

Time horizons in ESRS 1

Background

- 1 As required by the CSRD, undertakings shall include in their sustainability reporting information related to short, medium and long term time horizons as applicable.
- 2 Appendix 1 to this paper reports the approach in ESRS EDs and Appendix 2 reports the approach in IFRS S1.
- 3 This topic represents a key concept for the overall materiality approach and, as such, it is relevant for achieving alignment with the IFRS Standards.

Feedback from the consultation

- 4 The average support rate across categories is the following:
 - (a) Q31: do you think it is relevant to define short-, medium- and long-term horizon for sustainability reporting purposes? Average recalculated support rate across all the categories is 74%, while relevant differences exist between business associations and companies (between 22% and 45 %) and NGOs/Academics/Trade Union/Rating agencies (between 80% and 100%).
 - (b) Q32: if yes, do you agree with the proposed time horizons? Average recalculated support rate across all the categories is 60%, while relevant differences exist between business associations and companies (between 19% and 30%) and NGOs/Academics/Trade Union/Rating agencies (between 60% and 100%).
- 5 At the time of preparation of this paper, the analysis of the consultation's feedback is still in progress. The paragraphs below report the preliminary feedback, including on the basis of a sample of responses. Different views exist.
 - (a) The standard should require to disclose how short-medium-long terms have been defined by the undertaking but the undertaking should be able to define its own time horizons. A more principles-based approach should be promoted, aligned with the IFRS approach;
 - (b) it is not clear whether ESRS 1, par. 84 (which hints at some tailoring of time horizons) takes precedence or should be read in conjunction with par. 83 (which instead mandates strict time bands);
 - (c) for different sustainability topics, different definitions for time horizons are relevant;
 - (d) alternative definitions have been proposed, such as: short term (1/3 year), medium (4-9 year), long (more than 10 years);
 - (e) suggestion to add a 'very long term' horizon (more than 10 years) on top (in particular suggested by insurers);
- 6 Among the respondents, CDP Europe has proposed the following redrafting of paragraph 84 of ESRS 1:

*In its processes of identification and management of material impacts, risks and opportunities, the undertaking shall adopt time horizons, **which may differ from the ones presented in paragraph 83 and are to be specified at the level of topical and/or sector standards, that reflect the expected impacts on people or the environment or the expected financial effects**, including an additional breakdown for the long-term*

when necessary. When defining its action plans and setting targets, the undertaking shall adopt time horizons that reflect its strategic planning horizons and resource allocation plans. When preparing its sustainability report, the entity shall: (a) present its material impacts, risks and opportunities classifying them in the relevant time horizon; and (b) present its action plans and targets classifying them in the relevant time horizon.

- 7 Among the respondents, EBA suggests that a strict definition of short-, medium- and long-term horizon should be avoided in order to make easier the interconnection between sustainability disclosures and undertakings' financial plans and business strategy. Moreover, a flexible definition can foster the alignment between ISSB and Pillar 3 disclosure requirements. In the latter, it is required that institutions shall indicate the time horizon used for the assessment of the environmental risk on the accounting and prudential metrics, i.d. short-term, medium-term or long-term time horizon.
- 8 Among the respondents, ESMA suggests that EFRAG work with the ISSB to get to a common understanding of time horizons and their possible definition. The draft IFRS S1 proposes a principles-based approach that EFRAG may want to consider.

EFRAG Secretariat assessment

- 9 The statistics show a strong support rate for having a definition of time intervals for reporting purposes. The support rate is lower for the time horizons proposed in ESRS E1.
- 10 ESRS 1 paragraph 84 requires to adopt time horizons that reflect the undertaking's specific facts and circumstances in the identification and management of material impacts, risks and opportunities and in defining its action plans and setting targets. In this respect it is consistent with the approach in IFRS S1. The time intervals defined in ESRS 1 par. 83 set conventional (but mandatory) ranges to be applied in the presentation of information about impacts, risks and opportunities and action plans, targets, etc. This will support to achieve comparability across undertakings. Further explanation can be found in the BfC to ESRS 1.
- 11 However, in ESRS1 ED, the use of these predefined time intervals for reporting purposes should not limit the ability of an undertaking to have its own definition of short, medium and long term for their managerial purposes, i.e. when assessing its IROs and defining its action plans/targets. As shown by the feedback to the consultation, the current text of paragraphs 83 and 84 is not clear in this respect.

Proposed amendments to ESRS 1 proposed to the EFRAG SR TEG

- 12 EFRAG Secretariat suggests to amend the two paragraphs as described below.
- 13 As an illustration, assume that an undertaking has defined medium term from two to three years and has defined a number of targets to be achieved by the end of this period. When presenting the information in their sustainability statements, their medium-term plan would be presented as part of the time interval 'two to five years'. They would explain that medium term for them is from two to three years, but still present the targets in the conventional time interval from two to five years.

ESRS 1 – Par. 83

When preparing its sustainability report, the undertaking shall adopt the following *conventional* time intervals as of the end of the reporting period:

- (a) one year ~~for short-term~~;
- (b) two to five years ~~for medium-term~~; and
- (c) ~~from more than five to ten years for long-term~~; and
- (d) more than ten years.

Topical or sector specific ESRS standards may define specific conventional time intervals to be used when reporting on a specific matter; in that case the provisions of the topical standard prevail.

ESRS 1 – Par. 84

In its processes of identification and management of material impacts, risks and opportunities, the undertaking shall adopt time horizons that reflect the expected impacts on people or the environment or the expected financial effects, including an additional breakdown for the long-term when necessary. When defining its action plans and setting targets, the undertaking shall adopt time horizons that reflect its strategic planning horizons and resource allocation plans. Such time horizons may differ from the conventional time intervals defined in paragraph 83. When preparing its sustainability report, the entity shall:

- (a) disclose how it defines short, medium and long term and how these definitions are linked to the entity's strategic planning horizons and capital allocation plans;*
- (b) present its material impacts, risks and opportunities classifying them in the conventional ~~relevant~~ time intervals defined in paragraph 83 ~~horizon~~; and*
- (c) present its action plans and targets classifying them in the conventional ~~relevant~~-time intervals ~~horizon~~ defined in paragraph 83.*

EFRAG SR TEG discussion on the 6 September 2022

- 14 EFRAG SR TEG discussed the proposed re-drafting of paragraphs 83 and 84 described above. 17 members participated to the meeting.
- 15 A majority of them supported the compromised proposed by the EFRAG Secretariat, with the following individual comments:
 - (a) The proposed re-drafting adds complexity, however this complexity is a price to pay to have at the same time alignment with the concepts in the IFRS and TCFD and more comparability;
 - (b) The flexible approach would not be in the spirit of the CSRD, comparability is in the public interest;
 - (c) The IFRS foundation serves only investors while ESRS have to accommodate the need of other stakeholders;
 - (d) Adopting conventional intervals when preparing the disclosure doesn't impair the ability of preparers to use their own time horizons when assessing their IROs and their actions;
- 16 A minority of them supported a different approach, with the conventional intervals applied by the undertakings only when reporting items for which they do not contradict the managerial definitions of short, medium and long terms. When another timing is considered more relevant, the undertakings would have the ability to apply their entity-specific timing and do not apply the conventional intervals. The following individual comments were made:
 - (a) There is a trade between relevance and comparability. The IFRS approach allows to link the reporting with the way the business is steered, anything else would be artificial;
 - (b) A non-mandatory guidance (i.e. 'the undertaking may apply these intervals') for conventional time intervals would help, but the main point is to align with the IFRS flexible approach;
 - (c) The proposed conventional time horizons may trigger double reporting, to the extent that for IFRS reporting the entity-specific time horizon for medium term is up to four years while for ESRS it is up to five years;

- 17 Members agreed to add the fourth time interval (more than five years) as five years is not sufficient for topics such as climate.

Questions to SRB members and observers

- 18 Do you agree with the proposed re-drafting?
- 19 Do you have any specific suggestion on how to improve the proposed drafting?

APPENDIX 1 – APPROACH IN ESRS ED

ESRS 1 – Par. 83

When preparing its sustainability report, the undertaking shall adopt the following time intervals as of the end of the reporting period:

- (a) one year for short-term;
- (b) two to five years for medium-term; and
- (c) more than five years for long-term.

ESRS 1 – Par. 84

In its processes of identification and management of material impacts, risks and opportunities, the undertaking shall adopt time horizons that reflect the expected impacts on people or the environment or the expected financial effects, including an additional breakdown for the long-term when necessary. When defining its action plans and setting targets, the undertaking shall adopt time horizons that reflect its strategic planning horizons and resource allocation plans. When preparing its sustainability report, the entity shall:

- (a) present its material impacts, risks and opportunities classifying them in the relevant time horizon; and
- (b) present its action plans and targets classifying them in the relevant time horizon.

ESRS E1 – AG 17

When disclosing the information required under paragraph AG14 (b) on physical risks, the undertaking shall explain whether and how:

- (a) it has identified climate-related hazards (see table below) over the short-, medium and long-term and screened whether its assets and business activities may be exposed to them;
- (b) it has defined short-, medium- and long-term time horizons and how these definitions are linked to the expected lifetime of the undertaking's assets, strategic planning horizons and capital allocation plans;
- (c) it has assessed the extent to which its assets and business activities may be exposed to the identified climate-related hazards, taking into consideration likelihood, magnitude and duration of the hazards; and
- (d) the identification of climate-related hazards and assessment of exposure are informed by high emissions climate scenarios, for example based on IPCC SSP5- 8.5 or relevant regional scenarios. For general requirements regarding climate related scenario analysis see paragraphs AG19 to 21.

ESRS E1 – AG19

When disclosing the information required under paragraphs AG14 (b) and (c), the undertaking shall explain how it has used climate-related scenario analysis to inform the identification and assessment of physical and transition risks and opportunities over the short-, medium- and long-term, including:

- (a) which scenarios were used, their sources and their alignment with state-of-the-art science;
- (b) narrative, time horizons used, and endpoints used with a discussion of why it believes the range of scenarios used covers its plausible risks and uncertainties;
- (c) the key forces and drivers taken into consideration in each scenario and why they are relevant to the undertaking, such as policy assumptions, macroeconomic trends, energy usage and mix, and technology assumptions; and

(d) key inputs and constraints of the scenarios, including their level of detail (e.g., whether the analysis of physical climate-related risks is based on geospatial coordinates specific to the undertaking's locations or national- or regional-level broad data).

ESRS E2 – par. 52

The undertaking may include an assessment of the market size of related products and services at risk over the short-, medium-, and long-term, explaining how these are defined, how financial amounts are estimated and which critical assumptions are made.

ESRS E4 – par. 34

The targets disclosed under paragraph 27 shall include where applicable:

(a) regarding the timeframe of the target: short-term relates to 1-5 years from the baseline year, medium-term to 5-10 years and long-term to 10 years and more, but no later than 2050;

(b) a presentation with milestones including a set date in 2030;

(...).

APPENDIX 2 – APPROACH IN IFRS ED

IFRS S1 – par. 16

The entity shall disclose:

(a) a description of significant sustainability-related risks and opportunities and the time horizon over which each could reasonably be expected to affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term; and

(b) how it defines short, medium and long term and how these definitions are linked to the entity's strategic planning horizons and capital allocation plans.

IFRS S1 – par. 18

The short, medium and long term time horizons referred to in paragraph 16(a) can vary and depend on many factors, including industry-specific characteristics, such as cash flow and business cycles, the expected duration of capital investments, the time horizons over which the users of general purpose financial reporting conduct their assessments, and the planning horizons typically used in an entity's industry for strategic decision-making.