Beyond the GAAP

Forvis Mazars' monthly newsletter on financial and sustainability reporting

Contents

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Editorial

The Corporate Sustainability Due Diligence Directive (CSDDD) has now entered into force following its publication in the Official Journal of the European Union on 5 July 2024. It must be transposed into national law by 26 July 2026. This major new directive, which establishes a corporate due diligence duty, will apply to around 6,000 European companies and around 900 non-EU companies. In other European news, this summer's publications include an EFRAG study on initial ESRS implementation practices, which we look at in detail in a feature in this issue.

On the financial reporting front, this summer saw the International Accounting Standards Board (IASB) publish multiple exposure drafts, including one that proposes illustrative examples of how to apply current IFRS Accounting Standards to report the effects of climate-related and other uncertainties in financial statements. This proposal, which responds to significant stakeholder demand, will certainly give rise to interesting discussions over the coming months.

IFRS Highlights

Improvements to IFRS Accounting Standards – Volume 11

In July 2024, the IASB published volume 11 of the Annual Improvements to IFRS Accounting Standards. We have summarised the content of these limited-scope amendments.

IFRS 1 – *First-time Adoption of International Financial Reporting Standards*

This amendment slightly changes the wording of paragraph B6 of IFRS 1 to improve consistency with the rules on hedge accounting set out in IFRS 9 – *Financial Instruments*. Cross-references to IFRS 9 have also been added to paragraphs B5 and B6 of IFRS 1.

IFRS 7 – *Financial Instruments: Disclosures*

- **Gain or loss on derecognition**

This amendment updates an obsolete cross-reference in paragraph B38 of IFRS 7.

- **Introduction**

This amendment clarifies that the application guidance does not necessarily illustrate all the requirements in the referenced paragraphs of IFRS 7.

- **Disclosures on differences between fair value and transaction price**

This amendment changes the wording of paragraph IG14 to bring it into line with the wording and concepts used in IFRS 13 – *Fair Value Measurement* (the wording of paragraph 28 of IFRS 7, which IG14 refers to, was changed when IFRS 13 was published in May 2011).

- **Credit risk disclosures**

This amendment changes the wording of paragraph IG20B to simplify the explanation of which aspects are not illustrated.

IFRS 9 – *Financial Instruments*

- **Derecognition of lease liabilities**

This amendment clarifies that, when a lessee derecognises a lease liability in accordance with IFRS 9, paragraph 3.3.3 of IFRS 9 applies (i.e. the lessee recognises a gain or loss in profit or loss).

- **Transaction price**

This amendment removes an inconsistency between paragraph 5.1.3 of IFRS 9 and the requirements of IFRS 15 – *Revenue from Contracts with Customers* (the wording “their transaction price (as defined in IFRS 15)” has been replaced by “the amount determined by applying IFRS 15”).

IFRS 10 – *Consolidated Financial Statements*

This amendment changes paragraph B74 to clarify that the relationship described is only one example of a situation in which judgement must be used to determine whether a party is acting as a ‘de facto agent’.

IAS 7 – *Statement of Cash Flows*

This amendment slightly alters paragraph 37 of IAS 7 by replacing the phrase “cost method” with “at cost”. The definition of the cost method was removed in May 2008, on publication of *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, but the term had remained in paragraph 37 of IAS 7 until now.

Effective date and transition provisions

The amendments above will be mandatory for financial periods beginning on or after 1 January 2026. However, early application is permitted.

An entity shall apply the amendment on the derecognition of lease liabilities to lease liabilities that are extinguished on or after the beginning of the annual reporting period in which the entity first applies that amendment. There are no transition provisions for any of the other amendments.

Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements*

At the end of July 2024, the IASB published an exposure draft (available here) offering eight examples illustrating the application of current IFRS Accounting Standards to the presentation of the effects of climate-related and other uncertainties in financial statements:

- Example 1 – Materiality judgements leading to additional disclosures (IAS 1/IFRS 18)
- Example 2 – Materiality judgements not leading to additional disclosures (IAS 1/IFRS 18)
- Example 3 – Disclosure of assumptions: specific requirements (IAS 36)
- Example 4 – Disclosure of assumptions: general requirements (IAS 1/IAS 8)
- Example 5 – Disclosure of assumptions: additional disclosures (IAS 1/IFRS 18)
- Example 6 – Disclosure about credit risk (IFRS 7)
- Example 7 – Disclosure about decommissioning and restoration provisions (IAS 37)
- Example 8 – Disclosure of disaggregated information (IFRS 18)

In response to strong demand from stakeholders, particularly investors, these examples aim to:

- improve the transparency of disclosures in the financial statements; and
- strengthen the link between financial statements and other aspects of an entity's reporting, such as sustainability disclosures.

These examples are not intended to add new requirements or amend existing standards. Instead, they aim to indicate how existing standards can be applied to provide investors with better information on climate-related risks and other uncertainties.

The comment period runs until 28 November 2024.

Exposure Draft *Translation to a Hyperinflationary Introduction Currency*

In late July 2024, the IASB published an exposure draft (available here) proposing to amend IAS 21 – *The Effects of Changes in Foreign Exchange Rates*.

These proposals follow on from the discussions held by the IFRS Interpretations Committee (IFRS IC) in 2022 as to the accounting treatment to be applied by:

- a parent entity whose presentation currency is that of a hyperinflationary economy, when it consolidates a subsidiary whose functional currency is that of a non-hyperinflationary economy; and
- an entity whose functional currency is that of a non-hyperinflationary economy, when it presents

its financial statements in the currency of a hyperinflationary economy.

Recognising the existence of this problem in many jurisdictions, and the inadequacy of existing standards to address it, the IFRS IC recommended the IASB to make narrow-scope amendments to IAS 21.

This exposure draft therefore proposes to clarify that:

- when an entity translates amounts from a functional currency that is the currency of a non-hyperinflationary economy to a presentation currency that is the currency of a hyperinflationary economy, it translates those amounts, including comparative amounts, using the closing rate at the date of the most recent statement of financial position; and
- an entity applying this translation method must disclose that fact and provide summary financial information on its foreign operations translated using this method.

The comment period runs until 22 November 2024.

Exposure draft proposing to amend IFRS 19

In late July 2024, the IASB published an exposure draft (available here) proposing to amend IFRS 19 – *Subsidiaries without Public Accountability: Disclosures*, published in May 2024 (see Beyond the GAAP no.187, 2024).

IFRS 19 simplifies the financial reporting of eligible subsidiaries (meaning subsidiaries without public accountability – i.e. that are neither listed nor financial institutions – and whose ultimate or intermediate parent produces consolidated financial statements under IFRS Accounting Standards that are available for public use) by allowing them to apply IFRS Accounting Standards with reduced disclosure requirements.

When drafting this standard, the IASB considered the disclosure requirements resulting from standards published as of 28 February 2021. Pending discussions on the appropriateness of further relief, the disclosure requirements arising from standards and amendments issued between 28 February 2021 and 1 May 2024 had been incorporated into IFRS 19 in their entirety.

The purpose of this consultation is therefore to ask stakeholders whether it would be appropriate to reduce the disclosure requirements arising from standards and amendments published between 28 February 2021 and 1 May 2024.

More precisely, the exposure draft proposes to reduce the disclosure requirements concerning:

- Lack of Exchangeability (amendments to IAS 21 – *The Effects of Changes in Foreign Exchange Rates*, issued in August 2023);
- International Tax Reform – Pillar Two (amendments to IAS 12 – *Income Taxes,* issued in May 2023);
- Supplier Finance Arrangements (amendments to IAS 7 – *Statement of Cash Flows* and IFRS 7 – *Financial Instruments: Disclosures,* issued in May 2023); and
- the financial statements (IFRS 18 – *Presentation and Disclosure in Financial Statements* issued in April 2024).

However, the IASB is not proposing to reduce the disclosure requirements arising from amendments relating to the classification and measurement of financial instruments (amendments to IFRS 7 – *Financial Instruments: Disclosures* and IFRS 9 – *Financial instruments*, issued in May 2024).

Finally, the exposure draft includes some thoughts on the forthcoming standard on Regulatory Assets and Regulatory Liabilities that will replace IFRS 14 – *Regulatory Deferral Accounts*.

The comment period runs until 27 November 2024.

PiR IFRS 9, Phase 2 – *Impairment:* IASB work reaches a conclusion

Following last May's decision to conclude the Post-implementation Review (PiR) of the impairment requirements in IFRS 9 – *Financial instruments*, the IASB published a report in July 2024 summarising its work and conclusions (the summary of findings and feedback statement can be found here).

The IASB focuses in particular on matters requiring action (for a detailed consideration of these topics, see the study published in Beyond the GAAP no.188, May 2024). These are:

- targeted improvements to credit risk disclosures under IFRS 7 – *Financial Instruments: Disclosures*. These disclosures include those relating to the impact of climate risks on the methods used to calculate the impairment of a financial asset, which are the subject of an illustrative example in the exposure draft on disclosures of climate risks and other uncertainties in financial statements (see above);

- clarification of the interaction of the impairment requirements and other IFRS 9 provisions, such as modification of contractual cash flows, derecognition and write-offs, along with aspects of presentation in the income statement, such as a component of the cost of risk. These will be examined in the IASB's ongoing Amortised Cost Measurement project; and
- the postponement of questions relating to financial guarantee contracts (FGC), considered low priority matters, to the next agenda consultation. The questions raised relate to:
  - assessing whether a financial guarantee contract held is an integral part of the contractual terms of a loan;
  - accounting for a non-integral financial guarantee contract held; and
  - accounting for a financial guarantee contract issued for which premiums are received over time.

PiR IFRS 15 approaches completion

During its July 2024 meeting, the IASB finalised its decisions on the Post-implementation Review of IFRS 15 – *Revenue from Contracts with Customers*. Concluding that, overall, the requirements of IFRS 15 are working as intended, the IASB does not plan to take any standard-setting action in the immediate future.

The following matters were therefore postponed to the next agenda consultation:

- assessing control over services and intangible assets to determine whether an entity acts as a principal or an agent;
- reporting consideration payable to a customer;
- applying IFRS 15 with IFRIC 12 – *Service Concession Arrangements,* including accounting for contractual obligations to maintain or restore service concession infrastructure;
- applying IFRS 15 with IFRS 10 – *Consolidated Financial Statements,* with particular reference to accounting for transactions in which an entity, as part of its ordinary activities, sells an asset by selling an equity interest in a single-asset entity that is a subsidiary (a 'corporate wrapper') and with IFRS 11 – *Joint Arrangements,* in particular accounting for collaborative arrangements.

The IASB has decided to wait for the Post-implementation Review of IFRS 16 – *Leases* to gather further evidence on matters related to assessing whether the transfer of an asset in a sale and leaseback transaction constitutes a sale under IFRS 15.

The IASB will shortly issue a project summary and a feedback statement to conclude the PiR of IFRS 15.

Updated IPTF working document on hyperinflationary economies

At the end of July 2024, the International Practices Task Force (IPTF) at the Center for Audit Quality's SEC Regulations Committee updated its working document listing countries that are considered to have hyperinflationary economies (accessible here).

The countries with a three-year cumulative inflation rate exceeding 100% are Argentina, Ethiopia, Ghana (newly included in the list), Haiti, Iran, Lebanon, Sierra Leone, Sudan, Suriname, Turkey, Venezuela and Zimbabwe. Yemen is no longer included (cumulative inflation rate over three years of between 70% and 100% in the last calendar year).

The countries where the cumulative inflation rate over three years is expected to exceed 100% this year are Egypt, Laos, Malawi and South Sudan

As in previous editions, the IPTF notes that the list is based on available data and does not claim to be exhaustive (e.g. Eritrea, Syria and Afghanistan are omitted).

IASB Board composition

The Trustees of the IFRS Foundation have announced the reappointment of Zach Gast and Bruce Mackenzie as members of the IASB. Their renewed terms of office will expire on 31 July 2028 and 30 September 2030 respectively.

The Trustees also extended Nick Anderson's second term of office by two years, to its maximum five-year term, until 31 August 2027.

For more details, see the IASB press release here.

Updates on jurisdictional adoption of sustainability reporting

The latest developments in adoption of the IFRS Sustainability Disclosure Standards around the world include:

- Switzerland – The Federal Council of Switzerland published a consultation which is open for comment until 17 October 2024 with two documents: Amendment to the Code of Obligations (transparency on sustainability aspects)—Explanatory report on the opening of the consultation procedure and Code of Obligations (transparency on sustainability aspects)—Preliminary draft.
- Chile – the Financial Market Commission (CMF) has issued regulatory proposals, modifying reporting requirements in the Integrated Annual Report, for public comment by 27 September 2024. The proposals include the application of IFRS S1 – *General Requirements for Disclosure of Sustainability-related Financial Information* and S2 – *Climate-related Disclosures* from 2026 for reporting on sustainability information.
- Translations of the IFRS Sustainability Disclosure Standards are now available in Japanese and Korean.

ISSB implementation insights

The second episode of the ISSB's Implementation Insights podcast summarises the key highlights of the June 2024 Transition Implementation Group (TIG) meeting, including questions related to the requirements to revise estimates when new information becomes available and comparative information when a company acquires or disposes of a subsidiary. The meeting summary provides details of the TIG discussions.

ISSB maintenance of the SASB standards

At its July 2024 meeting, the ISSB (International Sustainability Standards Board) discussed its approach to enhancing the SASB (Sustainability Accounting Standards Board) standards, concluding that:

- a phased approach will be followed;
- exposure drafts of enhancements to all standards in the Extractive & Minerals Processing sector, the Electric Utilities and Power Generators standard in the Infrastructure sector, and three standards in the Food & Beverage sector, will be developed with publication expected in the first half of 2025;
- targeted amendments to other Standards to ensure consistency of measurement of common topics across industries will be considered; and
- research to prioritise the sectors in the second phase and how to enhance the Sustainable Industry Classification System (SICS) will be made.

ISSB Webcast: overview of ESRS-ISSB standards interoperability

This IFRS Foundation webcast sets out an overview of the interoperability guidance issued in May 2024 (see Beyond the GAAP no. 188, 2024), explaining how companies can use the guidance to ensure compliance with both sets of standards.

European Highlights

EU Directive on corporate sustainability due diligence published in OJEU

On 5 July 2024, the Corporate Sustainability Due Diligence Directive (CSDDD) was published in the Official Journal of the European Union (OJEU), following the European Parliament's vote to adopt the legislation in April 2024 (see Beyond the GAAP no. 187, 2024) and its ratification by the EU Council in May 2024. The text of the directive is available in all EU languages (click here).

The CSDDD entered into force 20 days later, on 25 July 2024. On the same date, the European Commission also published an FAQ on the new directive. There are now no barriers to transposing the directive into national law; this must happen by 26 July 2026 at the latest.

The implementation schedule for the CSDDD is as follows:

- from 26 July 2027, i.e. three years after the CSDDD comes into force:

- EU companies and groups with more than 5,000 employees on average and global net turnover of more than €1,500m over the last financial period preceding 26 July 2027, with the exception of the measures necessary to comply with Article 16, concerning the disclosure of an annual statement on topics covered by the CSDDD, which member states shall apply to those companies for financial years starting on or after 1 January 2028; and
    - non-EU companies and groups with net turnover in the EU of more than €1,500m;
- from 26 July 2028, i.e. four years after the CSDDD comes into force:
    - EU companies and groups with more than 3,000 employees on average and global net turnover of more than €900m over the last financial period preceding 26 July 2028, with the exception of the measures necessary to comply with Article 16, concerning the disclosure of an annual statement on topics covered by the CSDDD, which member states shall apply to those companies for financial years starting on or after 1 January 2029; and
    - non-EU companies and groups with net turnover in the EU of more than €900m;
- from 26 July 2029: all other companies that fall within the scope of the CSDDD. Readers will remember that this scope includes: (i) EU companies (or groups) with more than 1,000 employees on average, and global net turnover of more than €450m; (ii) companies (or groups) that have entered into franchising or licensing agreements in the EU in exchange for royalties received from independent third-party companies of more than €22.5m in the EU, provided that the company had global net turnover of more than €80m; (iii) non-EU companies (or groups) with net turnover in the EU of more than €450m; and (iv) non-EU companies (or groups) that have entered into franchising or licensing agreements in the EU in exchange for royalties received from independent third-party companies of more than €22.5m in the EU, provided that the company had net turnover in the EU of more than €80m.

According to the FAQ mentioned above, the CSDDD is expected to apply to around 6,000 EU companies (or groups) and around 900 non-EU companies (or groups).

It should be noted that SMEs do not fall within the scope of the CSDDD. However, if they form part of the value chain of companies within the scope of the CSDDD, they may be asked to share information on their adverse actual or potential impacts, and to address those in line with the obligations of the company within the scope of the CSDDD.

European Commission publishes FAQ on CSRD

On 7 August 2024, the European Commission published an FAQ document to support companies with implementation of the Corporate Sustainability Reporting Directive (CSRD). Readers will remember that large undertakings that are public-interest entities and that have more than 500 employees must apply the CSRD from 1 January 2024.

The FAQ document was prepared by the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA). At this stage it has the status of a ‘Draft Commission Notice’; the final version of the FAQ will be translated into all the EU languages for publication in the Official Journal of the European Union (EU). It is thus still possible that changes will be made.

The European Commission also repeatedly emphasises that it is essential to refer to the legislation transposing the CSRD into national law to correctly understand how to implement the CSRD.

In practical terms, the document includes 90 FAQs, covering:

- sustainability information to be reported under Articles 19a and 29a of the Accounting Directive as amended by the CSRD (individual and consolidated sustainability statements, respectively);
- sustainability information reported under Article 40a of the Accounting Directive, which relates to non-EU companies or groups with significant activity in the European Union;
- the assurance of sustainability reporting; and
- a range of additional topics, including one question on the interaction with the Sustainable Finance Disclosure Regulation (SFDR).

The FAQ document provides useful clarifications on topics such as the scope of the CSRD (a flowchart is provided to help companies to identify the applicable sustainability reporting requirements and the corresponding application date); the conditions that must be met for European subsidiaries within the scope of the CSRD to be exempted from reporting requirements (particularly when the parent company is a non-EU undertaking); and the interactions with the EU Taxonomy Regulation (relating to Article 8 disclosures).

The European Commission also provides a limited number of clarifications on the interpretation of some of the requirements in 'ESRS Set 1' (European Sustainability Reporting Standards) adopted at end-July 2023, on matters where legal interpretation from the European Commission was deemed necessary.

For example, question 29 on the value chain provides clarification on the concept of 'reasonable effort' in paragraph 69 of ESRS 1 – *General Requirements*, which states that an entity shall estimate the information to be reported about its upstream and downstream value chain, if it has been unable to collect the necessary information after making reasonable efforts to do so.

In this question, the European Commission states that:

- each undertaking should determine 'reasonable effort' taking into consideration its specific factors and circumstances, as well as the external environment in which it operates. The European Commission lists the criteria that it considers may be useful when carrying out this analysis in accordance with paragraph 69 of ESRS 1. It states that any one of these criteria could on its own be sufficient to determine that reasonable effort has been made by the undertaking (though the criteria may also be applied in combination). The seven criteria listed by the European Commission are as follows:
    - the size and resources of the undertaking in relation to the scale and complexity of its value chain;
    - the technical readiness of the reporting undertaking to collect value chain information;
    - the availability of tools to access and share value chain information;
    - the size and resources of the actors in the value chain;
    - the technical readiness of the actors in the value chain;
    - the level of influence and buying power of the undertaking; and
    - connected to the level of influence, the 'proximity' of the actor in the value chain;
- it is expected that undertakings will more frequently have recourse to estimates in the first years of application of the new reporting requirements; and
- in all cases, the undertaking must consider whether the use of estimates is likely to affect the quality of the reported information.

These 'clarifications' should be particularly useful for reporting entities (see our feature in this issue on EFRAG's study, which highlights that value chain analysis is one of the most challenging areas for companies when implementing ESRS).

A final point to note is that in question 38, the European Commission clarifies that until the XBRL Taxonomy has been adopted by the EU (via amendments to the regulation on the European Single Electronic Format or ESEF), undertakings are not required to mark-up their sustainability statements or to prepare the management report in XHTML.

ESMA issues public statement on ESRS

On 5 July 2024, ESMA (the European Securities and Markets Authority) issued a public statement on ESRS (European Sustainability Reporting Standards) aimed at preparers (i.e. large issuers, who are part of either the first group to fall in the implementation scope of the CSRD, reporting in 2025 on the 2024 financial period, or the second group, reporting in 2026 on the 2025 financial period) as well as their auditors. The statement highlights topics that are deemed to be particularly relevant for first-time application of ESRS.

ESMA calls on members of the governing bodies of issuers, as well as on those providing assurance on sustainability statements, to ensure that the aspects highlighted in this public statement are carefully considered.

ESMA emphasises, in particular, the responsibility of the governing bodies, as well as the importance of the oversight role of the audit committee and other relevant committees, to (i) ensure the internal consistency of the sustainability statement and its consistency with the other parts of the annual financial report; (ii) implement and supervise internal controls; and ultimately (iii) contribute to a high-quality sustainability statement.

In practice, ESMA's statement focuses on two main areas:

- the resources that preparers and auditors should draw on when preparing and auditing the first sustainability statements: ESMA reminds them of the support material provided by the European Commission and EFRAG. It is important to consult the support material already published (FAQs, implementation guidance, explanations, etc.; see 'European Highlights' in this issue) and to escalate unanswered questions through EFRAG's Q&A platform, which was launched last October. EFRAG observes that, while most of the issuers who will publish a sustainability statement in 2025 already have experience with the Non-Financial Reporting Directive (NFRD), the novelty and depth of the exercise when applying the CSRD create challenges;
- 2025 reporting marks the start of a multi-year learning curve; however, ESMA notes that acknowledging this learning curve does not relieve issuers of their responsibility to ensure compliance with ESRS. The key areas to consider in 2025 are as follows:
    - establishing governance arrangements and setting up appropriate information systems and internal controls – even companies with experience of the NFRD must carefully assess whether the existing processes, systems and controls are still fit-for-purpose;
    - carrying out a robust double materiality assessment – an undertaking that previously reported under the NFRD will often need to reconsider the process and its associated disclosures. ESMA therefore encourages companies to consider the process described as an illustration in chapter 3 of EFRAG's implementation guidance on the materiality assessment (IG 1) in the design or update of their materiality assessment. Moreover, ESMA emphasises that properly applying the qualitative characteristics of sustainability information (see Appendix B of ESRS 1) is essential to prevent greenwashing. ESMA also underlines that transparency is required on how the materiality assessment has been carried out, and points out that the information required by Disclosure Requirement IRO-1 (a description of the processes to identify and assess material impacts, risks and opportunities) is mandatory for all the topics covered by ESRS, regardless of the outcome of the materiality assessment. ESMA also reminds issuers of the principles governing disclosure requirements on material impacts, risks and opportunities identified. In particular, ESMA emphasises the importance of the materiality assessment in the case of metrics, since if a metric is not published, this implicitly suggests that the metric is not material (with the exception of metrics required under other European legislation such as the SFDR, for which an undertaking must indicate where the metric is presented, or state that it is not material);
    - being transparent about the use of transitional reliefs permitted by ESRS 1 and about any uncertainties and data limitations, as well as the methodologies applied and significant assumptions used. This is essential to enable users of the sustainability statement to evaluate any limitations in comparability of information. ESMA notes that, as a general rule, the ESRS do not envisage cases in which a lack of data justifies the omission of disclosure of material information. Finally, ESMA reminds issuers that any complementary information that is not specifically required by ESRS must not obscure material information;
    - preparing a sustainability statement whose structure facilitates the future digitisation of published disclosures, with close attention paid to historical practices that may no longer be consistent with the legislation (cf. especially the conditions that must be met to incorporate information by reference); and
    - creating connectivity between financial and sustainability information.

ESMA also emphasises the importance for issuers of engaging in continuous training and dialogue with industry peers, as well as with auditors (or independent assurance services providers, if appropriate).

The public statement will be complemented by the publication at year-end of ESMA's annual European Common Enforcement Priorities, which will cover sustainability reporting under ESRS, as well as disclosures required under the Article 8 of the Taxonomy Regulation that must be included in the sustainability statement.

ESMA publishes guidelines on enforcement of sustainability information

Also on 5 July 2024, ESMA published its Guidelines on Enforcement of Sustainability Information (GLESI). With this report, ESMA and the regulators of financial markets in EU Member States are signalling that they intend to play a significant role in ensuring consistent and rigorous implementation of ESRS, as they do for financial reporting (like the 'GLEFI' – Guidelines on Enforcement of Financial Information).

The GLESI will apply to enforcement of sustainability information published in 2025 (i.e. the first ESRS sustainability statements).

In addition to the enforcement actions set out in the GLESI, the guidelines also encourage dialogue between issuers and other stakeholders, such as auditors and independent assurance services providers, to promote continuous improvement in the quality of ESRS sustainability reporting.

EFRAG publishes a fourth batch of answers on the application of ESRS

On 26 July 2024, EFRAG published its fourth Q&A on the implementation of ESRS, based on questions submitted through the Q&A Platform launched in late 2023 (see Beyond the GAAP no. 181, 2023). The published document is a compilation of 93 explanations released since February 2024, organised by standard and Disclosure Requirement.

For each case, EFRAG provides references to and extracts from the standards on which its explanations are based, to help the reader. EFRAG intends to publish responses on a regular basis, to support preparers and stakeholders with implementation of ESRSs.

Of the 25 explanations released in the July 2024 batch, 13 relate to environmental standards, 11 to cross-cutting standards and one to social standards. Some of EFRAG's explanations deserve particular attention, such as ID 432, which deals with disclosures on net-zero targets and GHG removals, and ID 555, which addresses information to disclose on the anticipated financial effects of climate change.

Finally, it should be noted that this time, EFRAG has added in an appendix a log of questions received that were categorised as 'already asked/answered'. For each of them, it provides a reference to the location where they have been answered, thus justifying the decision to reject these questions.

EFRAG delivers proposed XBRL Taxonomy for ESRS and Article 8

On 30 August 2024, EFRAG published its propositions of XBRL Taxonomy, which will be used for tagging sustainability information published in accordance with ESRS Set 1 and with Article 8 of Regulation (EU) 2020/852 on the European Taxonomy. The documents are accompanied by explanatory notes and illustrative examples of how to implement each taxonomy.

EFRAG was requested by the European Commission to provide technical support on the transposition of disclosure requirements relating to ESRS Set 1 and to Article 8 into a digital taxonomy using the XBRL (eXtensible Business Reporting Language) markup language. Using the taxonomy, each datapoint is assigned an XBRL tag. The aim is to make sustainability information machine-readable, in accordance with the rules set out in the CSRD, which requires tagging of information and publication of the management report, which includes the sustainability statement and thus Article 8 disclosures, in the XHTML format.

Drafts XBRL taxonomy were published for comment by EFRAG in February 2024, via two separate consultations (which ran until 8 April 2024). One consultation focused on tagging of ESRS disclosures, and the other on Article 8 disclosures. EFRAG has taken stakeholders' comments into account when developing its final proposals.

In practice, the two taxonomies will serve as a basis for the work that ESMA (the European Securities and Markets Authority) must now carry out. ESMA has been requested by the European Commission to develop the associated Regulatory Technical Standards (RTS). The RTS will eventually be adopted by the European Commission by way of a delegated act amending Commission Delegated Regulation (EU) 2019/815 on the European Single Electronic Format (ESEF), which already applies to annual financial reporting.

EFRAG publishes a study on initial ESRS implementation practices

On 25 July 2024, EFRAG issued a study entitled *State of play as of Q2 2024 – Implementation of ESRS: Initial Observed Practices from Selected Companies*, to identify the preliminary practices and issues observed in the implementation of ESRS in relation to the initial transition work.

On 25 July 2024, EFRAG issued a study entitled *State of play as of Q2 2024 – Implementation of ESRS: Initial Observed Practices from Selected Companies*, developed with the assistance of the Boston Consulting Group (BCG). The study considers a sample of undertakings that are subject to the Corporate Sustainability Reporting Directive (CSRD).

The study aims to identify the preliminary practices and issues observed in the implementation of the European Sustainability Reporting Standards (ESRS) in relation to the initial transition work (state of progress at Q2 2024). As the analysis is taking place during the first compliance period for these entities, EFRAG observes that the comments included in this study are in no way indicative of best practices, but represent a compilation of existing practices identified to date for this sample.

The study therefore focuses on the four topics that EFRAG considered critical for this first year of implementation, namely: the double materiality assessment, datapoints to be reported, the value chain and the organisational approach to Environment, Social and Governance (ESG) reporting.

The study sample consists of 28 large undertakings based in the EU, participating on a voluntary basis and drawn from a pool of the largest companies in each sector of interest. Focusing solely on large undertakings makes it possible to study issuers with a relatively higher level of maturity and greater resources at their disposal to address the challenge of ESRS implementation. These 28 undertakings represent eight industries evenly split between financial institutions (banking, insurance, asset management) and non-financial institutions (healthcare technology, chemicals, road transport, textiles and services). EFRAG points out that this sample does not represent all market participants and that, consequently, the practices cited in the study are not intended to be seen as generalised practices or industry trends.

Interviews and surveys were conducted with those responsible for ESG reporting and other key contributors (e.g. from the finance/risk, communications and operations teams) on the four focus areas mentioned above. The diversity of these points of view has enabled EFRAG to understand the overall context in which these preliminary practices are evolving and to identify the main challenges arising from them.

The double materiality assessment

The ESRS principles governing the double materiality assessment entail major methodological changes for undertakings. The EFRAG study suggests that most undertakings in the sample recognise that the double materiality assessment requires objective evidence, based on internal and external data, as well as the opinion of internal experts and stakeholders external to the company.

Against this background, 70% of sample undertakings have already started to deploy an objective evidence-based approach to the double materiality assessment, based on evidence derived from measurable data or, where no data is available, on the judgement of internal experts and of stakeholders. Undertakings use a combination of internal data, data supplied by third parties (e.g. data providers, benchmarks, etc.) and data derived from scientific research. This is seen as a strategic exercise for reporting purposes and for setting sustainability priorities. However, the study found that companies are encountering difficulties in terms of data availability, due to the lack of appropriate sectoral methodologies, and in setting appropriate thresholds, particularly for impact materiality assessment. To assess financial materiality, around 80% of the undertakings surveyed rely on the thresholds and methodologies used as part of their risk management approach.

More than 65% of participants say that they involve internal experts and external stakeholders during the double materiality assessment, using two or more communication channels (most commonly interviews, surveys and workshops). While around 70% of companies use surveys in combination with interviews and workshops, only around 5% of companies use surveys exclusively. This is because this data collection method is seen as inconclusive and often targets stakeholders with insufficient expertise. It is used inter alia to collect data from hard-to-reach stakeholders.

70% of sample undertakings run interviews to ascertain in-depth views. Workshops are also increasingly preferred, with 45% of undertakings leveraging this engagement channel.

The study also reveals that the stages at which these interactions occur during the double materiality assessment differ from one undertaking to another.

EFRAG also notes that the implementation of an ESRS-compliant double materiality assessment requires undertakings to have access to relevant data and to have (or have access to) expertise on ESG issues. This last condition is crucial if undertakings are to be able to analyse the information gathered and reach a conclusion about its relevance or materiality.

Identification of datapoints

Once they have identified their material impacts, risks and opportunities (IROs) using a double materiality assessment, undertakings must carry out gap analyses of the differences between the information already reported and/or available and the information required by ESRS standards. To support them, EFRAG has issued an *Implementation Guidance List of ESRS datapoints* (IG 3), covering ESRS Set 1. Around 95% of participants use IG 3 in their gap analysis.

Given the difficulties encountered by most of the sample undertakings in obtaining, extracting and collecting the required data, these undertakings will use the levers offered by the ESRS, in particular the transitional provisions, which will be applied by around 75% of the participants. This is indeed possible, provided, as EFRAG emphasises, that the undertaking communicates properly about the use of these provisions. Similarly, around 40% of undertakings leverage the information materiality principle to focus their efforts on disclosures in relation to their material IROs. However, EFRAG notes that only a minority of undertakings understand how to conduct an information materiality assessment at the datapoint level. The main risks associated with the disclosure of all datapoints lie in the effort required for reporting and the potential obscuration of material information.

The study also shows that around 10% of undertakings choose to report both mandatory and voluntary data points (DPs) for material topics while another ~10% opt for disclosure of voluntary DPs which they were already reporting in the past.

Value chain analysis

The ESRS require undertakings to carry out an in-depth analysis of their value chain, both upstream and downstream, in order to identify and account for the material IROs that result. The extent and granularity of this analysis may lead to complexity for undertakings, particularly those with several business activities.

At present, value chain analysis remains one of the most challenging and least mature areas for the undertakings surveyed, which are calling for more sector guidance. More than 90% of the undertakings mention that work on their value chain is still in progress. This work focuses primarily on identifying the appropriate level of granularity and segmentation of the value chain that will enable them to account for the resulting material IROs. Currently, around 45% of the sample have already adopted a more granular mapping of their value chain (i.e., more granular than upstream, downstream and own operations only). Finding the right level of value chain aggregation is a challenge for undertakings.

The study also revealed that financial and non-financial undertakings do not face the same difficulties when analysing their value chain. While financial institutions are limited in their access to data from the downstream part of their value chain, non-financial undertakings generally have a better overview of their value chain (and in particular the upstream component). However, these companies point to the difficulty of gathering data and deploying policies, actions and targets beyond direct business relationships.

The difficulties encountered by undertakings in retrieving information beyond direct relationships will be counterbalanced by the fact that several undertakings state their intention to make use of the value chain transitional provisions (ESRS allow a three-year period for gathering this information, subject to conditions). EFRAG expects the quality of reporting to improve over time, with the challenge now being to focus on sensitive areas of the value chain in relation to material IROs.

Organisation of governance

Implementing ESRS requires undertakings to adapt their governance systems to incorporate the 'cross-functional' dimension required to address ESG issues. They must also put in place robust information systems and quality controls enabling them to produce data that meets the quality requirements of the ESRS and to prepare for their audit. The study shows that the entities surveyed are implementing these changes following different timetables.

In around 65% of organisational structures observed, responsibility for non-financial reporting is assumed by a single function (most often the CSO or CFO) while around 35% employ a joint leadership model. 30% of sample undertakings expect changes in the organisational model in the near or medium term. The study reveals that the CSRD implementation process generally requires the regular involvement of at least five departments (in addition to the board / board-level committees overseeing the end-to-end reporting process), including departments such as Human Resources, Internal Control and Risk Management, as well as Sustainability and Finance. Departments such as Procurement, Communications and Strategy are also commonly engaged, reflecting the interdisciplinary nature of effective ESG reporting.

One of the challenges identified by EFRAG remains the training of the people responsible for this new reporting and the implementation of effective communication systems both to involve all these functions and to facilitate decision-making. The report also reveals that the majority of participants in this study are currently in the process of strengthening their ESG data controls (approximately 90% of undertakings have already adopted or are adopting internal control techniques akin to those used in financial reporting) and are planning to integrate this data into their operational and decision-making processes (around 85% of companies state that their ambition is to take ESG reporting and the results of their double materiality assessment into account). Finally, around 85% of undertakings acknowledge the need for IT transformation.

In the future, EFRAG expects to publish an annual analysis of ESRS implementation practices (a 'State of play'), which will cover a larger number of undertakings and will focus on audited sustainability statements.

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