Attn Mr John Berrigan
Director General DG FISMA
European Commission
1049 Brussels

7 July 2022

Dear Mr Berrigan,

Subject: Feedback on the draft Commission delegated regulation supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards

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 provide feedback on the draft Commission delegated regulation supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards European sustainability reporting standards (the draft ESRS delegated regulation).

We recognise the challenging and essential task that the Commission and EFRAG have carried out since last summer, in seeking to acknowledge and reflect the many comments a wide range of stakeholders have provided regarding the first draft of ESRS developed by the EFRAG Project Task Force, and also to preserve the ambition of the European Green Deal and the Corporate Sustainability Reporting Directive (CSRD), which we support.

We welcome significant changes in the draft Commission regulation on ESRS that increase focus on providing decision-useful information and, for smaller companies in particular, give more time to set up the processes, systems and internal controls needed to deliver high quality data.

However, we continue to believe that the overall level of information to be provided under ESRS and the speed of its implementation are ambitious, particularly for the early years of reporting, especially for those EU and non-EU entities that have not previously prepared a non-financial statement under the Non-Financial Reporting Directive (NFRD). We emphasise that, in order to support high-quality corporate reporting, companies will need sufficient time to put in place processes, systems and internal controls and governance in order to fulfil their legal responsibility to report reliable information (the first line of defence for quality reporting). Assurance providers, and oversight bodies, respectively the second and third lines of defence for corporate reporting, will face significant challenges in carrying out their roles since there is a significant risk that potentially many companies will not be ready in the timeframe set by the CSRD to report high-quality information, which in that event may lead assurance providers to issue modified rather than clean conclusions, including qualified conclusions or disclaimers of opinion. Clear communications from ESMA and member state regulators to the markets on the challenges of sustainability reporting may help alleviate market concerns if qualified assurance reports are issued.

We have the following main comments with respect to the first set of ESRS and going forward, which we believe will contribute to the successful deployment of ESRS in the EU and around the world:

a) Interoperability between ESRS and the International Sustainability Standards Board (ISSB) standards is key to promote global comparability and reduce additional reporting burden. The lack of alignment of the definition of financial materiality between ESRS and IFRS Sustainability Disclosures Standards (SDS) is a critical issue that needs to be addressed;

b) Articulation of the materiality approach should be further clarified;

c) Guidance on the materiality assessment process and value chain is needed;

d) The disclosure requirements for entities benefitting from phase-in measures (ESRS 2 paragraph 17) should be clarified;

e) Other pieces of EU legislation will need to be reviewed to ensure interoperability; and

f) Robust due process is needed to ensure the quality of the standards.

a) Interoperability between ESRS and ISSB standards is key to promote global comparability and reduce additional reporting burden. The lack of-alignment of the definition of financial materiality between ESRS and IFRS SDS is a critical issue that needs to be addressed

Interoperability between ESRS and IFRS SDS developed by the ISSB is crucial. Companies that wish to adopt and state compliance with both the ESRS and ISSB standards should ultimately be confident that they can use the same data collected and processed by the company and supplement disclosures as needed to meet the respective requirements of both sets. As the ISSB standards have been designed to become the global baseline, it is important that ESRS integrate this baseline as much as possible.

In that respect, we welcome the engagement between EFRAG and the Commission and the ISSB to achieve greater interoperability of standards. As both sets of standards will continue evolving in the future, we encourage the Commission, EFRAG and the ISSB to continue to cooperate.

As the extent to which ESRS and IFRS SDS are interoperable may not be obvious due to different wording and terminology (see our comment below on financial materiality), we ask that an interoperability analysis be provided to stakeholders as soon as practicable, as well as guidance how interoperability would work in practice in sustainability statements. This is critical to understanding how to apply both sets of standards together. Issuance of this analysis and guidance by the standard-setters themselves would provide greater confidence to those who will be applying those standards.

Definition of financial materiality

The interoperability of ESRS and IFRS SDS definitions of financial materiality is particularly crucial. We observe that the definition of "*financial materiality*" [1] in Annex II of the proposed delegated regulation on

[1] Definition of financial materiality in the proposed delegated regulation on ESRS: "*A sustainability matter is material from a financial perspective if it generates **risks** or **opportunities** that affect (or could reasonably be expected to affect) the*

ESRS, in conjunction with the descriptions of the scope of financial materiality in paragraph 47[2] of ESRS 1 *General requirements* and the financial materiality assessment in paragraph 48[3] of ESRS 1, is different from the definition of "*material information*"[4] in IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, in conjunction with the requirement in paragraph 17[5], which specifies the disclosure of material information.

We consider those differences to be a critical issue for the interoperability of ESRS and IFRS SDS, as those differences mean that the financial materiality filter is not the same under ESRS and IFRS SDS. They also work against the connectivity requirements set out in ESRS. Indeed, the explanation in paragraph 47, which attempts to explain the "scope of financial materiality", suggests that filtering material financial information could differ depending on whether it relates to the financial statements or the sustainability reporting. In our view, the concept should be the same as set out in IFRS Accounting Standards and IFRS Sustainability Disclosure Standards and should be applied in the same way in ESRS, as it is applied for financial reporting purposes in IFRS.

We acknowledge that reporting on "*material information under ESRS*" may result in a broader range of information provided in the sustainability reporting than reporting on "*material information under IFRS SDS*", due to the fact that ESRS build on the double materiality principle. However, the judgment about whether a financial disclosure is material should be conducted in the same way under both ESRS and IFRS SDS; we do not see any value in this being done differently.

This is a critical issue that we ask the Commission to resolve before the ESRS are finalised.

b) Application of the materiality approach should be further clarified

We support the application of the materiality filter to all disclosures and data points in topical standards (other than some of the requirements stemming from ESRS 2). Appropriate application of the concept of materiality leads to information that is relevant and decision-useful, encourages a proportionate approach that avoids clutter, and reduces the risk of greenwashing, and companies taking a compliance-based mentality.

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undertaking's financial position, financial performance, cash flows, access to finance or cost of capital over the short, medium or long term"

2 ESRS 1.47: "*The scope of financial materiality for sustainability reporting is an expansion of the scope of materiality used in the process of determining which information should be included in the undertaking's financial statements.*"

3 ESRS 1.48: "*The financial materiality assessment described in paragraph 37 includes, but is not limited to, the identification of information that is considered material for primary users of general purpose financial reporting in making decisions relating to providing resources to the entity. In particular, information is considered material for primary users of general-purpose financial reporting if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the undertaking's* ***sustainability statement***."

4 Definition of material information in IFRS S1: "*In the context of sustainability-related financial disclosures, information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity*."

5 IFRS S1.17 : "*An entity shall disclose <u>material information</u> about the sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects*."

Robust governance and controls over this process will be required to support a comprehensive materiality assessment process and, in that regard, we welcome the disclosure requirements in ESRS about the governance over sustainability matters, and the main features of entities' risk management and internal control system in relation to the sustainability reporting process(es).

We indicate below areas where we believe that further clarity is needed on how ESRS intend the materiality approach to be implemented.

Identifying material information / Paragraph 34 of ESRS 1

We ask for clarity as to whether paragraph 34 of ESRS 1[6] is supposed to represent the ultimate materiality filter for selecting the information to be reported relating to a material sustainability matter in general, or only for information related to material sustainability matters' metrics. This is because paragraph 34 follows paragraph 33, which explains when datapoints related to metrics for a material sustainability matter shall be disclosed.

Furthermore, we believe that information reported under paragraph 34 of ESRS 1 should be disclosed when both conditions (a) **and** (b) are met (and not when (a) **or** (b) are met): information should be both significant **and** meet the users' decision-making needs.

Voluntary disclosures

We believe that it is critical that the Commission specifies clearly in ESRS 1 and ESRS 2 whether disclosures are mandatory in all cases, mandatory subject to materiality assessment, voluntary (optional) disclosures or subject to phasing-in.

Indeed, it is not clear whether the "voluntary" disclosures are truly optional and proposed as best practices, or whether they are meant to be implicitly mandatory if they relate to a material IRO. For greater clarity, we suggest that it is explicitly stated in ESRS 1 (for instance, in a new paragraph following paragraph 11) that those "voluntary" disclosures are truly optional, despite relating to a sustainability matter that is assessed as material. Renaming them as "optional" disclosures could also bring this clarity.

List of datapoints in cross-cutting and topical standards that are required by EU law (Appendix B of ESRS 2)

We understand that datapoints in cross-cutting and topical standards that are required by EU law (Appendix B of ESRS 2) are subject to the materiality assessment, i.e. they shall be disclosed only if the topic to which they relate consists of a material IRO.

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[6] ESRS 1.34: "*The applicable information prescribed within a Disclosure Requirement (including its datapoints), or an entity-specific disclosure, shall be disclosed when the undertaking assesses it to be relevant from one or more of the following perspectives in the **sustainability statement**:*

(a) the significance of the information in relation to the matter it purports to depict or explain; or

(b) the capacity of such information to meet the users' decision-making needs, including the needs of primary users of general-purpose financial reporting described in paragraph 48 and/or the needs of users whose principal interest is in information about the undertaking's impacts."

This conclusion is not obvious as it is stated in paragraph 29 of ESRS 1 that "*Irrespective of the outcome of its materiality assessment, the undertaking shall always disclose the information required by ESRS 2 General Disclosures (i.e. all the Disclosure Requirements and data points specified in ESRS 2)*".

As the appendices to ESRS are an integral part of ESRS 2, one could conclude that the data points specified in Appendix B should always be disclosed, despite relating to a topic for which there is no material IRO. We suggest that clarity is explicitly provided on whether this is the case. If our understanding is correct, the clarification could be provided in the introductory paragraph of the list of datapoints stemming from EU law in Appendix B of ESRS 2.

c) Guidance on the materiality assessment process and value chain is needed

We support the Commission's initiative to put in place a mechanism to provide formal interpretation of the standards, and to ask EFRAG to also publish additional guidance and educational material addressing the materiality assessment process, the value chain, anticipated financial effects, as well as other areas where clarifications and/or will be needed. This would be much appreciated to enable the consistent application of ESRS, as many concepts are new to stakeholders.

Guidance on the approach companies can apply in performing a double materiality exercise should also cover impact materiality, financial materiality and information materiality found in ESRS 1, as well as disclosures about the materiality assessment process. We look forward to the drafts being swiftly published for comment, allowing stakeholders to have sufficient time to share input, and for EFRAG to respond to stakeholders' needs, recognising the critical importance of this guidance to the successful application of ESRS.

d) The disclosure requirements for entities benefitting from phase-in measures (ESRS 2 paragraph 17) should be clarified

ESRS 2 paragraph 17 requires that an entity that applies the new phase-in measures provided by ESRS 1 (e.g. possibility to temporarily omit the information required by ESRS E4, ESRS S1, ESRS S2, ESRS S3 or ESRS S4 for companies or groups not exceeding 750 employees) shall nonetheless disclose a large amount of information, including metrics, for topics related to the material IROs they have identified.

We understand that ESRS 2 paragraph 17 aims to be consistent with the requirements of the CSRD. Still, we suggest that, to be consistent with the Commission's proposal to provide relief to entities during the phase-in period, it is made very clear that the mandatory disclosures required by ESRS 2 constitute a layer of information intended to provide users of the sustainability statement with high-level information, and that it is not expected that an entity will provide the same amount of information as required by the related topical standard (including providing metrics, if it has not yet developed such a metric in-house).

e) Review of other pieces of EU legislation to ensure interoperability

Now that ESRS have been developed, other pieces of EU legislation such as the Sustainable Finance Disclosures Regulation (SFDR) will need to be reviewed and adapted where necessary, to ensure there is a cohesive and coherent approach to EU regulation and to align the sustainability disclosure requirements with the other sustainability information that companies are required to publish, so that the overall requirements do not lead to an increased reporting burden for companies, including financial market participants.

f) Robust due process to ensure the quality of the standards

Going forward, successful implementation and development of further ESRS standards will require an appropriate and robust due process, which allows sufficient time for stakeholders to express their views, and for those views to be considered by the European standard-setter and reflected in both the technical discussions and the final standards. This should include a dialogue with stakeholders to identify issues and the development of high-quality guidance by EFRAG. In that regard, we also believe that adequate funding for EFRAG's activities remains a pre-requisite, to allow it to continue to exercise its vital role in developing and maintaining ESRS that are fit for purpose.

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. Mr Sven Gentner
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