Critical success factors for EFRAG standard setting in the area of sustainability reporting

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The Administrative Board of the Accounting Standards Committee of Germany (DRSC) has repeatedly welcomed the aspirations of the European Union to become a world leader in sustainability reporting. According to the European Commission's proposal for a Corporate Sustainability Reporting Directive (CSRD), EFRAG will play an important role in elaborating detailed standards in this area. Such new role requires a significantly adapted structure for EFRAG which needs to be underpinned by the commitments of relevant stakeholders, in particular national standards setters. This restructuring effort led by its president Jean-Paul Gauzes is now well advanced. Today, the Administrative Board has formally approved the participation of DRSC in the sustainability reporting pillar of EFRAG and the respective financial contribution to support EFRAG's work in this area as one of the large national standard setters in the European Union. At the occasion of this important decision, the Administrative Board would like to accompany this commitment to the new EFRAG structure with key advice regarding critical success factors for standard setting in the area of sustainability reporting. Ideally, these success factors should already be enshrined into the final CSRD legislation to provide binding guidance to EFRAG.

1. **EFRAG should be ambitious in tackling pressing issues, in particular the climate crisis, but not all ESG issues may bear equal weight in terms of urgency.** In light of the EU Green Deal, there is no doubt that in order to achieve the European climate objectives, effective reporting on climate-related issues which caters in a concise manner to the information needs of stakeholders is absolutely necessary. Other areas, e.g. to what extent and how to report on intangibles from a sustainability perspective under the CSRD, will need more time to develop meaningful reporting concepts. In the meantime, EFRAG should also be careful in setting up new initiatives in the area of financial reporting as companies need to cope with the sustainability reporting challenges. Further clarity on prioritisation on ESG reporting issues should be provided by the Co-legislators during the legislative process.
2. **EFRAG should address the specific information needs of European stakeholders, particularly in the context of EU sustainable finance regulation**. The EU sustainable

finance regulatory framework has reinforced the urgent need for sustainability data in an electronic format to allow financial undertakings to properly exercise their duties in terms of risk management and reporting to retail investors. Moreover, the CSRD proposal foresees a double materiality perspective in defining reporting requirements. This results in a broader view compared to a purely investor-oriented reporting, which needs to be refined and improved over time where other stakeholders' information demands differ or go beyond investors' information demands. EFRAG should also look for meaningful consistency regarding other sustainability-related legislative initiatives, e.g. the Taxonomy Regulation and Sustainable Finance Disclosure Regulation (SFDR).

3. **EFRAG should look beyond the EU and follow a global baseline approach as being developed by the International Sustainability Standards Board (ISSB).** Standard setting is not limited to the EU itself. Rather, global ESG topics require global solutions. European companies are operating globally, and their economic success is the backbone of the EU's economic strength. EFRAG should formalise its relationship with relevant standard setting initiatives and should consciously make reference to existing standards to achieve a smoother transition to reporting under the CSRD. Particularly important is the use of a global baseline approach as currently being developed by the International Sustainability Standards Board (ISSB). Besides its global footprint the ISSB is in the process of basing its board and chairman's office in the European Union, namely in Frankfurt. EFRAG should explicitly build its activities and advice on this global baseline to achieve better compatibility with standards applied elsewhere in the world. Only a fully-fledged orientation towards a global baseline can offer European companies a truly comprehensive framework for effective sustainability reporting. In addition, this is the only way to achieve a level-playing field for preparers and to allow the EU financial sector to comprehensively incorporate ESG matters in their investment decisions.
4. **EFRAG should remain focussed on proper due process.** The CSRD proposal outlines that the new sustainability reporting standards should be developed with proper due process, public oversight and transparency, accompanied by cost-benefit analyses, and be developed with the expertise of relevant stakeholders. However, under the current time pressure, the new EFRAG sustainability reporting board may be tempted to deviate from the proper due process by shortening consultation periods or reducing the involvement of external experts and stakeholders. But a proper due process with appropriateinvolvement and sufficient time for stakeholders to respond is key. Therefore, we applaud EFRAG's early consultation on proper due process for its new structure but also want to reemphasise the administrative board's comments on proper due process in the work of the project task

force. Again, further relaxation regarding timeline and prioritisation of reportable issues should be provided by the Co-legislators.

5. **EFRAG should not consider – as a general rule – particularly granular reporting requirements as superior to more concise reporting standards.** Standard setting does not require to be overly granular in order to fulfil its objectives. A similar consideration exists in financial reporting where in Europe usually principles-based standard setting is considered superior compared to rules-based standard setting. The array of ESG topics to be covered by EFRAG standard setting activities is wide. Therefore, due consideration is necessary as to in which detail standards should cover certain topics. However, a certain level of prescription is necessary to achieve comparability across sectors or entities within specific sectors. In defining this minimum, EFRAG should apply a focussed approach, reflecting parallel requirements such as Taxonomy and SFDR.
6. **EFRAG should devote sufficient attention to the proportionality of reporting requirements.** The proposed scope of the CSRD would lead to a significant increase in reporting entities. In Germany alone, the increase is thirty-fold, from around five hundred to about fifteen thousand entities. This is the consequence of referring to the existing definition of "large entities" as used in the EU Accounting Directive which also includes entities with limited resources, but often also limited ESG impacts. Therefore, it is particularly important to consider what kind of companies are covered by a particular reporting obligation. They may not only differ in their ability to meet the respective reporting obligations, but also the reporting obligation may not offer sufficient benefits compared to the costs incurred by them. The reporting requirements need to be proportionate to the size and ESG impacts of these entities. Also here, further clarity regarding the proportionality of reporting requirements may be provided by the European Co-legislators.

The Administrative Board
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