Summary of feedback to the ED ESRS
EFRAG/DRSC-Outreach event, Berlin, 10 June 2022

Introduction

About 80 participants were on-site for the outreach event and (at peak-time) over 500 participants were following the event online. The participants of this event acknowledged the work of EFRAG and especially of the EFRAG Project Task Force on European Sustainability Reporting Standards (EFRAG PTF-ESRS) in developing substantive Exposure Drafts for European Sustainability Reporting Standards (ED ESRS). These ED ESRS represent an important step forward towards high quality sustainability reporting standards that are designed to foster the transformation of economic activities. Participants welcomed the event as a great opportunity to understand the background of these proposals, to discuss challenges of the ED ESRS and possible suggestions as to what EFRAG should reconsider if and when revising the ED ESRS.

The following minutes reflect the main points addressed during the panel discussion, the Q&A with regard to the cross-cutting standards and the breakout sessions (environment, social, governance).

1. Panel discussion "The German stakeholders' perspective

Panellists

- Dr Uta-Bettina **von Altenbockum** (Deutsches Aktieninstitut)
- Philippe **Diaz** (WWF)
- Nadine-Lan **Hönighaus** (econsense)
- Max **Kolb** (NABU, Naturschutzbund Deutschland)
- Georg **Lanfermann** (DRSC, moderator of this panel discussion)
- Prof Dr Bernd **Stibi** (IDW)
- Götz **Treber** (GDV)
- Dr Sigurt **Vitols** (Wissenschaftszentrum Berlin für Sozialforschung gGmbH / ETUI)

Statements / Findings from the discussion

One aspect that was addressed first by some panellists was the process for the development of the ESRS: these are being developed while the CSRD is not yet finalized. This results in stakeholders commenting on exposure drafts that – depending on final EU decisions – might not be in line with the final CSRD. This approach together with the extremely tight timeline for the consultation of stakeholders (leaving little to no room to actually consider the stakeholders' comments) bears the risk of inadequately developed ESRS which reduces acceptance of the ESRS. This process is questionable in the light of the paradigm shift that the CSRD and the ESRS stand for (e.g., much wider scope of undertakings and extensive disclosure requirements). Undertakings are not only challenged by the requirements of the ESRS but are asked to implement other requirements, such as the EU taxonomy, as well.

Other panellists point out that the objectives of the CSRD and the ESRS are clearly defined. A paradigm shift is necessary due to the fact that the ecological system is in a stage of urgently needed improvement and recovery (e.g., drastic deterioration of biodiversity). In light of these ongoing developments, the current economic system cannot survive. The economy will have to change through changes in investment decisions (depending on reliable information) and changes in undertakings themselves (ESRS will help foster that transformation). The past practice of voluntary disclosures has not proven successful. It is important that the CSRD and ESRS are implementing obligatory requirements based on the numerous international treaties and voluntary standards on frameworks of the past. These panellists consider the costs for undertakings to follow ESRS as comparably low. In addition, there have been adjustments to ED ESRS, for example, the number of disclosure requirements in ED ESRS E4 have been reduced. This resulted in an ED ESRS E4 of lesser quality.

Other panellists agreed with the "steering function" of the undertakings' reporting (reporting as the basis for accountability and decision-making) – which includes reporting as an instrument to support the transformation towards a sustainable economy. However, during the development of the ED ESRS not enough emphasis was put on cost-benefit-considerations, practicability (e.g., SMEs) or the international level playing field (i.e., global baseline). These aspects are important to increase credibility and acceptance of the ESRS.

Standards could be more ambitious in the longer run. In the short run EFRAG should focus on consistency between ESRS, digitalization (ESAP & tagging) and adhering to an international global baseline. The quality of data is important.

Other panellists noted that the ESRS need to be innovative as it is not enough to carry on with existing standards. Current sustainability reporting has a lack of credibility: demands have risen, due also to changes between different generations, but there is a gap between expectations and reality and instead of actual changes the sustainability reporting is a platform for greenwashing. Sustainability reporting needs to gain credibility. It is not appropriate to request additional time for this transition.

Not only does the state of the ecosystem not allow for more time. Time pressure is also important to force undertakings to tackle the issues as soon as possible. Although ESRS may not be perfect (IFRS aren't either), further delays are inacceptable.

Company representatives confirm that there is a high awareness for ecological issues. But especially SMEs cannot cope with the burden that ESRS would impose. A fast track for ESRS reporting would result in misleading steering- / investment-information and false investment decisions. The consultation period for ED ESRS should be extended to allow for a higher quality of ESRS and the decisions based on these.

Mentimeter poll question to all participants: regarding the rebuttable presumption and the resulting lists and explanations for non-material information. Is this information necessary?

- 51% No. Sector-specific ESRS are a more efficient instrument to secure comparability and could result in reductions of voluminous sector-agnostic reporting requirements.
- 35% Yes. Among other necessary to secure comparability between reporting undertakings.
- 14% No opinion.

The panellists reacted to these poll results by pointing out that for undertakings with more than 250 employees all ESRS reporting areas will be relevant. Sector-specific requirements and/or principle-based ESRS, as some suggested, are not deemed helpful as these would not require undertakings to deal with certain topics in detail even though they should (e.g., bio-diversity).

Mentimeter poll question to all participants: re/ prioritization of disclosure requirements

- 43%: Staggered implementation of ESRS. Minimum requirements for all reporting areas.
- 32%: Implement all ESRS at once to ensure reporting about all areas at the level proposed in the ESRS.
- 25%: Staggered implementation of ESRS. Which ESRS to prioritise depends on the urgency of the reporting areas and/or the maturity of the standards developed.

A panellist reacted to these poll results by pointing out that in his opinion a staggered approach was not an option under the CSRD. In addition, for example, regarding social matters: the information should be available in human resource departments of the undertakings. Others supported the prioritization approach / phasing-in, which they see as part of the concept described by the CSRD. If all ESRS were to be applied as of the same time undertakings would need more time to implement the necessary processes.

Mentimeter poll question to all participants: re/ reference to international standards

- 85%: ESRS should clearly refer to the global baseline standards.
- 7%: Global reporting standards are not as relevant for undertakings. Reference to and joint work on internationals sustainability reporting standards is not necessary.
- 7% No opinion.

A panellist reacted to these poll results by pointing out that EFRAG's PTF-ESRS have considered international standards but wanted to incorporate European specifics. Other panellists added that while international standards are desirable, there is doubt, whether international proposals are currently ambitious enough. In light of the objectives of the EU the debate about differences between ED ESRS and e.g., ED IFRS S1 and S2 is not useful. Instead, the orientation on international standards might result in a “race to the bottom”. Other panellists agreed that an international alignment is essential for many undertakings, even SMEs who might be part of a value chain of larger undertakings. Appendix V should include – next to a comparison with IFRS – a comment on whether EFRAG considers these requirements to be aligned / not aligned.

In their closing remarks the panellists again brought up the points crucial to them: undertakings will need more time unless requirements are prioritized (allowing for a staggered implementation of ESRS), ESRS should be less complex and consistent throughout the ESRS and – as far as possible – aligned with the global baseline. After all, the reporting transition required by the CSRD and ESRS is like an “open-heart-surgery” for undertakings and should therefore consider issues that undertakings might face. Other comments referred to the ED ESRS E4 on biodiversity which should include more ambitious disclosure requirements. Within the undertakings the governance bodies should face the complexity of sustainability issues and include all stakeholder groups in the undertaking’s processes / decisions.

2. Q&A regarding cross cutting standards (ED ESRS 1 and ED ESRS 2) – based on the presentation given by Professor Alexander Bassen

- Many questions evolved around the materiality assessment that undertakings are asked to conduct (concept of double materiality).
    - Clarification of this concept needed to understand – among other questions – who will decide about the materiality of sustainability matters.
    - Comments that from a practical point of view undertakings often do not experience a gap / a difference between matters that are material based on the impact materiality versus matters material due to financial materiality. Companies basically face the same questions from investors and from other stakeholder groups. The motivation might be different, but the outcome/information needs are comparable. Therefore, the differentiation appears artificial. However, there is not empirical evidence yet.
    - Understanding that the gap between impact and financial materiality has decreased over the last years.
- Equally important were questions regarding the concept of the rebuttable presumption and the consequences of this concept. How this concept is to be applied specifically; guidance would be helpful (answer: to be seen) and whether undertakings could decide to leave information out (answer: no)? More clarification within the ESRS is necessary. Feedback to EFRAG on this concept is desirable.
- It would be important that the information is not to be provided on the level of each subsidiary but on the consolidated level.
- Participants wondered about the consequences for undertakings that do not have the structures to be reported about (e.g., do not have separate sustainability committees or no variable,

sustainability related part of the total remuneration). ESRS are reporting standards but seem to result in requirements for an undertaking's organisational structures.

- Participants discussed indirect consequences for undertakings that are not within the scope of the CSRD but – voluntarily agreed to – report in line with requirements for limited liability companies. These undertakings are not directly, but indirectly affected by the CSRD, but they can opt out through statutory changes.

3. Breakout-Session Environment

<u>**Agenda**</u>

- **Presentation: Introduction of topical standards on environment**
- **Presentation and Q&A/discussion on**
  - **ED ESRS E1 Climate change**
  - **ED ESRS E4 Biodiversity and ecosystems**

<u>**Panellists**</u>

- Martin **Bolten** (NRW.Bank, Director Controlling/Financial Reporting, ASCG Sustainability Reporting Technical Committee).
- Philippe **Diaz** (WWF, Project Manager, EFRAG SR TEG, EFRAG PTF-ESRS).
- Dr Klaus **Hufschlag** (Deutsche Post DHL Group, Senior Vice President CREST Finance Business Intelligence & Analytics, EFRAG SR TEG).
- Dr Lothar **Rieth** (EnBW, Head of Sustainability, ASCG Sustainability Reporting Technical Committee.
- Christoph **Töpfer** (Umweltbundesamt, Research Associate, EFRAG PTF-ESRS).

<u>**Presentation and Q&A/discussion**</u>

ED ESRS E1 Climate change

- Presentation given by Christoph Töpfer (German Environment Agency, EFRAG PTF-ESRS).
- Participants discussed different aspects and asked a number of questions. The matters subject to the session on ESRS E1 were the following:

<u>Reporting financial opportunities</u>

- Participants noted that many disclosure requirements address forward-looking information including information on strategy and opportunities in detail.
- In this respect, some participants expressed concerns that undertakings might be required to making sensitive information public in future (e.g., market opportunities for innovative products). These participants; therefore, were in favour to limiting such information to qualitative disclosures.

Data basis for the assessment of climate risks

- Participants asked what data bases were expected to be used by undertakings for the assessment of climate-related risks. It was noted that future climate risks should actually be assessed on the basis of and in comparison with historical data from pre-industrial periods. Since this data is not available, current data/knowledge must be used.
- It was explained that the development of the standard was based on existing international and EU guidelines for climate reporting (such as TCFD or the NFRD-Guidelines). These differentiate between physical and transition risks.
- Undertakings are expected to consider a range of climate scenarios and other aspects including the geographic regions in which they are active.
- One participant pointed out that the banking industry is already working with climate stress tests, which can also be used to determine the financial impact of climate risks.

References to the Greenhouse Gas Protocol (GHGP)

- ED ESRS E1 includes many references to the guidance contained in the GHG Protocol. Participants noted that the GHG Protocol gives undertakings a number of options for accounting and reporting on their GHG emissions. It was questioned whether those options are meaningful since the reporting standards are meant to enable comparability across undertakings. Examples mentioned include:
    - organisational / reporting boundaries (financial control, operational control, equity share) and
    - emission factors for Scope 1 determination, methods for Scope determination.
- Participants were informed that ED ESRS E1 aims to limit these options, where reasonably possible, to increase comparability of reported information. Examples are the prescription of the "financial control" approach (based on ED ESRS 1 and in line with the Accounting Directive), the requirement to report both the location-based approach and the market-based approach for Scope 2 emissions, or the reference to most recent Global Warming Potential factors published by the IPCC.

Consideration of "facilitated emissions" by financial sector undertakings

- It was observed that facilitated emissions are not addressed in ED ESRS E1, however, the ISSB had done so in its ED IFRS S2 Climate-related Disclosures.
- It was clarified that ED ESRS E1 mentions that financial institutions shall consider the GHG Accounting and Reporting Standard for the Financial Industry from the Partnership for Carbon Accounting Financial (PCAF). PCAF contains requirements for the accounting of financed/facilitated emissions and is based on the GHG protocol. In addition, the important issue of financed/facilitated GHG emissions should be considered when developing sector-specific standards.

ED ESRS E4 Biodiversity and ecosystems

- Presentation given by Philippe Diaz (WWF, EFRAG SR TEG, EFRAG PTF-ESRS)
- Participants discussed different aspects and asked a number of questions. The matters subject to the session on ED ESRS E4 were the following:

<u>Metrics/net loss</u>

- Participants noted that there is no clarity how to quantify net losses.
- It was explained that ED ESRS E4 does not yet contain precise metrics. These would still have to be developed and specified.

<u>TNFD Framework/Gap-Analysis</u>

- With regard to a gap-analysis on biodiversity and on the application of the TNFD framework participants noted: Although there have been great learning processes in undertakings in the application of climate scenarios in recent years, there is still a lack of experience and know-how on biodiversity scenarios.
- It was explained that such scenarios do not exist at the moment, they still have to be developed. At the moment, undertakings could base their analysis on the countries in which they are active and which targets exist for the protection of land, for example.

<u>Impact-Assessment/Supply chain</u>

- Participants questioned how undertakings should analyse the impacts to be disclosed of their operations and the impacts of their supply chain as part of their impact assessment.
- It was explained that a risk-based approach should be taken in the analysis, e.g., by considering the individual countries in which the undertaking is active. Reference was made to a current WWF project, the development of a biodiversity risk filter. This is to be available free of charge. A demo version is expected by October 2022.

4. Breakout-Session Social

<u>Agenda</u>

- **Presentations: Introduction of topical standards / ED ESRS S1-S4**
- **Q&A/discussion**

<u>Panellists</u>

- Dr Sigurt **Vitols** (Wissenschaftszentrum Berlin für Sozialforschung gGmbH / ETUI, EFRAG PTF-ESRS Cluster Lead, EFRAG SR TEG).
- Dr Carsten **Zielke** (Zielke Research Consult GmbH, Managing Director, EFRAG PTF-ESRS).
- Tanja **Castor** (BASF, Senior Expert Sustainability Strategy, ASCG Sustainability Reporting Technical Committee).
- Laura **Curtze** (Human Rights & Labour and Deputy Executive Director at UN Global Compact Network Germany).

Main findings

- Participants and panellists **welcomed the strengthening of social issues** by the ED ESRS. Overall, the proposed EDs are expected to strengthen reporting on social issues. The mandatory requirements restrict the voluntary nature of reporting. It is important that information needs of all stakeholders of an undertaking are reflected. The interaction of social matters with the other sustainability matters must be considered. Thus, the interaction of environment, social and governance in the reporting standards is fundamental and to be welcomed. All three dimensions are equally important.
- The following points were **positively highlighted**: double materiality, consideration of different information needs of all stakeholders of an undertaking, equal treatment of financial and sustainability reporting, comprehensive definition of the undertaking's own workforce, references to social dialogue, collective bargaining and involvement of trade unions and trade union rights, audit of sustainability reporting by the auditor.
- **Comparability of information** is crucial from the users' perspective.
- The steering relevance and the **usefulness of the information for stakeholders** should always be considered; reporting should not be an end in itself. Data collection in the undertakings should not take place just for the reporting purpose, but for the purpose of transformation towards sustainable business activity. Provided that the data is used adequately by the stakeholders, the companies are willing to collect the data. It is imperative that the usefulness of the information is given greater consideration when finalizing the standards. Example: certain topics/key figures are defined differently in different countries. Combining data based on different definitions results in the disclosure of a metric whose meaningfulness is questionable. It is **not always clear** in the ED ESRS by whom certain information is to be used.
- **Data protection issue** in relation to own employees as well as in relation to non-employee workers shall be considered (legal check required). German companies cannot access certain data required by the ED ESRS. Example: In Germany, employees are not required to disclose the degree of disability to the employer.
- Reporting should be seen as a **driver of transformation**. Honesty in the communication of sustainability information (comply-or-explain, what has not gone optimally in the past) as well as the future perspective (what specific plan does the undertaking have) strengthens the credibility of reporting.
- The rebuttable presumption must not apply to social matters, as it opens a door to avoid disclosure of certain content.
- Specification of the percentage of women in management positions would be very important.
- **Definition of worker representatives** in the cross-cutting standards is necessary to sharpen the terminology and clearly work out which actors are involved (strong participation of all relevant stakeholders is desirable).
- Participants asked what is meant by **stakeholder engagement**: Is a workshop/survey necessary or is the internal assessment of the undertaking on stakeholder expectations sufficient to satisfy reporting requirements on stakeholder engagement? Panelists' view was:

  - Undertakings should seek an active exchange with stakeholders when setting up due diligence processes and ask them specifically about certain sustainability-related topics.
  - Defining a clear objective is critical to the success of stakeholder engagement. Stakeholder engagement should be understood as an ongoing process, not a one-time exercise.
  - Every undertaking has an impact on the community. Reporting on community impact is therefore very important.
  - Stakeholder engagement means active involvement of internal and external stakeholders. Undertakings should not rely solely on internal assessment, as this may leave material aspects undetected.
  - ESRS do not require stakeholder engagement but require undertakings to report on it. If there is no stakeholder engagement, it should be reported.
- Participants asked whether **an ESRS could be omitted entirely due to immateriality**. According to panelists, social ESRS must be relevant for all undertakings. In this respect, omitting an ESRS for immateriality seems hard to imagine. In practice, this will be a decision together with the auditor; a good justification for the omission is important.
- The reporting requirements in the ED ESRS are quite reasonable, but some expressed the view that the **many detailed information in the application guidance** are questionable in part and consequently should be shortened.
- ED ESRS S1 *Own workforce* requires a lot of reporting on non-employees. Treating non-employees as own employees can lead to problems such as **bogus self-employment**. Reporting on non-employees suggests they are treated as employees. And in this case, they can argue for employment in the undertaking.

5. Breakout-Session Governance

Agenda

- **Presentation: Introduction of topical standards ED ESRS G1-G2**
- **Q&A/discussion**

Panellists

- Stefan **Schnell,** moderator of the panel (BASF, Senior Vice President – Head of Group Reporting & Performance Management, EFRAG PTF-ESRS Cluster Lead, EFRAG SR Board).
- Carsten **Beisheim** (GvW Graf von Westphalen, Rechtsanwalt und Partner, Compliance und ESG, ASCG Sustainability Reporting Technical Committee).
- Dr Cordula **Heldt** (Head of Secretariat to the German Corporate Governance Code, Head of Corporate Governance and Company Law, Deutsches Aktieninstitut).
- Dr Julia **Menacher** (Allianz, Group Accounting & Reporting - Accounting Policy Department, EFRAG SR TEG).
- Prof Dr Patrick **Velte** (Leuphana University Lüneburg, Professorship for Accounting, Auditing & Corporate Governance).

Main findings

- All panellists **agreed on the importance of good governance structures**. Good governance is viewed as an **enabler / prerequisite for including sustainability matters** in undertakings' organisational structures (which it why one panel member suggests that it should be "GES" instead of "ESG"). The information is not only relevant for investors and other stakeholders, but also helpful for undertakings to appropriately address sustainability aspects within the organisation. But there were **different views on reporting requirements regarding governance aspects as laid out in ESRS**.
- General agreement that there are **numerous governance related requirements at EU level** for undertakings to consider in addition to / parallel to ESRS (e.g., Shareholder Rights Directive, CSDDD); it would have been preferrable if ESRS requirements were embedded in an overall, non-overlapping concept for the various requirements at EU level. The spectrum of current requirements reduces clarity (especially since for ESRS purposes references outside the management report would most likely not be allowed, possibly resulting in duplication of disclosures and/or in different level of assurance levels for the same disclosure, e.g., corporate governance statement in accordance with ESRS but also with Article 20 of the Accounting Directive).
- Regarding the governance related disclosure requirements **within the ESRS structure** the views of the panel members varied from **strong support** for the concept of including general governance disclosure requirements in addition to sustainability specific aspects of governance (majority) to the demand to **delete general governance requirements in ED ESRS G1** as these are not in line with the CSRD (one panellist).
- ED ESRS differentiate between general and sustainability related governance disclosures (ED ESRS 1 and ED ESRS G1 / G2). While participants understand the reasoning behind this structure, the majority supports **integrating all governance aspects** into one part of the ESRS and not – artificially – differentiate between general and sustainability governance. Some see the risk of duplication of disclosures and unnecessary increase of complexity due to the current structure of differentiating between general and sustainability specific governance disclosures. One panellist would even suggest integrating information on the Internal Control Systems (ICS) and the Risk Management System (RMS) into this "governance ESRS" as these are also inherent aspects of governance.
- Overall, panellists concluded that **many undertakings have established good governance structures** and have addressed governance matters in their corporate reporting in the past; disclosure requirements are well known – however, this is true mostly for large (capital market oriented) undertakings which should be able to easily cope with these governance related disclosure requirements; listed **SMEs,** however, are in the scope of the CSRD / ESRS as well and will likely have to implement these structures as many may lack (sophisticated) structures for risk management or internal control systems. These undertakings would face **huge challenges on their path to adhere to the governance disclosure requirements**; in addition: these are often very detailed (e.g., re/ lobbying activities).

- Panel members asked EFRAG to **carefully consider the comment letters** they will receive to strike an appropriate balance between costs and benefits of these information requirements (e.g., re/ SME environment; required level of granularity); it would seem more important to incorporate the different requirements into a consistent ESRS than to add detailed disclosure requirements, otherwise the ESRS might result in **information overload.**
- In the light of ESRS and various other governance related requirements in the EU the panel members and participants asked EFRAG to reconsider the **concept of cross-referencing** between these information (to avoid duplication, to ensure consistency).
- Panel members and participants discussed the need to **integrate tax related issues** as an aspect of governance (e.g., as part of business conduct disclosures).
- Panel members and participants expressed **doubt** as to whether the proposed **payment practices indicators** adequately depict an undertaking's business conduct / business integrity. It is suggested to reconsider these indicators.
- Panel members and participants discussed whether ESRS require a **comply-or-explain-mechanism**; this is addressed explicitly for some disclosure requirements within ED ESRS, but ESRS should clarify on the concept in general.
- Participants discussed the **(indirect) requirement to implement these structures** (e.g., remuneration schemes including variable sustainability related portion): while ESRS are reporting standards, participants and panel members agree that it is likely that there will be some pressure on undertakings to establish the structures that need to be described / informed about under ESRS.
- Participants asked how governance related disclosures can expand over the **value chain**; but there is agreement that disclosure along the value chain is relevant (e.g., information about termination of business relationship in case of corruption in undertakings along the value chain).