RÉPUBLIQUE FRANÇAISE
Liberté
Égalité
Fraternité

ADEME
AGENCE DE LA TRANSITION ÉCOLOGIQUE

EU non-financial reporting:

What are the draft requirements of the EFRAG climate standard?

January 2022

EXPERTISES

ESG and sustainability disclosure and reporting requirements for listed and non-listed companies are rapidly taking shape. The CSRD proposal was released in April 2021 and will replace the Non-Financial Reporting Directive (NFRD). It is a transformative piece of legislation, targeting most large companies headquartered in Europe or listed on EU regulated markets and mandating standardised, audited corporate sustainability disclosures.
The first batch of working papers related to European Sustainability Reporting Standards (ESRS) has been released the 18th of January 2022. Among other documents, the first ESRS on climate change is published, leveraging the TCFD recommendations, GRI standards and inspired by SBTi and ACT initiatives and referencing GHG protocols and ISO standards. EFRAG plans to deliver a full set of draft standards to the European Commission in 2022, which are expected to embrace the CSRD's "double materiality" principle, covering both risks to and impacts of companies.

Avec la contribution du programme LIFE de l'Union Européenne

1. General architecture

The draft detailed architecture of ESRS is presented in Figure 1 below and in detail in the EFRAG cover letter. The Working Papers included in Batch 1 are highlighted in blue. In this article, we focus on the ESRS E1 related to climate change.

Figure 1

				SECTOR-SPECIFIC STANDARDS		PRESENTATION
Strategy, governance, impacts, risks, opportunities	**Environment**	**Social**	**Governance**	**Classification**	**ESG sector-specific disclosures**	
ESRS 1 General provisions	ESRS E1 Climate change	ESRS S1 Own workforce – general	ESRS G1 Governance, risk management and internal control	ESRS SEC1 Sector classification		ESRS P1 Sustainability statements
ESRS 2 Strategy and business model	ESRS E2 Pollution	ESRS S2 Own workforce – working conditions	ESRS G2 Products and services, management and quality of relationships with business partners			
ESRS 3 Sustainability governance and organisation	ESRS E3 Water & marine resources	ESRS S3 Own workforce – equal opportunities	ESRS G3 Responsible business practices			
ESRS 4 Sustainability material impacts, risks and opportunities	ESRS E4 Biodiversity & ecosystems	ESRS S4 Own workforce – other work-related rights				
ESRS 5 Definitions for policies, targets, action plans and resources	ESRS E5 Circular economy	ESRS S5 Workers in the value chain				
		ESRS S6 Affected communities				
		ESRS S7 Consumers/ End-users				

CONCEPTUAL GUIDELINES					
ESRG 1 Double materiality	ESRG 2 Characteristics of information quality	ESRG 3 Time horizons	ESRG 4 Boundaries and levels of reporting	ESRG 5 EU and international alignment	ESRG 6 Connectivity

2. Structure of the European Sustainability Reporting Standard – Climate mitigation and adaptation

The scope of the standard is framed by the CSRD proposal and aligned with the EU's Sustainable Finance Disclosure Regulation (SFDR) and the EU taxonomy. The first draft standard was supported by a comprehensive Basis for Conclusions document and brings three different areas of disclosure, as shown in figure 2. The Basis for conclusions explains the rationale behind the proposed disclosure requirements. It describes why disclosures should be required (objective and scope of the standard, background, references to the main EU and international frameworks.

3. Overview of ESRS E1 Disclosure Requirements:

Figure 2

Specific topical DR on Strategy	DR on Implementation	DR on Performance measurement
- **DR1:** Transition plan in line with the Paris Agreement - **DR2**: Resilience of the strategy and business model to principal climate-related transition and physical risks - **DR3**: Climate-related targets and performance indicators in relation to compensation scheme - **DR4**: internal carbon pricing schemes - **DR5**: processes to identify material climate-related impacts, risks and opportunities - **DR6**: material climate-related impacts, risks and opportunities	- **DR7**: policies implemented to manage climate change mitigation and adaptation - **DR8**: measurable targets for climate change mitigation and adaptation - **DR9**: climate change mitigation and adaptation action plans - **DR10**: resources allocated to climate change mitigation and adaptation action plans	- **DR11**: Energy consumption & mix - **DR12**: Energy intensity - **DR13**: Scope 1 GHG emissions - **DR14**: Scope 2 GHG emissions - **DR15**: Scope 3 GHG emissions - **DR16**: Total GHG emissions - **DR17 - optional**: GHG removals - **DR18 - optional**: Financing GHG mitigation projects outside of the undertaking's value chain - **DR 19**: Avoided GHG emissions from products and services - **DR20**: GHG intensity - **DR21**: Financial exposure to physical risks - **DR22**: Financial exposure to transition risks - **DR23 – optional**: financial opportunities related to climate change mitigation or adaptation other than the Taxonomy Regulation

Today the draft working paper contains 23 disclosure requirements that are familiar to preparers as a significant part of them was required by the NFRD and other reporting standard initiatives.
Four main disclosures items from EFRAG draft on Climate Change stand out from the current landscape.

3.1. Transition plans: What is the objective of the transition plan in line with the Paris Agreement ?

From this date, the transition plan requirement disclosure reflects parts of the best practices available such as UNFCCC ACT initiative and the TCFD latest guideline and is mostly in line with the IFRS prototype. The concept of corporate transition plans has gradually permeated the sustainable finance discourse, especially within the CSRD EU Commission proposal and the EU Taxonomy. The main objective is to help preparers, stakeholders and regulators to assess the credibility of the climate target set by the company. It contains innovative disclosures such as the identification of the decarbonisation levers and the locked-in emission, requiring modelling efforts from the company. These items are crucial to give credibility to the readiness of the company to achieve its transition and it gives visibility on the likelihood of the achievement of the targets.

It is a very important signal and the EU Commission should now build upon this draft and explore the relationship between transition plans and sustainable finance policies. The EU Commission may now work on the usability of the information for future regulations, in particular, the Sustainability Governance Regulation, and the link with the Capital Requirement Regulation and the EU Taxonomy. The objective should be to identify pathways of action for achieving efficient use of the corporates' climate transition plans.

3.2. Targets: Does the standard reflect the best available targets setting practices?

First of all, the draft standards specify what shall be disclosed about the company's climate change mitigation targets. It does not prescribe that companies must adopt a target – the corporate obligation regarding targets could instead be included in different regulations such as the Sustainable Corporate Governance. However, **the standard makes mandatory the disclosure of any "adopted" target** intending to ensure compatibility with limiting global warming to 1.5 °C.
The climate disclosure shall include the undertaking's GHG emissions reduction targets for **Scope 1, 2, and 3 and if the GHG emission reduction target is not consistent with the GHG inventory, the undertaking shall disclose the percentage of the GHG emissions** (Scope 1, 2, 3 and total) covered by the target, in addition with :

- an explanation of the expected contributions from different decarbonisation levers to the achievement of the target (related to the transition plan)
- a presentation of the information over the target period preferably in five years rolling periods and at least including target values for the years 2030 and 2050
- a presentation of the information over the target period with reference to a 1.5°C climate scenario or, if not available, with reference to the -55% EU GHG emissions reduction target in 2030

This requirement would give credibility to companies commitment, it acknowledges the modelling efforts of the company with regards to the foreseen reduction levers compatible with the transition plan and should allow a comparison with the 1.5°C target or the -55% EU GHG emissions reduction target in 2030. Regarding the Net Zero target, EFRAG concludes that there is not at this time a consensus on the definition and methodologies for assessing climate neutrality and/or net-zero emissions at the entity level. However, the standard requires specifying the methodology and frameworks applied and use for the net-zero target, to which scopes the target applies and how the residual GHG emissions are intended to be neutralised.

3.3. Scope 3: does the draft standard take into account Scope 3 GHG emissions?

EFRAG recognises that for many undertakings, Scope 3 GHG emissions are the main components of the GHG inventory and an important driver of their transition risks. Scope 3 is included and shall be limited to GHG emissions from significant Scope 3 categories and presented as a breakdown by GHG emissions from: (i) upstream purchasing, (ii) downstream sold products, (iii) goods transportation, (iv) travels and (v) financial investments. Significant Scope 3 categories should be based on estimated GHG emissions following the criteria provided by GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard (Version 2011, p. 63) or ISO 14064-1:2018 Annex H.3.

3.4. Removal, offsets and avoided emissions

These three items are part of the working paper as additional optional disclosures. The application guidance of the main body gives calculation rules and principles for the disclosure. Offsets and avoided emissions shall not be included for GHG inventory to settle its total GHG emissions and shall not be disclosed as a means to reach GHG reduction targets. However, EFRAG recognises that the financing of GHG mitigation projects can avoid, reduce or remove GHG emissions.

These Working Papers are not open to public consultation but will serve as work-in progress documents leading to the exposure drafts to be submitted to future public consultations. Subsequent steps of the due process are detailed in the cover letter.

Building upon the draft standards, the EU Commission may consider doing further work on specific guidelines on the use of transition plans, net-zero emissions target and carbon budget allocation approaches. This would be helpful for market participants and regulators to assess the credibility of company's transition plans and targets, which can then adjust their actions and policies accordingly.