Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Sector-specific European Sustainability Reporting Standards: Making them a success right from the start

Dear Patrick,

We acknowledge the enormous task and timeline set by the Corporate Sustainability Reporting Directive (CSRD) for developing set 2 of the European Sustainability Reporting Standards (ESRS). It is our understanding that the EFRAG SRB will need to decide on a first subset of sector-specific standards in the coming weeks. Respective drafts will be due for consultation in spring 2023.

To support the development of this first subset of sector-specific standards, DRSC would like to provide to EFRAG at an early stage a few high-level recommendations to better achieve a workable framework that serves the needs of a broader array of stakeholders according to the double-materiality approach enshrined in the CSRD. The DRSC Sustainability Reporting Technical Committee discussed the following three high-level recommendations at its meeting on 13 December 2022.

High-level Recommendation 1: Clearly define the boundaries of sectors respecting the way how businesses and their accounting systems are organised and based on the sustainability profile of the companies.

A well-defined boundary of sectors is a prerequisite for an easy implementation by companies falling under the scope of the CSRD. Unlike in the sector-specific standards developed by the Sustainability Accounting Standards Board (SASB), ESRS 2 foresees the application of multiple sector-specific ESRS based on a ten percent threshold in revenues. In defining the boundaries, it is certainly worth considering the NACE code system as it forms a classification system for economic activities within the European Union. It has also been used in the development of the EU taxonomy for environmentally sustainable activities. However, it needs to be noted that the NACE code system is very granular and does not tend to take into account the economic reality of how companies organise their businesses. Moreover, the NACE code system is not based on the sustainability-related risks and opportunities of the companies. This shows the existing criticism towards the granular approach of the EU taxonomy and the difficulties in showing business activities in value chains.

Regarding the sector classification, particular consideration should be given to the determination of the boundaries to reflect business realities and sustainability profiles of the companies. E.g., in sectors in which the manufacturer also sells its products directly to end customers, it seems counterintuitive to separate sales from production. Taking revenue as the basis for determining the application of sector-specific standards would not work in this case, since production does not generate revenue. Calculating external/internal revenues for sales/production for purposes of determining an ESRS sector is very time-consuming and does not add any value. Other examples are the large financial services and leasing business, the after-sales-business, or the management of the real estate portfolio by industrial companies: Classifying these activities within separate sector-specific ESRS would not accurately reflect the economic reality and would impose an additional burden on affected companies with no discernible benefit for the reporting users. Furthermore, a consideration of suppliers within a sector specific ESRS is important. The aim should be an approach that is oriented towards the business realities, the economic structure of the sector, the way the company is managed and furthermore, easy to apply for preparers.

To achieve this, we recommend that EFRAG not only follow the NACE code system, but also the management approach used to determine operating segments in financial reporting according to IFRS 8. We note that ESRS 2 already require the sector revenue information be reconciled with IFRS 8 information. The benefits of adapting this mixed approach are that:

- entities will only report on those sectors that correspond to their operating segments and thus, to their internal management reports,
- entities will use the data for sustainability reporting purposes that they use for segment reporting and will not have to collect data solely to fulfil the ESRS reporting requirements,
- users of the sustainability reports will receive the relevant information and will be able to review this information from the same perspective as management.

High-level Recommendation 2: Stay focussed on reporting issues particularly relevant to the sector; keep reporting requirements at the necessary minimum

The ambitious approach of the ESRS set 1 of sector-agnostic reporting requirements with at least 400 mandatory data points already puts significant reporting burden on the companies falling under the scope of the CSRD. In Germany alone, these are estimated to be around 15.000 companies. In particular smaller companies will face significant difficulties in handling these comprehensive reporting requirements due to constraints in qualified personnel. Accordingly, further sector-specific reporting requirements should be diligently determined with a focussed approach. Some sectors have more ESG impacts than others. Thus, significant differences in the number of disclosure requirements in individual sector-specific standards are to be expected. Not necessarily covering each and every sustainability matter, the sector-specific characteristics should form the basis for complementary reporting requirements which cater to actual needs of users to understand the ESG performance of a company. The focus should be on indicators relevant for steering the company.

High-level Recommendation 3: Make use of and stay aligned with international standards

The first subset of sector-specific ESRS seems to already make clear reference to the four already existing GRI sector-specific standards for about half of the first envisaged standards. Less clear is the use of the reference to the about seventy exclusively sector-specific standards of SASB which is now under the umbrella of the International Sustainability Standards Board (ISSB). Even though a further step in internationalisation in SASB's existing standards is currently under work at ISSB level, we understand that preparatory work for using the SASB standards had been undertaken at Project Task Force (PTF). We would like to encourage the SRB to make active use of the SASB standards and preparatory work already undertaken at EU level during the PTF phase. This regards not only the development of the sector specific disclosure requirements but also the sector classification, where EFRAG seems to use a different approach as the SASB does.

We stand ready at your disposal to further discuss our high-level recommendations.

Kind regards

Georg Lanfermann
President

CC: Sven Gentner, Head of Unit, DG FISMA