Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Technical Committee Sustainability Reporting

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Sven Gentner
Head of Unit, DG FISMA
European Commission
Rue de Spa 2

B-1000 Brussel

Berlin, 31 January 2023

Dear Mr Gentner,

the ASCG's Technical Committee Sustainability Reporting welcomes the opportunity to comment on the Draft European Sustainability Reporting Standards (ESRS) which European Financial Reporting Advisory Group (EFRAG) delivered to the European Commission in November 2022.

General observation

The Draft ESRS as delivered to the European Commission have been profoundly improved compared to the Exposure Draft ESRS published for consultation in April 2022. Main conceptual improvements include:

- Improved applicability through removal of *rebuttable presumption* and through alignment with ISSB IFRS SRS Drafts including alignment with terms and definitions such as *financial materiality*.
- Clarification provided on and more prominence given to the company specific *impact and risk-based approach* to the integration of value chain information.
- Allow for *incorporation by reference* which addressed issue of potential redundancies.
- Clarification that disclosures on *policies*, *targets*, *action plans* and *resources* are required only when implemented by the undertaking.
- Provide *phase-in* provisions, e.g., limited value-chain disclosures in the first three years of application or limited disclosures on financial effects from environmental risks and opportunities.

Despite these improvements the ASCG`s Technical Committee Sustainability Reporting would like to comment on some major points of critique on the Draft ESRS. We believe that

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addressing these points will result in more relevant, comparable sustainability information as well as less sustainability standards that are clearer and less complex to apply.

Inclusion of perspective of mid-tier undertakings

Despite the successful reduction of disclosure requirements, including datapoints compared to the Exposure Drafts the Draft ESRS remain complex and granular. This remains challenging for many undertakings within the scope of the ESRS and particularly so for those large undertakings that only barely meet the criteria for "large" undertakings in Art. 3 (4) of the Accounting Directive. These undertakings typically have fewer resources to prepare sustainability information. Furthermore, we would like to point out that undertakings that are owner-financed and are not listed on or financed through capital markets should not have to disclose the same level of sustainability information as large, internationally operating corporations with thousands of employees. Instead of a general link of all disclosure requirements to Art. 3 of the Accounting Directive ESRS should define additional levels for sustainability information requirements in order to allow for proportionate ESRS disclosure requirement. The current differentiation is limited to large undertakings (Draft ESRS) on the one side and SMEs (Draft ESRS under development) on the other. This is not sufficient to account for the criteria of proportionality as laid out in the CSRD.

In addition to this general remark the following points address more specific aspects of the Draft ESRS.

ESRS 1

Clarify understanding of value chain-related disclosure requirements for Financial Institutions (ESRS 1.66ff): There is a lack of clarity about the understanding of value chains for financial institutions, and insurance companies in particular. For one, the Draft ESRS lack an explanation on whether these undertakings have to include in their value chain information the economic activities and value chains of undertakings they are invested in or insurance policy holders. In addition, the Draft ESRS lack guidance on how to apply the value chain requirements. The Draft ESRS do not, for example, provide an explanation on whether insurance companies sufficiently apply ESRS S2 *Workers in the value chain* and ESRS S3 *Affected communities* by considering their own, immediate value chain (e.g., intermediates, agents) or if consideration of workers / communities that are indirectly connected is necessary (e.g., workers of companies in which the insurance company is invested in or workers of companies holding an insurance policy) and, if so, to what extent / in what way the coverage is required (e.g., full vs. limited "look-through"). Looking through very comprehensively does not seem adequate, would be a tremendous challenge for financial institutions and would strongly overload their reporting as well as make it highly complex. Indeed, a full look-through principle could implicitly also mean that, for example, insurers would need to end up reporting on every sector-specific ESRS, where they invest or provide insurance cover to an entity in the respective sector, which must clearly be avoided.

Rather, to adequately account for the specificities of financial companies' business models, we suggest the following:

- **Look-through principle to apply for a limited set of material metrics that provide decision-useful information** on a financial company's indirect impact, especially in terms of financed (or insured) emissions, subject to in-depth assessments as to feasibility/data availability and decision-usefulness.
- **Additional sector-specific qualitative disclosure requirements should be defined that would require financial companies to provide certain sustainability-related information as regards their portfolios**, such as on investment or underwriting policies, the extent to which ESG considerations feed into the investment or underwriting decision-making and engagement process with investees or policyholders, and respective due diligence processes.

For example, financial companies should not be required to report on the actual adverse impacts of an investee on its workers, but they should be required to report on their due diligence process to identify such impacts and how these feeds into e.g., the investment decision-making process and any engagement activities.

Reconsider current restrictions for "incorporation by reference" (ESRS 1.120ff): The *incorporation by reference* is limited (e.g. the information in another document that is referenced to in the sustainability statements has to be published at the same time as the management report, be subject to the same level of assurance as the sustainability statements, and has to be available with the same technical digitalisation requirements as the sustainability statements). It can be expected that these restrictions will substantially reduce possible incorporations by references.

Clarification regarding significant differences between subsidiaries (ESRS 1.106): ESRS 1.106 implements the CSRD which requires adequate disclosures in case of significant differences between material impacts, risks or opportunities at group level and material impacts, risks or opportunities of one or more of its subsidiaries. However, ESRS 1 does not clarify or specify the circumstances under which such differences are "significant".

Reconsider the omission of the materiality assessment for disclosures on certain social aspects for undertakings with 250 or more employees (ESRS 1.32(d)): ESRS 1, section 3.2 addresses the scope of the materiality assessment performed by undertakings for identifying disclosure content. ESRS 1.32 defines disclosures that are required irrespective of the outcome of the materiality assessment. ESRS 1.32(d) requires undertakings with 250 or more employees to disclose the information in line with Disclosures Requirements ESRS S1-1 to S1-9 (including their datapoints). While a mandatory consideration of these Disclosure Requirements seems appropriate, we believe an undifferentiated disclosure of all required details (datapoints) will result in irrelevant information and unnecessary reporting burden in a number of circumstances.

An example being discussed in this respect concerns an undertaking that operates in multiple countries in the EEA and elsewhere. According to the requirements of ESRS S1-8 the undertaking would have to provide detailed information on the collective bargaining coverage on a country-by-country-basis (see ESRS S1 par 61) even if the percentage of total employees covered by collective bargaining agreements is within a very narrow range for all of these countries. The arguments put forward to support the detailed approach of ESRS S1 include criticism of the lack of quantitative data in current reporting on social aspects and the

need for such data as indicated by social stakeholders. Another argument relates to the interdependencies and interactions with other social indicators, which, according to some stakeholders, can only be assessed on the level of granularity as required by ESRS S1, regardless of the specific circumstances.

We understand these arguments and acknowledge that granular disclosures are useful information in a number of cases, but we are not entirely convinced that these arguments justify unconditional disclosure requirements that exclude a company's discretion in all circumstances. In the example given, a general, shorter, information indicating the very narrow range of the collective bargaining coverage in the countries of a certain region seems to make more sense in some instances; however, according to our understanding, this is currently not permitted under ESRS S1.

ESRS E1

Reporting options in line with Greenhouse Gas Protocol (ESRS E1.44): ESRS E1.44 requires, without exemption, an undertaking to include in its GHG emissions the full Scope 1 GHG emissions and full Scope 2 GHG emissions from unconsolidated subsidiaries, associates, and joint ventures (accounted for under either the equity method or proportionally consolidated) in the case of an undertaking having operational control of these entities. For one, we believe this is not in line with ESRS 1.71. According to this paragraph, when determining impact metrics (here: GHG emissions), undertakings shall consider associates or joint ventures on the basis of the impacts that are directly linked to the undertaking's products and services through its business relationship. The data of the associate or joint venture shall not be limited to the share of equity held. To include the full Scope 1 and Scope 2 emissions of these entities is therefore not appropriate. In addition, ESRS E1.44 limits the current reporting practice. To determine the emissions the GHG Protocol (which in many places is the basis for ESRS E1) offers the financial-control-approach and the equity-share-approach in addition to the operational-control-approach referred to in ESRS E1. Even if the equity-share-approach does not seem appropriate for industrial undertakings there are valid arguments for the application of this approach in the financial sector (e.g., investments in subsidiaries, which are not consolidated). This equity-approach is, however, explicitly excluded in ESRS E1.44(a)(ii).

Delete disclosure with regard to EU-Taxonomy-Alignment (ESRS E1.15): According to ESRS E1.15(e) undertakings have to explain their objective for aligning its economic activities with the Taxonomy Regulation and disclose plans for future Taxonomy alignments (revenue, CapEx and CapEx plans). The EU Taxonomy itself does not require such disclosure. In order to not exceed the requirements in the EU Taxonomy, this requirement should be deleted in ESRS E1.15(e) ("and its plans for future Taxonomy alignment (revenues, CapEx and CapEx plans)"). Furthermore, ESRS do not otherwise replicate any requirements of the EU Taxonomy. Instead, the EU Taxonomy represents a separate and independent body of disclosure requirements.

Avoid requirements regarding undertakings` targets (ESRS E1.57): ESRS 1.57 addresses that, where an undertaking discloses a net-zero target in addition to gross GHG

emission reduction targets, the undertaking shall explain the scope, methodologies and frameworks applied and how the residual GHG emissions (after 90-95% GHG emission reduction) are intended to be neutralised by GHG removals in its own operations and value chain. We understand that wording to require undertakings to reduce gross emissions by 90% in order to claim their target is a "net-zero-target". We concede the assumption that the gross GHG needs to first be reduced by at least 90% is in line with current scientific findings (SBTi). However, this disclosure requirement seems to dictate the criteria for the undertakings` targets. Therefore, the wording should be reconsidered.

ESRS E4

Align understanding of inclusion of value chain information within ESRS (ESRS 1.68; ESRS E4, par AR 26(b)(ii)): Generally, in extending the information about the reporting undertaking to include value chain information the undertaking shall follow the outcome of its sustainability due diligence processes and its materiality assessment regarding material impacts, risks and opportunities (ESRS 1.66.71). Explicitly, it is not required to include information on each and every entity in the value chain, but to include material value chain information (ESRS 1.68). However, ESRS E4 par AR 26(b)(ii) requires that an undertaking considers the "*entire value chain*" for metrics and methodologies and is thereby in conflict with the general principle described in ESRS 1.

ESRS S1

Allow a relative materiality criterion for country-specific disclosures instead of a reference to a fixed number of employees (ESRS S1-6, S1-8): ESRS S1-6 and ESRS S1-8 require country-specific information on employees and the collective bargaining coverage when undertakings have a significant employment, which is defined as "50 or more employees". This rigid criterion for the materiality of these information (fixed number of 50 employees) does not necessary result in meaningful information; especially in the case of large, internationally operating undertakings. Therefore, we suggest referring to a relative materiality criterion which better mirrors differences among undertakings (e.g., country-specific information for countries with 10% or more of the total employees of the undertaking). As mentioned above, we also believe that readability and processing of the information would be increased if the standard were to allow an aggregated presentation for those countries that have the same or similar characteristics in terms of employees and collective bargaining coverage.

In addition, ESRS S1 contains several disclosure requirements which, according to preparers, do not seem feasible.

- **Avoid conflict of ESRS Disclosure Requirements with data privacy protection requirements (ESRS S1)**: Some requirements to provide metrics on *own workforce* and *non-employee workers* (e.g., workers with temporary contracts) conflict with data privacy protection requirements. These data protection requirements also, in some countries, prevent undertakings from the collection, storage or usage of gender-related data. Therefore, possible conflicts of ESRS disclosure requirements with data privacy requirements should be duly reviewed before adopting ESRS.

- **Avoid ESRS Disclosure Requirements which require data for which there is no legal basis to collect the data such as number of work-related ill health (ESRS S1-14):** The disclosure of the number of work-related ill health (S1-14) requires that these are identifiable by the undertaking and that the data is collected. At least in Germany undertakings differentiate between work-related accidents and occupational diseases only and can provide reliable information on these cases only. Occupational diseases are, however, only part of the work-related ill health cases. There is no legal basis on which to collect data on other work-related ill health cases.

- **Clarify terms (ESRS S1, various paragraphs):** Various terms used in ESRS S1 are not or not clearly defined:
  - "basic wage", "pay category", "fixed additional payments" (S1-10, par AR 72),
  - "decent pay" (S1-4, par AR 33),
  - "earnings" (S1-16, par 92),
  - "incidents", "complaints" (S1-17, par 95ff),
  - "region" (S1-6, par 51(b), par 52).

- **Align definitions of terms for which understanding differs internationally (ESRS S1, various paragraphs):** Some terms used in ESRS S1 are not yet internationally consistently defined. These include:
  - "total fair value of all annual long-term incentives" as part of the „total compensation" (S1-16, par AR 103; the term „fair value" is defined in IFRS, and also in national tax legislation within the national context),
  - Social protection (S1-11), and
  - Disabilities (S1-12).

Last but not least we would like to draw attention to the remarks of Emmanuel Faber, Chair of the ISSB, who announced in December 2022 at the UN Biodiversity Conference in Montreal that biodiversity will be a priority immediately after publishing the rules on climate disclosures this year. To ensure alignment of ESRS E4 and an IFRS Standard on biodiversity EFRAG should closely follow these developments in the upcoming months.

Please, do not hesitate to reach out to the ASCG with any question you might have.

Kind regards,

Georg Lanfermann

President ASCG