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European Round Table for Industry

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**Subject: ERT response to the EFRAG consultation on ESRS**

ERT welcomes the publication by the European Financial Regulatory Advisory Group (EFRAG) of the exposure drafts underpinning the development of the European Sustainability Reporting Standards. We think the introduction of such standards can provide stakeholders with more comparable insights and streamline the reporting process for companies in scope of the CSRD.

However, we do have a number of concerns with regard to the overall process and certain disclosure requirements that we explain below.

### 1. *Ensure sufficient time for implementation*

The Corporate Sustainability Reporting Directive (CSRD) will be applicable to companies that fall under the scope of the current Non-Financial Reporting Directive (NFRD) already for the financial year 2024 (reporting in 2025). The delegated act on the first set of European Sustainability Reporting Standards (ESRS) is expected to be adopted by the Commission only in June 2023. As the CSRD does not give any further indication on the entry into force of the ESRS, the period between adoption by the Commission and entry into application could be as short as only 4 months.

We strongly emphasise that such a short time window is not sufficient to implement the new disclosure requirements and to gather the required data and information, to adapt or introduce new IT systems and implement the required reporting processes. There are a number of reporting processes, for which data gathering will need to start from day one of the reporting year to provide complete and reliable full-year data. **Preparers should have at least 12 months to implement the provisions of the ESRS delegated act before the start of the period to be reported on.**

The consequence of not having sufficient time is that the reports which companies have to prepare will lack in completeness and quality and will thus not be comparable, which defeats the purpose of the exercise. Even for companies that today already have extensive ESG disclosures, reporting in line with the ESRS will require major efforts. For most of the companies subject to reporting about the financial year 2024 this will be a "mission impossible" with the current scope and level of detail required in the 13 ESRS. Many companies also do not have assurance provided on (all of) their ESG disclosures, which require (1) the engagement of an assurance provider, and (2) the creation of the required internal control frameworks. This will be especially challenging for value chain disclosures but also for disclosures on social matters.

### 2. *Create alignment of standards, in particular at international level*

**Global alignment of reporting standards** for sustainability matters is crucial to provide a comprehensive view of a company's sustainability performance. A single trusted set of standards does not only reduce reporting costs of preparers, but also ensures consistency and comparability of reporting content for users and other stakeholders. Thus, global alignment would allow preparers to build public trust through greater transparency of their sustainability initiatives, which would also benefit the overall credibility of reporting standards globally and in regional jurisdictions.

Separate and differing sets of standards for sustainability reporting in different jurisdictions or between global and national level - that in a worst-case scenario might be even contradictory - must be avoided. Preparing different reports based on differing standards would de facto lead to double reporting and, in consequence, to unnecessary additional costs and reduced validity and comparability of the reports. At the same time, this fragmentation would also lead to additional costs and lower quality of information for the data users. Global financial markets need reliable and consistent data on the sustainability performance of undertakings.

The CSRD requires EFRAG and the Commission to take into account to the greatest extent possible the work of global standard-setting initiatives for sustainability reporting. This includes the work of the newly established International Sustainability Standards Board (ISSB) under the umbrella of the IFRS Foundation. **Interoperability and coherence between the ESRS and standards developed by the ISSB** is of utmost importance to ensure the comparability and usefulness of disclosures as well as to reduce reporting burdens for preparers. We strongly recommend **close and constructive cooperation and collaboration between EFRAG, the European Commission and the ISSB** to pave the way for a complete integration of the global baseline as developed by the ISSB into the European regulatory framework. The participation of EFRAG in the "Jurisdictional Working Group" can only be a first step. Thus, ongoing collaboration will need to be ensured as ISSB will develop future topical standards, and as EFRAG will develop the Set 2 of the ESRS, including sector-specific standards.

The devil is in the technical details. Alignment between the ESRS and the IFRS Sustainability Disclosure Standards requires **reconciliation of the differing underlying concepts** of the ESRS and the international standards that are being developed by the ISSB. Whereas the ESRS cover the information needs of a diverse set of stakeholders (double materiality), the ISSB's approach aims at providing information for investors (financial materiality). The ESRS will also cover a very wide range of ESG matters from the start of application, while the ISSB standards focus in a first step only on general reporting requirements and climate-related disclosures but include sector-specific requirements.

We strongly support a harmonisation of the different standards at the international level. The full integration of the Value Reporting Foundation (VRF) and the Climate Disclosure Standards Board (CDSB) into the ISSB and the deepening of the announced collaboration between the ISSB and the Global Reporting Initiative (GRI) to coordinate work programs and standard-setting activities are essential steps to create a global set of sustainability reporting standards.

### *3. Ensure proportionality*

The published exposure drafts for 13 European Sustainability Reporting Standards (ESRS) contain no less than 137 disclosure requirements, with most of these disclosure requirements having multiple 'sub-disclosures' and detailed application guidance, adding further requirements. Many of these disclosure requirements and their application guidance are of very high granularity, and considerably increase the reporting effort for preparers while at the same time creating limited value for users.

We strongly recommend a **critical review of the detailed disclosure requirements** and a **phased approach for implementing the ESRS**. Preparers do not have information on all ESG topics at the same granular level of detail and maturity readily available. This is especially true for disclosures related to the value chain – for example the ESRS S2 (Workers in the value chain) – and newer sustainability matters such as biodiversity (ESRS E4 (Biodiversity and ecosystems). A critical review and phased approach would ensure that preparers are not overburdened, and new disclosure requirements are introduced successively – allowing for a stringent implementation with high quality, which would therefore also be of benefit to users and other stakeholders. ERT believes that in a first step, the overarching standards ESRS 1 (General Principles) and ESRS 2 (General, strategy, governance, materiality assessment disclosure requirement) could be implemented as well as the ESRS E1 which covers the disclosures on the most pressing issue of climate-related matters. The required information for these standards would be already adequately available for preparers and hence allow for becoming familiar with the new reporting requirements more easily, while paving and sketching the way for the following ESRS standards.

We would strongly recommend **reducing the contents of the individual ESRS, and apply a "core and comprehensive" approach** with the prospect to first focus on the 'core' disclosures, and make the 'comprehensive' optional. Next, we suggest moving some of those elements to the sector-specific standards to further reduce the burden on preparers and streamline the quantity of information disclosed for investors. The exposure drafts simply contain too many granular disclosure requirements that both from a usefulness, cost-benefit but also a confidentiality perspective can be questioned. The more granular the information is, the more costly it is to prepare. We very much doubt that the disclosure of details beyond Group level provides any benefits for users. For example: the county-specific disclosure of detailed information on employees (e.g. gender, union representation, etc.) for all countries with more than 50 employees will not only cause immense costs for preparers but will also overload the users while providing no added value. This can lead to relevant information being lost and could potentially also encourage greenwashing.

### *4. Clarify materiality and application of rebuttable presumption*

Materiality in terms of the significance and reference of the reported information is a key concept that should apply, as only material information is likely to influence the assessment process and decisions of stakeholders. We do encourage the implementation of double materiality in the ESRS but think materiality should also be a qualifier for the disclosure requirements. We would reiterate that **preparers should only be required to report material information** about the significant sustainability-related risks and opportunities to which they are exposed.

In the ESRS 1 and ESRS 2, the **concept of the "rebuttable presumption"** is introduced. It contradicts the concept of a materiality analysis tailored to the company, by turning the materiality concept 'upside down'. Through a materiality analysis - which is still also foreseen as part of the ESRS - companies identify the sustainability issues where they have the highest 'impact' and which sustainability matters have the highest impact on their business model and financial success. Disclosures are only necessary if a sustainability matter is identified as material, which is a concept also retained for disclosure requirements of the ESRS. The ‘rebuttable presumption’ as proposed by EFRAG requires preparers to indicate – and also prove and document for assurance purposes – for each and every disclosure requirement listed in the ESRS if it is material or not and to explain why a particular sustainability topic is not material. Applying the rebuttable presumption option to every non-material disclosure seems very impractical and will dilute the management report with a lot of irrelevant content as a list of ‘non-material issues’ is of very limited value for any stakeholder, in particular as the concept of the ‘rebuttable presumption’ coexists with the double-materiality concept of the CSRD. And, as the materiality assessment will be subject to an audit, there is no need to justify why certain sustainability topics are not material. **If a sustainability topic is not material, the preparer should not have to disclose on that topic at all.**

### *5. Set clear reporting boundaries*

We strongly recommend to clearly define the boundaries of the value chain to explicitly set the scope for preparers. A broad definition of the term ‘value chain’ will create difficulties in reporting data outside the control of an undertaking (problems of availability and verifiability, data access, quality and control of the data in multi-tier value chains). Currently, the Co-legislators are defining the scope of the value chain under the Corporate Sustainability Due Diligence Directive (CSDDD). We recommend postponing the development of value chain reporting standards pending the finalisation of the CSDDD. ESG reporting standards generally should be fully aligned with, and not extend beyond, what is required by the CSDDD. Requirements should also be in line with the existing and well recognised international frameworks (e.g. UN General Principles, and OECD Multinational Enterprise Guidelines).

We strongly recommend **restricting the value chain to tier 1 suppliers and customers**. It might be difficult for preparers with very complex supply chains to fulfill reporting requirements that cover the whole value chain as smaller suppliers might not be equipped to deliver the required information, and also the use of products down the value chains might be very difficult in certain instances and sectors. Alternatively, individual disclosure requirements regarding the value chain could be replaced with a general requirement to establish a management system for value chain due diligence.

We also encourage the continuous dialogue with the ISSB and other standard setters to come up with globally identical definitions for the same concepts. Concepts like ‘value chain’ should be consistently defined on a global level to ensure interoperability and comparability.

The entity reporting boundary should coincide with the financial perimeter for the Annual Report. It should be better defined what is to be included in this perimeter (i.e. fully integrated, consolidated joint operations, fair value, investment at cost, etc.) in order to avoid misunderstandings. We would recommend clarifying that reporting boundaries should include only controlled subsidiaries.

### *6. Provide exceptions for the disclosure of company/competitor sensitive information*

We urge EFRAG to consider that some data may be company/competitor sensitive to report publicly, and accordingly the ESRS should allow for exceptions where needed. This is especially true for forward-looking information that is required by several disclosure requirements. For example, **some required disclosures** – such as descriptions of investment plans or information on the cost of raw materials and respective turnover, or the

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use of shadow prices for investment of R&D decisions – **are highly confidential and can contain information that is commercially sensitive**. Requiring companies to disclose such information is problematic from a number of perspectives. Firstly, consideration must be given to the protection of trade secrets. Competition is a vital component of innovation for all companies (both within the EU and outside the EU) and requiring the disclosure of certain forward-looking information risks dampening the competitive structure, in and of itself. Secondly, and of no less importance, is compliance with competition law. This covers both unilateral disclosures as well as exchange of information between competitors. Non-compliance carries significant commercial risk. A 'one-size-fits-all' is impossible as these rules require a full appreciation and understanding of individual markets. Finally, there is a need to consider whether certain disclosure requirements would place EU companies at a competitive disadvantage with competing companies in non-EU jurisdictions that do not have to disclose such information. Discouraging investment in the EU makes little commercial sense.

As a general guidance, preparers should never be obliged to report on sensitive and confidential information that could be used by competitors to reverse engineer strategic decisions, get deep insights into the company's strategy or gain a direct competitive advantage. **We suggest removing forward-looking information and/or competitive information from the ESRS**. Alternatively, clear exceptions to disclosure requirements should be available with appropriate legal safeguards for compliance with competition law. Such disclosure requirements should be considered in the revisions to the sections on information exchange and standardisation in the Commission's Horizontal Guidelines.

### *7. Ensure a balanced management report*

Including all disclosures in the management report is likely to lead to unbalanced reporting, with a management report growing considerably in size as it would be dominated by the sustainability-related disclosures of a very granular nature. It will also not achieve the aim to make reported sustainability data easily identifiable. A more balanced alternative would be to require a summary of the past year's key performance in relation to environmental, social and corporate governance in the management report, and that additional, more detailed disclosures on policies, management systems, disaggregated KPIs, etc., are allowed to be made in a separate section similar to the notes to the financial statements. This would require the **use of cross-references** which should be allowed by the ESRS. The incorporation of information by cross-reference helps to avoid duplication of information and promotes a more understandable and concise report. The possibility of cross-referencing should be extended also to other reporting documents required by law that are published earlier or at the same time of the Annual Report.

In that sense, also past achievements in establishing integrated reporting through certain preparers shall be maintained – and even fostered in the future – to achieve the desired connectivity between financial and sustainability reporting.

### *8. Add guidance and definitions*

There are several disclosure requirements for which the exposure drafts contain only limited or no guidance at all. We strongly recommend providing sufficient guidance on all requirements to ensure that preparers know what they have to do to comply with the disclosure requirements.

In many cases, (basic) definitions are missing. This is the case for all 'risk and opportunities' disclosure requirements in the exposure drafts for the environmental standards. EFRAG seems not to have been able to agree to a common methodology. **Requesting preparers to**

**apply their own approach based on their own interpretation of the requirement will lead to a high level of uncertainty,** significant room for interpretation and result in disclosures that will not be comparable. We are afraid that this is the complete opposite of what standardisation should be. ERT strongly requests that if EFRAG cannot give or find a common methodology, these disclosure requirements should be deprioritised and/or delayed until topics are more mature and substantially more and detailed guidance or a sophisticated glossary is available.

Another example of missing guidance relates to the application of materiality. We strongly ask to provide for substantial guidance on what constitutes 'significant' impact and introduce objectivity rather than subjective opinions of selected stakeholders. We have also encountered massive **inconsistencies** between the use of terms and definitions within and between standards (Examples: 'turnover' vs. 'revenue', 'sustainability report' vs. 'sustainability statement', definition of 'circular economy' varies in E5, 'significant employment' within S1).

### *9. Stick to the due process*

High-quality standards should be based on the principles of legitimacy, independence, transparency, public accountability, and a thorough, well-governed, and evidence-based due process. Stakeholder engagement and due process must be inclusive and allow for timely and high-quality input from the business community.

Despite the fact that the 13 exposure drafts contain 137 disclosure requirements and cover a total of approximately 400 pages, the consultation period was reduced to just 100 days instead of allowing it to run for 4 months as set out in the EFRAG due process. Additionally, EFRAG was not able to provide for all necessary information at the start of the consultation (e.g. Basis for Conclusion, Cost-Benefit Analysis). It seems also not in line with the due process that the Expert Working Groups (which were established to review, provide input and, where necessary, contribute to the work of the PTF-ESRS) are now tasked with the development of the sector-specific standard. The new EFRAG governance with the EFRAG SRB and the SR TEG should develop the additional standards.

The feedback on the ESRS is due on 8 August 2022, and afterwards there will be some 2 ½ months to review, process, and propose changes to the ESRS in the 13 ESRS and have these approved. We expect many comments, and, in all fairness, **we do not think this limited time allows for a quality process**. Rushing the process could result in ESRS that do not meet the quality that should be expected in this important initiative.

### *10. No introduction of new legal requirements through reporting standards and no contradiction to the European legal framework*

We are very concerned that the disclosure requirements in the ESRS might in some cases be misused to introduce new legal requirements for European companies through the backdoor and without a proper legislative process with full involvement of the European Parliament and the Member States. **Many disclosure requirements are going way beyond current European legislation** thereby trying to indirectly tighten European laws, e.g. in the case of the environmental standards. This is not the purpose of reporting standards.

Certain disclosure requirements, especially in the social standards, would require information that is subject to existing data protection laws and cannot be gathered. ESRS S1-1 requires the disclosure of data on temporary workers. In compliance with EU data protection law, this data is only available to the main employer (temporary workers agency), but not the preparer.

The proposed relief clauses do not help and result in irrelevant information ("if it is confidential info in a country, do not include"). ERT strongly opposes the introduction of disclosure requirements that cannot be fulfilled because they contradict or would even violate other European or national legislation.

We hope that our comments will help not only EFRAG but also the European Commission in this critical phase to ensure the success of the ESRS in the coming years. We stand ready to discuss any aspect of our comments with you and your services in more detail.

Yours sincerely,

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*This Letter represents the views of the entire ERT Membership, consisting of 58 major multinational companies headquartered in Europe covering a wide range of industrial and technological sectors:*

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