european contact group

Attn Mr Hans Buysse
Administrative Board President, EFRAG
European Financial Reporting Advisory Group (EFRAG)
35, Square de Meeûs
1000 Brussels

1 August 2022

Subject: Public consultation on the first set of draft European Sustainability Reporting Standards (ESRS)

Dear Mr Buysse,

The European Contact Group (ECG), which brings together the six large professional services networks in Europe (BDO, Deloitte, EY, Grant Thornton, KPMG and PwC), welcomes the opportunity to respond to the public consultation on the draft European Sustainability Reporting Standards (ESRS) developed by the EFRAG Project Task Force (PTF).

We acknowledge the difficult and challenging task that EFRAG and its PTF have had in providing a first draft of ESRS within a complex legal framework and with limited time and resources. Sustainability reporting standards are a fundamental component in achieving the high quality, reliable and comparable corporate information needed for decision-making and to transform the European economy to a sustainable one. Other key components include effective internal processes and controls, independent audit committees, high quality independent external assurance, engaged investors and stakeholders and strong supervisory bodies.

We support the level of ambition of the European Green Deal and the Corporate Sustainability Reporting Directive (CSRD). We agree that there is a need for sustainability standards of quality that deliver relevant information to stakeholders, including investors, and which incorporate requirements necessary for in-scope companies to describe how they are transforming their business models for sustainability under EU law.

The draft ESRS are without doubt comprehensive. That said, we have concerns about their structure, content, overall complexity, practicability for companies to implement, and due process. We make some recommendations on how to address these concerns and to help ensure that the standards can achieve their objectives and command the confidence of preparers, users and other stakeholders.

Our main comments can be summarised as follows:

a) We support a global baseline for sustainability reporting, onto which EU and other jurisdictional requirements can be added. We therefore encourage EFRAG to continue its work with the International Sustainability Standards Board (ISSB) and other parties in pursuit of this aim. Companies should ultimately be confident that by complying with the ESRS, they also comply with the ISSB standards, using the same data collected and processed by the company.

b) Additional guidance is needed on the concepts of double materiality, impact materiality, financial materiality, and information materiality found in ESRS 1 *General Principles.* The aim of this additional guidance would be to support practical implementation, fit for purpose and comparable reporting, and interoperability with ISSB's standards. In addition, guidance needs to be developed on how to perform the double materiality exercise. More precise requirements and guidance would remove the need for the rebuttable presumption of materiality of each disclosure requirement.

c) The level of detail and quantity of information required by ESRS is likely to lead to information overload, so reducing transparency and potentially confidence. We recommend reducing the number of mandatory disclosures. In addition, it is also important to allow companies sufficient time to collect data and to build processes, systems, and internal controls that deliver high quality data. This is a pre-condition for providing high quality independent assurance. When considering the level of detail and quantity of information to specify in the standards, we recommend that EFRAG focus on decision-useful information under cost benefit aspects, with the objective of identifying and retaining only those disclosures that are the most urgent requirements of the EU legal framework.

d) We understand the reasons for the timetable set out by the EU legislators. We are, however, concerned that it will not allow EFRAG sufficient time (i) to analyse and properly address stakeholder feedback on the proposals; (ii) to perform an impact assessment; (iii) for the EFRAG Sustainability Reporting Technical Experts Group and Board to do their technical work; and (iv) to deliver a final set of high quality standards. We strongly recommend that EFRAG ask for more time to allow appropriate due process, better integration of the global baseline, and to help ensure that the final standards are fit for purpose and command the confidence of both preparers and users.

A. Global baseline and interoperability

We welcome the EU's commitment under the CSRD[1] to build on, and contribute to, a global baseline for sustainability reporting, while catering for the needs of the EU's sustainable finance legislation. European standards should therefore seek to avoid duplicating reporting by integrating and converging with the key concepts and definitions of the global baseline being developed by the ISSB to the greatest extent possible.

For this to happen, we urge EFRAG and ISSB to work even more closely together and publicly to communicate progress made in this regard. We support the collaboration that has already been established through the ISSB Jurisdictional Working Group.

Currently, the differences between the draft standards of EFRAG and ISSB are such (including materiality considerations, the architecture of the standards, and differences in terminology and requirements) that they appear to prevent companies within the scope of the CSRD from claiming compliance with both at the same time within a single report.

Structure of standards

The proposed reporting areas used in ESRS (strategy, implementation and performance measurement) are different from those used by the ISSB, who have adopted the four pillars of the TCFD recommendations (governance, strategy, risk management, and metrics and targets).

We recommend that ESRS should be based explicitly on these four TCFD pillars, rather than adopting a divergent approach. A consistent four pillar approach would facilitate the integration of the content of global baseline standards to be developed by the ISSB into the ESRS. A divergent approach would complicate the reporting landscape for both preparers and users of sustainability information.

Interoperability

It would be helpful for preparers and users to understand where ESRS integrate the global baseline and where they go further, so that companies can have confidence that by applying European standards they also comply with the ISSB standards. For instance, EFRAG could clearly identify in its standards where the content is the same as that produced by the ISSB. Furthermore, going forward, as revisions and further requirements will be published by both EFRAG and the ISSB for their respective standards, we believe that it is important to set a governance process to address considerations of ongoing alignment.

---

[1] Recital 37 (*"European standards should reduce the risk of inconsistent reporting requirements on undertakings that operate globally by integrating the content of global baseline standards to be developed by the ISSB, to the extent that the content of the ISSB baseline standards is consistent with the EU's legal framework and the objectives of the European Green Deal."*)

Article 29b.2: *"The standards shall avoid disproportionate administrative burden on undertakings, including by taking account to the greatest extent possible the work of global standard-setting initiatives for sustainability reporting as required by paragraph 3, point (a)."*

B. Double materiality, impact materiality, financial materiality, information materiality and materiality rebuttable presumption

We acknowledge the double materiality approach followed by the EU, as required by the CSRD (and previously embedded in the Non-Financial Reporting Directive (NFRD)). We agree on the importance of transparency around companies' impacts to effectively drive corporate behaviour towards more sustainable outcomes.

We consider that additional guidance is urgently needed about the concepts of double materiality, impact materiality, financial materiality, and information materiality found in ESRS 1 *General Principles.* The aim of such guidance would be to support practical implementation, fit for purpose and comparable reporting, and compliance with EU regulations.

In that respect:

(a) We support EFRAG and ISSB (and GRI) working diligently together to align the definitions and explanations where the concepts and their use are intended to be the same (e.g. financial materiality, impact materiality, enterprise value). Where different terminology must be used due to legal or other considerations, we recommend there is a clear explanation and illustration of how the concepts differ, so as not to confuse the users of those frameworks. As the CSRD requires ESRS to be revisited regularly, this would open up the opportunity for integration of updated content issued in the future by ISSB (and GRI).

(b) Guidance needs to be developed which explains the approach to be applied in performing a double materiality exercise. The guidance should fully accommodate the interconnectedness of the two aspects of double materiality and position it as an integrated exercise. Because this will be a very judgemental area, we recommend requiring companies to disclose their materiality matrix, including who they have identified as their key stakeholders and why.

(c) More precise requirements and guidance in these areas should remove the need for the rebuttable presumption of materiality of each disclosure requirement. As currently proposed, we are concerned that preparers may in fact decide to disclose everything listed in ESRS in a box-ticking exercise that risks giving rise to excessive boilerplate and lower quality reporting rather than having to document how and why the need for each individual item of disclosure that has been omitted was rebutted. This may create significant challenges, and result in a poor outcome for stakeholders.

(d) We ask EFRAG to clearly identify those disclosure requirements to which the materiality considerations would not apply because they are required by EU law; for example the CSRD and the Sustainable Finance Disclosure Regulation - SFDR.

C. Complexity and granularity

The high level of complexity and granularity of the disclosure requirements will result in companies having to set up extensive new systems and processes to collect the information. This is a major undertaking especially for those reporting for the first time under the extended scope of the CSRD, but also for those already reporting under the NFRD.

The level of detail and quantity of information to be disclosed carries a significant risk of information overload. This would effectively reduce transparency for users and do little to engender confidence and support from preparers and users alike.

To seek to reduce this risk, we recommend EFRAG focuses on decision-useful information and reduces the number of mandatory qualitative and quantitative disclosures; especially those aimed at explaining compliance with laws and regulations (e.g. some of the disclosure requirements in the social standards). They would be more suitable for a dedicated technical report than in the more concise management report. Focusing on quantitative indicators with explanatory notes where possible (instead of many qualitative disclosures) will also improve the readability and comparability of the reports. Furthermore, some of the sector agnostic disclosure requirements may be better located under sector-specific standards (e.g. some of the disclosure requirements of the environmental standards).

In addition, many of the draft ESRS disclosure requirements are currently too generic to result in meaningful information that can be enforced consistently (e.g. the disclosures on the financial effects of environmental matters other than climate). In such instances, we recommend that EFRAG clarify what is expected from companies, particularly when they relate to forward-looking information. EFRAG could also consider a progressive approach to disclosures matching an entity's measurement and reporting maturity over time, e.g. narrative first, then quantitative ranges, and ultimately detailed quantification.

Value chain

We believe the proposed definition of the value chain will make it challenging for companies to identify what should be included or excluded. Considering all possible impacts upstream and downstream may lead to inconsistent approaches. Some preparers, auditors and regulators could conclude that every conceivable aspect of the value chain is covered by a reporting obligation. This approach would not lead to comparable information for users and could overburden preparers. Accordingly, we recommend that EFRAG provide additional guidance to enable entities to identify the boundaries of the value chain for reporting under ESRS.

In addition, where information on the value chain cannot be practically collected, it would be burdensome for many preparers to make approximations using *"all the reasonable and supportable information including peer group or sector data"* *"after making every reasonable effort"*. This will be the case for the disclosures about targets and performance measures related to the value chain, required by all the environmental standards. In this regard, we recommend EFRAG take the wording from the best-effort clause in the CSRD and apply it to value chain information in the ESRS for the first three years of application.

We note that the Corporate Sustainability Due Diligence Directive ("CSDDD") proposal and the CSRD requirements / EFRAG's standards would benefit from streamlining, in particular as it relates to the scope of the two regulations, terminology and definitions (e.g. for the definitions of "stakeholder, "value chain" and "business relationship").

Determining the financial effects of sustainability matters

We highlight the difficulty of determining and verifying the financial effects of sustainability matters. This presupposes that an entity has performed a detailed assessment of its impacts, risks and opportunities, and then determined how the matters identified should affect its future strategy, targets, policies, and action plans. Corporate practices are not yet at this stage of maturity regarding all their significant sustainability matters.

Until science-based methodologies are further developed, it may not be possible for a company to assess (and for assurance providers to verify) the impact of sustainability matters on their future financial position, financial performance, and cash flows, particularly over the medium and long-term. The standards need to take account of companies' practical abilities to provide information on financial effects, by including provisions that allow companies to disclose qualitative information, related uncertainties and where possible, ranges or estimates, until financial quantification is possible.

In this regard, it could be very useful for the market for EFRAG and ISSB to work closely together to develop common guidance on how to determine the financial effects of sustainability matters, and specify the expected disclosures.

Prioritisation and phasing-in

Recognising that new sustainability reporting standards represent a challenge for preparers, it is essential that EFRAG adopt the most pragmatic approach possible as to what companies can achieve during the initial adoption period. It can do this by prioritising and phasing-in different reporting topics.

In particular, we recommend that EFRAG phases-in the requirements for:

(a) the description of the policies, targets, action plans and resources related to the value chain, and related performance measures;

(b) the potential financial effects of the risks and opportunities arising from environmental-related impacts and dependencies; and

(c) the performance metrics that are complex to determine and that do not relate to one of the SFDR indicators.

Such phasing would also allow further time for work with the ISSB in developing and integrating the global baseline.

Corporate governance

The assurability of the envisaged disclosures will strongly depend on the robustness of companies' risk management, internal control and reporting systems. We therefore welcome the proposed disclosure requirements on risk management and internal controls systems, as set out under ESRS G1 *Governance, risk management and internal control*. More transparency about these matters as well as the board(s)' oversight should incentivise accountability and promote higher quality disclosures.

D. Due process

With the publication of the thirteen draft standards at the end of April (and the subsequent publication of the Basis for Conclusions), EFRAG exposed proposals for public comment for a comprehensive, detailed framework for sustainability reporting in the EU.

We observe that insufficient time has been allowed for stakeholders to provide comprehensive feedback, for EFRAG to be able to analyse and appropriately address that feedback, and for research, analysis, and suggestions for technical enhancements essential to enable achieving high-quality outcomes. Furthermore, we question how the current timing can allow for adequate, meaningful dialogue between EFRAG, the ISSB and other global bodies, necessary to enable global consistency and interoperability.

We appreciate the EU's ambition on sustainability matters and the pace of change sought to address the urgency. That said, the success of the EU's sustainable finance agenda relies on confidence in it from all market participants. High quality reporting standards and due process are a vital component of engendering that confidence. Accordingly, we strongly recommend that EFRAG discusses with EU policymakers at the earliest opportunity how time can be found to allow for sufficient stakeholder feedback on the proposals, impact assessment, and technical deliberations by the EFRAG Sustainability Reporting Technical Experts Group and Board. We also recommend that sufficient time is allowed for the development of, and due process around, appropriate implementation and application guidance to enable high-quality preparation of disclosures.

We would welcome the opportunity to discuss these observations and recommendations in more detail at your earliest convenience.

On behalf of the European Contact Group,

Maurizio Donvito
Chairman

The European Contact Group is registered under number 0633841538-63 in the EU Transparency Register

CC: Sven Gentner
Head of Unit DG FISMA, Corporate reporting, audit and credit rating agencies
European Commission