, as required also for financial information. Lastly, I want to emphasize that the CSRD also states that ESRS should provide for the following minimum content: environmental, social, and governance. Consequently, the three topics should be considered right from the beginning.

4. Can you please clarify the role of EFRAG in the new EU landscape?

As mentioned earlier, the CSRD, even in its proposal, indicates that EFRAG is the technical body that should prepare the standards to be approved as Delegated Regulations by the EC. This legislative formula, unlike the directives, is of direct application to the affected undertakings, so it does not need transposition to national legislations. Therefore, it guarantees fast and equal implementation of the ESRS all over the EU.

As a result of the CSRD proposal, in January 2022, EFRAG was restructured², and a second pillar dedicated to sustainability reporting was created in parallel to the financial reporting one, with different objectives and powers. The new pillar includes the EFRAG *Sustainability Reporting Board* (EFRAG SRB) and the EFRAG *Sustainability Reporting TEG* (EFRAG SR TEG). The SRB is responsible for developing, with the help of the EFRAG SR TEG, and approving the ESRS that should be sent to the EC so that, if it deems it appropriate, it will endorse them and publish them following the procedure established in European legislation; while the EFRAG *Financial Reporting Board* (FRB) intervenes through its Board for the approval of the *International Financial Reporting Standards* (IFRS) in their endorsement, a necessary step for them to become mandatory in the EU. Another difference between the two Boards is that, unlike the FRB, the SRB includes the civil society chapter, in which academia, the *European Accounting Association* (EAA), is sitting.

² And since then, it is no longer called the *European Financial Reporting Advisory Group* but just EFRAG.

5. Regarding the introduction of the ESRS, can you please summarize the timing?

The CSRD provides for a staggered entry into force according to certain business characteristics, mainly size, based on employees, assets, and turnover, as is the case with the obligation to report different types of annual accounts. Regarding employees, as of January 1, 2024, public interest companies with more than 500 employees (already subject to the previous regulations adapted to the 2014 Directive) should submit their reports in 2025. As of January 1, 2025, large companies, listed or not, with more than 250 employees, will file their reports in 2026. As of January 1, 2026, listed small and medium enterprises (SMEs), except micro-enterprises, small and non-complex credit institutions, and captive insurance companies, will submit them in 2027, although they may delay it by two years. In 2029, third-country companies with at least one subsidiary or branch with registered office in the EU or with a net turnover of more than EUR 150 million in the European Community will have to submit the report for the 2028 financial year. Leaving aside entities in wave one that have already published their reports, the Omnibus proposes to postpone the application of CSRD for two years for other large companies and SMEs, and this has already been voted on. Moreover, the Omnibus proposes that only entities with more than 1,000 employees should prepare the sustainability statement on a mandatory basis.

The Directive also indicates that the ESRS must be proportionate, which explains the need to develop standards for listed SMEs.

6. To what extent do ESRS have to consider other frameworks for sustainability reporting?

The CSRD indicates that ESRSs have to consider existing frameworks. In particular, it refers to: GRI, *Sustainability Accounting Standards Board* (SASB), *International Integrated Reporting Council* (IIRC), *International Accounting Standards Board* (IASB), *Task Force on Climate-related Financial Disclosures* (TCFD), *Carbon Disclosure Standards Board* (CDSB), and CDP (formerly known as *Carbon Disclosure Project*). Many of these institutions, SASB, IIRC, IASB, and CDSB, have been integrated into the IFRS Foundation, which also holds the *International Sustainability Standards Board* (ISSB).

Moreover, the CSRD also states that ESRS should integrate ISSB standards if they are consistent with the Union's legal framework and the objectives of the European Green Deal. In that sense, one could argue that ISSB could be seen as a global baseline.

It is important to mention that in September 2023, an agreement was signed by EFRAG and the *Global Sustainability Standards Board* (GSSB), the issuer of GRI, so that there is interoperability between the two standards. This means that if a company follows ESRS, it is understood that it also reports in accordance with GRI. Some months later, in May 2024, guidance material was published to illustrate the high level of alignment between the ISSB Standards and the ESRS. This means that entities using ESRS will be able to report on climate and also comply with the ISSB Standards, with a very limited number of points to consider. This guidance confirms that the ISSB standards are a global baseline against which the incremental disclosures required by the ESRS may be added.

7. What is the current state of ESRSs?

In July 2023, the first Delegated Regulation was published, including 12 ESRSs that are related to: general standards (2), environmental aspects (5), social issues (4), and governance (1). This Delegated Regulation passed the scrutiny procedure by the Parliament and the Council in October 2023, and has been applied to wave one entities, as I mentioned earlier. However, Omnibus proposes to revise the ESRSs and develop a simplified version that, as indicated above, will be applied by the very large entities only.

In January 2024, EFRAG SRB issued for consultation the draft standards for listed SMEs. Draft recommendations have also been published for unlisted SMEs, the VSME, which will be affected by their role in the value chain of other companies, including financial institutions. Standards for non-EU companies remain to be addressed.

Regarding sectoral standards, about 40 were planned, and the work on Oil and Gas, and Mining Quarrying and Coal is in a very advanced stage. The drafts were already published for comment, but since Omnibus suggests that there should not be European sectoral standards, their development has been stopped.

In addition, and at the behest of the EC, in the last quarter of 2023, Standards three Implementation Guides were published, and after the comment period, they were already approved and published on the EFRAG

website. They have been developed with the aim of helping entities, assurers, and any stakeholder better understand how to interpret the ESRS. They deal with the following aspects:

- Value chain (*upstream*: suppliers and *downstream*: customers).
- Materiality analysis.
- List of Datapoints to be included in the ESRS.

To further facilitate the implementation and interpretation of the standards, in October 2023, the EFRAG SRB launched a platform for the Q&A *implementation process*. It aims to facilitate the adoption of the standards through the form of clarifications, implementation guidance, and application examples, as appropriate.

8. Final remarks

Financial reporting has been the main, and only, reporting system for many years worldwide, and its internationalization has occurred at a relatively slow pace over the last century. However, sustainability reporting, which appeared at the turn of the century, has gained enormous speed in recent years and, unlike financial reporting, has been international from the start. Thus, I would argue that two words characterize this new reporting system: speed and internationalization.

It is important to note that reporting standards may be mandatory, but they do not oblige companies to behave in one way or another. However, I would say that this seems to be the main goal of the CSRD: to be a mechanism to change the way companies and stakeholders behave to have a more sustainable planet. Indeed, this will entail some costs for the entities that have to prepare the information, and even some competitive disadvantages, but opportunities will also arise if they adapt their business model.

It is expected that companies will be more socially aware and even want to avoid the potential reputational cost of non-compliance, which could be detrimental to their profitability and therefore to their value.

Finally, it is important to note that the implementation of ESRS is a major challenge for preparers, auditors, and assurers of information, which makes it a priority to find a balance between advantages and disadvantages. This is an interesting challenge for the future of our society and opens doors to research on changes in stakeholder behavior.

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