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DRSC observations on status of EFRAG's work on the ESRS revision

Dear Patrick, dear Chiara

On behalf of the Deutsches Rechnungslegungs Standards Committee (DRSC) I am writing to inform you about some pressing issues that our Sustainability Reporting Committee has identified recently in the context of the ongoing work of EFRAG with respect to the revision of ESRS Set 1 as requested by the European Commission in light of its Omnibus-1-proposal.

We clearly note and welcome the fact that EFRAG, including the secretariat and its technical groups, is working with extraordinary commitment to a targeted revision of the ESRS and has incorporated many of the simplification suggestions made. We also note that EFRAG is operating under considerable time pressure and has therefore assigned parts of the content-related work among to various working streams.

Through our involvement in EFRAG's technical groups, our technical committees and a supporting working group at the DRSC have the opportunity to look at EFRAG's working papers, which we note were developed by the SR Board subgroups and discussed in the SR TEG, in order to provide EFRAG with well-founded feedback on a broad basis. We are, of course, aware that these papers represent a very early stage of work, which will undergo numerous changes during further discussions. However, after an initial review of these papers we made a number of observations that we consider so important that we would like to share them with you immediately.

According to the European Commission's mandate as of end of March 2025 the ESRS revision shall involve a substantive reduction of the number of mandatory disclosures. Even though we have not yet completed a full analysis of the current working papers, we notice that concepts are amended, and new wording is introduced, which are not easily understood but are not yet well defined or even consistently applied throughout the standard. It will not just make the transition for current preparers difficult but will also undermine the objective to simplify ESRS.

There are examples where additional requirements seem to be considered, e.g., in ESRS E1. This is contrary to the Commission's objective and poses an issue both formally and in practical terms, which must be addressed.

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Furthermore, the Commission's mandate involves enhancing understandability of the requirements including their consistency within ESRS. An example is the problem arising on the basic perspective on risks and potential impacts. ESRS currently suggest the gross perspective, but EFRAG has been working on clarifying and differentiating the approach to include the net perspective when appropriate. However, while this is a basic concept underlying all the ESRS reporting, there is still no convincing and consistent understanding of it laid out in the ESRS working papers. The gross approach is generally maintained, but nevertheless there are many aspects of the net-perspective, for example in the disclosure requirement on anticipated financial effects arising from material risks and opportunities. Since financial effects incurred by undertakings always come after deduction of other countereffects, these are net effects by nature. Hence, both concepts do not seem to go hand in hand in all circumstances. A consistent approach is crucial as many disclosure requirements built on this concept.

In this context, we are also afraid that inconsistencies or unclear requirements might increase. An example is the frequently discussed issue of which level policies, measures, and targets (PATs) should be assigned to. From a practical and conceptual perspective, it does not seem appropriate to assign PATs in the form of a requirement at the IRO level. Instead, PATs must be permitted to be defined at the topic or subtopic level. In our view, this should be consistently reflected in the requirements, but in the papers we looked at, PATs are sometimes placed in the context of IROs and sometimes in the context of matters, which seems to form a contraction in our view.

Another objective pursued by the European Commission is to strengthen the concept of materiality. We see this as a measure to achieve reporting that is based on meaningful information and avoids the disclosure of immaterial information. However, we believe that the concept of stakeholder relevance in the context of "materiality of information" is too broad. This weakens rather than strengthens the materiality principle as it puts at risk the objective of limiting reporting to material and meaningful information. Furthermore, the immateriality of certain topics would have to be explicitly demonstrated, which would keep administrative burdens very high. In our view, the materiality principle should be based on the decision-usefulness of information, because all users of sustainability information ultimately make decisions, and it is irrelevant whether stakeholders pursue financial or non-financial interests.

Although we clearly see elements in the amendments discussed that seem heading in the right direction as per the European Commission's mandate; there are a number of aspects we are concerned of as mentioned above. We know that EFRAG is aware that the simplification of ESRS Set 1 is under close scrutiny by all stakeholders, but that, in particular, practitioners and users of ESRS must be convinced of the amendments to the ESRS.

To achieve this, EFRAG needs to ensure, on the one hand, to adhere strictly to the Commission's directives and, on the other hand, to adapt the technical governance allowing for closely monitoring the individual working streams established at EFRAG for the ESRS revision to ensure a higher degree of consistency of the amendments discussed.

Some more details on our findings to date are laid down in the appendix (not public). If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely

Georg Lanfermann